Q. In the Standard and Poor's report entitled Assessing US Utility Regulatory Environments dated November 7, 2007 and republished on November 15, 2011 and filed in reply to CA-NP-300, Standard and Poor's states at page 4, "Notably, the analysis does not revolve around 'authorized' returns, but rather on actual earned returns. We note that many examples of utilities with healthy authorized returns that, we believe, have no meaningful expectation of actually earning that return because of rate case lag, expense disallowances, etc." Does Dr. Vander Weide and Ms. McShane agree with this observation and how have they taken it into account in assessing the cost of equity for Newfoundland Power compared to American utilities?

A. Dr. Vander Weide agrees with Standard & Poor's opinion that credit analysis should focus on actual earned returns rather than authorized returns. He also agrees that some U.S. utilities earn less than their authorized returns, and some utilities earn more than authorized returns, as a result of regulatory lag. However, Dr. Vander Weide believes that regulatory lag has been significantly reduced for most U.S. utilities since November 2007 due to increased use of cost recovery and rate stabilization mechanisms, as discussed in Dr. Vander Weide's written evidence. After reviewing the business, financial, and regulatory risks of U.S. and Canadian utilities, Dr. Vander Weide believes that U.S. utilities are reasonable proxies for the risk of investing in Canadian utilities such as Newfoundland Power.

Ms. McShane agrees that there are utilities which, due to regulatory lag and cost disallowances, will not be able to earn their authorized rates of return. Ms. McShane notes that, although the report was republished in 2011, it was authored in 2007 (five years ago) as a primer to explain S&P's approach to evaluating regulated utilities. During the last five years, there have been an increasing number of regulatory mechanisms adopted by regulators throughout the U.S., in particular, decoupling mechanisms and capital cost recovery mechanisms, which enhance the affected utilities' ability to earn their allowed rate of return. As Ms. McShane indicated in her testimony, at lines 1469-1499, she did not rely on the universe of U.S. utilities to estimate the fair return for Newfoundland Power, which would be the context in which S&P's 2007 observation was made.