



NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES
120 Torbay Road, P.O. Box 21040, St. John's, Newfoundland and Labrador, Canada, A1A 5B2

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2016-02-26

Mr. Thomas Johnson
O'Dea Earle
323 Duckworth Street
P.O. Box 5955
St. John's, NL A1C 5X4

Dear Mr. Johnson:

**Re: Newfoundland Power Inc. – 2016-2017 General Rate Application
Requests for Information – Expert Evidence**

Enclosed are Information Requests PUB-CA-001 to PUB-CA-031 regarding the above-noted application.

If you have any questions, please do not hesitate to contact the Board's Legal Counsel, Ms. Jacqui Glynn, by email, jglynn@pub.nl.ca or telephone (709) 726-6781.

Yours truly,


Sara Kean
Assistant Board Secretary

/cpj
Encl.
ecc.

Newfoundland Power Inc

Mr. Peter Alteen, QC, E-mail: palteen@newfoundlandpower.com

Mr. Gerard Hayes, E-mail: ghayes@newfoundlandpower.com

Mr. Ian Kelly, QC, E-mail: ikelly@curtislaw.com

Newfoundland and Labrador Hydro

Mr. Geoff Young, E-mail: gyoung@nlh.nl.ca

NLH Regulatory, E-mail: NLHRegulatory@nlh.nl.ca

Consumer Advocate

Ms. Colleen Lacey, E-mail: clacey@odeaearle.ca

1 **IN THE MATTER OF**

2 the *Electrical Power Control Act, 1994*,
3 SNL 1994, Chapter E-5.1 (the "*EPCA*")
4 and the *Public Utilities Act*, RSNL 1990,
5 Chapter P-47 (the "*Act*"), as amended; and
6

7 **IN THE MATTER OF** a general rate
8 application filed by Newfoundland Power
9 Inc. on October 16, 2015.

**PUBLIC UTILITIES BOARD
REQUESTS FOR INFORMATION**

PUB-CA-001 to PUB-CA-031

Issued: February 26, 2016

Direct Testimony of Dr. Laurence Booth dated February 2016

PUB-CA-001 Page 5: Please explain in detail the basis for the 3.8% trigger for the forecast long Canada bond yield referred to in lines 4-5.

PUB-CA-002 Page 42: Dr. Booth uses the consensus forecast of 2.81% for the average long term Canadian bond yield for 2016 in his "simple" CAPM fair return estimate for 2016. Mr. Coyne, in his evidence, page 27, states that his CAPM analysis relies on the 2016 to 2018 average Consensus Economics forecast and, at page 35, stated that this forecasted Canadian risk free rate is one of the adjustments he makes to compensate for concerns on the ability of CAPM to produce reasonable results without adjustment in the current market environment. Is Dr. Booth of the opinion that a forecast for the average long term bond yield over the period 2016 to 2018 is one of the appropriate adjustments that can be made to the "simple" CAPM estimate to adjust for the current market conditions?

PUB-CA-003 Page 43: Dr. Booth states that he makes two adjustments to his "simple" CAPM estimate to adjust for current market conditions. The first is to add a 50% adjustment for credit spreads. Is Dr. Booth aware of any Canadian regulator that has applied or considered the application of a credit spread adjustment in their allowed ROE conclusions? If yes, please provide details of such decision.

PUB-CA-004 Page 51: Dr. Booth's second adjustment for his CAPM estimate is to add a 1.3% spread as a current "Operations Twist" adjustment. Is Dr. Booth aware of any Canadian regulator that has applied or considered applying such an adjustment in their ROE conclusions? If yes, provide details of such decision.

PUB-CA-005 At page 34 of this evidence Mr. Coyne states that he has "*concerns with the ability of CAPM to produce reasonable results without adjustments for the current market environment*" and further that he "*attempted to compensate for these concerns by using forward-looking inputs, including a forecasted Canadian risk-free rate, an MRP that combines both Canadian and U.S. market inputs, including both historic and forward-looking estimates, and the adjusted beta coefficient for the Canadian and U.S. proxy companies*". Please provide Dr. Booth's opinion as to whether each of the adjustments made by Mr. Coyne in his analysis is appropriate to adjust for current market conditions.

PUB-CA-006 Page 43: Dr. Booth states that CAPM is appropriate under "normal" or average markets and that at the current point in time conditions in the Canadian bond market are being driven by external factors so these are still not "average" requiring adjustments to be made in the inputs of CAPM. Has Dr. Booth considered any adjustment other than his credit spread and Operations Twist adjustments that might also be used to make adjustments to reflect market conditions? If yes, what adjustments were considered and rejected? If not, why not?

- 1 **PUB-CA-007** Page 51: Dr. Booth recommends an ROE of 7.5% for a benchmark utility.
 2 Please explain what is meant by a benchmark utility and whether it is an
 3 overall average risk utility.
 4
- 5 **PUB-CA-008** Page 51 and page 65: The mid-point of the range of the CAPM estimate, after
 6 adjustments for credit spreads and Operations Twist is 7.83%, however, Dr.
 7 Booth recommends an ROE of 7.5%. Please explain in further detail why Dr.
 8 Booth believes it is appropriate to be "conservative" and reduce the
 9 recommended ROE to 7.5%.
 10
- 11 **PUB-CA-009** Page 51: Dr. Booth's recommendation of an ROE of 7.5% for a benchmark
 12 utility is considerably lower than the current allowed ROE's of Canadian
 13 investor-owned utilities. Please explain whether this is an indication that your
 14 recommended ROE is not reflective of regulators' assessment of the fair return
 15 or ROE for Canadian utilities in the current market conditions.
 16
- 17 **PUB-CA-010** Page 52: Dr. Booth states that "*the big advantage of the CAPM is that it is*
 18 *difficult to make big mistakes*". What does Dr. Booth consider is the range of
 19 "mistakes" that wouldn't be "big"?
 20
- 21 **PUB-CA-011** Page 52 and page 65: Explain in what manner Dr. Booth believes that the DCF
 22 method and DCF estimates should be considered by the Board in establishing
 23 the fair return for Newfoundland Power, for example should it be given equal
 24 weight with the adjusted CAPM result?
 25
- 26 **PUB-CA-012** Page 65: Dr. Booth adjusts the DCF equity cost down for "*the known optimism*
 27 *of analyst forecasts*". Explain how Dr. Booth determined what the appropriate
 28 adjustment should be to account for this optimism.
 29
- 30 **PUB-CA-013** Page 66: Explain in what manner Dr. Booth believes that U.S data should be
 31 considered by the Board in evaluating results from the DCF method and in
 32 setting a fair return generally.
 33
- 34 **PUB-CA-014** Page 70: Dr. Booth does not recommend that the Automatic Adjustment
 35 Formula be re-instituted at this time. Does he believe that there are other
 36 appropriate considerations for the fair return that could be implemented that
 37 would trigger a hearing to review the return?
 38
- 39 **PUB-CA-015** Pages 80-83: Dr. Booth considers the long run risks of higher electricity costs
 40 for Newfoundland and Labrador Hydro (a risk factor raised by Mr. Coyne and
 41 Newfoundland Power) and concludes on page 84 that there is no material
 42 change in business risk, however, Dr. Booth does not discuss the power supply
 43 risk which is highlighted by Mr. Coyne (pages 15-16 of Appendix A of his
 44 evidence) and Newfoundland Power (Application pages 4-29 to 4-30). How
 45 does the uncertainty in power supply from Newfoundland and Labrador Hydro

1 raised by Mr. Coyne and Newfoundland Power affect Dr. Booth's assessment
2 of Newfoundland Power's business risk?

3
4 **PUB-CA-016** Page 96: Dr. Booth recommends that Newfoundland Power's common equity
5 component be reduced by 5% from the currently approved 45%. Please list any
6 changes that have occurred since 2009 that would indicate that the level of
7 common equity approved at that time is no longer appropriate.
8

9 **PUB-CA-017** Page 96: Please explain in detail why Dr. Booth is recommending that 5%
10 common equity be replaced with preferred shares only as an interim step.
11

12 **PUB-CA-018** Pages 99-101: Dr. Booth provides analysis of the impact on Newfoundland
13 Power's interest coverage if its common equity is reduced to 40% as
14 recommended and at page 101 states that all the values indicated are
15 "*consistent with maintaining the financial integrity of NP*". In Dr. Booth's
16 opinion what reduction in interest coverage would there have to be for a
17 concern on Newfoundland Power's financial integrity to arise?
18

19 **Direct Evidence of Dr. Sean Cleary dated February 17, 2016**
20

21 **PUB-CA-019** Page 18: Dr. Cleary states that Newfoundland Power operates "*in an extremely*
22 *supportive regulatory environment, which represents a big strength in terms of*
23 *minimizing its business risk*". In Dr. Cleary's opinion what impact would a
24 decision by the Board that Newfoundland Power's common equity be reduced
25 to 40% and its allowed return on equity be reduced to 7.5% have on his
26 assessment that the regulatory environment is "*extremely supportive*"?
27

28 **PUB-CA-020** Further to PUB-CA-019 please discuss the likely impact of such a Board
29 decision on DBRS's and Moody's view of the supportive regulatory
30 environment in Newfoundland and Labrador.
31

32 **PUB-CA-021** Page 20: Dr. Cleary states that the evidence suggests that Newfoundland
33 Power "*can be expected to weather this economic decline, just as it has in the*
34 *past*". During the historical record on which this statement is based,
35 Newfoundland Power's approved return on equity and capital structure would
36 have been significantly more than 7.5% and 40% (which are recommended in
37 this proceeding). What consideration, if any, should be given to the impact of a
38 reduced return and equity in its capital structure on Newfoundland Power's
39 ability to "weather" the current economic forecast for Newfoundland for 2016
40 to 2018?
41

42 **PUB-CA-022** Pages 22-23: Dr. Cleary refers to weather related risk in his assessment of
43 Newfoundland Power's business risk but does not refer to the cost uncertainty
44 in power supply arising from the Muskrat Falls project referred to by
45 Newfoundland Power on pages 4-29 to 4-30 of its Application, and page 10

and pages 15-17 of Mr. Coyne's evidence. How did Dr. Cleary consider this factor in his assessment of Newfoundland Power's business risk?

PUB-CA-023 Pages 22-23: Dr. Cleary refers to weather related risk in his assessment of Newfoundland Power's business risk but does not refer to power supply reliability risk referred to by Newfoundland Power on page 4-30 of its Application and by Mr. Coyne on page 16 of his evidence. How did Dr. Cleary consider this risk in his assessment of Newfoundland Power's business risk?

PUB-CA-024 Page 25-26: Please confirm that the utilities included in the U.S. Groups and the Canadian Group in Figures 7 and Table 8 are the same.

PUB-CA-025 Page 26: Please explain the basis for the selection of the utilities in the U.S and Canadian Groups in Table 8 and their comparability to Newfoundland Power for the purpose of assessing Newfoundland Power's business risks.

PUB-CA-026 Page 28-30: Is Dr. Cleary of the opinion that all the companies listed in Tables 9 and 10 are directly comparable to Newfoundland Power in the consideration of its overall risks, its appropriate return and its capital structure? In the response describe any factors that are materially different between each company listed and Newfoundland Power.

PUB-CA-027 Page 31: Please explain in detail the basis for the selection of the companies listed in Table 11 and how Dr. Cleary determined they were appropriate comparables to Newfoundland Power.

PUB-CA-028 Page 32: Dr. Cleary states that the data in Exhibit 3 of Newfoundland Power's Application was used to construct the base case for 2013-2017 shown in Table 13. Please provide the calculations to demonstrate how the Exhibit 3 data was used in the derivation of Table 13 numbers.


PUB-CA-029 Page 34, lines 2-4: Dr. Cleary concludes that Newfoundland Power is a below-average-to-average business risk Canadian utility and has lower financial risk. On page 37 it is stated that Newfoundland Power has "*low business risk, similar or slightly lower than for similar Canadian firms*". Please clarify what is Dr. Cleary's overall assessment of Newfoundland Power risk, that is, is it an overall average risk Canadian utility or is it below-average risk in his opinion?

PUB-CA-030 Page 36: Dr. Cleary states that Newfoundland Power's credit metrics "would remain solid" if its allowed equity ratio was reduced to 40% and its allowed return on equity was reduced to 7.5%. What, in Dr. Cleary's opinion, would be the change in the allowed return required at 40% common equity to cause Newfoundland Power's credit metrics to cause concern?

PUB-CA-031 Is Dr. Cleary aware of any Canadian regulated utility that currently has an allowed return on equity of 7.5% or 8%?

DATED at St. John's, Newfoundland this 26th day of February, 2016.

BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

Per 
Sara Kean
Assistant Board Secretary