

- 1 **Q. a) Please provide the application to set customer rates for 2011 using the automatic**
2 **adjustment formula.**
- 3 **b) Please confirm that in the application of the automatic adjustment formula for**
4 **setting 2011 customer rates that the change in the weighted average cost of capital**
5 **(WACC) resulting from updating the return on equity was applied to the test**
6 **year rate base in computing the change in revenue requirement to be recovered**
7 **through customer rates. If not confirmed, please explain.**
- 8 **c) Please provide proforma 2024 finance schedules (in the formats provided in**
9 **Appendix A to Appendix E) using the following scenario: A proforma 2024**
10 **WACC is computed by updating the 2023 Test Year WACC to reflect the forecast**
11 **% cost of debt for 2024 (with no other changes to the computation of WACC)**
12 **and this 2024 pro-forma WACC is applied against the approved 2023 Test Year**
13 **rate base to compute the required change in revenue requirement. In the**
14 **response, please include the calculations.**
- 15 **d) Does Newfoundland Power believe the approach presented in part c) to this**
16 **question would reasonably reflect the change in 2024 revenue requirement**
17 **associated with the increased cost of debt since the 2023 test year? Please provide**
18 **reasons for the response.**
- 19
- 20 **A. a) See Attachment A.**
- 21
- 22 **b) It is confirmed. Newfoundland Power notes that the Board suspended the use of the**
23 **automatic adjustment formula in December 2011. Since the suspension of the**
24 **automatic adjustment formula, for years following test years the Board has ordered**
25 **the Company to file applications for approval of its forecast average rate base and**
26 **rate of return on rate base.**
- 27
- 28 *The 2024 Rate of Return on Rate Base Application was filed in compliance with*
29 *Order No. P.U. 3 (2022) and follows the same approach as prior applications*
30 *approved by the Board for the 2015, 2018 and 2021 forecast years. A key difference*
31 *between the rate of return on rate base applications and the automatic adjustment*
32 *formula application in 2011 is that in its orders associated with the 2015, 2018 and*
33 *2021 applications, the Board approved Newfoundland Power's rate of return on rate*
34 *base and its average rate base for that forecast year as opposed to the latest test year.*
35
- 36 **c) See Attachment B.**

1 Table 1 provides key financial metrics associated with the requested approach.

**Table 1:
Requested Approach
Key Financial Metrics**

	2024 Forecast (After Recovery)	2024 Regulated¹	Difference
Rate of return on rate base (%)	6.42	6.72	(0.30)
Rate of return on common equity (%)	7.56	8.50	(0.94)
Average rate base (\$millions)	1,359	1,287	72

2 Under the requested approach, after cost recovery of \$4.2 million, the Company’s
3 2024 forecast rate of return on rate base would be 30 basis points lower than the
4 2024 regulated rate of return on rate base, which is outside of the ±18 basis point
5 range established by the Board.²

6 Similarly, Newfoundland Power’s 2024 forecast rate of return on common equity
7 would be 94 basis points lower than the 8.50% ratemaking rate of return on common
8 equity, which is outside of the implied ±40 basis point range on rate of return on
9 common equity.

10 Finally, the Company’s 2024 forecast average rate base would be \$72 million higher
11 than the 2023 test year average rate base used to establish cost recovery and
12 customer rates under the requested approach.

13 As such, the requested approach does not provide Newfoundland Power with an
14 opportunity to earn a just and reasonable return on rate base in 2024 in accordance
15 with section 80 of the *Public Utilities Act* (the “Act”).

16 d) No, Newfoundland Power does not believe the approach outlined in part c)
17 reasonably reflects the change in 2024 revenue requirement associated with the
18 increased cost of debt since the 2023 test year. The Company’s 2024 forecast cost of
19 debt is determined by dividing its 2024 forecast return on debt by its average debt in
20 its 2024 capital structure. Therefore, the change in 2024 revenue requirement should
21 reflect both the higher interest rates since the 2023 test year as well as the higher
22 forecast level of debt necessary to finance Newfoundland Power’s operations in
23 2024. As proposed in the Application, the 2024 forecast cost of debt is \$8.6 million
24 higher than the 2023 test year.³

25 Further, the approach is not consistent with Order No. P.U. 3 (2022), which directed
26 the Company to file an application for approval of its 2024 average rate base and
27 rate of return on that 2024 average rate base. It is also not consistent with Board
28
29
30
31
32

¹ The *regulated* terminology refers to 2024 rate of return on rate base determined specific to the requirements set out in Appendix B in Attachment B.

² See Appendix C to Attachment B which shows the \$4.2 million change in 2024 revenue requirement from the 2023 test year.

³ See Appendix C, line 10 of the *2024 Rate of Return on Rate Base* report filed with the Application.

1 approvals associated with Newfoundland Power’s rate of return on rate base
2 applications for the 2015, 2018 and 2021 forecast years.
3
4 Finally, as outlined in part c), the approach does not provide the Company a
5 reasonable opportunity to earn a just and reasonable return on rate base in 2024.

Operation of the Automatic Adjustment Formula for 2011

DELIVERED BY HAND

November 24, 2010

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

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

Ladies & Gentlemen:

Re: Operation of the Automatic Adjustment Formula for 2011

A. Background

In Order No. P.U. 43 (2009), the Board ordered that the Company shall apply, by no later than November 30th in each of 2010 and 2011, for the application of the Automatic Adjustment Formula (the "Formula") to the rate of return on rate base and, if required, for a revised schedule of rates, tolls and charges to become effective January 1 in each year following.

The enclosed application (the "Application") requests that the Board make an Order approving:

- (i) a revised rate of return on rate base for 2011 of 7.96% in a range of 7.78% to 8.14%;
- (ii) a revised definition of the Excess Earnings Account reflecting the revised rate of return on rate base; and
- (iii) the deferral to December 15th, 2010 of the requirement to file an application for a revised schedule of rates, tolls and charges effective January 1st, 2011.



Join us in the fight against cancer.

B. The Application

Operation of the Formula For 2011

In Order No. P.U. 46 (2009), the Board approved the range of return on rate base of 8.23% in a range of 8.05% to 8.41% which reflects a forecast cost of equity of 9.00%.

The operation of the Formula for 2011 results in a forecast rate of return on rate base of 7.96%, which reflects a forecast cost of equity of 8.38%. The forecast rate of return of rate base for 2011 is lower than the current approved range of 8.05% to 8.41%.

In accordance with the terms of Order No. P.U. 36 (1998-99), the operation of the Formula for 2011 will result in a downward adjustment to the range of return on rate base for 2011 and a corresponding average reduction in customer rates of approximately 0.63% effective January 1, 2011.

Excess Earnings Account

The definition of the Excess Earnings Account requires revision to reflect changes to the rate of return on rate base for 2011 based upon the operation of the Formula.

The current Excess Earnings Account definition, approved in Order No. P.U. 46 (2009), reflects a forecast cost of common equity of 9.00%. The revised definition reflects the forecast cost of common equity of 8.38% which results from operation of the Formula for 2011.

Deferral of a Revised Schedule of Rates, Tolls and Charges

Order No. P.U. 43 (2009) provides that the Company shall, unless the Board orders otherwise, apply no later than November 30th in each of 2010 and 2011, for the application of the Formula to the rate of return on rate base and, if required, for a revised schedule of Customer Rates to become effective January 1st in each year following.

On June 30th, 2010, Newfoundland Power filed a comprehensive proposal for the 2011 adoption of accrual accounting for OPEBs costs (the "OPEBs Application"). The target date established by the Board for an Order on the OPEBs Application is December 10th, 2010. If the Board approves the 2011 adoption of accrual accounting for OPEBs costs by Newfoundland Power, an adjustment to customer rates will be required effective January 1st, 2011.

The deferral in filing a revised schedule of rates, tolls and charges is intended to accommodate the possibility that an order of the Board on the OPEBs Application will be received by December 10th, 2010. If this occurs, the deferral requested will permit both (i) the *decrease* in customer rates arising from operation of the Formula for 2011 and (ii) the proposed *increase* in customer rates arising from the Company's adoption of accrual accounting for OPEBs in 2011 to



Join us in the fight against cancer.

be fully reflected in a revised schedule of rates, tolls and charges effective January 1st, 2011. Such an approach is, in the Company's view, consistent with both regulatory efficiency and Customer Rate transparency.

C. Concluding

We trust the above and enclosed are satisfactory. A copy of this letter, together with a copy of the enclosure, has been forwarded directly to Mr. Geoffrey Young, Counsel to Newfoundland & Labrador Hydro and Mr. Thomas Johnson, the Consumer Advocate. If there are any questions with respect to these matters, please contact the undersigned at your convenience.

Yours very truly,



Peter Alteen
Vice President, Regulation
& Planning

Enclosures

c. Mr. Geoffrey Young
Newfoundland and Labrador Hydro

Mr. Thomas Johnson
Messrs. O'Dea, Earle



Join us in the fight against cancer.

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

IN THE MATTER OF an application
(the "Application") by Newfoundland Power Inc.
(the "Company") for an Order:

- (i) approving a revised rate of return on rate base for 2011 and a revised definition of the Excess Earnings Account; and
- (ii) permitting deferral until December 15th, 2010 of the Company's application for a revised schedule of rates, tolls and charges to be effective January 1st, 2011;

pursuant to the operation of the automatic adjustment formula (the "Formula") approved in Order Nos. P.U. 43 (2009) and P.U. 12 (2010).

TO: The Board of Commissioners of Public Utilities (the "Board")

THE APPLICATION OF the Company SAYS THAT:

A. Background

1. The Company is a corporation organized and existing under the laws of the Province of Newfoundland and Labrador, is a public utility within the meaning of the Act and is subject to the provisions of the *Electrical Power Control Act, 1994*.
2. By Order Nos. P.U. 16 (1998-99), P.U. 36 (1998-99), P.U. 19 (2003), P.U. 32 (2007) and P.U. 43(2009), the Board ordered the establishment of the Formula for use in determining the Company's rate of return on rate base and in setting customer rates, tolls and charges (collectively, "Customer Rates") in years subsequent to a test year.
3. By Order No. P.U. 43 (2009), the Board ordered that the Company shall apply, by no later than November 30th in each of 2010 and 2011, for the application of the Formula to the rate of return on rate base and, if required, for a revised schedule of Customer Rates to become effective January 1st in each year following, unless the Board orders otherwise.
4. By Order No. P.U. 12 (2010), the Board ordered that the risk free rate used to calculate the forecast cost of common equity for use in the Formula to establish the Company's annual rate of return on rate base for 2011 and 2012 shall be determined by adding (i) the average of the 3-month and 12-month forecast of 10-year Government of Canada Bonds as published by *Consensus Forecasts* in the preceding November, and (ii) the average observed spread between 10-year and 30-year Government of Canada Bonds for all trading days in the preceding October.

5. By Order Nos. P.U. 43 (2009) and P.U. 46 (2009), the Board approved the establishment of the 2010 test year parameters including a range of return on rate base of 8.05% to 8.41% for 2010 for use in calculating Customer Rates.
6. By Order No. P.U. 46 (2009), the Board approved the definition of the Excess Earnings Account whereby earnings for 2010 and subsequent years in excess of the maximum allowable rate of return on rate base of 8.41% are, unless otherwise ordered by the Board, to be credited to the Excess Earnings Account.
7. The operation of the Formula for 2011 yields a forecast rate of return on rate base of 7.96% based on a forecast cost of common equity of 8.38%. The forecast rate of return on rate base for 2011 is below the range of return on rate base approved in Order No. P.U. 46 (2009). In accordance with the operation of the Formula for 2011, Customer Rates must be adjusted effective January 1st, 2011.
8. On June 30th, 2010, Newfoundland Power filed, pursuant to Order No. P.U. 43 (2009), a comprehensive proposal to adopt the accrual method of accounting for other post employment benefits beginning on January 1st, 2011 (the "OPEBs Application"). The target date established by the Board for an order on the OPEBs Application is December 10th, 2011.
9. The operation of the Formula for 2011 will result in an average reduction in Customer Rates of approximately 0.63% effective January 1st, 2011. An order of the Board on the OPEBs Application may require the Company to file an application to increase Customer Rates effective January 1st, 2011.

B. The Application

10. Pursuant to the operation of the Formula, the rate of return on rate base for 2011 is 7.96%, in a range of 7.78% to 8.14%.

Appendix A to the Application sets out the forecast cost of common equity for 2011 calculated in accordance with Order No. P.U. 12 (2010).

Appendix B to the Application sets out the calculation of the rate of return on rate base for 2011 of 7.96%, based upon the operation of the Formula and a forecast 2011 cost of common equity of 8.38%.

Appendix C to the Application sets out the calculation of the return on rate base for 2011 based upon the operation of the Formula.

Appendix D to the Application sets out the calculation of a revised 2010 test year revenue requirement based upon the operation of the Formula.

11. The definition of the Excess Earnings Account requires revision to reflect changes to the rate of return on rate base for 2011 based upon the operation of the Formula.

Appendix E to the Application sets out the proposed definition of the Excess Earnings Account.

12. It is appropriate in the circumstances set out in paragraphs 8 and 9 to defer the filing of the Company's application for revised customer rates to be effective January 1st, 2011 as a result of the operation of the Formula until December 15th, 2010. This would permit both the decrease in customer rates arising from operation of the Formula for 2011 and any increase in customer rates which may arise from the Board's Order on the OPEBs Application to be fully reflected in a revised schedule of rates, tolls and charges to be effective January 1st, 2011.

C. Order Requested

13. The Company requests that the Board make an Order:
 - (i) pursuant to Section 80 of the Act, approving a rate of return on rate base for 2011 of 7.96% in a range of 7.78% to 8.14%, as set out in paragraph 10 of the Application;
 - (ii) pursuant to Section 58 of the Act, approving a revised definition of the Excess Earnings Account, as set out in Appendix E to the Application; and
 - (iii) pursuant to Section 70 of the Act, permitting deferral until December 15th, 2010 of the filing of the Company's application for a revised schedule of rates, tolls and charges to become effective January 1st, 2011.

D. Communications:

14. Communications with respect to the Application should be forwarded to the attention of Gerard M. Hayes, Counsel to the Company.

DATED at St. John's, Newfoundland and Labrador, this 24th day of November, 2010.

NEWFOUNDLAND POWER INC.



Gerard M. Hayes
Counsel to Newfoundland Power Inc.
P.O. Box 8910
55 Kenmount Road
St. John's, NL A1B 3P6

Telephone: (709) 737-5609
Telecopier: (709) 737-2974

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

IN THE MATTER OF an application
(the "Application") by Newfoundland Power Inc.
(the "Company") for an Order:

- (i) approving a revised rate of return on rate base for 2011 and a revised definition of the Excess Earnings Account; and
- (ii) permitting deferral until December 15th, 2010 of the Company's application for a revised schedule of rates, tolls and charges to be effective January 1st, 2011;

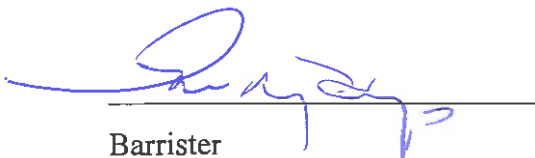
pursuant to the operation of the automatic adjustment formula (the "Formula") approved in Order Nos. P.U. 43 (2009) and P.U. 12 (2010).

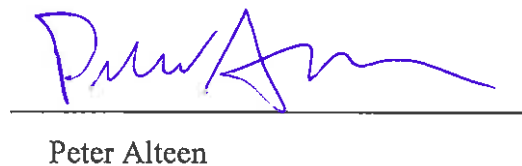
AFFIDAVIT

I, Peter Alteen, of the City of St. John's in the Province of Newfoundland and Labrador, make oath and say as follows:

- 1. That I am Vice-President, Regulation and Planning of Newfoundland Power Inc.
- 2. To the best of my knowledge, information and belief, all matters, facts and things set out in this Application are true.

SWORN to before me at St. John's
in the Province of Newfoundland and
Labrador this 24th day of November, 2010:


Barrister


Peter Alteen

Newfoundland Power Inc.

Automatic Adjustment Formula
2011 Forecast Cost of Common Equity

3-Month Forecast of 10-year Government Bond Yield ¹	2.80%
12-Month Forecast of 10-year Government Bond Yield ¹	3.30%
Average 10-year Government Bond Yield	<u>3.05%</u>
 Add: Average Observed Spread - 10-year and 30-year Government Bonds ²	 0.67%
 Forecast Long Canada Bond Yield	 3.72%
Long Canada Bond Yield: Order No. P.U. 43 (2009)	<u>4.50%</u>
Change in Long Canada Bond Yield	<u>-0.78%</u>
Change in Cost of Common Equity ³	<u>-0.62%</u>
 Cost of Common Equity: Order No. P.U. 43 (2009)	 9.00%
Change in Cost of Common Equity	<u>-0.62%</u>
2011 Cost of Common Equity	<u><u>8.38%</u></u>

¹ Yields are those reported in the *November Consensus Forecasts*.

² Average observed spread for all trading days in October between 10-year and 30-year Government of Canada Bonds as reported on the Bank of Canada website.

³ Reflects an adjustment in the total risk premium by a factor of 0.20 as required by Orders No. P.U. 16 and 36 (1998-99).

Newfoundland Power Inc.

Rate of Return on Rate Base¹
Based on Revised Forecast Cost of Common Equity For 2011

	%	Cost	Weighted Cost
Debt	54.27% ²	7.64% ²	4.15%
Preference Shares	1.04% ²	6.23% ²	0.06%
Common Equity	44.69% ²	8.38% ³	3.75%
2011 Rate of Return on Rate Base			<u>7.96%</u> ⁴

¹ Under the Asset Rate Base Method approved by Order No. P.U. 32 (2007), the rate of return on rate base equals the weighted average cost of capital.

² Based on 2010 Test Year, approved by Order No. P.U. 46 (2009).

³ 2011 Cost of Common Equity as per Appendix A.

⁴ The calculated rate of return on rate base of 7.96% is outside the range of return on rate base of 8.05% to 8.41% approved by the Board in Order No. P.U. 46 (2009).

Newfoundland Power Inc.

Calculation of Return on Rate Base
(000's)

Return on Rate Base Formula Approved by Order No. P.U. 32 (2007):

$$\text{Return on Rate Base} = \text{Rate Base} \times \text{Rate of Return on Rate Base}$$

2010 Test Year Return on Rate Base (approved by Order No. P.U. 46 (2009)):

$$\$ 71,750^1 = \$871,585^1 \times 8.23\%^1$$

2011 Return on Rate Base:

$$\$ 69,378 = \$871,585^1 \times 7.96\%^2$$

Change in 2010 Test Year Return on Rate Base:

$$\$ (2,372) = \$ 69,378 - \$ 71,750$$

¹ Approved by the Board in Order No. P.U. 46 (2009).

² As calculated in Appendix B.

Newfoundland Power Inc.

2010 Test Year Revenue Requirement
Adjusted for the Operation of the Automatic Adjustment Formula for 2011
(\$000s)

	2010 Test Year ¹	Changes	Revised
1 Return on Rate Base	71,750	(2,372) ²	69,378
2			
3 Other Costs			
4 Power Supply Cost	351,034	-	351,034
5 Operating Costs	51,689	-	51,689
6 Pension	8,196	-	8,196
7 Amortization of Depreciation Cost Recovery Deferral	3,861	-	3,861
8 Depreciation	43,378	-	43,378
9 Income Taxes	17,098	(1,041) ³	16,057
10	<u>475,256</u>	<u>(1,041)</u>	<u>474,215</u>
11			
12 2010 Revenue Requirement	547,006	(3,413)	543,593
13			
14 Deductions			
15 Other Revenue	(13,692)	-	(13,692)
16 2005 Unbilled Revenue	(4,618)	-	(4,618)
17 Other Adjustments	87	-	87
18	<u>(18,223)</u>	<u>-</u>	<u>(18,223)</u>
19			
20			
21 2010 Revenue Requirement from Base Rates⁴	<u>528,783</u>	<u>(3,413) ⁵</u>	<u>525,370</u>

¹ Approved in Order No. P.U. 46 (2009).

² From Appendix C.

³ Income tax is calculated based on the statutory rate of 30.5%. The calculation is as follows:

	(\$000s)	
Reduction in Return on Rate Base	(2,372)	
Gross-up for Income Tax Purposes	(3,413)	= (2,372/(1-30.5%))
Income Tax Rate	<u>30.5%</u>	
Change in Income Taxes	(1,041)	= (3,413 * 30.5%)

⁴ The reduction in base rates is 0.65% and is calculated as \$3,413,000/\$528,783,000. The reduction in Customer Rates which includes the effects of RSA and MTA is 0.63% and is calculated as:

$$\frac{3,413,000 + 84,000 \text{ (MTA effects)}}{528,783,000 + 13,302,000 \text{ (MTA billings)} + 12,254,000 \text{ (RSP billing)}}$$

⁵ This is the change in the 2010 Test Year Revenue Requirement and is equal to \$2,372,000 + \$1,041,000 = \$3,413,000.

Newfoundland Power Inc.

Excess Earnings Account

Current Definition

3.05 Excess Earnings Account 284xx

This account shall be credited with any earnings in excess of the upper limit of the allowed range of return on rate base as determined by the Board. Disposition of any balance in this account shall be as determined by the Board. For 2010 and subsequent years, all earnings in excess of an 8.41% rate of return on rate base shall, unless otherwise ordered by the Board, be credited to this account.

Proposed Definition

3.05 Excess Earnings Account 284xx

This account shall be credited with any earnings in excess of the upper limit of the allowed range of return on rate base as determined by the Board. Disposition of any balance in this account shall be as determined by the Board. For 2011 and subsequent years, all earnings in excess of an 8.14% rate of return on rate base shall, unless otherwise ordered by the Board, be credited to this account.

Schedule 1

Current Definition

3.05 Excess Earnings Account

284xx

This account shall be credited with any earnings in excess of the upper limit of the allowed range of return on rate base as determined by the Board. Disposition of any balance in this account shall be as determined by the Board. For 2010 and subsequent years, all earnings in excess of an 8.41% rate of return on rate base shall, unless otherwise ordered by the Board, be credited to this account.

Proposed Definition

3.05 Excess Earnings Account

284xx

This account shall be credited with any earnings in excess of the upper limit of the allowed range of return on rate base as determined by the Board. Disposition of any balance in this account shall be as determined by the Board. For 2011 and subsequent years, all earnings in excess of an 8.14% rate of return on rate base shall, unless otherwise ordered by the Board, be credited to this account.