Q. Did Newfoundland Power consider the use of a deferral account for the recovery of the $2.9 million in costs over a shorter period of time as opposed to having these costs included in rate base and recovered over the life of the project? Please explain if this could be an alternative for the recovery of these costs. If not, please explain why.

A. Yes. Newfoundland Power did consider the use of a deferral account to recover the $2.9 million in general project implementation costs related to the proposed Customer Information System ("CIS").[1]

In Newfoundland Power's view, deferred cost recovery is a reasonable alternative to recover the general project costs for a number of reasons:

- The Board has, in the past, permitted the use of cost recovery deferrals and amortizations where it determines the circumstances justify such treatment of utility costs;[2]
- The Board has approved the recovery of costs related to capital expenditures over both shorter and longer time periods;[3]
- The Board has approved cost recovery deferrals with the amortization period to be determined at a later date;[4]
- U.S. GAAP would allow the creation of a regulatory asset resulting from the approved deferred cost recovery;[5] and,
- Deferred cost recovery is conceptually similar to capitalization.[6]

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[1] The $2.9 million in general project costs relate to data conversion, employee training and certain activities related to the Request for Proposals process and are a result of implementing the proposed modern Customer Information System. Please see the response to Request for Information PUB-NP-006 for a breakdown of the general project costs.

[2] See, for example, Order No. P.U. 37 (1984) where the Board considered the deferral and amortization of $650,000 in operating costs associated with an April sleet storm.

[3] For example, the Board approved the true-ups from the 2000 and 2005 depreciation studies to be amortized over 3 and 4 years, respectively. See Order Nos. P.U. 19 (2003), page 81, *et. seq.* and P.U. 32 (2007), page 1. The true-ups resulting from the 2010 and 2014 depreciation studies were ordered by the Board to be amortized over the average remaining service life of the related assets. See Order Nos. P.U. 13 (2013), page 2 and P.U. 18 (2016), page 1. The amortization period related to the 2014 depreciation study is approximately 20 years.

[4] For example, in Order P.U. 13 (2009) the Board approved the creation of a *Conservation Cost Deferral Account* to provide for deferred recovery costs associated with the implementation of the Company's *Conservation Plan* in 2009. The disposition of the deferred amount was subject to a future Order of the Board. The Board has approved the deferred recovery of costs by Newfoundland Power outside the context of a general rate application on 5 other occasions since 2005, with the amortization period to be determined at a later date. The deferral amounts ranged from $2.4 million to $7.6 million. In each case, the justification for approval was *Section 80 of the Public Utilities Act*. See Order Nos. P.U. 40 (2005), P.U. 39 (2006), P.U. 30 (2010), P.U. 22 (2011) and P.U. 17 (2012).

[5] *ASC 980 Regulated Operations* permits the creation of assets and liabilities to reflect the economic impact of rate-regulated activities.

[6] Both deferred cost recovery and capitalization allow for recovery of the costs over a longer timeframe, and are therefore more consistent with the principles of rate stability and intergenerational equity than expensing the costs. Both approaches require the Company to finance the up-front cash outlay and are included in the computation of the Company's rate base.

In the Company's view, capitalization has a number of practical and customer benefits when compared to the deferred cost recovery alternative. These include:

- The Board's approval of the CIS project as proposed will allow *all* CIS project implementation costs to be treated in the same manner and recovered from customers evenly over the service life of the system;[7]
- Capitalization of the general project costs is consistent with the Board's treatment of the Company's General Expenses Capitalized ("GEC");[8]
- Capitalization better reflects established regulatory principles of the Board;[9] and,
- Capitalization better reflects sound public utility practice.[10]

For these reasons, Newfoundland Power has included the general project costs of $2.9 million in the total proposed capital budget for the CIS project.

[7] The total CIS project costs of $31.6 million are required to implement the CIS. For example, if customer data is not converted from the existing Customer Service System to the new CIS, the new CIS would not be able to be implemented in a way to provide customer service delivery to customers at least-cost.

[8] The Company's GEC is approved as part of the Company's capital budget application each year. Consistent with the Company's approved GEC methodology, the CIS general project costs of $2.9 million are incremental, in that they would not be incurred but for the CIS project. Costs included in the Company's GEC are amortized over the estimated life of the related assets.

[9] For example, intergenerational equity is a principle of fairness that holds that ratepayers in a given period should pay only the costs necessary to provide them with service in that period. In the context of utility ratemaking, the principle of intergenerational equity requires that the costs of capital assets should be recovered from the customers who will benefit from those assets. In Newfoundland Power's view, recovering all costs of the CIS project over the life of the system better reflects this regulatory principle than recovering the costs over a shorter time frame.

[10] The capitalization of general expenses is a generally accepted accounting practice in the electric utility industry. For example, *FERC Uniform System of Accounts – Electric Plant Instructions, Section 4,* provides for the capitalization of all overhead construction costs, such as engineering, supervision and general office salaries and expenses. Further, the *Survey of Capitalization Practices of Canadian Utilities* included as Appendix E to Newfoundland Power's *Review of Capitalization Policies and Guidelines* report, filed with the Board on August 14, 2020, confirms that the capitalization of general expenses is standard utility industry practice in Canada.