

DELIVERED BY HAND

September 13, 2006

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

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

Ladies and Gentlemen:

**Re: Newfoundland Power's 2007 Amortization and Cost Deferrals Application**

Enclosed are 15 copies of Newfoundland Power Inc.'s ("Newfoundland Power" or the "Company") 2007 Amortization and Cost Deferrals Application (the "Application").

**A. Description of the Filing**

The primary purpose of the Application is to address the following 2007 costs which are not reflected in customer rates:

- (i) increased income tax costs of approximately \$2,714,000 related to the 2005 tax settlement with the Canada Revenue Agency;
- (ii) increased costs of \$5,793,000 related to the conclusion of a depreciation true-up in 2005; and
- (iii) forecast replacement energy costs of approximately \$1,795,000 attributable to the proposed 2007 refurbishment of the Rattling Brook hydroelectric plant.

The proposals in the Application will, if approved by the Board, enable Newfoundland Power to defer a rate increase in 2007 which would otherwise be necessary to address these costs. This would, in turn, position Newfoundland Power to file its next general rate application ("GRA") in 2007 to set customer rates for 2008. This is conducive to the orderly establishment of customer rates as Newfoundland Power's 2007 GRA would follow, and reflect the impacts of, Newfoundland and Labrador Hydro's ("Hydro") 2006 GRA.



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The Application also seeks approval of forecast 2007 values for rate base and invested capital for use in the automatic adjustment formula.

The proposals in the Application impact the 2007 forecast values for rate base and invested capital. The Application therefore provides an appropriate context for consideration of these forecast amounts.

No changes to the automatic adjustment formula itself are proposed in the Application.

### **B. Order Sought in the Application**

In the Application, Newfoundland Power is seeking an Order approving:

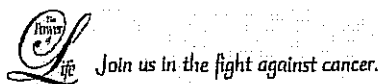
- (a) the amortization of \$2,714,000 of the 2005 Unbilled Revenue as revenue for regulatory purposes in 2007;
- (b) the deferred recovery, until a further Order of the Board, of \$5,793,000 in 2007 related to the conclusion of the Depreciation True-Up in 2005;
- (c) the deferred recovery, until a further Order of the Board, of the net impact of \$1,147,000 of the forecast 2007 replacement energy cost of \$1,795,000;
- (d) a 2007 forecast value for rate base of \$785,271,000 and a 2007 forecast value for invested capital of \$787,990,000, subject to a Board Order approving the Company's 2007 Capital Budget Application, to be used in the automatic adjustment formula for calculating Newfoundland Power's 2007 rate of return on rate base.

### **C. Filing Details and Circulation**

The enclosed material has been provided in a binder with appropriate tabbing. For convenience, additional materials such as Responses to Requests for Information will be provided on three-hole punched paper.

A PDF version of the filing will be forwarded to the Board in due course.

A copy of the filing has been forwarded directly to the people indicated below.



Board of Commissioners  
of Public Utilities  
September 13, 2006  
Page 3 of 3

We trust the foregoing and enclosed are found to be in order. If you have any questions on this filing, please contact us at your convenience.

Yours very truly,



Peter Alteen  
Vice President, Regulatory Affairs  
& General Counsel

Enclosures

c. Geoffrey Young  
Newfoundland & Labrador Hydro

Thomas Johnson  
O'Dea Earle Law Offices

Mark Kennedy  
Law Atlantic



Join us in the fight against cancer.

**IN THE MATTER OF** the *Public Utilities Act*, (the "Act"); and

**IN THE MATTER OF** an application by Newfoundland Power Inc. for an order pursuant to Sections 58, 78 and 80 of the Act:

- (a) approving a certain amortization and the deferred recovery of certain costs for 2007; and
- (b) approving forecast values for rate base and invested capital for use in the automatic adjustment formula for the calculation of the rate of return on rate base for 2007 pursuant to Order No. P.U. 19 (2003).

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**2007 Amortization and Cost Deferrals Application**

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**IN THE MATTER OF** the *Public Utilities Act*, (the "Act"); and

**IN THE MATTER OF** an application by Newfoundland Power Inc. for an order pursuant to Sections 58, 78 and 80 of the Act:

- (a) approving a certain amortization and the deferred recovery of certain costs for 2007; and
- (b) approving forecast values for rate base and invested capital for use in the automatic adjustment formula for the calculation of the rate of return on rate base for 2007 pursuant to Order No. P.U. 19 (2003).

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

**THE APPLICATION OF Newfoundland Power Inc. ("Newfoundland Power") SAYS THAT:**

**A. Background**

1. Newfoundland Power is a corporation duly 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) and P.U. 19 (2003), the Board ordered, in effect, that an automatic adjustment formula be established to set the electrical rates and allowed rates of return for Newfoundland Power based upon changes in long term Government of Canada bond yields (the "Formula").
3. By Order No. P.U. 19 (2003), the Board, in effect, approved Newfoundland Power's amortization of a \$17,200,000 depreciation reserve variance over a three year period commencing in 2003 and concluding in 2005 (the "Depreciation True-Up").
4. By Order No. P.U. 40 (2005), the Board approved, amongst other things, (i) the amortization as revenue for regulatory purposes in 2006 of \$3,086,000 of an accounting accrual for unbilled revenue arising from adoption of the accrual method of revenue recognition (the "2005 Unbilled Revenue"); and (ii) deferred recovery, until a further Order of the Board, of 2006 costs of \$5,793,000.
5. Newfoundland Power's 2007 Capital Budget Application has sought approval for the refurbishment of the Rattling Brook hydroelectric plant in 2007.

**B. Proposed 2007 Amortization and Cost Deferrals**

6. In 2007, the rates Newfoundland Power charges its customers for the service it provides will not reflect the following costs:

- (a) \$2,714,000 related to the amortization of the 2005 Unbilled Revenue for income tax purposes;
- (b) \$5,793,000 related to the conclusion of the Depreciation True-Up in 2005; and
- (c) \$1,795,000 related to the cost of replacement energy required as a result of the proposed refurbishment of the Rattling Brook hydroelectric plant.

7. Newfoundland Power proposes in 2007:

- (a) to amortize a portion of the 2005 Unbilled Revenue as revenue for regulatory purposes in 2007 to offset the amount referred to in paragraph 6(a); and
- (b) to defer recovery, until a further Order of the Board, of:
  - (i) an amount of \$5,793,000 to offset the amount referred to in paragraph 6 (b); and
  - (ii) an amount of \$1,147,000 to offset the after tax impacts of the amount referred to in paragraph 6 (c).

**C. 2007 Forecast Rate Base and Invested Capital**

8. The proposals set out in paragraph 7 will, if approved by the Board, affect the calculation of Newfoundland Power's forecast 2007 rate base and invested capital.

9. Newfoundland Power's 2007 forecast value for rate base of \$785,271,000 and 2007 forecast value for invested capital of \$787,990,000 incorporate the proposals set out in paragraph 7.

**D. Order Requested**

10. Newfoundland Power requests that the Board make an Order approving for 2007:

- (a) pursuant to Sections 58 and 80 of the Act:
  - (i) the amortization as revenue for regulatory purposes of \$2,714,000 of the 2005 Unbilled Revenue; and

- (ii) the deferred recovery, until a further Order of the Board, of costs totaling \$6,940,000 related to (i) the conclusion of the Depreciation True-Up and (ii) the after tax cost of replacement energy associated with the proposed refurbishment of the Rattling Brook hydroelectric plant;
  - (b) pursuant to Sections 78 and 80 of the Act, subject to a Board Order approving the Company's 2007 Capital Budget Application, a forecast value for rate base of \$785,271,000 and a forecast value for invested capital of \$787,990,000 to be used in the Formula for the calculation of Newfoundland Power's 2007 rate of return on rate base; and
  - (c) such further, other or alternate matters which may, upon the record of proceedings in respect of this Application, appear just and reasonable in all of the circumstances.
11. The Order requested in this Application, if granted by the Board, will not result in a change in the electricity rates charged by Newfoundland Power to its customers in 2007. Any required change to the 2007 allowed rate of return for Newfoundland Power and 2007 customer rates will be determined by the Formula as ordered by the Board in Order No. P.U. 19 (2003).

**E. Communications**

12. Communication with respect to this Application should be forwarded to the attention of Ian Kelly, Q.C. and Peter Alteen, counsel to Newfoundland Power.

**DATED** at St. John's, Newfoundland and Labrador, this 13<sup>th</sup> day of September, 2006.

**NEWFOUNDLAND POWER INC.**



Ian Kelly, Q.C. and Peter Alteen  
Counsel to Newfoundland Power Inc.  
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55 Kenmount Road  
St. John's, NL A1B 3P6

Telephone: (709) 737-5859  
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**IN THE MATTER OF** the *Public Utilities Act*, (the "Act"); and

**IN THE MATTER OF** an application by Newfoundland Power Inc. for an order pursuant to Sections 58, 78 and 80 of the Act:

- (a) approving a certain amortization and the deferred recovery of certain costs for 2007; and
- (b) approving forecast values for rate base and invested capital for use in the automatic adjustment formula for the calculation of the rate of return on rate base for 2007 pursuant to Order No. P.U. 19 (2003).

**AFFIDAVIT**

I, Robert G. Meyers, of St. John's in the Province of Newfoundland and Labrador, Certified General Accountant, make oath and say as follows:

- 1. That I am employed with Newfoundland Power Inc. as Treasurer.
- 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 13<sup>th</sup> day of September, 2006:



Barrister



Robert G. Meyers



**IN THE MATTER OF** the *Public Utilities Act*, (the "Act"); and

**IN THE MATTER OF** an application by Newfoundland Power Inc. for an order pursuant to Sections 58, 78 and 80 of the Act:

- (a) approving a certain amortization and the deferred recovery of certain costs for 2007; and
- (b) approving forecast values for rate base and invested capital for use in the automatic adjustment formula for the calculation of the rate of return on rate base for 2007 pursuant to Order No. P.U. 19 (2003).

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**Evidence of  
Newfoundland Power Inc.**

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# 2007 AMORTIZATION AND COST DEFERRALS APPLICATION

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1 **PART 1:**  
2 **APPLICATION OVERVIEW**

3 **1.1 Application Background**

4 In its 2006 Accounting Policy Application, Newfoundland Power Inc. (“Newfoundland Power”  
5 or the “Company”) indicated that it expected to file a general rate application (a “GRA”) in 2006  
6 to establish retail customer rates for 2007. Subsequent to this, Newfoundland and Labrador  
7 Hydro (“Hydro”) indicated its intention to file a GRA in 2006 seeking to establish rates for its  
8 customers, including Newfoundland Power, for 2007. On August 3, 2006, Hydro filed a GRA.

9  
10 Hydro supplies over 90% of the electricity which Newfoundland Power delivers to its customers.  
11 The cost of this electricity constitutes over 60% of the total costs reflected in Newfoundland  
12 Power’s retail customer rates.

13  
14 It is expected that the cost of electricity supplied to Newfoundland Power by Hydro will change  
15 as a result of the Hydro GRA, although the degree of change will not be known until the Board  
16 fully considers the matter.

17  
18 Given these developments, Newfoundland Power now expects to file its next GRA in 2007. By  
19 the time Newfoundland Power’s GRA is filed, it is expected that the results of Hydro’s GRA will  
20 be known and incorporated in Newfoundland Power’s GRA. Given the large proportion of  
21 Newfoundland Power’s total costs that are represented by the cost of electricity supplied to it by  
22 Hydro, such an approach is conducive to the orderly establishment of retail customer rates for the  
23 island interconnected grid.

1   **1.2   Application Overview**

2   In 2007, Newfoundland Power will incur three material costs that are not currently reflected in  
3   customer rates. They are:

- 4   (i)     \$2,714,000 attributable to the adoption of the accrual method of revenue recognition for  
5           income tax purposes effective January 1, 2006 pursuant to a 2005 agreement (the “Tax  
6           Settlement”) with the Canada Revenue Agency (the “CRA”);
- 7   (ii)    \$5,793,000 attributable to the 2005 conclusion of a depreciation true-up; and
- 8   (iii)   \$1,795,000 in forecast replacement energy costs attributable to the proposed 2007  
9           refurbishment of the Rattling Brook hydroelectric plant (the “Rattling Brook Project”).

10

11   This application (the “Application”) proposes that these 2007 costs be addressed by way of  
12   amortization and deferred recovery.

13

14   2007 forecast values for rate base and invested capital for use in the operation of the automatic  
15   adjustment formula (the “Formula”) in 2007 are also proposed in this Application.

16

17   The specific Newfoundland Power proposals contained in the Application are set out below.

18

19   **2007 Income Tax:** The January 1, 2006 adoption of the accrual method of revenue recognition  
20   for regulatory purposes<sup>1</sup> gave rise to an accounting accrual for 2005 unbilled revenue of  
21   approximately \$23.6 million (the “2005 Unbilled Revenue”). Newfoundland Power is proposing

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<sup>1</sup> Approved by the Board in Order No. P.U. 40 (2005).

1 to amortize \$2,714,000 of the 2005 Unbilled Revenue<sup>2</sup> as revenue for regulatory purposes in  
2 2007 to offset the increase in 2007 income tax expense attributable to the Tax Settlement.

3  
4 This proposal is identical to the treatment approved by the Board in Order No. P.U. 40 (2005)  
5 with respect to increased 2006 income tax expense of \$3,086,000 attributable to the Tax  
6 Settlement.

7  
8 **2007 Depreciation True-Up Deferral:** To address the 2007 effects of the 2005 conclusion of a  
9 depreciation true-up, Newfoundland Power is proposing to defer recovery, until a further Order  
10 of the Board, of 2007 costs of \$5,793,000.

11  
12 This proposal is identical to the deferred recovery approved by the Board in Order No. P.U. 40  
13 (2005) with respect to increased 2006 depreciation expense of \$5,793,000 attributable to the  
14 conclusion of the depreciation true-up in 2005.

15  
16 **2007 Replacement Energy Cost Deferral:** Newfoundland Power is proposing to defer recovery,  
17 until a further Order of the Board, of the impact of the 2007 replacement energy costs associated  
18 with the Rattling Brook Project which are not reflected in current customer rates. This would  
19 result in a deferral of \$1,147,000 in 2007.

20  
21 **2007 Forecast Rate Base and Invested Capital:** The proposals contained in this Application  
22 will, if approved by the Board, affect the 2007 forecast values for Newfoundland Power's rate

---

<sup>2</sup> Insofar as they refer to the 2005 Unbilled Revenue in the Application, the accounting terms *amortize* and *recognize* are synonymous.

1 base and invested capital. These values are used in the operation of the Formula. The subject  
2 matter of this Application provides an appropriate context for considering these values.

3

4 Newfoundland Power is proposing, subject to a Board Order approving the Company's 2007  
5 Capital Budget Application, a 2007 forecast value for rate base of \$785,271,000 and a 2007  
6 forecast value for invested capital of \$787,990,000 to be used in the Formula for calculating its  
7 2007 rate of return on rate base. No changes to the Formula itself are proposed in this  
8 Application.

1 **PART 2:**  
2 **2007 AMORTIZATION AND COST DEFERRALS**

3 **2.1 2007 Income Tax**

4 In June 2005, Newfoundland Power resolved a longstanding income tax dispute with the CRA  
5 concerning its historical policy of using the billed method of revenue recognition<sup>3</sup> for income tax  
6 purposes.

7  
8 Under the terms of the Tax Settlement, Newfoundland Power (i) does not have to pay any  
9 additional taxes, interest or penalties under the provisions of the *Income Tax Act (Canada)* in  
10 respect of its historical revenue recognition policy, (ii) adopted the accrual method of revenue  
11 recognition<sup>4</sup> for income tax purposes effective January 1, 2006 and (iii) is amortizing the 2005  
12 Unbilled Revenue as taxable income over the period 2006 through 2008.

13  
14 The amortization of the 2005 Unbilled Revenue as taxable income over 2006 through 2008 gives  
15 rise to income tax costs for Newfoundland Power in these years.<sup>5</sup> The forecast income tax cost  
16 associated with this amortization in 2007 is \$2,714,000.<sup>6</sup>

17  
18 In accordance with Order No. P.U. 40 (2005), Newfoundland Power adopted the accrual method  
19 of revenue recognition for regulatory purposes effective January 1, 2006. In Order No. P.U. 40  
20 (2005), the Board approved the amortization in 2006 of \$3,086,000 of the 2005 Unbilled

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<sup>3</sup> Under the billed method, revenue is recognized as customers are billed for the electrical service provided to them.

<sup>4</sup> Under the accrual method, revenue is recognized as electrical service is delivered to customers.

<sup>5</sup> The income tax costs do not represent incremental income tax. In the absence of the Tax Settlement, the 2005 Unbilled Revenue would have been fully taxable in 2006. The effect of the Tax Settlement in this regard was to (i) defer payment of income tax on the 2005 Unbilled Revenue over a three year period and (ii) reduce the total income taxes that will be paid on the 2005 Unbilled Revenue. The latter effect reflects a decline in the Company's statutory income tax rate from 36.12% in 2006 and 2007 to 34.5% in 2008.

<sup>6</sup> Based on Newfoundland Power's statutory income tax rate of 36.12%.

1 Revenue as revenue for regulatory purposes to offset the 2006 income tax effects of the Tax  
2 Settlement.

3  
4 In the Application, Newfoundland Power is proposing to amortize \$2,714,000 of the 2005  
5 Unbilled Revenue as revenue for regulatory purposes in 2007 to offset a like amount of 2007  
6 income tax expense attributable to the Tax Settlement.<sup>7</sup>

7  
8 To the extent Newfoundland Power amortizes the 2005 Unbilled Revenue as revenue for  
9 regulatory purposes, it effectively displaces cash revenue that would otherwise be required from  
10 customers upon which income tax would be payable. The amortization of \$2,714,000 of the  
11 2005 Unbilled Revenue in 2007 is, from a customer perspective, the least cost means of  
12 satisfying the 2007 income tax effects of the Tax Settlement.<sup>8</sup>

13

## 14 **2.2 2007 Depreciation True-Up Deferral**

15 In Order No. P.U. 19 (2003) the Board approved the amortization of an accumulated  
16 depreciation reserve variance of approximately \$17.2 million (the “Depreciation True-Up”) over  
17 a three year period beginning in 2003. The amortization served to decrease Newfoundland

<sup>7</sup> If the Company’s proposal to amortize \$2,714,000 of the 2005 Unbilled Revenue in 2007 to satisfy increased income tax expense is approved by the Board, there would be approximately \$17.5 million of 2005 Unbilled Revenue that remains to be amortized. This is calculated as follows (000s):

Unamortized 2005 Unbilled Revenue at December 31, 2005	\$ 23,631
Amortized as revenue in 2006 pursuant to Order No. P.U. 40 (2005)	(3,086)
Netted against the Unbilled Revenue Increase Reserve pursuant to Order No. P.U. 40 (2005)	(295)
Proposed amortization as revenue in 2007	<u>(2,714)</u>
Unamortized 2005 Unbilled Revenue	<u>\$ 17,536</u>

<sup>8</sup> Offsetting the 2007 income tax effects of \$2,714,000 with cash revenue from rates would increase taxable income by a like amount in 2007 and, in turn, increase 2007 income tax expense. An amount of approximately \$4,249,000 of cash revenue from rates would be required to offset \$2,714,000 of 2007 income tax expense. The \$1,535,000 difference between these amounts reflects additional income tax that would be payable, i.e., \$4,249,000 less income tax at 36.12% equals \$2,714,000.



1 Power's depreciation expense by a like amount in these years, resulting in lower rates to  
2 customers.<sup>9</sup>

3  
4 The conclusion of the Depreciation True-Up in 2005 effectively increases annual depreciation  
5 expense by \$5,793,000 beginning in 2006, which was the amount of the Depreciation True-Up  
6 that was amortized in each of the years 2003, 2004 and 2005.

7  
8 Pursuant to Order No. P.U. 40 (2005), recovery of the \$5,793,000 increase in 2006 depreciation  
9 expense that is attributable to the conclusion of the Depreciation True-Up was deferred until a  
10 further Order of the Board. This deferred recovery is being recorded as an expense reduction on  
11 the Company's 2006 statement of income. This treatment effectively offsets the increase in 2006  
12 depreciation expense that is attributable to the conclusion of the Depreciation True-Up.

13  
14 In the Application, Newfoundland Power is proposing to address the 2007 effects of the  
15 conclusion of the Depreciation True-Up in the same manner as was approved for 2006 in Order  
16 No. P.U. 40 (2005).

17  
18 The *pro forma* impact of the 2006 deferred recovery and the proposed 2007 deferred recovery on  
19 the Company's costs is shown in Table 1.

---

<sup>9</sup> The Depreciation True-Up was based on Newfoundland Power's 2002 depreciation study that was performed by Gannett Fleming Inc. Newfoundland Power's 2006 depreciation study, which is based on plant in service at December 31, 2005, indicates an accumulated depreciation reserve variance of \$694,920 (amount greater than the 5% tolerance threshold). It is expected that the 2006 depreciation study will be considered at the Company's next GRA.

1

**Table 1**  
**Pro Forma Impact of Deferred Recoveries**  
**2006-2007**  
**(000s)**

	<b>Actual</b>	<b>Pro Forma</b>	
	<b>2005</b>	<b>2006</b>	<b>2007</b>
Gross Depreciation Expense	\$ 37,936	\$ 39,013 <sup>10</sup>	\$40,327 <sup>10</sup>
Depreciation True-Up	(5,793)	-	-
Net Depreciation Expense	32,143 <sup>11</sup>	39,013 <sup>11</sup>	40,327 <sup>11</sup>
2006 Deferred Recovery	-	(5,793)	-
Proposed 2007 Deferred Recovery	-	-	(5,793)
Net Expense	<u>\$ 32,143</u>	<u>\$ 33,220</u>	<u>\$ 34,534</u>
<i>Pro Forma</i> Increase in Costs		<u>\$1,077<sup>12</sup></u>	<u>\$1,314<sup>12</sup></u>

2

3 Table 1 shows that both the 2006 deferred recovery approved by Order No P.U. 40 (2005) and  
4 the proposed 2007 deferred recovery serve only to offset the effects of the 2005 conclusion of the  
5 Depreciation True-Up of \$5,793,000 that is not reflected in current customer rates. The deferred  
6 recoveries do not offset any increased depreciation expense related to increased plant  
7 investment.<sup>13</sup>

<sup>10</sup> Based on (i) depreciation rates approved by the Board in Order No. P.U. 19 (2003) and, (ii) as applicable, forecast plant investment for 2006 and 2007. Forecast plant investment for 2006 is based on actual plant investment as of December 31, 2005 and forecast 2006 capital expenditures approved by the Board. Forecast 2007 plant investment is based on forecast 2006 plant investment and forecast capital expenditures for 2007 as contained in the Company's 2007 Capital Budget Application.

<sup>11</sup> Represents the amount of depreciation expense recorded in Newfoundland Power's statement of income.

<sup>12</sup> These amounts represent the forecast increases in net depreciation expense in 2006 and 2007 that are attributable to increased plant investment.

<sup>13</sup> In Order No. P.U. 40 (2005), the Board specifically did not approve the Company's proposal for relief associated with increased 2006 depreciation expense related to increased plant investment.

1   **2.3   2007 Replacement Energy Cost Deferral**

2   The Rattling Brook hydroelectric plant is the largest generating facility operated by  
3   Newfoundland Power. The normal annual production at Rattling Brook constitutes almost 17%  
4   of Newfoundland Power's total annual hydroelectric production.

5  
6   In 2007, it is planned that the Rattling Brook hydroelectric plant will be refurbished.<sup>14</sup> During  
7   the period of construction, Newfoundland Power will have to purchase replacement energy from  
8   Hydro to replace the normal production of the Rattling Brook hydroelectric plant. The forecast  
9   spill associated with the Rattling Brook Project indicates a loss of 38.2 gigawatt hours (GWh) of  
10   energy production in 2007.

11  
12   In setting Newfoundland Power's customer rates, normal annual energy production is assumed  
13   for the Company's hydroelectric generating facilities. Newfoundland Power has a Hydro  
14   Production Equalization Reserve that normalizes the Company's annual purchased power costs  
15   to account for changes in Newfoundland Power's hydroelectric production resulting from  
16   variations in available water resources associated with that production.<sup>15</sup> The Hydro Production  
17   Equalization Reserve ensures that Newfoundland Power's annual power supply costs reflect  
18   energy production from the Company's hydroelectric generating facilities that approximates the  
19   production assumed for the purposes of setting customer rates.

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<sup>14</sup> The Rattling Brook Project is before the Board as part of the Company's 2007 Capital Budget Application.

<sup>15</sup> The Hydro Production Equalization Reserve was established by Order No. P.U. 32 (1968).

1 Each year, Newfoundland Power’s estimate of normal energy production from its hydroelectric  
2 generating facilities is adjusted, as necessary, to reflect physical plant changes and scheduled  
3 plant availability.<sup>16</sup> For 2007, the estimate of normal energy production for use in the Hydro  
4 Production Equalization Reserve will be reduced by 38.2 GWh to reflect the forecast scheduled  
5 unavailability of the Rattling Brook hydroelectric plant due to the proposed refurbishment. The  
6 effect of this adjustment is that the Company will incur an additional 38.2 GWh of energy  
7 purchases from Hydro in 2007 at a cost of \$1,795,000.<sup>17</sup>

8  
9 The Rattling Brook Project was not contemplated at the time of setting current customer rates.  
10 As a result, the cost of replacement energy associated with the Rattling Brook Project is not  
11 reflected in those rates. In addition, the operation of the Hydro Production Equalization Reserve  
12 will not provide for recovery of the Company’s extraordinary purchased power costs arising  
13 from the Rattling Brook Project.

14  
15 The forecast 2007 cost to Newfoundland Power of \$1,795,000 for replacement energy due to the  
16 Rattling Brook Project will be deductible for income tax purposes. Accordingly, the net 2007  
17 impact upon Newfoundland Power of the requirement to purchase the replacement energy is this  
18 actual cost of \$1,795,000 which will be paid to Hydro, less the applicable reduction in income  
19 tax.

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<sup>16</sup> This annual assessment of estimated normal energy production was recommended by Acres International in its December 2000 *Water Management Study*. By annually adjusting these estimates, transfers to and from the Hydro Production Equalization Reserve should more closely track the effects of *stream flows*. Over the long term, this practice should help ensure the balance in the Hydro Production Equalization Reserve tends to zero. Annual adjustments in normal annual energy production since 2001 have typically been less than 1% of the normal annual energy production assumed for the purposes of setting customer rates.

<sup>17</sup> The estimated cost of replacement energy cost for the Rattling Brook Project (38.2 GWh x 1,000,000 x 4.7¢ per kWh = \$1,795,400, or approximately \$1,795,000).

1 Table 2 shows Newfoundland Power’s 2007 net cost of replacement energy arising from the  
2 Rattling Brook Project which is not reflected in current customer rates.

3

**Table 2**  
**The Rattling Brook Project**  
**Net Cost of Replacement Energy**  
**(000s)**

Replacement Energy Cost	\$1,795
Income Tax Effects	<u>(648)<sup>18</sup></u>
Net Cost Not Reflected In Rates	<u>\$1,147</u>

4

5 In the Application, Newfoundland Power is proposing to address the 2007 cost of replacement  
6 energy by deferring recovery, until a further Order of the Board, of an amount equal to  
7 \$1,147,000.<sup>19</sup>

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<sup>18</sup> The income tax effects of the replacement energy costs ( $\$1,795,400 \times 36.12\% = \$648,498$ , or approximately \$648,000).

<sup>19</sup> The deferred recovery would be recorded as a reduction in purchased power expense on Newfoundland Power’s 2007 statement of income.

1 **PART 3:**  
2 **THE AUTOMATIC ADJUSTMENT FORMULA**

3 **3.1 Formula Operation for 2007**

4 In Order Nos. P.U.16 (1998-99), P.U. 36 (1998-99) and P.U. 19 (2003), the Board established  
5 the Formula to set an appropriate rate of return on rate base for Newfoundland Power on an  
6 annual basis. The Formula adjusts Newfoundland Power's rate of return annually based upon  
7 changes in the forecast cost of common equity. The forecast cost of common equity is based  
8 upon changes in long-term Government of Canada bond yields.

9  
10 The proposals in this Application impact the values for the Company's 2007 forecast rate base  
11 and invested capital. The Application therefore provides an appropriate context for the Board's  
12 consideration of these values.

13  
14 No changes to the Formula itself are proposed in this Application.

15  
16 **3.2 2007 Forecast Rate Base and Invested Capital**

17 Subject to a Board Order approving the Company's 2007 Capital Budget Application,  
18 Newfoundland Power's forecast average rate base for 2007, which incorporates the proposals  
19 made in the Application, is \$785,271,000.

20  
21 The detailed calculation of Newfoundland Power's forecast average rate base for 2006 and 2007  
22 is shown in Exhibit NP-1.

1 Subject to a Board Order approving the Company's 2007 Capital Budget Application,  
2 Newfoundland Power's forecast average invested capital for 2007, which incorporates the  
3 proposals in the Application, is \$787,990,000.

4

5 The detailed calculation of Newfoundland Power's forecast average invested capital for 2006  
6 and 2007 is shown in Exhibit NP-2.

7

8 In the Application, Newfoundland Power is proposing that forecast 2007 values for rate base of  
9 \$785,271,000 and invested capital of \$787,990,000 be used in the Formula for the calculation of  
10 Newfoundland Power's rate of return on rate base for 2007.

**PART 4:  
CONCLUSION**

**4.1 Summary of Proposals**

In this Application, Newfoundland Power is seeking the approval of the Board to:

1. amortize \$2,714,000 of the 2005 Unbilled Revenue as revenue for regulatory purposes in 2007;
2. defer recovery, until a further Order of the Board, of the amount of \$5,793,000 in 2007 related to the conclusion of the Depreciation True-Up in 2005;
3. defer recovery, until a further Order of the Board, of the amount of \$1,147,000 related to the Rattling Brook Project; and
4. use, subject to a Board Order approving the Company’s 2007 Capital Budget Application, forecast 2007 values for rate base of \$785,271,000 and invested capital of \$787,990,000 in the Formula for the calculation of Newfoundland Power’s rate of return on rate base for 2007.

**4.2 Pro Forma Effects of Proposals**

Exhibit NP-3 summarizes Newfoundland Power’s *pro forma* 2007 financial results incorporating the proposals in the Application.



**Newfoundland Power Inc.**

**Forecast Average Rate Base  
2006 - 2007  
(000s)**

		<u>2006</u>	<u>2007<sup>1</sup></u>	
			<u>Existing</u>	<u>Proposed</u>
1	Plant Investment	\$ 1,189,256	\$ 1,236,647	\$ 1,236,647
2				
3	<u>Deduct:</u>			
4	Accumulated Depreciation	501,647	527,420	527,420
5				
6	Contributions in Aid of Construction	21,403	21,611	21,611
7				
8	Purchased Power Unit Cost Variance Reserve	1,344	1,344	1,344
9				
10	Weather Normalization Reserve	(11,314)	(10,189)	(10,189)
11		<u>513,080</u>	<u>540,186</u>	<u>540,186</u>
12				
13		676,176	696,461	696,461
14	Add - Contributions Country Homes	<u>575</u>	<u>575</u>	<u>575</u>
15				
16	Balance - Current Year	676,751	697,036	697,036
17				
18	Balance - Previous Year	<u>659,797</u>	<u>676,751</u>	<u>676,751</u>
19				
20	Average	668,274	686,894	686,894
21				
22	Cash Working Capital Allowance (@1.7%)	5,538	5,529	5,529
23				
24	Materials and Supplies	4,578	4,902	4,902
25				
26	Average Deferred Charges	94,530	103,369	106,839 <sup>2</sup>
27				
28	Average 2005 Unbilled Revenue	<u>(21,941)</u>	<u>(20,250)</u>	<u>(18,893) <sup>3</sup></u>
29				
30	Average Rate Base	<u>\$ 750,979</u>	<u>\$ 780,444</u>	<u>\$ 785,271</u>

<sup>1</sup> Pursuant to the approval of the 2007 Capital Budget Application.

<sup>2</sup> Includes the impacts of the proposed 2007 deferral of \$1,147,000 of replacement energy costs and the proposed 2007 cost recovery deferral of \$5,793,000.

<sup>3</sup> Includes the impact of the proposed amortization of \$2,714,000 of the 2005 Unbilled Revenue.

Newfoundland Power Inc.

Forecast Average Invested Capital  
2006 - 2007  
(000s)

		2007		
		<u>2006</u>	<u>Existing</u>	<u>Proposed<sup>1</sup></u>
1	Average Capital Structure			
2	Debt	\$ 409,088	\$ 432,067	\$ 432,067
3	Preferred Equity	9,400	9,390	9,390
4	Common Equity	329,940	341,706	346,533
5	Total	<u>\$ 748,428</u>	<u>\$ 783,163</u>	<u>\$ 787,990</u>

<sup>1</sup> Incorporates the effects of the proposals set out in the Application.

Newfoundland Power Inc.

*Pro forma* 2007 Financial Results  
(000s)

	<u>Existing</u> <sup>1</sup>	<u>Proposed</u> <sup>2</sup>	<u>Difference</u>
1			
2			
3	\$ 410,177	\$ 412,891	\$ 2,714 <sup>3</sup>
4	<u>260,090</u>	<u>258,943</u>	<u>(1,147)</u> <sup>4</sup>
5	<u>150,087</u>	<u>153,948</u>	<u>3,861</u>
6			
7	<u>10,260</u>	<u>10,260</u>	<u>-</u>
8			
9	Other Expenses:		
10	Operating Expenses	46,999	46,999
11	Pension & Early Retirement Costs	4,867	4,867
12	Depreciation Expense	40,327	40,327
13	Deferred Costs	-	(5,793) <sup>5</sup>
14	Finance Charges	<u>32,776</u>	<u>32,776</u>
15		<u>124,969</u>	<u>(5,793)</u>
16			
17	Income before Income Taxes	35,378	45,032
18	Income Taxes	<u>14,261</u>	<u>14,261</u>
19			
20	Net Income	21,117	30,771
21	Preferred Dividends	<u>589</u>	<u>589</u>
22			
23	Earnings Applicable		
24	to Common Shares	<u>\$ 20,528</u>	<u>\$ 30,182</u>
25			
26			
27	<b>Rate of Return Metrics</b>		
28			
29	Regulated Return on Book Equity	6.29%	8.99%
30	Rate of Return on Rate Base	7.03%	8.22%

<sup>1</sup> *Pro forma* 2007 results before incorporating the proposals in the Application.

<sup>2</sup> *Pro forma* 2007 results after incorporating the proposals in the Application.

<sup>3</sup> The proposed 2007 amortization of \$2,714,000 of 2005 Unbilled Revenue.

<sup>4</sup> The proposed 2007 deferral of \$1,147,000 of replacement energy costs.

<sup>5</sup> The proposed 2007 cost recovery deferral of \$5,793,000.