

HAND DELIVERED

September 27, 2011

Board of Commissioners
of Public Utilities
P.O. Box 21040
120 Torbay Road
St. John's, NL A1A 5B2

Attention: Ms. Cheryl Blundon
Board Secretary

Ladies & Gentlemen:

Re: Newfoundland Power's 2012 Capital Budget Application

Enclosed are the original and 10 copies of Newfoundland Power's Brief of Argument.

For convenience, the Argument is provided on three-hole punched paper.

A copy of this letter, together with enclosures, has been forwarded directly to Geoffrey Young, of Newfoundland & Labrador Hydro and Mr. Thomas J. Johnson, the Consumer Advocate.

If you have any questions regarding the enclosed, please contact the undersigned at your convenience.

Yours very truly,



Gerard M. Hayes
Senior Counsel

Enclosures

c. Geoffrey Young
Newfoundland & Labrador Hydro

Thomas Johnson
O'Dea Earle Law Offices



Join us in the fight against cancer.

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

IN THE MATTER OF capital expenditures and rate base of Newfoundland Power Inc.; 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 a 2012 Capital Budget of \$77,293,000;
- (b) approving certain leases to be entered into in 2012;
- (c) approving certain capital expenditures related to multi-year projects commencing in 2012; and
- (d) fixing and determining a 2010 rate base of \$875,210,000.

**BRIEF OF ARGUMENT
OF
NEWFOUNDLAND POWER INC.**

SEPTEMBER 27, 2011

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1.0 INTRODUCTION

Newfoundland Power's 2012 Capital Budget was filed with the Board of Commissioners of Public Utilities (the "Board") on July 8, 2011. The \$77.3 million budget is larger than the 2011 Capital Budget, principally due to the requirement to construct fish pass structures at the Rattling Brook hydroelectric development to comply with an order of the federal Department of Fisheries and Oceans issued in 2010.

The 2012 Capital Budget Application (the "Application") seeks an Order of the Board:

(1) pursuant to Section 41(1) of the *Public Utilities Act*, approving proposed 2012 capital expenditures totalling \$77,293,000; (2) pursuant to Section 41(1) of the *Public Utilities Act*, approving proposed 2013 capital expenditures of \$7,745,000 and proposed 2014 capital expenditures of \$150,000; (3) pursuant to Section 41(1) of the *Public Utilities Act*, approving certain leases to be entered into in 2012; and (4) pursuant to Section 78 of the *Public Utilities Act*, fixing and determining Newfoundland Power's average rate base for 2010 in the amount of \$875,210,000.

2.0 OVERVIEW

To provide context for the Board's consideration of the Application, this submission will:

First, review the legislative framework under which the Application is brought;

Second, address specific compliance requirements;

1 Third, summarize the process engaged in by the Board and participants in the consideration of
2 the Application;

3
4 Fourth, address matters raised in the Consumer Advocate's Submission; and

5
6 Finally, conclude with Newfoundland Power's formal submissions with respect to the
7 Application.

8
9 **3.0 LEGISLATIVE FRAMEWORK**

10 Section 37(1) of the *Public Utilities Act* states that a public utility shall provide service and
11 facilities that are reasonably safe and adequate and just and reasonable. Section 37(1) is a
12 cornerstone of Newfoundland Power's obligation to serve its customers.

13
14 Section 3(b) of the *Electrical Power Control Act, 1994* states that all sources and facilities for the
15 production, transmission, and distribution of power in the province should be managed and
16 operated in a manner that would result in:

- 17 i. the most efficient production, transmission, and distribution of power,
18 ii. consumers in the province having equitable access to an adequate supply of
19 power, and
20 iii. power being delivered to customers in the province at the lowest possible cost
21 consistent with reliable service.

1 Section 3(b) does not create a hierarchy between these three principles; rather, each is equally
2 important in the management and operation of electrical facilities in the province.

3
4 Section 41(1) of the *Public Utilities Act* requires that Newfoundland Power submit to the Board
5 “an annual capital budget of proposed improvements and additions to its property” for the
6 Board’s approval.

7
8 Section 41(3) of the *Public Utilities Act* prohibits a utility from proceeding with an improvement
9 or addition in excess of \$50,000 or a lease in excess of \$5,000 per year without the Board’s prior
10 approval.

11
12 The focus of this proceeding is whether Newfoundland Power’s proposal for \$77.3 million in
13 capital expenditures in 2012 is reasonably required for it to meet its statutory obligation to serve
14 its approximately 245,000 customers.

15
16 Newfoundland Power submits that its 2012 Capital Budget represents the capital expenditures
17 necessary to maintain its electrical system and to continue to meet its statutory obligations under
18 Section 37(1) of the *Public Utilities Act* and Section 3(b) of the *Electrical Power Control Act*,
19 1994.

4.0 COMPLIANCE MATTERS

4.1 Board Orders

In Order No. P.U. 28 (2010) (the “2011 Capital Order”), the Board required specific information to be filed with the Application. The Application complies with the requirements of the 2011 Capital Order.

In Order No. P.U. 35 (2003) (the “2004 Capital Order”), the Board required specific information, and in particular a 5-year capital plan, to be provided with the Application. The Application complies with the requirements of the 2004 Capital Order.

In Order No. P.U. 19 (2003) (the “2003 Rate Order”), the Board required that evidence relating to deferred charges and a reconciliation of average rate base to invested capital be filed with the Application. The Application complies with the requirements of the 2003 Rate Order.

In Order No. P.U. 32 (2007) (the “2008 Rate Order”), the Board approved Newfoundland Power’s calculation of rate base in accordance with the Asset Rate Base Method. The Application complies with the requirements of the 2008 Rate Order.

4.2 The Capital Budget Application Guidelines

In the Capital Budget Application Guidelines dated October 2007 (the “CBA Guidelines”), the Board outlined certain directions on how to define and categorize capital expenditures. Although compliance with the CBA Guidelines necessarily requires the exercise of a degree of judgment,

1 the Application, in Newfoundland Power's view, complies with the CBA Guidelines while
2 remaining reasonably consistent and comparable with past filings.

3
4 Section 2 of the *2012 Capital Plan* provides a breakdown of the 2012 Capital Budget by
5 definition, classification, costing method and materiality segmentation as required in the CBA
6 Guidelines.

7 8 **5.0 PROCESS**

9 ***5.1 Proceedings of Record***

10 On August 5, 2011, the Board issued 24 Requests for Information ("RFI's") to Newfoundland
11 Power. On August 8, 2011, the Consumer Advocate issued 21 RFIs. Newfoundland Power
12 responded to the 45 RFIs on August 24, 2011.

13
14 No intervenor evidence was filed in the proceeding, and no intervenor requested a technical
15 conference or formal hearing of the Application.

16 17 ***5.2 Consumer Advocate's Submission***

18 The Consumer Advocate filed written submissions in the proceeding on September 23, 2011.

19 The Consumer Advocate's written submissions did not take issue with *any* of the specific capital
20 expenditures proposed in the Application.

21
22 After setting out some general observations regarding historic and projected levels of capital
23 expenditure, the Consumer Advocate's written submissions focus primarily on a

1 recommendation that Newfoundland Power implement a formal ranking of the importance of
2 projects being proposed in its annual capital budgets.

3 4 **6.0 RESPONSE TO CONSUMER ADVOCATE'S SUBMISSION**

5 **6.1 General Recommendation**

6 The Consumer Advocate's principal submission is that Newfoundland Power should be required
7 to rank the importance or criticality of proposed capital projects in its Capital Budget
8 Applications. A similar recommendation was raised in the Consumer Advocate's written
9 submission on Newfoundland Power's 2011 Capital Budget Application and addressed by the
10 Board in the 2011 Capital Order.

11
12 In support of the formal ranking of capital projects, the Consumer Advocate offers the example
13 of Xcel Energy, a U.S. utility, which according to McKinsey & Company, assigns a "criticality
14 rating" to capital projects as part of its capital budget "vetting process" to help its executives
15 determine "which projects to push forward and which ones to delay."¹ The Consumer Advocate
16 submits that this example of the ranking of capital projects by an energy company is evidence
17 that such ranking is sound public utility practice.

18 Reference: Consumer Advocate's Submission, page 5.

19
20 The McKinsey & Company article submitted by the Consumer Advocate which mentions the
21 ranking of capital projects by Xcel Energy does not describe Xcel Energy's ranking process in

¹ According to its website, Xcel Energy is a combined electricity and natural gas energy company that has regulated operations in eight U.S. states, and serves 5.3 million electricity and gas customers. It has over 12,000 employees.

1 any reasonable detail, nor does it indicate whether such ranking is used for purposes of
2 regulatory oversight of Xcel Energy's capital expenditures.

3 Reference: Consumer Advocate's Submission, Tab 1.

4
5 Newfoundland Power submits that the general reference in an article of one aspect of the capital
6 management practices of a single U.S. utility does not constitute evidence in this proceeding that
7 ranking capital projects is "a sound public utility practice". When dealing with similar anecdotal
8 evidence of other practices regarding service reliability standards, the Board has taken care to
9 understand the context of such practices to ascertain their applicability.²

10
11 The Consumer Advocate also submits that Newfoundland Power, as a regulated utility that is
12 regulated on return on rate base, does not have incentives to improve its capital spending
13 efficiency. In support of this observation and its implications for the capital budget application
14 process, the Consumer Advocate cites two articles *published in 1993* by McKinsey & Company.

15 Reference: Consumer Advocate's Submission, pages 6 - 8.

16
17 The 1993 McKinsey & Company articles principally consist of broad observations and anecdotal
18 accounts of the shortcomings of the capital budgeting practices of certain unidentified regulated
19 and unregulated companies 18 years ago. The articles do not specifically address or consider the
20 process of regulatory approval of the capital expenditures of public utilities.

21 Reference: Consumer Advocate's Submission, Tabs 2 and 3.

² See Order No. P.U. 32 (2007) where the Board observed at Page 38 "While such standards or requirements appear to exist in Ontario or Alberta, it is noted that these standards were developed in response to a specific set of circumstances associated with the deregulation of the industry in the case of Alberta and as part of the implementation of PBR in Ontario. The applicability of the examples provided for Vermont and Delaware, while informative, is also questionable."

1 Newfoundland Power submits that the vague generalities contained in the 1993 McKinsey &
2 Company articles are neither reliable evidence in this proceeding nor of any practical assistance
3 to the Board in evaluating Newfoundland Power's 2012 Capital Budget.

4 5 **6.2 Changing the CBA Guidelines**

6 The Consumer Advocate's Submission references the 2011 Capital Order and the Board's view
7 stated therein that any proposal to change the Capital Budget Guidelines, such as the Consumer
8 Advocate's recommendation that proposed capital projects be formally ranked, should be raised
9 with all the stakeholders and, following consultation, brought forward to the Board for
10 consideration.

11 Reference: Order No. P.U. 28 (2010), page 5.

12
13 The Consumer Advocate submits that, in light of Newfoundland Power's submissions on the
14 matter in the 2011 Capital Budget proceeding, Newfoundland Power is opposed to formally
15 ranking its proposed capital projects, and he "sees no useful purpose to be served by further
16 consultations on this issue with Newfoundland Power." The Consumer Advocate submits that
17 the Board should either consider the matter in the context of the Application or as soon as
18 practicable outside of this process.

19 Reference: Consumer Advocate's Submission, pages 5 – 6.

20
21 The CBA Guidelines were developed in a review process conducted under the supervision of the
22 Board between 2005 and 2007. The process involved detailed consultation among Board staff,

1 Newfoundland Power, Newfoundland and Labrador Hydro, counsel for the Industrial Customers
2 and the Consumer Advocate. The CBA Guidelines are, in effect, 4 years old.

3 Reference: Correspondence from Board Counsel, October 29, 2007.

4
5 The Board has clearly indicated the desirability of “more stable and predictable year over year
6 capital budgets for Newfoundland Power which will assist in fostering stable and predictable
7 rates for consumers into the future.” At the same time, the Board also directed Newfoundland
8 Power to file a detailed 5-year capital plan with its next capital budget filing. These features are
9 now integral parts of the Company’s annual Capital Budget Applications.³

10 Reference: Order No. P. U. 36 (2002-2003).

11
12 As noted in the detailed 5-year 2012 Capital Plan, Newfoundland Power’s annual capital
13 expenditure for the next 5 years will be consistent on an inflation adjusted basis with that of the
14 previous 5 years. This is consistent with stable and predictable customer rates.

15 Reference: 2012 Capital Plan, page 7.

16
17 The Consumer Advocate submits that, in light of escalating capital expenditures of the two
18 public utilities regulated by the Board, and in light of the known absence of financial incentives
19 for rate base regulated utilities to strive for capital efficiency, the Board should provide direction
20 to the utilities on the ranking of proposed capital projects.

21 Reference: Consumer Advocate’s Submission, pages 8 – 9.

³ In Order No. P.U. 36 (2002-2003), the Board directed Newfoundland Power 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, including an analysis of capital expenditures, both budgeted and actual, over the previous 10 years, 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.

1 It is Newfoundland Power's submission that the Act requires the Board to consider
2 Newfoundland Power's Capital Budgets upon their own basis, not on the basis of *forecast*
3 *Newfoundland and Labrador Hydro* Capital Budgets.

4
5 It is Newfoundland Power's submission that there is no evidence in this proceeding that the
6 existing capital budget approval process, as set out in the CBA Guidelines, does not achieve the
7 stated objectives of providing clarity and consistency in the submission of capital expenditures
8 by a utility, while ensuring transparent and fair oversight by the Board. There is no evidence in
9 this proceeding that the formal ranking of capital projects by Newfoundland Power (or any other
10 change to the CBA guidelines) would assist in reducing capital expenditure requirements or
11 contribute to efficiency either in capital spending or regulatory oversight. There is therefore no
12 evidentiary basis in this proceeding (as there was no evidence in the 2011 Capital Budget
13 Application) for consideration of the Consumer Advocate's recommendation that the Board
14 require Newfoundland Power to formally rank proposed capital projects as part of its capital
15 budgeting process.

16 17 **7.0 CONCLUSIONS**

18 **7.1 Capital Projects**

19 **7.1.1 General**

20 The projects presented in Newfoundland Power's 2012 Capital Budget Application are necessary
21 to: respond to customer growth and changes in customer requirements; replace deteriorated,
22 defective or obsolete equipment; respond to legislative and regulatory requirement; address

1 safety and environmental issues; and maintain or improve customer service levels and
2 operational efficiency gains.

3
4 No challenge has been made to any specific engineering judgments and assessments that form
5 the basis of the capital expenditures proposed in Newfoundland Power's 2012 Capital Budget.

6
7 Newfoundland Power's proposed capital expenditures for 2012 are necessary to provide service
8 to customers that is safe and adequate and just and reasonable, and they are consistent with the
9 provision of least cost electrical service.

10
11 *7.1.2 Newfoundland Power's Capital Management Practices*

12 To provide a broad context for the Board's consideration of the Application, Newfoundland
13 Power's *2012 Capital Plan* provides overviews of (i) the Company's capital management
14 practice and how it is reflected in its annual capital budgets, (ii) the 2012 capital budget and (iii)
15 the 5-year capital outlook through 2016.

16
17 The *2012 Capital Plan* contains an overview of the Company's capital management practices,
18 with particular emphasis on the impact of customer growth, including increased utilization of
19 transformer capacity. The impact of customer growth on system capacity requirements will
20 increase planned expenditures through 2016.

21 Reference: *2012 Capital Plan*.

Compliance with federal regulation governing a number of aspects of Newfoundland Power's operations has influence on the 2012 Capital Plan. This includes regulation of PCBs, fisheries, and, likely, electricity metering.

Reference: 2012 Capital Plan.

7.1.3 Sound Engineering Judgment

The provision of service and facilities which are "reasonably safe and adequate and just and reasonable" as required by Section 37(1) of the *Public Utilities Act* requires the exercise of judgment. In particular, the timing, necessity and appropriateness of the investment to meet the obligation to serve on a least cost basis involve sound engineering judgment.

To assist the Board in determining whether the engineering judgments reflected in the 2012 Capital Budget are sound, it is submitted that there was no evidence before the Board in this proceeding that:

- contradicts the engineering judgments reflected in the capital projects presented in the 2012 Capital Budget;
- demonstrates reasonable alternatives that were not considered by Newfoundland Power; or
- demonstrates that not proceeding with a particular capital project represented is a preferable alternative.

7.1.4 Submission

Newfoundland Power submits that the 2012 Capital Budget contained in the Application represents the capital expenditures and leases required to meet its statutory obligations, including

1 the delivery of electrical power at the lowest possible cost consistent with reliable service.

2 Pursuant to Section 41 of the *Public Utilities Act*, the 2012 Capital Budget should be approved in
3 its entirety by the Board.

4
5 **7.2 Rate Base**

6 **7.2.1 General**

7 Newfoundland Power has requested that the Board fix and determine the 2010 average rate base
8 for the purpose of regulatory continuity and certainty, in the same manner as the Board has
9 exercised this regulatory supervisory power since 1999.⁴

10
11 Newfoundland Power's actual average rate base for 2010 is shown in Schedule E to the
12 Application.

13
14 **7.2.2 Submission**

15 Based upon the evidence before the Board and pursuant to section 78 of the *Public Utilities Act*,
16 the Board should fix and determine Newfoundland Power's average rate base for 2010 at
17 \$875,210,000.

⁴ See Order No. P.U. 24 (2000-2001).

1 **RESPECTFULLY SUBMITTED** at St. John's, Newfoundland and Labrador, this 27th day of
2 September, 2011.

3
4 

5 **NEWFOUNDLAND POWER INC.**
6 P.O. Box 8910
7 55 Kenmount Road
8 St. John's, Newfoundland A1B 3P6
9

10 Telephone: (709) 737-5609
11 Telecopier: (709) 737-2974