

1 Q. Per PUB-NLH-059, Attachment 1, Page 2. Please provide a copy of the 2008 debt
2 guarantee review.

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5 A. Please see IC-NLH-115 Attachment 1.



Guarantee Fee Analysis

November 2008

Executive Summary

Request

- Newfoundland Hydro (Hydro) requested Scotia Capital's (Scotia) thoughts on the value of the guarantee provided by the Province. It is our understanding that the Province charges an annual fee to Hydro based on the principal amount of debt outstanding.
- Hydro thought that the most valid comparison would be with Newfoundland Power, however since Newfoundland Power's bonds do not trade with any regularity, Scotia thought a more valid comparison would be with Hydro One, Enbridge Gas and Gaz Met.

Conclusion

- Scotia Capital believes that the guarantee is worth between 25 and 50 bps. Given the nature of Hydro's liabilities (across the maturity spectrum) the firm would suggest a fee of 25 bps for ten years and under, and a fee of 50 bps for over ten years.
- For comparison purposes Scotia's understanding that other Provinces charge the following:
 - » Province of British Columbia: 3.3 bps on anything over 1 year. The basis of the charge is cost recovery rather than a comparison to the private sector alternative.
 - » Province of Quebec: 50 bps on maturities over one year.
 - » Province of Ontario: 50 bps on maturities over one year.
 - » Province of Saskatchewan: zero
 - » Province of Alberta: for ATB a fee equal to federal deposit insurance (to create a level playing field with the Banks), for all others such as ACFA or AFC: zero

Newfoundland Spreads vs Various Corporate Utility Spreads

Province of Newfoundland and Labrador Spreads vs Various Corporate Benchmark Spreads

Bond	For the Period ending June 1, 2007			For the Period ending Nov 6, 2008		
	Average	Median	Std Deviation	Average	Median	Std Deviation
Hydro One (Aa3, A+, A(H)) 6.40% due Dec 2011	18 bps	14.4 bps	11 bps	22.5 bps	16.8 bps	14.4 bps
Hydro One (Aa3, A+, A(H)) 5.36% due May 2036	29.7 bps	30.3 bps	5 bps	41.5 bps	34.4 bps	19 bps
Enbridge Gas (A-, , A) 5.16% due Sept 2014	21.8 bps	21.6 bps	3.3 bps	29.5 bps	24 bps	15 bps
Enbridge Gas (A-, , A) 5.21% due Feb 2036	49.6 bps	50.3 bps	3.5 bps	64 bps	53 bps	22.5 bps
Gaz Metro (A, , A) 5.70% dues July 2036	46.8 bps*	46.7 bps*	1.3 bps*	62.5 bps	49.2 bps	26.8 bps
DEX Ten year "A" Rated Corporate Index	30.7 bps	31.8 bps	12.5 bps	55.7	33.75 bps	64.6 bps

* the period under review is approx 1 year

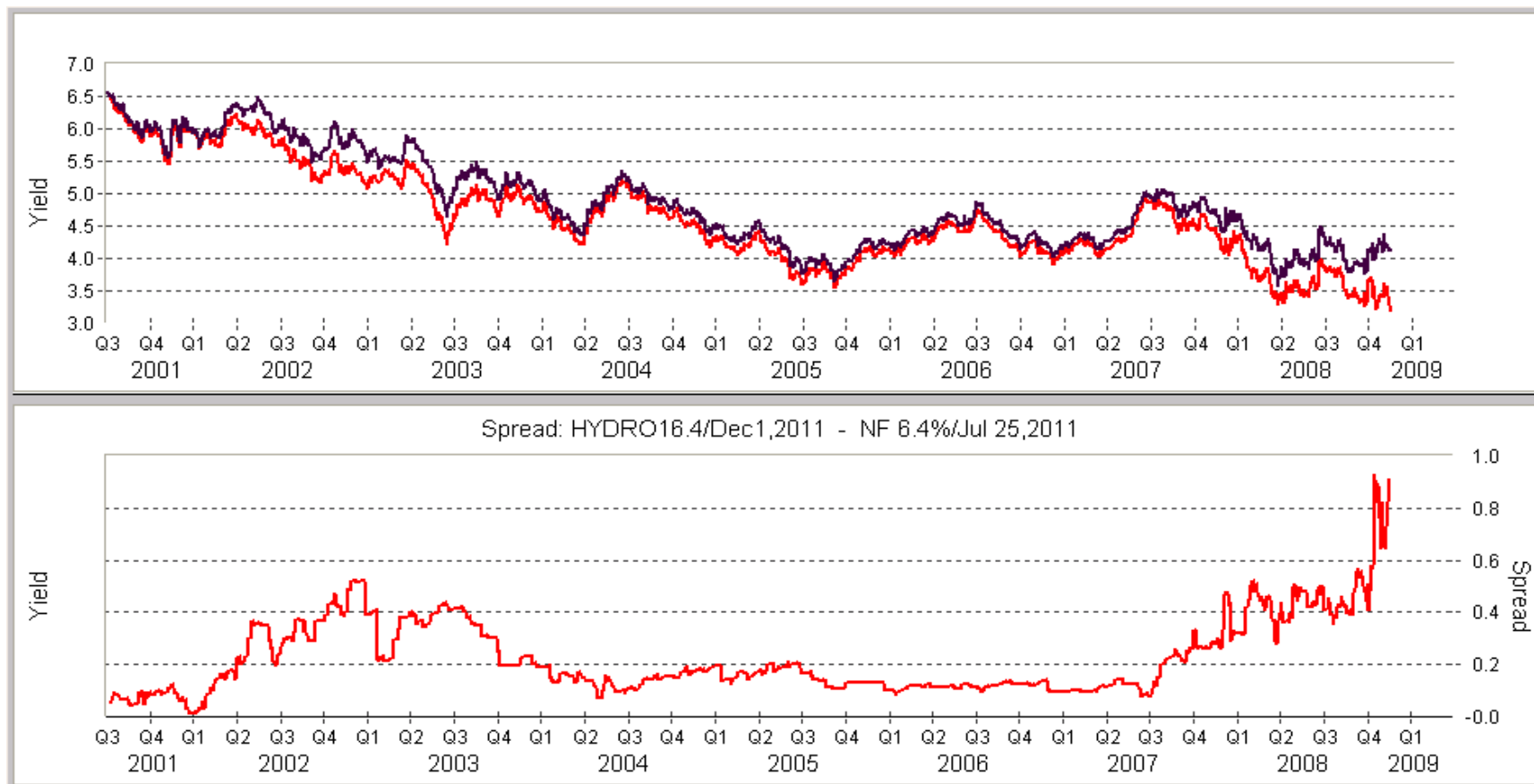
Newfoundland Spreads vs Various Corporate Utility Spreads

- The chart on the previous page illustrates the spread differences between bonds issued by Hydro One, Enbridge Gas, Gaz Met with bonds with similar maturities issued by the Province of Newfoundland. The concept was to try and isolate what the value of the Provincial guarantee is worth in terms of cost savings by comparing bonds of a comparable private sector issuer with those issued by the Province.
- Scotia chose Hydro One, Enbridge Gas and Gaz Met as they are three regulated utilities with ratings that would be somewhat similar to Newfoundland Hydro's rating, without a provincial guarantee. However within this comparison is an assumption that Newfoundland Hydro receives the \$100 million equity injection from the Province and that Hydro would be subject to a regulatory environment that grants, including amongst other things, a continuation of the existing timely cost recovery and a favourable Return on Equity that is similar to other Canadian jurisdictions.
- Of the three Utilities, Scotia believes that Hydro One would represent the lower band (in terms of spread over Cda's) given that it has a split rating "AA3/A+" and is 100% owned by the Province of Ontario. Scotia has assumed that even if Newfoundland Hydro were not guaranteed it would still be 100% owned by the Province. The only negative to the comparison is that Hydro One has a lower debt to equity ratio (approx 60/40) and does not contain any generation, it's purely transmission. Bond investors typically require higher spreads for regulated generation. Enbridge Gas and Gaz Met would represent the upper band (in terms of spread) as they have ratings of "A" and are owned by private sector investors.
- In addition to Hydro One, Enbridge and Gaz Met, Scotia also compared the Dex's "A" Rated 10 year Index to the constant 10 year maturity for Newfoundland. Scotia dismissed this comparison as the Dex "A" Index contains non utility names that given their industry sector trade at wider spreads, for example Suncor or GTAA.
- Where possible, Scotia compared both maturities under five years and maturities thirty years and over. As one would expect the spread difference for maturities under five years was tighter than those spreads for maturities over 30 years. The former ranged between 20 and 30 bps. The latter ranged between 40 and 65 bps (a wider range is understandable give the volatility of the long end).

Newfoundland Spreads vs Various Corporate Utility Spreads

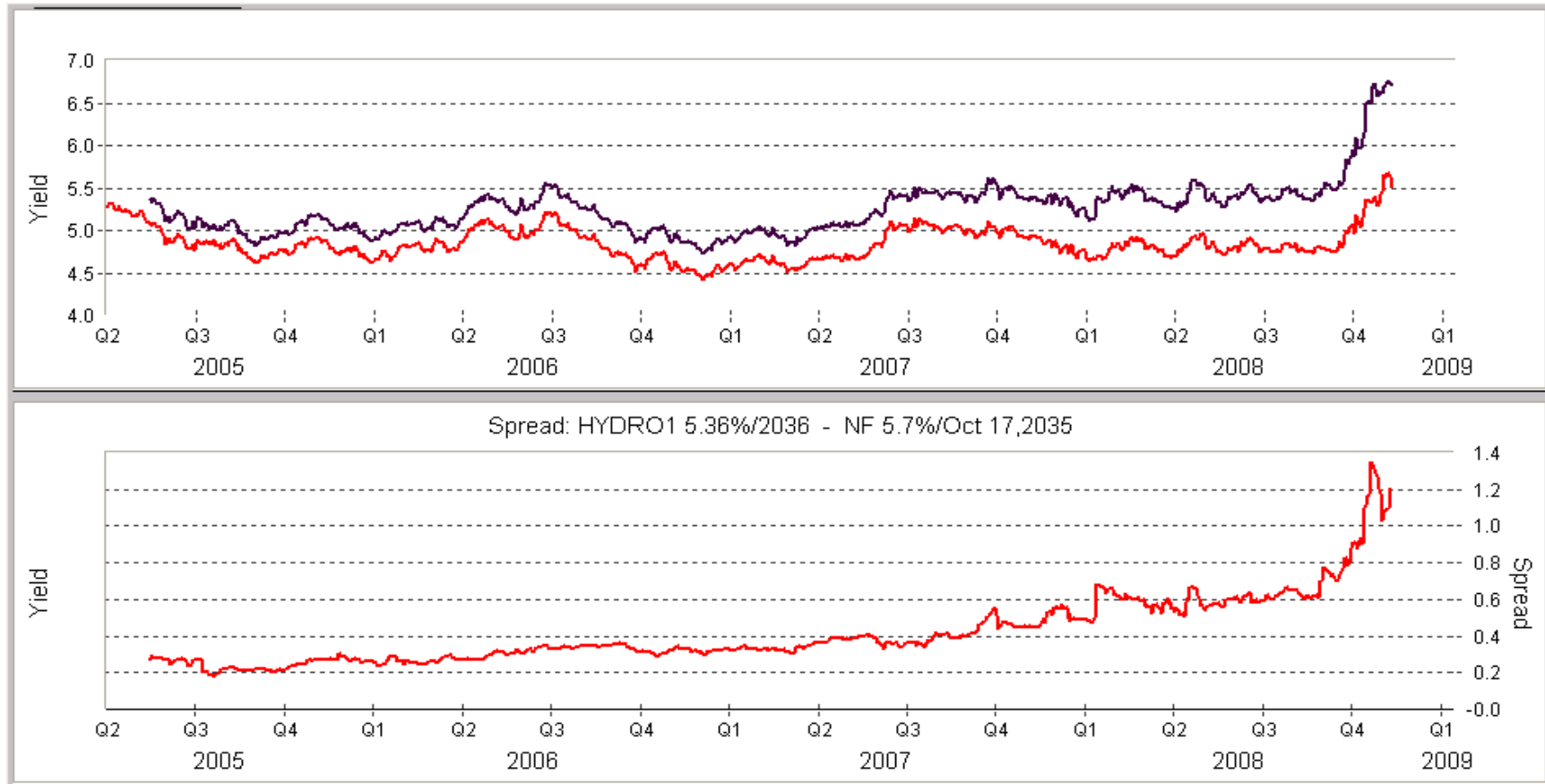
- The chart also illustrates the difference in spreads over two periods: from launch to Nov 2008 and from launch to Jun 2007. The reason for the two periods is to illustrate the impact of the “Credit Crunch” on spreads, particularly in the long end. Scotia assumed that the “Credit Crunch” started in August 2007, so the firm arbitrarily chose June 1st as the cut off date to ensure that the impact of the “Credit Crunch” would be isolated.
- As illustrated in the chart the Credit Crunch has had a dramatic impact on spreads and thus the value of the Guarantee. Credit spreads on average have widened by 4 to 8 bps in the under five year term and by 12 to 16 bps in the thirty year term. If one were to believe that the Credit Crunch is a temporary aberration then one should put a greater emphasis on the spread comparison ending June 2007. If one were to believe it represents a harbinger of things to come, then one should put a greater emphasis on the spread comparison ending Nov 2008.
- It is Scotia’s view that neither period is a valid comparison: the firm believes that spreads have “overshot” during the credit crunch and that eventually the market will return to a new “norm”. Therefore the firm believes that at this time a simple average of the two is probably more representative of the credit markets to come.
- Based on the credit spread analysis of the three utilities and taking into consideration what other Provinces charge the Hydro Crown corporations, Scotia Capital believes that the Provincial guarantee is worth between 25 and 50 bps.

Newfoundland 6.40% due July 2011 vs Hydro One (A+) 6.40% due Dec 2011



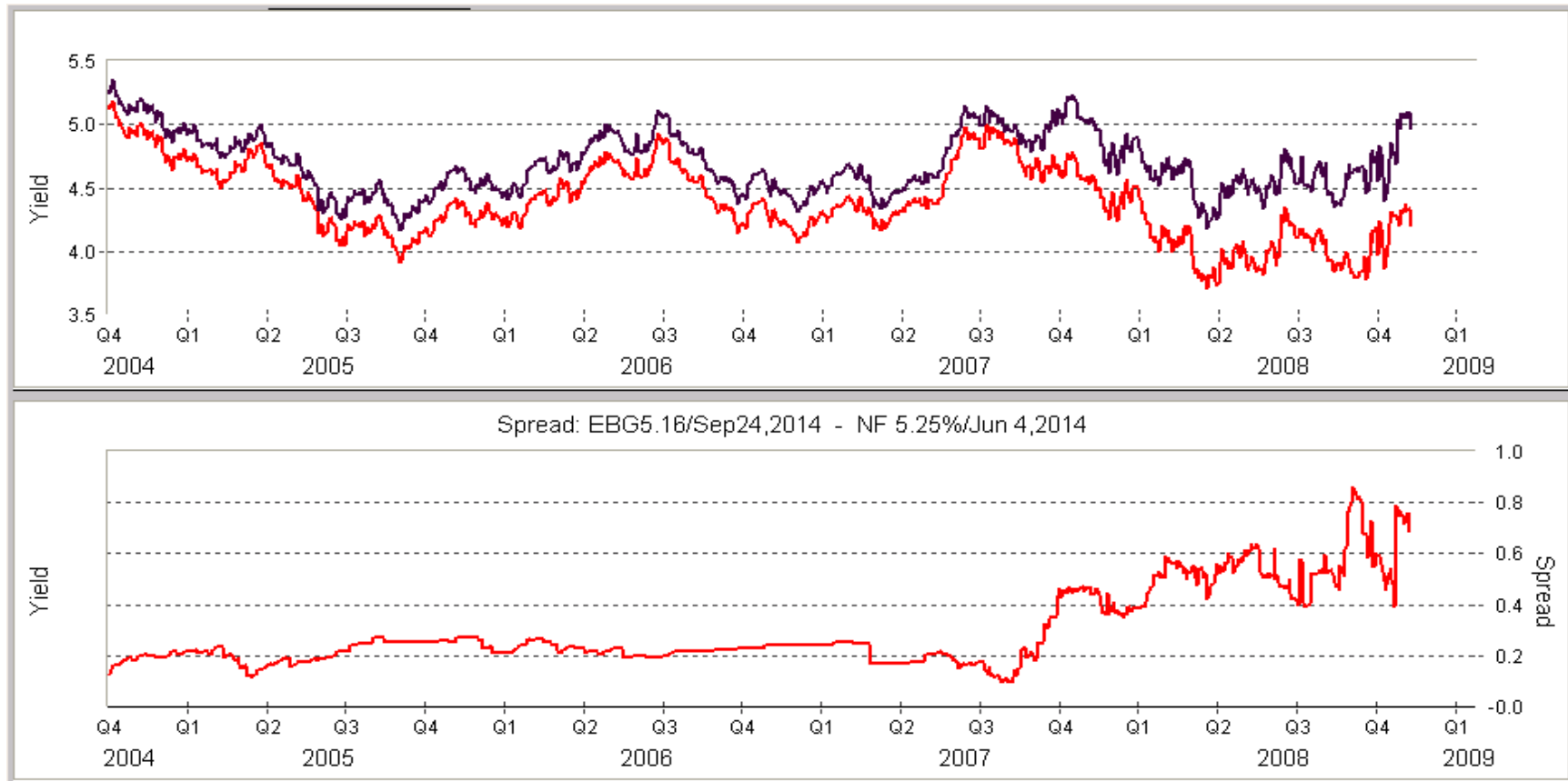
Average: 22.5 bps, Median: 16.8 bps, Std Deviation: 14.4 bps

Newfoundland 5.70% due Oct 2035 vs Hydro One (A+) 5.36% due April 2036



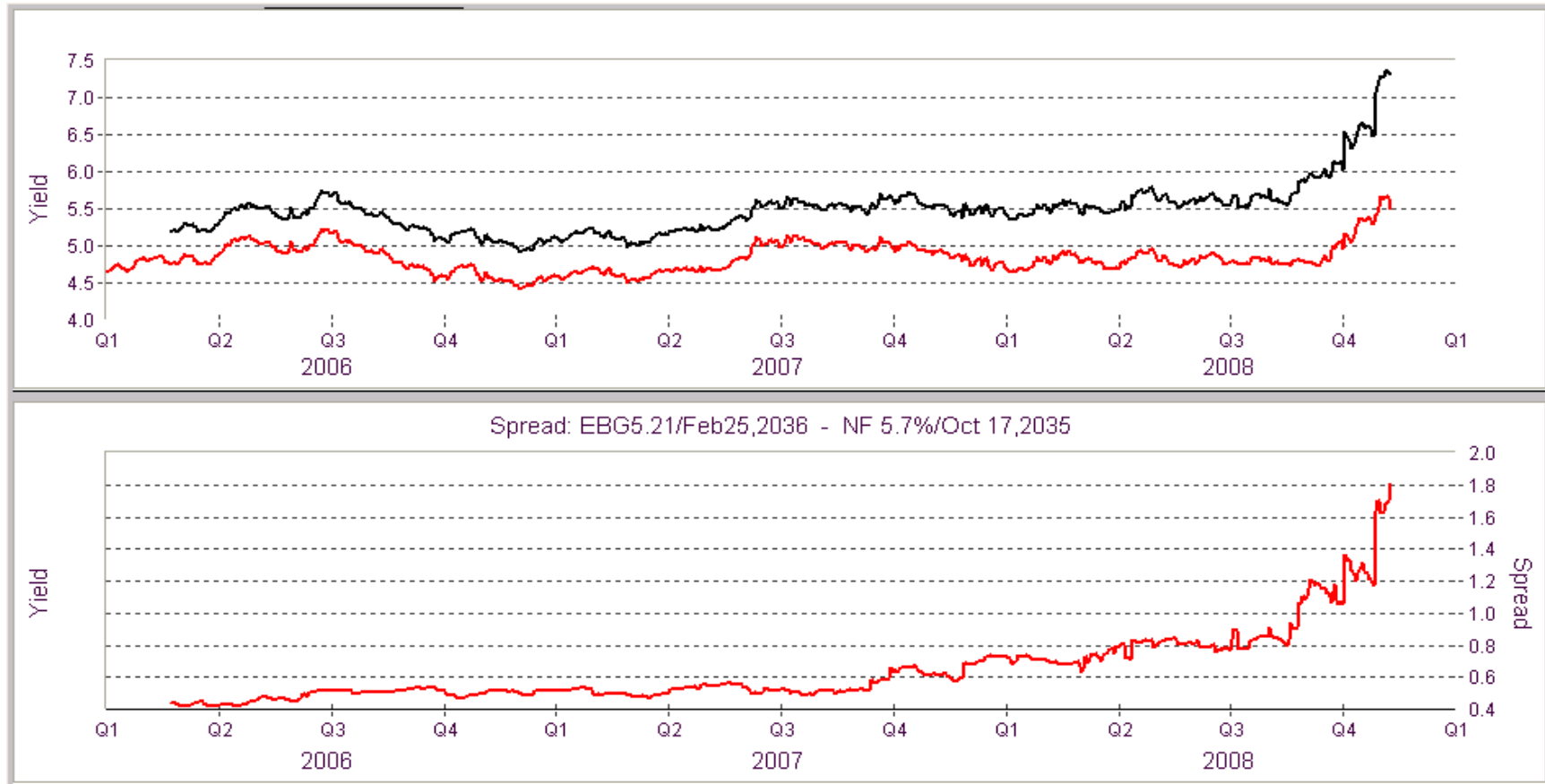
Average: 41.5 bps, Median: 34.4 bps, Std Deviation: 19 bps

Newfoundland 5.25% due June 2014 vs Enbridge Gas (A) 5.16% due Sept 2014



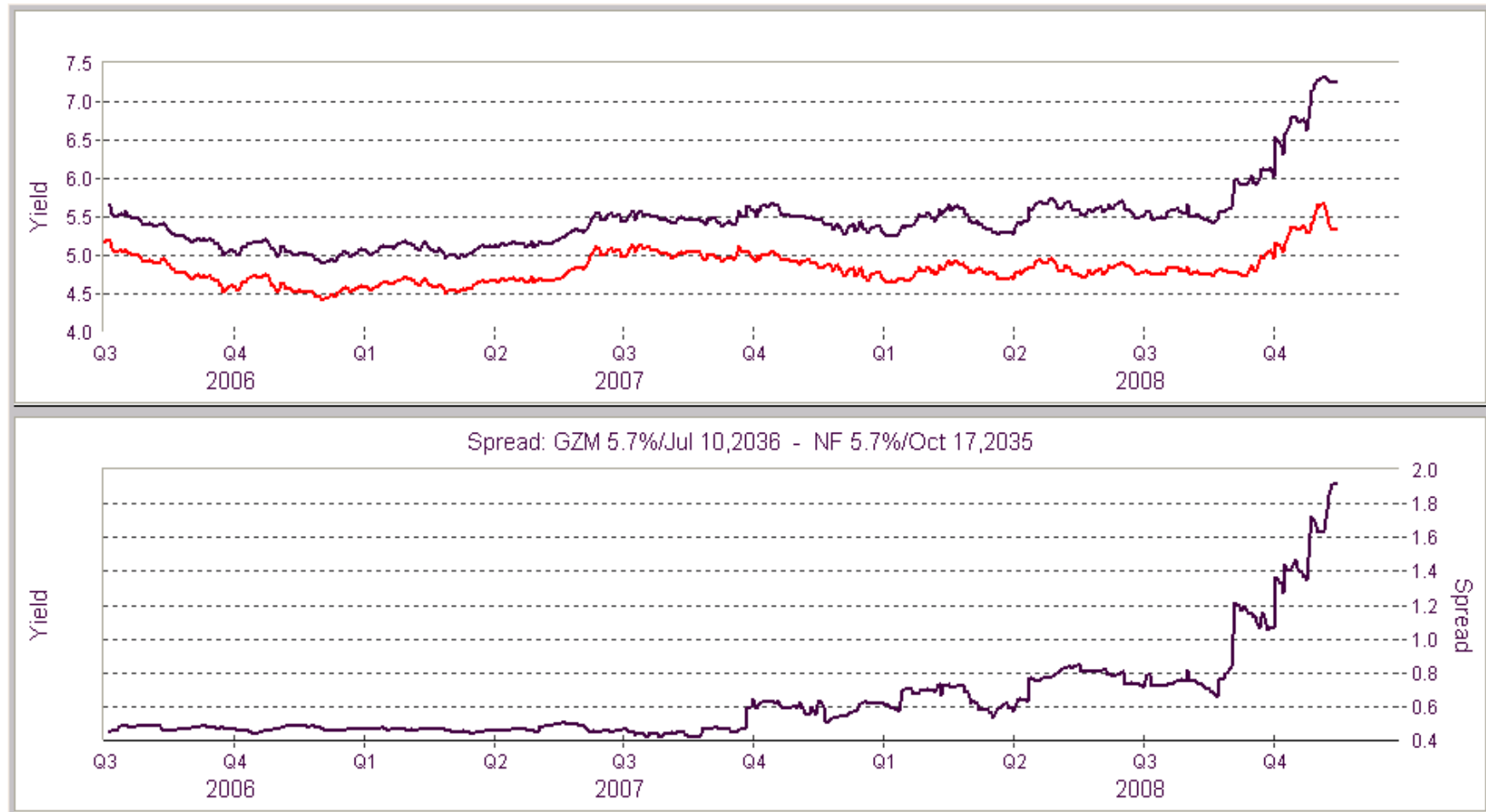
Average: 29.5 bps, Median: 24 bps, Std Deviation: 15 bps

Newfoundland 5.70% due Oct 2035 vs Enbridge Gas (A) 5.21% due Feb 2036



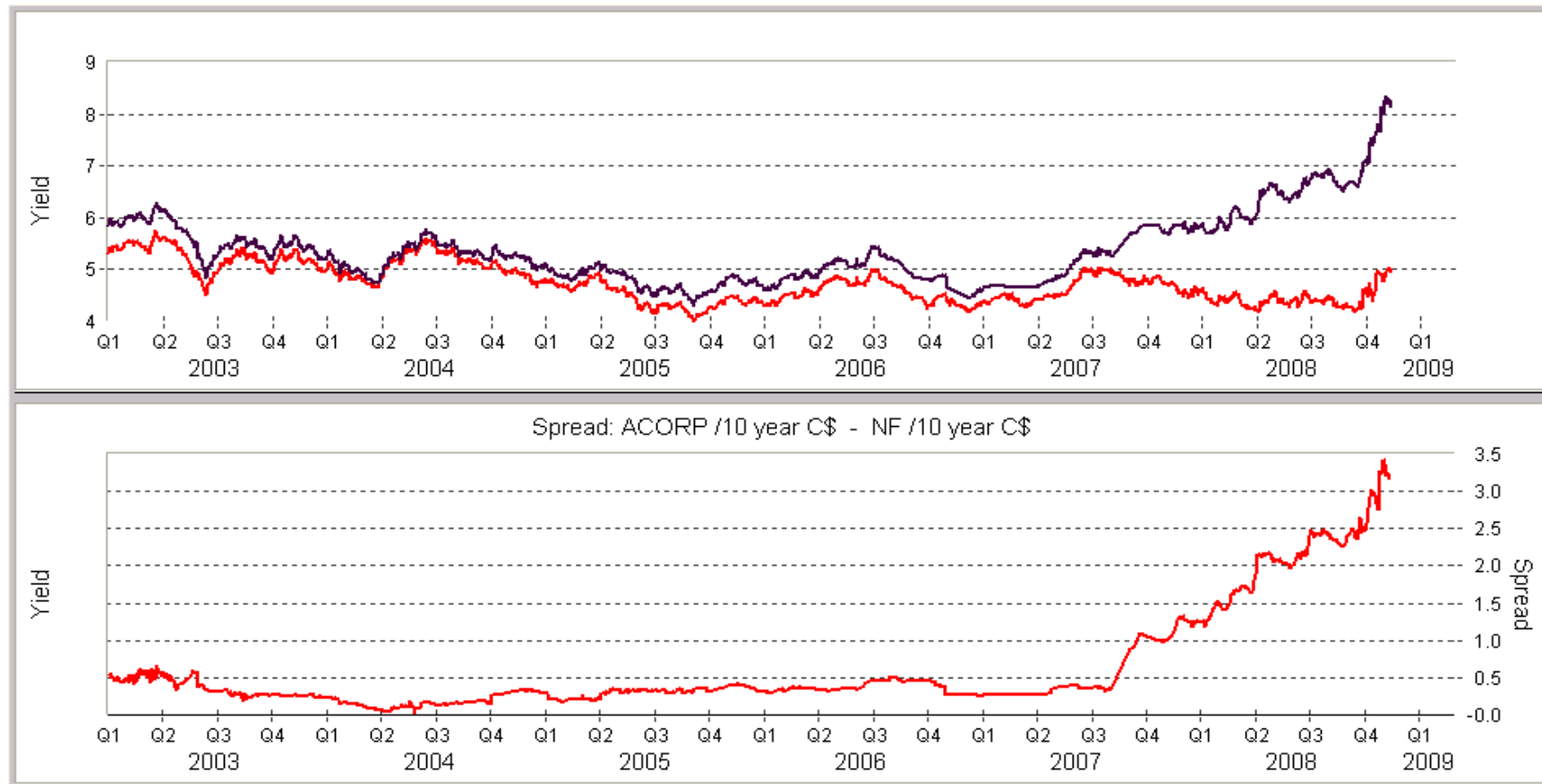
Average: 64 bps, Median: 53 bps, Std Deviation: 22.5 bps

Newfoundland 5.70% due Oct 2035 vs Gaz Metro (A) 5.70% due July 2036



Average: 62.8 bps, Median: 49.2 bps, Std Deviation: 26.8 bps

Ten Year Province of Newfoundland vs Ten Year “A” Rated Corporate Bond



Average: 62.5 bps, Median: 33.75 bps, Std Deviation: 71.2 bps