Reference: Volume 2, Review of General Expenses Capitalized

Q. Volume 2, Review of General Expenses Capitalized. On page 3 of Appendix B Newfoundland Power notes that it is challenging to determine a specific reduction in general expenses for the finance, human resources and information systems departments (non-construction activities) if there was no capital program. Currently, a nominal rate of 13% is applied as a reasonable proxy and, according to Newfoundland Power, this rate reflects the nominal rate applied at the end of the phase-in period of the incremental cost method in 1999. Newfoundland Power is proposing to change this nominal rate from 13% to 10% for non-construction activities and indicates that 10% was the Board's suggestion in Order No. P.U. 3 (1995-96), page 19. Please explain why NP is now proposing to adjust this rate to 10% from the 13% that has been in place since 1999. Please provide the impact on revenue requirement, rate base and rates if this percentage did not change to 10%.

A. As part of the *Review of General Expenses Capitalized* (the "GEC Review"), Newfoundland Power completed a review of each general expense to determine the appropriate cost ratios to be applied in the allocation of general expenses to GEC. The Company approached the review of each general expense as if no ratio existed to determine appropriate ratios given current operations. Newfoundland Power then assessed the reasonableness of the revised ratios by comparing the amount of GEC determined using the revised ratios to the amount of GEC determined using the existing GEC ratios.[1]

As part of the GEC Review, Newfoundland Power concluded that there would be lower work requirements performed by the finance, human resources and information systems departments ("non-construction activities") if there were no capital program.[2] However, given the nature of the departments, it is difficult to determine a specific cost reduction.

In the Company's view, the use a nominal rate of 10%: (i) recognizes there would be some reduction in general expenses related to non-construction activities if the capital program were eliminated; and (ii) reasonably addresses the practical limitations associated with quantifying a specific reduction in these general expenses if the capital program were eliminated.[3] Order No. P.U. 3 (1995-96) confirmed the reasonableness of applying a 10% nominal rate.

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[1] Under the revised ratios, total GEC is approximately \$3.5 million, or \$0.1 million higher than if total GEC was determined using existing ratios. See the *2022/2023 General Rate Application, Volume 2, Supporting Materials, Tab 6, Review of General Expenses Capitalized, Appendix B*, page 5.

[2] For a discussion of the lower work requirements for each department, see the *2022/2023 General Rate Application, Volume 2, Supporting Materials, Tab 6, Review of General Expenses Capitalized, Appendix B*, pages 3 and 4.

[3] For example, while there would be reductions in finance employees if there were no capital program, it would be limited. Core finance tasks, such as financial reporting and budgeting would still be required to be completed, as well as a baseline of payroll, accounts payable and accounts receivable related activities.

If the existing ratio of 13% was applied to general expenses related to non-construction activities, rather than the 10% ratio, the amount allocated to GEC would be approximately $0.2 million higher in 2023. The Company's revenue requirement would decrease by $0.2 million, with a corresponding increase in rate base of $0.2 million.[4] The customer rate impact would be a reduction of 0.03%.[5]

[4] Using the revised ratios, GEC related to non-construction activities is $756,000 (based on the *pro forma* analysis) [$756,000 ÷ 10% x 13% = $982,800. $982,800 – 756,000 = 226,800]. See the *2022/2023 General Rate Application, Volume 2, Supporting Materials, Tab 6, Review of General Expenses Capitalized,* page 10, Table 1.

[5] $0.2 million / $726.7 million existing revenue from customer rates = 0.00027, or approximately 0.03%. See the *2022/2023 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Exhibit 10.*