NEWFOUNDLAND POWER
A FORTIS COMPANY

Newfoundland Power Inc.

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DELIVERED BY HAND

February 5, 2013

Board of Commissioners
of Public Utilities
P.O. Box 21040
120 Torbay Road
St. John's, NL A1A 5B2

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

Ladies and Gentlemen:

Re: 2013/2014 General Rate Application

Enclosed are the original and twelve copies of Newfoundland Power's Written Submissions.

A copy of this letter, together with copies of the enclosure, have been forwarded directly to Thomas Johnson, Consumer Advocate and Geoffrey Young, Newfoundland and Labrador Hydro.

Respectfully submitted,

Peter Alteen
Vice President,
Regulation & Planning

Enclosures

c. Thomas Johnson (3 copies)
Consumer Advocate

Geoffrey Young (1 copy)
Newfoundland and Labrador Hydro

Written Submissions

February 2013

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1. DEFINED TERMS

Term	Reference
ALG	Average Life Group Procedure
Application	Newfoundland Power's Application to the Board of Commissioners of Public Utilities, filed September 14, 2012.
AUC	Alberta Utilities Commission, formerly the Alberta Energy and Utilities Board
BCUC	British Columbia Utilities Commission
Board	Newfoundland and Labrador Board of Commissioners of Public Utilities
Booth Evidence	Pre-filed Evidence of Laurence D. Booth, Fair Return for Newfoundland Power, November 2012.
Canadian GAAP	Canadian Generally Accepted Accounting Principles, prior to January 1, 2012.
CAPM	Capital Asset Pricing Model
Company Evidence	Newfoundland Power's Evidence, September 14, 2012.
Company Rebuttal Evidence	Newfoundland Power's Rebuttal Evidence, December 14, 2012.
Conservation Plan	The Five Year Energy Conservation Plan: 2012-2016, September 2012, Volume 2, Tab 1 of Exhibits and Supporting Materials of Newfoundland Power filed September 14, 2012.
Cost of Service Study	Newfoundland Power's Cost of Service Study, July 2012, Volume 2, Tab 5 of Exhibits and Supporting Materials of Newfoundland Power filed September 14, 2012.
Customer, Energy and Demand Forecast	Newfoundland Power's Customer, Energy and Demand Forecast, August 2012, Volume 2, Tab 4 of Exhibits and Supporting Materials of Newfoundland Power filed September 14, 2012.

Term	**Reference**
DBRS	Dominion Bond Rating Service
DCF	Discounted Cash Flow
Depreciation Study	Gannett Fleming Inc. Depreciation Study, Calculated Annual Depreciation Accruals Related to Electric Plant at December 31, 2010, Volume 3, Expert Evidence and Studies, Tab *Depreciation Study Gannett Fleming Inc*. of Newfoundland Power, filed September 14, 2012.
ELG	Equal Life Group Procedure
Electrical Power Control Act, 1994	Electrical Power Control Act, 1994, SNL 1994, c.E-5.1.
ERP	Equity Risk Premium
Formula	The Automatic Adjustment Formula
Grant Thornton Report	Grant Thornton Report, *Board of Commissioners of Public Utilities Financial Consultants Report Newfoundland Power Inc. 2013-2014 General Rate Application Hearing*, November 9, 2012, filed as Consent #2.
Hydro	Newfoundland and Labrador Hydro
Long Canada Bond Yields	Yields of Government of Canada 30 year benchmark bonds.
MacDonald Evidence	Opinion on Capital Structure, Return on Equity and the Automatic Adjustment Formula for Newfoundland Power Inc., Troy MacDonald, Grant Thornton, LLP, November 2012.
McShane Evidence	Pre-filed Evidence of Kathleen McShane, Opinion on Capital Structure and Fair Return on Equity, September 2012, Volume 3, Expert Evidence and Studies, Tab *Cost of Capital: Ms. Kathleen McShane* for Newfoundland Power Inc., filed September 14, 2012.
Moody's	Moody's Investors Service
NEB	National Energy Board

Term	**Reference**
OEB	Ontario Energy Board
OPEBs	Other Post Employee Benefits
Pous Evidence	Testimony of Jacob Pous, November 28, 2012.
Pous Surrebuttal Evidence	Surrebuttal Testimony of Jacob Pous, January 18, 2013.
Public Utilities Act	Public Utilities Act, RSNL 1990, c. P-47.
Régie	Régie de l'énergie Quebec
Retail Rate Review	The Retail Rate Review agreed as part of the settlement agreement reached in Newfoundland Power's 2008 general rate application.
RSA	Newfoundland Power's Rate Stabilization Account originally approved by Order No. P.U. 34 (1985).
Settlement Agreement	Settlement Agreement with effective date of December 21, 2012 relating to the Original Application and filed as Consent #1.
Stated Case	Supreme Court of Newfoundland and Labrador, Court of Appeal, 1996 No. 141, Stated Case re Section 101 of the Public Utilities Act.
Supply Cost Mechanisms Report	The Report on Newfoundland Power's Supply Cost Mechanisms, September 2012, Volume 2, Tab 7 of Exhibits and Supporting Materials of Newfoundland Power filed September 14, 2012.
U.S. GAAP	United States Generally Accepted Accounting Principles
Vander Weide Evidence	Pre-filed Evidence of Dr. James Vander Weide, September 2012, Volume 3, Expert Evidence and Studies, Tab *Cost of Capital: Dr. James Vander Weide* of Newfoundland Power filed September 14, 2012.

Term	Reference
Weather Normalization Reserve	Newfoundland Power's Weather Normalization Reserve, which adjusts revenue and power supply costs to account for variations in weather as originally approved in Order Nos. P.U. 32 (1968) and P.U. 1 (1974).
Weidmeyer Rebuttal Evidence	Rebuttal Evidence of John W. Wiedmeyer, Jr., December 2012.

2. RESPONSES TO REQUEST FOR INFORMATION

Responses to Requests for Information are simply referred to by the number of the Request for Information. For example, the Response to Request for Information CA-NP-001 would be referred to as CA-NP-001.

3. ORAL TESTIMONY

References to oral testimony are referred to by the name of the witness, the date of the testimony, and the transcript page and line numbers. For example a reference to oral evidence of Ms. Jocelyn Perry would be referred to as Ms. Perry, Transcript, January ●, 2013, Page •, Line •.

4. CONSENTS, EXHIBITS, UNDERTAKINGS AND INFORMATION ITEMS

References to undertakings are referred to as "U" and their number. For example, undertaking 1 would be referred to as U-1.

References to consents are referred to as "Consent #" and their number. For example, Consent #1.

References to exhibits are referred to as "Exhibit" and their number. For example, Exhibit 1.

References to information items are referred to as "Information #" and their number. For example, Information #1.

A. INTRODUCTION

A.1 Procedural Background

This volume contains the written submissions of Newfoundland Power Inc. ("Newfoundland Power" or the "Company") in support of its Application to establish 2013-2014 customer rates.

On May 29, 2012, Newfoundland Power was directed by the Board to file a general rate application by September 14, 2012. The Company filed the Application to establish 2013-2014 customer rates on September 14, 2012.

Following due notice of the Application, the Board issued Order No. P.U. 32 (2012) on October 11, 2012, which set out the schedule of dates and procedures for the hearing of the Application. This Order established a detailed schedule providing for: review of the Application by Grant Thornton, the Board's financial consultants; written interrogation of the Application by intervenors; filing of evidence by intervenors; Board facilitated negotiations; and a public hearing, all in accordance with established Board practice.

As a result of Board facilitated negotiations, a Settlement Agreement with respect to certain matters raised in the Application was reached on December 21, 2012 between Newfoundland Power, the Consumer Advocate and Board staff.

A.2 Evidentiary Matters

The Board is legally required to determine issues on the basis of the evidence before it.

The primary evidence on the Application includes (i) Newfoundland Power's three volume filing of September 14, 2012 which included Company Evidence, Exhibits and Supporting Materials and Expert Evidence and Studies; (ii) Expert Evidence on cost of capital filed by the Consumer Advocate and Board staff; (iii) Expert Evidence on depreciation filed by the Consumer Advocate; (iv) the responses to almost 1,000 Requests for Information; and (v) oral testimony of Company management and expert witnesses.

The Application has also been extensively reviewed by Grant Thornton, the Board's financial consultants. The Grant Thornton Report contains the findings of this review and forms a part of the evidence before the Board.

A small number of additional documents were also filed by consent. Additional materials were filed by parties, by way of information, to assist in examination and cross-examination of witnesses but not necessarily as proof of the content of those documents.

The extensive body of evidence before the Board has not raised any issue regarding the reasonable accuracy of the financial or operational data placed before the Board by the Company in support of the Application. Accordingly, the procedural history of the

Application has provided an evidentiary record concerning Company operations and finance which can be confidently relied upon by the Board.

A.3 Regulatory Policy Framework

The Public Utilities Act

The *Public Utilities Act* defines the Board's powers in the regulation of Newfoundland Power. In addition, the *Public Utilities Act* sets out the obligations and rights of Newfoundland Power as a public utility providing a regulated service.

The *Public Utilities Act* provides for the Board's general supervision of Newfoundland Power's utility operations (s. 16) and, amongst other things, requires the Board to specifically approve rates (s. 70), capital expenditures (s. 41) and the issue of securities (s. 91) of Newfoundland Power.

Newfoundland Power has an obligation under the *Public Utilities Act* to provide service to all who require it (s. 54) and to ensure that its service and facilities are reasonably safe and adequate (s. 37). This obligation, commonly referred to as the "obligation to serve", necessarily requires investment in the systems that provide that service.

Section 80 of the *Public Utilities Act* entitles Newfoundland Power to earn annually a just and reasonable return on its rate base in addition to recovering its reasonable and prudent operating expenses.

The entitlement of a utility to earn a just and reasonable return has been described by the Newfoundland and Labrador Court of Appeal as follows:

> "[23] This statutory entitlement of the utility to earn a "just and reasonable" return is the linguistic touchstone for the balancing exercise. This phrase emphasizes the fairness aspect, both to the utility, in earning sufficient revenues to make its continued investment worthwhile and to maintain its credit rating in financial markets, and to the consumer, in obtaining adequate service at reasonable rates. It also emphasizes the need for tempering of each group's economic imperative by consideration of the interests of the other.
>
> [24] Having said that, the entitlement of the utility to a fair return on its investment is always regarded as of fundamental importance…"

Reference: *Stated Case, Page 16, paragraphs 23 and 24.*

Provincial Power Policy

The *Electrical Power Control Act, 1994* sets out the electrical power policy of the province.

The electrical power policy of the province deals specifically with rates [s. 3(a)] and management of utility resources [s. 3(b)].

The electrical power policy requires rates to: (1) be reasonable and not unjustly discriminatory; (2) be based on forecast costs for supply for one or more years; and (3) enable the producer or retailer to earn a just and reasonable return 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.

The electrical power policy requires all sources and facilities to be managed and operated in a manner that results in: (1) the most efficient production, transmission and distribution of power; (2) equitable access to an adequate supply of power for all consumers in the province; and (3) delivery of power to consumers at the lowest possible cost consistent with reliable service.

All aspects of the electrical power policy are imperative and apply in a general and continuing manner to all utilities, including Newfoundland Power.

The issue of cost efficient management and operations and the issue of the fair return are interrelated. In a capital intensive enterprise with long-life assets such as a public utility, the cost of capital will have a significant impact on rates and whether they are least-cost over the long term. Simply put, least-cost customer rates require both: (1) cost efficient management and operations; and (2) fair returns which allow the utility to maintain its financial integrity.

The balance contained in the regulatory policy framework in this Province has been appropriately recognized by the Board on a number of occasions including in Order No. P.U. 32 (2007), where the Board observed:

> "The real challenge for the Board, in keeping with its legislative mandate, is to balance oftimes competing objectives within the regulatory environment to ensure a set of sound and reasoned decisions serving the interests of both customer and utility alike."

***Reference**: Order No. P.U. 32 (2007), Appendix A, Page 8.*

B. OVERVIEW

B.1 Application Overview

The Application seeks an average increase in current customer rates of approximately 6%, effective March 1, 2013. This increase is primarily the result of two changes in the Company's cost of service. The first relates to Newfoundland Power's energy supply cost and accounts for an approximate 2.6% increase from current customer rates. The second relates to Newfoundland Power's return on equity and accounts for approximately 1.8% of the increase from current customer rates. The remaining 1.6% increase from current customer rates results from a mixture of cost changes.

While the Application proposes an average increase in customer rates of 6%, the proposed rate increases are not uniform by class of service. The Application proposes a number of changes to customer rates and rate structures arising from the Retail Rate Review commenced by agreement following the Company's 2008 general rate application.

The Application, and Company Evidence filed in support of it, provided a broad overview of Newfoundland Power's customer operations, including the cost of those operations. During the course of interrogation of the Application and the subsequent public hearing, no material issues were raised concerning the Company's fulfillment of its obligation to serve its customers. The largest forecast increase in the cost of Newfoundland Power's customer operations relates to increased customer energy

conservation program costs. These costs are justified by greater savings in Hydro generation costs. No issue has been raised in respect of the reasonableness of this increased cost. Overall, the evidence before the Board indicates Newfoundland Power's operations are efficient and will continue to be so through 2013 and 2014. The record on the Application indicates the Company's delivery of power to customers is consistent with least cost reliable service. Grant Thornton's examination of the Application and Company Evidence has indicated nothing that would suggest that the Company's 2013 and 2014 operating costs are unreasonable on an overall basis.

It is Newfoundland Power's submission that the evidence before the Board overwhelmingly supports the inclusion of forecast operating costs in the Application in calculation of customer rates for 2013 and 2014.

All cost of service and rate design issues which were raised by the Application were the subject of the Settlement Agreement. Many of these issues, particularly the rate design issues, were the subject of the comprehensive, consultative multi-year Retail Rate Review. By the time the rate design changes appeared in the Application, they had been subject to review by a variety of stakeholders, including the Consumer Advocate and Board staff, over an extended period. This eliminated any controversy associated with the rate design changes and reduced the complexity of the processes and public hearing associated with this Application from what it might otherwise have been. Agreement with respect to the Customer, Demand and Energy Forecast and the

regulatory accounting changes and amortizations proposed in the Application had a similar effect.

The central, unresolved, subject areas on the Application are twofold. The first is Newfoundland Power's cost of capital. Here, the issues include an appropriate capital structure for regulatory purposes; a fair return on equity for Newfoundland Power for 2013 and 2014; and whether the Board should discontinue use of the Formula to annually change the Company's cost of equity. The second subject area is depreciation. Here, the issues include Newfoundland Power's continued use of the ELG procedure to calculate depreciation; the appropriate service life estimates for 7 of the Company's mass property accounts; and the appropriate net salvage estimate for overhead services.

Newfoundland Power has maintained a common equity ratio of approximately 45% for over two decades. It is a cornerstone of the Company's creditworthiness. The evidence before the Board supports the maintenance of this common equity ratio through 2013 and 2014.

Newfoundland Power remains an average or typical risk investor-owned Canadian electric utility. Financial market conditions are currently uncertain. The Company's forecasts indicate regulated returns on equity of approximately 7.6% and 6.9% for 2013 and 2014. These forecast returns are not consistent with the fair return standard. The evidence before the Board supports higher returns on equity for ratemaking purposes if

Newfoundland Power is to be permitted a reasonable opportunity to earn a return commensurate with that of other regulated utilities and to maintain its creditworthiness.

The Formula was adopted by the Board to improve regulatory efficiency and reduce regulatory uncertainty. In current financial market conditions, the Formula has not achieved these objectives. Given the lack of Canadian regulatory consensus on this matter, the Formula should be discontinued until such time as financial market conditions justify its reinstatement.

The Depreciation Study which was filed with the Application was prepared by recognized experts in a comprehensive manner. It is consistent with both past practice and Board orders. The alternative proposals before the Board were not the result of any comprehensive review of Newfoundland Power's plant in service. Nor are they consistent with past practice or Board orders governing the Company's determination of depreciation.

The Consumer Advocate has proposed that the Company: adopt an alternative procedure for determining depreciation expense; vary estimated service lives for 7 selected mass property accounts; and change net salvage parameters for a single property account. There is no reasonable evidentiary support for any of these proposals. Their effect would be to reduce depreciation expense for a limited period of time; but ultimately to increase the Company's rate base and future customer rates.

The Board's determinations on the unresolved subject areas of Newfoundland Power's cost of capital and depreciation expense may have an impact upon the Company's 2013 and 2014 revenue requirements. The Grant Thornton Report did not note any material discrepancies in Newfoundland Power's calculation of its revenue requirements in the Application. However, the final calculation of 2013 and 2014 revenue requirements (and customer rates) will be performed following receipt of the Board's order on the Application. For this reason, Newfoundland Power has not included detailed submissions on 2013 and 2014 revenue requirements in these written submissions.

B.2 Written Submissions

These written submissions summarize the key aspects of the Settlement Agreement, including the evidentiary basis which supports the Board's approval of that Settlement Agreement.

These written submissions specifically address each of the unresolved issues raised upon the Application and they also address Newfoundland Power's forecast operating efficiency through the 2013 and 2014 test period.

C. SETTLED ISSUES

C.1 The Settlement Agreement

In the Settlement Agreement, Newfoundland Power, the Consumer Advocate and Board staff have agreed to recommend that the Board implement their agreement regarding the settled issues in its order arising out of the Application.

Reference: *Settlement Agreement, Items 1 and 2.*

In the Settlement Agreement, Newfoundland Power, the Consumer Advocate and Board staff have agreed upon resolution of the following settled issues:

(i) 2013 and 2014 customer, energy and demand forecast;

(ii) Approval, with effect from January 1, 2013, of the calculation of defined benefit pension expense for regulatory purposes in accordance with U.S. GAAP, and the amortization over 15 years of the forecast defined benefit pension expense regulatory asset of approximately $12.4 million;

(iii) Approval, with effect from January 1, 2013, of the deferral and amortization of annual customer energy conservation program costs over a 7 year period;

(iv) Approval, with effect from January 1, 2013, of the annual disposition of prior year-end balances in the Weather Normalization Reserve through the Rate Stabilization Account ("RSA");

(v) Approval, with effect from January 1, 2013, of the recovery over a 3 year period of certain 2011 and 2012 cost recovery deferrals;

(vi) Approval, with effect from January 1, 2013, of the recovery over a 3 year period of an estimated $1.25 million in Board and Consumer Advocate costs related to the Application;

(vii) Approval, with effect from January 1, 2013, of the amortization over a 3 year period of the outstanding year-end balance for 2011 in the Weather Normalization Reserve of approximately $5.0 million due to customers;

(viii) Approval, with effect from January 1, 2013, of the recovery over *a* 3 year period of a 2013 revenue shortfall associated with the timing of the implementation in 2013 of customer rates;

(ix) Approval of 2013 forecast average rate base of $917,891,000 and 2014 forecast average rate base of $954,123,000, subject to such adjustments as may result from the Board's determinations with respect to issues in the Application that are not included in the settled issues;

(x) Rate design and rate structure; and

(xi) Amendments to the Rate Stabilization Clause.

Reference: *Settlement Agreement, Item 6.*

C.2 Customer, Energy and Demand Forecast

Newfoundland Power's Customer, Energy and Demand Forecast indicates that: (i) the number of customers Newfoundland Power serves will increase by 1.3% in each of 2013 and 2014; (ii) energy sales will increase by 1.2% in each of 2013 and 2014; and (iii) peak demand will increase by 1.6% in 2013 and 1.3% in 2014. These forecasts include the impact of price elasticity associated with the proposed average increase of

6.0% effective March 1, 2013, as well as the impact of conservation and demand management programs.

Reference: *Company Evidence, Page 5-3, Line 5 to Page 5-5, Line 2; Customer, Energy and Demand Forecast, Page 5 and Appendix B and C.*

The assumptions used in forecasting revenue and expenses in the Customer, Energy and Demand Forecast are based upon, and incorporate, data from independent sources. The overall methodology used by the Company for estimating revenue, expenses and net earnings is similar to, and consistent with, the process and methodology used in the 2010 general rate application.

Reference: *Grant Thornton Report, Page 23, Lines 25-27 and Page 24, Lines 12-14.*

In the Settlement Agreement, it has been agreed that the Board may accept, and rely upon, the Customer, Energy and Demand Forecast in establishing 2013 and 2014 customer electricity rates.

Reference: *Settlement Agreement, Items 7 and 8.*

C.3 Regulatory Accounting Matters

C.3.1 Calculation of Defined Benefit Pension Expense

The approval by the Board of the adoption of U.S. GAAP for regulatory purposes effective January 1, 2012 was accompanied by the creation of regulatory assets and liabilities, including those related to the differences in the annual calculation of defined pension expense under U.S. GAAP and Canadian GAAP.

Reference: *Company Evidence, Page 3-45, Line 9 to Page 3-46, Line 4.*

The Application proposes that, effective January 1, 2013, Newfoundland Power will: (i) calculate annual defined benefit pension expense in accordance with U.S. GAAP, and (ii) amortize the recovery of the forecast defined benefit pension expense regulatory asset of approximately $12.4 million over 15 years.

Reference: *Application, Paragraph 12; Company Evidence, Page 3-47, Lines 8-10.*

Newfoundland Power's proposal for future accounting for annual defined benefit pension expense will reduce the Company's revenue requirements to be recovered from customers. The proposal will also eliminate the single remaining difference between financial reporting and regulatory reporting that arose upon the Company's adoption of U.S. GAAP. This will enhance ongoing regulatory transparency. The proposed 15 year amortization period for the defined benefit pension expense regulatory asset is consistent with the amortization period approved by the Board for the recovery of the OPEBs regulatory asset.

Reference: *Company Evidence, Pages 3-48, Lines 1-13; Grant Thornton Report, Page 4, Lines 1-26.*

In the Settlement Agreement, it has been agreed that the Board should approve, with effect from January 1, 2013, the Company's proposals in respect of the calculation of pension expense for regulatory purposes in accordance with U.S. GAAP.

Reference: *Settlement Agreement, Item 9.*

C.3.2 Recovery of Supply Costs

In compliance with Order No. P.U. 43 (2009), Newfoundland Power filed the Supply Cost Mechanisms Report with the Application. The Supply Cost Mechanisms Report

concluded that the Company's current mechanisms remain consistent with sound public utility practice and current Canadian regulatory practice, and provide reasonable incentives for the Company to further customer conservation of demand and energy. The Supply Cost Mechanisms Report recommended that annual recovery of Weather Normalization Reserve transfers through the RSA would provide an increased measure of regulatory consistency and continued rate stability.

Reference: *Company Evidence, Pages 5-19, Lines 1-18; Supply Cost Mechanisms Report, Page 9;* Grant Thornton Report, Page 8, Lines 13-53.

The Application proposes recovery of annual Weather Normalization Reserve balances through the RSA. This provides an efficient means of adjusting customer rates to reflect the effects of weather and hydrology without the need for a separate review to consider disposition of the annual balances. This regulatory accounting change will not directly affect 2013 and 2014 revenue requirements. The Application also proposes the amortization of the outstanding year-end balance for 2011 over three years, which will affect the 2013 and 2014 revenue requirements.

Reference: *Application, Paragraph 14; Company Evidence, Page 3-52, Lines 4-5; PUB-NP-041.*

In the Settlement Agreement, it has been agreed that the Board should approve, with effect from January 1, 2013, the Company's proposals with respect to changes in the Weather Normalization Reserve. This includes the amortization of the outstanding year-end balance for 2011 in the Weather Normalization Reserve of approximately $5.0 million due to customers over three years.

Reference: *Settlement Agreement, Items 12 and 13.*

C.3.3 Conservation Costs

During 2013 and 2014, Newfoundland Power will materially increase its expenditures on customer energy conservation programs. The forecast expenditures reflect the Conservation Plan developed by Newfoundland Power and Hydro. The benefits of the increased energy conservation programming are cumulative and enduring.

Reference: *Company Evidence, Page 2-15, Line 10 to Page 2-18, Line 15; Conservation Plan, Pages 23-24*.

Newfoundland Power's current practice is to expense all energy conservation costs in the year in which they are incurred. The Application proposes amortizing the customer energy conservation program costs over a 7 year period. The increased recovery period for program costs better matches the period over which the benefits of the programs will be realized, and is reasonably consistent with Canadian public utility practice. The proposed definition of the Conservation and Demand Management Cost Deferral Account describes the operation of the account, including details of the program costs to be amortized.

Reference: *Application, Paragraph 13; Company Evidence, Pages 3-49, Lines 4-11; Conservation Plan, Pages 23-24; Exhibit 7.*

In the Settlement Agreement, it has been agreed that (i) the Company's proposal to defer and amortize annual customer energy conservation program costs, commencing in 2013, over seven years and (ii) the proposed definition of the Conservation and Demand Management Cost Deferral Account, should be approved by the Board.

Reference: *Settlement Agreement, Item 10.*

C.4 Regulatory Amortizations

Table C-1 summarizes the effect of the regulatory amortizations and deferrals proposed to be approved by the Board in the Application. Each of these proposed amortizations in the Application are over the 3 year period from 2013 through 2015.

Table C-1
Amortization of Regulatory Deferrals
***Pro forma* Revenue Requirement Impact**
2011 to 2015
($000s)

	2011	2012	2013	2014	2015
2011/12 Cost Deferrals	(2,363)	(2,363)	1,575	1,575	1,575
2012 Cost of Capital Deferral	-	(2,487)	829	829	829
Hearing Costs	253	250	417	417	416
Weather Normalization Reserve	2,101	2,101	(2,335)	(2,335)	(2,335)
2013 Revenue Shortfall	-	-	(692)	346	346
Revenue Requirement Impact	**(9)**	**(2,499)**	**(206)**	**832**	**831**

The proposed regulatory deferrals and amortizations described in this section will, in aggregate, reduce Newfoundland Power's revenue requirements by approximately $0.2 million in 2013, and increase revenue requirements by approximately $0.8 million in 2014.

Reference: *Company Evidence, Pages 3-56, Lines 4-12.*

The 2011/12 cost deferrals of $2,363,000 for each of 2011 and 2012 were approved by the Board to offset revenue shortfalls resulting from the conclusion of regulatory amortizations reflected in the 2010 test year.

Reference: *Company Evidence, Pages 3-53, Lines 19-21; Grant Thornton Report, Page 12, Lines 13-16; Order Nos. P.U. 30 (2010) and P.U. 22 (2011).*

The 2012 cost of capital deferral of $2,487,000 was approved by the Board based upon the joint recommendations of the parties to Newfoundland Power's 2012 cost of capital proceeding. It represents the difference in revenue requirement between the 8.38% return on equity reflected in 2012 customer rates, and the 8.80% return on equity approved by the Board for use in determining a just and reasonable return on rate base for Newfoundland Power for 2012.

Reference: *Company Evidence, Pages 3-53, Lines 21-23; Grant Thornton Report, Page 12, Lines 16-17; Order No. P.U. 17 (2012).*

The Company estimates that approximately $1,250,000 in third party hearing costs will be incurred with respect to the Application. The Application proposes that the estimated third party hearing costs incurred with respect to the Application be amortized over a 3 year period. This is consistent with past practice of the Board.

Reference: *Company Evidence, Page 3-54, Lines 8-12 and Footnote 158; Application, Paragraph 15 (b); Grant Thornton Report, Page 13, Lines 10-21.*

As described in ***C.3.2 Recovery of Supply Costs****,* the Application proposes that future annual Weather Normalization Reserve balances be disposed of through the RSA. To accommodate this regulatory accounting change, it is proposed that the 2011 year-end balance in the Weather Normalization Reserve, which is approximately $5.0 million (pre-tax) due to customers, be amortized over a 3 year period. The proposed - amortization will reduce the revenue requirement for each of 2013 and 2014 by $2,335,000.

Reference: *Application, Paragraph 15 (c); Company Evidence, Pages 3-55, Lines 7-12; Grant Thornton Report, Page 12, Lines 21-26.*

In the Settlement Agreement, it has been agreed that the Board should approve, with effect from January 1, 2013, the Company's proposals for recovery of the 2011/2012 cost deferrals; the 2012 cost of capital deferral; and the 3rd party hearing costs evenly over a 3 year period from 2013 through 2015.

Reference: *Settlement Agreement, Items 13, 15 and 16.*

Customer rates specifically designed to recover the forecast 2014 revenue requirement, if implemented effective March 1st, would result in a $980,000 shortfall in the recovery of the revenue requirement for 2013. To address this, the proposed rates provide for recovery of the resulting 2013 revenue shortfall through a regulatory amortization reflected in the 2013 and 2014 revenue requirements. The regulatory amortization is proposed to commence on the customer rate implementation date and conclude on December 31, 2015.

Reference: *Company Evidence, Page 3-55, Line 14 to Page 3-56, Line 2; Grant Thornton Report, Page 12, Lines 28-33.*

In the Settlement Agreement, it was acknowledged that a delay in the implementation of customer rates beyond the proposed March 1st implementation date will affect the amount of a 2013 revenue shortfall. Accordingly, it was agreed that the Board should approve a revenue amortization, from the effective date of the new rates to December 31, 2015, to provide for recovery in customer rates of any 2013 revenue shortfall.

Reference: *Settlement Agreement, Items 17-20.*

All regulatory amortizations proposed in the Application will conclude at the end of 2015. A 3 year amortization period is consistent with regulatory amortizations previously approved by the Board. The Company typically files rate applications approximately every three years. Deferral and amortization of these costs smoothes the effect of the Company's cost of service between rate hearings and is consistent with past regulatory practice.

Reference: *Grant Thornton Report, Page 13, Lines 1-21, CA-NP-396; Order No. P.U. 43 (2009), Page 41, Line 13 to Page 42, Line 14; PUB-NP-112 and PUB-NP-115.*

C.5 Customer Rates

C.5.1 General

The Application proposes to (i) vary the rate increase by customer rate class so cost recovery for each class is within the target revenue to cost ratio range of 90% to 110%, and (ii) to implement changes in customer rate designs in accordance with the Retail Rate Review.

Reference: *Application, Paragraph 17; Company Evidence, Page 5-5, Line 4 to Page 5-7, Line 8.*

Maintaining revenue to cost ratios for each customer rate class within a range of 90% to 110% has been an accepted approach to ensure that there is no undue cross-subsidization among the various classes. The Cost of Service Study indicates revenue to cost ratios for the General Service 0-10 kW class (Rate 2.1) and 10-100 kW (110 kVA) class (Rate 2.2) are materially greater than 110%. In the 2010 general rate application, the Company proposed to make adjustments to bring revenue to cost ratios for all rate classes within the accepted range following completion of the Retail Rate

Review. The Application includes proposals to bring the revenue to cost ratios for all classes within the target range.

Reference: *Application, Schedule A; Company Evidence, Page 5-5, Line 8 to Page 5-6, Line 10.*

The Retail Rate Review was carried out by Newfoundland Power in consultation with the Consumer Advocate, Hydro and Board staff, and consisted of a comprehensive review of existing rates and an evaluation of alternative rates. In this Application, Newfoundland Power is proposing to implement rate structure changes to standard rates arising from the Retail Rate Review. The proposed rate structure changes are intended to improve fairness and better reflect marginal costs in rates.

Reference: *Company Evidence, Page 5-8, Line 1 to Page 5-9, Line 16 and Page 5-10, Lines 1-5; CA-NP-144.*

In the Settlement Agreement, it has been agreed that the Board should approve varying increases by customer rate class as set out in the Application so that cost recovery for each class is within the target revenue to cost ratio range of 90% to 110%. In the Settlement Agreement, it has also been agreed that the Board should approve the proposed changes to rate design and rate structures as set out in the Application.

Reference: *Settlement Agreement, Items 23-26.*

C.5.2 Specific Customer Rate Design Changes

The proposal to merge Rate 2.1 and Rate 2.2 into a single rate class addresses the fairness of relative pricing for customers currently served under the two rate classes. The proposed rate design ensures smooth transition from an energy only rate to a

demand and energy rate and is an accepted rate design approach among electric utilities in Canada.

Reference: *Company Evidence, Page 5-11, Line 13 to Page 5-12, Line 20; CA-NP-144.*

The proposal to increase the upper limit of the first energy block from 30,000 kWh per month to 50,000 kWh per month in Rate 2.3 reduces the cost recovery differences among customers with different demand requirements.

Reference: *Company Evidence, Page 5-13, Lines 9-15; CA-NP-144.*

The proposal to reduce the first block size from 100,000 kWh per month to 75,000 kWh per month in Rate 2.4 provides a smooth price transition for customers that move between Rate 2.3 and Rate 2.4.

Reference: *Company Evidence, Page 5-13, Lines 17-20; CA-NP-144.*

The introduction of a separate higher basic customer charge for Domestic customers with electrical services in excess of 200 Amps better reflects the materially higher cost of providing services in excess of 200 Amps.

Reference: *Company Evidence, Page 5-14, Line 1 to Page 5-15, Line 18; CA-NP-144.*

The proposal to increase the demand price differential between winter and non-winter periods from $1.50 to $2.50 per kW/kVA better reflects the higher marginal capacity costs during the winter period.

Reference: *Company Evidence, Page 5-16, Lines 9-11; CA-NP-144.*

The proposal to provide all customers a 1.5% early payment discount with no minimum or maximum provisions treats all customers equally, irrespective of the total bill amount.

Reference: *Company Evidence, Page 5-17, Lines 12-19; CA-NP-144.*

Newfoundland Power submits that the evidence shows that the proposed customer rates are reasonable and not unjustly discriminatory.

C.6 Rate Base

Newfoundland Power's forecast 2013 and 2014 average rate base, including rate base allowances, is calculated in accordance with Board orders and regulatory practice.

Reference: *Company Evidence, Page 4-1, Lines 20-22; Grant Thornton Report, Page 16, Lines 3-22.*

In the Settlement Agreement, it has been agreed that the forecast 2013 and 2014 average rate base should be used for rate making purposes, subject to such adjustments as may result from the Board's determinations with respect to issues in the Application that are not included in the settled issues.

Reference: *Settlement Agreement, Item 22.*

C.7 Regulation Changes

A number of proposals in the Application provide for costs to be recovered from, or credited to, customer rates through the RSA. In the Settlement Agreement, it has been agreed that the Board should approve the amendments to the Rate Stabilization Clause to permit this. Exhibit 14 provides the revised wording of the Rate Stabilization Clause necessary to implement these changes.

Reference: *Settlement Agreement, Items 27-28; Exhibit 14.*

The Application proposes a revision to Section III of the Rate Stabilization Clause to allow the Maximum Monthly Charge to be updated annually to reflect changes in the Rate Stabilization Adjustment Factor. This provides a more reasonable recovery of changing fuel costs between test years from customers that benefit from the Maximum Monthly Charge. To limit the customer impact of implementing this change, it is proposed that the change become effective at the time Hydro's next base rate increase is flowed through to Newfoundland Power's customers.

Reference: *Company Evidence, Page 5-16, Line 14 to Page 5-17, Lines 1-3 and Page 5-20, Lines 6-13; Exhibit 14, Page 1 of 4.*

The Application proposes a revision to Section II(3) of the Rate Stabilization Clause to update the energy consumption information for the Company's street and area lighting fixtures.

Reference: *Company Evidence, Page 5-20, Lines 15-21; Exhibit 14, Page 2 of 4.*

As describe in ***C.3.3 Conservation Costs***, the Application proposes that a conservation and demand management cost recovery clause be included in the Rate Stabilization Clause to provide for the recovery of customer energy conservation program costs over a 7 year period.

Reference: *Company Evidence, Page 5-21, Lines 1-10; Exhibit 14; Page 3 of 4.*

As described in ***C.3.2 Recovery of Supply Costs***, the Application proposes that the annual balance in the Weather Normalization Reserve be recovered from, or credited

to, customers as part of the annual RSA adjustment to customer rates on July 1st of each year.

Reference: *Company Evidence, Page 5-21, Lines 13-19; Exhibit 14; Page 4 of 4.*

D. 2013/2014 COST OF CAPITAL

D.1 Background

The evidence indicates that Newfoundland Power's forecast returns and credit metrics for 2013 and 2014 under existing customer rates reflect an eroding financial position. Company forecasts indicate a return on equity of 7.57% in 2013 and 6.89% in 2014.

Reference: *Company Evidence, Page 3-13, Line 7 to Page 3-14, Line 9 and Exhibit 3; Ms. Perry, Transcript, January 10, 2013, Page 146, Line 14 to Page 147, Line 9.*

Newfoundland Power's allowed returns on equity for 2010 through 2012 were amongst the lowest in Canada for investor-owned electric utilities. The Company's achieved regulated returns on equity averaged approximately 9% through this period. These achieved returns on equity were sufficient to preserve the financial integrity of Newfoundland Power.

Reference: *See McShane Evidence, Schedule 3, Page 2 of 2 for comparison of allowed returns for electric utilities and Exhibit 4 and Exhibit JP-4 for Moody's comments; Company Evidence, Exhibit 3 shows achieved regulated returns on equity from 2010 through 2012 forecast; and Ms. Perry, Transcript, January 10, 2013, Page 147, Line 10 to Page 148, Line 3.*

In this Application, the Consumer Advocate's witness, Dr. Booth, recommends a return on equity for Newfoundland Power of 7.5% and a reduction in Newfoundland Power's common equity component of its capital structure from 45% to 40%. The recommended return on equity is significantly below the allowed return of any investor-owned electric utility in North America. It is not a fair return. In addition, the low recommended return on equity combined with the reduced common equity ratio is not consistent with the maintenance of the Company's creditworthiness. The recommendations of the

Consumer Advocate in this Application, if adopted, would put the Company at risk for a credit rating downgrade.

Reference: *Booth Evidence, Page 2, Lines 29–38; Ms. Perry, Transcript, January 10, 2013, Page 152, Line 13 to Page 153, Line 6 and Page 164, Line 4 to Page 166, Line 4.*

D.2 Capital Structure

D.2.1 45% Common Equity

Newfoundland Power's target of a 45% common equity component in its capital structure is consistent with Board orders since 1990. This issue has been considered by the Board from time to time as part of the Board's review of the Company's cost of capital and consistently approved as reasonable for ratemaking purposes.

Reference: *Order Nos. P.U. 1 (1990), P.U. 6 (1991), P.U. 7 (1996-97), P.U 16 (1998-99), P.U. 19 (2003), P.U. 32 (2007) and P.U. 43 (2009).*

Newfoundland Power's 45% common equity is favorably recognized by credit rating agencies. DBRS views the Company's "strong balance sheet, with a capital structure based on a 45% allowable equity component established by the PUB" as a strength. Moody's considers the 45% common equity ratio to be an aspect of the Company's "supportive regulatory and business environment".

Reference: *Company Evidence, Exhibit 4, DBRS Report, Page 2 and Moody's Report, Page 2; Ms. Perry, Transcript, January 10, 2013, Page 148, Lines 6-19.*

It is the evidence of Ms. McShane, Dr. Vander Weide and Mr. MacDonald that the Board's approval of a 45% common equity component for Newfoundland Power for ratemaking purposes would be reasonable for 2013 and 2014. Mr. MacDonald

advocated ongoing review of the continued appropriateness of the 45% common equity ratio.

Reference: *McShane Evidence, Page 2, Lines 42-47 and Page 29, Line 740 to Page 30, Line 785; Vander Weide Evidence, Page 54, Lines 25-28; MacDonald Evidence, Page 21, Lines 379-393; Mr. MacDonald, Transcript, January 18, 2013, Page 182, Line 17 to Page 183,Line 19.*

D.2.2 Dr. Booth's Recommendation

Dr. Booth recommends that the Board reduce Newfoundland Power's common equity ratio to 40%. It is Dr. Booth's evidence that the Company should issue 5% of preference shares.

Reference: *Booth Evidence, Page 2, Lines 36-38 and Page 92, Lines 3-5.*

Dr. Booth has not examined Newfoundland Power's ability to issue the preference shares that he recommended. He has examined Fortis Inc.'s ability to issue preference shares and seemed to suggest that Fortis Inc. could issue the preference shares and drop them down to Newfoundland Power. Dr. Booth has agreed that this would be contrary to Newfoundland Power's standalone financial integrity and would be inconsistent with the ring fencing provisions of prior Board orders.

Reference: *Dr. Booth, Transcript, January 18, 2013, Page 88, Line 1 to Page 91, Line 20; see Order No. P.U. 19 (2003), Pages 37-40 for the Board's direction vis-à-vis the preservation of Newfoundland Power's financial integrity and independence from Fortis Inc.*

Ms. Perry specifically addressed Dr. Booth's proposal on Newfoundland Power's capital structure. She was unsure that, due to its small size, Newfoundland Power could issue the retractable preference shares suggested by Dr. Booth. It was her evidence that, from a credit rating perspective, (i) issuing preference shares as indicated by Dr. Booth

would effectively be the same as issuing additional debt and (ii) such a change could lead to a re-evaluation of the regulatory support perceived by credit rating agencies.

Reference: *Ms. Perry, Transcript, January 10, 2013, Page 149, Line 7 to Page 150, Line 21.*

Dr. Booth performed an assessment of the fair return for Newfoundland Power in May 2012, six months prior to his filing evidence in this proceeding. In May 2012, Dr. Booth did not recommend that Newfoundland Power's common equity ratio be reduced from 45%. Furthermore, it is Dr. Booth's evidence in this proceeding that no changes in capital market conditions have occurred since May 2012 in relation to capital structure.

***Reference*:** *PUB-CA-015; Dr. Booth, Transcript, January 18, 2013, Page 78, Line 13 to Page 82, Line 25.*

Dr. Booth's evidence was that during the 2009 period, other regulators took steps to strengthen the capital structures of utilities they regulated. This was consistent with Ms. McShane's evidence.

Reference: *Dr. Booth, Transcript, January 18, 2013, Page 85, Line 2 to Page 86, Line 22; Ms. McShane, Transcript, January 14, 2013, Page 5, Lines 4-9.*

D.2.3 Submission on Capital Structure

Section 3(a)(iii) of the *Electrical Power Control Act, 1994* provides that it is the power policy of the province that the rates charged for the supply of power provide sufficient revenue to enable Newfoundland Power to earn a just and reasonable return under the *Public Utilities Act* so it may maintain a sound credit rating in the financial markets of the world.

It is clear from the evidence that Newfoundland Power's longstanding 45% common equity ratio is a key component of the Company's current creditworthiness. The witnesses, Ms. McShane, Dr. Vander Weide, Mr. MacDonald and Ms. Perry all support the maintenance of Newfoundland Power's 45% common equity ratio.

In addition to being contrary to the weight of the evidence before the Board, Dr. Booth's recommendation to reduce Newfoundland Power's common equity ratio to 40% is: (i) not based upon an examination of Newfoundland Power's actual ability to issue securities; (ii) inconsistent with his May 2012 assessment of a fair return for Newfoundland Power and; (iii) inconsistent with recent Canadian regulatory orders which have strengthened capital structures for other utilities.

D.3 Risk and Market Conditions

D.3.1 Risk

D.3.1.1 Changes in Risk

In Order No. P.U. 19 (2003), the Board indicated that the business risk profile for Newfoundland Power had not changed appreciably since 1998. In Order No. P.U. 43 (2009), the Board found Newfoundland Power continued to be an average risk Canadian utility.

Reference: *Order No. P.U. 19 (2003), Page 33; Order No. P.U. 43 (2009), Page 13, Lines 11-12.*

Newfoundland Power's evidence is that its principal business, regulatory and financial risks have not materially changed.

Reference: *Company Evidence, Page 3-16, Lines 15-16.*

Ms. McShane's evidence is that Newfoundland Power would be viewed by investors as an approximately average risk Canadian utility. Mr. MacDonald's evidence is that Newfoundland Power would be viewed by investors as an average risk Canadian utility.

Reference: *McShane Evidence, Page 30, Lines 782-783; MacDonald Evidence, Page 21, Lines 391-393.*

Dr. Booth's evidence is that Newfoundland Power is a "typical" Canadian utility with average business risk and lower than average financial risk. Dr. Booth essentially regards Newfoundland Power as very similar to every other regulated utility in Canada and finds it very difficult to see the differences of risk across them. Dr. Booth does not consider Newfoundland Power's overall risk profile to have substantially changed since 2009.

Reference: *Dr. Booth, Transcript, January 17, 2013, Page 201, Lines 3-7 and Page 162, Lines 11-16; Booth Evidence, Page 2, Lines 2-3; Dr. Booth, Transcript, January 18, 2013, Page 15, Lines 11-20.*

D.3.1.2 Relative Risk Between Canada and U.S.

Dr. Vander Weide's evidence is that the business risk of Canadian utilities, such as Newfoundland Power, is approximately equal to the business risk of the average U.S. utility, while the financial risk of Canadian utilities is higher than the average U.S. utility. Dr. Vander Weide's evidence is that while there are differences between Canadian and U.S. utilities, there is not any difference in total risk between Canadian utilities and U.S. utilities other than the fact that Canadian utilities have higher financial risk.

Reference: *Vander Weide Evidence, Page 53, Lines 27-30; Dr. Vander Weide, Transcript, January 17, 2013, Page 35, Line 25 to Page 36, Line 9; CA-NP-264, Lines 37-41.*

Ms. McShane's evidence is that U.S. and Canadian business environments are similar, regulatory models are similar, capital markets are significantly integrated, and the cost of capital environment is similar.

Reference: *McShane Evidence, Page 57, Line 1457 to Page 58, Line 1460.*

Dr. Booth's evidence is that U.S. financial markets exhibit more risk than Canadian markets and, while the principles of regulation are the same, their implementation is different. Dr. Booth considers significant adjustments to be required in comparing estimates from U.S. utilities to Canada and his evidence refers to a BCUC adjustment of between 50 and 100 basis points. But, Dr. Booth indicated that if you do enough screens, "…you can come down to some group that is equivalent to risk as Canada and that's about 5 or 6 companies that Ms. McShane has used."

Reference: *Booth Evidence, Page 82, Lines 2-9 and Page 89, Line 11 to Page 90, Line 1; Dr. Booth, Transcript, January 17, 2013, Page 198, Lines 17–21.*

Mr. MacDonald's evidence indicated the Canadian and U.S. economies exhibit a high level of integration; that the 2013 *Consensus Economics* is forecasting identical real GDP growth and 10 year government bond yields; and *Consensus Forecasts* for 2013 consumer price inflation are almost identical for both countries. Both countries share regulatory similarities through the application of the fair return standard.

Reference: *MacDonald Evidence, Page 37, Lines 757-763.*

D.3.2 Market Conditions

Ms. McShane's evidence is that the systemic risk to the global financial system, as assessed by the Bank of Canada, is no lower today than at the end of 2009. Long Canada Bond Yields are much lower than in late 2009 and credit risk is not perceived to have declined. Investor confidence is lower, equity market volatility is similar and the indicated market cost of equity is higher than it was at the end of the oral portion of Newfoundland Power's 2010 general rate application.

Reference: *McShane Evidence, Page 31, Line 800 to Page 32, Line 819.*

Mr. MacDonald's evidence is that the Canadian economy continues to be challenged by an uncertain global economic environment and risk remains high. Long Canada Bond Yields are significantly lower than in January 2010, which is partly influenced by the Bank of Canada's monetary policy in the challenging economic conditions.

Reference: *MacDonald Evidence, Page 25, Lines 460-463.*

Dr. Booth's evidence is that, overall, the Canadian economy is in good shape. The only "problem" is low Long Canada Bond Yields. Overall market conditions are remarkably benign.

Reference: *Booth Evidence, Page 40, Lines 10-16.*

D.3.3 Submission on Risk and Market Conditions

The evidence is consistent that Newfoundland Power's overall risk profile has not changed materially since 2009 and that Newfoundland Power is either an average risk Canadian utility or a typical Canadian utility.

All expert witnesses use U.S. utility data in some manner in their assessments of a fair return for Newfoundland Power. This appears consistent with the NEB's view of the matter in its March 2009 decision concerning Trans Quebec & Maritimes Pipeline Inc., where it concluded:

> "In light of the Board's views expressed above on the integration of U.S. and Canadian financial markets, the problems with comparisons to either Canadian negotiated or litigated returns, and the Board's view that risk differences between Canada and the U.S. can be understood and accounted for, the Board is of the view that U.S. comparisons are very informative for determining a fair return for TQM for 2007 and 2008."

Reference: *Vander Weide Evidence, Page 24, Lines 20-27.*

The evidence of Ms. McShane and Mr. MacDonald is that current financial markets continue to have a significant degree of uncertainty. Dr. Booth's evidence, on the other hand, is that market conditions are benign.

Overall, the evidence supports a finding by the Board that Newfoundland Power's risk profile has not changed since 2009 and that current financial market conditions continue to be challenging.

D.4 Fair Return on Equity

D.4.1 The Fair Return Standard

It is the common evidence of Mr. MacDonald, Ms. McShane and Dr. Vander Weide that a fair return for a regulated utility is a return which permits the utility the opportunity to (i) earn a return equal to what investors expect to earn on investments of comparable risk; (ii) maintain the utility's financial integrity; and (iii) attract capital on reasonable terms.

Reference: *MacDonald Evidence, Page 6, Lines 121-130; McShane Evidence, Page 6, Lines 165-172; Vander Weide Evidence, Page 6, Lines 16-25.*

Dr. Booth's evidence appears to be that the fair return is defined simply as the amount that could be earned by investing in similar securities elsewhere.

Reference: *Booth Evidence, Page 7, Lines 3-17.*

The evidence of Ms. Perry is that there is more than the consideration of a return on equity in comparable risk companies to be considered in determining a fair return. In addition, preservation of the Company's financial integrity is also a requirement of a fair return.

Reference: *Ms. Perry, Transcript, January 15, 2013, Page 21, Line 18 to Page 28, Line 18.*

The evidence of Mr. MacDonald, Ms. McShane, Dr. Vander Weide and Ms. Perry is consistent with the Board's past considerations of a fair return. For example, in Order No. P.U. 43 (2009), the Board found:

> To be considered fair, the return must be commensurate with the return on investments of similar risk and sufficient to ensure financial integrity and to attract necessary capital.

In addition, the provincial power policy specifically provides, in effect, that a just and reasonable return must be sufficient to ensure the maintenance of a sound credit rating in the financial markets of the world.

Reference: *Order No. P.U. 43 (2009), Page 11, Lines 18-20; Electrical Power Control Act, 1994, Section 3(a)(iii).*

D.4.2 Summary of Expert Recommendations

Table D-1 summarizes the recommendations of each of the expert witnesses that appeared before the Board on a fair return on equity for Newfoundland Power.

Table D-1
Summary of Expert Recommendations

Expert	McShane	Vander Weide	Booth	MacDonald
ROE	10.50%	10.40%	7.50%	8.91%

Appendix A to these submissions contains a more detailed summary of the expert witnesses' recommendations.

D.4.3 Ms. McShane

Ms. McShane's evidence relies on multiple tests to estimate a fair return on equity for Newfoundland Power. In her view, no single test is strong or sufficient enough to ensure that the fair return standard is met. Different tests have different perspectives, different strengths and weaknesses, and more or less reliability under different capital market and economic conditions.

Reference: *McShane Evidence, Page 49, Line 1208, et. seq.; Ms. McShane, Transcript, January 14, 2013, Page 9, Line 14 to Page 11, Line 5.*

The need to consider the results of multiple tests has been recognized by other regulators, including the OEB and BCUC.

Reference: *McShane Evidence, Page 53, Line 1316 to Page 54, Line 1354.*

Ms. McShane's recommendation for a fair return on equity for Newfoundland Power for 2013 and 2014 is 10.50%. This recommendation is based upon: (i) the results of three

separate equity risk premium tests, which indicated costs of equity before adjustment for financing flexibility of 8.9% - 10.25% (average of approximately 9.6%); and (ii) the results of five discounted cash flow models, which indicated costs of equity between 9.1% and 9.8% (mid-point of approximately 9.4%) before adjustment for financing flexibility. To these "bare-bones" costs of equity which approximated 9.5%, Ms. McShane added an allowance for financing flexibility of 1% to arrive at her recommendation of a fair return on equity for Newfoundland Power of 10.5%.

Reference: *McShane Evidence, Page 4, Lines 100-103 for equity risk premium test results; McShane Evidence, Page 97, Table 29 for discounted cash flow test results; McShane Evidence, Page 104, Lines 2594-2609 for summary, including allowance for financing flexibility; Ms. McShane, Transcript, January 14, 2013, Page 7, Line 2 to Page 9, Line 12.*

Ms. McShane's allowance for financial flexibility of 1% is 0.5% higher than she recommended in 2009. This results, in part, from the need to recognize that the market data upon which market based tests, such as the equity risk premium and discounted cash flow tests, are based upon market values, not book values; but the return on equity approved by the Board will be applied to a book value equity capitalization of Newfoundland Power.

Reference: *McShane Evidence, Page 104, Lines 2604-2609 and Appendix E; Ms. McShane, Transcript, January 14, 2013, Page 7, Line 21 to Page 8, Line 1.*

Ms. McShane also performed a comparable earnings test which indicated a fair return on equity for Newfoundland Power of 11.0% – 12.0%. Her evidence recognizes that the Board, in previous decisions, decided not to give weight to the comparable earnings test. Should the Board decide to give weight to Ms. McShane's comparable earnings

test results, then an appropriate allowance for financing flexibility would be 0.5%, however, the fair return for Newfoundland Power would still be approximately 10.5%.

Reference: *McShane Evidence, Page 104, Lines 2611-2618 and Appendix E; Ms. McShane, Transcript, January 14, 2013, Page 8, Line 1 to Page 9, Line 12.*

Ms. McShane was cross-examined extensively on detailed risk differences between Canadian utilities, including differences between B.C. utilities and Newfoundland Power; differences between different types of utilities; and the existence of weather normalization accounts. The cross-examination stands in contrast to Dr. Booth's reluctance to get "bogged down" in the minutia of individual risk differences, including operating deferral accounts and mechanisms.

Reference: *Ms. McShane, Transcript, January 14, 2013, Page 41, Line 17 et. seq.; Dr. Booth, Transcript, January 18, 2013, Page 16, Lines 11-19 and Page 21, Line 3 to Page 22, Line 4.*

D.4.4 Dr. Vander Weide

Dr. Vander Weide's evidence also relies on multiple tests to indicate a fair return on equity for Newfoundland Power. Dr. Vander Weide analyzed Newfoundland Power's cost of equity by: (i) identifying several groups of utilities that are broadly comparable in risk to Newfoundland Power; (ii) estimating the cost of equity for each group of comparable risk utilities using DCF, ERP and CAPM methodologies; and (iii) adjusting cost of equity results for comparable groups to reflect possible differences in risk between the comparable group and Newfoundland Power. Dr. Vander Weide applies his methods to multiple groups to reduce uncertainty in the estimation process and in the definition of risk.

Reference: *Vander Weide Evidence, Page 14, Line 2 to Page 15, Line 8.*

Dr. Vander Weide's recommendation for a fair return on equity for Newfoundland Power for 2013 and 2014 is 10.40%. This recommendation is based upon (i) the application of the DCF model to two groups of U.S. utilities, which indicated costs of equity in a range of 10.1% - 10.3% and (ii) two risk premium studies, one based upon two groups of Canadian utility stocks and one based upon two groups of American utility stocks, which indicated costs of equity in a range of 9.9% - 11.1%. Dr. Vander Weide used an allowance for financial flexibility of 0.5% in all results.

Reference: *Vander Weide Evidence, Page 45, Lines 6-13 and Table 3; Vander Weide Evidence, Page 31, Line 32 to Page 32, Line 3 and Exhibits 6 and 7 for discounted cash flow test results, including allowance for financial flexibility; Vander Weide Evidence, Page 35, Line 17 to Page 36, Line 4 for Canadian risk premium study results and Page 38, Line 15 to Page 39, Line 3 and Appendix 2 for U.S. risk premium study results.*

Dr. Vander Weide also performed a CAPM test which indicated a return on equity for Newfoundland Power of 8.05%. Modified CAPM test results indicated a return on equity for Newfoundland Power of 9.3%. Based upon evidence from the financial literature that the CAPM may underestimate the cost of equity and the CAPM's high degree of sensitivity to the risk free rate as measured by long term government bond yields, Dr. Vander Weide concluded CAPM results should be given little or no weight in estimating Newfoundland Power's cost of equity.

Reference: *Vander Weide Evidence, Page 40, Lines 25-31 and Exhibit 12 for 8.05%; Vander Weide Evidence, Page 43, Lines 23-28 and Exhibit 14 for 9.3%; Vander Weide Evidence, Page 40, Line 32 to Page 45, Line 4 for evidence of the CAPM's underestimation of the cost of equity and sensitivity to long term government bond yields.*

Dr. Vander Weide was cross-examined extensively on differences between Canadian utilities and U.S. utilities. It was Dr. Vander Weide's evidence that differences existed

between Canadian utilities and U.S. utilities and that the average Canadian utility may have less business risk than U.S. utilities. However, in terms of "total risk", Dr. Vander Weide indicated that Canadian utilities are similar to U.S. utilities. It was Dr. Vander Weide's evidence that only two Canadian utilities that are market traded would meet his screening criterion for U.S. utilities of having 80% assets devoted to regulated activities.

Reference: *Dr. Vander Weide, Transcript, January 17, 2013, Page 35, Line 25, et. seq.; Dr. Vander Weide, Transcript, January 17, 2013, Page 113, Line 25 to Page 119, Line 17 and Page 128, Line 5 to Page 130, Line 2.*

D.4.5 Dr. Booth

Dr. Booth's evidence relies upon an adjusted CAPM estimate to indicate a fair return on equity for Newfoundland Power. Dr. Booth creates a "simple" CAPM estimate for a benchmark utility for 2013 of 5.75% - 6.80%. To this "simple" CAPM estimate, Dr. Booth adds an adjustment of (i) 0.40 % for currently high credit spreads, and (ii) 0.80% for the impact of Operation Twist. The adjustments which total 1.2% were added to Dr. Booth's "simple" CAPM estimate to establish his fair return estimate of 6.95% - 8.00%, with a mid-point of 7.50%. Dr. Booth used a flotation cost allowance of 0.5%.

Reference: *Booth Evidence, Page 45, Line 4 to Page 46, Line 10 for "simple" CAPM estimate; Booth Evidence, Page 56, Lines 21-29 for adjustments for credit spreads and Operation Twist and estimated fair return.*

Dr. Booth's recommendation for a fair return on equity for Newfoundland Power in 2013 is 7.50% and is based upon an adjusted application of CAPM. Between August 2009 and November 2012, Dr. Booth's adjustments to "simple" or base CAPM estimates of fair utility returns on equity have increased from 0.25% to account for his margin of error in estimating the market risk premium in Newfoundland Power's 2010 general rate

application to 1.20% to account for high credit spreads and Operation Twist in this proceeding. It is Dr. Booth's evidence that more judgment is required at the current point in time in relying on the CAPM formula.

Reference: *Dr. Booth, Transcript, January 18, 2013, Page 47, Line 16 to Page 59, Line 25; NP-CA-029, PUB-CA-018 and PUB-CA-019.*

Dr. Booth performs a DCF analysis of U.S. utilities which indicates a result of 8.73% before any allowance for financial flexibility. When Dr. Booth was questioned as to whether a 50 basis point adjustment was reasonable, he indicated such an adjustment was reasonable but he didn't use the DCF estimate. All except one of the utilities in Dr. Booth's U.S. sample are included in Ms. McShane's U.S. samples in this proceeding.

Reference: *Booth Evidence, Page 64, Line 26 and Appendix D, Page 15; Dr. Booth, Transcript, January 18, 2013, Page 70, Line 6 to Page 75, Line 3.*

Dr. Booth recognized that there has been a shift in emphasis in Canada in terms of the use of DCF with CAPM. Dr. Booth did not use the DCF methodology as a primary technique to estimate a fair return for Newfoundland Power, however, he has "started to look more seriously at DCF models" and prior to the shift to formulas in 1993, routinely placed 50% weight on DCF models and 50% on risk premium models.

Reference: *Dr. Booth, Transcript, January 18, 2013, Page 40, Line 10 to Page 46, Line 14; PUB-CA-026.*

In response to questioning on utility returns on equity in 2012, Dr. Booth indicated that utility allowed ROEs set out in Schedule 3 to Ms. McShane's testimony averaged 9.08% for 2012. In cross-examination, Dr. Booth indicated that some of the returns are for utilities that are "demonstrably more risky than Newfoundland Power". This risk

differentiation may be contrasted with Dr. Booth's assertion in direct testimony that he regarded "Newfoundland Power as very similar to every other regulated utility in Canada. It's very difficult to objectively see significant differences of risk across them."

Reference: *PUB-CA-023; McShane Evidence, Schedule 3, Page 2 of 3; Dr. Booth, Transcript, January 18, 2013, Page 77, Line 16 to Page 78, Line 12 and January 17, 2013, Page 162, Lines 11-16.*

Dr. Booth made reference to long run equity returns estimated by TD economics and pension fund advisors, such as Mercer. Mercer, which is Newfoundland Power's actuary, has in response to a Request for Information from the Consumer Advocate, indicated the long run expected average rate of return for equities in Newfoundland Power's pension plan to be 9.9% per year. Use of long run geometric estimations of returns to establish a utility's cost of equity is not advocated by any expert in this proceeding.

Reference: *See, for example, Dr. Booth, Transcript, January 18, 2013, Page 131, Line 18 to Page 134, Line 18; CA-NP-382; see McShane Evidence, Appendix A, Page A-6, et. seq. and Booth Evidence, Page 63, Line 8 to Page 64, Line 12.*

D.4.6 Mr. MacDonald

Mr. MacDonald's evidence relies on multiple tests to indicate a fair return on equity for Newfoundland Power. In his view, no single universally accepted method exists to determine a fair return on equity for an investor-owned utility. Further, Mr. MacDonald indicated it is best to estimate the cost of capital using more than one methodology as the return determined by any model or test will not perfectly capture all of the variables that might be considered in determining a fair return.

Reference: *MacDonald Evidence, Page 26, Lines 465-473.*

Mr. MacDonald's recommendation for a fair return on equity for Newfoundland Power for 2013 and 2014 is 8.91%. This recommendation is based upon (i) a CAPM estimate of 6.84%, (ii) a DCF result of 9.63% and (iii) a ERP estimate of 10.26%, each of which Mr. MacDonald weights equally. Mr. MacDonald used an allowance for financial flexibility of 0.5% in all results.

Reference: *MacDonald Evidence, Page 37, Table 19; Page 30, Table 15; Page 33, Line 651; Page 36, Table 18.*

Mr. MacDonald justified his use of U.S. comparables for his DCF test on (i) the lack of Canadian data, (ii) the strong degree of economic and financial market integration between Canada and the U.S., and (iii) the large universe of comparable public companies in the U.S. market which permits the construction of a proxy group that is similar in total risk to Newfoundland Power. Mr. MacDonald selected his U.S. comparables from a total investment perspective.

Reference: *MacDonald Evidence, Page 33, Line 674 to Page 34, Line 704; Mr. Macdonald, Transcript, January 18, 2013, Page 193, Line 3-23.*

It is Mr. MacDonald's evidence that in applying a weighting to his methodologies he was able to "adjust" his CAPM result of 6.84% which was below what he believed to be a fair allowed return on equity for the Company. Because Mr. MacDonald weights his results equally, the 9.63% DCF result is, in his view, "adjusted" by 72 basis points in his return on equity recommendation of 8.91%.

Reference: *MacDonald Evidence, Page 33, Lines 652-653; Mr. MacDonald, Transcript, January 18, 2013, Page 189, Line 10 to Page 191, Line 3, and Page 178, Line 23 to Page 180, Line 13.*

It was Mr. MacDonald's evidence that although there may be merit in attempting to adjust the CAPM to the "perfect answer" it is inherently difficult to determine the nature and level of adjustments. His view is that using multiple methodologies is better than introducing potentially arbitrary adjustments.

Reference: *MacDonald Evidence, Page 33, Lines 666-673.*

D.4.7 Submission on Fair Return

It is common ground in this Application that Newfoundland Power is an average risk or typical Canadian regulated utility.

The expert recommendations on a fair return on equity for an average risk or typical Canadian regulated utility range from 7.50% (Dr. Booth) to 8.91% (Mr. MacDonald) to 10.4% (Dr. Vander Weide) to 10.5% (Ms. McShane). In considering this range of recommendations, it is observed that the estimation of utility rate of return is not an exact science.

In this Application, all expert recommendations on Newfoundland Power's cost of equity, except those of Dr. Booth, are based upon multiple tests. Use of multiple tests was endorsed by Ms. McShane, Dr. Vander Weide and Mr. MacDonald because of the imperfections and inexactness of the estimation of utility rate of return. For this reason, the Board should give greater weight to recommendations arrived at by use of multiple tests or methodologies.

Similarly, the financial markets outlook for all witnesses, except Dr. Booth, is cautious. Financial market conditions are a critical part of the context for estimating Newfoundland Power's cost of equity. Current financial market conditions, which include extraordinarily low Long Canada Bond Yields, cannot be considered "normal" from the perspective of the estimation of utility rate of return. For this reason, the Board should give greater weight to recommendations which are based upon a realistic view of financial market conditions.

Finally, the Board is required by the power policy of the province to consider the impact of the return it allows upon Newfoundland Power's credit rating. The evidence indicates that the equity returns achieved by Newfoundland Power in the period from 2010 through 2012 have been sufficient, in combination with a 45% common equity ratio, to preserve the Company's sound credit rating. The evidence also indicates that the recommendations of Dr. Booth would put that credit rating at risk. For this reason, the Board should give greater weight to the recommendations of the other cost of capital experts.

E. THE FORMULA

E.1 Background

Up to 1998, the Board set Newfoundland Power's return through a general rate application or cost of capital application initiated by the Board or the Company. In 1998, the Board first ordered adoption of the Formula to reduce (i) cost associated with reviews of cost of capital and (ii) regulatory uncertainty. For the decade ending in 2007, the year the Company's 2008 general rate application was determined, the Formula appeared to broadly achieve these objectives.

Reference: *Company Evidence, Page 3-31, Lines 7-15.*

Cost of capital formulas similar to the Formula, and also based upon changes in Long Canada Bond Yields, were approved by the AUC, BCUC, Manitoba PUB, NEB, OEB and the Régie for use in the period up to 2008. Since 2009, there has been no broad consensus amongst Canadian utility regulators concerning formula based approaches to annually update utilities' cost of equity. Since 2009, only the OEB and the Régie have retained use of a formula for the mandatory determination of utility cost of equity. For the OEB, the use of a formula is required due to the large number of distribution utilities regulated and the practical impossibility of having hearings for all of them.

Reference: *Company Evidence, Page 3-32, Lines 4-8 and Page 3-33, Line 1; Dr. Booth, Transcript, January 18, 2013, Page 107, Line 25 to Page 108, Line 25.*

In 2009, the Board determined that Newfoundland Power's rate of return on rate base for 2011 and 2012 would be set using the Formula. The Formula approved by the Board at that time was:

Forecast cost of equity = 9.00% + (0.80 (RFR – 4.50%))

where:

(i) 9.00% is the cost of equity approved for ratemaking purposes in 2010;
(ii) 0.80 is the adjustment coefficient for the change in the forecast risk-free rate;
(iii) RFR is the risk-free rate; and,
(iv) 4.50% is the risk-free rate approved by the Board for the 2010 test year.

Reference: *Company Evidence, Page 3-33, Lines 3-14.*

In 2009, the Company filed a general rate application with the Board to address, in part, the failure of the Formula to estimate a fair return on equity for 2010. As a result, the Board established a higher ratemaking return on equity for 2010 than that indicated by the Formula. The Board did not, however, discontinue use of the Formula as proposed by Newfoundland Power at the time.

Reference: *Order No. P.U. 43 (2009), Page 30, Lines 25-26.*

In 2010, the Formula estimated a ratemaking return on equity for Newfoundland Power for 2011 of 8.38%, the lowest ratemaking return on equity then allowed for a Canadian investor-owned electric utility. The evidence indicates that Newfoundland Power did not seek to suspend operation of the Formula at that time due to a number of factors, including the disposition of joint-use poles to Bell Aliant. In 2011, Newfoundland Power earned a regulated return on common equity of 9%, which was consistent with the 9% allowed in Order No. P.U. 43 (2009). The Company's ability to earn a return on equity higher than that indicated by the Formula for 2011 was principally the result of the Bell Aliant transaction.

Reference: *Order No. P.U. 32 (2010); Ms. Perry, Transcript, January 10, 2013, Page 145, Lines 20-25 and Page 153, Line 24 to Page 155, Line 12; Company Evidence, Page 3-14, Lines 1-3 and Footnote 41.*

In 2011, the Formula estimated a ratemaking return on equity for Newfoundland Power for 2012 of 7.85%, again the lowest ratemaking return on equity allowed for a Canadian investor-owned electric utility. In Order No. P.U. 25 (2011), the Board ordered suspension of the operation of the Formula for 2012. Following a subsequent application by the Company to establish a fair return for 2012, the Board approved a ratemaking return on equity for Newfoundland Power for 2012 of 8.80%.

Reference: *Order Nos. P.U. 25 (2011) and P.U. 17 (2012).*

E.2 Newfoundland Power's Position

E.2.1 Bond Yields and Forecasts

Current Long Canada Bond Yields are abnormally low and reflect the impact of governmental actions in financial markets. According to Ms. McShane, because of this, the trend in Long Canada Bond Yields is not indicative of the trend in the market cost of equity. According to Dr. Booth, current forecast Long Canada Bond Yields is an interest rate that is not made in Canada but reflects U.S. and Eurozone problems.

Reference: *Company Evidence, Page 3-38, Lines 10-12; McShane Evidence, Page 31, Line 790 to Page 32, Line 819; Booth Evidence, Page 26, Lines 1-4.*

Ms. McShane indicates Long Canada Bond Yields should rise to more normal levels over the longer term. However, persistently unsettled markets and the unstable relationships between the utility cost of equity and Long Canada Bond Yields makes it difficult to construct a formula that would successfully capture prospective changes in

the utility cost of equity. In particular, any formula tied to changes in Long Canada Bond Yields has a potential to unfairly suppress the allowed return on equity.

Reference: *McShane Evidence, Page 45, Lines 1121-1129 and Page 48, Lines 1192-1197.*

E.2.2 Looking Forward

Newfoundland Power proposes that the Board should discontinue use of the Formula given current financial market conditions. The experience with the Formula since 2008 has not been consistent with improved regulatory efficiency or reduced regulatory uncertainty.

Reference: *Company Evidence, Page 3-31, Lines 17-18 and Page 3-38, Lines 10-12.*

There is no requirement for a formula and a formula is not necessary for the Board to exercise a reasonable degree of regulatory supervision over Newfoundland Power's allowed return on equity. The Board may order Newfoundland Power to file its next rate case at any time determined by the Board to be reasonable.

Reference: *PUB-NP-115 and CA-NP-398.*

E.3 The Booth Proposal

Dr. Booth recommended the following automatic adjustment formula:

ROE = 7.50 + 0.50*(Spread-1.80%) + 0.75*(max(Forecast LTC Yield, 3.80%)-3.80%)

where:

(i) 7.50 is the cost of equity approved for ratemaking purposes in 2013;
(ii) 0.50 is the adjustment coefficient for the change in the A grade utility bond credit spread;
(iii) 1.80% is the A grade utility bond credit spread;

(iv) 0.75 is the adjustment coefficient for the change in Long Canada Bond Yields; and
(v) 3.80% is the floor under which Long Canada Bond Yields will not change.

Dr. Booth's recommended formula was not necessarily tied to his recommended return on equity of 7.5%.

Reference: *Booth Evidence, Page 70, Lines 6-11.*

Dr. Booth's evidence was that Long Canada Bond Yields would have to rise 130 basis points to 3.80% for his formula to result in an adjustment to the Company's ratemaking return on equity. Dr. Booth indicated that the perception of most forecasters was that such an increase in Long Canada Bond Yields was unlikely until 2015 or beyond; however, capital market conditions can change quite rapidly.

Reference: *Dr. Booth, Transcript, January 18, 2013, Page 110, Line 1 to Page 111, Line 20.*

Ms. Perry gave evidence that the operation of Dr. Booth's recommended formula could signal a reduction in Newfoundland Power's 2014 cost of equity if Long Canada Bond Yields rose by less than 1.2% but this was accompanied by a decline in the utility bond spread. Dr. Booth agreed this could be a result of the operation of his recommended formula. However, Dr. Booth seemed to indicate that this was the result of a more "complicated model".

Reference: *Ms. Perry, Transcript, January 10, 2013, Page 159, Line 9 to Page 162, Line 5; Exhibit JP-2; Dr. Booth, Transcript, January 18, 2013, Page 112, Line 24 to Page 117, Line 5.*

Dr. Booth indicated he was recommending an adjustment formula because he was asked to recommend an adjustment formula and in order to capture capital markets,

which did not have normal Long Canada Bond Yields, Dr. Booth thought his formula would accurately reflect a fair return on equity for the next few years. Dr. Booth thought it was a reasonable option for the Board to set the Company's rate of return and wait and see what happens with the capital markets. For this reason, Dr. Booth recommended a "fixed" rate of return of 8.25% for a 5 year period.

Reference: *Dr. Booth, Transcript, January 18, 2013, Page 119, Line 22 to Page 121, Line 25; Booth Evidence, Page 73, Line 10 to Page 74, Line 11; Dr. Booth, Transcript, January 18, 2013, Page 111, Line 22 to Page 112, Line 17.*

Mr. MacDonald indicated that the 3.80% floor in Dr. Booth's recommended formula would require the risk free rate to increase above this level before Newfoundland Power would receive an increase in its ratemaking return on equity; that the 0.75 coefficient recommended by Dr. Booth would cause similar sensitivity to the risk free rate as experienced to date; and given the current low interest rates, this appeared to be a burden to Newfoundland Power by way of delayed increases in the return on equity as the risk free rate increased.

Reference: *Mr. MacDonald, Transcript, January 18, 2013, Page 185, Line 21 to Page 187, Line 7.*

E.4 The MacDonald Proposal

Mr. MacDonald recommended the following automatic adjustment formula:

ROE = Base ROE + (0.50(LCBF-Base LCBF)) + (0.50(Util Bond Spread-Base Util Bond Spread)

where:

(i) The Utility Bond Spread is the Bloomberg Series 29530Y index less the Long Canada Bond Yields; and

(ii) The Base Utility Bond Spread is the Utility Bond Spread reflected in the base ROE.

Mr. MacDonald's recommended formula would not result in a change in Newfoundland Power's ratemaking return on equity when the formula indicated variations within a dead band of ± 0.25%. There would be a full cost of capital review if Mr. MacDonald's recommended formula estimated a ratemaking return on equity of ± 1%.

Reference: *MacDonald Evidence, Page 40, Lines 835 to Page 41, Line 891.*

Dr. Booth indicated that, conceptually, the 0.50 coefficient for Long Canada Bond Yields violates basic economic assumptions. However, Dr. Booth indicated he didn't think it mattered as much now as it did in the 1990s and 2000s.

Reference: *Dr. Booth, Transcript, January 18, 2013, Page 107, Lines 1-23 and Page 109, Lines 11-24.*

Ms. Perry indicated that the lack of consensus on the relationship between Long Canada Bond Yields and a utility's cost of capital was the reason Newfoundland Power did not propose a formula and that the differences between Mr. MacDonald's recommended formula and Dr. Booth's recommended formula demonstrated that lack of consensus. Under Mr. MacDonald's recommended formula, a 1.2% increase in Long Canada Bond Yields would almost certainly increase Newfoundland Power's forecast cost of equity, whereas under Dr. Booth's recommended formula, such an increase in Long Canada Bond Yields would either leave Newfoundland Power's forecast cost of equity unchanged or, possibly, reduced.

Reference: *Ms. Perry, Transcript, January 10, 2013, Page 162, Lines 6-21.*

Mr. MacDonald's evidence was that a formula was appropriate because it created regulatory certainty so all parties understood what would happen in 2015 if there was not a rate hearing. Mr. MacDonald agreed that application of the formula to the cost of equity resulted in the Board refreshing one cost but not refreshing other costs, such as annual depreciation expense.

Reference: *Mr. MacDonald, Transcript, January 18, 2013, Page 199, Line 1 to Page 201, Line 10.*

Mr. MacDonald agreed that one of the alternatives for the Board with respect to setting rate of return is simply to set the rate of return and have any party apply to change it as needed.

Reference: *Mr. MacDonald, Transcript, January 18, 2013, Page 214, Lines 8-22.*

E.5 Submission on the Formula

Applications to the Board by Newfoundland Power related to the Company's return on equity have increased markedly since 2007. In applications resulting in Order Nos. P.U. 32 (2007), P.U. 43 (2009), P.U. 17 (2012) and in this Application, the sufficiency of the allowed return on equity for Newfoundland Power was considered by the Board. In addition, in the applications resulting in Order Nos. P.U. 35 (2008), P.U. 12 (2010), P.U. 32 (2010) and P.U. 25 (2011), the mechanics, operation or suspension of the Formula was considered by the Board.

Reference: *Company Evidence, Page 3-31, Line 17 to Page 3-32, Line 1 and footnote 103.*

The number of regulatory examinations of Newfoundland Power's cost of equity since 2009 has not been consistent with the primary regulatory objectives of the Formula: (i)

reduced regulatory cost and (ii) reduced regulatory uncertainty. This has been the result of the inability of the Formula to estimate a fair return for Newfoundland Power in current financial market conditions.

In this Application, two formulas are recommended for the Board's consideration to establish a fair return for Newfoundland Power. The two formulas proposed do not indicate similar estimates of Newfoundland Power's cost of equity in similar financial market circumstances. They, in effect, highlight the difficulty of using pre-established formulas to estimate a utility's cost of capital in current financial market conditions. Dr. Booth's proposed "floor" in relation to Long Canada Bond Yields demonstrates the lack of any predictable relationship between Long Canada Bond Yields and a utility's cost of equity in current market conditions.

Section 80 of the *Public Utilities Act,* in effect, entitles Newfoundland Power to a reasonable opportunity to earn a fair return each year. This entitlement has been characterized by the Newfoundland and Labrador Court of Appeal as a matter of "fundamental importance".

Reference: *Stated Case, Page 16, Paragraph 24.*

Recent experience indicates that, in current financial market conditions, the Formula has not provided such a reasonable opportunity. The divergent formulas proposed in this proceeding simply do not provide a reasonable basis for ensuring that Newfoundland Power will have a reasonable opportunity to earn a fair return following the test period. For this reason, the Board should discontinue use of a formula to

establish Newfoundland Power's ratemaking return on equity for years following the test period.

F. DEPRECIATION

F.1 The Depreciation Study

The Depreciation Study filed with the Application was prepared by Gannett Fleming. Gannett Fleming has performed comprehensive depreciation studies of Company plant in service since 1996. These studies have formed the basis of the Company's depreciation rates since that time. The Depreciation Study uses methods and procedures which are the same as used for prior depreciation studies and complies with orders of the Board.

Reference: *Company Evidence, Page 3-42; Order Nos. P.U. 7 (1996-97), P.U. 19(2003) and P.U. 32(2007); Mr. Wiedmayer, Transcript, January 23, 2013, Page 43, Line 24 to Page 44, Line 11.*

The depreciation rates and related cost recovery deferrals proposed in the Depreciation Study result in depreciation estimates for 2013 and 2014 of $46.6 million and $48.3 million, respectively.

Reference: *Company Evidence, Page 3-44, Line 6 et. seq., including Table 3-17; Grant Thornton Report, Page 28, Lines 1-34.*

The Consumer Advocate's consultant, Mr. Pous, recommends that Newfoundland Power's depreciation expense be reduced by $10.5 million, which reflects a combination of reduced annual depreciation expense and amortization of deferred balances. The deferred balances arise from Mr. Pous' recommendation that Newfoundland Power adopt the ALG procedure in substitution for the current ELG procedure, which has been approved by the Board.

Reference: *Pous Evidence, Page 6, Line 26 to Page 7, Line 2 and Schedule (JP-1).*

The evidence indicates that, in preparing the Depreciation Study and the previous three studies, Gannett Fleming has reviewed and analyzed historical data of asset service life and net salvage; interviewed key engineering and operations staff from Newfoundland Power; and toured a number of the Company's facilities. Interviews with engineering and operations staff help Gannett Fleming understand the major causes of past asset retirements and factors that are likely to affect future asset retirements. Visual inspection of assets helps Gannett Fleming assess the condition of the assets and interpret historical data. Comparison with prior Newfoundland Power depreciation studies approved by the Board and other depreciation studies performed by Gannett Fleming in Canada and the U.S. provide reasonableness checks on service life estimates.

Reference: *Mr. Wiedmayer, Transcript, January 23, 2013, Page 14, Line 18 to Page 26, Line 7.*

The evidence indicates that, in preparing his recommendations, Mr. Pous did not develop individual life and salvage account parameters for each Newfoundland Power asset account. Mr. Pous selected 7 of the 57 mass property accounts and made recommendations in respect of them. Typically, Mr. Pous analyzes specific asset accounts, usually not all accounts. Mr. Pous appeared to indicate that this approach constituted a "depreciation study".

Reference: *Mr. Pous, Transcript, January 24, 2013, Page 113, Line 25 to Page 116, Line 13.*

F.2 The Equal Life Group Procedure

F.2.1 Regulatory History

The Board first approved Newfoundland Power's use of the ELG procedure to calculate depreciation rates in Order No. P.U. 20 (1978). At that time, Newfoundland Power was authorized to use the ELG procedure for property added after January 1, 1979.

Reference: *Order No. P.U. 20 (1978), Pages 2-3.*

In determining that the Company should use the ELG procedure to calculate depreciation for *all* plant in service, effective January 1, 1983, the Board observed in Order No. P.U. 47 (1982) that it:

> **"…agrees that rates of depreciation based on the [ELG] procedure is the best method of recovering invested capital over the useful life of the plant.** Having reached this conclusion, the [ELG] procedure stands the test of a reasonable and prudent expense properly charged to operating account." (emphasis added)

For the 30 years since January 1, 1983, Newfoundland Power has used the ELG procedure to calculate depreciation for all plant in service.

Reference: *Company Rebuttal Evidence, Page 2, Line 3 to Page 7, Line 8; CA-NP-017 provides depreciation studies performed by Monenco Consultants Limited and Gannett Fleming since 1983 which use the ELG procedure to calculate depreciation.*

F.2.2 Regulatory Practice

Of 34 Canadian utilities surveyed by Newfoundland Power, 17, or 50%, currently use the ELG procedure to calculate depreciation compared to 14 of the utilities surveyed, or 41%, which currently use the ALG procedure to calculate depreciation. Use of the ELG

procedure to calculate depreciation rates for utility ratemaking purposes is consistent with generally accepted public utility practice in Canada.

Reference: *Company Rebuttal Evidence, Page 7, Line 10 to Page 8, Line 7 and Exhibit R1. Mr. Pous was only able to identify one Canadian utility that used the ALG procedure in NP-CA-037 and conceded that while the survey results in Exhibit R1 are not complete, they are more complete than what he did. See Mr. Pous, Transcript, January 24, 2013, Page 119, Line 15 to Page 120, Line 5.*

In the U.S., use of the ELG procedure is less common for gas and electric utilities. Gannett Fleming indicated that approximately 20% of its studies for American utilities done in the past 10 years use the ELG procedure; approximately 80% of its studies over this period use the ALG procedure.

Reference: *CA-NP-006 and CA-NP-618; and Mr. Wiedmayer, Transcript, January 23, 2013, Page 67, Line 13 to Page 68, Line 2.*

ELG has been described by Robley Winfrey, the creator of the Iowa type survivor curves widely used in utility depreciation practice, as the "only mathematically correct procedure" for calculating depreciation. Mr. Wiedmayer provided an example in evidence of why this is so.

Reference: *Wiedmayer Rebuttal Evidence, Pages 2-5; Mr. Wiedmayer, Transcript, January 23, 2013, Page 46, Line 18 to Page 55, Line 16; CA-NP-006 and CA-NP-623.*

This aspect of the ELG procedure has been previously recognized by the Board. In Order. No. P.U. 34 (1977), the Board observed that "There is merit in amortizing the cost of both short-life and longer-life units during their respective service lives as is done by the [ELG] procedure". In Order No. P.U. 20 (1978), the Board observed that "…deferring depreciation on short-life property units to future years gives users incorrect information on the current cost of electric energy."

Reference: *Order No. P.U. 34 (1977), Page 18; and Order. No. P.U. 20 (1978), Page 13.*

Mr. Pous accepts the "theoretical correctness" of the ELG procedure and that he "probably" would have adopted ELG in the early 1980s, though he disputes its "real world" application in this proceeding. Mr. Pous is not aware of any companies in Canada that are transitioning from the ELG procedure to the ALG procedure.

Reference: *Pous Evidence, Page 11, Lines 4-6; Pous Surebuttal Evidence, Page 12, Line 8 and Page 23, Lines 9-11; Mr. Pous, Transcript, January 24, 2013, Page 84, Line 4 to Page 89, Line 4; Mr. Pous, Transcript, January 24, 2013, Page 123, Lines 21-25.*

In support of his recommendation to have Newfoundland Power adopt the ALG procedure, Mr. Pous provided an excerpt of his own testimony on the ELG procedure in a 1997 proceeding before the Railroad Commission of Texas concerning Lone Star Pipeline Company ("Lone Star"). In response to Request for Information NP-CA-049, Mr. Pous provided a copy of an Administrative Law Judges proposed decision in that proceeding before the Railroad Commission of Texas. At the hearing, the final decision of the Railroad Commission of Texas was provided. The final decision indicated, amongst other things, that the Commission ruled "…Because it provides a more accurate estimate of the actual consumption of property, the ELG depreciation procedure requested by Lone Star is reasonable." Lone Star continues to use the ELG procedure today.

Reference: *Pous Evidence, Appendix B; NP-CA-049; Information #22; Mr. Pous, Transcript, January 24, 2013, Page 156, Line 1 to Page 160, Line 11 and Page 170, Lines 2-14.*

F.2.3 Customer Rate Impacts

The evidence is that the Company's historical use of the ELG procedure to calculate depreciation rates (as opposed to the ALG procedure) has resulted in *reduced* pro forma 2014 revenue requirements of approximately $3.7 million. This includes the combination of reduced depreciation expense under the ALG procedure and the increased return and associated taxes resulting from an increased rate base under the ALG procedure.

Reference: *Company Rebuttal Evidence, Page 9, Line 6 to Page 10, Line 11 and Exhibit R2.*

Mr. Pous' depreciation recommendations for Newfoundland Power, including the adoption of the ALG procedure, would result in the transfer of approximately $70 million, net of tax, that has been collected from customers in the past to the customers in the future. That amount would have to be collected from customers at some point in the future. In short, these recommendations advocate a current rate reduction at the expense of higher cost for customers in the future.

Reference: *Ms. Perry, Transcript, January 10, 2013, Page 162, Line 22 to Page 163, Line 19; Mr. Pous, Transcript, January 24, 2013, Page 137, Line 13 to Page 140, Line 12.*

F.3 Service Lives

Of the 57 mass property accounts assessed in the Depreciation Study, an increase in service lives is recommended in 27 cases and a reduction of service life is recommended in 5 cases. No change is recommended for the remaining 25 mass property accounts.

Reference: *Wiedmayer Rebuttal Evidence, Page 15; Mr. Wiedmayer, Transcript, January 23, 2013, Page 31, Line 8 to Page 32, Line 7.*

Table F-1 summarizes the currently approved and proposed service life estimates for the 7 mass property accounts for which Mr. Pous has recommended an extension of service lives.

Table F-1
Estimated Service Lives
Current and Proposed[1]

Account	Description	Currently Approved	Newfoundland Power Proposal	Consumer Advocate Proposal
355.1 *	Transmission Poles	44	47	51
355.2 *	Transmission Poles and Fixtures	44	47	51
361.12	Distribution Bare Aluminum	50	55	61
361.2	Distribution Underground Cables	40	45	57
362.1 *	Distribution Poles (Under 35')	45	48	57
362.2 *	Distribution Poles (35' and Over)	45	48	57
365.1	Services Overhead	39	44	51

* Accounts 355.1 and 355.2 and accounts 362.1 and 362.2 are combined for life analysis

[1] Table F-1 is taken from Mr. Wiedmayer's Rebuttal Evidence, Appendix B, Page 1. Estimated service lives have been substituted for the survivor curves that appear in Mr. Wiedmayer's Rebuttal Evidence.

For each account in respect of which Mr. Pous is recommending to extend service life, the Depreciation Study has also proposed to extend service life. The essential issue is one of degree. Mr. Pous' proposed extension to service lives for these accounts, averages more than 25% over current estimated service lives. This compares to an average increase of just under 10% proposed by Gannett Fleming.

The evidence is that the determination of estimated service lives for property is a subjective or judgmental exercise. However, evidence is required to indicate that service lives are either increasing or decreasing. The examples of meters, which are expected to experience reduced service lives due to changes in technology, and distribution line transformers, which are expected to experience increased service lives due to use of stainless steel, were canvassed in the evidence of Gannett Fleming.

Reference: *The Depreciation Study, Page II-27 to 28; Mr. Wiedmayer, Transcript, January 23, 2013, Page 21, Line 1 to Page 24, Line 8; Page 147, Line 6 to Page 149, Line 12.*

According to the evidence of Mr. Pous, industry, technology, and management input are all relevant to the judgmental exercise of establishing estimated service lives. In his evidence, Mr. Pous referred to the use of stub poles and implied they might extend life expectancy of utility poles by 10 to 15 years. The evidence of Newfoundland Power's Vice-President, Customer Operations and Engineering, Mr. Smith, indicated that Newfoundland Power used stub poles only as an emergency repair. This use would not extend life expectancy of utility poles by 10 to 15 years.

Reference: *Mr. Pous, Transcript, January 24, 2013, Page 103, Line 23 to Page 109, Line 2; Mr. Smith, Transcript, January 25, 2013, Page 83, Line 12 to Page 85, Line 6.*

Nothing on the record of this proceeding indicates that the judgments, with respect to service lives, which are contained in the Depreciation Study, are anything but reasonable. These judgments are informed by Gannett Fleming's comprehensive approach to preparation of the Depreciation Study.

Reference: *See Page F-2, Lines 1-11 of this submission.*

F.4 Salvage for Services

Mr. Pous recommends that Newfoundland Power decrease its salvage estimate for overhead services from -60% to -40%. A primary justification for Mr. Pous' recommendation for salvage on services is the concept of economies of scale; that higher quantities of services will be retired in the future, so the cost will be lower. Gannett Fleming maintains that the salvage estimate of -60% should remain unchanged from the last Depreciation Study.

Reference: *Pous Evidence, Page 42, Line 1 to Page 44, Line 2; Wiedmayer Rebuttal Evidence, Pages 26-29 and Appendix C.*

The evidence is that there is just as much labour associated with removal of a service as putting a service in in the first place and that -60% net salvage for overhead services is quite typical. Gannett Fleming has seen companies that use -100% or higher.

Reference: *Mr. Wiedmayer, Transcript, January 24, 2013, Page 50, Line 8 to Page 52, Line 5.*

There is no reason to expect that either a higher quantity of services will be retired in the future or that the cost of retirement will be lower. The current standards and practices for retirement of services are outlined in the evidence and have not been challenged as factually inaccurate.

Reference: *Wiedmayer Rebuttal Evidence, Pages 26-29 and Appendix C; CA-NP-679, CA-NP-680 and CA-NP-681.*

F.5 Submission on Depreciation

The Depreciation Study filed with the Application was conducted in a manner consistent with past depreciation studies of the Company and orders of the Board. The

Depreciation Study included a review of historical data, current practices and engineering management's future expectations. It provides reasonable and prudent estimates of depreciation expense for the purpose of establishing customer electricity rates.

In this Application, the Consumer Advocate's consultant, Mr. Pous, recommends Newfoundland Power's depreciation expense be reduced by approximately $10.5 million per year. Approximately $7.1 million of this recommended reduction is associated with the recommendation that Newfoundland Power adopt the ALG procedure for calculating annual depreciation expense. Approximately $2.8 million of this recommended reduction is associated with the extension of service lives for 7 mass property accounts by an average of over 25%. The remaining $0.6 million in reduced depreciation expense is attributable to reduced salvage costs for overhead services on the basis that more services will be retired in the future so the cost will be lower.

Since first ordered by the Board in 1978, Newfoundland Power has used the ELG procedure to calculate depreciation expense. Since 1983, it has used this procedure exclusively. The evidence before the Board is that the use of the ELG procedure to calculate depreciation is consistent with generally accepted sound public utility practice in Canada within the meaning of section 4 of the *Electrical Power Control Act, 1994.* In addition, the evidence before the Board is clear that the ELG procedure is the most mathematically correct and theoretically sound basis for calculating depreciation expense. The evidence before the Board indicates that the Company's 2014 revenue

requirements are approximately $3.7 million lower than they otherwise would be as a result of the Board's ordering Newfoundland Power to adopt the ELG procedure approximately 30 years ago. Finally, the evidence indicates that after a limited period, future electricity rates will be higher because of the increase in rate base. No reasonable evidentiary support for the Company's adoption of the ALG procedure has been shown on the record with this Application.

Each of the 7 mass property accounts for which the Consumer Advocate's consultant, Mr. Pous, recommends extension to service life has already been recommended for service life extension in the Depreciation Study. The average service life extension proposed by Mr. Pous for these accounts averages just over 25% more than that in the previous depreciation study. There is no reasonable evidence on the record supporting changes of this magnitude. More significantly, there is no evidence whatsoever on the record of this Application indicating that the service lives recommended in the Depreciation Study are not reasonable.

The Depreciation Study does not propose a change to Newfoundland Power's current salvage for overhead services of -60%. Mr. Pous recommends a reduction in salvage to -40% based upon projected economies of scale. There is no evidence that any change in retirement practices for overhead services is expected by the Company or that any economies of scale are possible.

G. OTHER MATTERS

G.1 Operating Efficiency

It is Newfoundland Power's evidence that its forecast 2013 and 2014 costs are appropriate for the purpose of establishing customer rates. These costs are required for the management and operation of the electrical system at the lowest possible cost consistent with the provision of safe, reliable service to Newfoundland Power's customers.

Reference: *Company Evidence, Page 2-1, Lines 19-22.*

Newfoundland Power's operating costs reflect reasonable and sustainable levels of cost efficiency. Effective use of technology contributes to the Company's ability to improve efficiency in its maintenance operations. Ongoing deployment of automated meter reading meters reduces meter reading costs. Increased customer participation in *eBills,* Newfoundland Power's electronic billing program, reduces billing costs. Operational efficiencies implemented by the Company since its last general rate case and an explanation of potential test period efficiencies have been provided.

Reference: *Company Evidence, Page 2-10, Line 1 to Page 2-12, Line 6; PUB-NP-001, CA-NP-126, CA-NP-136 and CA-NP-682.*

Newfoundland Power's labour costs are forecast to increase by approximately 1% less than the Company's average labour rate increase from 2010 through 2014. Mr. Smith's evidence was that, when energy conservation costs are excluded, the Company's operating costs per customer actually decrease on an inflation adjusted basis; and that in 2014, the Company expects to serve 2.6% more customers than in 2012 at labour

costs that are 2% less on an inflation adjusted basis. In the test period, continued efficiency improvements are forecast so that customers will receive the benefit of the efficiencies regardless of whether the Company actually achieves them.

Reference: *Company Evidence, Page 2-29, Line 15 to Page 2-30, Line 1; Mr. Smith, Transcript, January 25, 2013, Page 8, Line 3 to Page 10, Line 6.*

Grant Thornton has reviewed and analyzed the Company's operating expenses for the test period and have concluded, based on their analysis, that nothing has come to their attention indicating that the 2013 and 2014 forecast operating expenses are unreasonable on an overall basis.

Reference: *Grant Thornton Report, Page 31, Line 8 to Page 32, Line 44.*

G.2 Submission on Operating Efficiency

The provincial power policy requires, in effect, that Newfoundland Power's operations be consistent with the provision of least cost, reliable service to its customers. The evidence before the Board indicates that the Company's operations through the test period meet provincial power policy requirements.

2013/2014 Return on Equity
Summary of Expert Recommendations

Expert Witness	McShane	Vander Weide	Booth	McDonald
Recommended Return on Equity	**10.50%**	**10.40%**	**7.50%[1]**	**8.91%**
Test Results:				
1. Equity Risk Premium				
Risk-Free Rate	3.50%[2]	2.73%[3]	3.00%[4]	3.04%[5]
Market Risk Premium	8.00%[6]	6.60%[7]	5.0% - 6.0%[4]	5.50%[5]
Beta	0.65 – 0.70[8]	0.73-0.92[7]	0.45 – 0.55[4]	0.60[5]
Utility Equity Risk Premium				
Risk-Adjusted Equity Market	5.40%[9]	-	-	-
DCF-Based	6.00%[9]	-	-	-
CAPM	-	-	2.25% - 3.30%[4]	3.30%[10]
Historic Utility	6.75%[9]	-	-	6.72%[11]
Ex Post Risk Premium	-	6.7%[12]	-	-
Ex Ante Risk Premium	-	7.7%-8.1%[13]	-	-
Indicated Cost of Equity	9.6[14]	9.4%-10.8%[15]	5.75% - 6.80%[16]	6.34% & 9.76%[17]
Allowance for Financing Flexibility	1.00%[18]	0.50%[19]	0.50%[4]	0.50%[11]
Other Adjustments	-	-	1.20%[20]	-
Indicated Fair Return on Equity	**10.6%**	**9.9% & 11.1%[21]**	**7.5%**	**6.84% &10.26%[22]**
2. Discounted Cash Flow				
Indicated Cost of Equity	9.4[23]	9.6% – 9.8%[24]	-	9.13%[25]
Financing Flexibility	1.00%[17]	0.50%[23]	-	0.50%[24]
Indicated Fair Return on Equity	**10.4%**	**10.1% - 10.3%**	**-**	**9.63%**
3. Comparable Earnings	**11.0% – 12.00%[26]**	**-**	**-**	**-**
Equity Ratio	**45%[27]**	**45%[28]**	**40%[29]**	**45%[30]**

[1] Booth's recommended ROE only applies to the 2013 test year. For 2014 he recommends use of his recommended ROE adjustment mechanism or fix the ROE at 8.25% for the indefinite future. See Booth Evidence, p. 2 lines 29-35.

[2] McShane Evidence, p. 61, lines 1541-1542.

[3] Vander Weide Evidence, p. 35, lines 20-24.

[4] Booth Evidence, p. 46, lines 3-7.

[5] McDonald Evidence, p. 33, line 651

[6] McShane Evidence, p. 71, lines 1771-1780.

[7] Dr. Vander Weide has calculated an expected return on equity using both a CAPM approach and risk premium method. The betas noted in the table are those used in the calculation of CAPM. Dr. Vander Weide has calculated the return on equity using two different approaches to CAPM. For reasons contained in his evidence, Dr. Vander Weide has given no weight to the results of CAPM method in his final recommendation of a fair return on equity for Newfoundland Power. Dr. Vander Weide has used two separate equity risk premium models in his calculation of a fair return. He has applied equal weighting to the each of the equity risk premium models. See Vander Weide Evidence, p. 35, lines 20-24; p. 36, line 16 to p. 37, line 2; p. 38, lines 15-28; p. 40, lines 25-31; p. 45, lines 2-4; and Exhibits 12 and 14, p. 81, and p. 85.

[8] McShane Evidence, p. 82, lines 2022-2029.

[9] McShane Evidence, p. 93, lines 2291-2302.

[10] It is included for comparative purposes. It is calculated as the Indicated Cost of Equity using CAPM method (6.34%) less the Risk Free Rate (3.04%).

[11] McDonald Evidence, p. 30, Table 15.

[12] Vander Weide Evidence, p. 35, lines 20-24.

[13] Vander Weide Evidence, p. 38, lines 15-28.

[14] McShane Evidence, p. 4, lines 100-103.

[15] It is included for comparative purposes. It is calculated as the cost of equity results less 0.50%, Vander Weide's amount for financing flexibility. Vander Weide Evidence, p. 45, Table 3.

[16] Booth Evidence, p. 46, lines 9-10.

[17] It is included for comparative purposes. It is calculated as Indicated Fair Return on Equity less Financing Flexibility.

[18] McShane Evidence, p. 4, lines 108-115.

[19] Vander Weide Evidence, p. 35, line 20 to p.36, line 4, and p. 38, lines 15-28.

[20] This is Booth's credit spread adjustment and impact of Operation twist. See Booth Evidence, p. 56, lines 21-23.

[21] Vander Weide Evidence, p. 45, Table 3.

[22] McDonald Evidence, p. 37, Table 19, 6.84% for CAPM and 10.26% for Historic ERP.

[23] McShane Evidence, p. 97, lines 2406-2420.

[24] Vander Weide Evidence, p. 66, Exhibits 6 and p. 68, Exhibit 7.

[25] McDonald Evidence, p. 36, Table 18.

[26] McShane Evidence, p. 103, lines 2579-2592.

[27] McShane Evidence, p. 29, lines 746-747.

[28] Dr. Vander Weide does not provide specific comment on the appropriateness of Newfoundland Power's capital structure, however, he notes that the Company's 45% average allowed equity is less than the average allowed equity of 49% indicated in his U.S. sample. Vander Weide Evidence, p. 54, lines 12-14.

[29] Dr. Booth recommends a reduction in Newfoundland Power's common equity ratio to 40% and an increase in preferred shares of 5%. See Booth Evidence, p. 2, lines 36-38.

[30] McDonald Evidence, p. 21, lines 380-390.