Q. In reference to the evidence of Earl Ludlow, page 7, Table 1, and page 49, graph 6, although there has been overall cost savings from 1998 through 2002, costs are forecast to increase in 2003 and 2004 over 2002 levels. Why does Newfoundland Power not expect to achieve similar savings in the coming two years?

A. Newfoundland Power has been able to control operating expenses while continuing to improve electrical system maintenance and the quality of service provided to customers. From 1998 to forecast 2004, gross operating costs (excluding pension and deferred regulatory costs) will have decreased by 0.1 per cent and gross operating costs per customer will have decreased by 4.5 per cent, while inflation (as measured by the GDP deflator) is forecast to have been 12.4 per cent. Over the same period, both the number of customers and total sales will have increased by 4.5 per cent and 10.2 per cent respectively.

As reviewed in detail in the *Operations & Customer Service Evidence*, these gains primarily have resulted from organizational changes, process improvements, the implementation of technology, and workforce reduction. The savings achieved by implementing technology and improving the Company's organization and processes, and the workforce reductions that these measures have enabled, will continue to have a positive impact on the cost-effectiveness of the Company's operations into the future. However, in order to continue to meet the expectations of the Company's customers with respect to reliability of supply and service levels, moderate increases in operating expenses will be necessary from time to time.

For example, to achieve further improvements in the quality and effectiveness of customer service, the Company must address the aging of its workforce and will have to recruit to maintain appropriate staff levels in its core competencies. While this may tend to put upward pressure on costs, it is necessary to ensure that customers continue to receive appropriate levels of service over the longer term.

Reducing costs through productivity initiatives is one way of reducing the cost of electricity for customers. Another approach is to seek ways to increase revenues. By enabling the Company to take advantage of economies of scale in operations, for example, the purchase of support structures from Aliant has generated additional revenues which more than offset any associated increases in operating costs, and which result in an overall reduction in the revenue that must be recovered through customer rates.

From 2002 to 2004, the Company is forecasting that its gross operating expense per customer will increase by approximately 2.2 per cent. This increase is forecast to be outstripped by inflation, as measured by the GDP deflator, which over this three-year period is forecast at 3.6 per cent.