Q. NP does not want to return to an automatic ROE adjustment formula for test year 2021 and beyond. In its judgment, does a review of its ROE and common equity ratio for the 2021 test year lower NP's risk as compared to setting the ROE according to an automatic ROE adjustment model?

A. *How* a fair return on equity is determined does not result in higher or lower risk. In determining an appropriate capital structure and return on equity for Newfoundland Power, the Board is guided by the fair return standard.[1]

The Board suspended use of the Automatic Adjustment Formula (the "Formula") in April 2013 following Newfoundland Power's *2013/2014 General Rate Application*. In its final order, the Board stated:

> *"While the Board continues to see the value of an automatic adjustment formula, the evidence is clear that the formula as it is currently structured may not result in a fair return for Newfoundland Power in the current circumstances. Long-term Canada bond yields are abnormally low which is particularly problematic in the operation of the automatic adjustment formula. In the absence of a clear relationship between the long-term Canada bond yield and the cost of equity it is difficult to see that the established return can be appropriately adjusted for 2015 without the exercise of further judgement."*[2]

In Newfoundland Power's view, current circumstances do not warrant reinstatement of the Formula to determine a fair rate of return on equity.[3]

In the absence of a Formula that can determine a return on equity that is consistent with the fair return standard, the exercise of further judgment or a review would be required to determine the Company's return on equity beyond 2020.

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[1] In Order No. P.U. 32 (2007), the Board described the fair return standard as *"Regulated utilities are given the opportunity to earn a fair rate of return. To be considered fair, the return must be: (i) Commensurate with return on investments of similar risk; (ii) Sufficient to ensure financial integrity; and (iii) Sufficient to attract necessary capital. The fair return principle is consistent with both Section 80(1) of the Act and Section 3(a)(iii) of the EPCA."*

[2] See Order No. P.U. 13 (2013), page 36, lines 38-44.

[3] Please refer to responses to Requests for Information PUB-NP-037 and PUB-NP-038 for further information on this issue.