BEFORE THE NEWFOUNDLAND AND LABRADOR BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

SUR-REBUTTAL EVIDENCE

OF DR. SEAN CLEARY, CFA,

BMO PROFESSOR OF FINANCE

SUBMITTED ON BEHALF OF:
THE NEWFOUNDLAND CONSUMER ADVOCATE

March 31, 2016

Q1. Mr. Coyne's rebuttal evidence (page 9 and page 51) suggests that the fact that you believe that NP's business risk has not changed materially since the 2012 GRA is inconsistent with your recommendation of a 5 percent reduction in the equity ratio (ER). Do you agree with this argument?

A2. This logic is incorrect. Under this assumption, the Board would never consider changing the equity ratio unless they feel NP's business risk changed. Yet, as noted in my evidence, as well in Mr. Coyne's evidence, on page 17 of Order No. P.U. 13 (2013), the Newfoundland and Labrador Board of Commissioners of Public Utilities (hereafter the Board) stated:

> *"The Board notes that it has been some time since Newfoundland Power's capital structure has been comprehensively reviewed and that it may be appropriate for this issue to be addressed in Newfoundland Power's next general rate application."*

Therefore, the whole premise that a "new" recommendation cannot be made in light of existing evidence does not make sense.

Dr. Cleary's evidence clearly shows that NP continues to be a low risk regulated Canadian utility, and that a reduction in the ER to bring NP's ER in line with other low-risk Canadian regulated utilities, would be consistent with this low risk profile.

Q2. Mr. Coyne's rebuttal evidence (page 9) suggests that he has provided detailed evidence demonstrating NP's business risk is "somewhat higher" than at the time of the 2012 GRA filing. Please comment on this assertion.

A2. Dr. Cleary finds little support for this statement based on Mr. Coyne's evidence. While Mr. Coyne spends a lot of time "discussing" various business risks facing NP and then comparing them to his proxy samples, he provides no compelling evidence that NP's business risk has changed. For example, with respect to regulatory risk, as noted on page 18 of my evidence, Mr. Coyne "rates the Newfoundland regulatory environment among the top four in Canada." Nothing in his evidence suggests that regulatory risk is now "higher" than in 2012.

Similarly, he discusses several other issues but his conclusion that NP is no longer an "average risk" utility is based largely on two issues - Muskrat Falls and NP's size. Dr. Cleary discusses the size issue in response to question #5, but clearly this is not a new development. With regards to Mr. Coyne's assertion that the Muskrat Falls supply system will lead to increased cost uncertainty and power supply reliability, Dr. Cleary addressed these issues in his direct evidence (pages 22-23) and in response to PUB-CA-022 and PUB-CA-023. PUB-CA-022 asked specifically to the cost uncertainty, to which Dr. Cleary responded:

> "Dr. Cleary evaluated this factor and found conflicting evidence from NP regarding whether or not supply risk has in fact increased, stayed the same, or decreased. Like Mr. Coyne, I do not claim to be an expert in transmission reliability or weather-related risks. Therefore, I have to rely on evidence provided by such experts. The evidence is conflicting since NLH has claimed that supply risk will be reduced, while NP is claiming it will be increased. Since the matter is currently under review, Dr. Cleary has no way of knowing whether supply risk has increased, decreased or stayed the same. Therefore, Dr. Cleary assumes that supply risk has not increased, at least not in any material way. The basis for this conclusion is provided in greater detail in the response to PUB-CA-023.

With respect to the cost uncertainty associated with Muskrat Falls, Dr. Cleary would note the following:

Page 16, lines 16-23, of Mr. Coyne's evidence states:

> "With regard to the impact of Nalcor Energy's new generation plant at Muskrat Falls, Newfoundland Power expects that electricity rates will increase substantially due to higher supply costs. According to Newfoundland Power's evidence, power supply costs currently account for approximately 64 percent of the Company's 2014 revenue. Newfoundland Power recovers changes in power supply costs through the Rate Stabilization Account ("RSA"), which allows for recovery of variations in NLH's production costs. The RSA also recovers or credits, as

appropriate, variations in Newfoundland Power's supply costs due to changes from test year energy and demand costs."

So, in other words, if NP's supply costs increase, it can pass on these increased costs to consumers through rates charged, as is usual for cost of service arrangements. And if the increase was not anticipated (i.e., in the test year estimates) NP would be able to pass on such unexpected cost increases to consumers through the RSA. Therefore, it is not clear to Dr. Cleary what increased risk this poses to NP. In essence, the risk is to the consumer who would pay higher rates, but NOT to NP, since NP can pass these additional costs through to consumers.

NP has stated that any increase in electricity rates may cause many customers to "convert" to alternative energy sources; however, Dr. Cleary does not find this argument compelling. For example, as noted in the response to CA-NP-041, NP estimated that it costs $10,000 to convert to a forced air furnace and $15,000-$25,000 for oil fired hot water radiators. This is a significant cash outlay that has to be covered by annual fuel savings which NP estimated as only being 10% cheaper than electricity. In fact, NP estimated that oil had a 40% cost advantage during the 1990s (CA-NP-042) and yet only 6,000 customers or 3.7% of the total switched from electric space heating.

Based on these estimated costs of switching and the historical evidence noted above, Dr. Cleary believes that it seems extremely unlikely that a significant number of customers would be inclined to convert from electricity."

PUB-CA-023 was focused on the related issue of resulting supply reliability, to which Dr. Cleary responded:

"As noted in the response to PUB-CA-022, Dr. Cleary evaluated this factor and found conflicting evidence from NP regarding whether or not supply risk has in fact increased, stayed the same, or decreased. Like Mr. Coyne, I do not claim to be an expert in transmission reliability or weather-related risks. Therefore, I have to rely on evidence provided by such experts. The evidence is conflicting since

NLH has claimed that supply risk will be reduced, while NP is claiming it will be increased. Since the matter is currently under review, Dr. Cleary has no way of knowing whether supply risk has increased, decreased or stayed the same. Therefore, Dr. Cleary assumes that supply risk has not increased, at least not in any material way. The basis for this conclusion is provided below.

Mr. Coyne's evidence, Appendix A: Capital Structure: On page 15, lines 21 to 24, states:

> *"The new electricity supply will be served by a new 1,100 kilometer transmission line, which will cross eight different climactic zones to reach St. John's, thereby increasing potential weather-related risk to Newfoundland Power's electricity supply".*

However, the response to CA-NP-173, which asked Mr. Coyne to provide all documentation supporting the premise that the new electricity supply will increase the weather related risk to Newfoundland Power's electricity supply, stated that:

> "Mr. Coyne is not an expert in transmission reliability or weather-related risk of electricity supply."

And further stated:

> "the necessary studies to address commissioning, start-up and integration of the Muskrat Falls project are incomplete and that Hydro's belief that **reliability of supply will be improved** is currently untested."

And then concludes saying:

> "Mr. Coyne understands that matters related to the reliability of Newfoundland Power's power supply following commissioning of the Muskrat Falls project are **currently being studied** by the Board as part of Phase II of its *Investigation and Hearing into the Supply Issues and Power Outages on the Island Interconnected System*. This proceeding is **not yet complete**. The results of the Board's investigation into the reliability of power supply following commissioning of the Muskrat Falls project, including its assessment of the future reliability of power supply, are therefore **currently uncertain**."

Further, CA-NP- 175 asks Mr. Coyne to reconcile his statement regarding increased supply risk with the response to CA-NLH-115 (for the Board's Outage Inquiry) where it is stated:

> *"Hydro does not believe there would be any scenarios where the post-Muskrat Falls power system would be less reliable than the power system currently in place. In fact, the reliability of supply to customers will be improved".*

In its response, Hydro goes on to provide the reasons why reliability of supply will be improved.

Mr. Coyne's response to CA-NP-175 goes on to say:

> "Mr. Coyne understands that matters related to the reliability of Newfoundland Power's power supply following commissioning of the Muskrat Falls project are currently being studied by the Board as part of Phase II of its *Investigation and Hearing into the Supply Issues and Power Outages on the Island Interconnected System*. **This proceeding is not yet complete**. The results of the Board's investigation into the reliability of power supply following commissioning of the Muskrat Falls project, including its assessment of **the future reliability of power supply, are therefore currently uncertain**."

Obviously, Mr. Coyne cannot say for certain whether or not supply risk has increased, decreased or remained the same while the matter is currently being reviewed, nor can Dr. Cleary. In fact, given NLH's response to CA-NLH-115, it could at least be equally possible that supply reliability will be improved; however, Dr. Cleary does not speculate on the outcome of the current review."

So, Dr. Cleary fails to see any detailed or compelling evidence provided by Mr. Coyne to even suggest, let alone confirm, that NP's risk is "somewhat higher" than it was at the time of the 2012 GRA. Basically, Mr. Coyne's conclusions seem to be based on a number of unsubstantiated conjectures. This view is substantiated by recent NP debt rating reports by Moody's and DBRS, which refer to NP's low business risk as a strength as noted in my response to NP-CA-003, which I have copied below:

"Moody's report, January 19, 2015:

1. Page 1, the first two points under the heading "Rating Drivers" read:
   - "Low-risk regulated electric utility"
   - "Supportive regulatory and business environment"

2. Page 2, under "Summary Rating Rationale":

"NPI's Baa1 issuer rating reflects the company's low business risk as a vertically integrated cost-of-service regulated utility with no unregulated business activities. Approximately 93% of NPI's power requirements are purchased from provincially-owned Newfoundland & Labrador Hydro (Hydro), the cost of which is passed through to ratepayers. Despite NPI's allowed Return on Equity (ROE) of 8.80% for 2013-2015, we continue to view the PUB as one of the more supportive regulators in Canada. Regulatory decisions tend to be reasonably timely and balanced and NPI's 45% deemed equity is among the highest in Canada. In addition, NPI benefits from a number of deferral accounts that are intended to protect it from factors beyond management's control."

3. Page 2, under "Detailed rating Considerations":
   Heading #1 – "Low-risk business model" – the two paragraphs that follow this heading provide reasons for this assessment.
   Heading #2 – "Supportive regulatory and business environment" – the four paragraphs that follow this heading provide reasons for this assessment.

DBRS report, August 21, 2015:

1. Page 1, paragraph 1:
   "The confirmations reflect the stable nature of the Company's regulated electricity distribution business and its solid financial risk profile."

2. Page 1, paragraph 2:

"Newfoundland Power's business risk profile continues to be supported by the reasonable regulatory regime in Newfoundland and Labrador. The Company, which is regulated by the Board of Commissioners of Public Utilities (PUB), operates under a cost-of-service (COS) framework, which allows Newfoundland Power to recover all prudently spent operating expenses and earn a reasonable return. The Company currently has an allowed return on equity (ROE) of 8.80% and regulated capital structure of 45% common equity, which is comparable to its peers across Canada. Newfoundland Power also benefits from having a Rate Stabilization Account (RSA) and a Weather Normalization Account (WNA), which help reduce volatility in its earnings. These accounts limit the Company's exposure to power price risk as the RSA passes through to customers changes in the cost and quantity of fuel burned by the Company's main power supplier, Newfoundland and Labrador Hydro (NLH; rated "A" with a Stable trend by DBRS), while the WNA stabilizes earnings during extreme weather conditions."

3. Page 2, under the heading "Strengths":

"**1. Stable and supportive regulatory environment**
Newfoundland Power operates in a stable and supportive regulatory environment that is based on COS regulation. The PUB allows for the pass-through of purchased power costs and an RSA is in place to absorb fluctuations in purchased power costs relating primarily to the cost of fuel oil used by NLH to generate electricity. Furthermore, the Company also has a WNA to stabilize earnings during extreme weather conditions."

4. Page 2, under the heading "Strengths":

"**3. Stable customer base**

Newfoundland Power has a stable customer base, with power sales consisting solely of those to residential and commercial customers."

Q3. Mr. Coyne's rebuttal evidence (page 9) suggests that you have provided "no detailed evidence in relation to other Canadian or U.S. utilities..." Please comment on this assertion.

A3. This assertion has no merit whatsoever. As discussed in Dr. Cleary's response to Question 2, Dr. Cleary reviewed Mr. Coyne's evidence and found his conclusions to be very subjective, and found little objective support for his main conclusions. In contrast, pages 16-18 of Dr. Cleary's evidence argues that NP continues to be a very low risk regulated utility operating a virtual monopoly in a mature market that possesses low business risk, consistent with the statements made by the debt rating agencies (i.e., as in my response to Question 2 above). Dr. Cleary provides strong "objective" quantitative evidence in Section 3.2.2 that shows the resiliency of NP's revenues and EBIT through time, which supports Dr. Cleary's assertions regarding NP's low business risk. Dr. Cleary's quantitative analysis in Section 3.2.4 provides detailed and objective evidence showing that NP has much lower business risk than Mr. Coyne's sample of U.S. utilities, and marginally lower than three Canadian utilities. This evidence is clear, well-supported and irrefutable, unlike the unsubstantiated conjectures put forward by Mr. Coyne.

Q4. Mr. Coyne's rebuttal evidence (pages 9-10) states that:

"Dr. Cleary's EBIT analysis, however, is conducted at the holding company level for the U.S. proxy group companies, at the operating company level for two of three Canadian proxy group companies (i.e., Enbridge Gas Distribution and Nova Scotia Power) and at the holding company level for the other Canadian proxy group company (i.e., Gaz Métro Limited Partnership), and at the operating utility level for Newfoundland Power. As

such, Dr. Cleary's quantitative analysis provides an inconsistent basis of comparison that cannot be relied upon to assess the relative business risk of Newfoundland Power."

How would you assess Mr. Coyne's statement?

A4. It is ironic that Mr. Coyne's comments above highlight the very inconsistency in his U.S. utility proxy group that Dr. Cleary's evidence verifies – the U.S. holding companies included in Mr. Coyne's sample have significantly more risk than NP, which is a regulated Canadian operating distribution utility. As noted in Dr. Cleary's response to PUB-CA-025, copied below:

> "The purpose of Dr. Cleary's analysis reported in Table 8 was to provide quantitative evidence to evaluate Mr. Coyne's claims that NP had higher business risk than both his Canadian proxy group and his U.S. proxy group. In order to avoid debate over Dr. Cleary's sample choices, he used the same companies for comparables as Mr. Coyne.
>
> The three Canadian utilities examined in Table 8 were the operating companies of three of the Canadian utilities that Mr. Coyne included in his Canadian proxy group. Dr. Cleary was unable to find the required information in public annual reports at the operating level for the operating company of CU Ltd. That was referenced by Mr. Coyne (ATCO Electricity Distribution).
>
> Table 8 has the results for six of the seven U.S. utilities that Mr. Coyne included in his U.S. proxy group – with Eversource being left out since data was not available for them in the Compustat database used by Dr. Cleary. As mentioned, in order to avoid debate over sample selection, Dr. Cleary used information for the companies that were chosen by Mr. Coyne even though all seven are holding companies, most of which are involved heavily in transmission as well as distribution, and even though six of them (with Eversource being the lone exception) have a significant amount of assets devoted to generation.
>
> Not surprisingly, Dr. Cleary's evidence shows clearly that NP had significantly lower volatility in operating income than all of the utilities included in Mr. Coyne's U.S. proxy group, which shows that they have much higher business risk.

As a result, Dr. Cleary does not use the U.S. sample when further analyzing NP's business and financial risk – since they are not good comparators."

Aside from the fact that the utilities included in Mr. Coyne's U.S. proxy sample are holding companies, they operate in different operational and regulatory jurisdictions than NP, and most of them have significant exposure to generation risks, unlike NP. That is why Dr. Cleary does not use U.S. utilities as comparators. Therefore, since Dr. Cleary chose to focus on Canadian utilities, it was logical to focus on operating utilities that focused on distribution, similar to NP. While Gaz Metro MLP is a holding company, its operating risk is comprised of three operating companies that are primarily gas distribution companies, with distribution accounting for close to 90% of 2015 net income and gas transportation accounting for just over 8% of 2015 net income, even if close to one third of this is generated in Vermont.[1] So it is not nearly as inappropriate as the U.S. holding companies included in Mr. Coyne's sample.

The differences in Dr. Cleary's quantitative results for U.S. holding companies versus operating Canadian utilities does not detract from the validity of his CV-EBIT analysis approach. Rather, **it verifies that the approach works effectively to distinguish among companies facing different levels of business risk.**

Q5. Mr. Coyne's rebuttal evidence (page 10 and page 56) contends that the risk associated NP's size is a major area of disagreement between you and he. How do you respond to this comment?

A5. We both agree that NP's size has not changed, so there is no disagreement on this point. Unfortunately, it is still not clear to Dr. Cleary why a small utility with a virtual monopoly and virtually no cost pass-through risk could be considered "riskier" than a large utility (such as one of those included in Mr. Coyne's U.S. proxy group) that face different operating risks such as greater competition from non-regulated utilities or possessing generation risk would be considered "less" risky. Mr. Coyne continues to suggest that the Board has consistently recognized this fact. However, as noted in Dr. Cleary's response to NP-CA-013:

[1] Source: DBRS rating report for Gaz Metro Inc., December 21, 2015.

"Dr. Cleary did not find any such conclusions in the most recent Board Orders (2013, 2009 or 2007) with respect to the Board's conclusions regarding NP's risk or capital structure. Dr. Cleary acknowledges that in a previous order (Order No. P.U. 2003) the Board stated on page 45:

> "Generally in the past it has been determined by the Board that a strong equity component is needed to mitigate the impact of NP's relatively small size and low growth potential."

This statement does not suggest that NP's size makes it "more risky than other electric utilities in Canada." In fact, in that same order, the Board concluded its discussion of Business Risk on pages 31-33, stating on page 33 that:

> "The Board does not anticipate a change in the business risk of NP in the foreseeable future and concurs with the assessment of NP and the cost of capital experts that NP is of **average business risk** compared to other utilities."

Similarly, on page 35 of the 2003 Order, the Board concluded its discussion of NP's financial risk on pages 33-35, stating on page 35:

> "The Board finds that capital market conditions, in particular affecting the equity market, have changed substantially since 1998. This volatility has contributed to an overall reduction in investor expectations in the equity market from historic levels. In addition, volatility has contributed to greater spreads being demanded by corporate bondholders and equity investors to account for added risk as compared to long-term government securities. The Board finds these trends will similarly influence NP but present **no greater financial risk to NP than will be experienced by other comparable Canadian utilities**."

Finally, on page 40 of the 2003 Order, the Board provides a "summary of risks" and concludes on page 40:

> "Despite the change in circumstances since 1998, the Board finds that **the overall investment risk of NP is average when compared to other Canadian utilities**. This finding will be the basis on which the Board will consider a commensurate capital structure and ROE for the utility."

As mentioned, Dr. Cleary similarly saw no direct references by the Board to NP's size in reaching its conclusions regarding NP's risk or capital structure in the 2007, 2009 or 2013 Orders. For example, the Commission makes no mention of NP's size in Order No. P.U. 13 (2013), in the section entitled "Board Findings - Risk and Capital Structure," on pages 16-17 of that Order. The Order concludes this section on page 17, lines 19-23, stating:

> "The Board finds that Newfoundland Power **continues to be an average risk Canadian utility**. The Board will accept a common equity component of no greater than 45% for ratemaking purposes for Newfoundland Power. The Board will require Newfoundland Power to file a report in relation to its capital structure with its next general rate application."

As noted on page 23 (lines 5-15) of his evidence, Dr. Cleary does not view NP's size to be a big risk:

> "First of all, NP has always been small relative to some, but not all, other utilities, so this does not seem to warrant attention as something that has changed since the last hearings to affect NP's business risk. Secondly, NP operates in a mature segmented market with virtually no competition and with a proven business and regulatory model that allows it to steadily grow its revenue base and pass through its costs to maintain earnings and cash flow stability. In other words, there is no reason to believe that a small firm operating a virtual monopoly in such a supportive environment is any riskier than a big firm operating in markets where there is more competition, or where they face greater regulatory risk, for example. Finally, there is no evidence that its small size has hindered NP from accessing public (or private) debt markets, as attested to by its successful long-term bond issue in 2015, and its existing short-term credit facility that is available to it."

Q6. Mr. Coyne's rebuttal evidence (page 10 and on pages 57 and 58) contends that Muskrat Falls represents a large risk to NP due to its distance from the primary

load centre which could create supply uncertainties, and due to potential price increases. How do you respond to these comments?

A6. Regarding the increased risk due to additional distance from the hub, Dr. Cleary still has not seen any direct evidence suggesting verifying that a new facility that is further from the hub is riskier than an aging facility located near the hub. Therefore, Dr. Cleary is not clear why Mr. Coyne is able to make such conclusions, even though he has acknowledged this matter is still under study, as acknowledged in Dr. Cleary's response to Question 2 earlier, and in the response to PUB-CA-023. With respect to the conclusion that the Board would not permit any such increase in costs to be passed on to consumers, or that this would cause a significant decline in demand for NP, please refer to Dr. Cleary's response to Question 2 above, and his response to PUB-CA-022.

Q7. Mr. Coyne's rebuttal evidence (page 11) contends that:

> **Dr. Cleary's credit metric analysis is based on his incorrect belief that Newfoundland Power has an "A" rating, when in fact the Company's long term issuer rating from Moody's is "Baa1". Newfoundland Power finances its rate base with first mortgage bonds, which are rated "A2" by Moody's, due to the collateral provided to debtholders (i.e., the debt is secured by utility property, plant and equipment).**

How do you respond to this assertion?

A7. Dr. Cleary is clearly aware that NP is rated Baa1 by Moody's, but that secured NP bonds are rated A2 by Moody's due to the collateral provided. This is very clear on the first page of the January 19, 2015 Moody's report, which Dr. Cleary has referred to several times in evidence and in RFI responses. At no point in Dr. Cleary's evidence does he ever suggest otherwise. So it is a complete mystery to Dr. Cleary why Mr. Coyne asserts that he conducted his analysis based on the "incorrect belief" that NP is rated A by Moody's. In fact, all of Dr. Cleary's metric analysis discussion related to the evidence provided in Tables 13-15 on pages 33-36 of his direct evidence shows how NP's metrics remain in Moody's "Baa" ranges. Similarly, Dr. Cleary's discussion on pages 31-32 of results reported in Table 11 show that NP is rated A by DBRS, while his discussion of NP's

metrics in Tables 13-15 shows that NP maintains metrics in the A-AA range, under various scenarios. Again, this assertion is a complete mystery to Dr. Cleary.

Q8. Mr. Coyne's rebuttal evidence (page 11) contends that:

> **"In addition, Dr. Booth notes that credit metrics are not the most important tool used by credit rating agencies in assigning debt ratings."**

Further, on page 55 of his rebuttal evidence, Mr. Coyne suggests that:

> **"Dr. Booth's position directly contradicts the analysis presented by Dr. Cleary on pages 31-32 of his evidence where he compares the credit metrics of Newfoundland Power to other Canadian electric and gas utilities in an attempt to quantify the Company's relative risk. While I believe that credit metrics are important in terms of evaluating financial risk, I agree with Dr. Booth that rating agencies place more somewhat weight on cost recovery and regulatory protection measures than on financial metrics."**

How do you respond to these assertions?

A8. These statements are clearly misleading. First of all, the fact that Dr. Booth focuses his discussion on factors other than credit metrics does not "contradict" Dr. Cleary's decision to examine credit metrics. If this were the case, then every debt rating agency report would be "contradictory," since they all consider metrics as well as other factors more related to business and regulatory risk.

Secondly, the implication that Dr. Cleary does NOT consider information other than credit metric analysis is equally misleading. Dr. Cleary performs a credit metric analysis to "complement" his analysis of business risk and regulatory risk. Dr. Cleary's evidence clearly suggests that NP faces low business and regulatory risk, similar to the conclusions of rating agencies. Dr. Cleary felt it was logical to follow this up with a credit metric analysis, while recognizing that business and regulatory risk assessments are weighted heavier by rating agencies. Dr. Cleary noted this in his response to NP-CA-018, which is copied below:

> "Dr. Cleary is well aware that credit metrics are only a part of what debt rating agencies consider in determining their ratings.

For example, the response to CA-NP-029 provides a copy of the 2013 Moody's Methodology for utilities, from which Dr. Cleary notes the following:

- Page 4 of this document provides the overall framework, which involves making a business risk assessment (BRA) and a financial risk assessment (FRA).
- Page 6 provides an outline of the primary BRA factors that include assessing regulation, business mix, and franchise and customer mix respectively.
- Page 7 of this document discusses additional BRA factors that may be considered.
- Page 8 of this document discusses primary FRA metrics, plus some additional metrics, while page 9 discusses other criteria.
- Notably, DBRS states the following on page 9 of this document:

"The final issuer rating is a blend of the BRA and FRA. In most cases, the BRA will have greater weight than the FRA in determining the issuer rating."

Similarly, the Moody's 2013 Methodology Report provided in the response to CA-NP-028, from which Dr. Cleary notes the following rating grid which is provided on page 6 of that document and which summarizes the factors they consider, and the weightings they attach to the various factors:

Factor / Sub-Factor Weighting - Regulated Utilities

Broad Rating Factors	Broad Rating Factor Weighting
Regulatory Framework	25%
Ability to Recover Costs and Earn Returns	25%
Diversification	10%
Financial Strength, Key Financial Metrics	40%

Pages 6-31 of the Moody's Methodology report provide details in terms of how they assess utilities according to the factors in the grid provided above."

Q9. On page 4 of its rebuttal evidence, NP calculates several ratios based on a 7.5% ROE and 40% ER scenario. Do you have any comments on the calculated metrics?

A9. Yes. First of all, Dr. Cleary notices that the calculated metrics for 2016 and 2017 for Cash Flow Interest Coverage (3.7 and 3.5) are similar to those he calculated under the same ROE/ER scenario as presented in Table 15 of his evidence (3.50 and 3.49), which lie in the Baa(mid) range for Moody's. Similarly, NP's calculated 2016 and 2017 Cash Flow Debt Coverage ratios (15.9% and 14.5%) are similar to those Dr. Cleary calculated (14.9% and 14.8%) and lie in DBRS's A(high) range. So this verifies Dr. Cleary's conclusions with respect to these two metrics.

The Pre-Tax Interest Coverage measures for 2016 and 2017 (2.0 and 2.0) presented on page 4 of NP's rebuttal evidence are lower than the EBIT/Interest coverage ratios Dr. Cleary calculated in Table 15 (2.21 and 2.22), but are still in the DBRS A(mid) range. This discrepancy is difficult to explain, since Dr. Cleary uses the figures provided by NP in Exhibit 3 to calculate this ratio, and uses the approach and formula used by DBRS. Dr. Cleary also noticed that the reported interest coverage ratios presented by NP on page 1 of Exhibit 3 for 2013 and 2014 of 2.3 and 2.3 (as well as in the 2nd revision of this Exhibit) are below those provided by DBRS for NP for 2013 and 2014 which were 3.06 and 2.95, according to the August 21, 2015 DBRS report provided in NP's evidence. Combining these two observations leads Dr. Cleary to conclude that NP is calculating interest coverage in a different manner.

The response by Grant Thornton to CA-PUB-004 indicates that at least part of this discrepancy is due to NP's subtracting interest during construction from the numerator (i.e., EBIT) of this ratio, but not from the denominator (i.e., interest). It is not clear why NP does this, since DBRS does not appear to do so, but this does seem to explain some of the discrepancies between NP's interest coverage ratio calculations from both Dr. Cleary's and DBRS's calculations.

Q10. On pages 7-8 of its rebuttal evidence, NP compares NP's credit metrics according to Moody's to that of Fortis Alberta Inc. and concludes on page 8 that:

> **"Over the period 2012 to 2014, FortisAlberta 1 generated slightly stronger credit metrics, on average, than Newfoundland Power. However, during the period, FortisAlberta had both a lower allowed return on equity and a lower equity ratio than Newfoundland Power. The returns on equity authorized by the AUC for FortisAlberta have enabled FortisAlberta, with its 40% equity ratio, to achieve credit metrics that are comparable to those at Newfoundland Power with its 45% equity ratio.**
>
> **The fact that Newfoundland Power's 45% common equity ratio has allowed it to generate credit metrics which are only comparable (and, on average, slightly weaker) than utilities such as FortisAlberta supports the continuing reasonableness of the Company's current capital structure. It also supports DBRS's observation that Newfoundland Power's regulated capital structure of 45% common equity is comparable to its peers across Canada."**

Do you have any comments on these conclusions?

A10. Yes. First of all, Dr. Cleary's comparison of NP's credit metrics to other Canadian utilities shows that NP's DBRS metrics were clearly better than the six Canadian utilities in Table 11 (which includes Fortis Alberta Inc.). In fact, evidence submitted by FortisBC Energy Inc. to the British Columbia Utilities Commission in October 2015 also shows otherwise. In particular, Table 4 on page 26 of that evidence shows that NP had superior EBIT interest coverage and debt to total capital ratios over the 2012-14 period to Fortis Alberta Inc., FortisBC Inc., and FortisBC Energy Inc. Therefore, it seems this conclusion is not well supported by a broader view of existing evidence.

Q11. Does that conclude your testimony?

A11. Yes it does.