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2 **Q. Page 96: Dr. Booth recommends that Newfoundland Power's common equity**
3 **component be reduced by 5% from the currently approved 45%. Please list any**
4 **changes that have occurred since 2009 that would indicate that the level of common**
5 **equity approved at that time is no longer appropriate.**
6
7 A. Generally Dr. Booth would judge a change in common equity ratio to be justified
8 on the basis of one of the following:
9
10 - The common equity ratio was inappropriate in 2009;
11 - The business risk of NP has gone down since 2009;
12 - Capital market conditions are more favourable and the cost of an inefficient
13 capital structure has increased since 2009.
14
15 In Dr. Booth's judgement the business risk of NP has not changed materially since 2009.
16 Further in 2009 the memories of the financial crisis were too recent to consider a change
17 in NP's common equity ratio so he did not recommend it. However, in his executive
18 summary to his August 2009 evidence Dr. Booth stated:
19
20 *"I do not see any increase in the relative riskiness of NP and regard business risk*
21 *analysis to be of marginal importance in this hearing. This is particularly true*
22 *given that Moody's on August 3, 2009 upgraded NP's first mortgage bonds two*
23 *notches from Baa1 to A2. Although much of this significant upgrade is due to*
24 *technical factors more related to Moody's rating philosophy than NP's business*
25 *risk, nonetheless it does signal NP's very strong credit background. For this*
26 *reason I relegate a discussion of NP's business risk and financial health to*
27 *Appendix H. However, it does point out that NP's common equity ratio of 45%*
28 *significantly exceeds the Canadian norm for a low risk regulated utility. As more*
29 *of the financial market uncertainty recedes I would recommend that this be*
30 *reduced to bring NP more in line with practises in other Canadian jurisdictions."*
31

1 Since 2009 most of this financial market uncertainty has now receded. Although we are
2 still living with the after effects of the financial crisis in terms of central bank bond
3 buying programs, but that's about all. The unemployment rate in Canada is approaching a
4 normal cyclical low and it is already below 5.0% in the United States, so the real
5 economy is in reasonable shape even as Canada adjusts to lower oil prices. So the
6 question is whether an inefficient common equity ratio is still justified, particularly when
7 the shareholder invests in that 45% common equity with only 35% common equity and
8 10% preferred shares and regards an S&P bond rating of A- as strong?