NEWFOUNDLAND POWER
A FORTIS COMPANY

Newfoundland Power Inc.

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DELIVERED BY HAND

November 6, 2009

Board of Commissioners
of Public Utilities
P.O. Box 21040
120 Torbay Road
St. John's, NL A1A 5B2

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

Ladies and Gentlemen:

Re: 2010 General Rate Application

Enclosed are the original and ten copies of Newfoundland Power's Written Submissions.

A copy of this letter, together with a copy of the enclosure, has been forwarded directly to Geoffrey Young, Newfoundland & Labrador Hydro and Thomas Johnson, Consumer Advocate.

Respectfully submitted,

Peter Alteen
Vice President, Regulatory Affairs
& General Counsel

Enclosures

c. Geoffrey Young (3 copies)
Newfoundland and Labrador Hydro

Thomas Johnson (2 copies)
Consumer Advocate

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A. DEFINED TERMS

Term	**Reference**
Aboud Evidence	Pre-filed Evidence of Karl Aboud, Newfoundland Power Inc. Executive Compensation Review, September 21, 2009, Volume 2, Tab 11, of Supporting Materials of Newfoundland Power filed September 21, 2009.
Amended Application	Newfoundland Power's Amended Application to the Board of Commissioners of Public Utilities, September 28, 2009.
Amended Evidence	Newfoundland Power's Amended Evidence to the Board of Commissioners of Public Utilities, September 28, 2009.
ARBM	Asset Rate Base Method.
Board	Newfoundland and Labrador Board of Commissioners of Public Utilities.
Booth Evidence	Pre-filed Evidence of Laurence D. Booth, Fair Return for Newfoundland Power, August 2009.
Cicchetti Evidence	Pre-filed Evidence of Mark A. Cicchetti, Report on Capital Structure and Fair Return on Equity, August 2009.
Cost of Service Study	Newfoundland Power's Cost of Service Study, May 2009, Volume 2, Tab 7 of Supporting Materials of Newfoundland Power filed May 28, 2009.
Customer, Energy and Demand Forecast	Newfoundland Power's Customer, Energy and Demand Forecast (1st Revision), September 2009, Volume 2, Tab 6 of Supporting Materials of Newfoundland Power filed September 28, 2009.
DBRS	Dominion Bond Rating Service.
Depreciation Study	Gannett Fleming Inc. Depreciation Study, Calculated Annual Depreciation Accruals Related to Electric Plant at December 31, 2005.

Term	**Reference**
DMI Report	Newfoundland Power's Report on Demand Management Incentive Account, May 2009, Volume 2, Tab 8 of Supporting Materials of Newfoundland Power filed May 28, 2009.
Electrical Power Control Act, 1994	Electrical Power Control Act, 1994, SNL 1994, c.E-5.1.
ESCV Report	Newfoundland Power's Report on Energy Supply Cost Variance, May 2009, Volume 2, Tab 9 of Supporting Materials of Newfoundland Power filed May 28, 2009.
Formula	The Automatic Adjustment Formula
FTEs	The workforce expressed on a full-time equivalent basis.
GAAP	Generally Accepted Accounting Principles.
Grant Thornton 1st Report	Grant Thornton Report, July 31, 2009.
Grant Thornton 2nd Report	Grant Thornton Supplementary Report, October 8, 2009.
Hydro	Newfoundland and Labrador Hydro.
Labour Forecast Report	Newfoundland Power's Report on Labour Forecast 2009-2010, May 2009, Volume 2, Tab 1 of Supporting Materials of Newfoundland Power filed May 28, 2009.
McShane Evidence	Pre-filed Evidence of Kathleen McShane, Opinion on Capital Structure and Fair Return on Equity, May 2009, Volume 2, Tab 10, of Supporting Materials of Newfoundland Power filed May 28, 2009.
Moody's	Moody's Investors Service.
NEB	National Energy Board
OPEBs	Other Post Employee Benefits

Term	**Reference**
OPEBs Valuation	Newfoundland Power's Actuarial Valuation of OPEBs at December 31, 2008, Volume 2, Tab 5 of Supporting Materials of Newfoundland Power filed May 28, 2009.
OPEBs Report	Newfoundland Power's Report on Other Post Employment Benefits (1st Revision) at September 2009, Volume 2, Tab 4 of Supporting Materials of Newfoundland Power filed September 28, 2009.
Original Application	Newfoundland Power's Original Application to the Board of Commissioners of Public Utilities May 28, 2009.
Original Evidence	Prefiled Evidence of Newfoundland Power, May 28, 2009.
Pension Valuation	Newfoundland Power's Report on the Actuarial Valuation for Funding Purposes as at December 31, 2008, Volume 2, Tab 3 of Supporting Materials of Newfoundland Power filed May 28, 2009.
Public Utilities Act	Public Utilities Act, RSNL 1990, c. P-47.
Rate Base Allowances Report	Newfoundland Power's Report on 2010 Rate Base Allowances, May, 2009, Volume 2, Tab 2 of Supporting Materials of Newfoundland Power filed May 28, 2009.
Rate Design Report	Newfoundland Power's Rate Design Report, filed with the Board in January 2009.
SAIDI	System Average Interruption Duration Index..
SAIFI	System Average Interruption Frequency Index.
Settlement Agreement	Settlement Agreement with effective date of September 23, 2009 relating to the Original Application and filed as Consent #1.
Stated Case	Supreme Court of Newfoundland and Labrador, Court of Appeal, 1996 No. 141, Stated Case re Section 101 of the Public Utilities Act.

Term	**Reference**
Todd Evidence	Pre-filed Evidence of John D. Todd, Newfoundland Power 2010 General Rate Application, August 21, 2009.

B. RESPONSES TO REQUEST FOR INFORMATION

Responses to Requests for Information are simply referred to by the number of the Request for Information. For example, the Response to Request for Information CA-NP-1 would be referred to as CA-NP-1.

C. ORAL TESTIMONY

References to oral testimony are referred to by the name of the witness, the date of the testimony, and the transcript page and line numbers. For example a reference to oral evidence of Ms. Jocelyn Perry would be referred to as Ms. Perry, Transcript, October 19, 2009, Page •, Line •.

D. CONSENTS, EXHIBITS, UNDERTAKINGS AND INFORMATION ITEMS

References to undertakings are referred to as “U” and their number. For example, undertaking 1 would be referred to as U-1.

References to consents are referred to as “Consent #” and their number. For example, Consent #1.

References to exhibits are referred to as “Exhibit” and their number. For example, Exhibit 1.

References to information items are referred to as “Information #” and their number. For example, Information #1.

A. INTRODUCTION

A.1 Background

This volume contains the written submissions of Newfoundland Power Inc. ("Newfoundland Power" or the "Company") in support of its Amended Application to establish 2010 customer rates.

On May 28, 2009, Newfoundland Power filed its Original Application to establish 2010 customer rates.

Following due notice of the Original Application, the Board issued Order No. P.U. 24 (2009) on June 17, 2009, which set out the schedule of dates and procedures for the hearing of the Original Application. This Order established a detailed schedule providing for: review of the Original Application by Grant Thornton, the Board's financial consultants; written interrogation of the Original Application by intervenors; filing of evidence by intervenors; Board facilitated negotiations; and a public hearing, all in accordance with established Board practice.

As a result of Board facilitated negotiations, a Settlement Agreement with respect to certain matters raised in the Original Application was reached on September 23, 2009, between Newfoundland Power and the Consumer Advocate.

The Amended Application, filed on September 28, 2009, reflected material changes to Newfoundland Power's forecast of 2010 costs and sales which occurred over the four-month period between filing of the Original Application and the Amended Application. The effects of the Settlement Agreement are also fully reflected in the Amended Application.

A.2 Evidentiary Matters

The Board is legally required to determine issues on the basis of the evidence before it.

Both the Original Application and the Amended Application have been reviewed by Grant Thornton. In addition, the Company has responded to comprehensive written interrogation by the Consumer Advocate and Board staff. Neither of these processes has raised any material issue regarding the reasonable accuracy of the financial or operational data placed before the Board by the Company. Accordingly, the procedural history of the Amended Application has provided an evidentiary record concerning Company operations and finance which can be relied upon by the Board.

The Settlement Agreement resulted in agreement on a number of proposals in the Original Application and reduced the length of the hearing of the Amended Application from what it would otherwise have been. It is Newfoundland Power's submission that certain matters agreed in the Settlement Agreement require approval of the Board. The Company is mindful that the Board requires evidence as the basis for its decision making, and accordingly, these written submissions specifically address the evidence supporting the matters agreed upon which require Board approval.

A number of issues arising from the Amended Application were not resolved in the Settlement Agreement. These issues were the primary subject matter of the public hearing into the Amended Application which took place from October 14 through October 27, 2009. All of these issues are addressed in these submissions.

B. OVERVIEW

B.1 Regulatory Policy Framework

The legislative and regulatory policy framework within which the Board must make decisions requires the balancing of the interests of the utility and the consumers of the service it provides.

The Public Utilities Act

The *Public Utilities Act* defines the Board's powers in the regulation of Newfoundland Power. In addition, the *Public Utilities Act* sets out the obligations and rights of Newfoundland Power as a public utility providing a regulated service.

The *Public Utilities Act* provides for the Board's general supervision of Newfoundland Power's utility operations (s. 16) and, amongst other things, requires the Board to specifically approve rates (s. 70), capital expenditures (s. 41) and the issue of securities (s. 91) of Newfoundland Power.

Newfoundland Power has an obligation under the *Public Utilities Act* to provide service to all who require it (s. 54) and to ensure that its service and facilities are reasonably safe and adequate (s. 37). This obligation, commonly referred to as the "obligation to serve", necessarily requires investment in the systems that provide that service.

Section 80 of the *Public Utilities Act* entitles Newfoundland Power to earn annually a just and reasonable return on its rate base in addition to recovering its reasonable and prudent operating expenses.

The entitlement of a utility to earn a just and reasonable return has been described by the Newfoundland and Labrador Court of Appeal as follows:

> "[23] This statutory entitlement of the utility to earn a "just and reasonable" return is the linguistic touchstone for the balancing exercise. This phrase emphasizes the fairness aspect, both to the utility, in earning sufficient revenues to make its continued investment worthwhile and to maintain its credit rating in financial markets, and to the consumer, in obtaining adequate service at reasonable rates. It also emphasizes the need for tempering of each group's economic imperative by consideration of the interests of the other.
>
> [24] Having said that, the entitlement of the utility to a fair return on its investment is always regarded as of fundamental importance…"

Reference: *Stated Case, Page 16, paragraphs 23 and 24*.

Provincial Power Policy

The *Electrical Power Control Act, 1994* sets out the electrical power policy of the province.

The electrical power policy of the province deals specifically with rates [s. 3(a)] and management of utility resources [s. 3(b)].

The electrical power policy requires rates to: (1) be reasonable and not unjustly discriminatory; (2) be based on forecast costs for supply for one or more years; and (3) enable the producer or retailer to earn a just and reasonable return under the *Public Utilities Act* so that it is able to achieve and maintain a sound credit rating in the financial markets of the world.

The electrical power policy requires all sources and facilities to be managed and operated in a manner that results in: (1) the most efficient production, transmission and distribution of power; (2) equitable access to an adequate supply of power for all consumers in the province; and (3) delivery of power to consumers at the lowest possible cost consistent with reliable service.

All aspects of the electrical power policy are imperative and apply in a general and continuing manner to all utilities, including Newfoundland Power.

The Regulatory Balance

The issue of cost efficient management and operations and the issue of the fair return have a degree of interrelation. In a capital intensive enterprise with long-life assets such as a public utility, the cost of capital will have a significant impact on rates and whether they are least-cost over the long term. Simply put, least-cost customer rates require both: (1) cost efficient management and operations; and (2) continued financial integrity of the utility.

The balance contained in the regulatory policy framework in this Province has been appropriately recognized by the Board on a number of occasions including in Order No. P.U. 19 (2003), where the Board observed:

> "The real challenge for the Board, in keeping with its legislative mandate, is to balance oftimes competing objectives within the regulatory environment to ensure a set of sound and reasoned decisions serving the interests of both customer and utility alike."

Reference*: Order No. P.U. 19 (2003), Page 16 to 17.*

A means of achieving the balance required by the regulatory policy framework is through negotiated resolution of issues. The Board has indicated that the negotiated settlement process provides an opportunity to improve regulatory efficiencies.

Impact on Written Submissions

In the Amended Application, it is Newfoundland Power's submission that the issues concerning cost efficient management and operations that must be resolved by the Board are relatively limited in scope and number.

For example, at the hearing of the Amended Application, it was the evidence of Mr. Ludlow that:

> "Newfoundland Power is first and foremost an electricity, delivery, and service company. The market we serve is mature, with annual growth in customers and sales of 1 to 2 percent. The company's primary focus is serving our customers, and over the past few years electricity service to customers has been reliable. The price of that service has been reasonably stable, and customer's overall level of satisfaction with Newfoundland Power's service has remained consistent in the 88 to 89 percent range. It's my assessment that current service levels to our customers are reasonably satisfactory."

Reference: *Mr. Ludlow, Transcript, October 14, 2009, Page 35, Line 13 to Page 36, Line 5.*

This evidence, like much of the Company evidence in support of the Amended Application, was not challenged during the course of this proceeding. For this reason, these written submissions will not address in detail matters such as current service levels to customers.

B.2 Background to the Application

There have been material changes in Newfoundland Power's financial outlook since 2007. A forecast combination of increased costs and decreased revenues indicate that Newfoundland Power will not have a reasonable opportunity to earn a just and reasonable return in 2010.

Changes in financial market conditions are a substantial contributor to this forecast and indicate that a re-examination of Newfoundland Power's cost of capital is timely.

Order No. P.U. 32 (2007) required Newfoundland Power to file a general rate application no later than June 30, 2010, seeking 2011 rates, but it contemplated the possibility of an earlier application.

Reference: *Order No. P.U. 32 (2007), Pages 53-54.*

Since the Board issued Order No. P.U. 32 (2007) following Newfoundland Power's 2008 general rate application, Newfoundland Power has experienced material changes in its circumstances. Due to a combination of evolving service requirements of customers, changes in the mix of costs required to maintain reliable service, and the demographics of the Company's workforce, the cost of providing service is rising. Increased volatility experienced in the financial markets in 2008 has also contributed to cost increases. The current forecast of pension expense for 2010 of $8.2 million, as compared to a forecast for 2009 of $2.7 million, is one prominent example of this.

Reference: *Amended Evidence, Page 3-23, Lines 10-11; Mr. Ludlow, Transcript, October 14, 2009, Page 40, Line 16 to Page 41, Line 7.*

Financial market conditions are also affecting the Company's forecast revenues. As a result of changes in long Canada bond yields, the operation of the Formula would result in a reduction in revenue in 2010.

Reference: *Mr. Ludlow, Transcript, October 14, 2009, Page 41, Line 16 to Page 42, Line 5.*

Due to the combination of increased costs and decreased revenues, Newfoundland Power's regulated return on equity for 2010 is forecast to decline to 6.45% under existing rates. For 2010, Newfoundland Power forecasts deterioration of its credit metrics as a result of this decline. The financial forecast for 2010 under existing rates is not consistent with the maintenance of Newfoundland Power's financial integrity. Newfoundland Power filed the Original Application to ensure it had a reasonable opportunity to earn a just and reasonable return on its rate base in 2010.

Reference: *Exhibit 3 (1st Revision), Page 1, Lines 35-40; Amended Evidence, Page 3-1, Lines 8-11 and Page 3-2, Lines 8-18; Mr. Ludlow, Transcript, October 14, 2009, Page 40, Line 16 to Page 42, Line 5.*

Newfoundland Power does not expect that the customer rates set as a result of this Application will be in effect beyond 2010, but this is a possibility. Newfoundland Power provided a 5-year financial forecast which indicates material revenue shortfalls in each year from 2011 through 2013. What action, if any, Newfoundland Power will be required to take to address revenue shortfalls which may actually materialize beyond 2010 is currently uncertain.

Reference: *CA-NP-43 (1st Revision), Attachment A, Page 1, Line 43; Ms. Perry, Transcript, October 19, 2009, Page 109, Line 7 to Page 110, Line 21; PUB-NP-12.*

Current financial market conditions are materially different than those existing in 2007. Yields on long Canada bonds have declined while the credit spread on Newfoundland Power's First Mortgage Bonds has increased. But the Formula, which forecasts the cost of equity based upon long Canada bond yields, indicates Newfoundland Power's cost of equity has decreased. These dynamics indicate that a re-examination of Newfoundland Power's cost of capital is timely. Similar re-examinations of utilities' cost of capital are occurring across the country. Newfoundland Power's 2010 cost of capital is the central unsettled issue in the Amended Application.

Reference: Amended Evidence, Page 3-13, Lines 4-9; McShane Evidence, Page 15, Footnote *10; Ms. McShane, Transcript, October 20, 2009, Page 9, Line 21 to Page 10, Line 19; Dr. Booth, Transcript, October 22, 2009, Page 47, Line 3 to Page 49, Line 25; PUB-NP-13.*

That the Formula forecasts a decreasing cost of equity for Newfoundland Power in current financial market conditions raises questions concerning its continued use. The possibility that changes in financial market conditions could suggest that the Formula would not accurately reflect the appropriate return on equity for Newfoundland Power was recognized at the time the Formula was adopted. The continued use of the Formula is a prominent unsettled issue in the Amended Application.

Reference: *McShane Evidence, Page 11, Lines 268-278, and Page 12, Lines 304-308; Cicchetti Evidence, Page 26, Line 552 to Page 27, Line 568; and Order No. P.U. 16 (1998-99) Pages 104 to 105.*

In 2007, consideration of Newfoundland Power's adoption of accrual accounting for OPEBs was deferred to its next general rate application due to recent significant increases in the consumer price of electricity. Accrual accounting for OPEBs is mainstream regulatory practice in Canada. In the Amended Application, Newfoundland Power proposes adopting accrual accounting for OPEBs in 2010. Newfoundland Power's accounting treatment for OPEBs is another prominent unsettled issue in the Amended Application.

Reference: *Amended Evidence, Page 3-28, Footnote 86; Ms. Perry, Transcript, October 14, 2009, Page* 59*, Line 20 to Page 61, Line 3.*

C. COST OF CAPITAL

C.1 Current Context

Since 2007, there have been material changes in financial market conditions. This is essentially undisputed in the evidence before the Board. These changes have implications for cost of capital generally, including the cost of capital for regulated utilities.

This has, in part, resulted in a broad regulatory re-examination of how utilities' cost of capital is established across Canada. Since the mid-1990s, many Canadian regulators, including this Board, have used formulas to forecast utilities' cost of equity. These formulas have been based upon the equity risk premium methodology.

In 2009, several Canadian public utility regulators will consider the cost of capital for regulated utilities. These considerations will include both the tests used to determine utilities' cost of capital, and the continued appropriateness of the use of equity risk premium-based automatic adjustment formulas to determine forecast cost of equity for regulated utilities.

Already, the NEB has determined that use of its automatic adjustment formula will be discontinued. The response of other Canadian public utility regulators is outstanding, and therefore uncertain.

These developments are vital components of the context for the Board's consideration of Newfoundland Power's Amended Application, and in particular, the Company's 2010 required return on equity and proposed discontinuance of use of the Formula.

C.2 Business Risk and Market Conditions

Both business risk and financial market conditions affect the Company's cost of capital.

Newfoundland Power's business risk has not materially changed since the last time its cost of capital was reviewed. The Company remains an average, or typical, low risk Canadian utility.

Financial market conditions have materially changed since the last time Newfoundland Power's cost of capital was reviewed. This is indicated by increases in the credit spreads between the Company's bonds and long Canada bonds. The outlook for financial market conditions is characterized by uncertainty.

C.2.1 Business Risk

In Order No. P.U. 19 (2003), the Board found that Newfoundland Power is of average business risk compared to other utilities.

Reference: *Order No. P.U. 19 (2003), Page 33.*

The evidence in this proceeding is consistent with this finding. Ms. McShane's evidence was that, at its forecast capital structure, Newfoundland Power would be viewed by investors as an average risk utility relative to its Canadian peers. Dr. Booth concluded that Newfoundland Power is a typical low-risk Canadian utility. Mr. Cicchetti concluded that Newfoundland Power was a low-risk, regulated, transmission and distribution utility, operating in a low-risk market under supportive regulation.

Reference: *McShane Evidence, Page 39, Lines 976-977; Booth Evidence, Appendix H, Page 23, Line 17; Cicchetti Evidence, Page 15, Lines 324-326.*

This assessment is broadly borne out by Newfoundland Power's credit ratings. Both DBRS and Moody's maintain stable ratings on the Company and regard its relatively strong capital structure and supportive regulatory environment as credit strengths.

Reference: *Exhibit 4 (1st Revision).*

No witness indicated a material change in the *relative* riskiness of Newfoundland Power. Dr. Booth indicated that he regarded business risk analysis to be of marginal importance in this proceeding.

Reference: *McShane Evidence, Page 33, Lines 841-842 and Page 39, Lines 957-959; Booth Evidence, Page 3, Lines 42-43.*

Dr. Booth gave evidence that he viewed Canadian utilities generally as having an absence of risk because they have earned their allowed returns on equity. Dr. Booth's evidence was that utilities across Canada typically exceed allowed returns on equity by 50 to 100 basis points.

Reference: *Dr. Booth, Transcript, October 22, 2009, Page 94, Line 7 to Page 98, Line 12.*

For Newfoundland Power, however, this general observation of achieved returns on equity exceeding allowed returns on equity appears overstated. Dr. Booth indicated that, since 1990, the Company exceeded its allowed return on equity by an average of 21 basis points. This is consistent with the Company's experience in the 5 years ending in 2008. In 2009, Newfoundland Power is forecasting a return on equity of 8.62%, or 33 basis points *below* the return on equity allowed in customer rates.

Reference: *For returns since 1990, see Booth Evidence, Appendix H, Page 16, Lines 14-15; CA-NP-28, Attachment A; and for forecast 2009 return on equity, see Exhibit 3 (1st Revision), Page 1, Line 36.*

Newfoundland Power *typically* achieving returns on equity which exceed allowed returns by 50 to 100 basis points is highly improbable given the current regulatory mechanisms and reporting requirements for the Company. Newfoundland Power is subject to excess earnings regulation which requires that the Company credit to an Excess Earnings Account all earnings in excess of the upper limit of the allowed return on rate base as approved by the Board. This limit is currently 18 basis points above the allowed return on rate base used for ratemaking purposes, or approximately $2.3 million before tax in 2010. In addition, the Board requires that in any year where the actual rate of return on regulated equity exceeds that determined by the Formula by more than 50 basis points, the Company must file a report setting out the circumstances contributing to the difference. This permits the Board to make an assessment of the most appropriate course of action, which may include calling a hearing on the cost of capital.

Reference: *See CA-NP-55, Attachment A, for the definition of the Excess Earnings Account; see Amended Evidence, Page 3-27, Footnote 77, for the range of return on rate base for 2010; see Order No. P.U. 19 (2003), Pages 68 to 69 for reporting requirements when returns on equity exceed expectation by more than 50 basis points.*

C.2.2 Market Conditions

The global financial crisis, which commenced in late 2008, has had substantial impacts on financial markets. These impacts have included increased market volatility, declining yields on government bonds and increasing credit spreads on corporate bonds.

Reference: *McShane Evidence, Page 12, Line 310 to Page 13, Line 329; Booth Evidence, Page 2, Lines 8-18; and Cicchetti Evidence, Page 11, Lines 245-248.*

Newfoundland Power has been affected by these changes in financial markets. In May 2009, the Company issued First Mortgage Bonds at a 6.61% interest rate. This rate was based upon a 275 basis point, or 2.75%, credit spread over prevailing long Canada bond yields at the time of issue. By comparison, in 2007 and 2005, the Company issued First Mortgage Bonds at credit spreads of 1.4% and 1.06%, respectively.

Reference: *Amended Evidence, Page 3-13, Lines 4-9.*

Financial market conditions have improved somewhat since earlier in 2009.

Reference: *Ms. McShane, Transcript, October 20, 2009, Page 7, Line 22 to Page 8, Line 17; Booth Evidence, Page 2, Lines 24-30; Ms. Perry, Transcript, October 19, 2009, Page 108, Lines 3-4.*

On October 2, 2009, the indicative credit spread for Newfoundland Power's First Mortgage Bonds was 187 basis points, or 1.87%. Because Newfoundland Power's First Mortgage Bonds are normally bought by life insurance companies and pension funds and not often traded, an indicative yield does not reflect an actual transaction.

Dr. Booth's evidence was that current credit spreads are on the order of 50 to 75 basis points higher than where they were in 2007.

Reference: *U-1; Dr. Booth, Transcript, October 22, 2009, Page 30, Line 22 to Page 39, Line 16.*

Both Ms. McShane's and Mr. Cicchetti's evidence was that the market conditions which have indicated increased corporate debt yields and falling stock prices (and higher dividend yields) have increased utilities' cost of capital.

Reference: *McShane Evidence, Page 11, Lines 268-276; Cicchetti Evidence, Page 11, Lines 245-248.*

There is substantial evidence of uncertainty in forecasts of financial market conditions into 2010. Ms. McShane described the current economic recovery as fragile. Mr. Cicchetti indicated that there are a lot of things that could potentially go wrong. Ms. Perry expressed concerns about the true economic activity which will exist following reductions in government spending.

Reference: *Ms. McShane, Transcript, October 20, 2009, Page 8, Lines 23-25; Mr. Cicchetti, Transcript, October 22, 2009, Page 109, Lines 14-17; Ms. Perry, Transcript, October 19, 2009, Page 163, Line 20 to Page 164, Line 14.*

It was Dr. Booth's evidence that the financial crisis that existed until March 2009 was the largest financial meltdown in 70 years. And that it was caused by significant economic problems in the U.S. spilling over into the global economy.

Reference: *NP-CA-19; Booth Evidence, Page 27, Lines 16-26.*

But Dr. Booth's outlook was materially different from that of the other witnesses. Dr. Booth characterized current market conditions as normal recovery from a recession. And he viewed no likelihood of significant economic problems in the U.S. spilling over into Canada.

Reference: *NP-CA-19; Dr. Booth, Transcript, October 21, 2009, Page 147, Lines 11-13; Transcript, October 22, 2009, Page 86, Line 12 to Page 93, Line 24.*

C.3 Capital Structure

Newfoundland Power proposes maintaining an equity ratio of approximately 45% in its capital structure for rate making purposes.

This is consistent with past Board Orders, maintenance of the Company's creditworthiness, and the expert evidence in this proceeding. It has been agreed that the Board should adopt the proposed capital structure for ratemaking purposes.

In the Amended Application, Newfoundland Power proposes a capital structure for rate making purposes with a 44.69% common equity ratio.

Reference: *Exhibit 11 (1st Revision), Page 6, Line 9.*

Newfoundland Power's target of 45% common equity in its capital structure is consistent with Board orders since 1990.

Reference: *Amended Evidence, Page 3-16, Lines 12-13; Order Nos. P.U. 1 (1990), P.U. 6 (1991), P.U. 7 (1996-97), P.U. 16 (1998-99), P.U. 19 (2003), and P.U. 32 (2007).*

Both DBRS and Moody's indicate that the Company's 45% common equity ratio is a credit strength.

Reference: *Exhibit 4 (1st Revision).*

The cost of capital experts' evidence supports the Board's adoption of this proposed capital structure. Both Ms. McShane and Mr. Cicchetti characterized a common equity ratio of 45% for Newfoundland Power as "reasonable". Dr. Booth observed that

Newfoundland Power's common equity ratio exceeded the Canadian norm for a low risk regulated utility. But, given the stage in the business cycle and the fragility in the markets, he recommended Newfoundland Power maintain its 45% common equity ratio.

Reference: *McShane Evidence, Page 3, Lines 55-59; Cicchetti Evidence, Page 20, Lines 432-434; Booth Evidence, Page 4, Lines 5-8 and Appendix H, Page 20, Lines* 13-18*.*

In the Settlement Agreement, it was agreed that the proposed capital structure should be used for rate making purposes in the Amended Application.

Reference: *Settlement Agreement, Item 27.*

C.4 Fair Return on Equity

There are three expert recommendations before the Board on a fair return on equity for Newfoundland Power for 2010.

The experts use a variety of tests and data sources to arrive at their recommendations. This section of the Company's submission provides general observations concerning the estimation of a fair return and details the bases of each expert witness's recommendation. It concludes with an assessment of the various expert recommendations.

The depth of economic analysis, methodological scope, and breadth of comparative data underpinning Ms. McShane's recommendation qualify it to be given the greatest weight by the Board in its determination of a fair return on equity for Newfoundland Power for 2010.

C.4.1 Summary of Expert Recommendations

Table C-1 summarizes the recommendations and test results of each of the expert witnesses that appeared before the Board on a fair return on equity for Newfoundland Power.

Table C-1
Summary of Expert Recommendations

Expert Witness	**McShane**	**Booth**	**Cicchetti**
Recommended Return on Equity	11.0%	7.75%	9.6%
Test Results:			
Equity Risk Premium	10.25%	7.75%	9.0%
Discounted Cash Flow	11.0% - 11.5%	-	9.6%
Comparable Earnings	11.5% - 11.75%	-	-

A more detailed summary of expert recommendations, test results, and key inputs is set out in Appendix A to this written submission.

C.4.2 General Observations

To be considered fair, Newfoundland Power's return must be: (i) commensurate with return on investments of similar risk; (ii) sufficient to assure financial integrity; and (iii) sufficient to attract necessary capital.

Reference: *Order No. P.U. 19 (2003), Page 15; McShane Evidence, Page 18, Lines 453-463; Cicchetti Evidence, Page 7, Lines 143-155; Booth Evidence, Appendix B.*

The estimation of a fair return on equity for a utility requires forward looking analysis of the investor required return. For this application, the Board must assess and determine the required return on Newfoundland Power's equity for 2010. This approach is consistent with the prospective nature of rate making.

Reference: *McShane Evidence, Appendix A, Page A-3; Dr. Booth, Transcript, October 21, 2009, Page 184, Lines 13-24.*

The cost of equity for Newfoundland Power, like virtually all regulated utilities in Canada, is not directly observable. For this reason, the estimation of the fair return on equity for Newfoundland Power is indirect and necessarily dependent on the use of proxies of relatively similar risk.

Reference: *McShane, Transcript, October 21, 2009, Page 59, Lines 8-25; McShane Evidence, Page 63, Lines 1573-1574; and Cicchetti Evidence, Page 18, Lines 380-383.*

The estimation of the fair return on equity inevitably has subjective qualities. For example, choices in estimation methodologies and data selection will affect analysis results. For this reason, a degree of professional judgment is required in any analysis. In addition, the estimation of a prospective required return is essentially a forecast, with the inherent uncertainties associated with any economic forecast.

Reference: *Cicchetti Evidence, Page 16, Lines 331-337; Dr. Booth, Transcript, October 21, 2009, Page 189, Line 23 to Page 190, Line 4;. Dr. Booth, Transcript, October 21, 2009, Page 184, Lines 13-24.*

The capital asset pricing model is a theoretical, formal model of the equity risk premium test. It essentially provides that an investor requires a return on a security equal to a risk-free rate plus an equity risk premium which compensates the investor for the relative additional risk associated with holding the security. One acknowledged problem associated with application of the capital asset pricing model is the use of realized past returns to estimate a future market risk premium. Another is the difficulties associated with estimating relative risk, or beta.

Reference: *For the basis of the model, see McShane Evidence, Appendix B, Page B-1; for the acknowledged problem of estimating a future market risk premium, see McShane Evidence, Page 41, Lines 1027-1031; Dr. Booth, Transcript, October 21, 2009, Page 190, Lines 6-13; and Mr. Cicchetti, Transcript, October 22, 2009, Page 123, Lines 9-17; for the difficulties associated with estimating beta, see McShane Evidence, Page 50, Lines 1258-1261; Dr, Booth, Transcript, October 22, 2009, Page 21, Line 21 to Page 25, Line 19; and Mr. Cicchetti, Transcript, October 22, 2009, Page 114, Lines 10-16.*

The discounted cash flow approach to estimating an investor required return is based upon the proposition that the price of a security is the present value of future expected cash flows to the investor. It therefore directly estimates the utility's required return on equity. An acknowledged problem associated with the application of discounted cash flow models to estimate utility cost of capital is reliable estimation of expected future cash flows, particularly for utilities which are not publicly traded.

Reference: *For the basis of the model, see McShane Evidence, Page 61, Lines 1544-1545; for the direct nature of estimates, see McShane Evidence, Page 62, Lines 1551-1556; Dr. Booth, Transcript, October 21, 2009, Page 192, Lines 2-13; Mr. Cicchetti, Transcript, October 22, 2009, Page 110, Lines 15-24; for the acknowledged problem, see McShane Evidence, Page 62, Line 1568 to Page 63, Line 1574; Dr. Booth, Transcript, October 22, 2009, Page 70, Line 3 to Page 75, Line 8; Mr. Cicchetti, Transcript, October 22, 2009, Page 118, Line 3 to Page 119, Line 8.*

The comparable earnings test measures the fair return based on the concept of opportunity cost. Specifically, it arises from the notion that capital should not be committed to a venture unless it can earn a return commensurate with that prospectively available in alternative ventures of comparable risk. Acknowledged problems with the application of the comparable earnings test include the determination of comparable investments, the time period over which returns are to be measured in order to estimate prospective returns, and adjustments which may be required to ensure comparability. The comparable earnings test has not been relied upon by Canadian regulators since the adoption of equity risk premium based formulas; however, some regulators have indicated it provides useful information.

Reference: *For the basis of the model, see McShane Evidence, Page 66, Line 1654 to Page 67, Line 1704; for acknowledged problems, see McShane Evidence, Page 67, Line 1706 to Page 68, Line 1715; and for use in Canada, see CA-NP-1 and Ms. McShane, Transcript, October 20, 2009, Page 21, Line 2 to Page 22, Line 1.*

Several of these methodologies require selection of a sample of investments comparable to Newfoundland Power. Each expert witness found that there is insufficient data available to construct a sample of low-risk Canadian regulated utilities. Citing the significant integration between U.S. and Canadian capital markets and similarities between operating and regulatory environments, Ms. McShane and Mr. Cicchetti selected a comparable sample of U.S. utilities for use in their analyses. Dr. Booth used the discounted cash flow method based on a sample of U.S. utilities as a reasonableness check for his recommendation.

Reference: *Ms. McShane, Transcript, October 20, 2009, Page 34, Lines 12-18; McShane Evidence, Page 7, Line 182 to Page 8, Line 185; Cicchetti Evidence, Page 18, Line 385 to Page 19, Line 405; Dr. Booth, Transcript, October 22, 2009, Page 69, Line 19 to Page 74, Line 5.*

The expert evidence of Ms. McShane and Mr. Cicchetti was that the U.S. companies they selected provided a more accurate assessment, from an investor perspective, of the cost of capital for Newfoundland Power than the limited number of publicly traded Canadian utilities.

Reference: *McShane Evidence, Page 22, Line 566 to Page 23, Line 596; Ms McShane, Transcript, October 20, 2009, Page 29, Line 21 to Page 36, Line 2; Cicchetti Evidence, Page 18, Line 385 to Page 19, Line 412.*

In examination in chief, Dr. Booth outlined three reasons why U.S. utility returns on equity cannot be compared to Canadian returns on equity without adjustment. The first reason is, notwithstanding similarities in technology and regulatory philosophy, there are differences in the implementation of utility regulation in the U.S. The second reason was event risk such as occurred with Enron. The final reason was related to macroeconomic differences between the two countries.

Reference: *Dr. Booth, Transcript, October 21, 2009, Page 173, Line 8 to Page 180, Line 2.*

With respect to Dr. Booth's first reason, he also gave evidence that he does not follow U.S. utilities because he doesn't consider them to be relevant.

Reference: *Dr. Booth, Transcript, October 22, 2009, Page 41, Line 14 to Page 42, Line 15.*

With respect to Dr. Booth's second reason, Ms. McShane's evidence was that Enron was "the" example of such an event as described by Dr. Booth and that she would never have considered Enron to be a utility company for the purpose of estimating cost of equity for a utility. In addition, Ms. McShane didn't see that one situation like Enron impacts the way you would view the risk of these companies that have a clear history of regulated operations, not involved in the kinds of businesses that Enron was.

Reference: *Ms. McShane, Transcript, October 21, 2009, Page 62, Line 13 to Page 64, Line 5.*

The NEB considered the matter of U.S. comparisons in its March 2009 decision concerning Trans Quebec and Maritimes Pipeline Inc. and expressed the view that:

> "The Board is not persuaded that the U.S. regulatory system exposes utilities to notable risks of major losses due either to unusual events or cost disallowances. The Board views the losses and disallowances experienced by U.S. regulated entities as a result of the restructuring that took place to terminate the merchant gas function of pipelines, as well as some other circumstances such as the Duquesne nuclear build, to be, to a large extent, unique events. The Board also finds that such instances are not likely to weigh significantly in investors' perceptions today, and would thus have little or no impact on cost of capital."

Reference: CA-NP-201, Attachment A, Page 67.

With respect to Dr. Booth's final reason, Mr. Cicchetti's evidence was that inflation projections for the U.S. and Canada are very similar. In addition, Mr. Cicchetti indicated that long Canada bond yield rates and long U.S. rates are fairly close, with the U.S. rate at about 4.2% and the long Canada bond yield at about 3.95%.

Reference: *Mr. Cicchetti, Transcript, October 22, 2009, Page 230, Line 23 to Page 231, Line 14.*

Detailed comparisons of specific elements of differences between Newfoundland Power and certain U.S. companies used in comparable samples by Ms. McShane and Mr. Cicchetti were undertaken at the hearing. Both Ms. McShane and Mr. Cicchetti indicated that the appropriate perspective on selection of comparable utilities to use in samples was overall *investor* perception of the comparable companies' investment risk profile.

Reference: *Ms. McShane, Transcript, October 20, 2009, Page 103, Lines 9-20; Page 120, Lines 6-20; Page 132, Line 20 to Page 133, Line 5; October 21, 2009, Page 18, Line 20 to Page 20, Line 14; Page 53, Line 5 to Page 55, Line 4; Mr. Cicchetti, Transcript, October 22, 2009, Page 125, Line 18 to Page 126, Line 24; Page 183, Lines 7-10; Page 199, Lines 2-21.*

Dr. Booth's perspective appeared similar. When questioned as to whether he considered the actual risk profile of the utility he analyzed, or looked at the matter more on a global basis, Dr. Booth, in part, responded:

> "So this is –- when I look at utilities, the utilities wanted to get us to look at specific risks, and that's sort of a quagmire, because it's always a little bit specific to Newfoundland Power, things specific to Enbridge Gas, things specific to TransCanada. I look at what the capital markets look at, which is do they earn their allowed ROE."

Reference: *Dr. Booth, Transcript, October 22, 2009, Page 96, Line 21 to Page 97, Line 4.*

It is clear that credit rating agencies compare Canadian utilities with U.S. peers.

Reference: *U-2.*

C.4.3 Ms. McShane

General

Ms. McShane's recommendation for a fair return on equity for Newfoundland Power in 2010 is 11.0%.

Reference: *McShane Evidence, Page 4, Lines 86-88.*

The recommendation is based upon (i) equity risk premium tests, (ii) discounted cash flow tests, and (iii) a comparable earnings test. It was Ms. McShane's evidence that:

> "Each of the tests is based on different premises and brings a different perspective to the fair return on equity. None of the individual tests is, on its own,

> a sufficient means of estimating the fair return; each of the tests has its own strengths and weaknesses. Individually, each of the tests can be characterized as a relatively inexact instrument; no single test can pinpoint the fair return. Moreover, different tests may be more or less reliable depending on prevailing economic and capital market conditions."

Reference: *McShane Evidence, Page 40, Lines 991-999.*

In arriving at her fair return recommendation, Ms. McShane gave primary weight to equity risk premium test results and discounted cash flow test results. Together these test results, which were weighted equally, comprised an overall 75% weighting. The comparable earnings test result was given a weighting of 25%.

Reference: *McShane Evidence, Page 70, Lines 1786-1792; Ms. McShane, Transcript, October 20, 2009, Page 14, Line 10 to Page 16, Line 1.*

Ms. McShane considered bond ratings and credit metrics in arriving at her fair return recommendation.

Reference: McShane Evidence, Page 33, Line 846 to Page 38, Line 947.

Equity Risk Premium Test Results

Ms. McShane performed three equity risk premium tests.

Reference: *McShane Evidence, Page 3, Lines 67-71.*

For the purposes of equity risk premium analysis, Ms. McShane determined a risk-free rate based upon the *Consensus Forecast* of 10-year Canada bonds plus the spread between 10 and 30 year Canada bonds. Ms. McShane arrived at a long-term Canada bond yield forecast for 2010 of 4.25% which was the risk-free rate used in her equity risk premium tests.

Reference: *McShane Evidence, Page 42, Lines 1040-1048.*

For the purposes of equity risk premium analysis, Ms. McShane used a market risk premium of 6.75%. To derive the 6.75% market risk premium, Ms. McShane examined realized rates of return in the Canadian and U.S. markets. She examined the interrelationship between these markets including their increasing level of integration. In her assessment of the market risk premium for this application, Ms. McShane observed that approximately 47% of Canadian portfolio investment in foreign equities at the end of 2007 was in the U.S.

Reference: *McShane Evidence, Page 49, Line 1237 to Page 50, Line 1244; and Page 46, Lines 1141-1142.*

Ms. McShane used a relative risk adjustment, or beta, of 0.65 - 0.70. She derived this by analyzing betas provided by the investment research firm *Bloomberg* for the five major Canadian utilities and by analyzing betas provided by *Value Line* for her sample of comparable low risk U.S. utilities.

Reference: *McShane Evidence, Page 53, Line 1338 to Page 55, Line 1375.*

Both Ms. McShane's market risk premium of 6.75% and beta of 0.65 – 0.70 are substantially similar to those developed by Mr. Cicchetti for his equity risk premium analysis.

Reference: *Mr. Cicchetti, Transcript, October 22, 2009, Page 136, Line 13 to Page 137, Line 1; Cicchetti Evidence, Schedule MAC-8 and Schedule MAC-9; Mr. Cicchetti, Transcript, October 22, 2009, Page 131, Lines 3-7.*

The results of Ms. McShane's three equity risk premium tests indicated an estimated utility cost of equity of 8.75% to 10.5%, or approximately 9.75% before any allowance for financing flexibility. To this, Ms. McShane added an allowance for financing flexibility of 0.50% to obtain an estimate for return on equity of 10.25%.

Reference: *McShane Evidence, Page 61, Lines 1534-1540 and Page 65, Lines 1627-1652.*

Discounted Cash Flow Test Results

Ms. McShane performed two discounted cash flow, or DCF, tests applied to a sample of low risk U.S. electric and gas utilities.

Reference: *McShane Evidence, Page 3, Lines 72-74; Page 62, Lines 1563-1566.*

Ms. McShane's evidence explains why the use of samples is necessary for DCF analysis on a company such as Newfoundland Power, which does not have traded shares. It also explains why the use of U.S. proxies is appropriate due to the limitations of Canadian data. Both Dr. Booth and Mr. Cicchetti also recognized these limitations.

Reference: *McShane Evidence, Page 62, Line 1568 to Page 63, Line 1574; Ms. McShane, Transcript, October 20, 2009, Page 32, Line 10 to Page 33, Line 25; Dr. Booth, Transcript, October 22, 2009, Page 70, Line 3 to Page 74, Line 5; Cicchetti Evidence, Page 18, Lines 385-395; Mr. Cicchetti, Transcript, October 22, 2009, Page 127, Lines 1-14.*

Ms. McShane's sample of utilities of comparable risk to Newfoundland Power is set out in Schedule 15 of her evidence. A summary of key features of the regulatory environments for this sample was also provided by Ms. McShane. Ms. McShane was cross examined concerning specific isolated aspects of these companies' operations in some detail. She was generally knowledgeable about the companies' operations and, more importantly, knowledgeable about how these specific isolated aspects impact overall risk perceptions of equity investors.

Reference: *McShane Evidence, Schedule 15; CA-NP-18, Attachment A; see, for example, Ms. McShane, Transcript, October 20, 2009, Page 103, Lines 9-20; Page 120, Lines 6-20; Page 132, Line 20 to Page 134, Line 1; and October 21, 2009, Page 18, Line 20 to Page 20, Line 14; Page 53, Line 5 to Page 55, Line 4.*

The results of Ms. McShane's discounted cash flow analysis tests indicated a cost of equity of approximately 10.4% and 11% before adjustment for financing flexibility. To this, Ms. McShane added an allowance for financing flexibility of 0.50% to obtain an estimate for a fair return on equity of 11% to 11.5%.

Reference: *McShane Evidence, Page 64, Lines 1603-1615; Page 65, Lines 1627-1652; and Page 70, Table 11.*

Comparable Earnings Test Results

Ms. McShane performed a comparable earnings test based on a sample of low risk unregulated Canadian companies. The reasonableness of the results was corroborated by returns on low-risk unregulated U.S. companies.

Reference: *McShane Evidence, Page 4, Lines 81-84; Page 68, Line 1726 to Page 69, Line 1762.*

Ms. McShane specifically assessed the need for a market to book adjustment to the comparable earnings test results, and concluded that no adjustment was necessary. Mr. Cicchetti's evidence indicated a broad conceptual disagreement with Ms. McShane's assertion that the notion that market to book ratio of utility shares should be approximately 1.0 times is incompatible with the standard of comparable returns. On the issue of market to book adjustments, however, Mr. Cicchetti did not advocate setting utility rates by targeting the market to book ratio.

Reference: F*or the conclusion no adjustment is necessary, see McShane Evidence, Page 69, Line 1764 to Page 70, Line 1776, and Appendix F, Page F-6 to F-10; for Mr. Cicchetti's views, see Cicchetti Evidence, Page 29, Line 615 to Page 30, Line 630; for Ms. McShane's conceptual basis, see McShane Evidence, Appendix A.*

The results of Ms. McShane's comparable earnings tests indicated a cost of equity of approximately 11.5% to 11.75%.

Reference: *McShane Evidence, Page 70, Lines 1776-1777.*

C.4.4 Dr. Booth

General

Dr. Booth's recommendation for a fair return on equity for Newfoundland Power for 2010 is 7.75%.

Reference: *Booth Evidence, Page 3, Lines 36-41.*

The recommendation is based upon two equity risk premium analyses which are, in turn, based upon the capital asset pricing model, or CAPM. It was Dr. Booth's evidence that:

> "Currently, the CAPM is overwhelmingly the most important model used by a company in estimating their cost of equity capital."

In support of this proposition, Dr. Booth reproduced a table from a survey of 392 U.S. Chief Financial Officers.

Reference: *Booth Evidence, Page 32, Line 18 to Page 33, Line 3.*

Dr. Booth assessed the reasonableness of his equity risk premium estimates by use of a discounted cash flow estimate on a sample of U.S. utilities. In addition, Dr. Booth referred to the Company's actuarial pension plan asset valuation assumptions. Dr. Booth also performed a basic "Litmus test" to assess the fairness of the allowed return.

Reference: *Booth Evidence, Page 71, Lines 7-15; Page 77, Lines 6-8; Dr. Booth, Transcript, October 21, 2009, Page 182, Line 9 to Page 184, Line 2.*

Dr. Booth did not consider pre-tax interest coverage relevant for determining a fair or reasonable return on equity. He appeared to consider restrictions in bond contracts to be 'technical' in nature and have nothing to do with the fair rate of return standard.

Reference: *PUB-CA-8; Dr. Booth, Transcript, October 22, 2009, Page 82, Line 22 to Page 85, Line 24.*

Equity Risk Premium Test Results

Dr. Booth performed two equity risk premium tests, both of which yielded the same result of 7.0%.

Reference: *Booth Evidence, Page 52, Lines 2-12.*

For the purposes of equity risk analysis, Dr. Booth determined a risk-free rate for 2010 of 4.50%. This was based upon the long-term Canada bond yields returning to the 2007 level of 4.50% to 4.75% in 2011.

Reference: *Booth Evidence, Page 21, Lines 3-7.*

Dr. Booth used a 5.0% market risk premium in his analysis. To derive the 5.0% market risk premium, Dr. Booth examined realized rates of return in the Canadian market. In concluding his assessment of the market risk premium for this application, Dr. Booth indicated he did not see any significant impact on long term Canada interest rates which remain around the 4.0% level similar to the late 1950's. And, he discounted much of the recent stock market performance.

Reference: *Booth Evidence, Appendix E; Appendix E, Page 12, Lines 24-29.*

Dr. Booth's evidence also referred to a study of the market risk premium used in 2008 by finance professors. He conceded in his pre-filed evidence that his estimate may be marginally low. Dr. Booth explained his views on this reasonableness check, including his testimony on October 1, 2009 before the British Columbia Utilities Commission where he indicated "The facts are, the market risk premium, 5-6%,conceivably 7%...", in evidence before the Board.

Reference: *Booth Evidence, Page 48, Line 14 to Page 49, Line 19; Consent #19, Page 721-723; Dr. Booth, Transcript, October 22, 2009, Page 4, Line 14 to Page 6, Line 21 and Page 9, Line 12 to Page 11, Line 4.*

Dr. Booth has estimated the market risk premium at 5.0% since 2006. He also accepted that the market risk premium changes over time. Dr. Booth indicated that he could predict that the market risk premium results are going to go up in 2010.

Reference: *NP-CA-12; Dr. Booth, Transcript, October 22, 2009, Page 8, Lines 1-22 and Page 82, Lines 12-20.*

Dr. Booth's 5.0% estimate of the 2010 market risk premium was materially lower than Ms. McShane's estimate of 6.75% and Mr. Cicchetti's implied estimate of 6.4%.

Reference: *Booth Evidence, Page 3, Lines 33-35; McShane Evidence, Page 49, Line 1241 to Page 50, Line 1244; Mr. Cicchetti, Transcript, October 22, 2009, Page 136, Line 13 to Page 137, Line 1.*

Dr. Booth used a relative risk adjustment, or beta, of 0.50. He referred to this beta as a "judgment adjusted beta". It was based on Dr. Booth's judgment concerning the tendency of utility betas to return to their long run average. Dr. Booth accepted that you would have to go back to 1998 to observe a mathematical calculation of a utility beta of 0.50.

Reference: *Booth Evidence, Page 47, Lines 18-20 and Page 41, Lines 21-23; for judgment adjusted beta, see Booth Evidence, Page 34, Lines 13-17 and PUB-CA-7, PUB-CA-9, and PUB-CA-13; for the tendency of utility betas to return to their long run average and the mathematical calculation, see Dr. Booth, Transcript, October 22, 2009, Page 24, Line 23 to Page 25, Line 12 and Page 19, Line 17 to Page 20, Line 1.*

Dr. Booth's estimate of a 2010 beta of 0.50 was materially lower than Ms. McShane's estimate of 0.65 – 0.70 and Mr. Cicchetti's estimate of 0.66 – 0.69.

Reference: *Dr. Booth, Transcript, October 22, 2009, Page 18, Line 19-22; McShane Evidence, Page 55, Lines 1374-1375; Mr. Cicchetti, Transcript, October 22, 2009, Page 130, Line 6 to Page 131, Line 7.*

Dr. Booth added an allowance for financing flexibility of 0.5% to the 7.0% results of his two equity risk premium tests. This was similar to the allowance made by Ms. McShane.

Reference: *Booth Evidence, Page 55, Line 7 to Page 56, Line 12; McShane Evidence, Page 65, Lines 1627-1652.*

Dr. Booth indicated that the margin of error in his estimates might be 0.50%. As far as Dr. Booth was aware, he has never included a margin of error in previous testimony.

Reference: *Booth Evidence, Page 56, Lines 15-24; NP-CA-30.*

Reasonableness Checks

Dr. Booth performed a DCF analysis on U.S. utilities as a reasonableness check of his equity risk premium test results. The analysis was done for all U.S. utilities followed by Standard & Poors. This analysis indicated an historical value for return on equity of

11.94% and a prospective estimate, based upon 2008 data, for return on equity of 9.59%.

Reference: *Booth Evidence, Page 71, Lines 8-9 and Appendix C; Dr. Booth, Transcript, October 21, 2009, Page 193, Line 8 to Page 201, Line 25.*

Dr. Booth also referred to the long run equity market return of 8.50% used by the Company's actuarial consultant, Mercer (Canada) Limited, for Canadian and U.S. equities in evaluating pension plan funding liabilities as a reasonableness check for his estimate of a fair return for 2010. It was also Dr. Booth's evidence that the 8.50% Mercer return was an indefinite long run return which he guessed was calculated differently than the way he estimates returns.

Reference: *Booth Evidence, Page 77, Line 6 to Page 78, Line 7; Dr. Booth, Transcript, October 22, 2009, Page 100, Line 14 to Page 101, Line 18.*

The last step in Dr. Booth's process of estimating a fair return was a broad assessment of the result to see if the number looked right. How this assessment actually is conducted, and whether it affects methodological or data choices, appears unclear in the evidence.

Reference: *Dr. Booth, Transcript, October 21, 2009, Page 182, Line 9 to Page 184, Line 2 and October 22, 2009, Page 77, Line 6 to Page 82, Line 20.*

C.4.5 Mr. Cicchetti

General

Mr. Cicchetti's recommendation for a fair return on equity for Newfoundland Power for 2010 is 9.60%.

Reference: *Cicchetti Evidence, Page 25, Lines 526-540.*

Mr. Cicchetti's recommendation is based upon discounted cash flow analysis and an equity risk premium analysis grounded in the discounted cash flow methodology. It was Mr. Cicchetti's evidence that:

> "The discounted cash flow model is the most commonly used market-based approach for estimating a utility investor's required return on common equity capital…"

Reference: *Cicchetti Evidence, Page 16, Lines 347-348.*

In arriving at his fair return recommendation, Mr. Cicchetti also considered credit metrics which resulted from his recommendation and concluded that his recommended return would allow the Company the opportunity to maintain its financial integrity, raise capital at reasonable rates and compare favorably to firms of similar risk.

Reference: *Cicchetti Evidence, Page 25, Lines 534-540.*

Discounted Cash Flow Analyses Results

Mr. Cicchetti performed discounted cash flow analyses on indices of U.S. electric and gas distribution utilities comparable to Newfoundland Power. In selecting his group of comparable companies, Mr. Cicchetti examined both Canadian and U.S. utilities. He determined that the selected regulated U.S. utility companies had overall investment risk characteristics which made them good proxies.

Reference: *Cicchetti Evidence, Page 18, Line 385 to Page 20, Line 428; Mr. Cicchetti, Transcript, October 22, 2009, Page 118, Line 3 to Page 119, Line 8 and Page 142, Line 7 to Page 145, Line 25.*

Mr. Cicchetti's sample of comparable electric companies is set out in Schedules MAC-6 and MAC-8 of his evidence. Mr. Cicchetti's sample of comparable gas companies is set out in Schedules MAC-7 and MAC-9 of his evidence. Mr. Cicchetti was cross-examined concerning specific isolated aspects of these companies' operations and repeatedly indicated that the appropriate selection criteria is based upon the overall investment risk characteristics of the comparable company.

Reference: *Cicchetti Evidence, Schedules MAC-6, MAC-7, MAC-8 and MAC-9; for overall investment risk characteristics see, for example, Mr. Cicchetti, Transcript, October 22, 2009, Page 143, Lines 16-23; Page 145, Lines 4-15; Page 183, Lines 7-10, Page 195, Lines 6-17, Page 199, Lines 14-21; Page 205, Lines 15-22; Page 216, Line 18.*

In his discounted cash flow analysis, Mr. Cicchetti included an adjustment to recognize the expenses associated with issuing stock. This adjustment was conceptually similar to the allowance for financing flexibility made by Ms. McShane and Dr. Booth. Mr. Cicchetti's adjustment had the effect of increasing the required return by 0.20% to 0.25% as compared to Ms. McShane's and Dr. Booth's allowance of 0.50%.

Reference: *Cicchetti Evidence, Page 21, Line 463 to Page 22, Line 486; Mr. Cicchetti, Transcript, October 22, 2009, Page 132, Line 23 to Page 134, Line 25; CA-PUB-16(c).*

The results of Mr. Cicchetti's discounted cash flow analysis indicated a required return on common equity for the sample of comparative electric utilities of 9.57% and a required return on common equity for the sample of comparative natural gas distribution utilities of 9.53%.

Reference: *Cicchetti Evidence, Page 23, Lines 488-491.*

Equity Risk Premium Analysis Results

Mr. Cicchetti performed an equity risk premium analysis on his index of comparable U.S. gas distribution utilities.

Reference: *Cicchetti Evidence, Page 23, Lines 503-507.*

For the purposes of equity risk premium analysis, Mr. Cicchetti determined a risk-free rate based upon the *Blue Chip Financial Forecast* for the long-term government bond yield for 2010. By combining the next four quarters' expected yields, Mr. Cicchetti determined the risk-free rate of 4.625%.

Reference: *Cicchetti Evidence, Page 24, Lines 514-517.*

The betas used by Mr. Cicchetti in his analysis are from *Value Line*, an independent agency which provides market information including adjusted betas.

Reference: *Cicchetti Evidence, Schedule MAC-8; Mr. Cicchetti, Transcript, October 22, 2009, Page 114, Line 10 to Page 115, Line 8.*

To determine an equity risk premium, Mr. Cicchetti compared the required returns derived from his discounted cash flow analyses to the then-current yield on long term government bonds. This analysis yielded an equity risk premium of 4.35% which implied a market risk premium of about 6.4%.

Reference: *Cicchetti Evidence, Page 23, Line 509 to Page 24, Line 519; and Mr. Cicchetti, Transcript, October 22, 2009, Page 136, Lines 22-25.*

The result of Mr. Cicchetti's equity risk premium analysis was a cost of equity of 9.00%.

Reference: *Cicchetti Evidence, Page 24, Lines 517-521.*

Mr. Cicchetti's equity risk premium analysis reflected an adjustment for stock issue costs of approximately 0.20% to 0.25% which was consistent with his discounted cash flow analysis.

Reference: *Mr. Cicchetti, Transcript, October 22, 2009, Page 135, Lines 2-25; CA-PUB-16(c).*

C.4.6 Assessment

The expert recommendations on a fair return on equity for Newfoundland Power range from 7.75% (Dr. Booth) to 9.6% (Mr. Cicchetti) to 11.0% (Ms. McShane).

In considering the expert recommendations on fair return on equity for Newfoundland Power for 2010, the Board should be mindful that the estimation of the rate of return is not an exact science no matter what methodology or methodologies are used.

Expert evidence before the Board was based on multiple methodologies of determining the return on equity for Newfoundland Power in 2010. All expert witnesses indicated that professional judgment was required to estimate a utility's cost of capital.

Both Ms. McShane and Mr. Cicchetti have indicated that current market conditions have increased utilities' cost of capital and reflected this in their recommendations on a return on equity for Newfoundland Power for 2010. Dr. Booth has recommended a reduced return on equity for Newfoundland Power in 2010.

One primary reason for this difference rests in the differing judgments of the expert witnesses. For example, Ms. McShane and Mr. Cicchetti estimated a market risk premium for 2010 of 6.75% and 6.4%, respectively. Dr. Booth estimated a market risk premium for 2010 of 5%. Similarly, Ms. McShane and Mr. Cicchetti estimated a relative risk factor, or beta, for 2010 of 0.65-0.70 and 0.66-0.69, respectively. Dr. Booth estimated a beta for 2010 of 0.50.

The differing judgments implicit in the experts' recommendations should be considered in the context of the overall evidence before the Board. This includes the outlook for the economy in 2010. It includes the impact of each expert witness's recommendation on the Company's creditworthiness. It also includes the tendency for the market risk premium and beta to change over time. And, it includes the breadth of perspective each expert witness brings to the overall estimation process.

Ms. McShane's and Mr. Cicchetti's outlooks for the economy in 2010 were relatively consistent, but differed materially from that of Dr. Booth. Dr. Booth was the only witness before the Board to characterize the current economic outlook as *normal*.

Both Ms. McShane and Mr. Cicchetti considered the impact of their recommendation upon Newfoundland Power's credit metrics. At least so far as pre-tax interest coverage and bond restrictions were concerned, Dr. Booth did not consider them relevant for determining a fair or reasonable return on equity.

Ms. McShane's and Mr. Cicchetti's estimated market risk premiums for 2010 were relatively consistent, but differed materially from that of Dr. Booth. While Dr. Booth predicted the market risk premium would increase in 2010, he estimated the market risk premium at the same level as he did in 2006. Ms. McShane's and Mr. Cicchetti's estimated betas for 2010 were relatively consistent, but differed materially from that of Dr. Booth. Ms. McShane's and Mr. Cicchetti's estimated betas were based upon *data* provided by investment research firms. Dr. Booth's estimation of beta for 2010 was based upon his *judgment* concerning the tendency of utility betas to return to their long run average. Dr. Booth's long run average was consistent with utility betas last observed in 1998, but not since.

Of the three expert witnesses appearing on the Amended Application, Ms. McShane provided the broadest perspective to the estimation of a fair equity return for Newfoundland Power for 2010 by using the equity risk premium, discounted cash flow and comparable earnings tests.

Mr. Cicchetti used both discounted cash flow and equity risk premium tests, although Mr. Cicchetti's equity risk premium test was substantially grounded in the discounted cash flow methodology.

Dr. Booth used only the equity risk premium test to arrive at two identical estimates of a fair equity return for Newfoundland Power. Dr. Booth also performed a discounted cash flow test on U.S. utilities as a reasonableness check on his equity risk premium test results. The results on this discounted cash flow test indicated a required equity return of 9.59%. While this was materially higher than the 7.00% indicated cost of equity yielded by each of his equity risk premium tests (before adjustments for financing flexibility and margin of error), it appeared to have no impact on his recommendation of a fair return for Newfoundland Power in 2010.

Much time in the hearing of the Amended Application was devoted to specific operational and regulatory differences between Newfoundland Power and certain U.S. utilities used as comparators by Ms. McShane and Mr. Cicchetti. It bears observation that while Dr. Booth made *general* observations concerning the comparability of Canadian and U.S. utilities, there is no expert evidence on the record which indicates that these *specific* U.S. utilities are not comparable from an overall investor risk perspective.

The NEB considered the matter of U.S. comparisons in its March 2009 decision concerning Trans Quebec & Maritimes Pipeline Inc., where it concluded:

> "In light of the Board's views expressed above on the integration of U.S. and Canadian financial markets, the problems with comparisons to either Canadian negotiated or litigated returns, and the Board's view that risk differences between Canada and the U.S. can be understood and accounted for, the Board is of the view that U.S. comparisons are very informative for determining a fair return for TQM for 2007 and 2008."

Reference: *CA-NP-201, Attachment A, Page 71.*

Ms. McShane also used Canadian data to support her recommendation of a fair return for Newfoundland Power. This, like the broader variety of tests used by Ms. McShane, distinguishes her recommendation from that of Mr. Cicchetti.

The depth of economic analysis, methodological scope, and breadth of comparative data underpinning Ms. McShane's recommendation qualify it to be given the greatest weight by the Board in its determination of a fair return on equity for Newfoundland Power for 2010.

C.5 Creditworthiness

Newfoundland Power's current investment grade credit ratings are 'sound' within the meaning of Section 3 (a) (iii) of the Electrical Power Control Act, 1994.

The proposals in the Amended Application concerning capital structure and a fair return, if approved by the Board, will result in the maintenance of those credit ratings.

Newfoundland Power's current credit ratings from DBRS and Moody's are both investment grade, with a stable outlook.

Reference: *Amended Evidence, Page 3-13, Line 11 to Page 3-14, Line 4.*

In August 2009, Moody's upgraded its rating of Newfoundland Power's First Mortgage Bonds to A2, which is the same relative rating as DBRS's A rating of the Company's First Mortgage Bonds. Moody's assigned Newfoundland Power a Baa1 issuer credit rating. In making the upgrade of the Company's First Mortgage Bonds, Moody's commented that it believed that 2008 improvement in the Company's credit metrics is likely to be sustained. In addition, Moody's observed that the Company's credit metrics remain somewhat weaker than those of other Baa1-rated low risk utilities but this was balanced by the Company's supportive regulatory environment. The upgrade was primarily based on changes in Moody's rating methodology.

Reference: *Exhibit 4 (1st Revision); Ms. Perry, Transcript, October 14, 2009, Page 53, Lines 13-25; Booth Evidence, Page 4, Lines 2-4.*

Moody's and DBRS evaluate qualitative and quantitative data including a number of credit metrics in establishing the Company's credit rating. The Moody's methodology for establishing credit metrics was thoroughly canvassed at the hearing. Of the six companies considered by Moody's to be the closest peers of Newfoundland Power for the purposes of credit rating comparison, five are U.S. operating utilities.

Reference: *Information #1 and #2; Amended Evidence, Page 3-14, Lines 6-7; Ms. Perry, Transcript, October 15, 2009, Page 84, Line 25 to Page 168, Line 8 and October 19, 2009, Page 14, Line 9 to Page 16, Line 22; U-2; Ms. McShane, Transcript, October 21, 2009, Page 121, Line 24 to Page 123, Line 25.*

The key credit metrics for Newfoundland Power are pre-tax interest coverage, cash flow interest coverage and cash flow debt coverage. Table C-2 summarizes the evidence of these metrics from 2008 through 2010.

Table C-2
Credit Metrics: 2008 to 2010

	2008 Actual	**2009 Forecast**	**2010 Existing**	**2010 Proposed**
Pre-tax Interest Coverage (times)	2.5	2.3	2.0	2.7
Cash Flow Interest Coverage (times)	3.1	3.1	2.8	3.6
Cash Flow Debt Coverage (%)	15.8	15.4	13.1	19.5

Reference: *Amended Evidence, Page 3-15, Lines 5-7; Exhibit 11 (1st Revision), Page 1, Lines 39-41.*

Newfoundland Power would not be able to issue First Mortgage Bonds with the pre-tax interest coverage of 2.0 times indicated in 2010 under existing conditions. The cash flow interest and cash flow debt coverages which result from the proposals in the Amended Application are within the ranges indicated by Moody's to be appropriate for a Baa1 utility.

Reference: *Ms. Perry, Transcript, October 15, 2009, Page 98, Line 1 to Page 102, Line 25; Ms. Perry, Transcript, October 15, 2009, Page 148, Line 2 to Page 149, Line 18.*

The credit metrics which result from the proposals in the Amended Application were observed to be higher than historical metrics. This was canvassed in cross examination by Board counsel.

Reference: *Ms. Perry, Transcript, October 19, 2009, Page 121, Line 25 to Page 135, Line 13; CA-NP-65 (1st Revision), Attachment A, Page 1 of 9, Lines 38-40; Exhibit 11 (1st Revision), Page 1, Lines 39-41; Exhibit 5 (1st Revision).*

The Board has traditionally considered pre-tax interest coverage to be a primary indicator of creditworthiness in evaluating the relationship between capital structure, rate of return on common equity and interest coverage. For this metric, Ms. Perry indicated that if Newfoundland Power wanted to achieve a coverage of 2.5 times instead of 2.7 times, as proposed in the Amended Application, the return on equity would have to be between 9.5% and 9.75%.

Reference: *Grant Thornton 1st Report, Page 22, Lines 13-15; Ms. Perry, Transcript, October 19, 2009, Page 131, Line 1 to Page 133, Line 6.*

C.6 Return on Rate Base

Section 78 of the Public Utilities Act mandates that the Board approve Newfoundland Power's forecast rate base. The evidence before the Board indicates that Newfoundland Power's forecast 2010 average rate base of $869,241,000 is appropriate for ratemaking purposes.

Section 80 of the Public Utilities Act mandates that the Board determine a just and reasonable return on rate base. A just and reasonable return on rate base is the rate making translation of Newfoundland Power's cost of capital.

The evidence before the Board indicates a forecast 2010 return on rate base of $79,361,000, or 9.13%, reflects a 2010 regulated return on equity of 11%.

C.6.1 Rate Base

Newfoundland Power's forecast 2010 average rate base, as set out in the Amended Application, is calculated in accordance with Board orders and regulatory practice.

Reference: *Amended Evidence, Page 4-1, Lines 15-17; Rate Base Allowances Report.*

Newfoundland Power proposes to adopt accrual accounting for OPEBs costs for regulatory purposes effective January 1, 2010. Under the accrual method, the excess of OPEBs expense recognized in any period over OPEBs payments made in the period would, in accordance with accounting guidelines, be recorded as a net liability on Newfoundland Power's balance sheet. Under ARBM, the accrued OPEBs liability serves to decrease Newfoundland Power's rate base. Consistent with ARBM, Newfoundland Power proposes that the accrued OPEBs liability be deducted from its rate base commencing in 2010 upon the adoption of the accrual method of accounting for OPEBs.

Reference: *OPEBs Report, Pages 6 and 7; Ms. Perry, Transcript, October 14, 2009, Page 59, Lines 9-18; Exhibit 6 (1st Revision), Line 14.*

Newfoundland Power's forecast average rate base for 2010 is $869,241,000.

Reference: *Exhibit 6 (1st Revision), Line 27.*

Grant Thornton's review of the forecast 2010 rate base, provided with the Original Application, found that it (i) is calculated in accordance with established practice and follows the ARBM as approved in the 2008 general rate application; (ii) accurately reflects the Company's proposals with respect to OPEBs, including tax effects thereof; and (iii) accurately reflects the updated calculations related to the rate base allowances.

Reference: *Grant Thornton 1st Report, Page 19, Lines 6-11.*

Grant Thornton's review of the revised forecast 2010 average rate base of $869,241,000, found that it appropriately incorporates the impacts of the revised forecast included in the Amended Application.

Reference: *Grant Thornton 2nd Report, Page 5, Lines 11-12.*

C.6.2 Return on Rate Base

The forecast 2010 cost of debt is 7.65% which reflects the Company's First Mortgage Bond issue earlier in 2009 and an updated forecast of short-term interest rates.

Reference: *Exhibit 8 (2nd Revision), Line 15.*

The forecast 2010 cost of preferred equity is 6.23%.

Reference: *Exhibit 8 (2nd Revision), Line 16.*

The forecast 2010 cost of common equity is 11.00%.

Reference: *Exhibit 8 (2nd Revision), Line 17.*

The 2010 return on rate base proposed in the Amended Application is summarized in Table C-3.

Table C-3
Proposed 2010 Return on Rate Base
($000s)

Regulated return on common equity	42,941
Return on debt	35,852
Return on preferred equity	568
Return on rate base	**79,361**

Reference: *Amended Evidence, Page 4-6 (2nd Revision), Table 4-6.*

C.6.3 Rate of Return on Rate Base

The proposed 2010 return on rate base reflects a rate of return on average rate base of 9.13%. This is shown in Table C-4.

Table C-4
Proposed 2010 Rate of Return on Rate Base

Return on rate base ($000s) (A)	79,361
Average rate base ($000s) (B)	869,241
Rate of return on rate base (A÷B)	**9.13%**

Reference: *Amended Evidence, Page 4-6 (2nd Revision), Table 4-6; Exhibit 8 (2nd Revision), Line 23.*

Grant Thornton's review indicates that the Company's forecast 2010 rate base, 2010 rate of return on rate base, revenue requirement and revenue requirement from rates (which includes the Company forecast 2010 return on rate base of $79,361,000) appropriately incorporates the impact of the revised forecast included in the Amended Application.

Reference: *Grant Thornton 2nd Report, Page 5, Lines 3-19.*

C.7 Automatic Adjustment Formula

In the Amended Application, Newfoundland Power is proposing discontinuation of the use of the Formula.

The Formula, like similar formulas used in other Canadian regulatory jurisdictions, has yielded materially lower estimates of the cost of equity in current financial markets. There is no expert consensus as to what adjustments, if any, are appropriate to be made to the Formula for future use.

The National Energy Board has already discontinued use of its formula and other Canadian regulatory jurisdictions are currently reviewing the matter.

The Formula, which is used to adjust the Company's rate of return on rate base and customer rates to reflect changes in the forecast cost of equity, has been in use for over a decade. The Formula was originally established pursuant to Order Nos. P.U. 16 and

36 (1998-99). Continued use of the Formula, with minor modifications, was approved in Order Nos. P.U. 19 (2003) and P.U. 32 (2007). The principal benefits to consumers associated with use of the Formula are reduced costs associated with cost of capital hearings and reduced regulatory risk resulting from increased predictability and certainty.

Reference: *Order No. P.U. 16 (1998-99), Page 103; Mr. Todd Transcript, October 27, 2009, Page 116, Lines 14-23.*

Newfoundland Power supported the adoption of the Formula in 1998.

Reference: *Order No. P.U. 16 (1998-99), Pages 79 to 81.*

The realization of the benefits associated with the Formula is based upon the Formula's accurate reflection of the appropriate return on equity. For this reason, the Board has consistently indicated that, if financial market conditions change, so as to suggest that the Formula is not accurately reflecting the appropriate return on equity, the Board would review continued use of the Formula.

Reference: *Order No. P.U. 16 (1998-99), Pages 104 to 105; Order No. P.U. 19 (2003), Page 69; PUB-NP-13.*

It was Ms. McShane's evidence that the application of formulas used by Canadian regulators in 2009 tended to result in lower allowed returns on equity in 2009 than in 2008. This resulted from the formulas being tied solely to government bond yields. These lower allowed returns on utility equity occurred in a period when corporate debt and equity yields were indicating an increased cost of capital. This was indicated by Ms. McShane to make "no logical sense".

Reference: *McShane Evidence, Page 11, Lines 268-278 and Page 12, Lines 304-308.*

Mr. Cicchetti's evidence also focused on the particularly low yields on Canadian long-term government bonds, the relatively high yields on corporate bonds and declines in equity values. Mr. Cicchetti believed changes in financial market conditions caused the Formula to produce a return below the bottom of a reasonable range of the cost of equity for the Company.

Reference: *Cicchetti Evidence, Page 26, Lines 545-547 and Line 563 et. seq.; NP-PUB-3.*

Dr. Booth's evidence advocated continued use of formulas even though they generated allowed returns on equity which exceeded his estimate of a fair return on equity. Dr. Booth indicated that statements that suggest formulas are broken because they lowered allowed returns on equity while utility bond yields increased are "simply wrong". Dr. Booth did, however, appear to acknowledge that equity holders have greater risk than bond holders.

Reference: *Booth Evidence, Page 86, Lines 4-9 and Page 7, Lines 3-5; Dr. Booth, Transcript, October 22, 2009, Page 29, Line 18 to Page 30, Line 6.*

Each of the cost of capital experts also provided opinions on possible changes to the Formula on examination by Board Counsel. Ms. McShane indicated substituting a long term Canada bond yield with a corporate bond yield might be considered. She also indicated that the current 0.8 factor might be more appropriately replaced with a factor of 0.5. Dr. Booth indicated that he would be happy with a 1 to 1 adjustment or the current 0.8 adjustment. Mr. Cicchetti indicated it is generally accepted that risk premiums vary as interest rates vary. He also indicated that the 0.8 factor will put pressure on financial metrics if there is a continued low long-term Canadian rate.

Reference: *Ms. McShane, Transcript, October 21 2009, Page 108, Line 13 to Page 109, Line 22; Dr. Booth, Transcript, October 22, 2009, Page 67, Lines 16-20; Mr. Cicchetti, Transcript, October 22, 2009, Page 119, Line 20 to Page 120, Line 17.*

In a decision dated October 8, 2009, the NEB was of the view that there is a doubt as to the ongoing correctness of its RH-2-94 Decision. This Decision established the formula used by that regulator for forecasting the cost of equity. The October 8, 2009 Decision discontinued the use of this formula.

Reference: *PUB-NP-14 (1st Revision), Attachment B.*

Both Ms. McShane and Dr. Booth indicated that automatic adjustment formulas are currently under review by regulators in a number of other Canadian jurisdictions including Quebec, Ontario, Alberta, and British Columbia.

Reference: *McShane Evidence, Page 15, Footnote 10; Ms. McShane, Transcript, October 20, 2009, Page 9, Line 21 to Page 10, Line 19; Dr. Booth, Transcript, October 22, 2009, Page 47, Line 2 to Page 49, Line 25.*

D. OTHER COSTS

D.1 Operating Costs

Newfoundland Power's operating costs represent approximately 10% of its forecast 2010 cost of service. The evidence shows that the Company's cost management reflects an appropriate balance of cost and service in both the short and long term.

While Newfoundland Power's test year operating costs were scrutinized since the filing of the Original Application, there is no basis in the evidence to indicate they are unreasonable.

General

Newfoundland Power is required to manage and operate at the lowest possible cost consistent with reliable service. Newfoundland Power is therefore obligated to operate efficiently and ensure there is an appropriate balance between cost and service.

Reference: *Electrical Power Control Act, 1994, Section 3 (b) (iii).*

In addition to its obligation to operate efficiently, Newfoundland Power is obliged to provide safe and reliable electrical service, and to effectively respond to customers' service requirements.

Reference: *Public Utilities Act, Section 37.*

Test Year Operating Costs

Operating costs are those costs over which Newfoundland Power has the greatest degree of management control. Operating costs represent approximately 10% of the Company's forecast 2010 revenue requirement. Excluding deferred costs, pension costs and general expenses capitalized, labour costs represent approximately 58% of Newfoundland Power's 2010 operating costs.

Reference*:* *Amended Evidence, Page 2-16, Lines 3-5; Exhibit 2 (1st Revision).*

Grant Thornton has reported that, based on their review and analysis, nothing has come to their attention to indicate that Newfoundland Power's 2010 forecast operating expenses are unreasonable on an overall basis.

Reference: *Grant Thornton 1st Report, Page 32, Lines 20-21*.

In Order No. P.U. 32 (2007), Newfoundland Power was directed to provide, as part of its next general rate application, detailed information concerning the method used to forecast test year full time equivalents ("FTEs") and labour expense, and an explanation of the assumptions used to determine forecast vacancies. Newfoundland Power complied with the Board's direction in this regard by filing the Labour Forecast Report. The Labour Forecast Report explains how Newfoundland Power reconciles forecast work requirements and workforce options in the ongoing management of its labour requirements.

Reference*:* *Order No. P.U. 32 (2007), Page 48; Grant Thornton 1st Report, Page 33, Lines 27-30; Labour Forecast Report.*

The forecast increase from 628 FTEs in 2008 to 651 FTEs in 2010F, as identified in the Labour Forecast Report, is primarily driven by specific identified new work requirements and the need to address workforce demographics.

Reference*: CA-NP-110, Lines 9-10.*

An important consideration in determining the appropriateness of Newfoundland Power's forecast of operating costs is whether the forecast reflects an appropriate balance between cost and service. Mr. Smith described the issue as follows:

> "An important consideration is whether the operating forecast reflects an appropriate balance between cost and service. Efficiency is not just about cutting costs. Our cost management efforts are focused on the overall impacts of cost and service. For example, if we were to delay hiring the apprentice powerline technicians, we could avoid adding cost now, however, this would have a negative impact on the company's ability to provide service in the long term. Each year, Newfoundland Power is required to serve a growing number of customers and to operate and maintain a growing electrical system. We must all keep pace with customer expectations. Each year we got approximately 100 kilometers of new line. With more line to maintain and more meters to read and more customers to serve, the cost of service will tend to increase unless we find more efficient ways to operate. At Newfoundland Power, it is always our goal to achieve sustainable cost efficiencies for the long term. When this is achieved, customers benefit. I believe our record has been very good in this regard. For example, since 2004, the number of customers has increased by 7.6 percent. Inflation has increased by 12.4 percent, and this compares to an increase in Newfoundland Power's controllable operating cost of 4.5 percent. Over this same period, we have continued to maintain a good safety record and the reliability of service has improved. We have also maintained a high level of customer satisfaction."

Reference: *Mr. Smith, Transcript, October 26, 2009, Page 100, Line 25 to Page 102, Line 15; CA-NP-87 (1st Revision).*

Newfoundland Power compared its test year labour forecast to a pro-forma labour forecast in order to estimate the forecast labour productivity improvement in the test year. The pro-forma labour forecast includes material labour cost changes forecast for

2010 due to energy conservation, the Powerline Technician apprenticeship program and increases in labour rates. The forecast labour productivity improvement in 2010 is $337,000 or approximately 1.1% of total forecast operating labour. This productivity improvement represents approximately 23% of the material forecast operating labour cost increases in 2010. The 2010 forecast productivity improvement is similar to what was actually achieved in 2008.

Reference*: Mr. Smith, Transcript, October 26, 2009, Page 102, Line 16 to Page 103, Line 4; CA-NP-103; CA-NP-104; CA-NP-112.*

Newfoundland Power has hired 6 additional employees to deliver the Company's expanded energy conservation program. The additional work associated with energy conservation programming in 2010 is expected to exceed the capacity of the 6 new employees. The delivery of the expanded energy conservation program in 2010 will therefore require the Company to further improve the efficiency of its operations. This implies additional productivity that is not reflected in the Company's estimate of forecast test year labour productivity improvement.

Reference*: Mr. Smith, Transcript, October 26, 2009, Page 103, Line 7 to Page 104, Line 17.*

Overtime has remained relatively consistent since 2007, with only a $52,000, or 3%, increase in the period 2007 to 2010. The Consumer Advocate questioned why overtime was not forecast to decrease, given the improvement in service reliability. Mr. Smith testified that operating overtime cost is largely related to customer trouble calls. Most of the work aimed at improving reliability on the distribution system in recent years was undertaken on the trunk part of the system. Most trouble calls relate to smaller problems away from the trunk part of the system on the many laterals and service wires. In the two-year period ending in 2008, trouble calls increased by 3.4%.

Reference: *Amended Evidence, Page 2-22, Table 2-11 and Page 2-23, Lines 1-2; Mr. Smith, Transcript, October 26, 2009, Page 143, Line 9 to Page 145, Line 6; Amended Evidence, Page 2-18, Lines 9-10.*

Uncollectable bills for 2010 are forecast to be consistent with 2009, $129,000 more than 2008, and $130,000 less than 2007. The Consumer Advocate questioned the increase in the cost of uncollectible bills from 2008 to 2009F, and the appropriateness of the forecast for the test year. Newfoundland Power's forecast for uncollectible bills is based on the average of actual results for the three most recent complete years. Mr. Smith testified that Newfoundland Power believes that this is a more appropriate way of forecasting the cost of uncollectible bills, than basing a forecast on the result for the most recent year.

Reference: *Exhibit 2 (1st Revision), Line 15; Mr. Smith, Transcript, October 27, 2009, Page 15, Line 9 to Page 16, Line 6.*

The Consumer Advocate questioned the basis of Newfoundland Power's forecast of consulting fees and legal fees for regulatory proceedings in 2010. Mr. Smith testified as to Newfoundland Power's expectations regarding regulatory proceedings in 2010 upon which the estimate of regulatory fees and consulting fees was based. Newfoundland Power subsequently filed an undertaking providing a detailed breakdown of its total forecast of $315,000 for costs associated with regulatory proceedings in 2010. Given the Company's outlook for regulatory activity in 2010, the $315,000 forecast for costs associated with regulatory proceedings is reasonable.

Reference: *Mr. Smith, Transcript, October 26, 2009, Page 177, Line 9 to Page 180, Line 23; U-8.*

Executive Compensation

The basic structure of Newfoundland Power's executive compensation arrangements, which includes base salary, short-term incentive, long-term incentives in the form of Fortis Inc. stock options, and benefits, has not changed since 1998.

Reference: *Order No. P.U. 36 (1998-99), Pages 34 to 41.*

Newfoundland Power has used the 50th percentile of the Hay Group's Canadian Commercial Industrial Index as the basis for establishing executive compensation for a number of years. Over the past decade, the proportion of executive labour costs to Newfoundland Power's total labour costs has not materially changed.

Reference: Mr. Aboud, Transcript, October 26, 2009, Page 27, Lines 11-22; CA-NP-126; Mr. Ludlow, Transcript, October 14, 2009, Page 45, Line 12 to Page 46, Line 2.

Newfoundland Power led the evidence of Mr. Karl Aboud, the National Director of Hay Group Canada's Reward Consulting Practice, as an expert on executive compensation. Mr. Aboud's evidence was that: (i) it is reasonable for Newfoundland Power to use comparative executive jobs within the broad Canadian Commercial Industrial marketplace as its comparator group; (ii) it is reasonable for Newfoundland Power to use the median / 50th percentile levels of comparator group compensation values as the basis by which to establish its executive pay standards; and (iii) the Newfoundland Power incumbent-specific pay values are within the normal range of variance to its market pay standards that Hay Group typically experiences in these types of reviews.

Reference: *Aboud Evidence, Page 2.*

The cost of long-term incentives and short-term incentive payments above the 100% performance level are treated as non-regulated expenses.

Reference: *Grant Thornton 1st Report, Page 43, Lines 13-14; Order No. P.U. 19 (2003), Page 96; Aboud Evidence, Page 6.*

Mr. Aboud indicated that for the President and Chief Executive Officer of Newfoundland Power, ratepayers cover the cost of his compensation at the 25th percentile of the Canadian Commercial Industrial market. The remaining cost of the President and Chief Executive Officer's compensation, which is long-term incentives, is treated as a non-regulated expense.

Reference: *Mr. Aboud, Transcript, October 26, 2009, Page 22, Line 25 to Page 23, Line 15; and Page 66, Lines 4-19.*

There is no evidence before the Board indicating that the proportion of Newfoundland Power's executive compensation recognized for ratemaking purposes is anything but reasonable.

D.2 Deferrals and Amortizations

In the Amended Application, Newfoundland Power proposes amortizations in respect of third party costs associated with the Application and 2009 conservation costs.

For Application costs, which are estimated at $750,000, Newfoundland Power has proposed a 1-year amortization. There is evidence suggesting a

3-year amortization is appropriate. Newfoundland Power considers the amortization period to be a matter of regulatory judgement.

For 2009 conservation costs, which are estimated at approximately $1.5 million, Newfoundland Power has proposed a 4-year amortization. This amortization period has been agreed in the Settlement Agreement.

General

Table D-1 summarizes current amortizations of regulatory deferrals approved by the Board together with those proposed in the Amended Application.

Table D-1
Amortization of Regulatory Deferrals
***Pro forma* Revenue Requirement Impact**
2009 to 2013
($000s)

	2009	**2010**	**2011**	**2012**	**2013**
Revenue Deferrals					
2005 Unbilled Revenue	(6,893)	(6,791)	-	-	-
Municipal Tax Liability	(1,362)	(1,362)	-	-	-
Cost Recovery Deferrals					
Depreciation	5,764	5,679	-	-	-
Replacement Energy	598	598	-	-	-
Purchased Power Unit Cost Reserve	(688)	(688)	-	-	-
Weather Normalization Reserve	2,101	2,101	2,101	2,101	-
Conservation Cost Deferrals	(1,516)	379	379	379	379
Application Costs	-	750	-	-	-
Revenue Requirement Impacts	(1,996)	666	2,480	2,480	379

With the exception of the Company's proposals with respect to the amortization of Application costs and 2009 conservation cost deferrals, the revenue and cost deferrals shown in Table D-1 were approved by the Board in Order No. P.U. 32 (2007).

Reference: *Order No. P.U. 32 (2007), Page 60; Amended Evidence, Page 3-39, Table 3-18.*

Application Costs

The Company proposes to recover an estimated $750,000 in external regulatory costs incurred with respect to this proceeding in 2010 customer rates.

Reference: *Amended Evidence, Page 3-38, Line 18 to Page 3-39, Line 1.*

Mr. Todd testified that Newfoundland Power's proposal to recover the Application costs over a single year seems to be inconsistent with the desire to have general rate applications on a three-year cycle when possible. Mr. Todd indicated it made more sense to him to consistently amortize such costs over a three year period.

Reference: *Mr. Todd, Transcript, October 27, 2009, Page 78, Line 4 to Page 80, Line 5.*

Mr. Todd acknowledged that there is no mandatory period between general rate proceedings in this jurisdiction. Mr. Todd testified that, if there is no Newfoundland Power general rate proceeding for 2011, the recovery of Application costs provided for in rates under Newfoundland Power's proposal would correspond to costs that were not actually incurred.

Reference: *Mr. Todd, Transcript, October 27, 2009, Page 90, Line 25 to Page 92, Line 1; and Page 78, Line 23 to Page 79, Line 4.*

Ms. Perry testified that the revenue shortfall that is currently forecasted for 2011 would be larger if Newfoundland Power was proposing to recover the Application costs over a longer period.

Reference: *Ms. Perry, Transcript, October 15, 2009, Page 47, Line 10 to Page 48, Line 9.*

It is possible, but not currently expected; that the rates set as a result of this Amended Application will be in effect beyond 2010. This is the basis for Newfoundland Power's proposal to recover the Application costs over a single year.

Reference: *PUB-NP-12; Ms. Perry, Transcript, October 14, 2009, Page 55, Lines 6-25; October 15, 2009, Page 46, Line 12 to Page 47, Line 8.*

An appropriate amortization period is a matter of regulatory judgment. The Board in the past has ordered recovery of Application costs over a 3-year period. In each of these cases, it was expected that the rates set by the Board would be in effect for multiple years.

Reference: *Order Nos. P.U. 36 (1998-1999), P.U. 19 (2003), P.U. 32 (2007).*

2009 Conservation Costs

In Order No. P.U. 13 (2009), the Board approved the creation of the Conservation Cost Deferral Account to provide for the deferred recovery of Newfoundland Power's 2009 customer energy conservation programming costs related to the implementation of the 5-year Conservation Plan.

Reference: *Order No. P.U. 13 (2009).*

In the Amended Application, Newfoundland Power is proposing to recover over a four-year period beginning in 2010, an estimated $1.5 million in deferred 2009 Conservation costs. The proposal allows for recovery of the deferred Conservation costs over the remaining four years of the 5-year Energy Conservation Plan.

Reference: *Amended Evidence, Page 3-38, Lines 10-16; Ms. Perry, Transcript, October 14, 2009, Page 6, Line 21 to Page 7, Line 1.*

Grant Thornton has observed that Newfoundland Power's proposal is consistent with the number of years remaining in the Company's conservation plan.

Reference: *Grant Thornton 1st Report, Page 14, Lines 16-17.*

In the Settlement Agreement, it has been agreed that Newfoundland Power's proposal regarding the recovery of the 2009 Conservation costs should be approved by the Board.

Reference: *Settlement Agreement, Items 10-13.*

E. REGULATORY POLICY MATTERS

E.1 Pension Expense Variance Deferral Account

E.1.1 Pension Cost Variability

Financial market conditions have materially increased the variability of Newfoundland Power's annual defined benefit pension expense. This increased variability could result in the Company achieving excess earnings or not having a reasonable opportunity to earn its allowed return solely due to annual fluctuations in pension expense arising from financial market conditions.

Background

Newfoundland Power maintains both defined benefit and defined contribution pension plans for its employees. Newfoundland Power's principal pension plan is its defined benefit pension plan. Defined benefit plans provide retirement income based upon an employees' pay and years of service at the time of retirement. Defined contribution plans provide retirement income based upon the contributions made by the Company and the employee together with accrued returns on those contributions. Since May 2004, Newfoundland Power's defined benefit pension plan has been closed to new entrants.

Reference: *Amended Evidence, Page 3-21, Lines 1-6.*

The evidence is that financial market conditions affect defined benefit pension plans in two fundamental ways. The first relates to the *actual* value of assets held in a plan. Changes in asset values resulting from market conditions impact both the funding obligations and the accounting for the expense associated with defined benefit pension plans. The second relates to the valuation of *future* obligations in accounting for the expense associated with defined benefit pension plans.

Reference: *Amended Evidence, Page 3-21, Lines 13-17.*

Forecast Pension Expense

Newfoundland Power's pension expense is expected to increase to approximately $8.2 million in 2010 compared to $2.7 million in 2009. The Company's 2011 pension expense is expected to increase further to approximately $11.0 million.

Reference: *Amended Evidence, Page 3-23, Lines 10-12; Exhibit 1 (1st Revision), Line 29.*

The forecast increase in 2010 pension costs is a result of the combination of a forecast 1% reduction in the discount rate used to value defined benefit pension obligations, and defined benefit pension plan asset value losses experienced in 2008, partly offset by higher forecast returns on those assets in 2009.

Reference: *Amended Evidence, Page 3-6, Line 11 to Page 3-7, Line 1.*

The financial market conditions which commenced in 2008 have given rise to increased volatility in the discount rate used to present value future plan obligations for accounting purposes. This increased volatility has increased the uncertainty associated with forecasting future pension expense.

Reference: *Amended Evidence, Page 3-22, Lines 9-12.*

Changes in the discount rate can result in large differences in pension expense from year to year and can result in material differences from forecast. In general, for a defined benefit pension plan, a higher discount rate tends to lower pension expense and a lower discount rate tends to increase pension expense. From 2008 to 2009, the discount rate increased by 2%. A change in the discount rate used to value pension obligations of +/- 1% will vary Newfoundland Power's pension expense in the next year by approximately +/- $2.3 to $3.4 million.

Reference: *Amended Evidence, Page 3-26, Line 1 to Page 3-27, Line 3; Ms. Perry, Transcript, October 14, 2009, Page 70, Line 9 to Page 71, Line 3.*

The discount rate that will be used to determine actual pension expense for 2010 will not be known until the end of 2009. The variability of pension expense is not reasonably predictable in current volatile financial market conditions. As a result, the actual pension expense for 2010 may differ materially from that estimated several months prior to year end. The uncertainty of pension expense forecasting in current financial market conditions presents potential risks for both the Company and its customers. On one hand, a 1% increase in the discount rate used to calculate pension expense could result in the Company achieving earnings in excess of its allowed return solely due to fluctuations in pension expense. On the other hand, a 1% decrease in the discount rate could result in the Company not having a reasonable opportunity to earn its allowed return solely due to fluctuations in pension expense.

Reference: *Amended Evidence, Page 3-27, Lines 5-15.*

E.1.2 Proposed Regulatory Mechanism

Newfoundland Power has proposed the establishment of a Pension Expense Variance Deferral Account to address the increased variability in annual pension expense.

The evidence indicates that establishment of such a deferral account is consistent with current regulatory practice. It has been agreed that the Board should establish such an account.

Newfoundland Power has proposed the creation of a Pension Expense Variance Deferral Account to account for the difference between (i) the annual defined benefit pension expense most recently approved for the establishment of revenue requirement from rates for a test year and (ii) the actual expense computed in accordance with generally accepted accounting principles for any year.

Reference: *Exhibit 9 (1st Revision); Ms. Perry, Transcript, October 14, 2009, Page 70, Line 9 to Page 71, Line 17.*

The Pension Expense Variance Deferral Account is intended to address the variability and unpredictability associated with forecasting pension expense, including 2010 forecast pension expense.

Reference: *CA-NP-44 (b) (1st Revision).*

The Pension Expense Variance Deferral Account will provide an efficient means of ensuring forecast test year costs approved for establishing customer rates will reasonably reflect the actual cost of providing service. This benefits both Newfoundland Power and its customers.

Reference: *Ms. Perry, Transcript, October 15, 2009, Page 53, Line 1 to Page 54, Line 7.*

Grant Thornton concluded that the use of the Pension Expense Variance Deferral Account will limit the variability of pension expense due to changing assumptions, in particular discount rates. In addition, they concluded that the existing provisions of the Rate Stabilization Clause approved in Order No. P.U. 6 (2008) allows for the flexibility to adjust the Rate Stabilization Account to allow for the disposition of the balance in this deferral account.

Reference: *Grant Thornton 1st Report, Page 8, Lines 1-5.*

It is not the purpose of the Pension Expense Variance Deferral Account to address pension cost variances that result from factors within the Company's control that impact pension expense, such as an early retirement program. Pension cost changes resulting from such programs are not expected to flow through the Pension Expense Variance Deferral Account. Ms. Perry indicated that it was not objectionable that Newfoundland Power notify the Board in advance of any programs or steps it chose to take which could affect pension expense.

Reference: *Ms. Perry, Transcript, October 19, 2009, Page 151, Line 3 to Page 153, Line 10.*

The evidence before the Board is that currently Terasen Gas Inc., Terasen Gas (Vancouver Island) Inc., FortisBC, and Hydro One have mechanisms that permit recovery of *actual* pension costs incurred in each year. FortisAlberta Inc. has proposed a similar mechanism in its current general rate application. Of the sample of 13 U.S. electric and gas utilities of comparable risk to Newfoundland Power, as selected by Ms. McShane for DCF analysis, 11 have deferral mechanisms which provide for recovery of pension expense or post-retirement benefit costs.

Reference: *CA-NP-45(a); CA-NP-18, Attachment A.*

In the Settlement Agreement it has been agreed that the Board should approve the Pension Expense Variance Deferral Account be implemented January 1, 2010. The definition of the Pension Expense Variance Deferral Account is provided in the Settlement Agreement.

Reference: *Settlement Agreement, Items 21-24.*

E.2 Other Post Employment Benefits

E.2.1 Accounting for Employee Future Benefits

Accrual accounting for OPEBs costs is mainstream Canadian regulatory practice.

Newfoundland Power has proposed to adopt accrual accounting for OPEBs costs on a tax effected basis commencing in 2010. It is also proposed that the $46.2 million transitional obligation which will exist at that time be further considered at a future general rate application.

Mr. Todd has recommended that the matter of accrual accounting for OPEBs costs be deferred, and the Company be required to present a further proposal at

its next general rate application to deal with both the adoption of accrual accounting for OPEBs costs and the transitional obligation at that time.

In 2007, the adoption of accrual accounting for OPEBs costs was deferred due to significant increases in the consumer price of electricity. Given the relative stability of electricity prices since that time, further deferral of adoption of accrual accounting for OPEBs costs is not warranted.

Currently, Newfoundland Power recognizes costs associated with OPEBs on a cash basis as opposed to an accrual basis. The cash cost of OPEBs in 2010 is forecast to be $1.7 million. The accrued cost of OPEBs in 2010 is forecast to be $8.4 million.

Reference: *Amended Evidence, Page 3-28, Lines 9-11.*

Under the accrual method of accounting, OPEBs costs are recognized as an expense as employees earn the benefits that they will receive after retirement. As a result, using the accrual method of accounting, OPEBs costs are expensed and included in revenue requirement in the period during which the services giving rise to those costs are provided. The adoption of accrual accounting for OPEBs in 2010 will serve to reduce Newfoundland Power's rate base and the cost of financing the rate base, which is ultimately borne by customers.

Reference: *CA-NP-185 (c) (1st Revision), Page 2, Line 25 to Page 3, Line 6; OPEBs Report, Page 3; OPEBs Report, Page 6.*

Accrual accounting for OPEBs is mainstream regulatory practice in Canada. Of 24 utilities surveyed by Newfoundland Power, 22, or 92%, use the accrual basis of accounting for the recognition of OPEBs costs. Hydro recognizes OPEBs costs on an accrual basis.

Reference: *OPEBs Report, Pages 4 to 5.*

The accounting approach for OPEBs was first considered by the Board in 2003. At that time, regulatory practice was not consistent across Canada. In Order No. P.U. 19 (2003), the Board ordered the Company to submit a report at its next general rate application to address the use of the accrual method as an alternative to the use of the cash method. At its 2008 general rate application, the Company proposed in its original application to adopt the accrual method of accounting for OPEBs expense for regulatory purposes effective January 1, 2008. At that time, 25% of the Canadian utilities surveyed were still using the cash method of accounting for OPEBs. The settlement agreement on the Company's 2008 general rate application provided for the continuation of the cash accounting treatment for OPEBs until the Company's next general rate application. The reason indicated for deferring the adoption of accrual accounting for OPEBs at that time was recent significant increases in the consumer price of electricity.

Reference: *Order No. P.U. 19 (2003), Page 83; Ms. Perry, Transcript, October 14, 2009, Page* 59*, Line 20 to Page 61, Line 3.*

In the Amended Application, Newfoundland Power proposes to adopt the accrual method of accounting for OPEBs costs for regulatory purposes effective January 1, 2010. The Company proposes to tax-effect accrued OPEBs costs. In addition, the Company is proposing that the disposition of the $46.2 million legacy transitional obligation be addressed at a future general rate proceeding.

Reference: *Amended Evidence, Page 3-29, Line 6 to Page 3-30, Line 10; OPEBs Report, Page 12.*

Grant Thornton reviewed the Company's OPEBs proposal. They concluded that: (i) the Company's proposal is in accordance with Canadian GAAP; (ii) is consistent with the Company's treatment of pension costs; and (iii) is consistent with Hydro's OPEBs accounting practice. Grant Thornton indicated that the Company's proposed treatment of tax for OPEBs was in accordance with Canadian GAAP and consistent with its treatment of tax related to pension costs. Grant Thornton also concluded that if the Board approves the Company's proposal to adopt accrual accounting for OPEBs, the legacy transitional balance of $46.2 million will not change in subsequent years.

Reference: *Grant Thornton 1st Report, Page 4, Lines 32-35, Page 5, Lines 15-17, and Page 6, Lines 5-10.*

Mr. Todd, on behalf of the Consumer Advocate, gave evidence that accrual accounting for OPEBs has become the mainstream regulatory practice in Canada and that accrual accounting for OPEBs is consistent with intergenerational equity. Mr. Todd recognizes that moving from the cash basis of accounting to an accrual basis of accounting for OPEBs is appropriate.

Reference: *Mr. Todd, Transcript, October 27, 2009, Page 102, Line 8 to Page 105, Line 8 and Page 123, Line 3 to Page 125, Line 8.*

Mr. Todd recommended that the matter of adopting accrual accounting for OPEB costs be deferred and the Company be required to present a further proposal at its next general rate application. The three reasons he gave were: (i) the introduction of risks associated with volatility of OPEBs costs calculated on an accrual basis were similar to those associated with volatility in pension costs; (ii) the uncertainty of OPEBs costs in light of the 2010 benefits review; and (iii) that the change to accrual accounting and the transitional obligation should be considered as a package. Mr. Todd explained that consideration of the change to accrual accounting and the transitional obligation as a package permitted the Board to fix an amount to be included in expenses for the test year which could be designed to be large enough to include the current OPEBs expense on an accrual basis plus some amount on top of that to reduce the transitional amount. He also indicated that deferral of a decision to move to the accrual method would increase the magnitude of the transitional obligation.

Reference: *Mr. Todd, Transcript, October 27, 2009, Page 83, Line 12 to Page 87, Line 8; Page 125, Line 19 to Page 127, Line 5; and Page 122, Line 4 to Page 123, Line 1.*

It was Ms. Perry's evidence that: (i) the additional volatility associated with OPEBs costs being calculated on an accrual basis was one third of that associated with volatility in pension costs; (ii) the impact on OPEBs costs as a result of the 2010 review was unknown and any changes that should occur will be incorporated in customer rates going into the future; and (iii) the Newfoundland Power proposal was balanced in that it deferred consideration of recovery of the transitional obligation and thereby moderated the immediate impact of the accounting change on customer rates. On the issue of the 2010 review, Ms. Perry indicated:

> "The change that will come about as a result of this review is, it's completely unknown at this point in time. I suspect that some change will occur, that change will occur in the future and certainly when those changes are known and if they do have a cost impact, that will certainly be factored into customer rates in the future. But in terms of waiting until we can actually nail down the accrued OPEBs' cost on an annual basis, I don't think it's necessary to wait. Adoption of accrual accounting is a better estimate of what today's costs are based on the plan that we have today

> and certainly if we continue to wait, the transitional obligation will continue to grow and it's certainly going to be a bigger cost that we have to deal with in the future."

Reference: *Ms Perry, Transcript, October 19, 2009, Page 43, Line 24, to Page 44, Line 23; Page 99, Line 8 to Page 101, Line 3; and October 14, 2009, Page 61, Lines 5-22; OPEBs Report, Page 13.*

E.2.2 Cost of Other Post Employee Benefits

The Consumer Advocate has taken issue with the fact that post age 65 retirees do not currently contribute to premiums costs associated with retirement benefits.

The Company's payment of the full cost of premiums associated with current post age 65 retiree benefits is, in all the circumstances, reasonable.

Newfoundland Power intends to review its benefits program, including benefits provided to post age 65 retirees, in 2010. While this review may result in changes to OPEBs costs, the extent of any change is currently uncertain.

The OPEBs provided by the Company to its retirees include allowances payable on retirement and medical and life insurance for retirees and their dependents. Once a retiree reaches the age of 65, their medical and life insurance benefits are reduced. Medical coverage is reduced to a maximum of $5,000 per person per year, and life insurance is reduced to $10,000.

Reference: *Ms. Perry, Transcript, October 14, 2009, Page 61, Line 24 to Page 63, Line 5.*

Newfoundland Power currently pays the full cost of insurance coverage for retirees over the age of 65. For retirees up to the age of 65, the cost of insurance is shared on a 50/50 basis between the Company and the retiree. The average annual cost of current Newfoundland Power medical insurance for retirees over the age of 65 is $2,580 per retiree.

Reference: *CA-NP-345 (d), Page 3.*

In March 2009, Newfoundland Power agreed with IBEW Local 1620 to review the group benefits program affecting current employees of the Company. In concert with this review, Newfoundland Power intends to review the group benefits program which currently applies to retirees of the Company. This review is expected to be concluded by the end of 2010.

Reference: *CA-NP-345 (e), Page 4; Ms. Perry, Transcript, October 19, 2009, Page 89, Line 19 to Page 91, Line 25.*

Ms. Perry gave context for the timing of this review in evidence. Following a group insurance plan review completed in late 2005, the Company changed insurance carriers for employee benefits in October 2006. At this time, there was an initial indication of a benefits review being conducted in 2007. However, in 2007 as Newfoundland Power was about to come out of a 5-year collective agreement, there was a pension committee struck to investigate how to improve the defined benefit pension plan. The Company's defined benefit pension plan was seen as deficient when compared to others. A decision was made not to touch other post employment benefits at this time as improvements to the Company's defined benefit pension plan was a big issue. Collective bargaining concluded without making changes to the defined benefit pension plan because they were simply too costly. As part of collective bargaining, the Company managed to open up the door with respect to reviewing its benefits plan. Retiree benefits as well as future retiree benefits will be included in this review.

Reference: *Ms. Perry, Transcript, October 19, 2009, Page 83, Line 25 to Page 91, Line 25; CA-NP-293, Attachment A.*

Newfoundland Power has assessed the reasonableness of the cost of health insurance coverage for retirees over the age of 65 by comparison to the benefits provided by Hydro. The average annual premium cost per retiree of Newfoundland Power's current arrangements was $260, or approximately 10%, higher than that estimated for coverage similar to that provided by Hydro. In the context of total benefits for current retirees over the age of 65, including pension benefits, this was considered reasonable.

Reference: *Ms. Perry, Transcript, October 14, 2009, Page 64, Line 20 to Page 66, Line 24.*

The average defined benefit pension currently paid by Newfoundland Power to retirees over the age of 65 is less than $14,000 per year. The total Company pension could be a couple of thousand dollars higher including the 1.5% supplemental group RRSP.

Reference: *Mr. Ludlow, Transcript, October 14, 2009, Page 44, Lines 21-23; Ms. Perry, Transcript, October 19, 2009, Page 73, Line 1 to Page 76, Line 6.*

Modification of post retirement benefits for future retirees, including modification to provide for cost sharing of medical benefits, would practically require a number of considerations. One consideration is the impact of the modification on overall post retirement benefits. Another consideration is the provision of reasonable notice to employees of the modifications to enable them an opportunity to adjust their personal retirement plans. A third consideration is whether transitional arrangements are warranted in the circumstances. This approach was taken by Newfoundland Power when it closed its defined benefit pension plan to new entrants in 2004.

Reference: *CA-NP-345(e), Page 4, Lines 9-26.*

The evidence indicates a reduction in OPEBs benefits will reduce annual OPEBs costs. On the question of what the possible cost changes arising from the benefits review might be, Ms. Perry indicated as follows:

> "If we just simply assume that we make the changes that you're referring to, Mr. Earle, the expense would be two million or so lower going forward, but I guess that's where I struggle with respect to making that assumption that that is going to be the change. I simply do not know the change today or the magnitude of the change and I also do expect that there will be a reasonable notice period. I don't expect to see changes January 1, 2010 and there may be some transitional arrangements that we will make to secure or to institute change in our post retirement benefits, and I'd even go as far as to say that we may actually incur some costs in the short term to achieve any long-term savings. So with respect to what the cost changes are going to be, at this particular point that 2.5 that you're referring to is a scenario that you ask for, but it's certainly not, it's not something that is on the table today with respect to what it is we're actually going to do. So the cost changes at this point are still unknown."

Reference: *Ms. Perry, Transcript, October 19, 2009, Page 101, Line 13 to Page 102, Line 22.*

E.3 Supply Cost Recovery Mechanisms

Current supply cost dynamics on the electrical system are such that Newfoundland Power's marginal cost of supply exceeds its marginal revenues. To address this, in Order No. P.U. 32 (2007), the Board ordered the establishment of regulatory mechanisms to (i) permit reasonable recovery of wholesale supply

costs in customer rates and (ii) incent continued Company initiatives to minimize peak demand.

It has been agreed that the Board should approve continuation of the Demand Management Incentive Account and the recovery of energy supply cost variances through the Rate Stabilization Account as proposed in the Amended Application, until further order of the Board.

Background

In Order No. P.U. 44 (2004), the Board approved a demand and energy wholesale pricing structure for Hydro's electricity supply to Newfoundland Power effective January 1, 2005. To mitigate the risk of insufficient recovery of Newfoundland Power's supply costs and provide an incentive to take reasonable action to minimize peak demand requirements, the Board approved the creation of the Purchased Power Unit Cost Variance Reserve ("PPUCVR").

Reference: *CA-NP-373, Page 1, Lines 23-36*.

In Order No. P.U. 32 (2007), the Board approved the Demand Management Incentive ("DMI") Account to replace the PPUCVR and an addition to the Rate Stabilization Clause to provide for reasonable recovery of energy supply costs.

Reference: *CA-NP-373, Page 1, Line 38 to Page 2, Line 32.*

The implementation of the demand and energy wholesale pricing structure in 2005, in combination with the reserves that have been implemented since that time, has effectively served to increase the financial impact of supply cost variances by +/-1% of annual wholesale demand costs.

Reference: *CA-NP-373, Page 2, Lines 39-43.*

DMI Account

The DMI Account limits the impacts on the Company of variability in demand supply cost to +/-1% of test year wholesale demand charges.

Reference: *DMI Report, Page 1.*

In Order No. P.U. 32 (2007), the Board directed Newfoundland Power to provide, with its next general rate application, a report on the operation of the DMI Account, setting out any recommendations for changes if necessary. The Company has filed the DMI Report in compliance with the Order.

Reference: *DMI Report, Page 1.*

The operation of the DMI Account and its predecessor, the PPUCVR Account, has resulted in supply cost savings to the benefit of customers and the Company. Since 2005, approximately $3.2 million of the $5.4 million in cumulative savings have been credited to the benefit of customers.

Reference: *DMI Report, Page 2; Amended Evidence, Page 5-14, Lines 1-4.*

The DMI Account provides a meaningful incentive for Newfoundland Power to undertake reasonable initiatives to minimize peak demand.

Reference: *DMI Report, Page 2.*

The DMI Account provides better transparency in monitoring supply cost variability resulting from variability in peak demand than the PPUCVR Account it replaced. The Company does not recommend any changes to the DMI Account.

Reference: *Amended Evidence, Page 5-14, Line 9.*

It has been agreed in the Settlement Agreement that no changes should be made to the DMI Account. It has also been agreed in the Settlement Agreement that Newfoundland Power will provide a report to the Board on the performance of the DMI Account with its next general rate application. The required contents of the report are outlined in the Settlement Agreement.

Reference: *Settlement Agreement, Items 19-20.*

Energy Supply Cost Recovery

In January 2007, the 2nd block of the wholesale energy rate from Hydro increased from 4.7¢ per kWh to 8.805¢ per kWh (the "Marginal Supply Cost"). This increase in the Marginal Supply Cost resulted in a dramatic increase in the cost to Newfoundland Power to supply increases in customer load primarily resulting from the addition of new customers.

Reference: *ESCV Report, Page 1; Amended Evidence, Page 5-14, Lines 12-14.*

The increased Marginal Supply Cost is the result of higher fuel costs related to production at Holyrood. The wholesale rate effective January 1st, 2007 remains the wholesale rate for forecasting supply costs for 2010. Therefore, Marginal Supply Costs continue to exceed the average supply costs which are embedded in Newfoundland Power's customer rates.

Reference: *ESCV Report, Page 1; Amended Evidence, Page 5-14, Lines 15-17.*

In Order No. P.U. 32 (2007), the Board approved an amendment to the Rate Stabilization Clause to ensure reasonable recovery of prudently incurred energy supply costs. The amount charged to the Rate Stabilization Account is the difference between the marginal energy supply cost and the average energy supply cost (the "Energy Supply Cost Variance"). In Order No. P.U. 32 (2007), the Board indicated they would carry out a review of the recovery of the Energy Supply Cost Variance through the Rate Stabilization Account at the next general rate proceeding. The Company has filed the ESCV Report to assist the Board in its review.

Reference: *Order No. P.U. 32 (2007), Page 27; ESCV Report, Page 1.*

The Rate Stabilization Clause provides that on December 31st of each year from 2008 up to and including 2010, the Rate Stabilization Account shall be increased (reduced) by the Energy Supply Cost Variance.

Reference: *Order No. P.U. 32 (2007), Schedule B, Page 5.*

There continues to be a requirement for the recovery of the Energy Supply Cost Variance through the Rate Stabilization Account to permit Newfoundland Power the opportunity to recover prudently incurred energy supply costs.

Reference: *Amended Evidence, Page 5-16, Lines 6-8.*

It has been agreed in the Settlement Agreement that the Board should approve the continued use of the Energy Supply Cost Variance clause in the Rate Stabilization Account until further order of the Board.

Reference: *Settlement Agreement, Item 16.*

E.4 International Financial Reporting Standards

Effective January 1, 2011, all publicly accountable enterprises in Canada will be required to comply with International Financial Reporting Standards, or IFRS.

For regulated utilities in Canada, the preeminent outstanding issue associated with IFRS is the future accounting treatment of regulatory assets and liabilities. There is still a measure of uncertainty pertaining to this issue.

Grant Thornton has recommended that the Board require the Company to provide updates on the status of its transition to IFRS as part of its quarterly reporting to the Board. The Company accepts this recommendation as reasonable.

To facilitate its transition to IFRS, Newfoundland Power has proposed to complete its next depreciation study based on plant in service at December 31, 2009. It has been agreed that the Board should approve this proposal.

The Canadian Accounting Standards Board, the committee of the Canadian Institute of Chartered Accountants responsible for establishing Canadian GAAP, has adopted a strategic plan to transition Canadian GAAP to IFRS by 2011.

Reference: *Amended Evidence, Page 3-31, Lines 14-19; Grant Thornton 1st Report, Page 51, Lines 3-9.*

For regulated utilities in Canada, the future accounting treatment of regulatory assets and liabilities is the preeminent issue. Canadian rate regulated enterprises, including Newfoundland Power, recognize the economic effects of regulatory decision making in external financial statements through the use of regulatory assets and liabilities. Regulatory assets and liabilities are typically created in cost of service regulation by timing differences that reflect the economic impact of regulatory decision making. The creation of regulatory assets and liabilities is an accepted feature of current Canadian regulatory practice.

***Reference**: Amended Evidence, Page 3-32, Lines 7-8; Ms. Perry, Transcript, October 19, 2009, Page 154, Line 16 to Page 155, Line 10; Amended Evidence, Page 3-32, Line 12 to Page 3-33, Line 17.*

In July 2009, the International Accounting Standards Board, which is responsible for IFRS, published an exposure draft concerning the recognition and measurement criteria for regulatory assets and liabilities. This exposure draft accepts in principle that rate regulation may create assets and liabilities recognizable under IFRS. A final standard is currently expected to be published in June 2010. Based on the scope criteria identified in the exposure draft, Newfoundland Power would qualify as a utility that can recognize regulatory assets and liabilities. Until a final standard indicating the details of recognition and measurement criteria is released, a measure of uncertainty will continue to exist surrounding the treatment of regulatory assets and liabilities upon adoption of IFRS in 2011. This is because it is possible for elements of any exposure draft to change considerably when a final standard is issued.

***Reference**: Amended Evidence, Page 3-35, Lines 1-10; Ms. Perry, Transcript, October 19, 2009, Page 154, Line 21 to Page 156, Line 1; Grant Thornton 1st Report, Page 51, Lines 28-36.*

Grant Thornton has reviewed Newfoundland Power's progress to date with respect to IFRS transition and have concluded that the Company is working toward the IFRS conversion timelines and appears to have a robust implementation plan in place.

***Reference**: Grant Thornton 1st Report, Page 52, Lines 20-22.*

In Order No. P.U. 32 (2007), the Board ordered Newfoundland Power to provide an update on the status of the Canadian Accounting Standards Board considerations of the transition to IFRS as part of its quarterly reporting. Grant Thornton has recommended that the Company provide updates on the status of its transition to IFRS as part of its quarterly reports to the Board.

***Reference**: Order No. P.U. 32 (2007), Page 61, Item 20; Grant Thornton's 1st Report, Page 52, Lines 24-31; Ms. Perry, Transcript, October 19, 2009, Page 153,Lines 12-20.*

In Order No. P.U. 32 (2007), the Board ordered Newfoundland Power to file its next depreciation study relating to plant in service as of December 31, 2010. In light of Newfoundland Power's requirement to file IFRS compliant financial statements in 2011, which include comparative results for 2010 and 2011, Newfoundland Power is proposing that the next depreciation study relate to plant in service as of December 31, 2009. A depreciation study as of December 31, 2009 will provide detailed information concerning the Company's property, plant and equipment that can be used in comparative financial statements for 2010 and 2011. Grant Thornton has concluded that a depreciation study as of December 31, 2009 would provide the Company with detailed information on its property, plant and equipment to facilitate transition to IFRS.

***Reference:** Order No. P.U. 32 (2007), Page 60, Item 15; Amended Evidence, Page 3-37, Lines 8-17; Ms. Perry, Transcript, October 14, 2009, Page 8, Line 20 to Page 9, Line 2; Grant Thornton 1st Report, Page 52, Lines 14-16.*

Newfoundland Power's proposal to complete its next depreciation study based on plant in service as of December 31, 2009 has been agreed in the Settlement Agreement.

Reference: *Settlement Agreement, Item 26.*

F. 2010 REVENUE REQUIREMENTS AND RATES

F.1 Customer, Energy and Demand Forecast

Section 3(a)(ii) of the Electrical Power Control Act, 1994 states that rates should be established wherever practicable based on forecast costs.

The evidence shows that Newfoundland Power's 2010 Customer, Energy and Demand Forecast is appropriate for the purposes of establishing 2010 customer rates. It has been agreed that the Board may accept and rely upon the 2010 Customer, Energy and Demand Forecast filed with the Amended Application.

Newfoundland Power's 2010 Customer, Energy and Demand Forecast indicates that: (i) the number of customers the Company will serve will increase by 1.1% from 2009; (ii) energy sales will increase by 1.2% from 2009; and (iii) purchased peak demand will increase by 1.3% from 2009. These forecasts include the impact of price elasticity associated with the proposed average increase of 7.2% effective January 1, 2010, as well as the impact of conservation and demand management programs.

Reference: *Customer, Energy and Demand Forecast, Page 5 and 6; Amended Evidence, Page 5-3, Line 1 to Page 5-5, Line 10; CA-NP-313 (1st Revision), Lines 18-28; CA-NP-159.*

Newfoundland Power's actual energy sales have differed from forecast by 1% or less in 6 of the past 10 years. Actual differences from forecast have ranged from –2.8% to +2.4% over this period. Differences between forecast and actual energy sales have been higher half of the time and lower half of the time through this period.

Reference: *Customer, Energy and Demand Forecast, Page 6; Appendix D.*

The assumptions used in forecasting revenue and expenses are based upon and incorporate data from independent sources. The overall methodology used by the Company for estimating revenue, expenses and net earnings is similar to the process and methodology used in the 2008 General Rate Application.

Reference: *Grant Thornton 1st Report, Page 23, Lines 25-27 and Page 24, Lines 9-11.*

The 2010 Customer, Energy and Demand Forecast filed with the Amended Application did not include any methodological revisions to the original forecast; rather, inputs were updated based on more recent information. The changes to the 2010 Customer, Energy and Demand Forecast have been appropriately incorporated into the 2010 forecast of revenue requirement, forecast average rate base and forecast rate of return on average rate base.

Reference: *Grant Thornton 2nd Report, Page 2, Lines 8-10 and Page 3, Lines 13-15.*

In the Settlement Agreement it was agreed that the Board may accept and rely upon the 2010 Customer, Energy and Demand Forecast in establishing 2010 customer electricity rates.

Reference: *Settlement Agreement, Items 7-9.*

F.2 Summary of 2010 Revenue Requirements

The evidence before the Board shows that Newfoundland Power's forecast 2010 revenue requirements including the revenue required to be recovered from customer rates appropriately reflect the proposals in the Amended Application.

Table F-1 provides a summary of the Company's 2010 revenue requirements proposed in the Amended Application.

Table F-1
Summary of 2010 Revenue Requirements
($000s)

Power Supply Cost	349,009
Operating Costs (including OPEBs)	67,226
Depreciation & Related Amortization	47,244
Income Taxes	21,300
Return on Rate Base	79,361
2010 Revenue Requirements	**564,140**
Deductions	(18,223)
2010 Revenue Requirements from Rates	**545,917**

Reference: *Amended Evidence, Page 4-3; Exhibit 7 (1st Revision).*

Grant Thornton has reviewed the Company's 2010 revenue requirement and has indicated that the 2010 revenue requirement properly reflects the proposals and incorporates the impact of the revised forecasts included in the Amended Application.

Reference: *Grant Thornton 2nd Report, Page 5, Lines 7-9.*

The forecast increase in revenue from rates to meet the Company's 2010 proposed revenue requirement is approximately $36.7 million. This increase in revenue requires an average increase in current customer rates of 7.2% effective January 1, 2010.

Reference: *Amended Evidence, Page 4-7, Table 4-8; Exhibit 10 (1st Revision); Exhibit 11 (1st Revision).*

F.3 Customer Rates

Section 70 of the Public Utilities Act requires that the Board approve a schedule of rates, tolls and charges.

Section 3(a) of the Electrical Power Control Act, 1994 requires that the rates to be charged should be reasonable and not unjustly discriminatory, established based on forecast costs, and provide sufficient revenue to enable the retailer of power to earn a just and reasonable return.

The evidence before the Board shows that Newfoundland Power's rate change proposals are reasonable and not unjustly discriminatory. The evidence before the Board also shows that the proposed customer rates to be effective January 1, 2010 will recover the forecast 2010 revenue requirement from rates of $545,917,000 contained in the Amended Application.

Maintaining revenue to cost ratios for each class within the range of 90% to 110% has been an accepted approach to ensure that there is no undue cross-subsidization among the various classes.

The revenue to cost ratios for the General Service 0-10 kW class (Rate 2.1) and 10-100 kW (110 kVA) class (Rate 2.2) are materially greater than 110%, while the General Service 110-1000 kVA class (Rate 2.3) is slightly above 110%. Rates should change to reduce the revenue to cost ratios for these classes.

In 2007, Newfoundland Power indicated it intended to bring all customer classes within the target revenue to cost ratio range at its next general rate proceeding. The customer rates proposed in the Amended Application achieve continued progress towards the target 90% to 110% cost recovery range in 2010. The Company is now proposing to complete the cost recovery adjustments to achieve the target revenue to cost ratios for Rates 2.1 and 2.2 coincident with implementation of the rates that result from the Retail Rate Review.

Reference: *Amended Application, Schedule A; Amended Evidence, Page 5-9, Line 1 to Page 5-10, Line 2.*

Table F-2 provides the 2010 proposed relative rate change by class and the resulting *pro forma* revenue to cost ratios.

Table F-2
Proposed Relative Rate Changes by Class

Rate	**Class**	**Relative to Average**	***Pro forma* Revenue to Cost Ratios**
1.1	Domestic	0.7% above	94.8
2.1	General Service 0-10 kW	2% below	113.6
2.2	General Service 10-100 kW (110 kVA)	2% below	112.8
2.3	General Service 110-1000 kVA	1% below	109.3
2.4	General Service 1000 kVA and Over	Equal	104.4
4.1	Street and Area Lighting	Equal	103.1

The proposed changes in customer rates will result in reduced revenue to cost ratios for Rates 2.1, 2.2 and 2.3 and an increased revenue to cost ratio for Rate 1.1.

Reference: *Amended Evidence, Page 5-10, Line 4 to Page 5-10, Line 9.*

The current relationship of demand and energy charges to marginal costs indicates that an emphasis on increasing energy charges is reasonable at this time. Accordingly, the required increase in revenue from rates resulting from the Amended Application for the Domestic and General Service classes is proposed to be recovered through increases in energy charges. This approach is broadly consistent with the marginal cost focus of the Retail Rate Review.

Reference: *Amended Evidence, Page 5-6, Line 13 to Page 5-8, Line 2.*

The proposed rates for all classes of service, excluding Street and Area Lighting, were derived by recovering the required increase in revenue from rates through increased energy charges. The Street and Area Lighting rates were derived, consistent with past practice, so that the prices of fixtures, poles and wiring vary in a manner reflective of the differences in fixed costs and variable operating costs.

Reference: *Amended Evidence, Page 5-11, Lines 8-16.*

It is proposed that the availability of the Curtailable Service Option for General Service customers be maintained based on the current credit of $29 per kVA. The Curtailable Service Option provides operational benefits in dealing with system constraints on the isolated system, and it may be beneficial in planning for future system capacity requirements. The Curtailable Service Option may provide additional benefits should the Labrador Infeed proceed.

Reference: *Amended Evidence, Page 5-11, Lines 18-19; CA-NP-188(d).*

There is no evidence before the Board indicating the Company's approach to proposed January 1, 2010 customer rate changes, as contained in the Amended Application, is unreasonable or unjustly discriminatory.

The customer rates effective January 1, 2010, proposed in the Amended Application, will recover the forecast 2010 revenue requirement from rates of $545,917,000.

Reference: *Exhibit 10 (1st Revision); PUB-NP-10; Grant Thornton 2nd Report, Page 5, Lines 17-19.*

G. OTHER MATTERS

G.1 General Observations

In this proceeding, the Consumer Advocate has raised a number of issues that essentially appear to suggest the Board should take a particular action. These issues are canvassed in this section of Newfoundland Power's written submissions.

For these issues, there has been no evidence put before the Board to support any action. It is the Company's view that the Board has not been provided a sufficient evidentiary basis to justify any action in respect of them.

G.2 Other Matters

G.2.1 Inter-Corporate Transactions

Inter-corporate transactions has been identified by the Consumer Advocate as an issue in this proceeding. At the hearing, the focus of this issue was on storm assistance provided by Newfoundland Power to other utilities, and on secondments of Newfoundland Power personnel to Fortis affiliates

Reference*: Consumer Advocate's Issues List, Item 7.*

Storm Response

In 2008, Newfoundland Power contributed to a relief effort involving a number of utilities to assist in the repair of major damage sustained to the electrical system of Fortis Turks and Caicos as a result of hurricanes. The relief effort involved personnel from Fortis utilities as well as from local Caribbean utilities that are part of a network. Newfoundland Power was compensated for the time spent by its field personnel on the basis of fully distributed costs, except for the time that was spent by Managers which was compensated at 1.2 times fully distributed cost. All charges by Newfoundland Power related to the relief effort were made in accordance with its Inter-Corporate Transactions Policy.

Reference: *Mr. Ludlow, Transcript, October 15, 2009, Page 14, Line 4 to Page 16, Line 10; Mr. Smith, Transcript, October 27, 2009, Page 36, Line 24 to Page 37, Line 16; October 26, 2009, Page 111, Line 2 to Page 112, Line 22; CA-NP-148 (1st Revision); CA-NP-270; CA-NP-271.*

In the past 15 years, Newfoundland Power has participated in three such Caribbean relief efforts for affiliated Fortis utilities. On a number of occasions, Newfoundland Power has provided assistance to and received assistance from Hydro. Such efforts are common among electrical utilities.

Reference: *CA-NP-269; Mr. Smith, Transcript, October 27, 2009, Page 34, Line 8 to Page 36, Line 6.*

Such assistance is provided when it does not negatively impact Newfoundland Power's customers. A primary benefit of participating in such restoration efforts is reciprocity. Because safety rules, work methods and practices, and equipment are standardized among Fortis utilities, crews from those utilities can be mobilized very safely and quickly in a storm restoration situation. The evidence indicates that Caribbean line crews have worked effectively in winter conditions and demonstrated knowledge of the proper work techniques and procedures.

Reference: *Mr. Smith, Transcript, October 26, 2009, Page 134, Line 11 to Page 137, Line 4; October 26, 2009, Page 114, Line 14 to Page 115, Line 23;October 26, 2009, Page 119, Line 14 to Page 121, Line 2.*

The evidence indicates that unaffiliated utilities pay fully distributed cost for storm restoration assistance.

Reference: *Mr. Smith, Transcript, October 27, 2009, Page 36, Lines 8-22.*

Secondments

During the period 2007 to present, four Newfoundland Power employees were seconded to other Fortis Inc. utilities. Secondments provide career development opportunities for the seconded employee, as well as for any employee who temporarily assumes the duties of the seconded employee. When seconded employees return to their regular employment they bring new skills, knowledge and experience which ultimately benefits both Newfoundland Power and the individual employee.

Reference*: CA-NP-150; CA-NP-278.*

Mr. Ludlow testified that he views secondments as an opportunity for an employee to grow and learn, and to have someone else pay for the training.

Reference*: Mr. Ludlow, Transcript, October 15, 2009, Page 10, Line 25 to Page 12, Line 2.*

Secondments can sometimes provide an opportunity to assist Newfoundland Power in its ongoing efforts to consolidate, reorganize and reduce costs. Mr. Ludlow testified that the secondment of Newfoundland Power's Treasurer following the 2008 general rate proceeding occurred at a time when the Company was being reorganized. Following the reorganization and the secondment, Newfoundland Power determined that it no longer required someone in the Treasurer position, and the individual in question remained with the affiliate.

Reference*: Mr. Ludlow, Transcript, October 15, 2009, Page 12, Line 4 to Page 13, Line 3.*

In another instance, the secondment of the Director of Environment provided a development opportunity for others in the Environment section. When the seconded individual ultimately returned to Newfoundland Power, he was able to take on a different role, while his former responsibilities were assumed by another individual.

Reference*: Mr. Ludlow, Transcript, October 15, 2009, Page 13, Line 5 to Page 14, Line 2.*

Seconded employees are charged at fully distributed cost.

Reference: *Ms. Perry, Transcript, October 19, 2009, Page 2, Line 10 to Page 3, Line 8; CA-NP-150.*

G.2.2 Kenmount Road Property

The appropriate treatment of the gain from the sale of land on Kenmount Road, St. John's, has been identified by the Consumer Advocate as an issue in this proceeding.

Reference*: Consumer Advocate's Issues List, Item 9.*

From 1961 to 1989, Newfoundland Power assembled a parcel of land adjacent to its head office property on Kenmount Road, St. John's. The land did not have significant street frontage on Kenmount Road. The total book value of the land was $234,000, including the cost of a 2009 land survey.

Reference*: CA-NP-281; CA-NP-184, Attachment A, see drawing for street frontage on Kenmount Road.*

The Kenmount Road land was assembled as a central location for future Newfoundland Power offices and operations in St. John's. The land was never used for that purpose, and remained vacant and unimproved. Newfoundland Power subsequently decided to construct its regional operations centre on Duffy Place, and its control centre on Topsail Road.

Reference*: Mr. Ludlow, Transcript, October 15, 2009, Page 30, Line 25 to Page 39, Line 4; Ms. Perry, Transcript, October 19, 2009, Page 6, Line 18 to Page 10, Line 8.*

In 2009, the automobile dealership that occupied the property to the west and north of Newfoundland Power's land at Kenmount Road was expanding its facilities. It came to Newfoundland Power's attention that the owner of the dealership was interested in acquiring the vacant Kenmount Road land for the dealership's use. Newfoundland Power sold the land to the dealership for $618,000.

Reference*: Ms. Perry, Transcript, October 19, 2009, Page 3, Line 22 to Page 4, Line 10; CA-NP-184 (a).*

The gain of $345,000 on the sale of the land was recorded as miscellaneous revenue and included in Other Revenue in Newfoundland Power's books of account.

Reference*: Amended Evidence, Page 3-4, Table 3-2.*

In his report filed in this proceeding, the Consumer Advocate's witness, Mr. Todd, listed options that may merit the Board's consideration for dealing with the gain on the sale of the Kenmount Road land. They included accepting the Company's *proposal* that 100% of the gain accrue to the Company; recognizing a portion of the gain as a credit to customers; and sharing the gain in a proportion that is deemed to be equitable.

Reference*: Todd Evidence, Page15, Line 20 to Page 16, Line 4.*

Newfoundland Power has made no proposal regarding treatment of the gain on the sale of the Kenmount Road land. Newfoundland Power's accounting treatment of the gain from the sale of the Kenmount Road land is in accordance with the historical regulatory practice in this jurisdiction of treating the financial impact of *ad hoc* land sales as miscellaneous revenue or losses. A gain on the sale of surplus land at Duffy Place, which was a subject of Board consideration in Order No. P.U. 36 (1998-1999), was accounted for in the same manner.

Reference*: CA-NP-184 (c); Ms. Perry, Transcript, October 19, 2009, Page 7, Line 5 to Page 9, Line 5.*

With this accounting treatment of the gain from the sale of the Kenmount Road land, Newfoundland Power's forecast regulated return on equity for 2009 is 8.62%.

Reference: *Exhibit 3 (1st Revision), Page 1, Line 36.*

G.2.3 Mobile River Watershed Litigation

Whether a deferral account should be established to capture the liabilities and benefits associated with the litigation and ultimate resolution of the Mobile River Watershed dispute with the City of St. John's has been identified by the Consumer Advocate as an issue in this proceeding.

Reference*: Consumer Advocate's Issues List, Item 10.*

By a lease dated October 21, 1949 (the "Lease"), the City of St. John's (the "City") granted to Newfoundland Power certain rights, including water rights, within the watershed of the Mobile River. The Lease was for a fifty-year term, renewing automatically thereafter for five-year periods, with a right of termination by the City upon three years' notice after forty-seven years.

Reference*: CA-NP-264, Attachment A.*

Newfoundland Power subsequently constructed hydroelectric generating facilities in the Mobile River watershed. These facilities annually supply approximately 49 GWh of low cost hydroelectric energy to the Island interconnected grid.

Reference*: CA-NP-265.*

On February 9, 2006, the City of St. John's notified Newfoundland Power in writing of its intention to terminate the Lease. The Lease requires the City to pay to Newfoundland Power upon termination the value of the hydroelectric assets. An arbitration panel appointed pursuant to the terms of the Lease to determine the value of the assets has made a ruling on certain preliminary questions in the matter. The City has appealed this ruling to the Supreme Court of Newfoundland, Trial Division. The Court's decision on the matter is pending.

Reference*: CA-NP-263; CA-NP-264, Attachment A; CA-NP-139.*

Section 48 of the *Public Utilities Act* provides as follows:

> *A public utility shall not sell, assign or transfer the whole of its undertaking or a part of it to a person or corporation until the approval of the board has been obtained.*

Reference*: Public Utilities Act, RSNL 1990, c. P-47, s. 48.*

Until such time as the litigation regarding the Mobile River Watershed is resolved, it is uncertain whether there will be any transfer of the Mobile River hydroelectric assets to the City. Before any transfer to the City of the Mobile River assets that would give rise to payment to Newfoundland Power of the value of the assets, the matter will be submitted to the Board for consideration and approval in accordance with Section 48 of the *Public Utilities Act*.

Consideration in this proceeding of the need for a deferral account to capture the liabilities and benefits associated with the litigation and ultimate resolution of the Mobile River Watershed dispute with the City of St. John's is premature.

Reference: *Mr. Ludlow, Transcript, October 15, 2009, Page 27, Line 19 to Page 28, Line 12.*

2010 Return on Equity
Summary of Expert Recommendations

Expert Witness	McShane	Booth	Cicchetti
Recommended Return on Equity	**11.0%**	**7.75%**	**9.6%**
Test Results:			
1. Equity Risk Premium			
Risk-Free Rate	4.25%[1]	4.5%[2]	4.625%[3]
Market Risk Premium	6.75%[4]	5.0%[5]	6.4%[6]
Beta	0.65 – 0.70[7]	0.50[8]	0.66 - 0.69[9]
Utility Equity Risk Premium	-	2.5%[10]	4.35%[11]
Risk-Adjusted Equity Market	4.5%[12]	-	-
DCF-Based	5.35%[13]	-	-
Historic Utility	6.25%[14]	-	-
Indicated Cost of Equity	8.75% - 10.5%[15]	7.0%[16]	9.0%[17]
Allowance for Financing Flexibility	0.50%[18]	0.50%[19]	-[20]
Other Adjustments	-	0.25%[21]	-
Indicated Fair Return on Equity	**10.25%**	**7.75%**	**9.0%**
2. Discounted Cash Flow			
Indicated Cost of Equity	10.5% – 11.0%[22]	-	9.6%[23]
Financing Flexibility	0.50%[24]	-	-[25]
Indicated Fair Return on Equity	**11.0% - 11.5%**	**-**	**9.6%**
3. Comparable Earnings	**11.5% – 11.75%** [26]	**-**	**-**
Equity Ratio[27]	**45%**[28]	**45%**[29]	**45%**[30]

Notes

1 McShane Evidence, p. 42, lines 1035-1041.

2 Booth Evidence, p. 47, lines 20-22.

3 Cicchetti Evidence, p. 24, lines 515-517.

4 McShane Evidence, p. 50, lines 1243-1244.

5 Booth Evidence, p. 47, line 15.

6 Mr. Cicchetti, Transcript, October 22, 2009, Page 136, Lines 22-25.

7 McShane Evidence, p. 55, lines 1374-1375.

8 Booth Evidence, p. 47, lines 18-20.

9 Cicchetti Evidence, p. 20, lines 420-428.

10 Dr. Booth performed two equity risk premium tests. The first indicated a utility equity risk premium of 2.5% over forecast long Canada bond yields. See Booth Evidence, p. 47, line 20. The second test which indicated a cost of equity of 7.0% that was identical to the indicated cost in the first equity risk premium test. The second test was based upon risk premiums over long run Treasury Bill yields and therefore did not explicitly recognize a utility equity risk premium over a forecast long Canada bond yield. See Booth Evidence, p.51, lines 15-21.

11 Cicchetti Evidence, p. 24, lines 514-515.

12 McShane Evidence, p. 55, lines 1381-1382.

13 See Consent #2 where it was indicated that reduced spreads since May 2009 between A rated utility bond yields and long-term government bond yields revised the cost of equity estimate under this test to 10.1% (9.6% excluding the 0.50% allowance for financing flexibility). 9.6% less the risk free rate of 4.25% (long Canada bond yield) = 5.35%.

14 McShane Evidence, p. 61, lines 1527-1528.

15 McShane Evidence, p. 61, lines 1537-1538.

16 Booth Evidence, p. 47, lines 20-22.

17 Cicchetti Evidence, p. 24, lines 517-519.

18 McShane Evidence, p. 65, lines 1650-1652.

19 Booth Evidence, p. 56, lines 7-9.

20 It appears that Mr. Cicchetti's equity risk premium implicitly recognizes floatation costs of approximately 0.20% to 0.25%. See Mr. Cicchetti, Transcript, October 22, 2009 p.136, lines 25 *et. seq.*

21 This is Dr. Booth's margin of error. See Booth Evidence, p. 56, lines 23-24.

22 Ms. McShane performed two DCF tests applied to a sample of low risk U.S. electric and gas distributors. McShane Evidence, p. 70, line 1784.

23 Mr. Cicchetti performed two DCF tests for the required return on equity for a comparison of electric utilities and natural gas distribution utilities. See Cicchetti Evidence, p. 23, lines 488-491.

24 McShane Evidence, p. 65, lines 1650-1652.

25 In his DCF analysis, Mr. Cicchetti made an adjustment of 5% to recognize the expenses associated with issuing stock. See Cicchetti Evidence p. 21, line 463 *et. seq*. This translates into an approximate allowance for financing flexibility of 0.20% to 0.25%. See Mr. Cicchetti, Transcript, October 22, 2009, Page 134, Lines 2 *et. seq*.

26 Ms. McShane performed a comparable earnings test on the achievable returns of low-risk unregulated Canadian firms, the results of which were corroborated by the returns in unregulated U.S. firms. See McShane Evidence, p. 4, lines 81-84, and p. 67 line 1706 *et.seq.*

27 Newfoundland Power's 2010 capital structure was agreed in the Settlement Agreement. See Consent #1, p.5.

28 McShane Evidence, p. 3, line 55.

29 Booth Evidence, p. 4, lines 5-8, and Appendix H, p. 20, lines 16-18.

30 Cicchetti Evidence, p. 20, lines 432-434.