Volume 1, Section 3 – Finance

Q. (page 56, footnote 40)

a. Please provide the relevant passages from the Company's First Mortgage Bond Trust Deed that set out and explain the referenced 2.0 times interest coverage test.

b. Please provide the detailed calculation, with explanations of the nature and source of the figures on each line of the calculation, to support the assertion contained in the second sentence of footnote 40.

c. Please provide a revised calculation mirroring that requested in (b) based on the assumption that the Company's rates reflect the acceptance of all of its Application proposals except that its allowed return on common equity for 2008 is set at (i) 8.00% and (ii) 9.00%.

d. Is the 30-year, $60 million debt issue planned for August 2007 expected to be a First Mortgage Bond? If so, why is it necessary for the Company to issue a First Mortgage Bond instead of a debt instrument with less security? If not, what kind of bond does the Company intend/hope to issue, and why?

A. (a) The relevant passage from the Company's First Mortgage Bond Trust Deed is found in Article 6.2, which states as follows :

> *6.2 **Earnings Test**. No Additional Bonds shall be certified and delivered hereunder unless the Net Earnings of the Company for the Earnings Period selected by the Directors shall have been at least two (2) times the maximum annual interest charges on all Bonds to be outstanding after the proposed issue of Additional Bonds.*

(b) The detailed calculation of interest coverage as referred to in the question, together with explanations of the inputs to the calculation, is provided in Table 1.

Table 1
Newfoundland Power Inc.
Earnings Test Interest Coverage
2008 Forecast (Existing)
($000s)

Operating Revenue	489,336	Includes estimated revenue from rates and other revenue recorded on the forecast income statement for 2008E.
Less : Operating Expenses	(380,857)	Includes estimated purchased power costs, operating costs, pension cost and other regulatory costs recorded on the forecast income statement for 2008E.
Less : Amortization of fixed assets	(41,002)	This is the estimated annual depreciation expense recorded on the forecast income statement for 2008E.
Less : Amortization of capital stock issue expenses	(62)	This is the annual charge to operations (or amortization) of the costs related to the issuance of capital stock.
Less : Other interest cost (net of interest earned)	(1,362)	This is the estimated short-term interest expense less estimated interest earned on overdue accounts.
(A) Total	66,053	
(B) Interest – long term debt	31,513	Includes estimated interest expense on all outstanding first mortgage bonds including the $60 million expected to be issued in August 2007 at an estimated interest rate of 5.5%.
Earnings Test Interest Coverage (A) / (B)	2.10	

(c) Table 2 provides a proforma calculation of interest coverage based on the assumption that all of the proposals in the Application are approved by the Board, except that the Company's allowed return on common equity for 2008 is set at (i) 8.00% and (ii) 9.00%.

Table 2
Newfoundland Power Inc.
Proforma Earnings Test Interest Coverage
2008
($000s)

Allowed Return on Common Equity	8.00%	9.00%
Operating Revenue	508,154	513,717
Less : Operating Expenses	(387,634)	(387,634)
Less : Amortization of fixed assets	(40,207)	(40,207)
Less : Amortization of capital stock issue expenses	(62)	(62)
Less : Other interest cost (net of interest earned)	(2,060)	(2,064)
(A) Total	78,191	83,750
(B) Interest – long term debt	31,513	31,513
Earnings Test Interest Coverage (A) / (B)	2.48	2.66

(d) The debt issue planned for August 2007 is expected to be an issue of First Mortgage Bonds.

First Mortgage Bonds are the principal source of long-term debt financing for Newfoundland Power, and are the least cost means by which the Company can obtain long-term financing.

A First Mortgage Bond is secured by the Company's assets. This security, and the higher credit rating that is assigned to the secured debt, enables the Company to obtain debt financing at a lower interest rate than would be the case if the Company were to finance through unsecured means.

Unsecured debt would rank subordinate to, or behind, secured debt. Debt on an unsecured basis would require a higher rate of interest be paid in order to compensate creditors for the additional credit risk. This would increase the Company's overall long-term debt cost and the cost of debt to be borne by Newfoundland Power's customers.