

THE BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

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| TITLE: Capital Budget Application Guidelines | | PAGE | 1 of 11 |
| DATE ISSUED: June 2, 2005 (Provisional) | | REVISION DATE: October 2007 | |

This policy is designed to provide direction as to general administrative process utilized in the handling of Capital Budget Application filings made to the Board

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I. GENERAL

This policy applies to capital budget applications filed with the Board pursuant to Section 41 of the *Public Utilities Act* for approval of the annual capital budget or supplementary capital expenditures of a utility. This policy provides directions on process and timing and highlights specific information and other requirements which are part of the approval process.

II. LEGISLATION

- A.** *Public Utilities Act*, R.S.N.L. 1990, c. P-47, in particular section 41.
- B.** *Electrical Power Control Act, 1994*, R.S.N.L. 1994, c. E-5.1, in particular section 3.

III. POLICY STATEMENT

In fulfilling its mandate with respect to the supervision of the capital expenditures of a utility the Board balances the interests of consumers and the utility in the context of the applicable legislative provisions. In balancing these interests the Board is committed to the efficient and effective review and approval of expenditures in keeping with the provision of least cost reliable service.

IV. PURPOSE

The purpose of this policy is to provide clarity and consistency in the submission of capital expenditures by a utility, while ensuring transparent and fair oversight by the Board. The policy sets out the format, process, schedule and obligations of the utility and participating parties.

V. POLICY

A. ANNUAL CAPITAL BUDGET

1. Application Schedule

The filing date for the annual capital budget application for each utility shall be set out by the Board from time to time (currently July 15 for Newfoundland Power and August 1 for Newfoundland and Labrador Hydro). Upon receipt of an application the Board will set a schedule of dates certain based on the schedule below.

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| ACTION | NP | NLH |
|--|--------------|--------------|
| Application filed with supporting evidence and copied to interested persons | July 15 | August 1 |
| Notice published | July 22 | August 8 |
| Intervenor Submissions filed | August 2 | August 19 |
| i) RFIs filed ii) Request for technical conference made | August 5 | August 22 |
| Replies to RFIs | August 19 | September 6 |
| Target date for technical conference to be held | August 26 | September 13 |
| i) Intervenor evidence filed ii) RFIs arising from Technical Conference filed iii) Request for a hearing filed | August 30 | September 17 |
| i) RFIs on Intervenor Evidence ii) Notice if Hearing will be held | September 4 | September 21 |
| i) Replies to RFIs on Intervenor Evidence ii) Replies to RFIs arising from the Technical Conference | September 11 | September 28 |
| Hearing, or if no hearing written submissions must be filed | September 30 | October 15 |
| Decision | November 15 | December 1 |

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2. Application Format

A utility shall present its annual capital budget with sufficient detail for the Board and interested parties to understand the nature, scope and justification for individual expenditures and the capital budget overall. Each expenditure will be presented in the following manner:

- a) Step 1 Define the capital expenditure.
- b) Step 2 Classify the capital expenditure.
- c) Step 3 Segment by materiality.

a) Step 1 Defining Capital Expenditures

Capital expenditures are to be defined as one of the following:

- i. Clustered;
- ii. Pooled; or
- iii. Other.

i. Clustered Expenditures

Definition Clustered expenditures are those which would logically be undertaken together. Clustered expenditures are to be divided between items that are “inter-dependent” and those which are “related”.

1. Inter-dependent items - those which are necessarily linked to each other, such that the repair, replacement or acquisition of one item necessarily triggers the repair, replacement or acquisition of another item.
2. Related items - those which, although not necessarily linked to the repair, replacement or acquisition of another item, are nonetheless, logically undertaken together.

Supporting Information

For Clustered Expenditures, in addition to the information required as set out below in **Classifying Capital Expenditures**, the utility will have to show:

1. Why the series of expenditures should logically be undertaken together.
2. Which components of the expenditures are considered to be:
 - a. Inter-dependent; and
 - b. Related only.
3. A breakdown in costs and, where appropriate, separate costing for the series of inter-dependent items and the series of related items.

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ii. Pooled Expenditures

Definition A series of expenditures which are neither inter-dependent nor related but which nonetheless are logically grouped together.

Supporting Information

1. For pooled expenditures, in addition to the information required as set out below in **Classifying Capital Expenditures**, the utility will have to provide unit or aggregate costing data, as appropriate.
2. Clear parameters for the pool must be set out showing amounts in relation to identified anticipated projects and amounts for expenditures anticipated based on historical spending or other forecasting. For example, in the case of Distribution and Extensions the information should set out the significant amounts for known geographic locations of growth (i.e. a particular cottage area which is being developed) as well as the amount which is anticipated based on general forecasting.

iii. Other Expenditures

Definition Expenditures which do not fit the definition of Clustered or Pooled.

Supporting Information

No specific additional information is required. See **Classifying Capital Expenditures** below for the general information requirements.

b) Step 2 Classifying Capital Expenditures

Once an expenditure is defined as Clustered, Pooled or Other, the utility will apply the Classification Scheme, identifying the expenditure as either:

- i. Mandatory;
- ii. Normal Capital; or
- iii. Justifiable

i. Mandatory

Definition A Capital expenditure which the utility is obliged to carry out as a result of:

1. Legislation,
2. Board Order,
3. Safety issues, or
4. Risk to the environment.

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Supporting Information

In relation to mandatory expenditures a utility must show:

1. On what basis the expenditure is mandatory;
2. All reasonable alternatives, where available, and the reasons this particular alternative was chosen; and
3. Whether the proposed expenditure is the least cost reasonable alternative and if not why it was chosen.

ii. Normal Capital

Definition A capital expenditure that is required based on identified need or on historical patterns of repair and replacement.

Supporting Information

In relation to normal capital expenditures a utility must show, where appropriate:

1. There is evidence of the need, ie. historical spending patterns, maintenance history, reliability data, growth;
2. All reasonable alternatives, including deferral, have been considered;
3. The expenditure as proposed is the least cost option;
4. Unit and/or aggregate cost data including, where available, similar costs for the preceding five (5) years; and
5. Net Present Value (NPV).

iii. Justifiable Expenditures

Definition Expenditures which are justified based on the positive impact the project will have on the utility's operations.

Supporting Information

In relation to justifiable expenditures a utility must show:

1. All reasonable alternatives, including deferral, have been considered; and
2. The expenditure will provide tangible benefits to ratepayers, such as information showing a positive NPV, or the proposed resolution to an identified deficiency.

c. Step 3 Segmenting by Materiality

i. Purchases & Improvements

Capital expenditures should be segmented by their materiality as follows:

1. Expenditures under \$200,000
2. Expenditures between \$200,000 and \$500,000
3. Expenditures over \$500,000

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1. Expenditures under \$200,000

Expenditures under \$200,000 will be supported with evidence showing that the expenditure is prudent and necessary to provide reasonably safe, adequate, just and reasonable service. These expenditures will be considered based on the written record filed, including the utility's application, any relevant RFIs and replies, other evidence and written submissions.

2. Expenditures between \$200,000 and \$500,000

Expenditures of this amount will be supported with evidence showing that the expenditure is prudent, or necessary to provide reasonably safe, adequate, just and reasonable service. The utility will be expected to provide the following information where appropriate and when available:

- o Age of equipment or system
- o Major work/upgrades completed since installation/implementation
- o Anticipated useful life
- o Summary of maintenance records
- o Summary of outage statistics
- o Relevant industry experience
- o What maintenance/support arrangements available (internal and external)
- o Vendor recommendations
- o Availability of replacement parts
- o Safety performance (if relevant)
- o Environmental performance (if relevant)
- o Operating regime (continuous, cyclic, standby, etc.)
- o Net Present Value NPV calculation
- o Levelized cost of energy
- o Cost benefit analysis
- o Other legislative or regulatory compliance requirements
- o Historical average and/or unit cost information
- o Forecast customer growth estimate
- o Energy efficiency benefits
- o Losses incurred during construction
- o Anticipated consequences of maintaining the status quo
- o Any other alternatives considered
- o Description of proposed solution
- o Budget estimate
- o Project schedule
- o Detailed report/analysis of condition (if available).

Expenditures between \$200,000 and \$500,000 would be normally considered based on the written record filed, including the application, any relevant RFIs and replies, other evidence and written submissions. These expenditures may be challenged during a hearing if the Board, on its own motion or upon receiving a request from an Intervenor, determines that an oral hearing is necessary to properly assess whether the expenditure should be approved.

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3. Expenditures in excess of \$500,000

Expenditures of this amount are considered significant expenditures which must be supported with more comprehensive and detailed documentation than other expenditures. It is expected that all the items in the checklist will be addressed with either the information provided or an explanation of why it is not appropriate in the circumstances. Where appropriate, a utility is expected to provide a report/analysis by a qualified engineer or other appropriate expert in support of the expenditure.

Expenditures in excess of \$500,000 are open to review at a hearing if it is determined by the Board, upon request or on its own motion, that the expenditure should be reviewed in an oral hearing.

ii. Capital Leases

Annual lease amount less than \$20,000

Capital leases proposed to start in the year and involving an annual expenditure less than \$20,000 would be reviewed and generally approved based on the written record.

Annual lease amount equal to or in excess of \$20,000

Capital leases proposed to start in the year and involving an annual expenditure equal to or greater than \$20,000 would be open to review at a hearing, if it is determined by the Board, upon request or on its own motion, that the lease should be reviewed in an oral hearing.

3. General

a. Lease or Purchase Option

Where it is appropriate at the time of making the application to maintain the option to purchase or lease a capital item, a utility may seek the approval of the Board for an expenditure on the basis that it may proceed either by way of a purchase or a lease. In this case, in addition to the usual information required, the utility will advise the Board as to the lease and purchase options that are available in relation to the capital expenditure at the time of the application and seek the approval of the Board to proceed with the capital item either by way of lease or purchase, depending on the NPV. The utility shall advise in the subsequent capital expenditures report as to the approach that was taken and the NPV justification.

b. Multi-year Expenditures

Each year of a expenditure will be considered in the initial year of application. Where a utility shows in each subsequent year of a multi-year expenditure that the scope, nature and amount of the capital expenditures are consistent with the original approval, further approval is not required.

Expenditures in subsequent years will be subject to further review if there is a material change in the scope, nature or forecast cost of the expenditure. A change will be considered material if the nature or scope of the expenditure changes such that that original rationale provided is no longer applicable or where the revised forecast expenditure exceeds the approved amount by 10% or more.

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c. Technical Conference

Where appropriate, a utility may conduct a technical conference.

A technical conference will be used in concert with the RFI process to gain a full understanding of the scope and nature of the proposed projects and will most often involve the participation of Board staff. To the extent that relevant information is brought forward at the technical conference, it will not be available for the consideration of the panel unless it is entered on the record through the RFI process or in the evidence of a witness. The technical conference will generally not be recorded and the information provided will not be part of the record.

Where the parties agree and the Board determines that it would be of assistance, the Commissioners of the Board hearing the application may participate in the presentation portion of the technical conference. Where the Commissioners participate the technical conference shall be transcribed or, in the alternative with the agreement of the parties, the utility shall file as part of the record a written copy of the substance of the presentation which shall be reflective of the presentation and may be referred to in the decision making of the Board. After the presentation the Commissioners may ask questions but generally will not be present during the discussion/questions of the other participants.

d. Site Visit

In appropriate circumstances a utility may provide a site visit. These visits will be organized by the utility where practical in the context of a request in writing from the Board or an Intervenor. Where the parties agree and the Board determines that it is reasonably necessary, the Commissioners of the Board hearing the application may participate in the site visit. All Commissioners hearing the application will participate together.

B. Supplemental Capital Expenditures

1. Application for Approval of Supplemental Capital Budget Expenditures

Where a utility determines that a capital expenditure which was not anticipated and included in the annual capital budget is necessary in the year and should not be delayed until the following year it may make an application for approval of a supplemental capital expenditure in the year. In the case of a pooled amount supplemental capital approval will be necessary where the additional expenditure was not included as an anticipated identified expenditure and is beyond the scope of the items contemplated in the general forecast amount.

Where a utility identifies a necessary capital expenditure which is supplemental to the annual capital budget and which does not satisfy the requirements to be included in the Allowance for Unforeseen Items it may apply to the Board for approval of a supplemental capital expenditure. This application must be supported with appropriate evidence and analysis similar to the format and requirements in relation to expenditures which were part of the annual capital budget. In addition, the utility will provide evidence as to:

- i) why the project was not anticipated and included in the annual capital budget application for the year; and
- ii) why the project cannot wait until next year and be included in the annual capital budget application.

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When making an application for approval of a supplemental capital expenditure a utility need not apply for approval of an increase to the total annual capital budget. For regulatory purposes the approved annual capital budget would generally not be expected to change with subsequent approvals of supplementary capital expenditures. However, it may be necessary to apply for changes to the previously approved annual capital budget where those supplemental projects replace or otherwise relate to an expenditure included in the approved annual capital budget.

2. Allowance for Unforeseen Items

Where it is impractical to make application to the Board for approval of a supplemental capital expenditure, a utility may proceed with the expenditure using the Allowance for Unforeseen Items account. The purpose of this account is to permit the utility to act expeditiously to deal with events affecting the electrical system which cannot wait for the specific approval of the Board. The expenditure must be so urgent that any delay would have serious negative consequences. The utility must be able to show that a delay was not possible in the circumstances.

The amount of the Allowance for Unforeseen Items account is established for each utility in the annual capital budget process. Where significant expenditures have been made in the year using the allowance for Unforeseen Items Account the balance in the account may be eroded. A utility may file an application for supplemental approval of an additional amount in the Allowance for Unforeseen Items Account. If an application is made for approval of a supplementary allowance the utility will have to show that the usage to date of the account was consistent with this policy.

Before proceeding with work using the Allowance for Unforeseen Items account, or as soon as practical thereafter, the utility must notify the Board in writing that it intends to proceed with an expenditure greater than \$50,000 without the approval of the Board using the Allowance for Unforeseen Items account. This notice must set out the detailed circumstances, including the justification for the expenditure and the reason for the use of the Allowance for Unforeseen Items account, providing to the extent available at the time, a scope and costing for the expenditure.

Within 30 days after the completion of the work the utility shall file a detailed report setting out:

- i) the circumstances of the expenditure;
- ii) any reliability or safety issues;
- iii) why the work was not anticipated in the annual capital budget;
- iv) the alternatives considered;
- v) the financial effects of each alternative and the reasons for the chosen alternative;
- vi) a timeline setting out all relevant dates;
- vii) the nature and scope of the work;
- viii) the detailed costs incurred; and
- ix) any other implications for other aspects of the utility business/system.

A summary report detailing the use of the Allowance for Unforeseen Items account shall be filed with each annual capital expenditure report.

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C. GENERAL

1. Capital Expenditures Report

A utility must file a report by March 1 of each year on the annual capital expenditures to December 31 of the previous year. This report will include a detailed explanation of each actual expenditure variance from the approved expenditures which variance is more than both \$100,000 and 10%. The utility will provide a full explanation of the reason for the variance setting out any change in the scope of the project together with confirmation that the expenditure remains least cost and, where originally approved based on a NPV calculation, that the NPV has not been materially affected. This report should include a thorough explanation of all of the components that caused the actual total capital expenditures in any year to exceed the budgeted total capital expenditures by more than \$100,000 or 10%. This report should also set out a summary in table or graph format of these variances both on a dollar and percentage basis for each of the last ten years. Should the overall variance in any two years exceed 10% of the budgeted total the report should address whether there should be changes to the forecasting or capital budgeting process which should be considered. In addition a utility must file with each general rate application each of the annual reports filed since the last general rate application.

2. Related Applications

a. Abandonment of Plant

If a capital expenditure is related to the abandonment of plant requiring approval of the Board under section 38, the application for abandonment of plant and the application for approval of capital expenditures should be made together.

b. Contributions In Aid of Construction

If there is a contribution in aid of construction associated with a supplemental capital expenditure application the two applications should be filed together.

