

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

**AN ORDER OF THE BOARD**

**NO. P.U. 24(2016)**

1 **IN THE MATTER OF** the *Electrical Power*  
2 *Control Act, 1994*, SNL 1994, Chapter E-5.1 (the  
3 "*EPCA*") and the *Public Utilities Act, RSNL 1990*,  
4 Chapter P-47 (the "*Act*"), as amended, and  
5 regulations thereunder; and  
6

7 **IN THE MATTER OF** an application by  
8 Newfoundland and Labrador Hydro for approval  
9 of a deferral account for diesel fuel consumed in  
10 2016 to provide capacity and energy to the  
11 Island Interconnected system pursuant to section  
12 70 of the *Act*.  
13  
14

15 **The Application**  
16

17 On February 5, 2016 Hydro filed an application requesting approval of an account for the  
18 deferral and recovery of diesel fuel costs incurred on the Island Interconnected System for  
19 standby generation (the "Application").  
20

21 The Application was circulated to Newfoundland Power Inc. ("Newfoundland Power"), the  
22 Consumer Advocate, a group of three Island Industrial customers: Corner Brook Pulp and Paper  
23 Limited, North Atlantic Refining Limited and Teck Resources Limited (the "Industrial Customer  
24 Group"), Vale Newfoundland and Labrador Limited ("Vale"), and Praxair Canada Inc.  
25

26 Requests for information were filed by Newfoundland Power, the Consumer Advocate, the  
27 Industrial Customer Group and the Board. Hydro filed responses to the requests for information  
28 on March 3, 2016.  
29

30 Submissions were filed by Newfoundland Power, the Consumer Advocate, the Industrial  
31 Customer Group and Vale on March 16, 2016. Hydro filed a submission on March 21, 2016.  
32

33 **Background**  
34

35 On July 30, 2013 Hydro filed a general rate application proposing a 2013 test year and customer  
36 rate changes, as well as other changes which included amendments to Hydro's Rate Stabilization  
37 Plan ("RSP"). One such amendment related to the inclusion of variations from forecast in energy  
38 supply costs for the Island Interconnected system, including diesel generation, gas turbine  
39 generation and power purchases from wind generation, Corner Brook Pulp and Paper Limited

1 cogeneration and hydraulic generation. On November 10, 2014 Hydro filed an amended general  
2 rate application which proposed that, instead of this amendment to the RSP, an Energy Supply  
3 Cost Variance Deferral Account be approved to defer variances associated with the supply of  
4 energy on the Island Interconnected system. There was no agreement of the parties in relation to  
5 the proposed Energy Supply Cost Variance Deferral Account. The Consumer Advocate and the  
6 Industrial Customer Group argued that the Board should reject the proposed account.  
7 Newfoundland Power submitted that the proposed Energy Supply Cost Variance Deferral  
8 Account should be approved only in relation to supply cost variances arising from the operation  
9 of the Holyrood combustion turbine. Vale submitted that the Board should not approve the  
10 proposed account unless consumers are protected. It was Hydro's position that the approval of  
11 the Energy Supply Cost Variance Deferral Account would provide it with appropriate financial  
12 incentives to operate its system on a reliable, least cost basis.  
13

14 In this Application Hydro requests approval of a "2016 Standby Fuel Deferral Account" to  
15 provide for the deferral and recovery of diesel fuel costs incurred on the Island Interconnected  
16 System for standby generation.<sup>1</sup> Hydro also proposes that variances from test year fuel costs  
17 resulting from volume variances for the hydraulic power purchases from Nalcor Exploits, Star  
18 Lake and Rattle Brook also be recovered. The Application states:  
19

20 In late 2015 and to date in 2016, Hydro experienced low precipitation, low inflows and  
21 lower than usual snowpack in its reservoirs and in the reservoirs and in all hydro-electric  
22 reservoirs on the Island. Hydro understands that similarly low hydrologic conditions are  
23 occurring in the reservoirs of Hydro's customers with hydraulic generation. Also, Hydro is  
24 experiencing reduced energy generation at the Holyrood TGS in recent months due to  
25 reheater tube failures in Unit 2 requiring repairs and a likelihood of similar problems  
26 occurring in Unit 1, requiring an operational derating of these units. In addition, Hydro has  
27 been experiencing a period of continuous customer load growth. This combination of  
28 factors has resulted in Hydro needing to run standby thermal generating sources, notably  
29 combustion turbines and diesel generators, at considerably higher levels than forecast.  
30

31 The Application explains that the costs associated with the increased consumption of diesel fuel  
32 in its other thermal generating resources in 2016 could be material, as high as \$33.3 million.  
33 According to the report filed in support of this Application Hydro's reservoir storage is at the  
34 lowest level since 1993. Even under the average inflow scenarios assumed in its general rate  
35 application, there would be increased standby generation in 2016 compared to the 2015 test year.  
36 It is noted that the total energy output at the Holyrood Thermal Generating Station ("Holyrood")  
37 was reduced by the emergency boiler tube replacements in early 2016 and the associated reduced  
38 maximum capacity. In addition, following the outage on March 4, 2015, Hydro now operates its  
39 standby generation in advance of single largest contingencies on the Avalon and to meet  
40 spinning reserves requirements on the Island Interconnected system.  
41

42 The Application explains that the 2016 Standby Deferral Account is proposed to recover the cost  
43 of increased standby generation for the provision of reliable service to customers. Hydro states  
44 that it "...is seeking approval for deferral of the financial impact of increased Standby fuel costs

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<sup>1</sup> Standby generation includes the Holyrood combustion turbine, the gas turbines at Hardwoods and Stephenville, the diesel plants at Hawke's Bay and St. Anthony, the Holyrood black start diesels and thermal purchases from Newfoundland Power.

1 incurred in 2016 as a result of low hydraulic production, hydraulic purchases, and system  
 2 reliability.”<sup>2</sup> While the RSP provides for recovery of increased Holyrood fuel costs in a low  
 3 hydrology year, there is no deferral mechanism to allow for recovery of increased costs  
 4 associated with operating standby generation in the event of a shortfall in Holyrood capability or  
 5 to provide for reliable service to customers.

6  
 7 The Application states that the recovery of additional fuel costs not included in base rates is  
 8 consistent with regulatory practice in this jurisdiction. Further Hydro argues that it should not be  
 9 at risk for the cost of the increased standby fuel in 2016 because the primary drivers, low  
 10 hydrology and reliability requirements associated with the load on the Avalon Peninsula, are  
 11 beyond its control. The Application states:

12  
 13 Approval of this Application by the Board will permit Hydro to defer fuel costs prudently  
 14 incurred in the provision of service to customers due to low hydrology. It will also allow  
 15 Hydro to provide reliable service to customers while still giving Hydro an opportunity to  
 16 earn a just and reasonable return in 2016.<sup>3</sup>

## 17 18 **Regulatory Framework**

19  
 20 The Board regulates Hydro pursuant to the provisions of the *Electrical Power Control Act, 1994*,  
 21 SNL 1994, Chapter E-5.1 (the “*EPCA*”) and the *Public Utilities Act*, RSNL 1990, Chapter P-47  
 22 (the “*Act*”). The regulatory policy framework set out by the legislation requires the Board to  
 23 balance the interests of Hydro and its customers. Section 4 of the *EPCA* requires the Board to  
 24 implement the power policy of the province which is set out in section 3 as follows:

- 25  
 26 (a) the rates to be charged, either generally or under specific contracts, for the supply of power  
 27 within the province  
 28 (i) should be reasonable and not unjustly discriminatory,  
 29 (ii) should be established, wherever practicable, based on forecast costs for that supply of  
 30 power for 1 or more years,  
 31 (iii) should provide sufficient revenue to the producer or retailer of the power to enable it to  
 32 earn a just and reasonable return as construed under the *Public Utilities Act* so that it is  
 33 able to achieve and maintain a sound credit rating in the financial markets of the world,  
 34 (iv) should be such that after December 31, 1999 industrial customers shall not be required  
 35 to subsidize the cost of power provided to rural customers in the province, and those  
 36 subsidies being paid by industrial customers on the date this Act comes into force shall  
 37 be gradually reduced during the period prior to December 31, 1999, and  
 38 (v) should promote the development of industrial activity in Labrador;  
 39  
 40 (b) all sources and facilities for the production, transmission and distribution of power in the  
 41 province should be managed and operated in a manner  
 42 (i) that would result in the most efficient production, transmission and distribution of  
 43 power,  
 44 (ii) that would result in consumers in the province having equitable access to an adequate  
 45 supply of power,

<sup>2</sup> Application, page 13.

<sup>3</sup> Application, page 13.

- 1 (iii) that would result in power being delivered to consumers in the province at the lowest  
2 possible cost consistent with reliable service,  
3 (iv) that would result in, subject to Part III, a person having priority to use, other than for  
4 resale, the power it produces, or the power produced by a producer which is its wholly-  
5 owned subsidiary,  
6 (v) where the objectives set out in subparagraphs (i) to (iv) can be achieved through  
7 alternative sources of power, with the least possible interference with existing contracts,  
8

9 and, where necessary, all power, sources and facilities of the province are to be assessed and  
10 allocated and re-allocated in the manner that is necessary to give effect to this policy;  
11

12 The *Act* provides for the Board's general supervision of Hydro's utility operations and requires  
13 Hydro to provide service which is reasonably safe and adequate.<sup>4</sup> Section 80 of the *Act* entitles  
14 Hydro to the opportunity to earn annually a just and reasonable return on its rate base in addition  
15 to those expenses that the Board may allow as reasonable and prudent and properly chargeable to  
16 operating account. The *Act* does not stipulate how a determination is to be made with respect to  
17 the recovery of reasonable and prudent operating expenses.  
18

### 19 Submissions

20

21 Newfoundland Power stated that further clarification is required in relation to how the proposed  
22 2016 Standby Fuel Deferral Account is to be addressed in light of the fact that an Energy Supply  
23 Cost Variance Deferral Account was proposed in Hydro's ongoing general rate application.  
24 Newfoundland Power noted that, while Hydro provided a basic outline of a number of  
25 differences and overlaps between the two accounts, it did not clearly indicate how these  
26 differences and overlaps should be addressed by the Board. Newfoundland Power noted that  
27 Hydro indicated that, even absent low water considerations, the proposed deferral account would  
28 be required to recover fuel costs associated with operating standby generation for reliability  
29 considerations. Further it was noted that Hydro advised that on February 26, 2016 it had  
30 suspended the use of standby generation for water management considerations. Newfoundland  
31 Power submitted that the Board should approve the standby fuel deferral account for 2016 but  
32 Hydro should be permitted recovery only if the costs are shown to be reasonable in the  
33 circumstances and that Hydro should be required to provide evidence as to the circumstances of  
34 the operation of Hydro's standby generation.  
35

36 The Consumer Advocate argued that this Application is not needed as Hydro already has an  
37 application before the Board for a deferral account for standby fuel costs. The Consumer  
38 Advocate further submitted that it is not clear how the account proposed in this Application  
39 would "mesh" with the account proposed in the general rate application. The Consumer  
40 Advocate stated that Hydro does not explain how approval of this Application would provide an  
41 "appropriate degree of certainty" and that Hydro has not demonstrated that the deferral account  
42 proposed in this Application provides value over the account proposed in the general rate  
43 application. The Consumer Advocate noted that the account in this Application does not include  
44 the deadband of +/- \$500,000 as an incentive for Hydro to manage costs.

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<sup>4</sup> *Public Utilities Act*, sections 16 and 37.

1 The Industrial Customer Group did not oppose the Application provided that measures are  
2 considered to ensure that Hydro minimize the use of standby generation. The Industrial  
3 Customer Group submitted that "...there is a meaningful distinction to be made between fuel  
4 costs of standby thermal generation reasonably incurred to address low hydrology, on the one  
5 hand, and fuel costs of standby generation incurred by Hydro to address system reliability  
6 concerns, on the other hand."<sup>5</sup> The Industrial Customer Group submitted that, while low  
7 hydrology is beyond Hydro's control, "...at least some aspects of maintaining system reliability  
8 are matters that can be reasonably expected to be within Hydro's ability to manage, in a manner  
9 that provides least cost, reliable service to its customers."<sup>6</sup> The Industrial Customer Group  
10 suggested that Hydro be required to include in its bi-weekly reporting a substantive report in  
11 relation to Hydro's decisions to use, reduce, or suspend standby generation during the period  
12 going back to January 1, 2016 and further that the fuel costs associated with the use of standby  
13 generation for reliability rather than hydrology should be defined and segregated in the deferral  
14 account and set out in Hydro's bi-weekly reporting.  
15

16 Vale did not object to the order requested in the Application on condition that it does not endorse  
17 the accuracy of Hydro's calculation of its recoverable costs and that it does not give rise to a  
18 presumption of entitlement by Hydro of any balance in the deferral account. Vale submitted that  
19 approval of the account would provide no certainty of recovery and may result in a write down  
20 of a 2016 balance in a future year. Vale also questioned whether the account is representative of  
21 utility/regulatory practice, noting that there was a significant amount of evidence presented  
22 during the general rate application in relation to the appropriateness of deferral mechanisms.  
23 Specifically Vale noted the fact that Hydro's return on equity is fixed by government directive.  
24 Vale stated that the account proposed in the Application is not identical to the account proposed  
25 in the general rate application but there is a lot of overlap, noting that the account does not  
26 include the \$500,000 deadband. Vale also noted that, while Hydro argues that the account is  
27 necessary because of low hydrology, the scope of the account is not limited to costs incurred for  
28 that reason and that Hydro confirmed that the other standby generation would not have been  
29 required if Holyrood was operating at full capacity. Vale raised concerns in relation to the  
30 prudence of costs associated with the failure of the boiler tubes at Holyrood, which Hydro stated  
31 was the reason the plant was not at full capacity. Vale also raised concerns in relation to  
32 intergenerational equity.  
33

34 Hydro argued that there should be no disincentive to operate standby generation for either  
35 reliability or in support of Hydro's reservoirs. Hydro confirmed in its submission that, should the  
36 account proposed in this Application be approved, Hydro would suspend the use of the account  
37 proposed in the general rate application for 2016 only. Hydro submitted that the account  
38 proposed in this Application provides more transparency on the financial impact of standby fuel  
39 cost increases for 2016. In relation to the exclusion of a deadband in the proposed account Hydro  
40 argued that a deadband is not appropriate as it would negatively impact its financial results and  
41 would not serve to create an incentive to manage costs as Hydro cannot control the main drivers  
42 of the costs, hydrology and customer load requirements. Hydro submitted that the level of  
43 reporting suggested by the Industrial Customer Group would be sufficient to assess the prudence  
44 of the standby fuel costs. Hydro argued that the recovery of standby fuel cost variances is

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<sup>5</sup> Industrial Customer Submission, March 16, 2016, page 2.

<sup>6</sup> Industrial Customer Submission, March 16, 2016, page 2.

1 consistent with regulatory practice in this jurisdiction as Newfoundland Power recovers standby  
2 fuel costs incurred for reliability purposes through its rate stabilization account and that it is  
3 consistent with Hydro's RSP and section 80 of the *Act*. Hydro submitted that the additional  
4 standby fuel costs for 2016 are material and prudently incurred and should be eligible for  
5 deferral and recovery from customers and that approval of the 2016 Standby Fuel Deferral  
6 Account would provide a reasonable balance of the interests of the utility and customers.

7  
8 **Board Findings**  
9

10 The Application seeks approval of an account to defer diesel fuel costs incurred for standby  
11 generation on the Island Interconnected system in 2016. Hydro argues that the Application  
12 should be approved to ensure that there is no disincentive for Hydro to operate its facilities  
13 efficiently. The Board notes that the legislative framework in this province requires that Hydro  
14 manage its facilities, which would include standby generation, so as to result in power being  
15 delivered to customers in the lowest possible cost consistent with reliable service. Further, the  
16 Board is required to observe the power policy of the province which provides for rates which  
17 permit Hydro to earn a just and reasonable return. It is in this context that Hydro's rate  
18 stabilization plan and Newfoundland Power's rate stabilization account as well as a number of  
19 other deferral accounts for both utilities were established by the Board over the years.  
20

21 Prior to filing this Application Hydro requested approval in its general rate application of an  
22 Energy Supply Cost Variance Account which also would provide for the deferral of the fuel  
23 costs associated with the use of standby generation. The Board notes that the submissions in the  
24 general rate application set out significant disagreement of the parties with respect to the  
25 proposed account. The deferral account proposed in this Application is similar to the account  
26 proposed in the general rate application in that both accounts provide for the deferral of  
27 variances in fuel costs associated with diesel generation, gas turbine generation and power  
28 purchases from hydraulic generation. The main differences are that the account proposed in this  
29 Application: i) applies only to 2016 fuel costs; ii) does not propose a \$500,000 deadband; iii)  
30 does not reflect variances associated with wind generation or Corner Brook Pulp and Paper  
31 cogeneration; and iv) would include only the variance associated with volume and not price in  
32 relation to Nalcor Exploits, Star Lake and Rattle Brook.  
33

34 The overlap and differences between the two proposed accounts was an issue in this Application.  
35 Newfoundland Power submitted that Hydro did not clearly indicate how the differences and  
36 overlap in the two accounts should be addressed and that further clarification is required. The  
37 Consumer Advocate submitted that it is not clear how the two accounts would "mesh" and that it  
38 is not necessary to approve the account proposed in this Application in light of the proposals in  
39 the general rate application. Vale also noted that, while there are differences in the two accounts,  
40 there is a lot of overlap. Hydro clarified in its submission, filed after the other parties'  
41 submissions, that if this Application is approved Hydro would suspend the use of the account  
42 proposed in the general rate application for 2016 but did not address how this would be done.  
43

44 The Board notes Hydro's statement that the requirement to consume diesel fuel is caused  
45 primarily by low hydrology; however, the proposed language of the deferral account is not

1 restricted to fuel costs associated with low hydrology. In relation to the distinction between costs  
2 related to low hydrology and reliability Hydro explained that:

3       While Hydro anticipates that the majority of costs charged to the deferral will be a result of  
4 low hydrology, Hydro will incur standby fuel costs in 2016 associated with increased  
5 reliability to customers. Increased Standby Generation will not only provide energy to the  
6 system thereby increasing the amount of energy in Hydro's reservoirs, it will also provide  
7 increased reliability to customers. Hydro expects that in most events of deployment of the  
8 Standby generation, it will be understood to be providing both energy and reliability  
9 benefits simultaneously. For these reasons, Hydro believes that for 2016, drawing  
10 distinctions in the deferral account balance between standby fuel costs incurred to provide  
11 capacity or reliability, would be impracticable and would not produce meaningful results.<sup>7</sup>  
12

13 The Board notes that the parties in this Application set out a number of qualifications on the  
14 approval of the proposed account related to the circumstances of the use of standby generation.  
15 Newfoundland Power suggested that Hydro should be permitted recovery only if the costs are  
16 shown to be reasonable and that, before recovery of the costs is approved, Hydro should be  
17 required to provide evidence as to the circumstances of the use of standby generation. The  
18 Industrial Customer Group submitted that measures should be put in place to ensure that Hydro  
19 minimizes the use of standby generation, including bi-weekly reporting and segregation of costs  
20 associated with the use of standby generation for reliability. Further it was suggested that there  
21 be a process to decide on disposition of the balance and whether the account should be  
22 continued. Vale submitted that prudence should be addressed when Hydro applies for recovery  
23 of the costs. The Board accepts Hydro's explanation that it would be impractical and would not  
24 be meaningful to draw distinctions based on the circumstances of the use of standby generation.  
25 As such the Board believes that it would not be appropriate to approve the account at this time  
26 subject to a later review of whether the costs were reasonable and prudence in the absence of  
27 clarity as to what costs would be recoverable.  
28

29 The Board finds the evidence to be unclear as to why the account proposed in this Application  
30 should be approved for 2016 given that the general rate application proposed a different account  
31 for 2016 and subsequent years. In particular the Board does not accept Hydro's explanation for  
32 the exclusion of the \$500,000 deadband since the scope of the proposed account is not restricted  
33 to matters beyond Hydro's control such as low hydrology. In addition Hydro did not clearly  
34 explain why the account proposed in this Application excludes the variances associated with  
35 wind generation or Corner Brook Pulp and Paper Limited cogeneration. The Board is concerned  
36 that approval of the account proposed in this Application would preempt, at least for 2016, the  
37 consideration of the issues raised in the general rate application in relation to the implication of  
38 approving an account to provide for the deferral and recovery of variations in fuel costs  
39 associated with the use of standby generation other than at Holyrood. The Board finds that Hydro  
40 has failed to demonstrate that the 2016 Standby Fuel Deferral Account proposed in this  
41 Application should be approved in advance of consideration of the Energy Supply Cost Variance  
42 Account proposed in the general rate application.

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<sup>7</sup> PUB-NLH-009.

**1 Costs**

2  
3 A claim for costs in this Application was made by both the Industrial Customer Group and Vale.  
4 The Industrial Customer Group argued that its intervention was warranted by the group's interest  
5 in Hydro's management of the low hydrology, noting that approximately 10% of the estimated  
6 cost of \$33 million would fall to the industrial customers. Further it was argued that the  
7 participation of the Industrial Customer Group contributed to the Board's consideration of the  
8 issues. Vale submitted that an award of costs is justified based on the fact that its consumption is  
9 steadily increasing and that, with time, it will be the single largest industrial customer of Hydro.  
10 Vale explained that its interests are discreet from the interests of the Industrial Customer Group,  
11 noting in particular that Vale and the Industrial Customer Group may not be aligned in relation to  
12 the recovery of past deficiencies through future rate riders. Hydro did not comment on the  
13 requests for an order for costs. The Board believes that the Industrial Customer Group and Vale  
14 had legitimate and distinct interests in this Application and that both parties participated in a  
15 responsible manner and contributed to the Board's understanding of the issues. The Board finds  
16 that an award of cost to the Industrial Customer Group and Vale is appropriate in the  
17 circumstances.

1 **IT IS THEREFORE ORDERED THAT:**

- 2
- 3 1. The Application is denied.
- 4
- 5 2. The Industrial Customer Group and Vale are entitled to an award of costs in an amount to
- 6 be determined by the Board upon the filing of a detailed cost submission within 30 days of
- 7 the date of this Order.
- 8
- 9 3. Hydro shall pay the expenses of the Board arising from this Application.

**DATED** at St. John's, Newfoundland and Labrador, this 22<sup>nd</sup> day of June, 2016.



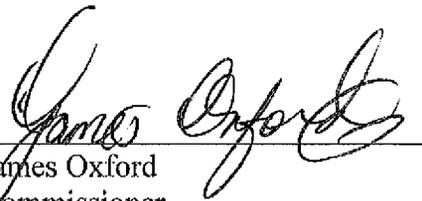
Andy Wells  
Chair and Chief Executive Officer



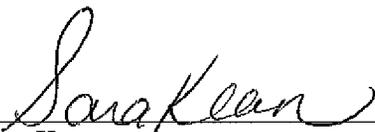
Darlene Whalen, P.Eng.  
Vice-Chair



Dwanda Newman, LL.B.  
Commissioner



James Oxford  
Commissioner



Sara Kean  
Assistant Board Secretary