

Office of the Consumer Advocate

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October 22, 2020

Board of Commissioners of Public Utilities
120 Torbay Road, P.O. Box 2140
St. John's, NL A1A 5B2

**Attention: G. Cheryl Blundon, Director of
Corporate Services / Board Secretary**

Dear Ms. Blundon:

Re: Newfoundland Power Inc. – 2021 Capital Budget Application

On July 9, 2020 Newfoundland Power (“NP”) submitted to the Public Utilities Board (the “Board”) its 2021 Capital Budget Application (“2021 CBA”). For many years, the Consumer Advocate has been concerned about the significant level of capital spending by Newfoundland Power. However, capital spending has become even more of a concern at the present time – absent rate mitigation - when rates could potentially double in 2021 with the commissioning of the Muskrat Falls Project (“MFP”) while we are in the midst of the Covid-19 global pandemic and its profound impacts on the Provincial economy.

The Board has directed the parties to file submissions on NP’s 2021 Capital Budget Application by October 22, 2020. This submission documents the Consumer Advocate’s position on NP’s 2021 Capital Budget Application.

1. MIDGARD REPORT

Midgard Consulting Inc. has been retained by the Board to review the current Capital Budget Guidelines. Midgard filed its report with the Board on August 24, 2020. As stated on page 3 of the report:

“Midgard Consulting Incorporated (“Midgard”) has been retained by the Newfoundland and Labrador Board of Commissioners of Public Utilities (“NLPUB” or “the Board”) as an expert consultant to perform a review of the NLPUB’s existing Capital Budget Application Guidelines (“Guidelines”). The objective of this work is to provide recommended changes to the existing Guidelines to help improve the overall efficiency and effectiveness of the annual Capital Budget Application processes required under legislation.”

In its report Midgard makes a number of recommendations that would significantly improve the capital budget process without the need for changes to legislation. Midgard received extensive feedback from both the utilities and the intervenors involved in the Capital Budget Application process. Because these recommendations can be implemented under existing legislation they are directly relevant to the 2021 Capital Budget Applications of both Newfoundland Power and Hydro. Some key findings and recommendations documented in the Midgard report follow:

- 1) (Table 8, page 28) Midgard notes that while the ratepayer groups identified a number of concerns with the current Guidelines, the *“Utility groups are generally of the opinion that the current Guidelines are adequate and that most of the concerns raised by ratepayer groups are reasonably addressed under the current Guidelines.”*
- 2) (Page 54) *“The quantified results produced by asset management, risk management and asset condition assessment processes should help address stakeholder concerns regarding the informational asymmetries that impede their effective participation and intervention in the capital budget approval process.”*
- 3) (page 56) *“It is acknowledged that current NLPUB practice is to explicitly approve and disapprove each capital budget line item with the sum of the individual approved line items becoming the total approved budget (see Section 4.3). Upon review of legislation, it appears that the NLPUB can also approve a capital budget that includes a set of projects that is a combination of explicitly disapproved projects and a basket of approved projects that the utility then prioritizes and/or modifies to work within the approved budget.”* (later on page 56) *“Midgard does not believe that either the Capital Budget Application guidelines or existing legislation need to be changed to enable the NLPUB to adopt this practice.”* (page 62) *“Midgard recommends that the Board affirms its right to explicitly approve, modify or disallow individual budget line items, and in the absence of explicit decisions regarding specific line items, require that the utility manage the list of budgeted projects within an approved budget envelope even if the total budget envelope is not equal to the sum of the individual budget line items. In Midgard’s assessment, although this recommendation would involve a change in Board practice, it does not change the Board’s legislated approval authority or process discretion.”*
- 4) (page 61) *“declaring that a project went to competitive tender as evidentiary justification for meeting least cost reliable services does not address key Board questions such as “At what unit cost are system reliability and risk profile improved by the project”, “Does the ratepayer value the improvement in system reliability and risk reduction more than the project cost?, and “How cost effective are the proposed improvements in system reliability and risk reduction compared to other budget items being proposed and other alternatives that are available?”* Midgard goes on to say (on the same page) *“Consequently, Midgard recommends that explicit reference to the trade-off between cost (to ratepayers), system reliability and risk be added to the Guideline*

policy statement to shift discussion regarding least cost reliability service away from execution activities such as tendering execution.”

- 5) (page 65) *“Midgard recommends that utilities be required to adopt formal asset management processes and standardized reporting to increase the level of accountability and transparency in decision making, but does not recommend at this time that a particular asset management standard (such as ISO 55000) be prescribed.”*
- 6) (page 66 – recommended wording change) *“The burden of proof is on the Utility to provide sufficient data, information and analyses necessary to justify the Capital Budget Application, and to support the Board’s decisions regarding the trade-off between cost to ratepayers, system reliability and risk, in accordance with formal asset management practices.”*
- 7) (page 67) *“Midgard also recommends that all sections of the Capital Budget Application, expert reports, transcripts (if any) and RFI responses be attributed to a lead individual (e.g., department head or manager) who takes responsibility for the materials and contents therein.*
- 8) (page 74) *“Midgard recommends implementing the six (6) following Investment Classifications ordered in from lowest to highest in terms of utility discretion (except for General Plant which is a special category of its own): 1) Mandatory 2) Access 3) System Growth 4) Renewal 5) Service Enhancement 6) General Plant.”*
- 9) (page 93) *“Projects and programs shall be evaluated for risk mitigation in the following categories: 1) Reliability 2) Safety 3) Environment. Risk mitigation shall be calculated as the difference in risk before and after the proposed alternatives was implemented.” The calculation of risk shall conform to an internationally recognized standard for calculating risk. The evaluation shall be supported by a documented risk management program that clearly demonstrates how risk is evaluated and equivalency given to the different risk elements (i.e., how risk-based prioritization functions), and how risk reduction is calculated.”*
- 10) (page 94) *“A prioritized list of all Projects and Programs shall be provided.”* The text goes on to say that the list will be organized into the following sub-sections: mandatory, access, system growth, renewal, service enhancement and general plant.

2. CONSUMER ADVOCATE COMMENTS

It is within the context of Midgard’s findings and recommendations, and the current economic situation in the Province brought on by the Muskrat Falls Project and the Covid-19 pandemic that the Consumer Advocate makes the following comments on Newfoundland Power’s 2021 Capital Budget Application.

- While the utilities believe that the current Guidelines are adequate (point 1 in section 1), the ratepayer groups do not. There is a significant asymmetry of information between the utilities and the intervenors (point 2 in section 1). This suggests that the current Guidelines are favourable to the utilities. Newfoundland Power has made no attempt in its 2021 CBA to address this asymmetry of information, and in fact ignores attempts by the Consumer Advocate to obtain the information through the RFI process. For example, when asked to categorize projects according to primary driver (CA-NP-002) and to prioritize the projects within each of these categories (CA-NP-003), NP objected “*on the basis that it is not relevant or necessary for a satisfactory understanding of the matters to be considered in this Application as required by Section 14 of the Board of Commissioners of Public Utilities Regulations, 1996.*” In other words, NP will continue to take advantage of the asymmetry of information as long as the Board allows them to do so. The Consumer Advocate commends the Board’s decision to engage Milgard as a step to rectifying this information asymmetry.
- The Consumer Advocate notes that Midgard’s findings and recommendations identified in section 1 above are made within the context of existing legislation so there is nothing stopping the Board from incorporating the Midgard recommendations in its order on the 2021 CBAs.
- As recommended by Midgard (point 6 in section 1), the burden of proof is on the utility to provide sufficient data, information and analyses to justify its expenditures and support the Board’s decisions regarding the “*trade-off between cost to ratepayers, system reliability and risk, in accordance with formal asset management practices.*” NP appears to agree that the onus is on the utilities to justify its expenditures when it states (CA-NP-128) “*It is Newfoundland Power’s position that the onus is on the utility to fully support with evidence the expenditures proposed in its capital budgets.*” In other words, the onus is ***not*** on the intervenor to submit evidence that an expenditure is not needed.
- To emphasize the imbalance in the current CBA process, it is important to note that not once in the past 5 years has the Board rejected a project submitted in an NP CBA. As stated by NP (CA-NP-001) “*All capital projects for the 5-year period were approved as filed.*” NP has submitted about 40 projects for approval in this year’s CBA (see Application Schedule A). Assuming a similar number of projects in each of the 5 previous years means that the Board has approved roughly 200 projects proposed by NP in its Capital Budget Applications without a single project, or a single dollar, being rejected. NP states (CA-NP-005) “*Newfoundland Power does not currently employ a methodology for prioritizing capital expenditures. As a result, there is no documentation to provide between senior management and line managers relating to prioritization and cost cutting, nor is there any documentation to provide from senior management relating to rate pressures brought on by the Muskrat Falls project.*” When NP says a project is needed, it gets approved. It is not surprising that NP senior management

accepts every project submitted by its line managers and makes no attempt to prioritize the projects – the current system is working extremely well for them.

- In the 2021 CBA NP repeatedly states that they have not quantified the benefits of a project in terms of reliability improvements (improvements in reliability metrics such as SAIDI and SAIFI) or costs to consumers, and not once have they quantified the risk of deferring the project to a future year. The NP approach appears to reflect a “*trust us– we know what’s best*” attitude. NP repeatedly states that it needs these projects to meet its mandate of providing reliable power at least cost. However, this statement can be made about any project, and, since investment in plant is the major determinant of rate base, NP has an incentive to undertake projects that are only marginally beneficial to its customers.
- As stated by Midgard (point 4 in section 1) providing “*least cost reliable services does not address key Board questions such as “At what unit cost are system reliability and risk profile improved by the project”, “Does the ratepayer value the improvement in system reliability and risk reduction more than the project cost?, and “How cost effective are the proposed improvements in system reliability and risk reduction compared to other budget items being proposed and other alternatives that are available?”*”
 - NP does not know what its customer are willing to pay for improvements in reliability metrics such as SAIDI and SAIFI (CA-NP-060), so does not know if ratepayers value the improvement in system reliability and risk reduction more than the project cost.
 - NP does not employ a methodology for prioritizing projects (CA-NP-005).
 - NP has done virtually no benchmarking against other utilities except in one case where they compare SAIDI and SAIFI to Atlantic Canada (CA-NP-007).
 - NP admits that it used no reliability risk metrics to justify expenditures in its budget (CA-NP-010).
 - NP did no laboratory testing on equipment in its 2021 capital budget (CA-NP-011).
 - NP cannot quantify benefits relating to reliability versus cost (CA-NP-026).

Every piece of equipment owned by NP might fail in 2021. The risk of failure and the impact of failure on consumers must be quantified if the Board is to make an informed decision on the Application.

- In PUB-NP-001 the Board requests NP to “*highlight any actions that Newfoundland Power has taken in response to the current economic conditions within Newfoundland and Labrador*”

to control and/or reduce capital expenditures while maintaining reliable service.” Regrettably, NP’s response to the Board is to provide a description of its approach to capital expenditures under “*all economic conditions.*” NP thereby effectively dismisses the Board’s specific question. NP has taken ***no*** specific actions in response to the current economic conditions in the Province. Barring rate mitigation, NP customers are facing a potential doubling of rates owing to the Muskrat Falls project and are in the midst of the Covid-19 global pandemic and its associated economic consequences. It is important to note that NP, with guidance from the Board, previously did respond to difficult economic conditions in the Province brought on by the cod moratorium in the early 1990s (CA-NP-004), but apparently believes the current economic conditions in the Province, while a concern for their customers, is no concern of NP’s and no reason to change its business-as-usual approach.

- What’s more, it is clear that NP will continue to leverage its advantage relating to the asymmetry of information in the Capital Budget Process until the Board forces them to do otherwise. NP refuses to provide information requested by the Consumer Advocate:
 - NP ***objects*** to filing its proposed projects according to primary driver as recommended by Midgard. They claim that the Application “*fully complies with the existing Capital Budget Application Guidelines and all applicable directives of the Board*”. In other words, NP will not submit information that may be helpful to the Board’s review if they have not done it in the past, and it is not specifically identified in the current Capital Budget Guidelines (CA-NP-002).
 - NP ***objects*** to providing a prioritized list of projects according to primary driver as proposed by Midgard on the basis that “*it is not relevant or necessary for a satisfactory understanding of the matters to be considered in this Application*”. In fact, NP has not prioritized projects even according to its own categorization methodology (CA-NP-005). Like Midgard, the Consumer Advocate believes a prioritized list of projects is indeed necessary to understand the matters to be considered in the Application. That is why the question was asked.
 - NP ***objects*** to providing correspondence between them and CORE Engineering (CA-NP-122), again because they claim “*it is not necessary for a satisfactory understanding of the matters to be considered in this Application.*” The Consumer Advocate simply wants to know how much “*guidance*” was provided by NP to CORE Engineering.
 - NP ***objects*** to providing correspondence between them and EY (CA-NP-092), again because they claim “*it is not necessary for a satisfactory understanding of the matters to be considered in this Application*”. It should be noted that EY will be allowed to bid on implementation of the \$31.6 million customer service system project (CA-NP-087). One can hardly consider EY an independent expert under such circumstance.

- NP objects to providing names of witnesses on RFI responses (CA-NP-129) on the basis that “*it is not necessary for a satisfactory understanding of the matters to be considered in this Application*”.
- Every one of NP’s roughly 200 capital projects have been approved in the past 5 years. This may lead NP to believe that even marginal projects can be added to its capital budgets without challenge, and it has an incentive to do so. As long as the Board and interveners are handicapped by informational asymmetry this problem will persist. NP can continue to spend on capital projects rather than manage its customers’ money. This is especially worrisome in light of the realities facing the Provincial economy and the uncertainties surrounding the pending integration of Muskrat Falls into the island interconnected grid. When will the Board say “enough”?
- CA-NP-006 shows that even without the 3 projects that NP claims are driving the increased capital requirements in this year’s CBA, capital expenditures are forecast to increase to \$120.4 million in 2025, an increase of almost 25% over the capital budget approved for 2020 (\$96.6 million – see Schedule C, P.U.5(2020)). NP is attempting to make a \$120 million budget the new normal going forward. This is troubling in light of the difficult and uncertain economic conditions in the Province.
- The Board’s decision to separate one project, the proposed new CIS, is, like the Board’s decision to engage Midgard, a welcome sign that NP’s capital applications may be subject to more scrutiny than in the past. That project entails a \$9.9 million cost for 2021 and is a multi-year project with a total estimated cost of \$31.6 million. Still, exclusive of this project, NP is requesting \$101.4 million (= \$111.3 million - \$9.9 million).

3. SUMMARY OF CONSUMER ADVOCATE’S POSITION

Given that NP’s Capital Budget is deficient - Newfoundland Power has not quantified the risks of not proceeding with the projects in its 2021 CBA; neither has it quantified the benefits of the projects included in its 2021 CBA such as cost reductions owing to efficiency improvements, or improvements in reliability metrics such as SAIDI and SAIFI. NP has not provided a prioritized list of projects as has been done by Hydro in its 2021 CBA. An argument could be made that the Board should reject the Application and require NP to re-file with project benefits and risks quantified.

However, Midgard indicates that the Board has the authority to approve an envelope of expenditures rather than approve/disapprove individual projects. Midgard states that this can be done under current legislation and current Capital Budget Guidelines. By approving an envelope rather than individual projects, the Board avoids the appearance of managing the utility. Further, it forces NP to “*manage*” rather than simply “*spend*” its customers’ money. Given the current economic conditions in the Province there has never been a better time to approve an envelope and send a message to NP that it must from this day forward justify its CBA and “*manage*” its customers’ money.

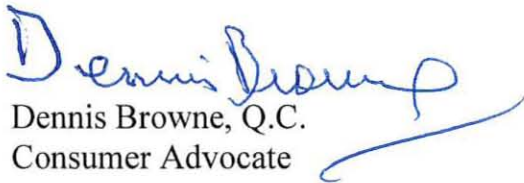
In this regard, the Consumer Advocate recommends the Board approve a budget cap limiting NP's 2021 capital expenditures to the level approved last year, or \$96.6 million less the \$9.9 million for the CIS, which the Board intends to treat separately. Thus, exclusive of the CIS, the capital budget for NP for 2021 should be \$86.7 million.

At this stage, the recommendation of the application of a cap for 2021 is meant as a one-time measure, pending the completion of the Midgard report and subsequent policy changes that may be made by the Board in light of it.

Additionally, the Consumer Advocate recommends directing NP to re-submit its capital budget reflecting its prioritized list of projects within this cap. This approach avoids the appearance of the Board managing the utility from the regulatory chair.

Further, the Consumer Advocate recommends that the Board serve notice to NP that in future CBAs, projects will only be approved if the benefits to consumers of the project in terms of cost savings and/or improvements in reliability metrics such as SAIDI and SAIFI, and the risks of not proceeding with the project are quantified.

Yours truly,


Dennis Browne, Q.C.
Consumer Advocate

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