

**Q. Reference Evidence of Newfoundland Power, pages 3.1
Cost of Capital**

- a. In May NP negotiated an 8.80% ROE for 2012, please confirm that this was the only item negotiated in that settlement and if not what other items were part of the settlement.
- b. Please indicate the ROE formula result for 2012 and separate out the forecast long Canada bond yield and the implied utility risk premium.
- c. Please indicate the difference in the forecast long Canada bond yield at the “current” point in time relative to that used in the ROE formula for 2012.
- d. Please indicate the implicit NP risk premium involved in the 8.8% ROE for 2012 and what factors NP judges might persuade the Board to increase it for 2013.
- e. If NP no longer wants to use an ROE formula, is it the company’s judgment that the Board should revert to annual cost of capital hearings or that the Board set a fixed ROE for a fixed time period. If the latter please indicate how long the ROE should remain fixed and whether NP would impose any “off ramps” in the sense that it should remain fixed, for example, until long Canada bond yields and credit spreads revert to “normal”?
- A. a. Attachment A provides a copy of the June 5, 2012 Settlement Agreement.
- b. The 2012 cost of equity estimated by the Formula was 7.85% and reflected a forecast long Canada bond yield of 3.06% and an implied utility risk premium of 4.79% (7.85% - 3.06% = 4.79%).
- c. Based upon the August 2012 *Consensus Forecasts*, the forecast long Canada bond yield was 2.66%. This reflects a decrease of 40 basis points from that used in the Formula to estimate cost of equity for 2012.
- d. There was no implicit risk premium acknowledged in the settlement agreement provided as Attachment A. For reasons that might persuade the Board that 10.4% is an appropriate ratemaking return on equity, please see (i) *Volume 1, Application and Company Evidence, Section 3: Finance*, pages 3-14 to 3-40; and (ii) expert Cost of Capital evidence of Ms. Kathleen McShane and Dr. James Vander Weide (*Volume 3: Expert Evidence & Studies, Tabs 1 and 2*).
- e. The Company is proposing that the Board should establish a ratemaking return on equity which will remain fixed until at least 2014. The Company accepts that changes in financial market conditions can provide a reasonable basis for the

- 1 Board to reconsider Newfoundland Power's cost of capital, including its
- 2 ratemaking return on equity.

Attachment A
Settlement Agreement

IN THE MATTER OF the *Public Utilities Act*,
(the “Act”); and

IN THE MATTER OF the establishment of a
just and reasonable return on rate base pursuant
to Section 80 of the Act for Newfoundland
Power Inc. (“Newfoundland Power”).

**Settlement Agreement
for the Proposed Resolution of
Issues Arising from the Application**

Whereas Newfoundland Power (the “Applicant”) has applied to the Board of Commissioners of Public Utilities (the “Board”) for an Order, *inter alia*, approving a just and reasonable rate of return on rate base for 2012 (the “Application”);

And Whereas the Consumer Advocate has been granted Registered Intervenor status by the Board;

And Whereas the Board has directed the Applicant to file its next general rate application, with a 2013 test year, (“General Rate Application”) by September 14, 2012;

And Whereas the Applicant and the Consumer Advocate (the “Parties”), with participation by Board hearing counsel, have engaged in negotiations;

And Whereas the Parties have agreed to make joint recommendations to the Board for the resolution of the issues arising out of the Application.

Terms of Agreement

1. The Parties jointly advise the Board that the issues arising from the Application have been settled by negotiation between them in accordance with this Settlement Agreement (the “Settled Issues”).
2. The Parties recommend that the Board implement the agreement of the Parties regarding the Settled Issues in its Order.
3. At the hearing of this Application, the Parties do not intend to examine or cross-examine witnesses, and will only present evidence and make submissions reasonably necessary to assist the Board’s understanding and to explain or clarify the Parties’ agreement concerning the Settled Issues.

4. This Agreement is without prejudice to the positions the Parties may take in proceedings other than this Application, including, without limitation, the General Rate Application. It sets no precedent for any issue addressed in this Agreement in any future proceeding or forum.

Rate of Return on Common Equity

5. The Parties agree that the rate of return on common equity to be used in determining a just and reasonable return on rate base for 2012 will be 8.80%.

Rate of Return on Rate Base

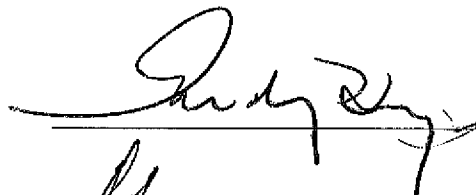
6. The Parties agree that the allowed rate of return on rate base for 2012 will be 8.14% within a range of 7.96% to 8.32%.

Deferred Revenue Recovery

7. The Parties agree that the Applicant will be granted deferred recovery of the full difference between the 8.38% return on common equity currently in rates and an 8.80% return on common equity, calculated on the basis of the Applicant's 2010 test year costs. The recovery of the additional revenue requirement for 2012 of approximately \$2.5 million will be deferred and fully recovered by the Applicant in accordance with a further Order of the Board. Schedule 1 is a proposed definition of the 2012 Cost of Capital Cost Recovery Deferral Account.

Agreed to effective the 5th day of June, 2012.

For Newfoundland Power:



For the Consumer Advocate:



For the Board's hearing counsel:



Newfoundland Power Inc.

2012 Cost of Capital Cost Recovery Deferral Account

Proposed Definition

This account shall be charged with the full amount of the difference in revenue between an 8.38% return on common equity and an 8.80% return on common equity for 2012, calculated on the basis of the 2010 test year costs.

Disposition of the Balance in this Account

The disposition of this cost recovery deferral amount will be subject to a future order of the Board.