Q. Section 4(i) of the Electrical Power Control Act (EPCA) requires that rates should provide sufficient revenue to the producer or retailer of the power to enable it to earn a just and reasonable return as construed under the Public Utilities Act so that it is able to achieve and maintain a sound credit rating in the financial markets of the world. Provide evidence (if any exists) to demonstrate that the forecast 8.08% return on equity for 2016 will present a risk to the credit ratings of Newfoundland Power.

A. **A. Evidence in Support of the Application**

Newfoundland Power has not provided any evidence in this Application concerning risks to the Company's credit ratings.

This Request for Information appears to imply that a just and reasonable return under the *Public Utilities Act* is solely based upon a utility's ability to maintain a sound credit rating. A just and reasonable return under the *Public Utilities Act* is assessed by the Board by reference to the fair return standard.

B. The Fair Return Standard

The Board regularly reviews Newfoundland Power's cost of capital and applies the fair return standard to determine an appropriate return on equity and capital structure for the Company. The review and determination of a fair return for Newfoundland Power considers risks to the Company's credit ratings, amongst other things.

The fair return standard applied by the Board requires the return be (i) commensurate with the return on investments of similar risk, (ii) sufficient to assure financial integrity, and (iii) sufficient to attract necessary capital.[1]

Application of the fair return standard includes a consideration of creditworthiness, but is not limited to this consideration.

C. Newfoundland Power's Credit Ratings

The response to Request for Information NLH-NP-036 provides Newfoundland Power's most recent credit ratings reports from DBRS and Moody's. These reports specifically identify challenges, or risks, to maintaining the Company's existing credit ratings.

The August 13, 2014 DBRS credit rating report identifies the following challenges for rating considerations of Newfoundland Power: (i) reliance on one major power supplier; (ii) managing forecast risk; and (iii) limited population growth. The report further states

[1] See, for example, Order No. P.U. 13(2013), page 12, lines 24-26.

that "although the Company's rate increases have been reasonable, higher rates, driven by the high cost of oil in recent years and [Newfoundland and Labrador Hydro's] high capex program over the next few years, could make it more difficult for the Company to receive approval for future rate increases."

The January 19, 2015 Moody's credit rating report states "The rating is consistent with [Newfoundland Power's] financial metrics but reflects a cautionary note related to our concern that the utility's future ability to fully recover costs and earn returns may be compromised as the Province of Newfoundland and Labrador undertakes development of the Muskrat Falls hydroelectric project on the lower Churchill river and the related transmission infrastructure. This politically charged project is large relative to the provincial economy and is expected to place considerable upward pressure on future electricity rates."[2]

D. Relevance to the Application

In the Application, Newfoundland Power seeks the Board's approval for 2016 deferred cost recovery to permit the Company to file its next GRA by June 1, 2016 with a 2017 test year. If the Board approves the 2016 deferred cost recovery as proposed in the Application, (i) Newfoundland Power will have the opportunity to earn a just and reasonable return in 2016; (ii) Hydro's amended GRA will be concluded in as timely a manner as possible; and (iii) rates for customers served by the Island interconnected system will be established in an orderly manner.

Newfoundland Power has not filed detailed evidence concerning its forecast cost of capital in support of the Application. Such detailed evidence would include a consideration of the Company's creditworthiness, including its credit rating reports. This detailed evidence has not historically been required to support applications for deferred cost recovery.[3] It is not necessary for the Board's consideration of the Application.

If the Board approves the 2016 deferred cost recovery sought in the Application, a full review of Newfoundland Power's forecast cost of capital will occur at the Company's next GRA, which will be filed by June 1, 2016 with a 2017 test year.

[2] See *Moody's Investor Credit Rating Report: Newfoundland Power Inc.* dated August 13, 2014, page 2, which is also Attachment B to the response to Request for Information NLH-NP-036.

[3] The Board typically considers, and where it sees fit approves, deferred cost recovery without requiring detailed evidence of the utility's forecast cost of capital.