

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 2012 Capital Budget
pursuant to s. 41(1) of the Act; (2) its 2012
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
2012 pursuant to s. 41(5) of the Act and for an
Order pursuant to s. 78 of the Act fixing and
determining its average rate base for 2010

WRITTEN SUBMISSIONS OF THE ISLAND INDUSTRIAL CUSTOMERS

PHASE I

Introduction

These are the written submissions of the Industrial Customers of Newfoundland and Labrador Hydro on the Island of Newfoundland, the current customers being Corner Brook Pulp and Paper Limited, North Atlantic Refining Limited, and Teck Resources Limited, and the future customer being Vale Newfoundland & Labrador Limited (the “Industrial Customers”), in relation to Phase I of Hydro’s 2012 Capital Budget Application.

The Island Industrial Customers submit that, apart from the necessary scrutiny of individual projects, Hydro, the Intervenor and, respectfully, the Board must re-examine the need for scrutiny of Hydro’s overall proposed levels of capital expenditure, for 2012 and as projected by Hydro for the coming years. It is on this issue that the Island Industrial Customers commence these submissions.

1 ***Electrical Power Control Act, 1994***

2 Hydro's Capital Budget process is governed by the *Electrical Power Control Act, 1994* (the
3 "EPCA"). Section 3(b) of the EPCA states:

4 (b) *all sources and facilities for the production, transmission and distribution*
5 *of power in the province should be managed and operated in a manner*

6 (i) *that would result in the most efficient production, transmission and*
7 *distribution of power,*

8 (ii) *that would result in consumers in the province having equitable*
9 *access to an adequate supply of power,*

10 (iii) *that would result in power being delivered to consumers in the*
11 *province at the lowest possible cost consistent with reliable service.*

12 (iv) *that would result in, subject to Part III , a person having priority to*
13 *use, other than for resale, the power it produces, or the power produced by a*
14 *producer which is its wholly-owned subsidiary,*

15 (v) *where the objectives set out in subparagraphs (i) to (iv) can be*
16 *achieved through alternative sources of power, with the least possible*
17 *interference with existing contracts,*

18 *and, where necessary, all power, sources and facilities of the province are to be*
19 *assessed and allocated and re-allocated in the manner that is necessary to give*
20 *effect to this policy;*

21 Section 4 of the EPCA charges this Board with the responsibility of implementing the power
22 policy set out in section 3.

23 Hydro, in its response to PUB-NLH-146, instead of making reference to the above provisions of
24 the EPCA, has chosen to refer to a "duty of a power company to supply electrical energy" under
25 section 54 of the *Public Utilities Act*. In further response to PUB-NLH-146, Hydro refers to a
26 power of the Board (under subsection 54(4) of the *Public Utilities Act*) to relieve Hydro from its

obligation to supply power to customers. In the context of the question posed by PUB-NLH-146, and of Hydro's response to it, this reference strongly implies that the Board has little option but to accept the judgment of Hydro on its proposed and forecast capital expenditures, notwithstanding the impact on Hydro's revenue requirement and on its rate payers. The reference by Hydro to this "duty", and to the Board's authority to relieve Hydro of it, taking up as it does almost half of Hydro's response to a question from the Board about how Hydro considers the impact of capital expenditures on electricity rates, is so surprising that we feel it necessary to address it in these submissions in detail, below.

The Island Industrial Customers reject the assertion or implication that the "duty of a power company to supply electrical energy" under section 54 of the *Public Utilities Act* stands as principle, ranking equally with the provisions of the EPCA, governing the Board in relation to the issues before it in this Capital Budget Application, or in relation to the impact of Hydro's overall capital expenditures on its Province-wide rate payers. A reading of the whole of Section 54 of the *Public Utilities Act*, reproduced below, makes clear that it is a provision intended to deal with the narrow circumstance of a minority of Hydro's potential customers who may find themselves in proximity to a Hydro "transmission line, main supply-wire or cable" but are without service:

Duty of power company to supply electrical energy

54. (1) A power company shall supply electrical energy to premises situated within 100 metres of a transmission line, main supply-wire or cable suitable for that purpose, on being required by the owner or occupier of the premises to do so.

(2) The power company before taking steps to supply the energy, and before supplying the energy or making a connection, or as a condition of the power company continuing to supply it, may require the owner or occupier to give reasonable security for the repayment of the costs of making the connection when those costs exceed \$50, and for the payment of the proper tolls for electrical energy and the rent of instruments.

1 (3) *In the event of the power company and the owner or occupier*
2 *failing to agree upon the nature or amount of the security to be given within 14*
3 *days from the date upon which the owner or occupier requires the power*
4 *company to supply electrical energy, the amount of the security and the manner*
5 *in which it shall be given shall, upon the application of either party, be determined*
6 *by the board, and the board may make an order for security under this section for*
7 *other matters that under the circumstances the board may consider just and*
8 *equitable.*

9 (4) *The board may, for good cause and after hearing the interested*
10 *parties, relieve a power company from the statutory obligation to supply electrical*
11 *energy upon the terms and conditions that the board may consider appropriate*
12 *and in the public interest.*

13 The Board is not obliged to either accept Hydro's judgment on its overall level of proposed
14 capital expenditures or otherwise relieve it of its statutory obligation to supply electrical energy.
15 Section 4 of the EPCA places on the Board, and not Hydro, the responsibility and authority to
16 implement the power policy of the Province set out in section 3 of the EPCA.

17 While it is unarguable that the implementation of power policy must be "consistent with reliable
18 service", the manner of that implementation must also be balanced with the "most efficient"
19 production, transmission and distribution of power, at the "lowest possible cost". It may be trite
20 to say it, but each of these principles of the power policy must be given a distinct meaning, and
21 must be balanced against each other. In short, such balancing requires the making of difficult
22 choices.

23 Ultimately, it is the rate payers who will be called upon to meet the revenue requirements
24 stemming from Hydro's capital expenditure choices; Hydro confirms it expects this will be the
25 case by its responses to PUB-NLH-151 and PUB-NLH-152. In this context, the Island Industrial
26 Customers would note that increased rates for power have "knock on" effects on industrial and
27 other commercial activity and investment in the Province, and consequently on the employment
28 and economic well-being of its citizens.

Hydro's overarching choice in this Capital Budget Application has been to propose and project escalating capital expenditures, at a level and rate of increase which have no precedent in Hydro's history as a regulated utility. It is difficult not to come to the conclusion that Hydro is more concerned about securing, as part of its rate base, the "sustaining capital" for the indefinite refurbishment of existing infrastructure (including generation infrastructure which will be rendered redundant or of considerably diminished importance as a source of power supply for Hydro's Island customers by 2017) and the large capital outlays necessary to implement a Labrador Infeed than it is about addressing the question of what are sustainable levels of capital expenditure for the Province's rate payers.

The Industrial Customers further respectfully submit that, in light of the expansion of Hydro's rate base which will normally arise from Hydro's capital expenditure and in light of OC2009-063 and the pegging of Hydro's rate of return on equity to that of Newfoundland Power, these unprecedented increases in proposed capital expenditure need to be a matter of even greater scrutiny by the Board.

The impact on rates of its proposed capital expenditures is the "second consideration" of Hydro, as stated by Hydro in PUB-NLH-146. The Island Industrial Customers submit that, under the EPCA, the power policy of the Province is that the impact on rate payers is the primary consideration, and that the impact on rate payers is to be measured not only by reliability of service, but also by efficient production and transmission of power by Hydro, all at the lowest possible cost.

Hydro's Proposed and Projected Capital Expenditures for 2012-2017

The Island Industrial Customers have in past Capital Budget Applications strongly expressed their concern about the unchecked growth of Hydro's capital expenditure demands. In the Island

Industrial Customers' submissions on the 2009 Hydro Capital Budget (which submissions were reiterated in their submissions on the 2010 and 2011 Budget), the Industrial Customers stated:

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

1 million of this expenditure was approved in the original 2008 Hydro Capital
2 Budget Application, with the balance being the subject of supplementary
3 applications to the Board. The final approved budgeted Capital Expenditures for
4 2008 of \$52.836 million (which Section H confirms will be almost entirely
5 expended) represent a nearly 50% increase over the 2007 actual capital
6 expenditure (which was close to the annual average for the period 2004-2007).

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

15 The "new normal" of annual Hydro capital expenditure, regarding which the Island Industrial
16 Customers have expressed concern in the past, has come to pass, and has been greatly
17 surpassed, by the capital expenditure levels proposed by Hydro for 2012 and projected into the
18 foreseeable future. The forecast capital for the years 2012-2016, as presented in the 2012
19 Budget Application (Volume I, Section H), and their effect on Hydro's revenue requirement as
20 brought out by the Board's RFIs PUB-NLH-38 and PUB-NLH-39, speak for themselves, and
21 hardly need to be repeated here in detail to register the level of concern of Hydro's rate payers.
22 The forecast is for a doubling and tripling over the 2012-2016 period of the annual level of
23 capital expenditure by Hydro from the already-high levels referred to above for as recently as
24 2008 and 2009.

25 This forecast increase in annual level of capital expenditure is all the more startling when
26 comparison is made with Hydro's forecast in the 2011 Capital Budget Application. A comparison

1 of the total capital expenditures forecast in the 2011 Capital Budget (page G-1 of that
2 Application) and in the 2012 Capital Budget (at page H-1 of the present Application) are
3 presented below:

2011 Capital Budget: Schedule of Capital Expenditures 2006-2015				
BUDGET				
2012	2013	2014	2015	2016
70,159	65,667	60,496	64,384	

2012 Capital Budget: Schedule of Capital Expenditures 2006-2015 [sic]				
BUDGET				
2012	2013	2014	2015	2016
87,862	121,369	151,686	155,237	146,973

4 Even if the proposed capital expenditures for the transmission line corridor from Bay D'Espeir to
5 Western Avalon (project B-27) are backed out of the 2012-2016 projected expenditures, there
6 will still be an unprecedented increase in capital expenditures as projected by Hydro for the next
7 five years. In large part, this capital expenditure burden on the rate payers will only serve to
8 maintain existing infrastructure at the *status quo*; much of this existing infrastructure will be
9 rendered either redundant or of much diminished importance to the delivery of the "most
10 efficient" production, transmission and distribution of power, at the "lowest possible cost
11 consistent with reliable service" to Hydro's customers in the Province, once the Labrador Infeed
12 is achieved in 2017.

13 The question that cannot be avoided by the Intervenor and, it is respectfully submitted, by the
14 Board, even though it has not been addressed by Hydro, is how the rate payers are to be
15 expected to bear the burden of Hydro's concurrently ill-timed, "in with the old and in with the

new” capital expenditure programs. Hydro presents this dilemma as an inescapable result of “aging infrastructure.” An alternative explanation should be considered – that the planning and risk management practices of Hydro take insufficient account of the impact of its overall proposed capital expenditures on rates and the rate payers.

Prioritization of capital expenditure

In response to the Requests for Information of the Consumer Advocate, starting in the 2011 Capital Budget Application and again in this Application, Hydro has disclosed its internal rankings of Capital Budget projects.

Up until last year, Hydro steadfastly refused to entertain (or disclose) such project rankings. In the 2007 Hydro Capital Budget Application, the Industrial Customers by Requests for Information raised the issue of prioritization of projects, and submitted in their final Written Submission that there was no evidence that Hydro even attempts to prioritize its capital projects. In its reply submission, Hydro responded:

“The reason that Hydro does not prioritize all of its projects is simply that it is not a productive or informative process to carry out for projects that must be undertaken and completed to ensure the safety of the public or of Hydro’s employees, or to ensure compliance with environmental regulations.”

Hydro’s disclosure of project rankings in these last two Capital Budget applications is an apparent indication that Hydro no longer takes the view that prioritization of projects “is not a productive or informative process”.

However, as noted by the Island Industrial Customers in their submissions on the 2011 Capital Budget, Hydro’s prioritization system, at least as implemented and disclosed by Hydro, has left essentially unchanged Hydro’s monolithic and undifferentiated approach to capital budgeting –

that all proposed projects are necessary and none can be deferred: see Hydro's response to CA-NLH-4 in the current Application.

Hydro's decision to exclude almost \$27 million of its proposed 2012 capital expenditure (almost 40% of the Phase I project expenditures) on "Multi-Year Projects" from the prioritization system is presumptuous in its implication that once the first year or second year expenditures have been made the Board does not have the continuing right and responsibility to scrutinize whether approval of further years' expenditure on such projects should be postponed, modified or denied. The Board is given no perspective as to how Hydro prioritizes subsequent years of a multi-year project, as compared to new projects.

With reference to Hydro's response to CA-NLH-2, the 50 ranked Phase I projects are only assigned priorities of 1 through 27; no less than 14, or over one-third, are given a "1" priority. This is an example of Hydro asserting that its judgment should be relied upon, but being unwilling to exercise, or disclose, its judgment – its choices – in capital budgeting. In effect, the Board is still being asked to accept that it is neither "productive" nor "informative" to differentiate the relative importance and urgency which Hydro attaches to these 14 "1" ranked projects.

However, if Hydro chooses to be opaque in respect to how it arrives at its ranking of multiple projects as number "1" priority, then the Island Industrial Customers submit this is all the more reason to submit to stricter scrutiny those projects that Hydro assigns, under this less-than-transparent process, lower rankings. While submissions will be made on individual projects below, the Island Industrial Customers would suggest that all Phase I projects not ranked at "1" invite, and require, consideration for denial or deferral on the basis,

(1) in some cases, of insufficient justification to be approved at all,

(2) in most cases as they can be deferred assuming and expecting reasonable risk management practices by Hydro, and

(3) in all cases because Hydro's overall proposed and projected capital expenditure over the next year and as projected through to 2017 is unsustainable by the rate payers, and fails to meet the EPCA power policy principles.

The Island Industrial Customers, in making the foregoing submission, should not be taken as necessarily endorsing all of the proposed capital expenditures which have been ranked at "1". In particular, we note that project B-27 for the Transmission Line Corridor between Bay D'Espeir and Western Avalon will be scrutinized in a different Phase of this Application.

As a final comment on Hydro's prioritization process, the Island Industrial Customers note that the Board, in P.U. 38 (2010), indicated that the clarification was needed regarding how Hydro prepares, considers and presents its rankings, and suggested this could be achieved by discussion amongst the parties. These discussions have not occurred. Hydro's prioritization process is no more transparent in the present Application than it was in the 2011 Capital Budget Application. The Island Industrial Customers respectfully request a further Board directive on the development of guidelines on prioritization of capital projects.

Managing capital expenditure and managing risk vs. the sought-after conversion of operational expenditure to capital expenditure

In response to CA-NLH-4, Hydro states that "Deferral of required projects exposes employees, customers or the environment to an avoidable risk, whether it be safety, reliability or environmental." As previously noted above, in the same response, Hydro states that it does not recommend deferring any of the Phase I projects.

1 Implicit in Hydro's position regarding "avoidable risk" is that if a risk can be eliminated by capital
2 expenditure, then the capital expenditure is sufficiently justified. What is missing from Hydro's
3 analysis is any reasonable weighing or balancing of the probability of a risk manifesting itself as
4 against the cost of eliminating that risk. What is also missing is a willingness to reasonably
5 manage risk, by better operational practices, and increased operational expenditure if
6 necessary.

7 Hydro has presented no evidence that any decrease in reliability of service has occurred in
8 recent years due to "aging infrastructure". As recently as the 2008 Capital Budget, Hydro was
9 still able to manage "aging infrastructure" issues within an annual capital expenditure level at or
10 below \$50.0 million. Hydro, despite this record of reliability of its existing infrastructure, posits
11 that various calamities may occur within the next five years, to justify the need for rapidly
12 escalating capital expenditure. The Island Industrial Customers urge the Board to consider
13 whether Hydro's positing of worse case scenarios to justify substantial capital expenditures (and
14 to reduce its operational expenditures) represents reasonable risk management on the part of
15 Hydro, including management of the risk of incurring levels of capital expenditure which are
16 unsustainable by Hydro's rate payers.

17 A related trend has been Hydro's proposal of projects aimed at maintaining or improving
18 property which is not Hydro property, and in the guise of characterizing these projects as capital
19 improvements or additions, seeking to reduce or eliminate what were in the past understood to
20 be reasonably expected operational risks and operational expenditures. The Island Industrial
21 Customers have recently made this point in relation to Hydro's proposed project to upgrade the
22 public access road to the Bay D'Espoir Hydroelectric Generation Station. There are projects in
23 the 2012 capital budget application which raise similar issues, in particular the Upgrade

Transmission Line Access Trails project (C-136), which the Island Industrial Customers will address in greater detail below under Individual Projects.

The Island Industrial Customers respectfully submit that the Board should continue to maintain a clear distinction between expenditures for improvement or addition to Hydro's property and other expenditures. Section 41 of the *Public Utilities Act* clearly identifies that Hydro's capital budget, and the contributions Hydro intends to demand from its customers, are required to be toward the cost of improvement or additions to the property of Hydro:

41. (1) A public utility shall 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, and the budget shall include an estimate of contributions toward the cost of improvements or additions to its property the public utility intends to demand from its customers.

(2) The budget shall contain an estimate of future required expenditures on improvements or additions to the property of the public utility that will not be completed in the next calendar year.

(3) A public utility shall not proceed 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 without the prior approval of the board.

(4) A public utility shall submit a report on its actual expenditures on improvements or additions to its property in the prior calendar year, together with an explanation as to expenditures in excess of those approved under subsection (1) not later than April 1 in each year.

(5) A public utility that intends to demand from its customers a contribution towards the cost of improvements or additions to its property shall not demand the contribution without the prior approval of the board.

1 (6) *Notwithstanding subsection (5), a public utility may, without the prior*
2 *approval of the board, demand from its customers a contribution toward the cost*
3 *of an improvement or an addition to its property where the demand for the*
4 *contribution is approved under a policy of the board.*

5 **Premature Application for Approval of Capital Expenditures**

6 The Board, in PUB-NLH-1 and in PUB-NLH-142, has noted that in recent years Hydro has
7 reported that planned capital projects have not been completed because of lack of resources.

8 The Board has further noted that in light of this recent experience of Hydro, Hydro would be
9 expected to have put in place plans to ensure that proposed capital budgets, at the significantly
10 higher levels of proposed capital expenditure for the coming years, will in fact be able to be
11 carried out in the budget year for which they are proposed. With respect, Hydro's half page
12 answer to PUB-NLH-142 does not inspire confidence that Hydro has any better plan to manage
13 the carrying out of proposed capital projects in future years, with ever increasing budgets, than it
14 had in the recent past.

15 An example of this prematurity problem can be found in the proposed Upgrade to the Burnt
16 Dam Spillway, project B-15, where it is proposed that the capital expenditure for both further
17 inspection to determine what work needs to be done, and the work assumed will be identified as
18 required in 2012 by that inspection be approved in this Application. The Island Industrial
19 Customers will comment further on this Project below under Individual Projects.

20 **IFRS**

21 In response to PUB-NLH-4, Hydro advises that it intends to provide a more comprehensive
22 overview of the overall impact of the transition to IFRS during Q4 2011. Hydro states that the
23 comprehensive overview will outline the impact on net income as well as capital expenditures.

One wonders why this comprehensive review could not have been prepared and presented by Hydro prior to, or coincident with, the 2012 Capital Budget Application. Hydro is proposing that the Board approve in the 2012 Hydro Capital Budget different treatment of what were previously accounted as operating expenses, as capital expenditure, with IFRS being advanced by Hydro as the justification for this changed treatment. In the absence of the presentation of a comprehensive overview on IFRS by Hydro, the Island Industrial Customers, by IC-NLH-7, sought Hydro's disclosure of the reports and other documentary resources relied upon by Hydro in developing the proposed policies and guidelines in relation to IFRS and capital expenditure. Hydro in its response made reference to the existence of a number of IFRS working position papers, and other documentation, but did not disclose same.

It is noteworthy that in response to PUB-NLH-140 and PUB-NLH-141, Hydro, "to reflect a more detailed review" made material adjustments for the Allowance for Funds Used During Construction treatment (from \$2.6 million to \$2.2 million) and for the Interest During Construction treatment (from \$2.7 million to \$2.4 million). The fact that such material adjustments had to be made, and it appears may only have been made due to a detailed review generated by the Board's request for information, does not provide a high level of assurance regarding Hydro's proposed implementation of IFRS effects in the 2012 Hydro Capital Budget.

The Island Industrial Customers submit that the treatment of IFRS related issues in the 2012 Capital Budget Application, as outlined at page 2 of the 2012 Capital Projects Overview, Volume I, should be deferred until Hydro has presented its promised comprehensive overview, and until such other processes as may be ordered by the Board coming out of that comprehensive overview have been completed.

1 Costs of this Application for the Island Industrial Customers

2 In the context of the present Capital Budget Application, the Industrial Customers request that
3 there be an award of costs in favour of the Island Industrial Customers, on the same or similar
4 basis on which the Consumer Advocate's costs are dealt with in the capital budget process.
5 There are a number of aspects of the present Capital Budget Application which in the view of
6 the Island Industrial Customers strongly militate towards there being such an award of costs :

7 (1) The Board's division of the Application into distinct phases, in relation to the new
8 Holyrood generation facility projects and the Bay D'Espoir to Western Avalon
9 Transmission Corridor, provides some indication to the Island Industrial
10 Customers that decisions made in relation to these capital projects in this
11 Application may have significant effect on future decisions to be made on related
12 capital projects leading up to 2017;

13 (2) The unprecedented proposed increase in capital expenditure, for 2012 and
14 coming years, on a year to year basis compared to the level of increase on a
15 year to year basis in the 2004 to 2011 period;

16 (3) Hydro's own late filing of, or failure to file or present, evidence such as the report
17 on the Transmission Line Corridor from Bay D'Espoir to Western Avalon, the
18 comprehensive overview in relation to IFRS, and an update of the Generation
19 Planning Issues 2010 July Update, has resulted and will result in the incurring of
20 additional costs in this Capital Budget Application, for all parties including the
21 Island Industrial Customers; and

22

(4) It is neither fair to the Island Industrial Customers, nor to the Consumer Advocate, to assume that the Consumer Advocate can represent the interests of all of Hydro's rate payers, in all circumstances, from every needed perspective. In this regard, it is also to be noted that there can be significant differences between the positions advocated by the Island Industrial Customers and by the Consumer Advocate, most recently in relation to the disposition of the RSP surplus. Given the very important issues raised by the present Application, the Island Industrial Customers would respectfully submit that their intervention and participation in this Application is necessary to the Board's implementation of the power policy of the Province, and that that necessity should be reflected in an appropriate award of costs.

INDIVIDUAL 2012 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 and mandates.

Upgrade Burnt Dam Spillway, p. B-14

The Board, in Order No. P.U. 38 (2010), required Hydro to provide evidence, in addition to what was provided in its 2011 Capital Budget Application, if Hydro intended to bring forward this project again in the future, as it has done in the present Application.

1 It is noteworthy that although this Project was presented by Hydro in the 2011 Capital Budget
2 Application as one that was required and could not be deferred at that time, now, a year later, it
3 is still only a priority ranking of "26", and is the second last ranked of the 50 ranked Phase I
4 projects, per page 3 of Hydro's response to CA-NLH-2.

5 In a Capital Budget Application in which Hydro is proposing and forecasting unprecedented
6 increases in capital expenditure over the next five years, this project represents a significant
7 proposed capital expenditure of \$1.7 million.

8 In the 2011 Capital Budget Application, and again in this Application, Hydro has filed the Hatch
9 report dated May 22, 2009 (Volume 2, Tab 6, Appendix A). At page A-27 of the Hatch report (as
10 was previously noted by the Island Industrial Customers in the 2011 Capital Budget Application)
11 Hatch recommended \$495,000 of expenditure, over a seven year period. In the present
12 Application, Hydro asserts that its proposed expenditure, in 2012 alone, of \$1.7 million dollars
13 on upgrading the Burnt Dam Spillway is justified, notwithstanding Hatch's recommendation, by a
14 more recent inspection conducted by Weir Power & Industrial (Volume 2, Tab 6, Appendix B).
15 The pricing provided in Weir report, in relation to, apparently, the recommendations found at
16 page B23 of that report, is \$257,440 for two gates. Neither the pricing provided by the Hatch
17 report nor the Weir report justify anywhere near the \$1.7 million expenditure proposed by Hydro.

18 Hydro, in response to CA-NLH-12, confirms that the \$257,440 pricing provided by Weir at
19 Appendix B, page B24 is the estimated cost of a full condition assessment. It appears that the
20 remainder of the \$1.7 million dollars sought by Hydro is in respect of work that Hydro assumes
21 will be found necessary and justified, for completion in the year 2012, by the Weir condition
22 assessment.

Hydro, in its response to CA-NLH-12, attempts to justify this anticipatory budgeting of a capital expenditure by asserting that there will be an estimated redundant person hours of 644 hours, if the refurbishment work does not take place at the same time as the detailed inspection. However, this again assumes that the inspection will in fact disclose that such refurbishment work is immediately necessary. Again, the Island Industrial Customers would note that it was Hatch's assessment, just two years previous, that the work required could be done over a seven year period.

In light of the above, and the low rank priority to which Hydro itself assigns to this expensive and largely premature and anticipatory capital expenditure, Island Industrial Customers submit that no more than the Weir pricing for the full condition assessment, of \$257,440, should be approved for the 2012 Capital Budget.

Upgrade Replace Emergency Diesel Generator (Bay D'Espoir), p. B-25

With reference to Hydro's response to CA-NLH-2, this project has only been accorded a priority ranking of "21" by Hydro; it is ranked 43rd when ranked sequentially with the 50 other ranked Phase I projects.

In response to IC-NLH-10, Hydro has identified that there have been only three black start conditions since 1974, less than one per decade. Per Hydro's response to IC-NLH-11, the procedure referred to in Hydro's justification of this project as both unsafe for the mechanic and creating a risk of equipment damage – that the diesel mechanic had to manually operate the diesel engine governing unit during the last black start condition in 2003 – was clarified to be due not to the generator being 200 kW in size, but due to another problem with the generator, which was subsequently repaired.

1 With reference to Hydro's response to PUB-NLH-50, Hydro identifies that the existing 200 kW
2 generator became, as Hydro characterizes it, "undersized for the task" in or about 1970, over
3 four decades ago. In the three rare black start conditions which have occurred since then, none
4 of the calamitous failures posited by Hydro to justify this capital expenditure have come to pass.

5 With respect to the worker safety concerns of Hydro in relation to a rare black start event,
6 Hydro's response to PUB-NLH-53 identifies that there are battery equipped lights which provide
7 lighting in those circumstances; these were only installed after the 2003 black start. Hydro
8 indicates that these lights can only operate on battery power for approximately one hour. It is
9 the submission of the Island Industrial Customers that if it is felt that the one hour running time
10 of these battery operated lights is not sufficient to ensure worker safety in a black start
11 condition, then undoubtedly the cost of ensuring that replacement batteries are available, and
12 that there is a protocol in place when a black start condition occurs for replacement of those
13 batteries within the one hour run time, would be, by several magnitudes, less expensive than
14 the proposed capital expenditure for a replacement 500 kW diesel generator.

15 While Hydro refers to the potential for lack of spare parts for the present 200 kW diesel
16 generator, due to its age, it is unclear whether notwithstanding this the existing generator still
17 has some remaining usable life. However, if Hydro satisfies the Board that the present 200 kW
18 diesel generator is in and of itself unreliable due to its age, then with reference to Hydro's
19 response to IC-NLH-13, the Island Industrial Customers would submit that the Board should
20 only approve the \$461,400 cost of installing a new 200 kW emergency diesel generator,
21 approximately half the total cost estimated for this project of \$894,000, if a 500 kW diesel unit is
22 acquired.

1 **Perform Wood Pole Management Program, p. B-36**

2 Hydro, in its response to CA-NLH-2, has accorded a priority ranking of “4” to this project; it is the
3 16th of 50 ranked Phase 1 projects.

4 The Industrial Customers have repeatedly expressed concern about this Program in past capital
5 budget applications, starting from when this Program was first proposed for the 2005 capital
6 budget year. At a cost of well over \$2.0 million dollars a year, this Program represents a
7 substantial continuing capital burden on the rate payers. As the Program goes on, the Industrial
8 Customers have only grown more sceptical about whether the Program justifies expenditures in
9 excess of \$2.0 million dollars a year (and for the year 2012, a proposed expenditure of over
10 \$2.5 million dollars).

11 As noted at page B-36, Volume 1 of the Application, Hydro has approximately 26,000 poles
12 which it intends to inspect, apparently one by one, as part of this Program. Furthermore, as
13 indicated by the “Future Plans”, on page B37, upon completion of this inspection Program,
14 Hydro intends to repeat it, for a second ten year inspection cycle. Presumably, it can be
15 expected that the cost of these annual inspection programs will continue to escalate, to be
16 consistently in excess of \$2.5 million dollars over the remainder of this first ten year inspection
17 cycle, and then continuing into the second one.

18 In the report supporting this project, at Tab 13, Volume II of the Application, in the Project
19 Description on page 4, the following statement is made:

20 *To give quantitative benefits on the improvement of transmission line reliability,*
21 *sufficient long term data, derived from two full inspection cycles will be required*
22 *to provide adequate statistical evidence.*

23 It is startling to appreciate that by the above statement, Hydro is projecting that it will have to
24 expend in excess of \$50 million dollars over twenty years (assuming an average expenditure of

1 \$2.5 million dollars per year on this Program) to obtain “adequate statistical evidence” to arrive
2 at “the quantitative benefits on the improvement of transmission line” reliability achieved by this
3 Program.

4 Hydro seeks to justify the benefits of the program, “in the absence of this long term data”, by the
5 anecdotal evidence of two recent ice storms in March 2008 and March 2009 (Hydro
6 characterizes this anecdotal evidence as “analysis”, but the only analysis involved is that there
7 were no reported failures of poles on the subject lines during those two ice storms). What Hydro
8 does not present is any evidence, anecdotal or otherwise, that there has been a material loss of
9 reliability in relation to those transmission lines which have not yet been inspected by the
10 Program, when exposed to severe weather conditions.

11 The Island Industrial Customers find it extremely troubling that six years into a pole by pole
12 inspection program, Hydro can provide no better analysis of the quantitative benefits of the
13 program, other than this anecdotal evidence, and moreover does not propose any such analysis
14 until twenty years of data, at an expense of \$2.5 million dollars or more per year, has been
15 gathered.

16 The Industrial Customers have further concerns when the historical information on this Program
17 is considered. At page 7 of the report in support of this project (Volume II, Tab 13, page 7),
18 Table 1 indicates that there has been a consistent history of this Program’s actual expenditures
19 exceeding the budgeted expenditure. Table 6, at page 14 of the same report identifies that the
20 percentage budget overruns have ranged from 8.4% to 15.8% in the 2008 – 2010 period (the
21 2011 data not yet being available). This is an indication of an already expensive program being
22 subject to only lax budgetary controls.

Concerns regarding the cost effectiveness of this Program should also arise from what Hydro itself projects it will achieve by this proposed \$2.5 million dollar expenditure in 2012. With reference to Hydro's response to PUB-NLH-63, it intends to inspect 1685 poles of an average age of twenty eight years, with an expected rejection rate of 2.6% and only 44 poles replaced, all at the cost of \$2.5 million dollars.

Hydro's own information about its experience with transmission poles in the past undermines the pole by pole inspection approach taken by this Program. In Operating Experience, at page B-36, Hydro speaks to having not had to replace many transmission size poles during the past thirty years, and refers to previous intensive inspections (i.e. before the implementation of the Wood Pole Line Management Program) "targeting lines for specific issues". These targeted inspections no doubt contributed to Hydro's good record with respect to replacement of transmission poles in twenty four of the past thirty years when that Program was not in place.

At page 8 of the report in support of this Project (Volume II, tab 13), Hydro reiterates that the inspection schedule for transmission poles is generally built on the strategy of focusing on the older lines first and working towards the newer lines. Surely, it is a reasonable expectation that after six years of this Program, the older, and more at risk, lines have already been inspected; if this is not the case, then this raises serious questions about Hydro's reasonable management of risk. The reasonable presumption should be that deferral of inspection of those lines which have not yet been inspected would be a matter of lower risk, manageable in the same targeted fashion as Hydro was able to do prior to the implementation of this Program.

In the Project Justification on page B-37, Hydro refers to analysis completed at Memorial University since 1999 (i.e. predating this Program) which was able to identify a 25% reduction of average pole strength over a thirty five year period. Surely, with the wealth of data which has now been compiled in the last six years of this Program, at an expense of over \$12.0 million

dollars, Hydro can provide some substantial analysis of the quantitative benefits of the Program, and, it is to be hoped, can develop a more targeted approach to inspection and replacement of transmission poles based on that analysis.

In the coming period of projected high capital expenditure, the Island Industrial Customers would submit that the cost benefit of the Wood Pole Line Management Program is a luxury which Hydro's rate payers can ill-afford. The Island Industrial Customers urge the Board to direct Hydro to prepare a quantitative benefit analysis, based on the data it has already collected from this Program, and to pause this Program, indefinitely, until Hydro files such a quantitative benefit report.

Upgrade Transmission Line Access Trails, p. C-136

As noted by Hydro at page C-137, Volume I of the Application, this project is with respect to access trails which are on Crown owned land that Hydro is permitted to use. The Island Industrial Customers would submit that this raises similar issues to the ones raised in relation to the Bay D'Espoir access road project about whether this is a capital expenditure which can be demanded from the rate payers pursuant to section 41 of the *Public Utilities Act*. In the submission of the Island Industrial Customers, this in itself is sufficient reason to deny approval of this project, as a capital expenditure to be added to rate base.

However, should the Board entertain this project as a potentially approvable capital expenditure, then the Island Industrial Customers would submit that it falls well below the level of justification necessary under the power policy principles set out in the EPCA.

Hydro, in response to CA-NLH-2, has accorded only a "22" priority ranking to this project; it is the 44th ranked of the 50 ranked Phase I projects.

By IC-NLH-18, the Island Industrial Customers requested copies of the incident reports with respect to the ATV and snowmobile incidents tabulated in Table 3, at page C-138, Volume 1 of the Application. In addition to providing these reports in response, it is noteworthy that Hydro also rectified Table 3, significantly reducing the number of ATV and snowmobile incidents which it was attributing to access trail locations.

A review of the incident reports themselves is illuminating. While the Island Industrial Customers do not propose to enter into an incident by incident analysis, it is evident from a review of these incident reports that the great majority of the incidents are not attributable to the inherent condition of the access trails, but rather to issues such as:

- (1) Operator error;
- (2) Inadequate training in the operation of ATVs and snowmobiles;
- (3) Inadequate securing of equipment while travelling on snowmobiles and ATVs;
- (4) The operation of ATVs and snowmobiles by one personnel where safety would have required two personnel to be used;
- (5) The operation of snowmobiles in inadequate snow conditions;
- (6) The inherent instability of ATVs in any off road operating conditions;
- (7) The use of ATVs in circumstances where safety would have indicated that the operator should have walked to the location;
- (8) Failure to schedule work in the winter at times when snow conditions allowed for safe snowmobile travel (per observation number 2008000082, 01/09/2008);

(9) The failure to, in the non-winter months, identify and document structures where ATV and snowmobile use is unsafe, and to ensure that this is understood by all operators;

(10) Mechanical malfunction of an ATV (observation number 20070022927, observed on June 19, 2007 (06/19/2007);

(11) Improper procedure in offloading and loading of ATVs;

(12) Collisions between snowmobiles (observation number 2009001327).

The above list is not exhaustive. However, all of these incidents speak to the need for better operational management, primarily in the form of better training of ATV and snowmobile operators and better trail maintenance and usage policies, rather than as justification for capital expenditure on non-Hydro owned property to upgrade the access trails. Moreover, given the character of these incidents, even if the access trails are upgraded, it appears likely that the risk of these incidents will remain if Hydro fails to implement adequate operational management, including operator training, in relation to the use of these access trails.

While this project is for a proposed capital expenditure of \$313,000 in 2012, Hydro advises, in the project description at page C-136, that this is the first year of a program intended to improve the condition of Hydro's transmission line access trail system throughout the island interconnected system. When reference is made to the 2012 Capital Plan, in Volume 1 of the Application, at page A-10, it can be seen that Hydro is projecting the incurring of \$1.6 million dollars of expenditure under this program over the next five years.

A further aspect of concern in relation to this project is that the incidents which Hydro is putting forward in justification of this project all date from since Hydro phased out its ground maintenance crews, in 2001: see Hydro's response to IC-NLH-16. For seven years afterwards,

1 from 2001 to 2008, no maintenance was carried out on the access trails due to what Hydro
2 refers to as “operating budget constraints”. Hydro notes that the maintenance work which would
3 have been previously done by these ground maintenance crews would have involved clearing
4 vegetation, repairing washouts, potholes and ruts. It is noteworthy that many of the incidents
5 reported since 2003 involve as causes or contributing causes high grass or other vegetation
6 obscuring potential hazards on the trail way and loss of control or tipping of ATVs in potholes
7 and ruts.

8 With reference to IC-NLH-21, it is not clear from Hydro’s response whether the private
9 contractors which have been used since 2008 for access trail maintenance are following any
10 policies or guidelines in relation to maintenance of these access trails. Moreover, after seven
11 years of lack of maintenance, it is reasonable to surmise that the current apparently poor
12 condition of the trails is primarily due to that extended lack of maintenance.

13 In response to IC-NLH-20, Hydro states that “if employees cannot safely traverse trails due to
14 trail condition, no amount of training, PPE or equipment will suffice.” In reply, the Island
15 Industrial Customers would submit that the preponderance of the evidence, including the
16 incident reports disclosed by Hydro and the total lack of maintenance on these access trails for
17 the period 2001 to 2008, points to inadequate operational procedures for maintenance and use
18 of the trails and training of operators as the primary causes of these incidents. The Island
19 Industrial Customers would submit that Hydro should first address these operational issues, and
20 determine whether operational measures can reduce access trail safety incidents, before
21 proposing a capital expenditure solution (again always assuming that the Board accepts that
22 these access trails are the proper subject of capital expenditure in any event, given that they are
23 not property owned by Hydro).

1 **The overall level of proposed capital expenditure and Hydro's priority rankings of the**
2 **Phase I Projects**

3 The Island Industrial Customers have no interest in micro-managing, or in seeking to have the
4 Board micro-manage, Hydro's setting of priorities for capital expenditure. However, once one
5 gets past Hydro's priority "1" rank projects (which, if the Board is to place any reliance on
6 Hydro's prioritization, must be expected to be given some weight) and those projects which
7 raise particularly egregious issues in relation to Hydro's operational and risk management
8 (some of which have been addressed in detail above), the Island Industrial Customers submit
9 that some meaning must be given to Hydro's own choices in assigning lower rankings to the
10 remaining projects.

11 Priority "1" ranked projects, together with the unranked projects, represent alone over \$48
12 million of the proposed expenditure for Phase I projects. The remaining lower rank projects
13 propose a further \$20 million of capital expenditure. In the forthcoming extended period of
14 projected high and increasing capital expenditure, if these lower priority expenditures cannot be
15 subjected to some fiscal discipline, then none of them can. However, the power policy of the
16 EPCA will be rendered meaningless if "most efficient production, transmission and distribution of
17 power" and "lowest possible cost" is interpreted to permit levels of capital expenditure which are
18 unsustainable by Hydro's rate payers.

19 In the 2011 Hydro Capital Budget Application, the Island Industrial Customers proposed that the
20 Board not approve capital expenditure projects below a certain ranking. In the absence of Hydro
21 transparency about how it arrives at its relative rankings and the internal meaning Hydro
22 attaches to those rankings, it may be difficult to justify a specific cut off point. The Island
23 Industrial Customers wish to propose an alternative, so that the capital budgeting process does
24 not become mired in such questions as how many power transformers, circuit breakers, surge

1 arrestors, instrument transformers, disconnects and battery banks (and the like) really need to
2 be replaced, and how many “minor enhancements” (project D-89) need to be performed, by
3 Hydro, in 2012, to arrive at the “most efficient production, transmission and distribution of
4 power” and the “lowest possible cost consistent with reliable service”.

5 To this end, the Island Industrial Customers propose that the \$20 million sought to be approved
6 for lower than priority “1” ranked projects be reduced to a level, together with reductions in
7 proposed capital expenditure achieved by the denial and deferral of specific projects in this
8 Phase I and potentially in Phases II and III, so that the increase in Hydro’s capital budget for
9 2012 over that approved in 2011 is at least brought in line with the average annual increase in
10 capital budgets over the last 5 years. By that means, Hydro itself can be left to decide how
11 many power transformers, circuit breakers, surge arrestors, instrument transformers,
12 disconnects and battery banks will be replaced, and how many “minor enhancements” will be
13 performed, in 2012, within the approved level of expenditure, and report to the Board
14 accordingly. This proposal would serve the purpose of planning predictability for Hydro’s
15 customers (and of imposing greater planning discipline on Hydro), as it would bring approved
16 2012 expenditure closer in line to the \$70 million which Hydro forecast for 2012 as recently as in
17 the 2011 Capital Budget.

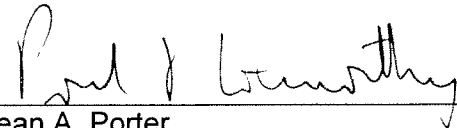
18 Hydro will presumably respond that reliable service will be put at risk if all its proposed capital
19 expenditures are not approved. This is an impossible proposition to prove, or disprove,
20 particularly if the prevailing ethos is that all “avoidable risks” should be eliminated, whatever the
21 cumulative cost. It is a proposition that Hydro’s rate payers cannot afford to simply accept.
22 Moreover, it is a proposition which allows Hydro to avoid appropriate planning discipline and
23 appropriate operational risk management.

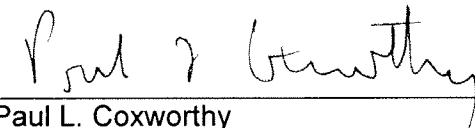
All of which is respectfully submitted on behalf of the Island Industrial Customers.

DATED at St. John's, in the Province of Newfoundland and Labrador, this 7th day of October, 2011.

Poole Althouse / Stewart McKelvey

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