Q. Reference Evidence of Dr. Sean Cleary dated September 25, 2018

Pages 16, line 27 to page 19: In Dr. Cleary's discussion of operating environment there is no reference to the business risks outlined in Newfoundland Power's evidence at page 1-7 and in Mr. Coyne's at pages 2 and 54-57 of the increased risks since 2016 of the declining provincial economy and the anticipated significant rate increases due to the Muskrat Falls Project. Please provide Dr. Cleary's opinion as to how these factors were taken into account in his consideration of Newfoundland Power's business risk and his conclusion that Newfoundland Power has very low business risk.

A. Dr. Cleary considered both of these factors in his analysis. With respect to the declining economy, Dr. Cleary discussed the Newfoundland and Labrador (NL) economy in Section 2.2 (pages 11-13) of his direct evidence and noted in his summary on page 2 of his evidence that:

> "the Newfoundland and Labrador economy is expected to display flat economic growth during 2018, but positive growth in 2019."

In particular, in its' Summer 2018 Provincial Outlook, the Conference Board of Canada (CB) forecast real GDP growth of 0.3% in 2018, followed by 4.8% growth in 2019 and 1.3% growth in 2020. Hence, average growth over the 2018-2020 period is forecast to be 2.13% annually.

Dr. Cleary focused his analysis on the test period, since future changes can be addressed during future proceedings. However, he does recognize that the forecast for longer term NL growth is approximately zero according to the CB. Dr. Cleary addresses the potential impact of slow economic growth on pages 17-18 of his evidence, where Figure 4 demonstrates the resilience that NP's revenue has displayed with respect to previous periods of negative or slow growth. He summarizes this point on page 18 (lines 10-11): "In other words, the evidence suggests that NP's sales have been resilient to economic decline."

With respect to Muskrat Falls, Dr. Cleary is aware of the concerns created by the cost over-runs and the likely significant increase in electricity rates that will occur as the result of the transition to the new power source. This matter has been discussed at length by NP and Mr. Coyne during these proceedings and also during the 2016 proceedings. The evidence of NP and Mr. Coyne both focus the discussion of the risks posed by Muskrat Falls as those caused by "expected increases in the cost of electricity following the interconnection of Nalcor Energy's Muskrat Falls project."[1]

With respect to the risks caused by potential future rate increases, Dr. Cleary would note that these increases are not scheduled to occur until at least mid-2020, almost at the end of the test period. Secondly, the amount of these increases is still uncertain; although some

[1] Newfoundland Power Evidence, page 1-2, lines 18-19.

forecasts have been provided. Thirdly, it is unclear at this point in time what steps will be undertaken to mitigate these rate increases. In its' response to PUB-NP-012, NP provided a "non-exhaustive" list of rate mitigating alternatives, most of which do not appear to be mutually exclusive. NP concludes on page 6 (lines 7-10) of its response that:

> "The Government has indicated that it is preparing plans for rate mitigation. To date, Newfoundland Power has had discussions with Government, Nalcor and Hydro concerning rate mitigation and the Company looks forward to having the opportunity to participate in further efforts along these lines."

Dr. Cleary is not disputing that rate increases are likely to occur; however, the amount and timing of these rate increases is not yet clear. In addition, it seems that rate mitigation actions are available and that talks are in motion to implement some combination of such mechanisms. Irrespective of the foregoing, Dr. Cleary does not believe it makes sense to increase the allowed ROE and maintain a high equity ratio during the test period to provide NP with current returns at the expense of its existing customer base, based on the fact that future rates will increase. In essence, doing so would penalize current customers "early" in anticipation of future rate increases that the majority of them would continue to bear. It is important to note that, unlike increasing supply costs which NP simply passes on to customers, the additional costs associated with higher ROEs and/or equity ratios benefits NP at the expense of its customers.[2] This is counter-intuitive – i.e., customers should pay more "now" because they will be asked to pay more in the future.

In summary, Dr. Cleary considered both items raised above during the process of his determination that NP continues to be a low risk regulated Canadian utility.

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[2] As Dr. Cleary demonstrates on pages 32-36 of his evidence, there is a real and tangible cost to consumers associated with maintaining higher equity ratios.