Newfoundland & Labrador

BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

IN THE MATTER OF A

GENERAL RATE APPLICATION FOR 2018 AND 2019 TEST YEARS

FILED BY

NEWFOUNDLAND AND LABRADOR HYDRO

DECISION AND ORDER OF THE BOARD

ORDER NO. P.U. 16(2019)

BEFORE:

Darlene Whalen, P. Eng., FEC
Chair and Chief Executive Officer

Dwanda Newman, LL.B.
Vice-Chair

James Oxford
Commissioner

NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

AN ORDER OF THE BOARD

NO. P.U. 16(2019)

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

IN THE MATTER OF a general rate application filed by Newfoundland and Labrador Hydro on July 28, 2017.

BEFORE:

Darlene Whalen, P. Eng., FEC
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PART ONE: APPLICATION AND PROCEEDING

1.0 The Application

Newfoundland and Labrador Hydro ("Hydro") filed a general rate application (the "Application") with the Board of Commissioners of Public Utilities (the "Board") on July 28, 2017 requesting approval of, among other things, interim rates for all its customers to be effective January 1, 2018, and final rates to be effective January 1, 2019.

In the Application Hydro proposed the Board approve:

(1) that Hydro's 2018 and 2019 test year revenue requirements reflect the costs of the continued supply of power to the Island Interconnected System from existing Island generation and that an Off-Island Purchases Deferral Account be established to collect any difference resulting from off-island power purchases;

(2) forecast 2018 and 2019 test year revenue requirements of $673,056,000 and $692,766,000, respectively;

(3) pursuant to OC2009-063, for purpose of calculating Hydro's return on rate base, the return on equity last approved by Order No. P.U. 18(2016) from Newfoundland Power's general rate application of 8.50%;

(4) an allowed rate of return on forecast average rate base of 5.73% for the 2018 test year and 5.68% for the 2019 test year; and

(5) an allowable range of return on rate base of ± 20 basis points.

The Application also included proposals for certain changes to Hydro's cost of service methodology as well as proposals related to:

i) working capital methodology;

ii) average rate base methodology;

iii) depreciation rates and methodology;

iv) automatic adjustment mechanism for return on equity to reflect any changes to Newfoundland Power's approved return on equity; and

v) amortization and recovery of deferred costs.

2.0 Procedural Matters

2.1 Notice and Pre-Hearing Conference

Notice of the Application and pre-hearing conference was published in newspapers throughout the province beginning on August 19, 2017. The pre-hearing conference was held on September 21, 2017 in the Board's Hearing Room. In Order No. P.U. 30(2017) the Board identified registered intervenors, established procedural rules and set the schedule for the proceeding. Registered intervenors for the proceeding were:

Intervenor		Represented by:
1.	Newfoundland Power Inc. ("Newfoundland Power")	Liam O'Brien and Gerard Hayes
2.	Consumer Advocate Dennis Browne, Q.C.	Stephen Fitzgerald
3.	Corner Brook Pulp and Paper Limited, North Atlantic Refining Limited and Vale Newfoundland and Labrador Limited (the "Industrial Customer Group")	Paul Coxworthy, Dean Porter and Denis Fleming
4.	Communities of Labrador City, Wabush, Happy Valley-Goose Bay and Sheshatshiu First Nation ("Labrador Interconnected Group")	Senwung Luk
5.	Iron Ore Company of Canada ("IOC")	Van Alexopoulos and Benoit Pepin

Hydro was represented by Alex Templeton, outside counsel, and Geoffrey Young, in-house counsel. The Board was assisted by Maureen Greene, Q.C., Board hearing counsel, Jacqueline Glynn, legal counsel for the Board, and Cheryl Blundon, Board Secretary.

2.2 Pre-Filed Evidence

On December 4, 2017 the Board's financial consultants, Grant Thornton LLP ("Grant Thornton"), filed its report *Board of Commissioners of Public Utilities, Financial Consultants Report, Newfoundland and Labrador Hydro 2017 General Rate Application*, which presented Grant Thornton's observations, findings and recommendations with respect to their analysis of Hydro's proposals.

Pre-filed evidence was filed on behalf of experts for the intervenors as follows:

1. Douglas Bowman and Dr. James Feehan, (on behalf of the Consumer Advocate)
2. Patrick Bowman, InterGroup Consultants Ltd., and Patricia Lee, BCRI Inc. (on behalf of the Industrial Customer Group)
3. Mark Drazen, Drazen Consulting Group (on behalf of IOC)
4. Philip Raphals, Helios Group (on behalf of the Labrador Interconnected Group)

Hydro also filed expert evidence from JT Browne Consulting in relation to the proposed Off-Island Purchases Deferral Account and regulatory principles.

A total of 1261 Requests for Information ("RFIs") were issued to and answered by Hydro and 65 RFIs were issued to and answered by the intervenors.

2.3 Motions and Related Applications

2.3.1 RFIs and Confidential Information

On October 11, 2017 the Labrador Interconnected Group requested that the Board order Hydro to provide responses to certain RFIs which Hydro had advised it would not answer on the basis that the RFIs were outside the scope of the Labrador Interconnected Group's intervention or were not relevant to the proceeding and would not assist in the parties understanding of the issues. In Order No. P.U. 35(2017) the Board found that, with the exception of LAB-NLH-016, the information requested should be provided by Hydro to the extent that it was relevant to the issues to be addressed in the Application.

On October 19, 2017 Hydro advised that it would not respond to certain of the Consumer Advocate's RFIs stating that they were outside the scope of the proceeding as they raised issues for consideration that were better dealt with in a future proceeding and that would not be determined by the Board in the Application. The Consumer Advocate withdrew CA-NLH-122 but requested the remaining RFIs be answered. Hydro indicated that it would provide a response to CA-NLH-007 and, in Order No. P.U. 36(2017), the Board found that the remaining RFIs were relevant and should be answered by Hydro.

On April 11, 2018 the Labrador Interconnected Group requested that the Board order Hydro to provide full responses to certain RFIs. On April 20, 2018 Hydro advised that it "… has determined that the interests of all concerned would likely be best served by providing revised responses to these RFIs which explain in greater detail the basis for its original response." The Labrador Interconnected Group subsequently withdrew their challenge on the basis of Hydro's replies to these RFIs.

On April 13, 2018 Hydro filed an application for an order of the Board that its responses to PUB-NLH-149 and CA-NLH-254 be considered confidential and that the intervenors' access to the confidential information be governed by the terms of an undertaking to be executed by the intervenors' representatives prior to the receipt of the confidential information. In Order No. P.U. 13(2018) the Board found that the responses to PUB-NLH-149, with the exception of Table 2, and to CA-NLH-254, with the exception of the contract between Nalcor Energy Marketing and Hydro, were confidential and provided Hydro the opportunity to make a further confidentiality application in relation to the excepted information. On May 18, 2018 Hydro made a further application in relation to Table 2 of PUB-NLH-149 and, in Order No. P.U. 18(2018), the Board ordered that this information would also be considered confidential.

2.3.2 Application to Delay

On January 4, 2018 the Consumer Advocate filed an application requesting that, until Hydro filed certain additional information, the Board should delay the schedule for Hydro's general rate application. Specific concerns were identified by the Consumer Advocate with respect to Hydro's proposed cost of service study and Off-Island Purchases Deferral Account. In Order No. P.U. 2(2018) the Board ordered that certain of the information requested by the Consumer Advocate should be filed as follows:

> Hydro shall file forecast 2018 and 2019 revenue requirements and cost of service studies based on the expected supply scenario, setting out the basis and support for the forecasts and assumptions used and including information related to customer rates and the updated fuel price forecast, in accordance with the findings of the Board in this Order.[1]

[1] Order No. P.U. 2(2018), page 9.

As a result of this Order the hearing, which was scheduled to begin on January 30, 2018, and other scheduled processes were delayed.

On March 22, 2018 Hydro filed *2017 GRA Additional Cost of Service Information in Compliance with Order No. P.U. 2(2018)*.

2.3.3 Application on Cost of Service Issues

On April 4, 2018 Hydro filed an application with the Board to limit the scope of the cost of service methodology issues to be addressed in the proceeding. Given the delay of the inclusion of Muskrat Falls Project costs in the cost of service, the 2017 general rate application was filed based on the existing approved cost of service methodology. Hydro proposed that the scope of the cost of service methodology issues be limited to issues not related to the completion of the Muskrat Falls Project. While agreeing that some of the issues raised by the Consumer Advocate were proper matters for the Board's inquiry Hydro submitted that the general rate application proceeding was not the most efficient and effective process for their examination. In Order No. P.U. 14(2018) the Board denied Hydro's motion, stating:

> For the reasons set out above the Board will not accept Hydro's request to define the scope of the cost of service issues to be addressed in the general rate application by excluding those issues raised by the Consumer Advocate. Nevertheless, the Board asks that the parties make every effort to ensure an efficient proceeding bearing in mind that there will be a full cost of service methodology and rate design review application filed by Hydro in the fall. The Board leaves open the opportunity for further settlement discussions on any cost of service matters, including those raised by the Consumer Advocate, in advance of the scheduled recommencement of the hearing in July, 2018.[2]

2.3.4 Application for a Determination on Jurisdictional Questions

On April 5, 2018 the Consumer Advocate applied to the Board for determination on a number of jurisdictional questions. The Consumer Advocate questioned whether the Off-Island Purchases Deferral Account proposed by Hydro in the Application conformed to OC2013-343, which specifically prohibits the recovery of Labrador Island Link costs until the project is "commissioned or near commissioning." The proposed account would recover operating and maintenance costs associated with the Labrador Island Link in 2018 and 2019. In Order No. P.U. 17(2018) the Board found there was insufficient evidence on the record to make a determination on this jurisdictional issue.

2.3.5 Interim Rates and Cost Deferrals

During the course of the proceeding Hydro filed several applications for interim rates and rule changes as well as cost deferrals.

i) Interim Rates for Island Industrial Customers and Labrador Industrial Transmission

On February 9, 2018 Hydro filed an interim application for approval of proposed Island Industrial customer rates and Labrador Industrial Transmission rates to be effective April 1, 2018. In Order No. P.U. 7(2018) the Board approved interim rates for Island Industrial customers and ordered a

[2] Order No. P.U. 14(2018), page 8.

deferral account with respect to specifically assigned charges for these customers. The Board did not approve the proposed Labrador Industrial Transmission rates on the basis that Hydro had not provided justification for its proposed rates.

ii) Deferral of 2015, 2016 and 2017 Supply Costs

On March 29, 2018 Hydro applied to the Board for approval to defer the 2015, 2016, and 2017 balances in the Isolated Systems Supply Cost Variance Deferral Account, the Energy Supply Cost Variance Deferral Account, and the Holyrood Conversion Rate Deferral Account. On April 9, 2018 the Board advised the parties by correspondence that the application to defer these 2015, 2016 and 2017 costs would be considered as part of this Application.

iii) Interim Rates for Newfoundland Power and Changes to Rate Stabilization Plan (RSP) Rules

On April 13, 2018 Hydro filed for approval of proposed rates for Newfoundland Power effective July 1, 2018. The Application proposed:

i) to modify the RSP rules to permit a deviation from the use of the test year number of barrels of No. 6 fuel in the calculation of the RSP Fuel Rider;
ii) to update the Newfoundland Power RSP Adjustments (including the conclusion of the RSP Current Plan Mitigation Adjustment);
iii) to update the CDM Cost Recovery Adjustment; and
iv) to implement an interim increase in base rates for Newfoundland Power.

In Order No. P.U. 15(2018) the Board approved the proposed revisions to the RSP rules, the proposal to permit a deviation from the test year number of barrels on No. 6 fuel in the calculation of the RSP Fuel Rider, and the proposed interim rates to be effective on all electrical consumption on and after July 1, 2018.

iv) Interim Rates for Island Industrial Customers and Cost Deferrals

On October 26, 2018 Hydro filed an application proposing:

i) deferral of the operating and maintenance costs for the Labrador Island Link and the Labrador Transmission Assets;
ii) interim Island Industrial customer rates to be effective January 1, 2019; and
iii) a cost deferral for 2018 related to the proposed change in depreciation methodology to provide Hydro an opportunity to earn a reasonable rate of return in 2018.

Subsequent to the filing of the application the Board received Order in Council OC2018-213 which directed that all costs, expenditures and payments incurred by Hydro for the term of the Interim Transmission Funding Agreements for the Labrador Island Link and the Labrador Transmission Assets be placed into a deferral account. On November 16, 2018 Hydro revised the application to remove the proposal for the deferral of the operating and maintenance costs for the Labrador Island Link and the Labrador Transmission Assets.

In Order No. P.U. 48(2018) the Board approved the interim rates for Island Industrial customers and the cost deferral account for 2018 related to the differential in the 2018 depreciation expense associated with the proposed changes in depreciation methodology.

2.4 Negotiations and Settlement Process

The schedule for the proceeding included a period for negotiation to enable and/or facilitate discussion between Hydro and the intervenors to determine what, if any, agreement might be reached. The settlement process was facilitated by Board hearing counsel.

On April 11, 2018 a settlement agreement was filed with the Board (the "Settlement Agreement"). This agreement was signed by Hydro, the Consumer Advocate, Newfoundland Power and the Industrial Customer Group. The Labrador Interconnected Group and IOC also signed its consent to the extent each were affected by the settled issues. The Settlement Agreement addressed a range of issues, including revenue requirement, rate base, cost of service, rate design for the Labrador Industrial Transmission Rate, rate stabilization plan, rural rates, deferral mechanisms, excess earnings, automatic return on equity adjustment and future reporting requirements.

Negotiations continued after the filing of the Settlement Agreement. On July 16, 2018 a supplemental settlement agreement was filed with the Board (the "Supplemental Settlement Agreement"). The Supplemental Settlement Agreement set out the parties' agreement that the Expected Supply Scenario as presented in the Additional Cost of Service Information filed by Hydro would be used as the basis for Hydro's revenue requirement for the 2018 and 2019 test years. The Supplemental Settlement Agreement also addressed a range of other issues, including cost of service, a pilot agreement with Corner Brook Pulp and Paper Limited, Newfoundland Power's wholesale rate, allocation and recovery of deferred supply costs, revenue deficiency/excess and capacity assistance agreements. This agreement was signed by Hydro, the Consumer Advocate, Newfoundland Power and the Industrial Customer Group.

On September 6, 2018 a further settlement agreement regarding issues specific to the Labrador Interconnected System was filed with the Board (the "Labrador Settlement Agreement"). The Labrador Settlement Agreement addressed matters related to the Muskrat Falls to Happy Valley Interconnection capital project, the allocation and recovery of deferred supply costs, amortization of the 2018 revenue deficiency and the 2019 test year load forecast for the Labrador Interconnected system. This agreement was signed by Hydro, the Labrador Interconnected Group and IOC.

2.5 Supplementary Filings and Information

On July 20, 2018 Hydro filed *Supplemental Evidence – Customer Impacts Reflecting 2017 GRA Settlement Agreements*.[3]

On July 26, 2018 the Board requested that Hydro file:

1. a clear statement as to the rates that it proposed to be implemented for each customer class effective January 1, 2019;
2. clarification on whether Hydro proposed the implementation of a rate stability rider, and if so, Hydro's proposal for the same; and
3. a revision to its 2017 general rate application by August 2, 2018, reflecting the significant changes that had been made throughout this proceeding, including the supplemental evidence.

[3] Revised on August 3, 2018.

On July 30, 2018 Hydro confirmed the proposed rates and that it did not intend to request a rate stability rider and committed to filing a revision to the Application by August 2, 2018.

On August 2, 2018 Hydro filed: i) *Additional information related to Supplemental Evidence filed on July 20, 2018*, which provided an update to Part B of the Application to reflect the settlement agreements and supplemental evidence; ii) a revised Table 5-7 showing 2018 revenue deficiencies/excess revenues by customer class; and iii) a revised Table 5-8 showing 2019 billing impacts by customer class.

On August 31, 2018 Hydro filed *Information Filing - Interim Transmission Funding Agreements*, which provided Hydro further details on the interim agreements related to the early availability of the Labrador Island Link and Labrador Transmission Assets and Hydro's associated obligations.

Hydro filed *Timing of the Labrador Island Link (LIL) and the Labrador Transmission Assets (LTA), and 2017 GRA forecast customer rate impacts for 2019*, which provided updates to the monopole commissioning date and Hydro's forecast for off-island purchases, on August 27, 2018, September 7, 2018 and September 14, 2018.

On October 26, 2018, at the request of the Board, Hydro filed an update reflecting both the revised forecast of off-island purchases for 2018 and 2019 and the updated fuel price forecast along with the revised customer rate projections for 2019 for each customer class. Hydro also filed a revision to its 2017 general rate application to update Part B: Hydro Proposals.[4] On November 7, 2018 Hydro completed its filing of outstanding undertakings.

2.6 Public Hearing

The hearing started on April 16, 2018, was adjourned on April 26, 2018, and reconvened on July 16, 2018. Oral testimony was heard throughout July and August 2018.

During the hearing the following witnesses testified:

<u>On behalf of Hydro:</u>

Jim Haynes	President
Dawn Dalley	Vice President, Regulatory Affairs and Corporate Services
Jennifer Williams	Vice-President, Production
Ron LeBlanc	Vice-President, Transmission, Distribution and the Newfoundland and Labrador System Operator (NLSO)
Terry Gardiner	Vice-President, Engineering Services
Lisa Hutchens	Vice-President, Financial Services
Kevin Fagan	Director, Regulatory Affairs

Interested persons and organizations were also given the opportunity to participate by submitting a letter of comment or making an oral presentation to the Board. On August 16, 2018 the following made presentations to the Board:

[4] This update was provided in the evidence filed as part of the 2018 Cost Deferral and Interim Rates Application filed on October 26, 2018 and revised on October 30, 2018 and November 14, 2018.

Dr. Suzanne Brake	Seniors' Advocate for Newfoundland and Labrador
James Murphy	Public Presenter
Keith Fillier	Public Presenter
Lori Moore	Public Presenter

In addition the Board received several written comments. The Board expresses its appreciation to those who took the time to participate in the proceeding.

Final submissions were filed by Hydro and the parties on February 1, 2019. Hydro filed a reply submission on February 8, 2019.

3.0 Updated Proposals

In its August 2, 2018 filing Hydro updated its proposals to reflect the settlement agreements.[5] On November 14, 2018, as part of its Cost Deferral and Interim Rates Application, Hydro filed a further update to its proposals to reflect the most up-to-date off-island power purchases forecast, the settlement agreements and an updated Energy Supply Variance Deferral Account.[6] In its final submission Hydro set out the Order requested arising from its Application (see Exhibit 1).[7]

PART TWO: REGULATORY FRAMEWORK

4.0 Legislation and Role of the Board

The Board is an independent, quasi-judicial body established under legislation to regulate public utilities in the Province. Regulation is designed to ensure consumers receive safe and reliable electricity at rates that are reasonable while allowing the utility to earn a fair return on its investment in supplying the electrical service. Regulation strives to strike an equitable balance between the interests of consumers and the utility.

The Board's authority is derived from its statutory powers and responsibilities as set out in the *Public Utilities Act* (the *"Act"*) and the *Electrical Power Control Act, 1994* (the "*EPCA*"). The *Act* sets out the structure of the Board and defines its powers. The Board has responsibility for the general supervision of public utilities in the Province, and approves rates, capital expenditures and other aspects of the business of public utilities. The *EPCA* mandates the Board to make rate decisions that are reasonable and not unjustly discriminatory, and provides that the utilities are permitted to earn a just and reasonable financial return while maintaining a sound credit rating in the financial markets of the world. The *EPCA* also calls for the most efficient production, transmission and distribution of power that will afford consumers the lowest possible cost electricity consistent with equitable and reliable service.

[5] Hydro Correspondence, August 2, 2018.
[6] Appendix H, 2018 Cost Deferral and Interim Rates Evidence – Revision 2, November 14, 2018.
[7] Hydro noted in its submission (page 62) that the relief requested differs in some respects from that filed with the Board on November 14, 2018.

5.0 Government Directives

5.1 Hydro's Return on Rate Base, Rural Assets in Rate Base and Capital Structure

In OC2009-063 Government directed the Board as follows:

1. In calculating the return on rate base for Hydro the Board is to set the same target return on equity as was most recently set for Newfoundland Power through a general rate application or calculated through the Newfoundland Power Automatic Adjustment Mechanism.
2. Hydro is entitled to earn annually, a rate of return equal to the weighted average cost of capital, as ordered from time to time, on the entire rate base as fixed and determined by the Board, including amounts used solely for the provision of service to its rural customers.
3. The capital structure approved for Hydro should be permitted to have a maximum proportion of equity as was most recently approved for Newfoundland Power.

This directive was effective commencing with the first general rate application after January 1, 2009 and applies for the 2018 and 2019 test years on which the Application is based.

5.2 Muskrat Falls Project Costs and Interim Transmission Funding Agreement Costs

In OC2018-213 Government directed the Board to adopt a policy that all costs incurred by Hydro for the use of the Labrador Island Link and the Labrador Transmission Assets under the Interim Transmission Funding Agreements be placed in a deferral account, with disposition to be determined with a subsequent application by Hydro. The Board approved the deferral account in Order No. P.U. 47(2018).

5.3 Subsidization of Rural Rates

The rates for Hydro's rural customers are subject to longstanding policy direction from Government.[8] OC2003-347 continued the policy that directs the Board to set rates for Hydro's Isolated customers such that: i) first block "lifeline rates" are continued for domestic residential customers, ii) fish plants in diesel areas are charged Island Interconnected rates, iii) churches and community halls in diesel areas are charged diesel domestic rates, and iv) there is a preferential electricity rate for provincial government facilities, including schools, health facilities and government agencies, in rural isolated diesel serviced communities and for the Burgeo school and library. This directive also provides for the implementation of a demand-energy rate structure for general service customers in diesel areas and requires that the rural deficit be financed through electricity rates charged to only Newfoundland Power and Hydro's Labrador Interconnected customers, excluding Island Industrial customers.

On July 5, 2007 Government issued OC2007-304 which provided for the establishment of a policy resulting in the implementation of an energy rebate to offset the costs of the monthly basic customer charge and lifeline block (or equivalent) of energy consumption for Hydro's Labrador rural isolated diesel customers and residential electricity customers in the Labrador Straits/L'Anse-au-Loup areas. This policy makes these customers' costs for the basic customer charge and the

[8] Copies of the relevant Orders in Council referred to in this section are provided in PUB-NLH-084.

lifeline energy block equivalent to Hydro's residential Happy Valley-Goose Bay Labrador Interconnected electricity customers' costs.

Since 2006 Government issued a series of directives which, together, deferred the approved rate increases for non-government customers on isolated systems to July 1, 2019.[9] Government funded the revenue requirement impacts of these deferred rate increases until January 1, 2017 and directed that Hydro absorb the costs since January 1, 2017.

PART THREE: BOARD DECISIONS

The Application as filed by Hydro in July 2017 requested approval of 37 proposals, including proposals related to test year revenue requirements for 2018 and 2019, capital structure, rate base and rate of return on rate base, forecasting assumptions, cost of service, regulatory accounting matters as well as rate design and rules and regulations for service. The evidence provided with Application has been subject to review by the Board and its financial consultants and the intervenors and their experts through the RFI process and a public hearing. In its February 2019 submission Hydro requested approval of 57 proposals.

In this section the Board will set out its determinations on the Application. Through the negotiation and settlement process the parties agreed on settlement proposals for a significant number of issues, which are addressed in this section. Matters which were contested by the parties or were not settled or those which have been identified by the Board in its review of the Application and evidence before it are also set out in this section, along with the Board's findings on each. To the extent that any proposals have not been specifically addressed the proposals are accepted as filed.

6.0 Settlement Agreements

The Settlement Agreement dated April 11, 2017, the Supplemental Settlement Agreement dated July 16, 2018 and the Labrador Settlement Agreement dated September 6, 2018 (the "Settlement Agreements") set out the agreement of Hydro, the Consumer Advocate, Newfoundland Power, the Industrial Customer Group, the Labrador Interconnected Group and IOC with respect to certain issues on the Island Interconnected system and in Labrador. Pursuant to the terms of the Settlement Agreements the individual agreements of the parties are not intended to be severable and the parties recommended that the Board make its determination on the agreed upon issues in accordance with the Settlement Agreements. The parties also agreed that the examination and cross-examination of any witnesses would be limited to questions necessary to explain or to clarify the provisions of the Settlement Agreements. Issues not agreed upon would be determined by the Board based on the full record of the hearing.

In considering the Settlement Agreements the Board must be satisfied that the proposals represent a reasonable and equitable balance between the interests of both the utility and customers, considering Hydro's requirement to deliver reasonable least cost electricity to customers and the ongoing financial integrity of Hydro, consistent with the province's regulatory policy framework. The Board recognizes that, through the negotiation process, compromises were made to arrive at the consensus outlined in the Settlement Agreements. The Board notes that the negotiation process

[9] OC2006-512, OC2008-365, OC2009-390, OC2010-322, OC2012-329, OC2014-372, OC2015-300, OC2016-104, OC-2016-287, OC-2017-121, OC-2017-193, and OC-2018-116.

was comprehensive and involved Board hearing counsel and the experts of the parties where necessary. The negotiations also followed the exchange of expert reports and numerous RFIs. Appreciation is extended to the parties and their counsel in arriving at the Settlement Agreements.

The Board will address the terms of the Settlement Agreements in the relevant sections of this Decision and Order.

7.0 Capital Structure and Return

In OC2009-063 the Board was directed to approve Hydro's return on rate base calculated using the rate of return on equity last approved for Newfoundland Power in a general rate application. The Board was also directed that Hydro would be permitted to have the proportion of equity in its capital structure up to a maximum of the same approved for Newfoundland Power.

Hydro requested approval of its forecast capital structure for the 2018 and 2019 test years, with an estimated weighted average cost of capital of 5.45% and a 19% equity component in each year. In addition, pursuant to Order in Council OC2009-063, for purpose of calculating the return on rate base for 2018 and 2019, Hydro requested that the return on equity of 8.5% last approved for Newfoundland Power in Order No. P.U. 18(2016) be used. Subsequent to the filing of the Application, in Order No. P.U. 2(2019) the Board accepted a rate of return on equity of 8.5% for Newfoundland Power and a common equity component in its capital structure not to exceed 45%.

The capital structure and return on equity proposed by Hydro are in accordance with OC2009-063. The Board will accept Hydro’s proposed rate of return on equity and capital structure to be used for rate setting purposes, subject to any adjustment required as a result of the Board’s findings in this Decision and Order.

The forecast capital structure proposed by Hydro for the 2018 and 2019 test years is accepted, subject to any adjustment required as a result of the Board’s findings in this Decision and Order.

The target return on equity to be used in calculating the allowed rate of return on rate base for the 2018 and 2019 test years shall be 8.5%.

In Order No. P.U. 49(2016) the Board noted that the language of OC2009-063 did not specifically address the issue of changes to Hydro’s target return on equity outside of a general rate application by Hydro. Hydro was directed to file a proposal in relation to an adjustment mechanism for its target return on equity to reflect any future changes to Newfoundland Power’s approved target return on equity in the years between Hydro’s general rate applications.

On June 30, 2017 Hydro filed a report outlining its proposal in relation to an adjustment mechanism for its target return on equity. The Board advised that it would consider this proposal as part of this Application. In the Application Hydro proposed that it would file an automatic adjustment application with the Board within 10 business days following the publication of an Order approving Newfoundland Power’s return on equity. Hydro’s application would include:

- a revised test year weighted average cost of capital and rate of return on rate base to reflect a return on equity equal to that approved for Newfoundland Power;
- finance schedules providing revised revenue requirements from customer rates;

- a revised test year cost of service study identifying changes in revenue requirement by customer class;
- a derivation of revised customer rates;
- a revised Excess Earnings Account Definition; and
- a proposed revised Schedule of Rates, Tolls and Charges.

In the Settlement Agreements the parties agreed to the following with respect to the automatic return on equity adjustment for Hydro:

> (i) The methodology proposed in Exhibit 12 of the Application should be accepted for determining revenue requirement adjustments to flow-through by customer class as a result of changes in the ROE between test years for Hydro that result from changes in the ROE for Newfoundland Power.
>
> (ii) Hydro's excess earnings account definition will be revised to reflect the revised ROE to apply between test years.
>
> (iii) The revenue requirement adjustments to flow through to customers on the Labrador Interconnected system will occur through rate changes at the same time as the implementation of the Hydro rural rate change reflecting the revised ROE for Newfoundland Power.
>
> (iv) The revenue adjustments to flow through to customer classes on the Island Interconnected System will be held in a deferral account until disposition through customer rates at the time of rate changes that result from the operation of the Rate Stabilization Plan. Hydro will file details of this account by May 15, 2018.[10]

On May 15, 2018 Hydro filed the definition of the Return on Equity Rate Change Deferral Account as required by the Settlement Agreements.

The Board has reviewed Hydro's proposals and the parties' agreement set out in the Settlement Agreements as well as the proposed definition for the Return on Equity Rate Change Deferral Account. The Board is satisfied that these proposals should be approved.

The settlement proposals in relation to an automatic adjustment mechanism for Hydro's target return on equity to reflect any changes to Newfoundland Power's approved target return on equity for rate setting are accepted.

Hydro's proposed definition of the Return on Equity Rate Change Deferral Account is accepted.

8.0 Forecasting Assumptions

In preparing its forecast of 2018 and 2019 test year operating costs Hydro relied on a number of assumptions, including the assumed supply scenario for determining test year costs, customer load forecasts, expected hydraulic/thermal production, power purchases and fuel price forecasts.

8.1 Supply Scenario for 2018 and 2019 Test Year Revenue Requirement

The Application stated that from 2018 to 2020, during the interconnection of Muskrat Falls to the North American grid, the Labrador Island Link and the Maritime Link would be available to

[10] Settlement Agreement, April 11, 2018, page 5, paragraph 24.

provide an opportunity to reduce Holyrood generation by using lower cost off-island purchases in 2018, 2019 and 2020. In determining the 2018 and 2019 test year revenue requirements Hydro proposed to establish an Off-Island Purchases Deferral Account which would include any difference between: (i) the actual costs attributable to off-island power purchases including the cost of delivery; and (ii) the costs that would have been incurred if that same amount of energy had been supplied from the Holyrood Thermal Generating Station based on the approved test years' unit cost of No. 6 fuel. Hydro further proposed that the costs incurred to use the Muskrat Falls Project transmission assets be recognized and paid for from the fuel savings with the remaining fuel savings to be set aside to mitigate the customer rate impact resulting from the Muskrat Falls Project.

There was significant discussion and information requested by the parties relating to the proposed Off-Island Purchases Deferral Account. In Order No. P.U. 2(2018) the Board noted the following with respect to the Application proposals:

> In 2018 the Island Interconnected system will be interconnected to the North American grid and will no longer be considered an isolated system. With the commissioning of both the LIL and ML expected in mid-2018, energy can be purchased from off-island sources to supply the Island Interconnected system. This will fundamentally change how the Island Interconnected system is supplied as well as the costs of supply. The revenue requirement and cost of service proposed in Hydro's general rate application does not reflect this fundamental change in how the Island Interconnected system will be supplied. Instead the 2018 and 2019 test year revenue requirements, cost of service studies and rates are based on an isolated scenario with the net savings associated with off-island purchases proposed to be placed in a deferral account to be used for future rate mitigation.[11]

The Board ordered Hydro to file 2018 and 2019 revenue requirements and cost of service studies based on the expected supply scenario, setting out the basis and support for the forecasts and assumptions used and including information related to customer impacts and the updated fuel price forecast.

In the *2017 GRA Additional Cost of Service Information in Compliance with Order No. P.U. 2(2018)* Hydro set out the cost of service, revenue deficiencies and customer rate impacts for both the Deferral Account Scenario and the Expected Supply Scenario. In the Settlement Agreements the parties agreed as follows:

> The Parties agree that the Expected Supply Scenario as presented in Hydro's Additional Cost of Service Information dated March 22, 2018 (the "Expected Supply Scenario") and not the Deferral Account Scenario reflected in Hydro's GRA will be used as the basis for Hydro's revenue requirement for the 2018 and 2019 Test Years.
>
> Notwithstanding paragraphs 15 and 16 herein, the Parties agree that the appropriateness of all costs proposed in the Expected Supply Scenario (save and except for any costs agreed and/or excluded pursuant to the Settlement Agreement of April 11, 2018) remain unresolved and shall be the subject of viva voce evidence at the hearing of the Application.[12]

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[11] Order No. P.U. 2(2018), page 6.
[12] Supplemental Settlement Agreement, page 4, paragraphs 14 and 17.

The settlement proposal in relation to the use of the Expected Supply Scenario for establishing Hydro's 2018 and 2019 test year revenue requirement is accepted.

8.2 Load Forecasts

Hydro's load forecasts on the Island Interconnected system for the 2018 and 2019 test years were based on direct input from the Industrial customers and Newfoundland Power, with the total load requirement determined from an analysis of overall system losses, station service and demand diversity. The following table shows the 2018 and 2019 test year load forecasts for the Island Interconnected system, as compared to the 2015 test year:[13]

Hydro's Electricity Requirements Island Interconnected System
2015, 2018 and 2019 Test Years (GWh)

	2015	**2018**	**2019**
Newfoundland Power	5,924.1	5824.5	5,833.6
Island Industrial Customers	621.4	726.0	743.3
Hydro Rural Interconnected	463.9	457.0	451.5
Losses	225.7	215.0	206.9
Total	**7,235.1**	**7222.5**	**7,235.3**

For the 2018 test year Hydro forecasted an increase in load requirements relative to 2017 due to increased requirements forecast for Vale and Praxair upon attaining full load levels at the end of 2017. Newfoundland Power's load forecast requirements remain stable through the 2018 test year. For the 2019 test year Hydro forecasted a modest increase in load relative to the 2018 test year due to increased requirements for the Island Industrial customers and Newfoundland Power.

The Industrial Customer Group submitted that evidence of the reasonableness of the March 2017 load forecast was provided by Hydro, with the exception that the load forecast for Newfoundland Power purchases from Hydro is no longer accurate. The Industrial Customer Group noted Newfoundland Power's updated load forecast filed as part of its 2019/2020 general rate application reduces Newfoundland Power's forecast purchases from Hydro by 39.4 GWh, and submitted that this is a material change and should be incorporated into Hydro's revenue requirement calculations. According to the Industrial Customer Group it would be inconsistent and unfair to customers that the two utilities would have rates covering the same year that are based on different load forecasts.

In its reply Hydro stated that any variations in energy purchases by Newfoundland Power and the Industrial Customer Group between test years flow through the RSP for allocation by customer class based on annual energy usage. Hydro further stated that a reduction in Newfoundland Power's energy forecast without a reduction in its coincident peak demand forecast would impact both system load factor and fixed costs allocation in the 2019 test year cost of service study to be used in establishing customer rates. Hydro does not object to updating the Newfoundland Power energy purchase forecast and peak demand forecast to reflect the load forecast used as a basis for establishing Newfoundland Power customer rates for 2019.

The Board notes that the 2018 test year load forecast was not an issue in the proceeding and that Hydro did not object to updating the Newfoundland Power energy purchase and peak demand

[13] Application, Volume I, page 3.16.

forecast to reflect the most recent load forecast available. The Board agrees that the updated 2019 load forecast for Newfoundland Power approved in Order No. P.U. 2(2019) should be used in determining Hydro's 2019 test year load forecast and revenue requirements.

The proposed 2018 test year customer load forecasts for the Island Interconnected system are accepted.

Hydro will be required to revise the 2019 test year customer load forecast for the Island Interconnected system to reflect the load forecast approved in Order No. P.U. 2(2019).

With respect to the load forecast for the Labrador Interconnected system the Settlement Agreements set out the following:

> The Parties agree that the 2017 GRA forecast for the Labrador Interconnected System will be updated in the 2017 GRA compliance application reflecting Hydro's most recent projections: i) of data centre loads for 2018 and 2019 including both the revenue and supply costs impacts and (ii) of 2019 Power on Order requirements for Labrador Industrial customers.[14]

The settlement proposal to update the load forecast for the Labrador Interconnected system is accepted.

8.3 Off-Island Purchases Forecast

In the Application Hydro did not provide a forecast of its expected off-island purchases of energy for upcoming years but instead estimated that such purchases could result in a reduction in generation at the Holyrood Thermal Generating Station of between 1.3 and 2.3 TWh during the period leading up to the full commissioning of the Muskrat Falls Project. Subsequent submissions by Hydro refined the estimates for off-island purchases for the 2018 and 2019 test years, as shown in the following table:

[14] Labrador Settlement Agreement, page 3, paragraph 11.

Hydro Off-Island Purchases Summary

Date	Reference	Energy Supply Source	2018	2019
July 28, 2017	Original *Hydro 2017 GRA* submission, page 1.9, lines 19-20.	Recapture Energy Other Off-Island Purchases	• Reduction in Holyrood generation of between 1.3 – 2.3 TWh • No yearly breakdown on purchases	
October 20, 2017	Hydro response to NP-NLH-115	Recapture Energy	520 GWh	859 GWh
		Other Off-Island Purchases		
November 27, 2017	Hydro response to PUB-NLH-110 (also served as a revised response to NP-NLH-115).	Recapture Energy	453 GWh	1055 GWh
		Other Off-Island Purchases		
March 22, 2018	*Summary Report - Additional Cost of Service Information* submitted in compliance with Order No. P.U. 2(2018), page 7, Table 5.	Recapture Energy	388 GWh	919 GWh
		Maritime Link Purchases	93 GWh	41 GWh
July 20, 2018	*Supplemental Evidence - Customer Impacts Reflecting 2017 GRA Settlement Agreements*, page 2, Table 1.	Recapture Energy	493 GWh	920 GWh
		Other Off-Island Purchases	113 GWh	96 GWh
October 26, 2018	*2018 Cost Deferral Evidence* submitted as part of Hydro's *2018 Cost Deferral and Interim Rates Application*, page 5, Table 1.	Recapture Energy	69 GWh	667 GWh
		Other Off-Island Purchases	83 GWh	49 GWh
January 11, 2019	Hydro response to PUB-NLH-176.	Recapture Energy	53 GWh	637 GWh
		Other Off-Island Purchases	56 GWh	49 GWh

In its submission Newfoundland Power noted the large monetary variability of the Holyrood production savings resulting from the different off-island purchases forecasts and requested that the Board direct Hydro to use its most reliable forecast of off-island purchases for the test years in its compliance application. Newfoundland Power also submitted that Hydro should address the reasonableness of the forecast used.

The Consumer Advocate noted the multiple revisions to the forecasts for off-island purchases and submitted that Hydro's cost of service "should reflect Hydro's best forecast of costs, and at this point, the costs associated with the off-island purchases do not appear to do so."[15] The Consumer Advocate further asserted that the benefits of off-island purchases could not be quantified because of a lack of information pertaining to the purchase strategy of Nalcor Energy Marketing or the review process for its sales and purchases. The Consumer Advocate noted that Hydro's response to CA-NLH-340 indicated that a report on Nalcor Energy Marketing's 2018 activities would be filed with the Board by the end of the first quarter of 2019. According to the Consumer Advocate Hydro's 2019 test year estimate for off-island purchases does not represent the best forecast of costs to serve customers and that an order concerning the Application should be delayed until the Nalcor Energy Marketing summary report on 2018 sales and purchases activities has been submitted to the Board and reviewed by interested parties.

In its reply submission Hydro agreed that the most reliable forecast of off-island purchases for the test years should be used in its compliance application. Hydro also acknowledged that the off-

[15] Consumer Advocate Submission, page 6/15-17.

island purchases update filed on January 11, 2019 in response to PUB-NLH-176 estimates approximately 43 GWh less energy being purchased off-island in 2018 than forecasted on October 26, 2018 as part of its *2018 Cost Deferral and Interim Rates Application*.

In response to the Consumer Advocate's assertion that there is a lack of information pertaining to the purchase strategy of Nalcor Energy Marketing, Hydro countered that the evidence provided in the Application makes it clear that Hydro's off-island purchase strategy is to reduce Holyrood generation. Hydro reiterated that it oversees the work of Nalcor Energy Marketing so as to ensure that Nalcor Energy Marketing activities are beneficial to Hydro's customers. Hydro also repeated its commitment to file a report on Nalcor Energy Marketing's activities by the end of the first quarter of 2019. Hydro recognized that there remains uncertainty with respect to the forecasted 2019 savings from off-island purchases but submitted that a further delay in the general rate application order would be of no benefit to stakeholders given that an update would be provided as part of its compliance application.

The Board notes the many revisions to the forecast for off-island purchases over the course of the proceeding, especially for the 2018 test year due to uncertainty with the availability of the Labrador Island Link. As noted in PUB-NLH-176 the recent announcement of Tacora Resources to restart the Scully Mine in Labrador West is also expected to reduce 2019 energy deliveries over the Labrador Island Link. The updated off-island purchases forecast for 2018 and 2019 filed in response to PUB-NLH-176 provides the most current information before the Board in this proceeding. The Board agrees that Hydro should use its most reliable forecast of off-island purchases for the 2018 and 2019 test years and will require Hydro to update the off-island purchase forecast in its compliance application, with full explanation for any changes since its last update. In relation to the Consumer Advocate's comments related to the work of Nalcor Energy Marketing the Board notes that the report on the activities of Nalcor Energy Marketing carried out on behalf of Hydro in 2018 was filed on April 2, 2019.

Hydro will be required to update its 2018 and 2019 test year forecasts for off-island purchases, providing full explanation for any changes since its last forecast update.

8.4 Hydraulic/Thermal Production Forecast

Hydro meets its customer load requirements on the Island Interconnected system through a number of supply sources, including hydraulic and thermal generation and power purchases.[16] Customer and system requirements in excess of that which can be met by Hydro's hydraulic assets and purchase contracts are assumed to be met with thermal generation from the Holyrood Thermal Generating Station and standby generation from its gas turbines.

The Application set out the forecast production plan (in GWh) by supply source for 2017, 2018 and 2019 for the Island Interconnected system assuming access to off-island power purchases and the continued use of thermal generation from Holyrood. As noted previously the agreement to use the expected supply scenario as the basis for the 2018 and 2019 test year revenue requirements is expected to result in availability of purchased energy from off-island sources and a reduction in energy production at Holyrood.[17]

[16] Newfoundland Power also receives a generation credit for its generation capacity based on the Island Interconnected system's reserve at criteria. Capacity assistance agreements are also in place with a number of Hydro's Island Industrial customers (see Application, Volume I, page 3.23).
[17] Application, Volume I, Schedule 3-IV.

In its submission Hydro noted that the test year hydraulic production forecast was developed consistent with the 2015 test year hydraulic forecast methodology and that the forecast was not contested. Hydro proposed that the Board accept the 2018 test year hydraulic production forecast of 4,601 GWh and the 2019 test year hydraulic production forecast of 4,600 GWh. Hydro noted that the 2019 test year hydraulic production forecast should also be used for the operation of the RSP effective January 1, 2019.

Hydro's thermal production forecast was not contested by the parties except to the extent that the Holyrood production forecast would be affected by off-island purchases over the Labrador Island Link and the Maritime Link. Newfoundland Power, in its submission, also raised the issue of Hydro's increased reliance on generation from the Holyrood gas turbine in recent years for reliability purposes, as reflected in the balances in the Energy Supply Cost Variance Reserve Deferral Account for 2015-2017.[18] Newfoundland Power noted that it would explore this issue further with Hydro through ongoing dialogue.

With respect to Hydro's use of its gas turbines the Board notes that its consultants reviewed Hydro's approach to generation dispatch and found that it was consistent with industry practice, and that Hydro's production plan for the 2018 and 2019 test years for its gas turbines reflects its current generation dispatch approach. The cost-effectiveness of the criteria for generation dispatch and the appropriate balance between cost and reliability are important issues and will be addressed in the Reliability and Resource Adequacy Review currently before the Board. The Board also notes that Hydro undertook to communicate with and obtain feedback from the parties on the planned operation of its gas turbines and other generation sources for the winter of 2018-2019.[19] The Board is satisfied that the production forecast should be accepted for the 2018 and 2019 test years, subject to any adjustment required as a result of the Board's findings in this Decision and Order.

The 2018 and 2019 test year hydraulic and thermal production forecasts are accepted, subject to any adjustments arising from this Decision and Order.

8.5 Fuel Price Forecast

The 2018 and 2019 test year fuel costs associated with No. 6 fuel to be used at the Holyrood Thermal Generating Station and for fuels used in Hydro's gas turbines and diesel units are determined using forecast prices from independent sources and the expected energy to be supplied by the units.

With respect to the 2018 test year Hydro proposed that the No. 6 fuel supply costs reflect the approved 2015 test year fuel cost of $64.41 per barrel. Hydro also proposed that the other 2018 test year supply costs on the Island Interconnected system reflect the 2015 test year inputs used in the calculation of the deferral balances for 2018 and that the RSP operate for 2018 on the basis of 2015 test year cost of service inputs. Hydro stated that this will ensure no duplication between the balances in these accounts and the calculation of the 2018 test year revenue requirement.

The Settlement Agreements set out the following with respect to the price of No. 6 fuel in the 2019 test year:

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[18] This issue is discussed further in Section 13.

[19] On December 5, 2018 Hydro reported on its planned dispatch of gas turbines for 2018/19 winter season and requested feedback from the parties. At the Board's request on January 16, 2019 Hydro provided a report on the feedback received.

> The Parties agree that the 2019 Test Year cost of No. 6 fuel to be used in Hydro's 2017 GRA Compliance filings shall be set based on the most current fuel rider forecast (either March or September).[20]

In its submission Hydro noted the agreement of the parties with respect to the use of the most current fuel rider forecast for the cost of No. 6 fuel in its 2019 test year costs. Hydro also submitted that gas turbine and diesel fuel supply costs on the Island Interconnected system for the 2019 test year should reflect the updated forecast.

The Board notes that no objections were raised in relation to Hydro's proposals for the 2018 test year fuel costs to be used in the calculation of the 2018 test year revenue requirement. The Board accepts Hydro's proposed approach as reasonable. With respect to the 2019 forecast fuel costs the Board agrees that the most current fuel price forecasts should be used for fuel costs to be included in the 2019 test year revenue requirement and will accept the settlement proposal. The costs of diesel and gas turbine fuels for the 2019 test year should also reflect the most current forecast price. This is consistent with previous general rate application orders and ensures that customer rates are recovering the most current costs for fuels.

Hydro's proposal to use the approved 2015 test year fuel costs for the fuel supply costs to be included in the 2018 test year revenue requirement is accepted.

The settlement proposal that the 2019 test year cost of No. 6 fuel be set based on the most current fuel rider forecast is accepted. The forecast 2019 diesel and gas turbine fuel costs should also reflect the most current price forecast for those fuels.

8.6 Holyrood Conversion Factor

The forecast of fuel consumption at the Holyrood Thermal Generating Station and the associated production costs are affected by the energy conversion factor for a barrel of No. 6 fuel. In Order No. P.U. 49(2016) the Board approved a conversion factor of 618 kWh per barrel for No. 6 fuel at Holyrood for the 2015 test year. In the Application Hydro proposed a conversion factor of 616 kWh per barrel for both the 2018 and 2019 test years.

As noted previously Hydro has proposed using the approved 2015 test year cost of service inputs for the 2018 test year supply costs. As a result the Holyrood conversion factor to be used for the 2018 test year will be 618 kWh per barrel.

The Settlement Agreements set out the following with respect to the Holyrood conversion factor for the 2019 test year:

> The Parties agree that the Holyrood conversion rate for the 2019 test year used in setting customer rates is 583 kWh per barrel.[21]

The Board has reviewed the evidence and accepts the settlement proposal for a Holyrood conversion rate of 583 kWh per barrel for No. 6 fuel as a reasonable assumption for the 2019 test year.

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[20] Supplemental Settlement Agreement, page 4, paragraph 19.
[21] Supplemental Settlement Agreement, page 4, paragraph 16.

Hydro's proposal to use of the approved 2015 test year Holyrood conversion factor for the 2018 test year revenue requirement is accepted.

The settlement proposal to use a conversion factor of 583 kWh per barrel for No. 6 fuel at the Holyrood Thermal Generating Station in the 2019 test year is accepted.

9.0 2018 and 2019 Test Year Costs

Hydro's revenue requirement consists of its return on rate base plus reasonable costs forecast to be incurred in the provision of service, which include fuel, power purchases, operating costs and depreciation. The Application proposed approval of the 2019 test year revenue requirement to be used for setting customer rates in the amount of $692.7 million. The Application also proposed the approval of Hydro's 2018 test year revenue requirement in the amount of $673.0 million, interim rates effective January 1, 2018 in advance of final rates, and the deferral and recovery of the revenue deficiency resulting from interim rates for 2018.

The proposed revenue requirements for the 2018 and 2019 test years were subsequently revised by Hydro to reflect the impacts of the Settlement Agreements, the revised fuel price forecast and the proposed deferral of operating and maintenance cost for the Labrador Island Link and Labrador Transmission Assets.[22] The revised forecast test year revenue requirements were $578.7 million for 2018 and $591.9 million for 2019.[23]

The forecast costs for each of the cost categories included in the 2018 and 2019 test year revenue requirements are addressed below.

9.1 Fuel

The Application proposed to include $250.2 million and $255.2 million for fuel costs in the revenue requirement for the 2018 and 2019 test years, which includes the cost of No. 6 fuel used at the Holyrood Thermal Generating Station and fuel for Hydro's gas turbines and diesel generators. These amounts were subsequently revised by Hydro to reflect updated forecasts of power purchases and No. 6 fuel costs as below:[24]

Fuel Costs ($ millions)

	2018 Test Year	**2019 Test Year**
No. 6 Fuel	147.7	137.9
Diesel and Gas Turbine	21.0	28.5
Total	**168.7**	**166.4**

The Board notes that the amount of the fuel costs in the test year is determined by Hydro's forecasting assumptions, including those related to load, hydraulic production, the Holyrood conversion factor and the fuel price, which have already been addressed in the previous section.

[22] 2018 Cost Deferral and Interim Rates Application, Revision 2, November 14, 2018, Schedule 1, Evidence on Customer Rates, page 11 of 81.
[23] 2018 Cost Deferral and Interim Rates Application, Revision 2, November 14, 2018, Schedule 1, Appendix H, pages 67 and 68. Hydro confirmed in PUB-NLH-185 that the proposals in Appendix H to Schedule 1 set out all matters that Hydro is requesting the Board to approve in this Application.
[24] Hydro Submission, page 39. The proposed fuel cost for 2018 is determined using 2015 test year inputs.

As a result of the Board's findings the fuel costs for the test year revenue requirement will be required to be updated.

Hydro will be required to revise the 2018 and 2019 test year fuel costs to reflect the findings of the Board in this Decision and Order.

9.2 Power Purchases

Under the expected supply scenario Hydro's forecast test year costs for 2018 and 2019 include power purchases from on-island sources, including Exploits Generation, wind and capacity assistance agreements, as well as off-island purchases over the Labrador Island Link and Maritime Link. Hydro's updated forecast of power purchases is set out below: [25]

Power Purchases ($ millions)

	2018 Test Year	**2019 Test Year**
On-Island	59.2	62.3
Isolated Systems	3.0	3.9
Labrador Interconnected	1.5	1.7
Off-Island	7.7	6.4
Total	**71.4**	**74.3**

The forecast costs included for capacity assistance were also updated by to reflect the Settlement Agreements, which set out the following with respect to the capacity assistance agreements in place for the 2018/2019 winter season:

> The Parties agree that in its 2017 GRA Compliance filing, Hydro will reduce its 2019 Test Year revenue requirement to reflect the capacity assistance agreements to be in effect for the 2018/2019 Winter Season. The removal of the costs of the capacity assistance agreements that have not been renewed for the 2018/2019 winter season will reduce the 2019 Test Year revenue requirement by approximately $600,000.[26]

In November 2018, subsequent to the filing of the Settlement Agreements, Hydro filed applications for approval of an Amended and Restated Capacity Assistance Agreement with Corner Brook Pulp and Paper and a 2018 Load Curtailment Agreement with Vale, which were approved by the Board.[27] Hydro subsequently advised during this proceeding that it was proposing to revise the 2019 test year revenue requirement to include the costs associated with the capacity assistance agreements that it had entered into for the 2018/2019 winter season.[28] The total cost associated with these agreements was estimated to be $3.373 million, an increase of approximately $240,000 from the capacity assistance costs reflected in the Application.

In its submission Newfoundland Power noted that, as a result of the approval of two additional capacity agreements, the proposed 2019 test year revenue requirement increased by $240,000 rather than decreasing by $600,000 as anticipated at the time of the Settlement Agreements. Newfoundland Power submitted that, consistent with the Settlement Agreements, the Board should

[25] Hydro Submission, page 39.
[26] Supplemental Settlement Agreement, page 5, paragraph 22.
[27] Order No. P.U. 40(2018) and Order No. P.U. 44(2018).
[28] PUB-NLH-178.

direct Hydro to reflect the capacity assistance agreements in effect for the 2018/2019 winter season in its compliance application.

Hydro submitted that the costs related to its capacity assistance arrangements are prudently incurred and that the capacity assistance agreements are an important, cost-effective mechanism to minimize disruptions to customers in the event of a contingency or to maintain a sufficient level of operating reserves for reliable operation of the electrical system. Hydro reiterated that, at the time the Settlement Agreements were signed, Hydro was not planning to renew its capacity assistance agreements with Vale and Praxair and, as a result, the anticipated adjustment to 2019 capacity assistance costs would have provided a decrease in revenue requirement for 2019. However, with the uncertainty of available supply over the Labrador Island Link for the 2018/2019 winter season, Hydro renewed its agreements with Vale and entered into an agreement for increased capacity assistance from Corner Brook Pulp and Paper.[29] Hydro submitted that the intention of the Settlement Agreements was to revise capacity assistance costs for 2019 to reflect the capacity assistance agreements to be in effect for the 2018/2019 winter season. Hydro submitted that its proposed recovery of the revised capacity assistance costs in the 2019 test year is reasonable and consistent with the intent of the Settlement Agreements.

The Settlement Agreements set out that the 2019 costs associated with capacity assistance should be revised to reflect the capacity agreements to be in effect for the 2018/2019 winter season. Additional capacity agreements have been approved by the Board for 2018/2019. The Board believes that approval of the increased capacity assistance costs for 2019 is consistent with the intent of the Settlement Agreements. The Board also notes that, as set out in the previous section, Hydro will be required to update its forecast of off-island purchases which may impact the forecast 2018 and 2019 test year power purchase costs.

The settlement proposal to reflect the capacity assistance agreements to be in effect for the 2018/19 winter season in the 2019 test year costs is accepted.

Hydro will be required to revise the proposed power purchases costs in the 2018 and 2019 test years to reflect the findings of the Board in this Decision and Order.

9.3 Operating Costs

The Application set out forecast operating costs, including labour, system equipment maintenance and other costs, as well as cost allocations, of $142.4 million for the 2018 test year and $145.3 million for the 2019 test year.[30] During the hearing Hydro provided an update to its forecast operating costs to reflect changes associated with the Settlement Agreements, setting out 2018 and 2019 test year operating costs in the amount of $138.5 million and $141.0 million respectively.[31] Hydro provided a further update, including actuals to the end of November 2018, as follows:

[29] Hydro Submission, page 21.
[30] Application, Volume I, page 3.36, Table 3-18.
[31] Undertaking #17.

Total Operating Expenses ($000s)[32]

	2015 Proposed Test Year	2015 Approved Test Year	2015 Actual	2016 Actual	2017 Actual	2018 Proposed Test Year	2018 Forecast	2019 Proposed Test Year	2019 Budget
Labour	88,888	83,255	90,566	77,547	81,582	85,269	84,837	86,830	85,503
SEM	26,825	26,784	31,927	25,048	25,791	26,228	23,477	26,796	26,796
Other	30,922	29,882	36,334	24,687	25,370	29,645	28,736	29,634	29,634
Cost Allocations	(7,066)	(7,184)	(7,906)	(3,370)	(2,530)	1,235	(84)	2,073	(968)
Total Operating	139,569	132,737	150,921	123,912	130,213	142,377	136,966	145,333	140,965

According to the Application actual operating costs for 2015 were higher than proposed, primarily as a result of labour cost increases and maintenance related costs due to the work effort associated with maintenance back log catch up activity as well as consulting and related costs increases associated with regulatory proceedings. The Application explained that in 2016 there were reductions in labour costs, primarily due to changes in full-time equivalents ("FTEs"), changes in actuarial assumptions related to employee future benefits, as well as higher capitalization. Various operating activities were also temporarily deferred or limited which, according to the Application, did not compromise safety and reliability but which did not reflect normalized operating cost levels and were not sustainable. In 2017 forecast operating costs returned to normalized levels with the primary drivers for increases being labour and other costs, as well as cost allocations. In addition the 2017 forecast operating costs reflect the reorganization of Hydro to create a dedicated and separate executive team and establish support functions for Hydro.

9.3.1 Operating Cost Components

i) Labour Costs

Labour costs represent approximately 60% of Hydro's total operating costs and include labour related costs, employee future benefits and overtime. The Application proposed to include $85.3 million and $86.8 million in the 2018 and 2019 test year revenue requirements for labour costs. During the proceeding Hydro provided an update with respect to labour costs as set out below:[33]

Labour Costs ($000s)

	2015 Proposed Test Year	2015 Approved Test Year	2015 Actual	2016 Actual	2017 Actual	2018 Proposed Test Year	2018 Forecast	2019 Proposed Test Year	2019 Budget
Labour related	75,611	69,978	73,287	64,481	68,328	73,906	71,714	75,224	73,897
Employee Future Benefits	8,371	8,371	6,690	6,902	6,282	6,489	6,819	6,705	6,705
Overtime	4,906	4,906	10,589	6,164	6,972	4,874	6,304	4,901	4,901
Total	**88,888**	**83,255**	**90,566**	**77,547**	**81,582**	**85,269**	**84,837**	**86,830**	**85,503**

[32] PUB-NLH-187, Attachment 1, page 1 of 1.
[33] PUB-NLH-187, Attachment 1.

According to Hydro the updated 2018 labour related costs decreased from the proposed 2018 test year costs primarily related to FTE vacancies, variations in salaries from budget, higher utilization of resources on capital work, and a reduction in fringe benefits. A forecast increase in 2018 overtime was explained to be primarily the result of operational support requirements and variation in maintenance schedules.

The Application noted that the 2019 proposed labour cost is 4.3% higher than the 2015 test year, but lower than 2015 actuals. The Application stated that, since its last general rate application, Hydro has undergone significant organizational changes to create greater operational independence from its parent company and to ensure continued focus on its core business as a regulated utility.[34] The primary changes were the creation of a separate and dedicated executive team for Hydro, reduced reliance on Nalcor for shared services and the transfer to Nalcor of certain functions, including human resources, safety and information systems. According to the Application 41 positions were transferred from Hydro's information systems department in 2016 and there was an increase in FTEs in 2017 to reflect the impact of the Hydro reorganization.[35]

Grant Thornton reviewed the proposed operating costs, including salaries and fringe benefits and commented that gross payroll costs are estimated to be 1.6% higher in 2017 than 2016, 1.8% higher in 2018 than 2017 and 1.4% higher in 2019 than 2018. Grant Thornton noted that the salaries component has maintained its upward trend from 2015 to 2019 test year, stating:

> Salary fluctuations were noted within several of the divisions when comparing the 2017 forecast to 2016 actuals, the 2018 test year to the 2017 forecast and the 2019 test year to the 2018 test year; however, the most significant increases occurred within the following divisions – Executive Leadership, Finance, Engineering, Production Operations, and Recharged Salaries.[36]

Grant Thornton noted that, according to Hydro, the 2017 forecast increases in the Executive Leadership, Finance, Engineering, and the Production Operations divisions, as compared to 2016, are primarily due to the Hydro reorganization with the forecast increase in the number of FTEs for 2017 reflecting the impact of the reorganization.[37] Grant Thornton reported that the 2017 overtime costs were forecast to decrease by $5.4 million from 2016 which Hydro explained was primarily due to Hydro's continued effort to reduce overtime. Grant Thornton referenced Hydro's explanation that there is a focused proactive effort by Hydro Executive and Senior Leadership to manage the amount of overtime.[38]

The Settlement Agreements set out the following with respect to the proposed labour costs:

> Hydro's proposed accounting treatment and methodology for calculation of Employee Future Benefits in the 2018 and 2019 Test Years ("Test Years") should be approved.
>
> The number of vacancies in full time equivalent positions to be used in calculation of operating labour costs in the Test Years shall be 55 and not 40 as proposed in the Application.[39]

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[34] Application, Volume I, pages 3.1 to 3.3.
[35] Application, Volume I, page 3.4.
[36] Grant Thornton Financial Consultants Report, December 4, 2017, page 52.
[37] Hydro subsequently reported in Undertaking #29 that actual 2017 FTEs were 815.
[38] Grant Thornton referenced Hydro's response in CA-NLH-141.
[39] Settlement Agreement, page 2, paragraphs 7 and 10.

Hydro provided the following update in relation to FTEs to reflect the 2017 actuals and the vacancy factor of 55 as agreed by the parties:

Net FTEs from 2013 Actual to 2019 Test Year[40]

	2013	2014	2015T	2015	2016	2017F	2017A	2018T	2019T
Hydro Based FTEs	813	833	903	872	826	866	846	846	846
FTE time charged to Hydro	22	28	14	27	28	13	15	7	6
FTE time charged by Hydro	-28	-34	-29	-38	-45	-19	-46	-16	-17
Total	**807**	**827**	**888**	**861**	**809**	**860**	**815**	**837**	**835**

According to Hydro the increase in the number of FTE vacancies from 40 to 55 was estimated to reduce the test year revenue requirement by $1.328 million in both 2018 and 2019.[41]

The proposed labour costs also include the costs associated with Hydro's short-term incentive plan for executive and senior leadership in the amount of $829,852 in the 2018 test year and $856,029 in the 2019 test year. According to Hydro it has addressed the Board's concerns in relation to this plan which were set out in Order No. P.U. 49(2016):

> Hydro has redesigned its short term incentive plan to ensure clear and demonstrable benefit to the customers and it is focused only on Hydro measures of performance related to the areas of: safety; reliability; financial/cost management; integration of Muskrat Falls assets; and regulatory. Hydro has included 100% of its forecast performance contract payments in its revenue requirement.[42]

During the hearing Ms. Dalley explained that Hydro's incentive program represents about one percent of labour costs and that the plan facilitates Hydro being competitive in recruitment and retention for its senior positions. Ms. Dalley stated:

> So, this portion of it is a portion of compensation that is variable. It is at risk, and it is part of our overall compensation package for a group of individuals that have the ability to really influence and direct the change that we need in the organization for customers.[43]

In relation to why the proposed amount to be included in the revenue requirement related to incentives has more than doubled since the 2015 test year Mr. Haynes stated that organizational change and the increased number of employees entitled to an incentive contributed to the increase.[44] Mr. Haynes explained that they strive to have objective measures but there is a place for qualitative measures as well.[45]

Mr. Haynes also confirmed that Hydro has proposed recovery of 100% financial and regulatory performance incentives despite the fact that the Board has in the past ordered that Newfoundland Power should only include 50% of payments for these type of incentives.[46] Mr. Haynes agreed that there is nothing that would distinguish Hydro from Newfoundland Power in this regard but stated that the incentive to deliver lower costs would lead to lower costs over time if there was a sustained

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[40] Undertaking #29.
[41] Supplemental Evidence – Customer Impacts Reflecting the 2017 GRA Settlement Agreement, page 7.
[42] PUB-NLH-060.
[43] Transcript, April 25, 2018, page 206/11-18.
[44] Transcript, April 24, 2018, pages 155/23 to 157/4.
[45] Transcript, April 24, 2018, pages 171/19 to 172/6.
[46] Transcript, April 24, 2018, pages 157/15 to 158/7.

reduction in operating costs, lead to lower costs, although he acknowledged that there would not be a benefit to ratepayers in the short term.[47] Ms. Hutchens explained in relation to Hydro's proposal to include 100% of the payments in the test year revenue requirement:

> Hydro has redesigned its short-term incentive plan to ensure clear and demonstrable benefit to the customer and it is focused only on Hydro measures of performance related to the areas of safety reliability, financial cost management, integration and regulatory. And then we included the 100 percent on that basis.[48]

According to Hydro, excluding 50% of the payments related to financial and regulatory performance would reduce the amount included in the 2018 and 2019 test years to $720,000 and $730,000, respectively.[49]

ii) System Equipment and Maintenance

System equipment maintenance costs include materials and contract labour costs associated with maintenance activity with year over year variations reflecting changes in operational requirements. The Application proposed system equipment maintenance costs of $26.228 million and $26.796 million in the 2018 and 2019 test years.

Grant Thornton noted that these costs are forecast to increase by approximately $530,000 in 2018 in comparison to the 2017 forecast and by $570,000 in 2019 in comparison to the 2018 test year.[50] Grant Thornton noted that, according to Hydro, forecasting for system equipment and maintenance costs is based on preventative and corrective program requirements, consultation with contractors on the upcoming annual work packages as well as knowledge and history of the equipment and processes.

Hydro subsequently provided an update in relation to system equipment maintenance costs which set out 2017 actual costs of $25.791 million as well as the 2018 forecast, updated to end of November 2018, in the amount of $23.477 million.[51]

iii) Other Operating Costs

Other operating costs include expenses associated with office supplies and expenses, professional sources, insurance, equipment rentals, travel, building rental and maintenance and transportation. The Application proposed other operating costs in the amount of $29.645 million in the 2018 test year and $29.634 million in the 2019 test year.[52]

Grant Thornton reviewed Hydro's other operating costs and noted that, according to Hydro, the forecast increase in insurance costs is due to a general forecast increase in the premiums and the forecast increase in travel costs is related to the fact that 2017, 2018 and 2019 forecasts for travel were adjusted to sustainable levels after targeted cost reductions in 2016.

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[47] Transcript, April 24, 2018, pages 159/9 to 161/8.
[48] Transcript, July 26, 2018, pages 165/17-25.
[49] Undertaking #19.
[50] Grant Thornton Financial Consultants Report, December 4, 2017, page 60.
[51] Undertaking #51, Attachment 1; PUB-NLH-187, Attachment 1.
[52] Application, Volume I, Schedule 3-IX, page 1.

Hydro subsequently provided an update with respect to other operating costs setting out 2018 forecast costs of $28.7 million.[53] The update showed changes with respect to each of the categories of these costs with the two largest being a decrease in professional services in the amount of $874,000, primarily due to changes in scope and activity, and an increase in transportation costs in the amount of $794,000, associated with an increase in vehicle fleet costs as a result of lower capitalization.

The proposed external regulatory costs included in professional services are $1.7 million in total, comprising of $1.2 million related to this Application and $0.5 million related to the Cost of Service and Rate Design Methodology Review. Hydro explained that the proposed costs related to this Application are based on the amount approved for Newfoundland Power in Order No. P.U. 18(2016) and that the costs related to the cost of service review are based on judgement considering the anticipated number of intervenors and experts.

The Settlement Agreements set out the following with respect to other operating costs:

> The Board should approve that external regulatory costs related to the Application and the Cost of Service and Rate Design Methodology Review be recovered in customer rates evenly over a three year period, commencing with the 2018 Test Year with the amount of such costs to be determined by the Board. [54]

iv) Cost Allocations

Cost allocations include fees charged by or to Hydro for common services to or from other lines of business within Nalcor. The Application proposed cost allocations in the amount of $1.235 million in the 2018 test year and $2.073 million in the 2019 test year. The test year cost allocations include $2.542 million in 2018 and $3.042 million in 2019 related to the Business Systems Transformation Program costs.

The Settlement Agreements set out the following with respect to the Business Systems Transformation Program costs:

> All costs and expenses related to the Business Systems Transformation Project described in the Application which are forecast to be $2.54 million in 2018 and $3.04 million in 2019 shall be removed from the Revenue Requirements in the Test Years and set aside in a deferral account. The reasonableness and prudence of these costs will be reviewed with the recovery of any of these costs to be determined by an Order of the Board. Hydro shall provide a report by June 22, 2018 that (i) explains the costs with supporting detail on the reasonableness and prudence of such costs and (ii) sets out a proposal on the timing for the review of the costs and a proposed definition of the deferral account to be created.[55]

Hydro subsequently provided an update with respect to cost allocations which set out 2018 forecast cost allocations of ($84,000) and 2019 budget cost allocations of ($968,000).[56] The 2018 forecast decrease was explained to be primarily due to variations in the intercompany admin fees and a lower allocation of Business Systems Transformation Program costs as a result of project delays.

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[53] PUB-NLH-187, Attachment 1.
[54] Settlement Agreement, page 4, paragraph 22.
[55] Settlement Agreement, page 3, paragraph 11. Hydro filed its report *Corporate Business Systems Transformation Program* on June 22, 2018. This project is currently being considered by the Board in a separate proceeding.
[56] PUB-NLH-187, Attachment 1.

Hydro advised that the 2018 forecast did not reflect the agreed deferral of the Business Systems Transformation Program costs on the basis that the settlement agreement had not yet been approved. The 2019 budget was adjusted to reflect the deferral of the Business Systems Transformation Program costs.

9.3.2 Productivity Allowance and Cost Control

According to the Application productivity allowances of $1.039 million and $1.102 million are reflected in the 2018 and 2019 test year costs to reflect Hydro's commitment to cost management and efficiency activities.[57] Hydro explained that this was a self-imposed target to reflect actions being taken to manage costs but there was no calculation underlying the amount of the productivity allowance and there were no specific guidelines issued to staff.[58] Hydro noted that the productivity allowance is in addition to the commitment to not budget any new FTE positions for the 2018 and 2019 test years which meant that six required positions in the Energy Control Centre were not reflected and further that there was a $3.5 million vacancy allowance included, representing 40 FTEs.[59] Hydro also explained that there is a focused, proactive effort by Hydro Executive and Senior Leadership to manage the amount of overtime.[60] Overtime management efforts include the introduction of new measures to monitor overtime throughout the year, a review of the application of overtime compensation policy and actions to identify improvements, the implementation of targeted attendance support programs and a decrease in Hydro's operating overtime budgets included in the test years.[61] During the hearing Ms. Hutchens noted that the forecast overtime budget is less than was experienced in 2015, 2016 and 2017.[62]

In relation to its budgeting process Hydro explained that there are a series of reviews of operating costs with each Vice President, the Finance Department and the President, a detailed review by the Executive Team when the budgets are consolidated and, depending on cost levels, there may be multiple reviews and iterations until the final numbers are approved by Hydro's Board of Directors.[63] According to Hydro the reviews resulted in FTE neutral budgets in 2018 and 2019 and the inclusion of a productivity allowance. Hydro also provided the guidance which was given regarding operating cost control, including that operating and maintenance costs for 2017 were not to exceed 2016 budget of $139.6 million, all new FTEs required justification and executive approval and travel costs were limited to business critical and operational needs only.[64] During the hearing Ms. Hutchens explained that Hydro managers understand the need for cost efficiencies and there are some very strong messages that are sent through the gating process, the vacancy allowance and the productivity allowance. She further explained:

> We have monthly meetings to review costs and challenge and talk about, you know, underlying cost drivers in the business and, you know, they're all expected to look at innovation and productivity in terms of, you know, what are some ways that we can do things better, faster, cheaper. So, that would absolutely be my expectation; that we would be looking at, you know, anything we could to reduce the costs.[65]

[57] Application, Volume I, page 3.38, Table 3-20.
[58] PUB-NLH-064.
[59] Hydro subsequently agreed to increase the vacancy allowance to reflect 55 FTEs.
[60] CA-NLH-141.
[61] CA-NLH-215.
[62] Transcript, July 24, 2018, page 130.
[63] PUB-NLH-051.
[64] PUB-NLH-121.
[65] Transcript, July 24, 2018, page 38/10-20.

Ms. Hutchens explained that in 2016 and 2017 work was being done at Hydro with respect to productivity opportunities and, in January of 2018, an Innovation and Productivity Team was formally established. The purpose of the team is to drive innovation and productivity in the organization and to promote the culture of innovation and productivity. Ms. Hutchens explained that since the team has started work several initiatives have been implemented related to the attendance management program, changes in security and janitorial, overtime, travel guidelines, communications infrastructure and laptop replacement profile, technology to convert paper-based email and cell phone evaluation.[66] The estimated operational savings related to the work of the Innovation and Productivity Team for 2018 was $479,000 and the sustainable annual savings beginning in 2019 were forecast to be $665,000.[67] In addition sustainable annual capital savings of $675,000 are expected which are not a contributing factor to the productivity allowance.

In relation to whether there is a general philosophy to try to keep operating costs at inflationary levels, Mr. Haynes explained that in the last couple of years there have been some restrictions on travel, conferences and training. Mr. Haynes noted that when he started in 2016 there was a concerted effort to reduce costs which included a significant reduction in the system equipment maintenance budget associated with vegetation management and in relation to gas turbines. He noted the need for sustainable spending and the importance of having "the right balance of cost in the operating area and the capital area to serve our customers to the greatest extent that we can".[68]

According to Mr. Haynes the biggest challenge associated with controlling operating costs is the maintenance that has to be done on the assets especially in light of concerns about reliability issues on some aging assets, including the Holyrood Thermal Generating Station. He stated:

> So, those things all have some incurrence of additional costs, maybe in overtime or external resources required occasionally to help us get things in order, but you know, I think the budget that we put forward for 2018 and 2019 is realistic. [69]

In relation to the question of whether the increase in total operating costs from $130 million in 2016 to $142 million as proposed for the 2018 test year is consistent with cost control within Hydro, Ms. Dalley explained that the reorganization, which was one of the primary drivers of the increase, was necessary to deliver Hydro's mandate for least cost power balanced with reliable service and that the investment is prudent for customers.[70]

9.3.3 Submissions

The Consumer Advocate did not accept that the proposed labour costs for 2018 and 2019 are reasonable and recommended that labour costs be frozen at the level approved for the 2015 test year. This would result in reductions of $3.928 million and $5.246 million for the 2018 and 2019 test years. The Consumer Advocate noted:[71]

- In Hydro's last general rate application the Board approved $69.978 million for the 2015 test year for labour cost (exclusive of employee future benefits and overtime), which was $5.633 million less than proposed by Hydro.

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[66] Transcript, July 24, 2018, pages 121 to 123.
[67] Undertaking #93, page 2.
[68] Transcript, April 17, 2018, pages 46/7 to 47/19.
[69] Transcript, April 17, 2018, pages 81/6-11.
[70] Transcript, April 25, 2019, page 171/12 to 172/10.
[71] Consumer Advocate Submission, page 4.

- Actual labour costs in 2016 and 2017 were less than that approved by the Board for 2015.
- Hydro proposed $73.906 million for labour in 2018, an increase of $5.578 million over 2017 actual, and $2.192 million over 2018 actual (based on 11 months of actual costs and 1 month of forecast costs).
- A main driver of Hydro's reorganization in 2016 was to improve efficiency; however, Hydro has proposed $75.224 million for labour costs in the 2019 test year, about $6.9 million more than 2017 actual labour costs when Hydro states that operating costs returned to normal.
- Hydro is now budgeting for labour costs of $73.897 million for 2019, after the vacancy allowance changes, which is $1.327 million less than proposed for the 2019 test year.

According to the Consumer Advocate it is difficult to know how much Hydro needs for Labour as it cannot be determined if Hydro has reasonable labour productivity. The Consumer Advocate referenced the interim report of The Liberty Consulting Group ("Liberty") in the Board's Rate Mitigation Reference:

> We did not encounter a strong Hydro focus on work execution productivity. Work planning and management is dispersed, its systems and methods are not as strong as we have seen elsewhere, productivity metrics are not robust, work measurement and data analysis do not appear to be "central" elements of cost management, and accountability for productive performance is not well-placed. The Hydro organization is large enough to make this issue matter - - each two percent improvement in productivity (a modest assumption here) has a value well in excess of $1 million per year.[72]

The Consumer Advocate submitted that Hydro will have little incentive to improve its work execution productivity if the Board approves the proposed labour costs for 2019. The Consumer Advocate stated that the problem is exacerbated by the fact that Hydro has the same return on equity as Newfoundland Power.

Newfoundland Power submitted that the revised forecast 2018 and 2019 test year operating costs are markedly higher than the 2016 actuals of $123.9 million. Newfoundland Power submitted that Hydro has not provided convincing evidence that its 2016 cost reductions were not sustainable and noted that Hydro's actual 2017 operating costs totaled $130.2 million, $4.0 million lower than Hydro's forecast, at a time when Hydro states operating costs had returned to normalized levels. Newfoundland Power submitted that the cost increases, when considered in light of recent cost levels, are not consistent with effective cost management. According to Newfoundland Power Hydro's 2018 test year operating cost proposal exceeds what is required.

Newfoundland Power submitted that Hydro has not proven that the proposed test year costs are consistent with efficient operation and that, because the complexity of the evidentiary record makes year over year comparisons problematic, it is difficult to recommend reductions in specific costs. Newfoundland Power noted the evidence that Hydro did not implement improved processes in relation to identifying, establishing and documenting efficiency measures before the filing of the Application as directed in Order No. P.U. 49(2016). Newfoundland Power stated that, with timely implementation of efficiency measures, the forecast 2018 costs may have been lower. Newfoundland Power further stated that the self-imposed productivity allowances of

[72] The Liberty Consulting Group, *Final Report on Phase One of Muskrat Falls Project Potential Rate Mitigation Opportunities*, December 31, 2015, page 7.

approximately $1.0 million in the 2018 test year and $1.1 million in the 2019 test year represent less than 0.8% of Hydro's total operating costs for these years. Newfoundland Power also noted that the self-imposed targets include savings of approximately $500,000 in 2018 and $700,000 in 2019 already identified by Hydro's Innovation and Productivity Team. In Newfoundland Power's view the productivity allowance included in the test years is not a sufficient incentive for future cost control, and the evidence before the Board justifies a productivity allowance of at least 3% of Hydro's total operating costs for each of the 2018 and 2019 test years. According to Newfoundland Power this would result in a revenue requirement reduction of approximately $4.2 million in each of the test years.

Newfoundland Power supported approval of the settlement agreement proposals related to operating costs but raised an issue related to the Business Systems Transformation Project. Newfoundland Power noted that Hydro did not seek approval of these costs through the normal capital budget approval process with recovery of Hydro's allocated share of the costs provided for in a cost allocation from Nalcor through the Business System Fee. Newfoundland Power submitted that, for large capital projects led by Nalcor or an affiliate for which significant costs are to be allocated to Hydro, the Board should direct that, before Hydro may recover the associated costs from its customers, Hydro should be required to demonstrate the value of such projects for Hydro's customers in accordance with the Board's Capital Budget Application Guidelines.

In its submission the Industrial Customer Group noted the settlement agreement proposal to use a vacancy factor of 55 rather than 40 is supported by the fact that at the end of 2017 the actual vacancies were 60. The Industrial Customer Group also noted that the review process in relation to costs and expenses of the Business Systems Transformation Project is ongoing. The Industrial Customer Group supported the productivity team initiative by Hydro but submitted that it is important to establish a reporting framework which sets measurable dollar goals for cost control and allows for review in the next general rate application as to whether the goals were met. The Industrial Customer Group suggested that Hydro be directed to report annually on the cost control goals set for and by the Innovation and Productivity Team, measuring the degree of success in achieving those goals and setting cost control goals for the coming year.[73]

Hydro submitted that its forecast operations and maintenance costs reflect requirements to efficiently and effectively run the business, are properly budgeted and comprise only those expenses necessary to ensure reliable service. In Hydro's view the operations and maintenance costs are prudent and meet with its least-cost mandate. According to Hydro it has addressed the concerns of the Board set out in Order No. P.U. 49(2016) regarding the development of effective efficiency initiatives and practices through changes in management structure, redesign of short-term incentives and focused efforts on efficiencies, including the creation of a dedicated Innovation and Productivity Team and improved cost management and budgeting.

Hydro also submitted that the evidence before the Board in this Application differs greatly from the last general rate application when Hydro was trying to correct the circumstances which led to the outage in 2014. In 2016, due in part to a directive from the Government to reduce costs, Hydro cut back significantly on expenditures which led to a reduction in 2016 operating expenses. This resulted in internal directives to review all service agreements, conduct only mandatory training, conduct only travel that was operationally critical and reduce costs in all other areas where possible. Hydro submitted that:

[73] Industrial Customer Group Submission, pages 21/12 to 22/5.

> … while these levels of expenditure might appear to be least-cost in the short-term, they are not sustainable over the longer term without exposing customers to an unacceptable risk of poor reliability and service. Therefore, it is irresponsible to attempt to operate at the 2016 levels of expenditure for more than a temporary period.[74]

According to Hydro the new organizational structure implemented in 2016 enhances organizational effectiveness with a structure appropriate for Hydro's business environment and objectives for the near-term period and reduces the reliance on Nalcor for services that were previously shared among the Nalcor lines of business.

Hydro submitted that, in response to the Board's observations in Order No. P.U. 49(2016), the Innovation and Productivity Team initiative was introduced to pursue efficiencies and improvements with an aim to achieve long-term, sustainable improvements which reduce costs and provide value to Hydro's customers. Hydro submitted that this initiative demonstrates its proactive approach to cost management and further that it fully expects that this program will produce productivity gains in the coming years.[75] Hydro also noted it has committed to not increase FTEs in 2018-2019 which includes the absorption of five Energy Control Centre Operator positions. Hydro submitted that one of the drivers of increased labour costs in the last few years has been overtime and it has implemented a new process to facilitate improved management of overtime costs.

According to Hydro its budget process is structured, disciplined and rigorous, and assures that Hydro's operations and activities are focused on providing customers with maximum long-term value. Hydro set out the following specific budgetary guidelines which were given with respect to the budgets for the 2018 and 2019 test years:

- Operating and maintenance costs for the 2017 budget were not to exceed the 2016 budget with structural salary and other increases to be offset by reductions in other areas.
- All new FTEs required justification and all FTE requests were to be approved by general managers and vice-presidents with executive level review and approval of all FTE requests prior to hiring.
- Salary and related labour costs estimates were provided by Human Resources.
- Template provided for professional services requests.
- Template provided for training costs with management of these costs by Human Resources.
- Travel costs to include business critical and operational needs only.

Hydro stated:

> Hydro is confident that its new corporate structure, monthly finance meetings, and new O&M reporting drive focus and accountability within its leadership to facilitate effective, least-cost management of the company. Hydro's budgetary process is rigorous and provides the structure within which management can assure that operating funds are spent where they can provide the greatest benefit and in amounts which provide least-cost service.[76]

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[74] Hydro Submission, page 27.
[75] Hydro Submission, page 34.
[76] Hydro Submission, page 37.

In relation to its short-term incentive program Hydro submitted that it reflects prudent expenditures required to provide incentives for efficacious and innovative actions by Hydro senior managers and executives to achieve excellence in least-cost, reliable service. Hydro explained that the incentive plan is part of Hydro's overall compensation to ensure the company is competitive within the labour market and able to attract and retain senior leaders to drive business success. The incentive opportunity is designed to influence performance in key areas that drive customer focus, reliability and business success. Hydro explained that it has reviewed and updated the design of the incentive program to have a greater focus on indicators that benefit customers while still maintaining those that promote business success and that this redesign addresses the concerns set out by the Board in Order No. P.U. 49(2016). Hydro submitted that providing incentives to Hydro's executive and senior managers to meet budget, produce cost savings, and focus on sustainable cost management provides value to customers by lowering overall expenses which will, in time have the effect of lowering revenue requirement and rates.[77]

In its reply submission Hydro addressed Newfoundland Power's suggestion that it is not clear whether the organizational changes that were made are consistent with the obligation to provide least cost reliable service. Hydro submitted that the organizational structure is reasonable and strikes the appropriate balance between cost and reliable service to customers. Further Hydro submitted that it considers Newfoundland Power's characterization of a "confused" record with respect to the proposed test year costs to be misleading and unfounded. Hydro stated that it has not revised its proposed test years' operating costs during the process. With respect to Newfoundland Power's submission that a 3% productivity allowance should be applied, Hydro stated that it has imposed a productivity allowance and that, as a result of this productivity allowance and its commitment to absorb the six positions in the Energy Control Centre, the forecast test year operating costs have already been reduced by $1.7 million which equates to an approximate 1.2% productivity allowance. Hydro stated that any consideration of a productivity allowance should acknowledge these amounts, and that the amount proposed by Hydro provides an appropriate and sufficient incentive to seek further efficiencies.

In reply to Newfoundland Power's suggestion that Hydro should be required to justify the value of its projects similar to the Business Systems Transformation project in accordance with the Board's Capital Budget Guidelines, Hydro submitted that this is not required for a proper and full regulatory review. According to Hydro the Board looks to whether the utility is getting appropriate and prudent value from operating expenses which provide value and service from a third party's assets and the Board determines the amount of those operating expenses that it will permit to be recovered in rates under subsection 80(2) of the *Act*.

In relation to the suggestion by the Industrial Customer Group that there should be reporting in relation to the Innovation and Productivity Team initiative Hydro submitted that this is unwarranted, stating:

> Hydro submits that the work of the team and the guidance and response of the team are matters of day-to-day management of the company's operations. It is obvious that cost control will always be an important component of every GRA. With respect, Hydro submits that it should be permitted to carry out and report on the work of the Productivity and Innovation Team in the manner that Hydro determines is appropriate to substantiate its efforts and outcomes.[78]

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[77] Hydro Submission, page 32.
[78] Hydro Reply Submission, page 11.

9.3.4 Board Findings

The forecast operating costs proposed in the Application are $142.4 million in the 2018 test year and $145.3 million in the 2019 test year. These costs make up approximately 20% of Hydro's forecast test year costs and are generally considered to be controllable. While Hydro stated in its final submission that it has not revised the proposed operating costs to be included in the test years, the Board notes that approval of the Settlement Agreements in relation to the vacancy allowance and the Business Systems Transformation Project was estimated to reduce the forecast operating costs by approximately $3.9 million in 2018 and $4.4 million in 2019.[79] According to the most recent update, the forecast operating costs are $137.0 million for 2018 and the budgeted operating costs are $141.0 million in 2019.[80]

The Board notes that the proposed test year operating costs are substantially higher than the actual operating costs in 2016 of $123.9 million and $130.2 million in 2017. According to the evidence, in 2016, the year following the 2015 test year, Hydro made substantial cuts in operational costs, which included some reductions which Hydro claims were not sustainable related to vegetation management, training and conferences and travel.[81] While the Board accepts that some of the operating cost reductions in 2016 may not have been sustainable, the evidence does not demonstrate the extent to which the reductions were unsustainable. The Board notes that, according to the latest update, the actual 2017 and the forecast 2018 operating costs are significantly lower than the operating costs proposed to be included in the 2018 and 2019 test years.

Labour costs make up the majority of the forecast operating costs, in the amount of $85.3 million for the 2018 test year and $86.8 million for the 2019 test year. These amounts are significantly higher than the actuals in 2016 of $77.6 million and in 2017 of $81.6 million. The Board notes that, while the 2017 forecast for net FTEs set out in the Application was 860, the 2017 actual was subsequently reported to be 815.[82] The updated test year FTEs were 837 in 2018 and 835 in 2019. While the Board accepts that the increase in labour costs is largely associated with the organizational changes introduced in 2016, it is difficult to conclude, based on the evidence, that the proposed labour costs are reasonable when looking year over year since the last general rate application. In terms of the proposed system equipment maintenance costs, these costs are in keeping with historical levels with moderate increases consistent with inflationary increases. It is noted however, that the proposed 2018 test year system equipment maintenance costs are approximately $2.8 million or 12% higher than the updated forecast 2018 system equipment maintenance costs. Other operating costs which comprise approximately 20% of Hydro's operating costs, include costs which may be somewhat controllable such as travel, professional services and other costs. The Board accepts that there have been increases in these costs but notes that the proposed other operating costs for the 2018 test year are approximately $4.3 million or almost 17% higher than 2017 actual costs.

[79] Supplemental Evidence-Customer Impacts Reflecting the 2017 GRA Settlement Agreement, page 7.
[80] PUB-NLH-187, Attachment 1.
[81] PUB-NLH-054.
[82] Undertaking #29.

In Hydro's last general rate application the Board stated:

> The Board expects Hydro to implement improved processes in relation to identifying, establishing and documenting efficiency measures before the filing of its next general rate application. In the absence of such evidence the Board may consider further disallowances as well as a productivity allowance.[83]

The Board acknowledges that the evidence demonstrates that Hydro has implemented some improvements with respect to efficiency measures and cost control since the last general rate application. The Board is not satisfied, however, that the measures which have been introduced meet the expectations set out in Order No. P.U. 49(2016). While Hydro implemented measures with respect to overtime and new FTEs it did not demonstrate that all aspects of the proposed operational costs were appropriately tested through the budget process or otherwise. In particular the Board has concerns in relation to the proposed labour costs and other operating costs and whether there are appropriate controls in relation to the amount of these costs. The Board acknowledges the efforts that Hydro has made towards finding efficiencies and that it has implemented a productivity allowance as well as an increased vacancy allowance. Hydro has not demonstrated, however, that the improved processes are sufficient or that the benefits of this process have been appropriately shared with ratepayers. In this regard the Board notes the significant increases in costs in the 2018 and 2019 test years as compared to actual costs in 2016 and 2017 and further that, according to the latest updates, the forecast 2018 costs are lower than the proposed 2018 test year costs. The Board also notes that, based on Grant Thornton's calculations, the total costs per kWh have steadily increased since 2015.[84] The Board finds that Hydro has not proven that the proposed test year costs are consistent with least-cost reliable service.

Both Newfoundland Power and the Consumer Advocate submitted that the productivity allowance proposed by Hydro is not adequate in the circumstances. The Board notes that Hydro confirmed that the amount which was proposed was not based on any calculation. The Board calculates that it is less than 1% of Hydro's operating costs in each of the test years. Further the Board notes that the operational savings which have already been identified in relation to the work of the Innovation and Productivity Team initiative are approximately $500,000 for 2018 and $700,000 for 2019. Because this team was only established in 2018 it is difficult at this stage to assess the impact that this initiative will have on operational costs in the short-term, although the Board notes that the Execution Plan for 2018/2019 set out that one of the deliverables was the identification of initiatives/efficiencies that would produce long-term sustainable savings of $5.0 million or greater.[85] The Board believes that this initiative should result in more savings on an ongoing basis than provided for in the proposed productivity allowance.

The Board finds that, considering the levels of operational costs in the years since Hydro's last test year, the latest information with respect to actual costs for 2018 and the potential reductions associated with the ongoing work of the Innovation and Productivity Team initiative, it is appropriate to require reductions in the proposed operating costs for the 2018 and 2019 test years. The Consumer Advocate suggested a reduction of $3.9 million for the 2018 test year and $5.3 million for the 2019 test year to effectively freeze labour costs at the level approved for the 2015 test year. Newfoundland Power suggested a productivity allowance of at least 3% of operating

[83] Order No. P.U. 49(2016), page 53.
[84] Grant Thornton Financial Consultants Report, December 4, 2017, page 50.
[85] Undertaking #65, Attachment 1, page 6.

costs for each of the test years, or approximately $4.2 million. In Hydro's last general rate application the proposed 2015 test year operating costs were reduced by approximately $6.8 million as a result of the Board's findings.[86] The Board notes that the proposed 2019 test year operating costs are approximately $21.4 million higher than 2016 actual and $15.1 million higher than 2017 actual.[87] In addition the proposed 2018 test year operating costs are approximately $5.4 million higher than the updated 2018 forecast, and this does not reflect the removal of the Business Systems Transformation Program costs in accordance with the Settlement Agreements. Considering Hydro's recent efforts related to cost control and efficiency and the actual and forecast operating costs since Hydro's last test year, the Board is satisfied that the 2018 and 2019 test year operating costs should be reduced by an additional $4.0 million dollars.

Short-Term Incentive Payments

The proposed operating costs for the 2018 and 2019 test years reflect forecast performance contract payments in the amount of $829,852 and $856,029, respectively. This is more than double the amount that Hydro proposed to include in the 2015 test year of approximately $400,000. According to Hydro this increase is largely the result of the organizational changes introduced in 2016 and the increased number of employees covered by the short-term incentive plan.

In Order No. P.U. 49(2016) the Board found that the costs related to Hydro's short-term incentive plan should be removed from the proposed test year costs. The Board stated:

> Before the costs of any such plan are reflected in rates Hydro will have to demonstrate that the plan provides incentives for the provision of least-cost reliable power and provides a demonstrable benefit to ratepayers.[88]

The Board found that the plan at that time did not place enough emphasis on reliability and customer satisfaction while the financial performance of both Hydro and Nalcor were given significant weight. Since the last general rate application Hydro has made changes to the short-term incentive plan such that it is now focused only on Hydro measures of performance related to safety, reliability, financial/cost management, integration of Muskrat Falls assets and regulatory.

The Board continues to believe that the costs of an incentive plan may be reasonable and prudent costs which should be reflected in rates where it is shown that the plan provides a demonstrable benefit to ratepayers. While Hydro has made improvements to its short-term incentive plan the onus is on Hydro to show that the proposed expenditures are reasonable and should be recovered from ratepayers. The Board notes that the proposed payments include 100% of the incentives related to Hydro's financial and regulatory performance. The Board continues to believe that the recovery of 100% of the incentives related to financial and regulatory performance from ratepayers is not appropriate.[89] Further, the Board is not satisfied based on the evidence that the proposed expenditures provide a demonstrable benefit to ratepayers with respect to electricity rates, customer service and satisfaction and safe and reliable operations. The Board will require that the

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[86] Application, Volume I, page 3.36, Table 3-18 and Order No. P.U. 49(2016). In addition in Order No. P.U. 7(2002-2003) the Board ordered a productivity allowance of $2.0 million.
[87] PUB-NLH-187, Attachment 1.
[88] Order No. P.U. 49(2016), page 46.
[89] In Order No. P.U. 49(2016) the Board stated that customers should not be required to pay all of the costs associated with incentives related to financial performance.

proposed forecast performance contract payments be removed from the revenue requirement for the 2018 and 2019 test years.

Other Issues

In relation to the suggestion by the Industrial Customer Group that there should be increased reporting with respect to the Innovation and Productivity Team initiative the Board does not believe that this is necessary or appropriate. The Board's role is not to manage the utility but to ensure that the utility is being managed so that power is delivered consistent with the power policy of the province which includes the provision of least-cost reliable service. The regulatory framework provides for the general supervision of a utility and a full review of operational costs through the general rate application process. The Board believes that requiring reporting with respect to the Innovation and Productivity Team would add unnecessarily to Hydro's regulatory burden.

In relation to the issue raised by Newfoundland Power related to the process to be followed for projects similar to the Business Systems Transformation Program the Board notes that this project is currently the subject of a separate proceeding before the Board and that this issue may be more appropriately addressed in that proceeding.

Settlement Agreements

The Board finds that the agreement of the parties with respect to the matters related to the operating costs in the 2018 and 2019 test years, including the vacancy allowance, the accounting treatment and methodology for calculation of employee future benefits as well as the deferral of the Business Systems Transformation Program costs and the recovery of external regulatory costs, is reasonable and justified based on the evidence. The Board notes that the agreement to increase the vacancy allowance based on 55 FTEs rather than 40 as proposed in the Application is consistent with the actual vacancies in 2017 of 60.[90] Further the deferral of external regulatory costs is consistent with past practice and the deferral of the Business Systems Transformation Program costs allows for a full review of these costs. The Board accepts the proposals in the Settlement Agreements with respect to these issues.

In terms of the proposed external regulatory costs of $1.7 million, the Board is satisfied that the proposed costs are reasonable and that these costs should be recovered as proposed in the Settlement Agreements.

Conclusion Operating Costs

Hydro's proposal to recover external regulatory costs in the amount of $1.7 million is accepted.

The settlement proposals in relation to the proposed accounting treatment and methodology for calculation of employee future benefits, the number of vacancies, the deferral of the Business Systems Transformation Program costs and the recovery of the external regulatory costs are accepted.

[90] Undertaking #18.

Hydro will be required to revise the proposed operating costs to be included in the 2018 and 2019 test year revenue requirements to reflect:

i) a reduction of $4.0 million in each of the 2018 and 2019 test years; and

ii) the removal of the proposed performance contract payments in each of the 2018 and 2019 test years.

9.4 Depreciation, CIAC and Other

The Application proposed Depreciation, CIAC and Other costs of $87.1 million and $92.5 million for the 2018 and 2019 test years.[91] According to the Application these costs have increased from the 2015 test year primarily as a result of an increase in depreciation costs associated with capital additions of $753.7 million in 2018 and $168.3 million in 2019 as well as an increase of $2.1 million in other costs related to an inventory allowance associated with the Holyrood Thermal Generating Station. The increase was partially offset by reductions associated with the depreciation study by Concentric Advisors relating to plant in-service as of December 31, 2015, as well as the asset retirement obligation at Holyrood.[92]

Grant Thornton confirmed that the main reason for the forecast increase in depreciation in 2018 and 2019 is associated with capital additions since the 2015 test year, partially offset by a reduction associated with the new depreciation study. Grant Thornton explained that the overall expected impact on the revenue requirement for the test years as a result of the changes described in the depreciation study is a reduction of approximately $2.5 million. With respect to the depreciation study recommendations Grant Thornton confirmed that the use of a group method which would result in the inclusion of a loss on asset disposal costs in depreciation expense and of asset removal costs in depreciation rates are both consistent with International Financial Reporting Standards ("IFRS"). Grant Thornton commented that, while both the Average Service Life and Equal Life Group depreciation methods are used by regulated utilities and are consistent with the requirements of IFRS, employing the use of both dependent on asset acquisition date does not appear to be in accordance with IFRS. Grant Thornton also noted that there was an error in the 2019 test year depreciation expense related to Holyrood accelerated assets which would have an impact of $800,000 which Hydro intends to correct in the compliance filing.[93] Grant Thornton also noted that for the 2018 test year there was a discrepancy related to the truncation date for several Holyrood assets and further with respect to the 2017 forecast there was an error in the depreciation calculation for a particular asset. According to Grant Thornton these discrepancies were being evaluated by Hydro.

The Settlement Agreements set out the parties' agreement with respect to the proposed Depreciation, CIAC and Other expenses as follows:

> Hydro's proposed accounting treatment and calculation of Asset Retirement Obligations in the 2018 and 2019 Test Years should be approved.

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[91] Application, Volume I, page 4.6, Table 4-5.

[92] The recommendations of the depreciation study conducted by Concentric Advisors relating to plant in service as of December 31, 2015 included, use of updated estimates of service lives, use of Average Service Life Group procedure applied on a remaining life basis for assets acquired prior to 2015, use of Equal Life Group procedure applied on a remaining life basis for assets acquired in 2015 and after, inclusion of asset removal costs in depreciation rates, and inclusion of loss on asset disposal costs in depreciation rates.

[93] Grant Thornton Financial Consultants Report, December 4, 2017, page 33. At the time of the Grant Thornton report Hydro had not confirmed whether the error was an understatement or overstatement of depreciation.

With respect to depreciation expense the following, which results in reductions in the 2018 and 2019 Test Years' revenue requirements of approximately $10.1 million and $8.9 million, respectively is agreed:

a. Hydro will continue to use the Average Service Life Group methodology applied on a deemed cost basis for assets put into service in 2015 and earlier and a whole life basis for assets put in service after 2015 to calculate depreciation expense in the Test Years.
b. the proposed updated estimates of service lives of assets included in the Application, including the revised truncation date for the Holyrood Plant, are appropriate and should be used in the calculation of depreciation expense in the Test Years.
c. net salvage costs and asset removal costs for assets where assets are not replaced in the same location should be included in depreciation rates. For the calculation of the appropriate asset removal costs to be included in depreciation rates the units of property listed in Schedule A attached should not be included and the removal costs to be included in depreciation expense associated with the units of property listed in Schedule B should be at the rate of - 5%.
d. Gains/losses on retirements will be recovered through accumulated amortization and not recorded on the Income statement.

Hydro's proposal to record an inventory allowance of approximately $2.1 million in each of the Test Years associated with the Holyrood Plant shall be withdrawn.[94]

In Order No. P.U. 48(2018) arising from 2018 Cost Deferral and Interim Rates Application the Board approved a 2018 Cost Deferral Account providing for the deferral of the 2018 depreciation expense differential between Hydro's existing depreciation expense methodology and the depreciation methodology as provided for in the Settlement Agreements.

In its submission Newfoundland Power stated that, in accordance with the settlement proposals, the Board should approve the proposed changes in Hydro's depreciation methodology and that Hydro's 2018 and 2019 test year revenue requirements be reduced accordingly. Newfoundland Power further submitted that, if the depreciation methodology is approved, the Board should order that the 2018 Cost Deferral Account be eliminated. Newfoundland Power also noted that Hydro's proposal to record an inventory allowance of approximately $2.1 million in each of the test years should be withdrawn as agreed.

The Industrial Customer Group submitted that the settlement recommendations related to depreciation are supported by expert evidence and that, in particular, its experts supported the transition to group accounting as proposed by Hydro which was also driven in part by directions of the Board in Order No. P.U. 40(2012).

In its submission Hydro noted the agreement of the parties with respect to depreciation methodology and fuel inventory and recommended the acceptance of the Settlement Agreements. The Board notes that the proposals in the Settlement Agreements with respect to depreciation result in estimated revenue requirement reductions in the 2018 and 2019 test years of approximately $10.1 million and $8.9 million, respectively.[95] The Board believes that the depreciation proposals set out in the Application, as amended by the Settlement Agreement proposals, are supported by the evidence and are reasonable in the circumstances. In relation to the discrepancies identified by Grant Thornton in its review, including consistency with IFRS, Hydro should address these items

[94] Settlement Agreement, page 2, paragraphs 8, 9 and 21.
[95] Supplemental Evidence – Customer Impacts Reflecting the 2017 GRA Settlement Agreement, page 7.

with a full explanation in its compliance filing. Hydro should also address the close out of the 2018 Cost Deferral Account approved in Order No. P.U. 48(2018).

The Board notes that the proposals in the Settlement Agreements with respect to the removal of the proposed inventory allowance relating to Holyrood would result in a reduction of approximately $2.1 million for each of the test years. The Board believes that the agreement of the parties with respect to the removal of the proposed inventory allowance is reasonable in the circumstances and should be approved.

The settlement proposals in relation to depreciation and the inventory allowance for the Holyrood Thermal Generating Station are accepted.

Hydro will be required to address the disposition of the 2018 Cost Deferral Account and the issues related to depreciation identified by Grant Thornton.

9.5 Interest and Debt Guarantee Fee

The Application proposed interest in the amount of $94.8 million for the 2018 test year and $96.8 million for the 2019 test year. The forecast interest is primarily made up of long-term debt costs and the debt guarantee fee.[96]

The Settlement Agreements set out the following agreement of the parties with respect to the proposed interest costs:

> (a) Hydro shall reduce the amounts included in the Test Years related to the debt guarantee fee paid to the Government of Newfoundland and Labrador to:
> (i) adjust the fee on long-term debt issues to be consistent with the recovery of such fee approved in Hydro's 2013 Amended General Rate application proceeding which results in a reduction of $567,000 in the 2018 Test Year and $672,000 in the 2019 Test year revenue requirements; and
> (ii) reduce interest costs to reflect savings of $515,000 in the 2018 Test Year and $529,000 in the 2019 Test Year associated with Hydro borrowing from the Government and not in the capital markets as forecast in the Application.
> (b) The inclusion in the revenue requirement of a guarantee fee on debt borrowed by Hydro from the Government of Newfoundland and Labrador remains an issue and shall be addressed during the hearing of the Application.[97]

As set out in the Settlement Agreements the parties did not resolve the issue of the inclusion in revenue requirement of the proposed guarantee fee related to the recent debt issued by Hydro to Government. In 2017 and 2018 Hydro borrowed funds directly from the Province of Newfoundland and Labrador.[98] This differed from the previous debt issuances which involved Hydro borrowing in the capital markets with a guarantee from Government. During the hearing Ms. Hutchens explained that this new approach was anticipated to generate a seven basis point average savings but that the savings had not been reflected because the Application was already filed when the debt was issued. Ms. Hutchens explained that, while Hydro had done some analysis in relation to the difference in interest costs with the new approach to borrowing, there was no

[96] Application, Volume I, Schedule 4-II, page 8 of 9.
[97] Settlement Agreement, page 3, paragraph 12.
[98] Approved in Order No. P.U. 42(2017).

evaluation of the fee associated with the borrowing as it is difficult to do in the absence of a credit rating for Hydro apart from government.[99] Hydro explained its view as follows:

> The debt guarantee fee expense is the same whether the funds are borrowed directly from the capital markets versus Government borrowing in the capital markets and lending the proceeds to Hydro. The fall 2017 and the 2018 debt issuances result in debt guarantee fee expenses of $2,000,000 in the 2018 Test Year and $3,250,000 in the 2019 Test Year. The corresponding amounts included in the Test Year revenue requirements, net of the disallowed portion, is $865,000 in the 2018 Test Year and $1,377,500 in the 2019 Test Year.[100]

Hydro provided correspondence from the Province of Newfoundland and Labrador, dated after the debt issuance, which set out that a guarantee fee was authorized and required for debt on-lent to Hydro under the authorization of OC2017-347, calculated using the same terms and condition as presented under OC2011-218.[101] The letter stated that OC2017-347 authorizes the Government to provide Hydro with funding on such terms and conditions as to form, rates of interest, and terms to maturity as the Minister of Finance may determine, on a cost recovery basis.

In its submission Newfoundland Power stated that a debt guarantee fee on amounts borrowed directly from the Provincial Government is neither authorized nor required, and should therefore not be recovered from Hydro's customers. According to Newfoundland Power the proposed debt guarantee fee should be reduced by the amount attributable to debt directly borrowed from the Provincial Government.[102]

The Industrial Customer Group affirmed their support of the parties' agreement relating to the reduction in the amounts to be included in the test years but did not comment on fees related to amounts borrowed directly from the Provincial Government.[103]

Hydro explained that debt guarantee fees of up to 1% are commonplace among Canada's regulated utilities and noted two Crown utilities that pay a fee of 1% and another that pays a fee of 0.65%. Hydro submitted that the inclusion of a debt guarantee fee in revenue requirement of an amount as determined by the method set out in the Settlement Agreement remains reasonable and should be approved.[104] Hydro stated:

> The form of the borrowing is not the essential nature of the value passing under the Debt Guarantee Fee; the value stems from the Province making its credit rating and borrowing ability available to Hydro, thus providing the opportunity for lower borrowing costs to Hydro and, therefore, its customers. The obligation to pay the fee has not changed since the last hearing.[105]

The Board notes that no issues were raised related to the proposed interest costs except as set out in the Settlement Agreements. In the Settlement Agreements the parties agreed that Hydro will revise the proposed interest costs to reflect the savings associated with borrowing directly from

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[99] Transcript, July 26, 2018, pages 156/15 to 160/11.
[100] Undertaking #90.
[101] Undertaking #78, Letter from Deputy Minister of Finance dated March 29, 2018.
[102] Newfoundland Power Submission, page D-10.
[103] Industrial Customer Group Submission, pages 6/16 to 7/5.
[104] Hydro Submission, page 25; CA-NLH-131, Table 1.
[105] Hydro Submission, pages 24- 25.

Government and to reflect the calculations of the guarantee fee, in accordance with the Board's previous orders.

As noted by the Board in Order No P.U. 49(2016) a guarantee fee has been paid to the Province for most of the last 20 years, with the amount of the fee based on 1% of Hydro's outstanding debt obligations. The Board explained:

> The Board has in the past accepted the essential role that the Government guarantee plays in Hydro's ability to maintain a sound credit rating in the financial markets of the world and to borrow at reasonable rates. While Hydro's debt ratio has recently improved somewhat it does not approach the level normally associated with stand-alone status. The evidence shows that Hydro's DBRS long-term debt rating of "A" continues to be a flow through of the rating of the province. In the circumstances the Board continues to believe that the Government guarantee plays a key role in supporting Hydro's ability to maintain a sound credit rating and access to capital at reasonable rates. The Board is satisfied that the guarantee serves to support least cost reliable service by increasing access to and flexibility in financing of Hydro's operating and capital requirements at reasonable rates. The Board finds that the Government guarantee provides a benefit to ratepayers and therefore it is appropriate to include an amount in the 2015 test year revenue requirement which reflects the reasonable costs and benefits associated with the guarantee.[106]

The Board accepts that the guarantee fee amounts included in revenue requirement related to the guarantee provided by Government for the debt issued by Hydro in the capital markets provides a benefit to ratepayers and that the proposed amounts as amended by the Settlement Agreements are reasonable and consistent with the previous findings of the Board.

In terms of the debt issued by Hydro directly to Government in 2017 and 2018, the Application proposed to include the associated debt guarantee expenses in the 2018 and 2019 test year revenue requirement. The parties did not agree with the recovery of these expenses. The Board also has concerns related to the recovery of these amounts. Unlike previous debt issuances Hydro did not go to the capital markets for financing with the support of a Government guarantee, but rather borrowed directly from Government. The Board believes that these circumstances distinguish it from the guarantee fee paid in Hydro's previous financing arrangements. While the Board has previously found that the guarantee played a key role in supporting Hydro's ability to maintain a sound credit rating and access to capital at reasonable rates, in this case Hydro did not receive a guarantee and did not access the capital markets. Further, while Hydro has in the past provided evidence supporting the amount of the guarantee fee and value to ratepayers, it did not do so in this case. The Board believes that, before such fees are included in revenue requirement, Hydro must demonstrate such value. In addition the Order-in-Council which authorizes and directs the Government's loan to Hydro sets out that the terms and conditions as to form, rates of interest and terms to maturity which are to be on a cost recovery basis may be established by the Minister.[107] Hydro did not address how this direction provides authority with respect to charging a guarantee fee. The letter which authorizes and requires the fee was dated after the debt was issued and does not set out that the fee is to provide for recovery of costs. In the circumstances the Board does not accept that it is appropriate to include an amount in the 2018 and 2019 test years for a guarantee fee on borrowings by Hydro from the Government of Newfoundland and Labrador in 2017 and 2018.

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[106] Order No. P.U. 49(2016), pages 58-59.
[107] OC2017-347.

The settlement proposals in relation to interest and the guarantee fee are accepted.

Hydro will be required to reduce the 2018 and 2019 test year revenue requirements to reflect the exclusion of the proposed amounts for a guarantee fee related to the 2017 and 2018 debt issuances to the Government of Newfoundland and Labrador.

9.6 Conclusion 2018 and 2019 Test Year Costs

The Board concludes that the proposed 2018 and 2019 test year revenue requirements should be adjusted to reflect the findings of the Board in this Decision and Order, including the disallowances in relation to operating costs and the debt guarantee fee.

Hydro will be required to file revised proposals for its 2018 and 2019 test year revenue requirements to reflect the findings of the Board in this Decision and Order.

10.0 Average Rate Base and Return on Rate Base for 2018 and 2019 Test Years

Hydro's rate base is comprised of its investment in capital assets in use, unamortized balances of deferred charges, fuel inventory, materials and supplies inventory and cash working capital allowance. The average rate base was forecast to be $2,263.1 million for the 2018 test year and $2,364.5 million for the 2019 test year.[108] This compares to the 2015 test year average rate base of $1,785.4 million. The increase is primarily due to capital additions for the period from 2016 to the 2018 test year, which included the addition of a 230 kV transmission line from Bay d'Espoir to Western Avalon.

In its submission Hydro requested that, for the purposes of calculating Hydro's test year, subject to change following the Board's final order and its compliance application, the Board approve:

a) for 2018 an estimated forecast average rate base of $2,244,455,753, and an estimated rate of return on rate base of 5.45% in a range of 5.25% to 5.65%; and
b) for 2019 an estimated forecast average rate base of $2,335,231,298, and a rate of return on rate base of 5.45% in a range of 5.25% to 5.65%.[109]

10.1 Rate Base Methodologies

Hydro engaged Christensen Associates Energy Consulting ("CA Energy") to review the practices used by other utilities to establish rate base and provide recommendations or changes, if required, to Hydro's average rate base methodology. CA Energy recommended that Hydro continue to use beginning-of-year and end-of-year averaging for capital assets in service and 13-month averages for fuel, materials and supplies, and deferred charges. CA Energy also recommended that significant capital additions be included in both the opening and closing rate base for rate setting purposes. Hydro proposed this change, stating that this approach was consistent with the Board's direction regarding the inclusion in rate base of the Holyrood gas turbine in Order No. P.U. 49(2016).[110] CA Energy also reviewed Hydro's working capital methodology and did not recommend any changes.

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[108] Application, Volume I, page 4.8
[109] Hydro Submission, page 63.
[110] Application, Volume I, page 4.12.

As part of the Settlement Agreements the parties agreed to the following:

> Hydro shall continue to use the currently approved method to determine rate base, including beginning-of-year and end-of-year averaging for capital assets in service. Hydro may apply to the Board for a different treatment of significant capital additions on a case-by-case basis.
>
> Hydro shall continue to use the currently approved working capital methodology with the updated net lag days as proposed in the Application.[111]

The settlement proposal in relation to the continued use of the currently approved methodology to determine rate base, including beginning-of-year and end-of-year averaging for capital assets in service, is accepted.

The settlement proposal in relation to the continued use of the currently approved working capital methodology is accepted.

10.2 Capital Assets in Rate Base

Since the Application was filed the forecast of capital assets to be included in Hydro's 2018 and 2019 test year average rate base has changed as a result of ongoing capital programs and subsequent Board orders.[112]

In Order No. P.U. 43(2017), approving Hydro's 2018 Capital Budget, the Board deferred consideration of the proposed two-year Muskrat Falls to Happy Valley Interconnection project on the basis that the evidence did not demonstrate it was necessary and consistent with the provision of least cost service. The project was again deferred in Order No. P.U. 9(2018) pending further information to be provided by Hydro.

The Settlement Agreements set out the following agreements in relation to this project:

> The Parties agree to the following in relation to the Muskrat Falls to Happy Valley Interconnection Capital Project (the "MF-HV Project"):
>
> a. Exclusion of the MF-HV Project from Hydro's rate base in the 2018 Test Year and in the calculation of depreciation expense for the 2018 Test Year;
> b. Inclusion of the MF-HV Project in Hydro's closing rate base for the 2019 Test Year if approved by the Board for construction to be completed in 2019 prior to Hydro's 2017 GRA Compliance Filing;
> c. If, at the time of the Hydro's 2017 GRA Compliance Filing, the MF-HV Project is not approved by the Board for construction to be completed in 2019, the Parties agree the MF-HV Project will be excluded from the 2019 Test Year rate base; and
> d. Exclusion of depreciation associated with the MF-HV Project in the calculation of 2019 Test Year revenue Requirement.[113]

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[111] Settlement Agreement, page 3, paragraphs 13 and 14.

[112] Order Nos. P.U. 43(2017) and P.U. 5(2018) approved a 2018 Capital Budget of $181,193,700. Supplementary 2018 capital expenditures were approved in Order Nos. P.U. 6(2018), P.U. 25(2018), P.U. 28(2018), P.U. 33(2018) and P.U. 38(2018). Order No. P.U. 29(2018) addressed the inclusion of certain expenses in excess of the approved 2016 and 2017 Allowance for Unforeseen Items in the 2016 and 2017 rate base. Hydro's 2019 Capital Budget of $116,140,700 was approved in Order No. P.U. 46(2018).

[113] Labrador Settlement Agreement, page 2, paragraph 7.

In Order No. P.U. 9(2019) the Board approved the project in the amount of $12,586,400 in 2019 and $7,392,100 in 2020.

In its submission Hydro advised that the customer impact of the inclusion of the Muskrat Falls to Happy Valley Interconnection project would not be known until its compliance application pending the Board's determination on the approval of the project. Hydro also advised that it intends to reflect an updated forecast of capital assets to be included in its forecast 2018 and 2019 test year average rate base in its compliance application.[114]

The Board accepts the proposals in the Settlement Agreements with respect to the exclusion of the Muskrat Falls to Happy Valley Interconnection project in the forecast 2018 test year rate base. The project was approved in Order No. P.U. 9(2019) as a multi-year project with expenditures contemplated in both 2019 and 2020. Consistent with regulatory principles this project should only be included in the 2019 test year rate base upon meeting the test of being used and useful by the end of 2019. As part of its compliance filing Hydro should set out clearly the basis on which it has assessed whether the Muskrat Falls to Happy Valley Interconnection project should be included in the 2019 test year rate base. The 2018 and 2019 test year average rate base should also be revised to reflect subsequent Board orders since the Application as well as updated information for capital expenditures incurred in 2018 and forecast for 2019.[115]

The forecast average rate base for the 2018 test year will be updated to reflect subsequent Board orders and the 2018 capital expenditures as outlined in the *2018 Capital Expenditures and Carryover Report,* excluding the Muskrat Falls to Happy Valley Interconnection project.

The forecast average rate base for 2019 will be updated to reflect subsequent Board orders and the most current 2019 capital expenditure forecast.

10.3 Excess Earnings Account

In Order No. P.U. 49(2016) the Board ordered Hydro to file a revised excess earnings account definition to reflect a range of return on rate base of ± 20 basis points.[116] In the Application Hydro proposed a definition for the excess earnings account which continued to be based on an allowed range of ± 20 basis points.

In the Settlement Agreements the parties agreed that "The definition of the Excess Earnings Account proposed in the Application should be approved."[117]

The Board accepts that, given circumstances for the Application with respect to Hydro's capital structure and return on equity for rate setting, the existing range of return on rate base of ± 20 basis points approved in Order No. P.U. 49(2016) continues to be appropriate.

The settlement proposal to approve the proposed definition of the Excess Earnings Account is accepted.

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[114] Hydro Submission, page 16.
[115] Hydro Submission, page 16.
[116] The range of ± 20 basis points represented an increase from +/- 15 basis points approved in Order No. P.U. 8(2007) and was proposed by Hydro to reflect the changes in Hydro's capital structure and the new approach to setting the return on equity.
[117] Settlement Agreement, page 4, paragraph 23.

10.4 Forecast Rate Base and Rate of Return on Rate Base for 2018 and 2019

In its submission Hydro advised that during the course of the proceeding its cost of debt has decreased, resulting in a decrease in the 2018 rate of return on rate base. Hydro proposed to update the 2018 and 2019 test year cost of debt in its compliance filing to reflect Hydro's actual long term debt issuances in 2017 and 2018 and its planned borrowing.[118]

The Board agrees that the rate of return on rate base and the average rate base calculations should be updated given the timeframe covered by the proceeding, the changes noted by Hydro and the Board's findings in this Decision and Order. Hydro will be required to file a revised calculation of its 2018 and 2019 test year forecast average rate base and rate of return on rate base.

Hydro will be required to file a revised 2018 and 2019 test year forecast average rate base and rate of return on rate base for rate setting purposes to reflect the findings of the Board in this Decision and Order.

11.0 Cost of Service

The costs incurred by Hydro associated with the provision of electrical service are recovered from its customers based on a cost of service methodology. The cost of service methodology establishes how test year costs are allocated to each customer class to be recovered in rates. The existing methodology was approved by the Board in 1993 following a generic cost of service hearing.

In its 2013 general rate application Hydro proposed to conduct a cost of service methodology review prior to its next general rate application. The settlement agreements to the 2013 general rate application set out the scope of the cost of service methodology review and required Hydro to file a Cost of Service Review report by March 31, 2016. Hydro filed its report *Cost of Service Methodology Review* on March 31, 2016, which assumed that the supply costs from the Muskrat Falls Project would be reflected in the 2019 costs for the full year. The delay in the commissioning of the Muskrat Falls Project removed the requirement for these costs to be recovered through the 2017 general rate application filing and prompted Hydro to propose a delay in the planned review of the cost of service methodology until after its next general rate application. The Board accepted Hydro's proposal but required Hydro to advise as to its plans for the cost of service methodology review as part of its next general application.

The cost of service proposed in the Application materially reflects the existing approved cost of service methodology. Several issues were identified by Hydro as requiring a decision, including:

- i) the Corner Brook Pulp and Paper Generation Credit Pilot Project;
- ii) the assignment of the frequency converter to Corner Brook Pulp and Paper as a specifically assigned asset;
- iii) the methodology of allocating operating and maintenance costs to specifically assigned assets;
- iv) the demand and energy classification of wind purchases; and
- v) a further review of the rural deficit allocation methodology.

[118] Hydro Submission, page 18.

In the Settlement Agreements the parties agreed to several cost of service and rate design issues for the 2018 and 2019 test years as follows:

> The assignment of assets as common or specifically assigned as proposed in the Application and amended by a report from Hydro dated December 21, 2017, with the exception of the assignment of the frequency converter as specific, should be approved.
>
> The revenue requirement method to allocate the rural deficit between Newfoundland Power and the Labrador Interconnected system approved by Order No. P.U. 49(2016) should continue to be applied.[119]
>
> Hydro has stated in this proceeding that in preparation for the implementation of customer rates reflecting the costs of the Labrador-Island interconnection, it will file with the Board an application no later than November 15, 2018 for a Cost of Service and Rate Design Methodology Review and the Parties agree that the Board should in its Order direct Hydro to file this applications by the date set out by this paragraph.[120]
>
> The Parties agree on the cost of service methodologies in Exhibit 14 (2018 Test Year Cost of Service) and Exhibit 15 (2019 Test Year Cost of Service) with respect to:
> a. the classification of wind energy purchases as 100% energy related;
> b. the specific assignment of the frequency converter to Corner Brook Pulp and Paper (CBPP) Limited;
> c. the 2017 GRA proposed methodology for determining the test year operating and maintenance costs to be recovered through specifically assigned charge to Industrial Customers; and
> d. the functionalization of transmission assets TL 267 as 100% demand related.
>
> The Parties agree that the generation credit agreement between Hydro and Corner Brook Pulp and Paper Limited which was approved on a pilot basis by the Board in Order No. P.U. 4(2012) should be continued on a pilot basis.[121]
>
> The parties agree that the cost of service methodology proposed in the Expected Supply Scenario should be used to allocate costs to customer groups for the 2018 and 2019 Test Years.[122]

The settlement proposals in relation to cost of service are accepted.

12.0 Rates, Rules and Regulations

12.1 Rates

The Settlement Agreements set out the following with respect to Newfoundland Power's Wholesale Rate design:

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[119] Settlement Agreement, page 3, paragraphs 15 and 16.
[120] Settlement Agreement, page 5, paragraph 25. The Board confirmed the requirement for the filing by letter to Hydro on October 23, 2018. Hydro filed its Cost of Service Methodology Application, including a *2018 Cost of Service Methodology Review Report*, on November 15, 2018.
[121] Supplemental Settlement Agreement, page 2, paragraphs 7 and 8.
[122] Supplemental Settlement Agreement, page 4, paragraph 15.

The Parties agree that:

a. Newfoundland Power's demand charge will equal $5.00 per kW of billing demand.
b. The sizing of Newfoundland Power's first block energy component will be determined in consultation with Newfoundland Power prior to the filing of Hydro`s 2017 GRA Compliance Filing.
c. Newfoundland Power's approved 2019 Test Year revenue requirement not recovered through the demand charge and the end-block energy charge will be used to compute the first block energy charge.
d. Newfoundland Power's end-block firm energy rate for use in Hydro's 2017 GRA Compliance filing will be determined based on the most current fuel rider forecast (either March or September) divided by the approved 2019 Test Year Holyrood No. 6 fuel conversion rate and expressed on a cent per kWh basis.
e. The wholesale rate will continue to include the Generation Credit and Curtailable Credit in computation of the billing demand of Newfoundland Power.
f. The Generation Credit will equal 118,054 kW for the 2018 Test Year and the 2019 Test Year.[123]

With respect to Labrador rates and billings the following was agreed:

> The current rate design for the Labrador Industrial Transmission Rate should continue to apply and the proposed changes in the Application shall not be implemented in this proceeding.[124]
>
> The Parties agree that IOC is eligible for a billing credit from Hydro if monthly Labrador Industrial firm load requirements exceed the approved 2019 Test Year forecast more than 10 MW as a result of Tacora's operation of Wabush Mines (hereinafter referred to as "Test Year Power on Order"). If Test Year Excess Power on Order occurs in 2019, the billing credit to IOC would be equal to the monthly firm demand charges resulting from Excess Power on Order. The billing credit would not apply to billings associated with interruptible load. Any billing credit will be applied on a quarterly basis.[125]

The settlement proposals in relation to i) Newfoundland Power's rate design, ii) the continuation of the current Labrador Industrial Transmission Rate, and iii) the billing credit to IOC are accepted.

In Order No. P.U. 26(2018) the Board approved the sale of the Corner Brook Frequency Converter to Corner Brook Pulp and Paper Limited. In its submission the Industrial Customer Group advised that the sale of the converter has been completed, resulting in a reduction of the specifically assigned charge to $11,458.[126] The Industrial Customer Group submitted that final rates for 2019 should reflect the sale of the Corner Brook Frequency Converter.

In its final submission Hydro requested approval of the existing interim specifically assigned charge of $11,458 for Corner Brook Pulp and Paper Limited, which reflects the sale of the Corner Brook Frequency Converter. The Board agrees that final rates for 2019 should reflect the sale of

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[123] Supplemental Settlement Agreement, page 3, paragraph 9.
[124] Settlement Agreement, page 4, paragraph 17.
[125] Labrador Settlement Agreement, page 3, paragraph 10.
[126] This specifically assigned charge was approved on an interim basis in Order No. P.U. 48(2018) arising from Hydro's application seeking approval of changes to Industrial customer rates on an interim basis.

the Corner Brook Frequency Converter to Corner Brook Pulp and Paper Limited and accepts Hydro's proposed specifically assigned charge for Corner Brook Pulp and Paper Limited.

Hydro's final rates for 2019 should reflect the sale of the Corner Brook Frequency Converter to Corner Brook Pulp and Paper Limited.

12.2 Rules and Regulations

The Application proposed the following changes to Hydro's Rules and Regulations:

(i) Section 9(b) will be revised to be consistent with Newfoundland Power and remove the requirement of payment in advance for temporary service charges.

(ii) Section 9(c) will be revised to be consistent with Newfoundland Power and remove the requirement of payment in advance for special facilities.

(iii) Section 16(a) will be revised to permit automatic rate changes for the Burgeo School and Library, consistent with rate changes approved from Newfoundland Power's customers.

In the Settlement Agreements the parties agreed to the following with respect to the Rules and Regulations:

> The Proposed changes to sections 9(b), 9(c) and 16(a) of the Rules and Regulations for service to rural customers should be approved effective the date that new rates from the Application are implemented.[127]

The Application also proposed a change to the Rural Rate Alteration component of the RSP which was agreed to by the parties in the Settlement Agreements as follows:

> The proposed change to calculation of the Rural Rate Alteration component to use Test Year data instead of actual billing data in the monthly calculations should be approved as of January 1, 2018.[128]

As required by Order No. P.U. 49(2016) the Application also addressed the issue of information regarding the rural deficit being included on its rural customers' bills. In the Settlement Agreements the parties agreed to the following:

> The consideration of whether information on the rural deficit should be included on customers' bills shall be deferred for consideration in a separate proceeding or a future Hydro general rate application.[129]

The settlement proposals in relation to the proposed changes to Hydro's Rules and Regulations, including the proposed change to the RSP Rules, are accepted.

The settlement proposal to defer consideration of whether information on the rural deficit should be included on customers' bills is accepted.

[127] Settlement Agreement, page 4, paragraph 19.
[128] Settlement Agreement, page 4, paragraph 18.
[129] Settlement Agreement, page 4, paragraph 20.

In its report Grant Thornton raised the question of whether the existing RSP rules allow for foreign exchange gains or losses to be reflected in inventory when converted to Canadian dollars from US dollars purchases. Grant Thornton recommended that, if the Board wanted to continue with the past practice to allow Hydro to flow foreign exchange losses and gains through the RSP upon consumption of fuel, the RSP rules be clarified to state that fuel costs converted to Canadian dollars include foreign exchange losses and gains.

In its submission Hydro requested a revision to the RSP rules clarifying that No. 6 fuel costs in Canadian dollars reflect foreign exchange gains and losses. No other submissions were made on this issue.

The Board agrees that the RSP rules should be changed to clarify that foreign exchange losses and gains are reflected in the No. 6 fuel costs.

Hydro will be required to file revised RSP rules to clarify that No. 6 fuel costs in Canadian dollars reflect foreign exchange gains and losses.

13.0 Deferrals and Recovery Mechanisms

13.1 Deferred Supply Costs for 2015, 2016 and 2017

Hydro seeks approval for the recovery of the 2015, 2016 and 2017 balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account, and the Isolated Systems Supply Cost Variance Deferral Account. These supply cost deferral accounts were approved in Order No. P.U. 49(2016) effective January 1, 2015 with recovery of account balances to be addressed in an annual application for disposition of the balances. In Order No. P.U. 22(2017) the Board approved the account definitions and required a disposition application by March 31 of each year.

On October 11, 2017 Hydro filed an application for approval of, among other things, the recovery of the 2015 and 2016 balances in the supply costs deferral accounts totaling $42.2 million. In Order No. P.U. 39(2017) the Board dismissed the application, stating:

> In the Board's view the general rate application may be the most convenient forum to address the issues related to the recovery of the supply costs. This would permit the consideration of the issues in the context of additional information related to generation dispatch, hydrology and the factors affecting rates and account balances through the full range of processes available in a general rate application, including cross examination, and technical and settlement conferences.[130]

On March 29, 2018, in accordance with the requirement for an annual application for disposition of the account balances, Hydro applied to the Board for approval to defer 2015, 2016 and 2017 balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account and the Isolated Systems Supply Cost Variance Deferral Account. The net amount requested for deferral approval was approximately $65 million. Hydro proposed that recovery of any amounts approved be dealt with through its ongoing general rate application. In a letter to the parties on April 9, 2018 the Board advised that the timing and method for recovery of

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[130] Order No. P.U. 39(2017), page 3.

the 2015, 2016, and 2017 balances in the three supply deferral accounts would be addressed in Hydro's ongoing general rate application proceeding.[131]

13.1.1 Account Balances

In the Application Hydro discussed its operational philosophy, culture and reliability particularly as it related to the operation of standby generation incorporating the lessons learned from the power system outages in 2013, 2014 and 2015. According to Hydro the Energy Supply Cost Variance Deferral Account accumulated a significant balance of $58.8 million over the three-year period primarily as a result of substantial increases in Hydro's use of standby generation.

To assist in the review of the proposed balance in each deferral account Grant Thornton was asked to review and verify the data incorporated in the calculation reflected in the deferral account formulas. On May 2, 2018 Grant Thornton submitted its findings confirming that the amounts requested by Hydro, as summarized below, are in accordance with account definitions as approved in Order No. P.U. 22(2017).

Deferral Account	**2015**	**2016**	**2017**	**Total**
Holyrood Conversion Deferral	$3,582,048	$2,150,665	$4,163,799	**$9,896,512**
Isolated Systems Deferral	$0	$(2,186,570)	$(1,106,821)	**$(3,293,391)**
Energy Supply Deferral	$14,200,429	$24,462,996	$20,134,732	**$58,798,157**
Total	**$17,782,477**	**$24,427,091**	**$23,191,710**	**$65,401,278**

The Board also requested Liberty to review, among other things, the factors driving the balance of the Energy Supply Cost Variance Deferral Account. In its report Liberty did not recommend any specific disallowances for the period 2015-2017, stating:

> …Hydro's adoption of N-1 and the higher spinning reserve requirement simply reflected a practice in near-universal use in the industry. It is difficult to challenge the prudence of a decision that simply aligns one's practices with the rest of the industry. While critical of the failure to address costs at the time, we simply could not conclude with a reasonable degree of certainty that doing so would have led to a different decision, and this it is our opinion that the decision Hydro made fell within the range of alternatives a reasonable utility manager would consider.[132]

In its submission Hydro stated that "its approach to generation dispatch is consistent with the provision of least cost reliable service and is supported by Liberty's conclusion that Hydro's gas turbine costs are not imprudent."[133] Hydro also submitted that the evidence addressed the concerns raised by the Board in Order No. P.U. 39(2017) and that the supply costs were prudently incurred.

In its submission Newfoundland Power acknowledged that the 2013 and 2014 outages "put pressure on Hydro to improve its performance and that it may not have been unreasonable for Hydro to take a more conservative approach to reliability."[134] As a result Newfoundland Power

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[131] On April 1, 2019 Hydro filed its annual application for recovery of deferred 2018 supply costs of approximately $22.1 million. This application will be considered by the Board in a separate proceeding.
[132] Liberty Report: *Analysis of Hydro's Energy Supply Cost Variance Deferral Account*, June 22, 2018, pages 1-2.
[133] Hydro Submission, page 59.
[134] Newfoundland Power Submission, page E-3.

submitted that it has not challenged the reasonableness of the 2015, 2016 and 2017 gas turbine operating costs. Newfoundland Power noted however that “the information provided to date has not shown that the increased cost of maintaining the higher spinning reserve criteria strikes the appropriate balance of cost and reliability” and that it will explore this issue further through ongoing dialogue with Hydro.

In its reply submission Hydro noted that Newfoundland Power was the only party to comment on Hydro’s 2015 to 2017 deferred supply costs and reiterated that Newfoundland Power stated that it had not challenged the reasonableness of the 2015 to 2017 gas turbine operating costs. Hydro submitted that its deferred 2015, 2016, and 2017 supply costs should be approved for recovery as requested.

The Board has reviewed the evidence and is satisfied that the balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account and the Isolated Systems Supply Cost Variance Deferral Account, as set out above, are in accordance with the approved account definitions. The Board notes that Hydro has provided information in relation to its operational philosophy for generating unit dispatch and spinning reserve on the Island Interconnected System in 2015, 2016 and 2017, and that Liberty concluded that the associated costs were not imprudent. Newfoundland Power and the other parties did not challenge the reasonableness of these costs. The Board finds that the supply costs were prudently incurred and that the balances in the supply cost accounts should be approved for recovery from customers.

The balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account and the Isolated Systems Supply Cost Variance Deferral Account for 2015, 2016 and 2017 will be approved.

13.1.2 Allocation and Recovery of 2015, 2016 and 2017 Deferred Supply Costs

Of the total amount of approximately $65.4 million in 2015, 2016 and 2017 deferred supply costs Newfoundland Power is allocated approximately $60.1 million, including a credit of approximately $3.2 million in respect of the Isolated Systems Supply Cost Variance Deferral Account.

In the Settlement Agreements the parties agreed to the following with respect to allocation and recovery of the deferred supply costs in the Energy Supply Cost Variance and Holyrood Conversion Rate Deferral Accounts:

> The Parties agree that the deferred supply costs in the Energy Supply Cost Variance and Holyrood Conversion Rate Deferral Accounts of 2015, 2016 and 2017 as approved by the Board for recovery from customers (the “Approved Deferred Supply Costs”) will be allocated between customer classes in a manner consistent with the fuel cost allocation methodology used in the Rate Stabilization Plan (RSP). The allocation percentage will be based on the RSP energy allocators consistent with the year in which the Approved Deferred Supply Costs were incurred.
>
> The Parties agree that the Approved Deferred Supply Costs allocated to each of Newfoundland Power and Island Industrial customers will be recovered through rate riders determined separately for each customer class and computed reflecting a 20 month

> recovery period beginning with the effective date of the 2017 GRA final rates approved by the Board.[135]

With respect to the Isolated Systems Supply Cost Variance Deferral Account the parties agreed as follows:

> The Parties agree that Newfoundland Power's portion of the credit balance of the Isolated Systems Deferral Account as of December 31, 2017 should be calculated based on the proportion of the 2018 Test Year Rural Deficit allocated to Newfoundland Power.
>
> The Parties agreed that the Newfoundland Power credit from the Isolated Systems Deferral Account will be applied to reduce the 2018 Revenue Deficiency approved by the Board to be recovered from Newfoundland Power. [136]

There was also agreement as to the treatment of any cost allocated to Labrador customers arising from the recovery of these costs:

> The Parties agree that, consistent with the allocation methodology in the Rate Stabilization Plan, the net portion of the 2015, 2016 and 2017 deferred supply costs from the Isolated Systems Deferral Account, the Energy Supply Cost Variance Deferral Account, and the Holyrood Conversion Rate Deferral Account allocated to Labrador as of December 31, 2017 (approximately $60,000) will be written off to Hydro's 2018 net income.[137]

The Board has reviewed the evidence and is satisfied that the settlement proposals with respect to the allocation and recovery of the 2015, 2016 and 2017 deferred supply costs should be accepted.

The settlement proposals in relation to the allocation and recovery of the 2015, 2016 and 2017 balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account and the Isolated Systems Supply Cost Variance Deferral Account are accepted.

13.2 Recovery of 2018 and 2019 Revenue Deficiencies/Excesses

In its November 14, 2018 filing Hydro provided an update of its projected revenue deficiencies/excesses (excluding charges related to RSP and CDM adjustments) for 2018 and 2019 based on the Expected Supply Scenario and reflecting the Settlement Agreements.[138] To be consistent with the proposed operation of the 2018 RSP Hydro submitted that it is appropriate that the 2018 test year revenue requirement for the revenue deficiency or excess also be based on the 2015 RSP inputs using the 2018 test year load.[139] In addition, to avoid duplication of fuel cost recovery through 2018 revenue deficiencies and balances accumulating in the Supply Cost Variance Deferral Account, the supply costs for the 2018 test year for on-island gas turbine and

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135 Supplemental Settlement Agreement, page 3, paragraphs 12 and 13.

136 Supplemental Settlement Agreement, page 3, paragraphs 11 and 12.

137 Labrador Settlement Agreement, page 2, paragraph 8.

138 The revenue deficiencies/excesses for 2018 were determined by comparing, on a class basis, the 2018 test year revenue requirement to the 2018 test year revenue forecast calculated using approved base rates in effect for 2018. The revenue deficiencies/excesses for 2019 were determined in the same manner except that the base rates in effect for 2019 were used to determine 2019 test year revenues. Interim rates for Island Industrial customers were set as of January 1, 2019 and interim rates for all other customer classes were set as of July 1, 2018.

139 The 2015 test year reflects a No. 6 fuel price of $64.41 per barrel and a Holyrood conversion factor of 618 kWh per barrel.

diesel costs would be based on 2015 test year inputs for the purpose of computing revenue deficiency or excess for the 2018 test year.

The projected revenue deficiencies/excesses for the 2018 and 2019 test years are set out below:[140]

Projected Test Year Revenue Deficiency/Excess by Customer Class ($ millions)

Customer	2018 Test Year Revenue Excess (Deficiency)	2019 Test Year Revenue Excess/Deficiency
Newfoundland Power	(9.4)	(9.0)
Island Industrial	2.1	0.0
Rural Labrador Interconnected	0.2	0.4
Labrador Industrial Transmission	(0.2)	(0.8)
Hydro Rural Government Diesel	0.0	(0.3)

As part of the Settlement Agreements the parties agreed to the following:

> The Parties agree that for Newfoundland Power and Industrial Customers any revenue deficiency or excess revenues arising from the difference between actual rates charged in 2018 and those which recover Hydro's approved 2018 Revenue Requirement by customer class, will be recovered or refunded through rate riders determined separately for each customer class and computed reflecting a 20 month period beginning with the effective date of final rates approved by the Board in the 2017 GRA Compliance Application.
>
> The Parties agree that for Hydro Rural Government Diesel customers any class revenue deficiency or excess revenues arising from the difference between actual rates charged in 2018 and those which recover Hydro's approved 2018 Revenue Requirements by class, will be recovered or refunded through cost amortizations reflected in customer rates and computed reflecting a 20 month period beginning with the effective date of final rates as approved by the Board in the 2017 GRA Compliance Application.[141]

For Hydro's Labrador Customers the Settlement Agreements set out the following:

> The Parties agree to amortize 2018 revenue deficiency over 24 months, beginning with the effective date of the 2017 GRA final rates approved by the Board.[142]

In its submission Hydro stated that the amortization periods included in the Settlement Agreements are still appropriate and that the same approach should be taken for any 2019 revenue deficiency or excess, the amount of which will be determined through its compliance application to be filed following the Board's Order.

The Board notes that the projected revenue deficiencies or excesses for the 2018 and 2019 test years will have to be adjusted to reflect the findings of the Board in this Decision and Order. The Board is satisfied that the recovery or refund of the revenue deficiencies or excesses from or to customers as proposed in the Settlement Agreements for 2018 should be accepted and should be used for 2019 recoveries or refunds as well.

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[140] 2018 Cost Deferral and Interim Rates Application, Schedule 1, page 13 of 78.
[141] Supplemental Settlement Agreement, page 4, paragraphs 20 and 21.
[142] Labrador Settlement Agreement, page 2, paragraph 9.

The settlement proposals in relation to the amortization of any revenue deficiency or excess for 2018 are accepted, with the same approach to be used for the amortization of any revenue deficiency or excess for 2019 up to the date of the implementation of final rates.

Hydro will be required to file an update of the projected revenue deficiencies or excesses for the 2018 and 2019 test years, setting out the allocations for each customer class and the associated rate impacts.

13.3 Recovery of Supply Costs Associated with Lower Off-Island Purchases

Under the Expected Supply Scenario the forecast savings resulting from off-island power purchases are to be included in customer rates. Hydro requested approval of a Revised Energy Supply Cost Variance Deferral Account effective January 1, 2018 which would allow Hydro to defer supply cost variances which result from variations between the actual and forecast quantities and prices of off-island purchases in the 2018 and 2019 test years. In the Settlement Agreements the parties agreed to the implementation of the proposed Revised Energy Supply Cost Variance Deferral Account, with the effective date to be determined by the Board.[143] Hydro requested approval of the Revised Energy Supply Cost Variance Account effective January 1, 2019.

Hydro also submitted that it should be allowed to recover the increased supply costs for 2018 incurred as a result of the reduction in deliveries of off-island power purchases of 43 GWh by either: i) approving the Revised Energy Supply Cost Variance Deferral Account definition to be effective January 1, 2018, or ii) including the increased 2018 supply costs in the 2018 revenue deficiency to be addressed in its compliance application.[144] According to Hydro the first option would result in deferral of the costs for future recovery from customers, while including these costs in the 2018 revenue deficiency would mean the costs are included in the 2018 test year revenue requirement. Hydro submitted that including these costs in the 2018 revenue deficiency is consistent with the concept of intergenerational equity in matching the costs incurred in 2018 with the 2018 test year revenue requirement. Hydro noted that this is also consistent with Order No. P.U. 49(2016) which approved the inclusion of 2014 deferred capacity-related costs in the determination of the 2014 test year revenue requirement.

The Board is satisfied that Hydro's proposal to recover the supply costs associated with lower off-island purchases in 2018 as part of the 2018 revenue deficiency is appropriate in the circumstances. These additional costs were incurred in 2018 to provide service to customers when expected lower cost off-island supply was not available and are costs that Hydro is entitled to recover.

With respect to the Revised Energy Supply Cost Deferral account definition the Board accepts the proposed revision to allow recovery of variations in actual and forecast quantities and prices of off-island purchases. Given that the Board has determined that the 2018 supply cost variations associated with lower off-island purchases are to be recovered in the 2018 revenue deficiency it is appropriate that the effective date for the Revised Energy Supply Cost Variance Deferral Account be January 1, 2019.

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[143] The parties agreed to the proposed Revised Energy Supply Cost Variance Deferral Account as filed in Appendix L of Hydro's Additional Cost of Service Information dated March 22, 2018. This definition was revised in the 2018 Cost Deferral and Interim Rates Application – Revision 2 to reflect that the account will not include any expenditure related to the use of the Labrador Island Link or Labrador Transmission Assets under the Interim Transmission Funding Agreements as per OC 2018-213.

[144] Hydro Submission, pages 54/26 to 55/1.

Hydro's proposal to include the additional 2018 supply costs associated with lower off-island purchases in the 2018 revenue deficiency is accepted.

Hydro's proposed Revised Energy Supply Cost Variance Deferral Account is accepted with an effective date of January 1, 2019.

13.4 Operation of Supply Cost Deferral Accounts for 2018

The RSP, the Energy Supply Cost Variance Deferral Account, the Holyrood Fuel Conversion Deferral Account and the Isolated Systems Deferral Account have operated during 2018 based on supply cost variances relative to the 2015 test year cost of service inputs. As noted previously, to be consistent with the No. 6 fuel cost variances being recovered through the RSP during 2018, Hydro has calculated its No. 6 fuel supply costs for the 2018 test year based on the 2015 test year No. 6 fuel cost of $64.41 per barrel and the 2015 test year Holyrood conversion factor of 618 kWh per barrel. To ensure the RSP allocates load variation component variances consistent with the 2018 test year load forecast Hydro has also proposed to use the 2018 test year load forecast in calculation of RSP load variations for 2018. Hydro proposes to make an adjustment to the 2019 RSP balance to reflect the use of the approved 2018 test year load forecast in the RSP calculations to be provided with its compliance application.

Similarly, to avoid duplication between the balances in the Energy Supply Cost Variance Account, the Holyrood Fuel Conversion Deferral Account, the Isolated Systems Deferral Account and the calculation of the 2018 test year revenue requirement to be recovered from customers, Hydro has proposed the 2018 test year energy supply costs which are subject to the operation of these deferral accounts (with the exception of the variances related to off-island purchases in 2018) be calculated based on the 2015 test year inputs.

The Board accepts that Hydro's proposed approach is reasonable and will provide consistency between the operation of the RSP and other supply cost deferral accounts and the calculation of the 2018 test year revenue requirement.

Hydro's proposal to use the 2015 test year inputs for the operation of the RSP and the supply cost deferral accounts for 2018 is accepted.

14.0 Other Matters

14.1 Communication with Industrial Customers

In Hydro's last general rate application issues were raised related to Hydro's communication with its Industrial customers. In Order No. P.U. 49(2016) the Board stated:

> In the Board's opinion the establishment of a key account representative for each Industrial customer is an important step, along with the other actions identified in the Account Management Framework. It is not clear from the record as to the final timeline for the implementation by Hydro of its Account Management Framework and the Board has no information as to whether the framework has been implemented to date. The Board will request from Hydro an update as to the status and timelines of this initiative.[145]

[145] Order No. P.U. 49(2016), page 126.

Hydro was directed to provide a report as to the status of the implementation of its Account Management Framework, including the designation of key account representatives for industrial customers. Hydro subsequently reported that it established the position of Manager of Key Accounts and noted in its *Customer Service Road Map Update July 2017* that the Key Accounts Manager was expected to be an “advocate” for the Industrial customers.

In their submission the Industrial Customer Group stated that, while they are pleased there has been progress with respect to Industrial customer communications since 2016, they take the position that Hydro must actively monitor and set appropriate key performance indicators to ensure that the Key Accounts Manager’s job duties permit him or her to spend the time necessary to attend to the Industrial customer communication concerns.[146] The Industrial Customer Group submitted that Hydro should be directed to monitor the Key Account Manager's ability to effectively communicate with Industrial customers in a timely manner in light of the position’s other duties and to take steps to ensure that all Hydro departments are instructed to include the Key Accounts Manager in discussions on matters of significance to Industrial customers.

In its submission Hydro stated that the record demonstrates that communication has occurred within Hydro about the Key Accounts Manager role and the expectations and goals of the position. Hydro submitted that the level of reporting requested by the Industrial Customer Group is managerial, not regulatory, in nature and furthermore, is more appropriately reviewed in future general rate application proceedings. Hydro stated that it values the Industrial Customer Group feedback and acknowledges that there will be evolution in the function as it matures.

The issue of communication between Hydro and its Industrial customers is not new and was addressed in Order No. P.U. 49(2016) and was also identified by Liberty in its recommendations to the Board as part of the investigation into the supply issues and power outages on the Island Interconnected system in 2014. While Hydro has provided information on the status of its Account Management Framework and has established a Key Account Manager there appears to be some concerns on the part of the Industrial customers with respect to the effectiveness of this role. The Board believes that these are important concerns which should be addressed in a timely fashion in consultation with the Industrial customers. The Board will require an update from Hydro on the implementation of its Account Management Framework, which should set out information on the expectation and outcomes of the Framework and how the concerns raised by the Industrial customers have been addressed.

Hydro will be required to provide an update on the implementation of its Account Management Framework by September 30, 2019.

14.2 Reporting Requirements on Reliability Performance

Newfoundland Power submitted that, based on Hydro’s response to NP-NLH-045 and NP-NLH-187, Hydro’s reliability performance continues to lag behind other Canadian utilities.[147] Newfoundland Power acknowledged that Hydro’s recent organizational restructuring is intended, in part, to support the delivery of safe, reliable service to its customers and that Hydro’s *Reliability and Resource Adequacy Study* filed on November 16, 2018, addresses Hydro’s long-term approach to providing continued least-cost, reliable service for its customers by establishing an action plan

[146] Industrial Customer Group Submission, page 14.
[147] Newfoundland Power Submission, page E-5.

to meet customer demand and energy requirements. Newfoundland Power also noted that Phase Two of the Supply Issues Investigation, which is focused on reliability on the Island Interconnected system following the interconnection with Muskrat Falls, has not yet concluded and submitted that until the Board is satisfied that Hydro's reliability performance is acceptable, Hydro should remain subject to the detailed reporting requirements imposed by the Board.

In its submission Hydro noted that the evidence presented during the hearing indicated that the ongoing detailed reporting requirements have contributed to increased salary and benefit costs in Regulatory Affairs over the period 2015 to 2019. Hydro stated that it has not proposed any changes in its reporting requirements to the Board and that it will continue to comply with the Board's reporting requirements.[148]

The Board acknowledges the concerns raised by Newfoundland Power and notes that Newfoundland Power has not suggested additional reporting and that Hydro does not propose any changes in its reporting requirements. In addition the issue of reliability in Hydro's provision of safe, reliable service to its customers has been a key focus of the Board in the last number of years. Hydro has been subject to a number of additional comprehensive reporting requirements related to reliability, arising from the Board's investigation into supply issues and power outages on the Island Interconnected system in 2014 and in the lead up to the Muskrat Falls Project interconnection. The Board notes that a separate proceeding will address Hydro's *Reliability and Resource Adequacy Study* and that ongoing reporting requirements related to both supply and reliability will likely arise in that context. The Board is satisfied that no action is required at this time.

14.3 Operating and Maintenance Costs for Specifically Assigned Assets

In the Application Hydro proposed an alternate method for the allocation of operating and maintenance expenses to specifically assigned assets, based on a review and recommendations by CA Energy. The proposed methodology would allocate these costs based on determination of test-year transmission asset value via Handy-Whitman indexes rather than direct assignment based on original asset costs. The proposed methodology was reflected in the 2018 and 2019 test year cost of service. In Order No. P.U. 7(2018) the Board approved the establishment of a deferral account to track, for each Island Industrial Customer beginning on April 1, 2018, the difference between the approved specifically assigned charges and the amount that would be charged if the proposed methodology to allocate operating and maintenance expenses to specifically assigned charges is approved.

In the Settlement Agreements the parties accepted the proposed methodology and, in Order No. P.U. 48(2018) approving interim rates for Island Industrial customers as of January 1, 2019, the Board accepted Hydro's proposal to revise the specifically assigned charges to reflect the methodology accepted in the Settlement Agreements.[149]

In its submission the Industrial Customer Group stated that, while the settlement agreement provides an initial directionally appropriate solution to an immediate issue of fairness with regard to specifically assigned assets, it still fails to reflect the actual efforts (or lack thereof) and costs

[148] Hydro's Rebuttal Submission, page 9.
[149] Order No. P.U. 48(2018) approved the following specifically assigned charges on an interim basis: Corner Brook Pulp and Paper $11,458; North Atlantic Refinery Limited $104,051; Teck Resources $50,030 and Vale $114,378.

that are required to be expended by Hydro to maintain the specifically assigned facilities.[150] The Industrial Customer Group submitted that Hydro should be directed to continue to investigate the potential of directly charging customers for operating and maintenance activities performed on specifically assigned assets when they occur, and not using the coarse allocation of operating and maintenance through the cost of service study. The Industrial Customer Group stated that the results of this investigation should then be made available for adjudication in the next general rate application or in the ongoing cost of service review.

In its reply submission Hydro stated that it has implemented internal processes to track operating and maintenance costs related to specifically assigned assets. Hydro referenced its response to PUB-NLH-078 where it stated that it plans to make the results of its cost tracking of specifically assigned assets available in its next general rate application.

The Board agrees that forecast test year operating and maintenance costs to be assigned to specific assets should reflect actual costs to the extent possible. In its response to PUB-NLH-078 Hydro indicated that it may require several years of history under the new methodology to reasonably forecast annual operating and maintenance costs for specifically assigned assets. The Board notes that the new methodology has been implemented as of January 1, 2019 and, as such, there may not be sufficient data on actual costs for consideration in the ongoing cost of service review. Hydro should include the results of its tracking of actual operating and maintenance costs related to specifically assigned assets as part of its next general rate application. Hydro should also file, as part of its compliance filing arising from this Application, an update on the deferral account directed in Order No. P.U. 7(2018) to track the difference between the approved specifically assigned charges and the amount that would be charged under the proposed methodology. This update should include the account definition, the account activity, balances owing to/from customers as well as a proposal for the disposition of the balances.

Hydro will be required to provide an update on the results of its tracking of actual operating and maintenance costs related to specifically assigned assets as part of its next general rate application.

Hydro will be required to file an update on the deferral account directed in Order No. P.U. 7(2018) to track the difference in specifically assigned charges under the existing and proposed methodology to allocate operating and maintenance expenses.

15.0 Costs

The Industrial Customer Group requested an award of costs in respect of the participation of their counsel and their experts in this proceeding. The Industrial Customer Group submitted that their representation by co-counsel served to promote efficiency and provided the right balance between ensuring the distinct interests and concerns of each customer are understood and considered while presenting a common position on the issues wherever possible. While acknowledging that there are many issues where the Island Industrial customers had a commonality of interest with the other intervenors the Industrial Customer Group submitted that their experts were able to bring distinct, well-informed and constructive analysis and perspectives on these issues.

[150] Industrial Customer Group Submission, page 16.

As set out in Section 90(1) of the *Act* an award of costs for any proceeding shall be in the discretion of the Board. The Board makes its determination on any claim for costs based on the intervenor's contribution to the proceeding and the resulting impact on the Board's ability to discharge its legislative responsibilities in considering the Application. The Board also considers whether there was a distinct interest in the Application that justified the costs.

The Board is satisfied that the Industrial Customer Group had a distinct interest and that it participated responsibly and contributed to the Board's understanding of the matters before it in this proceeding. The Board notes that Hydro did not respond to the request for costs by the Industrial Customer Group in its reply submission. The Board will make an award of costs to the Industrial Customer Group for its participation in this proceeding.

With regards to the quantum of costs to be awarded the Board notes that Hydro will be filing a compliance application as a result of this Decision and Order, incorporating the findings of the Board. The intervenors will have the opportunity to review and comment on the compliance filing, following which the Board will be issuing a final Order. In these circumstances the Board finds that the quantum of the cost award should be set following the conclusion of this proceeding. The Industrial Customer Group will be required to file a detailed claim for costs with supporting documentation to justify its cost claim. The Board will also allow the other intervenors in this proceeding to file a cost claim, with supporting documentation, at the conclusion of this proceeding.

The Industrial Customer Group are entitled to an award of costs in an amount to be determined following the filing of a detailed claim for costs at the conclusion of this proceeding.

16.0 Implementation

Since the Application was filed on July 28, 2017 there have been a number of significant changes which impact Hydro's proposals. The Board notes that the recommendations in the Settlement Agreements address a broad range of issues, including the use of the Expected Supply Scenario as the basis for the revenue requirement in the 2018 and 2019 test years and the use of the current fuel rider forecast in the calculation of the 2019 test year cost of No. 6 fuel consumed at the Holyrood Thermal Generating Station. In addition the findings of this Decision and Order, including the test year costs disallowances and the requirement to use the most up-to-date forecast for off-island purchases, will impact the Application proposals.

During this proceeding Hydro provided updated information, including the impacts of the Settlement Agreements as well as the impact of forecast changes in the price and volume of No. 6 fuel used at the Holyrood Thermal Generating Station. Following the filing of submissions in this proceeding, in accordance with the provisions of the RSP, Hydro also filed an application for approval of revised RSP and CDM adjustments to, among other things, implement a new fuel rider for July 1, 2019. This application proposes the implementation of an RSP adjustment on July 1, 2019 to reflect the March forecast fuel rider. As agreed in the Settlement Agreements the March forecast fuel rider is to be used in the calculation of the 2019 test year cost of No. 6 fuel. In the interest of ensuring the orderly implementation of rates flowing out of this general rate application and to avoid multiple rate changes for customers in a short period of time the Board will direct Hydro to withdraw the April 23, 2019 application and address the fuel and CDM adjustments as part of its compliance application.

The Board acknowledges, that to reflect the findings of the Board, Hydro will have to revise its proposals which will require the preparation of a new cost of service and Schedule of Rates, Rules and Regulations. As such the Board will not set out a specific date for the filing of the compliance application or the implementation of final rates as this will largely depend on the time that is required for Hydro to prepare and file its compliance application and the process established to address the application. Board staff will work with Hydro and the parties to determine the process and associated timelines. To the extent that rates cannot be implemented for July 1, 2019, Hydro may request the necessary changes to the RSP rules to address the current required July 1 adjustment. To ensure an efficient process Hydro's compliance application should clearly set out its proposals as well as the impact on rates for all classes, including addressing any concerns which may arise with respect to the impacts on customers.

In terms of Hydro's next general rate application the Board acknowledges that there is a great deal of uncertainty as to a number of important factors that will have to be considered in the preparation of this application. In particular the Board notes that the commissioning of the Muskrat Falls Project will result in a material change to the forecast supply cost. Currently it is expected that 2021 will be the first full year of operation after the commissioning of Muskrat Falls. To ensure that this significant change can be addressed in a timely and orderly fashion Hydro should file its next general rate application by September 30, 2020. To the extent that circumstances change Hydro may apply to the Board to alter this filing date.

Hydro will be required to file its next general rate application no later than September 30, 2020 for rates based on a 2021 test year.

17.0 Summary of Board Findings

1. The forecast capital structure proposed by Hydro for the 2018 and 2019 test years is accepted, subject to any adjustment required as a result of the Board's findings in this Decision and Order.

2. The target return on equity to be used in calculating the allowed rate of return on rate base for the 2018 and 2019 test years shall be 8.5%.

3. The settlement proposals in relation to an automatic adjustment mechanism for Hydro's target return on equity to reflect any changes to Newfoundland Power's approved target return on equity for rate setting are accepted.

4. Hydro's proposed definition of the Return on Equity Rate Change Deferral Account is accepted.

5. The settlement proposal in relation to the use of the Expected Supply Scenario for establishing Hydro's 2018 and 2019 test year revenue requirement is accepted.

6. The proposed 2018 test year customer load forecasts for the Island Interconnected system are accepted.
7. Hydro will be required to revise the 2019 test year customer load forecast for the Island Interconnected system to reflect the load forecast approved in Order No. P.U. 2(2019).

8. The settlement proposal to update the load forecast for the Labrador Interconnected system is accepted.

9. Hydro will be required to update its 2018 and 2019 test year forecasts for off-island purchases, providing full explanation for any changes since its last forecast update.

10. The 2018 and 2019 test year hydraulic and thermal production forecasts are accepted, subject to any adjustment arising from this Decision and Order.

11. Hydro's proposal to use the approved 2015 test year fuel costs for the fuel supply costs to be included in the 2018 test year revenue requirement is accepted.

12. The settlement proposal that the 2019 test year cost of No. 6 fuel be set based on the most current fuel rider forecast is accepted. The forecast 2019 diesel and gas turbine fuel costs should also reflect the most recent price forecast for those fuels.

13. Hydro's proposal to use the approved 2015 test year Holyrood conversion factor for the 2018 test year revenue requirement is accepted.

14. The settlement proposal to use a conversion factor of 583 kWh per barrel for No. 6 fuel at the Holyrood Thermal Generating Station in the 2019 test year is accepted.

15. Hydro will be required to revise the 2018 and 2019 test year fuel costs to reflect the findings of the Board in this Decision and Order.

16. The settlement proposal to reflect the capacity assistance agreements to be in effect for the 2018/19 winter season in the 2019 test year costs is accepted.

17. Hydro will be required to revise the proposed power purchases costs in the 2018 and 2019 test years to reflect the findings of the Board in this Decision and Order.

18. Hydro's proposal to recover external regulatory costs in the amount of $1.7 million is accepted.

19. The settlement proposals in relation to the proposed accounting treatment and methodology for calculation of employee future benefits, the number of vacancies, the deferral of the Business Systems Transformation Program costs and the recovery of the external regulatory costs are accepted.

20. Hydro will be required to revise the proposed operating costs to be included in the 2018 and 2019 test year revenue requirements to reflect:
    i) a reduction of $4.0 million in each of the 2018 and 2019 test years; and
    ii) the removal of the proposed performance contract payments in each of the 2018 and 2019 test years.

21. The settlement proposals in relation to depreciation and the inventory allowance for the Holyrood Thermal Generating Station are accepted.

22. Hydro will be required to address the disposition of 2018 Cost Deferral Account and the issues related to depreciation identified by Grant Thornton.

23. The settlement proposals in relation to interest and the guarantee fee are accepted.

24. Hydro will be required to reduce the 2018 and 2019 test year revenue requirements to reflect the exclusion of the proposed amounts for a guarantee fee related to the 2017 and 2018 debt issuances to the Government of Newfoundland and Labrador.

25. Hydro will be required to file revised proposals for its 2018 and 2019 test year revenue requirements to reflect the findings of the Board in this Decision and Order.

26. The settlement proposal in relation to the continued use of the currently approved methodology to determine rate base, including beginning-of-year and end-of-year averaging for capital assets in service, is accepted.

27. The settlement proposal in relation to the continued use of the currently approved working capital methodology is accepted.

28. The forecast average rate base for the 2018 test year will be updated to reflect subsequent Board orders and the 2018 capital expenditures as outlined in the *2018 Capital Expenditures and Carryover Report*, excluding the Muskrat Falls to Happy Valley Interconnection project.

29. The forecast average rate base for 2019 will be updated to reflect subsequent Board orders and the most current 2019 capital expenditure forecast.

30. The settlement proposal to approve the proposed definition of the Excess Earnings Account is accepted.

31. Hydro will be required to file a revised 2018 and 2019 test year forecast average rate base and rate of return on rate base for rate setting purposes to reflect the findings of the Board in this Decision and Order.

32. The settlement proposals in relation to cost of service are accepted.

33. The settlement proposals in relation to i) Newfoundland Power's rate design, ii) the continuation of the current Labrador Industrial Transmission Rate, and iii) the billing credit to IOC are accepted.

34. Hydro's final rates for 2019 should reflect the sale of the Corner Brook Frequency Converter to Corner Brook Pulp and Paper Limited.

35. The settlement proposals in relation to the proposed changes to Hydro's Rules and Regulations, including the proposed change to the RSP Rules, are accepted.

36. The settlement proposal to defer consideration of whether information on the rural deficit should be included on customers' bills is accepted.

37. Hydro will be required to file revised RSP rules to clarify that No. 6 fuel costs in Canadian dollars reflect foreign exchange gains and losses.

38. The balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account and the Isolated Systems Supply Cost Variance Deferral Account for 2015, 2016 and 2017 will be approved.

39. The settlement proposals in relation to the allocation and recovery of the 2015, 2016 and 2017 balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account and the Isolated Systems Supply Cost Variance Deferral Account are accepted.

40. The settlement proposals in relation to the amortization of any revenue deficiency or excess for 2018 are accepted, and the same approach to be used for the amortization of any revenue deficiency or excess for 2019 up to the date of the implementation of final rates.

41. Hydro will be required to file an update of the projected revenue deficiencies or excesses for the 2018 and 2019 test years, setting out the allocations for each customer class and the associated rate impacts.

42. Hydro's proposal to include the additional 2018 supply costs associated with lower off-island purchases in the 2018 revenue deficiency is accepted.

43. Hydro's proposed Revised Energy Supply Cost Variance Deferral Account is accepted with an effective date of January 1, 2019.

44. Hydro's proposal to use the 2015 test year inputs for the operation of the RSP and the supply cost deferral accounts for 2018 is accepted.

45. Hydro will be required to provide an update on the implementation of its Account Management Framework by September 30, 2019.

46. Hydro will be required to provide an update on the results of its tracking of actual operating and maintenance costs related to specifically assigned assets as part of its next general rate application.

47. Hydro will be required to file an update on the deferral account directed in Order No. P.U. 7(2018) to track the difference in specifically assigned charges under the existing and proposed methodology to allocate operating and maintenance expenses.

48. The Industrial Customer Group are entitled to an award of costs in an amount to be determined following the filing of a detailed claim for costs at the conclusion of this proceeding.

49. Hydro will be required to file its next general rate application no later than September 30, 2020 for rates based on a 2021 test year.

PART FOUR: BOARD ORDER

<u>IT IS THEREFORE ORDERED:</u>

<u>SETTLEMENT AGREEMENTS</u>

1. The proposals set out in the Settlement Agreement, the Supplemental Settlement Agreement and the Labrador Settlement Agreement are accepted and shall be incorporated into the revised proposals to be filed as a result of this Decision and Order.

<u>COST OF CAPITAL AND RETURN ON EQUITY</u>

2. The return on equity to be used in calculating the allowed rate of return on rate base for 2018 and 2019 for the purpose of calculating the 2018 and 2019 revenue deficiencies and for setting rates as of July 1, 2019 shall be 8.5%, with a common equity component in the capital structure not to exceed 45%.

3. Hydro's proposed automatic adjustment mechanism for its target return on equity to reflect any changes to Newfoundland Power's approved target return on equity for rate setting is approved.

4. Hydro's proposed definition of the Return on Equity Rate Change Deferral Account is accepted and shall be filed for the approval of the Board.

<u>RATE BASE AND RETURN ON RATE BASE</u>

5. Hydro shall file a revised rate base for 2017 and a revised forecast average rate base for 2018 and 2019, incorporating the findings of the Board in this Decision and Order.

6. Hydro's proposed excess earnings account definition to reflect a range of rate of return on rate base of ±20 basis points is accepted and shall be filed for the approval of the Board.

<u>REVENUE REQUIREMENT</u>

7. Hydro shall file, for the approval of the Board, a revised revenue requirement for the 2019 test year for rate setting purposes, and a revised revenue requirement for the 2018 test year for the purpose of determining the 2018 revenue deficiency, incorporating the findings of the Board in this Decision and Order, including:

a. a reduction of $4,000,000 in each of 2018 and 2019 related to the disallowance of operating costs;

b. a reduction in each of 2018 and 2019 related to the disallowance of Hydro's performance contract payments; and

c. a reduction in each of 2018 and 2019 related to the proposed guarantee fee.

DEFERRED CHARGES AND PROPOSED DEFERRAL ACCOUNTS

8. The balances in the Energy Supply Cost Variance Deferral Account, the Holyrood Conversion Rate Deferral Account and the Isolated Systems Supply Cost Variance Deferral Account for 2015, 2016 and 2017 are approved.

9. Hydro's proposed revised Energy Supply Cost Variance Deferral Account definition is accepted to be effective January 1, 2019 and shall be filed for the approval of the Board.

10. Hydro's proposal to defer external regulatory costs related to this Application and the Cost of Service and Rate Design Methodology Review of up to $1.7 million over a three-year period, commencing with the 2018 test year, is accepted.

11. Hydro shall file a proposal in relation to the disposition of the balance in the account related to specifically assigned charges approved in Order No. P.U. 7(2018).

12. Hydro shall file a proposal in relation to the disposition of the balance in the 2018 Cost Deferral Account.

COST OF SERVICE

13. Hydro shall file updated cost of service studies for the 2018 and 2019 test years, incorporating the findings of the Board in this Decision and Order.

RATES, RULES AND REGULATIONS

14. Hydro shall file, for the approval of the Board, a revised Schedule of Rates, Rules and Regulations and revised RSP Rules, incorporating the findings of the Board in this Decision and Order.

REVENUE DEFICIENCIES

15. Hydro shall file a revised calculation of the 2018 and 2019 revenue deficiencies setting out revised calculations of the revenue requirement, rate base and rate of return on rate for each year, incorporating the findings of the Board in this Decision and Order.

OTHER MATTERS

16. As part of its revised filing Hydro shall file:
- **a. an update on the implementation of its Account Management Framework by September 30, 2019; and**
- **b. an update on the results of its tracking of actual operating and maintenance costs related to specifically assigned assets as part of its next general rate application.**

17. Hydro shall file its next general rate application no later than September 30, 2020 for rates based on a 2021 test year.

HEARING COSTS

18. Hydro shall pay the expenses of the Board associated with this matter, including the expenses of the Consumer Advocate incurred by the Board pursuant to Section 117 of the *Act.*

19. The Industrial Customer Group will be awarded costs, in an amount to be determined by the Board.

20. Leave is granted to intervenors to apply for an award of costs within 30 days of the Order of the Board establishing final rates in this matter.

DATED at St. John's, Newfoundland and Labrador this 7th day of May, 2019.

Darlene Whalen, P. Eng., FEC
Chair and Chief Executive Officer

Dwanda Newman, LL.B.
Vice-Chair

James Oxford
Commissioner

Sara Kean
Assistant Board Secretary

Hydro's Proposals as of February 1, 2019

Revenue Requirement

(1) that the Board approve the Settlement Agreement dated April 11, 2018, the Supplemental Settlement Agreement dated July 16, 2018 (Supplemental Settlement Agreement), and the Labrador Settlement Agreement dated August 24, 2018;

(2) that Hydro's proposal to have its 2018 and 2019 test year revenue requirements, and resulting rates, reflect the cost of the expected supply of power to the Island Interconnected System from both off-island power purchases and existing Island generation as described in the Additional Cost of Service Information filed in compliance with Board Order No. P.U. 2(2018) and agreed to in section 14 of the Supplemental Settlement Agreement dated July 16, 2018;

(3) that a revised definition to the Energy Supply Cost Variance Deferral Account to include variances in both price and volume of off-island power purchases, as originally provided in Appendix L of the Additional Cost of Service Evidence filed on March 22, 2018 in compliance with Board Order No. P.U. 2(2018); agreed to in section 18 of the Supplemental Settlement Agreement dated July 16, 2018, to be approved, effective January 1, 2019; and updated in Appendix I of Hydro's filing of November 14, 2018;

(4) that the inclusion of variances in net savings from forecast 2018 off-island power purchases reflected in Hydro's 2018 Revenue Deficiency be approved;

(5) that for the purposes of calculating Hydro's 2018 Test Year, subject to change following the Board's final order and Hydro's Compliance Application:
   a) an estimated 2018 test year revenue requirement of $578,650,604 be approved;
   b) an estimated 2018 forecast average rate base of $2,244,455,753 be approved; and
   c) an estimated rate of return on rate base of 5.45% in a range of 5.25% to 5.65%, be approved;

(6) that for the purposes of calculating Hydro's 2019 Test Year, subject to change following the Board's final order and Hydro's Compliance Application:
   a) an estimated 2019 Test Year revenue requirement of $591,852,326 be approved;
   b) an estimated 2019 forecast average rate base of $2,335,231,298 be approved; and
   c) an estimated rate of return on rate base of 5.45% in a range of 5.25% to 5.65%, be approved;

(7) a) that Hydro's forecast capital structure for 2018, as set out in Chapter 4 of the evidence in support of this Application, with an estimated weighted average cost of capital of 5.45%, to be updated in Hydro's Compliance Application, be approved; and
   b) that Hydro's forecast capital structure for 2019, as set out in Chapter 4 of the evidence in support of this Application, with an estimated weighted average cost of capital of 5.45%, to be updated in Hydro's Compliance Application, be approved;

(8) that pursuant to Order in Council OC2009-063, for purpose of calculating Hydro's return on rate base for 2018 and 2019, the return on equity last approved by Order No. P.U. 2(2019) as a result of Newfoundland Power's general rate application, of 8.5%, be approved;

(9) that the Holyrood conversion rate of 583 kWh per barrel for the 2019 Test Year, as agreed to in Section 16 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(10) that Hydro's revenue requirement include the updated costs associated with Capacity Assistance agreements for 2018 and 2019, as updated in Hydro's October 26, 2018 filing, referenced in Section 22 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(11) that Hydro's revenue requirements reflecting vacancies in full time equivalents of 55, as agreed to in Section 10 of the Settlement Agreement dated April 11, 2018, be approved;

(12) that Hydro's costs and expenses related to the Business Systems Transformation Project described in the Application be deferred in a separate account with recovery subject to a further order of the Board, as agreed to in Section 11 of the Settlement Agreement dated April 11, 2018, be approved;

(13) that the Debt Guarantee Fee be included in Hydro's revenue requirement in accordance with Section 12 of the Settlement Agreement dated April 11, 2018, be approved;

(14) that Hydro's 2018 Test Year fuel expense and power purchase expense reflect the 2015 Test Year inputs for the operation of: the Rate Stabilization Plan, Energy Supply Cost Variance Deferral Account, Holyrood Conversion Rate Deferral Account, and the Isolated Systems Cost Variance Deferral account including: (i) a No. 6 fuel cost of $64.41 per barrel, (ii) a conversion rate of 618 kWh per barrel, and (iii) the 2018 Test Year load for use in the Rate Stabilization Plan, be approved;

Regulatory Accounting

(15) that Hydro's continued use of the working capital methodology, as agreed to in Section 14 of the Settlement Agreement dated April 11, 2018, be approved;

(16) that Hydro's proposed average rate base methodology, as agreed to in Section 13 of the Settlement Agreement dated April 11, 2018, be approved;

(17) that Hydro's proposed depreciation rates and methodology, as agreed to in Section 9 of the Settlement Agreement dated April 11, 2018 and Section 7 of the Labrador Settlement Agreement, be approved;

(18) that Hydro's proposal in relation to an automatic adjustment mechanism for its target return on equity to reflect any changes to Newfoundland Power's approved target return on equity for rate setting, as agreed to in Section 24 of the Settlement Agreement dated April 11, 2018, be approved;

(19) that Hydro's proposal to amortize and recover general rate and cost of service hearing costs over a three year period commencing in 2018, as agreed to in Section 22 of the Settlement Agreement dated April 11, 2018, be approved;

(20) that, for Newfoundland Power, Island Industrial and Hydro Rural Government Diesel customers, Hydro's proposal to recover its 2018 and 2019 revenue deficiencies or revenue excesses over a 20-month period commencing on the dates 2017 GRA final rates are implemented, consistent with Sections 20 and 21 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(21) that, for customers on the Labrador Interconnected system, Hydro's proposal to recover its 2018 and 2019 revenue deficiencies or revenue excesses over a 24-month period commencing on the dates 2017 GRA final rates are implemented, consistent with Section 9 of the Labrador Settlement Agreement dated August 24, 2018, be approved;

(22) that Hydro's proposal to include its 2018 and 2019 revenue deficiency or revenue excesses in rate base, as set out in Chapter 4 of the evidence in support of this Application, be approved;

(23) that Hydro's proposal to include 2015, 2016, and 2017 deferred supply costs of approximately $65.4 million in rate base, be approved;

(24) that the No. 6 fuel price used in the calculation of the 2018 and 2019 Test Year fuel inventory for rate base, reflecting the approved test year fuel cost per barrel, be approved;

(25) that Hydro's excess earnings account definition, as agreed to in Section 23 of the Settlement Agreement dated April 11, 2018, be approved;

(26) that Hydro's proposed accounting treatment and methodology for calculation of Employee Future Benefits in the 2018 and 2019 Test Years, as agreed to in Section 7 of the Settlement Agreement dated April 11, 2018, be approved;

(27) that Hydro's proposed accounting treatment and calculation of Asset Retirement Obligations in the 2018 and 2019 Test Years, as agreed to in Section 8 of the Settlement Agreement dated April 11, 2018, be approved;

(28) that the MF-HVY Capital Project will be:

a) excluded in Hydro's rate base in the 2018 Test Year and excluded in the calculation of depreciation expense for the 2018 Test Year;
b) included in Hydro's closing rate base for the 2019 Test Year, if the project approved by the Board, prior to Hydro's 2017 GRA Compliance filing, for construction to be completed by the end of 2019;
c) excluded for the calculation of depreciation for the 2019 test Year;

Cost of Service Methodology

(29) that the generation credit service agreement between Hydro and Corner Brook Pulp and Paper, which was approved on a pilot basis by the Board in Order No. P.U. 4(2012), and as agreed to in Section 8 of the Supplemental Settlement Agreement dated July 16, 2018, be approved to continue on a pilot basis;

(30) that Hydro's proposal to allocate operating and maintenance expenses for specifically assigned assets by customer be based on the determination of test year transmission asset values via Handy-Whitman indexes, and as per Hydro's report dated December 21, 2017, as agreed to in Section 15 of the Settlement Agreement dated April 11, 2018 and section 7(c) of Supplemental Settlement Agreement dated July 16, 2018, be approved;

(31) that wind energy purchases classified as 100% energy-related, as agreed to in Section 7(a) of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(32) that the functionalization of TL 267 as 100% demand, as agreed to in Section 7(d) of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(33) that the revenue requirement method to allocate the rural deficit between Newfoundland Power and the Labrador Interconnected system approved by Order No. P.U. 49(2016), as agreed to in Section 16 of the Settlement Agreement dated April 11, 2018, for use in the 2018 and 2019 Test Years, be approved;

(34) that a filing date of no later than November 15, 2018 for Hydro's Cost of Service and Rate Design Methodology Review, as agreed to in the Section 25 of the Settlement Agreement dated April 11, 2018, be approved;

2019 Rate Proposals

(35) that, effective July 1, 2019, rates reflecting the 2017 GRA Order for all of Hydro's customers be approved on a final basis;

(36) that, effective July 1, 2019, Newfoundland Power’s rates, as agreed to in Section 9 of the Supplemental Settlement Agreement dated July 16, 2018, be approved as follows:

a) Newfoundland Power's demand charge will equal $5.00 per kW of billing demand;

b) The size of Newfoundland Power's first block energy component will be determined in consultation with Newfoundland Power prior to the filing of Hydro's 2017 GRA Compliance filing;

c) Newfoundland Power's approved 2019 Test Year revenue requirement not recovered through the demand charge and the end-block energy charge will be used to compute the first block energy charge;

d) Newfoundland Power’s end-block firm energy rate for use in Hydro's 2017 GRA Compliance filing will be determined based on the most current fuel rider forecast (either March or September) divided by the approved 2019 Test Year Holyrood No.6 fuel conversion rate and expressed on a cent per kWh basis;

e) The wholesale rate will continue to include the Generation Credit and Curtailable Credit in computation of the billing demand of Newfoundland Power; and

f) The Generation Credit will equal 118,054 kW for the 2018 Test Year and the 2019 Test Year;

(37) that, effective July 1, 2019, the RSP fuel rider applicable to Newfoundland Power, as approved in Board Order No. P.U. 15(2018), be discontinued;

(38) that for Newfoundland Power an additional 2017 GRA Recovery rider to become effective July 1, 2019 and remain in effect for 20 months to recover or refund the forecast 2018 and 2019 revenue deficiencies or revenue excess, consistent with Section 20 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(39) that for the Island Industrial Customers an additional 2017 GRA Recovery rate rider to become effective July 1, 2019 and remain in effect for 20 months to recover or refund the forecast 2018 and 2019 revenue deficiencies or revenue excess, consistent with Section 20 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(40) that the 2017 GRA recovery rider for the Island Industrial Customers forecast 2018 and 2019 revenue deficiencies or revenue excess be tracked by month and any over or under recovery at the conclusion of the 20 month period be charged or credited to the Island Industrial Customer’s Rate Stabilization Plan Current Plan account;

(41) that on an interim basis for Island Industrial Customers, effective upon the implementation of revised in 2019 RSP adjustments: (i) a firm demand charge increase from $9.95 per kW to $10.90 per kW and the firm energy charge of 3.521 cents per kW, and (ii) the following specifically assigned charges per year:

Corner Brook Pulp and Paper	$11,458
North Atlantic Refinery Limited	$104,051
Teck Resources Limited	$50,030
Vale	$144,378

(42) that, effective January 1, 2019, the RSP fuel rider applicable to Island Industrial Customers approved in Board Order P.U. 7(2018), be discontinued;

(43) that, effective January 1, 2019, a loss factor of 3.34% be approved for use in calculation of the non-firm Island Industrial energy rate, as set out in Chapter 5 and Exhibit 17 to the evidence in support of this Application, be approved on a final basis;

(44) that the deferral of consideration of whether information on the rural deficit should be included on customers’ bills for inclusion in a separate proceeding or a future Hydro general rate application, as agreed to in Section 20 of the Settlement Agreement dated April 11, 2018, be approved;

(45) that IOC is eligible for a billing credit from Hydro if actual monthly Labrador firm load requirements exceed the 2019 Test Year Load forecast by more than 10 MW. The billing credit will be calculated in accordance with Section 10 of the Labrador Settlement Agreement;

Deferred Supply Costs

(46) that Hydro's deferred supply costs be approved as prudent, specifically:
  a) 2015 Isolated Systems Supply Cost Variance Deferral Account balance of $0.00;
  b) 2016 Isolated Systems Supply Cost Variance Deferral Account credit balance of $2,186,570.00;
  c) 2017 Isolated Systems Supply Cost Variance Deferral Account credit balance of $1,106,821.00;
  d) 2015 Energy Supply Cost Variance Deferral Account debit balance of $14,200,429.00;
  e) 2016 Energy Supply Cost Variance Deferral Account debit balance of $24,462,996.00;
  f) 2017 Energy Supply Cost Variance Deferral Account debit balance of $20,134,732.00;
  g) 2015 Holyrood Conversion Rate Deferral Account debit balance of $3,582,048.00;
  h) 2016 Holyrood Conversion Rate Deferral Account debit balance of $2,150,665.00;
  i) 2017 Holyrood Conversion Rate Deferral Account debit balance of $4,163,799.00;

(47) that the allocation of balances from the Isolated Systems Cost Variance Deferral Account based upon the same methodology as that which is approved for the allocation of the Rural Deficit, as agreed to in Section 10 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(48) that the Labrador Interconnected System allocated portions of the Isolated Systems Cost Variance Deferral Account Energy Supply Cost Variance Deferral and Holyrood Conversion Rate Deferral Account be written off to Hydro's 2018 net income as agreed to in Section 8 of the Labrador Settlement Agreement;

(49) that the allocation of balances in the Energy Supply Cost Variance Deferral and Holyrood Conversion Rate Deferral Account computed by customer class based upon the fuel cost allocation methodology used in the Rate Stabilization Plan, and the allocation percentage be based upon the energy allocators consistent with the year in which the costs were incurred, as agreed to in Section 12 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(50) that balances allocated to Newfoundland Power and the Island Industrial Customers be recovered through rate riders to be determined separately for each customer class and computed reflecting a 20 month recovery period effective July 1, 2019, as agreed to in Section 13 of the Supplemental Settlement Agreement dated July 16, 2018, be approved;

(51) that the recovery rider for the Island Industrial Customers portion of the Energy Supply Cost Variance Deferral and Holyrood Conversion Rate Deferral Account be tracked by month and any over or under recovery at the conclusion of the 20 month period be charged or credited to the Island Industrial Customer's Rate Stabilization Plan Current Plan account;

Rules and Regulations

(52) that the calculation of the Rural Rate Alteration component to use Test Year data, as agreed to in Section 18 of the Settlement Agreement dated April 11, 2018, be approved effective January 1, 2018;

(53) that the proposed rules and regulations governing service as set out in Chapter 5 and Exhibit 17 to this evidence in support of this Application, as agreed to in Section 19 of the Settlement Agreement dated April 11, 2018, be effective the date that new rates from the Application are implemented; and

(54) that upon hearing this Application, the Board grant such alternative, additional or further relief as the Board shall consider fit and proper in the circumstances.

(55) that a revision to the RSP rules clarifying that No. 6 fuel cost in Canadian dollars reflect foreign exchange gains and losses, be approved for filing in Hydro's 2017 GRA Compliance Application;

Load Forecast

(56) that Hydro's proposed load forecast for the Island Interconnected Systems for the 2018 and 2019 Test Years, be approved; and

(57) that the 2018 and 2019 Test Year load forecast for the Labrador Interconnected System be updated in Hydro's Compliance Application, in accordance with the Labrador Settlement Agreement, be approved.

Newfoundland & Labrador
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES
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