
Newfoundland & Labrador
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

NEWFOUNDLAND AND LABRADOR HYDRO

**AMENDED GENERAL RATE APPLICATION
PRUDENCE REVIEW**

FEBRUARY 27, 2015

TERMS OF REFERENCE

1. Background

The Board of Commissioners of Public Utilities (the “Board”) has retained The Liberty Consulting Group (“Liberty”) to provide expert assistance relating to a prudence review undertaken by the Board relating to certain actions and decisions taken by Newfoundland and Labrador Hydro (“Hydro”) and whether associated costs are to be recovered from Hydro’s customers.

Liberty will review the decisions and actions (or inactions) taken by Hydro and associated costs related to certain capital projects and operating expenses, which are listed in Appendix A.

2. Standards for Prudence Review

The standards or tests for determining prudence have been discussed in a number of jurisdictions. While the standards may be described differently among the various jurisdictions, all generally contain certain common principles. A representative selection of the prudence standards from other jurisdictions is described below.

The Nova Scotia Utility and Review Board (NSUARB)¹ has adopted the following definition of prudence as set out in a decision of the Illinois Commerce Commission:

prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made.. Hindsight is not applied in assessing prudence...A utility’s decision is prudent if it was within the range of decisions reasonable persons might have made...The prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being imprudent.

The NSUARB further determined that while the definition of imprudence may vary among jurisdictions it has the following fundamental principles:

- Were the utility’s decisions reasonable in the context of information which was known or should have been known at the time?
- Did the utility act in a reasonable manner and use a reasonable standard of care in its decision-making process?
- The imprudency test should relate to the circumstances at the time in question and not to hindsight.

The approach to a “prudence” review used by the Ontario Energy Board, which contains similar elements to the principles articulated by the NSUARB, has been considered and upheld by the

1 Ontario Court of Appeal.¹ The approach which was referred to with approval by the Court is that
 2 a review of prudence involves the following:

- 3
- 4 • Decisions made by the utility's management should generally be presumed to be
 5 prudent unless challenged on reasonable grounds.
- 6 • To be prudent, a decision must have been reasonable under the circumstances that
 7 were known or ought to have been known to the utility at the time the decision was
 8 made.
- 9 • Hindsight should not be used in determining prudence, although consideration of the
 10 outcome of the decision may legitimately be used to overcome the presumption of
 11 prudence.
- 12 • Prudence must be determined in a retrospective factual inquiry in that the evidence
 13 must be concerned with the time the decision was made and must be based on facts
 14 about the elements that could or did enter into the decision at the time.

15
 16 Liberty will take the above approaches to prudence reviews into account in conducting its
 17 review.

18 19 **3. Review Approach by Liberty**

20
 21 Utility management must act with prudence in making decisions and taking (or deciding not to
 22 take) actions that involve or affect assets, personnel and operations related to the provision of
 23 service to customers. Their decisions and actions must be focused on promoting the delivery of
 24 safe, adequate, reliable and least cost service to their customers.

25
 26 Prudent decisions and actions require that management:

- 27
- 28 • Identify all relevant information;
- 29 • Identify a reasonable range of alternative solutions;
- 30 • Test those solutions through the application of criteria and values consistent with
 31 such delivery of service;
- 32 • Choose an option that falls within the range of those properly determined to be
 33 reasonable; and
- 34 • Act with the level of dispatch and care as is consistent with the timing needs for
 35 making a decision or effectuating actions.

36
 37 In determining whether an action or decision was prudent, Liberty will consider:

- 38
- 39 • Information that was known or ought to have been at the time of the decision or
 40 action (or inaction);
- 41 • Whether the utility applied reasonable foresight, that is, perfect foresight is not
 42 required; and

¹ Enbridge Gas Distribution Inc. v. Ontario Energy Board, 2006Can LII 10734:41 Admin LR (4th) 69, (leave to appeal to CSC denied) and Power Workers' Union, Canadian Union of Public Employees, Local 1000 v. Ontario (Energy Board) (365 D.L.R.(4th)247.

- Whether the solution selected was within the range of reasonable alternatives.

The questions of imprudence and customer impact are distinct. Because the future is unknown, imprudent actions can produce either higher or lower customer costs than would have occurred under a prudent course of action. Similarly, prudent actions can produce either higher or lower customer costs than would have occurred under an imprudent course of action. Where actions are found to be prudent by Liberty, no examination of resulting cost impacts will be completed. Where actions are found to be imprudent, Liberty will examine where and by how much costs would have differed under a prudent course of action.

Liberty will begin its work by reviewing the information that has been filed to date by Hydro and other parties, including Hydro's applications, responses to requests for information and the Board orders. Liberty will also meet with Hydro representatives to review relevant information and will file formal requests for information as necessary. Liberty will file a report with the Board outlining its conclusions on prudence and cost recovery considerations.

4. Schedule

Liberty will file its report by mid-June, 2015. This date assumes that Hydro will provide full and prompt cooperation with data and interview requests.

Liberty will respond to requests for information on its report, provide testimony and be subject to cross-examination, if required.

1 **Items Subject to Prudence Review¹**
2
3

4 **1. Black Start – Order No. P.U. 38(2013)**
5

6 Hydro applied on November 22, 2013 for approval of capital expenditures of \$1,124,000
7 and for deferred lease costs of \$5,724,000 to lease and install eight 1.825 MW diesel-
8 generators to provide black start capability at Holyrood as a temporary solution. Hydro
9 stated that a planned, late-2015 installation of a 60 MW combustion turbine would provide
10 black start capability when completed.

11
12 The Board approved the proposed capital expenditures and the creation of the deferral
13 account with recovery of the costs to be determined later.
14

15 **2. New Combustion Turbine – Order No. P.U. 16(2014)**
16

17 Hydro applied on April 10, 2014 for approval of capital expenditures of \$119,000,000 to
18 purchase and install a 100 MW (nominal) Combustion Turbine at Holyrood. Hydro stated
19 it planned to have the unit in-service in late 2014 and available for the winter of 2014-
20 2015.

21
22 The Board approved the project with the issue of the costs and cost recovery to be
23 determined later.
24

25 **3. Restoration of Holyrood Unit 1 Turbine Generator – Order No. P.U. 14(2013)**
26

27 Hydro applied on April 2, 2013 for approval of capital expenditures of \$13,154,700, which
28 was revised on April 15, 2013 to \$12,809,700 to repair Unit 1 at Holyrood which was
29 damaged when the Unit tripped during a during a winter storm on January 11, 2013.

30
31 The Board approved the expenditures and stated the expenditures could not be included in
32 Hydro's rate base until further order of the Board.
33
34

35 **4. Sunnyside Replacement Equipment – Order No. P.U. 29(2014)**
36

37 Hydro applied on June 19, 2014 for approval of capital expenditures of \$7,197,800 in 2014
38 and \$1,266,400 in 2015 to purchase and install a new transformer and associated
39 equipment, modifications to the protective relay system, and a 230kV breaker at the
40 Sunnyside terminal station. This work was required due to the extensive damage to the

¹ See relevant Board Orders, applications and documentation filed by the parties for additional information which now form part of the record for this proceeding.

1 existing transformer which occurred on January 4, 2014 due to a failure of the transformer
2 and a subsequent fire.

3
4 The Board approved the expenditures with their recovery to be addressed in a subsequent
5 order of the Board following a further application by Hydro.

6
7 **5. Western Avalon Terminal Station T5 Tap Changer Replacement – Order No. P.U.**
8 **32(2014)**

9
10 Hydro applied on June 19, 2014 for approval of capital expenditures of \$1,452,500 to
11 replace the Western Avalon T5 transformer “on-load tap changer,” and clean and dry the
12 T5 transformer. This tap changer was damaged when Transformer T5 experienced a phase
13 to phase fault in January, 2014.

14
15 The Board approved the expenditures with their recovery to be addressed later.

16
17 **6. Capacity Related Supply Costs – Order No. P.U. 56(2014)**

18
19 Hydro applied on October 8, 2014, to defer expenses of \$9,650,000 of additional costs
20 incurred to address supply shortages it experienced in 2014. These costs included payments
21 under a short-term agreement with Corner Brook Pulp and Paper to provide capacity,
22 additional diesel and gas turbine generation costs and costs for requesting Newfoundland
23 Power to run its thermal generation.

24
25 The Board approved the creation of the requested deferral account with the recovery of the
26 costs to be addressed in a subsequent order.

27
28 **7. Holyrood Unit 3 Forced Draft Fan Motor, Overhauls of Sunnyside B1L03 and**
29 **Holyrood B1L17 230 kv Breakers – Order No. P.U. 23(2014)**

30
31 Hydro applied on April 11, 2014 requesting, *inter alia*, that \$580,000 be added to the
32 Allowance for Unforeseen Items to repair the forced draft fan motor for Unit 3 at Holyrood
33 (\$82,687) which failed on December 26, 2013 and \$497,313 to repair two 230kv breakers
34 (Sunnyside B1L03 and Holyrood B1L17), both of which had failed in January, 2014.

35
36 The Board approved the expenditures with recovery of the expenditures to be addressed
37 later.

38
39 **8. Restoration of Black Tickle Diesel Plant after a Fire – Order No. P.U. 27(2014)**

40
41 On March 14, 2012, a fire at the Black Tickle diesel plant caused significant damage and
42 an outage of the entire Black Tickle system which affected about 100 customers. Hydro

1 restored service on a temporary basis and later restored the plant to pre-fire conditions. The
2 net cost, after insurance recovery of \$274,801 was \$1,427,031.

3
4 Hydro applied on August 5, 2013 for approval of its 2014 capital budget and to fix its 2012
5 rate base. In Order No. 42(2013) the Board, *inter alia*, did not approve the 2012 rate base
6 and said it would be subject to a separate process. Subsequently, in Order No. P.U.
7 27(2014) the Board approved Hydro's 2012 rate base but excluded the costs related to the
8 restoration of the Black Tickle diesel plant and stated Hydro could propose in the future to
9 include the expenditures with supporting additional evidence to demonstrate they were
10 reasonable and necessary in the circumstances.

11
12 **9. Labrador City Terminal Station Over-Budget Expenditures of \$4,194,000 – Order**
13 **No. P.U. 42(2013)**

14
15 The Board in Order No. P.U. 36(2008) approved a capital project related to the Labrador
16 City Terminal Station at a total of \$9,990,600 and in Order No. P.U. 2(2012) approved a
17 revised budget of \$12,650,000 (a variance of \$2,660,000) for this project. The project was
18 completed in 2013 for an actual total cost of \$16,844,000, a variance of \$4,194,000 above
19 the 2012 revised budget of \$12,650,000 and a variance of \$6,853,400 above the 2009
20 budget of \$9,990,600.

21
22 The Board in Order No. 42(2013) decided that Hydro would not recover any expenditure
23 over \$12,650,000 until further review and order of the Board.

24
25 **10. \$45.9 Million Revenue Deficiency in 2014 – Order No. P.U.58(2014)**

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27 On November 28, 2014, Hydro applied, *inter alia*, for approval to defer and recover \$ 45.9
28 million forecast revenue deficiency for 2014. The revenue deficiency was based on
29 Hydro's estimated 2014 operating costs and calculated returns compared to the 2007 costs
30 used to set current rates, offset by higher revenues.

31
32 The Board approved the creation of the deferral account and the segregation of \$45.9
33 million in the account but did not approve recovery fully or in part.

34
35 **11. Extraordinary Repairs**

36
37 In its Amended General Rate Application, dated November 10, 2014 Hydro requested,
38 *inter alia*, approval to defer and amortize \$0.2 million a year for five years relating to
39 maintenance on air blast circuit breakers and transformers. Hydro states that, in their view,
40 the associated expense for 2015 is not a recurring expense, and proposes that the full
41 amount be deferred and amortized over a 5-year period.