

1 **Q. What, if any, changes to the Capital Budget were made by the Executive upon its**
2 **presentment for its approval?**

3
4 A. A. General

5
6 The question appears to misapprehend the Company's engineering and management
7 practice in developing annual capital budgets.

8
9 What follows is a background of Newfoundland Power's annual capital expenditure and
10 description of the current Company capital budget practice.

11
12 *B. The Nature of Annual Capital Expenditure*

13
14 The vast majority of Newfoundland Power's annual capital expenditure is based upon a
15 (i) specifically identified need or (ii) an historical pattern for repair and replacement. A
16 typical identified need would be the Distribution Reliability Initiative project (see
17 *Distribution Reliability Initiative*, 2010 Capital Budget Application, Schedule B, page 52
18 of 96). A typical historically based repair or replacement expenditure would be the
19 requirement to reconstruct damaged distribution lines (see *Reconstruction*, 2010 Capital
20 Budget Application, Schedule B, page 45 of 96).

21
22 Capital expenditures based upon a specifically identified need or an historical pattern for
23 repair or replacement are classified as *Normal* in the Board's *Capital Budget Application*
24 *Guidelines* of October 2007. For each of 2008, 2009 and 2010, approximately 95% of
25 Newfoundland Power's annual budgeted capital expenditure has been classified as
26 *Normal*.

27
28 The single biggest *cause* for, or origin of, Newfoundland Power's annual capital
29 expenditure is plant replacement. In 2010, this will represent approximately 53% of the
30 annual capital budget (see *2010 Capital Plan*, p. 2), or approximately \$34.5 million. The
31 relative proportion of annual capital expenditure directed to plant replacement has been
32 consistent for the past 5 years and is forecast to remain so for the next 5 years.

33
34 The second biggest *cause* for, or origin of, Newfoundland Power's annual capital
35 expenditure relates to serving additional customers and additional customer electricity
36 usage. These expenditures reflect the costs associated with the Company's fulfillment of
37 its obligation to serve its customers. The relative proportion of annual capital
38 expenditure directed to serving additional customer electricity usage is currently forecast
39 to increase over the next 5 years as described in the *2010 Capital Plan*.

40
41 Newfoundland Power's annual capital expenditures are predominantly driven by the need
42 to replace aged and deteriorated assets and to serve additional customers and additional
43 customer electricity usage. Forecast annual capital expenditures are also predominantly
44 based upon specifically identified need to replace plant and serve customers or historical
45 patterns of expenditure.

1 *C. Annual Capital Budget Development*

2
3 The Vice President, Engineering and Operations (the “Engineering Vice President”) is
4 the member of the Executive primarily responsible for developing the annual capital
5 budgets of Newfoundland Power.

6
7 The Engineering Vice President works directly with the engineering and operations
8 managers, and senior engineering, operations and information technology staff
9 responsible for the various classes of Company assets, in the development of each year’s
10 annual capital budget. In addition, the Engineering Vice President consults others in the
11 Company, including Executives, as necessary.

12
13 Each year, Newfoundland Power prepares, and files with the Board, a Capital Plan. Each
14 Capital Plan provides a 5 year outlook on anticipated capital expenditures of the
15 Company. Newfoundland Power has prepared and filed Capital Plans with the Board as
16 part of its Capital Budget Applications since 2003. The most recent Capital Plan is the
17 typical starting point for development of the Company’s next annual capital budget.

18
19 Practically, capital budgeting aims to maintain stability in the Company’s annual capital
20 budgets and respond to the factors which affect the level of required capital expenditure
21 in any year. These factors will include diverse matters such as observed asset condition,
22 construction inflation, and evolving customer requirements.

23
24 The annual capital budget for the succeeding year is typically developed over a period of
25 months. During this period, forecast capital requirements for the ensuing year are
26 reviewed and assessed in light of the most recent information available. This information
27 would include asset performance and condition assessments; engineering reviews; and
28 forecasts of additional customers and customer electricity requirements.

29
30 The practical effect of review is reflected in the 2010 capital budget. For example,
31 capital expenditures in the Transmission class have decreased by approximately \$1.5
32 million in the 2010 capital budget from the 2010 forecast in the *2009 Capital Plan*.
33 This broadly reflects the most recent information concerning the condition of the
34 Company’s transmission assets. Capital expenditures in the Substation class have
35 increased by approximately \$0.7 million in the 2010 capital budget from the 2010
36 forecast in the *2009 Capital Plan*. This broadly reflects the cost of additional
37 transformation requirements driven by increased customer electricity usage.

38
39 *D. Post Capital Budget Development*

40
41 The manner in which Newfoundland Power’s annual capital budgets are developed is
42 consultative, based upon the most recent data available, and responsive to those factors
43 which can be reasonably expected to affect capital expenditures. Annual capital budgets
44 are developed in the context of broader Capital Plans which are aimed at maintaining
45 year to year capital expenditure stability.

1 The annual capital budget is not created by a specific *level* of Company management and
2 submitted to the Executive for approval and changes in the formal manner that the
3 question appears to assume.
4

5 Once developed, an annual capital budget is considered, and approved, by the
6 Company's Directors upon the recommendation of the Executive. The 2010 capital
7 budget was approved by Newfoundland Power's Directors in May 2009.
8

9 Following corporate approval of the annual capital budget, the Company commences
10 preparation of a Capital Budget Application which reflects the approved budget for
11 submission to the Board.
12

13 The 2010 Capital Budget Application was prepared by Company engineers together with
14 regulatory staff to ensure compliance with Board requirements, including the *Capital*
15 *Budget Application Guidelines* of October 2007. The Engineering Vice President and the
16 Vice President, Regulatory Affairs provided Executive oversight of preparation of the
17 2010 Capital Budget Application. In addition, the contents of the 2010 Capital Budget
18 Application were reviewed by the President of the Company prior to its being filed with
19 the Board.