



NEWFOUNDLAND AND LABRADOR

AN ORDER OF THE BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

NO. P.U. 3 (1995-96)

**IN THE MATTER OF THE PUBLIC  
UTILITIES ACT, 1990**

**AND**

**IN THE MATTER OF THE APPLICATION  
OF NEWFOUNDLAND LIGHT AND POWER  
CO. LIMITED FOR AN ORDER APPROVING  
CERTAIN POLICIES CONCERNING  
CAPITALIZATION OF GENERAL EXPENSES,  
INCOME TAX ACCOUNTING, PENSION  
FUNDING AND ACCOUNTING, AND RELATED  
MATTERS.**

**THE APPLICATION**

On August 11, 1995, Newfoundland Light and Power Co. Limited (the Applicant) filed an application requesting an Order of the Board:

- (i) approving for regulatory purposes, effective January 1, 1995, the Applicant's allocation of deferred taxes to account for timing differences arising out of differing treatment of General Expenses Capitalized (GEC) for the purposes of regulatory accounting and income tax accounting, except for that part of GEC which is related to pensions;
- (ii) approving for regulatory purposes the Applicant's provision in 1995 of additional funding of its defined benefit pension plan in the amount of \$12,000,000;

- (iii) approving for regulatory purposes the Applicant's provision in 1996 of additional funding of its defined benefit pension plan in the amount of \$6,000,000;
- (iv) approving for regulatory purposes a change in the basis of the Applicant's allocation of costs to GEC which will result in the Applicant's allocation to GEC of only those costs which are incremental costs of capital projects;  
and
- (v) granting such alternate, additional or further relief as after consideration of the Applicant's submission and all relevant matters shall, in the opinion of the Board, appear fit and proper in the circumstances.

On September 6, 1995, the Applicant filed an amendment to its application previously filed on August 11, 1995 requesting an Order of the Board:

- (i) approving for regulatory purposes a change in the basis of the Applicant's allocation of costs to GEC which will result in the Applicant's allocation to GEC of only those costs which are incremental costs of capital projects;
- (ii) approving for regulatory purposes the Applicant's provision in 1995 of additional funding of its defined benefit pension plan in the amount of \$12,000,000;

- (iii) approving for regulatory purposes the Applicant's provision in 1996 of additional funding of its defined benefit pension plan in the amount of \$6,000,000; and
- (iv) granting such alternate, additional or further relief as after consideration of the Applicant's submission and all relevant matters shall, in the opinion of the Board, appear fit and proper in the circumstances.

On September 7, 1995, the Applicant submitted its evidence and the exhibits it intended to enter through its witnesses at the public hearing. Notice of the application and hearing was given in the newspapers circulated throughout the Applicant's service territory. This notice advised the public that the Board would conduct Phase 1 of the Hearing on the application in its Hearing Room, in St. John's on September 8, 1995.

The Phase 1 Hearing was called by the Board to bring together the Applicant and the Intervenors of record at the time. The purpose of the Phase 1 Hearing was to give each party an opportunity to indicate the nature of their evidence, to obtain or give notice of their intention to obtain information, to indicate whether they intended to call expert witnesses and to agree on a time, date and place for commencement of Phase 2 of the Hearing into the application.

At Phase 1 of the Hearing, Peter Alteen, LL.B., appeared for the Applicant; Geoffrey Young, LL.B., appeared for Newfoundland and Labrador Hydro Corporation (Hydro); and Sean Hanrahan, LL.B. was present as Counsel to the Board.

It was decided to commence Phase 2 of the Hearing in the Hearing Room of the Board at 9:30 A.M. on October 23, 1995.

The application was heard by the Board on October 23, 24 and 25, 1995.

Peter Alteen, LL.B., appeared for the Applicant.

There were no intervenors present.

The Board was assisted by Sean Hanrahan, LL.B., Legal Counsel, Raymond G. Noseworthy of NKHK, Chartered Accountants and Keith S. Vance of BDO Dunwoody Chartered Accountants, Financial Consultants to the Board.

Evidence was given for the Applicant by the following officers and management:

A.F. Ryan, President and Chief Executive Officer;

K.S. Warr, Vice -President, Finance & Treasury;

L.C. Henderson, Planning Engineer;

K.P. Lawrence, Manager of Corporate Accounting.

The Applicant also called as a witness:

Mr. Keith Boocock, CA,CFE, Senior Partner, Deloitte & Touche, Chartered Accountants.

Mr. Boocock is "National Partner, Litigation Support" of Deloitte & Touche and is his firm's Chairman of the Telecommunication Industry Service Group. Mr. Boocock served as Chairman of the CICA task force on The Application of Accounting Principles by Regulated Enterprises.

The Board called as a witness:

K.S. Vance, FCA, Executive Partner, BDO Dunwoody, Chartered Accountants.

### **STATUTORY GUIDELINE**

The Board is constituted by way of the Public Utilities Act, 1990 which under Section 16 thereof, mandates that it "shall have the general supervision of all public utilities..."

As to the specific application before it, the Board is guided primarily by the following provisions of the Act:

"58. The board may prescribe the form of all books, accounts, papers and records to be kept by a public utility and a public utility shall keep its books, accounts, papers and records and make its returns in the manner and form prescribed by the board and comply with all directions of the board relating to those books, accounts, papers, records and returns."

"64. (1) The board may, with the assistance of the engineers, accountants, valuers, counsel and others that it thinks advisable to employ, inquire into and determine the extent, condition and value of the whole or a portion of the property and assets of a public utility used and useful in providing or supplying a particular service to or for the public, as of a date to be fixed by the board.

"(2) The board may determine the value of the property and assets of a public utility in accordance with the following rules:

- (b) where the property and assets are new property and assets created or acquired on or after January 1, 1950, the value shall be determined on the basis of the prudent original cost, with depreciation since the date of creation or acquisition;

"(2) (c) where the property and assets are property and assets other than those referred to in paragraphs (a) and (b) and were acquired on or after January 1, 1950, the value shall be determined on the basis of the prudent cost at the time of the acquisition, with depreciation since the date of acquisition.

"(4) The board may make those rules and regulations to facilitate inquiries under this section that it may consider convenient, and the rules and regulations so made are binding on all public utilities."

"78. (1) Except as otherwise provided in this Act, the board may fix and determine a separate rate base for each kind of service provided or supplied to the public by a public utility, and may revise the base.

"(2) In fixing a rate base the board may, in addition to the value of the property and assets as determined under section 64, include...

(h) other fair and reasonable expenses which

- (i) the board thinks appropriate and basic to the public utility's operation, and
- (ii) has, with the approval of the board, been charged to capital account,

but the expenses shall be allowed only to the extent not amortized in previous years."

"80. (3) Reasonable payments each year to former employees of a public utility who have retired and are receiving payments of supplemental income from the public utility are expenses that the board may allow as reasonable and prudent and properly chargeable to the operating account of the public utility.

(4) The board may use estimates of the rate base and the revenues and expenses of a public utility."

The Board interprets the foregoing statutory provisions to mean that the Board has the responsibility to ensure that public utilities provide reasonably adequate service

responsive to public need. Operating and capital expenditures of the public utility must be reasonable and prudent for the purpose of providing such services and the means of recording those expenses and capital expenditures may be prescribed by the Board. Expenses relating to retired former employees, that are reasonable and prudent, are properly chargeable to the operating accounts of the public utility.

The Board will be guided by the foregoing provisions in its consideration of this application.

#### **BASIS OF APPLICATION**

By Order No. P.U. 6 (1991) the Board ordered the Applicant to continue to apply the previously approved basis of accounting for GEC without any reduction to its annual allocation. The full cost method of capitalizing general expenses has been utilized by the Applicant since 1967. This basis of accounting has been reviewed in the past and currently involves the capitalization of such expenses as: Tools and Instruments, Operating Supervision and Miscellaneous, Linesmen's Rubber Goods Testing, Free Issue, Head Office Accounting, Printing and Stationery, Corporate Effectiveness, Management Information System Expenses, Human Resources, Safety Meetings, Training and Educational Costs, Apprentice Training, Coffee and Lunch Room Supplies, Administration, Internal Audit and Building Operations. These allocations to capital assets have risen from \$0.4 million in 1967 to a high of \$11.5 million in 1992.

The percentage of GEC as a percentage of Gross Capital Expenditures has risen from

6% in 1967, rising sharply to 13% in 1978 and more sharply in 1984 to 22%. In 1994, GEC was 28% of Gross Expenditures. (See Exhibit 1 on the page opposite.) The Applicant seeks approval of a change in its accounting allocation methodology for GEC from the full cost method to the incremental method. The change in accounting methodology is proposed to be phased in gradually, to minimize the effects on rates.

In 1993, the Applicant implemented an early retirement program in its overall effort to control costs and avoid rate increases. This program was undertaken to reduce the size of its work force in line with the low sales growth and its attempt to achieve greater efficiency. A total of 120 employees retired under the terms of the program. In 1992, the Applicant had total labour costs of permanent, temporary and contract staff, including overtime, of \$54 million. These costs in the Applicant's 1995 forecast are now \$46 million. The Board approved of the program in December 1993, however, the Board stated at that time that the program costs and benefits would be reviewed at the Applicant's next public hearing. The Applicant seeks approval of its early retirement program and its related expenses, as a prudent and reasonable program.

By Order No. P.U. 37 (1984) the Board ordered that past service costs under the contributory funded defined benefit pension plan, adopted April 1, 1984, were reasonable and prudent expenses properly chargeable to its operating account. By Order No. 17 (1987), the Board approved the use of the "management best estimate approach", which was in accordance with the CICA recommendations, as the accounting methodology for pension costs. In 1984 the Applicant's past service



unfunded liability was approximately \$48 million, which was to be funded over a 25 year period. The Applicant proposes to accelerate the funding in 1995 and 1996. The Applicant has filed net present value analysis in support of this accelerated funding plan.

### **GENERAL EXPENSE CAPITALIZED**

The Applicant, a distribution utility primarily, annually undertakes a capital construction program. During a period of high growth, this program can be a significant portion of the Applicant's operation. In more recent years, however, sales growth has been low, therefore resulting in a smaller capital program. At previous hearings the Applicant has petitioned the Board to reduce the allocation of GEC. The Applicant believes that less general expenses should be allocated to capital assets. Also the Applicant believes that its capitalization policy results in approximately three and one half times more capitalization of general expenses than other similar utilities. The Applicant seeks a more moderate policy, through the use of the incremental basis of capitalization.

The Board has identified four issues with respect to the accounting for GEC arising from the hearing. These issues are:

- (i) the theoretical basis upon which GEC should be allocated, namely the appropriateness of full cost accounting versus incremental accounting;

- (ii) the identification of general expenses which are related to the capital program and therefore should be allocated to capital;
- (iii) the allocation percentages to be applied to capital assets; and
- (iv) if a change in methodology should be deemed appropriate, over what period should a transition in policy take place.

(1) **Theoretical basis for allocating General Expenses to capital assets**

Accounting theory has developed two appropriate bases on which to capitalize general expenses to capital assets in companies which carry out self-construction. These bases are the full cost method or the incremental method. Both methods have equal acceptability in theory, however, the current trend amongst utilities appears to favour the adoption of the incremental basis.

The full cost basis suggests that general overhead, required to run an enterprise capable of carrying out a capital program, would be eligible for allocation. Any expense directly related to carrying out a capital program would be capitalized, as would common costs that benefit both the operation and capital program of the utility. The rate of allocation would be determined on a rational basis related to the accounts involved. These common costs would include expenses that may be affected in any way by the size or extent of the capital program.

The incremental basis is similar to full cost in that all costs directly attributed to a capital program would be allocated but it also allocates certain common costs as well. The difference is that the costs allocated must be expenses that are incremental to the utility as a result of carrying out a capital program. The following item is an example that distinguishes the two bases of account. If a utility must employ a general accountant, regardless of whether a capital program was carried out, then the incremental basis would not allocate any portion of that staff accountant's salary or benefits. The full cost method may allocate a portion of the accountant's salary and benefits, because the accountant spends some time accounting for the capital program. Consequently, the incremental basis of accounting capitalizes fewer general expenses than does the full cost method.

Mr. Boocock conducted a survey of 12 other utilities in Canada and determined that five of twelve utilities use the incremental approach, two use a hybrid approach and five appear to use a full cost basis. Ten utilities capitalize general expenses at a rate of less than 12% of the gross capital expenditure. The Applicant indicates GEC is approximately 28% of their gross capital expenditure. The Applicant is the only utility which includes pension costs in the GEC allocation. There is a trend of utilities switching from full cost to the incremental basis over the last twenty years. Mr. Boocock recommends that the utility follow the incremental approach. Costs which are not incremental would be expensed.

Mr. Vance also provided evidence before the Board. Mr. Vance provided the following direct testimony:

"The two basic observations that we made in this regard were that firstly, the General Expenses Capitalized did not seem to bear any direct relationship to the amount of construction activity undertaken and secondly, the allocation of these costs amongst the capital asset categories was such that the amount that ultimately ended up being charged to distribution assets was merely by difference as for a number of other asset categories, the amounts of GEC's to be added to these categories were restricted to specified percentages and then the remaining balance of General Expenses Capitalized was merely added to distribution assets regardless of the relative level of construction activity."...

"I felt that the amounts being allocated to GEC were somewhat excessive and that the manner of allocating these costs to the various departments or assets categories did not seem to have a logical rationale. Neither bore any relationship to the acquisition of capital assets in a given year."....

"...from the perspective of generally accepted accounting principles (GAAP), I feel the proposed changes would result in the Applicant's accounting policies more closely paralleling generally accepted accounting principles than would be the case if the Applicant remained on a full-cost allocation to GEC."

The Board has considered the evidence before it and the final argument of the Applicant. It appears that while the full cost method is acceptable and theoretically

sound, the manner in which it has been applied has resulted in an excessively high allocation of general expenses, particularly when compared with other utilities.

Regulatory practice has seen a noticeable shift toward the incremental method. The risk of a method that capitalizes high amounts of overhead, would be to disadvantage future generations who would ultimately be asked to bear these costs. Consequently, the Board accepts the proposal of the Applicant to change its accounting policy with respect to GEC to the incremental basis.

(2) **Incremental accounts to be capitalized**

During the hearing the Board heard evidence with respect to which accounts were incremental to the capital program. The Applicant had conducted a survey of its staff involved in the departments that had previously capitalized overhead. These staff were asked to consider which of their accounts and staff would be truly incremental to the capital program, i.e. which costs would not be incurred if there were no capital program. The Applicant submitted Exhibit KB-6, which details the result of the survey and its consequential effect of allocating general overhead on an incremental basis.

The Applicant has presented the accounts presently being transferred through general expenses capitalized to capital asset accounts in Exhibit KSW-1. These costs have been reviewed by the Applicant's Corporate Accounting Division in preparation for the public hearing.

Demand for particular PUB-9 states:

"Exhibit KB-6 was prepared by the Applicant's Corporate Accounting Department and is an analysis on a department by department basis, of costs which would be incurred if there were no capital program. If costs would be incurred by the Applicant even if there were *no* capital expenditures, then those costs do not vary with the level of capital expenditures. Put another way, annually occurring costs which do not vary with capital expenditures ought to be treated as operating expenses."

During the course of the hearing attention was drawn to these accounts, the manner in which incremental accounts were selected and the manner in which incremental items were valued.

The Board is persuaded to approve the incremental basis for accounting for General Expenses Capitalized. It believes the numbers must be based on sound judgement of what is incremental from the theoretical position of absolutely no construction or capital program. The Board had accepted in the past the merits of full costs, however, in light of low sales growth and diminished capital programs, full cost appears to be excessive. This does not mean the Board wishes to minimize capitalization, since to do so would burden today's customers with the costs associated with delivering services long into the future.

Evidence was provided by Mr. Ken Lawrence. On page 47 of the transcript of October 25, 1995 Mr. Lawrence indicated how the Applicant determined how much incremental costs would be for a particular incremental item.

Question:

"Does that go against the basic philosophy of what incremental represents, which is the incremental effect of not having the capital program and the incremental effect is to lose the full salary, because we're no longer worried about full cost?"

The answer of Mr. Lawrence was:

"Technically speaking you are correct if we had no construction; however, this isn't intended to show a picture of if we had absolutely no construction, this is intended to show what would happen in 1995 if we were following the incremental method. You know, the amount of work was the same regardless of the accounting treatment of it, and that technician would be on and the other people would be on."

Hence, the Board believes some of the potentially incremental costs were not fully picked up by the Applicant in Exhibit KB-6. These omissions occurred through capitalizing only a portion of an incremental staff person's salary, overhead and benefits, which is inconsistent with the philosophy of the incremental basis; or through dismissing items summarily without a full theoretical analysis. The Board has reviewed

the accounts and evidence and considers the following items to be appropriately included as incremental.

## CONSTRUCTION ACTIVITIES

### Direct charges to GEC by Time Sheet Employees:

The Exhibit KB-6, pages 2 and 3 disclose the time sheet employees who have charged time directly to the capital program. The Applicant assigned an incremental value to these staff costs. The incremental theory applied suggests that these staff members would not be required if there was no capital construction. It was evident from the evidence that the rule was not appropriately applied to the staff that do not spend their full job hours at capital programs. This is in error. If these staff were not required, Mr. Lawrence explained the balance of their non-construction work assignments would be shared amongst other staff. Therefore, the Board is convinced the full cost of those staff persons, including benefits, shall be capitalized under the incremental program. The staff considered to be incremental are:

#### Power System Development

- \* Five engineering technicians
- \* Assistant Property negotiator
- \* Surveyor

#### Avalon Region



- \* Two engineering technicians

#### Eastern Region

- \* Two engineering technicians

Since only labour charges greater than \$10,000 were analysed, the Applicant increased their figure by an equal proportion for those charging less than \$10,000. This increase amounted to \$158,000. This proportion also must be equated to full positions in a reasonable manner.

Exhibit KB-6, pages 4 - 8 detail the costs associated with incremental general expenses related to capital programs. Once again, the Board is of the opinion that the incremental method dictates all of the salary and benefits and allocated percentage overhead per staff person required for the capital program should be capitalized, not a portion of their salary.

Incremental costs are deemed to include:

#### Distribution systems and services:

- \* Superintendent of Distribution Standards \$56,871
- \* Engineering Technician \$50,470

#### St. John's Region

- \* Technical Supervisors \$60,285

#### Eastern Region

- \* Engineering Technician \$50,471
- \* Engineering Technician \$50,471
- \* Technical and Maintenance Supervisor \$60,287

**Western Region**

*	Three Engineering Technicians	\$154,413
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**Power System Development**

*	Technical Specialist	\$56,284
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Tools, Equipment and Clothing, Linesmen's Rubber Goods and Free issue appears reasonable as proposed, but capitalized labour should include any adjustments referred to in this Order as well as any consideration for free issue or tools and the like to any contractors engaged to conduct construction activities.

**NON-CONSTRUCTION ACTIVITIES****Accounting:**

The Applicant has argued on KB-6, page 9 that there would be no reduction in accounting staff if gross capital expenditures were reduced to zero. This is a reduction of \$35 million in expenditures. The Board notes that total curtailment of construction would also eliminate the need to come before the Board for a capital budget review and should eliminate the need for many new Bond issues other than refinancing. It seems unrealistic to suggest that such a dramatic reduction in expenditures, approximately 70% of "other expenses", would not eliminate even one staff member and the associated benefits and overhead. Therefore the Board does not accept the

Applicant's position on this matter and requires that the matter be addressed and included in GEC's.

**Printing:**

The Applicant has provided a similar argument for printing as it did for accounting. The Applicant recognizes that some capital related work is still performed by the Printing Department. If the vast majority of printing is customer service related, then a nominal rate of 10% of printing costs seems an appropriate and reasonably expected amount to be eliminated if no capital program was undertaken. The Board accepts such a nominal rate as reasonable.

**Corporate Effectiveness:**

In Exhibit KB-6 the Applicant provided its rationale for not capitalizing corporate effectiveness costs. The Board accepts this rationale.

**Management Information System Costs:**

The rationale for not capitalizing any supervision, computer operations and system development and support is provided on page 10 of Exhibit KB-6. The Board accepts the rationale for the computers and software expense provided that the portion

of these expenses associated with the staff identified earlier as incremental staff are included in the benefits and overhead associated with their costs.

Personal Illness, Employee Welfare, Employee Relations, Safety Meetings, Training and Education, Apprentice Training and Coffee Supplies:

These accounts should be allocated to capital on the basis of "capital labour" plus all labour transferred through GEC as a percentage of total labour costs.

Presumably these costs vary in relation to staff employed. Hence, the Board deems this overall approach to be reasonable.

Human Resources Planning and Administration and Services:

These costs comprise: publishing Tie Lines, Human Resources Planning and Administration, Health and Safety, Training Sections, Employee Relations. According to Exhibit KB-6, the Applicant suggests these costs are unaffected by the capital program.

The Board accepts this logic with respect to Tie Lines and health and safety costs. However, the Board notes that 50% of the utilities who provided GEC details in the Deloitte Touche survey, capitalized a portion of human resources. The Board believes the staff involved in a minimum capital program of \$35 million would still attract overhead costs through human resources. The Board deems it necessary for the

Applicant to review these departments again to determine, if there was no capital program, to identify which costs would be eliminated.

**Administration:**

The Board agrees that administration is not likely to incur incremental costs.

**Internal Audit and Miscellaneous Administrative Costs:**

The Board agrees that there would be no incremental costs in these areas that would be material.

**Building Rental, Operation and Repairs, Ground Maintenance, Snow Clearing and Warehouse Operation and Repairs:**

In the event of no capital program, all direct construction employees and an identifiable number of general employees would be eliminated. Therefore, less office and warehouse space is required and any surplus space could be eliminated from space currently leased. It does not appear reasonable with \$35 million of activity eliminated, the Applicant would still require as much rented space elsewhere. A rational approach should be used to determine how much rental space could be eliminated for the purpose of this incremental cost exercise.

**Applicant Pension Plan:**

The rationale provided for \$362,000 being charged to capital from pension expenses appears reasonable and is deemed acceptable by the Board.

In summary, the Board accepts the approach provided by the Applicant in identifying their incremental cost with some aforementioned adjustments. The Applicant shall make all identified adjustments and file the revised schedule similar to Exhibit KB-6, together with explanatory notes, with the Board on or before February 28, 1996. The changes identified in this section should be compiled from January 1, 1995 and phased in as specified in the later section of this Order on Transition and Phase-In.

**ALLOCATION TO CAPITAL ASSETS**

The Applicant has allocated GEC on the basis of: 10% to hydro assets, 10% to diesel assets, 20% to substations, 22% to transmission, 5% to general property, 5% to transportation, 20% to communication, and 5% to computer and software costs. Any balance in GEC not allocated to the aforementioned accounts is transferred to Distribution Assets. In periods with minimum capital programs, less is allocated to the specific assets and a disproportionate share is thereby transferred to distribution. (See Boocock's direct evidence page 29.)

Mr. Boocock recommended a flat GEC percentage common to all asset classes.

The percentage would vary each year in accordance with the value of the underlying incremental general expenses. Mr. Vance stated in his direct evidence on GEC, page 3, that the manner of allocating these costs to the various departments or asset categories did not seem to have a logical rationale. Mr. Vance concurred with Mr. Boocock's proposal to apply a flat rate to each asset category.

The Board has considered the evidence and expert opinions on the allocation to the various capital asset classes and approves of the proposed flat rate allocation of GEC.

#### Transition and Phase-In of the New Incremental Approach to Allocating GEC

Due to the significant impact of changing to the incremental method, which could result in a rate impact of 3.9% according to the evidence of K.S. Warr, page 9, a phase-in period has been recommended by the Applicant and expert witnesses. In order to accomplish the phase-in, the Applicant must keep track of both the full cost allocation and incremental allocation throughout the period.

The Applicant and its expert witness recommend a phase-in period of three years, including 1995. The Board's expert witness believes a transition period of three years is on the aggressive side and recommended a five year time frame as more suitable.

The Board is concerned with a rate impact of 3.9% caused only by a change in accounting methodology. As both accounting methods are in use by Canadian utilities,

and both methods are theoretically sound, it does not seem appropriate to implement the method on a fast track. Therefore, the Board concludes a five year phase-in beginning at January 1, 1995 is appropriate.

During the phase-in period, the Applicant shall maintain records of the GEC using both methods. In 1995, GEC will be the incremental amount plus an adjustment of 80% of the difference between full cost and incremental amounts. Each year thereafter, the adjustment will be reduced by 20% until 1999 when only incremental costs will be allocated. The Applicant may determine how specific general expense costs may be adjusted over this period, providing the total impact arrives at the phase-in schedule described in this paragraph.

With respect to allocation to specific capital assets, the Applicant's proposal is deemed to be appropriate, bringing the benefit of transition to the distribution assets first.

#### **FUNDING OF THE UNFUNDED PAST SERVICE PENSION PLAN**

The Applicant has proposed to accelerate their payments toward their Unfunded Pension Plan at a rate of \$12 million as of December 31, 1995 and \$6 million as of December 31, 1996. This proposed payment would have an impact on the Applicant's after tax net income for those years.

Mr. Lorne Henderson presented a net present value analysis of the proposed additional funding. This analysis concluded that as long as pension assets earned an



average annual return of 8.4%, this funding plan would not cost the Applicant any more than the present schedule of funding. The net present value analysis utilized a discount rate of 8.88%. This discount rate uses a 9.5% before tax cost of debt and a 12.25% return on common equity.

Mr. Vance agreed with the evidence presented and explained that the additional payments serve to earn income as pension assets, which directly reduces the pension expense in subsequent years, as compared to paying according to the present schedule of payments. This reduced pension expense would offset the interest expense incurred from the borrowing necessary to finance the additional funding.

The Board has evaluated the evidence set before it regarding the proposed additional funding to the defined benefit pension plan. The Board notes that Consent Exhibit No. 1 indicates for each year commencing in 1996 through to 2020, the pension expense is reduced significantly. This fact, together with the favourable net present value analysis, indicates the funding will not impact adversely on any ratepayer group.

The Board approves of additional pension funding of the defined benefit pension plan up to \$12 million as of December 31, 1995 and up to \$6 million in additional pension payments as of December 31, 1996. The Applicant shall file an affidavit indicating the amounts actually paid and a revised net present value statement to indicate the actual amounts disbursed. These affidavits shall be filed on February 28, 1996 and again on February 28, 1997, respectively.

**EARLY RETIREMENT PROGRAM**

In 1993, the Applicant undertook an early retirement program in which 120 of the Applicant's employees retired. The Applicant had filed all information leading up to the early retirement program with the Board. The Board approved of the Applicant proceeding with the program with the results to be reviewed at the Applicant's next public hearing.

The Applicant has filed information in support of the reasonableness and prudence of the program. Consent Exhibit No. 18 indicates contractor costs appear to be consistent or below levels in place in the early 1990's, with the exception of 1994 when unusual expenses arose with respect to the December sleet storm as well as with a special brush clearing program. Consent Exhibit No. 17 indicates that both gross and net early retirement savings in salaries and pension costs were above those originally forecast and presented to the Board in 1993. This is true for 1993, 1994 and 1995. Consent Exhibit No. 16 provides a pay back analysis on the early retirement program. This pay back analysis employed a net present value approach. This analysis indicates that as of December 31, 1995 the early retirement program already had netted more benefits (\$259,773) than its all associated costs through to 2004. Each year that follows will increase the net present value to the Applicant. If the present trend continues, the program should exceed the benefits originally filed with the Board, amounting to approximately \$14 million as its net present value.

Consent Exhibit No. 11 indicates that from June 1993 until June 1995 staff positions have fallen by 128 full time equivalents, after giving affect to increases in temporary positions in "full time position." Consent Exhibit No. 12 indicates from December 1992 to August 1995, approved positions have decreased by 160 positions, total regular positions filled by full time or temporary staff have decreased by 145 positions and total employees including temporary staff in temporary positions have decreased by 118 positions.

The Board finds the program has proven to be reasonable and prudent to date. The Board requires the Applicant to continue to file Exhibits in the format shown in Consent No. 12, and Consent Nos 16 - 18 by April 30 of each year indicating the annual progress of the early retirement program.

#### **COSTS**

The Applicant will be ordered to pay the expenses of the Board arising out of the hearing.

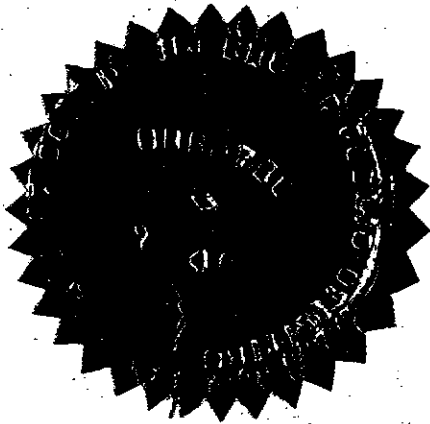
**IT IS THEREFORE ORDERED THAT:**

1. The accounting policy to be applied for the purpose of capitalization of general expenses, will be the incremental basis which will result in the Applicant's allocations to capital assets of only those costs which are incremental costs of capital projects.
2. Overhead costs will be considered to be incremental costs of capital projects to the extent they vary with the level of construction as compared to no capital projects whatsoever. Otherwise the overhead costs are expenses of the period in which they are incurred.
3. The guideline for capitalization of general expenses are set out on pages 16 - 22 of this Order. The Applicant will follow these guidelines to the extent practicable.
4. General Expenses Capitalized will be allocated to hydro assets, diesel assets, substations, transmission, general property, transportation, communication, computer and software assets, and distribution assets through a flat rate.
5. The change in accounting policy for general expenses capitalized to the incremental basis, from the full cost method, will be phased in over the period January 1, 1995 to December 31, 1999. In 1995, GEC will be the incremental

## 5. (con't)

amount plus an adjustment of 80% of the difference between full cost and incremental amounts. Each year thereafter, the adjustment will be reduced by 20% until 1999 when only incremental costs will be allocated. The Applicant may determine which specific general expense costs are adjusted during the period of transition, providing the total impact arrives at the phase-in schedule described above. With respect to allocation to specific capital assets during the period of transition, the Applicant shall allocate the reduction in GEC to distribution assets first.

6. Additional pension funding toward the Applicant's Unfunded Pension Liability is approved up to a limit of \$12 million in 1995 and \$6 million in 1996. The Applicant shall file an affidavit with the Board subsequent to each years funding indicating the actual additional amounts contributed together with a revised net present value analysis reflecting the actual additional contribution.
7. The Applicant shall file annually with the Board a report tracking the results of the early retirement program.
8. The Applicant shall pay the expenses of the Board arising out of this hearing.



Dated at St. John's, Newfoundland this 11th day of December, 1995.

David A. Vardy  
David A. Vardy,  
Chairperson.

Leslie E. Galway  
Leslie E. Galway, C.A., M.B.A.,  
Vice-Chairperson.

Wallace S. Read  
Wallace S. Read  
Commissioner.

Carol Horwood  
Carol Horwood,  
Clerk.