**Q. Reference Evidence of Newfoundland Power, pages 3.31 to 3-37**

**Automatic ROE formula**

**a. Would NP accept that the ROE formula by adjusting the ROE for only 80% of the change in the long Canada bond yield automatically increases NP's risk premium by the residual 20%?**

**b. Please provide a table with the allowed ROE, the Long Canada bond yield used in the ROE formula, and the yield on NP's long term debt consistent with the long Canada bond yield for each year since the automatic ROE formula was introduced.**

**c. Please indicate who requested that NP be regulated by the use of an automatic ROE formula and if not NP did it object or file an alternative ROE formula?**

**d. Please indicate whether the ROE formula has ever been subject to off ramps in the sense that it is only applicable if forecast long Canada bond yields were within a particular range?**

**e. Would NP accept that the long Canada bond yield is the only objective expected rate of return on a long term security that is available in the market? If not please recommend an alternative given that corporate bond yields are promised yields and reflect maximum not expected rates of return.**

**f. Please provide NP's forecast yield consistent with the Consensus graph for the ten year bond yield on page 3-36.**

**g. With reference to the comments of the Governor of the Bank of Canada on page 3-37, is NP aware that the Governor went much further in August and indicated that the Canadian financial system is "firing on all cylinders"? Please indicate why NP judges current financial market conditions to pose a problem in terms of NP 's financial integrity if Canada's financial system is firing on all cylinders?**

**h) If the current forecast long Canada bond yield were 4.5% (page 3-33) instead of about 3.0% would NP regard the formula as giving a fair and reasonable ROE?**

**i) Would NP accept an ROE formula that bases its ROE on a fixed spread over its forecast bond yield for the test year so that it relies on NP specific data? If yes what would it recommend as a spread and if not why not?**

A. a. No. Operation of the Formula is such that when long Canada bond yields increase Newfoundland's Power's risk premium decreases.

b. Table 1 provides the allowed ROE, the long Canada Bond yield used in the Formula and Newfoundland Power's embedded cost of debt used in the Formula for 1999 through 2012.

**Table 1**
**Approved ROE**
**1998 – 2012**
**(Percent)**

| | **Approved ROE**[1] | **LCB Yield**[2] | **Cost of Debt**[3] |
|---|---|---|---|
| 1998[4] | 9.25 | 5.75 | 9.11 |
| 1999[5] | 9.25 | 5.75 | 9.18 |
| 2000 | 9.59 | 6.18 | 9.18 |
| 2001 | 9.59 | 6.18 | 9.18 |
| 2002 | 9.05 | 5.50 | 9.18 |
| 2003[5] | 9.75 | 5.60 | 8.39 |
| 2004[6] | 9.75 | 5.60 | 8.39 |
| 2005 | 9.24 | 4.96 | 8.39 |
| 2006 | 9.24 | 4.96 | 8.39 |
| 2007 | 8.60 | 4.16 | 8.39 |
| 2008[6] | 8.95 | 4.60 | 7.93 |
| 2009 | 8.95 | 4.01 | 7.93 |
| 2010[7] | 9.00 | 4.50 | 7.64 |
| 2011 | 8.38 | 3.72 | 7.64 |
| 2012[8] | 8.80 | 3.72 | 7.64 |

[1] This is the approved ROE for ratemaking purposes.

[2] This is the Long Canada Bond yield that is used in the Formula to determine the risk free rate. For 1998, 1999, 2003, 2004, 2008, 2010 and 2012, the risk free rate was determined through a general rate application or a cost of capital hearing. For 1999 through to 2010, the Formula used actual observed bond yields for the first last five trading days in October and the first five trading days in November. In Order No. P.U. 12 (2010), the Board approved the use of a forecast long Canada Bond yield based on the November Consensus Forecasts of 10 year Government of Canada Bonds and the average observed spread between 10-year and 30-year Government of Canada Bonds for all trading days in the preceding October.

[3] The cost of debt used in the Formula is approved during a general rate application and is equal to the test year embedded cost of debt.

[4] The ROE for 1998 and 1999 was approved by the Board in Order Nos. P.U. 16 (1998/99) and P.U. 36 (1998/99) respectively.

[5] The ROE for 2003 and 2004 was set during the 2003 General Rate Application and approved by the Board in Order No. P.U. 19 (2003).

[6] The ROE for 2007 was set during the 2008 General Rate Application and approved by the Board in Order No. P.U. 32 (2007).

[7] The ROE for 2010 was set during the 2010 General Rate Application and approved by the Board in Order No. P.U. 43 (2009).

[8] In Order No. P.U. 25 (2011), the Board suspended operation of the Formula for 2012. The ROE of 8.80% for 2012 was approved in Order No. P.U. 17 (2012) based on a negotiated settlement agreement. Newfoundland Power's customer rates for 2012 were not adjusted for the approved ROE of 8.80% and currently reflect an ROE of 8.38% as approved in Order No. P.U. 36 (2010).

c. In 1998, the Board convened a hearing of its own motion to consider, amongst other things, the implementation of a formula to establish a ratemaking return on equity between test years (the "1998 Cost of Capital Hearing"). The Board filed its own evidence supporting implementation of a formula.

In the Company's evidence filed during the 1998 Cost of Capital Hearing, Newfoundland Power indicated that the use of an annual adjustment formula to establish the allowed return on common equity was becoming popular with Canadian regulators and that there was potential for such a formula to reduce regulatory costs and mitigate regulatory lag.[9]

In its evidence filed during the 1998 Cost of Capital Hearing, the Company also noted the importance of ensuring that the allowed rates of return established by a formula approach are consistent, comparable and contribute to stability in the market place. The Company noted that if the Formula established rates of return on equity that were below that of comparable utilities, it would be viewed negatively by the capital markets.[10]

Order No. P.U. 16 (1998-99) establishing the Formula followed the 1998 Cost of Capital Hearing.

d. Newfoundland Power's Automatic Adjustment Formula has not been subject to off ramps tied to ranges of forecast Long Canada Bond yields which would suspend operation of the Formula. In Order No. P.U. 16 (1998-99), the Board did, however, specifically recognize that changes in financial market conditions could render the use of the Formula to be inappropriate.[10]

e. Newfoundland Power does not accept that the long Canada bond yield is appropriate basis to establish estimates of a utilities cost of capital in current financial market conditions.

Newfoundland Power does not agree that corporate bond yields are promised yields if the bonds are traded. It is the Company's view that the coupon rate represents a promise and the bond's yield represents the markets valuation of that promise.

Newfoundland Power has not recommended an "alternative" because it is Newfoundland Power's view that based on current financial market conditions, the use of a formulaic approach in determining a fair return on equity is not appropriate at this time.

[9] Prefiled evidence of Newfoundland Power, 1998 Cost of Capital Application, pages 38-40.
[10] See Order No. P.U. 16 (1998-99), page 104.

f. The Company's evidence provides a forecast ROE based on the Canada Bond yields as published in the August 2012 *Consensus Forecasts*.[11]

Insofar as this question requests further or other data or information, it lacks sufficient clarity for the Company to provide a meaningful response.

g. Mr. Carney's full statement included the proviso, that the world is a "very dangerous place" and slowing global growth is having a knock-on effect on the country.

Given the partial, and in Newfoundland Power's view potentially misleading, quotation contained in the question, Newfoundland Power does not believe further response is warranted.

h. The August 2012 Consensus forecasts indicated a long Canada Bond forecast of 2.66%.[12] This is 184 basis points below the long Canada bond yield of 4.5% indicated in this question.

It is Newfoundland Power's opinion that in current financial market conditions the Formula is unable to produce a fair return on equity.

i. No. In this Application, Newfoundland Power has proposed a ratemaking return on equity of 10.4%.

[11] See *Volume 1, Application and Company Evidence, Section 3.3.2 Automatic Adjustment Formula*, page 3-34, lines 7-11. The 2013 forecast ROE is calculated as follows: 9.00 + (0.80 (2.66-4.50)) = 7.53%.

[12] See *Volume 1, Application and Company Evidence, Section 3.3.2 Automatic Adjustment Formula*, page 3-34, footnote 114.