

Q. On page 2, lines 9 to 10 of Mr. Brockman's Pre-filed Evidence, he states that there are no benefits to customers of imposing additional revenue volatility on Newfoundland Power. Would exposing NNP to additional revenue volatility provide incentive to NP to manage the volatility, thus transferring a portion of the volatility and supply risk from customers to NP?

A. Newfoundland Power obtains approximately 90 per cent of its electricity requirements from Hydro. The cost of purchased power represents about 60 per cent of the price of electricity to Newfoundland Power customers.

Newfoundland Power management has little control over expenses such as purchased power, depreciation, interest and taxes. The table below provides unit revenue and cost data for 1998 through 2002, and highlights the fact that Newfoundland Power's total unit costs are largely fixed in nature. Given this fact, Newfoundland Power has limited ability to manage the level of volatility inherent in the Sample Rate.

**Unit Revenue and Costs
(cents per kWh)**

	1998	1999	2000	2001	2002
Average Gross Unit Revenue ¹	7.50	7.55	7.59	7.56	7.61
Energy and Fixed Unit Cost ²	5.52	5.53	5.61	5.64	5.73
Variable Unit Cost ³	1.19	1.15	1.08	1.06	1.07

¹ Average Gross Unit Revenue = Revenue from Rates (before any adjustment for excess earnings)/Energy Sales

² Energy and Fixed Unit Cost = (Purchased Power + Depreciation + Net Interest)/Energy Sales

³ Variable Unit Cost = Operating Expenses (excluding early retirement costs)/Energy Sales

(Source: Newfoundland Power's 2003GRA, Finance & Accounting: Evidence, Page 23, Table 6)

Imposing additional earnings volatility on Newfoundland Power will not benefit its customers but will impact the Company's ability to earn a just and reasonable return as provided for in Section 80(1) of the Public Utilities Act. The establishment of a reserve or adjustment mechanism¹, which requires Board approval, in conjunction with the implementation of a demand/energy wholesale rate is the only way to effectively reduce the earnings volatility so that Newfoundland Power can earn a just and reasonable return as provided for in Section 80(1) of the Public Utilities Act.

¹ See Newfoundland Power's response to Request for Information CA-238 NP for a description of adjustment mechanisms in place in other Canadian regulatory jurisdictions.