

Section 1: Introduction

SECTION 1: INTRODUCTION

1.1 APPLICATION BACKGROUND

The business of Newfoundland Power (the "Company") is principally electricity delivery and customer service. Both the Company's electricity system and the market it serves are relatively mature.

Table 1-1 shows the number of customers served by Newfoundland Power and the annual weather adjusted sales of the Company for the period 2007 through 2009F.

**Table 1-1
Customers and Sales: 2007 to 2009F**

	2007	2008	2009F
Number of Customers	232,262	235,778	238,901
Annual Sales (GWh)	5,093	5,208	5,303

From 2007 through 2009F, the number of customers served by Newfoundland Power is increasing by an average of 1.4% per year and annual weather adjusted sales are increasing by an average of 2% per year. Currently, the price of the electricity Newfoundland Power delivers to its customers is approximately 5.9% higher than it was at the end of 2006.¹

Newfoundland Power's primary source of electricity supply is Newfoundland and Labrador Hydro ("Hydro") which generates approximately 93% of the electricity Newfoundland Power delivers to its customers.

¹ For 2007, a 2.8% decrease in Newfoundland Power's customer rates was the combined result of a reduction due to operation of the automatic adjustment formula and an increase as a result of a Hydro General Rate Application. For 2008, an 8.9% increase in Newfoundland Power's customer rates was the combined result of increases resulting from a Newfoundland Power General Rate Application and the operation of rate stabilization mechanisms. Current customer rates do not reflect an expected 6.6% decrease in customer rates on July 1st 2009 as a result of rate stabilization mechanisms.

1 Electrical service delivery for Newfoundland Power is evolving. There are a number of
2 influences contributing to this. One is the changing expectations of Newfoundland Power's
3 customers. Another is the mix of costs required to maintain least cost reliable service. A third
4 influence is Newfoundland Power's workforce demographics. These influences are reflected in
5 an increased focus on customer energy conservation programs and services; reduced levels of
6 capital expenditure targeted at plant replacement and increased levels of capital expenditure to
7 serve increased customer energy requirements; and a larger forecast workforce in the short term
8 to ensure the continuity of the necessary skills required to serve customers over the long term.
9 These influences affect the cost of the service Newfoundland Power provides to its customers.
10
11 Market conditions also influence the cost of the service Newfoundland Power provides to its
12 customers. Financial market conditions affect the cost of the capital required by Newfoundland
13 Power to fund the investment necessary for least cost reliable customer service. Financial
14 market conditions also affect Newfoundland Power's costs directly, as in the case of the
15 Company's pension costs. Commodity and foreign exchange market conditions determine the
16 cost of No. 6 fuel used at Hydro's Holyrood thermal generating station ("Holyrood") which is
17 the primary source of variability in Newfoundland Power's electricity supply costs.
18
19 Developments in accounting standards have the potential to materially impact Newfoundland
20 Power's financial reporting. Important aspects of the proposed adoption of International
21 Financial Reporting Standards ("IFRS") in 2011 by rate-regulated enterprises such as
22 Newfoundland Power are unlikely to be settled prior to June 2010. Changes in accounting
23 standards may not affect Newfoundland Power's cost of providing service to customers in a

1 direct way. However, the uncertainty surrounding the future treatment of regulatory assets and
2 liabilities under IFRS has regulatory implications.

3
4 Since 2007, Newfoundland Power has experienced material changes in its costs. Aggregate
5 capital expenditure at year end 2010 is now forecast to be approximately \$35 million higher than
6 was expected in 2007. For 2010, both conservation and pension costs are expected to materially
7 increase. While current short-term debt costs are at historic lows, the cost of long-term debt has
8 increased. These specific cost changes are integral to this Application.

10 **1.2 THE APPLICATION**

11 **1.2.1 2010 Revenue Requirements**

12 In this Application, Newfoundland Power is requesting an average increase in current customer
13 rates of approximately 6.1% in 2010. This increase results from four primary changes in
14 Newfoundland Power's 2010 cost of service.

15
16 In order to sustain Newfoundland Power's financial integrity in current market conditions, the
17 Company is targeting a 2010 return on equity of 11%. The return on equity currently reflected in
18 customer rates is 8.95%. An approximate 2% increase in current customer rates is required to
19 change the Company's 2010 return on rate base to reflect a return on common equity of 11% as
20 opposed to 8.95%.

1 Increases in 2010 operating costs account for an approximate 1.3% increase in current customer
2 rates for 2010. The majority of the forecast 2010 operating cost increase relates to two specific
3 items. One is increased pension expense. In 2010, Newfoundland Power's pension expense is
4 forecast to increase to a level comparable to 2007. The second is increased costs associated with
5 higher levels of customer energy conservation programming. In 2010, Newfoundland Power's
6 conservation costs are forecast to increase by over \$2 million compared to 2007.

7
8 Newfoundland Power is filing a 2010 test year in this Application. This requires forecast
9 electricity supply costs to be balanced with forecast revenue from rates for 2010. Absent the
10 filing of this Application, electricity supply cost increases in 2010 would have been recovered
11 through the existing energy supply cost variance mechanism in 2011. The effect of balancing
12 2010 test year supply costs with revenue from rates accounts for an approximate 1.1% increase
13 in current customer rates for 2010.

14
15 In this Application, Newfoundland Power proposes to commence recognizing other post
16 employment benefits on an accrual basis in 2010. This will result in Newfoundland Power's
17 accounting practice being consistent with current Canadian public utility practice. Implementing
18 this accounting change in 2010 accounts for an approximate 1% increase in current customer
19 rates for 2010.

20
21 In addition to these four primary changes, other factors affect the proposed 2010 revenue
22 requirements contained in this Application. These include proposed amortizations of application

1 process costs and 2009 conservation costs. They also include increased finance and depreciation
2 costs associated with rate base growth.

3

4 **1.2.2 Other Proposals**

5 The Company is proposing that Domestic customers receive an increase approximately 0.7%
6 higher than the average increase in rates of 6.1%. Most General Service customers are proposed
7 to receive an increase 1% to 2% below the average increase in rates of 6.1%. These proposals
8 will ensure greater fairness in recovery of Newfoundland Power's cost of service by customer
9 class.

10

11 In response to the current volatility in financial markets, this Application also proposes
12 discontinuing use of the automatic adjustment formula, and changes in annual pension expense
13 recovery.

14

15 Finally, Newfoundland Power proposes to complete its next depreciation study one year earlier
16 than required by Order No. P.U. 32 (2007). This is to facilitate the Company's adoption of IFRS
17 in 2011. It is proposed that the next depreciation study relate to plant in service as at
18 December 31, 2009.

SECTION 2: CUSTOMER OPERATIONS**2.1 OVERVIEW**

Current least cost customer service delivery for Newfoundland Power reflects the expectations of customers, the condition of the electrical system and workforce requirements.

Customer energy conservation programming is becoming a more prominent component of Newfoundland Power's service. This is responsive to current customer expectations and electrical system economics.

Reduced levels of capital expenditure to replace electrical system assets are expected. This reflects the current condition of the electrical system. However, increased capital expenditure to serve customers' increasing electricity requirements is expected.

Recruitment and training of the workforce necessary to ensure long term fulfilment of Newfoundland Power's customer service obligations is increasing the cost of service delivery to customers. This is necessary to address current workforce demographics.

2.2 SERVING CUSTOMERS

Customers' satisfaction with Newfoundland Power's service is consistent with recent experience.

This section of evidence outlines how Newfoundland Power responds to evolving customer expectations.