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## 1Q.Pg. 6, lines 5-6 - Mr. Pous states that there is a credit reserve variance amortization2of \$3,275,383 if the ALG calculation is used by Newfoundland Power rather than the3ELG procedure. Please confirm that this would increase the rate base.

A. Deny, from a historical perspective. The values presented by Mr. Pous are based on plant
as of December 31, 2010. Therefore, under normal ratemaking there would be no
adjustment to historical rate base. However, in the future rate base will be more in line with
where it should have been due to the true up of the prior over accrual of depreciation
expense. The same, but opposite situation would transpire if there had been an under
accrual of prior depreciation expense.

12 The reserve amortization is required in order to: (1) limit the capital recovery process to 100% of investment less net salvage, (2) comply with the matching principle; and (3) 13 eliminate intergenerational inequity. In accomplishing the three above noted objectives in 14 this case: (1) depreciation expense will decline, (2) depreciation expense will increase in 15 future cases, but to a lesser extent all else equal, and (3) rate base will increase. During the 16 17 corrective period until the next rate case, overall revenue requirements charged to customers will be lower due to the change from ALG to ELG. The total revenue requirement 18 reduction occurs due to the reduction in depreciation expense, which is a dollar-for-dollar 19 20 issue. The expense reduction is more significant than the impact relating to a change in 21 rate base.

The overall view regarding this matter should be from an intergenerational inequity standpoint as well as the matching principle standpoint. For example, a dollar expended for capital items in theory could be assigned a one-year life and recovered immediately just as an expense amount would be treated. However, if that capital item had a 10-year life, such recovery pattern would be inequitable to current customers and very beneficial to future customers. Moreover, it would not match the annual revenue requirements with the cost of providing services. However, if the item were recovered in year 1, rate base for that item

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would decline to zero (0) and there would be no return or depreciation expense for the remaining nine years associated with such investment.

Now assume that the one-year accelerated recovery of depreciation for the asset in the example is recognized and corrective action is desired. Under any corrective action, rate base would have to increase (since it had reached zero) while depreciation expense would decrease. In other words, customers beginning in year 2 would see a decline in depreciation expense in an effort to rebalance capital recovery to customers for their prior overpayments. The rebalancing process would cause rate base to be higher than the zero (0) level that occurred after year 1 as each year of credit-related depreciation was flowed through to customers. Under this situation, it is correct rate base would be higher, but it would not be higher than it should have been had the correct method been employed from the beginning. Absent a write-off of investment, which is not being proposed, there is the need for a repositioning of annual depreciation expense and its corresponding impact on rate base.

In summary, the implications for customers associated with conversion to an ALG calculation procedure results in lower current depreciation expense and an increase in future rate base from where it would have been otherwise. The combined impact of expense and rate base will result in lower revenue requirements for customers for a period of time as the rebalancing of capital recovery is completed.