Q. Reference Evidence of Newfoundland Power, pages 3.14 and 3-25 to 3-31 - Cost of Capital

a. The company defines the cost of capital as the rate of return that investors could expect to earn if they invested in equally risky securities. Please confirm that this is essentially the definition provided by Mr. Justice Lamont in the Supreme Court of Canada's decision on Northwestern Utilities. If not, please explain why NP would disagree with this definition.

b. Please confirm that NP understands that the fair return applies to securities and not the accounting ROE of other companies, since investors cannot invest at the accounting ROE of other companies.

c. NP points out that the Public Utilities Act requires the Board to regulate NP so that it can achieve a sound credit rating. Would NP please define what it regards as a "sound" credit rating? In particular, would NP accept that many US utilities operate with BBB credit ratings and would NP regard such a rating as sound?

d. Please confirm that financial risk magnifies business risk such that many regulators offset business risk differences by changing the common equity ratio, if not please have one of its experts address this question.

e. Please confirm that NP with a 45% common equity ratio has less financial risk than average risk Canadian utilities, such that the overall risk to the shareholder is lowered. If not please explain in detail why not?

f. Please discuss how much lower NP's allowed ROE should be, as compared to a benchmark utility, to offset its reduced financial risk.

g. Please indicate whether NP ever approached the Board prior to 2009 indicating that the formula ROE was unfair and unreasonable.

A. a. Confirmed the *Northwestern* decision of the Supreme Court of Canada referred to securities. However, Newfoundland Power observes that the *Northwestern* decision is not the only judicial guidance on utility cost of capital. For example, the Newfoundland and Labrador Court of Appeal specifically cites both the *Bluefield Waterworks* and *Hope Natural Gas* decisions of the U.S. Supreme Court in its evaluation of a just and reasonable utility return. In fact, the Court of Appeal has specifically recognized that the regulatory statutory regimes existing throughout North America can, as a generalization, be said to be broadly similar in approach. In Newfoundland Power's view, these similarities justify the Board's consideration of U.S. data in the determination of a fair return for Newfoundland Power.

b. Investors who buy shares of a utility must do so at market prices not book prices.

c. Newfoundland Power regards its current credit ratings as sound. Newfoundland Power understands that certain U.S. utilities have BBB credit ratings as do certain Canadian utilities.

d. Not confirmed. Newfoundland Power observes that, in Newfoundland and Labrador, the Board has consistently determined that a strong equity component is needed by Newfoundland Power to offset its relatively small size and low growth potential. Newfoundland Power's relatively strong financial profile is a factor which contributes to it being an average risk utility on an overall risk basis.

e. Please refer to d.

f. Newfoundland Power is an average risk utility on an overall risk basis. This includes its financial profile. No reduction in allowed return on equity is therefore justified on account of its relatively strong financial profile.

g. In its 2003/2004 general rate case Newfoundland Power proposed changes to the Formula because it yielded low estimates of return on equity. In its 2008 general rate case, Newfoundland Power again proposed changes to the Formula.