NEWFOUNDLAND POWER
A FORTIS COMPANY

Newfoundland Power Inc.

55 Kenmount Road
PO Box 8910
St. John's, Newfoundland
A1B 3P6
Business: (709) 737-5600
Facsimile: (709) 737-2974
www.newfoundlandpower.com

HAND DELIVERED

November 2, 2007

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

Attention: Ms. Cheryl Blundon
Board Secretary

Ladies & Gentlemen:

Re: Newfoundland Power's 2008 General Rate Application

Enclosed are the original and 8 copies of Newfoundland Power's Submission.

Electronic copies of the Submission will be forwarded in due course.

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

If you have any questions regarding the enclosed, please contact the undersigned at your convenience.

Yours very truly,

Peter Alteen
Vice President, Regulatory Affairs
& General Counsel

Enclosures

c. Geoffrey Young (4 copies)
Newfoundland and Labrador Hydro

Thomas Johnson (4 copies)
Consumer Advocate

Telephone: (709) 737-5859 *Email: palteen@newfoundlandpower.com* *Fax: (709) 737-2974*

IN THE MATTER OF the *Public Utilities Act*, R.S.N.L. 1990, Chapter P-47, as amended, (the "Act"); and

IN THE MATTER OF a general rate application by Newfoundland Power Inc. ("Newfoundland Power") to establish customer electricity rates for 2008.

SUBMISSION
OF
NEWFOUNDLAND POWER INC.

November 2, 2007

NEWFOUNDLAND POWER
A FORTIS COMPANY

A. DEFINED TERMS

Term	**Reference**
Amended Application	Newfoundland Power's Amended Application to the Board of Commissioners of Public Utilities, October 11, 2007.
ARBM Report	Newfoundland Power’s Report on the Implementation of the Asset Rate Base Method, May 2007, Volume 2, Tab 1 of Supporting Materials of Newfoundland Power filed May 10, 2007.
Bowman Evidence	Prefiled Evidence of C. Douglas Bowman, August 6, 2007.
Bowman Supplemental	Supplemental Evidence of C. Douglas Bowman, October 15, 2007.
Browne Evidence	Prefiled Evidence of J.T. Browne Consulting, Regulatory Accounting Issues Related to 2008 Rate Application, May 4, 2007, Volume 3, Tab 2, Expert Evidence filed May 10, 2007.
Cannon Evidence	Prefiled Evidence of Dr. William T. Cannon, August 3, 2007.
Cost of Service Study	Newfoundland Power’s Cost of Service Study, May 2007, Volume 2, Tab 10 of Supporting Materials of Newfoundland Power filed May 10, 2007.
Employee Future Benefits Report	Newfoundland Power’s Report on Employee Future Benefits, May 2007, Volume 2, Tab 4 of Supporting Materials of Newfoundland Power filed May 10, 2007.
Grant Thornton 1st Report	Grant Thornton Report, July 27, 2007.

Term	**Reference**
Grant Thornton 2nd Report	Grant Thornton Supplementary Report, October 17, 2007.
Lead/Lag Study	Newfoundland Power's Cash Working Capital Lead/Lag Study, May 2007, Volume 2, Tab 2 of Supporting Materials of Newfoundland Power filed May 10, 2007.
Load Research Study	Newfoundland Power's 2006 Load Research Study, June 16, 2006, Volume 2, Tab 11 of Supporting Materials of Newfoundland Power filed May 10, 2007.
Marginal Cost Study	Newfoundland Power's Marginal Cost of Electricity Service Study, January 29, 2007, Volume 2, Tab 12 of Supporting Materials of Newfoundland Power filed May 10, 2007.
McShane Evidence	Pre-filed Evidence of Kathleen McShane, March 2007, Volume 3, Tab 1, Expert Evidence filed May 10, 2007.
OPEBs Report	Newfoundland Power's Actuarial Valuation of OPEBs at December 31, 2006, Volume 2, Tab 5 of Supporting Materials of Newfoundland Power filed May 10, 2007.
Original Application	Newfoundland Power's Original Application to the Board of Commissioners of Public Utilities May 10, 2007.
Original Evidence	Prefiled Evidence of Newfoundland Power, May 10, 2007.
Rate Design Review	Newfoundland Power's Rate Design Review, May, 2007, Volume 2, Tab 13 of Supporting Materials of Newfoundland Power filed May 10, 2007.
Settlement Agreement	Settlement Agreement with effective date of October 12, 2007 relating to the Original Application.

Term	**Reference**
Stated Case	Supreme Court of Newfoundland and Labrador, Court of Appeal, 1996 No. 141, Stated Case re Section 101 of the Public Utilities Act.
Supplemental Evidence	Prefiled Supplemental Evidence of Newfoundland Power, October 11, 2007
Todd Evidence	Prefiled Evidence of John D. Todd, August 13, 2007
2006 Depreciation Study	Gannett Fleming Inc. Depreciation Study, Calculated Annual Depreciation Accruals Related to Electric Plant at December 31, 2005, Volume 3, Tab 3, Expert Evidence filed May 10, 2007.

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 Mr. Phonse Delaney would be referred to as Mr. Delaney, Transcript, October 22, 2007, 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 an amended application to establish 2008 customer rates dated October 11, 2007 (the "Amended Application").

On May 10, 2007, Newfoundland Power filed an application to establish 2008 customer rates (the "Original Application").

Following due notice of the Original Application, the Board issued Order No. P.U. 17 (2007) on June 22, 2007 which set out the schedule of dates and procedures for the hearing of the Original Application (the "Procedural Order"). The Procedural Order established a detailed schedule providing for: review of the Original Application by 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 comprehensive settlement of most of the matters raised in the Original Application was reached between Newfoundland Power and the Consumer Advocate (the "Settlement Agreement"). The effects of the Settlement Agreement are fully reflected in the Amended Application. In addition, the Amended Application reflected any material changes to Newfoundland Power's forecast of 2008 costs and sales which occurred over the five-month period between filing of the Original Application and 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 the Board's financial consultants. In addition, the Company has responded to comprehensive written interrogation by the Consumer Advocate. Neither of these processes has raised any material issue related to 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 yielded an evidentiary record concerning Company operations and finance which can be relied upon by the Board.

While the Settlement Agreement resolved most of the matters raised in the Original Application, it does not, in and of itself, satisfy the legal requirement that Board decision-making be based on the evidentiary record. Because of this, Newfoundland Power's submissions on the Amended Application have addressed each issue requiring a determination of the Board even where the evidence supporting the reasonableness is uncontroverted and uncontested.

There are certain issues which 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 22 through October 26, 2007. To facilitate the Board's consideration of these specific issues, Newfoundland Power has dealt with each issue in its submissions under the section titled *F. Matters Unresolved by Settlement Agreement.*

B. OVERVIEW

B.1 Regulatory Policy Framework

The regulatory policy framework requires the Board to make decisions which balance the interests of customers with those of the utility which provides service to those customers.

The *Public Utilities Act* defines the Board's structure and its 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), regulations governing service (s. 71), 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 *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)), the management of utility resources and an equitable access of supply for consumers (s. 3(b)).

The electrical power policy requires rates to (i) be reasonable and not unjustly discriminatory; (ii) 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 (i) the most efficient production, transmission and distribution of power; (ii) equitable access to an adequate supply of power for all consumers in the province; and (iii) delivery of power to consumers at the lowest possible cost consistent with reliable service.

The electrical power policy requires that the Public Utilities Board, in carrying out its duties and exercising its powers under the *Electrical Power Control Act, 1994* or under the *Public Utilities Act*, shall apply tests which are consistent with generally accepted sound utility practice (s. 4).

The inherent 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 – 17.*

B.2 The Amended Application

The Amended Application proposes a 2.8 percent average increase in 2008 customer rates. This increase provides a reasonable balance between Newfoundland Power's continued least cost delivery of reliable service on the one hand, and the maintenance of Newfoundland Power's continued financial integrity on the other.

Both the continued least cost delivery of reliable service and the maintenance of Newfoundland Power's financial integrity are consistent with the provincial regulatory policy framework and the interests of Newfoundland Power's customers.

The Amended Application, if approved by the Board, will maintain an appropriate balance of the interests of Newfoundland Power and its customers for 2008.

B.2.1 Least Cost Reliable Service

The evidence before the Board indicates that Newfoundland Power's management of service delivery to its customers is consistent with delivery of power at the lowest cost consistent with reliable service.

Since 2002, the reliability of electrical service delivery to customers has materially improved. Between 2002 and 2006, the frequency of outages experienced by customers has decreased by 39 percent and the duration of outages experienced by customers has decreased by 34 percent.

Reference*: Original Evidence, Pages 23 – 24.*

Customer satisfaction with the service provided by Newfoundland Power has remained reasonably consistent since 2002.

Reference*: Original Evidence, Page 22.*

Forecast 2008 net operating costs of approximately $51 million (inclusive of pension costs, deferred operating costs and transfers to general expenses capitalized) are consistent with 2002 levels.

Reference*: Exhibit 1 (1st Revision); Exhibit 2 (1st Revision).*

Should the Amended Application be approved by the Board, then:

(i) Newfoundland Power's total contribution to customers' cost of electricity in 2008 will be less than it was in 2002; and

(ii) Newfoundland Power's net impact on customer rate changes since 2002 will total 1 percent.

***Reference**: CA-NP-15 (1st Revision); CA-NP-16 (1st Revision).*

B.2.2 Maintenance of Financial Integrity

Newfoundland Power's continued financial integrity and performance are critical to the Company's long-term capability to deliver reliable service at least cost. The evidence before the Board concerning Newfoundland Power's financial management is consistent with least cost reliable power delivery to customers.

Since 2002, Newfoundland Power has earned a rate of return on rate base within the ranges approved by the Board; although, since 2005, the rate of return has been close to the lower end of the approved ranges.

***Reference**: Original Evidence, Page 3.*

Since 2005, the Company's cash flow metrics have eroded. This is partly attributable to reduced ratemaking rates of return on common equity. It is also partly attributable to the use of accounting accruals and cost recovery deferrals to address reduced recovery of depreciation costs in 2006 and 2007. The use of accruals and deferrals displaced cash revenue in those years that would typically have been recovered in customer rates.

***Reference**: Original Evidence, Page 3 and Page 55; Ms. Perry, Transcript, October 22, 2007, Page 88 Lines 10 - 25.*

Should the Amended Application be approved by the Board, then:

(i) Newfoundland Power's 2008 cash flow metrics will improve from current levels; and

(ii) Newfoundland Power should be in a position to maintain its continued financial integrity.

***Reference**: Supplemental Evidence, Pages 16 – 17; Ms. Perry, Transcript, October 22, 2007, Page 93, Lines 12 to Page 95, Line 23; Consent #2.*

C. 2008 REVENUE REQUIREMENTS

The Electrical Power Control Act, 1994 provides that rates to achieve the Company's revenue requirement should be established based on forecasts for one or more years.

Revenue requirement includes a just and reasonable return on rate base in addition to other prudently incurred costs.

C.1 Return on Rate Base

Section 78 of the Public Utilities Act mandates that the Board approve Newfoundland Power's forecast rate base.

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 essential to maintain the Company's financial integrity and creditworthiness.

Maintaining the Company's creditworthiness, and specifically, its investment grade credit rating, is essential to providing least cost service to customers over the long term as required by the Electrical Power Control Act, 1994.

C.1.1 Rate Base

Rate base is comprised primarily of Newfoundland Power's investment in plant and equipment required to provide service to customers.

In Order No. P.U. 19 (2003), the Board found that the Asset Rate Base Method ("ARBM") should be used to calculate Newfoundland Power's rate base. The Board ordered the Company to file a report, no later than its next general rate application, including in rate base the remaining reconciling items between invested capital and rate base, as identified by Grant Thornton.

Reference: *Order No. P.U. 19 (2003), Page 120.*

The Company has already implemented Board approved rate base changes that have substantially conformed its rate base to the ARBM.

Reference: *Original Evidence, Page 62; Grant Thornton 1st Report, Page 21, Lines 5 – 18 and Page 22, Lines 1 – 4.*

The remaining reconciling items and matters are (i) other assets and liabilities (ii) rate base allowances and (iii) unamortized deferred debt issue costs.

Reference: *ARBM Report, Page 2 and Pages 8 – 9.*

Other assets and liabilities include (i) the remaining customer finance programs receivables, (ii) customer security deposits, (iii) the accrued pension liability and (iv) the municipal tax liability. Under the ARBM, Newfoundland Power will add the other assets to its rate base and subtract the other liabilities from its rate base for 2008. This will eliminate these reconciling items between invested capital and rate base.

Reference: *ARBM Report, Pages 7 – 8; Original Evidence, Page 62, Line 17 to Page 63, Line 11; Grant Thornton 1st Report, Page 19, Lines 1 – 11; Browne Evidence, Pages 30 - 32.*

The Browne Evidence shows that this treatment is consistent with the determination of rate base under the ARBM and with established regulatory principles.

Reference: *Browne Evidence, Pages 29 – 32.*

It is mainstream practice for a utility's rate base to include allowances for (i) funds used during construction ("AFUDC"), (ii) cash working capital and (iii) materials and supplies. Under the ARBM, there will continue to be differences between invested capital and rate base for these items. As part of its transition to the ARBM, Newfoundland Power has updated the calculation of its rate base allowances.

Reference: *ARBM Report, Pages 3 – 6; Original Evidence, Page 64, Lines 5 – 9; Grant Thornton 1st Report, Page 19, Lines 13 – 19.*

Newfoundland Power's calculation of AFUDC, which reflects the cost of financing capital materials and supplies used to expand the electrical system, is consistent with the ARBM and with mainstream regulatory practice in Canada, including that of Newfoundland and Labrador Hydro ("Hydro").

Reference: *ARBM Report, Pages 3 – 5; Original Evidence, Page 64, Line 11 to Page 65, Line 2.*

Newfoundland Power has updated its Lead/Lag Study to calculate the cash working capital allowance to be included in rate base. The forecast 2008 cash working capital allowance is $9,669,000 which is 2.1 percent of regulated cash operating expenses.

Reference: *ARBM Report, Pages 6 – 7; Original Evidence, Page 65, Lines 6 – 12; Lead/Lag Study, Page 1; Grant Thornton 1st Report, Page 19, Lines 24 – 28; Exhibit 8 (1st Revision), Line 25.*

The methodology used to calculate Newfoundland Power's cash working capital allowance is consistent with established regulatory practice. It is also consistent with the approach used by Hydro.

Reference: *Browne Evidence, Pages 33 – 34; Lead/Lag Study, Page 2.*

Newfoundland Power's 2008 materials and supplies allowance is calculated using a thirteen month average. Unlike the twelve month average now used, a thirteen month average captures changes in inventory levels for all twelve months of the year. Hydro also uses a thirteen month average.

Reference: *ARBM Report, Page 5; Original Evidence, Pages 66, Line 5.*

Capital inventory related to the expansion of the electricity system is excluded from the Company's materials and supplies allowance because it is not yet considered used and useful in providing electricity service. Newfoundland Power's forecast 2008 materials and supplies allowance, based on a thirteen month average and a revised capital inventory factor for expansion of 19.4 percent, is $4,427,000.

Reference: *ARBM Report, Page 5; Original Evidence, Page 65, Line 19 to Page 66, Line 11; Exhibit 8 (1st Revision), Line 27.*

As part of the Company's transition to the ARBM, Newfoundland Power has included its unamortized deferred debt issue costs in the calculation of the Company's Weighted Average Cost of Capital ("WACC"). This is consistent with the approach used by Hydro.

Reference: *ARBM Report, Pages 8 – 9; Original Evidence, Page 66, Line 13 to Page 67, Line 2; Browne Evidence, Pages 31 – 32; Grant Thornton 1st Report, Page 19, Lines 30 – 36.*

The Browne Evidence shows that this treatment is consistent with the determination of rate base under the ARBM and with established regulatory principles.

Reference: *Browne Evidence, Pages 29 – 32.*

Newfoundland Power's forecast average rate base for 2008 is $812,212,000. This includes a reduction of $5,689,000 attributable to the transition to the ARBM.

Reference: *Exhibit 8 (1st Revision), Line 29.*

The Board's financial consultants' review of the forecast 2008 rate base has found that it (i) is calculated in accordance with established practice and (ii) appropriately incorporates proposed changes to transition to the ARBM.

Reference: *Grant Thornton 1st Report, Page 22, Lines 15 – 19; Grant Thornton 2nd Report, Page 6, Lines 20 – 22.*

Newfoundland Power's implementation of the ARBM as set out in the Amended Application has been agreed in the Settlement Agreement.

Reference: *Settlement Agreement, Section 17.*

The evidence before the Board indicates that Newfoundland Power's forecast 2008 average rate base of $812,212,000 is appropriate for ratemaking purposes.

C.1.2 Return on Rate Base

Newfoundland Power's 2008 rate of return on common equity and capital structure have been agreed in the Settlement Agreement.

Reference: *Settlement Agreement, Sections 12 – 15.*

The Amended Application provides for a 2008 capital structure of approximately 54 percent debt, 45 percent common equity and 1 percent preferred equity.

Reference: *Exhibit 10 (1st Revision), Lines 8 – 11; Settlement Agreement, Sections 14 and 15.*

The 45 percent common equity target is consistent with Board Orders since 1990.

Reference: *Original Evidence, Page 57, Lines 1 – 2; Order Nos. P.U. 1 (1990), P.U. 6 (1991), P.U. 7 (1996-97), P.U. 16 (1998-99) and P.U. 19 (2003).*

The Cannon and McShane Evidence shows that Newfoundland Power's business risk has not changed materially since its last GRA and that a 45 percent common equity ratio continues to be reasonable and should enable the Company to maintain its investment grade credit rating.

Reference: *McShane Evidence, Page 1, Lines 25 - 27 and Page 29, Lines 779 -785; Cannon Evidence, Page 22, Lines 21 - 22, and Page 26, Lines 20 – 22.*

The Amended Application provides for a 2008 regulated rate of return on common equity for ratemaking purposes of 8.95 percent.

Reference: *Exhibit 5.1, Page 1, Line 38; Ms. Perry, Transcript, October 22, 2007, Page 106, Lines 6 - 8; Settlement Agreement, Section 14.*

The regulated rate of return on common equity is composed of a risk free rate of 4.60 percent and an equity risk premium of 4.35 percent.

Reference: *Settlement Agreement, Sections 13 and 14; Ms. Perry, Transcript, October 22, 2007, Page 106, Lines 6 - 18.*

The forecast 2008 cost of debt is 7.93 percent which reflects the Company's recent bond issue and an updated forecast of short-term interest rates.

Reference: *Supplemental Evidence, Page 6, Lines 4 – 12; Exhibit 10 (1st Revision), Line 15.*

The forecast 2008 cost of preferred equity is 6.27 percent.

Reference: *Exhibit 10 (1st Revision), Line 16.*

The 2008 return on rate base proposed in the Amended Application is summarized in Table 1.

Table 1
Proposed 2008 Return on Rate Base
($000s)

Regulated return on common equity	32,700
Return on debt	34,680
Return on preferred equity	586
Return on rate base	**67,966**

Reference: *Supplemental Evidence, Page 25, Line 2; Exhibit 10 (1st Revision), Lines 25 – 30; Exhibit 9 (1st Revision), Line 1.*

The proposed 2008 return on rate base reflects a rate of return on average rate base of 8.37 percent. This is shown in Table 2.

Table 2
Proposed 2008 Rate of Return on Rate Base

Return on rate base ($000s)	67,966
Average rate base ($000s)	÷ 812,212
Rate of return on rate base	**8.37%**

Reference: *Supplemental Evidence, Page 25, Line 2.*

As a result of the completion of the transition to the ARBM, the Company's rate of return on rate base for ratemaking purposes will be the same as its WACC.

Reference: *Exhibit 10 (1st Revision), Lines 19 - 22.*

The Board's financial consultants' review indicates that the Company's forecast 2008 rate base, 2008 rate of return on rate base, and revenue requirement (which includes the Company forecast 2008 return on rate base of $67,966,000) appropriately incorporates the impact of the Settlement Agreement and the Company's revisions of its costs and sales forecasts.

Reference: *Grant Thornton 2nd Report, Page 6, Lines 12 - 26.*

The evidence before the Board indicates a forecast 2008 return on rate base of $67,966,000 which yields a rate of return on rate base of 8.37 percent is appropriate for ratemaking purposes.

C.1.3 Creditworthiness

The ability to raise capital on reasonable terms in both robust and difficult markets is consistent with the least cost policy objectives set out in the *Electrical Power Control Act, 1994*. Newfoundland Power currently has two investment grade credit ratings, one from DBRS and one from Moody's Investors Service ("Moody's"). Both are on a stand-alone basis. Having two investment grade credit ratings allows the Company to have competitive access to capital markets.

Reference: *Original Evidence, Page 53, Line 10 to Page 54, Line 2; Ms. Perry, Transcript, October 22, 2007, Page 88, Lines 1 - 6.*

Credit metrics play a key role in determining how credit rating agencies assess the Company's creditworthiness and ultimately its credit rating. The Company's key credit metrics are pre-tax interest coverage, cash flow interest coverage and cash flow debt coverage.

In order to maintain the Company's investment grade credit rating, Moody's requires a cash flow interest coverage of 3.0 times or higher and a cash flow debt coverage of 15 percent or higher.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 87, Lines 21 - 25; and Page 90, Line 22 to Page 91, Line 5 and Page 92, Line 5 to Page 93, Line 6; Exhibit 6, Moody's Investors Services Credit Opinion, Page 3.*

Exhibit 6 contains Moody's latest credit report, which was issued in March 2007. In this report Moody's states:

> *"The rating outlook is stable based on the expectation that NPI's 2007 GRA will result in a strengthening of the company's cash flow metrics beginning in 2008". ....."NPI's rating could be negatively impacted if, by 2008, its (cash flow interest coverage) has not met or exceeded 3.0x and its (cash flow debt coverage) has not met or exceeded 15%".*

Reference: *Exhibit 6, Moody's Investors Service Credit Opinion, Pages 2 to 3; Ms. Perry, Testimony, October 22, 2007, Page 92, Line 5 to Page 93, Line 6.*

Based on a common equity ratio of 45 percent and a rate of return on common equity of 8.95 percent, the Amended Application provides for an average customer rate increase of approximately 2.8 percent. This will provide the Company with additional revenue from rates of approximately $14 million which will improve the Company's cash flow and credit metrics. The forecast cash flow interest coverage ratio for 2008 is 2.9 times and the forecast 2008 cash flow debt coverage is 14.9 percent. These metrics will now be at, or just slightly below, the bottom of the range recommended by Moody's.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 93, Line 12 to Page 94, Line 19; Exhibit 5.1, Page 1, Lines 40 - 41.*

Moody's October 12, 2007 press release regarding the impact of the Amended Application on the Company's credit rating states:

> *"Moody's Investors Service believes that if approved by the Newfoundland and Labrador Board of Public Commissioners (PUB), the revised GRA will not in and of itself result in a change in either the rating or outlook of NPI."*

Reference: *Consent #2.*

The evidence before the Board indicates that a common equity component of 45 percent and a regulated rate of return on common equity of 8.95 percent provides the Company a reasonable opportunity to earn a return on rate base that will enable it to maintain its creditworthiness.

C.2 Other Costs

Section 80(2) of the Public Utilities Act mandates that a just and reasonable return shall be in addition to those expenses which the Board may allow as reasonable and prudent. These include Operating Costs, Depreciation and Employee Future Benefits.

C.2.1 Operating Costs

Newfoundland Power has controlled operating costs, while continuing to deliver safe, reliable service. Newfoundland Power's forecast 2008 operating costs are less than those of a decade earlier. Forecast 2008 operating costs represent approximately 11 percent of the Company's forecast 2008 cost of service.

Reference: *Original Evidence, Page 10, Lines 15 – 16; Mr. Delaney, Transcript, October 24, 2007, Page 5, Lines 22 - 23.*

Table 3 shows Newfoundland Power's operating costs (excluding deferred regulatory costs, pension costs, and transfers to general expenses capitalized) from 2002 to 2008 forecast.

Table 3
Operating Costs
2002 to 2008
($000s)

	2002	**2003**	**2004**	**2005**	**2006**	**2007F**	**2008F**
Operating Costs	48,804	49,506	49,102	49,111	48,691	49,099	49,383

Reference: *Exhibit 1 (1^{st} Revision), Line 18.*

Operating costs have remained stable at approximately $49 million from 2002 to 2006 and are forecast to remain so through 2008.

The Board's financial consultants have examined the Company's operating costs and concluded that they are reasonable on an overall basis.

Reference: *Grant Thornton 1st Report, Page 36, Lines 11-12.*

Cost management must be consistent with the fulfillment of the Company's obligation to provide a reasonable level of service to its customers. Newfoundland Power's continuing cost management efforts are principally aimed at achieving *sustainable* cost efficiencies in its operations.

Newfoundland Power does not view cost management as an exercise aimed simply at cost cutting because such an approach does not appropriately reflect the relationship between costs and service.

Reference*: CA-NP-324, Page 1, Line 26 to Page 2, Line 3.*

The Todd Evidence confirmed that Newfoundland Power has a solid track record in achieving sustained productivity improvements.

Reference: *Todd Evidence, Page 17, Lines 4 - 7.*

The Todd Evidence has also confirmed that the operating efficiencies achieved by Newfoundland Power from 2003 to 2006 have provided benefits to customers in the 2008 test year.

Reference: *NP-CA-91.*

The gross operating cost per customer is forecast to decrease by approximately 5.8 percent from 2002 to forecast 2008.

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

The Company's ability to achieve cost efficiency is related to productivity gains that have resulted from capital investment, organizational change, process improvements, technology and corresponding workforce reductions.

Reference*: Mr. Delaney, Transcript, October 24, 2007, Page 7, Lines 12 – 17.*

Newfoundland Power's 2008 operating costs include a projected labour productivity improvement of $531,000 which represents approximately 53 per cent of the forecast labour cost increase in 2008.

Reference*: CA-NP-47.*

Newfoundland Power believes that operating costs must be managed with a view to the long term.

Reference*: Mr. Delaney, Transcript, October 24, 2007, Page 12, Lines 19 – 20.*

In the near-term, demographic challenges will put upward pressure on Newfoundland Power's operating costs. However, these costs are necessary in the short-term to ensure that Newfoundland Power can fulfill its service obligations in the future. For example, currently the Company has 20 apprentice linepersons. This is the highest level of apprentices since the early 1970s. This is necessary to ensure the Company can fulfill its service obligations in the future.

Reference*: Mr. Delaney, Transcript, October 24, 2007, Page 13, Line 14 to Page 14, Line 9.*

The Company will look for opportunities, such as attrition through retirement, to partially offset the upward pressure on costs.

Reference*: Mr. Delaney, Transcript, October 24, 2007, Page 14, Lines 10 – 16.*

The evidence before the Board indicates that Newfoundland Power's forecast 2008 operating costs are reasonable and consistent with the provision of least cost reliable service.

C.2.2 Depreciation

Depreciation expense is calculated on the basis of rates of depreciation assigned to each class of the Company's assets. The Board's practice is to approve depreciation for ratemaking purposes based upon studies by experts who examine the various asset classes and determine the average service life of these assets for depreciation purposes.

Reference: *Original Evidence, Page 69, Lines 6 - 9.*

The 2006 Depreciation Study was based on plant in service as at December 31, 2005. The recommended depreciation rates result in a decrease in Newfoundland Power's composite depreciation rate from 3.5 percent to 3.4 percent.

Reference: *Original Evidence, Page 70, Lines 1 – 8; 2006 Depreciation Study, Page I-6.*

The 2006 Depreciation Study indicates an accumulated reserve variance of approximately $0.7 million at December 31, 2005. The accumulated reserve variance is the difference between accumulated depreciation recorded by the Company and a calculated, or theoretical, reserve based on the new depreciation rates recommended in the 2006 Depreciation Study.

Reference: *Original Evidence, Page 70, Line 10 to Page 71, Line 2; 2006 Depreciation Study, Pages I-5 and III-117.*

The Amended Application proposes, effective January 1, 2008 to (i) implement the depreciation rates resulting from the 2006 Depreciation Study and (ii) amortize the accumulated reserve variance of $0.7 million evenly over 4 years. These proposals yield a forecast 2008 depreciation expense of approximately $40,208,000.

The conclusion of the amortization of the accumulated reserve variance will coincide with the next depreciation study, which is expected to be completed in 2011. This reflects the Board's previous observations regarding the imprecise nature of depreciation true-up and the principle of intergenerational equity.

Reference: *Original Evidence, Page 71, Lines 4 – 13; Exhibit 5.1, Page 1, Line 23; Exhibit 9 (1st Revision), Line 8.*

Currently, Newfoundland Power's revenues do not provide for full recovery of depreciation costs. This is primarily the result of the use of cost recovery deferrals to offset the impact of the 2005 conclusion of the depreciation true-up that arose from the Company's 2002 depreciation study. Commencing in 2008, Newfoundland Power is seeking to fully recover its depreciation costs in customer rates. Depreciation cost recovery accounts for an approximate 1.8 percent increase in 2008 revenues.

Reference: *Original Evidence, Page 72, Lines 9 – 14; Supplemental Evidence, Page 2, Lines 6 - 7.*

The Board's financial consultants have concluded that the results and recommendations of the 2006 Depreciation Study have been incorporated into the Company's depreciation expense estimates for 2008.

Reference: *Grant Thornton 1st Report, Page 32, Lines 17 – 19.*

The forecast 2008 depreciation expense of $40,208,000 proposed in the Amended Application has been agreed in the Settlement Agreement.

Reference: *Settlement Agreement, Section 24.*

The evidence before the Board indicates that Newfoundland Power's forecast 2008 depreciation expense is reasonable and appropriately incorporates the results and recommendations of the 2006 Depreciation Study.

C.2.3 Employee Future Benefits

Accounting for Employee Future Benefits

Newfoundland Power maintains pension plans and other post employment benefits (“OPEBs”) plans for its employees which provide for benefits upon retirement.

OPEBs include retirement allowances payable upon retirement, and health, medical and life insurance for retirees and their dependents.

Newfoundland Power’s pension plans are accounted for on an accrual basis. Pension costs are recognized as an expense and included in revenue requirement as employees earn the benefits they will receive during retirement.

The Company accounts for OPEBs on a cash basis. The amount of OPEBs costs recognized as an expense and included in revenue requirement is equal to the retirement allowances and insurance premiums actually paid in the year.

Reference: *Original Evidence, Page 73, Line 4 to Page 76, Line 11.*

In Order No. P.U. 19 (2003), the Board ordered Newfoundland Power to file a report with its next general rate application that addressed the use of the accrual method of accounting for OPEBs as an alternative to the cash method. Newfoundland Power filed the *Employee Future Benefits Report* with the Original Application.

Reference: *Order No. P.U. 19 (2003), Page 83; Employee Future Benefits Report, Page 1.*

OPEBs Accounting Policy

Adopting the accrual method of accounting for OPEBs would increase 2008 revenue requirement by approximately $9.4 million. If Newfoundland Power also adopted the accrual method of accounting for income tax associated with OPEBs (i.e., tax-effect OPEBs costs), the increase in revenue requirement would instead be $6.4 million. This is composed of a $9.4 million increase for OPEBs accrual accounting and a decrease of $3 million for OPEBs tax-effecting.

Reference: *Grant Thornton 1st Report, Page 8, Line 4 to Page 10, Line 2; Supplemental Evidence, Page 13, Lines 5 – 6; Ms. Perry, Transcript, October 22, 2007, Page 101, Line 20 to Page 102, Line 13.*

The transitional obligation associated with moving from the cash method to the accrual method of accounting for OPEBs in 2008 would be approximately $34.1 million. The transitional obligation is the cumulative difference between the amount of OPEBs costs that have been recognized as an expense under the cash method and that which would have been recognized as an expense under the accrual method. It represents legacy OPEBs costs that have not yet been recovered from customers. The transitional obligation is shown as a regulatory asset in Newfoundland Power's financial statements.

Reference: *Supplemental Evidence, Page 13, Lines 5 – 6; Grant Thornton 1st Report, Page 10, Line 4 to Page 11, Line 9.*

The Browne Evidence shows that, in determining whether to shift from the cash method to the accrual method of accounting for OPEBs, the key regulatory principles are the cost of service standard, intergenerational equity and rate stability.

Reference: *Browne Evidence, Page 9.*

The choice of accounting methods for OPEBs does not impact the aggregate amount of OPEBs costs to be recognized or recovered. Accordingly, the principal issue related to OPEBs from a cost of service perspective is the *timing* of recognition, and recovery from customers, of Newfoundland Power's OPEBs costs.

Reference: *Browne Evidence, Page 10; Supplemental Evidence, Page 14, Lines 9 - 12; Ms. Perry, Transcript, October 22, 2007, Page 102, Lines 18 - 20.*

The principle of intergenerational equity supports the use of the accrual method because it results in a better matching of costs to the periods for which the costs are incurred.

Reference: *Browne Evidence, Page 10; Grant Thornton 1st Report, Page 8, Lines 33 – 36; Ms. Perry, Transcript, October 22, 2007, Page 102, Line 23 to Page 103, Line 2.*

The adoption of the accrual method of accounting for OPEBs, including tax-effecting, would increase Newfoundland Power's 2008 revenue requirement by approximately 1.3 percent. In the context of the principles of intergenerational equity and rate stability, the choice of accounting method for OPEBs necessarily requires consideration of the appropriate weight to be applied to each principle at this time. The need to weigh and strike a balance between these principles was recognized by the Board in Order No. P.U. 19 (2003) and has been recognized by other regulators.

Reference: *Order No. P.U. 19 (2003), Page 83; Browne Evidence, Pages 4, 5 and 10; Supplemental Evidence, Page 12, Lines 6 - 7 and Page 15, Lines 1 – 3.*

As provided for in the Settlement Agreement, the Amended Application proposes continued recognition of OPEBs costs on a cash basis at this time. The Settlement Agreement reflects the consensus of the parties that the principle of rate stability should be given more weight at this time. This consensus recognizes the rate increases already experienced by customers in recent years, principally because of significant increases in the price of fuel burned at Hydro's Holyrood thermal generating station.

Reference: *Settlement Agreement, Sections 21 and 22; Supplemental Evidence, Page 15, Lines 5 – 14; Ms. Perry, Transcript, October 22, 2007, Page 101, Line 7 to Page 102, Line 13 and Page 103, Lines 7 - 16.*

The evidence shows that both the cash method and accrual method of accounting for OPEBs are consistent with Canadian generally accepted accounting principles ("Canadian GAAP"). Both methods are reasonably consistent with current Canadian regulatory practice, particularly for investor-owned utilities.

Reference: *Todd Evidence, Page 19, Line 22 to Page 21, Line 29; Grant Thornton 2nd Report, Page 5, Lines 1 – 12; Supplemental Evidence, Page 14, Lines 5 – 7; Ms. Perry, Transcript, October 22, 2007, Page 102, Lines 21 - 23.*

The Settlement Agreement provides that accrual accounting for OPEBs be further considered by the Board at the Company's next general rate proceeding, which is currently expected in 2010 to establish customer rates for 2011. The estimated increase in annual revenue requirement associated with *adopting* the accrual method of accounting for OPEBs, with tax-effecting, would not be materially impacted by addressing the matter in 2011 rather than in 2008. In both years, the rate impact is about 1.3 percent.

Reference: *Settlement Agreement, Section 22; Supplemental Evidence, Page 13, Lines 1 – 9; Grant Thornton 2nd Report, Page 4, Lines 16 – 21; Ms. Perry, Transcript, October 22, 2007, Page 103, Line 21 to Page 104, Line 3.*

The principal impact of delaying consideration of adopting the accrual method of accounting for OPEBs is that the transitional obligation is currently expected to increase by approximately $6.3 million per year. It is forecast that the transitional obligation will increase from approximately $34.1 million in 2008 to $52.9 million in 2011.

Reference: *Supplemental Evidence, Page 13, Lines 5 - 6 and Lines 11 – 14; Grant Thornton 2nd Report, Page 4, Lines 21 – 25; Ms. Perry, Transcript, October 22, 2007, Page 104, Lines 4 - 9.*

The impact of the recovery of the transitional obligation on customer rates will only be determinable at the time the matter is addressed. A key determinant of the customer rate impact will be the period over which the Board approves recovery of the transitional obligation. For example, over a 10-year amortization period, the increase in revenue requirement would be 0.7 percent if amortization commenced in 2008 vs. 1.0 percent if amortization commenced in 2011 (with tax-effecting, based on 2008 forecast revenue).

Reference: *Supplemental Evidence, Page 14, Lines 1 – 3; Ms. Perry, Transcript, October 22, 2007, Page 104, Line 9 to Page 105, Line 11.*

Tax-Effecting Pension Expense

The Amended Application proposes that Newfoundland Power adopt the accrual method of accounting for income tax associated with pensions (i.e., tax-effect pension expense) effective January 1, 2008. This proposal, increases the Company's 2008 revenue requirement by approximately $0.8 million or 0.2 percent.

Reference: *Supplemental Evidence, Page 11, Lines 19 – 20 and Page 12, Lines 4 – 5; Ms. Perry, Transcript, Page 101, Line 14 to Page 102, Line 13.*

The adoption of the accrual method of accounting for income tax associated with pension costs is a step forward at this time in the accounting for employee future benefits and helps improve the Company's cash flow and financial integrity.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 105, Lines 22 - 25.*

Newfoundland Power's pension costs are already accounted for on an accrual basis. Tax-effecting pension costs would mean that both pension costs and their tax effects would be accounted for in a consistent manner.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 105, Lines 15 - 20.*

Tax-effecting pension costs would provide a better matching of current costs to related revenues because both pension costs and their related tax effects are recognized in the same period.

Reference: *Employee Future Benefits Report, Pages 8 – 10; Browne Evidence, Page 17; Grant Thornton 1st Report, Page 9, Lines 8 - 14.*

The evidence shows that tax-effecting employee future benefits costs is consistent with established regulatory principles, Canadian GAAP and accepted regulatory practice.

Reference: *Browne Evidence, Pages 13 – 18; Grant Thornton 1st Report, Page 9, Lines 25 – 35; Employee Future Benefits Report, Page 10.*

The proposal in the Amended Application to tax-effect pension expense has been agreed in the Settlement Agreement.

Reference: *Settlement Agreement, Section 23.*

The evidence before the Board shows that Newfoundland Power's continued recognition of OPEBs costs on a cash basis is reasonable given the rate increases experienced by customers since 2002. It is also consistent with GAAP and with current Canadian regulatory practice for investor-owned utilities.

The evidence before the Board shows that tax-effecting pension costs is consistent with established regulatory principles and GAAP.

C.2.4 Regulatory Deferrals and Reserves

In the Amended Application, Newfoundland Power seeks approval of the amortization of:

(i) $2,592,000 of the 2005 Unbilled Revenue in 2008 to offset the 2008 income tax arising from the tax settlement;

(ii) the remaining 2005 Unbilled Revenue; the municipal tax liability; the depreciation cost recovery deferral; the replacement energy cost recovery deferral; the December 31, 2006 balance in the purchased power unit cost variance reserve; and the Application costs, evenly over three years commencing in 2008; and

(iii) the non-reversing balance in the degree day component of the weather normalization reserve evenly over five years commencing in 2008.

Table 4 summarizes the amortization of regulatory deferrals and reserves proposed in the Amended Application.

Table 4
Regulatory Deferrals and Reserves
Proposed Amortization
($000s)

		Amortization[5]				
	Amount	**2008**	**2009**	**2010**	**2011**	**2012**
Revenue Deferrals						
2005 Unbilled Revenue	16,446[1]	7,210[6]	4,618[6]	4,618[6]		
Municipal Tax Liability	4,087[1]	1,363	1,362	1,362		
Cost Recovery Deferrals						
Depreciation	11,586[1]	3,862	3,862	3,862		
Replacement Energy	1,147[1]	383	382	382		
Reserves						
Weather Normalization Reserve	6,827[2]	1,366[2]	1,366[2]	1,365[2]	1,365[2]	1,365[2]
Unit Cost Variance Reserve	1,342[3]	447	447	448		
Application Costs	1,250[4]	417	417	416		

Reference:
1. *Original Evidence, Page 82, Line 14;*
2. *Grant Thornton 1st Report, Page 5, Line 24 and Page 4, Lines 4 and 5;*
3. *Original Evidence, Page 88, Line 8;*
4. *Grant Thornton 1st Report, Page 15, Line 20;*
5. *Amortizations equal Amount divided by 3, unless otherwise indicated; and*
6. *Supplemental Evidence, Page 19, Footnote 44.*

These amounts represent revenue and cost deferrals expressed on an accounting basis (as in the Amended Application) as opposed to on a revenue requirement basis (as in Table 13 at page 19 of the Supplemental Evidence).

An appropriate amortization period is a matter of regulatory judgment. The practice of the Board has been to amortize these types of items over a three to five year period. This is consistent with generally accepted regulatory principles and balances the interests of customers and the Company.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 106, Line 24 to Page 107, Line 14; Original Evidence, Page 85, Footnote 116; Grant Thornton 1st Report, Page 3 to 7 and 12 to 15; Grant Thornton 2nd Report, Page 6, Lines 16 – 18; Browne Report, Page 22.*

The amortizations proposed in the Amended Application have been agreed in the Settlement Agreement.

Reference: *Settlement Agreement, Section 18.*

The evidence before the Board shows that Newfoundland Power's proposed amortizations provide a reasonable balance between the interests of customers and the Company, and are consistent with past Board practice and generally accepted regulatory principles.

C.3 Forecasts of Sales and Supply Costs

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

Newfoundland Power's 2008 Customer, Energy and Demand Forecast indicates that (i) the number of customers the Company will serve will increase by 1.1 percent from 2007; (ii) energy sales will increase by 2.0 percent from 2007; and (iii) demand will increase by 1.7 percent from 2007.

Reference: *Customer, Energy and Demand Forecast (1st Revision), Pages 4 - 5; Supplemental Evidence, Page 7, Lines 5 – 8.*

Newfoundland Power's forecast accuracy indicates that actual energy sales have differed from forecast by 1 percent or less in 7 of the past 10 years. In addition, actual differences from forecast energy sales have been higher half of the time and lower half of the time through this period.

Reference: *Customer, Energy and Demand Forecast (1st Revision), Page 6.*

The revised 2008 Customer, Energy and Demand Forecast did not include any methodological revisions to the original forecast. The changes in the revised 2008 Customer, Energy and Demand Forecast have been appropriately incorporated into the revised forecasts of revenue requirement, rate base and return on rate base.

Reference: *Grant Thornton 2nd Report, Page 3, Lines 22 – 24 and Page 4, Lines 3 – 6.*

The evidence shows that Newfoundland Power's revised 2008 Customer, Energy and Demand Forecast is appropriate for the purposes of establishing 2008 customer rates.

C.4 2008 Revenue Requirement

Section 3(a)(iii) of the Electrical Power Control Act, 1994 requires that rates charged for the supply of power in the province provide sufficient revenue to enable the utility to earn a just and reasonable return so that it is able to achieve and maintain a sound credit rating.

Table 5 provides a summary of the Company's 2008 revenue requirement proposed in the Amended Application.

Table 5
Summary of 2008 Revised Revenue Requirement
($000s)

Power Supply Cost	337,159
Operating Costs	47,700
Employee Future Benefits	3,348
Depreciation & Related Amortization	44,070
Income Taxes	19,568
Return on Rate Base	67,966
Other Adjustments	92
	519,903
Deductions:	
Other Revenue	(12,122)
Non-Regulated Expenses (Net of Tax)	(983)
Proposed 2008 Revenue Requirement	**506,798**
Revenue Deferral Amortization	(8,572)
Proposed 2008 Revenue Requirement from Rates	**498,226**

Reference: *Supplemental Evidence, Page 22, Line 4.*

The Board's financial consultants have reviewed the Company's 2008 revenue requirement and have indicated that both the original 2008 revenue requirement in the

Original Application and the revised 2008 revenue requirement in the Amended Application are calculated appropriately.

Reference: *Grant Thornton 1st Report, Page 53, Lines 11 – 13; Grant Thornton 2nd Report, Page 6, Lines 16 – 18.*

The forecast increase in revenue from rates to meet the Company's 2008 revised revenue requirement is approximately $14.0 million. The increase in revenue required to recover the 2008 revenue requirement proposed in the Amended Application requires an average increase in current customer rates of 2.8 percent effective January 1, 2008.

Reference: *Exhibit 11 (1st Revision).*

The evidence before the Board shows that Newfoundland Power's forecast 2008 revenue requirement appropriately reflects its reasonable and prudent costs, including a just and reasonable return, consistent with the provision of least cost reliable service.

D. RATES, RULES AND REGULATIONS

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

Section 71 of the Public Utilities Act mandates that the Board approve changes to rules and regulations.

Section 3(a)(iii) of the Electrical Power Control Act, 1994 requires that rates should provide sufficient revenue to enable the utility to earn a just and reasonable return on rate base.

D.1 Cost of Service Methodology

Section 3(a)(i) of the Electrical Power Control Act, 1994 requires that the rates to be charged should be reasonable and not unjustly discriminatory.

Newfoundland Power assesses the fairness of its rates by comparing the cost to serve each class, as determined through an embedded cost of service study, with the revenue collected from that class ("revenue to cost ratio"). The revenue to cost ratios indicate whether cost recovery by class is reasonable. The Company completed an embedded cost of service study for the purpose of assessing customer rates for the 2008 test year (the "Cost of Service Study").

***Reference**: Original Evidence, Page 113, Lines 10 - 16.*

Newfoundland Power completed the Load Research Study to allocate demand costs to each class in the Cost of Service Study. The Load Research Study has resulted in the revenue to cost ratios increasing for the General Service classes and decreasing for the Domestic class and Street and Area Lighting class.

Reference*: Original Evidence, Page 114, Line 1 to Page 115, Line 3; Load Research Study.*

Reflecting marginal costs in customer rates, as determined by a marginal cost study, promotes the efficient use of electricity.

Reference*: Original Evidence, Page 115, Lines 7 - 9; Mr. Henderson, Transcript, October 25, 2007, Page 119, Lines 8 - 19; Mr. Bowman, Transcript, October 26, 2007, Page 131, Lines 2 - 5.*

The Marginal Cost Study includes both Hydro's marginal costs of generation and transmission and Newfoundland Power's marginal costs related to distribution and customer service. Based on the Marginal Cost Study, the Company has observed that: marginal costs on the system exceed the average costs recovered in customer rates; practically all marginal generation demand, transmission demand, and distribution demand costs are related to winter season demand requirements; and marginal energy costs are substantially the same year-round.

Reference*: Original Evidence, Page 115, Line 11 to Page 116, Line 7; Mr. Henderson, Transcript, October 25, 2007, Page 113, Lines 8 - 25; Marginal Cost Study.*

It is agreed in the Settlement Agreement that the Cost of Service Study and methodology is in keeping with previous Board Orders and should be used to design new rates.

Reference*: Settlement Agreement, Section 7.*

The evidence before the Board shows that Newfoundland Power's Cost of Service Study and Marginal Cost Study are appropriate to be used in establishing 2008 customer rates.

D.2 Customer Rate Change Plan

Section 70 of the Public Utilities Act requires that the utility request the Board to approve its rates, tolls and charges. Section 3(a)(iii) of the Electrical Power Control Act, 1994 requires that rates should provide sufficient revenue to enable the utility to earn a just and reasonable return on rate base.

Newfoundland Power's approach to rate changes is guided by generally accepted ratemaking principles and is consistent with past practice. Rate changes require a balancing of the relevant criteria often in conflict.

***Reference**: Original Evidence, Page 109, Line 8 to Page 110, Line 11.*

Newfoundland Power uses the results of the Cost of Service Study as a guide to design its customer rates in an effort to achieve revenue to cost ratios within the range of 90 percent to 110 percent. This practice is intended to ensure that there is no undue cross-subsidization among the various classes, and is consistent with past Board practice.

***Reference**: Original Evidence, Page 117, Lines 7 – 8; Mr. Henderson, Transcript, October 25, 2007, Page 111, Lines 7 – 15; Order No. P.U. 7 (1996-97), Page 87.*

Table 6 shows the revenue to cost ratios from the Cost of Service Study.

Table 6
Cost of Service Study Results

Class of Service	**Rate Code**	**Revenue to Cost Ratios %**
Domestic	1.1	93.7
General Service, 0-10 kW	2.1	119.8
General Service, 10-100 kW (110 kVA)	2.2	116.8
General Service, 110-1000 kVA	2.3	110.5
General Service, 1000 kVA and Over	2.4	103.9
Street Lighting	4.1	101.5

Reference*: Original Evidence, Page 117, Line 11.*

Table 6 shows that the revenue to cost ratios are above 110 percent for three of the General Service classes. Newfoundland Power's current plan is to propose bringing all customer classes within the target revenue to cost ratio range at its next general rate proceeding.

Reference*: Original Evidence, Page 117, Lines 10 - 15; CA-NP-190.*

The Company's proposal is consistent with the Bowman Evidence recommendation on cost recovery.

Reference*: Bowman Evidence, Page 3, Lines 1 – 10.*

Table 7 provides the 2008 proposed rate changes and relative rate changes for each class.

Table 7
Proposed Rate Changes by Class

Rate	Class	Proposed Rate Change %	Relative to Average
1.1	Domestic	3.9	1.1% above
2.1	General Service 0-10 kW	(1.2)	4% below
2.2	General Service 10-100 kW (110 kVA)	(0.2)	3% below
2.3	General Service 110-1000 kVA	1.8	1% below
2.4	General Service 1000 kVA and Over	2.8	Average
4.1	Street and Area Lighting	2.8	Average

***Reference**: Supplemental Evidence, Page 28, Line 15; Mr. Henderson, Transcript, October 25, 2007, Page 105, Line 15 to Page 106, Line 7.*

Table 8 shows the resulting *pro forma* revenue to cost ratios from the Cost of Service Study following implementation of the proposed rates.

Table 8
***Pro forma* Revenue to Cost Ratios**

Class of Service	Rate Code	Revenue to Cost Ratios %
Domestic	1.1	94.6
General Service, 0-10 kW	2.1	115.0
General Service, 10-100 kW (110 kVA)	2.2	113.3
General Service, 110-1000 kVA	2.3	109.4
General Service, 1000 kVA and Over	2.4	103.9
Street Lighting	4.1	101.5

The proposals in the Amended Application, if approved by the Board, will advance approximately half way the goal of bringing all customer classes within the target range.

***Reference**: Original Evidence, Page 118, Line 5; Mr. Henderson, Transcript, October 25, 2007, Page 111, Line 21 to Page 112, Line 15.*

Newfoundland Power has incorporated marginal cost considerations in its rate designs. For Domestic customers, Newfoundland Power is proposing to apply the increase to the energy charge to permit better reflection of current marginal energy costs. For General Service customers, a similar approach was taken in changing the tail block energy charges. For General Service customer demand charges, the seasonal price differential was increased to better reflect seasonal marginal demand cost differences.

The extent to which customer rates should be modified to better reflect marginal costs necessarily requires judgment. Economic efficiency in rate design should be balanced with customer considerations and other rate design criteria.

***Reference**: Original Evidence, Page 118, Line 11 to Page 119, Line 16; Mr. Henderson, Transcript, October 25, 2007, Page 124, Line 18 to Page 125, Line 8; CA-NP-254 (1st Revision).*

It has been agreed in the Settlement Agreement that Newfoundland Power's rate design, with the exception of the Basic Customer Charge for Domestic customers, should be used by the Board to set customers rates.

***Reference**: Settlement Agreement, Section 8.*

The customer rates proposed in the Amended Application will obtain the forecast 2008 revenue requirement from rates of $498,226,000.

***Reference**: Exhibit 11 (1st Revision); Grant Thornton 2nd Report, Page 6, Lines 16 - 18.*

The evidence before the Board shows that Newfoundland Power's rate change proposals are reasonable and balanced. Approval of the proposed customer rates will provide sufficient revenue to enable Newfoundland Power the opportunity to earn a just and reasonable return on its rate base.

D.3 Regulation Changes

Section 71 of the Public Utilities Act requires that the utility request the Board's approval changes to its rules and regulations.

D.3.1 Energy Supply Cost Recovery

The Settlement Agreement provides an Energy Supply Cost Variance clause be added to the Rate Stabilization Clause to ensure recovery of prudently incurred energy supply costs. The Settlement Agreement also provides for the Energy Supply Cost Variance clause to apply to energy supply costs incurred to the end of 2010 with any renewal or extension requiring further consideration by the Board.

Reference*: Settlement Agreement, Sections 26 – 28; See Section E.2 Supply Cost Dynamics for the policy justification of the Energy Supply Cost Variance clause.*

The Energy Supply Cost Variance clause identifies the change in energy supply costs that are related to the difference between purchasing energy at the 2^{nd} block energy charge in the wholesale rate and the test year energy supply cost reflected in customer rates.

The proposed 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. It also includes minor wording changes to the Rate Stabilization Clause intended to improve clarity.

***Reference**: Supplemental Evidence, Page 30, Line 18 to Page 31, Line 13; Exhibit 12 (1st Revision); Original Evidence, Page 124, Lines 1-2.*

D.3.2 Requirement for Payment in Advance

Newfoundland Power has proposed modifications to Regulations 9(b) and 9(c) to permit charges for temporary connections, special facilities and relocations to be included on customer bills, subject to credit approval. This proposal provides increased customer convenience as it eliminates the requirement for the advance payment of fees for temporary connections, special facilities and relocations. The proposed changes were agreed in the Settlement Agreement.

***Reference**: Original Evidence, Page 124, Lines 4 - 10; Exhibit 13; Settlement Agreement, Section 29(a).*

D.3.3 Rejected Payment Fee

Newfoundland Power has proposed that Regulation 10(d) be changed (i) so that the fee be increased to $16.00 to better reflect costs and (ii) to expand the application of the fee to include stopped payments and cheques rejected for reasons other than insufficient funds. Many Canadian utilities apply a comparable fee to all returned payments. The proposal was agreed in the Settlement Agreement.

***Reference**: Original Evidence, Page 124, Line 12 to Page 125, Line 17; Exhibit 14; Settlement Agreement, Section 29(b).*

Revenue related to the changes in the rejected payment fee is included in Other Revenue.

***Reference**: CA-NP-198.*

The evidence before the Board indicates that Newfoundland Power's proposed changes to its regulations are reasonable.

E. REGULATORY POLICY MATTERS

E.1 The Automatic Adjustment Formula

Modifications to the Automatic Adjustment Formula are necessary to reflect Newfoundland Power's full adoption of the Asset Rate Base Method for calculating its rate base.

The Automatic Adjustment Formula (the "Formula") was established, pursuant to Order Nos. P.U. 16 (1998-99) and P.U. 36 (1998-99), to adjust the Company's rate of return on rate base and customer rates in years subsequent to a test year. The continued use of the Formula, with modifications, was approved in Order No. P.U. 19 (2003).

The Amended Application proposes that the Board approve:

(i) use of the Formula to set rates for not more than three years following the 2008 test year; and

(ii) that the arithmetic expression of the Formula be changed to reflect the Asset Rate Base Method ("ARBM").

The revised arithmetic expression of the Formula is as follows:

$$\text{Return on Rate Base} = \boxed{\text{Rate Base} \quad \times \quad \text{WACC}}$$

The continued use of the Formula is justified upon the basis of the potential savings to be realized from a regulatory process that does not require frequent cost of capital hearings and provides greater regulatory predictability and certainty.

Reference: *Order No. P.U. 16 (1998-99), Pages 102, et. seq; Order No. P.U. 19 (2003), Pages 64 – 65.*

The evidence shows that the proposed arithmetic expression of the Formula is consistent with the ARBM.

Reference: *Original Evidence, Page 60, Line 10 to Page 61, Line 6; Grant Thornton 1st Report, Page 18, Lines 27 - 35.*

The proposals in the Amended Application regarding the Formula have been agreed in the Settlement Agreement.

Reference: *Settlement Agreement, Sections 16.*

The evidence before the Board supports both (i) the continued use of the Formula and (ii) the modifications to the arithmetic expression of the Formula sought in the Amended Application.

E.2 Supply Cost Dynamics

Changing supply cost dynamics on the electrical system have resulted in Newfoundland Power's marginal cost of supply exceeding its marginal revenues. To better reflect these dynamics, the Amended Application seeks approval of a Demand Management Incentive Account and the recovery of energy supply cost variances through the Rate Stabilization Account.

Load requirements on Newfoundland Power's electrical system increase annually, principally as a result of the addition of new customers. This increase in load requirements increases Newfoundland Power's supply costs from Hydro on a marginal basis. Recent changes in Hydro's wholesale rate have resulted in a dramatic increase in the cost to Newfoundland Power of supplying increases in customer load. The dramatic increase in cost is the result of higher fuel costs related to production at Hydro's Holyrood thermal generating station.

Reference: *Original Evidence, Page 91, Lines 2 - 7.*

Newfoundland Power's marginal contribution (i.e., revenue less supply cost) per kWh of sales has materially eroded since 2004.

Table 9 indicates the change in Newfoundland Power's contribution margin from 2004 to 2007.

Table 9
Marginal Contribution
2004 to 2007
(¢/kWh sold)

	2004	**2005**	**2006**	**2007**
Marginal Revenue	7.9	8.1	8.2	9.3
Marginal Supply Cost of Sales	5.1	6.3	6.6	10.5
Marginal Contribution	**2.8**	**1.8**	**1.6**	**(1.2)**

A negative average marginal contribution exists for 2007 and is forecast to continue into 2008. This negative contribution reflects a systemic shortfall in supply cost recovery related to increases in customer load resulting from Newfoundland Power's fulfillment of its obligation to serve. This shortfall impairs Newfoundland Power's ability to recover not only its supply costs from Hydro but also its own costs of providing service.

Reference: *Original Evidence, Page 91, Line 16 to Page 92, Line 10.*

The Purchased Power Unit Cost Variance Reserve (the "Reserve Account") was introduced in 2005. Its purpose was to limit the impact on the Company of purchased power cost variances that resulted from the introduction of a demand and energy wholesale rate from Hydro.

Reference: *Order No. P.U. 44 (2004); Original Evidence, Page 40, Line 17 to Page 41, Line 2.*

In 2006, the Reserve Account was credited with an amount reflecting purchased power cost savings to customers of approximately $2.1 million. The 2006 results demonstrate the variability in purchased power demand costs inherent in the demand and energy wholesale rate.

Reference: *CA-NP-80.*

The Reserve Account was not designed to deal with the current supply cost dynamics on the system. The difficulty with modifying the existing Reserve Account is that it encompasses both energy and demand costs. To ensure transparency and avoid duplication, the Company has proposed separate mechanisms to deal with the demand and energy components of purchased power.

Reference: *Mr. Henderson, Transcript, October 25, 2007, Page 128, Lines 13 to Page 129, Line 6; Supplemental Evidence, Page 30, Line 18 to Page 31, Line 13.*

The Settlement Agreement provides for the Reserve Account to be replaced with the Demand Management Incentive Account which explicitly deals with demand cost variability.

Reference: *Settlement Agreement, Section 25; Exhibit 4.*

The proposed Demand Management Incentive Account will provide a meaningful incentive for Newfoundland Power to undertake reasonable initiatives to minimize peak demand.

Reference: *Original Evidence, Page 41, Lines 1 - 2; CA-NP-444(c).*

The Settlement Agreement also provides for the recovery of the energy supply cost variance through the Rate Stabilization Account for the period 2008 up to and including 2010.

Reference: *Settlement Agreement, Sections 26 - 28; Exhibit 12 (1st Revision).*

The proposed recovery of the energy supply cost variance through the Rate Stabilization Account is consistent with generally accepted regulatory objectives, including (i) rates should allow the utility to recover its prudently incurred costs to provide service to customers; and (ii) the utility should have the opportunity to achieve a fair return.

In the absence of an adjustment mechanism, these regulatory objectives are unlikely to be achieved without an increased frequency of general rate applications. An increased frequency of general rate applications for the single, or predominant, purpose of providing for recovery of increased supply costs resulting from modest customer growth is not consistent with regulatory efficiency or the provision of least cost service to customers.

Reference: *CA-NP-444(d).*

Regulatory mechanisms that permit recovery of supply costs for Canadian regulated distribution companies are common regulatory practice.

Reference: *CA-NP-444(f).*

The circumstances under which electrical service is provided will inevitably change and cost dynamics and customers' service requirements will also evolve. The term of the Energy Supply Cost Variance clause will end in 2010, with any renewal or extension requiring further consideration by the Board. This provision will ensure reasonable and timely Board oversight with respect to the recovery of energy supply costs.

Reference: *Supplemental Evidence, Page 31, Lines 8 - 11.*

The evidence before the Board indicates that the proposed Demand Management Incentive Account will provide a meaningful incentive for Newfoundland Power to pursue reasonable peak management initiatives. This is responsive to Board Orders concerning this matter, including Order No. P.U. 44 (2004).

In addition, the evidence before the Board indicates that proposed recovery of the Energy Supply Cost variance through the Rate Stabilization Account will appropriately address current supply cost dynamics through 2010. This is consistent with current Canadian public utility practice for regulated distribution companies.

E.3 Retail Customer Rate Review

Newfoundland Power has not proposed structural changes to its retail rate designs for 2008. A comprehensive Retail Rate Review is planned to commence following conclusion of proceedings on the Amended Application.

Retail electricity prices in the Province of Newfoundland and Labrador have increased significantly in recent years owing in large part to the high price of fuel at the Holyrood thermal generating station. This has led to increased regulatory focus on rate design and, in particular, the economic efficiency of rate design.

Reference: *Original Evidence, Page 4, Line 2 to Page 5, Line 2 and Page 6, Lines 17 - 19.*

The Settlement Agreement provides for a process of examining issues and options related to Newfoundland Power's retail rate designs.

Reference: *Settlement Agreement, Section 11.*

The timing is appropriate for a rate review given the new information that is available from the Marginal Cost Study, the provincial energy plan and the information that will be available when the Conservation and Demand Management Potential Study is completed later this year. Recent experience with rate designs in other jurisdictions will also be given consideration.

Reference: *Mr. Henderson, Transcript, October 25, 2007, Page 125, Lines 11 – 19.*

The Retail Rate Review will focus on rate design changes that improve the efficiency of the price signal while maintaining reasonable cost recovery. The Retail Rate Review will include (i) a review of existing retail rate designs; (ii) a review of potential alternative rate designs; (iii) consideration of whether alternative rate designs should be mandatory or optional; and (iv) a detailed time-bound action plan for implementation of the rate design recommendations.

Reference: *Mr. Henderson, Transcript, October 25, 2007, Page 125, Line 22 to Page 126, Line 7; Settlement Agreement, Attachment A.*

The objectives of the Retail Rate Review process include: (i) to facilitate the exchange of information necessary to conduct a review of retail rate designs; (ii) to provide a mechanism for the participation of other interested parties in the process; and (iii) where appropriate, to recommend new rate designs for implementation at Newfoundland Power's next General Rate Application.

Reference: *Settlement Agreement, Attachment A.*

The evidence before the Board indicates that the proposed Retail Rate Review will provide a timely, open and transparent process to assess the appropriateness of current rate designs and the implementation of alternative rate structures for Newfoundland Power's customers to provide for increased emphasis on energy efficiency.

E.4 Inter-Corporate Relationships

Newfoundland Power's current inter-corporate relationships are fully transparent and both Newfoundland Power and its customers derive demonstrable benefits from inter-corporate transactions.

Newfoundland Power recognizes the unique nature of inter-corporate transactions and the requirement that they be fully transparent. Newfoundland Power has established accounting systems which ensure all costs are recorded and treated in accordance with Board Orders.

Reference: *Mr. Ludlow, Transcript, October 22, 2007, Page 79, Lines 11 - 23; Ms. Perry, Transcript, October 22, 2007, Page 109, Line 9 to Page 110, Line 1.*

On an annual basis, the Board's financial consultants review the Company's inter-corporate charges for compliance with Board Orders. Since 2003, the Board's financial consultants have not identified any non-compliance with Board Orders in their annual reviews and have determined each year that inter-corporate charges are reasonable.

Reference: *Ms. Perry, Transcript October 22, 2007 Page 109, Line 9 to Page 110, Line 1; CA-PUB-1, Attachment B, Pages 16 – 17, Attachment C, Pages 16 – 17; Attachment D, Pages 26 – 31, Attachment E, Pages 26 – 32.*

Newfoundland Power files a report on inter-corporate transactions with the Board on a quarterly basis.

Reference: *CA-NP-8, Attachments A - D.*

In Order No. P.U. 19 (2003), the Board specifically required the Company to (i) take the appropriate steps necessary to preserve its financial integrity and independence and (ii) undertake certain operational measures and reviews relating to inter-corporate relationships.

Reference: *Order No. P.U. 19 (2003), Pages 56 - 57.*

In its review of the 2008 General Rate Application, the Board's financial consultants assessed the Company's compliance with Order No. P.U. 19 (2003) and confirmed that inter-corporate charges were in compliance with Board Orders and assessed that they are reasonable.

Reference: *Grant Thornton 1st Report, Page 43, Lines 16 – 17.*

At the centre of the issue of the financial effect of inter-corporate relationships on Newfoundland Power, and potentially its customers, was the linkage made by Standard & Poor's between credit ratings of holding companies and credit ratings of their operating utilities.

In 2004, the Company completed a comprehensive review of its stand-alone credit status. The review was documented in *A Report on the Stand-Alone Credit of Newfoundland Power,* which was filed with the Board on June 30, 2004. This review led to the Company entering into a $100 million dollar committed short-term credit facility in early 2005.

Reference*: Original Evidence, Page 93, Line 19 to Page 94, Line 13; CA-NP-147.*

Newfoundland Power's stand-alone credit status has been confirmed by two credit rating agencies. Both DBRS and Moody's rate Newfoundland Power's creditworthiness on a stand-alone basis.

Reference: *Original Evidence, Page 54, Lines 1 – 2; Exhibit 6.*

Newfoundland Power's current treatment of inter-corporate charges is in compliance with the Board's directives in Order No. P.U. 19 (2003).

Reference: *Original Evidence, Page 96; Lines 1 – 4; CA-NP-156; CA-NP-162; Ms. Perry, Transcript, October 23, 2007, Page 41, Lines 5 - 25.*

In Order No. P.U. 19 (2003), the Board specifically ordered that Newfoundland Power propose an appropriate mark-up on its cost based rates as a proxy for market in the event that the utilization of market rates is not practical. The Company's survey of Canadian utility practices in 2004 disclosed that no Canadian utility had discerned an observable market for utility executive and senior managers and each utility charged for senior management time on a cost recovery basis. This survey was updated by the Company in 2007 prior to the hearing of the Amended Application. In 2004, Newfoundland Power implemented a mark-up rate of 20 percent on salaries and benefits of individual executives and managers. This was, and remains, the highest such mark-up used by a regulated utility in Canada for charging senior management time spent on business of affiliated companies.

Reference: *CA-NP-156, Attachment A, Schedule 3, Page 4; CA-NP-167; Ms. Perry, Transcript, October 23, 2007, Page 74, Line 23 to Page 75, Line 16.*

The total amount of inter-corporate charges to affiliates in 2006 was 27 percent of the 2002 level.

Reference: *Original Evidence, Page 96, Lines 11 – 14.*

Inter-corporate charges for senior management time in 2007 and 2008 are forecast to be less than $100,000 or approximately 15 percent of 2001-2002 levels and 10 percent of the 2003 level.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 111, Lines 5 – 13; Mr. Ludlow, Transcript, October 23, 2007, Page 50, Line 16 to Page 51, Line 20.*

The reduction in staff charges related to senior management time is consistent with the Company's intention to reduce the level of inter-corporate activity between Fortis and Newfoundland Power. This, in turn, has reduced both the perceived complexity and integration of inter-corporate relationships on an operational level.

Reference: *CA-NP-147, Attachment B.*

Inter-corporate relationships clearly benefit customers by helping Newfoundland Power reduce its operating costs.

Newfoundland Power is able to achieve economies of scale in its costs by managing all of the utility poles in its service territory. The revenue the Company receives from third parties, including Fortis, exceeds its costs. This effectively reduces Newfoundland Power's revenue requirements from its customers.

By being a part of the centralized insurance program Newfoundland Power's insurance costs are reduced by 25 percent. Newfoundland Power's annual insurance premiums would be over $600,000 higher on a stand-alone basis. The benefit of this single item represents over one percent of the Company's total 2008 operating cost forecast.

Inter-corporate transactions also benefit customers by reducing Newfoundland Power's capital costs. Newfoundland Power and three affiliated utilities negotiated an approximately five percent volume discount for 2007 transformer purchases. This reduced the Company's capital costs by approximately $230,000, which benefits customers over the long term.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 114, Line 22 to Page 116, Line 22; CA-NP-170 (1st Revision); Original Evidence, Page 98, Lines 5 – 11.*

In addition, Newfoundland Power receives other benefits that are not readily quantifiable such as exposure to different utility operations which help in developing a skilled workforce.

Reference: *Original Evidence, Page 98, Line 9 – 11; Mr. Ludlow, Transcript, October 22, 2007, Page 79, Line 24 to Page 80, Line 24.*

The evidence before the Board indicates that Newfoundland Power's treatment of inter-corporate transactions is in compliance with the directives, guidelines and principles contained in Board Orders, including Order No. P.U. 19 (2003). In addition, the evidence shows that the Company's current practice for charging for senior management time to affiliates is (i) methodologically consistent with

current Canadian public utility practice and (ii) includes the highest mark-up on senior management time currently charged by a Canadian public utility.

E.5 International Financial Reporting Standards

The Canadian Accounting Standards Board has indicated that Canadian generally accepted accounting principles, which govern the presentation of external financial statements, will transition to international standards by 2011. This development has created uncertainty, particularly with respect to recognition of regulatory assets and liabilities in external financial statements.

The Canadian Accounting Standards Board (the "AcSB"), is the committee of the Canadian Institute of Chartered Accountants (the "CICA") responsible for establishing Canadian GAAP. The AcSB has adopted a strategic plan to transition Canadian GAAP to International Financial Reporting Standards ("IFRS") by 2011.

Reference: *Grant Thornton 2nd Report, Page 5, Lines 14 - 38; Ms. Perry, Transcript, October 22, 2007, Page 118, Line 3, et. seq.*

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. The ability for rate regulated enterprises to continue to recognize regulatory assets and liabilities in their external financial statements following the transition of Canadian GAAP to IFRS in 2011 is uncertain. Recognition of regulatory assets and liabilities in external financial statements of Newfoundland Power will be consistent with Canadian GAAP until that time.

***Reference**: Grant Thornton 2nd Report, Page 5, Lines 14 – 22 and Lines 31 – 38, Ms. Perry, Transcript, October 22, 2007, Page 123, Line 21, et. seq.*

Newfoundland Power currently has four principal types of regulatory assets. They include unrecorded future tax obligations; OPEBs transitional obligations; unrecovered reserve balances; and cost recovery deferrals. Together, Newfoundland Power's regulatory assets totaled over $120 million at year end 2006. In addition, Newfoundland Power has regulatory liabilities that total approximately $22 million.

***Reference**: Ms. Perry, Transcript, October 22, 2007, Page 120, Lines 5 - 25.*

The Settlement Agreement provisions providing for amortization of deferred cost recoveries, reserve balances and deferred revenues will result in a material reduction in total regulatory assets and liabilities by 2011. In addition, the tax effecting of pension expense agreed in the Settlement Agreement will bring the Company's external financial statements closer to Canadian GAAP.

***Reference:** Ms. Perry, Transcript, October 23, 2007, Page 126, Line 15 to Page 127, Line 6.*

The transition of Canadian GAAP to IFRS will affect Newfoundland Power's external financial statements. It will not change the regulatory accounting basis upon which the Board determines Newfoundland Power's rates which, in turn, determines Newfoundland Power's revenues.

***Reference:** Ms. Perry, Transcript, October 22, 2007, Page 129, Line 15 to Page 132, Line 5.*

In a letter dated October 4, 2007, the International Accounting Standards Board indicated, amongst other things, that the decision of the International Financial Reporting Interpretations Committee ("IFRIC") "…does not preclude the recognition of regulatory assets and liabilities…". While the matter remains uncertain, the recognition of regulatory assets and liabilities following 2011 under IFRS appears to be a possibility.

***Reference**: U-4, Tab 8; Ms. Perry, Transcript, October 23, 2007, Page 151, Line 7 to Page 152, Line 18.*

The risks to Newfoundland Power's financial integrity presented by the transition of Canadian GAAP to IFRS will be affected by the perception and response of credit rating agencies and capital markets to the changes in external financial statements that occur in 2011. It would be speculative for the Company to assess this future reaction today.

***Reference:** Ms. Perry, Transcript, October 22, 2007, Page 129, Line 15 to Page 132, Line 5.*

The transition of Canadian GAAP to IFRS is the most fundamental change in accounting standards in Canadian history and affects approximately 4,500 public reporting entities. The scope of the transition is broad. Newfoundland Power has a comprehensive plan to address IFRS transition.

***Reference:** Ms. Perry, Transcript, October 22, 2007, Page 126, Line 10 to Page 129, Line 10; Consent #4.*

The AcSB has indicated that it will issue a progress report on IFRS transition in March 2008. It is a possibility that dates for IFRS implementation may change.

***Reference**: U-4, Tab 7; Ms. Perry, Transcript, October 22, 2007, Page 125, Lines 14 - 17.*

As part of its ongoing management of the transition of Canadian GAAP to IFRS, Newfoundland Power will be required to report to its Board of Directors and the Audit & Risk Committee of its Board of Directors. Ongoing reporting to the Board can therefore be expected to present no material additional effort or cost for the Company.

***Reference**: Ms. Perry, Transcript, October 23, 2007, Page 121, Line 20 to Page 122, Line 5.*

The evidence before the Board concerning the currently proposed 2011 transition of Canadian GAAP to IFRS is fairly characterized by a high degree of uncertainty. The potential risk, if any, to Newfoundland Power's customers presented by this transition is also difficult to meaningfully assess at this time.

It is Newfoundland Power's submission that the most appropriate regulatory response to this uncertainty is for the Board to ensure, as part of its powers of general supervision of the Company's operations, that it remains informed of developments associated with IFRS transition and Newfoundland Power's ongoing plans in respect of those developments. This approach will enable the Board to take timely action, if necessary, to deal with any hazard to Newfoundland Power's customers which may present itself as a result of IFRS transition.

F. MATTERS UNRESOLVED BY SETTLEMENT AGREEMENT

F.1 Inter-Corporate Charges

In this proceeding, the Consumer Advocate has raised a number of issues relating to current inter-corporate charge practices of Newfoundland Power. The evidence before the Board relating to the issues raised by the Consumer Advocate does not justify regulatory intervention.

In the context of inter-corporate charges, the following matters were unresolved in the Settlement Agreement:

(i) whether the charge out structure for executive and senior management time adequately protects the interests of customers;

(ii) bonuses paid to executives for inter-corporate services;

(iii) whether inter-corporate transactions provide demonstrable benefits to customers; and,

(iv) codification of an inter-affiliate Code of Conduct.

Reference: *Settlement Agreement, Sections 31(a) to 31(d).*

The evidence shows that there is no observable market rate for inter-corporate services provided by utility executives and senior managers. This evidence is consistent with the experience of other Canadian regulated utilities that have examined the issue. This is the basis of the current Canadian utility practice to charge senior management time related to affiliate business on a cost recovery basis.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 111, Line 14, to Page 112, Line 18; CA-NP-156, Attachment A, Schedule 3.*

The evidence shows that Newfoundland Power's charge out rate of full cost plus 20 percent fully protects the interests of customers. It provides for full cost recovery and for the highest mark-up currently used by a regulated utility in Canada for charges of this nature.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 113, Lines 3 – 11; CA-NP-156, Attachment A, Schedule 3; CA-NP-398.*

Customers' interests are also protected by a fully transparent reporting process for all inter-corporate transactions as described in *E.4 Inter-Corporate Relationships*.

There is no evidence before the Board that any regulated utility in Canada charges a standby fee for executives and senior management availability. The concept of a standby fee would not benefit customers because it implies the existence of an obligation on Newfoundland Power to provide service to Fortis when requested. Newfoundland Power provides services to affiliates at its discretion, subject to the requirements of Newfoundland Power.

Reference: *Mr. Ludlow, Transcript, October 23, 2007, Page 53, Line 15 to Page 54, Line 8; Ms. Perry, Transcript, October 22, 2007, Page 113, Line 12 to Page 114, Line 1.*

All bonuses paid to executives of Newfoundland Power for inter-corporate services are treated as non-regulated expenses by the Company. Accordingly, the cost of such bonuses are not borne by customers.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 114, Lines 2 to 12; CA-NP-402.*

The policies and guidelines for inter-corporate transactions are reflected in the *Report on Inter-Corporate Charges* filed with the Board on March 31, 2004. The current policies and guidelines are appropriate.

The Company is not opposed to the formalization of current inter-corporate practices in a format that the Board directs.

Reference: *Ms. Perry, Transcript, October 22, 2007, Page 116, Line 23 to Page 117, Line 13; CA-NP-156, Attachment A, Schedule 1.*

There are demonstrable benefits to customers associated with Newfoundland Power's current inter-corporate transactions. These are described in *E.4 Inter-Corporate Relationships*.

Newfoundland Power submits that its current inter-corporate charge practice for executives and senior management adequately protects the interests of customers. No bonuses associated with work performed for affiliates are borne by customers. Inter-corporate transactions provide demonstrable and significant benefits to customers.

F.2 Regulatory Reliability and Service Standards

In this proceeding, the Consumer Advocate has raised the issue of whether a distribution reliability and service standard should be developed for Newfoundland Power. Newfoundland Power opposes the development of such a standard as proposed by the Consumer Advocate.

The Background of Regulatory Standards

The Canadian experience with formal regulated service and reliability standards is limited, particularly for utilities under cost of service regulation. In Alberta, such standards were adopted in response to customer dissatisfaction with service following retail electricity deregulation in 2001. In Ontario, service quality standards were adopted to discourage distribution utilities from sacrificing service quality following the adoption of performance based regulation ("PBR") in 2000.

Reference: *Mr. Ludlow, Transcript, October 22, 2007, Page 30, Line 21 to Page 31, Line 1; Mr. Delaney, Transcript, October 24, 2007, Page 28, Line 3 to Page 31, Line 18; Mr. Bowman, Transcript, October 26, 2007, Page 94, Line 25, and Page 97, Lines 4 to 10; CA-NP-431; Information #16; CA-NP-432.*

Reliability and Service standards appear to be more common in the United States than in Canada but their application varies across jurisdictions. The adoption of standards appears to have come about largely to disincent underinvestment (i) in a *restructured* utility industry and/or (ii) by utilities under PBR. Customer dissatisfaction was often a catalyst for regulatory action.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 33, Lines 12 - 18; Mr. Bowman, Transcript, October 26, 2007, Page 92, Lines 6 - 21; Information #9.*

In the state of Delaware, the introduction of service reliability and quality standards originated in a 1999 investigation into outages by the Delaware Public Service Commission. A key focus of the investigation was whether Delmarva Power was investing sufficiently in the reliability of its transmission and distribution systems. The objective of the adoption of the standard was to keep service consistent with *pre-restructuring* levels.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 34, Lines 4 - 18; Mr. Bowman, Transcript, October 26, 2007, Page 102, Line 19 to Page 103, Line 21; Information #8.*

The regulated standard in Delaware broadly conforms to the current reliability *practices* of Newfoundland Power.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 34, Line 19 to Page 37, Line 5; CA-NP-65.*

In Delaware, the establishment of a final standard took approximately 6 years. In Ontario, the quality of service standard originally adopted in 2000 was revised in 2005 and is currently under further review.

Reference: *CA-NP-65; Mr. Delaney, Transcript, October 24, 2007, Page 39, Line 25 to Page 40, Line 5.*

In Newfoundland Power's 2007 Capital Budget Application, the Board considered the suggestion that the Company should identify the hours of service outages that customers are willing to accept and further that the Company should work to understand the correlation between amounts spent on improving reliability and the resulting improvement in reliability.

In Order No. P.U. 30(2006), which approved Newfoundland Power's 2007 capital budget application, the Board reviewed Newfoundland Power's approach to reliability investment and the comprehensiveness of current regulatory oversight. The Board decided that should the customer satisfaction level fall to an unacceptable level, steps could be taken to make improvements or seek additional information, but additional work in this area was not required at that time.

Reference: *Order No. P.U. 30 (2006), Pages 9 – 10.*

Current Reliability Management and Regulatory Oversight

Newfoundland Power manages system reliability, consistent with least cost service, through (i) capital investment, which is reviewed annually by the Board in advance of expenditures, (ii) maintenance practices, which are consistent with current industry standards, and (iii) operational deployment which is reasonably responsive to the realities of Newfoundland Power's service territory.

Reference: *Original Evidence, Pages 25 - 30; Mr. Delaney, Transcript, October 24, 2007, Page 26, Lines 10 – 23.*

Newfoundland Power recognizes that management is accountable for reliability and service performance. The Company establishes targets for reliability and service quality on an annual basis to focus organizational efforts in fulfilling its obligation to serve.

Reference: *Mr. Delaney, Transcript, October 25, 2007, Page 10, Line 16 to Page 12, Line 18.*

System reliability is largely a function of the condition of electrical system assets. Newfoundland Power's reliability-related expenditure requirements cannot usefully be assessed on the basis of statistical measures. They can only be determined based on engineering assessment of the condition of plant and equipment.

Reference: *Original Evidence, Page 22, Line 11; Mr. Delaney, Transcript, October 25, 2007, Page 18, Line 19 to Page 20, Line 2; Page 31, Line 4 to Page 32, Line 10; Mr. Bowman, Transcript, October 26, 2007, Page 118, Line 2 to Page 120, Line 14.*

All of Newfoundland Power's capital investment to upgrade or replace deteriorated plant and equipment helps, to some degree, to maintain or improve reliability of service to customers. The Company's direct capital expenditures on reliability are presented in the Distribution Reliability Initiative project in the Company's annual capital budget submissions. These reliability-related expenditures are targeted expenditures that address problems on feeders identified as the worst-performing feeders. All such expenditures are reviewed by the Board and approved in advance.

Reference: *Original Evidence, Page 25, Line 6 to Page 26, Line 2; Mr. Delaney, Transcript, October 24, 2007, Page 15, Line 9 to Page 20, Line 10; Transcript, October 25, 2007, Page 46, Line 1 to Page 48, Line 4.*

Although Newfoundland Power's customers place a high value on reliable electric service, it is difficult to establish a meaningful relationship between rates and the value customers place on reliability. Industry studies that have attempted to value reliability have been inconclusive.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 42, Line 11 to Page 43, Line 8.*

Different customers have different reliability expectations. For example, a fish plant owner may have higher reliability expectations than seasonal cottage owners served by the same distribution feeder, and may be willing to pay more for better reliability. But because they are served by common infrastructure at largely common cost, it is not practically possible for the utility to respond to differing reliability expectations on a customer by customer basis.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 43, Line 10 to Page 44, Line 12.*

The Board exercises regulatory oversight of Newfoundland Power's reliability and service performance through various means, including (i) the capital budget application process; (ii) comprehensive reporting of an array of service measures related to reliability, customer service, safety and environmental performance on a quarterly basis and; (iii) next business day reporting of outages exceeding 5000 customer hours of outage, all damage claims exceeding $5,000 or affecting 5 or more customers, and all safety incidents involving public contact.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 28, Line 3 to Page 31, Line 18; CA-NP-65.*

Newfoundland Power's practice of targeting worst-performing feeders and completing detailed engineering assessments to determine if capital expenditures are necessary to improve reliability performance is reasonable. Its maintenance practices and operational deployment are issues properly considered in reliability management.

Reference: *Mr. Bowman, Transcript, October 26, 2007, Page 106, Line 15 to Page 107, Line 6; NP-CA-6.*

The regulatory approval process which applies to Newfoundland Power's capital expenditures is open and transparent. The review of maintenance expenditures in general rate applications and the Board's historical practice of conducting engineering reviews is also transparent.

Reference: *Mr. Bowman, Transcript, October 26, 2007, Page 105, Line 23 to Page 106, Line 1 and Page 108, Line 13 to Page 109, Line 10.*

Many jurisdictions which have implemented formal reliability and quality of service standards, including Delaware and Vermont, do not appear to require prior regulatory approval of capital expenditures.

Reference: *NP-CA-2; Mr. Bowman, Transcript, October 26, 2007, Page 99, Line 18 to Page 102, Line 5.*

There is no evidence that Newfoundland Power's reliability or quality of service has deteriorated or that customers are dissatisfied with the reliability or quality of the service they receive from Newfoundland Power.

Reference: *Mr. Bowman, Transcript, October 26, 2007, Page 90, Line 25 to Page 91, Line 9.*

The Canadian Electricity Association is developing a set of standard performance indicators for use in the regulatory setting. The goal of the initiative is to propose a set of meaningful performance indicators by the end of 2007. Newfoundland Power is participating in this initiative.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 44, Line 13 to Page 45, Line 8.*

The Position of the Consumer Advocate

The Consumer Advocate has proposed that the Board order a distribution reliability and service standard be developed for Newfoundland Power.

Reference: *Bowman Supplemental, Page 5, Lines 5 – 6.*

The original stated goal of a distribution reliability and service standard for Newfoundland Power was to move the province toward a quality of service regulation format. At the hearing, this goal was restated to maintain Newfoundland Power's current practice with input from the Board and the Consumer Advocate on setting targets.

Reference: *Bowman Evidence, Page 3; Mr. Bowman, Transcript, October 26, 2007, Page 122, Lines 1 – 3.*

The Bowman Evidence recommended that the Board direct that a distribution reliability and service standard be developed for Newfoundland Power with reporting initiated under the standard during 2008. In the Bowman Supplemental, it was proposed that the Consumer Advocate lead development of the standard, with input and review by Newfoundland Power. At the hearing, it was indicated that the establishment of a standard might be achieved within weeks.

Reference: *Bowman Evidence, Page 38; Bowman Supplemental, Page 5; Mr. Bowman, Transcript, October 26, 2007, Page 81, Line 14 to Page 82, Line 1.*

The Bowman Evidence indicated that in the absence of a standard, with its attendant performance measures and benchmarks, it is not possible to determine if (i) Newfoundland Power is meeting its obligation under the *Electrical Power Control Act, 1994* to equitably deliver power to customers in the province at the lowest cost consistent with reliable service, and (ii) if the Company's expenditures on reliability-related projects are prudently incurred and to assist in determining the appropriate balance between improved service and cost control.

Reference: *Bowman Evidence, Page 7, Lines 1 – 10; Exhibit CDB-2, Page 2.*

There is no evidence before the Board of any specific examples where the establishment of formal distribution reliability and service standards had established that reliability and service-related expenditures are prudently incurred resulting in fair and consistent treatment of customers.

Reference: *NP-CA-3.*

It was suggested that reliability and service standards may be necessary for Newfoundland Power to ensure that reliability or quality of service does not deteriorate.

Reference: *Mr. Bowman, Transcript, October 26, 2007, Page 79, Line 18 to Page 80, Line 4.*

A component of the proposed standard for Newfoundland Power was a minimum standard for individual feeders, but no utility subject to such a standard was identified.

Reference: *Mr. Bowman, Transcript, October 26, 2007, Page 110, Line 3 to Page 113, Line 9.*

The Position of Newfoundland Power

Newfoundland Power's principal concerns with the implementation of reliability and service standards as proposed by the Consumer Advocate are as follows:

1. the problem of how to deal with the difference between urban and rural reliability when setting benchmarks;
2. the cost associated with implementing the standards and their ongoing administration; and
3. the extent to which such standards will reduce management's flexibility.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 38, Line 5 to Page 42, Line 10.*

Setting reliability benchmarks is problematic in Newfoundland due to the requirement to provide service to both densely populated urban areas and sparsely populated rural areas. Practically, the economics of providing service are such that it is not possible to provide comparable reliability of service to urban and rural areas.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 38, Line 5 to Page 39, Line 11.*

Implementing distribution reliability and service standards, and administering them on an ongoing basis, will add some level of cost that must be recovered from Newfoundland Power's customers.

Reference: *Mr. Ludlow, Transcript, October 22, 2007, Page 32, Lines 5 - 15; Mr. Delaney, Transcript, October 24, Page 38, Line 5 to Page 42, Line 10.*

The costs associated with the adoption of a regulatory reliability and service standard for Newfoundland Power are not quantified in the evidence before the Board.

Reference: *Mr. Delaney, Transcript, October 24, Page 39, Line 12 to Page 41, Line 3; Mr. Bowman, Transcript, October 26, 2007, Page 135, Line 11 to Page 139, Line 7.*

To the extent that the implementation of standards requires Newfoundland Power to track and report information not already used for business and reporting purposes, there could be material investment in information systems required. This is inconsistent with the Company's recent focus on reducing administrative costs.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 39, Lines 12 – 22 and Page 122, Line 2 to Page 123, Line 13.*

Newfoundland Power's cost management efforts are focused on overall impacts on cost and service, both in the short and long term. The implementation of formal reliability and service standards could have the effect of limiting or delaying decisions, such as the Company's decision to suspend the Distribution Reliability Initiative in 2007 to manage the overall size of the capital budget, or the decision to outsource cashier services to reduce overall costs. Such limits or delays could reduce the effectiveness of the Company's cost management efforts.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 41, Line 4 to Page 42, Line 10.*

Newfoundland Power's reliability management practices are consistent throughout its service territory. The result of current management practices has been an appreciable reduction in the difference between rural and urban reliability throughout the Company's service territory. The Company's cost contribution to customer rates on a per kWh basis in 2008 will be less than it was in 2002. This is consistent with (i) Newfoundland Power's reasonable fulfillment of its obligation under the *Electrical Power Control Act, 1994* to deliver power to customers at the lowest cost consistent with reliable service and (ii) a reasonable balance between improved service and cost control.

***Reference:** Mr. Delaney, Transcript, October 24, 2007, Page 106, Line 5- 17; Original Evidence, Page 25, Footnote 32; CA-NP-15 (1st Revision).*

The Board's current regulatory oversight of Newfoundland Power is reasonably comprehensive and reasonably efficient. The efficiency results from the consistency between business reporting and regulatory reporting. Further formal standards are not necessary to ensure that Newfoundland Power provides safe and reliable electrical service to its customers at the lowest cost consistent with reliable service. The implementation of formal standards is only likely to increase the cost and complexity of regulatory oversight of Newfoundland Power.

***Reference:** Mr. Delaney, Transcript, October 24, 2007, Page 27, Line 22 to Page 31, Line 18, and Page 42, Line 2 – 10.*

The evidence before the Board does not justify the adoption of a distribution reliability and service standard as proposed by the Consumer Advocate. There is no evidence of tangible customer benefits associated with the proposal. There is no quantifiable evidence of the costs associated with the proposal.

Distribution reliability and service standards of the nature proposed by the Consumer Advocate have been adopted in some jurisdictions in response to hazards to customer service created by industry restructuring or the adoption of performance based regulation. For Newfoundland Power, which is regulated on a cost of service basis, there is no justification for adoption of such a standard.

The current reliability and service management practices of Newfoundland Power provide tangible customer benefits in terms of least cost reliable service. The current regulatory reporting regime for reliability and service is both reasonably transparent and reasonably efficient.

F.3 Productivity Allowance

In this proceeding, the Consumer Advocate has raised the issue of whether the Board should recognize a productivity allowance for Newfoundland Power. The evidence before the Board does not justify the Board's recognition of a productivity allowance for the 2008 test year.

The Consumer Advocate has proposed the Board approve a level of 2008 operating costs for rate setting purposes that is equal to the 2007 forecast of operating cost. The basis for this recommendation was developed without a detailed review of line by line costs.

Reference: *Todd Evidence, Page 17, Lines 19 to 21; Mr. Todd, Transcript, October 26, 2007, Page 29, Lines 15 to Page 31, Line 5.*

The evidence with respect to how a global productivity allowance is practically quantified was vague.

Reference: *Mr. Todd, Transcript, October 26, 2007, Page 42, Line 6 to Page 49, Line 14.*

Newfoundland Power's productivity for the period through 2008 is clearly demonstrated in evidence. Newfoundland Power's 2008 forecast total contribution to customer rates is 3.13¢/kWh in 2008 compared to 3.19¢/kWh in 2002 on an actual basis. Newfoundland Power's 2008 forecast operating costs (exclusive of deferred regulatory costs, pension costs and transfers to general expenses capitalized) are consistent with 2003 costs on an actual basis.

Reference: *CA-NP-15 (1st Revision); Exhibit 1 (1st Revision).*

The Board's view that a range of return provides an incentive device to encourage Newfoundland Power to seek efficiencies between rate hearings that can then be passed on to customers is consistent with cost of service regulation.

Reference: *Order No. P.U. 19 (2003), Page 76.*

The view that the Board ought to seek to capture efficiency gains in advance of their achievement may be consistent with performance based regulation, but not cost of service regulation. Cost of service regulation in this Province effectively provides that a utility is entitled to recover its reasonable and prudent forecast costs in addition to its return.

Reference: *Public Utilities Act, Section 80(2).*

Newfoundland Power's 2008 forecast operating costs are reasonable and consistent with the provision of least cost service.

Reference: *Section C.2.1 Operating Costs.*

There is no justification in evidence for the Board to recognize a productivity allowance for Newfoundland Power.

F.4 The Domestic Basic Customer Charge

In this proceeding, the Consumer Advocate proposes that Newfoundland Power's monthly Basic Customer Charge for Domestic customers be reduced by $1. Newfoundland Power is proposing to leave its Basic Customer Charge for Domestic customers unchanged at this time.

The Current Basic Customer Charge

Newfoundland Power's current Basic Customer Charge for Domestic customers (the "BCC") is $15.60.

The BCC does not fully recover customer related costs. Embedded customer related costs are $20.88. Marginal customer related costs are $20.90.

The BCC is also lower than the *maximum basic customer charge* of $16.95 calculated in accordance with the terms of the settlement reached at Newfoundland Power's 2003 General Rate Application.

Reference: *Amended Application, Schedule A, Page 1; Rate Design Review, Page 5.*

The BCC is reasonable when compared to other Canadian utilities. The simple average for utilities shown in a survey is $15.28, which is not materially different from the BCC of $15.60. Comparable domestic basic customer charges of Canadian utilities have increased on average by approximately $2.00 since 2002. Newfoundland Power's BCC has been reduced by about $1.20 since 2002. Newfoundland Power's BCC is currently the second lowest in Atlantic Canada.

Reference: *Mr. Henderson, Transcript, October 25, 2007, Page 123, Line 6 to Page 124, Line 14; NP-CA-1; Information # 12*

The Retail Rate Review agreed in the Settlement Agreement provides for a comprehensive review of existing and alternative rate designs with the objective to provide increased emphasis on energy efficiency and conservation in rate designs.

Reference: *Supplemental Evidence, Page 32, Lines 1 – 2.*

The Position of Newfoundland Power

All aspects of Newfoundland Power's rate design for proposed 2008 customer rates are guided by the criteria for sound rate structure described by James Bonbright in *Principles of Public Utility Rates.*

Reference: *Original Evidence, Page 109, Line 8 to Page 110, Line 6.*

Leaving the BCC at the current level balances three considerations; fairness in recovery of costs, efficiency reflected in rates and the rate impact on individual customers.

Reference: *Mr. Henderson, Transcript, October 25, 2007, Page 116, Lines 17 - 23.*

A reduction in the BCC will *reduce* the current level of recovery of customer related costs through the basic customer charge.

Reference: *Rate Design Review, Pages 2 and 5; Mr. Henderson, Transcript, October 25, 2007, Page 117, Line 2 to Page 119, Line 2.*

To promote the efficient use of electricity, rates should reflect marginal costs. Energy charges, which vary with use, are considered more important in providing an efficient price signal than fixed charges such as the BCC which do not vary with use.

Reference: *Original Evidence, Page 115, Lines 7 - 9; Mr. Henderson, Transcript, October 25, 2007, Page 119, Lines 8 - 19; Mr. Bowman, Transcript, October 26, 2007, Page 131, Lines 2 - 5.*

In this proceeding, Newfoundland Power is proposing to recover the entire revenue increase from the Domestic rate class by increasing the energy charge in the Domestic rate. This improves the reflection of marginal costs in the Domestic rate.

Reference: *Rate Design Review, Pages 4 – 6; Original Evidence, Page 115, Lines 7 – 9.*

Under Newfoundland Power's proposed rates, customer impacts will range from zero percent to a maximum of 4.3 percent.

Reference: *Exhibit 11.1, Page 1.*

The Position of the Consumer Advocate

The Consumer Advocate's proposal would reduce the BCC by $1 and increase the energy charge accordingly. The increase in the energy charge would improve the efficiency of the price signal to customers.

Reference: *Bowman Evidence, Page 3, Lines 14 – 21; Mr. Bowman, Transcript, October 26, 2007, Page 55, Lines 4 - 7.*

The maximum increase under the Consumer Advocate's proposal is 4.9 percent.

Reference: *CA-NP-449 (1st Revision), Attachment A, Line 42.*

Under the Consumer Advocate's proposal approximately 20 percent of Domestic customers (or, approximately 40,000 customers) will experience increases higher than 4.3 percent.

Reference: *Mr. Henderson, Transcript, October 25, 2007, Page 120, Line 21 to Page 121, Line 13; Supplemental Evidence, Page 8, Line 8 shows the number of Domestic customers in 2007 is 200,935; Exhibit 11.1.*

Reducing the BCC by $1 will result in rate decreases to approximately 8 percent of Domestic customers.

Reference: *CA-NP-449 (1st Revision), Attachment A.*

The evidence shows that maintaining the BCC at the current level will achieve a reasonable balance of fairness, efficiency and customer impacts in the 2008 Domestic rate.

The evidence shows that decreasing the BCC by $1 will result in higher 2008 bill impacts than proposed by the Company for a significant number of Domestic customers.

The Retail Rate Review will comprehensively review all retail rates with an emphasis on better reflection of marginal costs in rate design. The Company believes decreasing the BCC, at this time, to better reflect marginal energy costs is premature.

F.5 Other Matters

In this proceeding, the Consumer Advocate has raised a number of issues that essentially involve Newfoundland Power's managerial judgment in respect of routine business issues. The evidence in respect of these issues does not support Board intervention.

F.5.1 Policy Observations

In the Stated Case, the Supreme Court of Newfoundland and Labrador, Court of Appeal, observed that the Board's determination of what constitutes a just and reasonable return under Section 80 of the *Public Utilities Act* merely provides the Company with an opportunity to earn that return. The Company remains subject to business risks and the effects of management decisions, and the financial risks associated with the operation of the utility, as in any private business, are borne by the investors in the enterprise and not by the consumers of the utility's service.

Reference*: Stated Case, Paragraphs 31 - 33.*

The corollary of this position is that the utility must be accorded a degree of managerial flexibility in decision-making in order to be able to minimize the risks to which it must respond. The Court held that, while the Board's power to determine reasonable rates necessarily requires supervision of operating expenses, there is a competing principle, namely, that the Board is not the manager of the utility and should not as a general rule substitute its judgment on managerial and business issues for that of the officers of the enterprise.

***Reference**: Stated Case, Paragraphs 117 - 118.*

The issues raised by the Consumer Advocate relating to eBills promotion, labour cost management, safety communication, support structure management and energy efficiency communication essentially concern routine managerial judgment in the operation of the business. To fulfill its practical responsibility to account for the service it provides customers in a general rate application, Newfoundland Power led evidence in respect of each of these matters at the hearing of the Amended Application. This evidence has not disclosed any basis for Board intervention in respect of any of these issues.

F.5.2 eBills Promotion

Whether Newfoundland Power should provide a financial incentive to customers who opt to receive their bills by e-mail is an unresolved issue in the proceeding.

***Reference**: Settlement Agreement, Section 31 (g).*

Newfoundland Power's electronic billing option, known as *eBills*, commenced in 2004. It provides customers with the opportunity to receive their electricity bill via e-mail as opposed to receiving a paper copy in the mail. In 2006, over 11,000 customers received their bill through email. The operating cost savings associated with eBills is principally related to postage. The savings are estimated at approximately $7.00 per customer per year.

***Reference**: Original Evidence, Page 35, Lines 1 - 3.*

Customer participation in eBills grew from 4,275 customers in 2004 to 14,195 in July 2007. In 2007, the Company improved the eBills option by eliminating the need for customers to log in to the Company's website to view their bill. As of mid-October 2007, eBills participation had grown to 15,600 customers.

***Reference**: CA-NP-73; Mr. Delaney, Transcript, October 24, 2007, Page 45, Line 9 to Page 46, Line 11.*

In 2007, Newfoundland Power completed a survey of Canadian electric utilities to compare participation rates and promotion of electronic billing. At approximately 7 percent, the percentage of Newfoundland Power customers participating in electronic billing is higher than any of the thirteen companies who responded to the survey. None of the utilities responding to the survey offered financial incentives related to electronic billing.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 47, Lines 12 - 22.*

Newfoundland Power promotes eBills through a variety of means including bill inserts, the Company's website, print advertising, promotional voice messaging at the Customer Contact Centre, and the VOCM News website. Newfoundland Power has also promoted eBills through emails to all customers for which the Company has an email address and during calls to the Customer Contact Centre. These are cost-effective methods of promotion that largely avail of the Company's existing resources.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 46, Lines 12 - 25.*

Financial incentives to promote eBills would be complex to administer and would require costly modifications to the Company's Customer Service System. Financial incentives could also be perceived as being unfair to customers who do not have the ability to receive bills via email.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 47, Lines 3 - 11 and Page 80, Line 6 to Page 82, Line 13.*

F.5.3 Labour Cost Management

How labour cost savings related to vacancies which may occur are reflected in customer rates is an unresolved issue in the proceeding.

***Reference**: Settlement Agreement, Section 31 (i).*

Newfoundland Power's operating labour cost over the period from 2002 to forecast 2008 is essentially unchanged. Total labour cost was $28,410,000 in 2002 and is forecast to be $28,671,000 in 2008. Over the period, regular labour cost decreased by 2 percent.

***Reference**: Original Evidence, Page 18, Lines 9 - 15.*

Over the same period, the Company has reduced its workforce from 666 to 623 full time equivalents ("FTE"). The workforce reduction was principally the result of an Early Retirement Program offered in the first quarter of 2005.

***Reference**: Original Evidence, Page 19, Lines 1 – 6.*

Newfoundland Power does not have a tracking system for vacant positions, and has not tracked vacancies for many years. When a position becomes vacant at Newfoundland Power, the Company first determines whether the duties of that position can be performed by modifying or expanding the duties of existing employees before a decision is made to fill the vacated position.

***Reference**: CA-NP-45.*

Newfoundland Power does not have a rigid organizational structure. Labour management focuses on employees and work requirements, not positions. An approach focusing on staff positions would restrict flexibility and limit the pursuit of productivity improvements. The Company avails of opportunities to reduce the workforce whenever it is prudent to do so. This ensures labour costs are minimized for the benefit of customers.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 48, Line 5 to Page 49, Line 11; Mr. Delaney, Transcript, October 25, 2007, Page 84, Line 6 to Page 86, Line 9.*

The Company forecasts its labour requirements not on the basis of a fixed complement of staff, but on the basis of FTEs. The forecast of FTEs includes specific information on expected vacancies, such as maternity leaves, absences due to disability and expected hire and retirement dates. This ensures that labour cost savings related to vacancies are reflected in customer rates.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 48, Line 9 to Page 49, Line 11; Mr. Delaney, Transcript, October 25, 2007, Page 86, Line 16 to Page 90, Line 25.*

F.5.4 Safety Communication

The coordination of safety communications with Hydro is an unresolved issue in the proceeding.

Reference*: Settlement Agreement, Section 31 (j).*

Newfoundland Power actively coordinates with Hydro on utility safety issues. The two utilities share safety information, including safety alerts and accident reports, and have cooperated in developing and delivering safety training programs. The utilities have also coordinated on seasonal safety advertising initiatives and in public safety campaigns responding to identified problems.

Reference*: Mr. Delaney, Transcript, October 24, 2007, Page 51, Line 4 to Page 52, Line 14; Mr. Delaney; Transcript, October 25, 2007, Page 2, Line 10 to Page 5, Line 2 and Page 92, Line 12 to Page 98, Line 1.*

The objective of cooperation between the two utilities in safety communications is to maximize the effectiveness of the safety programs, including safety messages to employees, workers and the public. It is not specifically intended to reduce safety related expenditures.

Reference*: Mr. Delaney, Transcript, October 24, 2007, Page 51, Line 9 to Page 52, Line 14.*

Newfoundland Power has allocated $241,500 for safety related advertising in the 2008 test year forecast. Safety related advertising is used to promote public awareness of electrical safety through television, radio and print advertising.

Reference*: CA-NP-87 (1st Revision).*

F.5.5 Support Structure Management

Whether Newfoundland Power's practice of purchasing used poles at new pole prices is consistent with the provision of least cost service to customers is an unresolved issue in the proceeding.

***Reference**: Settlement Agreement, Section 31 (k).*

Newfoundland Power fully outsourced its pole management function between 1997 and 1999. To ensure that the pole management function is carried out at the lowest cost consistent with reliable service, Newfoundland Power's contracting practices are designed to support the maintenance of a competitive market for pole contractors, and to minimize administration costs.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 52, Line 19 to Page 55, Line 12.*

The cost to install used poles in 2006 was $87,000, which is less than 2 percent of the overall cost of poles for Newfoundland Power. To reduce pole contract administration costs, and to encourage re-use of used, serviceable poles, Newfoundland Power pays contractors a blended rate for both new and used poles. A blended rate avoids the need for detailed tracking of the installation of new and used poles, and simplifies contract administration.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 53, Line 14 to Page 54, Line 22; Mr. Delaney, Transcript, October 25, 2007, Page 77, Line 13 to Page 80, Line 13.*

Newfoundland Power's pole management practices are cost effective. The cost to install a pole increased from $1,282 per pole in 1997 to approximately $1,392 per pole in 2007, a 9 percent increase over 10 years. On an inflation-adjusted basis, the cost decreased by 11 percent.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 54, Line 23 to Page 55, Line 12.*

F.5.6 Energy Efficiency Communication

Whether Newfoundland Power should devote additional resources to radio and television promotion of energy conservation is an unresolved issue in the proceeding.

***Reference**: Settlement Agreement, Section 31 (l).*

Newfoundland Power's energy efficiency program costs are forecast to be $595,000 in each of 2007 and 2008. This is approximately twice the level of expenditure in 2002 and 2003.

***Reference:** CA-NP-76.*

Newfoundland Power's promotion of electrical energy efficiency is consistent with the provision of least cost supply to its customers. The Company has been active in promoting energy efficiency. From 2002 to 2006, the number of customers who contacted Newfoundland Power about energy efficiency information and initiatives increased by 94 percent. To meet this growing need, the Company continues to expand its energy efficiency information initiatives and programs.

***Reference**: Original Evidence, Page 36, Lines 1 – 7; Mr. Delaney, Transcript, October 24, 2007, Page 55, Line 13 to Page 59, Line 6.*

Newfoundland Power employs a direct, practical approach to energy efficiency communications with customers. The Company uses its existing resources and expertise to provide practical advice to customers who wish to use energy efficiently.

***Reference:** Mr. Delaney, Transcript, October 24, 2007, Page 57, Line 8 to Page 58, Line 8 and Page 65, Line 9 to Page 66, Line 10.*

In 2005 and 2006, the Company's Customer Attitude Survey on Energy Efficiency found that customers' preferred source for information on efficient use of electricity is their electric utility, and that bill inserts were the preferred source of information, surpassing television. All bill inserts in 2007 have contained energy efficiency information.

***Reference**: Mr. Delaney, Transcript, October 24, 2007, Page 59, Lines 1 – 12 and Page 64, Line 12 to Page 65, Line 8.*

In addition to bill inserts, Newfoundland Power delivers energy efficiency information directly to customers through a variety of means, including print advertising, the Company's website, billboard messages, trade shows, mall displays, in-store promotions, seminars and presentations to community organizations, as well as through appearances on local television news programs and through interactions with customers at the Customer Contact Centre.

***Reference:** Mr. Delaney, Transcript, October 24, 2007, Page 55, Line 18 to Page 59, Line 18; CA-NP-359; CA-NP-367.*

Newfoundland Power's decisions on the use of the various advertising media have been taken with a view to ensuring the messaging is effective with respect to both cost and impact. The decision not to focus on television advertising for the Company's energy efficiency communications with customers was influenced by the fact that there is already a considerable amount of energy efficiency messaging from various sources on television, and by the fact that television advertising is expensive.

Reference: *Mr. Delaney, Transcript, October 24, 2007, Page 59, Line 12 to Page 61, Line 12 and Page 66, Line 10 to Page 70, Line 1.*

Future direction with respect to conservation messaging will be influenced by the Conservation and Demand Management Potential study and the Energy Conservation and Efficiency Partnership announced in the Provincial Government's Energy Plan.

Reference: *Mr. Ludlow, Transcript, October 22, 2007, Page 83, Line 3 to Line 22; Mr. Delaney, Transcript, October 24, 2007, Page 59, Line 21 to Page 60, Line 12.*

All matters canvassed in this section involve managerial judgment on routine business issues. There is no evidence before the Board on these matters that justifies any action by the Board.