Q. **(Application Volume 1, page 3-23) It is stated *The principal risks to which Newfoundland Power is exposed have not changed materially since 2018*.**

a) Is it accurate to say that the impacts of these risks would manifest themselves largely through changes in the volume of NP's sales?

b) If NP's volume of sales fell substantially below its forecast, what recourse, if any, would it have to recover any consequent reductions in earnings?

A. a) The risks outlined in Newfoundland Power's cost of capital evidence can challenge the Company's opportunity to earn a just and reasonable return from 2 primary perspectives.

The first perspective is through a decline in revenue that would materialize through declines in energy sales. For example, risks associated with the province's challenging economic conditions would primarily materialize through declines in energy sales.[1] This is consistent with Newfoundland Power's recent experience, as energy sales have declined annually since 2016.[2]

The second perspective is through unpredictability in costs and reduced flexibility to manage those costs. For example, unpredictability in costs can result from the requirement to mobilize the Company's workforce in response to customer outages due to the harsh environment in which Newfoundland Power operates. This occurred in January 2020 when the Company incurred approximately $1 million in costs in response to a severe blizzard.[3]

The Company's flexibility to manage unpredictable costs has been reduced. Operating costs are most directly within management's control. These costs now comprise a smaller proportion of revenue on a cents/kWh basis than they did 2 decades ago.[4] Fixed costs and purchased power costs, which are largely outside of management's control in any given year, now comprise a greater proportion of revenue.

Newfoundland Power's small size also limits the Company's financial flexibility in managing its costs. The Board has previously recognized that a strong equity component is needed to mitigate the impact of the Company's relatively small size and low growth potential.[5]

Certain risks can affect both Newfoundland Power's revenues and its costs. The continued decline of the provincial population could be expected to reduce the Company's energy sales. The continued concentration of the province's

[1] See the *2022/2023 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Section 3: Finance, Provincial Economy,* page 3-23 *et seq.*
[2] Ibid., *Energy Sales,* page 3-30 *et seq.*
[3] Ibid., page 3-39, footnote 98.
[4] Ibid., *Cost Flexibility,* page 3-35 *et seq.*
[5] Ibid., *Small Size,* page 3-37.

population in urban areas could be expected to exert pressure on costs required to maintain reliable service for a declining number of customers across a vast, geographically dispersed service territory.[6]

Risks associated with the Muskrat Falls Project also pose risks to both Newfoundland Power's revenues and its costs. Increases in customer rates due to the Muskrat Falls Project could be expected to result in lower energy sales. Ongoing concerns regarding the reliability of supply from the Muskrat Falls Project pose risks of unpredictable costs resulting from a loss of supply and associated requirements to mobilize the Company's workforce to restore service to customers.[7]

Based on the foregoing, no, it is not accurate to say that the impacts of the risks outlined in Newfoundland Power's cost of capital evidence would manifest themselves largely through changes in the volume of sales.

b) In a given year, Newfoundland Power bears the risk of changes in earnings due to volatility in sales.

For future years, a revision to the sales forecast underpinning customer rates would require an application to the Board and a determination by the Board that the revised forecast is reasonable and prudent and necessary for Newfoundland Power to earn a just and reasonable return.[8]

6 Ibid., *Service Territory Demographics*, page 3-25 *et seq.*
7 Ibid., *Muskrat Falls*, page 3-31 *et seq.*
8 Section 3(a)(ii) of the *Electrical Power Control Act, 1994* requires that customer rates should be established, wherever practicable, based on forecast costs.