

Q. The “rate of return on rate base formula” in Exhibit BVP-19 implies that as rate base declines, rate of return on rate base increases (and vice versa). Thus, if rate base is reduced by \$100,000,000 in the 2003 proposed calculation, the proposed rate of return on rate base increases to 12.59% so that the resulting rate of return on rate base revenue requirement remains unchanged:

597,232	497,232
<u>x .1048</u>	<u>x .1259</u>
62,210	62,610

Is this correct? If not, please explain and provide a corrected calculation. If so, does this mean that, when using this formula, rate base disallowances or additions do not alter the product of the rate of return times rate base calculation? Please explain.

A. The calculation shown in this question appears to be based upon the premise that if average rate base were reduced by \$100,000,000, then average invested capital would not be reduced by a like amount for rate making purposes. This premise is not correct. Accordingly, the calculation is not correct.

The rate of return on rate base formula set out in Exhibit BVP-19 appropriately reflects differences between Newfoundland Power’s rate base and invested capital. These differences are described in detail in the *Finance & Accounting Evidence* at page 39 *et. seq.*

Invested capital, in effect, includes those costs included in rate base and other recoverable costs which are not in rate base, most notably deferred pension costs. The assumed \$100,000,000 reduction in average rate base would therefore also be accompanied by a \$100,000,000 reduction in average invested capital. Therefore, rate base disallowances and additions will alter the return on rate base.

For example, in Order No. P.U. 36 (1998-99) the Board ordered that Newfoundland Power’s forecast 2000 rate base be reduced by the book value of unused land at Duffy Place if the land had no regulated use beyond December 31, 1999. The resulting reduction was reflected in both the forecast of 2000 rate base and 2000 invested capital presented to the Board as part of the Newfoundland Power’s 2000 Capital Budget Application. By reducing both the 2000 rate base and the 2000 invested capital by the disallowed amount of \$486,722, consumers’ rates no longer included recovery of return related to the Duffy Place land. This treatment, and its effect, was consistent with Order No. P.U.36 (1998-99).

Attachment A provides the calculation of return on rate base assuming a \$100,000,000 reduction in average invested capital and average rate base. The assumed \$100,000,000 reduction in average rate base results in a reduction in return on rate base of \$9,356,000 (\$62,210,000 minus \$53,254,000). This reduction equals 9.36% (i.e., the 2003 proposed weighted average cost of capital) of the amount assumed to be disallowed from rate base.