Volume 1, Section 3 – Finance

Q. **(Section 3.3.2: Financial Targets, and Exhibit 5, page 6 of 8)**

a. Given that the Company's preference shares are projected to be only 1.15% of its average 2008 test year capital structure, why is the Company proposing that its weighted average cost of capital be determined as if preference shares represented 2% of its overall capitalization?

b. By how much would the Company's 2008 revenue requirement be reduced if the Board opted to reduce the regulated preference share allowance to 1% and increase the regulated debt allowance to 54%, with all forecasted average cost rates remaining the same?

A. a. Newfoundland Power is not proposing a 2% preference share component in its average capital structure for determination of its 2008 revenue requirement. The preference share component of the Company's proposed average capital structure is 1.15% as shown in Exhibit 10, line 10.

b. The Company's 2008 proposed revenue requirement, shown in Exhibit 9, is based on a capital structure composed of 54.01% debt, 1.15% in preference shares and common equity of 44.84%.

Table 1 shows a *pro forma* weighted average cost of capital ("*WACC*") based on an average capital structure of 45.0% common equity, 1.0% preferred equity and 54.0% debt. All other forecast costs remain the same.

Table 1
***Pro forma* Calculation of 2008 WACC**
(percent)

	Average Capital Structure	**Costs[1]**	**WAAC**
Debt	54.0	7.69	4.15
Preference Shares	1.0	6.27	0.06
Common Equity	45.0	10.25	4.61
	100.0		**8.82**

[1] See Exhibit 10, lines 15-17 for the costs of each component of the capital structure.

As indicated in Table 1, reducing preference shares in the capital structure to 1% results in a WAAC (i.e., rate of return on rate base) of 8.82%. This is the same rate of return on rate base proposed in the Company's Application. Consequently, reducing preference shares as suggested would have no material impact on the Company's 2008 proposed revenue requirement.