

February 18, 2019

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

**Attention: Ms. Cheryl Blundon**  
**Director Corporate Services & Board Secretary**

Dear Ms. Blundon:

**Re: Newfoundland and Labrador Hydro – 2017 GRA Settlement Agreement –  
Business Systems Transformation Program**

## **Background**

### *Procedural History*

On July 28, 2017, Newfoundland and Labrador Hydro ("Hydro") filed its 2017 General Rate Application ("GRA") with the Newfoundland and Labrador Board of Commissioners of Public Utilities (the "Board") pursuant to the *Public Utilities Act*, RSN, 1990, Chapter P-47 (the "Act"). As part of that GRA, Hydro proposed recovery of its costs of participation in a shared services program with Nalcor Energy ("Nalcor"), more particularly, the Business Systems Transformation ("BST") Program.

In a Settlement Agreement filed April 16, 2018, Hydro and the Parties agreed that all costs and expenses related to the BST Program would be removed from the revenue requirements in the Test Years and set aside in a deferral account. The Board would conduct a separate proceeding to evaluate the reasonableness and prudence of those costs. A report, the *Corporate Business Systems Transformation Program Justification*, explaining the costs with supporting detail was filed on June 22, 2018 as required by the Board. Hydro provided responses to Requests for Information on February 4, 2019. On February 11, 2019, Hydro received comments from Newfoundland Power regarding the BST Program. No other submissions were received.

### *Shared Services*

For many years, Hydro and Nalcor used an organizational structure based on a matrix model. This changed in 2016 based on recommendations of the Board's external consultant, The Liberty Consulting Group ("Liberty"), a review of Hydro's pre-2007 structure, and a review of the structure of other regulated utilities across Canada, including Newfoundland Power Inc. ("Newfoundland Power"). The changes, approved in 2016 and implemented in 2017, were intended to assist Hydro to operate as an independent, stand-alone regulated utility. However,

a selection of services – some of which had been common to Nalcor and Hydro before the changes to organizational structure - remained under a shared services framework to capitalize on economies of scale. These include human resources, safety, and information systems.<sup>1</sup> Nalcor created the BST Program within this shared services framework. The BST Program was established to address technical and functional concerns with current processes and systems that were not meeting the evolving needs of each of Nalcor's subsidiary companies, including Hydro.

Although Nalcor managed and executed the BST Program, as Nalcor's largest information systems user, Hydro was actively involved in each stage including program development, the development and review of options for the Enterprise Resource Planning ("ERP") system, the Request for Proposal ("RFP") process for the Planning, Budgeting and Forecasting software, and the design, build and implementation of systems.

#### *Requirement for Updates and Upgrades*

JD Edwards World was implemented in 1999 as Hydro's ERP system at a cost of approximately \$12.8 million.<sup>2</sup> Upon review in 2015, Hydro determined that JD Edwards World lacked data standardization and integration, which impacted the availability of quality, reliable data required to inform decision-making and necessary equipment maintenance activities. Its existing functionality did not provide sufficient options to enhance productivity, improve reliability and customer service, and achieve long-term reductions in operating and administrative costs. In addition, vendor support will substantially end by March 2020.<sup>3</sup>

Prior to the BST Program, Hydro's process for budgeting and forecasting was limited to the use of multiple Microsoft Excel files and software applications. The use of multiple tools prevented the integration of budgeting and forecasting processes for operations and capital. As a result there were significant manual processes that operated independently, leading to increased risk of unreliable data forming the basis for decision-making.

In 2015 an Information Management Capacity Assessment ("IMCAT") was completed and identified the need for Hydro to have increased information management resources, toolsets, policies, and guidelines to provide enhanced management, and security of its information. Hydro is legislatively required to "*...develop, implement and maintain a record management system for the creation, classification, retention, storage, maintenance, retrieval, preservation, protection, disposal and transfer of...records.*"<sup>4</sup> An information management program which provides for consistent information management practices, procedures, expertise, and a strategic approach to managing and protecting Hydro's information is essential to ensure legislative compliance.

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<sup>1</sup> These services are provided in accordance with Hydro's Intercompany Transactions Costing Guidelines, "2017 General Rate Application," Vol. II, Ex. 5.

<sup>2</sup> Response to Request for Information PUB-NLH-189.

<sup>3</sup> Response to Request for Information PUB-NLH-188.

<sup>4</sup> *Management of Information Act, 2005.*

*Least-Cost Approach*

Participating in the BST Program enabled Hydro to avoid certain substantial costs it would have incurred had Hydro undertaken those activities on its own. Hydro did not incur costs related to the initial assessments, calculated at \$2.6 million. If Hydro had pursued a stand-alone option, it would have incurred assessment costs that would have been passed along to Hydro's customers for recovery, subject to approval of the Board.

As the BST Program is part of a shared services offering executed by Nalcor, Hydro is not required to raise capital for upfront investment, nor is Hydro seeking a return on the BST Program assets. The absence of costs related to interest during construction and a return on rate base are of direct benefit to Hydro's customers and support Hydro's approach to delivering least-cost service.<sup>5</sup>

Hydro's cost benefit analysis as detailed in the *Corporate Business Systems Transformation Program Justification Report*, demonstrated that the implementation of the BST Program supports Hydro's mandate of least-cost, reliable service. Hydro compared the life cycle cost associated with two scenarios:

- status quo - continuing with existing systems; and
- the business systems chosen under the BST Program.

The purpose of the analysis was to determine the minimum operating and maintenance savings necessary for the implementation of the new systems to be more economical than continuing with the previous systems. Included within the cost benefit analysis was an annual efficiency gain of \$415,000.<sup>6</sup> This was based on a review of readily identifiable benefits through the implementation process. The cost benefit analysis determined that an additional \$565,000 in efficiencies is required to achieve cost neutrality between the implementation of the new BST Program versus maintaining the previous system. Given the benefits the system will deliver, as outlined in Hydro's evidence,<sup>7</sup> savings will be achieved through the realization of efficiencies in the long-term. As noted in a study completed by Goss Gilroy Inc., resource and cost reduction is realized over the medium- to long-term with large projects, rather than during the initial implementation stages.<sup>8</sup>

Nalcor will incur all costs for the capital projects associated with the BST Program while projects are in progress. Once implementation is complete, Nalcor will recover the BST Program costs from its subsidiaries through inter-company administration fees. Hydro's share of the projected \$44.1 million cost of the BST Program (excluding the \$2.6 million related to preliminary

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<sup>5</sup> Response to Request for Information NP-NLH-368.

<sup>6</sup> Detailed in *Corporate Business Systems Program Justification Report*, "Appendix E, Scenario 1, Column H, and Response to Request for Information PUB-NLH-201.

<sup>7</sup> *Corporate Business Systems Program Justification Report*, "Section 5 and Appendices F and G.

<sup>8</sup> *Corporate Business Systems Program Justification Report*, section 4.0.

assessment costs for which Nalcor is solely responsible) is \$23.2 million. This will be recorded by Hydro as operating costs over a 15-year period.<sup>9</sup>

This cost recovery method will permit Hydro to pay for the use of the systems as it receives the benefit of the systems.

In comparing the cost of implementing only JD Edwards World in 1999 (\$12.8 million) to the cost Hydro is incurring as a result of the implementation of the BST Program (\$23.2 million), it is Hydro's position these costs are: (i) prudently incurred given the enhanced functionality and broader scope of the systems within the BST Program; and (ii) within a reasonable range of increased expense over a 20-year timeframe.

### **Submissions of Newfoundland Power**

Newfoundland Power acknowledges that the status quo is not a reasonable alternative given the deficiencies and shortcomings of the existing business systems highlighted by Hydro. Newfoundland Power has not contended that the annual cost that Hydro has proposed for recovery is unreasonable. Newfoundland Power contends that Hydro's participation in the BST Program as a shared service offering circumvented the Board's established process for review of large capital expenditures.

#### *Regulatory Process*

As noted in Hydro's 2017 GRA Rebuttal, there are differing prescribed approaches for the evaluation of capital assets and operating expenses.<sup>10</sup> However, the goal of ensuring that the cost a utility has or will incur is consistent with providing reliable service at least-cost is the same for each approach.

If a utility obtains value and service from a third party's assets, the Board is not required to set a value for the provider's assets, rather it looks to whether the public utility is getting appropriate and prudent value from the operating expenses it occurs.<sup>11</sup> Nalcor will incur all costs for the capital projects associated with the BST Program while projects are in progress. When implementation is complete, Nalcor will recover the costs from Nalcor subsidiaries through inter-company administration fees. Hydro's participation in the BST Program allowed Hydro to avail of economies of scale and other cost savings that would not otherwise be available.

The difference between the approaches are mainly to do with timing (under the capital assets approach, an application for approval is brought before an expenditure is incurred), and whether the Board can and will assign a value to the assets. However, in either case a thorough

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<sup>9</sup> *Corporate Business Systems Program Justification Report*, section 4.4, and Response to Request for Information NP-NLH-365.

<sup>10</sup> Page 6, line 28.

<sup>11</sup> Hydro's 2017 GRA Rebuttal, Page 6, lines 22-24.

review of the prudence of the expenses is completed and the Board has the option, in either case, to allow or disallow the costs.

The costs associated with Hydro's participation in the BST Program are being thoroughly vetted through its submission in the 2017 GRA. In addition, in each successive GRA the operating costs associated with the BST Program in the applicable test year will be reviewed.

In *Reference Re Section 101 of the Public Utilities Act (Nfld.)* (1998), 164 Nfld. & P.E.I.R. 60 (Nfld.C.A.) ("*Stated Case*"), Green J.A. stated some of the general principles applicable to the interpretation of the *Act* and *Electrical Power Control Act*, including the following:<sup>12</sup>

1. *The Act should be given a broad and liberal interpretation to achieve its purposes as well as the implementation of the power policy of the province;*
2. *The Board has a broad discretion, and hence a large jurisdiction, in its choice of the methodologies and approaches to be adopted to achieve the purposes of the legislation and to implement provincial power policy;*

....

In Order No. P.U. 14(2004), the Board referred to the *Stated Case*, maintaining that:<sup>13</sup>

*"The Court was clear in setting out that the Board must balance two sets of interests – the utility's right to a fair return and the consumer's right to reasonable access to power. Mr. Justice Green notes that the Board must be careful to balance both interests, when he says, at para. 144:*

*"It must always be remembered that, as has been emphasized throughout this opinion, the Board is charged with balancing the competing interests of the utility and the consumers of the service it provides. Neither set of interests can be emphasized in complete disregard of the interests of the other. Thus, in choosing to exercise a particular power within the Board's jurisdiction, the Board must always be mindful of whether, in so acting, it will be furthering the objectives and policies of the legislation and doing so in a manner that amounts to a reasonable balance between the competing interests involved."*

*In conclusion, the Court found that the Board can be regulative and corrective but not managerial in its prospective regulation of a utility. The Board notes that the Court of Appeal suggested that the Board should observe a presumption of managerial good faith."*

The Court of Appeal, in *Newfoundland and Labrador Hydro v. Newfoundland and Labrador (Board of Commissioners of Public Utilities)*, 2012 NLCA 38 (CanLII) confirmed that the exercise

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<sup>12</sup> Section 36.

<sup>13</sup> Page 21.

of the Board's jurisdiction is not contingent upon technical particularities such as, in that case, the wording of Hydro's application.<sup>14</sup> The Court was clear in stating that "*procedure cannot trump jurisdictional substance.*"<sup>15</sup>

Hydro's proposed expenditures are properly before the Board for review as prudent operating expenditures. Newfoundland Power's submission that the CBA Guidelines are the appropriate framework is focused on procedure. The substance of the issue can be provided a full and proper regulatory review through the general approach applicable to operating expenses. Public utilities must be permitted to consider all choices when deciding upon the overall, least-cost method of providing service. This will always be through a combination of deploying assets and contracting for services. It is unnecessary to artificially force a capital asset analysis approach where the Board has the full ability to consider the cost and value of contracted services.

Newfoundland Power agrees, on page 3 of its February 11, 2019 submission, with Hydro's statement in its 2017 GRA Rebuttal, that the "goal and result" of the differing prescribed approaches are the same. However, Newfoundland Power contends that the CBA Guidelines must still be followed and Hydro should be required to demonstrate the value of the shared programs in accordance with CBA Guidelines. While Hydro's operating costs associated with the BST Program were not submitted for approval under the CBA process, the analysis completed has met the requirements of those guidelines. As noted in Newfoundland Power's submissions on page 3, the Guidelines "require that a utility show that (i) all reasonable alternatives, including deferral, have been considered; and (ii) the proposed expenditure will provide tangible benefits to ratepayers, such as information showing a positive net present value ("NPV"), or the proposed resolution to an identified deficiency."<sup>16</sup> Hydro submits that both points will be met.

Newfoundland Power notes that the CBA Guidelines state that all items in the detailed checklist should be addressed and a report or analysis by a qualified engineer or other expert in support of the expenditure should be provided. Newfoundland Power further states that it is not clear whether other vendors' software solutions would be more reasonable than a Hydro only approach, and claims that a detailed analysis of the comparative benefits of software solutions offered by other vendor was not provided.

As stated in Response to Request for Information NP-NLH-371, each of the projects were evaluated and approved individually. Business cases were prepared for the ERP system and the Planning, Budgeting and Forecasting system to ensure the options met the identified requirements.<sup>17</sup> The projects were executed as a single program to avail of overhead efficiencies and cost savings, which were detailed on numerous occasions in Hydro's various

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<sup>14</sup> Paragraph 155.

<sup>15</sup> Paragraph 156.

<sup>16</sup> CBA Guidelines, page 6 of 11.

<sup>17</sup> See Responses to Requests for Information PUB-NLH-196 and PUB-NLH-198.

submissions. A cost benefit analysis was prepared analyzing the status quo option and the business systems chosen under the BST Program, which indicated that proceeding with the BST Program options was consistent with the least-cost mandate, once the realized and expected future efficiency gains were factored in.

### Conclusion

Newfoundland Power notes that: (i) the Board must be satisfied that Hydro's proposed expenditures are consistent with the least-cost provision of electrical service to Hydro's customers; (ii) the Board must determine whether Hydro's evidence adequately demonstrates that its chosen approach to the replacement of its major business systems will provide the lowest cost solution for Hydro's customers consistent with the provision of safe, reliable, electric service; and (iii) the Board must determine the appropriateness and timing of the recovery of Hydro's share of the costs of the BST Program in light of Hydro's stated expectation that cost savings sufficient to achieve cost neutrality with the status quo will be achieved once the program has been fully implemented.<sup>18</sup>

Hydro submits that it has demonstrated that its chosen approach and proposed expenditures have met the mandate of management to result in power delivered to consumers at the lowest possible cost consistent with reliable service. Hydro submits that the information provided in the *Corporate Business Systems Program Justification Report* and the responses to the Requests for Information issued on this subject clearly indicate the estimated cost savings associated with the BST Program are more than reasonable and will be achieved.

Hydro respectfully submits that its proposal to recover the costs of its participation in the BST Program by charges to the operating account forecast be approved.

Should you have any questions, please contact the undersigned.

Yours truly,

### **NEWFOUNDLAND AND LABRADOR HYDRO**



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<sup>18</sup> Submissions of Newfoundland Power on the BST Program, February 11, 2019, pages 4 and 5.