Nalcor Energy Response to Grant Thornton Question 9.5

Question:

In reference to the discount rate used in the CPW calculations for Interconnected and Isolated at DG3:
- The discount rate decreased from 8% at DG2 to 7% at DG3. What was the reason for this decrease?
- Why was the cost of equity used by Nalcor (9.25%) rather than the allowed 8.80% ROE as approved in the GRA filed by NL Power in Order No. P.U. 13 (2013) based on test years of 2012 and 2013.

Response:

The reason for the discount rate decrease from 8% at DG2 down to 7% at DG3 is due to the change in the components that make up the WACC calculation. The details of the 7% calculation can be found in the "NLH Long Term WACC" tab of the file "Nalcor Energy Corporate Planning Data Forecasts Transmittal File v2 As Of March 2012.xls".

Prior to DG3, the Corporate Assumption files that were examined only contained the fact that the NLH Long Term WACC was 8%, and did not show the supporting calculation. Having said that, using the same methodology as outlined in the file noted above that supported the 7% rate, using assumptions stated at the time of DG2 would have produced a rate of 8%. The following is a summary of the major assumptions used in developing these rates:

	January 2012	January 2010
Long Term Debt Cost		
Conference Board Long Term Government of Canada (GOC) Rate	4.83%	5.68%
Historical Spread for NLH Credit Over GOC	0.90%	0.67%
Forecast of NLH Long Term Cost of Debt	5.73%	6.35%
Debt Guarantee Fee Paid by NLH to Government	0.50%	1.00%
Average NLH Long Term Marginal Cost of Debt (Rounded)	**6.25%**	**7.35%**
Long Term Equity Cost		
Investor Owned Utility Long Term Opportunity Cost of Equity (Rounded)	**9.25%**	**10.00%**
Weighted Cost of Capital (WACC)		
Average of 75:25 Debt:Equity Splits	**7.00%**	**8.01%**

The cost of equity used by Nalcor for the DG3 WACC analysis was 9.25% rather than the 8.80% ROE approved under the PUB Order P.E. 13 (2013) as the ROE was intended to be a long-term expected ROE rather than just that approved in the individual filing. This rate can also be supported by reference to page 64 of the expert report "Opinion on Capital Structure and Return on Equity for Newfoundland Power Inc." prepared by Foster Associates Inc. and filed as part of "Newfoundland Power's 2012 Cost of Capital Application" which is available on the PUB website.

Date Prepared: 04-Jul-2018