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NEWFOUNDLAND POWER
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February 11, 2019

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

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

Ladies and Gentlemen:

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

Background

In its 2017 General Rate Application (the "2017 GRA"), Newfoundland and Labrador Hydro ("Hydro") described the Business Systems Transformation Program ("BST Program") as part of a shared services arrangement with its parent company, Nalcor.[1] In the 2017 GRA, Hydro proposed to recover the costs of its participation in the BST Program by charges to operating account forecast to be $2.54 million in 2018 and $3.04 million in 2019. In the Settlement Agreement dated April 16, 2018 ("the Settlement Agreement"), the parties to the 2017 GRA agreed that the costs and expenses related to the BST Program would be removed from the test year revenue requirements and recovery deferred, and that Hydro would provide a report justifying the costs and proposing a timeline for the Board's review of the matter.[2]

On June 22, 2018, Hydro submitted its report in accordance with the Settlement Agreement (the "Justification Report"). On January 21, 2019, Newfoundland Power and the Board submitted Requests for Information on the Justification Report, and Hydro's responses were provided on February 4, 2019.

By letter dated November 27, 2018, the Board set today as the deadline for comments on the BST Program. These are Newfoundland Power's comments.

1 2017 GRA, Evidence, page 3.41.
2 Consent 1, 2017 GRA, paragraph 11.

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The Justification Report

The Justification Report indicates that Hydro determined in 2015 that its existing Enterprise Resource Planning ("ERP") system, JD Edwards World, needed to be evaluated to address technical and functional concerns. In addition, Hydro identified a need for a "single and fully integrated solution to support capital, operating and labour budgeting", and a need for a centralized information management program.[3]

Hydro's identified requirements for (1) an upgraded ERP system, (2) a new planning, budgeting and forecasting program, and (3) a new information management program were ultimately addressed as part of the Nalcor-led BST Program. Hydro's projected share of the total BST Program cost of approximately $44.1 million is approximately $23.2 million.[4] This is proposed to be recovered over a 15-year period commencing in 2016.[5]

Hydro's cost-benefit analysis of the BST Program considered the life cycle cost associated with two scenarios: (i) the status quo, which involved continuing with JD Edwards World software and (ii) the business systems chosen through the Nalcor-led evaluation process – EnterpriseOne and Cognos TM1.[6] To achieve "cost neutrality" between these two scenarios, Hydro must find additional annual efficiency savings from the BST Program of approximately $565,000.[7] Put another way, additional annual savings greater than $565,000 are required for the BST Program to achieve a positive net present value as compared to the status quo. Hydro does not yet have a complete assessment of the known, quantifiable savings associated with the functionality enhancements of the new systems.[8]

Newfoundland Power's Comments

General

In Newfoundland Power's submission, Hydro's decision to address its requirements for new business systems through a shared services program led by Nalcor effectively circumvented the Board's established process for review of large capital expenditures. For capital expenditure requirements of a public utility involving construction or purchases in excess of $50,000 or leases in excess of $5,000 per year, prior approval of the Board is required.[9] To address such

3 Justification Report, pages 1-4.
4 In addition, Hydro expects the costs of the BST Program allocated to the Lower Churchill Project to be included in the charges paid by Hydro's Island Interconnected Customers. (Response to Request for Information NP-NLH-359).
5 Justification Report, page 5, lines 6-12 and Table 1.
6 Justification Report, page 14, lines 10-13.
7 Justification Report, page 15, lines 5-12.
8 Response to Request for Information NP-NLH-369, page 1 of 1, lines 12 to 14.
9 *Public Utilities Act*, section 41 (3).

approvals, the Board has a comprehensive and detailed framework of rules and practices which was developed over a number of years in consultation with the utilities and other interested parties. These rules and practices are set out in the Board's *Capital Budget Application Guidelines* (the "CBA Guidelines").[10]

In its *Written Submissions* in the 2017 GRA, Newfoundland Power submitted, with specific reference to the BST Program and with general reference to future shared programs of a capital nature, that Hydro should be required to demonstrate the value of such programs in accordance with the CBA Guidelines.[11]

In its rebuttal submission, while agreeing "that the value received and the amounts paid [for services provided by an affiliate] should be fully investigated, Hydro submitted that there are "some process differences" under the *Public Utilities Act* between evaluating capital assets related to self-supplied services and operating expenses related to services provided by a third party, and advised against Newfoundland Power's proposal.[12] Hydro's basis for its advice is not clearly stated in its submission.

In Newfoundland Power's submission, while the allocation of capital costs related to a shared program may not be captured by the provisions of the *Public Utilities Act* relating to capital expenditure approvals, it is a distinction without a difference. As Hydro acknowledges, while the two prescribed approaches differ, "the goal and result are the same." For this reason, Newfoundland Power submits that the CBA Guidelines, which were developed by consensus, and have been successfully applied by the Board for over a decade, provide an appropriate framework for evaluating Hydro's participation in the BST Program.

A particular advantage of the Board's established process for review of material capital expenditures is that it is typically undertaken in advance. In Newfoundland Power's submission, this is preferable to an approach that would have the reasonableness of project expenditures such as those involved in the BST Program reviewed only after they have been incurred.

Applying the Guidelines

The CBA Guidelines identify justifiable capital expenditures as those which are justified based on the positive impact the project will have on the utility's operations. In relation to justifiable expenditures, the CBA 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.[13]

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[10] *Capital Budget Application Guidelines*, Policy Number 1900.6, October 2007.
[11] 2017 GRA, *Written Submissions of Newfoundland Power*, February 1, 2019, page C-6 to C-7.
[12] *2017 General Rate Application Rebuttal*, February 8, 2019, pages 5-7.
[13] *Capital Budget Application Guidelines*, page 6 of 11.

For justifying expenditures between $200,000 and $500,000, the CBA Guidelines set out a detailed checklist indicating the type of information that may be required. For expenditures greater than $500,000, the CBA Guidelines state that, unless otherwise explained, all items in the checklist should be addressed and, where appropriate, a "report/analysis by a qualified engineer or other appropriate expert in support of the expenditure" should be provided.[14]

Hydro's justification of the BST Program presents a cost-benefit analysis that compares the costs of its chosen software systems against a single alternative, the status quo. Newfoundland Power acknowledges that, in light of the stated deficiencies and shortcomings of Hydro's existing business systems, the status quo is not a reasonable alternative. What is not clear from the evidence, however, is whether other vendors' software solutions, or a Hydro-only approach to replacement of its business systems, may have been reasonable alternatives in the circumstances.

The information and documentation presented in support of the proposed BST Program does not include detailed analysis of the comparative benefits of the software solutions offered by other vendors. Nor does it include a detailed cost-benefit analysis comparing the other alternatives noted in the Justification Report.

Furthermore, Hydro did not consider or conduct cost-benefit analyses of approaches to the ERP system other than the adoption of a single integrated solution.[15] There is no detailed analysis that demonstrates this is the least-cost solution for Hydro's customers as compared to a Hydro-only program.

Submission

Hydro has indicated it intends to utilize the shared services model for significant future Information Systems capital expenditures.[16] However, Hydro's 5-year capital plan for Information Systems and Computer Operations included in its 2019 Capital Budget Application continues to include forecast capital expenditures in these areas.[17]

In Newfoundland Power's submission, the detailed requirements for documentation and analysis set out in the CBA Guidelines provide a useful and appropriate framework for the Board's consideration of proposed large information technology expenditures, whether undertaken as Hydro capital projects or as part of a shared program led by another affiliate. In either case, the Board must be satisfied that the proposed expenditures are consistent with the least-cost provision of electrical service to Hydro's customers.

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[14] *Capital Budget Application Guidelines*, pages 7 and 8 of 11.
[15] Response to Request for Information NP-NLH-370, page 1 of 1, lines 11 to 13.
[16] Response to Request for Information NP-NLH-350, page 1 of 1, lines 6 to 10.
[17] Hydro's 2019 Capital Budget Application, Volume 1, 2019 Capital Plan, page A15.

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In its consideration of the BST Program, 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.

As regards the negative NPV indicated by Hydro's cost-benefit analysis, the Board must determine the appropriateness and timing of the recovery of Hydro's share of the costs of the BST Program from customers 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.

We trust this is in order. If you have any questions, please contact the undersigned.

Yours very truly,

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