



April 14, 2016

Newfoundland Power Inc.
55 Kenmount Road
St. John's, NL A1B 3P6

**Attention: Mr. Gerard Hayes
Ian F. Kelly, Q.C.**

Dear Sirs:

**Re: 2016/2017 Newfoundland Power General Rate Application
Interest Coverage Ratio**

As agreed at the hearing, the Consumer Advocate is putting the following to Newfoundland Power Inc. for a reply. Before setting out the specific request of the Consumer Advocate, the Background is useful to set out:

Background:

As noted in Dr. Cleary's presentation of his direct evidence on April 11, 2016, there appears to be an issue with respect to the interest coverage ratio as calculated by Newfoundland Power Inc. and by Dr. Cleary.

For example, as per page 16 of Dr. Cleary's sur-rebuttal evidence, Newfoundland Power Inc.'s reported interest coverage ratios (Exhibit 3) are lower than those reported by Dr. Cleary as well as those reported by DBRS (for 2013 and 2014):

	<u>NP</u>	<u>Cleary</u>	<u>DBRS</u>
2013	2.3	2.48	2.95
2014	2.3	2.52	3.06

On page 4 of Newfoundland Power Inc.'s rebuttal evidence (for ROE=7.5% and ER =40% scenario) and in U-4 (March 31) – (for ROE =8.3% and ER =40%), Newfoundland Power also calculates **lower Interest Coverage ratios** than Dr. Cleary (as in Table 15 of his direct evidence), but **similar ratios for “cash flow” related measures** – CF/Debt and CF/Interest – as shown below:

	NP 2016 (7.5/40)	Cleary 2016 (7.5/40)	NP 2017 (7.5/40)	Cleary 2017 (7.5/40)	NP 2017 (8.3/40)	Cleary 2017 (8.3/40)
CF/Debt Coverage	15.9%	14.91%	14.5%	14.78%	15.0%	15.32%
CF Interest Coverage	3.7	3.50	3.5	3.49	3.6	3.58
Interest Coverage	2.0	2.21	2.0	2.22	2.1	2.35
	NP 2016 (7.5/40)	Cleary 2016 (7.5/40)	NP 2017 (7.5/40)	Cleary 2017 (7.5/40)	NP 2017 (8.3/40)	Cleary 2017 (8.3/40)
CF/Debt Coverage	15.9%	14.91%	14.5%	14.78%	15.0%	15.32%
CF Interest Coverage	3.7	3.50	3.5	3.49	3.6	3.58
Interest Coverage	2.0	2.21	2.0	2.22	2.1	2.35

U-7 provides detailed calculations for one of the interest coverage ratios (and earnings test coverage ratios) provided in U-4.

Dr. Cleary noted in his evidence presentation on April 11th that Table 1 in U-7 calculates "Net Earnings" (to use as EBIT) using a "top-down" approach of \$80,199, and that net income available to common shareholders, net income (NI), or earnings before taxes (EBT) data are not provided.

Dr. Cleary attempted to estimate the implied NI and ROE figures according to the EBIT figure provided by Newfoundland Power Inc. as follows:

- subtract the Interest figure (after new issue) of \$41,454 provided by Newfoundland Power Inc., to obtain an EBT estimate of \$38,745.

- apply a 29.14% tax rate to EBT (from Newfoundland Power's Exhibit 3 assumptions) to get an implied net income figure of **\$27,455**.¹

Dr. Cleary then attempted to estimate the common equity value which could be combined with the NIACS figure in order to estimate the ROE, which equals net income available to common shareholders / common equity as follows:

- Using CE figure of \$440,199 (which is the \$495,199 for 2017E from Exhibit 3 page 6 minus the \$55 million), this **implies an ROE of 6.24%**.
- (Note: using the implied debt figure of \$674,539 (which = the 2017E figure + \$75 million), results in an equity ratio of 39.5%, so close to 40%).

Alternatively, Dr. Cleary showed that if we assume that \$27,455 does provide an 8.3% ROE, this implies a Common Equity dollar figure of \$330,780, which **implies an equity ratio of 32.9%, based on the debt figure of \$674,539 estimated above.**

Request:

In an attempt to reconcile the fact that Newfoundland Power Inc.'s calculations that are based on an 8.3% allowed ROE and a 40% equity ratio in U-7 do not appear to be consistent with an 8.3% ROE, we request the following information for 2015, 2016 and 2017 upon which Newfoundland Power Inc. calculates the interest coverage ratios as presented in U-7:

1. Please reconcile the fact that the earnings figure used in U-7 does not appear to generate an ROE of 8.3%, as it is supposed to under this scenario analysis. Completing items #2-11 below may assist in this reconciliation, and is requested to be provided in any event in order to verify the consistency of the numbers provided.
2. Complete (i.e., from Revenue to Net income available to common shareholders) Pro Forma Statements of Income for 2015, 2016 and 2017 upon which the estimated ratios are based (similar to page 1 of Exhibit 9 in NP's evidence).
3. Complete Statement of Retained Earnings for 2015, 2016 and 2017 (similar to page 2 of Exhibit 9 in Newfoundland Power Inc.'s evidence).
4. Complete Balance Sheets for 2015, 2016 and 2017 (similar to page 3 of Exhibit 9 in Newfoundland Power Inc.'s evidence).
5. Complete Statement of Cash Flows for 2015, 2016 and 2017 (similar to page 4 of Exhibit 9 in Newfoundland Power's evidence).
6. Complete Average Rate Base for 2015, 2016 and 2017 (similar to page 5 of Exhibit 9 in Newfoundland Power Inc.'s evidence).

¹ In fact, this ignores the estimated preferred dividends of \$552 from Exhibit 3 for 2017, which would actually produce a slightly lower net income available to common shareholders figure of \$26,903, which would produce an ROE of 6.11%.



7. Complete Weighted Average Cost of Capital for 2015, 2016 and 2017 (similar to page 6 of Exhibit 9 in Newfoundland Power Inc.'s evidence).
8. Complete Rate of Return Base for 2015, 2016 and 2017 (similar to page 7 of Exhibit 9 in Newfoundland Power Inc.'s evidence).
9. Please calculate the interest coverage ratio as reported on the bottom of page 1 of Exhibit 3). Describe **precisely** what figures (e.g., labelled "A," "B," etc. where interest coverage = A/B or $(A + C)/B$, etc.) were used for the numerator and denominator used to calculate this interest coverage ratio.
10. If the interest coverage ratio as calculated in #9 above is different than the ratio labelled "Earnings Test Coverage Prior to New Issue" ratio as in U-7, please indicate how it is different, and as in #9 show precisely how this variable is calculated.
11. Please calculate the "Earnings Test Coverage After New Issue" ratio as reported in U-7. Describe **precisely** what figures (e.g., labelled "A," "B," etc. where coverage = A/B or $(A + C)/B$, etc.) were used for the numerator and denominator used to calculate this interest coverage ratio.

Yours very truly,

O'DEA, EARLE

THOMAS JOHNSON, Q.C.

TJ/cel

cc: Board of Commissioners of Public Utilities
Attention: Ms. Cheryl Blundon, Board Secretary