Section 4: Rate Base and Return on Rate Base

Q. According to Newfoundland Power's Amended 2022-2023 General Rate Application ("GRA"), Exhibit 5 (1st Revision), page 6 of 9, the Weighted Average Cost of Capital ("WACC") of 6.39% was equal to the Rate of Return on Rate Base calculated for the 2023 test year. However, according to Exhibit 8 (2025 and 2026 Return on Rate Base) the proposed Rate of Return on Rate Base is not equal to the proposed WACC for the 2025 and 2026 test years.

a) Please provide a reconciliation of the difference between the WACC and the Rate of Return on Rate Base for each test year including an explanation of the reason for the difference between the WACC and the Rate of Return on Rate Base.

b) What would the change in revenue requirements be for the 2025 test year and the 2026 test year if the rate of return on rate base for each year was set to equal WACC in determining revenue requirement?

c) In its evidence in its 2008 GRA, Volume 1, page 61, Newfoundland Power stated: "The appropriate arithmetic expression of the Formula following the Company's transition to the Asset Rate Base Method is: Return on Rate Base = Rate Base X WACC". Why is Newfoundland Power not proposing to apply this formula in the determination of rate base for the 2025-2026 GRA? Please explain and indicate if the Board has explicitly approved a change in the 2008 approved approach of using WACC to equal return on rate base in computing test year revenue requirements.

A. a) Under the Asset Rate Base Method ("ARBM"), differences in invested capital and rate base exist related to construction work in progress, materials and supplies, and cash working capital amounts. These reconciling items can cause differences between Newfoundland Power's WACC and its rate of return on rate base ("Rate of RORB").

Table 1 on the following page provides the reconciliation between average rate base and invested capital for the 2025 and 2026 test years.

Table 1:
Average Rate Base vs. Average Invested Capital Reconciling Items
2025 and 2026 Test Years
($millions)

	2025TY	2026TY
Average rate base[1] (A)	1,406.8	1,451.2
Construction work in progress	4.6	7.5
Materials and supplies	2.7	2.8
Cash working capital	12.8	(23.6)
Average invested capital[2] (B)	**1,427.0**	**1,437.9**
Difference (B - A)	20.2	(13.3)
Difference: WACC vs. Rate of RORB	0.11%	(0.07%)

The primary reason for the differences relates to average cash working capital.

Table 2 summarizes the differences in average cash working capital for the 2025 and 2026 test years.

Table 2:
Cash Working Capital Detail
2025 and 2026 Test Years
($millions)

	2025TY	2026TY
Accounts receivable, prepaids and accounts payable	(25.9)	(24.5)
2025 Energy Supply Cost Variance Account ("ESCV")[3]	12.2	-
Rate Stabilization Account ("RSA")[4]	25.7	-
Deferral accounts and other	2.3	2.6
Rate base allowance	(1.5)	(1.7)
	12.8	**(23.6)**

[1] See the *2025/2026 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Exhibit 8*.
[2] Ibid.
[3] ESCV transfers from January to June in the 2025 test year total $24.4 million. The average impact is $12.2 million.
[4] Excludes the average 2025 ESCV of $12.2 million.

Overall, the variances in each year reflect forecast working capital versus the cash working capital allowance in rate base. In the 2025 test year, the ESCV and RSA differences are driven by higher purchased power costs and in particular, variances in cash flows driven by the current wholesale rate.

Newfoundland Power has removed RSA balances and interest effective July 1, 2025 (i.e. the effective date of the proposed customer rate change). These adjustments serve to align average invested capital and average rate base for 2025 and 2026, as well as forecast WACC and rate of return on rate base. Similar adjustments were completed for the 2022 and 2023 test years to lessen the impact of the volatility of power supply cash flow effects on the Company's test year forecasts, which have occurred since the current wholesale rate was implemented in 2019.

Newfoundland Power anticipates the volatility associated with power supply costs to be significantly reduced upon implementation of a new wholesale rate.[5]

b) Table 3 provides the requested scenario.[6]

Table 3:
***Pro Forma* Return on Rate Base Analysis**
2025 and 2026 Test Years
($millions)

	2025TY	**2026TY**
Average Rate Base[7]	1,406.8	1,451.2
WACC[8]	7.29%	7.28%
***Pro forma* Return on Rate Base**	**102.6**	**105.6**
Test Year Return on Rate Base[9]	104.0	104.7
Difference	**(1.4)**	**0.9**

c) Under the ARBM, rate base is determined so that it represents the invested capital necessary to finance the rate base (the debt and equity investments). In this way, the Company's return on rate base could theoretically be expressed by multiplying its rate base by its WACC.[10] However, Newfoundland Power's return on rate base has been

5 For further information, see the response to Request for Information PUB-NP-004.
6 Excludes income tax effects.
7 See the *2025/2026 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Exhibit 8*.
8 Ibid.
9 Ibid.
10 Newfoundland Power's return on rate base closely aligns with the calculation of rate base x WACC in years where the Company's invested capital is similar to its rate base. Under the ARBM, differences in invested capital and rate base still exist related to construction work in progress, materials and supplies, and cash

determined by adding the Company's return on debt, return on common equity and return on preferred equity together in its general rate applications and rate of return on rate base applications since 2008.[11]

To illustrate, Table 4 shows the calculation of Newfoundland Power's 2008 test year return on rate base.[12]

Table 4:
2008 Test Year Return on Rate Base Calculation
($000s)

Return on equity	32,700
Return on preferred equity	586
Return on debt	
Interest on long-term debt	32,334
Other interest	2,450
Amortization of bond issue expenses	179
AFUDC	(283)
	34,680
Return on rate base	**67,966**

The Company's 2008 test year return on rate base was calculated by adding its return on debt, return on common equity and return on preferred equity together, as opposed to the formula of rate base x WACC.

As provided in part b) of this Request for Information, the differences in approach for the 2025 and 2026 test years are relatively small in total.[13]

working capital amounts, which can create differences in the two calculations. See part a) of this Request for Information.

[11] Newfoundland Power's return on rate base was determined by multiplying its rate base by WACC in its 2011 application associated with the operation of the automatic adjustment formula. The operation of the formula was suspended in Order No. P.U. 25 (2011).

[12] The totals of each return are shown on lines 26 to 30 in *Exhibit 10 (1st Revision), 2008 Return on Rate Base* in Newfoundland Power's evidence to its *2008 General Rate Application (Amended)*.

[13] The difference in methodologies is a total difference of $0.5 million ($1.4 million less $0.9 million) for the 2025 and 2026 test years.