Section 3: Finance/Fair Return

Q. (Section 3) Is it Newfoundland Power's judgment that the use of an ROE adjustment formula for a future test-year increases or reduces the risk to Newfoundland Power's shareholders? Conversely, has the use of a formal review, held over relatively frequent three-year time periods, lowered Newfoundland Power's risk relative to what to would have been with the use of an ROE adjustment formula?

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

The Board suspended use of the Automatic Adjustment Formula (the "Formula") following Newfoundland Power's *2013/2014 General Rate Application*. In its 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 economic conditions do not provide the stability in financial markets necessary to establish a formula that can be used to adjust the Company's return on equity between test years. Expert evidence filed with this Application also recommends further suspension of the Formula.[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 would be required to determine the Company's return on equity beyond 2026.

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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 assure 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] See the *2025/2026 General Rate Application, Volume 2, Supporting Materials, Expert Evidence, Cost of Capital*, pages 83 to 85.