Q. Section 4(i) of the Electrical Power Control Act (EPCA) requires that rates should provide sufficient revenue to the producer or retailer of the power to enable it to earn a just and reasonable return as construed under the Public Utilities Act so that it is able to achieve and maintain a sound credit rating in the financial markets of the world. Provide evidence (if any exists) to demonstrate that the forecast return on equity for 2016 and 2017 will present a risk to the credit ratings of Newfoundland Power.

A. *Exhibit 4,* in *Volume 2, Exhibits & Supporting Materials,* shows Newfoundland Power's current credit ratings from Moody's and DBRS. As outlined in the *Company Evidence, Section 4: Finance*, Newfoundland Power's credit ratings are influenced by a number of factors, including credit metrics, financial metrics such as capital structure, and regulatory considerations such as the regulatory framework and the ability to recover costs and earn returns.[1]

Table 4-11 in the *Company Evidence, Section 4: Finance*, shows Newfoundland Power's actual and forecast rates of return on common equity from 2013 to 2017 under current customer rates. Under current customer rates, the rate of return on common equity is forecast to decline from 9.16% in 2013 to 7.22% in 2017. A return on common equity of 7.22% is well below current Canadian and U.S. allowed returns for regulated utilities. It is clear from *Exhibit 4* that the credit rating agencies which rate Newfoundland Power consider the existing supportive regulatory environment as a credit strength. If the Board were to allow returns on equity well below current North American norms, there is a risk that the credit rating agencies may take a more negative view on the regulatory environment. This, in turn, would increase the risk to Newfoundland Power's existing credit ratings.

Table 4-12 in the *Company Evidence, Section 4: Finance*, shows Newfoundland Power's actual and forecast credit metrics from 2013 to 2017 under current customer rates. Under current customer rates, pre-tax interest coverage is forecast to decline from 2.3 times in 2013 through 2015 to 2.1 times in 2017. Similarly, cash flow debt coverage is forecast to decline from 20.1% in 2013 to 16.9% in 2017. The erosion of Newfoundland Power's credit metrics increases the risk to existing credit ratings.

The *Company Evidence, Section 4: Finance*, outlines how the Board has interpreted the utility entitlement to a just and reasonable return under the *Public Utilities Act* (referred to in the question) in a manner consistent with the fair return standard. The evidence shows at page 4-19, *et. seq.* that the Board has indicated that the attributes of a fair utility return include that it be (i) commensurate with return on investments of similar risk, (ii) sufficient to ensure financial integrity, and (iii) sufficient to attract necessary capital. A forecast return on common equity of 7.22% would not meet the just and reasonable return standard required under Section 3(a)(iii) of the *Electrical Power Control Act, 1994*.

[1] See *Company Evidence, Section 4: Finance,* page 4-14 *et seq* and page 4-41 *et seq.*.