Q. CA 34.0 NP

Reference: PUB 8.0 NP, Attachment A
P.U. 37 (2000-2001)

Preamble: NP's response states that under the Full Recognition Scenario "the entire forecast 2005 accrued revenue of $24,262,000 would be recognized for regulatory purposes in 2006." Of this amount $12,447,000 is treated as additional revenue for regulatory purposes (2005 Unbilled Revenue Accrual on line 5) which would increase the rate of return on rate base and the regulated return on book equity (lines 31 and 32) to the maximum allowed. The remaining $11,815,000 appears as Excess Earnings (line 27).

Under the Full Recognition Scenario would NP consider it appropriate to dispose of the excess earnings through a customer rebate in 2006 as was done in the case of the balance in NP's Excess Revenue Account as at December 31, 2000 (P.U. 37 (2000-2001)? If NP would not consider a customer rebate to be appropriate under this scenario please explain the Company's view.

A. First of all, Newfoundland Power does not consider the Full Recognition Scenario to be an appropriate means of recognizing the 2005 Unbilled Revenue.

Furthermore, Newfoundland Power does not consider a refund of $11.8 million in excess revenue through a customer rebate in 2006 to be appropriate for several reasons.

Definition of Excess Earnings

The Excess Earnings Account in Newfoundland Power's System of Accounts is credited with any earnings in excess of the upper limit of the allowed range of return on rate base as determined by the Board, plus applicable income taxes. By definition, excess earnings in 2006 would not be determined prior to the end of the year. In practice, excess earnings in a year are determined on publication of the Company's annual financial statements and the annual returns filed with the Board at the end of March in compliance with Section 59 of the *Public Utilities Act*. Any consideration of disposition of excess earnings, including the possibility of a rebate to customers, would therefore necessarily not occur until some time following the end of the Company's 2006 financial year.

Rate Stability and Predictability

Newfoundland Power would not consider a refund of $11.8 million in 2007 to be appropriate from a rate stability perspective. It would possibly result in a refund in 2007 and a possible rate increase in the same year to recover additional depreciation and income tax.

Financial Integrity

Recognition of the 2005 Unbilled Revenue for regulatory purposes in 2006 does not result in any additional cash for Newfoundland Power. Therefore, the refunding of the excess earnings of $11.8 million under the Full Recognition Scenario would have a negative impact on the cash flow and credit metrics of Newfoundland Power.

Cash flow and credit metrics are measures used by investors and credit analysts to assess the overall creditworthiness of Newfoundland Power. Further detail of the impact on credit metrics is provided in the response to CA 20.0 NP.

Intergenerational Equity

Based on the regulatory principle of intergenerational equity, each of the years 2006, 2007 and 2008 should be allocated a portion of the 2005 Unbilled Revenue to offset the taxes arising from the tax settlement in those years.[1]

The provision of a refund to customers based on the Full Recognition Scenario would result in an additional $4.8 million in cash revenue being required from customers in each of 2007 and 2008 to pay the income taxes related to the tax settlement.[2] Providing a cash refund based on 2006 excess earnings arising from the Full Recognition Scenario is inconsistent with the principle of intergenerational equity.

Customer Benefits

The Full Recognition Scenario requires Newfoundland Power to earn its maximum allowed rate of return on rate base in 2006 before any of the 2005 Unbilled Revenue is credited to the Excess Earnings Account. This would increase Newfoundland Power's 2006 returns by approximately $2.9 million from those forecast based on the Company's proposals in the 2006 Accounting Policy Application.[3]

Newfoundland Power's proposal effectively results in an additional $2.9 million of the 2005 Unbilled Revenue remaining available to reduce the revenue that would otherwise be required from customers through rates in years subsequent to 2006. This equates to benefits for customers of approximately $4.5 million.[4]

Company's View

Newfoundland Power's view is that the best approach to the recognition of the 2005 Unbilled Revenue is that proposed by the Company in the 2006 Accounting Policy Application. That approach (i) considers the relevant regulatory principles, and (ii) balances the interests of customers and the Company.

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1 See page 20 of the report of JT Browne Consulting.
2 Revenue Requirement from Exhibit NP-6, line 15.
3 See PUB 8.0 NP, Attachment A, Line 5, $12,447,000 - $9,579,000 = $2,868,000.
4 The additional revenue from rates would be taxable. $2,868,000 ÷ (1-tax rate) = $2,868,000 ÷ (1-0.3612) = $4,489,668.