

P.U. 36 (2002-2003)

IN THE MATTER OF the *Public Utilities Act*, RSN 1990, c. P-47 (the “*Act*”);

and

IN THE MATTER OF an application by Newfoundland Power Inc. for an Order pursuant to Sections 41 and 78 of the *Act*:

- a) approving its 2003 Capital Budget of \$55,790,000;
- b) approving the purchase, construction and leases in 2003 of the improvements and additions to its property as set out in the application; and
- c) fixing and determining its average rate base for 2001 in the amount of \$545,162,000.

BEFORE:

Robert Noseworthy
Chair and Chief Executive Officer

Darlene Whalen, P.Eng.,
Vice-Chair

John William Finn, Q.C.,
Commissioner

December 23rd, 2002

TABLE OF CONTENTS

I. BACKGROUND

- 1. THE APPLICATION3
- 2. BOARD AUTHORITY AND PROCESS3

II. REGULATION OF CAPITAL BUDGETS.....5

- 1. ROLE OF THE BOARD.....6
- 2. BOARD'S APPROACH TO REGULATION OF CAPITAL BUDGETS.....7

III. PROPOSED 2003 CAPITAL BUDGET

- 1. OVERVIEW.....11
- 2. 2003 CAPITAL PROJECTS.....12
- 3. 2003 CAPITAL BUDGET.....24

IV. 2001 RATE BASE.....26

V. ORDER.....28

I. BACKGROUND

1. THE APPLICATION

Newfoundland Power Inc. (NP) filed an application with the Board of Commissioners of Public Utilities (the “Board”) on August 2, 2002 requesting the Board make an order:

- a) approving the purchase and construction in 2003 relating to improvements and additions to its property as set out in the application, including approval of its 2003 Capital Budget in the amount of \$55,790,000; and
- b) fixing and determining its average rate base for 2001 in the amount of \$545,162,000.

On October 21, 2002 NP filed an amended 2003 Capital Budget application (the “Application”) altering the wording of the original application to include a request for approval of leases in excess of \$5,000 which were not contained in the initial application. The amended application was accepted and is the subject of this Decision.

2. BOARD AUTHORITY AND PROCESS

i) Legislation

Section 41(1) of the *Act* requires a public utility to submit an annual capital budget of proposed improvements or additions to its property to the Board for its approval not later than December 15 in each year for the next calendar year. This budget is also required to include an estimate of contributions toward the cost of improvements or additions to its property which the public utility intends to demand from its customers.

Section 41(3) prohibits a public utility from proceeding without the prior approval of the Board with the construction, purchase or lease of improvements or additions to its property

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 of the lease.

Section 78 gives the Board the authority to fix and determine the rate base for the service provided or supplied to the public by the utility and also gives the Board the power to revise the rate base. Section 78 also provides the Board with guidance on the elements that may be included in the rate base.

ii) Process

The Board published notice of the Application commencing on October 23, 2002 in various newspapers throughout the Province, setting the hearing date for November 13, 2002 and inviting intervenor submissions. On October 30, 2002 the Board received intervenor submissions from the government appointed Consumer Advocate (CA), Mr. Dennis Browne, and from Newfoundland and Labrador Hydro (NLH).

Pursuant to section 14(1) of the Board's Regulations, information requests were directed to NP from the Board, the CA, and NLH, and also to the Board from the CA. NP pre-filed testimony and exhibits for its witnesses with the Board and parties on October 28, 2002.

The public hearing convened on Wednesday, November 13, 2002 with the following parties appearing:

<u>Party</u>	<u>Represented By</u>
Newfoundland Power Inc.	Gillian Butler, Q.C. and Peter Alteen, LL.B.
Consumer Advocate, Dennis Browne, Q.C.	Stephen Fitzgerald, LL.B.
Newfoundland and Labrador Hydro	Maureen Greene, Q.C. and Geoffrey Young, LL.B.

The Board was assisted by Board Hearing Counsel Mark Kennedy, LL.B. and by Board Counsel, Dwanda Newman, LL.B.

At the opening of the hearing the CA filed a notice of motion with the Board respecting the disclosure of certain information by NP, specifically the minutes of the company's Board of Director's meetings where the 2003 Capital Budget was discussed and received corporate approval. The CA asked the Board to make an order compelling NP to provide full disclosure of the information requested. The Board heard this motion on November 15, 2002. Upon hearing

from the parties the Board denied the CA's motion but did afford the CA the opportunity to request the Board's financial consultants Grant Thornton to review the minutes and make their notes available to the CA.

During the hearing NP called the following witnesses:

Philip Hughes, C.A., President and Chief Executive Officer

Barry Perry, C.A., Vice President, Finance and Chief Financial Officer

Earl Ludlow, P. Eng., Vice President, Engineering and Operations

Nora Duke, Vice President, Customer and Corporate Services, and

Peter Collins, Manager, Information Services.

The CA and NLH participated in the hearing through cross examination of NP's witnesses and presentation of final argument. The hearing covered 7 days (November 13-15 and November 19-22) with final oral argument heard on November 28, 2002.

II. REGULATION OF CAPITAL BUDGETS

This Application represented a significant departure for the Board, NP and Intervenors in expanding the process surrounding a utility's capital budget application. The pre-hearing process and filing requirements were more rigorous, the evidentiary record more extensive and the length of the public hearing was considerably longer than any previous capital budget application before the Board.

Prior to 1997, the capital budget approval process for NP was in the form of a meeting conducted by the Board with the utility. The approval of the capital budget followed questions and discussion resulting from the meeting as well as prior supervisory/compliance reviews undertaken by the Board. Beginning in 1997, the Board initiated public hearings into NP's annual capital budget proposals. This 2003 capital budget application of NP is the first application of its kind where a Consumer Advocate has been appointed by government to represent the interest of consumers.

With a view to the precedent established by this Application, before examining the particulars of the 2003 capital budget and rate base proposals of NP, the Board feels there is

merit in reviewing some of the broader issues raised during the hearing with respect to capital budget applications in general.

1. ROLE OF THE BOARD

As previously outlined the statutory authority of the Board regarding a utility's capital budget is vested in section 41 of the *Act*. Section 41(1) requires a public utility to submit an annual capital budget to the Board for its approval. Section 41(3) prohibits the utility, above specified dollar limits set out in the legislation, from proceeding with the construction, purchase or lease of improvements or additions to its property without the prior approval of the Board.

The first key issue arising from the legislation centers on the role of the Board in carrying out its authority respecting approval of capital budgets submitted by utilities.

NP submits that the Board's role is to ascertain whether its proposed capital expenditures are reasonable and properly incurred in keeping with the statutory provisions governing the utility. NP points to section 3(b) of the *Electrical Power Control Act, 1994* and in particular notes that the utility has statutory obligations to ensure sources and facilities for the production, transmission and distribution of power are managed and operated in an efficient manner, consumers have equitable access to an adequate supply of power, and that this power is delivered at the lowest possible cost consistent with reliable service. In a regulatory context NP indicates that if the Board concludes proposed capital expenditures are reasonable based on these legislative imperatives, then the capital budget must be approved.

In addition to the legislation, the CA refers to Mr. Justice Green's comments in the Stated Case¹ that the Board is generally charged with balancing the competing interests of consumers and investors in the utility. The CA submits that the public utility must prove the necessity and reasonableness of any expenditure before the Board and it is the Board's duty to determine what appropriate expense burden the ratepayer must bear.

The Board acknowledges its role as one of testing the necessity and reasonableness of the utility's capital expenditures based on efficient management and operation of its assets as well as equitable access to least cost and reliable power while at the same time maintaining a balance

¹ Newfoundland (Board of Commissioners of Public Utilities)(Re)(1998), 64 NFLD. & PEI R. 60.(NFLD.CA)

between the competing interests of consumers and investors in the utility. Over the years, these principles have been generally accepted by parties before the Board in capital budget hearings and this hearing is no exception.

2. BOARD'S APPROACH TO REGULATION OF CAPITAL BUDGETS

While the role of the Board is set along relatively straightforward principles, the central challenge in implementing regulation is how this role gets operationalized. 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.

NP submits that its 2003 capital budget application meets the requirements of the legislation and is consistent with regulatory practices which have evolved over many years resulting from prior capital budget applications. NP indicates net present value (NPV) methodology is applied as appropriate in accordance with P.U. 6 (1991). Numerous regulatory reports on capital expenditures are also filed as requested by the Board in its supervisory capacity under section 16 of the *Act*. In addition, NP notes the Board has previously commissioned an independent engineer to review its technical operations, most recently in 1998².

NP further argues the Board's supervisory mandate is to determine if the proposed capital budget is a reflection of sound management and engineering judgement but contends this mandate should not extend to a detailed review by the Board of the accounting or the engineering data and tools that underlie these judgements. NP submits that excessive detail is neither required in a capital budget application nor is it necessary in order for the Board to cost effectively fulfill its own mandate. NP submits the Board should not micro-manage the utility nor attempt to manage it at all.

NP concludes that its interpretation of the legislation, processes, justifications and reporting requirement which have matured and evolved over the years contains no ambiguity for

² Report on Newfoundland Light & Power Co. Limited Re Quality of Service and Reliability of Supply, Prepared for the Board by D.G. Brown, P.Eng., 1998-10-22

NP and the utility expressed a caution to the Board as to how it should treat these issues as a result of this hearing.

The CA referred to the Stated Case and again noted the comments of Mr. Justice Green that the Board has the right to obtain from the public utility all information necessary to enable the Board to fulfill its duties. The CA concurs with NP that the Board is not the manager of the utility and should not as a general rule substitute its judgement on managerial and business issues for that of the officers of the enterprise. The CA concludes that management's function is to set the level of expenses and reiterates that the Board's duty is to determine what appropriate expense the ratepayer must bear.

The CA argued NP's capital budget contains a number of shortcomings relating to expenditure variances, long-term planning, project justification/monitoring and its historical context.

NLH outlined in its final argument that consistency by the Board in regulating each utility was an important issue. NLH further endorsed the position that the Board should not micro-manage but acknowledged 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.

Board Hearing Counsel suggested a number of possible actions/directions the Board may wish to address arising from this hearing, including:

- Enhanced reliability targets tied to justifying capital expenditures and improving customer service;
- Financial benchmarking to determine an acceptable level of capital spending;
- Adoption of a policy on how utilities should view reports by Board experts;
- Distinction between expenditures for projects related directly versus indirectly to the provision of electrical service;
- Clarification of the budgetary approval process; and
- Improved technical monitoring by the Board of capital expenditures.

The Board acknowledges the importance of effectively regulating the capital expenditures of the utilities in discharging its broader obligations pursuant to section 80 of the *Act*, which mandates the implementation of a sound regulatory framework founded in rate base

regulation. Rate base by definition is the amount of investment comprising primarily depreciated plant and equipment plus working capital as well as certain deferred assets/costs attributable to future operations. The annual level of capital expenditures, and hence improvements and additions to property and equipment, contributes directly toward the setting of rate base and influences the cost of electrical service to the customer. In addition, the Board is cognizant of the ever-increasing complexity and technical considerations surrounding the supply of electricity by both utilities operating in the Province.

The Board accepts that NP's capital budget conforms with processes and procedures that have evolved over time. The Board is confident that sound engineering and managerial judgement is exercised by NP respecting the capital budget. The Board notes that corporate performance measures involving reliability, operating costs, and customer service have improved during the past few years and NP is to be commended for the positive trending in these key areas. The Board is also encouraged by the comments of Mr. Philip Hughes, NP's President and Chief Executive Officer, that he will be striving to further improve performance in these areas.

Despite these findings, the Board is ever cognizant of its own on-going responsibility to improve the regulatory framework under which utilities operate. Bearing this in mind, the Board acknowledges a number of concerns expressed throughout the course of the hearing by the intervenors and Board Hearing Counsel involving the regulation of NP's capital expenditures. Some of the more significant issues are as follows:

- The adequacy of existing tests and measures justifying to the Board the necessity and reasonableness of capital expenditures was raised. Some examples raised by the CA and Board Hearing Counsel include reliability measures, requirements for NPV analyses and enhanced project justification.
- The most recent independent technical reviews conducted by the Board of both NLH's and NP's operations were completed in 1999. The Board feels such reviews are useful and necessary in order for it to properly supervise the technical and operating characteristics of the utilities. The value of such an assessment was recognized by both the CA and Board Hearing Counsel at this hearing. The scope, timing and methodologies to be used in subsequent reviews should be examined with a view to improving the usefulness of these reviews to both the Board and the utilities.

- The question of the Board applying fair and consistent regulatory practices and requirements on each respective utility while recognizing their fundamental differences was an important issue which emerged from the hearing. This topic was raised by both NLH and the CA. NLH indicated Board guidance on this question as one of its primary motivations for intervening in the hearing. As an example, the Board notes that, based on NLH's requests for information on the applicability of the minimum filing requirements currently in place for both utilities, there seems to be a difference in interpretation of the guidelines and the projects to which they apply. These guidelines, which were put in place on the basis of a joint report from both utilities in 1998, should be reviewed.
- The issue of proper long range planning was raised by the CA during the hearing. The Board feels appropriate statements of goals and objectives by the utility coupled with measures and outcomes explaining whether or not such goals and objectives have been achieved will serve to better fulfill the regulatory obligations and responsibilities of the Board and hence reduce potential conflict between the role of the Board and the role of management.
- The separation of issues pertaining to the capital budget application and which issues, more appropriately, should be addressed as part of NP's General Rate Application filed with the Board on October 11, 2002, became the subject of argument at this hearing. For example, the question of whether or not it was absolutely critical that approval of the 2001 rate base be considered as part of the capital budget proceeding was raised. While the Board ruled on these matters in this Application, the parties may benefit in future from the development of suitable guidelines governing capital budget applications.
- The issue of what constitutes a project impacts the clarity, justification and regulatory accountability respecting capital budget applications. The Board believes a focus on enhanced project definition, format and justification will benefit both the utilities and the Board in streamlining future capital budget applications.

The Board is of the opinion that these specific concerns, along with any other regulatory matters of interest to the parties surrounding the capital budget, should be addressed. While the Board concludes there was insufficient evidence available to it at this hearing to render decisions on items identified above, the Board believes there is merit in exploring these capital budget

issues with the utilities and interested parties in the form of a technical conference. To that end NP will be required to attend a technical conference where the issues of process and filing requirements for capital budget applications will be addressed. It is also expected that this conference should serve to clarify the responsibilities of the utility and the Board with respect to the capital expenditure approval process as required under the *Act*. The Board anticipates other parties will be involved in this process, including NLH. An agenda identifying issues for the technical conference along with its timing will be formulated in consultation with the conference participants. NP will be required to attend a technical conference addressing the ongoing regulation of capital expenditures upon the terms and conditions directed by the Board.

Until these issues are addressed, the Board is of the opinion that it is necessary to provide specific guidelines to the utility for its next capital budget application. In P.U. 7(2002-2003) the Board ordered NLH to adhere to specific guidelines for its capital budget applications. The Board notes the argument of NP during the hearing that each utility is unique and that the same guidelines may not be appropriate. While the Board acknowledges the differences in the two utilities it finds that the guidelines as set out in P.U. 7(2002-2003) are appropriate to NP and would be of assistance to the Board in making a determination on the reasonableness of proposed capital expenditures.

NP will be required to follow guidelines and procedures with respect to capital budget applications in the future. Until further directed by the Board NP will follow the guidelines as set out in Schedule C to this Decision, which are based on those set by the Board for NLH in P.U. 7 (2002-2003).

III. PROPOSED 2003 CAPITAL BUDGET

1. OVERVIEW

NP has proposed a total capital budget of \$55,790,000 for 2003, according to the following breakdown:

Energy Supply	\$ 7,076,000
Substations	\$ 5,887,000
Transmission	\$ 4,629,000
Distribution	\$25,707,000
General Property	\$ 1,660,000
Transportation	\$ 2,141,000
Telecommunications	\$ 383,000
Information Systems	\$ 5,507,000
General Expenses Capital	<u>\$ 2,800,000</u>
	\$55,790,000

Each category of the capital budget consists of individual expenditure items organized along common subject lines. The Board will not describe or refer to each individual expenditure in this Decision but rather will focus its discussion and specific findings on those projects or expenditures in each category that have been objected to or questioned by the parties or those which the Board makes a specific finding on as a result of the proceeding.

2. 2003 CAPITAL PROJECTS

i) Energy Supply

This category consists of projects related to facility rehabilitation at NP's hydro and thermal plants, penstock replacement at Lockston, purchasing portable diesel generation, and major electrical equipment repairs. The CA questioned NP's proposal to purchase a portable generation unit.

NP currently has three (3) portable generation units, consisting of one 7.2 MW portable gas turbine and two portable diesel generators, rated at 700 kW (Portable #1) and 670 kW (Portable #2). All three portable generation units are located at NP's Grand Bay substation in Port aux Basques unless required elsewhere. These units are usually run during system outages in the area. NP plans to decommission Portable #2 in 2003 as it is no longer roadworthy.

In its Application NP is proposing to purchase a 2.5 MW portable diesel generating unit at a cost of \$1,500,000. It is proposed that the new portable generation unit be located at a radially fed substation during the winter months and, in the summer, the unit will be moved as necessary to support construction or repair activities.

The CA submits that NP has allowed the existing portable diesel generating units stationed at Port aux Basques to deteriorate to the point that they now need to be replaced instead of completing necessary maintenance work to extend the service life of the units. The CA points to NP's 1997 inspection reports filed in response to CA-17 which indicated that the service lives of both Portable #1 and Portable #2 could be extended if certain capital improvements were undertaken. The CA argued that NP could repair the existing diesel units and there is no need to purchase additional portable diesel generators at this time.

The Board accepts NP's evidence that the existing units should be decommissioned and replaced with a single 2.5 MW portable diesel generating unit as proposed. It is apparent that, even if the existing units could be refurbished, their capacity will not add much value to the system in terms of back up or emergency generation. The Board also notes the environmental concerns identified by NP associated with the existing units in terms of fuel handling and storage. It is the Board's view the expected useful life of the existing units is limited based on their age and condition.

The Board also notes its direction to NP in Order No. P.U. 1(1998-99) in which the Board dealt with the removal of certain diesel generating plants from service, including the diesel generating plant at Port aux Basques. In this Order the Board consented to the removal of the Port aux Basques plant as soon as practical after the commissioning of Rose Blanche Brook hydroelectric plant. In addition the Board also ordered that *"the diesel generating unit #10 at Port aux Basques, as well as the portable diesels currently stationed at the Grand Bay Substation, remain operational and maintained at their respective sites and that the portable units be relocated to other locations only in the event of an emergency"*. On the basis of the information before it the Board is satisfied that NP has complied with this directive. The Board is not satisfied that the circumstances in terms of service reliability under which the 1998 order was made have changed and will require the new 2.5 MW unit to be stationed in Port aux Basques.

The Board will approve the proposed improvements and additions in relation to Energy Supply in the amount of \$7,076,000. Unless otherwise directed by the Board, the 2.5 MW portable diesel unit being purchased will be required to be stationed in Port aux Basques unless required for emergency purposes or for planned construction activity.

ii) Substations

This category consists of a number of projects targeted at some of NP's 137 substations, including rebuilds, replacement of deteriorated and/or obsolete equipment, and improvements to monitoring and protection equipment. The budget also includes expenditures to add transformers to the Virginia Waters and Chamberlains substations at a cost of \$1,150,000 and \$1,250,000 respectively. In addition an amount of \$1,200,000 is proposed for continuation of a feeder remote control project that was initiated in 2002. This project involves replacing a number of aging, limited function, electromechanical feeder relays and oil-fired reclosers with modern multi-function electronic relays and reclosers that can be remotely controlled from the System Control Centre.

Projects that were questioned extensively in this category were the addition of the transformers at the Virginia Waters and Chamberlain substations. The CA questioned the need for these transformers and suggested that an upgraded transformer be used in these substations rather than putting in additional units.

The addition of power transformers at the Virginia Waters and Chamberlains substations was justified by NP on the basis of customer growth, with NP stating that these areas are two of the highest growth areas in its service territory. NP also submits that the additional transformer capacity to be installed at these substations will enable the company to continue to carry the entire substation load in the event of the failure of another substation transformer, except at times of peak load. A third 66/12.5kV 25 MVA transformer is proposed to be added to the Virginia Waters substation and a second 66/25kV 25 MVA is proposed for the Chamberlains substation.

NP has also indicated that the peak load at the Chamberlains substation has exceeded the nameplate capacity of the existing transformer, and that continuing to operate at +100% is not recommended. At the Virginia Waters substation the peak load on one of the two existing transformers is forecast to exceed its nameplate capacity in 2003 and the other transformer is approaching its nameplate capacity. The addition of these transformers will also provide greater operating flexibility at these substations.

The Board is satisfied that the proposal to add these transformers is justified on the basis of the projected customer growth and the existing operating loads at both substations.

The Board will approve the proposed improvements and additions in relation to Substations in the amount of \$5,887,000.

iii) Transmission

This category consists of projects aimed at rebuilding various transmission lines on NP's system (\$4,129,000) and also included an amount of \$500,000 for a Transmission System Engineering Study.

A number of questions were asked regarding NP's proposal to rebuild 11 km of the 66kV transmission line 24L which, along with the 66 kV line 17L, connects customers on the Southern Shore to the grid via the Goulds Substation. In its response to CA-28, NP stated that climbing inspections of both these transmission lines indicated the need for extensive upgrading, raising both reliability and safety concerns. NP has also indicated that, from a reliability perspective, one transmission line serving the Southern Shore is sufficient given the number of hydro plants and the load in the area. Since 17L would require more extensive upgrading NP has decided to focus on 24L and to retire 17L from service. On the basis of the information before it the Board accepts NP's proposal to upgrade 24L and to retire 17L from service. On-going monitoring by the Board of reliability and outage statistics will show whether the Southern Shore area is adversely affected by this decision.

NP has also proposed an expenditure of \$500,000 for a transmission system engineering study which is described as "*a detailed engineering study that will analyze opportunities to significantly improve the reliability of electrical service to customers served by radial transmission lines in the Old Perlican/New Chelsea area and the Port aux Basques/Rose Blanche area.*" The study is intended to include an evaluation of alternatives, such as the creation of a looped transmission system or the addition of generating facilities, as well as the detailed engineering necessary to determine the costs of the recommended solutions in preparation for possible construction in 2004. The \$500,000 costs are broken down evenly with \$250,000 allocated to each study area.

The CA argues that NP has not provided sufficient justification for the study on the basis that the reliability statistics, particularly in the Port aux Basques area, do not seem warrant such a study. The CA also pointed to the fact that there have been considerable expenditures in the Port

aux Basques area in recent years aimed at improving the reliability for customers, including \$14,000,000 on the Rose Blanche Brook hydroelectric development in 1998, which was justified at the time on the basis of improving reliability. In addition, it was pointed out that NLH has applied to the Board for approval of an expenditure in 2003 of \$2,946,000 to complete upgrade work on TL214, which is the transmission line that services the Port aux Basques area.

On the basis of the information before it the Board is not prepared to approve this expenditure of \$500,000. The Board points to differing project scopes outlined in the responses to information requests, and an insufficient breakdown of project costs which does not seem to correspond to the study purpose. For example, the proposed expenditure includes amounts for land acquisition and environmental preview reports, which, in the Board's opinion, are not properly a part of a study of alternatives as described by NP. In addition, it was indicated during the hearing that in its 2003 capital budget application NLH has applied for approval of \$2,946,000 to undertake work on TL214 to address reliability problems in the Port aux Basques area. It was not clear to what extent this work, when complete, will help in addressing the reliability issues in the Port aux Basques area that NP proposes to examine in its transmission system study. While the Board notes such a study may or may not be warranted, the information provided appears to be conflicting and insufficient to justify approval at this time. The Board will accept a supplementary capital budget application from NP for this study but such an application should include a complete description of the reliability issues for each area to be studied, including the expected impact of NLH's work on TL 214, and a more comprehensive breakdown of the study components and the outcomes expected at each stage, along with their associated costs.

The Board does not approve the expenditure of \$500,000 for the Transmission System Engineering Study. The Board will approve the proposed improvements and additions in relation to Transmission in the amount of \$4,129,000.

iv) Distribution

The proposed expenditure in the Distribution category of \$25,707,000 represents 46 percent of NP's capital budget for 2003. This category includes proposed expenditures of \$11,790,000 related to customer growth in the areas of line extensions, transformers, meters and

services. While the budget is estimated based on historical data the amount spent in each area will depend on actual customer growth. The budget for transformers also includes provision for replacement of deteriorated and damaged transformers, and for capacity upgrades for existing customers.

The Distribution category also includes several projects focused on upgrading and maintenance of NP's distribution lines. An amount of \$2,745,000 has also been proposed for reconstruction, which involves replacement of deteriorated or damaged equipment that is identified during line inspections or reflect operational problems. This amount is estimated based on historical expenditures related to unplanned repairs, and includes an allowance for the estimated cost of anticipated requirements of Aliant Telecom Inc. with respect to joint-use poles. An amount of \$3,504,000 is budgeted for rebuilding distribution lines that have been identified as being in need of repair based on their physical condition. An amount of \$1,078,000 has been included as part of the distribution reliability initiative, which targets those distribution lines with below average reliability. NP plans to focus in 2003 on the distribution feeders in Glovertown (GLV002), Long Lake (LGL-02) and Milton (MIL-02).

Other specific projects identified in this category include an allocation of an amount of \$275,000 for relocating/replacing distribution lines for third parties, improving distribution system protection/operation (\$457,000), and switch replacement and upgrade underground distribution on Water Street in St. John's (\$762,000). An amount of \$100,000 is also included for interest during construction calculated in accordance with Order No. P.U. 37 (1981).

There were no specific issues raised during argument concerning any of these projects and the Board is satisfied that the proposed expenditures are necessary and reasonable.

The Board will approve the proposed improvements and additions in relation to Distribution in the amount of \$25,707,000.

v) General Property

This category includes an expenditure of \$770,000 for replacement of tools and equipment for line and support staff, as well as the replacement or addition of office furniture and equipment. An amount of \$140,000 is also proposed for maintaining buildings and facilities.

This category also includes an allowance of \$750,000 for unforeseen expenditures not budgeted elsewhere.

The CA raised the issue of budget allocated for unforeseen items and the level of this allowance to be set by the Board.

NP provided an explanation of the operation of the Allowance for Unforeseen Items account in CA-44 (c) where it is stated: “ *The purpose of the account is to permit the company to act expeditiously to deal with events affecting the electrical system in advance of seeking specific approval of the Board. It would not be practical in these situations for the Company to delay making capital expenditures, which may be in excess of \$50,000, to restore service while awaiting Board approval.*” Under cross-examination Mr. Ludlow referred to the Allowance for Unforeseen Items as “an enabler or a trigger” to allow NP to react quickly to respond to restoration of power and stay within the spirit of the *Act*. This explanation agrees with the Board’s intention of the use of this account, which was put in place to allow NP to proceed with repairs in emergency situations without being in contravention of section 41(3) of the *Act*. The Board also notes that the variance in this account for the last number of years has been (\$750,000) meaning that NP did not have any expenditures allocated to this budget item. Where the account has been used, the expenditures are subsequently allocated to the appropriate budget category for end of year reporting.

With regard to the argument of the CA that the budget of \$750,000 in the Allowance for Unforeseen Items account be reduced, the Board is not convinced such a reduction is necessary. NP is not able to predict the level of expenditure which might be required to restore power in the event of an emergency but, based on recent experiences with lightening damage, NP submits \$750,000 is a reasonable allocation for most situations. If the provisional amount is not needed, the money is not spent. Alternatively, if more than \$750,000 is required to respond to an extraordinary or catastrophic event, customers will not benefit from a downward adjustment in this account. NLH has a similar capital budget account approved by the Board which is set at \$1,000,000 and is intended to operate in the same manner. The Board also acknowledges, even with the recently implemented insurance policy respecting storm damage on transmission and distribution lines, the Allowance for Unforeseen Items would still be necessary to effect the emergency repairs until the insurance claim is processed.

The Board will approve the proposed improvements and additions in relation to General Property in the amount of \$1,660,000. The Board will, however, require NP to separate the budgeting for General Property and the Allowance for Unforeseen Items and to report the actual expenditures and variances separately. This is consistent with NLH's reporting and will provide for easier tracking of the General Properties category expenditures.

vi) Transportation

This budget category includes an amount of \$2,141,000 for the replacement of passenger vehicles and line trucks. NP plans to purchase 48 passenger/off road vehicles at a cost of \$866,000 and 7 heavy fleet vehicles at a cost of \$1,275,000. The passenger/off road vehicles include cars, light duty trucks, snowmobiles, ATVs and trailers.

The CA raised a number of issues regarding this proposed expenditure. It was argued that the budget for replacement vehicles could be reduced by \$300,000 because NP has an overabundance of vehicles. As well the replacement criteria for vehicles was questioned, with the CA suggesting that, with better warranties available, NP should be able to get more use out of their vehicles. Finally, the CA objected to NP's policy on personal use of company vehicles, arguing that the use of vehicles should be tied to the provision of electrical service.

NP provided considerable information on this issue through responses to information requests and other undertakings filed for the CA during the hearing.

The Board is not convinced the 2003 budgeted expenditure for vehicles should be reduced. NP has indicated that these expenditures are for replacement vehicles only and that no additional vehicles are being purchased. The Board notes that since 1997 NP has reduced the total number of vehicles in its fleet by 23%, from 536 to 414.

On the question of whether the replacement criteria itself is encouraging early or unnecessary replacement of vehicles, the Board has insufficient evidence to indicate this is the case. In response to CA-45 (f) NP provided information on the vehicle replacement criteria used by NLH as filed in NLH's 2001 General Rate Application. The CA suggested that this information shows that NLH is able to get more use out of their vehicles than NP. NLH uses a 5-7 year/>150,000 km replacement cycle for passenger vehicles considering maintenance cost

and condition. NP uses an assessment of the remaining useful life of each vehicle as the basis for the decision for replacement, taking into account the overall condition, maintenance history and immediate repair requirements. According to NP the average life span of its passenger vehicles is 5 years or 150,000 km and for heavy fleet vehicles the average life span is ten years or 200,000 km. In reviewing CA-45 (a), it is clear that the vehicles being replaced will, in almost all cases, be older than 5 years as of 2003 and will have odometer readings of over 150,000 km. When considering the maintenance costs in addition to the age and mileage the Board is satisfied that the proposed replacements are reasonable and prudent.

In CA-45 (g) NP provided a copy of its policy for personal use of company vehicles. This policy clearly refers to the use of vehicles by employees while on stand by, which the Board accepts as being directly related to the provision of electrical service. For those employees the policy states clearly that “*the use of company vehicles for other than business purposes will be restricted to incidental usage.*” The Board does not take any issue with the need for standby employees to have immediate access to a vehicle in order to respond to an emergency call. It is not clear from the evidence and Mr. Ludlow’s testimony on cross-examination by the CA, that the company enforces restrictions on incidental usage or whether employees have access to company vehicles when they are not on standby. For example Mr. Ludlow indicated in response to a question from the CA that he might not restrict an employee from taking such a vehicle off island for personal use. The Board expects NP to restrict the use of company vehicles by employees to necessary usage related to the provision of electrical service and to not allow personal use of company vehicles by employees except for incidental use while on standby as covered by the policy.

The issue of the potential costs associated with the use of company vehicles for personal use by employees where the vehicle is not part of the employee’s compensation package or where the employee is not on standby status can be more appropriately dealt with as part of the Board’s review of operating expenses. The Board agrees that regulated expenses relating to vehicles should only include those expenses that are related to the provision of electrical service. The Board may request additional evidence on this issue as part of NP’s General Rate Application.

The Board will approve the proposed improvements and additions in relation to Transportation in the amount of \$2,141,000.

vii) Telecommunications

This category includes an expenditure of \$242,000 to replace or upgrade communications equipment and an amount of \$141,000 to install substation telephone circuit protection. There were no specific concerns raised regarding this budget category or the projects proposed by NP.

The CA did raise the issue of potential sharing by NP of NLH's VHF mobile radio system. This issue was also raised during NLH's 2001 General Rate Application. NP has included in its 2003 budget an amount of \$25,600 for the replacement of 20 VHF Mobile Radio units and \$10,000 for the replacement of 10 VHF Portable Radio units. Upon questioning from the CA NP confirmed that NLH does have a similar VHF system. On the issue of NP sharing NLH's VHF radio system, NP stated that this option is not cost effective for them and they are not prepared to enter into such an arrangement at this time.

NLH had proposed to replace its entire VHF Mobile Radio system in their capital budget application for 2002 at a total cost of \$8,700,000 spread over two years. In P.U. 7 (2002-2003) the Board did not approve this project, requiring NLH to file further justification. NLH did not apply for Board approval of this project in its 2003 capital budget application but did confirm during this proceeding that it plans to reapply as part of its 2004 capital budget application to Board. The Board also ordered NLH to file by December 31, 2002, a final report on the results of joint efforts to date to reduce duplication between NP and NLH. The Board has been made aware that there have been discussions on this issue between the utilities. Any further consideration of the issue of duplication and sharing of resources will only be taken after receipt of this report.

The Board is cognizant of the safety issues involved and the importance of personnel having access to a reliable communications system. The Board does not regard NP's proposed purchase of 30 VHF Radio units at a cost of \$35,000 to be unreasonable.

The Board will approve the proposed improvements and additions in relation to Telecommunications in the amount of \$383,000.

viii) Information Systems

This budget category consists of a number of projects relating to the information systems and computer technology infrastructure. The total expenditure proposed is \$5,507,000. The Board notes that the proposed budget of \$5,507,000 represents 9.9% of the total capital budget or 10.6%, if the expenditures relating to the purchase of joint-use poles from Aliant is excluded.

A number of issues were raised with respect to this category. It was suggested by the CA that the budget for Information Systems is too high or has been over-stated. The CA argues that NP has over budgeted in this expenditure category in the past and that the Board should disallow a portion of the budget for Information Systems. The CA points to information in Table 1 of CA-50 (c) on internet enhancements, stating that this information shows in every year except 2001 the budget presented by NP is significantly higher than that actually spent. It was suggested that a reduction of \$50,000 would be warranted for this category. The CA also questioned the unit cost of \$4,500 identified for replacement of 17 laptops, suggesting that this expenditure might be overstated by \$36,000 to \$40,000. In final argument the CA stated that NP has in the past five years over budgeted in the area of Information Systems by \$260,000.

In terms of specific projects the CA took issue with NP's computer inventory and the expenditure related to internet enhancements. With respect to the computer inventory the CA suggests that NP has an over supply of personal computers and points to the fact that NP retained 68 computers in 2002 that were designated to be retired. In the CA's view this fact should raise a question of whether NP actually needs the 140 computers for which it has requested expenditure approval in 2003. In the area of internet enhancements it was suggested by the CA that the \$60,000 expenditure related to internet enhancements is not a necessary expense since it only benefits 30-40 percent of NP's customers who have access to the internet.

As the CA pointed out during final argument, the Board dealt with the issue of NP's increasing expenditures in information technology in 1998. In P.U. 36 (1998) the Board required NP to file a report on the company's information technology strategy for the period 1999 to 2002, identifying planned expenditures, expected productivity gains and cost savings, and other benefits the company may realize as a result of these expenditures. This report which was filed in response to NLH-28, projected expenditures for 2002 of \$4,750,000, compared to a forecast expenditure of \$6,279,000 (CA-2), and a budget of \$6,298,000 approved by the Board. The

Board notes that many of the Information Systems projects in the 2003 budget relate to new projects aimed at addressing the risk of continuing to use the OpenVMS platform upon which many of NP's applications are supported, in particular the Customer Service System Study (\$170,000), projects in the Facilities Management budget (\$562,000), the Operations Support Systems (\$383,000), and the Outage Management project (\$282,000). The overall budget of \$5,507,000 would be reduced to approximately \$4,100,000 without these projects, comparable with the budgets of 1999 and 2000.

The Board also points to CA-2, which shows the variances since 1993 in the budget and actual expenditures for Information Systems. The Board does not agree that this information shows a consistent over budgeting since 1998 by NP in this expenditure category. During this period the variances range from 9% under budget in 2000 to an over budget of 19% in 1998. The Board has been provided with reasons for the variances in the capital budget variance reports filed with the Board each year and its Financial Consultants review the variances as part of the annual financial reviews. The Board has insufficient evidence to make a finding of consistent over budgeting and will not order a reduction in this expenditure area on that basis. The Board is of the view, however, that an update of the Information Technology Strategy Report should be prepared by NP.

Based on the information provided in CA-103 (b) regarding computer inventory and replacement practices at other utilities, the Board is satisfied that NP does not maintain excess computers or replace them at a rate that would encourage unnecessary retirements. Compared to other utilities NP appears to have what the Board would consider a "middle of the road" approach to its management of its personal computer infrastructure.

The Board will approve the proposed improvements and additions in relation to Information Systems in the amount of \$5,507,000. The Board will order NP to file an updated Information Technology Strategy Report for the period 2004-2008 as part of its 2004 Capital Budget application.

ix) General Expenses Capital

The 2003 Capital Budget includes an amount of \$2,800,000 for General Expenses Capital (GEC). The source of the items in the GEC account is direct charges to GEC and amounts

allocated from specific operating accounts. NLH-41 provides a breakdown of the forecast GEC for 2003.

NLH questioned NP about the calculation of the GEC, specifically with respect to the labour cost component. There was no evidence presented to indicate that the calculation of the GEC as presented by NP should be adjusted.

Over the period January 1, 1995 to December 31, 1999 NP has been moving from a full cost method to an incremental cost method of allocating costs to GEC based on Order No. P.U. 3 (1995-96). This has resulted in a decrease in the amount of GEC from a level of \$10,500,000 in 1995 to \$2,500,000 in 2002. The Board's financial consultants Grant Thornton have reviewed this account as part of their annual financial reviews and confirm that NP is in compliance with Order No. P.U. 3 (1995-96).

The Board is satisfied that the calculation of the amount to be allocated to GEC is in accordance with Order No. P.U. 3 (1995-96) and will approve the \$2,800,000 included in the 2003 Capital Budget.

3. 2003 CAPITAL BUDGET

Before dealing with the 2003 Capital Budget the Board feels there is merit in reviewing the overall level of the Capital Budget in relation to previous years. CA-1 sets out a summary of NP's capital budget expenditures since 1993. In final argument NP explains that in the five (5) year period from 1998 to 2002 the annual capital budget averaged \$49.4 million, whereas historically over the past twenty (20) years the capital budget has ranged from a low of \$30.9 million in 1996 to a high of \$68.02 million in 1990. NP points to CA-72(d) which outlines average capital budget per customer expenditure, as follows: 1990 -\$354; 1992 - \$240; 1996 - \$148; and forecast 2003 - \$253 (\$235 excluding Aliant). In describing NP's future budgetary directions, Mr. Hughes estimated annual capital expenditures in the \$50-\$60 million range over the next three years assuming inflation stays much the same and excluding the Aliant pole purchase. Mr. Hughes suggested beyond this timeframe he would not be certain of any projections.

In final argument the CA questioned the expansion of the capital budget in relation to historic levels. The CA also suggested that NP is assisting with the growth of its capital

expenditures through corporate advertising in direct violation of Order No. P.U. 6 (1991) and pointed to various examples of NP printed ad material to demonstrate his point. In addition, the CA expressed concerns in final argument regarding the level of the variance of actual versus budgeted expenditures by category (e.g. substations, distribution, transmission, etc.).

Mr. Hughes stated that NP does not engage in advertising for purposes of increasing the use of electricity but rather provides factual information on such areas as conservation and pricing of electricity. In direct examination Mr. Ludlow reviewed 2002 budgetary variances by category and explained particular circumstances which contributed to specific variances.

The Board does not believe NP is in violation of Order No. P.U. 6 (1991) based on its advertising expenses.

In examining NP's historic level of capital expenditures, the Board is, however, cognizant of the stepwise increase evidenced in certain years and the resulting new level of expenditures or trending established and continued into the following years. NP explained the increase in its 1998 capital budget resulted from under investment during the period 1993 to 1997 due to the economic downturn associated with the cod moratorium. The capital program expenditure fluctuated around the 1998 level until 2002, when another sharp increase in capital expenditure occurred, which is being further expanded into 2003 as proposed in this Application. Excluding the Aliant joint-use pole purchase, the Board notes capital expenditures have grown more than 17%³ over the past two (2) years and in excess of 67%³ over the last six (6) years. Given the current 2003 capital budget application of \$51,746,000 (excluding Aliant) and Mr. Hughes' assessment that the comparable figure could range in the next 2-3 years between \$50-60 million assuming constant inflation, the potential for further step increases in capital expenditure patterns exist.

While acknowledging annual budgetary versus actual variances are reported to the Board with explanations, the Board believes more stable and predictable year over year capital budgets for NP is a desirable objective which will assist in fostering stable and predictable rates for consumers into the future. The Board understands the uncertainties associated with inflation rates and other exigencies faced by the utility but maintains improvements should be pursued in stabilizing expenditure patterns.

³ Based on 2001 and 1997 actuals of \$44,203,000 and \$30,965,000 respectively.

Accompanying its 2004 capital budget application, NP will be directed to provide to the Board a plan for maintaining the stability of the capital budget and the capital works program over the ensuing five (5) year period. The plan will include an analysis of capital expenditures, both budgeted and actual, over the previous 10 years and will give an indication of the pattern of expenditures for each budgetary category and for the overall budget, along with a full explanation of the reasons for changes in expenditure patterns. The plan should assess maximum budget growth and a contingency for unexpected or unusual events during the period.

After consideration of the historical capital expenditure levels and review of the evidence surrounding the individual budget categories and projects, the Board accepts NP's proposed capital expenditures for improvements and additions to its property with the exception of the Transmission System Engineering Study in the amount of \$500,000, which the Board found was not sufficiently justified.

The Board will approve a 2003 capital budget in the amount of \$55,290,000 for improvements and additions to NP's property pursuant to section 41(1) of the *Act*.

IV. 2001 RATE BASE

The rate base consists mainly of fixed assets upon which, pursuant to the *Act*, the company is allowed to earn a return. Capital expenditures that are approved by the Board annually increase the rate base, and depreciation expense approved by the Board causes the rate base to decrease.

Schedule F of the Application shows the calculation of the average rate base for 2001 at \$545,162,000. NP indicated the rate base for 2001 increased over 2000 principally due to the 2001 capital program, including a \$20 million expenditure related to the purchase of joint-use poles from Aliant.

With respect to the calculation of rate base, NP in final argument refers to the response to CA-124 (d) outlining Grant Thornton's 2001 Annual Financial Review to the Board. NP highlighted Grant Thornton's conclusion that the 2001 average rate base is accurate and in accordance with established practice. NP noted the company's 2000 rate base was approved in Board Order P.U. 21 (2001-2002) and capital expenditure for 2001 was approved in Orders P.U.

24 (2000-2001), and P.U. 12 (2001-2002). In addition, NP indicated the Board specifically approved the capital expenditures which are included in the 2001 rate base related to the Aliant pole purchase in a separate Order, P.U. 17 (2001-2002). NP concluded all other elements of the rate base for 2001, that's the accumulated depreciation, contributions in aid of construction, weather normalization, cash work and capital allowance, materials and supplies, were all calculated in accordance with Board Orders, and Board approved policies, and accordingly, the fixing and determining of the 2001 rate base is a regulatory approval which should be granted in the normal course, as it was for the year 2000, and for the year 1999.

The CA in final argument points to the decision taken by the Court in the Stated Case recognizing that regulatory boards have a wide discretion to disallow or adjust the components of rate base and expense. The CA references CA-62 and CA-72 to demonstrate the increased trending in absolute and per customer rate base, which has occurred between 1998 and 2003. The CA concludes the figures are startling and improvements in SAIFI and SAIDI statistics exhibited in CA-104 (a) have not been commensurate. The CA uses the upward trend in the Information System budget as an example of where NP may be unnecessarily overcapitalizing and adding to its rate base.

The Board concurs it has discretion pursuant to section 78 of the *Act* to fix and determine the rate base. The Board was presented with insufficient evidence to make any adjustments to the 2001 rate base outlined in Schedule F.

The Board is satisfied that the average rate base of \$545,162,000 included in the company's annual report and reproduced in the Application is accurate and in accordance with the established practice as verified by Grant Thornton in its 2001 Annual Financial Review conducted for the Board.

Pursuant to section 78 of the *Act*, the Board will fix and determine NP's average rate base for 2001 at \$545,162,000.

V. ORDER**IT IS THEREFORE ORDERED THAT:**

1. Pursuant to section 41(3) of the *Act*, improvements and additions to NP's property are approved as follows:
 - a. Construction and purchases in excess of \$50,000, as set out in Schedule A attached to this Order; and
 - b. Leases in excess of \$5,000, as set out in Schedule B attached to this Order.
2. A 2003 capital budget for improvements and additions to NP's property in the amount of \$55,290,000 is approved pursuant to subsection 41(1) of the *Act*.
3. Unless otherwise directed by the Board, the 2.5 MW portable diesel unit to be purchased in 2003 will be stationed in Port aux Basques unless required for emergency purposes or for planned construction activity.
4. Unless otherwise directed by the Board, NP shall follow the guidelines as set out in Schedule C attached to this Order, which may be amended from time to time by the Board.
5. Unless otherwise directed by the Board, NP shall separate the budget categories for General Properties and Allowance for Unforeseen Items and report budget, actual and forecast expenditures separately for these categories.
6. Unless otherwise directed by the Board, NP shall provide in conjunction with the 2004 Capital Budget application, a status report on the 2003 capital expenditures showing for each project:

- i) the approved budget for 2003;
 - ii) the expenditures prior to 2003;
 - iii) the 2003 expenditures to the date of the application;
 - iv) the remaining projected expenditures for 2003;
 - v) the variance between the projected total expenditures and the approved budget; and
 - vi) an explanation of the variance.
7. As part of its 2004 Capital Budget Application, NP shall file an updated Information Technology Strategy report for the period 2004-2008.
8. Unless otherwise directed by the Board, NP shall file a “Capital Budget Plan” as part of its 2004 Capital Budget Application which should include:
 - a. An analysis of capital expenditures, both budgeted and actual, for the period 1993-2003;
 - b. A breakdown of the expenditure patterns for each budget category and for the overall capital budget for each year;
 - c. A full explanation of the reasons for the changes in expenditure patterns over the period 1993-2003; and
 - d. A five (5) year plan for maintaining the stability of the capital budget and the capital works program, including an assessment of maximum budget growth and a contingency for unexpected or unusual events during the period.
9. NP shall file an annual report to the Board on its capital expenditures within sixty (60) days after the end of the year 2003.
10. The rate base for the year ending December 31, 2001 is hereby fixed and determined at \$545,162,000 pursuant to section 78 of the *Act*.
11. NP shall pay all costs and expenses of the Board incurred in connection with the Application.

DATED at St. John's, Newfoundland and Labrador, this 23rd day of December, 2002.

Robert Noseworthy,
Chair & Chief Executive Officer.

Darlene Whalen, P.Eng.,
Vice-Chairperson.

John William Finn, Q.C.
Commissioner.

G. Cheryl Blundon,
Director of Corporate Services and
Board Secretary.