**Q. 2013-2014 General Rate Application, Company Evidence**

**Does the existence of the regulatory cost recovery mechanisms referred to in PUB-NP-22 reduce or eliminate Newfoundland Power's business risks? Please explain your response.**

A. ***A. Background:***

The Request for Information PUB-NP-022 requested Newfoundland Power show all *regulatory assets and liabilities* approved by the Board that are currently used by Newfoundland Power. This Request for Information appears to imply that all regulatory assets and liabilities reflect *regulatory cost recovery mechanisms*. This is not Newfoundland Power's view of these assets and liabilities.

The regulatory assets (i) 2011 Cost Recovery Deferral, (ii) 2012 Cost Recovery Deferral, (iii) 2012 Cost of Capital Deferral, (iv) 2010 Hearing Cost Deferral and (v) 2009 Conservation Cost Deferral referred to in the Response to Request for Information PUB-NP-022, for example, are not *mechanisms*. They are simple fixed cost deferrals or amortizations ordered by the Board. Items (i), (ii) and (iii) represent one-time deferrals approved by the Board solely to avoid the cost associated with Newfoundland Power seeking their recovery by way of a general rate application. Item (iv) relates to agreed recovery of 3rd party costs from the Company's 2010 general rate application which was deferred as a result of the Board's order on that application. Item (v) relates to the implementation of the Company's 2008 customer energy conservation program. This program promised clear benefits for customers, so the Board approved deferred recovery of its 2009 implementation costs in advance of the Company's next rate case. Had the Board chosen not to approve such deferred recovery, then the Company would simply not have incurred the costs in advance of its inclusion in rates.

The existence of regulatory assets which permit future recovery of costs as a result of Board decisions to avoid unnecessary hearing costs or amortize recovery of undisputed 3rd party costs or enable customer focused conservation programs do not, in Newfoundland Power's view, affect the Company's business risk profile.

On the other hand, certain regulatory assets and liabilities are reflections of regulatory mechanisms. For example, mechanisms such as Newfoundland Power's supply cost accounts and employee future benefit cost variance deferral accounts operate annually and effectively provide for recovery of actual costs. These can impact the Company's business risk profile.

***B. Business Risk:***

As a general proposition, regulatory mechanisms that provide for the recovery of actual costs incurred by a utility will tend to reduce that utility's business risk. Such mechanisms do not eliminate business risk.

As Newfoundland Power indicates at page 3-15 to 3-16 of its evidence, business risk is a *relative* concept and that cost of capital depends on how risks compare to those of other enterprises in the same industry.

The principal purposes of the annually operating regulatory mechanisms of Newfoundland Power is to ensure reasonable recovery of (i) supply costs, including those due to variations in weather and (ii) employee future benefit costs.[1]

The supply cost recovery mechanisms approved by the Board for Newfoundland Power are consistent with current Canadian regulatory practice. Mechanisms that permit full recovery of energy supply costs are commonplace for both Canadian and U.S. utilities.[2]

The employee future benefit recovery cost mechanisms approved by the Board for Newfoundland Power are also quite common for Canadian and U.S. utilities. [3] The mechanisms approved by the Board for Newfoundland Power do not *eliminate* the risk to Newfoundland Power's return associated with employee future benefit costs. Nor were they intended to. In Order No. P.U. 43 (2009) : Reasons for Decision, the Board made it clear that the use of these accounts was to capture variances arising from factors outside of Newfoundland Power's control. [4]

Given the widespread usage of supply cost recovery mechanisms and employee future benefit cost recovery mechanisms in North American utility practice, the existence of these mechanisms for Newfoundland Power neither increase nor decrease the Company's business risk *relative* to other utilities. The mechanisms do not *eliminate* Newfoundland Power's business risk.

1 See *Volume 1, Application and Company Evidence, Section 3: Finance*, page 3-26, lines 14-15.
2 See *Volume 2, Exhibits and Supporting Materials, Tab 7 Supply Cost Mechanisms*, page 2 and Appendix A.
3 This was recognized by the Board in respect of pension costs in Order No. P.U. 43 (2009) : Reasons for Decision, page 9, lines 28-30. See also, *Volume 1, Application and Company Evidence, Section 3: Finance*, page 3-27, line 15 to 3-28, line 2 and response to Request for Information, PUB-NP-036.
4 See Order No. P.U. 43 (2009) : Reasons for Decision, page 9, lines 12-13 and 30-32.