IN THE MATTER OF the *Public Utilities Act*, (the "Act")

AND

IN THE MATTER OF an Application by Newfoundland and Labrador Hydro for an Order Approving (i) its 2009 Capital Budget pursuant to s. 41(1) of the Act; (ii) its 2009 Capital Purchases, and Construction Projects in excess of $50,000.00 pursuant to s. 41(3)(a) of the Act; (iii) its Leases in excess of $5,000.00 pursuant to s. 41(3)(b) of the Act; and (iv) its estimated contributions in aid of construction for 2009 pursuant to s. 41(s)(5) of the Act and for an Order pursuant to s. 78 of the Act fixing and determining its average rate base for 2007

SUBMISSION OF THE INDUSTRIAL CUSTOMERS

November 10, 2008

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SUBMISSION OF THE INDUSTRIAL CUSTOMERS

INTRODUCTION

These are the written submissions of the Industrial Customers of Newfoundland and Labrador Hydro, the current customers being Abitibi Consolidated Company of Canada at its Grand Falls Division, Corner Brook Pulp and Paper Limited, North Atlantic Refining Limited, Teck Cominco Limited, and Vale Inco Newfoundland & Labrador Limited. As in all matters before this Board, the Industrial Customers contend for fair regulation consistent with the legislation applicable to Hydro and fostering economic efficiency in the provision of electric power to users in the Province of Newfoundland and Labrador.

As with all matters of electrical power regulation in the province, the Board's considerations are governed by the *Electrical Power Control Act, 1994* and specifically Section 3(b) thereof which requires Hydro to manage and operate its facilities in a manner that results in power being delivered to consumers in the province at the "lowest possible cost consistent with reliable

service". While the amounts spent on capital projects by Newfoundland and Labrador Hydro do not immediately appear in rates being charged to consumers, the funds required for such projects are sourced by Hydro as either debt or equity and the consumers ultimately pay the interest on the debt and the return on equity, as well as depreciation on the acquired assets, which confirms the application of Section 3(b) to this proceeding as it relates to the management of facilities which will affect the costs that consumers pay for electricity.

In this application, the onus is on Hydro to establish to the satisfaction of the Board the expenditures proposed are necessary in the year which they are proposed and represent the lowest cost alternative for the provision of electricity services in the province.

The Industrial Customers have significant concerns about Hydro's proposed 2009 Capital Budget, which concerns are addressed in these written submissions to the Board.

The Industrial Customers have not requested a hearing. The Industrial Customers, however, would urge against any perception that the Industrial Customers' concerns and objections in relation to this Application are of any lesser degree or weight because a full hearing has not been sought.

SIZE OF THE CAPITAL BUDGET

In their Submissions on the 2008 Hydro Capital Budget, the Industrial Customers reviewed in detail the principles which they believe ought to be applicable to Hydro's budgeting practices, within a regulatory context. In summary, the Industrial Customers submitted then, and would reiterate in these present Submissions, that the Board's function must be to act as a governor on Hydro's level of capital expenditure. Hydro has resisted the suggestion that regulation by the Board of Hydro's capital expenditures ought to extend beyond a project-by-project examination

of each annual capital budget. While such project-specific scrutiny is important, the Industrial Customers submit that the Board's review of the overall quantum of each annual capital budget, of the growth in the level of capital expenditure from year to year, and of what is being achieved by increasing capital expenditure, are also critical parts of the regulatory function. Such overall scrutiny is necessary to ensure that the legislative direction to provide electricity at the lowest possible cost consistent with reliable service is being achieved over time.

The Industrial Customers note that the Board in P.U. 30 (2007), while continuing to endorse project-specific review of Hydro's Capital Budget, also acknowledged the importance of monitoring levels of capital spending. The Board sought to address, at least in part, the latter issue by requiring Hydro to file a five-year Capital Expenditure Plan. However, the Plan as filed is largely reflective of a reactive approach to issues of aging plant (primarily Holyrood) and fails to indicate how anticipated increases in level of capital expenditure will serve the goal of providing electricity at the lowest possible cost consistent with reliable service.

Per Section G of the 2009 Application, annual Actual Capital Expenditures in the period 2004 - 2007 were $27.984, $33.952, $41.217, and $35.669 million, respectively. Per Section H of the 2009 Application, approved budgeted Capital Expenditures for 2008 are $52.836 million; it is noteworthy that only $42.898 million of this expenditure was approved in the original 2008 Hydro Capital Budget Application, with the balance being the subject of supplementary applications to the Board. The final approved budgeted Capital Expenditures for 2008 of $52.836 million (which Section H confirms will be almost entirely expended) represent a nearly 50% increase over the 2007 actual capital expenditure (which was close to the annual average for the period 2004-2007).

The proposed 2009 capital budget is $47.856 million. If approved this would represent an over 30% increase over the 2007 actual capital expenditure; if the potential for supplementary applications is considered, it is not unreasonable to anticipate that Hydro may seek to incur actual capital expenditures in 2009 at the same level as 2008. The Industrial Customers believe that, before such heightened level of annual capital expenditure becomes the "new normal", there should be commensurate heightened scrutiny of what is being sought to be achieved by Hydro, in the longer term, by its overall capital program.

It is noteworthy that no major capital expansion project, such as a new generation source or a major new transmission line, underlies this rapid rate of increase of capital expenditure. As the projects proposed by Hydro's Application indicate that this should be a typical year for capital works for Hydro, and the proposed level of capital spending is even more a matter of major concern.

THE PROVINCIAL ENERGY PLAN

The Province's Energy Plan was publicly released on September 11, 2007. The Plan has been put into evidence record in this Application by the Industrial Customers.

Section 4 of the Energy Plan sets out the Province's long-term strategy with respect to Electricity. Newfoundland and Labrador Hydro was closely involved in the Plan's development, in relation to Electricity resources, as is evident from the following passages from the Plan (at page 32):

> *Together with our existing hydroelectric and some wind power, the Lower Churchill project will meet our long-term electricity needs. There are, however, potential industrial developments both in Labrador and on the Island that could result in a sharp rise in demand before Lower Churchill is developed. NLH is actively*

> *working with existing and potential new industrial customers to ensure their needs can be met.*
>
> *To ensure that we can meet our future electricity needs, we must also have an alternate plan in the event Lower Churchill does not proceed as planned. In this case, we will provide future electricity needs from the most economically and environmentally attractive combination of thermal, wind, and smaller hydro developments. These sources could provide an additional 100-200 MW of power. The remainder would come from thermal generation. NLH is studying these sources in parallel with planning for the Lower Churchill to ensure the future energy supply for the province is secured. NLH is also studying the potential for landing gas in the province from our offshore resources to fuel a thermal electricity generating plant.*

It is clear that with respect to electricity, the primary long-term Plan initiative is the development of the Lower Churchill Hydroelectric Project. The Plan (at page 32) targets the year 2009 as the sanction date for that Project.

As can be noted from the Plan passages quoted at length above, the Plan also contemplates the possibility of the Lower Churchill Project not proceeding as planned. To address this possibility, the Plan identifies that Hydro is studying alternative electric power sources in parallel with planning for the Lower Churchill. The alternatives identified include smaller hydro developments and the potential for landing natural gas to fuel a thermal electricity generating plant.

The Industrial Customers continue to submit, as they did in the 2008 Capital Budget Application, that scrutiny of Hydro's proposed capital works, especially those projects aimed at long-term life extension of the Holyrood plant, should take appropriate of the initiatives being pursued by Hydro under the Energy Plan.

INDIVIDUAL 2009 CAPITAL BUDGET PROJECTS

The Industrial Customers comment below on some of the individual projects proposed by Hydro's Application. The Industrial Customers would note that the fact that they have not passed comment on a particular project does not necessarily indicate endorsement of the project. The Industrial Customers anticipate, based on past experience, that the Board and the other Intervenors will exercise their own due scrutiny of the Application, informed by their respective perspectives. The individual projects commented upon below represent those which, from the perspective of the Industrial Customers, appeared most problematic.

Page B-2 Refurbish Fuel Storage Facility: $2,866,700

This project alone accounts for over 5% of Hydro's proposed capital budget.

The work to be performed under the project has been identified by Hydro, in its Project Justification, as that "*necessary to refurbish the facilities for a further life extension of 20 years.*"

By the response to IC4-NLH, Hydro has acknowledged that the Fuel Storage Facility will not be required after completion of the Lower Churchill Project and Island infeed, and that Project sanction remains scheduled for 2009. Hydro states that even with sanction of the Lower Churchill Project and infeed, the Fuel Storage Facility will be required to at least 2015.

By the response to IC6-NLH, Hydro advises that the consultant report upon which Hydro relies was completed before milestone dates were set for the Lower Churchill Project. As a result, Hydro is unable to say whether the consultant's recommendations remain valid for a useful life extension of less than 10 years, which would appear to be the more appropriate time frame to consider in the anticipated circumstance of an Island infeed.

By the responses to CA-NLH6, Hydro confirms that there have been no oil leaks or spills at the Fuel Storage Facility, and that (somewhat at odds with what might be inferred from the statement in the "Project Justification" that "*This facility must ... meet provincial and federal regulations*") the project has not been described in Hydro's Application as "mandatory" because there is no federal or provincial legislation directly requiring this work to be done.

In the response to IC7-NLH, Hydro asserts that it is not prudent to delay the "Pipe Supports" component of this project due to the risk of an oil spill, but fails to explain how the level of concern evinced by Hydro is consistent with the "medium priority" accorded to this work by the consultant.

The response to IC5-NLH indicates that Hydro has been able to maintain draining of the dyked areas by overtime operator time, at an average cost of $5,000 per year. Even with a doubling of these overtime costs, continuing these conservative draining measures would be a more reasonable and fiscally prudent means of addressing any risk of oil leaks, as compared to the proposed $2.9 million dollar expenditure for a 20 plus year life extension of the Facility which may prove, within a year, to have been unnecessary.

Page B-13 Perform Wood Pole Line Management Program: $2,256,200

This project represents almost 5% of Hydro's proposed capital budget.

This Program, previously approved by the Board, represents substantial ongoing commitment of capital expenditure. In the four years since its approval in 2005, the aggregate cost of the Program has been almost $9.5 million dollars: see Table 1, page 8, of the 2009 Wood Pole Line Management" report at Volume II, Tab 4 of Hydro's Application (the "WPLM Report"). The Program will continue to be a source of substantial further capital expenditure, in the projected

total amount of $37,336,900, if allowed to proceed as presently contemplated through to 2023: see "Future Plans", page B-14 and Table 4, page 13, of the WPLM Report.

In the "Project Justification", Hydro asserts that the facts (full scale tests of selected poles) "*justify the strong need for a well managed wood pole inspection and treatment program that detects and corrects any 'danger poles'...*" (underlining added). Given that Hydro is proposing to enter into the fifth year of this Program, and given the high continuing expenditure level this Program represents, the Industrial Customers believe that further scrutiny of the facts arising out of the Program, and of whether the Program has been well managed, is warranted at this juncture.

The Industrial Customers have been concerned, from the first proposal of this Program, that it represented an insufficiently defined and refined approach to pole inspection. With the local knowledge of Hydro employees of line conditions and environmental conditions, it is not self-evident that an inflexible line-by-line inspection regime is necessary, or that the number of inspected poles per line could not be prudently reduced.

For instance, a review of the refurbishment work to be completed in 2008, based on the 2007 inspection program, reveals that the great preponderance of the work is in relation to two lines (TL-251 and TL-252) in the Central region: see page 10 and Appendix A of the WPLM Report. This calls into question the cost versus benefit gained by inspection of the other lines, and leads to the reasonable surmise that the poor condition of the two Central region lines would likely have been apparent to local Hydro personnel even without WPLM. The response to IC9-NLH with respect to 2007 refurbishment also indicates that only a minority of the lines inspected evinced significant problems.

Similarly, the comments at page 9 of the WPLM Report about reduced pole inspection rates for Labrador lines still fitting into the overall WPLM Program parameters call into question whether the high pole inspection rates on Island lines are in fact necessary.

The question of whether WPLM represents any advance in prudent pole management as compared to prior Hydro practice is also raised by Hydro's response to IC10-NLH, which does not indicate a substantial increase in the rate of pole and pole component replacement since the WPLM has been implemented.

With reference to Hydro's response to IC11-NLH, it is troubling that Hydro sees no need to consider revision or improvement in the WPLM model and is instead prepared to commit over $10 million more capital expenditure to this Program before considering such revision or improvement. The response to IC11-NLH also indicates that a pole test facility to have been developed in conjunction with Memorial University of Newfoundland has been delayed; the data that might have arisen from the timely implementation of this facility could have resulted cost-saving improvements to the WPLM. It is significant that the questions posed by IC11-NLH (and which have been posed by the Industrial Customers in previous Capital Budget Applications) address the ongoing measures recommended by the Hydro report filed in 2004 in support the initiation of the WPLM Program. Hydro's follow-through on these recommendations has been incomplete at best.

The Industrial Customers, by IC12-NLH, requested statistical evidence of improvement of the reliability of the transmission system which might be attributed to the WPLM, evidence that might be reasonably expected to be available after 4 years. In response, Hydro has given only the anecdotal evidence of its experience in the March 2008 ice storm. No comparable experience,

pre WPLM, was offered to suggest that the March 2008 experience would have been different but for the WPLM.

In summary, the Industrial Customers question whether the facts made available by Hydro since implementation of the Program support a strong need for WPLM, and question whether the WPLM is well-managed, in the sense of being cost-effective, as presently configured. The ongoing costs to rate payers of this Program are significant; it is reasonable for rate payers to expect that Hydro should be able to demonstrate substantial, objective evidence of benefit from its WPLM efforts, and not just provide evidence of the efforts themselves.

The Industrial Customers submit that the WPLM Program should be postponed, or significantly curtailed, until the above-identified issues are sufficiently addressed.

Page B-19 Replace Accommodations, Septic System and Upgrade Plant Communications (Cat Arm): $1,254,300

The Project Justification does not address why the existing accommodations at Pollard Point are so deficient as to warrant this level of expenditure for new on-site accommodation.

Hydro has confirmed by their response to IC15-NLH that there are no direct health or safety concerns arising from the quality of the Pollard Point accommodations. Per the response to IC19-NLH, Hydro has not investigated any possibility of acquiring and/or upgrading the existing Pollard Point accommodations. The only details of unsuitability of the Pollard Point accommodations are provided at page 8 of the Cat Arm Hydro Generating Station Replacement of Accommodations" report (Volume II, Tab 7 of Hydro's Application) (the "Accommodations Report"), which refers to issues with availability of hot water and cleaning staff. These are issues which could be addressed by a substantially lower level of expenditure than will be required to build a new on-site accommodations; moreover, with on-site accommodations, Hydro

would presumably have the same or greater problem with availability of cleaning staff or would require its on-site employees to do their own cleaning – a drain on productivity in and of itself.

Hydro asserts that the risks and costs associated with travel to and from the Cat Arm facility and the Pollard Point accommodations justify the substantial expenditure for on-site accommodations. While it is incontestable that no travel is safer than some travel, Hydro has not provided any evidence that the level of risk has resulted in accidents or other otherwise demonstrated that the level of risk is unacceptable when compared to travel by Hydro employees to other work sites. The travel time, 1 hour one-way or two hours round trip (per the response to IC14-NLH), to and from the Cat Arm facility and Pollard Point, is not on its face an exceptional commute time. The 2 hours each way referred to in the Project Justification applies only to the occasional commuting by some employees to and from Deer Lake; indeed, with reference to page 4 of the Accommodations Report, the only specific travel risks identified in the Report are those associated with the highway travel and possibility of moose accidents for those Hydro employees who choose to commute to and from Deer Lake.

At page 4 of the Accommodations Report, it is noted that the majority of the work at Cat Arm is planned and scheduled during the August-October period, when adverse weather conditions do not impact on access to the Cat Arm facility. The Accommodations Report does note that snowstorms and adverse weather conditions have sometimes curtailed access to the facility in winter, but this is hardly an exceptional circumstance for any work site in this Province in winter. Again, Hydro has not substantiated a level of risk arising from occasional curtailed access to the Cat Arm facility which would justify this substantial capital expenditure. At page 5 of the Accommodations Report, Hydro asserts that it has been Hydro's experience that problems very often occur when severe weather conditions curtail access to the facility, but acknowledges that

"*Unfortunately, we are not able to quantify instances when this occurred.*" Hydro also acknowledges that there have been no Cat Arm generation outages attributable to the accommodations facilities: see "Outage Statistics", page 6 of the Accommodations Report.

Per the response to IC17-NLH, break-even on a net present value comparison between the Pollard Point accommodations and new on-site accommodations would not be reached until 2028. By then, the new on-site facilities would already be almost 20 years old, and in all likelihood would be approaching the end of their useful life: see "Anticipated Useful Life", page 6 of the Accommodations Report - "*The service life of an accommodation camp is 20 years.*"

Taken together, the above-identified issues call into question whether new on-site accommodations are the least cost alternative, particularly as Deer Lake was used as the assumed accommodations for Hydro's cost benefit analysis. Hydro has not demonstrated that any deficiencies with the existing Pollard Point accommodations are irremediable and those accommodations cannot be considered to have been excluded as the least cost alternative. Nor does the material filed support a conclusion that the large amount requested for this project is necessary to produce a level of basic accommodation properly associated with an occasional use camp such as this.

Page B-31 Replace Vehicles and Aerial Devices: $2,156,400

As identified by examination of Table 1 in the "Replace Vehicles and Aerial Devices" Report (Volume II, Tab 16 of Hydro's Application) and noted in IC21-NLH, Hydro's Actual Purchase costs have run 10-20% below Budgeted Purchase costs. In the response to IC21-NLH, Hydro confirms that this trend has continued for most 2008 purchases. Vendors' information that dealer concessions and discounts may be discontinued run counter to recessionary indicators in the economy. As listed in Appendix A to the Report, most of the vehicles to be replaced are cars,

minivans, pickups and vans which are not specialized products, and which are not insulated from market conditions which promote dealer concessions and discounts. Given the high level of expenditure sought by Hydro for their overall 2009 Budget, and given the past experience of Actual Purchase costs running below Budgeted Purchase costs, it would be reasonable to reduce this budgeted expenditure by 20%.

Page D-30 Pave Parking Lots and Roadways (Bishop's Falls) : $150,200

This expenditure has not been demonstrated to be necessary, by any reasonable measure.

This facility has operated with gravel roads and parking areas for 40 years. Hydro attributes only $12,600 of additional maintenance costs, within the past 5 years, to the existing condition of these areas: see the response to CA-NLH-24. It would take many decades of saving of such costs to approach breakeven on this project, and well within that time frame further paving would be required. There is no evidence that the condition of these areas has materially impaired operations at the Bishop's Falls facility. In an environment of ever-increasing capital expenditure, this project is not justified.

All of which is respectfully submitted on behalf of the Industrial Customers.

POOLE ALTHOUSE

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