Q. Why does the company issue first mortgage bonds rather than senior unsecured debt?

A. First Mortgage Bonds are the least cost means by which the Company can obtain long-term financing.

A first mortgage bond is secured by a fixed and floating first charge on the Company's assets. Because of the security provided by the first mortgage, the bonds are assigned a higher credit rating than is assigned to senior unsecured debt. Moody's Investors Service indicated the following in its January 2015 credit rating report for Newfoundland Power[1]:

> *"The A2 rating of NPI's senior secured FMB reflects the first mortgage security over NPI's property, plant and equipment and floating charge on all other assets. This is consistent with the two notch differential between most senior secured debt ratings and senior unsecured debt ratings of investment-grade regulated utilities operating in North America. The differential is based on our analysis of the history of regulated utility defaults, which indicates that regulated utilities have experienced lower loss given default rates (higher recovery rates) than non-financial, non-utility corporate issuers."*

The issuance of First Mortgage Bonds enables the Company to obtain debt financing at a lower interest rate than would be the case if the Company were to finance through unsecured means.

Unsecured debt would rank subordinate to, or behind, secured debt. Debt on an unsecured basis would require a higher rate of interest be paid in order to compensate creditors for the additional credit risk. This would increase the Company's overall long-term debt cost and the cost of debt to be borne by Newfoundland Power's customers.

[1] See Exhibit 4.