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

A. Dr. Cleary notes that allowed ROEs and ERs that would have been prevailing over the historical period (1995-2014) to which his evidence refers, would have been the result of evidence based on capital market conditions and NP's operating conditions in existence at that point in time. For example, the allowed ROE for NP over this period declined from 13.25% in 1995 (down from 13.95% in 1991 – the year in which the Bank of Canada introduced its 2% inflation target) to 8.80% in 2014, representing a decrease of more than 33%. Despite this decline in allowed ROEs, NP's revenues grew in every year except 1998, including the six years where NL's GDP growth was negative. As a result of this steady growth, NP's revenues grew at an average rate of 3.4% versus NL's average GDP growth rate of 2.5% over the period. In addition, NP earned its allowable ROE or higher in the last 19 consecutive years of this period, providing even stronger evidence of its resiliency.

Certainly, 13.25% seems a far-fetched ROE in today's low interest rate environment, which has led to a corresponding decline in utilities' cost of debt. For example, Table 1 of NP's response to CA-NP-305 shows that the issuing yield NP bonds had declined to 5.44% and 5.90% by the pre-financial crisis years of 2005 and 2007 respectively. After an increase in May of 2009, which was in the midst of the financial crisis fallout period, the issuing yield on NP bonds continued their trend downwards, hitting 4.805% in 2013, and 4.445% in September, 2015. Not only has this reduced their interest expenses, the drop in NP's borrowing costs is reflective of a corresponding decline in the borrowing costs of utilities in general. This in turn is reflective of a decrease in the ROEs of utilities, which has been reflected in the general trend of reducing allowed ROEs, which was discussed in PUB-CA-19 and PUB-CA-20.

In short, Dr. Cleary notes that previous significant decreases in allowed ROEs did not affect NP's ability to grow revenues and earn allowable ROEs despite downturns in the NL economy. This is because such reductions were based on changes in market conditions and NP's operating conditions, based on available evidence at such times in the past. Therefore, Dr. Cleary has no reason to believe that NP's performance would be less than resilient to changes to allowed ROEs and ERs based on existing evidence today.