HAND DELIVERED

April 18, 2016

Board of Commissioners
of Public Utilities
P.O. Box 21040
120 Torbay Road
St. John's, NL A1A 5B2

Attention: G. Cheryl Blundon
Director of Corporate Services
and Board Secretary

Ladies and Gentlemen:

Re: Newfoundland Power 2016/2017 General Rate Application ("GRA")

In an exchange between the Consumer Advocate, the Chair of the Board of Commissioners of Public Utilities, and Newfoundland Power's counsel Mr. Ian Kelly QC at the close of the hearing, it was agreed that the Company would respond to the Consumer Advocate's written questions regarding the manner in which Newfoundland Power calculates its interest coverage ratios (Transcript, April 12, 2016, Page 135, Lines 1-16).

Newfoundland Power received the Consumer Advocate's written questions in a letter dated April 14, 2016. This letter and the attachments thereto provide detailed responses to the questions numbered 1, 9, 10 and 11. The information requests contained in items 2 through 8 are unduly burdensome, and are not necessary for a satisfactory understanding of the matters under consideration, as contemplated by Regulation 14 of the *Board of Commissioners of Public Utilities Regulations, 1996* (the "Regulations").

Overview

Newfoundland Power calculates its credit metrics on a financial reporting basis. This is because credit rating agencies base their credit metrics on published financial statements.

The Company's published financial statements are audited annually by Ernst and Young, Chartered Professional Accountants. Audited financial statements are required to be prepared in accordance with generally accepted accounting standards. Newfoundland Power prepares its financial statements in accordance with accounting principles generally accepted in the United States ("U.S. GAAP").

The Company is also required to calculate its earnings test interest coverage calculation, as specified by the trust deed which secures Newfoundland Power's First Mortgage bonds, based on audited financial information.

For ratemaking purposes, Newfoundland Power's revenue requirement is based on regulatory reporting requirements. This includes presentation adjustments such as reporting the tax savings associated with the cost of removal of plant as a reduction to depreciation expense rather than a reduction to income tax expense. Reporting tax on cost of removal within income tax expense is required for financial reporting purposes under U.S. GAAP.

Financial reporting standards and regulatory reporting requirements evolve over time. Further, credit metric calculations typically vary by credit rating agency. Therefore, differences in financial data reported under accounting standards, regulatory standards and by credit rating agencies are inevitable, and sophisticated users of such information are aware of these differences.

The Interest Coverage Ratio (times)

In the letter dated April 14, 2016, the Consumer Advocate indicated that there appears to be an issue with respect to the interest coverage ratio as calculated by Newfoundland Power and by Dr. Cleary. In particular, the Consumer Advocate points to Newfoundland Power's interest coverage ratio calculations of 2.3 for 2013 and 2014.

The calculation of the interest coverage ratio is based on Standard and Poor's Rating Services methodology. The calculation considers the ratio of Newfoundland Power's pre-tax earnings and interest costs to the Company's total interest costs.

In Requests for Information CA-PUB-001 to CA-PUB-006, the Consumer Advocate asked the Board's financial consultant, Grant Thornton, several questions relating to the calculation of Newfoundland Power's interest coverage ratio. The responses to these requests for information include a detailed discussion of the Company's interest coverage ratio as well as details relating to adjustments made to account for non-regulated expenses and tax on cost of removal.

In Request for Information CA-PUB-004, the Consumer Advocate asked Grant Thornton to provide "the exact numbers used to calculate the interest coverage ratios" in Table 14 of the Grant Thornton Report. The response to the Request for Information provided a reconciliation of Newfoundland Power's interest coverage ratio of 2.3 for 2013 and 2014 as well as interest coverage ratio calculations for 2015 to 2017 using existing and proposed rates. The 2015 to 2017 forecast information in the response was based upon the Company's original GRA filing. An update to the response to Request for Information CA-PUB-004 based upon Newfoundland Power's revised GRA filing is provided in Attachment A.

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Earnings Test Coverage Calculation

A 2017 *pro forma* earnings test interest coverage calculation was provided in Undertaking U-7. The calculation was based on an 8.30% return on equity and 40% equity capital structure.

The April 14, 2016 letter indicated that Newfoundland Power's calculations in Undertaking U-7 did not appear to be consistent with an 8.30% return on equity. Attachment B to this letter provides a detailed calculation of the regulated rate of return on common equity of 8.30% and common equity component of 40% in Newfoundland Power's capital structure under the scenario contained in U-7.

The Consumer Advocate has also requested a calculation of the "Earnings Test Coverage After New Issue" ratio as provided in Undertaking U-7. The figures used for the numerator ($80,199,000) and denominator ($41,454,000) are clearly specified in U-7. This information, together with the information provided in Attachment B, should be sufficient to provide a satisfactory understanding of the matter under consideration. It is not clear to Newfoundland Power what other information can be provided in relation to this matter.

Interest Coverage Ratio vs. Earnings Test Coverage Calculation

As detailed above, the interest coverage ratio and the earnings test coverage calculation are based on different methodologies.

Further, the interest coverage ratios as provided in Exhibit 3 (2nd Revision) and the earnings test coverage calculation provided in Undertaking U-7 are based on different forecasts.

The interest coverage ratio for 2016 is based on existing rates. In 2016, at existing rates, the regulated rate of return on equity is forecast to be 8.03% and the equity ratio is forecast to be 44.87%.

The earnings test coverage calculation in Undertaking U-7 provides a 2017 *pro forma* calculation based on the scenario of a regulated rate of return on equity of 8.30% and 40% common equity component in the capital structure.

This letter provides detailed information regarding the calculation of, and differences between, the two metrics. In Newfoundland Power's view, the information provided in this letter and the attachments is sufficient to provide a satisfactory understanding of these ratios, as contemplated by the Regulations.

Yours very truly,

Gerard Hayes
Senior Counsel
Enclosures

c. Geoffrey Young
Newfoundland and Labrador Hydro

Thomas Johnson, QC
Consumer Advocate

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Interest Coverage (times) Calculation

Calculation of Interest Coverage (times)
2013 to 2017 Forecast
($000s)

	2013 Actual	2014 Actual	2015 Actual	2016 Forecast	2017 Forecast	
Earnings before income taxes [1]	47,043	48,635	50,239	46,358	43,268	
Interest on Long Term Debt[2]	35,123	36,327	35,020	35,421	37,091	
Other Interest[2]	1,075	626	1,119	790	505	
Capitalized Interest[2]	(891)	(1,435)	(1,240)	(1,067)	(1,087)	
Amortization of Debt Issue Expenses[2]	302	254	242	218	213	
Numerator	**82,652**	**84,407**	**85,380**	**81,720**	**79,990**	**A**
Interest - Long Term Debt	35,123	36,327	35,020	35,421	37,091	
Other Interest	1,075	626	1,119	790	505	
Amortization of Debt Discount & Expense	302	254	242	218	213	
Denominator	**36,500**	**37,207**	**36,381**	**36,429**	**37,809**	**B**
Pre-tax Interest Coverage Ratio	**2.3**	**2.3**	**2.3**	**2.2**	**2.1**	**C = A / B**

[1] Earnings before income taxes (financial reporting basis) is calculated as follows:

Regulated earnings before income taxes*	53,422	56,030	57,642	54,447	51,821	D
Non-regulated expenses (before income taxes)	2,043	2,801	2,534	2,989	3,225	E
Tax on cost of removal**	4,336	4,594	4,869	5,100	5,328	F
	47,043	**48,635**	**50,239**	**46,358**	**43,268**	**G = D - E - F**

*See Exhibit 3 (2nd Revision), line 23.
**Recognized as income tax for financial reporting purposes.

[2] See Exhibit 3 (2nd revision), page 7 of 9, lines 6 to 9.

Undertaking U-7 Supporting Infomation

Calculation of Regulated Return on Common Equity of 8.30% and 40% Equity Capital Structure
December 31, 2016

Regulated Earnings		
Net earnings[1]	80,199	A
Less: funded obligation related interest[2]	37,533	B
Earnings before income taxes	**42,666**	**C = A - B**
Income taxes[3]	8,618	D
Net earnings	**34,048**	**E = C - D**
Preferred dividends	552	F
Earnings on common shares	**33,496**	**G = E - F**
Non-regulated expenses (net of income taxes)	2,122	H
Deemed dividends on excess common equity[4]	575	I
Regulated earnings	**35,043**	**J = G + H - I**
Average Common Equity		
Opening common equity[5]	466,255	K
Net earnings	34,048	L = E
Allocation of Part VI.1 Tax	252	M
Common dividends[4]	55,007	N
Preferred dividends	552	O = F
Forecast common equity at December 31, 2016 (before deeming)	**444,996**	**P = K + L + M - N - O**
Deemed dividends on excess common equity[4]	575	Q
Regulated Common Equity at December 31, 2016	**444,421**	**R = P - Q**
Regulated average common equity (before deeming)	455,338	S = (K + R) / 2
Excess common equity[4]	31,451	T
Deemed regulated average common equity	**423,887**	**U = S - T**
Regulated return on average common equity	**8.3%**	**V = J / U**
Equity Capital Structure		
Deemed regulated average common equity	423,887	W = U
Average total invested capital	1,060,438	X
% of Equity in capital structure	**40.0%**	**Y = W / X**

[1] See U-7.

[2] See U-7, footnote 1.

[3] Financial reporting basis.

[4] See the Company's Rebuttal Evidence, page 2, lines 11 to 17. To reduce the common equity ratio from 45% to 40%, a common dividend of approximately $55 million would be required in 2016. A practical transition to a 40% average common equity ratio will result in common equity in excess of 40% in 2016. It is assumed this excess common equity will be funded at the short term interest rate of 1.83% for the purposes of this pro forma calculation.

[5] See 2015 Annual Return 27 to the Board, line 11.