Maritime Electric (MECL) 2016 Capital Budget Application (UE20724) – Comments to IRAC

Baseline Regulatory Issues

1) For MECL customers, all costs arising from new annual capital expenditures are passed directly on to them as an electricity rate increase. For MECL there is no operating cost impact or financial risk, simply an increased Return on Investment (ROE). Customers pay directly for new borrowing interest, the increased ROE (profit) to MECL and future increased depreciation. In balancing the competing interests of customers requiring lowest cost electricity (hence minimum capital expenditure) and MECL driven to minimize operating risks and increase annual profit (hence maximum capital expenditure), it is noted that IRAC has a unique challenge.
2) The past capital expenditures approved by IRAC show a disturbing block trend. For 3 years from 2007, annual capital was around $21M, for the 4 years to 2013 annual capital was $23M, for 2 years to 2015 annual capital increased to around $27M and now for 2016 a further increase to $31M – an overall increase of 50% in 11 years. This compares to a total energy sales growth of 10% for the same 11 year period – less than an average of 1% per year! This is not controlled capital management.
3) Detailed commentaries in the application describe how the expenditures are allocated but give little guidance as to the priority of the individual project, the mitigated risks or investment return and offsets. As an example, the expenditures listed in sections 5.3 and 5.4 amount to nearly $7M.The application states (in section 5.3) that "These expenditures (and those in Section 5.4) are expected to be partially offset by customer contributions." Recorded in the separate section of capital listing is "Customer Contributions" of $400K; is this an adequate "partial offset"? Overall I suggest the content of this application does not enable or warrant approval.

Interrogatories Questions Commentary

This commentary offered to the Commission refers directly to the single question I presented to MECL and the subsequent response:

My question was based upon a standard industry-wide management practice when setting capital budgets of investigating the sensitivity of budget amount against ensuing operating risks. Unfortunately, MECL's answer was both disappointing and incomplete:

1) The selection of internally proposed capital projects was described subjectively without any objective criteria being explained. No comparative industry standards were offered.
2) As an answer to a 20% reduced budget question, an example set of deferred expenditures totaling $7.24M was listed but without description of the applicable operational changes, risks and mitigation actions other than the statement "would substantially restrict the Company to primarily making expenditures only in the areas of generation and customer/load growth….". I suggest that for 2016 when mainland cables and a proposed CT4 application would result in close to $120M additional capital expenses it might be prudent to defer some low priority projects.

3) In the absence of any specific selection criteria used by MECL for the example set of a $7.24M budget reduction, I pose the following:
    a. Why were the 3 highest individual expenditures totaling $13M excluded from reduction? The $5M "Substation Projects" is surely a potential deferral candidate especially as transmission projects proposed show a 60% increase over the last 3 years?
    b. The corporate expenses showing an increase of 24% over the last 3 years were not reduced.
    c. Why was the previously approved Y-104 multi-year project removed when the case for this 5 year project had apparently been proven and approved at the time? Perhaps the original priority of this project has changed; again no direct commentary was supplied.
    d. Existing and new generation has been discussed through previous MECL applications; maintaining the same capital expenditure on generation capital as for 2015 has to be questioned.
    e. A serious and thoughtful attempt to stop the high annual growth in capital expenditure must be demonstrated

I conclude that the 2016 capital budget application should be revised to a new format showing relative priorities of each proposed project and candidates for deferment including their associated quantified risks and the required mitigation. A new justification format for future capital applications and a reduced 2016 budget should be the outcome of this revision request.

I also repeat a previous comment on the need for a documented framework within which each regulatory application from MECL can be individually evaluated and the influence and connection between each understood. This framework for Utilities is an Integrated Resource Plan (IRP) which includes forecasts, risks and costs for at least the next 10 years. Without such a future planning document that is frequently updated and frequently referenced, logical and connected decisions cannot be made. This is especially relevant at this time when capital depreciation rates are being adjusted and end-of-life capital replacement is a significant portion of annual capital expenditures

I urge the Commission to seek an IRP from MECL before making any new or revised application decisions.