

**Responses of Seabron Adamson on behalf of
Newfoundland and Labrador Hydro to the
Information requests no. 1 of the Régie de
l'énergie**

Régie de l'Énergie

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1. Référence (i) Pièce C-NLH-0018, p. 15.

Préambule:

- (i) "I would recommend that a new HQT network upgrade policy reflect the following basic elements: [...]"

2. Elimination of the inefficient "requester pays" policy and substitution of a policy that allocates transmission upgrade costs based on benefits, regardless of customer class.

3. Development of a workable benefits-based cost allocation methodology, to be published after approval by the Régie, which will allow all transmission customers to understand cost allocation clearly and before potentially incurring costs. This methodology should be consistent with the cost allocation principles in FERC Order 1000.

4. Elimination of the chronological "waiting list" evaluation of transmission upgrades and replacement with a system of more holistic evaluation of major potentially-related transmission projects together. This will ensure that a proper cost-benefit analysis can be conducted using reasonable criteria and that cost allocation can be consistent."

Demande:

- 1.1 *Veuillez fournir un exemple de modalités applicables dans le cas d'une approche basée sur un partage de coûts selon les beneficiaries.*

Réponse:

- 1.1 Mr. Adamson believes that the second phase of the current Régie proceeding is the appropriate forum for setting the specific terms for a benefits-based cost allocation methodology for Québec, which must of course reflect the policy decisions made by the Régie in the first phase. However, lessons can be learned by examining the approaches used by utilities in the U.S. to satisfy the Order 1000 obligation imposed by the Federal Energy Regulatory Commission ("FERC") with respect to cost allocation,

With respect to specific elements of a benefits-based methodology, the following aspects should be included. First, the transmission project evaluation methodology should identify transmission needs and consider various transmission projects to address these needs. The potential projects within a period should be evaluated consistently (and hence simultaneously).

Second, the evaluation of transmission benefits requires the identification of types of benefits, a reasonable method for the quantification of these benefits, and a means of

evaluating which entities benefit. A method of identifying scenarios for evaluating projects will also be needed. A transmission capital “avoided cost” methodology may be a major component of transmission project benefits, but should not be the only potential source of benefits.¹ Other potential benefits include improvements in reliability, changes in potential reserves and transfer capabilities, etc. Mr. Adamson believes it is important that the Transmission Provider, the Régie and other stakeholders and transmission customers work together to define an appropriate and workable mechanism for quantifying benefits and costs for allocation, subject to Régie approval.

Third, once there is a mechanism for quantifying potential costs and benefits, a specific allocation mechanism is needed. The following description provides a simplified example of how benefits-based cost allocation principles might be applied to allocate qualified transmission project costs:

1. Calculation of the average net benefits to each potential beneficiary across a range of scenarios, subject to limits on differences between scenarios.
2. If the average net benefit to an entity is zero, or if the ratio of its estimated benefits to costs is below a threshold level, that entity would not be allocated any project costs.
3. Allocation of remaining project costs based on the share of net benefits.

Mr. Adamson notes that the Régie can learn from the experience of utilities that are defining their cost allocation procedures in the U.S., especially in non-ISO/RTO regions which are more analogous to the situation of HQT. All of the initial Order 1000 compliance filings on cost allocation and other issues are available on the FERC website.²

¹ The FERC for example has rejected cost allocation methodologies relying solely on avoided transmission capital costs.

² <http://www.ferc.gov/industries/electric/indus-act/trans-plan/filings.asp>

2. Référence (i) Pièce C-NLH-0018, p. 27.

Préambule:

(i) *“Depreciation Assumptions for Calculating Maximum Allowance”*

“The HQT upgrade policy limits the depreciation assumption to 20 years in calculating the Maximum Allowance for new transmission assets required for new service, even if these assets are expected to have a far longer life. This is especially important for transmission customers requesting new service over longer periods of time. Even if they are willing to contract for firm service for a longer period, the HQT policy effectively limits their Allowance and raises their required contribution, as noted by Ms. Chang.

If these assets, as Ms. Chang notes, are likely to last longer than 20 years, this policy shifts costs unjustifiably onto these transmission service customers. These customers are willing to contractually commit to pay for transmission service, which will allow HQT to recover its costs over the entire period. However under the HQT upgrade policy the long-term benefits (the value of those assets after the 20 period is up, in which all costs have already been recovered) of these assets paid for by the customer contribution are spread across all users.” [nous soulignons]

Demandes:

- 2.1 *Veillez fournir des exemples de periods utilisées aux fins de recouvrement des coûts auprès des clients par des entreprises comparables en Amérique du Nord*
- 2.2 *Veillez préciser les critères sur lesquels repose le choix des différentes periods utilisées pour les entreprises comparables*

Réponses:

- 2.1 Mr. Adamson is not aware of a system corresponding completely to HQT's Maximum Allowance mechanism. However, there are standard practices for considering the useful life of new transmission assets placed in service by transmission providers. These practices define the period over which these costs may be recovered from customers and therefore are relevant to this issue. FERC-regulated utilities may prepare a depreciation study which defines the appropriate method for determining the depreciation rate and method (e.g. straight line or other) based on the estimated useful life of the asset or group of assets. For new transmission projects, Mr. Adamson believes that a typical useful life of 40 years is commonly used.
- 2.1 In standard ratemaking purposes, Mr. Adamson believes that it is common in a U.S. ratemaking proceeding for a transmission provider to use either standard previously-approved assumptions for determining the useful life and depreciation rate for new

transmission assets, or to make a specific filing to support any other assumptions for cost recovery. In determining the period for depreciation and cost recovery, the FERC considers in determining depreciation not only physical wear and tear but also obsolescence, changes in technology, changes in supply and requirements of public authorities.

Mr. Adamson believes that the same economic principles could be applied in Québec with respect to the determination of the Maximum Allowance in the current proceeding. For example, if HQT was adding new transmission lines solely to serve specific generation facilities with a fixed lifetime, it would make sense that these assets should require recovery over the lifetime of the generation, under the principle that the new lines will be made obsolescent at the end of that generator's fixed life. For regional transmission lines, it may make more sense to assume that such facilities may be in service for many years, and make Maximum Allowance calculations more consistent with typical regulatory depreciation calculations.

It is important in considering the recovery period for assets to separate the concepts of useful life from credit exposure. HQT's proposed policy apparently seeks to limit any financial exposure by assuming that any new facilities must use a maximum of 20 years for depreciating the asset for the purpose of calculating the Maximum Allowance, even if a transmission service customer is willing to contract for transmission service for a longer period.

3. Référence: (i) Pièce C-NLH-0018, p. 27.

Préambule:

“Second, while the text of HQT’s proposal with respect to these follow-ups is not completely clear, it appears that the follow-ups could result in additional payments from point-to-point customers to meet future HQT revenue shortfalls.”

Demande:

3.1 Veuillez expliciter l'extrait en préambule.

Réponse:

- 3.1 Mr. Adamson does not believe that the HQT policy proposals provide sufficient detail for the Régie or other interveners to completely understand the future operation of the proposed HQT annual follow-ups. The table in Appendix 2 of HQT’s Policy on Network Upgrades provides historical information on Generator revenues and commitments but does not explain fully the implications of the application of the follow-up mechanism for transmission customers.

The HQT Policy on Network Upgrades states “for each customer, the sum of annual revenues must offset the sum of commitments for all of its projects.”³ This would appear to imply that if HQT faced an annual revenue shortfall against commitments from a customer these could be recaptured in an additional contribution payment (in addition to the original Contribution) and transmission rates at prevailing rates.

If the intention of this policy is re-visitation of upfront customer contributions, this creates significant uncertainty for transmission customers who have to finance these contributions. Furthermore, it is not evident what protection customers have in the event the tariff increases significantly over the term of the transmission service agreement from that at the time when the maximum allowance is determined.

³ HQT, Transmission Provider Policy on Network Upgrades, page 25.