Q. Evidence of Ms. McShane, bond ratings/credit metrics, Pages 18-23: On Page 20 Ms. McShane refers to NP's Baa1 rating as being partly caused by its lower allowed ROE, if long Canada interest rates increased by say 2%, so NP's formula allowed ROE increased by 1.6%, in her judgement would this cause an upgrade in NP's issuer rating and would this cause NP's debt to be safer? Would NP's bond holder be happy if long Canada interest rates increased by 2%, causing the value of their debt to fall?.

A. Ms. McShane's testimony states that "Moody's noted that, while the assigned rating of Baa1 is one notch lower than the rating implied by the grid, the difference in part reflects its belief that Newfoundland Power's future financial metrics will be modestly weaker than those in 2010 due primarily to the reduction in the allowed ROE to 8.38% in 2011 from 9.0% in 2010." It is possible based on Moody's statement in its July 2011 report that it would upgrade Newfoundland Power if its ROE were higher. The report states that the Company would likely be upgraded if there were a sustainable improvement in the credit metrics. Whether the sustainable improvement would occur in the circumstances premised in the question would also depend on what happened to Newfoundland Power's interest expense. As the question is premised, the ROE increases due to an increase in interest rates, which would also result in higher costs of new debt, both short-term and long-term. It would also depend on whether elements of cash flow other than earnings changed. Cash flow coverage is a function not only of earnings but of non-cash expenses which, in 2011, accounted for approximately 60% of cash flow before changes in working capital. Stronger metrics would, all other things equal (i.e., no change in regulatory environment), lead debt investors to view Newfoundland Power's debt as being safer. No debt investors are likely to be happy if the market value of their debt falls due to increases in interest rates, just as no equity investors are happy if the market value of their equity investment falls.