

DELIVERED BY HAND

April 15, 2015

Board of Commissioners  
of Public Utilities  
P.O. Box 21040  
120 Torbay Road  
St. John's, NL A1A 5B2

Attention: G. Cheryl Blundon  
Director of Corporate Services  
and Board Secretary

Ladies & Gentlemen:

**Re: 2016 Deferred Cost Recovery Application (the "Application")**

Enclosed are an original and 12 copies of the Application.

By Order No. P.U. 13 (2013), Newfoundland Power was required to file its next general rate application with a 2016 test year on or before June 1, 2015 unless otherwise directed by the Board.

The Application seeks approval of approximately \$4 million in deferred cost recovery for 2016 to enable Newfoundland Power to file its next general rate application with a 2017 test year on or before June 1, 2016. The Board should approve the Application because it (i) permits the orderly establishment of customer rates; (ii) conforms with regulatory practice; and (iii) is consistent with regulatory efficiency.

Detail concerning the Application, including reasons justifying the Board's granting the relief sought, can be found in the evidence provided as Schedule 1 to the Application.

We trust the foregoing and enclosed are found to be in order.

The Application has been forwarded directly to Newfoundland and Labrador Hydro and the Consumer Advocate.

Board of Commissioners  
of Public Utilities  
April 15, 2015  
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If the Board has any questions or comments, please feel free to contact the Company.

Yours very truly,



Peter Alteen, QC  
Vice President,  
Regulation & Planning

Enclosures

c. Geoffrey Young  
Newfoundland and Labrador Hydro

Thomas Johnson, QC  
O'Dea Earle Law Office



**IN THE MATTER OF** the *Public Utilities Act*, R.S.N. 1990, Chapter P-47 (the "Act"); and

**IN THE MATTER OF** an application by Newfoundland Power Inc. ("Newfoundland Power") to approve the deferred recovery of certain 2016 costs.

**TO:** The Board of Commissioners of Public Utilities (the "Board")

**THE APPLICATION OF** Newfoundland Power Inc. ("Newfoundland Power") **SAYS THAT:**

1. Newfoundland Power is a corporation duly organized and existing under the laws of the Province of Newfoundland and Labrador, is a public utility within the meaning of the Act and is subject to the provisions of the *Electrical Power Control Act, 1994*.
2. By Order No. P.U. 13 (2013), the Board ordered, amongst other things, that unless otherwise directed by the Board, Newfoundland Power shall file its next general rate application with a 2016 test year on or before June 1, 2015.
3. The largest component of Newfoundland Power's cost of service is the cost of wholesale electricity supply from Newfoundland and Labrador Hydro ("Hydro"). The cost of wholesale electricity supply from Hydro comprises approximately 65% of Newfoundland Power's total cost to serve its customers.
4. On July 30, 2013, Hydro filed its first general rate application since 2006. This general rate application was materially amended on November 10, 2014 (the "amended Hydro rate application").
5. The amended Hydro rate application will, amongst other things, change the cost of wholesale electricity supply that will be recovered in the rates paid by Newfoundland Power's customers.
6. The amended Hydro rate application is currently scheduled for hearing commencing September 2015. A final order of the Board establishing rates for Hydro's customers, including Newfoundland Power, is unlikely to be issued prior to 2016.

7. If Newfoundland Power were to file a general rate application as required by Order No. P.U. 13 (2013) by June 1, 2015:
  - (i) Newfoundland Power's cost of wholesale electricity supply would be uncertain and subject to change from that outlined in the application;
  - (ii) the application would likely not be concluded until sometime in 2016; and
  - (iii) the costs associated with conduct of the application would be increased from what they would otherwise be.
8. Schedule 1 to this Application provides evidence of the facts and circumstances related to the matters outlined in the previous paragraphs hereof.
9. Newfoundland Power requests, pursuant to Sections 67 and 80 of the Act, that the Board make an Order:
  - (i) approving a 2016 forecast average rate base for Newfoundland Power of \$1,054,192,000;
  - (ii) approving a just and reasonable 2016 rate of return on rate base for Newfoundland Power of 7.38% in a range of 7.20% to 7.56%;
  - (iii) approving deferred cost recovery of \$3,991,000 for 2016;
  - (iv) directing Newfoundland Power to file its next general rate application by June 1, 2016 with a 2017 test year; and
  - (v) continuing Newfoundland Power's existing rates, tolls and charges until modified by further order of the Board.
10. The Board should grant the Order requested because:
  - (i) it permits the orderly establishment of rates to be charged to customers served by the Island interconnected grid;
  - (ii) it is consistent with regulatory principle and practice before the Board; and
  - (iii) it is consistent with regulatory efficiency.

11. Communications with respect to this Application should be forwarded to the attention of Peter Alteen, QC and Liam P. O'Brien, Counsel to Newfoundland Power.

**DATED** at St. John's, Newfoundland and Labrador, this 15<sup>th</sup> day of April, 2015.

**NEWFOUNDLAND POWER INC.**



Peter Alteen, QC and Liam P. O'Brien  
Counsel to Newfoundland Power Inc.  
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**IN THE MATTER OF** the *Public Utilities Act*, R.S.N. 1990, Chapter P-47 (the "Act"); and

**IN THE MATTER OF** an application by Newfoundland Power Inc. ("Newfoundland Power") to approve the deferred recovery of certain 2016 costs.

**AFFIDAVIT**

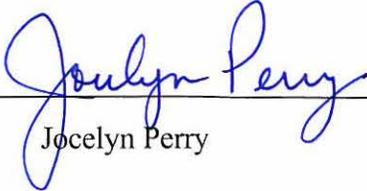
I, Jocelyn Perry, of St. John's in the Province of Newfoundland and Labrador, make oath and say as follows:

1. That I am Vice-President, Finance and Chief Financial Officer of Newfoundland Power Inc.
2. To the best of my knowledge, information and belief, all matters, facts and things set out in this Application are true.

**SWORN** to before me at St. John's in the Province of Newfoundland and Labrador this 15<sup>th</sup> day of April, 2015:



Barrister

  
Jocelyn Perry

**IN THE MATTER OF** the *Public Utilities Act*, R.S.N. 1990, Chapter P-47 (the "Act"); and

**IN THE MATTER OF** an application by Newfoundland Power Inc. ("Newfoundland Power") to approve the deferred recovery of certain 2016 costs.

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**2016 Deferred Cost Recovery: Evidence**

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1 **1.0 Summary**

2  
3 Newfoundland Power is currently required to file a general rate application with a 2016 test year  
4 by June 1, 2015.

5  
6 This Application seeks to defer the filing of Newfoundland Power's next general rate application  
7 by June 1, 2016. To enable this, it is proposed that approval be granted for a 2016 cost recovery  
8 deferral of approximately \$4.0 million. This will permit recovery of the increased cost to  
9 Newfoundland Power of financing the 2016 capital expenditures necessary to provide service to  
10 customers. The proposed cost recovery deferral amounts to just over 0.6% of Newfoundland  
11 Power's forecast 2016 revenue from customer rates.

12  
13 If approved, the proposed 2016 cost recovery deferral will assist in the orderly establishment of  
14 rates charged to customers served by the Island interconnected grid. It will do this by facilitating  
15 the conclusion of currently outstanding regulatory proceedings affecting Newfoundland Power's  
16 wholesale cost of supply in advance of consideration of Newfoundland Power's next general rate  
17 application. Wholesale cost of supply is Newfoundland Power's largest cost, accounting for  
18 almost 2/3 of Newfoundland Power's total cost to serve its customers.

19  
20 Approval of the proposed 2016 cost recovery deferral is consistent with regulatory efficiency.  
21 Newfoundland Power's filing of a general rate application by June 1, 2015 will ultimately result  
22 in a more extended regulatory process than a filing by June 1, 2016. Such an extended process  
23 can be expected to increase the overall cost of Newfoundland Power's next general rate  
24 application.

25  
26 Since 2005, cost recovery deferrals have been approved for Newfoundland Power outside the  
27 context of a general rate application on 5 separate occasions. The cost recovery deferrals ranged  
28 from \$2.4 million for 2011 to \$7.6 million for 2007. The 2007 approval was made in the context  
29 of Hydro's last general rate application; circumstances substantially similar to those existing  
30 today.

31  
32 The calculation of the proposed 2016 cost recovery deferral is consistent with prior  
33 determinations of the Board. In particular, it is calculated in a manner consistent with regulatory  
34 practice for determining Newfoundland Power's allowed annual return on rate base.

35  
36 If the 2016 cost recovery deferral is not approved, Newfoundland Power would practically be  
37 required to file its next general rate application in 2015 to enable it to have the opportunity to  
38 earn a just and reasonable return in 2016 as provided by Section 80 of the *Public Utilities Act*.

1 **2.0 Background**

2  
3 **2.1 The June 1, 2015 Filing Requirement**

4  
5 In Order No. P.U. 13 (2013), the Board of Commissioners of Public Utilities (the “Board”) ordered, amongst other things, that Newfoundland Power Inc. (“Newfoundland Power” or the “Company”), unless otherwise directed, file its next general rate application (“GRA”) on or before June 1, 2015 with a 2016 test year.

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7  
8  
9  
10 In July 2013, Newfoundland and Labrador Hydro (“Hydro”) filed a GRA seeking to establish rates for its customers, including Newfoundland Power.<sup>1</sup> In November 2014, Hydro amended its GRA (the “amended Hydro GRA”). It currently does not appear likely that Hydro’s amended GRA will yield final rates for Hydro’s customers before 2016.<sup>2</sup>

11  
12  
13  
14  
15 The current rate paid by Newfoundland Power to Hydro was established 8 years ago in 2007.<sup>3</sup> Since then, changes in supply and demand on the Island interconnected system have substantially altered the degree to which this rate has reflected costs.<sup>4</sup> By comparison, Newfoundland Power’s costs and customer rates have been reviewed by the Board on 3 occasions since 2007.<sup>5</sup>

16  
17  
18  
19  
20 Newfoundland Power’s wholesale electricity purchases from Hydro account for approximately 93% of the electricity which Newfoundland Power delivers to its customers. The cost of this wholesale supply is the largest component of Newfoundland Power’s cost of service and accounts for approximately 65% of the Company’s annual revenue requirement.

21  
22  
23  
24  
25 It is expected that the cost of wholesale electricity supply to Newfoundland Power by Hydro will change as a result of the amended Hydro GRA. The degree of the change will be uncertain until the Board fully considers the matter and renders an Order.

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26  
27  
<sup>1</sup> Hydro’s last general rate application was filed with the Board in 2006.

<sup>2</sup> The current Board schedule for the amended Hydro GRA indicates that public hearing will begin in September 2015. In Order No. P.U. 1 (2015), the Board indicated that “As a result of the filing of the amended general rate application on November 10, 2014 it is likely that the proceeding, which began with the filing of the original general rate application on July 30, 2013, will not conclude until late 2015 at the earliest.” Even if formal proceedings associated with the amended Hydro GRA were to conclude in late 2015, the establishment of new rates for Hydro’s customers would not likely occur until well into 2016 due to the time required for the Board to render a decision and subsequent compliance proceedings.

<sup>3</sup> See Order No. P.U. 8 (2007).

<sup>4</sup> The mismatch between Hydro’s rates, including its utility rate to Newfoundland Power, and the underlying costs reflected in those rates has, amongst other things, resulted in the accrual of large credit balances in Hydro’s Rate Stabilization Plan (“RSP”). At December 31, 2014, Hydro’s total RSP balance stood at - \$245,954,337. This balance conceptually represents amounts paid by users of the Island interconnected system, including Newfoundland Power’s customers, which are in excess of the costs used to establish Hydro’s rates.

<sup>5</sup> See Order Nos. P.U. 32 (2007), P.U. 46 (2009) and P.U. 13 (2013).

1 It is unlikely that a Newfoundland Power GRA filed by June 1, 2015 would be concluded prior  
 2 to sometime in 2016, likely late in 2016.<sup>6</sup> This degree of regulatory lag would be extraordinary  
 3 for a Newfoundland Power GRA.<sup>7</sup> It would also tend to increase the overall cost of a  
 4 Newfoundland Power GRA.<sup>8</sup>

5  
 6 The combination of (i) the currently uncertain wholesale supply cost outlook for Newfoundland  
 7 Power, (ii) the current scheduling for the amended Hydro GRA, and (iii) practical regulatory  
 8 efficiency indicate that the requirement in Order No. P.U. 13 (2013) that Newfoundland Power  
 9 file its next GRA by June 1, 2015, be re-examined by the Board.

## 10 11 **2.2 Newfoundland Power's 2016 Financial Outlook**

12  
 13 In Order No. P.U. 51 (2014), the Board established a 2015 rate of return on rate base for  
 14 Newfoundland Power of 7.50% in a range of 7.32% to 7.68%.<sup>9</sup>

15  
 16 Exhibit 1 shows Newfoundland Power's current 2015 and 2016 forecast returns.

17  
 18 Table 1 summarizes Newfoundland Power's current 2015 and 2016 forecast returns.

19  
 20  
**Table 1**  
**2015 and 2016**  
**Current Forecast Returns**  
**(%)**

	<b>2015</b>	<b>2016</b>
<b>Rate Base</b>	7.39	7.06
<b>Equity</b>	8.75	8.08

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<sup>6</sup> This assumes, of course, that the Board decides that conclusion of proceedings associated with the amended Hydro GRA should precede consideration and hearing of a Newfoundland Power GRA filed by June 1, 2015.

<sup>7</sup> The Board typically takes 7 to 9 months to render an Order on a Newfoundland Power GRA. See Order Nos. P.U. 19 (2003), P.U. 32 (2007), P.U. 46 (2009) and P.U. 13 (2013).

<sup>8</sup> Increased required revisions to, and review of data and management of a more complex regulatory record would be factors which tend to result in increased costs for Newfoundland Power's intervenors and the Board.

<sup>9</sup> In determining a just and reasonable 2015 rate of return on rate base, the Board followed its regulatory practice of determining a just and reasonable return for Newfoundland Power on an annual basis. Since 1998, the Board has determined a just and reasonable rate of return on rate base for Newfoundland Power through GRAs (see, for example, Order Nos. P.U. 36 (1998-99), P.U. 19 (2003), P.U. 32 (2007), P.U. 43 (2009) and P.U. 13 (2013)); or operation of an automatic adjustment formula (see, for example, Order Nos. P.U. 20 (1999-2000), P.U. 30 (2000-2001), P.U. 28 (2001-2002), P.U. 50 (2004), P.U. 3 (2006), P.U. 40 (2006), P.U. 35 (2008) and P.U. 32 (2010)); or, following suspension of the automatic adjustment formula, following application by Newfoundland Power (see, for example, Order Nos. P.U. 17 (2012) and P.U. 51 (2014)).

1 For 2016, Newfoundland Power's forecast return on rate base is 7.06%. This is below the range  
 2 of 7.32% to 7.68% approved by the Board for 2015 in Order No. P.U. 51 (2014). It is also below  
 3 a reasonable range of return on rate base for 2016 calculated in a manner similar to that used in  
 4 Order No. P.U. 51 (2014).<sup>10</sup>

5  
 6 For 2016, Newfoundland Power's forecast return on equity is 8.08%. This is below the 8.80%  
 7 allowed in Order No. P.U. 13 (2013). It is also below the returns on equity currently allowed  
 8 other investor owned Canadian regulated utilities.<sup>11</sup>

### 11 3.0 Regulatory Practice

12  
 13 The Board has a practice of permitting cost recovery deferrals and amortizations where it  
 14 determines the circumstances justify such treatment of utility costs.<sup>12</sup>

15  
 16 The Board has approved the deferred recovery of costs by Newfoundland Power outside the  
 17 context of a GRA on 5 occasions since 2005. Table 2 summarizes these Newfoundland Power  
 18 deferred cost recoveries.

19  
 20  
**Table 2**  
**Newfoundland Power**  
**Deferred Cost Recoveries**  
**2005-2015**

Approval	Year	Amount (\$ millions)
Order No. P.U. 40 (2005)	2006	5.8
Order No. P.U. 39 (2006)	2007	7.6
Order No. P.U. 30 (2010)	2011	2.4
Order No. P.U. 22 (2011)	2012	2.4
Order No. P.U. 17 (2012)	2012	2.5

<sup>10</sup> The calculation of the reasonable return on rate base for 2016 of 7.38% and the historical range of return on rate base of 36 basis points ( $\pm 0.18\%$ ) are described in 4.2: *Forecast 2016 Return on Rate Base* at p. 6, *infra*.

<sup>11</sup> Returns on equity currently allowed for investor owned utilities by Canadian regulators are 8.75% (British Columbia), 8.30% (Alberta), 9.30% (Ontario), 8.90% (Quebec) and 9.00% (Nova Scotia). The 8.80% approved by the Board in Order No. P.U. 13 (2013) appears to be at the mean (and marginally below the median) of current equity returns allowed by other Canadian regulators.

<sup>12</sup> See, for example, Order No. P.U. 37 (1984) where the Board considered the deferral and amortization of \$650,000 in operating costs associated with an April sleet storm.

1 In 2005, the Board approved the deferred recovery of approximately \$5.8 million related to an  
 2 expiring amortization of depreciation true up in 2006.<sup>13</sup> In 2006, the Board approved the  
 3 deferred recovery of approximately \$7.6 million related to (i) the expiring amortization of  
 4 depreciation true up and (ii) the additional wholesale supply costs associated with Newfoundland  
 5 Power’s refurbishment of its Rattling Brook hydroelectric station in 2007.<sup>14</sup> In each of 2010 and  
 6 2011, the Board approved the deferred recovery of approximately \$2.4 million associated with  
 7 expiring regulatory amortizations in 2011 and 2012, respectively.<sup>15</sup> In 2012, the Board approved  
 8 the deferred recovery of approximately \$2.5 million associated with Newfoundland Power’s  
 9 2012 return on equity.<sup>16</sup>

10  
 11 In 2006, Newfoundland Power was expected to file a GRA to rebalance its costs and customer  
 12 rates. However, prior to Newfoundland Power filing its GRA, Hydro filed a GRA. An Order on  
 13 Hydro’s GRA was not expected until sometime in 2007.<sup>17</sup> By permitting \$7.6 million in  
 14 deferred cost recovery for 2007, the Board effectively provided Newfoundland Power the  
 15 opportunity to earn a just and reasonable return for 2007 while proceedings concluded on  
 16 Hydro’s GRA.

17  
 18 In each case where the Board has approved deferred recovery of costs by Newfoundland Power,  
 19 the justification for approval was Section 80 of the *Public Utilities Act*.<sup>18</sup> The approved deferred  
 20 cost recovery, in effect, provided Newfoundland Power the opportunity to earn a just and  
 21 reasonable return in the succeeding year without requiring a GRA.

22  
 23  
 24 **4.0 Proposed 2016 Deferred Cost Recovery**

25  
 26 **4.1 Overview**

27  
 28 Newfoundland Power’s rate base changes on an annual basis. In 2016, Newfoundland Power’s  
 29 rate base will increase primarily due to capital expenditures required for the Company to provide  
 30 service to customers. These expenditures require the Board’s prior approval.<sup>19</sup>

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<sup>13</sup> See Order No. P.U. 40 (2005).

<sup>14</sup> See Order No. P.U. 39 (2006).

<sup>15</sup> See Order Nos. P.U. 30 (2010) and P.U. 22 (2011).

<sup>16</sup> See Order No. P.U. 17 (2012). This approval resulted in Newfoundland Power recording a total of approximately \$4.9 million in deferred cost recoveries for 2012. This included the \$2.4 million approved by Order No. P.U. 22 (2011) and the \$2.5 million approved by Order No. P.U. 17 (2012).

<sup>17</sup> Order No. P.U. 8 (2007) on Hydro’s 2006 GRA was filed April 12, 2007. See also Order No. P.U. 39 (2006), page 4, lines 16-20 which resulted from Newfoundland Power’s 2007 deferred cost recovery application.

<sup>18</sup> Section 80 of the *Public Utilities Act* provides, in part, that “A public utility is entitled to earn annually a just and reasonable return as determined by the board on the rate base as fixed and determined by the board...”

<sup>19</sup> See Section 41 of the *Public Utilities Act*.

1 The additional cost for Newfoundland Power to finance the 2016 rate base growth resulting from  
 2 2016 capital expenditures was not contemplated by current customer rates. Recovery of this  
 3 additional cost is the basis of the proposed 2016 deferred cost recovery.  
 4

5 Since 1998, the Board has considered a just and reasonable rate of return on rate base for  
 6 Newfoundland Power each year.<sup>20</sup> The Board has used forecast values in these considerations.<sup>21</sup>  
 7 This is consistent with the prospective nature of regulation in the province.<sup>22</sup> For example, in  
 8 2014, the Board considered both Newfoundland Power’s forecast rate base and returns to  
 9 determine a just and reasonable return on rate base for 2015.<sup>23</sup>  
 10

11 In this Application, Newfoundland Power proposes that the Board consider this regulatory  
 12 practice to establish a reasonable 2016 deferred cost recovery for Newfoundland Power. The  
 13 proposed 2016 deferred cost recovery is the difference between:  
 14

- 15 (i) a forecast just and reasonable return on rate base for 2016, determined in accordance  
 16 with regulatory practice; and  
 17
- 18 (ii) the return on rate base reflected in the calculation of current customer rates.  
 19

20 **4.2 Forecast 2016 Return on Rate Base**

21 *Forecast 2016 Rate Base*

22  
 23  
 24 Exhibit 2 shows the calculation of Newfoundland Power’s 2016 forecast average rate base.

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<sup>20</sup> The Orders of the Board establishing Newfoundland Power’s annual just and reasonable return on rate base are described in footnote 9.

<sup>21</sup> See, for example, Order Nos. P.U. 20 (1999-2000), P.U. 30 (2000-2001), P.U. 28 (2001-2002), P.U. 50 (2004), P.U. 3 (2006) and P.U. 40 (2006) where the Board used forecast values for invested capital and rate base to establish changes in the Company’s forecast return on rate base by use of the automatic adjustment formula.

<sup>22</sup> The Board has explicitly recognized the value of this consistency in applications concerning deferred recovery. In dealing with an argument that variances from past forecasts should be reflected in offsets against future cost deferrals, the Board observed “*Consistent with regulatory practice and in the interests of a predictable and fair regulatory framework* that accepts the necessity and practicality of prospective regulation the Board will not make the offset proposed by the Consumer Advocate.”(emphasis added) See Order No. P.U. 39 (2006), page 7, lines 1-3.

<sup>23</sup> See Order No. P.U. 51 (2014).

1 Table 3 shows Newfoundland Power's 2015 and 2016 forecast average rate base.  
 2  
 3

**Table 3**  
**2015 and 2016**  
**Forecast Average Rate Base**  
**(\$ millions)**

	<b>2015</b>	<b>2016</b>
<b>Rate Base</b>	1,014 <sup>24</sup>	1,054

4  
 5  
 6 The increase in Newfoundland Power's 2016 forecast average rate base primarily reflects  
 7 changes in plant investment and depreciation. Changes in plant investment occur as a result of  
 8 capital expenditures approved by the Board. Similarly, changes in depreciation reflect  
 9 depreciation rates specifically approved by the Board. To a lesser extent, changes in rate base  
 10 reflect additions and deductions from a combination of specific Board Orders, operation of  
 11 approved regulatory mechanisms and longstanding regulatory practice.<sup>25</sup>

12  
 13 *Forecast 2016 Return on Rate Base*

14  
 15 Exhibit 3 shows the calculation of Newfoundland Power's 2014 test year return on rate base, the  
 16 forecast used to establish the 2015 return on rate base and 2016 *pro forma* return on average rate  
 17 base.

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<sup>24</sup> The 2015 forecast rate base of \$1,014 million is approximately \$4 million higher than the 2015 forecast rate base approved in Order No. P.U. 51 (2014). This is primarily due to higher actual 2014 capital expenditures than forecast partially offset by lower special funding payments associated with the Company's defined benefit pension plan. The differences in 2014 capital expenditures are described in Newfoundland Power's 2014 Capital Expenditure Report which was filed with the Board on February 27, 2015.

<sup>25</sup> For example, Board determinations in Order No. P.U. 13 (2013) regarding specific cost recovery deferrals affect the calculation of the forecast 2016 rate base. Similarly, Board approved regulatory mechanisms, such as the Demand Management Incentive, can impact the annual calculation of rate base. These changes are reflected in the calculation of the forecast 2016 rate base. Smaller items, such as customer finance programs and customer security deposits, are determined in accordance with longstanding regulatory practice.

1 Table 4 compares the 2014 test year return used to establish Newfoundland Power's current  
 2 customer rates with a 2016 *pro forma* return which reflects the forecast cost of debt and the  
 3 currently approved cost of equity.

4  
 5

**Table 4**  
**2014TY and 2016F (*pro forma*)**  
**Comparative Returns**

	2014TY	2016F	Difference
<b>Rate Base (%)</b>	7.88	7.38	(0.50)
<b>Equity (%)</b>	8.80	8.80	-
<b>Rate Base (\$000s)</b>	75,235	77,769	2,534

6  
 7

8 The forecast 2016 *pro forma* return on rate base is 0.50% lower than that used to establish  
 9 Newfoundland Power's current customer rates. The decrease is substantially the result of a  
 10 lower cost of debt in 2016 compared to 2014.<sup>26</sup>

11  
 12 The forecast 2016 *pro forma* return on rate base is approximately \$2.5 million higher than that  
 13 used to establish Newfoundland Power's current customer rates. The increase substantially  
 14 reflects the increased cost of financing rate base due to forecast 2016 capital expenditures.

15  
 16 *Assessing the Need for Regulatory Relief*  
 17

18 Newfoundland Power's current forecast 2016 return on rate base is 7.06% and forecast 2016  
 19 return on common equity is 8.08%.<sup>27</sup> These forecast returns are materially lower than the  
 20 forecast 2016 *pro forma* returns indicated in Table 4 above.

21  
 22  
 23

Between test years, the Board has historically used ranges of 36 basis points ( $\pm 0.18\%$ ) and 80  
 basis points ( $\pm 0.40\%$ ) to assess the reasonableness of returns on rate base and common equity

<sup>26</sup> The lower cost of debt is a result of financing arrangements which were either (i) approved by the Board or (ii) before the Board for approval under Section 91 of the Act. In Order No. P.U. 30 (2013), the Board approved the Company's issue of 4.805% First Mortgage Bonds in an amount of \$70 million. Approximately \$30 million of this issue refunded maturing 10.55% bonds. In Order No. P.U. 22 (2008), the Board approved the Company's current committed short-term credit facility. Under this facility, the Company is forecasting 2016 short-term debt costs of approximately 2.4%. In March 2015, Newfoundland Power filed an application proposing to issue Series AO First Mortgage Bonds in an amount of up to \$100 million and at a coupon rate of up to 6%. Finally, approximately \$30 million of 10.900% Series AE First Mortgage Bonds will mature in May 2016 and be replaced by lower cost debt.

<sup>27</sup> See Table 1, page 3 and Exhibit 1.

1 respectively.<sup>28</sup> Newfoundland Power's current forecast 2016 return on rate base is 0.32% below  
 2 the forecast 2016 *pro forma* return on rate base.<sup>29</sup> In addition, Newfoundland Power's current  
 3 forecast 2016 return on common equity of 8.08% is 0.72% below the cost of equity of 8.80%  
 4 approved by the Board in Order No. P.U. 13 (2013).<sup>30</sup>

5  
 6 This analysis indicates that current customer rates will not provide Newfoundland Power the  
 7 opportunity to earn a just and reasonable return on its forecast 2016 rate base within the meaning  
 8 of Section 80 of the *Public Utilities Act*. This is substantially the result of forecast increases in  
 9 Newfoundland Power's rate base resulting from 2016 capital expenditures required to provide  
 10 service to customers.

11  
 12 Based upon historical practice, regulatory relief is justified.

### 13 14 **4.3 Proposed 2016 Cost Recovery Deferral**

#### 15 16 *Calculating the 2016 Cost Recovery Deferral*

17  
 18 Exhibit 4 shows the calculation of the 2016 amount for which deferred cost recovery is sought in  
 19 this Application.

20  
 21 Table 5 summarizes the components of the proposed 2016 cost recovery deferral.

22  
 23  
**Table 5**  
**2016 Cost Recovery Deferral**  
**(\$000s)**

	<b>2016PF</b>
Return on Rate Base	2,534
Income Tax	1,457
<b>Total</b>	<b>3,991</b>

24  
 25  
 26 The primary component of the proposed 2016 cost recovery deferral is the increased 2016 return  
 27 on rate base of \$2,534,000. Conceptually, this represents the additional cost of financing the  
 28 forecast 2016 capital expenditures required to provide service to customers. Because a portion

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<sup>28</sup> The Board's historical use of these "ranges" is fully described in *Newfoundland Power's 2015 Rate of Return on Rate Base Application*, Company Evidence, Section 2: Regulatory Practice, page 1, line 21, *et seq.*

<sup>29</sup> 7.38 - 7.06 = 0.32.

<sup>30</sup> 8.80 - 8.08 = 0.72.

1 of the additional cost of financing is comprised of the cost of equity, it attracts income tax. An  
 2 allowance of \$1,457,000 accounts for income tax effects of the additional return on rate base.<sup>31</sup>

3  
 4 *Impact of the 2016 Cost Recovery Deferral*

5  
 6 Exhibit 5 shows the impact of the proposed 2016 cost recovery deferral on Newfoundland  
 7 Power's 2014 test year revenue requirement. The only changes to the 2014 test year revenue  
 8 requirement relate to the return on rate base and related income tax effects outlined above.

9  
 10 Exhibit 6 shows Newfoundland Power's 2016 forecast returns before and after the proposed  
 11 2016 cost recovery deferral.

12  
 13 Table 6 summarizes Newfoundland Power's 2016 forecast returns before and after the proposed  
 14 2016 cost recovery deferral.

15  
 16  
**Table 6**  
**2016 Forecast Returns**  
**Before/After Proposed Deferral**  
**(%)**

	<b>Before</b>	<b>After</b>
<b>Rate Base</b>	7.06	7.32
<b>Equity</b>	8.08	8.66

17  
 18  
 19 If the proposed 2016 cost recovery deferral is approved, Newfoundland Power's forecast 2016  
 20 return on rate base would be 7.32% or 0.06% lower than the 2016 *pro forma* return on rate base  
 21 of 7.38%. Newfoundland Power's forecast 2016 return on common equity would be 8.66%, or  
 22 0.14% below the cost of equity of 8.80% approved in Order No. P.U. 13 (2013). Both returns  
 23 would be within the historical ranges used by the Board to assess the reasonableness of returns.

24  
 25 If the proposed 2016 cost recovery deferral is approved, Newfoundland Power would have the  
 26 opportunity to earn a just and reasonable return on its forecast 2016 rate base within the meaning  
 27 of Section 80 of the *Public Utilities Act*.

<sup>31</sup> Allowance for income tax effects is routinely considered by the Board. For such consideration in an application for deferred cost recovery, see *Newfoundland Power's Amended 2012 Cost of Capital Application*, Appendix 4: Revised 2010 Test Year Revenue Requirement, line 10.

1 **4.4 Account Definition**

2

3 Exhibit 7 contains a proposed definition for Newfoundland Power's 2016 cost recovery deferral  
4 account.

5

6

7 **5.0 Newfoundland Power's Next GRA**

8

9 If the Board approves the 2016 cost recovery deferral as proposed in this Application,  
10 Newfoundland Power will have the opportunity to earn a just and reasonable return in 2016. It  
11 will also enable Newfoundland Power to defer the need to file a GRA to obtain rate relief for  
12 2016.

13

14 A deferral of the requirement for Newfoundland Power to file its next GRA to June 1, 2016  
15 would result in a 2017 test year.<sup>32</sup> This, in turn, would enable the Board to conclude the  
16 proceedings associated with Hydro's amended GRA in advance of considering Newfoundland  
17 Power's overall costs and customer rates.

18

19 If the Board denies approval of the 2016 cost recovery deferral as proposed in this Application,  
20 then Newfoundland Power would be practically required to file its next GRA in 2015 to enable it  
21 to have the opportunity to earn a just and reasonable return in 2016.<sup>33</sup>

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<sup>32</sup> Section 3(a)(ii) of the *Electrical Power Control Act, 1994* provides that electricity rates to be charged ought to be based on *forecast costs* wherever practical (emphasis added).

<sup>33</sup> A Newfoundland Power GRA practically requires certain costs, including forecast electricity supply and employee future benefit costs, to be reconciled with forecast revenue from rates for the test period. The effect of this rebalancing can be material. For example, in Newfoundland Power's 2013/2014 general rate application, rebalancing 2013 and 2014 supply costs with revenue from rates accounted for an approximate 2.6% increase in customer rates (see *Newfoundland Power 2013/2014 General Rate Application, Company Evidence*, Section 1: Introduction, page 1-5, lines 13 to 19). Between test periods, changes in these costs are recovered/rebated through the Rate Stabilization Account. For a Newfoundland Power GRA with a 2016 test year, the effect of this rebalancing is currently estimated to be approximately \$7 million, or an approximate 1.1% increase in customer rates.

**Newfoundland Power Inc.**  
**2015 and 2016 Forecast Returns**  
(\$000s)

	<u>2015</u>	<u>2016</u>
1 Revenue from Rates	628,914	637,733
2 Transfers from (to) the RSA	9,303	8,809
3	<u>638,217</u>	<u>646,542</u>
4		
5 Purchased Power Expense	415,010	424,735
6 Amortization of Weather Normalization Reserve	(2,335)	-
7 Demand Management Incentive Account Adjustments	413	-
8	<u>413,088</u>	<u>424,735</u>
9		
10 Contribution	<u>225,129</u>	<u>221,807</u>
11		
12 Other Revenue	<u>5,403</u>	<u>5,281</u>
13		
14 Other Expenses:		
15 Operating Expenses	56,943	59,735
16 Employee Future Benefit Costs	26,481	22,248
17 Amortizations of Deferred Cost Recoveries	3,989	-
18 Depreciation	52,170	55,104
19 Finance Charges	34,960	35,509
20	<u>174,543</u>	<u>172,596</u>
21		
22 Income Before Income Taxes	55,989	54,492
23 Income Taxes	15,997	15,696
24		
25 Net Income	39,992	38,796
26 Preferred Dividends	552	552
27		
28 Regulated Return on Common Equity	<u>39,440</u>	<u>38,244</u>
29		
30		
31 Rate of Return on Rate Base (percentage)	7.39%	7.06%
32 Regulated Return on Equity (percentage)	8.75%	8.08%

<sup>1</sup> \$1,277,000 of the forecast \$2,792,000 increase in operating expenses in 2016 is attributable to year-over-year changes related to regulatory accounting for general expenses capitalized and cost deferrals/amortizations.

**Newfoundland Power Inc.**  
**2016 Forecast Average Rate Base**  
**(\$000s)**

	<u>2015</u> <sup>1</sup>	<u>2016</u> <sup>1</sup>
<b>1 Net Plant Investment</b>		
2 Plant Investment	1,666,074	1,750,103
3 Accumulated Depreciation	(673,344)	(701,146)
4 Contributions in Aid of Construction	<u>(35,213)</u>	<u>(36,630)</u>
5	957,517	1,012,327
6		
<b>7 Additions to Rate Base</b>		
8 Deferred Pension Costs	98,520	91,248
9 Unamortized Credit Facility Costs	56	40
10 Cost Recovery Deferral - Seasonal/TOD Rates	72	73
11 Cost Recovery Deferral - Conservation	7,854	9,926
12 2016 Deferred Cost Recovery	-	2,834
12 Customer Finance Programs	1,136	1,136
16 Weather Normalization Reserve	<u>457</u>	<u>-</u>
13	108,095	105,257
14		
<b>15 Deductions from Rate Base</b>		
17 Other Post Employment Benefits	39,298	46,013
18 Customer Security Deposits	700	700
19 Accrued Pension Obligation	4,996	5,375
20 Accumulated Deferred Income Taxes	1,405	1,289
21 Demand Management Incentive Account	293	-
22 Excess Earnings	<u>48</u>	<u>48</u>
23	46,740	53,425
24		
<b>25 Year End Rate Base</b>	1,018,872	1,064,159
26		
<b>27 Average Rate Base Before Allowances</b>	1,001,433	1,041,515
28		
<b>29 Rate Base Allowances</b>		
30 Materials and Supplies Allowance	5,905	6,081
31 Cash Working Capital Allowance	6,528	6,596
32		
<b>33 Average Rate Base at Year End</b>	<u>1,013,866</u>	<u>1,054,192</u>

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<sup>1</sup> Forecast figures.

**Newfoundland Power Inc.**  
**2014 Test Year, 2015 and 2016 Pro Forma Returns on Rate Base**

	<b>2014T<sup>1</sup></b>	<b>2015PF<sup>2</sup></b>	<b>2016PF</b>
<b>1 Average Capitalization (\$000s)</b>			
2 Debt	523,937	554,029	579,024
3 Preference Shares	9,081	8,953	8,948
4 Common Equity	433,603	452,399	474,232
5	966,621	1,015,381	1,062,204
6			
<b>7 Average Capital Structure</b>			
8 Debt	54.20%	54.57%	54.51%
9 Preference Shares	0.94%	0.88%	0.84%
10 Common Equity	44.86%	44.55%	44.65%
11	100.00%	100.00%	100.00%
12			
<b>13 Cost of Capital</b>			
14 Debt	7.14%	6.53%	6.29%
15 Preference Shares	6.23%	6.17%	6.17%
16 Common Equity	8.80%	8.80%	8.80%
17			
<b>18 Weighted Average Cost of Capital</b>			
19 Debt	3.87%	3.56%	3.43%
20 Preference Shares	0.06%	0.05%	0.05%
21 Common Equity	3.95%	3.92%	3.93%
22	7.88%	7.53%	7.41%
23			
<b>24 Return on Rate Base (\$000s)</b>			
25 Return on Debt	36,519	35,302	35,485
26 Return on Preference Shares	566	552	552
27 Return on Common Equity	38,150	39,835	41,732
28	75,235	75,689	77,769
29			
<b>30 Average Rate Base (\$000s)</b>	955,416	1,009,527	1,054,192
31			
<b>32 Rate of Return on Rate Base</b>	7.88%	7.50%	7.38%

<sup>1</sup> Approved in Order No. P.U. 23 (2013).

<sup>2</sup> Approved in Order No. P.U. 51 (2014).

<sup>3</sup> Newfoundland Power finances its rate base maintaining a capital structure of 55% debt and preference equity and 45% common equity.

<sup>4</sup> Order No. P.U. 13 (2013) approved a ratemaking common equity of 8.80%.

<sup>5</sup> Under the Asset Rate Base Method, differences between average invested capital and average rate base exist for the cash working capital allowance, the materials and supplies allowance and construction work in progress, which includes allowance for funds used during construction. For 2016, these differences result in the pro forma weighted average cost of capital of 7.41% differing by 0.03% from the pro forma rate of return on rate base of 7.38%.

<sup>6</sup> Finance charges presented in Exhibit 1 of \$35,509,000 less other interest of \$24,000 = \$35,485,000.

<sup>7</sup> From Exhibit 1.

<sup>8</sup> The return on common equity is calculated as: average common equity of \$474,232,000 (line 4) x 8.80% (line 16) = ~ \$41,732,000.

<sup>9</sup> From Exhibit 2.

**Newfoundland Power Inc.**  
**2016 Cost Recovery Deferral Calculation**  
(\$000s)

		Return on Debt	Return on Preference Shares	Return on Equity	Total Return on Rate Base
		(1)	(2)	(3)	(1)+(2)+(3)
1 2016 Pro Forma Return on Rate Base from Exhibit 3	<b>A</b>	35,485	552	41,732	77,769
2 2014 Test Year Return on Rate Base <sup>1</sup>	<b>B</b>	36,519	566	38,150	75,235
3 <b>Change in Return on Rate Base (A - B)</b>	<b>C</b>	<b>(1,034)</b>	<b>(14)</b>	<b>3,582</b>	<b>2,534</b>
4					
5 Gross up for Income Tax Purposes [(C / (1 - 0.29))]	<b>D</b>	-	(20)	5,045	5,025
6 <b>Income Taxes (D x 29%)</b>	<b>E</b>	-	<b>(6)</b>	<b>1,463</b>	<b>1,457</b>
7					
8 <b>2016 Cost Recovery Deferral (C + E)</b>		<b>(1,034)</b>	<b>(20)</b>	<b>5,045</b>	<b>3,991</b>

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<sup>1</sup> Approved in Order No. P.U. 23 (2013).

**Newfoundland Power Inc.**  
**Revised 2014 Test Year Revenue Requirement**  
*Adjusted for the revised return on rate base for 2016*  
**(\$000s)**

	<b>2014</b>		<b>2015</b>		<b>2016</b>
	<b>Test Year<sup>1</sup></b>	<b>Change</b>	<b>Revised<sup>2</sup></b>	<b>Change</b>	<b>Revised</b>
1 <b>Return on Rate Base</b>	75,235	-	75,235	2,534 <sup>3</sup>	77,769
2					
3 <b>Other Costs</b>					
4 Power Supply Cost	399,198	-	399,198	-	399,198
5 Operating Costs	55,406	-	55,406	-	55,406
6 Employee Future Benefit Costs	22,058	-	22,058	-	22,058
7 Amortization of Deferred Cost Recoveries	3,990	-	3,990	-	3,990
8 Depreciation	48,291	-	48,291	-	48,291
9 Income Taxes	16,056	-	16,056	1,457 <sup>3</sup>	17,513
10	544,999	-	544,999	1,457	546,456
11					
12 <b>2014 Revenue Requirement</b>	620,234	-	620,234	3,991	624,225
13					
14 <b>Deductions</b>					
15 Other Revenue	(5,247)	-	(5,247)	-	(5,247)
16 Interest on Security Deposits	12	-	12	-	12
17 Amortization of the Weather Normalization Reserve	(2,335)	-	(2,335)	-	(2,335)
18 Transfers to the RSA	(524)	-	(524)	-	(524)
19	(8,094)	-	(8,094)	-	(8,094)
20					
21					
22 <b>2014 Revenue Requirement from Base Rates</b>	612,140	-	612,140	3,991	616,131

<sup>1</sup> Approved in Order No. P.U. 23 (2013).

<sup>2</sup> By Order No. P.U. 51 (2014). No change to existing customer rates was proposed for 2015 as a result of the revised 2015 forecast average rate base and rate of return on rate base approved in Order No. P.U. 51 (2014).

<sup>3</sup> From Exhibit 4.

**Newfoundland Power Inc.**  
**2016 Forecast Returns**  
*Adjusted for the revised return on rate base for 2016*  
**(\$000s)**

	<b>2016 Forecast</b>	<b>2016 Cost Recovery Deferral</b>	<b>2016 Revised</b>
1 Revenue from rates	637,733	-	637,733
2 Transfers from (to) the RSA	8,809	-	8,809
3	646,542	-	646,542
4			
5 Purchased power expense	424,735	-	424,735
6			
7 Contribution	221,807	-	221,807
8			
9 Other revenue	5,281	-	5,281
10			
11 Other expenses:			
12 Operating expenses	59,735	-	59,735
13 Employee future benefit costs	22,248	-	22,248
14 2016 Cost recovery deferral	-	(3,991)	(3,991)
15 Depreciation	55,104	-	55,104
16 Finance charges	35,509	-	35,509
17	172,596	(3,991)	168,605
18			
19 Income Before Income Taxes	54,492	3,991	58,483
20 Income taxes	15,696	1,157 <sup>1</sup>	16,853
21			
22 Net Income	38,796	2,834	41,630
23 Preferred Dividends	552		552
24			
25 Regulated Return on Common Equity	38,244	2,834	41,078
26			
27 Regulated Return on Rate Base (percentage)	7.06%	0.26%	7.32%
28 Regulated Return on Equity (percentage)	8.08%	0.58%	8.66%

<sup>1</sup> Income taxes are calculated as 3,991 x 29% = 1,157.

**Newfoundland Power Inc.**

**2016 Cost Recovery Deferral Account**

**Proposed Definition**

This account shall be charged with the amount of \$3,991,000 representing the difference between the forecast 2016 and 2014 test year returns on rate base as determined by the Board, together with forecast income tax effects.

*Disposition of the Balance in this Account*

The disposition of this cost recovery deferral amount will be subject to a future order of the Board.