

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 (1) its 2010 Capital Budget pursuant to s. 41(1) of the Act; (2) its 2010 capital purchases, and construction projects in excess of \$50,000.00 pursuant to s.41(3)(a) of the Act; (3) its leases in excess of \$5,000.00 pursuant to s.41(3)(b) of the Act; and (4) its estimated contributions in aid of construction for 2010 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 2008

1 **SUBMISSION OF THE INDUSTRIAL CUSTOMERS**

2 **INTRODUCTION**

3 These are the written submissions of the Industrial Customers of Newfoundland and Labrador
4 Hydro, the current customers being Corner Brook Pulp and Paper Limited, North Atlantic
5 Refining Limited, Teck Resources Limited, and Vale Inco Newfoundland & Labrador Limited
6 (the “Island Industrial Customers”). As in all matters before this Board, the Industrial Customers
7 contend for fair regulation consistent with the legislation applicable to Hydro and fostering
8 economic efficiency in the provision of electric power to users in the Province of Newfoundland
9 and Labrador.

10 The Board’s considerations in ruling on Hydro’s Capital Budget are governed by the *Electrical*
11 *Power Control Act, 1994* and specifically Section 3(b) thereof which requires Hydro to manage
12 and operate its facilities in a manner that results in power being delivered to consumers in the
13 province at the “lowest possible cost consistent with reliable service”. While the amounts spent
14 on capital projects by Newfoundland and Labrador Hydro do not immediately appear in rates

1 being charged to consumers, the funds required for such projects are sourced by Hydro as either
2 debt or equity and the consumers ultimately pay the interest on the debt and the return on equity,
3 as well as depreciation on the acquired assets, which confirms the application of Section 3(b) to
4 this proceeding as it relates to the management of facilities which will affect the costs that
5 consumers pay for electricity.

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

9 The rationale for regulation of public utilities is largely related to the need to control the exercise
10 of monopoly power by an enterprise which has the sole legal right to provide a particular service.
11 In non-regulated business activities, competition exerts control over enterprises which forces
12 them to make economically sound choices on matters of expense and capital expenditure. They
13 are constrained by their ability to fund their activities from revenues produced by sales of their
14 services. In regulated utilities, prices are set by regulators rather than in the marketplace. Hence,
15 the regulatory agency must replace the competitive restraint that has been removed by the
16 monopoly character of the utility. One way in which this is done is by ensuring that expenses are
17 reasonable and necessary before they are considered in determining rates.

18 In the context of the capital budget, non-regulated enterprises must face internal approval
19 mechanisms in their organizations and compete within the enterprise for a limited amount of
20 capital based on the return which any project can generate. The enterprise as a whole can only
21 undertake such capital projects as it can fund based on its sources of revenue. Again, the
22 regulatory board must replace that constraint when it undertakes to approve a capital budget. The
23 Board here must control Hydro's capital spending to keep it within the limits that competition

1 would otherwise dictate and to ensure compliance with the legislation which requires least cost
2 electricity be provided to customers in the Province.

3 While the Industrial Customers have not requested a hearing, they rely on the Board to scrutinize
4 every project in the context of the submissions of the parties as if these submissions were made
5 after a contested hearing before the Board.

6 **SIZE OF THE CAPITAL BUDGET**

7 The overall size of the capital budget continues to be a concern of the Industrial Customers. In
8 our submissions relative to the 2009 Capital Budget, we said:

9 In their Submissions on the 2008 Hydro Capital Budget, the Industrial Customers
10 reviewed in detail the principles which they believe ought to be applicable to Hydro's
11 budgeting practices, within a regulatory context. In summary, the Industrial Customers
12 submitted then, and would reiterate in these present Submissions, that the Board's
13 function must be to act as a governor on Hydro's level of capital expenditure. Hydro has
14 resisted the suggestion that regulation by the Board of Hydro's capital expenditures ought
15 to extend beyond a project-by-project examination of each annual capital budget. While
16 such project-specific scrutiny is important, the Industrial Customers submit that the
17 Board's review of the overall quantum of each annual capital budget, of the growth in the
18 level of capital expenditure from year to year, and of what is being achieved by
19 increasing capital expenditure, are also critical parts of the regulatory function. Such
20 overall scrutiny is necessary to ensure that the legislative direction to provide electricity
21 at the lowest possible cost consistent with reliable service is being achieved over time.

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

9 Per Section G of the 2009 Application, annual Actual Capital Expenditures in the period
10 2004 - 2007 were \$27.984, \$33.952, \$41.217, and \$35.669 million, respectively. Per
11 Section H of the 2009 Application, approved budgeted Capital Expenditures for 2008 are
12 \$52.836 million; it is noteworthy that only \$42.898 million of this expenditure was
13 approved in the original 2008 Hydro Capital Budget Application, with the balance being
14 the subject of supplementary applications to the Board. The final approved budgeted
15 Capital Expenditures for 2008 of \$52.836 million (which Section H confirms will be
16 almost entirely expended) represent a nearly 50% increase over the 2007 actual capital
17 expenditure (which was close to the annual average for the period 2004-2007).

18 The proposed 2009 capital budget is \$47.856 million. If approved this would represent an
19 over 30% increase over the 2007 actual capital expenditure; if the potential for
20 supplementary applications is considered, it is not unreasonable to anticipate that Hydro
21 may seek to incur actual capital expenditures in 2009 at the same level as 2008. The
22 Industrial Customers believe that, before such heightened level of annual capital
23 expenditure becomes the "new normal", there should be commensurate heightened

1 scrutiny of what is being sought to be achieved by Hydro, in the longer term, by its
2 overall capital program.

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

8 All of these comments can be re-iterated here. The planned 2009 expenditures have increased to
9 \$56,780 according to p. H-1 of the Application, and as adverted to in last year's submissions will
10 therefore exceed the planned 2008 expenditures by a substantial margin. The already substantial
11 2008 and 2009 levels of expenditure will be substantially exceeded by the \$66,117 forecast for
12 2011 according to page i of the 2010 Capital Plan. It must be borne in mind that even this
13 substantially increased forecast cannot, based on past years experience, be relied upon to take
14 into account additional expenditures through 2010 from supplementary applications. A trend
15 seems to have appeared of making supplementary applications for capital projects in much
16 greater numbers and amounts than have been traditionally the case.

17 The unchecked trends of increasing forecasted capital budgets, and of increasing capital
18 expenditure by supplementary applications, is a continuing and growing concern that the Board
19 needs to address.

20 **INDIVIDUAL 2010 CAPITAL BUDGET PROJECTS**

21 The Industrial Customers comment below on some of the individual projects proposed by
22 Hydro's Application. The Industrial Customers would note that the fact that they have not passed

1 comment on a particular project does not necessarily indicate endorsement of the project. The
2 Industrial Customers anticipate, based on past experience, that the Board and the other
3 Intervenors will exercise their own due scrutiny of the Application, informed by their respective
4 perspectives. The individual projects commented upon below represent those which, from the
5 perspective of the Industrial Customers, appeared most problematic.

6 *Page B-2 Upgrade Gas Turbine Plant Life Extension: \$1,305,000—2010; \$4,690,000 future*
7 *years*

8 Aside from the major projects being undertaken in Labrador City, this is the largest single multi-
9 year project in the budget. In our submission, the supporting material does not justify this
10 expenditure at this time.

11 The evidence does not support a conclusion that failures or outages in this equipment have
12 reached the stage where such substantial expenditure is warranted. In IC-NLH-10, particulars of
13 the unplanned outages were requested. The answer produced was pages of specifics of incidents,
14 apparently in random order, which, while impressive in length, does not withstand scrutiny.
15 Careful examination shows that many of these “outages” are of very brief duration and very
16 close in time. For example, there were over 30 “outages” in July and August 1994. One suspects,
17 but cannot confirm from the material provided, that this may have been a single problem which
18 lead to various trial and error attempts at a fix. Rather than support the project, this information
19 casts doubt on what Hydro has alleged in the way of circumstances justifying an immediate
20 expenditure of such a large amount.

21 The response to CA-NLH 31 confirms that the 2009 work to determine what additional work
22 needs to be done in 2010 has not yet been completed. It is inappropriate to seek approval of the

1 expenditure of funds when the work necessary to justify that expenditure has not yet been
2 completed. This project should be rejected until such time as Hydro can provide more specific
3 information to justify an immediate need.

4 ***Page B-8 Refurbish Fuel Storage Facility-Holyrood: \$2,500,000***

5 As with the Hardwoods Plant Life Extension Project, it appears that this expenditure is being
6 requested before the necessity for it has been established. As can be seen from the responses to
7 IC-NLH-20 through 22, the information purporting to justify this project was produced in 2004
8 and has not been updated. Reference to IC-23 confirms that the context of the Labrador Infeed,
9 which will eventually render these assets redundant, has not been considered in putting forward
10 this project. There is also the disturbing fact that SGE Acres estimated the cost of this work,
11 including contingencies, in 2006 at \$1,453,000 while the current project is valued at \$2,500,000,
12 and increase of 72% over three years. In the absence of a plausible explanation for this huge cost
13 increase and more current information justifying this work, the project should not be approved.

14 ***Page B-10 Upgrade Plant Access Road Bay D'Espoir: \$1,550,000***

15 This is a proposal to spend significant funds on an asset that does not belong to Hydro and,
16 hence, should not be in the rate base. It is the responsibility of the owner, the Government of
17 Newfoundland and Labrador (and incidentally the shareholder of Hydro), to maintain and
18 refurbish this road. The value of the improvements accrues to the Government as owner. This
19 project represents a downloading by Government to the ratepayers of an expense that
20 Government has chosen not to incur, not unlike what has happened with road side off-loading
21 ramps, which equally should be, and in most other jurisdictions are, paid for by Government.

1 This project should not be considered for approval unless and until title to this road is vested in
2 Hydro.

3 Significantly, the Government of Newfoundland and Labrador did not deem Hydro's use of the
4 road or its condition to be a sufficient safety concern to justify allocating funding to this project.
5 In the April 20, 2009 Government correspondence responding to this request (attached to the
6 August 2009 Report to the Board on this Project), Hydro was advised that

7 *As noted in Mr. Mercer's response of last year, projects identified for consideration for*
8 *funding in our Provincial Roads Improvement Program are considered based on their*
9 *merits. The roads identified above function solely as access to Hydro facilities. Given the*
10 *demand on provincial funds to upgrade and rehabilitate trunk roads and bridges, as well*
11 *as, local roads servicing communities, we are unable to place a high priority on the*
12 *upgrading of the roads to these facilities.*

13 *I realize that we have been asked on many occasions to upgrade the road at Bay D'Espoir*
14 *in particular; however, it would be very difficult for the Province to commit funding for the*
15 *upgrading of the road when sections of Route 360 and others in the immediate area are in*
16 *need of substantial upgrading. [underlining added]*

17 Several points arise from Government's response. Unlike what is presumed by Hydro's inclusion
18 in the Justification section of its Report of a reference to use of the road by up to 150 tourists
19 annually, the road is only expected to function as access to Hydro's facilities; surely there is no
20 Hydro mandate to facilitate tourist or other public access which serves no generation purpose.
21 Government, considering the proposed upgrade on its merits, and comparing it to the condition
22 of other provincial roadways, was unable to place a high priority to this project. If there was not

1 sufficient justification for committing Provincial taxpayer dollars to this road upgrade, how can
2 this be justified as an expenditure to be borne by Hydro's ratepayers?

3 ***Page B-32 Upgrade TL-244—Plum Point to Bear Cove: \$144,000--2010; \$1,055,000 future***
4 ***years***

5 The portion of this project which relates to meeting ice load arises directly from defective work
6 on the part of Hydro for which ratepayers have already paid. Hydro, and not the ratepayers,
7 should bear the cost of this repair.

8 The Report at Vol. 2 Tab 13 at p. 4 clearly indicates that the clearances were miscalculated
9 originally by using thermal hot curve weather conditions as opposed to ice load figures. In the
10 response to IC-NLH-32, Hydro seems to contradict this statement by saying that the line was
11 "engineered to meet the standard of the day". While that might be technically accurate, it is clear
12 that the wrong standard was identified and was accepted and used by Hydro. The cost of the 20
13 cross-arms and one span being replaced as a result of this error should be excluded from the
14 project and borne by Hydro.

15 ***Page C-2 Install Meteorological Stations—Various Sites: \$443,000***

16 Hydro was offered the opportunity in IC-NLH-34 to explain why this project, designed to
17 enhance water management, could not be deferred in light of the additional hydro resources now
18 available to Hydro due to the shutdown of the Abitibi Grand Falls facility. The value of fine
19 tuning the water management abilities of Hydro is increased when hydro-electric production is
20 being pushed to its maximum. With additional hydro resources, Hydro has more flexibility and,
21 in our submission, can re-evaluate the necessity of spending more money to get greater amounts
22 of weather information. The response to IC-NLH-34 demonstrates no reason why this project

1 cannot be deferred, and it should therefore be excluded from the 2010 budget. That is the sort of
2 decision that a private company would take in light of the changed circumstances. The test ought
3 not to be whether the additional information may be of some incremental value; the test should
4 be whether the incremental value added justifies the expenditure. The Industrial Customers
5 submit that this is a project where the law of diminishing returns vis-a-vis additional expenditure
6 clearly applies.

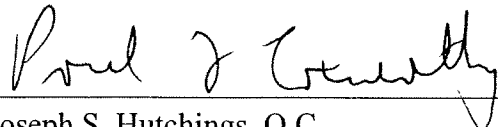
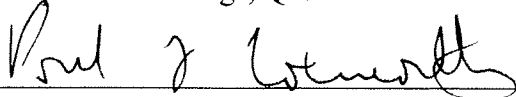
7 ***Page C-166—Replace Peripheral Infrastructure—Various Sites: \$222,000***

8 While this project does not represent a particularly large amount of money in the context of the
9 \$50 million plus capital budget, the result calls for comment. Reference to IC-NLH-35 shows
10 that Hydro, in each of the locations noted, has approximately one printer or multi-function
11 machine for every 5 employees. This appears on its face to be excessive. The Board should cut
12 this allotment in half as much to save those funds as to try to let Hydro know that this type of
13 expense deserves high level review.

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

DATED at St. John’s, in the Province of Newfoundland and Labrador, this 20th day of October,
2009.

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