

1 **Q. Page 18: Dr. Cleary states that Newfoundland Power operates "in an**
2 **extremely supportive regulatory environment, which represents a big strength in**
3 **terms of minimizing its business risk". In Dr. Cleary's opinion what impact would a**
4 **decision by the Board that Newfoundland Power's common equity be reduced to**
5 **40% and its allowed return on equity be reduced to 7.5% have on his assessment**
6 **that the regulatory environment is "extremely supportive"?**

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8 A. The quotes from the DBRS and Moody's reports provided on page 18 of Dr.
9 Cleary's evidence both allude to the fact that both DBRS and Moody's listed regulatory
10 support as a strength of NP. The quoted passages on page 18 refer to several factors that
11 DBRS and Moody's viewed as evidence of how the PUB is supportive including, but not
12 limited to:

13 • DBRS noted the effectiveness of the following mechanisms that are in
14 place to smooth out the effects of various expenses and events: weather
15 normalization reserve (WNR); rate stabilization account (RSA); demand
16 management incentive account (DMIA); and, the pension expense variance
17 deferral account (PEVDA).

18 • DBRS concluded that NP operates in a regulatory framework that "allows
19 Newfoundland Power to recover all prudently spent operating expenses and earn a
20 reasonable return."

21 • Moody's also referred to the pass through mechanisms mentioned by
22 DBRS above and also notes that they consider the Public Utility Board (PUB) to
23 be "supportive with a track record of reasonably timely and balanced decisions
24 that enable NPI to generate stable cash flow and earn its allowed ROE and are not
25 directly subject to political considerations."

26 • Moody's also noted that the "PUB's review and approval of NPI's capital
27 spending plans and long-term debt issuances significantly reduce the risk of cost
28 disallowances and support NPI's ability to fully recover costs on a timely basis."

1 None of the factors noted above would change if the allowed equity ratio (ER) or
2 allowed ROE were lowered. Since operating profit stability is a function of the ability
3 of companies to deal with unforeseen revenue disruptions and costs, and in
4 recovering legitimate expenses and capital expenditures, all in a timely matter, NP's
5 regulatory environment rates highly on these factors. The fact that Dr. Cleary's
6 evidence documents that NP has such low volatility in revenues and operating income
7 support this conclusion. So does the fact that NP has earned its allowed ROE or
8 higher for the last 19 years consecutively.

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10 Reducing the ER to 40 percent would merely bring NP "in line" with other Canadian
11 utilities, and in fact, this would still be slightly above average; and therefore on the
12 conservative side. NP's metrics would remain solid and in line to maintain their
13 existing credit ratings, so Dr. Cleary sees no reason to view this adjustment as being
14 unsupportive. Rather I would view it as a reaction to the existing environment in the
15 normal course of reviewing allowable ROEs and ERs in response to all evidence
16 submitted, which is the purpose for having such hearings. In short, Dr. Cleary does
17 not accept the implications of NP that the Board should never reduce the ER since it
18 has been at 45% for so long, because such a decision should be viewed as less than
19 supportive.

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21 For example, NP's parent holding company Fortis Inc. has only 36 percent common
22 equity as of September 30, 2015.¹ Yet, Fortis Inc. arguably has more risk exposure at
23 the consolidated level, since it includes non-regulated activities, including non-
24 regulated generation exposure. In contrast, NP is a regulated distributor operating a
25 virtual monopoly with the ability to pass legitimate costs and capital expenditures on
26 to customers through a traditional cost-of-service environment, with various
27 established pass-through mechanisms in place.

¹ Source: Fortis Inc., Q3 Interim Report, September 30, 2015, page 25.

1 While Dr. Cleary has not been asked to comment directly on NP's allowed ROE, he
2 would note that allowed ROEs by regulators have been declining in recent decisions
3 in reaction to low interest rates and the resulting low borrowing rates by utilities,
4 which have lowered their cost of capital. Therefore, Dr. Cleary does not see that
5 making such adjustments would change his view that NP's regulatory environment is
6 extremely supportive. Dr. Cleary's analysis of NP's credit metrics under various ROE
7 scenarios reinforces his opinion, since it indicates that NP's credit metrics would
8 remain solid if allowed ROEs were reduced.

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10 Dr. Cleary's opinions expressed above, find further support in his response to PUB-
11 CA-20, which addresses the impact of such decisions on the views of debt rating
12 agencies.

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