

Q. If the Board were to determine that the accrued revenue as a result of a change in the revenue recognition policy should be recognized on the same basis as that found in the Tax Settlement Agreement, with no other considerations other than tax implications, what effect, giving detailed reasons, would this decision have on the financial and operational plans of NP?

A. Under the scenario proposed (the “Tax Settlement Scenario”), Newfoundland Power would recognize \$8,087,000 of the accrued revenue for regulatory purposes in 2006.

Attachment A provides the Company’s forecast 2006 financial results comparing proposals contained in the 2006 Accounting Policy Application to the Tax Settlement Scenario suggested in this Request for Information.

The comparative impacts are summarized in Table 1.

Table 1
Forecast 2006 Impacts
Newfoundland Power Proposal vs. Tax Settlement Scenario

	Newfoundland Power Proposal	Tax Settlement Scenario
Rate of Return on Rate Base	8.56%	8.37%
Regulated Rate of Return on Book Equity	9.24%	8.80%

Under the Tax Settlement Scenario, the Company’s forecast 2006 rates of return are (i) lower than calculated under the Newfoundland Power proposal and (ii) below currently recognized just and reasonable rates of return.¹ As a result, the Tax Settlement Scenario would not provide the opportunity for Newfoundland Power to earn a just and reasonable return on rate base in 2006.

The Tax Settlement Scenario could result in Newfoundland Power accelerating its planned 2007 general rate application (“GRA”) in order to address a forecast 2006 revenue shortfall in 2006. Practically, this might result in Newfoundland Power requesting a rate increase to be implemented in the fall of 2006 to recover the additional revenue necessary to earn a just and reasonable return in 2006. It is uncertain whether a GRA process to implement revised rates in 2006 is feasible. Accordingly, the Tax Settlement Scenario would tend to create uncertainty in 2006 with respect to both (i) Newfoundland Power’s financial and operational plans and (ii) customer rates.

¹ The approved rate of return on rate base is currently 8.68%, in a range of 8.50% – 8.86%. The 8.68% rate of return on rate base is based upon a rate of return on common equity of 9.24%.

Newfoundland Power Inc.

2006 Forecast

**Newfoundland Power Proposal vs. Tax Settlement Scenario
(000s)**

	Newfoundland Power Proposal¹	Tax Settlement Scenario²
1		
2		
3	Billed Revenue	\$ 417,069
4	2006 Unbilled Revenue Accrual	457
5	2005 Unbilled Revenue Accrual	9,579
6		427,105
7	Purchased Power Expense	265,498
8	Contribution	161,607
9		
10	Other Revenue	9,950
11		
12	Other Expenses:	
13	Operating Expenses	54,153
14	Depreciation	39,079
15	Finance Charges	32,637
16		125,869
17		
18	Income Before Income Taxes	45,688
19	Income Taxes ⁴	15,335
20		
21	Net Income	30,353
22	Preferred Dividends	591
23		
24	Earnings Applicable	
25	to Common Shares	\$ 29,762
26		
27		
28	Rate of Return Metrics	
29		
30	Regulated Rate of Return on Book Equity	9.24%
31	Rate of Return on Rate Base ⁵	8.56%

¹ See Exhibit NP-14, Page 1 of 5.

² Assumes recognition of revenue for regulatory purposes based on the accrual method and all consequential matters as detailed in the 2006 Accounting Policy Application adjusted to reflect the Board's request for information.

³ See Exhibit NP-3, Page 8.

⁴ Income tax expense on the 2005 Unbilled Revenue is determined by the tax settlement. It is therefore unaffected by the amount of 2005 Unbilled Revenue that is recognized for regulatory purposes.

⁵ In Order No. P.U. 50 (2004), Newfoundland Power's rate of return on rate base, used to set customer rates for 2005, was approved at 8.68% in a range of 8.50% to 8.86%.