Q. McShane Evidence – In Moody's 2009 credit opinion on Newfoundland Power of August 3, 2009 (2009 GRA 1st Revision, Exhibit 4) stated:

"NP's Baa 1 issuers rating reflects the fact that the company's operations are exclusively based in Canada, a jurisdiction where regulatory and business environments in general are relatively more supportive than those of other international jurisdictions such as the United States, in Moody's view."

In Moody's 19 July 2011 NP Credit Opinion (Exhibit 4) states:

"All of NPI's operations are located in Canada whose regulatory and business environments we consider to be supportive relative to those in other jurisdictions."

Does Ms. McShane agree with Moody's assessments? If she does not, please explain why she does not.

A. In the aggregate, i.e., taking account of all of the regulatory jurisdictions in Canada and the U.S., Ms. McShane does not disagree that the utility regulatory environment in Canada is somewhat more supportive than in the United States. Regulatory support in Canadian regulatory jurisdictions has been more homogeneous than in the U.S. Historically, the typical regulatory model in Canada has taken a form that has provided somewhat greater assurance than in the U.S., when all regulatory jurisdictions are considered, that regulated companies will earn the allowed return from year to year than in the U.S. This difference has been narrowing in recent years, as U.S. regulators have been increasingly adopting cost recovery mechanisms. Nevertheless, there are still a number of U.S. jurisdictions where the availability of credit supportive mechanisms is more limited than in Canada. Ms. McShane notes that Moody's stated in its June 2010 report, (*Special Comment: Regulatory Frameworks - Ratings and Credit Quality for Investor-Owned Utilities Evaluating a Utility's Regulatory Framework*, June 18, 2010, page 13, provided in response to "CA-NP-369c Attachment 1.pdf"), "We view Canada's business and regulatory environments as being more supportive than many of those in the U.S." In Ms. McShane's opinion, that statement means that Moody's considers that there are regulatory jurisdictions in the U.S. that it would view as similarly supportive as those in Canada, and, by extension, that there are U.S. utilities that are of comparable regulatory risk to Canadian utilities.

Moreover, it is not sufficient to find that particular U.S. utilities are of higher regulatory risk than Canadian utilities to conclude that they are of higher equity risk than Canadian utilities. The impact of financial risk, e.g., the capital structure, is an important component of the total risk. It is the total risk, business, regulatory and financial risk that determines the cost of equity. Ms. McShane's utility sample has a higher equity ratio than Newfoundland Power (50% versus 45%).

That higher business risk, including size considerations, can be offset by lower financial risk (common equity ratio) so that total risk is equivalent is at the heart of the Alberta

Utilities Commission's approach to cost of capital i.e., it sets a capital structure for each utility under its jurisdiction based on its relative business risk sufficient to allow it on a stand alone basis to achieve a debt rating and then allows each utility the same ROE. In that context, with respect to Moody's specifically, the average and median debt rating of Ms. McShane's sample is the same as Newfoundland Power's debt rating, indicating that, from an overall risk perspective, Moody's views those companies of similar total (business, regulatory and financial) risk to Newfoundland Power.