NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

AN ORDER OF THE BOARD

NO. P.U. 4(2014)

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

IN THE MATTER OF an application by
Newfoundland and Labrador Hydro for approval
to treat costs associated with repairs to the fuel oil
system at the Holyrood Thermal Generating Station
as an extraordinary expense pursuant to sections
69, 78 and 80 of the Act; and

approving the creation of a deferral account for
the costs associated with the repairs to the fuel oil
system and setting aside the issue of the recovery
of the costs.

The Application

Newfoundland and Labrador ("Hydro") filed an application on December 9, 2013 for approval to
treat the expenses associated with the repair of the fuel oil system at the Holyrood Thermal
Generating Station ("Holyrood") as a major extraordinary repair and to defer the expenses (the
"Application"). The Application requests that the Board make an order approving 2013 costs of
$1,059,686 associated with repairs to the fuel oil system at Holyrood as a major extraordinary
repair such that the costs of those repairs are amortized over a five-year period and that the
unamortized balances are included in the rate base. A report Holyrood Fuel Oil System -
Operation and Maintenance Challenges in 2013 was filed as part of the Application.

Notice of the Application was provided to: Newfoundland Power Inc. ("Newfoundland Power"),
the Consumer Advocate, Corner Brook Pulp and Paper, North Atlantic Refining Limited, Teck
Resources Limited, Vale Newfoundland and Labrador Limited and Praxair Canada Inc.

The Board issued Order No. P.U. 41(2013) on December 13, 2013 approving the creation of a
deferral account for Hydro’s 2013 costs relating to the repairs to the fuel oil system but set aside
Hydro’s proposals in relation to the recovery of the 2013 costs to be addressed in a subsequent Order of the Board.

On December 16, 2013 the Board issued a schedule for the process to review the remaining issues in the Application. On January 8, 2014 requests for information were issued to Hydro by Newfoundland Power, the Consumer Advocate and the Board. A total of 42 requests for information were issued to Hydro. Written submissions were filed by the Consumer Advocate, Newfoundland Power and Corner Brook Pulp and Paper, North Atlantic Refining Limited and Teck Resources Limited on January 22, 2014. Vale Newfoundland and Labrador Limited and Praxair Canada Inc. did not file submissions. Hydro filed a reply submission on January 24, 2014.

Evidence and Submissions

In the Application Hydro explains that in 2013 there were a number of operational and maintenance issues with the fuel oil equipment at Holyrood as a result of the quality of fuel oil delivered in four separate shipments in January and February of 2013. The fuel oil contained high content levels of aluminum and silicon. Fuel oil stability was also an issue. Hydro explains that the fuel oil quality issues affected the main fuel oil tank suction heaters, the fuel oil day tank, the fuel oil suction strainers, the fuel oil pumps, the fuel oil heat exchangers, the fuel oil recirculation and control valves and the boiler burner nozzles. In addition Holyrood experienced two fuel oil spills in 2013 due to premature wear on the tubes on the suction heater of fuel oil tanks 1 and 2. Hydro’s evidence sets out the details of the specific issues and required corrective action and repairs associated with the quality of fuel delivered in early 2013.

Hydro estimates that the total cost of the required fuel oil equipment maintenance, replacement, inspection, repair, and cleanup was $1,059,686. Hydro explains that:

"Hydro now applies to the Board that the fuel oil system repairs be treated as extraordinary expenses in accordance with approved policy and that the expenses be deferred over a period of five years as the repairs to the fuel oil system equipment do not result in replacement of major components, are not typical of the normal repair expenditures, and the costs exceed $500,000. Further, the costs associated with the repairs are considerable and would constitute a significant adverse effect on Hydro's earnings were they to be expensed in the year in which they were incurred." (Application, Correspondence, dated December 9, 2013, page 1)

The Consumer Advocate does not support Hydro’s proposals in relation to the recovery of the costs relating to the repairs of the fuel system and the inclusion in rate base of the unamortized balance. The Consumer Advocate submits that, while the circumstances giving rise to the need for the repairs may have been out of the ordinary, Hydro has not shown in this case that the circumstances are extraordinary as regards the effect on Hydro’s regulated earnings. He points to the Board’s findings in Order No. P.U. 31(2008) in which the Board declined to allow Hydro to defer a $1.4 million expense for repairs to the Unit 2 turbine at Holyrood on the basis that Hydro had not shown that expensing these costs would cause a shock to its earnings. The Consumer Advocate also notes that, according to NP-NLII-007 and NP-NLH-008, Hydro’s internal labour costs of $241,600 associated with the repairs to the Holyrood fuel oil system were not
incremental to its initial 2013 operating budget since Hydro was able to defer other planned work.

In his submission the Consumer Advocate also raises the potential of future operational and maintenance issues in the fuel oil system which may be associated with the quality of the fuel oil supplied. He notes that, according to NP-NLH-011, an agreement between Hydro and its supplier regarding the acceptable amounts of damaging constituents has not been put into place. The Consumer Advocate also submits that it is presently unclear how Hydro proposes to ensure that the fuel has acceptable levels of aluminum and silicon. The Consumer Advocate recommends that Hydro advise the Board and the parties of the steps it proposes to take to ensure that similar losses are avoided in the future.

In its submission Newfoundland Power notes that the repairs to the fuel oil system had the effect of deferring other planned work. According to Newfoundland Power:

"Since work that would have otherwise been conducted within Hydro's initial 2013 operating budget was deferred, the full costs associated with the Holyrood fuel system repairs cannot be considered extraordinary and incremental to Hydro's 2013 expenses. Had the damage to the fuel oil system not occurred, Hydro would have completed other planned work and would still have incurred at least some, if not all, of the operating cost amounts requested in the Application." (Newfoundland Power, Written Submission, page 1)

Newfoundland Power submits that Hydro has not established that the costs incurred to repair the fuel oil system at Holyrood are extraordinary requiring special treatment, and also submits that the Application requests deferral of costs that are less material to earnings than the 2007 costs requested and denied by the Board in Order No. P.U. 31(2008).

Corner Brook Pulp and Paper, North Atlantic Refining Limited and Teck Resources Limited support the position taken by the Consumer Advocate in his submission, both in relation to Hydro having not demonstrated circumstances warranting deferral of the expenses and, secondly, in relation to whether Hydro has taken sufficient measures to avoid a recurrence. These customers suggest: i) implementation by Hydro of testing procedures that would allow for detection of the identified fuel oil quality issues prior to shipment; ii) Hydro entering into a written agreement with the supplier to address the identified fuel quality issues; and iii) Hydro submitting to the Board a report on the implementation of these measures and any other the Board may order.

In its reply submission Hydro states that it is appropriate for the Board to consider the fuel oil system expense as an extraordinary repair cost as it meets the minimum threshold of $500,000 previously established by the Board and will cause a significant shock to Hydro's earnings that is considered unreasonably high for a utility that has minimal 2013 net income. Hydro states that if the fuel oil system repair costs are expensed in 2013 its earnings would be reduced by 16% and submits that its earnings are such that any single event that causes a 16% reduction constitutes a shock to its earnings which impacts its ability to earn a just and reasonable return. Hydro also submits that that work associated with the repairs to the fuel oil system was incremental to
planned work at Holyrood and did not replace other planned work as the deferred work will be completed in a future year.

In relation to the suggested preventative measures for the future Hydro submits that this is outside the scope of this Application. Hydro states that the contract with its supplier is in place until at least 2014 and that any changes in the specifications would constitute a change in the tender and require a new tender. Hydro also submits that it has already put measures in place to help prevent future damages, including working with its supplier to lower concentrations of aluminum and silicon. Hydro is also considering other testing methods for fuel stability and a formal aluminum and silicon limit but notes there are no known standards for guidance. Hydro states that any required changes in the contract will be implemented in future tenders.

**Board Findings**

The Board will consider giving special treatment to expenses associated with a major extraordinary repair if the costs are greater than $500,000 and would cause a rate shock or shock in the utility’s earnings that is considered unreasonably high. In Order No. P.U. 31(2008) the Board explained at page 3:

> "The Board does not believe that it is appropriate to routinely consider each non-capital expense which is greater than $500,000 as a Major Extraordinary repair to be deferred. Each case has to be brought to the Board for consideration based on the circumstances."

In that matter Hydro had applied for approval to defer estimated expenses of $1,433,000 associated with the repair of the Unit 2 turbine at Holyrood as a major extraordinary repair. In its decision the Board found that Hydro had not demonstrated that expensing the costs of the Unit 2 turbine repair in that year would cause a shock to its earnings and denied the application. The Board stated at page 4:

> "While these expenses are clearly of a non-capital nature and greater than $500,000 Hydro has not shown that the circumstances are extraordinary requiring special treatment. The Board is not satisfied that it is appropriate in the circumstances of this Application to defer the cost of the repairs of the Unit 2 Turbine as a Major Extraordinary Repair."

In Order No. P.U. 44(2006) the Board determined that work on the Unit 2 boiler tube at Holyrood should be treated as a major extraordinary repair and that the estimated costs of $2,666,000 should be amortized over a five-year period. The Board stated at page 4:

> "The Board is satisfied having reviewed the record that expensing the cost of these repairs in 2006 would have a significant negative impact on Hydro's earnings. The costs if expensed would almost double Hydro's forecast loss for 2006. The Board finds that, in the current circumstances, these costs would cause a significant shock to Hydro's earnings if they were to be recognized in 2006 and should be deferred over a period of time."

Based on the evidence filed in this Application the Board is satisfied that the expenditures associated with the Holyrood fuel system repairs are non-capital in nature and were an unplanned operating expense. In the Application Hydro states that the costs associated with the repair were
$1,059,686, but in NP-NLH-006 Hydro explains that the 2013 costs associated with this deferral are $1,036,500, noting in a footnote that the costs were adjusted for an amount inadvertently included in labor costs (see also CA-NLH-013). Hydro did not amend the amount claimed in the Application but the Board notes, in NP-NLH-001, Hydro assumes costs of $1,036,500 to estimate that its forecast net income for 2013 would be reduced by 16% from $6,463,000 to $5,427,000 if the expenses are not deferred.

Hydro confirms, in NP-NLH-008, that the repairs were unplanned but states that other planned work was deferred. Hydro does not provide an estimate of the costs of the deferred work. Hydro does not set out whether the cost of the deferred work has been reflected in the calculation of the estimated impact on its 2013 earnings. Hydro submits that the planned work that was deferred will still have to be done in a subsequent year and will be expensed at that time. The Board notes that the matter before the Board in this Application is whether the circumstances justify special treatment for the subject expenses in 2013. This determination is based on the circumstances of 2013 and not future years.

Allowing for the recovery of unanticipated expenses outside of a test year is an extraordinary measure that the Board will order only when it is satisfied that it is appropriate and necessary in the circumstances. It would appear, based on the record, that Hydro deferred work which would have reduced to some extent the impact of the unplanned expenses on Hydro’s earnings in 2013. Hydro did not provide evidence showing the amount of the expenses which were deferred to another year. It is therefore not clear, based on the information provided, what impact the costs associated with the repairs to the fuel oil system would have on its income for 2013. The Board is not persuaded that the magnitude of the costs in this case is such that it would cause a shock to Hydro’s earnings that is considered unreasonably high. The Board finds that Hydro has not demonstrated that the circumstances in this case are extraordinary such that the expenses should be accorded special treatment.

As to the issues raised by the parties in relation to the measures that should be taken by Hydro to prevent similar occurrences, the Board will require Hydro to file a report with the Board no later than May 30, 2014. This report should set out the actions taken and planned for the future to ensure it is supplied with fuel of reasonable quality, specifically addressing the issues raised by the Consumer Advocate and Corner Brook Pulp and Paper, North Atlantic Refining Limited and Teck Resources Limited.
1. Hydro’s proposal to treat the 2013 costs of repairs to the fuel oil system at the Holyrood Thermal Generating Station as a major extraordinary repair such that the costs are amortized over a five-year period with the unamortized balance to be included in rate base is not approved.

2. Hydro shall expense the 2013 costs of the repairs to the fuel oil system at the Holyrood Thermal Generating Station in 2013.

3. Hydro shall file a report with the Board no later than May 30, 2014 setting out the actions taken and future plans in relation to the quality of fuel supplied to the Holyrood Thermal Generating Station.

4. Hydro shall pay all expenses of the Board arising from this Application.

DATED at St. John’s, Newfoundland and Labrador this 26th day of February 2014.

Darlene Whalen, P.Eng.
Vice-Chair

Dwanda Newman, LL.B.
Commissioner

James Oxford
Commissioner

Cheryl Blundon
Board Secretary