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 a general rate application filed by Newfoundland and Labrador Hydro on July 30, 2013; and

IN THE MATTER OF an amended general rate application filed by Newfoundland and Labrador Hydro on November 10, 2014; and

IN THE MATTER OF an application filed by Newfoundland and Labrador Hydro on November 28, 2014 for approval, among other things, to establish a deferral account and transfer $45.9 million to this account, with recovery in 2014 from the Rate Stabilization Plan.

The Application

On November 28, 2014 Newfoundland and Labrador Hydro ("Hydro") filed an application (the "Application") with the Board requesting approval of, among other things, the deferral and recovery of $45.9 million in forecast revenue deficiency for 2014. A 2014 cost of service study was filed with the Application. The interim relief sought in the Application is based on the proposals set out in Hydro’s amended general rate application filed on November 10, 2014.

The Application was circulated to Newfoundland Power Inc. ("Newfoundland Power"), the Consumer Advocate, a group of three Island Industrial customers: Corner Brook Pulp and Paper Limited, North Atlantic Refining Limited and Teck Resources Limited (the “Industrial Customer Group”), Vale Newfoundland and Labrador Limited (“Vale”), the Innu Nation, the Towns of Labrador City, Wabush, Happy Valley-Goose Bay and North West River (the “Towns of Labrador”), and Yvonne Jones, MP Labrador.

In the Application Hydro states that the proposal for recovery of the forecast revenue deficiency in 2014 is to provide Hydro interim revenue relief in 2014 and maintain the Board’s ability to test 2014 Test Year costs to determine the final 2014 Test Year revenue requirement during the hearing of the general rate application in 2015. Hydro requests that the Board approve:
the 2014 Test Year cost of service study as the basis for allocating the 2014 revenue deficiency by system and class, on an interim basis;

(ii) a deferral account to address the 2014 revenue deficiency;

(iii) a transfer of the 2014 revenue deficiency of $45.9 million from Hydro’s income statement to the 2014 revenue deficiency deferral account on December 31, 2014;

(iv) the use of the credit balance in the Rate Stabilization Plan (RSP) Hydraulic Variation Account balance at December 31, 2014 to provide recovery of the 2014 revenue deficiency; and

(v) the transfer from the RSP Hydraulic Variation Account, at December 31, 2014, to the 2014 revenue deficiency deferral account of the amount for each customer group that is sufficient to provide full recovery of the 2014 revenue deficiency for each customer group.

Background

On July 30, 2013 Hydro filed a general rate application proposing a 2013 Test Year and customer rate changes.

On November 18, 2013 Hydro filed an application seeking interim rate relief in advance of the conclusion of the general rate application. Hydro requested implementation of new interim rates effective January 1, 2014 for most of its customer or, in the alternative, a deferral and recovery mechanism for a revenue shortfall between existing and approved rates. On December 13, 2013 the Board issued Order No. P.U. 40(2013) deferring consideration of Hydro’s proposals for interim rate changes pending resolution of the issues and concerns raised in relation to the application.

On January 17, 2014 Hydro filed another application for interim relief, which it stated was supplemental to its November 18, 2013 application, changing its proposals in relation to several matters, including rates for Newfoundland Power and certain of its Rural customers. On February 11, 2014 Hydro withdrew this application and filed an amended application requesting, among other things, new rates for Island Industrial customers and a deferral mechanism for any revenue shortfall between interim and final rates for other customers. In Order No. P.U. 13(2014) issued on April 25, 2014 the Board stated at page 10:

"The Board believes that at this stage Hydro’s proposals and the impacts of its proposals should be clear. After three applications, four rounds of information requests, and 166 responses to information requests there appears to be no clear understanding of what Hydro is proposing and the impact on customers. The Board is especially concerned about approving this application given the size of the increase in base rates proposed to be reflected in a deferral account. The Amended Interim Rate Application proposes a deferral account to collect a revenue shortfall based on an overall average increase in base rates for Newfoundland Power of 18.7% and for Labrador Interconnected customers of 23.3%.

The Board acknowledges Vale’s concerns in relation to delays in the implementation of the phase-in of Island Industrial customer rates. The Board also acknowledges Hydro’s concerns in relation to its rate of return for 2014. Unfortunately, the Board finds that..."
Hydro has not filed an application with supporting evidence setting out a comprehensive, unambiguous set of proposals. The Board must therefore dismiss the Amended Interim Rate Application. It is open for Hydro to file another application which contains clear and unambiguous proposals supported with comprehensive and consistent evidence.

On May 12, 2014 Hydro filed an application again seeking interim relief.

The public hearing of the general rate application was scheduled to commence on July 9, 2014 but on June 6, 2014 Hydro advised by letter that it would be amending its general rate application to provide forecast information for 2014 and a 2015 test year. Hydro advised that the revisions to the general rate application were necessary to update financial information to provide a more current and relevant basis for rate setting purposes. The Intervenors in the general rate application did not object to Hydro’s proposal to amend the general rate application or the resulting postponement of the hearing. Hydro advised that it would file the amended application in the fall and further that it expected that the hearing would proceed in early 2015.

Hydro did not amend or withdraw the application for interim relief filed on May 12, 2014 and on September 17, 2014 the Board issued Order No. P.U. 39(2014) stating at page 11:

While the Board has in the past approved the use of deferral accounts, it has not to date been asked to approve a revenue transfer as proposed by Hydro in this Application. Hydro proposes a “revenue transfer” to address an overall “revenue shortfall” in a year which is not a test year and where no rate changes are proposed, with the review of the transfer and any necessary adjustments to be made in a subsequent year. The Board notes that the approval of interim relief in advance of the conclusion of a general rate application is an extraordinary measure which must be fully justified in the circumstances. Hydro now advises that its 2014 financial outlook has changed materially since the filing of the general rate application and that it plans to file an amended general rate application with updated forecasts. The Board finds that it is not clear that the evidence filed reflects Hydro’s financial circumstances for 2014 and further that the evidence does not adequately address customer impacts. Hydro has failed to provide a reasonable evidentiary basis consistent with good utility practice to justify the proposed revenue transfer.

Hydro proposes in its submission that an alternative to approval of the revenue transfer is the approval on an interim basis of a $29.4 million cost deferral account for 2014 with recovery to be determined following the testing of 2014 costs. The Board’s concerns in relation to the evidence which was filed in support of this Application, and Hydro’s stated intention to amend its general rate application also apply in the case of the proposed deferral account. The Board finds that Hydro has not demonstrated that it is appropriate in the circumstances to set aside the proposed revenue shortfall in a deferral account at this time.

On November 10, 2014 Hydro filed an amended general rate application and on November 28, 2014 Hydro filed the within Application for interim relief.
In correspondence to the parties dated December 3, 2014 the Board stated at page 2:

As Hydro filed this application on November 28, 2014 seeking relief by December 31, 2014 there is insufficient time to follow normal regulatory process. Therefore, the schedule must be compressed and the application will proceed without requests for information or the filing of additional evidence.

The parties were invited to make submissions and the Board requested that submissions specifically address the following issue:

What are the implications or issues which should be considered in relation to an Order of the Board which approves only the creation of the deferral account and the transfer of the amount of $45.9 million from Hydro’s income statement to the deferral account and denies all of Hydro's other requests. For clarity, there would be no approval at this time of Hydro's request i) to use the 2014 Test Year Cost of Service Study as a basis for allocating the revenue deficiency, ii) to use the credit balance in the RSP Hydraulic Variation Account balance at December 31, 2014 to provide recovery, and iii) to revise Section A of the RSP Rules to segregate the 2014 year-end balance in the RSP Variation Account.

The Board received submissions from Hydro, Newfoundland Power, the Consumer Advocate, the industrial Customer Group and Vale on or before December 10, 2014. On December 11, 2014 Hydro filed a further submission. The Board did not receive submissions from the Innu Nation, the Towns of Labrador or Yvonne Jones, MP Labrador.

Submissions

Hydro submits that it is appropriate that the Board approve the creation of the proposed 2014 revenue deficiency deferral account and approve the transfer of the amount of $45.9 million from operating costs on Hydro’s income statement to the deferral account. Hydro states that this approach would provide Hydro the opportunity to earn a reasonable return on rate base in 2014 while providing the Board and Hydro’s customers the opportunity to fully test costs for 2014 during the amended general rate application process in 2015. Hydro further states that if, following the testing of the 2014 test year costs, the Board determines that an adjustment to the deferral account is required, the Board could approve an adjustment to the deferral account balance in 2015 which would impact Hydro’s net income in 2015. Hydro also states that its external auditor has indicated that this approach would be in accordance with regulatory accounting practice in reporting year-end financial results for 2014 and 2015.

Hydro notes that there may be customer implications if the Board does not approve its proposal to provide recovery of the 2014 revenue deficiency through a transfer of the credit balance in the RSP Hydraulic Variation Account. Without approval to revise Section A of the RSP rules, 25% of the year-end balance plus the financing amounts for the current year will be transferred to the RSP for disposition, reducing the amount in the RSP Hydraulic Variation Account that would be available if the Board decides to avail of the RSP option for recovery of the 2014 revenue deficiency at a later date. Hydro further notes however, that there is a significant forecast year-
end credit balance in the segregated RSP Load Variation component which could be used to deal
with the recovery of the 2014 revenue deficiency instead.

Hydro states that there would be implications on the credit rating agencies’ opinion of the
regulatory environment in Newfoundland and Labrador if the Board were to deny approval of a
deferral account. Hydro also states that it is required to operate on a self-sustaining basis to
maintain its financial health and that, among other things, the Government directive to the Board
on Hydro’s return on equity implies an expectation that it should maintain a strong stand-alone
financial position and performance. Hydro believes that the approval of a deferral account would
avoid any change in the opinion of credit rating agencies and would be consistent with
legislation and Government’s directive to the Board.

Newfoundland Power submits that the Board has historically permitted cost deferral to account
for variations in unpredictable costs or to address specific cost items that are reasonably
quantified and justified and also clearly distinguishable from the costs reflected in a utility’s
rates. Newfoundland Power raises concerns that the $45.9 million in cost deferral and recovery
proposed in the Application is based upon a forecast return on equity for Hydro of 8.8% as well
as full recovery of Hydro’s forecast 2014 costs. Newfoundland Power notes that Hydro’s current
return on equity for ratemaking purposes, effectively approved by the Board in the 2007 general
rate application, is 4.47%. Newfoundland Power states that the assumption of an 8.8% return on
equity where the Board is not approving new rates for Hydro does not conform with the direction
provided by Government in OC2009-063. Newfoundland Power also notes that Hydro’s 2014
costs have not been tested and are substantially increased from 2007. Newfoundland Power
states the deferral and recovery of the $45.9 million in 2014 costs as proposed in the Application
is not consistent with regulatory practice. Newfoundland Power submits that full recovery of the
2014 costs would effectively amount to a guarantee of Hydro’s 2014 rate of return which would
be inconsistent with Section 80 of the Act. Newfoundland Power also submits that it is unclear
what jurisdiction, if any, the Board would retain to reduce recovery of the amount deferred.
Newfoundland Power submits that the Board should deny the Application as filed.

Newfoundland Power states that extraordinary circumstances may make it reasonable for the
Board to consider deferral of some amount of Hydro’s 2014 costs for possible future recovery.
Newfoundland Power states that the combination of circumstances in the Application, including
(i) the background and timing of the Application, (ii) the practical need to rebalance Hydro’s
costs and rates as soon as reasonably possible, and (iii) the maintenance of Hydro’s financial
integrity, might be considered extraordinary and lead the Board to conclude a degree of relief is
warranted or necessary in the public interest. Newfoundland Power submits that the amount of
$45.9 million is not justified given the substantial untested cost increases included in Hydro’s
2014 forecast, and that the amount for deferral should be much less than the $45.9 million
proposed in the Application.

The Consumer Advocate does not object to the creation of the deferral account and the transfer
of $45.9 million from Hydro’s income statement provided there is a full review during the
amended general rate application of: (i) the actual 2014 amount to be collected from customers;
(ii) the methodology and amounts to be allocated to each customer class; and (iii) the
methodology used to collect the amount owed by customers. The Consumer Advocate states that
his submission should not serve as recognition that the 2014 costs included in the Application have been prudently incurred.

The Industrial Customer Group notes the compressed time for filing submissions and submits that, in the circumstances, particular care should be taken to ensure that interim relief does not have unintended consequences and that interim relief is subject to a future full review. The Industrial Customer Group submits that any interim relief granted to Hydro should make clear that it is not grounded in any determination by the Board that (i) Hydro has incurred a revenue deficiency in 2014 in the amount of $45.9 million, or that (ii) any material revenue deficiency incurred by Hydro in 2014 will necessarily be recovered by rates charged to Hydro's customers or by transfers from the RSP Hydraulic Variation Account or the segregated RSP Load Variation Component. The Industrial Customer Group accepts that an interim order approving the creation of a deferral account and the transfer of the amount of $45.9 million from Hydro's income statement could be found by the Board to be appropriate provided that it is expressly confirmed that the questions of the amount and recovery of relief remain fully susceptible to being addressed in the amended general rate application. The Industrial Customer Group requests the Board make an order awarding the Industrial Customer Group its costs.

Vale states that, while it is prepared to accept that Hydro may have a revenue deficiency in 2014 and that a portion of that deficit may be subject to recovery from customers, it is concerned that the amount of revenue deficiency has not been tested and that it may include amounts that should not be recovered from rate payers. Vale submits government direction provided in OC2009-063 does not apply to the Application and any interim or final revenue deficiency recovery relief should be based on Hydro's existing approved return on equity. Vale further states that it is not clear whether Hydro is including in its 2014 revenue deficiency costs associated with the January 2014 outages and submits that these costs have to be tested for prudency by the Board prior to Hydro being permitted to recover them from its customers.

Vale questions whether the interim transfer from the RSP proposed by Hydro in the Application (i) is good regulatory practice and (ii) whether the requested transfer from the RSP, on a interim basis, achieves the stated goal as the transfer provides no certainty that the Board will ultimately accept that the amount requested accurately reflects Hydro's recoverable revenue shortfall. Vale states a further concern that the revenue shortfall relates to all Hydro's customer groups but the requested transfer is from a fund owed to only a subset of Hydro's customers. Vale requests that the Board award Vale its costs for participating in the Application and submits that all or a significant percentage of the costs of the Application should be borne by Hydro and not form part of Hydro's rate base.

In its December 11, 2014 reply Hydro addresses the submission of Newfoundland Power that there exists a risk that an interim order could, in effect, be a final order. Hydro states that the concern raised by Newfoundland Power is groundless and invites the Board to commit a jurisdictional error by imposing upon itself a restriction as to its authority to set rates through an interim order with respect to a deferral account. Hydro submits that, by the very nature of a deferral account holding encumbered revenues, the Board retains the power of disposition of amounts held in a deferral account. Hydro further submits that, where the Board issues an interim order as to a deferral account, there can be absolutely no doubt as to its authority to later
consider the amount in the account and the disposition of that amount. Hydro disagrees with Newfoundland Power's submission on this issue and submits that it is clear that the Board has and will retain full jurisdiction and broad authority to make a later Order as to the final amount of the proposed deferral account and its specific treatment or disposition.

**Board Findings**

The EPCA states that it is the power policy of the Province that the rates to be charged for the supply of power in the Province should be, wherever practicable, based on forecast costs for one or more years. The regulatory framework in this Province contemplates that a utility will file its general rate application well in advance of the proposed effective date of new rates. This allows the Board and interested parties the opportunity for a full review of the proposals, including the forecast costs to be recovered in the new rates, in a public hearing. In this case Hydro initially filed its general rate application on July 30, 2013 proposing a 2013 test year. The amended application filed on November 10, 2014 proposes both a 2014 and a 2015 revenue requirement and requests an Order of the Board before December 31, 2014 in relation to the proposed 2014 revenue requirement. The Board notes that, while the amended application was filed on November 10, 2014, a cost of service study for 2014 and the application for interim relief was not filed until November 28, 2014.

Where a utility files a general rate application during the test year and fails to proceed expeditiously through the process, it is unlikely that there will be a final Order of the Board establishing rates in the year. In this case the hearing of the original general rate application was scheduled to start in February of 2014 but was rescheduled to July 9, 2014, largely as a result of the time required for Hydro to respond to requests for information. The hearing did not proceed in July because Hydro advised in June that it was necessary to revise its application to update the financial information to provide a more current and relevant basis for rate setting purposes. Hydro filed its amended general rate application five months later seeking interim relief and asking that the Board approve a deferral account, the transfer of $45.9 million to this account, and recovery by Hydro in 2014.

Both Vale and the Industrial Customer Group raise concerns in relation to whether Hydro’s proposals with regard to the 2014 revenue requirement can be considered good regulatory practice and as to the precedent that may be established. Newfoundland Power states at page 5: “An approach along these lines would clearly be a departure from regulatory practice relating to cost deferrals.”

The Board has in the past granted interim relief in advance of the conclusion of a general rate application but this is an extraordinary measure which must be demonstrated to be reasonable and appropriate in the circumstances. Normally this relief is granted where there has been some opportunity for review of the proposals made and the evidence filed. However, as a result of Hydro’s approach to the management of its general rate application, including the late filing of the application seeking interim relief, there is no reasonable opportunity at this time to assess the evidence filed in support of Hydro proposals and determine the possible impacts and relevant considerations.
The Board notes that all parties appear to accept that, in the circumstances, a deferral account and transfer of an amount to this account should be approved in 2014. Despite this acknowledgement the parties raise several specific concerns in relation to Hydro’s proposals. The Consumer Advocate does not object to the transfer of $45.9 million to a deferral account provided that there is subsequently a full review. Newfoundland Power suggests a reduced amount be transferred and submits that there are substantial increases in costs which have not been tested, specifically noting the 8.8% return on equity. Vale questions the amount of the transfer noting that the evidence has not been tested through the request for information process or a hearing, specifically noting the proposed rate of return and costs associated with the January 2014 outages. The Industrial Customer Group submits that any interim relief granted be made subject to later review as to the amount and whether any of it can be recovered by Hydro, and state at page 2:

However, IIC Group would go further to submit that if $45.9 million is an appropriate amount to allocate, on an interim basis, to a revenue deficiency deferral account, it is only because, given the compressed process, the Board is constrained to consider interim relief based on Hydro’s evidence alone, untested by the GRA or an equivalent process.

In addition Newfoundland Power and Vale express concern that approval of the proposals may further serve to reduce the incentive for Hydro to proceed with its general rate application expeditiously.

While Hydro’s general rate application has been ongoing since 2013 the revisions set out in the amended application filed on November 10, 2014 are significant. Hydro proposes, for the first time, a 2014 test year revenue requirement and recovery based on a 2014 cost of service study. The amount Hydro proposes to recover of $45.9 million reflects Hydro’s forecast expenses and revenues for 2014 and an increased rate of return. The Board believes that there has been insufficient opportunity to assess these proposals and potential issues and impacts. The Board acknowledges Hydro’s concern about potential negative financial consequences in 2014 but the Board must also fully test the proposals to ensure that the interests of consumers are protected and that rates are reasonable and not unjustly discriminatory. Nevertheless the Board is concerned that if approval for a deferral account is not granted before December 31, 2014 the Board’s jurisdiction to make a determination in 2015 with respect to Hydro’s proposed 2014 revenue requirement may be limited. While Hydro’s proposals raise issues which, as a result of the late filing of the application, cannot be properly addressed at this time, the Board finds that approval in 2014 of a deferral account to segregate an amount associated with the 2014 revenue requirement is necessary to ensure that the Board retains jurisdiction with respect to Hydro’s 2014 revenue requirement. Given the extraordinary circumstances, the Board will grant approval to establish a deferral account in relation to Hydro’s proposed 2014 revenue requirement.

The Board notes the concerns expressed by some parties in relation to the amount proposed to be transferred to the account. Vale accepts the proposed transfer but raises issues in relation to certain amounts which were included. Newfoundland Power has similar concerns and suggests that a reduced amount be transferred. The Board finds, in the absence of a full review of the proposed 2014 revenue requirement, there is no reasonable basis upon which to reduce the amount transferred at this time.
The Board also finds that considering all of the circumstances and issues associated with Hydro's amended application, it cannot determine at this time whether Hydro should be granted recovery of any amount in relation to the proposed 2014 revenue requirement. While it is possible that the Board will, after a full review, grant approval for Hydro to recover all or part of the $45.9 million, there is no certainty at this time of any recovery. As stated by the Court of Appeal in Newfoundland (Board of Commissioners of Public Utilities), Re (1998), 164 Nfld and P.E.I R. 60:

The utility therefore takes the risk that its chosen management techniques and the future economic climate may not yield its expected success. Although some of the activities of the utility are regulated within the framework of the statutory objectives, the utility nevertheless remains subject to business risks and effects of management decisions. To that extent, the financial risks associated with the operation of the utility, just as in the case of any private business, are to be born by the investors in the enterprise, not the customer of the service.

The Board will therefore grant approval for Hydro to establish a deferral account in relation to the proposed 2014 revenue requirement and to segregate $45.9 million in the account in 2014, subject to the Board's subsequent determination, following a full review, as to whether it is appropriate to grant any recovery to Hydro.

**IT IS THEREFORE ORDERED THAT:**

1. The creation of a deferral account in relation to Newfoundland and Labrador Hydro's proposed 2014 revenue requirement, as set out in Schedule A, is approved.

2. The segregation of $45.9 million as of December 31, 2014 in the deferral account is approved, but recovery by Hydro of this amount, partial or full, is not approved.

3. The proposed 2014 Test Year cost of service study is not approved.

4. The proposed use of the credit balance in the RSP Hydraulic Variation Account balance to provide recovery is not approved.

5. The proposed transfer from the RSP Hydraulic Variation Account to the deferral account is not approved.

6. The Industrial Customer Group and Vale are entitled to an award of costs in an amount to be determined by the Board with costs submissions to be filed within 30 days of this Order.

7. Hydro shall pay all expenses of the Board arising from this Application.
DATED at St. John's, Newfoundland and Labrador this 24th day of December 2014.

Andy Wells  
Chair & Chief Executive Officer

Darlene Whalen, P.Eng.  
Vice-Chair

Dwanda Newman, LL.B.  
Commissioner

Cheryl Blundon  
Board Secretary
2014 Cost Deferral Account

This account shall be charged with the variance of $45.9 million between forecast operating costs, amortizations and cost of capital for 2014 and forecast revenue for 2014.