

Q. CA 18.0 NP

Reference: Exhibit NP-1 (Tax Settlement between Newfoundland Power Inc. and the Minister of National Revenue dated June 1, 2005), paragraph 9.

Preamble: The Tax Settlement states that NP “has also represented and agreed” that it will include a third of the unbilled revenue outstanding as at Dec. 31, 2005 in the computation of its taxable income for each of its 2005, 2006 and 2007 (sic).

As part of the Out of Court Settlement, did NP propose this time frame for inclusion of this unbilled revenue in income? If so, why?

A. 1. General

The 3 year timeframe was the result of negotiation between the parties.

2. Positions of the Parties

The broad position of Newfoundland Power in the tax dispute was that its recognition of revenue on a billed basis for tax purposes was appropriate for each year in question. Recognition of revenue on this basis was consistent with the Company’s historical practice for tax purposes. And it was also consistent with its recognition of revenue for regulatory and financial reporting purposes.

The broad position of the Minister of National Revenue in the tax dispute was that the only appropriate way for Newfoundland Power to recognize revenue for these years was on an accrual basis. Recognition of revenue on an accrual basis was, in the Minister of National Revenue’s view, the only manner of revenue recognition which was consistent with industry practice and legal precedent.

3. Reasonableness of 3 Years

Newfoundland Power was aware of industry practice regarding revenue recognition. The Company believed there was a substantial likelihood that, once the tax dispute was resolved, the Board would ultimately order the Company to conform with industry practice.

The federal tax authorities made it clear in discussions concerning this matter that they would not accept Newfoundland Power’s continuation of the recognition of revenue on the billed basis for tax purposes. Any negotiated resolution of the matter would require a limited ascertained timeframe for adoption of the accrual method of revenue recognition as a part of any settlement.

1 Newfoundland Power believes the period agreed upon was acceptable to the Minister of
2 National Revenue principally because it ensured that the Company would ultimately
3 adopt a revenue recognition policy for tax purposes which was consistent with industry
4 practice within an ascertained time period.
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6 Newfoundland Power believes that the agreed upon period was a reasonable one. It
7 effectively provided for transition to the accrual method of revenue recognition for tax
8 purposes by December 31, 2008. Such a time period provides a reasonable level of
9 flexibility in any prospective adoption of the accrual method of revenue recognition for
10 regulatory purposes.
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12 Newfoundland Power was also informed by confidential information it received from
13 another Canadian utility. Newfoundland Power was informed by this utility that it had
14 reached an agreement with federal tax authorities to transition to the accrual method of
15 revenue recognition over a 3 year period which included the year of the agreement.
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17 Newfoundland Power's assessment of the period agreed upon was influenced by this
18 information. The transition period Newfoundland Power accepted was effectively longer
19 than that agreed to by the other utility because it allows a transition period of 3 years
20 beyond the year of the agreement itself.