

**Q. McShane Evidence - Business Risk; pages 16-22**

- a. Ms. McShane references short and long run risks, has she looked at the short run ability of NP to earn its allowed ROE and if so what is her assessment. If not why has she not considered this objective evidence of NP's short run risk.**
- b. What long run risks would Ms. McShane judge NP to face, that is, what competitive fuels could displace the use of electricity in street lighting, heating and industrial use.**
- c. Would Ms. McShane agree that Canadian gas pipelines now face increased long term risk as a result of new gas supply areas disrupting the viability of pipelines connecting uncompetitive basins? Can she conceive of an equivalent risk facing NP?**

A. a. Yes, Ms. McShane is aware that Newfoundland Power has been able to earn an ROE close to the allowed ROE. Newfoundland Power's ability to earn its allowed return is implicit in its regulatory framework, discussed at lines 550 to 563 of Ms. McShane's testimony. The regulatory framework, which is a key determinant of a utility's ability to earn the allowed ROE, as well as the ability to recover the invested capital over the longer-term, is an important factor in the assessment of the utility's business risk. It is not only important that the utility be allowed the opportunity to earn the allowed ROE; the allowed ROE itself must be fair and reasonable.

b. As stated at page 17 of Ms. McShane's testimony, Newfoundland Power's long run risks are largely related to the demographics and long-term economic outlook for its service area, i.e., limited long-term growth prospects, a declining and aging population, transition of the population from rural to urban areas, while being required to maintain safe and reliable service in the former. Operating risks are relatively high, in part due to severe climate conditions, with potential attendant increases in costs. Newfoundland Power depends on Newfoundland and Labrador Hydro for most of its power supply, which means that its cost structure is dependent on Newfoundland and Labrador Hydro's cost structure. This limits Newfoundland Power's ability to influence its customers' consumption behaviour. All of the above have the potential to put upward pressure on the Company's prices and downward pressure on load. While there are no substitutes for a portion of Newfoundland Power's load, as a utility with a significant heating load, there are alternatives, e.g., oil, whose attractiveness will be, at least in part, determined by the price of electricity. Further, as energy prices increase, there is an increased incentive to continually develop technology to reduce the amount of energy that is required to be consumed. If the utility is losing customers and load, competitive limits on regulated prices may constrain its ability to earn a reasonable return or recover its invested capital.

c. Yes, she agrees that pipelines do face increased risk from this factor. Although she does not foresee that Newfoundland Power would face a similar increase, it

1 bears noting that the increased risk faced by pipelines in this regard had not been  
2 previously foreseen. For example, when TransCanada Pipelines filed extensive  
3 business risk evidence as recently as 2004, the Company made no mention of the  
4 increased risk it now faces largely as a result of the discovery of huge shale gas  
5 deposits which are changing the entire dynamic of North American natural gas  
6 markets.