NEWFOUNDLAND POWER
A FORTIS COMPANY

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August 21, 2009

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: 2010 NP General Rate Application

Please find enclosed the original and nine copies of Newfoundland Power's Requests for Information numbered NP-CA-1 to NP-CA-53 with respect to the prefiled evidence of Laurence Booth and NP-PUB-1 to NP-PUB-6 with respect to the prefiled evidence of Mark A. Cicchetti.

For convenience, the Requests for Information are provided on three-hole punched paper.

A copy of this letter, together with enclosures, has been forwarded directly to Geoffrey Young, of Newfoundland & Labrador Hydro and Thomas Johnson, Consumer Advocate.

Electronic copies of these Requests for Information will be forwarded in due course.

If you have any questions regarding the enclosed, please contact the undersigned at your convenience.

Yours very truly,

Peter Alteen
Vice President, Regulatory Affairs
& General Counsel

Enclosures

c. Geoffrey Young (3 copies)
Newfoundland and Labrador Hydro

Thomas Johnson (2 copies)
Consumer Advocate

IN THE MATTER OF the *Public Utilities Act*, R.S.N.L. 1990, Chapter P-47, as amended, (the "Act"); and

IN THE MATTER OF a general rate application (the "Application") by Newfoundland Power Inc. ("Newfoundland Power") to establish customer electricity rates for 2010.

Requests for Information by
Newfoundland Power Inc.

NP-CA-1 to NP-CA-53
NP-PUB-1 to NP-PUB-6

Requests for Information
<u>Evidence of Laurence Booth - 2010 General Rate Application</u>

NP-CA-1 For each case where Dr. Booth (or Dr. Booth and Dr. Berkowitz) has filed testimony since 1995, please provide in tabular format (i) the date of the testimony, (ii) the return on equity recommendation, (iii) the long-term Government of Canada bond forecast, (iv) the market risk premium, (v) the beta, (vi) any other adjustments made to arrive at the return on equity recommendation, and (vii) the return on equity allowed by the regulator in the proceeding.

NP-CA-2 Reference: Page 2, Lines 25-26 and Lines 30-31

"….it is important to note that the Company's evidence was prepared at a time when the recession and financial conditions were at their worst." and "If there ever was any case for changing the ROE adjustment mechanism that case has now collapsed."

Can Dr. Booth confirm that financial market conditions can justify changing the ROE adjustment mechanism and indicate what financial market conditions, in his professional opinion, might justify changing the ROE adjustment mechanism?

NP-CA-3 Reference: Page 3, Lines 6-8

"Only by carefully screening the total population of US utilities is it possible to come up with a small *sample* of equivalent risk US utilities to that of the total *population* of Canadian utilities."

How many publicly-traded utilities are there in the total population of U.S. utilities?

NP-CA-4 Reference: Page 3, Lines 6-8

"Only by carefully screening the total population of US utilities is it possible to come up with a small *sample* of equivalent risk US utilities to that of the total *population* of Canadian utilities."

How many of the publicly-traded utilities in the total population of US utilities would Dr. Booth consider relatively pure-play utilities?

NP-CA-5 Reference: Page 3, Lines 6-8

"Only by carefully screening the total population of US utilities is it possible to come up with a small *sample* of equivalent risk US utilities to that of the total *population* of Canadian utilities."

Of the pure-play utilities in the total population of US utilities, how many of them are vertically integrated electric utilities?

NP-CA-6 Reference: Page 3, Lines 6-8

"Only by carefully screening the total population of US utilities is it possible to come up with a small *sample* of equivalent risk US utilities to that of the total *population* of Canadian utilities."

Would the typical vertically integrated electric utility be of comparable business risk to the typical gas distribution or electric distribution utility?

NP-CA-7 Reference: Page 3, Lines 33-34

"My best estimate is that the market risk premium is 5.0%..."

Would Dr. Booth confirm that he defines the market risk premium as the difference between the long run equity and long run government bond return?

NP-CA-8 Reference: Page 3, Lines 33-34

"My best estimate is that the market risk premium is 5.0%..."

Would Dr. Booth agree that the CAPM formulation can be expressed as: Risk-free Rate + Beta × (Expected Market Return – Risk-Free Rate)?

NP-CA-9 Reference: Page 3, Lines 33-34

"My best estimate is that the market risk premium is 5.0%..."

Is the long-run government bond return the same as the risk-free rate? If no, please explain why not and provide Dr. Booth's estimate of the long-term government bond return.

NP-CA-10 Reference: Page 3, Lines 33-34

"My best estimate is that the market risk premium is 5.0%..."

Does Dr. Booth agree that the market risk premium changes constantly with market conditions?

NP-CA-11 Reference: Page 3, Lines 33-34

"My best estimate is that the market risk premium is 5.0%..."

Does Dr. Booth agree that the long-term Canada bond yield changes constantly with market conditions?

NP-CA-12 Reference: Page 3, Lines 33-34

"My best estimate is that the market risk premium is 5.0%..."

For how long has Dr. Booth's best estimate of the market risk premium been 5%?

NP-CA-13 Reference: Page 3, Lines 33-34

"My best estimate is that the market risk premium is 5.0%..."

Do Dr. Booth's ROE recommendations change with changes in the prevailing and forecast long-term Canada bond yield?

NP-CA-14 Reference: Page 3, Line 36

Dr. Booth recommends an ROE of 7.75% for NP

Please confirm that Dr. Booth recommended an ROE of 7.25% for the Alberta utilities in evidence filed in March 2009.

NP-CA-15 Reference: Page 3, Line 36

Dr. Booth recommends an ROE of 7.75% for NP

Please confirm that Dr. Booth's recommendation in this case is based on a long-term Canada bond yield of 4.5% and his recommendation in the Alberta utilities case in March 2009 was based on a long-term Canada bond yield of 4.25%.

NP-CA-16 Reference: Page 3, Line 36

Dr. Booth recommends an ROE of 7.75% for NP

Given the discussion in Dr. Booth's testimony with respect to the recovery in the equity markets, the improvement in credit markets, and the current stage of the economic recovery, please explain why the cost of equity is higher in July 2009 than it was in March 2009.

NP-CA-17 Reference: Page 3, Line 37

"Fairness has a variety of connotations…"

Please list all of the connotations which Dr. Booth has in mind which are relevant to the setting of the allowed ROE.

NP-CA-18 Reference: Page 3, Lines 39-40

Dr. Booth refers to a "zone of reasonableness" in ROE awards generated by formulae.

Please quantify the range of the "zone of reasonableness" referred to.

NP-CA-19 References: Page 4 and 20

At Page 4, Lines 5-8 Dr. Booth indicates that as "…more of the financial market uncertainty recedes…" he would recommend that Newfoundland Power's equity ratio be reduced.

At page 20, Lines 15 *et. seq.* of Appendix H, it is indicated that Dr. Booth would, in "normal" times, recommend Newfoundland Power's common equity be trimmed back to the 35 – 40% level.

Can Dr. Booth confirm that current financial market conditions are (i) uncertain and (ii) not "normal"? If not, why not?

NP-CA-20 Reference: Page 24, Lines 25-26

“This "flight to quality" is a regular part of the business cycle.”

When there is a “flight to quality”, do the yields on long-term government bonds typically decrease? Please explain.

NP-CA-21 Reference: Page 24, Lines 25-26

“This "flight to quality" is a regular part of the business cycle.”

When there is a flight to quality, does this typically mean that the costs of risky forms of capital increase? Please explain the response.

NP-CA-22 Reference: Page 24, Lines 25-26

“This "flight to quality" is a regular part of the business cycle.”

If the allowed return on equity tracks the yield on long-term government bonds, please explain why, over a business cycle, the allowed return rises when the cost of equity falls and falls when the cost of equity increases?

NP-CA-23 Reference: Page 25, Lines 16-18

“There are a number of reasons for the recent anomalous behaviour of A spreads starting with the credibility of the ratings themselves.”

Could Dr. Booth please explain in more detail how the credibility of the ratings themselves impacted the recent behaviour of A rated Canadian utility spreads?

NP-CA-24 Reference: Page 26, Line 26 to Page 27, Lines 1-2

“One indication of the lack of trust is a recent survey of CEOs reported by Reuters (November 11, 2008) where of the suggested changes 75% agreed that more regulation of credit rating agencies was needed.”

Please provide the referenced survey.

NP-CA-25 Reference: Page 34, Lines 8-11

"To the extent that long Canada bonds earn a maturity premium of at least 1.0% over the average Treasury bill yield, this classic CAPM automatically increases the risk free rate and lowers the slope of the CAPM in the same way as the ECAPM. In this way it adjusts for the bias noted in these early tests of the CAPM."

Based on Dr. Booth's assumptions for the market risk premium, utility beta and risk-free rate, by how much does the use of a long-term Canada bond, rather than a Treasury bill, raise the CAPM cost of equity?

NP-CA-26 Reference: Page 34, Lines 8-11

"To the extent that long Canada bonds earn a maturity premium of at least 1.0% over the average Treasury bill yield, this classic CAPM automatically increases the risk free rate and lowers the slope of the CAPM in the same way as the ECAPM. In this way it adjusts for the bias noted in these early tests of the CAPM."

Please provide all empirical evidence that reliance on a long-term bond yield, rather than a short-term rate, fully adjusts for the bias referenced in the preamble.

NP-CA-27 Reference: Page 34, Lines 8-11

"To the extent that long Canada bonds earn a maturity premium of at least 1.0% over the average Treasury bill yield, this classic CAPM automatically increases the risk free rate and lowers the slope of the CAPM in the same way as the ECAPM. In this way it adjusts for the bias noted in these early tests of the CAPM."

Please provide any studies of which Dr. Booth is aware that conclude that the adjustment referenced in the preamble does not fully adjust for its tendency to over estimate returns for high-risk stocks, and under-estimate returns for low risk stocks.

NP-CA-28 Reference: Page 40, Lines 18-19

"This is why they appeal to Canadian investors who can use the dividend tax credit and why their shares are generally held by Canadian and not foreign investors."

Please explain the difference in the dividend tax implications to a U.S. and a Canadian retail investor of owning shares in Canadian utilities.

NP-CA-29 Reference: Page 48, Lines 11-13

“My appendix E shows that inflation averaged not 2.0% but over 3.0% during this period, so her procedures may over estimate the market risk premium by at least 1.0%.”

Please provide all empirical evidence to support the proposition that the expected nominal equity market return has tracked the expected rate of inflation.

NP-CA-30 Reference: Page 49, Lines 16-19

Please provide copies of all testimony of Dr. Booth filed in other proceedings in which he uses a “margin of error” similar to that described at page 49, lines 16 to 19.

NP-CA-31 Reference: Page 49, Lines 16-19

Why did Dr. Booth not use a “margin of error” similar to that described in his evidence in this proceeding in evidence on a fair return for an Alberta utility which was filed before the Alberta Utilities Commission in March 2009?

NP-CA-32 Reference: Page 59, Lines 14-15

Does Dr. Booth believe that Newfoundland Power’s increased bond yields are caused by “…increases in default probabilities, increasing expected losses or increasing risk premiums”?

NP-CA-33 Reference: Page 60, Lines 2-5

“The important point to note is that bonds issued by the Government of Canada are many times more liquid than either bonds issued by the major provinces or corporate bonds. Even here the Bank of Canada has taken serious efforts to create liquidity in the major "benchmark" bonds by buying "off the run" relatively illiquid bonds and issuing more liquid benchmark bonds.”

Please explain what impact a lack of liquidity in the major benchmark bonds would have on the price of those bonds.

NP-CA-34 References: Page 64 and 68

Page 64, Lines 13-14 Dr. Booth says, "In this example the promised yield increases to 13.45% and the spread jumps to 345 basis points, which is about where A spreads actually are at the moment."

Page 68, Lines 8-10, he says "Conversely with the latest BBB spread in Canada (August 6, 2009) at 2.40% this would put the current market risk premium at just under my 5.0% market risk premium estimate."

Please reconcile these two spreads.

NP-CA-35 Reference: Page 65, Lines 3-5

"In my judgement a significant part of the increase in "A" spreads was caused by the major banks liquidating their bond inventories in order to raise capital and survive, particularly in the US."

Please provide all empirical support for the statement and explain how this would have been the case in Canada, given Dr. Booth's comments at page 28 regarding the differences between the banks in Canada and the U.S.

NP-CA-36 Reference: Page 65, Lines 14-15

"If NP's bonds continue to trade at 60 bps less than the Scotia Index…"

Please provide support for the conclusion that NP's bonds have traded at 60bps less than the Scotia Index.

NP-CA-37 Reference: Page 67, footnote 26

Please provide a copy of the referenced Damodaran paper.

NP-CA-38 Reference: Page 72, Lines 16-17

"If Ms. McShane's analysis is correct her fair ROE estimates should now be lower by a similar amount."

Please explain in more detail why the fair ROE estimates for a utility should be lower by a similar amount.

NP-CA-39 Reference: Page 76, Lines 20-21

"In a recent Investment Strategy report (October 22, 2008), just as the market was crashing the Royal Bank of Canada stated…"

Please provide a copy of the referenced report.

NP-CA-40 References: Page 77, Lines 2-3

Dr. Booth states, "What the chart indicates is that investing at a time when the PE ratio is low gives higher future returns, and the highest ten year average return for the US market is 8.1%."

Is the 8.1% return referred to real or nominal?

NP-CA-41 References: Page 77 and Appendix E, Page 8

In Appendix E, Page 8, Dr. Booth says, "In fact, going back as far as 1871, there is substantial evidence that the real return on US equities has been constant at just under 9.0%." At page 77, he states, "What the chart indicates is that investing at a time when the PE ratio is low gives higher future returns, and the highest ten year average return for the US market is 8.1%."

Please explain how both statements can be true.

NP-CA-42 Reference: Pages 86-97

Dr. Booth discusses the relationship between the utility cost of equity and long-term Canada bond yields.

Please provide any analysis that Dr. Booth has conducted or analysis of which Dr. Booth is aware which estimates the relationship between the required return on the equity market as a whole and long-term government bond yields.

NP-CA-43 Reference: Pages 86-97

Dr. Booth discusses the relationship between the utility cost of equity and long-term Canada bond yields.

Could Dr. Booth confirm that his conclusion regarding the implausibility of an adjustment coefficient of 0.50 for utilities is dependent on the relevant utility beta being 0.50? If this cannot be confirmed, please explain why not.

NP-CA-44 Reference: Page 88, Lines 4-5

Dr. Booth indicates that "…what matters is the outcome of the formula not how the formula is constructed."

Does Dr. Booth believe that this reasoning is applicable to the estimation of a fair return for Newfoundland Power generally? If not, why not?

NP-CA-45 Reference: Page 88, Line 17 to Page 89, Line 1

"The critical point is that if the Board changes its ROE formula, it not change the interest rate assumption without also changing the associated risk premium."

Please describe more specifically what Dr. Booth had in mind when he made the above statement. Could he please provide an example of a change in the associated risk premium that would be required if the Board changed its interest rate assumption.

NP-CA-46 Reference: Page 89, Lines 24-25

"This sort of data was previously included by Professor Berkowitz and myself in estimates of risk premiums over preferred stock yields."

Could Dr. Booth please confirm that in earlier proceedings he and Professor Berkowitz conducted a risk premium over preferred stock yields test?

NP-CA-47 Reference: Page 89, Lines 24-25

"This sort of data was previously included by Professor Berkowitz and myself in estimates of risk premiums over preferred stock yields."

If the answer to Request for Information NP-CA-47 is a confirmation, please explain why the same default and liquidity issues that Dr. Booth raises with respect to corporate bond yields would not create similar issues with respect to estimating the risk premium over preferred stock yields?

NP-CA-48 Reference: Page 96, Lines 17-18

Were the frauds to which Dr. Booth refers related to the utility businesses of those two firms? Please explain in detail.

NP-CA-49 Reference: Page 96, Lines 17-18

Please explain how, in Dr. Booth's view, the Enron and Worldcom frauds impact investors' perception of the risk currently of investing in relatively pure play U.S. utility stocks.

NP-CA-50 Reference: Page 96, Lines 18-19

"…a little further ahead are the stock market disasters represented by pipelines like Duke Energy."

To what disasters and what pipeline(s) is Dr. Booth referring?

NP-CA-51 Reference: Appendix F, Page 6, Lines 22-25

Please provide all support for the premise that lower yields are expected on long-term U.S. government bonds than on long-term Government of Canada bonds in the future.

NP-CA-52 Reference: Appendix F, Page 6, Lines 22-25

On Schedules 1 and 2 to Appendix F, Dr. Booth shows the standard deviations of equity market returns in Canada and the U.S. How much difference in the expected market equity return in the two markets should there be based on the relative difference in the historical standard deviations of the equity market returns in the two markets?

NP-CA-53 Reference: Appendix G, Page 4, Lines 5 *et. seq*

Reference is made to the current testimony of Dr. Vilbert. Please confirm that Dr. Vilbert has not filed testimony in this proceeding.

Requests for Information
Evidence of Mark A. Cicchetti - 2010 General Rate Application

NP-PUB-1 Reference: Page 8, Line 178

"However, in practice, beta has many documented drawbacks."

Please provide a list of the documented drawbacks.

NP-PUB-2 Reference: Page 12, Lines 260-261

"Consequently, I expect the yields on A-rated Canadian and U.S utility securities to increase commensurately."

Please provide Mr. Cicchetti's forecast of long-term A rated Canadian utility bond yields for 2010.

NP-PUB-3 Reference: Page 27, Lines 568-571

Is Mr. Cicchetti recommending that the Board retain an automatic adjustment formula? Please explain why or why not.

NP-PUB-4 Reference: Page 27, Lines 568-571

In Mr. Cicchetti's expert opinion, if the Board retains an automatic adjustment formula, should the allowed ROE vary by 80% of the change in the forecast long-term risk free rate or by some other percentage? Please provide support for the response.

NP-PUB-5 Reference: Page 30, Lines 628-630

Please explain what Mr. Cicchetti's understanding of the fair value method is and how it differs from the original cost method.

NP-PUB-6 Reference: Page 30, Lines 628-630

Is it Mr. Cicchetti's understanding that the end result should be different under the two methodologies? Please explain why or why not.