WHENEVER. WHEREVER.
We'll be there.

NEWFOUNDLAND POWER
A FORTIS COMPANY

DELIVERED BY HAND

April 26, 2016

Board of Commissioners
of Public Utilities
P.O. Box 21040
120 Torbay Road
St. John's, NL A1A 5B2

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

Ladies and Gentlemen:

Re: 2016/2017 General Rate Application

Please find enclosed the original and 12 copies of Newfoundland Power's Written Submissions.

If you have any questions regarding the enclosed, please contact the undersigned at your convenience.

Yours very truly,

Gerard M. Hayes
Senior Counsel

Enclosures

c. Geoffrey Young
Newfoundland and Labrador Hydro

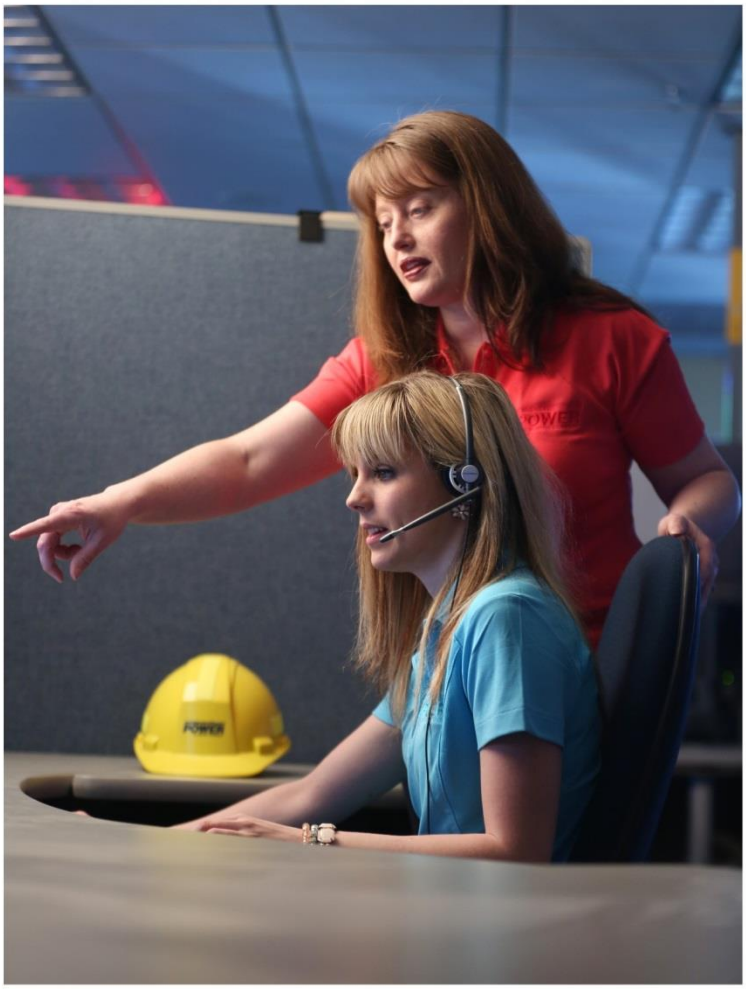
Thomas Johnson, Q.C.
Consumer Advocate

Newfoundland Power Inc.
55 Kenmount Road • P.O. Box 8910 • St. John's, NL A1B 3P6
PHONE (709) 737-5609 • FAX (709) 737-2974 • ghayes@newfoundlandpower.com

NEWFOUNDLAND POWER
A FORTIS COMPANY

2016/2017 General Rate Application

April 26, 2016
Written Submissions



Page

1. DEFINED TERMS

Term	Reference
Aboud Evidence	Pre-filed Evidence of Karl Aboud, *Newfoundland Power Inc. Executive Compensation Review*, March 2016
Application	Newfoundland Power's Application to the Board of Commissioners of Public Utilities, filed October 16, 2015, as amended by filing of March 8, 2016
AUC	Alberta Utilities Commission
BCUC	British Columbia Utilities Commission
Board	Newfoundland and Labrador Board of Commissioners of Public Utilities
Booth Evidence	Pre-filed Evidence of Laurence D. Booth, *Fair Return for Newfoundland Power*, February 2016
Booth Surrebuttal	Surrebuttal Evidence of Laurence D. Booth, March 2016
CAPM	Capital Asset Pricing Model
Cleary Evidence	Pre-filed Evidence of Sean Cleary, *Report on Capital Structure & Related Issues*, February 2016
Cleary Surrebuttal	Surrebuttal Evidence of Sean Cleary, March 2016
Company Evidence	Newfoundland Power's Evidence, October 16, 2015, as amended by filing of March 8, 2016. Where evidence was amended by the filing of March 8, 2016, it is referred to as Company Evidence (1st Revision).
Company Finance Rebuttal Evidence	Newfoundland Power's Finance Rebuttal Evidence, March 18, 2016
Concentric Evidence	Pre-filed Evidence of Concentric Energy Advisors, *Cost of Capital*, October 2016
Concentric Rebuttal	Prepared Rebuttal Evidence of Concentric Energy Advisors, March 2016

Conservation Plan	The *Five Year Conservation Plan: 2016-2020*, October 2015, Volume 2, Tab 1 of Exhibits and Supporting Materials of Newfoundland Power filed October 16, 2015
Cost of Service Study	Newfoundland Power's *Cost of Service Study*, October 2015, Volume 2, Tab 5 of Exhibits and Supporting Materials of Newfoundland Power filed October 16, 2015
Customer, Energy and Demand Forecast	Newfoundland Power's *Customer, Energy and Demand Forecast (1st Revision)*, February 2016, Volume 2, Tab 4 of Exhibits and Supporting Materials of Newfoundland Power filed March 8, 2016
DBRS	Dominion Bond Rating Service
DCF	Discounted Cash Flow
Depreciation Study	Gannett Fleming Valuation and Rate Consultants, LLC. *2014 Depreciation Study,* Volume 3, Tab 2 of Expert Evidence and Studies of Newfoundland Power, filed October 16, 2015
EBIT	Earnings Before Interest and Taxes
Electrical Power Control Act, 1994	*Electrical Power Control Act, 1994, SNL 1994, c.E-5.1*
Elimination of Unwarranted Three Phase Charge Report	Newfoundland Power's *Elimination of Unwarranted Three Phase Charge: Required Regulation and Policy Changes*, October 2015, Volume 2, Tab 7 of Exhibits and Supporting Materials of Newfoundland Power filed March 8, 2016
Formula	The Automatic Adjustment Formula
Grant Thornton Report	Grant Thornton Report, *Board of Commissioners of Public Utilities Financial Consultants Report Newfoundland Power Inc. 2016-2017 General Rate Application Hearing*, January 28, 2016
Hydro	Newfoundland and Labrador Hydro

Moody's	Moody's Investors Service
Muskrat Falls Project	Nalcor Energy's hydroelectric generating plant at Muskrat Falls and the interconnection of the island electrical system to the North American grid
NEB	National Energy Board
OEB	Ontario Energy Board
Public Utilities Act	*Public Utilities Act*, RSNL 1990, c. P-47
ROE	Return on Equity
Settlement Agreement	Settlement Agreement with effective date of March 18, 2016 relating to the Application and filed as Consent #1
Stated Case	Supreme Court of Newfoundland and Labrador, Court of Appeal, 1996 No. 141, Stated Case re Section 101 of the *Public Utilities Act*
Supplemental Grant Thornton Report	Grant Thornton Report, *Board of Commissioners of Public Utilities Financial Consultants Report Newfoundland Power Inc. 2016-2017 General Rate Application Hearing (March 8, 2016 Filing)*, March 28, 2016

2. RESPONSES TO REQUEST FOR INFORMATION

Responses to Requests for Information are simply referred to by the number of the Request for Information. For example, the response to Request for Information PUB-NP-001 would be referred to as PUB-NP-001. Where a response to Request for Information was amended by the filing of March 8, 2016, it is referred to as, for example, PUB-NP-001 (1st Revision).

3. ORAL TESTIMONY

References to oral testimony are referred to by the name of the witness, the date of the testimony, and the transcript page and line numbers. For example a reference to oral evidence of Mr. Gary Smith would be referred to as Mr. Smith Transcript, March ●, 2016, page ●, line ●.

4. CONSENTS, EXHIBITS, UNDERTAKINGS AND INFORMATION ITEMS

References to undertakings are referred to as “U” and their number. For example, undertaking 1 would be referred to as U-1.

References to consents are referred to as “Consent #” and their number. For example, Consent #1.

References to exhibits are referred to as “Exhibit” and their number. For example, Exhibit 1.

References to information items are referred to as “Information #” and their number. For example, Information #1.

A. BACKGROUND

A.1 Procedural Background

This volume contains the written submissions of Newfoundland Power Inc. ("Newfoundland Power" or the "Company") in support of its Application to establish 2016-2017 customer rates.

On July 15, 2015, Newfoundland Power was directed by the Board to file a general rate application by October 16, 2015 with a 2016 test year. The Company filed the Application to establish 2016/2017 customer rates on October 16, 2015.

Following due notice of the Application, the Board issued Order No. P.U. 32 (2015) on November 30, 2015, which set out the schedule of dates and procedures for the hearing of the Application. This Order established a detailed schedule providing for: review of the Application by Grant Thornton, the Board's financial consultants; written interrogation of the Application by intervenors; filing of evidence by intervenors; Board facilitated negotiations; and a public hearing, all in accordance with established Board practice.

The Application was amended and filed with the Board on March 8, 2016 to reflect (i) 2015 actual financial results of operations; (ii) updated 2016/2017 forecasts of customers, demand and energy; and (iii) changes to 2016/2017 test period costs.

As a result of Board facilitated negotiations, a Settlement Agreement with respect to certain matters raised in the Application was reached on March 18, 2016, between Newfoundland Power, the Consumer Advocate and Board staff.

A.2 Evidentiary Matters

The Board is legally required to determine issues on the basis of the evidence before it.

The primary evidence on the Application includes (i) Newfoundland Power's three volume filing which was revised on March 8, 2016, and included Company Evidence, Exhibits and Supporting Materials, and Expert Evidence and Studies; (ii) Expert Evidence on cost of capital filed by the Consumer Advocate; (iii) Expert Evidence filed by the Company on executive compensation; (iv) the responses to over 400 Requests for Information; and (v) oral testimony of Company management and expert witnesses.

A number of documents were also filed by consent. Additional materials were filed by parties, by way of information, to assist in examination and cross-examination of witnesses, but not necessarily as proof of the content of those documents.

Both the original Application and the Application as amended on March 8th, 2016, have been extensively reviewed by Grant Thornton, the Board's financial consultants. The Grant Thornton Report and the Supplemental Grant Thornton Report contain the findings of the financial consultants' review and form a part of the evidence before the

Board. This review did not raise any material issues regarding the reasonable accuracy of financial or operational data submitted to the Board by Newfoundland Power.

The procedural history of the Application has provided an evidentiary record concerning Company operations and finance which can be confidently relied upon by the Board.

A.3. Application Context

Significant changes since Newfoundland Power's last general rate application in 2013 provide essential context for this Application. In 2013, the provincial economy was strong, fueled by large construction projects and high resource prices. At that time, Newfoundland Power pointed out to the Board the importance the Company attributed to getting ready for the proposed interconnection of the Muskrat Falls Project and the decommissioning of Holyrood, which was 5 years into the future.

By 2014, the provincial electrical sector had come under significant pressure. The widespread outages in January 2014, now referred to as *#darkNL*, led to extensive investigation of the island interconnected system's reliability. These investigations are ongoing. Vulnerabilities already identified have increased the perceived risk of outages through to the interconnection of the Muskrat Falls Project. Further investigation into reliability following interconnection is expected through the balance of 2016.

In mid-2014, forecast costs of the Muskrat Falls Project began to increase. The most recent estimate of project costs exceeds $9 billion. The in-service date has been delayed.

By 2015, significant deterioration in the provincial economy was evident. The economic decline has been precipitous. Real GDP declined by 2.9% in 2014, and 5.4% in 2015. There has also been decline in household income, employment and housing starts. These economic conditions are expected to persist through 2019-2020. The dramatic economic downturn since 2013 is reflected in Newfoundland Power's sales outlook. The sales growth forecast for 2017 of 0.1% is not in dispute.

Newfoundland Power's Director, Revenue and Supply, Mr. Lorne Henderson, compared the 2001 to 2013 period to the Company's current outlook as follows:

> "During that time period, it was – I think it's 12 years average annual change in price of around 4 percent per year, averaged over that period. During that period, there was a substantial expansion of the economy. I had a quick look at this period. The personal disposable income or household disposable income, I think, increased – just a second. The household disposable income increased 5.7 percent, so the customers ability to pay for the increase in the rates over that period, you know, is reflected in their household disposable income. Home heating fuel price increased during that time period. It was like 6.5 percent, so that indicated that it wouldn't have impacted our home heat competitiveness, that sort of stuff. The CPI over the period was 2.1 percent on average. So given all that, there wouldn't have been any particular drop in our average use. We saw increases in our average use, which is consistent with fuel prices being higher, increase in the price of electricity, and people's disposable income going up, so they're building bigger homes and all that kind of stuff. So all that is reflected in the historical period. Looking forward, you know, we all are aware that the economy is not growing. The forecast, I know, for household disposable income is the lowest I've seen it looking back historically, and home heating fuel cost and alternate fuels have

> dropped a lot, and in that piece you've got mini-splits, you've got pending distributed generation that customers might be interested I installing like solar and all that sort of stuff. So there's lots of pressures that we see going forward which means that looking over that time period and the increases over that time period is really not a very good indicative period to consider how we're looking forward."

Reference: *Mr. Henderson Transcript, April 12th, 2016, page 116, line 3 to page 117, line 21.*

Before Muskrat Falls Project costs become embedded in customer rates, significant additional system costs can be expected to put upward pressure on electricity prices. For example, the Board has already approved capital expenditures totaling approximately $600 million for Hydro's new combustion turbine, an additional 230 kV transmission line and other projects contained in Hydro's 2015 and 2016 capital budgets.

In 2016, the Board will commence consideration of cost recovery of production from the Muskrat Falls Project. While the size of customer price increases associated with the project are uncertain, recent estimates indicate customer rates will increase by more than 50%.

Newfoundland Power's President & CEO, Mr. Gary Smith, described the Company's outlook for power supply as follows:

> "This is a big challenge with many unknowns. The new supply and the inter-connections to Labrador and Nova Scotia must work seamlessly for our customers. There's also uncertainty surrounding the price of electricity post Muskrat Falls. Muskrat Falls is a 9 billion dollar project,

> and to put that number in perspective for the Board, it's basically three times the current investment of Newfoundland Power and Newfoundland and Labrador Hydro in the electrical system. We also remain concerned about reliability of the system once Holyrood is decommissioned. Muskrat Falls is over 1,000 kilometres from the major load centre on the Avalon, and all the transmission lines must pass through the Isthmus of Avalon. The uncertainty associated with these matters is a significant concern for Newfoundland Power going forward."

Reference: *Mr. Smith Transcript, March 29th, 2016, page 27, line 22 to page 28, line 17.*

The conditions and outlook existing today are clearly more challenging than those existing in 2013. Even though the Muskrat Falls Project may be delayed, much remains to be done to ensure the interconnection to the North American grid is as seamless as it can be from a customer perspective. Integration details and expected system reliability levels remain somewhat uncertain. Resolving issues related to the interconnection may yet require significant additional investment by Hydro and/or Newfoundland Power. And these matters will be addressed against a provincial economic outlook that the Conference Board of Canada has characterized as "grim".

Newfoundland Power's Vice President, Finance & CFO, Ms. Jocelyn Perry, in response to questioning related to the impact of recent developments on the risk faced by the Company indicated:

> "I do believe that the economics of this province are much grimmer than they have been in a long time, in decades, I believe that's what is stated, but I can't help but say that the fact that I understand that the province is also going to be facing on top of its current deficits the financing and cost associated with Muskrat Falls, and the people of this province are also going to, in addition to a declining economy, be faced with pretty

> significant costs associated with the electricity potentially. Together, that's probably what pushed us up over the average risk utility. Now again I'm going to stop back leave that up to Mr. Coyne to make the assessment, but if you were to ask me, I think that the two together sort of do make it significant enough where I agree that, you know, we're just pushing the risk of this utility upwards with these two events."

Reference: *Ms. Perry Transcript, March 31st, 2016, page 100, lines 2-24.*

Mr. James Coyne of Concentric Energy Advisors summarized the impact of these changes in Newfoundland Power's risk relative to comparable North American electric utilities as follows:

> "I find higher business risk today than in 2012, and the reason for that is that the company is exposed to more risk due to changes in the company's electric supply from Newfoundland and Labrador Hydro particularly in terms of cost, and I'll come back to that. It also is exposed to more risk as a result of a weakened economy. Both of these factors place Newfoundland Power in a unique and higher risk position than its Canadian and U.S. peers."

Reference: *Mr. Coyne Transcript, April 4th, 2016, page 17, lines 11-22.*

This is the new reality in the provincial electrical sector. Newfoundland Power submits that this should inform the Board in its decision-making on the Application, particularly its determinations in relation to the Company's cost of capital.

B. ISSUES

B.1 The Central Issue

This Application seeks an average increase in current customer rates of approximately 2.5%, effective July 1, 2016. Of this 2.5%, approximately 0.9% relates to the Company's power supply costs and another 0.9% relates to changes in Newfoundland Power's costs since its last general rate application.

The remaining 0.7% increase proposed in the Application relates to the Company's proposal to increase its ROE from 8.8% to 9.5%. Newfoundland Power's cost of capital is the central issue for determination by the Board in this Application.

B.2 Uncontested Matters

The record before the Board on the Application indicates that Newfoundland Power's operations are consistent with both the *Public Utilities Act* and the provincial power policy contained in the *Electrical Power Control Act, 1994.* No serious evidentiary question was raised concerning the reasonableness or adequacy of the Company's fulfillment of its obligation to serve customers.

Newfoundland Power's costs in the 2016/2017 test period are reasonable as required by the *Public Utilities Act*. Total gross operating costs for 2017 are forecast to increase by approximately 6.2% over 2013, or approximately 1.6% per year. The Grant Thornton Report indicates that, following review and analysis, nothing has come to the financial

consultants' attention to indicate that test period forecast operating expenses are unreasonable on an overall basis.

Reference: *Company Evidence (1st Revision), page 3-25, lines 8-13; and Grant Thornton Report, page 36, lines 15-16.*

Newfoundland Power's operations in the 2016/2017 test period are also consistent with reasonable management efficiency as required by the *Electrical Power Control Act, 1994.* The evidence shows that the Company's overall operating efficiency will improve by approximately 2.2% per year over the period from 2013 to 2017.

Reference: *Company Evidence (1st Revision), page 3-33, lines 1-5.*

Newfoundland Power's electrical system reliability is adequate. The evidence shows that since 2010, the average annual duration of customer outages experienced by the Company's customers due to the performance of Newfoundland Power's electrical system has consistently been approximately ½ the Canadian average. The evidence also shows that during the period 2010 through 2014, Newfoundland Power's average response time to customer outages (excluding significant events) was less than ⅓ the Canadian average.

Reference: *Company Evidence (1st Revision), page 3-8, lines 1-7; and page 3-18, line 5 to page 3-19, line 2.*

Newfoundland Power remains reasonably responsive to the service expectations of its customers. The evidence of this includes continuing improvement in the Company's

overall capability to deal with its customers via digital channels. It also includes improvements in electrical system resilience and emergency practices undertaken following the widespread outages in January 2014, which will improve Newfoundland Power's ability to respond effectively to emergency circumstances which may present themselves.

Reference: *Company Evidence (1st Revision), page 2-4, line 12 to page 2-6, line 2; and page 3-21, line 15 to page 3-24, line 14.*

There is a relationship between the issue of cost effective management and operations of the Company and the central issue in this Application of the fair return. A public utility, such as Newfoundland Power, is a capital intensive enterprise with long-lived assets. This means the cost of capital for the Company will have a significant impact on rates and whether they are least-cost for customers over the long term. Least-cost customer rates require both: (i) cost efficient management and operations; and (ii) fair returns which allow the utility to maintain its financial integrity.

Newfoundland Power's management's approach to fulfilling its obligations as a monopoly service provider appropriately reflects this relationship. As the Company's President & CEO, Mr. Gary Smith, observed:

> "…the company works hard in many areas, including its return and we look at earning our return, I guess, as one of our things that we pay attention to each and every year, no different than we pay attention to safety and reliability, I guess, for that matter. And earning our return is something that we work hard on every year as part of just doing business, yes…"

Reference: *Mr. Smith Transcript, March 29th, 2016, page 94, lines 12-21.*

B.3 Settled Issues

B.3.1 The Settlement Agreement

On March 18th, 2016, the Settlement Agreement was reached between Newfoundland Power, the Consumer Advocate and Board hearing counsel.

In the Settlement Agreement, Newfoundland Power, the Consumer Advocate and Board staff have reached agreement upon the following issues:

(i) 2016 and 2017 customer, energy and demand forecast (the "Forecast");

(ii) 2016 and 2017 power supply costs, employee future benefits expense, depreciation expense, finance charges and income tax expense (the "Agreed Revenue Requirements Matters");

(iii) 2016 and 2017 forecast average rate base (the "Forecast Rate Base");

(iv) Rate design and rate structure proposals contained in the Application (the "Rate Design Matters");

(v) Changes to tests for evaluating customer energy conservation programs, recovery of hearing costs associated with the Application, and recovery of any 2016 Newfoundland Power revenue shortfall (the "Regulatory Policy Matters");

(vi) Continued suspension of the Formula; and

(vii) Changes to Uncollectible Bills expense arising from the administration of the Hydro RSP surplus refund.

In the Settlement Agreement, Newfoundland Power, the Consumer Advocate and Board staff have agreed to recommend that the Board implement their agreement regarding the settled issues in its order arising out of the Application.

Reference: *Consent #1.*

Appendix A provides a summary, by issue, of each of the settled issues agreed in the Settlement Agreement and the evidence which supports the Board's approval of each issue.

B.3.2 Submission on the Settlement Agreement

Settlement of issues before the Board is consistent with the least cost principle and, therefore, in the public interest. The resolution of each issue in the Settlement Agreement is supported on the evidentiary record before the Board on the Application.

The Board should approve all matters settled by way of the Settlement Agreement.

C. 2016/2017 COST OF CAPITAL

C.1 Background

Newfoundland Power's 2016/2017 cost of capital is the central issue in the Application.

Newfoundland Power proposes that the Board permit the Company to maintain its longstanding 45% equity ratio and allow an increase in allowed ROE from 8.8% to 9.5%. These measures will reasonably position the Company to respond to a riskier business outlook. The measures proposed by Newfoundland Power will also satisfy the fair return standard and the requirements of the provincial regulatory legislative framework.

The Consumer Advocate proposes that the Board reduce Newfoundland Power's equity ratio to 40% and decrease its allowed ROE to 7.5%. If adopted by the Board, these measures will not position the Company well to respond to the current economic environment and emerging risks. In addition, the measures proposed by the Consumer Advocate fail to meet the fair return standard and the requirements of the provincial regulatory legislative framework.

Appendix B contains a summary of the expert witnesses' cost of capital recommendations.

C.2 Regulatory Framework and History

The regulatory framework and history relating to Newfoundland Power's cost of capital provides context for the Board in its determination of a fair return for Newfoundland Power for the 2016/2017 test period.

C.2.1 Regulatory Framework

The cornerstones of the legislative framework governing the regulation of Newfoundland Power are the *Public Utilities Act* and the *Electrical Power Control Act, 1994.*

Section 80(1) of the *Public Utilities Act* provides that "A public utility is entitled to earn annually a just and reasonable return as determined by the board on the rate base as fixed and determined by the board."

Section 3 of the *Electrical Power Control Act, 1994* outlines the power policy of the province. Key features of this policy are reasonable customer rates and efficient utility operations. Section 3 of the *Electrical Power Control Act, 1994* specifically requires the Board to set customer rates that "…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." In addition, Section 3 of the *Electrical Power Control Act, 1994* directs that customer rates should be established based on *forecast* costs wherever practicable.

Reference: *Sections 3(a)(i), 3(a)(ii), 3(a)(iii) and 3(b), Electrical Power Control Act, 1994.*

Insofar as it relates to returns, the legislative framework in Newfoundland and Labrador is substantially similar to that in other North American jurisdictions. In considering Section 80 of the *Public Utilities Act* and Section 3 of the *Electrical Power Control Act, 1994*, the Newfoundland and Labrador Court of Appeal has observed that:

> "[24]…the entitlement of the utility to a fair return on its investment is always regarded as of fundamental importance. In the United States, controls which fail to allow a fair return have the potential of running afoul of constitutional strictures against confiscation of property without due compensation. While the same constitutional concerns may not be present in Canada, the case law has at times nevertheless referred to the entitlement to a fair return as a 'common law right' which should be read into the legislation even where it is not specifically expressed.
>
> [25] There is no uniform methodology employed in the regulatory jurisdictions in North America for the determination of a just and reasonable rate of return. What recurs, however, is a theme that the process is not an exact science and depends on a variety of factors necessary to balance the competing interests involved. Rate setting is essentially a prospective exercise where determinations are made on the basis of estimates and information that will not necessarily remain static."

Reference: *The Stated Case, June 15, 1998, Newfoundland and Labrador Court of Appeal, paragraphs 24-25.*

The prominence of risk in the context of the determination of a fair return has also been recognized by the Newfoundland and Labrador Court of Appeal:

> "[31]...because the setting of the rate of return is based on projections, one cannot be sure that the rate of return will be achieved in practice. Although the utility is 'entitled' by s. 80 of the Act to have the Board determine a just and reasonable rate of return based on appropriate predictive techniques and methodologies, it is not 'entitled', in the sense of being guaranteed, to that rate of return. The utility therefore takes the risk that its chosen management techniques and the future economic climate may not yield its expected success. Although some of the activities of the utility are regulated within the framework of the statutory objectives, the utility nevertheless remains subject to business risks and the effects of

> management decisions. To that extent, the financial risks associated with the operation of the utility, just as in the case of any private business, are to be born by the investors in the enterprise, not the consumer of the service."

Reference: *The Stated Case, June 15, 1998, Newfoundland and Labrador Court of Appeal, paragraph 31.*

C.2.2 Regulatory Practice

A Fair Return

The Board's application of the statutory principles contained in the *Public Utilities Act* and the *Electrical Power Control Act, 1994* has been consistent with the application of accepted regulatory principles in Canada and the United States. This flows from the requirement in Section 4 of the *Electrical Power Control Act, 1994* that "In carrying out its duties and exercising its powers under this Act or under the Public Utilities Act, the public utilities board shall implement the power policy declared in Section 3, and in doing so shall apply tests which are consistent with generally accepted sound public utility practice." With respect to those principles, the Board has observed:

> "In addition to the statutory principles which guide the Board there are a number of well accepted principles of public utility regulation which are used to estimate the required rate of return. These principles have been endorsed not only by regulators but also by appellate courts in both Canada and the United States. A public utility must be able to assure financial integrity, so that it can maintain a sound credit rating and be able to attract additional capital when required. In order to maintain access to capital financing it must achieve earnings comparable to those of other companies with similar risks.…"
>
> "…The Board is required not only to assess current return requirements but also to forecast what rate of return expectations and financial market conditions will be during the forecast period. Rates are set prospectively on the basis of forecast revenues and costs, including the cost of capital."

Reference: *Order No. P.U. 16 (1998-99), pages 9-10.*

The attributes of a fair utility return recognized by the Board have also reflected accepted regulatory principles in North America. The Board has repeatedly expressed those attributes as follows:

> "Regulated utilities are given the opportunity to earn a fair rate of return. To be considered fair, the return must be:
> - Commensurate with return on investments of similar risk;
> - Sufficient to assure financial integrity; and
> - Sufficient to attract necessary capital
>
> The fair return principle is consistent with both Section 80(1) of the Act and Section 3(a)(iii) of the EPCA."

Reference: *Order No. P.U. 32 (2007), Appendix A, page 6. See also, Order No. P.U. 19 (2003), page 15; Order No. P.U. 43 (2009), page 11; and Order No. P.U. 13 (2013), page 12, lines 17-26.*

Capital Structure

Newfoundland Power has maintained a stable capital structure for decades. The Board's evaluation of that capital structure has been consistent over this period. The significance of capital structure in the determination of a fair return has been recognized by the Newfoundland and Labrador Court of Appeal. In addition, the Court has alluded to the importance of stability in capital structure management:

> "[134]…the level of overall capitalization and the composition of the capital structure of a utility are both matters of regulatory concern, at least insofar as they affect the utility's rate of return on rate base and hence the cost to consumers of the delivery of reliable service…

> [135] In approaching these questions, it has to be remembered that there is no such thing as one ideal capital structure. It is a function of economic conditions, business risks and 'largely a matter of business judgement'. Furthermore, a given capital structure cannot be changed easily or quickly. As well, the long-term effects of changes on capital structure on the enterprise and on the future cost of capital may not be easily predictable."

Reference: *The Stated Case, June 15, 1998, Newfoundland and Labrador Court of Appeal, paragraphs 134-135.*

The justification for the Board's acceptance of the longstanding 45% equity ratio for Newfoundland Power has also been consistent. In Order No. P.U. 19 (2003), the Board observed:

> "The capital structure of NP has been maintained through the ongoing decisions of the Board as contained in its respective Orders and also NP's actions in managing the level of common equity accordingly. Generally in the past it has been determined by the Board that a strong equity component is needed to mitigate the impact of NP's relatively small size and low growth potential."

In considering an appropriate capital structure for Newfoundland Power in 2003, the Board characterized Newfoundland Power's existing capital structure as a "…sound and successful…" one.

Reference: *Order No. P.U. 19 (2003), page 45.*

This capital structure has historically been viewed by credit rating agencies as a credit strength.

Reference: *See, for example, Exhibit 4, (1st Revision), in Volume 2, Exhibits & Supporting Materials, DBRS Rating Report, August 21, 2015, page 2; and Moody's Investor's Service, Credit Opinion, February 5, 2016, page 2.*

C.2.3 Submission on Regulatory Framework

The regulatory framework and practice related to the establishment of a utility's cost of capital in Newfoundland and Labrador require prospective assessment of relative risk, creditworthiness, and the utility's ability to attract the capital necessary to fulfill its obligation to serve customers.

In the context of this Application, such prospective assessment requires consideration of a medley of factors. These include longstanding risk elements to which Newfoundland Power's operations have been exposed. They also include changes in risk which have evolved since the Board's last assessment of Newfoundland Power's relative risk. The conditions existing in the capital markets to which the Company must turn to raise necessary capital are also a component of this assessment.

C.3 Market Conditions and Risk

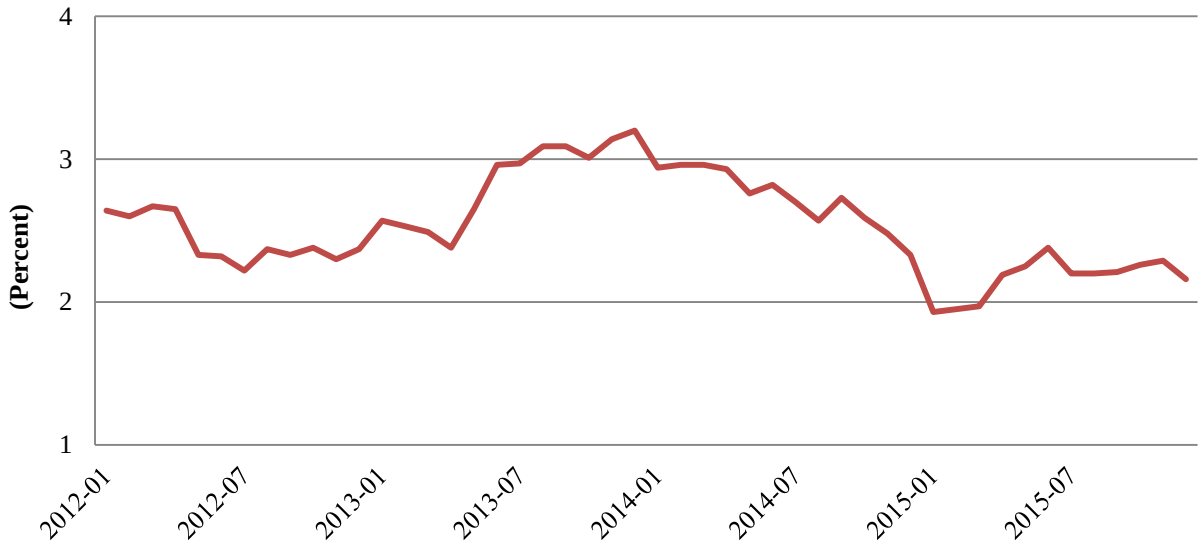
Capital market conditions and Newfoundland Power's longstanding historical risk elements remain largely unchanged since 2012. A struggling provincial economic outlook, combined with rising power supply risks, is increasing the Company's overall risk profile.

C.3.1 Market Conditions

Current capital market conditions appear to be substantially similar to those which existed at the time of Newfoundland Power's last general rate application. For example,

Chart 4-1 in the Company Evidence showed actual 30-year Canada bond yields from January 2012 to December 2015.

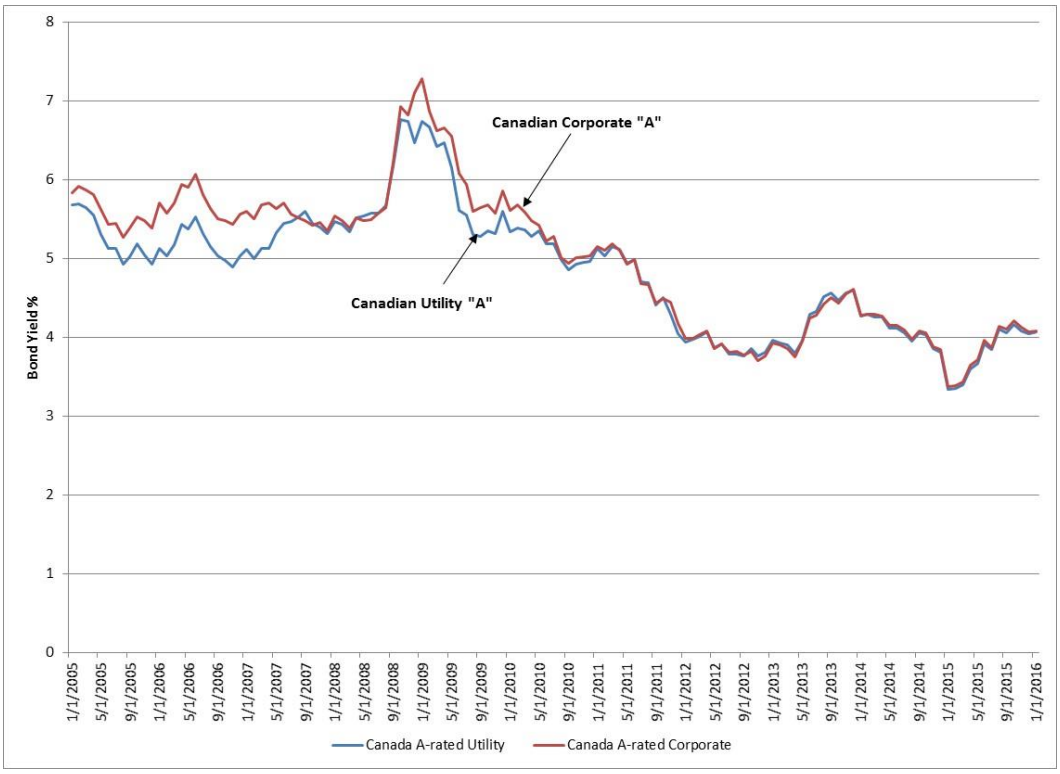
Chart 4-1
30-Year Canada Bond Yields
Actual
2012 - 2015



Reference: *Company Evidence (1st Revision), page 4-40.*

Mr. Coyne's evidence was that capital market conditions in Canada and the U.S. were generally improved with a mixed outlook. Current corporate and utility debt costs shown in Figure 5 in Concentric's Rebuttal Evidence were modestly higher at the start of 2016 than they were in late 2012 - early 2013.

Figure 5: Canadian 30-yr A-rated Corporate and Utility Bond Yields 2005-2016



Source: Bloomberg fair value curves

Reference: *Concentric Evidence, page 13, lines 8-13; and Concentric Rebuttal, page 19, Figure 5.*

Dr. Booth's evidence was that current market conditions are much the same as they were in 2012. Dr. Booth expected 30-year Canada bond yields to rise to about 3.35% towards the end of 2017.

Reference: *Booth Evidence, page 36, lines 4-5; and Dr. Booth Transcript, April 8th, 2016, page 4, line 15 to page 6, line 12; page 14, line 15 to page 18, line 17; and page 69, lines 3-13.*

Dr. Cleary did not provide evidence concerning comparative market conditions in 2012 and 2016.

C.3.2 Historical Risk Elements

The distinguishing risk elements historically recognized by the Board for Newfoundland Power have included the Company's small size and low growth potential. The low growth potential has resulted from a combination of service territory economics and service territory demographics.

The evidence is clear that Newfoundland Power remains a relatively small utility.

Mr. Coyne's evidence compared Newfoundland Power's size to that of investor-owned operating electric utilities in Canada and the United States. He concluded that the Company's small size presented greater risk associated with adverse economic conditions and reduced financial flexibility.

Reference: *Concentric Evidence, Appendix A, pages 11-13.*

Dr. Cleary's evidence was that Newfoundland Power "…has always been small relative to some, but not all, other utilities, so this does not seem to warrant attention as something that has changed since the last hearings to affect [Newfoundland Power's] business risk."

Reference: *Cleary Evidence, page 23, lines 5-7.*

The evidence is clear that Newfoundland Power's service territory demographics remain relatively unfavorable.

The demographic outlook for Newfoundland Power's service territory indicates that the population is forecast to decline in the 2016/2017 test period. Population decline is forecast through 2035.

Reference: *Company Evidence (1st Revision), page 4-26, lines 13-16.*

Mr. Coyne's evidence contained a comparison of projected macroeconomic and demographic conditions in Newfoundland and Labrador to those in the provinces where the other 5 Canadian investor-owned electric utilities are located, together with Ontario and Quebec. This comparison showed Newfoundland and Labrador is the only province for which population is forecast to decline over the period 2014-2035.

Reference: *Concentric Evidence, Appendix A, page 20, line 10 to page 21, line 4.*

Neither Dr. Booth nor Dr. Cleary addressed the matter of Newfoundland Power's service territory demographics in their evidence.

The evidence is clear that Newfoundland Power continues to be exposed to challenging operating conditions, eroding cost flexibility and a single source of power supply.

Reference: *Company Evidence (1st Revision), page 4-27, line 16 to page 4-34, line 8.*

Mr. Coyne's evidence recognizes weather related service disruptions as an important operating risk for Newfoundland Power.

Reference: *Concentric Evidence, Appendix A, page 15, lines 11-18.*

Dr. Cleary, on the other hand, finds it "…difficult to see why this creates so much additional business risk for [Newfoundland Power] than it does for other Canadian utilities who are also subject to similar risks."

Reference: *Cleary Evidence, page 22, lines 13-14.*

The evidence is un-contradicted that (i) weather conditions are a leading cause of electrical distribution system failures in Canada; and (ii) the climate across Newfoundland Power's service territory includes the most severe wind and ice conditions in populated regions of Canada. The evidence of Newfoundland Power's President & CEO was that the Company's ability to earn its return is "…a function of when it [severe weather] happens in the year...and what you have at your disposal to deal with it".

Reference: *Company Evidence (1st Revision), page 4-32, lines 1-8; PUB-NP-040; and Mr. Smith Transcript, March 31st, 2016, page 88, lines 18-21 et. seq.*

The evidence is also un-contradicted that Newfoundland Power's cost flexibility is eroding. The steady reduction in the proportion of operating costs to total costs reduces the Company's capability to respond to planned or unexpected events. Very low sales growth, such as that forecast for the 2016/2017 test period, further reduces

Newfoundland Power's ability to respond to unexpected occurrences, making the opportunity to actually recover costs more risky.

Reference: *Company Evidence (1st Revision), page 4-33, line 1 to page 4-34, line 8; and Mr. Smith and Ms. Perry Transcript, March 31st, 2016, page 95, line 19 to page 97, line 23.*

Newfoundland Power is practically dependent upon Newfoundland and Labrador Hydro as a single source of wholesale electricity supply. Mr. Coyne's evidence indicated such dependence was unique and created greater relative supply risk for the Company. DBRS characterizes the dependence as a "rating challenge".

Reference: *Company Evidence (1st Revision), page 4-27, line 16, et. seq.; Concentric Evidence, Appendix A, page 19, lines 18-20; and Exhibit 4 (1st Revision), DBRS Report, page 2.*

In their pre-filed evidence, neither Dr. Booth nor Dr. Cleary addressed the matter of Newfoundland Power's historic dependence upon Hydro as a single source of wholesale electricity supply in terms of risk.

C.3.3 Provincial Economic Outlook

Newfoundland and Labrador's current economic outlook has been described by the Conference Board of Canada as "grim". According to the Conference Board of Canada:

> "The next five years are going to be belt-tightening for Newfoundland and Labrador consumers. The labour market has been hemorrhaging jobs since last year and we expect the losses to continue over the medium term."

Reference: *Company Evidence (1st Revision), Customer, Energy and Demand Forecast, (1st Revision), Conference Board of Canada Provincial Outlook, Winter 2016, Executive Summary, page 4; and Customer, Energy and Demand Forecast, (1st Revision), Conference Board of Canada Provincial Outlook, Summer 2015, Newfoundland and Labrador, page 3.*

There is little controversy surrounding the fact that the economic outlook for the 2016/2017 test period is worse than the outlook which existed at the time of the Company's last general rate application. The Company's evidence is that:

> "Newfoundland and Labrador's short-term economic outlook is the most negative in a decade. It is materially reduced from the economic outlook in 2012 when the Company filed its last general rate application."

Reference: *Company Evidence (1st Revision), page 4-25, lines 4-6.*

Mr. Coyne's evidence refers to the negative impacts of the sharp drop in oil prices; Dr. Booth has indicated that it is "indisputable" that the provincial economy is not as strong as a few years ago; and Dr. Cleary characterizes the economic forecast as "not encouraging".

Reference: *Concentric Evidence, Appendix A, page 2, lines 19-22; Dr. Booth Transcript, April 8th, 2016, page 116, lines 6-11; and Cleary Evidence, page 19, lines 9-10.*

Mr. Coyne considered the changes in the provincial economic outlook in his assessment of Newfoundland Power's business risk relative to other utilities:

> "…the risk related to macroeconomic and demographic trends has increased as the Provincial economy is projected to experience weaker

> economic growth and an aging population/declining customer base over the next 20 years."

He specifically compared the current Newfoundland and Labrador economic outlook to those in the provinces where the other 5 investor-owned utilities are located, together with Ontario and Quebec. This comparison shows Newfoundland and Labrador had the lowest projected growth rates for a basket of economic indicators, including GDP growth, labour force growth, employment growth, disposable income and housing starts over the period 2014-2035.

Mr. Coyne summarized the investor perspective on these relative comparisons as follows:

> "When we work with investors that are looking at utility companies, one of the things that they look at very closely and we look at for them is what's the macroeconomic outlook, and there's a reason why they want to look at companies that are in more rapidly growing areas because they feel like that represents opportunity for growth and earnings over time. So when we work with investors and they're looking at utilities that are in slow growing or no growing service areas, they consider that a negative factor, and that means they are less interested in those types of investments which drives up their required return on them."

Reference: *Concentric Evidence, Appendix A, page 18, lines 3-6 and page 20, line 10 to page 21, line 4; and Mr. Coyne Transcript, April 7th, 2016, page 48, lines 2-17.*

The relationship between the provincial economic outlook and business risk was also captured in the following exchange between Newfoundland Power's counsel and Dr. Booth:

> "Q. Right, okay, and in terms of business risk, you would agree that business risk is based on the Newfoundland economy…not the Canadian or global economy.
>
> A. That's correct, I mean they're worried about how the local economy affects the ability of the utility to earn its allowed ROE."

Reference: *Dr. Booth Transcript, April 8th, 2016, page 114, lines 15-25.*

Dr. Cleary's evidence on the provincial economic outlook indicated that matters would improve beyond 2017:

> "Beyond 2017, the [Conference Board of Canada] predicts that the unemployment rate will fall below 12% and decline steadily to around 11% by 2020 *on the back of 2018-20 real GDP growth rates* of +1.4%, +7.0% and -1.6% respectively. Finally, it is interesting to note that the [Conference Board of Canada] expects the contribution to NL GDP from the utilities sector to remain positive in 2016-17 (+0.4% and +0.6% respectively), and also in the ensuing three years (+0.8%, +1.3%, and +5.9% respectively). This is consistent with the low risk nature of utilities such as Newfoundland Power, whose demand is less cyclical than most industries."

Reference: *Cleary Evidence, page 15, lines 13-19 and Table 7.*

However, Dr. Cleary may be misapprehending aspects of the Conference Board of Canada's forecasts. He admitted that the Conference Board of Canada forecast decline in the unemployment rate from 2017 through 2020 appeared to be due to a combination

of job losses and people moving out of the labour force. In addition, Dr. Cleary was uncertain of the degree to which the forecast utilities sector contribution to GDP through 2020 was simply related to forecast export electricity sales related to Muskrat Falls.

Reference: *Dr. Cleary Transcript, April 11th, 2016, page 66, line 2 to page 90, line 8.*

C.3.4 Power Supply Outlook

C.3.4.1 Rising Supply Costs

The Muskrat Falls Project will be the primary source of Newfoundland Power's future additional supply requirements. The current estimated total cost of the Muskrat Falls Project is approximately $9.05 billion. This $9.05 billion cost is approximately 3 times the total book value of current utility investment in the province. Material increases in Newfoundland Power's cost of power supply are likely, although the size of those increases is currently uncertain.

Reference: *Company Evidence (1st Revision), page 4-28, line 13 to page 4-29, line 8.*

Mr. Coyne's evidence was that expected changes in electricity supply resulting in a substantial increase in price over the near-term exposed Newfoundland Power to more risk than in 2012. His evidence concerning the supply cost risk that the Muskrat Falls Project presented to Newfoundland Power relative to other North American utilities was clear:

> "There is simply no other North American utility exposed to this level of risk that I am aware of from a supply cost perspective and this is a risk that's not off in the distant future. It's within the near-term planning horizon. This creates more supply cost risk than any other company we've analyzed in Canada or the US. One thing is clear, electricity prices will rise. Nalcor projects over 50 percent, and this creates both market

and regulatory uncertainty for the company because the company and the Board only have so many tools available to you and the company in order to be able to manage these cost pressures."

Reference: *Concentric Evidence, Appendix A, page 2, lines 15-22; and Mr. Coyne Transcript, April 4th, 2016, page 18, line 18 to page 20, line 21.*

Moody's, in its January 19th, 2015 *Credit Opinion on Newfoundland Power*, indicated a concern that the Company'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."

Similar concerns were raised in Moody's February 5th, 2016 Credit Opinion.

Reference: *Company Evidence (1st Revision), page 4-29 line 10 to page 4-30, line 4; and Exhibit 4 and Exhibit 4 (1st Revision).*

Mr. Coyne's evidence was that forecast increases in power supply costs would be considered by investors:

"From an investor perspective, it's on the horizon, it's visible and it's evident. And I also look at the fact that it's coming at a time when the province is facing the weakest economy in the country. So, you have an unprecedented increase in power supply costs combined with the weakest economy in the country. Both of those to me are significant risk factors that other utilities in either Canada or the U.S. don't face right now."

Reference: *Mr. Coyne Transcript, April 6th, 2016, page 186, lines 7-17.*

Mr. Coyne's evidence was consistent with that of Mr. Smith, the Company's President & CEO, relating to increased investor awareness of the potential cost impact on Newfoundland Power of rising power supply costs. Mr. Smith observed that:

> "…we're a long term asset base is what we are, you know, we put poles in the ground that last 40 and 50 years, and when you're looking to go to the markets and get debt from people, they look at where's your future and where you are going, because they know they're investing that money for the long haul."

Reference: *Mr. Smith Transcript, March 31st, 2016, page 113, line 19 to page 114, line 1.*

Dr. Booth's pre-filed testimony indicated, in effect, that "if" there was a significant increase in power costs for Newfoundland Power, the Board has tools to manage any rate shock should the cost increase significantly. His view at the public hearing expressed more concern but seemed to focus on the timing of the potential cost increases:

> "I think I've read enough and I saw enough to realize that there may be problems…so I'm certainly aware of the problems there and I'm aware that there may be electricity price shock, but I'm also very much aware that if there is significant price shock, then this Board and the Provincial Government would not sit idly by and let the utility be severely damaged. So I just don't think that that is a significant risk and it's certainly not a risk within the test year..."
>
> "Oh I think there's absolutely no question that going out to 2018 and beyond, there may be problems with the cost of power coming through as a result of Muskrat Falls, there's no question about that."

Reference: *Booth Evidence, page 83, line 8; Dr. Booth Transcript, April 7th, 2016, page 111, line 16 to page 112, line 5; and April 8th, 2016, page 131, lines 2-6.*

Dr. Booth did not analyze what the Board and the Provincial Government might do; however, he did not appear to believe such actions would be a serious matter. Dr. Booth's assessment of the potential consequences associated with the Muskrat Falls Project appeared to be based upon an unlimited ability for customers to pay.

Reference: *Dr. Booth Transcript, April 8th, 2016, page 141, line 2 to page 164, line 23.*

Dr. Booth indicated he had no comment on Moody's assessment that recovery of the costs of the Muskrat Falls Project may compromise Newfoundland Power's ability to recover its costs. Nevertheless, he did believe that "…the Board might in the future take actions that hurt the bond holder, such as changing the deemed capital structure or depreciation rate etc, but the bond holder is protected by contract law. That is why there is an interest coverage restriction, as well as others in the bond contract."

Reference: *NP-CA-061; and Booth Surrebuttal, page 16, lines 17-19.*

Dr. Cleary's pre-filed testimony indicated that "…there appears to be no concrete evidence to suggest that Muskrat Falls has led to an increase (or decrease) in [Newfoundland Power's] business risk." In Dr. Cleary's view, any risk presented by the Muskrat Falls Project was a risk to consumers, not Newfoundland Power, since the Company can pass these additional costs through to consumers.

Reference: *Cleary Evidence, page 22, lines 9-10; and Cleary Surrebuttal, page 3, lines 8-10.*

C.3.4.2 Other Supply Cost Considerations

Since 2013, Newfoundland Power has experienced substantial sustained interruptions in its power supply from Hydro. The extent to which the Company will be at higher risk of supply interruption until commissioning of the Muskrat Falls Project is uncertain; however, the near-term risks associated with supply reliability appear increased when compared to 2012, when Newfoundland Power filed its last general rate application.

Reference: *Company Evidence (1st Revision), page 4-30, lines 6-13.*

In addition, uncertainties exist with respect to technical details and supply reliability following decommissioning of Hydro's Holyrood generating station, when the Muskrat Falls Project is brought online. These have the potential to impact future supply costs for Newfoundland Power.

Reference: *Company Evidence (1st Revision), page 4-29, line 21 to page 4-30, line 4; PUB-NP-014; and Mr. Smith Transcript, March 30th, 2016, page 9, line 5, et. seq.*

Dr. Cleary's evidence related to the reliability of supply dismissed these uncertainties. It appears that Dr. Cleary simply assumed there was no increase in supply reliability risk for Newfoundland Power since 2012. Similarly, in respect of supply reliability risk following commissioning of the Muskrat Falls Project, Dr. Cleary assumed the status quo. To support this, he relied upon a single response by Hydro to a Request for Information in the Board's *Investigation and Hearing into the Supply Issues and Power Outages on the Island Interconnected System* that indicated reliability would be

improved. On cross-examination, Dr. Cleary admitted that he had not read more than this single response on the subject.

Reference: *Cleary Evidence, page 22, lines 4-10; and Dr. Cleary Transcript, April 11th, 2016, page 107, line 21 to page 112, line 5.*

C.3.5 Submission on Market Conditions and Risk

The evidence before the Board indicates that current capital market conditions are substantially similar to those existing at the time of Newfoundland Power's last general rate application. Overall, historical risk elements including Newfoundland Power's relatively small size, generally poor service territory demographics, challenging operating conditions, low cost flexibility and sole source dependence on Hydro are largely unchanged since 2012.

The evidence is clear that 2 significant changes in Newfoundland Power's overall risk profile have occurred since 2012. They relate to the struggling provincial economic outlook and increased power supply risk. Together, these 2 factors contribute to an overall increase in Newfoundland Power's risk profile since 2012. These factors also contribute to an increase in Newfoundland Power's risk profile when compared to other electric utility operating companies.

Neither Dr. Booth nor Dr. Cleary factor the relative impact of the declining provincial economic outlook for Newfoundland and Labrador compared to that of other provinces in their risk assessments. Similarly, neither expert

acknowledges that developments with the Muskrat Falls Project affect the current risk faced by investors in Newfoundland Power. Their failure to appropriately consider these factors should affect the weight the Board attributes to their evidence.

C.4 Capital Structure

The proportion of common equity in Newfoundland Power's capital structure is an issue in this Application.

The Company proposes the Board continue to authorize the historic "sound and successful" capital structure which includes a common equity ratio of 45%. Drs. Booth and Cleary propose to alter Newfoundland Power's capital structure in a way which will negatively affect both creditworthiness and future access to capital.

C.4.1 Newfoundland Power's Existing Capital Structure

Newfoundland Power has had a common equity ratio of approximately 45% for the past 25 years. This Application is the 6th application since 1996 in which the Board will consider Newfoundland Power's capital structure. As the Board observed in Order No. P.U. 13 (2013), in 2 of these applications there was a settlement recommending the 45% common equity ratio.

Reference: *PUB-NP-032; and Order No. P.U. 13 (2013), page 16, lines 37-38.*

Newfoundland Power's 45% common equity ratio is a cornerstone of the Company's creditworthiness and, from a credit rating perspective, a primary indicator of the level of regulatory support. Moody's has indicated that it considers timely and balanced regulatory decisions, deferral accounts and the Company's 45% equity ratio as indicators of regulatory support. DBRS has indicated that the Company's current ROE and 45% common equity ratio make Newfoundland Power "…comparable to its peers across Canada."

Reference: *Company Evidence (1st Revision), Exhibit 4 (1st Revision); and Ms. Perry Transcript, March 29th, 2016, page 34, line 9 to page 35, line 4.*

The evidence included *pro forma* 2017 Newfoundland Power credit metrics across a range of equity ratios and ROEs. The evidence indicated that, for Newfoundland Power to maintain the credit rating it has today, Moody's expected the Company's cash flow to debt coverage to be at the high end of the range of 15% - 17%. Coverage at the high end of this range was not achieved in all *pro forma* scenarios.

Reference: *Undertaking U-4; and Ms. Perry Transcript, March 31st, 2016, page 5, lines 12-18.*

The role of credit metrics and creditworthiness in the determination of a fair return for Newfoundland Power was specifically addressed in evidence. When asked to comment on forecast credit metrics contained in Table 4-12, the Company's Vice President, Finance & CFO, Ms. Jocelyn Perry, made the following observations:

> "What Table 4-12 is showing is the calculation of the company's credit metrics based on existing rates today, so that's why we had shown the prior table [Table 4-11] that reflects the return on equity of 8.03 and 7.3. So the credit metrics are within the ranges that I would say have been determined to be acceptable for Moody's for our credit rating. And that's a component of credit worthiness of Newfoundland Power. The return on equity is about a fair return, so there are two different components. Inside of a fair return standard, we need to maintain our financial integrity which we will consider such things as the credit metrics and the capital structure of Newfoundland Power, but it also has to be sufficient to ensure we have access to capital and also it needs to be comparable to other liked risk investments, so credit metrics are just a display of where you are from a credit worthiness perspective only and not from a fair return perspective."

Reference: *Company Evidence (1st Revision), page 4-14, line 1 to page 4-16, line 6; and Ms. Perry Transcript, March 31st, 2016, page 123, line 6 to page 124, line 3.*

The evidence also included *pro forma* 2017 earnings test interest coverage calculations required for Newfoundland Power to issue First Mortgage Bonds across a range of equity ratios and ROEs. This directly addresses the issue of access to capital. The evidence indicated that the Company might not be able to issue First Mortgage Bonds at equity ratios of 44% - 45% when the ROE was 8.3% - 8.5%. Newfoundland Power's Vice President, Finance & CFO, Ms. Jocelyn Perry, described how this affected sustainable financial planning as follows:

> "So we're trying to set the utility up so in all economic conditions and under all scenarios with respect to what we actually issue debt that we can be reasonably assured that we can issue first mortgage bonds. So a sustainable position that allows us to issue bonds, and that's what I consider this green area [on U-4] which is actually, you know, 2.15 and above. And I'll note as I did yesterday that the average that we have had for the last five bond issuances have been 2.24. And even though I've done the cut-off here at 2.15 I mean I'll note that we've only done one bond issue below that amount in the last ten years. So the green area is more of the comfort zone; the yellow area we might not be able to issue

bonds given the conditions; and certainly the red area is we certainly cannot issue bonds."

Reference: *Undertaking U-4; and Ms. Perry Transcript, March 31st, 2016, page 8, line 7 to page 9, line 1.*

C.4.2 Coyne's Recommendation

Based upon his financial and business risk analyses, Mr. Coyne concluded that Newfoundland Power's current common equity ratio of 45% remains the minimum appropriate level.

Reference: *Concentric Evidence, Appendix A, page 31, line 10 to page 32, line 7.*

Mr. Coyne's analyses included comparisons to Canadian investor-owned electric operating utilities, U.S. investor-owned electric operating utilities, and U.S. investor-owned transmission and distribution electric operating utilities.

Reference: *Concentric Evidence, Appendix A, page 5, line 8 to page 8, line 5.*

Mr. Coyne's analyses included an analysis of Newfoundland Power's business risk, including its relative small size, macroeconomic and demographic service territory trends, operating risks, power supply risks, and alternative fuel risks since 2012. His conclusion was that the business risk for Newfoundland Power is higher than it was in 2012 for the Company's previous general rate application.

Reference: *Concentric Evidence, Appendix A, page 10, line 18 to page 18, line 7.*

Mr. Coyne's analyses included detailed comparisons to other Canadian investor-owned electric utilities. These comparisons considered the following factors: power supply risk and electricity prices; macroeconomic and demographic conditions; volume/demand risk; competition and alternative fuels; regulatory environment; and capital and operating cost recovery. Based upon these comparisons, Mr. Coyne concluded that Newfoundland Power has above average business risk compared to other Canadian electric utilities.

Reference: *Concentric Evidence, Appendix A, page 18, line 8 to page 25, line 11.*

Mr. Coyne's analyses included detailed comparisons to a proxy group of U.S. electric utilities. This comparison included detailed assessment of U.S. regulated utility operations and regulatory frameworks. It also included consideration of the following factors: regulated generation risk; fuel and purchased power cost risk; volume/demand risk; capital cost recovery risk; rate regulation and earnings sharing; regulatory lag; and operating cost recovery mechanisms. Based upon these comparisons, Mr. Coyne concluded that Newfoundland Power has somewhat higher business risk than his proxy group of U.S. electric utilities.

Reference: *Concentric Evidence, Appendix A, page 25, line 12 to page 31, line 9.*

The results of Mr. Coyne's analysis pertaining to capital structure are consistent with the regulatory practice of the Board. When questioned concerning how changes in Newfoundland Power's assessed business risks justify its 45% common equity ratio, Mr. Coyne observed:

> "I'd say even more so now. It is at the higher end of its Canadian peers, but it's 5 percent below its U.S. peers, and that's true even for the pure T & D companies that we looked at. So it has a – given its risk profile, vis-à-vis those companies, I think it's appropriate to have it at the higher end of the Canadian competitors or comparators, but I worry about still being 5 percent below its U.S. peers. There's a history in Canada of Canadian regulators allowing lower capital equity ratios than the U.S. peers, so I take that into account. That's why I'm not recommending a 5 percent increase to look like the U.S. proxy companies, but I think you have to acknowledge that gap. So that's why I recommended 45 stay in place. I think it serves as a counter balance to these other risk factors. I would suggest to the Board that over time, as these risk factors play out, as we've talked about, it's something that should continue to be examined to see if it's representative and appropriate for the company on a going forward basis. I understand…..that Canadian regulators put in capital ratios and they leave them, and the same is true for U.S. regulators. They tend to put them in and leave them, and then they tend to adjust returns with the ROE that move with capital markets. I understand the track record of stability with this Commission in that regard, and I think it has been a good regulatory practice."

Reference: *Mr. Coyne Transcript, April 7th, 2016, page 77, line 21 to page 80, line 1.*

Mr. Coyne's evidence concerning possible changes to Newfoundland Power's capital structure between 40% and 45% indicated that caution is warranted. This caution reflects the fact that the future will not always unfold according to plan, so a margin is prudent:

> "So utilities don't typically like to be right on the margin in terms of these credit metrics for those reasons, and regulators don't typically like to have them there either because the consequences, as we looked at, the difference in cost between a BBB and an A rated bond rating in Canada is significant, and also the market for BBB debt in Canada is much more limited compared to the A rated market. So it's not a precipice, you want to be mindful of it, I agree with the analysis that the company has presented here, but you don't want to get so close to the edge that you're not providing yourself any cushion in case things don't work out exactly as you think it will, vis-à-vis your business plan. It also – I think any reduction

in the equity ratio certainly sends a negative message to debt investors and, of course, to equity investors…"

Reference: *Mr. Coyne Transcript, April 7th, 2016, page 77, line 21 to page 80, line 1.*

C.4.3 Booth's Recommendation

As in Newfoundland Power's last general rate application, Dr. Booth recommends that Newfoundland Power finance with a 40% common equity ratio. As a short-term measure, Dr. Booth recommends the 5% equity reduction be deemed using Fortis' cost of preferred shares until the next rate hearing. At that time, if there is no rate shock, then Dr. Booth recommends the 5% be replaced with long-term debt.

Reference: *Booth Evidence, page 3, lines 16-22.*

In Order No. P.U. 19 (2003), the Board concluded it was in the interest of both Newfoundland Power and its customers that the Company continue to be treated as a standalone utility. The Board required the Company to take all steps necessary to preserve its financial integrity and independence from Fortis. Dr. Booth's recommendation to deem a 5% equity reduction using Fortis' cost of preferred shares appears to be contrary to the standalone principle and the Board's direction in Order No. P.U. 19 (2003).

Reference: *Order No. P.U. 19 (2003), page 39.*

Following Newfoundland Power's last general rate application, in Order No. P.U. 13 (2013), the Board found that the evidence raised significant issues in relation to Dr.

Booth's suggested change to Newfoundland Power's capital structure. These issues included the possibility that a reduction in the common equity ratio might lead to a downgrade by credit rating agencies. In addition, there were issues related to the practicality of issuing preference shares.

Reference: *Order No. P.U. 13 (2013), page 16, line 40 to page 17, line 6.*

The evidence of Newfoundland Power's Vice President, Finance & CFO, Ms. Jocelyn Perry, was that Dr. Booth's proposals would result in material decline in the Company's credit metrics, preclude the Company from issuing First Mortgage Bonds and jeopardize Newfoundland Power's credit ratings. First Mortgage Bonds are the Company's least cost long-term source of financing.

Reference: *Ms. Perry Transcript, March 29th, 2016, page 49, line 7 to page 51, line 8.*

Dr. Booth's evidence was that the Canadian preferred debt market is not fluid or deep. It is an episodic market that periodically opens and closes. This evidence is consistent with evidence of current Canadian electric utility financing practice in which issuance of preferred shares by utilities is not common.

Reference: *Dr. Booth Transcript, April 7th, 2016, page 114, line 25 to page 115, line 5; and NP-CA-050.*

Newfoundland Power's evidence is that a preference share issue must be over $100 million to be marketable; this $100 million minimum is 9% of the Company's capital

structure. Any preferred shares issued by Newfoundland Power would have coupon reset provisions which would result in their not being treated as equity for credit rating purposes. For these reasons, Dr. Booth's recommendation that Newfoundland Power issue (or be deemed) 5% preferred equity remains impractical.

Reference: *Company Finance Rebuttal Evidence, page 2, line 19 to page 3, line 9; and CA-NP-050.*

Dr. Booth recognized the importance of stability in capital structure management and would generally recommend that capital structures not be changed unless there is a significant change in business risk. Dr. Booth indicated that he didn't think that the policy of the AUC, where there are changes to capital structure every couple of years "…makes a lot of sense".

Reference: *Dr. Booth Transcript, April 8th, 2016, page 165, line 20 to page 169, line 16.*

C.4.4 Cleary's Recommendation

Based upon his qualitative and quantitative analyses, Dr. Cleary recommends the Board reduce Newfoundland Power's common equity ratio to 40%. Dr. Cleary concludes that a 45% common equity ratio is not "…required to maintain solid credit metrics that will permit [Newfoundland Power] to maintain its ability to raise credit on reasonable terms".

Reference: *Cleary Evidence, page 2, line 27 to page 3, line 2.*

Dr. Cleary is "well aware" that quantitative measures such as credit metrics are only part of what debt rating agencies consider in determining ratings. Further, he acknowledged that qualitative factors are essentially 60% of Moody's assessment criteria.

Reference: *NP-CA-018; and Dr. Cleary Transcript, April 11th, 2016, page 90, line 9 to page 91, line 2.*

Dr. Cleary's qualitative analysis of Newfoundland Power's business risk for the purposes of his capital structure recommendation was limited to an examination of the Company's operating and regulatory environment. He did not provide any comparisons of Newfoundland Power's business risk to that of any other Canadian or U.S. investor-owned electric operating utilities. Dr. Cleary's evidence was that he did not have a background in utilities' operations or regulation.

Reference: *Cleary Evidence, page 16, line 6 to page 23, line 21; and Dr. Cleary Transcript, April 11th, 2016, page 58, lines 2-9.*

Dr. Cleary's assessment of key qualitative aspects of Newfoundland Power's business risk such as the economy and the Muskrat Falls Project seemed flawed. His assessment of the economic outlook, including forecast employment levels and other local economic conditions, appeared unduly optimistic. Further, he appeared to assess matters such as supply reliability and the impacts of the Muskrat Falls Project as inconsequential.

Reference: *Dr. Cleary Transcript, April 11th, 2016, page 66, line 2 to page 90, line 8; Cleary Evidence, page 22, lines 9-10; and Cleary Surrebuttal, page 3, lines 8-10.*

Dr. Cleary's quantitative analysis of Newfoundland Power's business risk for the purposes of his capital structure recommendation was a comparison of the coefficient of variation of EBIT estimates.

Reference: *Cleary Evidence, page 23, line 19 to page 28, line 6.*

Dr. Cleary was not aware of any regulator in Canada which used comparisons of the coefficient of variation of EBIT estimates to determine a regulated utility's equity ratio. Dr. Cleary was unable to tell the Board that any U.S. regulator used it either.

Reference: *NP-CA-014; and Dr. Cleary Transcript, April 11th, 2016, page 135, line 8 to page 139, line 12.*

Dr. Cleary was not aware of any debt rating agency which used comparisons of the coefficient of variation of EBIT estimates to determine a utility's financial or business risk.

Reference: *NP-CA-015; and Dr. Cleary Transcript, April 11th, 2016, page 139, line 13 to page 140, line 14.*

In his assessment of financial risk, Dr. Cleary compared Newfoundland Power's allowed ROE and equity ratio with those of other Canadian utilities. Amongst the comparators used by Dr. Cleary, were a number of municipal and provincial crown corporations including ENMAX Power Corp., EPCOR Distribution Inc., HydroQuebec Distribution, Saskatchewan Power Corp., and SaskEnergy.

Reference: *Cleary Evidence, Tables 9 and 10.*

Newfoundland Power's evidence was that an equity ratio of 40% and an allowed ROE of 7.5% would result in material decline in the Company's credit metrics, preclude the Company from issuing First Mortgage Bonds and jeopardize Newfoundland Power's credit ratings. In addition, Company evidence showed how an electric utility, such as FortisAlberta with a 40% common equity ratio and an 8.3% allowed ROE, was able to achieve credit metrics comparable to those achieved by Newfoundland Power with a 45% common equity ratio and an 8.8% allowed ROE.

Reference: *Company Finance Rebuttal Evidence, page 4, line 4 to page 8, line 12; and Ms. Perry Transcript, March 29th, 2016, page 50, line 15 to page 51, line 8.*

C.4.5 Submission on Capital Structure

Newfoundland Power's longstanding equity ratio of 45% is consistent with maintenance of the Company's creditworthiness and cost effective access to capital.

If adopted by the Board, the recommendations of Dr. Booth and Dr. Cleary will reduce Newfoundland Power's creditworthiness. Part of this reduced creditworthiness is reflected in weakened credit metrics; part is reflected in the likely perception of debt investors of reduced overall regulatory support. Furthermore, the recommendations of Dr. Booth and Dr. Cleary, if adopted by the Board, will preclude further issue of First Mortgage Bonds, the Company's least cost long-term source of financing. This will impair the Company's cost effective access to capital to fund its obligation to serve customers on a least cost basis.

Dr. Booth recommends the Board deem 5% of Newfoundland Power's common equity at Fortis Inc.'s cost of preferred shares. A similar recommendation was made by Dr. Booth in 2012. This recommendation is inconsistent with the standalone principle. It is also inconsistent with the provisions of Order No. P.U. 19 (2003).

Because the recommendations of Dr. Booth and Dr. Cleary reduce the Company's creditworthiness and impair its access to least cost funding, they are inconsistent with the fair return standard. Accordingly, the Board should not accept these recommendations.

C.5 Return on Equity

Newfoundland Power's ROE is an issue in this Application. In 2013, the Board continued the Company's ROE of 8.8% through 2015.

The Company proposes the Board allow an ROE of 9.5% for ratemaking purposes. This proposal is based upon the recommendation of Mr. Coyne, who has utilized market based inputs and well established methods to determine the fair ROE. This increased ROE is consistent with the increased risk presented by changes in the provincial economy and power supply outlook.

Dr. Booth proposed the Board allow an ROE of 7.5% for ratemaking purposes. This proposal is the same as that put forward by Dr. Booth at Newfoundland

Power's last general rate application and is substantially lower than current allowed ROEs for investor-owned electric utilities.

C.5.1 Current Canadian Electric Utility ROEs

The current allowed ROEs for investor-owned Canadian regulated electric utilities by province, other than Newfoundland and Labrador, are:

British Columbia	9.15%
Alberta	8.30%
Ontario	9.19%
Prince Edward Island	9.35%
Nova Scotia	9.00%

Newfoundland Power's current allowed return of 8.8% is the 2nd lowest in Canada next to Alberta. Currently, both the BCUC and the AUC are assessing cost of capital.

Reference: *PUB-NP-034 (1st Revision); and Ms. Perry Transcript, March 29th, 2016, page 44, line 12 to page 45, line 1.*

C.5.2 Coyne's Recommendation

Mr. Coyne's ROE recommendation is 9.5%.

To support this recommendation, Mr. Coyne performed analysis on 3 proxy groups of publicly traded utility companies with comparable business and financial risks to

Newfoundland Power. One proxy group consisted of Canadian companies; one consisted of U.S. electric utilities; and one consisted of a mixture of Canadian and U.S. electric utilities. For each proxy group, Mr. Coyne performed a CAPM analysis, a constant growth DCF analysis, and a multi-stage DCF analysis.

Figure 1 from Mr. Coyne's pre-filed evidence provides a summary of the results of his ROE analysis.

Figure 1: Summary of Results (including flotation costs)

	Canadian Regulated Utilities	US Electric Utilities	North American Electric Utilities	Average
CAPM	9.0%	10.4%	10.1%	9.8%
Constant Growth DCF	12.8%	9.8%	9.6%	10.7%
Multi-Stage DCF	10.3%	9.5%	9.2%	9.6%
Average	10.7%	9.9%	9.7%	10.1%

Reference: *Concentric Evidence, page 2, line 12 to page 3, line 17.*

Mr. Coyne indicated his belief that it is essential to use alternative models in the current market environment to estimate the cost of equity; to draw upon market based and transparent inputs to these models; and to use reliable 3rd party sources to minimize potential for analyst bias.

Reference: *Mr. Coyne Transcript, April 4th, 2016, page 21, line 12 to page 23, line 17.*

Mr. Coyne's approach is consistent with the Board's most recent observations concerning the appropriate methodologies for determining a fair return:

> "The Board concludes that given the current financial and economic conditions a simple application of the capital asset pricing model cannot be relied on to produce a fair return for Newfoundland Power. In the circumstances it is necessary to take a broader view and look to other available information in relation to fair return. The Board will continue to give primary weighting to the capital asset pricing model; however, it will also look to the other evidence in relation to the fair return for Newfoundland Power and in particular the results of other models…"

Reference: *Order No. P.U. 13 (2013), page 20, lines 32-41.*

Use of U.S. data and proxy groups has become more accepted by regulators of Canadian utilities, including the Board. This is primarily due to the lack of sufficient Canadian data. It is also in recognition of the integration of Canadian and U.S. financial markets, the similarity of utility regulatory regimes and the need for Canadian utilities to compete for capital in the global marketplace. The integration of Canadian and U.S. financial markets can be observed by the high correlation since 1990 of Canadian and U.S. real GDP growth (0.86) and 10-year government bond yields (0.97).

Reference: *Concentric Evidence, page 18, lines 1-20; Order No. P.U. 13 (2013), pages 43-44; Concentric Evidence, Exhibit JMC-1; and Mr. Coyne Transcript, April 4th, 2016, page 8, line 4 to page 13, line 11.*

C.5.3 Booth's Recommendation

Dr. Booth's ROE recommendation is 7.5%.

This recommendation is based upon a risk premium estimate following rejection of the results of a CAPM and what Dr. Booth calls a "conditional CAPM". This estimate is based upon a forecast 30-year Canada yield of 2.81%, an equity risk premium of 2.25% to 3.30% and an allowance for financing flexibility of 0.5%, for an indicated cost of equity of 5.56% to 6.61%.

To this indicated cost of equity, Dr. Booth adds a 0.45% adjustment for credit spreads and his Operation Twist adjustment of 1.3%. This yields an adjusted ROE estimate of 7.31% to 8.36%, which has a midpoint of 7.83%. Dr. Booth reduces this by 0.33% to arrive at his ROE recommendation of 7.5%.

Reference: *Booth Evidence, page 40, line 24 to page 51, line 13.*

Dr. Booth's ROE recommendation of 7.5% is the same as his 2012 recommendation to the Board.

Reference: *NP-CA-082.*

In 2012, Dr. Booth estimated his risk free rate over the 2013/2014 test period. For this Application, Dr. Booth averaged forecasts for March and December 2016 to estimate his risk free rate. Had Dr. Booth estimated his risk free rate over the 2016/2017 test

period as he did in 2012, his estimate of a risk free rate would have been 20 basis points (0.20%) higher.

Reference: *Booth Evidence, page 25, lines 10-17; and Dr. Booth Transcript, April 8th, 2016, page 26, line 11 to page 29, line 7.*

In 2012, Dr. Booth had a 0.4% adjustment for credit spreads and an Operation Twist adjustment of 0.8%; in 2016, Dr. Booth had a 0.45% adjustment for credit spreads and an Operation Twist adjustment of 1.3%. In respect of the difference in the Operation Twist adjustment, Dr. Booth expressed a level of discomfort:

> "Q. And the last time you had 80 basis points, and this time you have 130 basis points?
>
> A. Well, the last year I had 80 basis points and was reasonably comfortable with it. This time I have 130 and I'm very uncomfortable with it."

Reference: *Dr. Booth Transcript, April 8th, 2016, page 34, lines 10-17.*

Dr. Booth indicated that his risk premium analysis was "…directionally higher, but with a huge amount of uncertainty."

Reference: *Dr. Booth Transcript, April 8th, 2016, page 70, lines 5-16.*

In 2012, Dr. Booth performed DCF analysis on a United States utility sample. This analysis suggested a fair return of 9.23% for United States utilities. In this Application, Dr. Booth performed 2 DCF analyses on United States utilities; 1 analysis was performed on gas utilities and 1 was performed on electric utilities. If calculated on the

same basis as his 2012 analysis, the results of Dr. Booth's 2 DCF analyses in this Application would have indicated a fair return of 9.40% for his United States electric utilities sample and 8.88% for his United States gas utilities sample.

Reference: *Order No. P.U. 13 (2013), page 29, lines 1-2; Booth Evidence, Appendix D, page 13, line 13 to page 14, line 10; and Dr. Booth Transcript, April 8th, 2016, page 81, line 5 to page 90, line 8.*

Dr. Booth adjusted his U.S. DCF results to arrive at a fair return for a U.S. utility of around 7% to 7.5%.

Reference: *Booth Evidence, Appendix D, page 21.*

The adjusted results of Dr. Booth's DCF analyses were used to validate or inform his judgment with respect to his ultimate recommendation of a 7.5% ROE.

Reference: *Dr. Booth Transcript, April 8th, 2016, page 195, line 13 to page 196, line 3.*

Dr. Booth's U.S. electric utility proxy group for DCF analysis is the same as Mr. Coyne's. Dr. Booth's evidence was that he chose them because they're chosen by American experts, not because they were reasonable comparators or the result of his independent analysis. In fact, Dr. Booth acknowledged he was not an expert on U.S. utilities.

Reference: *Dr. Booth Transcript, April 8th, 2016, page 84, line 8 to page 85, line 12; and page 99, line 24 to page 100, line 2.*

Dr. Booth indicated that Canadian regulators, such as the BCUC, the OEB and the NEB, had used U.S. data in cost of capital matters. In addition, he observed that "…the capital markets are more integrated now than they were two years ago, five years ago, ten years ago, fifteen years ago, twenty years ago."

Reference: *Dr. Booth Transcript, April 8th, 2016, page 75, line 17 to page 78, line 5.*

Newfoundland Power's evidence was that an equity ratio of 40% and an allowed ROE of 7.5%, as recommended by Dr. Booth, would result in material decline in the Company's credit metrics, preclude the Company from issuing First Mortgage Bonds and jeopardize Newfoundland Power's credit ratings.

Reference: *Company Finance Rebuttal Evidence, page 4, line 4 to page 8, line 12; and Ms. Perry Transcript, March 29th, 2016, page 50, line 15 to page 51, line 8.*

C.5.4 Cleary's Perspective

Dr. Cleary did not make an ROE recommendation. He did, however, observe that Newfoundland Power "…would maintain solid metrics if the equity ratio was reduced to 40% and the allowable ROE was also reduced."

Reference: *Cleary Evidence, page 36, lines 13-14.*

C.5.5 Submission on Return on Equity

Current allowed ROEs for investor-owned Canadian electric utilities range from 8.3% to 9.35%.

Mr. Coyne's recommendation of a 9.5% ROE for Newfoundland Power is based upon multiple tests. The recommendation is marginally higher than the current range for Canadian investor-owned electric utilities but lower than those for comparable U.S. utilities. It is based upon his ROE analyses and supported by detailed risk assessment of Newfoundland Power in relation to its Canadian and U.S. peers. It is further supported by his assessment of the Company's increasing risk profile.

Dr. Booth's recommendation of a 7.5% ROE for Newfoundland Power is based, in effect, on an adjusted CAPM, or risk premium, estimate. The recommendation is substantially lower than the current range of allowed ROEs for investor-owned Canadian electric utilities. In addition, if Dr. Booth's ROE recommendation were adopted by the Board, the evidence indicates that it would put the Company's credit rating at risk and preclude further issue of First Mortgage Bonds, the Company's least cost, long-term source of financing.

Dr. Booth's recommendation does not reflect a return comparable to other investor-owned Canadian electric utilities, is inconsistent with the maintenance of the Company's creditworthiness, and impairs future access to least cost financing. Simply put, Dr. Booth's recommendation in this proceeding does not meet any element of the fair return standard.

D. EXECUTIVE COMPENSATION

The Board periodically examines Newfoundland Power's executive compensation in general rate applications. In the Application, the Company's executive compensation was reviewed.

D.1 History

Newfoundland Power adopted the median of the broad Canadian Industrial comparator group as the basis for executive compensation policy in 1997. The Board first reviewed this policy in 1998 and determined that the use of this market to establish the Company's executive compensation policy was appropriate.

Reference: *Order No. P.U. 36 (1998-99), page 41.*

The Company has continued to use the median of this comparator group for the purposes of establishing executive compensation. In every examination of Newfoundland Power's executive compensation policy since 1998, the Board has found Newfoundland Power's executive compensation costs to be reasonable.

Reference: *Order No. P.U. 19 (2003), page 93; Order No. P.U. 43 (2009), page 37; and Order No. P.U. 13 (2013), pages 54 to 55.*

D.2 The Evidence

D.2.1 The Hay Group

Newfoundland Power provided the opinion evidence of Mr. Karl Aboud, Senior Principal of Korn Ferry Hay Group Canada's Reward Consulting Practice, on executive

compensation. Mr. Aboud previously provided expert evidence on Newfoundland Power's executive compensation structure and testified before the Board as part of Newfoundland Power's 2010 General Rate Application.

Mr. Aboud's evidence was that: (i) it is reasonable for Newfoundland Power to use comparative executive jobs within the broad Canadian Commercial Industrial market place as its comparator group; (ii) it is reasonable for Newfoundland Power to use the median/50th percentile levels of comparator group compensation values as the basis by which to establish its own executive pay standards; and (iii) the Newfoundland Power incumbent-specific executive pay values are within the normal range of variance to the market pay standards that Hay Group typically experiences in these types of reviews.

In addition, it was Mr. Aboud's evidence that (i) the Newfoundland Power incumbent specific salaries range from being as low as 10% below market median to as high as 4.6% above market median. This range of differential is easily within the norms of virtually all sophisticated organizations within Canada; and (ii) the Newfoundland Power annual bonus value or short term incentive targets are less than the respective market median standards.

Reference: *Aboud Evidence, page 2.*

Newfoundland Power's executive long-term incentive costs are not recovered from customers. This results in Newfoundland Power's shareholders bearing a portion of

Newfoundland Power's executive compensation costs on a continuing basis.

Reference: *Aboud Evidence, page 7 and Table 3.*

D.2.2 2016/2017 Test Period Costs

In the 2016/2017 test period, executive labour costs are expected to be marginally lower than those incurred in the 2013/2014 test period.

Reference: *PUB-NP-074 (1st Revision), page 3, lines 10-11.*

In the 2016/2017 test period, the proportion of Newfoundland Power's executive labour as a percentage of total labour costs is forecast to be 2.7%. This is approximately 10% lower than the proportion in 2006 and 2011, and approximately 36%, or ⅓, lower than the proportion in 2001.

Reference: *PUB-NP-074 (1st Revision), page 4, lines 1-4.*

D.2.3 Submission on the Evidence

Newfoundland Power has consistently applied the same executive compensation policy that it adopted approximately 2 decades ago. Further, 2016/2017 test period executive labour costs borne by customers are marginally lower than those in the 2013/2014 test period. Finally, Company executive labour costs as a proportion of total Newfoundland Power labour costs are lower than at any time in the past decade.

The evidence indicates that the executive compensation costs proposed for the 2016/2017 test period are reasonable. There is no evidence to the contrary.

Appendix A
Settled Issues

1. THE FORECAST

It has been agreed that the Board may accept, and rely upon, the Forecast in establishing 2016 and 2017 customer electricity rates.

Reference: Settlement Agreement, Items 6 and 7.

Evidence Before the Board:
Newfoundland Power's Customer, Energy and Demand Forecast indicates that: (i) the number of customers Newfoundland Power serves will increase by 0.9% in 2016 and 0.8% in 2017; (ii) energy sales will increase by 0.6% in 2016 and 0.1% in 2017; and (iii) peak demand will increase by 0.3% in 2016 and 0.4% in 2017. These forecasts include the impact of price elasticity associated with the proposed average increase of 2.5% effective July 1, 2016, as well as the impact of energy conservation and demand management programs.

Reference: Company Evidence (1st Revision), pages 6-2 to 6-5 and Customer, Energy and Demand Forecast (1st Revision), page 5 and Appendix B and C.

The assumptions used in forecasting revenue and expenses in the Customer, Energy and Demand Forecast are based upon, and incorporate, data from independent sources. The overall methodology used by the Company for estimating revenue, expenses and net earnings is generally similar to, and consistent with, the process and methodology used in the 2013/2014 General Rate Application. The March 8, 2016 forecast revisions were properly incorporated into revenue requirements.

Reference: Grant Thornton Report, page 26, lines 24-26 and page 27, lines 22-24; and Supplemental Grant Thornton Report, page 5, lines 20-22.

2. REVENUE REQUIREMENT MATTERS

(i) Power Supply Costs

It has been agreed that the Company's test year revenue requirements include Power Supply costs of $448,896,000 for 2016 and $448,648,000 for 2017, subject to any adjustment resulting from the Board's determinations with respect to conservation and demand management.

Reference: Settlement Agreement, Items 14 and 15.

Evidence Before the Board:
Newfoundland Power's increases in Power Supply costs substantially reflect increased purchases from Hydro to meet Newfoundland Power's customers' requirements. Power Supply costs also reflect amortizations approved by the Board.

Reference: Company Evidence (1st Revision), page 4-6, lines 1-3.

The purchase power forecasts for 2015, 2016 and 2017 were reviewed by Grant Thornton and appeared consistent with billing rates from Newfoundland and Labrador Hydro and forecast increases in energy sales.

Reference: Grant Thornton Report, page 50, lines 18-19; and Supplemental Grant Thornton Report, page 4, lines 16-23.

(ii) Employee Future Benefits Expense
It has been agreed that the Company's test year revenue requirements include employee future benefit expense of $18,564,000 for 2016 and $15,852,000 for 2017, subject to adjustment, if any, arising from the Board's determinations with respect to executive compensation.

Reference: Settlement Agreement, Items 8 and 9.

Evidence Before the Board:
Newfoundland Power maintains plans for its employees which provide benefits upon retirement. The Company expects total employee future benefits expense to decrease by approximately $9.8 million from 2013 to 2017.

Reference: Company Evidence (1st Revision), page 4-8, line 8 to page 4-9, line 5.

The proposed employee future benefits expense for 2016 and 2017 were reviewed by Grant Thornton and no discrepancies in their calculation were found.

Reference: Grant Thornton Report, page 43, line 1 to page 45, line 10; and Supplemental Grant Thornton Report, page 2, lines 21-32 and page 4, lines 25-31.

(iii) Depreciation Expense
It has been agreed that the Company's proposal to calculate depreciation expense by use of the depreciation rates recommended in the Depreciation Study be approved by the Board.

Reference: Settlement Agreement, Item 16.

Evidence Before the Board:
Newfoundland Power, in accordance with Order No. P.U. 13 (2013), filed a Depreciation Study relating to plant in service as of December 31, 2014 in its 2016/2017 General Rate Application. The composite rate of depreciation recommended by Gannett Fleming in the Depreciation Study is the same composite rate of depreciation currently used by the Company. Changes in individual depreciation rates recommended in the Depreciation Study result in increases in the Company's depreciation expense for 2016 and 2017.

Reference: Company Evidence (1st Revision), page 4-6, line 5 to page 4-7, line 8; and 2014 Depreciation Study.

The depreciation rates used to calculate the proposed forecast for 2016 and 2017, including the true-up provision, agree to those recommended in the 2014 Depreciation Study and the Company's pre-filed evidence. The depreciation expense is calculated in accordance with the rates prescribed in the 2014 Depreciation Study.

Reference: Grant Thornton Report, page 31, lines 19-24.

(iv) Finance Charges
It has been agreed that the Company's test year revenue requirements include finance charges of $35,446,000 for 2016 and $36,873,000 for 2017, subject to any adjustments arising from the Board's determinations with respect to rate of return on equity or capital structure.

Reference: Settlement Agreement, Items 12 and 13.

Evidence Before the Board:
Finance charges in the 2016/2017 test period are relatively stable and forecast to increase by approximately $1.1 million from 2013.

Reference: Company Evidence (1st Revision), page 4-12, lines 14-15.
The forecast finance charges for 2015 and the proposed finance charges for 2016 and 2017 are not unreasonable.

Reference: Grant Thornton Report, page 46, lines 20-21.

(v) Income Tax Expense
It has been agreed that the Company's test year revenue requirements include income tax expense of $18,719,000 for 2016 and $19,636,000 for 2017, subject to any adjustments arising from the Board's determinations with respect to rate of return on equity or capital structure.

Reference: Settlement Agreement, Items 10 and 11.

Evidence Before the Board:
Newfoundland Power's effective income tax rate, which approximates the statutory corporate income tax rate of 29%, is forecast to remain stable through the 2016/2017 test period.

Reference: Company Evidence (1st Revision), page 4-13, lines 8-9.

Income tax expense for 2015, and proposed for 2016 and 2017, appear consistent with changes in the substantively enacted corporate income tax rates and forecast increases in net income.

Reference: Grant Thornton Report, page 47, lines 17-19.

3. FORECAST AVERAGE RATE BASE

It has been agreed that the 2016 and 2017 average rate base, as set out in the Application, are calculated in accordance with Board orders and regulatory practice. The 2016 and 2017 average rate base should be used for ratemaking purposes, subject only to adjustments resulting from Board determinations on issues that were not settled.

Reference: Settlement Agreement, Items 26 and 27.

Evidence Before the Board:
Newfoundland Power's forecast 2016 and 2017 average rate base is calculated in accordance with Board orders and regulatory practice.

Reference: Company Evidence (1st Revision), page 5-1, lines 20-22; and Exhibit 6 (1st Revision).

Grant Thornton's review of the Company's forecast 2016 and 2017 average rate base indicated no discrepancies in the calculation of average rate base except the use of 15% HST which was updated in the March 2016 revisions.

Reference: Grant Thornton Report, page 17, line 1 to page 20, line 9; and Supplemental Grant Thornton Report, page 3, lines 10-17.

4. RATE DESIGN MATTERS

(i) Rate Change Plan
It has been agreed to vary the rate increase by customer rate class so that cost recovery for each rate class is within the target revenue to cost ratio range of 90% to 110%.

Reference: Settlement Agreement, Item 28.

Evidence Before the Board:
Maintaining revenue to cost ratios for each class within a range of 90% to 110% has been an accepted approach to achieving fairness in rate design by avoiding undue cross subsidization among the various classes. The Company's rate proposals include bringing the revenue to cost ratios within the target range of 90% to 110%.

Reference: Order No. P.U. 7 (1996-97); and Company Evidence (1st Revision), page 6-6, line 1 to page 6-7, line 6.

(ii) Changes to Rate Structure and Curtailable Service Option
It has been agreed that the Board should approve the proposed changes to rate design and rate structures as set out in the Application.

Reference: Settlement Agreement, Items 29 and 30.

Evidence Before the Board:
The Company is proposing to implement separate basic customer charges in General Service Rate 2.1 for customers that have (i) unmetered service, (ii) single phase service and (iii) three phase service. This change is proposed to reflect the different costs to provide each type of service and was recommended in the Company's Retail Rate Review.

Reference: Company Evidence (1st Revision), page 6-9, line 20 to page 6-10, line 2.

The Company also proposes that modifications be made to the *Contribution in Aid of Construction Policy: Distribution Line Extensions and Upgrades to General Service Customers* to reflect the proposed elimination of the Unwarranted Three Phase Charge. This charge is no longer necessary.

Reference: Company Evidence (1st Revision), page 6-11, lines 11-14; and Elimination of Unwarranted Three Phase Charge Report, page 1.

Newfoundland Power proposes to modify the Curtailable Service Option. Firstly, the Company proposes to modify the penalty clause to (i) increase the number of failures allowed to 4 from 3; (ii) reduce the 50% credit reduction for the first failure to a 25% credit reduction; and (iii) introduce a tiered system which permits a customer to secure 50% of the curtailment credit achieved following the 5th curtailment request in a winter season.

Secondly, the Company proposes to modify the availability of the Curtailable Service Option to permit customers with multiple facilities to aggregate those facilities for the purposes of meeting the minimum 300 kW demand reduction required to take advantage of the rate option.

These changes are designed to promote continued reliable curtailment capability for the Island Interconnected system.

Reference: Company Evidence (1st Revision), page 6-14, lines 14-21; and Curtailable Service Option Review.

5. REGULATORY POLICY MATTERS

(i) Conservation Program Evaluation

It has been agreed to discontinue use of the Rate Impact Measure test and to evaluate customer conservation programs by use of the Total Resource Cost ("TRC") test and the Program Administrator Cost ("PAC") test.

Reference: Settlement Agreement, Item 17.

Evidence Before the Board:

The Company's *Five Year Conservation Plan: 2016-2020* evaluates the cost effectiveness of customer energy conservation programs based upon the TRC test and the PAC test. Prior plans evaluated customer energy conservation programs based upon TRC test and the Rate Impact Measure test. The Rate Impact Measure test is no longer widely used in evaluation of customer energy conservation programs. Adoption of the TRC test and PAC test is consistent with current Canadian utility practice for evaluating the cost effectiveness of customer energy conservation programs.

Reference: Company Evidence (1st Revision), page 2-14, line 14 to page 2-15, line 5.

The results of the TRC test and the PAC test have been used by the Company to determine inclusions in the Conservation and Demand Management Cost Deferral Account.

Reference: Grant Thornton Report: page 14, lines 6-8.

(ii) Hearing Costs

It has been agreed that the Board should approve the recovery of Board and Consumer Advocate hearing costs evenly over a three year period from 2016 to 2018. For rate setting purposes, it was agreed that these costs be estimated at $1.0 million, with any difference between actual costs and costs estimated for rate setting purposes to be rebated/collected through the RSA.

Reference: Settlement Agreement, Item 19.

Evidence Before the Board:
Newfoundland Power proposed the recovery of approximately $1.2 million in Board and Consumer Advocate related costs associated with the 2016/2017 General Rate Application in customer rates over a three year period commencing in 2016. Three year amortizations of hearing costs is consistent with past practice of the Board.

Reference: Company Evidence (1st Revision), page 4-45, lines 1-8.

(iii) 2016 Revenue Shortfall
It has been agreed that should the implementation of customer rates following the hearing be delayed beyond the proposed implementation date of July 1, 2016, the delay will affect the amount of a 2016 revenue shortfall projected on the basis of a July 1, 2016 implementation date. The parties also agree that the Board should approve a revenue amortization, if necessary, from the effective date of the new rates to December 31, 2018, to provide for recovery in customer rates of any 2016 revenue shortfall.

Reference: Settlement Agreement, Items 22, 23, 24 and 25.

Evidence Before the Board:
Based upon the July 1, 2016 implementation, customer rates designed to recover the 2017 revenue requirement would result in a $1,410,000 revenue shortfall in recovering the 2016 revenue requirement. Recovery of this shortfall over a 30 month period is consistent with past practice of the Board.

Reference: Company Evidence (1st Revision), page 4-45, lines 10-17.

The Company is proposing this shortfall be recovered over a 30 month period commencing July 1, 2016. This is consistent with the process approved in Order No. P.U. 13 (2013) to recover the 2013 revenue shortfall. Changes in the amortization to reflect the March filing indicated no discrepancies.

Reference: Grant Thornton Report: page 9, lines 36-38; and Supplemental Grant Thornton Report, page 4, lines 33-40.

The regulatory deferrals and amortizations in the Application are not unreasonable.

Reference: Grant Thornton Report, page 9, lines 40-42.

6. THE FORMULA

It has been agreed that the Board should approve the continued suspension of the use of the Formula until Newfoundland Power's next general rate application.

Reference: Settlement Agreement, Item 31.

Evidence Before the Board:
Since Order No. P.U. 13 (2013), there has not been an appreciable change in long Canada bond yields and bond forecasts do not appear to indicate that a return to more normal long Canada bond yields is imminent.

Reference: Company Evidence (1st Revision), page 4-41, lines 13-21.

Both Mr. Coyne and Dr. Booth agree that the Board should not reinstate the Formula for Newfoundland Power at this time.

Reference: Concentric Evidence, page 32, line 10 to page 33, line 17; and Booth Evidence, page 69, line 1 to page 70, line 11.

7. UNCOLLECTIBLE BILLS

It has been agreed that the Company's forecast uncollectible bills expense of $1,310,000 for 2016 and $1,337,000 for 2017 are reasonable for rate setting purposes.

The parties also agreed that changes in uncollectible bills expense in 2016 and/or 2017 as a result of the Hydro RSP Surplus refund will be addressed within the RSP Surplus refund process on the basis that the Applicant should neither benefit nor lose from the administration of the RSP Surplus refund.

The Parties further agreed that any recovery through the Hydro RSP Surplus refund of an amount written off as bad debt prior to 2016 will be addressed within the RSP Surplus process to ensure that the benefit of the recovery of any past amount is credited to customers.

Reference: Settlement Agreement, Items 20 and 21.

Evidence Before the Board:

In 2015, uncollectible bills expense totaled approximately $1.3 million. This represents approximately 0.20% of 2015 revenue. The Company attributes this increase to changing economic conditions. This level of uncollectible bills is not unprecedented. For example, in 1996, uncollectible bills represented approximately 0.4% of revenue.

Reference: Company Evidence (1st Revision), page 2-9, line 16 to page 2-10, line 3.

The Company's 2015, 2016 and 2017 operating costs, which include forecast uncollectible bills expense as a percentage of revenue from rates, do not appear unreasonable on an overall basis.

Reference: Grant Thornton Report: page 36, lines 4-16.

Appendix B
2016/2017 Return on Equity and Equity Ratio
Summary of Expert Recommendations

Expert Witness	**Coyne**	**Booth**	**Cleary**
Recommended Return on Equity	**9.50%**	**7.50%**	
Test Results			
1. Market Risk Premium			
Risk-Free Rate	3.68% - 4.29%[1]	2.81%[2]	
Beta	0.64 - 0.73[3]	0.45 - 0.55[4]	
Market Risk Premium	7.62%[5]	5.00% - 6.00%[6]	
Indicated Cost of Equity	8.54% - 9.87%[7]	5.06% - 6.11%[8]	
Allowance for Financing Flexibility	0.50%[9]	0.50%[10]	
Other Adjustments	-	1.75%[11]	
Indicated Fair Return on Equity	**9.04% - 10.37%**[12]	**7.31% - 8.36%**[13]	
2. Discounted Cash Flow			
Indicated Cost of Equity	8.94% - 11.05%[14]	8.38% - 8.91%[15]	
Allowance for Financing Flexibility	0.50%[16]	0.50[17]	
Indicated Cost of Equity Before Other Adjustments[18]	9.44% - 11.55%	8.88% - 9.41%	
Other Adjustments	-	(1.88%) - (1.91%)[19]	
Indicated Fair Return on Equity	**9.44% - 11.55%**[20]	**7.0% - 7.5%**[21]	
Equity Ratio	**45%**[22]	**40%**[23]	**40%**[24]

[1] Coyne Evidence, page 27, Figure 11. Mr. Coyne uses a risk free rate of 3.68% for Canadian utilities and a risk free rate of 4.29% for U.S. utilities.

[2] Booth Evidence, page 25, lines 15 – 17.

[3] Coyne Evidence, Exhibit JMC-8, column 3. Mr. Coyne uses average betas of 0.64, 0.73 and 0.72 for the Canadian, U.S. and North American Electric proxy groups, respectively.

[4] Booth Evidence, page 42, lines 2 – 3.

[5] Coyne Evidence, page 29, Figure 13. Mr. Coyne's 7.62% market risk premium is an average of Canadian and U.S. market risk premiums, both on a historical and forward-looking basis.

[6] Booth Evidence, page 40, lines 25 – 26.

[7] Coyne Evidence, page 31, Figure 14. The Indicated Cost of Equity in the table excludes the 0.50% flotation cost allowance.

[8] Booth Evidence, page 42, lines 10 – 12. The Indicated Cost of Equity in the table excludes the 0.50% flotation cost allowance.

[9] Coyne Evidence, page 31, lines 18 – 19.

[10] Booth Evidence, page 42, lines 6 – 9.

[11] This is a combination of Dr. Booth's credit spread adjustment of 0.45% and "Operation Twist" adjustment of 1.30%. See Booth Evidence, page 45, lines 11 – 14 and page 51, lines 1 – 2.

[12] Coyne Evidence, page 31, Figure 14. Mr. Coyne CAPM results indicate average fair returns of 9.04%, 10.37% and 10.12% for the Canadian, U.S. and North American Electric proxy groups, respectively.

[13] Booth Evidence, page 51, lines 3 – 5.

[14] Coyne Evidence, page 25, Figure 9. The Indicated Cost of Equity in the table excludes the 0.50% flotation cost allowance.

[15] Booth Evidence, page 65, lines 22 – 24. Based on Dr. Booth's U.S. utility sample.

[16] Coyne Evidence, page 31, lines 18 – 19.

[17] Booth Transcript, April 8th, 2016, page 87, line 23 to page 90, line 3.

[18] Indicated Cost of Equity + Allowance for Financing Flexibility.

[19] Booth Evidence, page 65, lines 24 – 28. Dr. Booth adjusts his DCF indicated cost of equity for his U.S. utility sample for (i) "the known optimism of analyst forecasts and using growth rates that are sustainable" and (ii) "to be consistent with fair regulation and a market to book ratio of 1.15". These adjustments result in an indicated fair return of 7.15%. Overall, Dr. Booth estimates the fair return for a U.S. utility to be approximately 7.0% – 7.5%. See Booth Evidence, Appendix D, page 21, lines 21 - 22. The "Other Adjustments" shown in the table are calculated as follows:

Low end: Indicated Fair Return on Equity of 7.0% minus the Indicated Cost of Equity Before Other Adjustments of 8.88% = (1.88%).

High end: Indicated Fair Return on Equity of 7.5% minus the Indicated Cost of Equity Before Other Adjustments of 9.41% = (1.91%).

[20] Coyne Evidence, page 25, Figure 9. Mr. Coyne DCF results indicate average fair returns of 11.55%, 9.61% and 9.44% for the Canadian, U.S. and North American Electric proxy groups, respectively.

[21] Booth Evidence, Appendix D, page 21, lines 21 – 22.

[22] Coyne Evidence, Appendix A, page 32, lines 5 – 7.

[23] Booth Evidence, page 3, lines 16 – 22. Dr. Booth recommends a reduction in Newfoundland Power's common equity ratio to 40% and the 5% equity reduction to be deemed using Fortis' cost of preferred shares until the next rate hearing.

[24] Cleary Evidence, page 2, lines 28 – 30.