**Q. The budget for a number of proposed projects is stated to be "based on an assessment of historical expenditures and inventory requirements." Please provide a list of the factors that are examined and the process used in the assessment of historical expenditures.**

A. Newfoundland Power's *2022 Capital Budget Application* includes 14 capital projects where the budget estimate is based in large part on historical expenditures.[1] Capital projects based on historical expenditures fall into 3 broad categories:

(i) Equipment that fails in service or is identified to be at imminent risk of failure through routine inspection;[2]
(ii) Third party or customer-driven work requests that occur throughout the year;[3] and
(iii) Upgrading or replacing a large number of relatively small items used in day-to-day operations.[4]

In each of these cases, overall work requirements tend to be reasonably stable on a year-over-year basis. However, the nature of these projects is such that the specific work requirements in a particular year are not foreseeable as they arise in many instances from factors outside the Company's control. The use of historical expenditures as the basis of budgeting these capital projects is reflective of these considerations.

Newfoundland Power uses 2 primary costing methodologies in determining budget estimates for projects based on historical expenditures: (i) the historical average method; and (ii) the historical average unit cost method.

The factors used under the historical average method are project costs, including extraordinary requirements, and inflation. This method involves 2 steps:

(i) An average annual cost is determined based on historical expenditures over the most recent 5-year period, which are adjusted to current-year dollars and normalized by removing any extraordinary requirements.[5]

---

1 These 14 projects are in addition to *General Expenses Capitalized ("GEC"), Allowance for Funds Used During Construction ("AFUDC")* and *Allowance for Unforeseen Items*, which are also based on historical expenditures, but do not pertain to specific capital work to be carried out in a particular year.

2 Capital projects based on historical expenditures and primarily driven by equipment failure or inspections include: *Transmission Line Maintenance and 3rd Party Relocations; Meters (Replacement); Reconstruction; Rebuild Distribution Lines; Services (Replacement); Street Lighting (Replacement); Transformers (Replacement); Thermal Plant Facility Rehabilitation*; and *Replacements Due to In-Service Failures*.

3 Capital projects based on historical expenditures and primarily driven by third party or customer-driven requests include: *Extensions; Meters (New); Relocate/Replace Distribution Lines for Third Parties; Services (New); Street Lighting (New);* and *Transformers (New).*

4 Capital projects based on historical expenditures and primarily driven by the replacement of small items used in day-to-day operations include *Additions to Real Property; Tools and Equipment;* and *Replace/Upgrade Communications Equipment.*

5 For example, the 2022 *Relocate/Replace Distribution Lines for Third Parties* project has identified for exclusion an extraordinary expenditure of $681,000 in 2018 associated with Rogers Communications fibre build in the St. John's area. This exclusion can be found on page 44 of Schedule B.

(ii) An average annual cost is then inflated using the GDP Deflator for Canada and adjusted to include any known extraordinary requirements.

The historical average unit cost method is used for capital projects required to connect new customers, such as the *Services* and *Meters* projects. The factors used under this method include unit costs, inflation and forecast customer requirements. This method involves 3 steps:

(i) Historical annual expenditures over the most recent 5-year period are adjusted to current-year dollars using inflation.
(ii) The adjusted costs are then divided by the number of new customer connections in each year to determine the historical average unit cost.
(iii) The average unit cost is then inflated by the GDP Deflator for Canada and multiplied by the forecast number of new customer connections for the budget year.

Adjustments are applied to project budgets, where appropriate. These adjustments ensure that the proposed budget amounts accurately reflect expected work requirements in a particular year. Examples include adjustments to reflect the need to upgrade or replace a particular piece of equipment[6] and adjustments based on available inventory levels.[7]

Schedule B provides the costing methodology used for each capital project.

[6] For example, the 2022 *Additions to Real Property* project includes 3 adjustments to the historical average. These adjustments include items for transformer storage racks, washroom refurbishment and electric vehicle chargers at Company buildings. The total adjustment for 2022 of $333,000 is detailed on page 64 of 99 in Schedule B.

[7] The *Replacements Due to In-Service Failures* project was introduced as part of the *2007 Substation Strategic Plan.* This project is ultimately driven by the need to replace failed equipment and equipment identified as being in imminent danger of failing and to maintain an adequate inventory of spare equipment to ensure the Company can effectively respond to in-service failures of substation equipment.