Q. The budget for a number of annual projects, such as Replacements due to In-Service Failures - $3,269,00, page 17 of 91; Extensions (Pooled) - $11,318,000, page 28 of 91; Street Lighting - $2,635,000, page 36 of 91; Transformers - $6,581,000, page 39 of 91 and Reconstruction - $5,513,000, page 41 of 91, are based on historical expenditures with an adjustment for inflation.

(a) Please identify any other budgeting tools/protocols that Newfoundland Power utilizes to ascertain the required budget amount.

(b) Please explain how Newfoundland Power tracks the annual spending on these projects and any budget safeguards that are in place.

(c) Please identify any cost efficiency measures that Newfoundland Power has put in place to control and monitor the budget for these annual projects.

(d) Are there any opportunities to reduce the level of expenditures associated with these types of projects? Please identify any issues that should be addressed when considering whether these capital expenditures can be reduced.

A. (a) Newfoundland Power's *2020 Capital Budget Application* includes 13 capital projects that are based in large part on historical expenditures.[1] Capital projects based on historical expenditures fall into 3 broad categories:

(i) Equipment that fails in service or is identified to be at imminent risk of failure through routine inspection;[2]

(ii) 3rd party or customer-driven work requests that occur throughout the year;[3] and

(iii) Upgrading or replacing large numbers of relatively small items used in day-to-day operations.[4]

[1] These 13 projects are in addition to General Expenses Capitalized ("GEC"), Allowance for Funds Used During Construction ("AFUDC") and Allowance for Unforeseen Items, which are also based on historical expenditures, but do not pertain to specific capital work to be carried out in a particular year. The costing methodology for these 16 total projects is identified as being based on historical patterns in Table 3 on page 5 of Newfoundland Power's *2020 Capital Plan*.

[2] Capital projects based on historical expenditures and driven by equipment failure or inspections include: Meters (Replacement); Reconstruction; Rebuild Distribution Lines; Services (Replacement); Street Lighting (Replacement); Transformers (Replacement); Thermal Plant Facility Rehabilitation; and Replacements Due to In-Service Failures.

[3] Capital projects based on historical expenditures and driven by 3rd party or customer-driven requests include: Extensions; Meters (New); Relocate/Replace Distribution Lines for Third Parties; Services (New); Street Lighting (New); and Transformers (New).

[4] Capital projects based on historical expenditures and driven by the need to upgrade or replace large numbers of relatively small items include: Additions to Real Property; Tools and Equipment; and Replace/Upgrade Communications Equipment. These expenditures are pooled as capital projects in accordance with the Board's Capital Budget Application Guidelines (Policy No. 1900.6, page 5 of 11).

In each of these cases, *overall* work requirements tend to be reasonably stable on a year-over-year basis. However, the nature of these projects is such that the *specific* work requirements in a particular year are not foreseeable as they arise in many instances from factors outside the Company's control. The use of historical expenditures as the basis of budgeting these capital projects is reflective of these considerations.

Historical expenditures, however, are not the only budgeting tool used to determine the budgeted amounts for these projects. Examples of other budgeting tools include:

(i) Forecasting work requirements based on new customer connections and applying historical unit costs, which is completed for projects such as Extensions, Street Lights, Services and Meters;

(ii) Applying adjustments to historical expenditures using engineering estimates for known work requirements in a particular year, such as the need to upgrade or replace a particular piece of equipment under Thermal Plant Facility Rehabilitation or Tools and Equipment; and

(iii) Applying adjustments to historical expenditures based on engineering assessments, such as adjustments to estimates for In-Service Failures based on available inventory levels.

These budgeting tools effectively account for foreseeable variations in the Company's year-over-year work requirements, ensuring proposed budgets for these projects are reasonably accurate.

Further information on the budgeting tools for each project are described under the Costing Methodology section of the Schedule B associated with each project.

(b) Newfoundland Power monitors the annual spending of all capital projects, including those based on historical expenditures, on a monthly basis. This monthly monitoring is the responsibility of senior management and informs various reports provided to the Company's Board of Directors and the Board.

Actual and forecast capital expenditures, including expenditures for the projects described in this response, are reported to the Board through: (i) Quarterly Regulatory Reports; (ii) Annual Reports; and (iii) Capital Expenditure Status Reports.[5] These reports provide for effective tracking of the Company's capital

[5] Newfoundland Power files 2 Capital Expenditure Status Reports with the Board annually: (i) a report based on forecast expenditures for the current year is filed mid-year with the Company's capital budget application; and (ii) a report on actual capital expenditures for the previous year is filed with the Board by March 1st each year.

expenditures throughout the year. Thorough explanations of variances provide safeguards to ensure expenditures are consistent with budgets approved by the Board.[6]

(c) Newfoundland Power routinely examines the effectiveness of the described budgeting tools in meeting annual work requirements. This allows the Company to both control and monitor expenditures under the capital projects described in this response.

Over the period 2015 to 2019F, total variances under these projects have averaged approximately 2% a year. This reasonably small degree of variance is an indicator of the effectiveness of applied budgeting tools.

Actual expenditures under these capital projects, in aggregate, are forecast to be approximately 15% lower in 2019 than in 2015.[7] This is reflective of the control Newfoundland Power exercises, to the extent feasible, over these expenditures.

(d) As described in part (a), Newfoundland Power uses a combination of budgeting tools for these capital projects. These budgeting tools ensure proposed budget amounts accurately reflect expected work requirements in a particular year, to the extent feasible. In instances where work requirements for a particular project are reduced, the proposed or actual capital expenditures are also reduced, as appropriate.

For example, over the period 2015 to 2017, approximately $4.0 million a year was budgeted for Meters. Over the period 2018 to 2020, this was reduced to approximately $636,000 per year. This reflects reduced capital requirements associated with concluded implementation of the *2016 Metering Strategy* and reduced meter testing requirements.

As an additional example, in 2016, actual expenditures under *Rebuild Distribution Lines* were budgeted at $3.7 million and actual expenditures were $2.8 million. This reduction was primarily the result of less work being identified through inspections and engineering assessments than what was anticipated based on historical expenditures.

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[6] For example, when approving Newfoundland Power's *2019 Capital Budget Application* in Order No. P.U. 35 (2018), the Board ordered the Company to file a status report on 2019 expenditures that show: (i) the approved budget for 2019; (ii) expenditures prior to 2019; (iii) 2019 expenditures to the date of the application; (iv) remaining projected expenditures for 2019; (v) any variance between the projected total expenditures and the approved budget; and (vi) explanations of any variances. In addition, the Board's Capital Budget Application Guidelines stipulate: "*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%.*" These are longstanding reporting requirements of the Board.

[7] Total capital expenditures for the 13 capital projects described in this responses were approximately $40.4 million in 2019 and $47.7 million in 2015 (($40.4 - $47.7) / $47.7 = -0.15, or -15%).

As described in part (a), budgets for capital projects based on historical expenditures enable Newfoundland Power to respond effectively to equipment failures and customer-driven work requests. This enables the Company to deliver reliable and responsive service to customers throughout its daily operations. Reductions to the budgets of these capital project that are not based on known changes in work requirements in a particular year could negatively impact Newfoundland Power's ability to provide safe and reliable service to its customers.