

IN THE MATTER OF the *Public Utilities Act* (the “Act”) and

IN THE MATTER OF an Application by Newfoundland and Labrador Hydro for approval of: (1) its 2004 Capital Budget pursuant to S. 41(1) of the Act; (2) its 2004 capital purchases, and construction projects in excess of \$50,000 pursuant to S. 41(3)(a) of the Act; and (3) its estimated contributions in aid of construction for 2004 pursuant to S. 41(5) of the Act

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TO:

The Board of Commissioners of Public Utilities (the “Board”)

THE APPLICANT’S BURDEN

1. The level of scrutiny afforded a capital budget application has increased in the last few years. The Board noted this trend in its decision on Newfoundland Power’s recent application seeking approval under s.41 of the *Public Utilities Act* for its 2003 capital expenditures (see P.U. 36 (2002-2003), p.5).
2. The increase in attention is understandable given the Board’s confirmation that the utilities are regulated on the basis of what is a fair and reasonable rate of return on their rate base. (P.U. 19 (2003).
3. Since rate base grows commensurate with the net gain in invested plant, a utility can, theoretically, increase its earned return in a given year, measured in absolute terms, by increasing the dollar value of its invested plant.
4. After reviewing Hydro’s 2002 capital budget application, the Board held in P.U. 7 (2002-2003), p.95:

The Board will require NLH commencing with its 2003 capital budget application, to use a net present value methodology together with supporting justification to evaluate projects of a material amount. Where a project is not evaluated against other acceptable alternatives and/or, if the project does not produce a positive net present value, sufficient rationale must be provided to justify implementation.

5. The Board also ordered Hydro to follow a set of guidelines when submitting future capital budgets (Schedule 3 to the Order).
6. These same guidelines now apply to Newfoundland Power by virtue of their inclusion in P.U. 36 (2002-2003) (p. 11).
7. In P.U. 36 (2002-2003), the decision resulting from Newfoundland Power's 2003 capital budget application, the Board states:

The Board acknowledges its role as one of testing the necessity and reasonableness of the utility's expenditures based on efficient management and operation of its assets as well as the equitable access to least cost and reliable power while at the same time maintaining a balance between the competing interests of consumers and investors in the utility. (p.6)

And later:

...the fundamental issue becomes one of justification and whether or not appropriate quantitative and qualitative data is available to the Board to determine the necessity and reasonableness of capital expenditures requested by the utility in meeting its legislative imperatives." (p.7)

8. Hydro argued during NP's 2003 Capital Budget Application that "for proper economic regulation to occur, the Board has to satisfy itself that the purpose, costs, benefits, alternatives and timing of every capital project is appropriate and reasonable."
9. Accordingly, Hydro's 2004 capital budget should be assessed against whether they have:
 - a. met the filing requirements of Schedule 3;
 - b. provided a NPV calculation against other acceptable alternatives; and
 - c. as a result, demonstrated that the project as proposed is necessary and reasonable.
10. Projects for which Hydro is seeking approval but for which they have not provided evidence of NPV comparisons against other acceptable alternatives, or which render negative net present values, will require additional justification.
11. While P.U. 36 (2002-2003) contains several other directions for the review of proposed capital projects, they apply to NP only. For example, NP was given instructions to provide, with its next application, a five (5) year capital budget plan and an analysis of capital expenditures made during the previous ten (10) years (p.26).

12. Hydro, however, did not receive a similar direction from the Board, either in P.U. 7 (2002-2003) or in the decision on its 2003 capital budget, P.U. 29 (2002-2003).
13. It would therefore, be patently unfair to test Hydro's 2004 capital budget proposal against a standard other than what it was directed to meet.
14. While the parties may argue for greater, or less, qualitative and/or quantitative documentation and/or justifications, Hydro's 2004 Capital Budget Application was filed under the rules and directions as directed by the Board in P.U. 7 (2002-2003) and the general directions provided to both utilities in P.U. 36 (2002-2003).

Technical Capital Budget Conference

15. Hydro's 2004 capital budget application marks what may be its last application under the existing rules and Board procedures.
16. In P.U. 36 (2002-2003), after acknowledging the concerns of the parties, the Board ordered NP to attend a technical conference where the issues of process and filing requirements for capital budget applications would be addressed. The Board also indicated that it expects Hydro to attend the technical conference. (p.11)
17. Although originally planned for 2003, this technical conference is to now take place in the early part of 2004.
18. It is beyond the scope of this hearing, and certainly beyond the scope of this submission, to canvass the issues involved, or likely to be raised, in a generic capital budget conference. Each party, arguing from their own vantage point, will, undoubtedly, have much to say, and write, concerning the evidentiary burden that should be met, the level and type of documentation that should be filed, the classification scheme that should be employed, and the various economic analysis that should be undertaken by the utility before proposing a capital project for approval under s. 41 of the *Public Utilities Act*. The Board has already identified some of the issues it feels should be addressed in the generic hearing (P.U. 36 (2002-2003), p. 9-10).
19. This does not however, preclude this Board panel from providing directions to Hydro concerning its current application. Nor does it impede this Board panel from exercising its jurisdiction as it sees fit.

Least Cost Consistent with Reliable Service

20. The principal goal of a utility's operations, including its capital budget process, is to deliver the lowest possible cost service consistent with reliable service. This requirement is mandated by s. 3 of the *Electrical Power Control Act*.

21. The EPCA states:

- s. 3(b) all sources and facilities for the production, transmission and distribution of power in the province should be managed and operated in a manner
 - (i) that would result in the most efficient production, transmission and distribution of power,
 - (ii) that would result in the consumers in the province having equitable access to an adequate supply of power,
 - (iii) that would result in the power being delivered at the lowest possible cost consistent with reliable service, and [remainder omitted]...

22. The relevant provisions of the *Public Utilities Act*, are as follows:

- s. 41(1) A public utility shall submit an annual capital budget of proposed improvements or additions to its property...and the budget shall include an estimate of [CIAC].
- s. 41(2) The budget shall contain an estimate of future expenditures on improvements or additions to the property of the public utility that will not be completed in the next calendar year”
- s. 41(3) A public utility shall not proceed with the construction, purchase or lease of improvements or additions to its property [without the prior approval of the Board] where
 - (a) the cost of the construction or purchase is in excess of \$50,000; or
 - (b) the cost of the lease is in excess of \$5,000 in a year
- s.41(4) Not later than April 1, “A public utility shall submit a report on its actual capital expenditures on improvements or additions...in the prior calendar year, together with an explanation as to expenditures in excess of those approved under [s.41(1)]”

23. One issue is whether each individual capital project, as so classified in the application, must meet the standard of section 3 of the EPCA.

24. That is, does section 3 of the EPCA require that each project meet the test of whether the project is, in and of itself, the least cost solution consistent with reliable service or, alternatively, whether, section 3 of the EPCA applies more

generally to whether the utility, on the whole, is delivering least cost service consistent with reliable service.

25. The Board's decision, in P.U. 7 (2002-2003), that a capital project may be approved, despite its not being least cost, if the utility can succeed in demonstrating that it is, nonetheless, justified, recognizes that a project must otherwise meet the least cost requirement. However, the Board has not expressly stated that this is its accepted interpretation of s.3 of the EPCA.
26. Similarly, we can not assume that Hydro's position as stated during NP's 2003 capital budget application that "the purpose, costs, benefits, alternatives and timing of **every** capital project is appropriate and reasonable" [emphasis added] means that Hydro accepts the proposition that every project must meet the requirements of s.3 of the EPCA.
27. It may be best to save any final pronouncement on the Board's interpretation of s. 3 of the EPCA, and any resulting test, for the generic hearing, where the issues can be more fully explored and the law authoritatively canvassed.

Projects

28. It is not the role of BHC to take a position, either for or against, on a particular capital project as proposed. As stated previously, the test that Hydro must meet, including the filing requirements for a capital budget application, have already been established by this Board.
29. However, direct comments will be made where, as is here, there are issues which impact more than one utility, or which have an impact on the general, supervisory role of the Board. This is particularly true where the capital project involves, or should involve, the participation of more than one utility.

Project B-71 – VHF Replacement

30. Hydro has applied for approval to expend a total of \$8.85 million, spread over 2004 and 2005, on a new VHF mobile radio system.
31. A considerable amount of evidence was led by Hydro to demonstrate the necessity and justification of the project, including a business case, and accompanying consultant's report.
32. The Board will have to determine whether, on the evidence, Hydro has met its burden as mandated by P.U. 7 (2002-2003), the Schedule 3 filing requirements, and general directions of P.U. 36 (2002-2003).

33. If approval is to be granted, the Board may wish to attach conditions to address the duplication issue.
34. In PU 36, the Board approved NP's proposed 2003 capital improvements to its telecommunications systems in the amount of \$383,000. This amount included \$35,000 to replace 30 VHF radios.
35. During the NP hearing, the Consumer Advocate questioned NP on sharing NLH's VHF radio system. NP stated at the time "that this option is not cost effective for them and they are not prepared to enter into such an arrangement at this time." (PU 36 (2002-2003), p. 21)
36. Previously, in P.U. 7 (2002-2003), the Board, after noting the lack of progress in avoiding duplication, wrote:
- The Board is of the opinion that with the right mindset by both utilities the question of duplication can be effectively and definitively resolved without future intervention of the Board.
37. A Report of Joint Co-ordination between Newfoundland and Labrador Hydro and Newfoundland Power was filed, as ordered by PU 7, in December of 2002.
38. Working Group #10 was responsible for exploring the opportunity to share in the use of a common VHF system. At page 10, the report states, "A consultant has determined that the additional initial capital cost of adding Newfoundland Power to Hydro's system would be in the order of \$3,000,000." However, this estimate may no longer be reliable given the fact that Hydro is leaning towards the purchase of a system that is materially different than the one originally proposed.
39. The report also notes that "Newfoundland Power has agreed to provide Hydro with input to ensure the design of the new system does not unnecessarily or unreasonably preclude the possibility of Newfoundland Power utilizing the system in the future." (p.10)
40. This could hardly be described as a rock solid commitment to participate fully in the design, selection, implementation, and operation of the new system.
41. In closing arguments on NP's 2003 Capital Budget Application, BHC submitted:

Information Technology

The Board should consider giving directions to NP, and subsequently Hydro, on the implementation of standard information platforms.

Both utilities are on the cusp of adopting new IT platforms – a process that will be perpetual. If coordinated, the utilities will be in a position in the future to share information electronically. The electronic sharing of information with each other, and with the Board, could reap significant productivity gains in the not too distant future.

If not coordinated, the utilities may find themselves unable to share and exchange information readily. Analogously, unless coordinated, we may end up in a situation where NP has all left hand cars and Hydro right hand, making their driving on the same roads rather hazardous.

The adoption of a common information platform will allow the utilities to share information electronically with each other, and, on the adoption by the Board of a similar platform, to share information with the Board electronically.

42. This same submission is appropriate in the context of project B-71 (save for the Board adopting a similar platform).

43. There is, it is submitted, ample evidence on record to show that while the utilities each operate and maintain VHF mobile radio systems, there has been little meaningful dialogue about sharing a new VHF system to achieve greater overall operational efficiency. NP has avoided making any meaningful, or enforceable commitments about sharing in the cost of and subsequently using the new VHF system. Hydro seems unconcerned by this lack of agreement, choosing to proceed with the project regardless.

44. Item (ix) of Schedule 3 from P.U. directs Hydro to file:

A description and related documentation outlining the results of any discussions of the project that have taken place between the utilities in an effort to reduce expenditures by avoiding duplication of services, or increased sharing of resources and expenses.

45. Since NP is now subject to this same direction by virtue of its inclusion in P.U. 36 (2002-2003), both utilities are under a positive obligation to work together on projects that allow for synergies and efficiencies.

46. It is submitted that the failure to meet, discuss and develop realistic and operationally based plans to make sharing happen should be at the peril of both utilities. In a market space as small as Newfoundland's, every effort should be made to avoid duplication.

47. In light of the absence of any meaningful agreement between the utilities on the joint operation of the proposed VHF replacement system, the Board may want to consider attaching conditions to the approval, assuming one is given, that are aimed at achieving this worthwhile objective.

48. Such conditions could include:

- a. By October 1, 2003, NP submit to Hydro a technical requirements document, including a detailed engineering assessment of the functional requirements needed by NP for operating a mobile VHF system in to the foreseeable future.
- b. By February 1, 2004, Hydro generate a detailed working specification of the new VHF system that Hydro has selected and deliver a technical specification document, together with detailed capital costs revised from vendor provided information, to NP;
- c. By February 15, 2004, NP confirm in writing to the Board, and Hydro, whether the VHF replacement project and its technical specification as described by Hydro will meet NP's future operational requirements for a VHF radio system, together with a NPV calculation comparing the remaining life expectancy of NP's existing VHF system against adopting the new VHF system at 2, 3 and 5 years out, together with confirmation of NP's participation in the new system once NP's existing VHF system has reached the end of its useful life as projected.
- d. In the event NP provides notice that it can not, or will not, participate as anticipated, the Board should require a show cause hearing in which the utilities are asked to account for the lack of agreement.
- e. In the event that NP provides notice that there is no technical, or other impediment to its using the new VHF system, NP and Hydro would provide, by March 31, 2003, confirmation of the basis on which the respective utilities would share in the capital and operating costs of the new VHF system.

Settlement Projects

49. The parties participated in a series of negotiations aimed at resolving any non-contentious projects, or those to which no party was objecting. A Settlement Report was filed with the Board detailing the outcome of this process. The Board has already adopted a portion of the Settlement Report in its early approval of project, C-2 (P.U. 20 (2003))

50. As a result, several projects as detailed in the Settlement Report are before the Board on the basis that no party is objecting to their consideration for approval.

Dark Skies

51. A recent letter to the editor of Sky and Telescope, the preeminent North American magazine for astronomy, addressed some of the difficulties in persuading utilities, and the general public to depart from standard lighting practices.
52. Newfoundland is in a unique position in that most of our sky is yet to be obliterated by wasteful and poorly designed lighting. While many urban areas, most notably the cities of St. John's and Mount Pearl, are already experiencing levels of light pollution that are having a detrimental impact on our ability to see the night sky, many other areas are still light pollution free. This should be preserved for aesthetic reasons, economic reasons and efficiency reasons.
53. Hydro has indicated that they will look at using low-pressure sodium lights wherever they are responsible for the maintaining street lighting. The Board, if for no other reason then it will result in lower costs for the municipality concerned, should commend and support Hydro in this effort.

Dated at St. John's, Newfoundland, this 23rd day of July 2003.

Mark Kennedy
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