

**NEWFOUNDLAND AND LABRADOR  
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

**AN ORDER OF THE BOARD**

**NO. P. U. 31(2008)**

1 **IN THE MATTER OF** the *Electrical Power*  
2 *Control Act*, RSNL 1994, Chapter E-5.1 (the  
3 “*EPCA*”) and the *Public Utilities Act*, RSNL 1990,  
4 Chapter P-47 (the “*Act*”) as amended, and their  
5 subordinate regulations;

6  
7 **AND**

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9 **IN THE MATTER OF** an application by  
10 Newfoundland & Labrador Hydro (“Hydro”)  
11 for approval of the deferral of expenses associated  
12 with the repair of the Unit 2 Turbine at the  
13 Holyrood Thermal Generating Station as a  
14 Major Extraordinary Repair, pursuant to Sections 69,  
15 78 and 80 of the *Act*.

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17  
18 **Application**

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20 On September 4, 2008 Hydro applied to the Board for an Order approving the amortization of  
21 costs incurred in 2007 in relation to repairs of the Unit 2 Turbine at the Holyrood Thermal  
22 Generating Station (the “Application”).

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24 On October 8, 2008 the Board sent information requests to Hydro in relation to the Application.  
25 Hydro responded to these information requests on October 30, 2008. A further information  
26 request was sent to Hydro on November 6, 2008. Hydro responded to the further request on  
27 November 14, 2008.

1 No submission in relation to the Application was received from the Consumer Advocate or  
2 Newfoundland Power, both having been copied with all correspondence. The Industrial  
3 Customers wrote the Board on September 11, 2008 to advise that the Industrial Customers would  
4 not be submitting any comments specific to the Application.

5  
6 **Decision**

7 In the fall of 2007, during a scheduled annual preventative maintenance inspection of the Unit 2  
8 Turbine at the Holyrood Thermal Generating Station, internal damage to the turbine was  
9 identified. In consultation with General Electric Energy Services Canada, the original equipment  
10 manufacturer, the cause and extent of the damage was identified and repaired in 2007. The total  
11 cost of the Unit 2 Turbine repair, including General Electric Energy Services Canada, Service  
12 and Plant service costs, net of the insurance proceeds was \$1,103,605.

13  
14 Hydro has applied to treat this repair as a Major Extraordinary Repair and to amortize the total  
15 cost of repairs plus financing of \$1,433,000 over a seven-year period. Hydro asks that the costs  
16 be treated as a Major Extraordinary Repair on the basis that the repair does not result in the  
17 replacement or betterment, is not typical of the normal repair expenditures, and the cost exceeds  
18 \$500,000. Hydro states that these costs would have a significant adverse effect on Hydro's  
19 earnings were they to be expensed in 2007, the year in which they were incurred.

20  
21 Generally Accepted Accounting Principles (GAAP) would require that these operating costs be  
22 recognized as expenses in the fiscal year in which they are incurred unless an alternative  
23 treatment is approved by the Board. The Board has in the past acknowledged that it is  
24 appropriate in certain circumstances to defer certain major extraordinary repairs. The Board has  
25 accepted that it is appropriate to consider whether an expense is an extraordinary repair cost if it  
26 meets the minimum threshold of \$500,000 and would cause a rate shock or a shock in Hydro's  
27 earnings that is considered unreasonably high. This approach was accepted by the Board based  
28 on a Peat Marwick report completed for Hydro in July of 1991, "Accounting for Major Plant  
29 Replacement and Repairs".

1 Based on this accepted approach the Board will, in appropriate circumstances, allow the deferral  
2 of costs incurred in relation to a Major Extraordinary Repair. This determination depends on the  
3 circumstances and will not necessarily be made in every case of a non-capital repair costing  
4 more than \$500,000. The Board notes that the Holyrood Thermal Generating Station is an aging  
5 plant and as such more of these types of unexpected repairs may be seen in the future. The  
6 Board does not believe that it is appropriate to routinely consider each non-capital expense  
7 which is greater than \$500,000 as a Major Extraordinary repair to be deferred. Each case has to  
8 be brought to the Board for consideration based on the circumstances.

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10 Hydro acknowledges that GAAP would require that in the ordinary course these costs be  
11 expensed as incurred (PUB-NLH-2). However Hydro says that rather than expensing these costs  
12 in 2007 as required by GAAP, these costs were deferred as at the December 31, 2007 year-end,  
13 without an order of the Board. Hydro states in PUB-NLH-1 that it relied on the precedent set in  
14 Order No. P. U. 44(2006) in deferring the estimate of costs as at the December 31, 2007 year-  
15 end. However, Hydro did not apply to the Board in 2007 before year-end for approval of this  
16 deviation for GAAP.

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18 The Board notes that the circumstances considered in Order No. P. U. 44(2006) were  
19 substantially different than those in the within application. In Order No. P. U. 44(2006) the  
20 Board allowed the deferral of costs in the amount of \$2,233,060, plus financing costs, which  
21 were incurred in relation to the failure of a boiler tube in Unit 2 at the Holyrood Thermal  
22 Generating Station. In Order No. P. U. 44(2006) the Board noted that Hydro was in a loss  
23 position in 2006 and said in relation to the costs of the 2006 Unit 2 boiler repair:

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25 *“The costs if expensed would almost double Hydro’s forecast loss for 2006. The Board*  
26 *finds that, in the current circumstances, these costs would cause a significant shock to*  
27 *Hydro’s earnings if they were to be recognized in 2006 and should be deferred over a*  
28 *period of time.”*

29  
30 The circumstances in the within matter are substantially different. In 2007 Hydro was not in a  
31 loss position and in fact had earnings on regulated activities of \$2,891,000 (Return 13, 2007

1 Annual Report, March 2008). Also the repair costs set out in the Application are \$1,103,605,  
2 substantially less than the repair costs deferred in 2006 of \$2,233,060. Hydro has not shown that  
3 expensing the costs of the Unit 2 Turbine repair would cause a shock to its earnings. While  
4 these expenses are clearly of a non-capital nature and greater than \$500,000 Hydro has not  
5 shown that the circumstances are extraordinary requiring special treatment. The Board is not  
6 satisfied that it is appropriate in the circumstances of this Application to defer the cost of the  
7 repairs of the Unit 2 Turbine as a Major Extraordinary Repair.

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9 It should also be noted that the Board has concerns about the approach taken by Hydro to defer  
10 these costs in 2007 without applying to the Board for approval before the year-end and then  
11 proceeding to finalize the 2007 financial statements contrary to GAAP which would require that  
12 the costs be treated as an expense in the absence of an order of the Board. The Board notes that  
13 Hydro's proposal to approve this deferral as of 2007 may raise jurisdictional issues if such an  
14 approach were found to constitute retroactive regulation. In light of the findings of the Board as  
15 discussed above this determination is not necessary in this case; however, this may be a  
16 consideration in the future.

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18 In the circumstances the Board finds that Hydro's proposal to treat the 2007 costs in relation to  
19 the repair of the Unit 2 Turbine as a Major Extraordinary repair with deferral of the costs over  
20 seven years is not reasonable and prudent in the circumstances.

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23 **IT IS THEREFORE ORDERED THAT:**

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25 1. The Application is denied.

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27 2. Hydro shall pay the expenses of the Board arising from this Application.

**DATED** at St. John's, Newfoundland and Labrador, this 18<sup>th</sup> day of December 2008.

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Andy Wells  
Chair & Chief Executive Officer

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Darlene Whalen, P. Eng.  
Vice-Chair

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Dwanda Newman, LLB  
Commissioner

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G. Cheryl Blundon  
Board Secretary