

1 **Q. P. 42 Common Equity Calculate the impact on the 2004 revenue requirement of**
2 **seeking a 10.71% return on an average balance of \$8,904,000 of “notional equity”,**
3 **representing the accumulated disallowed expenses.**
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5 A. The impact of seeking 10.71% return on an average equity balance of \$8,904,000
6 increases 2004 Revenue Requirement by \$1,443,000.
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8 The calculation of average regulated common equity is appropriate for ratemaking
9 purposes under the current practice of determining return on rate base for Newfoundland
10 Power. The adding back to the net earnings of the Company of non-regulated expenses
11 provides regulatory continuity to the calculations of common equity used for ratemaking
12 purposes.
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14 The calculations supporting the reduction in 2004 revenue requirement of \$1,443,000 are
15 shown in Tables 1-5 below.
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17 If the current practice of calculating the average regulated common equity was not
18 established, the Company would have requested a return on equity for 2003 and 2004 of
19 11.05 and 11.03 respectively instead of 10.75% and 10.71% respectively. Details of this
20 calculation are included in the response to Request for Information NLH-236.
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22 The higher return on equity would be justified in combination with the Company's
23 proposed capital structure to allow the Company to generate a sufficient return on
24 ratebase to maintain its current bond rating as required by section 3(a)(iii) of the
25 *Electrical Power Control Act, 1994*. A just and reasonable return on ratebase as
26 described in section 80(1) of the *Public Utilities Act* must be sufficient to maintain a
27 utility's creditworthiness.

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Table 1 Forecast Weighted Average Cost of Capital 2004 Proposed ¹			
	%	Cost Rate	Weighted Cost Rate
Debt	54.15	8.21%	4.45%
Preferred	1.39	6.31%	0.09%
Common	44.46	10.71%	4.76%
	100.00		9.30%

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¹ As shown in Exhibit BVP-18, page 1 of 1, line 26.

Table 2 Forecast Weighted Average Cost of Capital Using Book Common Equity 2004 Pro Forma			
	%	Cost Rate	Weighted Cost Rate
Debt	54.85	8.21%	4.50%
Preferred	1.41	6.31%	0.09%
Common	43.74	10.71%	4.69%
	100.00		9.28%

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Table 3
Rate of Return on Rate Base
Using Average Regulated Equity
2004 Proposed
(000s)

$$2004 = \left[\frac{\$698,959^1}{\$619,125^2} \times 9.30\%^3 \right] + \frac{(\$66^4 + \$30^5 - \$191^6)}{\$619,125}$$

$$= \mathbf{10.48\%}$$

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¹ Forecast of Average Invested Capital for 2004 proposed as shown in Exhibit BVP-10, page 1 of 1, line 6.

² Forecast of Average Rate Base for 2004 proposed as shown in Exhibit BVP-9, page 1 of 2, line 27.

³ Weighted Average Cost of Capital as calculated in Table 1 above and as shown in Exhibit BVP-18, page 1 of 1, line 26.

⁴ Forecast of Amortization of Capital Stock Issue expenses for 2004 as shown in Exhibit BVP-13, page 1 of 1, line 31.

⁵ Forecast of Interest on customer deposits for 2004 as shown in Exhibit BVP-13, page 1 of 1, line 33.

⁶ Forecast of Capitalized Interest for 2004 as shown in Exhibit BVP-13, page 1 of 1, line 32.

Table 4
Rate of Return on Rate Base
Using Book Equity
2004 Pro Forma
(000s)

$$2004 = \left[\frac{\$690,055^1}{\$619,125^2} \times 9.28\%^3 \right] + \frac{(\$66^4 + \$30^5 - \$191^6)}{\$619,125}$$

$$= \mathbf{10.33\%}$$

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¹ Forecast of Average Invested Capital for 2004 using book equity comprised of Average Invested Capital for 2004 proposed as shown in Exhibit BVP-10, page 1 of 1, line 6 less difference between book equity and regulated average common equity for 2004 of \$8,904,000.

² Forecast of Average Rate Base for 2004 proposed as shown in Exhibit BVP-9, page 1 of 2, line 27.

³ Weighted Average Cost of Capital as calculated in Table 2 above.

⁴ Forecast of Amortization of Capital Stock Issue expenses for 2004 as shown in Exhibit BVP-13, page 1 of 1, line 31.

⁵ Forecast of Interest on customer deposits for 2004 as shown in Exhibit BVP-13, page 1 of 1, line 33.

⁶ Forecast of Capitalized Interest for 2004 as shown in Exhibit BVP-13, page 1 of 1, line 32.

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Table 5 Impact on 2004 Revenue Requirement of Using Book Equity 2004 Pro Forma (000s)			
	Average Rate Base¹	Rate of Return on Rate Base²	Return on Rate Base³
2004 Proposed	\$619,125	10.48%	\$64,894
2004 Pro Forma	\$619,125	10.32%	63,956
Reduction In 2004 Revenue Requirement Due To Reduction In Rate Of Return On Rate Base ⁴			938
Reduction In 2004 Revenue Requirement Due To Reduction In Taxes ⁵			505
Total Reduction In 2004 Revenue Requirement Due To The Removal of \$8,904,000 in Equity From Average Invested Capital ⁶			\$1,443

¹ Forecast of Average Rate Base for 2004 proposed as shown in Exhibit BVP-9, page 1 of 2, line 27.

² Rate of Return on Rate Base For 2004 proposed as shown in Exhibit BVP-16, page 1 of 1, line 21 and 2004 Pro Forma Rate of Return on Rate Base with \$8,904,000 reduction in Average Invested Capital as shown in Table 4 above.

³ Return on Rate Base For 2004 proposed and 2004 Pro Forma. It is equal to the Average Rate Base multiplied by the Rate of Return on Rate Base.

⁴ Reduction in revenue requirement for 2004 due to a reduction in required Return on Rate Base equal to \$64,894,000 minus \$63,894,000.

⁵ Reduction in revenue requirement for 2004 due to a reduction in taxes associated with a reduced return on rate base, calculated as \$1,000,000 * (.35/.65). The reduction in taxes assumes no tax impact from a change to the pro forma average debt.

⁶ Total reduction in 2004 revenue requirement due to the reduction in Average Invested Capital of \$8,904,000.