

1      **Q. Please confirm the Board approved on a final basis a cost deferral account to be**  
2      **charged with the full amount of the difference in 2012 revenue between an 8.38%**  
3      **return on common equity and an 8.80% return on common equity calculated on the**  
4      **basis of 2010 test year costs. If confirmed, please explain why it was appropriate**  
5      **that this cost deferral be approved on a final basis without a full testing of**  
6      **Newfoundland Power's costs in 2012.**

7      A. It is so confirmed.

10     ***Background***

12     In Order No. P.U. 43 (2009), the Board ordered the continued use by Newfoundland  
13     Power of an automatic adjustment formula (the “AAF”) to reflect changes in  
14     Newfoundland Power’s cost of equity in Newfoundland Power’s rate of return on rate  
15     base for 2011 and 2012. The AAF operated annually in a manner which is conceptually  
16     consistent with the operation of Newfoundland and Labrador Hydro’s (“Hydro”) rate  
17     stabilization plan (the “RSP”).

19     The primary difference between the AAF and RSP is that the AAF made annual  
20     adjustments for Newfoundland Power’s cost of equity and the RSP makes annual  
21     adjustments for Hydro’s cost of fuel at Holyrood. Both the AAF and RSP adjust  
22     customer rates to reflect annual changes in the cost of equity or fuel in the context of the  
23     most current test year parameters approved by the Board. Such regulatory mechanisms,  
24     which provide for annual adjustments for specified utility costs, are commonplace in  
25     Canadian utility practice.

27     In November 2011, when it was apparent to management at Newfoundland Power that  
28     the operation of the AAF for 2012 would reflect a return on equity of 7.85%, the  
29     Company applied to reconsider, and suspend operation in 2012 of, the AAF. In support  
30     of this application, Newfoundland Power filed expert opinion. Subsequently, expert  
31     opinion was filed by the Consumer Advocate. In Order No. P.U. 25 (2011), the Board  
32     suspended operation of the formula for 2012 and ordered continued use of Newfoundland  
33     Power’s then current customer rates on an interim basis with effect from January 1, 2012.

35     In March 2012, Newfoundland Power filed an application with the Board to approve a  
36     just and reasonable return on rate base for 2012, discontinue further use of the AAF, and  
37     approve customer rates to reflect a revised return on rate base. In support of this  
38     application, Newfoundland Power filed comprehensive evidence, including expert  
39     evidence. The Consumer Advocate also filed expert evidence.

41     On June 5<sup>th</sup>, 2012 a settlement agreement between the Consumer Advocate and  
42     Newfoundland Power which was facilitated by Board Hearing Counsel was reached on  
43     the issues of the Company’s 2012 return. This settlement provided for (i) a 2012  
44     regulated return on equity of 8.8% to be used to determine the Company’s 2012 return on

1       rate base and (ii) deferred recovery of an additional revenue requirement for 2012 of  
2       approximately \$2.5 million, representing the difference in return on equity between 8.8%  
3       and 8.38% (the amount reflected in the Company's interim rates). The approximately  
4       \$2.5 million was calculated on the basis of 2010 test year costs which were approved by  
5       the Board. In Order No. P.U. 17 (2012), the Board approved the terms of the settlement  
6       agreement, including the deferred recovery.

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8       ***Appropriateness of Board Approval***

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10      The Board approval of the deferred recovery by Newfoundland Power of the \$2.5 million  
11      in 2012 revenue, which reflected the difference between an 8.38% and 8.8% return on  
12      equity was appropriate for a number of reasons, including:

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14      1. the Board had comprehensive expert cost of capital evidence before it indicating an  
15       appropriate return on equity for Newfoundland Power for 2012, including over 300  
16       responses to Requests for Information;

17      2. the amount which the Board approved for deferred recovery by Newfoundland Power  
18       was calculated on the basis of 2010 test year costs;

19      3. the deferred recovery was consistent with the Board's clear intention in Order No.  
20       P.U. 46 (2009) that Newfoundland Power's return on rate base be changed in 2011  
21       and 2012 to reflect market changes in the Company's cost of equity; and

22      4. the deferred recovery reflected a settlement agreement between the Consumer  
23       Advocate and Newfoundland Power which was facilitated by Board Hearing Counsel.