

1 **Q. Has Newfoundland Power undertaken studies, either internally or by consultants, to**  
2 **determine whether greater emphasis on maintenance and repair, which entails**  
3 **higher operating costs, could reduce overall costs by prolonging the life of capital?**  
4 **Explain whether and how Newfoundland Power incorporates this trade-off between**  
5 **operating costs and capital costs in its capital expenditure planning.**  
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7 A. Newfoundland Power has not undertaken any comprehensive studies to determine  
8 whether greater emphasis on maintenance and repair, which entails higher operating  
9 costs, could reduce overall costs by prolonging the life of capital assets.

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11 Newfoundland Power's approach to asset management is to balance the maximization of  
12 asset lives with the proactive replacement of deteriorated or inefficient plant.

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14 ***Failure and Imminent Failure***

15 Newfoundland Power's reliability will in significant measure reflect the general condition  
16 of its plant. If the plant is deteriorated or defective, it will be more prone to failure. The  
17 cost of replacement of deteriorated or defective plant is a significant factor in the cost of  
18 maintaining or improving the level of service reliability.

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20 As Newfoundland Power is obligated to continue to provide a reasonable level of service  
21 to its customers, in cases of plant failure there is usually no question that the plant must  
22 be replaced. The only question is how can it be replaced in a least cost manner that  
23 contributes effectively to improved reliability.

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25 From Newfoundland Power's perspective, the same essential logic applies to cases of  
26 imminent plant failure. It simply would not be prudent for Newfoundland Power to not  
27 replace plant which appeared through inspection, experience or sound engineering  
28 judgement to be reasonably close to failure or unreasonably prone to failure.

29  
30 ***Aging Plant***

31 Maintaining 30 to 40 year old deteriorated plant, particularly in areas subject to severe  
32 weather conditions, requires Newfoundland Power to incur operating costs on a recurring  
33 basis. These costs include the cost of reinstating service when failures occur, which are  
34 often in severe weather conditions. Increased failure reduces the level of reliability that  
35 customers experience. These operating costs are ultimately reflected in the rates charged  
36 to Newfoundland Power's customers.

37  
38 Replacing 30 to 40 year old deteriorated plant has tended to help Newfoundland Power  
39 reduce its operating costs by reducing failures. Reduced failure also improves the level  
40 of reliability that customers experience. Replacement has the effect of increasing capital  
41 costs, which is principally the result of long-term inflation. These capital costs are  
42 ultimately reflected in the rates charged to Newfoundland Power's customers.

**Capital versus Operating**

The Company recognizes that both capital and operating costs impact revenue requirement and subsequently customer rates. However, through prudent management and the use of sound engineering judgement the Company seeks to achieve least cost solutions. In all cases, the Company must also consider the impact of its decisions on the safety of employees and the public and on the reliability of the service it provides to customers.

If an expenditure effects a substantial betterment to an existing asset (the primary aim of which is to make the asset more useful, more efficient, of greater durability, or of greater capacity), or prolongs an assets life, the expenditure will typically be capitalized in accordance with Section 2.01 of the Company's approved System of Accounts. Otherwise, the expenditure will be charged to the appropriate operating account.

The guidelines used by Newfoundland Power to determine whether an expenditure is categorized as operating or capital, as per Section 2.01 of the Company's approved System of Accounts are summarized in the Company's response to Request for Information CA-260.

**Balancing Cost and Reliability**

Newfoundland Power's customers value both reliability of supply and price. Increased investment in the electrical system will contribute to improved reliability. So long as such investments are made in a manner that gives due regard to rate stability, customers' expectations will be reasonably fulfilled.

From a reliability perspective, the year-to-year mix of capital and operating costs that must be recovered in customers' rates is not a matter of fundamental importance. Stability of customer rates is, on the other hand, very important. Newfoundland Power's goal is to improve reliability without significantly increasing the total costs to be recovered in rates from customers. If reliability of service can be improved without causing customers' rates to increase, Newfoundland Power believes it should be.

For further information on the Company's approach to balancing operating costs, capital expenditures and reliability of service, please refer to the Company's response to Request for Information CA-85(b), submitted during the Company's 2003 Capital Budget Hearing.