Q. In this Application, Newfoundland Power is proposing an equity risk premium of 4.75% and a risk free rate of 6%. Please advise, from a dollar perspective, what this changed increase in the equity risk premium means.

A. In P.U. 16 (1998-99), the Board determined that the equity risk premium to be used in the Formula was 3.5% (350 basis points). In comparison to the 4.75% proposed by Newfoundland Power, this represents an increase of 1.25%. A change in the equity risk premium results in a change in the rate of return on equity.

As noted in our response in CA-635, in order to determine with accuracy the impact for the test year of a change in rate of return on equity, it would be necessary to rerun the Company's entire financial model. Adjusting the rate of return on equity in the test year would result in secondary impacts such as changes in interest cost attributable to changes in cash flow, elasticity effects on energy consumption, etc.

However, without adjusting for the potential secondary impacts, the estimated impact of a change in the equity risk premium of 1.25% would be as follows:

Proposed rate of return on equity	10.75%
Adjusted rate of return (10.75 – 1.25%)	9.50%
Decrease in rate of return	1.25%
Regulated average common equity for 2003 test year[1]	$ 295,920,000
Estimated reduction in earnings	$ 3,699,000
Statutory tax rate	37%
Estimated impact on revenue requirement	$ 5,871,400

(1) As per the February 10, 2003 revision. Assumes no change in the amount of average common equity in the capital structure.