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July 31, 2024

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

Attention: Jo-Anne Galarneau
Executive Director and Board Secretary

Re: Newfoundland Power Inc. – 2025–2026 General Rate Application – Written Submissions

Please find enclosed Newfoundland and Labrador Hydro's Written Submissions in relation to Newfoundland Power Inc.'s 2025–2026 General Rate Application.

Should you have any questions, please contact the undersigned.

Yours truly,

NEWFOUNDLAND AND LABRADOR HYDRO

SWalsh

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Senior Legal Counsel, Regulatory
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Encl.

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IN THE MATTER OF the *Public Utilities Act*, RSNL 1990, Chapter P-47, as amended (“*Act*”); and

IN THE MATTER OF an application by Newfoundland Power Inc. (“Newfoundland Power”) to establish customer electricity rates for 2025 and 2026 (“Application”).

Newfoundland and Labrador Hydro

Written Submissions

July 31, 2024

1.0 Introduction

Newfoundland and Labrador Hydro ("Hydro") is a public utility within the meaning of the *Act* and is the primary distributor of electricity for the province. Newfoundland Power is Hydro's largest customer and the energy that Newfoundland Power purchases from Hydro constitutes approximately 85% of the energy that is generated or purchased and transmitted by Hydro for consumption within the province of Newfoundland and Labrador. Hydro is also a customer of Newfoundland Power at several locations throughout the island of Newfoundland including Hydro's head office in St. John's.

Hydro's Rural customers served by the Island Interconnected Grid, and its customers in the Labrador Straits area, pay the same rates as those approved by the Board of Commissioners of Public Utilities ("Board") for Newfoundland Power's customers. Also, Hydro's Non-Government customers served by its isolated diesel systems are charged the same rates for their "lifeline" consumption as those charged by Newfoundland Power.

Hydro is acutely aware of the importance of the reliable delivery of electricity to the people of the province, as well as the concerns of customers regarding the cost of living, including electricity rates. As the primary generator and transmitter of power throughout Newfoundland and Labrador, Hydro is also cognizant of the costs associated with ensuring the provision of safe, reliable electricity in an environmentally responsible manner. Hydro's participation in Newfoundland Power's 2025–2026 General Rate Application ("GRA") was intended to gain a better understanding regarding a number of issues underlying Newfoundland Power's proposals and how those proposals considered the resulting costs to customers. Hydro trusts that its participation in the GRA process has been helpful to the Board in making their determinations.

2.0 Newfoundland Power's Proposals

Newfoundland Power proposes that the Board approve, among other things, an average increase in current electricity rates for all customer rate classes of 5.5% to become effective July 1, 2025. Newfoundland Power's Application indicates that the proposed rate increase is primarily the result of:

a) A proposed increase in the company's return on equity ("ROE") from 8.5% to 9.85% to be used in establishing customer rates; and

b) Increase in costs since its last GRA.

The issues within the Application that were of particular interest to Hydro were Newfoundland Power's submission that a fair ROE for Newfoundland Power in 2025 and 2026 is 9.85% based on a 45% common equity ratio; Newfoundland Power's justification of its operating costs, with focus on executive compensation and related costs; and Newfoundland Power's proposed amendments to the definition of the Demand Management Incentive Account ("DMI Account").

3.0 Settled Issues

Several issues were resolved through settlement negotiations among the parties, and detailed in a Settlement Agreement dated June 4, 2024.[1] Those issues included the continued suspension of the use of an automatic adjustment formula for setting the allowed rate of return, the approval of the proposed calculation of the depreciation expense, approval of the 2025 and 2026 Customer, Energy and Demand forecast proposed in the Application, and approval of various regulatory accounting issues including amendments to the DMI Account. Hydro's concerns with respect to the definition of the DMI Account were mitigated by the agreed modification of Newfoundland Power's proposed definition to establish a threshold of ±$500,000 and Newfoundland Power's commitment to prepare a report ahead of its next GRA. That report will review each of Newfoundland Power's supply cost mechanisms, including a review of the recommendations in The Brattle Group Report on Newfoundland Power's Deferral Accounts, dated April 24, 2024, and a jurisdictional review. A further Settlement Agreement was made between Newfoundland Power, Hydro, and the Consumer Advocate on June 12, 2024, detailing the agreement by Newfoundland Power and Hydro to apply to the Board to revise the wholesale rate charged by Hydro to Newfoundland Power effective January 1, 2025, and to file such application on or about September 15, 2024.[2]

Through the settlement of the above issues, the parties did not then present evidence, examine, cross-examine or present an argument in relation to the settled issues. The remaining issues of interest to Hydro that were further examined through the hearing that took place beginning June 13, 2024, were Newfoundland Power's proposals regarding ROE, and their overall operating costs.

[1] Consent #1.
[2] Information Item #2.

4.0 Return on Equity

In Newfoundland Power's 2016 GRA, the Board approved an ROE of 8.5% with a common equity ratio of 45%. Since that time, Newfoundland Power's approved ROE has remained at 8.5% through two GRA filings, as a result of settlements negotiated with the parties that were then approved by the Board. In all years since 2016, Newfoundland Power has achieved and even exceeded its ROE each year.[3]

In its Application, Newfoundland Power proposed an increased ROE of 9.85% and a consistent 45% common equity ratio. The basis of that proposal was the supposition, detailed by Newfoundland Power's expert Concentric Energy Advisors, Inc. ("Concentric"), that Newfoundland Power had above-average business risk in comparison to other Canadian utilities.[4] The factors Newfoundland Power argued contributed to that above-average business risk were ". . . weak service territory demographics in comparison to the rest of Canada, a harsh operating environment, [Newfoundland Power's] small size and its limited cost flexibility."[5] Newfoundland Power stated that the provincial outlook remained weak with lagging economic indicators, including historically low housing starts, and that the Muskrat Falls Project continued to pose risks to the delivery of least-cost, reliable service. These were the same points put forth by Newfoundland Power in its 2016/2017 GRA, in which the Board determined that Newfoundland Power's business risk was average and not above average.[6] Newfoundland Power has stated, in this Application, that its 2023 business risks are largely consistent with those described in its 2022/2023 GRA; a Settlement Agreement reached in that GRA, which was approved by the Board, maintained Newfoundland Power's ROE at the levels approved in its 2016/2017 GRA. As noted later in this submission, the unchanged ROE did not impact Newfoundland Power's credit rating with the credit rating agencies.

An increase in ROE would be based on changes to the utility's risk profile and market conditions. Newfoundland Power, and Concentric, submit that market conditions have been volatile. Concentric states in its report that there has been a "fundamental shift" in the economy and capital markets since it

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[3] CA-NP-079, Table 1.

[4] "2025/2026 General Rate Application," Newfoundland Power Inc., December 12, 2023, vol. 1, Company Evidence, sec. 1.1.4, p. 1-6/22–23, and vol. 2, Expert Evidence, "Cost of Capital," Concentric Energy Advisors, Inc., November 7, 2023, ch. VI(B)(3)(h), p. 78/3–4.

[5] "2025/2026 General Rate Application," Newfoundland Power Inc., December 12, 2023, vol. 1, Company Evidence, sec. 1.1.4, p. 1-6/15–17, and sec. 3.3.2, p. 3-22/17–18.

[6] Order No. P.U. 18(2016), p. 19/31–33.

had prepared evidence for Newfoundland Power's last GRA in 2021.[7] However, in 2021 for the 2022/2023 GRA, Concentric's recommended ROE was 9.8% on 45% equity. The current proposal of 9.85% is only five additional basis points higher than recommended in the 2021 GRA. Mr. Coyne's evidence is that this is due to "offsetting factors" in the development of that recommendation.

4.1 Uncertainty Related to Rate Mitigation

Among the uncertainties Newfoundland Power submitted that contribute to its business risk, are factors associated with the Muskrat Falls Project. Specifically, Newfoundland Power references concerns regarding costs and reliability that could put pressure on Newfoundland Power's ability to earn a fair return.

On May 7, 2024, the provincial government issued Order in Council OC2024-062 directing Hydro to ". . . structure any application for utility rate increases such that retail rate increases to domestic rate class customers attributable to Newfoundland and Labrador Hydro shall be targeted at 2.25 per cent per year" for the period up to and including 2030.[8]

Legal counsel for the Consumer Advocate, Mr. Coffey, KC, suggested to Mr. Coyne, on behalf of Concentric, that there is support from the Government of Canada and the provincial government to ensure rates don't rise uncontrollably.[9] However, Mr. Coyne testified that he would view the rate mitigation plan as a "stop-gap measure" that did not address the huge problem and only recovered a small portion of the cost up to 2030.[10] Mr. Coyne did not appreciate or understand that the balance of the costs associated with the Muskrat Falls Project that was not recovered from customers and federal funding sources during that period would be covered by investment from Hydro, and would not be deferred for future collection from customers.[11]

Hydro submits that the rate mitigation plan has removed the uncertainty in the near term with respect to costs and rate impacts related to the Muskrat Falls Project,[12] and, within that period, there is now less

[7] "2025/2026 General Rate Application," Newfoundland Power Inc., December 12, 2023, vol. 2, Expert Evidence, "Cost of Capital," Concentric Energy Advisors, Inc., November 7, 2023, ch. III(A), p. 9/17–18.
[8] OC2024-062 (*Hydro Corporation Act, 2007*, SNL 2007 c H-17*)*, <https://www.exec-oic.gov.nl.ca/public/oic/details?order-id=21851>.
[9] Transcript, June 18, 2024, p. 57/17–p. 58/10.
[10] Transcript, June 18, 2024, p. 62/8–22.
[11] Information Item #7, and Transcript, June 19, 2024, pp. 51–52.
[12] Transcript, June 13, 2024, p. 139/2–p. 140/22.

concern regarding the impact of Muskrat Falls-related costs on forecast demand from customers,[13] one of the main issues raised by the credit rating agencies.[14] Hydro notes that Mr. Trogonoski of Concentric testified that they would typically categorize short term as anywhere from one to three years.[15] Moody's Investors Service ("Moody's") had also noted that if there were to be increases in rates from the Muskrat Falls Project that lead to lower electricity demand, the difference would be expected to be temporary.

4.2 Uncertainty Related to Reliability

The reliability of the Labrador-Island Link ("LIL") and its impact on the reliability of supply to Newfoundland Power is also a concern noted by Newfoundland Power in support of its argument that it has above-average business risk. However, the LIL has now been commissioned and in the first year since it was commissioned it had an Equivalent Forced Outage Rate of 2.70%.[16] Newfoundland Power noted in its response to NLH-NP-091 of this proceeding that during the 2019–2023 period, only 2% of Newfoundland Power's outages to distribution customers were caused by Hydro outages. Newfoundland Power further confirmed that although they expressed concerns about the future reliability of supply from Hydro, they had not factored those concerns into its 2025–2026 forecast. If this experience with the LIL does not alleviate the concern with reliability, at minimum, it does not worsen the estimation of the risk that has already been considered by the credit agencies.

4.3 Credit Agencies

Newfoundland Power utilizes two credit rating services, Moody's and DBRS Morningstar ("DBRS"). Both Newfoundland Power and its expert Concentric referenced the concerns expressed by Moody's and DBRS regarding how higher supply costs may impact customer demand and timely cost recovery for Newfoundland Power.

The credit ratings from Moody's–Baa1 Stable–have been consistent since 2005.[17] This includes the period from 2016 to the present when Newfoundland Power has stated very similar business risk principles. Notably, the rating was provided before the certainty of the province's rate mitigation

[13] Transcript, June 13, 2024, p. 142/12–19.
[14] "Credit Opinion – Newfoundland Power Inc. – Update to credit analysis," Moody's Investors Service, April 30, 2024.
[15] Transcript, June 18, 2024, p. 44/24–25.
[16] Information Item #5, p. 20.
[17] Transcript, June 17, 2024, p. 35/13–14.

announcement on May 16, 2024.[18] The credit ratings from DBRS–A Stable – have also been consistent, since approximately 1996.[19] With the described business risks being largely consistent since 2016, aside from changes that would reduce risk, (i.e., the rate mitigation announcement and the commissioning and positive first year of operation of the LIL) Hydro believes it is likely that the credit ratings would not be negatively impacted in such a way as to require the proposed increase in ROE.

4.4 Comparator Groups

Concentric's opinion, contained within its Cost of Capital report, was that the North American Electric proxy group in Figure 21 was the most appropriate comparator for Newfoundland Power. Concentric further confirmed its opinion that a country risk adjustment, as had been previously ordered by the Board in Order No. P.U. 18(2016), was not necessary.[20] The use of the North American Proxy Group, without adjustment, results in a proposed ROE for Newfoundland Power that results in the second highest weighted ROE in the context of the Canadian electric and gas investor-owned utilities.[21] In fact, in comparison to those same Canadian electric and gas investor-owned utilities, Newfoundland Power is already above the weighted Canadian electric average at its current ROE of 8.5% and common equity ratio of 45%.

4.5 Impacts of Increased ROE

An increase in the test year ROE for Newfoundland Power will also result in a material increase in Hydro's supply costs and revenue requirement, and could contribute to customer rate changes in the long term. When asked whether this relationship should be considered when establishing the test year ROE for Newfoundland Power, Newfoundland Power cited Order No. P.U. 18(2016), among other decisions of the Board, for the Board's description of the fair return standard as one that: ". . . must be commensurate with return on investments of similar risk and sufficient to assure financial integrity and to attract necessary capital."[22] Newfoundland Power's position was that the interests of third parties are not a component of the fair return standard.

Newfoundland Power submitted that the Board should consider whether consideration of third parties' interests is in accordance with the stand-alone principle, which Newfoundland Power noted the Board

[18] Transcript, June 17, 2024, p. 45/4–12.
[19] Transcript, June 17, 2024, p. 61/19–22.
[20] PUB-NP-115, and Transcript, June 19, 2024, p. 77/15–p. 79/6.
[21] Undertaking #6.
[22] PUB-NP-134.

has upheld in past rulings. Board Order No. P.U. 19(2003) cited by Newfoundland Power, was one where the Board had to determine whether to consider the relationship between Newfoundland Power and its parent company Fortis Inc. ("Fortis"), and the impacts of that relationship on Fortis. The Board determined at that time to continue to treat Newfoundland Power as a stand-alone utility, but did note that "The Board is not prepared to simply presume a stand-alone utility in the future and has an obligation to ensure the financial integrity and independence of Newfoundland Power is fully protected on behalf of those it serves."[23] Fortis is not a utility under the regulation of the Board, nor is Fortis a distinct customer in the province that would be afforded consideration by the Board separate from the Board's consideration of customers generally. However, the Board has a legislative duty to consider Newfoundland and Labrador customers. The consideration of how an increased ROE would impact Hydro's revenue requirement, inclusive of payments made to cover Lower Churchill Project costs under the Transmission Funding Agreement, is material in considering the ultimate impacts of Newfoundland Power's requests on customers.

Mr. Coyne, on behalf of Concentric, was asked whether the Board should take into account in their consideration of the appropriate fair return for Newfoundland Power the flow-through impacts on Hydro's rates, and ultimately, customers. Mr. Coyne noted that the Board has the responsibility to set a fair return, utilizing the fair return standards, but also has a broader set of responsibilities in setting just and reasonable rates.[24] This is consistent with the decision of Mr. Justice Green in *Newfoundland (Board of Commissioners of Public Utilities)(Re)*(1998), 64 NFLD. & PEI R.60 (NFLD.C.A.) ("Stated Case"), summarized in Board Order No. P.U. 19(2003),[25] noted among other general principles that the Board must balance the interests of public utilities and electrical consumers. The Board noted that the Court, in the Stated Case, clearly set out the requirement of the Board to balance the utility's right to a fair return and the consumer's right to reasonable access to power. The utility's right to a fair return is not a solitary consideration.

Hydro submits that the Board must use its discretion and judgement to consider the inputs and analysis used to determine the proposed ROE and determine what is appropriate in this context. The Board has the jurisdiction to balance Newfoundland Power's right to earn a fair return with the overall impacts on customers. In light of the relatively unchanging nature of the business risks and the apparent minimal

[23] Order No. P.U. 19(2003), p. 39.
[24] Transcript, June 19, 2024, p. 118/1–121/7.
[25] Order No. P.U. 19(2003), p. 13.

impact of the changing market conditions, Hydro does not believe that Newfoundland Power has demonstrated that an increase to the ROE is needed to meet the fair return standard or indeed that the existing ROE of 8.5% does not already meet that standard as it has done since 2016.

5.0 Operating Costs

Newfoundland Power's evidence indicates that gross operating costs are forecast to increase by approximately 3.9% per year from 2022 to 2026, with operating labour costs increasing by 3.1% over the same period.[26] Although Newfoundland Power's operating costs had been declining from 2014 to 2018, they had started to slightly increase in 2019. Aside from a substantial dip in 2020, which recovered in 2022, the costs have continued to increase.[27] The increase in operating costs is actually 18% between the 2023 Test Year to the proposed 2026 Test Year,[28] and the impact from the forecast increases make up approximately 1.6% of the proposed 5.5% rate increase for July 1, 2025.

Newfoundland Power argued that the general reason for the increases are inflationary pressures and that they are doing all they can to find efficiencies and manage costs;[29] however, Newfoundland Power could not provide examples of specific actions or efficiencies that were any different from what they had included in previous GRAs.[30] Newfoundland Power noted that productivity allowances are intended to provide an incentive to manage costs and find efficiencies.[31] Hydro observes the inclusion of the same productivity efficiencies within the 2025 and 2026 test years that have been consistently applied since the 2013/2014 GRA; however, for five of the ten years between 2013–2023, a primary reason for variances in Newfoundland Power's actual regulated earnings is attributed to lower operating costs than forecast (2015, 2016, 2017, 2020, and 2021).[32] In seven years of that ten-year period, Newfoundland Power has achieved higher than forecast other revenue (2013, 2016, 2017, 2018, 2019, 2020, and 2023).[33] As a result of the outperformance of test year forecasts, the additional revenues and efficiencies have resulted in higher earnings than forecast for the last ten years for Newfoundland Power shareholders.[34] Hydro submits that this information, in addition to the substantial increase

[26] "2025/2026 General Rate Application," Newfoundland Power Inc., December 12, 2023, vol. 1, Company Evidence, sec. 2.1, p. 2-2/11–12.
[27] NLH-NP-011.
[28] NLH-NP-030, att. A.
[29] Transcript, June 27, 2024, p. 63/24–p. 64/7.
[30] Transcript, June 14, 2024, p. 55/12–p. 57/13, and Transcript, June 27, 2024, p. 62/19–p. 64/19.
[31] PUB-NP-140.
[32] PUB-NP-075.
[33] Ibid.
[34] PUB-NP-075, att. A.

between test year operating costs, and Newfoundland Power's indication that it has taken no additional actions to reduce costs for its proposed test years, it is appropriate for the Board to issue directives to Newfoundland Power that will provide incentive for Newfoundland Power to manage costs and find efficiencies that provide benefit to both customers and shareholders.

5.1 Executive Compensation

Labour costs are 54% of Newfoundland Power's operating costs,[35] and Newfoundland Power's evidence indicates that labour rate increases are 3.00% in 2022, 2.75% in 2023, 3.80% in 2024, 4.45% in 2025, and 4.50% in 2026.[36]

For executive compensation, the comparator group used to determine the basis for reasonable compensation is the broad Canadian Commercial Industrial market.[37] This comparator group of 390 organizations included only 3 electrical utilities, 3 Atlantic Canada organizations, and no organizations from this province. The Korn Ferry Report noted that jobs are compared between those of similar skill, effort, and responsibility and not necessarily the same title or role. The organizations utilized in this comparator group are classified as "private sector commercial industrial" and are considered valid by Korn Ferry based on the assumption that Newfoundland Power competes for its executive resources with organizations across the "breadth and depth of business sectors across Canada."[38]

The current executives at Newfoundland Power were all either previous employees of Newfoundland Power or its parent company Fortis and recruited locally.[39] Further, in over 20 years approximately 3 executives have been hired from outside the Fortis Group of Companies. Very few Newfoundland Power executives have been recruited from across the country, outside of those already employed with Newfoundland Power's parent company.

Hydro questions whether the comparator group utilized is the most appropriate given the lack of utility representation and geographic consideration of organizations included within it. Korn Ferry states that the comparator group does not include public sector utilities because Newfoundland Power has a very

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[35] Transcript, June 14, 2024, p. 76/14–19.

[36] "2025/2026 General Rate Application," Newfoundland Power Inc., December 12, 2023, vol. 1, sec. 2.4.1, p. 2-31, f.n. 57. The annual base compensation increases and short-term incentive payments for executives during that period are listed in the response to PUB-NP-029, Tables 3 and 4, respectively.

[37] "Executive Compensation Review ("Korn Ferry Report")," Korn Ferry, April 11, 2024, app. C.

[38] "Executive Compensation Review," Korn Ferry, April 11, 2024, sec. 4, p. 7, and Transcript, June 25, 2024, p. 102/8–23.

[39] Transcript, June 14, 2024, p. 25/13–19.

different approach on executive compensation, as they do not take into account constraints such as fiscal policies, provincial policies or other public policies. Newfoundland Power states that it defers to its expert Korn Ferry on the reasonableness of its executive compensation;[40] however, Korn Ferry does not have access to historical data that would be important in making those determinations[41] and stated that the Board of Directors of Newfoundland Power is ultimately responsible for decisions on changes to comparator groups.[42] Further, Korn Ferry's comparator group included only a limited number of privately owned utilities, which would be of key importance to the composition of an appropriate comparator group for Newfoundland Power at any level. As a result, Korn Ferry was unable to complete the analysis on how Newfoundland Power's executive compensation compares to that of other Canadian privately owned or Crown-owned regulated public utilities and could not provide that information.[43]

At present, Newfoundland Power's total executive remuneration is slightly higher than the commercial industrial market median by about 5–6%.[44] The evidence from Korn Ferry notes that excluding the non-regulated portions puts the amount of Newfoundland Power executive compensation recovered from customers below the market median compensation.[45] Hydro suggests that if the overall total compensation were at or below the market median, the amount that was recovered from customers would be even less.

The underlying assumptions for executive compensation appear to have not been fully analyzed for their appropriateness and applicability to Newfoundland Power and its operating environment. With labour costs being such a substantial portion of operating costs, and executive compensation a predominant portion of those, it is key to ensure that the appropriate comparator group is utilized such that the benchmarks for compensation are accurate and attuned to similar organizations—particularly when the results have direct implications for rates charged to customers.

[40] Transcript, June 14, 2024, p. 115/17–22.
[41] CA-NP-308, part (b).
[42] Transcript, June 25, 2024, p. 86/4–6.
[43] CA-NP-309.
[44] Transcript, June 25, 2024, p. 15/8–12.
[45] Transcript, June 25, 2024, p. 16/4–9.

6.0 Conclusion

When considering the applications that Newfoundland Power had, or intended to have, before the Board and their associated rate increases, the cumulative proposed rate increases from July 1, 2024, and July 1, 2025, were approximately 16%.[46] Of the 5.5% proposed in the Application, 1.6% is related to the requested ROE increase,[47] and a further 1.6% is related to the increases in operating costs including labour.[48]

As referenced above, the Court in the Stated Case noted that the Board must balance the interests of public utilities and electrical consumers and, in doing so, must balance the utility's right to a fair return and the consumer's right to reasonable access to power. Newfoundland Power's response to how it had considered the interests of its customers and how to limit the impact on them was to note that its operations had been managed in a manner consistent with the provincial power policy (i.e., in a manner that results in power being delivered to customers at the lowest possible cost, in an environmentally responsible manner, consistent with reliable service).[49] Newfoundland Power stated that a fair ROE would provide it with the ability to attract incremental capital on reasonable terms, which would be a benefit to customers. The Board must determine whether the increases in Newfoundland Power's costs are reasonable based on the evidence presented. In Hydro's view, the evidence does not support the proposed increased ROE and, at best, it is not clear as to whether operating costs and in particular executive compensation, have been managed in such a way as to ensure that the costs Newfoundland Power seeks to recover from customers through rates are reasonable.

[46] When including an additional 4.3% related to rebasing, Newfoundland Power rate increases are approximately 20% as noted in Transcript, June 14, 2024, p. 51/12–p. 55/10.
[47] Transcript, June 14, 2024, p. 139/5–10.
[48] Transcript, June 14, 2024, p. 67/20–p. 68/1.
[49] NLH-NP-062.