Q. **(page 94, footnote 146) Please provide for the record a copy of the report, "A report on the Stand-Alone Credit of Newfoundland Power" filed on June 30, 2004.**

A. Attachment A contains a copy of *A Report on the Stand-Alone Credit of Newfoundland Power* filed on June 30, 2004.

Attachment B contains a copy of *A Supplementary Report on the Stand-Alone Credit of Newfoundland Power* filed on April 15, 2005.

Attachment C contains a copy of *A 2nd Supplementary Report on the Stand-Alone Credit of Newfoundland Power* filed on July 20, 2005.

A Report on the Stand-Alone Credit of Newfoundland Power

June 30, 2004

A Report on the Stand-Alone Credit of Newfoundland Power

June 30, 2004

(filed in compliance with Order No. P.U. 19 (2003))

CONTENTS

A. INTRODUCTION

A.1 Order No. P.U. 19 (2003) Reporting Requirements

During the hearing the 2003 General Rate Application of Newfoundland Power Inc. ("Newfoundland Power"), the potential financial impact on Newfoundland Power and its customers of Standard & Poor's ("S & P") credit rating linkage between Fortis Inc. ("Fortis") and Newfoundland Power was an issue.

In Order No. P.U. 19 (2003) issued in June 2003, the Board of Commissioners of Public Utilities of Newfoundland and Labrador (the "PUB") concluded that in the interest of both the utility and its customers, Newfoundland Power should continue to be treated as a stand-alone utility. Newfoundland Power was directed to take all appropriate steps necessary to preserve the financial integrity and independence of the utility.

As a first step, Newfoundland Power was required to file a report addressing this matter by June 30, 2004.

A.2 Subsequent Event

On January 7, 2004, S & P downgraded its corporate rating of Newfoundland Power from "A- " to "BBB+" and its rating of the First Mortgage Bonds of Newfoundland Power from "A" to "A-".

The S & P downgrade was stated to be the result of Fortis' relatively weak financial profile offset by an above-average business profile modestly aided by proposed acquisitions. A secondary reason cited by S & P was a slight reduction in the credit emphasis on the supportive regulatory framework in the markets in which Fortis operates.

Any impact of the January 2004 downgrade by S & P on consumer costs will not occur until Newfoundland Power makes its next issue of First Mortgage Bonds. This is currently not expected before late 2005.

A.3 The Report

This report is provided as a first step to address how Newfoundland Power can ensure stand-alone status in respect of its corporate credit linkage by S&P to Fortis.

This report provides an overview of the parent-subsidiary credit linkage in the utility industry and the effects of, and reaction to, S & P's rating actions. The report also outlines in detail the Fortis/Newfoundland Power financial relationship and assesses the current level of structural protection provided through the relationship. Finally the report presents Newfoundland Power's approach to ensuring the maintenance of its stand-alone credit status.

B. OVERVIEW OF PARENT-SUBSIDIARY CREDIT LINKAGE

B.1 Industry Structure and Credit Ratings

The Canadian electrical industry is composed of provincially owned Crown corporations and investor-owned electric utilities. Crown corporations typically have the benefit of the explicit or implicit credit support of a province and are not comparable with investor-owned corporations.

Currently, there is a total absence of investor-owned pure-play electric utilities in Canada.[1] The extent of wholly owned investor-owned electric utilities in the current Canadian electrical industry structure makes the linkage of parent-subsidiary credit ratings a national issue as opposed to an issue affecting just Newfoundland Power.

There are currently 3 agencies which rate the credit of Canadian investor-owned utilities and their holding companies. They are S & P, Dominion Bond Rating Service ("DBRS"), and Moody's Investors Service ("Moody's").

Current credit ratings of Canadian investor-owned utilities and their utility holding companies are set out in Schedule A.

It can be observed from Schedule A that DBRS rates the credit of investor-owned utilities distinct from the credit of their holding companies. Investor-owned utilities tend to have higher credit ratings by DBRS than their respective holding companies.

S & P's current credit ratings of investor-owned utilities are linked to the credit ratings of their respective holding companies. Accordingly, S & P's corporate credit ratings for investor-owned utilities mirror those of their holding companies. S & P's debt issue ratings do indicate some variation between utilities and holding companies with some operating utilities having higher S & P debt issue ratings than their holding companies. This is the current case with Newfoundland Power and Fortis.

Moody's does not currently rate the credit of many investor-owned utilities but does rate the credit of a number of holding companies.

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[1] See, for example, the prefiled testimony of Dr. Roger A. Morin, October 2002 filed in Newfoundland Power's 2003 General Rate Application, p. 38. An investor-owned pure-play electric utility is one whose common shares are widely held and publicly traded.

B.2 Rating Actions of Standard & Poor's

B.2.1 Background

In October 2000, S & P acquired the Canadian Bond Rating Service ("CBRS"). S & P is a large independent U.S. based credit rating agency and CBRS was a smaller independent Canadian based credit rating agency. In the years following its acquisition of CBRS, S & P reviewed a number of aspects of its credit ratings for Canadian utilities and utility holding companies which had been formerly rated by CBRS.

Commencing in 2001, S & P reassessed existing CBRS ratings using S & P's global metrics. This reassessment, sometimes referred to as "harmonization", took place over a number of years. Included in the harmonization process for Canadian utilities was the direct linkage of parent and subsidiary credit ratings[2] and the reassessment of Canadian utility regulation as a ratings factor.[3]

The comparative S & P credit ratings for investor-owned utilities and their holding companies showing S & P's initial rating and the ratings at May 14, 2004 are set out in Schedule B.

It can be observed from Schedule B that the initial credit ratings of virtually all Canadian utilities and their holding companies have been downgraded by S & P since 2001.

B.2.2 Industry Reaction and Events

Other regulated Canadian utilities are facing similar challenges to those faced by Newfoundland Power as a result of the ratings actions by S & P.

Newfoundland Power has discussed the issue (on a confidential basis) with regulated utilities and utility holding companies to ascertain what, if any, actions regulated utilities were taking on account of the rating downgrades made by S & P. Most observed that S & P's decisions to harmonize and link holding company/utility credit ratings were undertaken in a gradual way over a period of time. This is consistent with Newfoundland Power's experience.

To date, no regulated utility or utility holding company contacted by Newfoundland Power indicated that it had taken any specific action on account of credit rating downgrades made by S & P.

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[2] Standard & Poor's Research: Ring Fencing a Subsidiary, October 19, 1999; Standard & Poor's Research: Newfoundland Power Inc., October 16, 2002.
[3] Standard & Poor's Research: Canadian Utility Regulation Reassessed as a Ratings Factor, March 5, 2004.

However, in 2003, Emera Inc. and its subsidiary, Nova Scotia Power Inc., established Moody's credit ratings for the first time. In 2004, Terasen Inc. and its subsidiary, Terasen Gas Inc., discontinued rating relationships with S & P. Neither of these actions was attributed by management of either enterprise to be on account of S & P downgrades.[4]

Newfoundland Power is continuing to monitor industry reaction to this issue.

B.2.3 Regulatory Reaction

Newfoundland Power has also reviewed current Canadian regulatory orders with a view to ascertaining what actions, if any, Canadian regulators have taken on account of credit downgrades of S & P. To date, it does not appear that any regulator has yet taken any specific action on account of rating downgrades made by S & P.

The issue of S & P's ratings has been before regulators and been the subject of some commentary, if not the explicit basis for specific decisions. In ATCO Electric Ltd's (a subsidiary of Canadian Utilities Ltd.) 2003-2004 General Tariff Application, the Alberta Energy and Utilities Board made the following observation in respect of reliance on S & P guidelines to evaluate business profiles and appropriate debt ratios:

> "The Board believes that the actual debt ratings of all relevant debt rating agencies and the actual equity ratios and coverage ratios of utilities are more indicative of the actual capital market requirements than is the S & P guideline in isolation. In the Board's view, therefore, the actual equity ratios and other key debt-rating-agency ratios of Canadian regulated utilities of comparable risk, with adequate credit ratings, are useful and objective indicators of an appropriate equity ratio."[5]

Newfoundland Power's assessment is that the ultimate regulatory reaction to S & P's rating actions, if any, is currently uncertain. Accordingly, Newfoundland Power is continuing to monitor regulatory reaction to this issue.

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[4] Terasen Inc. simply reported that the discontinuation of the S & P engagement followed a reassessment of its relationship with S & P and that the credit ratings of DBRS and Moody's were sufficient to meet creditors' requirements and maintain capital market access. S & P continues to provide an *unsolicited* rating on Terasen debt based upon publicly available information.

[5] EUB Decision 2003-071 (October 2, 2003), *ATCO Electric Ltd.: 2003-2004 GTA, Rate Case Deferrals and 2001 Deferral Application*, p. 45.

C. THE FORTIS/NEWFOUNDLAND POWER FINANCIAL RELATIONSHIP

C.1 Key Features of the Relationship

C.1.1 Fortis' Interest in Newfoundland Power

Fortis is the sole common shareholder of Newfoundland Power. In addition, Fortis owns approximately 25% of the approximately 940,000 issued and outstanding voting First Preference Shares of Newfoundland Power.

Fortis is not a holder of debt securities of Newfoundland Power.

Fortis as owner of Newfoundland Power's common equity and First Preference Shares has no security interest in, or to, the assets of Newfoundland Power.

C.1.2 Newfoundland Power's Debt Financing Arrangements

Newfoundland Power's sole source of long-term debt financing is its First Mortgage Bonds. First Mortgage Bonds are secured by a first fixed and specific charge on the property, plant and equipment owned or to be acquired by Newfoundland Power and by a floating charge on all other assets.

All proposed issues of First Mortgage Bonds of Newfoundland Power are approved by the PUB prior to issue. To approve an issue of First Mortgage Bonds, the PUB must satisfy itself that the proposed issue is for a purpose approved by the PUB. Typically, the purpose is to finance capital expenditures necessary to provide service under the provisions of the *Public Utilities Act* (the "Act"). As part of the approval process, the PUB is required under the Act to prescribe the purpose to which the proceeds of the issue are to be applied. Once an issue of First Mortgage Bonds is approved by the PUB, Newfoundland Power is prohibited from materially altering the terms of the issue without further approval of the PUB.

In addition to the provisions of the Act governing the issue of securities, the Act specifically prohibits the sale, assignment or transfer of the whole or part of Newfoundland Power's undertaking or franchise without the PUB's approval. Any sale, assignment or transfer (including those necessary to convey a security interest) made without PUB approval is simply invalid and of no legal effect. Newfoundland Power's financing arrangements have resulted in its First Mortgage Bonds having the sole security interest against Newfoundland Power's assets.

Accordingly, Fortis, as the owner of Newfoundland Power's common equity, has no security interest in the assets of Newfoundland Power. Any agreement which could provide such an interest to Fortis, whether subordinate to the interest of the First Mortgage Bonds or otherwise, would require the prior approval of the PUB.

C.1.3 Operational Overview of the Relationship

Fortis' financial relationship with Newfoundland Power is that of a shareholder. Newfoundland Power is a rate regulated utility whereas its shareholder Fortis is not.

All of the electric utilities in which Fortis is a shareholder, including Newfoundland Power, are operated and financed on a stand-alone basis.

Stand-alone financing of electric utilities helps ensure both creditworthiness and access to capital which are necessary components of least cost service over the long term. In addition, stand-alone operation and financing of utilities provides transparency in regulation of utility operations.

Each Fortis electric utility subsidiary is managed, operated and financed on a stand-alone basis with a local executive which reports to a board of directors with local representation. This operating philosophy has a number of practical financial implications for Newfoundland Power.

Firstly, Newfoundland Power manages its own financial integrity with regard to capital markets and regulatory requirements. Newfoundland Power manages its debt market access and its relationship with the PUB in its own right.

Secondly, Newfoundland Power's financial management is the responsibility of Newfoundland Power. Newfoundland Power's dividend policy, for example, is highly influenced by its capital structure management. Following both the PUB's 1998 cost of capital ruling and the 2001 acquisition of Aliant Telecom Inc.'s support structures, Newfoundland Power reduced common dividends payable to Fortis to maintain an equity ratio of 45%.

Thirdly, in its own financial management Fortis has conducted its affairs in a way which facilitates the continuing financial independence of Newfoundland Power.

Overall, the view of DBRS of the Fortis / Newfoundland Power relationship is an accurate portrayal from a credit perspective. In its October 29, 2003 Credit Rating Report of Newfoundland Power, DBRS commented:

> "It is expected the parent company, Fortis, would reduce dividend requirements and/or inject equity in Newfoundland Power to maintain Newfoundland Power's financial profile".[6]

[6] DBRS Credit Rating Report: Newfoundland Power Inc., October 29, 2003.

In its November 6, 2003 Credit Rating Report of Fortis, DBRS commented:

> "Fortis is a holding company whose debt is structurally subordinate to debt in the operating companies. As such, the rating for the holding company is lower than the weighted ratings of Fortis' key holdings."[7]

These comments are supported by both the structure and history of the Fortis/Newfoundland Power financial relationship.

C.2 Assessment of Protection Provided by the Relationship

C.2.1 S & P's General Position

S & P's general position is that the rating of a wholly owned subsidiary is constrained by the rating of a parent.

The essential basis for this position is that, in circumstances of financial distress, the parent might have both the incentive and ability to either (i) siphon assets out of a healthy subsidiary and burden it with liabilities and/or (ii) cause the healthy subsidiary to become part of bankruptcy proceedings.[8]

An assessment of the application of the underlying basis of S & P's position to the Fortis / Newfoundland Power financial relationship follows in this section.

C.2.2 Limitations on Loans and Dividends

C.2.2.1 General

In practical terms, a financially distressed holding company could only access assets of a healthy subsidiary to its disbenefit via 2 avenues – excessive dividends or excessive loans.

The restrictions against Newfoundland Power issuing excessive dividends or making excessive loans to Fortis have a number of sources. These include (i) the legislated utility regulatory regime under which Newfoundland Power operates, (ii) the corporate law and governance regime under which Newfoundland Power operates, and (iii) the typical contractual terms of Newfoundland Power's operating lines of credit.

[7] DBRS Credit Rating Report: Fortis Inc., November 6, 2003.
[8] Standard & Poor's, Research: Ring-Fencing a Subsidiary, October 19, 1999.

C.2.2.2 Restrictions Presented by Utility Regulation

In its latest General Rate Order affecting Newfoundland Power (Order No. P.U. 19 (2003)), the PUB maintained an allowed equity ratio in Newfoundland Power's capital structure of just under 45% for ratemaking purposes. Part of the PUB's logic in approving such a capital structure was to maintain Newfoundland Power's creditworthiness. The PUB also noted that Newfoundland Power had historically managed its capital structure to maintain a common equity component of close to 45%. Newfoundland Power's maintenance of an actual capital structure consistent with that approved by the PUB for ratemaking purposes ensures that its electricity rates fairly reflect the cost of capital incurred by Newfoundland Power.

Given this regulatory history, a decision by Newfoundland Power to issue dividends that would materially weaken Newfoundland Power's financial condition would be subject to review and potential action by the PUB. One action the PUB could take would be to reduce the allowed equity ratio for ratemaking purposes to that which exists following the payment of the excessive dividends. Such an action would reduce both Newfoundland Power's revenues and cash flow. In these circumstances, it is difficult to conceive by what logic the directors of Newfoundland Power could reach the determination that a material weakening of Newfoundland Power's financial condition was in the best interests of Newfoundland Power (see *C.2.2.3 Restrictions Presented by Corporate Law and Governance*, below for greater detail on directors' duties vis-à-vis dividends).

Loans from Newfoundland Power to Fortis are subject to the PUB's requirement that inter-corporate transactions (i) not disadvantage the interests of ratepayers and (ii) provide some benefit to ratepayers and Newfoundland Power. Excessive loans from Newfoundland Power to Fortis that materially weaken Newfoundland Power's financial condition cannot be said to benefit either Newfoundland Power or its ratepayers. Accordingly, the making of excessive loans to Fortis which materially weaken Newfoundland Power's financial condition is effectively prohibited by current PUB orders governing inter-corporate transactions.

C.2.2.3 Restrictions Presented by Corporate Law and Governance

<u>Corporate Law</u>

Newfoundland Power is incorporated under the provisions of the *Corporations Act (Newfoundland and Labrador)* (the "Corporations Act").

The Corporations Act provides that a corporation shall not declare or pay a dividend where there are reasonable grounds to believe that, after payment, the corporation would be unable to pay its liabilities as they become due or the realizable value of the corporation's assets would be less than the aggregate of its liabilities and stated capital. These restrictions are often referred to as the "solvency tests" and are common in both provincial and federal corporations legislation.

In considering whether or not to declare a dividend, directors of a corporation are required to act in *the best interests of the corporation*. Newfoundland Power's status as a public utility with a continuing legal obligation to provide electrical service to its customers would be a necessary factor for directors to consider in dealing with any proposal to issue an excessive dividend that would result in a material weakening of Newfoundland Power's financial condition. For example, the payment of an excessive dividend which would place Newfoundland Power in a position where it was unable to raise the capital necessary on an ongoing basis to fulfill its legal obligation to serve its customers would not be in the best interest of Newfoundland Power.

Governance and Disclosure

The majority of Newfoundland Power's First Mortgage Bonds were issued by way of public offering. In addition, Newfoundland Power has First Preference Shares which were similarly issued to the public. As a result, Newfoundland Power is a reporting issuer in provincial securities regimes across Canada.

One of Newfoundland Power's obligations as a reporting issuer is continuous disclosure of matters affecting the First Mortgage Bonds and the Preferred Shares. Required disclosure includes disclosure of dividend policy generally and common dividend policy in particular.

In addition to its continuous disclosure obligations, Newfoundland Power has a board of directors with a majority of independent members. A primary purpose of Newfoundland Power's board of directors including a majority of independent members is to ensure that the board can act with a view to the best interests of the corporation. Independent directors' terms of office are currently 3 years. This provides a measure of tenure which encourages independence.

The continuous disclosure obligations and board composition of Newfoundland Power serve to ensure that the corporate governance of Newfoundland Power is both transparent (to holders of First Mortgage Bonds and Preferred Shares as well as capital markets generally) and independent.

In the event that the board of directors of Newfoundland Power was called upon to consider the payment of excessive dividends or making loans to Fortis that resulted in a material weakening of the financial condition of Newfoundland Power, it would have to make its decision in this governance context. This would, depending upon the specific circumstances, likely require a committee of independent directors be struck to consider the proposition based upon independent financial and legal advice. It would definitely require that capital markets be promptly informed of any decision of the board of directors which had a material impact on Newfoundland Power's financial condition.

C.2.2.4 Purpose of Operating Credit Lines

If Newfoundland Power was to issue or make an excessive dividend or loan to Fortis, it would likely have to finance the dividend or loan in the first instance with funds available through Newfoundland Power's demand operating lines of credit (the "Operating Lines"). The Operating Lines currently provide $110 million of credit.

The specific terms of the Operating Lines vary somewhat over time. Operating Lines typically provide that they are to finance Newfoundland Power's operations. A common condition of drawing on an Operating Line is that there has been no material adverse effects on the financial condition of Newfoundland Power's business.

It is unlikely that the Operating Lines could be used in accordance with their terms by Newfoundland Power to finance an excessive dividend or loan to Fortis where the effect of the dividend or loan would materially weaken Newfoundland Power's financial condition. Newfoundland Power's Operating Lines were established to provide liquidity for public utility operations. They were not intended to be the source of funds for payments of excessive dividends, or making of excessive loans, to Fortis.

C.2.3 The Effect of a Fortis Bankruptcy

The bankruptcy remoteness of Newfoundland Power in the event of a Fortis bankruptcy filing is largely attributable to the stand-alone nature of Newfoundland Power's financing arrangements which is described above in *C.1.2 Newfoundland Power's Debt Financing Arrangements*.

Under the *Bankruptcy and Insolvency Act (Canada,)* creditors may petition a court for a receiving order against a debtor which creditors believe has committed an act of bankruptcy. The most common act of bankruptcy is where the debtor has ceased to meet its liabilities generally as they become due. Once a receiving order is granted by a bankruptcy court, the debtor's estate falls under the administrative jurisdiction of a court appointed official (the "Trustee").

In the event of a possible Fortis bankruptcy filing, Newfoundland Power could only be made part of the proceeding if the *assets* of Newfoundland Power somehow supported the obligations of Fortis. As indicated above in *C.1.2 Newfoundland Power's Debt Financing Arrangements*, no such arrangements exist.

Since Fortis has no recourse to the assets of Newfoundland Power, the Trustee would have no such recourse to those assets upon a Fortis bankruptcy filing. Accordingly, Newfoundland Power (and its assets) would not become subject to a Fortis bankruptcy proceeding.

Fortis' equity holdings in Newfoundland Power would become part of the overall estate of Fortis which would be administered by the Trustee in the event of a Fortis bankruptcy filing. Should this occur, it is possible that those equity holdings might be auctioned by the Trustee for the benefit of Fortis' creditors. Such a development, however, would not expose the holders of Newfoundland Power's First Mortgage Bonds to any additional risk of return of interest or principal.

In the event of a Fortis bankruptcy filing, it is Newfoundland Power's assessment that (i) Newfoundland Power would not be subject to a bankruptcy filing, and (ii) the secured creditors of Newfoundland Power would not be exposed to any additional risk of return of interest or principal as a result of the Fortis filing.

C.2.4 Summary of Current Protection

Newfoundland Power is subject to public interest regulation both as a public utility in Newfoundland and Labrador and as a public issuer of securities in Canadian capital markets.

Any dividends paid by Newfoundland Power to Fortis or any loans made by Newfoundland Power to Fortis could be paid, or made, only if the dividends or loans were adjudged to be in the best interests of Newfoundland Power. Newfoundland Power's current governance practices exist, to a large degree, to ensure that its board of directors is in a position to act in the best interests of Newfoundland Power.

The degree of transparency of Newfoundland Power's financial affairs together with the independence of the board of directors provides a high degree of protection to all interested parties, including holders of First Mortgage Bonds, against the unjustified weakening of the Company's financial condition at the instance of Fortis.

Newfoundland Power's Operating Lines support the operation of its public utility business and do not provide a source of funds for payments of excessive dividends, or making of excessive loans, to Fortis.

Finally, the structural features of the Fortis / Newfoundland Power financial relationship provide a high degree of protection to Newfoundland Power from adverse effects of any Fortis financial difficulty, including bankruptcy.

C.3 Credit Rating Agencies' Assessment of the Relationship

S & P has made it clear that ratings actions in respect of Newfoundland Power will be directly determined by ratings actions on Fortis. This matter has been discussed in detail with S & P and, as matters currently stand, it appears unlikely that S & P will alter this position.

S & P's view of the Fortis / Newfoundland Power financial relationship is part of a broader view held by S & P of Canadian utility holding companies and operating companies. The direct linkage made by S & P is not made by other credit rating agencies.

DBRS has not indicated any intention to directly link parent-subsidiary credit ratings in the manner adopted by S & P. DBRS continues to rate Newfoundland Power's First Mortgage Bonds at A (higher than S & P's A-) and Fortis at BBB (high) (equivalent to S & P's BBB+).

Moody's, which currently rates neither Fortis nor Newfoundland Power, does not draw a direct link between parent-subsidiary credit ratings as does S & P.

D. PLAN

D.1 Approach to Ensuring Stand-Alone Status

As is described in *C. THE FORTIS / NEWFOUNDLAND POWER FINANCIAL RELATIONSHIP* above, the current structural relationship between Fortis and Newfoundland Power effectively provides for the independence of the utility, including the independence necessary to preserve its financial integrity. Nevertheless, S & P's current view of the Fortis / Newfoundland Power relationship has caused Newfoundland Power to reassess what steps, if any, would be prudent to more completely insulate Newfoundland Power from potential adverse financial impacts as a result of S & P's views.

Described another way, Newfoundland Power has reviewed matters comprehensively with a view to more completely, if reasonably possible, ensuring its stand-alone status.

D.2 Results of Assessment

D.2.1 Reassessing Current Operating Lines

As a part of its review of its stand-alone credit status, Newfoundland Power considered its current Operating Lines. The current Operating Lines are demand facilities as opposed to committed facilities. Lenders are not obliged to extend credit under demand facilities. Lenders are legally obliged to provide credit under committed facilities so long as the conditions of the agreement are met.

In assessing its overall credit status, the lack of committed Operating Lines was assessed as a potential weakness in Newfoundland Power's stand-alone credit status. Historically, Newfoundland Power has experienced no issues relating to demand Operating Lines. However, the lack of committed Operating Lines presents the possibility that Newfoundland Power could conceivably be in a future position where it would have to rely on Fortis for operating credit in the event Newfoundland Power's lenders were unwilling for some reason, say turbulent market conditions, to extend credit. While such a possibility seems highly unlikely, the existence of committed Operating Lines does provide more transparent assurance of Newfoundland Power's continued financial independence to all interested parties, including credit rating agencies. Such agreements typically have some commercial restrictions on the debtor's ability to make payments to shareholders.

Newfoundland Power is currently assessing this issue. Should this path be undertaken, an application may be required to be made to PUB for approval of such a facility.

D.2.2 Reassessing Current Operational Relationship

In Order No. P.U. 19 (2003), the PUB expressed the belief that Newfoundland Power's relationship with Fortis had become more complex and integrated since 1998.

On March 31, 2004, Newfoundland Power filed a Report on Inter-Corporate Charges with the PUB as required by Order No. P.U. 19 (2003). The measures undertaken in inter-corporate reporting as outlined in this report ensure, among other things, that the operational relationship between Fortis and Newfoundland Power remains fully transparent.

On a broader footing, Newfoundland Power intends to reduce the level of incorporate activity between Fortis and Newfoundland Power. This should, in turn, substantially reduce both the perceived complexity and integration of the relationship on an operational level as was identified in Order No. P.U. 19 (2003).

D.2.3 Reassessing Current Credit Ratings

Newfoundland Power's current assessment is that it is desirable to maintain two investment grade credit ratings to assure continued access to capital markets for its First Mortgage Bonds.

Following full consideration and, if appropriate, the establishment of committed Operating Lines, there may be little else Newfoundland Power can, or should, do to more effectively ensure its stand-alone status.

At that point, Newfoundland Power will further consult with credit rating agencies with a view to maintaining two investment grade credit ratings.

D.3 Timing of Implementation/Further Reporting

As Newfoundland Power does not currently expect to issue further First Mortgage Bonds before late 2005, that is the effective target date for implementing any necessary actions.

Currently, Newfoundland Power expects to implement all necessary steps to ensure maintenance of its stand-alone financial integrity by the end of 2004, after which it will report further to the PUB on the steps undertaken.

Credit Ratings of Canadian Investor-Owned Utilities

	DBRS Rating	Standard & Poor's Ratings		Moody's Rating
		Corporate	Debt Issue	
Electric Distribution Utilities				
Newfoundland Power Inc.	A	BBB+	A-	-
Maritime Electric Co. Ltd.	-	BBB+	BBB+	-
Nova Scotia Power Inc.	A (low)	BBB+	BBB+	Baa1
FortisBC Inc.	BBB (high)	-	-	-
FortisAlberta Inc.	A (low)	-	-	-
Great Lakes Power Limited	A (low)	-	-	-
Gas Distribution Utilities				
Enbridge Gas Distribution	A	A-	A-	-
Union Gas Ltd.	A	BBB	BBB	-
Terasen Gas Inc.	A	BBB	A-	A2
Pacific Northern Gas Ltd.	BBB (low)	(1)	(1)	
Combined Gas & Electric Utilities				
Canadian Utilities Limited	A	A	A-	-
Gas Transmission Utilities				
Westcoast Energy Inc.	A (low)	BBB	BBB	-
TransCanada Pipelines Ltd.	A	A-	A-	A2
Trans Quebec & Maritimes Pipeline Inc.	A (low)	BBB+	BBB+	-
Utility Holding Companies				
Gaz Metro Inc.	A	A-	A	-
Fortis Inc.	BBB (high)	BBB+	BBB	-
Emera Inc.	BBB (high)	BBB+	BBB	Baa2
Enbridge Inc.	A	A-	A-	A3
Atco Ltd.	A (low)	A	n/a	-
Terasen Inc.	A (low)	BBB	BBB-	A3
Duke Energy Corporation	BBB (high)	BBB	BBB+	Baa1
Great Lakes Power Inc.	BBB (high)	BBB	BBB-	Baa3

(1) Rating withdrawn after Pacific Northern Gas Ltd. was acquired by Duke Energy Corporation.

Standard & Poor's Credit Ratings for Canadian Investor-Owned Utilities

	Initial S & P Ratings		Ratings at May 14, 2004		Most Recent Change
	Corporate	Debt	Corporate	Debt	
Electric Distribution Utilities					
Newfoundland Power Inc.	A-	A	BBB+	A-	Downgraded Jan. 7/04
Maritime Electric Co. Ltd.	BBB	BBB+	BBB+	BBB+	Corporate Rating changed to reflect parent Jan. 7/04
Nova Scotia Power Inc.	A-	A-	BBB+	BBB+	Downgraded Dec. 21/01
Gas Distribution Utilities					
Enbridge Gas Distribution	A	A	A-	A-	Downgraded Dec. 18/01
Union Gas Ltd.	A-	A-	BBB	BBB	Downgraded Feb. 10/04
Terasen Gas Inc.	BBB+	A-	BBB	A-	Downgraded Jun. 26/03
Pacific Northern Gas Ltd.	BB-	BB-	(1)	(1)	
Combined Gas & Electric Utilities					
Canadian Utilities Limited	A+	n/a	A	A-	Downgraded Jan. 7/04
Gas Transmission Utilities					
Westcoast Energy Inc.	A-	A-	BBB	BBB	Downgraded Feb. 10/04
TransCanada Pipelines Ltd.	A-	A-	A-	A-	No Change
Trans Quebec & Maritimes Pipeline Inc.	BBB+	BBB+	BBB+	BBB+	No Change
Utility Holding Companies					
Gaz Metro Inc.	A-	A	A-	A	No Change
Fortis Inc.	A-	BBB+	BBB+	BBB	Downgraded Jan. 7/04
Emera Inc.	A-	BBB+	BBB+	BBB	Downgraded Dec. 21/01
Enbridge Inc.	A	A	A-	A-	Downgraded Dec. 18/01
Atco Ltd.	A+	n/a	A	n/a	Downgraded Jan. 7/04
Terasen Inc.	BBB+	BBB-	BBB	BBB-	Downgraded Jun. 26/03
Duke Energy Corporation	A+	AA-	BBB	BBB+	Downgraded Feb. 10/04
Great Lakes Power Inc.	BBB	BBB-	BBB	BBB-	Placed on watch May 20/04

(1) Rating withdrawn after Pacific Northern Gas Ltd. was acquired by Duke Energy Corporation.

A Supplementary Report on the Stand-Alone Credit of Newfoundland Power

April 15, 2005

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April 15, 2005

(filed in compliance with Order No. P.U. 19 (2003))

NEWFOUNDLAND POWER
A FORTIS COMPANY

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A. INTRODUCTION

In Order No. P.U. 19 (2003) issued in June 2003 (the "2003 Order"), the Board of Commissioners of Public Utilities of Newfoundland and Labrador (the "PUB") concluded that in the interest of both the utility and its customers, that Newfoundland Power Inc. ("Newfoundland Power" or the "Company") should continue to be treated as a stand-alone utility. Newfoundland Power was directed to take all appropriate steps necessary to preserve the financial integrity and independence of the utility.

In response to the 2003 Order, Newfoundland Power filed a *Report on the Stand-Alone Credit of Newfoundland Power* on June 30, 2004. It provided: (i) a Canadian utility industry review of the issue of parent-subsidiary linkage in assigning credit ratings; (ii) an assessment of the financial independence of Newfoundland Power provided by the parent-subsidiary relationship between Fortis Inc. and Newfoundland Power, and (iii) Newfoundland Power's approach to further strengthen the financial independence of Newfoundland Power to ensure stand-alone status.

This report is provided as an update on the steps undertaken by Newfoundland Power since June 30, 2004 to ensure its continued stand-alone status.

B. RECENT INITIATIVES

The following activities were undertaken to more completely ensure the stand-alone status of Newfoundland Power.

B.1 Current Operating Lines

In the *Report on the Stand-Alone Credit of Newfoundland Power* filed June 30, 2004, Newfoundland Power indicated it would be reassessing its then current operating lines of credit (the "Operating Lines"). At the time, the Company had demand Operating Lines as opposed to committed Operating Lines. Lenders are obliged to extend credit under committed Operating Lines in accordance with the terms of the facility, a certainty that does not exist under demand Operating Lines. The use of committed Operating Lines is consistent with current Canadian public utility practice.

The Company determined it would be prudent to change from demand Operating Lines to committed Operating Lines.

On January 21, 2005, the Company entered into a committed credit facility agreement with a syndicate of banks for a $100 million revolving term credit.[1] The shift to the use of committed Operating Lines provides a greater certainty of credit availability thus strengthening the Company's financial independence.[2]

B.2 Current Operational Relationship

In the 2003 Order, the PUB noted that Newfoundland Power's relationship with Fortis Inc. had become more complex and integrated since 1998. In the 2003 Order, the PUB outlined principles to be observed by the Company in all inter-corporate transactions. The PUB ordered: (i) that the Company compare and quantify the benefits of the Company's administration of, and participation in, a centralized insurance program rather than being insured on a stand-alone basis; and (ii) that the Company investigate the utilization of market rates for charging executive and management time charges.

On March 31, 2004, the Company filed a *Report on Inter-Corporate Charges* with the PUB as required by the 2003 Order. The report included: (i) information on the types of inter-corporate charges; (ii) the Company's formal policy and pricing guidelines for inter-corporate transactions; (iii) a review of the benefits of the Company's administration of and participation in a centralized insurance program; and (iv) a review of Canadian utility practices for dealing with senior management time charges.

B.2.1 Types of Inter-Corporate Charges

The level of regulated charges from Fortis Inc. and its subsidiaries (the "Related Companies") is relatively low (approximately $250,000 in 2004). The relatively low level of services being provided by the Related Companies to Newfoundland Power is indicative of Newfoundland Power's operational autonomy.

Newfoundland Power and Fortis Inc. have separate and distinct executive groups and separate functional departments. This contrasts with the approach of a number of parent-subsidiary relationships among utility companies.[3]

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1 The PUB approved the facility in Order No. P.U. 1(2005).

2 The committed revolving term credit facility places specific restrictions on Newfoundland Power's payment of dividends, affiliate transactions and inter-corporate loans.

3 For example, some senior management at Nova Scotia Power also have senior management responsibilities with its parent company Emera Inc.

The level of charges by Newfoundland Power to Related Companies is provided in Table 1 below.

Table 1

Annual Inter-Corporate Charges to Related Companies

($000s)

2001	2002	2003	2004
4,452	4,962	4,081	3,418

The charges to Related Companies have declined by approximately $1.5 million or 30% from 2002 to 2004.

The emergency relief effort for the Cayman Islands, which was extraordinary, resulted in approximately $800,000 of the Related Company charges for 2004 reflected in Table 1.

Table 2 provides Staff Charges to Related Companies provided by senior management (i.e., executive and managers) for the period 2001 to 2004.

Table 2

Annual Senior Management Staff Charges to Related Companies

($000s)

2001	2002	2003	2004
656	646	1,254	271

Table 2 illustrates a reduced involvement of the Company's senior management in activities of Related Companies in 2004.

The reduction in Staff Charges related to senior management time is consistent with the Company's intention to reduce the level of incorporate activity between Fortis and Newfoundland Power. This should, in turn, reduce both the perceived complexity and integration of the relationship on an operational level.

B.2.2 Implementation of Policy and Pricing Guidelines

In the 2003 Order, the Board directed that transactions between Newfoundland Power and Related Companies should not disadvantage the interests of ratepayers and the utility should derive some demonstrable benefit from such transactions. The Company's current policy explicitly recognizes these principles, and contains pricing guidelines to ensure that ratepayers benefit from all inter-corporate transactions. Any transactions that do not provide benefits to ratepayers are charged as non-regulated costs.[4]

Newfoundland Power's finance management monitor ongoing policy compliance and a review of inter-corporate transactions as part of the Company's internal audit compliance program.

The formalization of the policy and the provision of pricing guidelines will result in standardization and consistency in inter-corporate activities between Newfoundland Power and Related Companies. This, in turn, will result in increased regulatory transparency.

B.3 Current Credit Ratings

Newfoundland Power is currently consulting with credit rating agencies with respect to its credit ratings for its first mortgage sinking fund bonds.

C. REGULATORY DEVELOPMENTS

It does not appear that any regulator has yet taken any specific action on account of rating actions taken by Standard & Poor's ("S&P").

The issue of S&P's ratings was the subject of some commentary in the Alberta Energy and Utilities Board's (the "AEUB") 2004 Generic Cost of Capital decision.[5] The Board's relevant observations included the following:

> "The Board notes that S&P does not rigorously apply its guidelines with respect to each specific financial ratio. In addition to interest coverage ratios, S&P reviews a number of other key financial ratios, as well as many diverse and often subjective factors, in order to arrive at a specific credit rating for an individual utility…."

4 Newfoundland Power's policy and pricing guidelines can be found at Schedule 1 to the *Report on Inter-Corporate Charges* filed on March 31, 2004.

5 EUB Decision 2004-052 (July 2, 2004) *Generic Cost of Capital*.

> "The Board does not have a target credit rating for utilities under its jurisdiction…..interest coverage ratios and credit ratings are important considerations in assessing the appropriate capital structure. However, the Board considers that the foregoing are just one set of factors to consider." (at p. 40).
>
> "However, the Board notes that the S&P report indicates that the credit rating (of NGTL) is effectively that of TCPL (NGTL's parent), rather than that of NGTL itself. Therefore, in the Board's view, the adjusted actual ratio of NGTL may not be indicative of its required equity ratio, on a stand-alone basis." (at p. 43).

D. CONCLUDING

Newfoundland Power shall report further to the Board on this matter as circumstances warrant.

Credit Ratings of Canadian Investor-Owned Utilities

	DBRS Rating	Standard & Poor's Ratings		Moody's Rating
		Corporate	Debt Issue	
Electric Distribution Utilities				
Newfoundland Power Inc.	A	BBB+	A-	-
Maritime Electric Co. Ltd.	-	BBB+	BBB+	-
Nova Scotia Power Inc.	A (low)	BBB+	BBB+	Baa1
FortisBC Inc.	BBB (high)	-	-	Baa3
FortisAlberta Inc.	A (low)	-	-	Baa1
Great Lakes Power Limited	A (low)	-	-	-
Gas Distribution Utilities				
Enbridge Gas Distribution	A	A-	A-	-
Union Gas Ltd.	A	BBB	BBB	-
Terasen Gas Inc.	A	BBB	A-	A2
Pacific Northern Gas Ltd.	BBB (low)	(1)	(1)	
Combined Gas & Electric Utilities				
Canadian Utilities Limited	A	A	A-	-
Gas Transmission Utilities				
Westcoast Energy Inc.	A (low)	BBB	BBB	-
TransCanada Pipelines Ltd.	A	A-	A-	A2
Trans Quebec & Maritimes Pipeline Inc.	A (low)	BBB+	BBB+	-
Utility Holding Companies				
Gaz Metro Inc.	A	A-	A	-
Fortis Inc.	BBB (high)	BBB+	BBB	-
Emera Inc.	BBB (high)	BBB+	BBB	Baa2
Enbridge Inc.	A	A-	A-	A3
Atco Ltd.	A (low)	A	n/a	-
Terasen Inc.	A (low)	BBB	BBB-	A3
Duke Energy Corporation	BBB (high)	BBB	BBB+	Baa1
Brascan Power Inc. [2]	BBB (high)	BBB	BBB	-

(1) Rating withdrawn after Pacific Northern Gas Ltd. was acquired by Duke Energy Corporation.

(2) Name change from Great Lakes Power Inc. Moody's rating withdrawn.

Standard & Poor's Credit Ratings for Canadian Investor-Owned Utilities					
	Initial S & P Ratings		Ratings at April 4, 2005		Most Recent Change
	Corporate	Debt	Corporate	Debt	
Electric Distribution Utilities					
Newfoundland Power Inc.	A-	A	BBB+	A-	Downgraded Jan. 7/04
Maritime Electric Co. Ltd.	BBB	BBB+	BBB+	BBB+	Corporate Rating changed to reflect parent Jan. 7/04
Nova Scotia Power Inc.	A-	A-	BBB+	BBB+	Downgraded Dec. 21/01
Gas Distribution Utilities					
Enbridge Gas Distribution	A	A	A-	A-	Downgraded Dec. 18/01
Union Gas Ltd.	A-	A-	BBB	BBB	Downgraded Feb. 10/04
Terasen Gas Inc.	BBB+	A-	BBB	A-	Downgraded Jun. 26/03
Pacific Northern Gas Ltd.	BB-	BB-	(1)	(1)	
Combined Gas & Electric Utilities					
Canadian Utilities Limited	A+	n/a	A	A-	Downgraded Jan. 7/04
Gas Transmission Utilities					
Westcoast Energy Inc.	A-	A-	BBB	BBB	Downgraded Feb. 10/04
TransCanada Pipelines Ltd.	A-	A-	A-	A-	No Change
Trans Quebec & Maritimes Pipeline Inc.	BBB+	BBB+	BBB+	BBB+	No Change
Utility Holding Companies					
Gaz Metro Inc.	A-	A	A-	A	No Change
Fortis Inc.	A-	BBB+	BBB+	BBB	Downgraded Jan. 7/04
Emera Inc.	A-	BBB+	BBB+	BBB	Downgraded Dec. 21/01
Enbridge Inc.	A	A	A-	A-	Downgraded Dec. 18/01
Atco Ltd.	A+	n/a	A	n/a	Downgraded Jan. 7/04
Terasen Inc.	BBB+	BBB-	BBB	BBB-	Downgraded Jun. 26/03
Duke Energy Corporation	A+	AA-	BBB	BBB+	Downgraded Feb. 10/04
Brascan Power Inc. (2)	BBB	BBB-	BBB	BBB	Debt rating upgraded Nov. 10/04

(1) Rating withdrawn after Pacific Northern Gas Ltd. was acquired by Duke Energy Corporation.

(2) Name change from Great Lakes Power Inc.

A 2nd Supplementary Report on the Stand-Alone Credit of Newfoundland Power

July 20, 2005

A 2nd Supplementary Report on the Stand-Alone Credit of Newfoundland Power

July 20, 2005

(filed in compliance with Order No. P.U. 19 (2003))

CONTENTS

A. INTRODUCTION

In Order No. P.U. 19 (2003) issued in June 2003 (the "2003 Order"), the Board of Commissioners of Public Utilities of Newfoundland and Labrador (the "PUB") concluded that in the interest of both the utility and its customers, Newfoundland Power Inc. ("Newfoundland Power" or the "Company") should continue to be treated as a stand-alone utility. Newfoundland Power was directed to take all appropriate steps necessary to preserve the financial integrity and independence of the utility.

The Company has filed two reports with the PUB outlining its response to the 2003 Order. On June 30, 2004, the Company filed a *Report on the Stand-Alone Credit of Newfoundland Power* (the "Report"). The Report provided (i) a Canadian utility industry review of the issue of parent-subsidiary linkage in assigning credit ratings; (ii) an assessment of the financial independence of Newfoundland Power provided by the parent-subsidiary relationship between Fortis Inc. ("Fortis") and Newfoundland Power, and (iii) Newfoundland Power's approach to further strengthen the financial independence of Newfoundland Power to ensure stand-alone status.

Newfoundland Power filed *A Supplementary Report on the Stand-Alone Credit of Newfoundland Power* on April 15, 2005 (the "Supplementary Report"). The Supplementary Report provided an update on the initiatives undertaken by the Company to ensure its stand-alone status.

This report deals with steps undertaken by the Company to strengthen its stand-alone status subsequent to April 15, 2005.

B. CREDIT RATING INITIATIVE

Newfoundland Power has received an additional independent verification of its financial and operational independence from its affiliates.

Newfoundland Power requested Moody's Investors Service ("Moody's") to provide a credit rating on Newfoundland Power's First Mortgage Sinking Fund Bonds. Moody's are one of the 3 main agencies which rate the credit of Canadian investor-owned utilities and their holding companies. The others are Standard and Poors ("S & P") and Dominion Bond Rating Service ("DBRS").

The Moody's Credit Opinion dated June 9, 2005 and supporting Analysis publication, dated July 11, 2005 ("Moody's Credit Opinion and Analysis") is provided as Schedule A. Moody's has provided a credit rating of Baa1 for Newfoundland Power's First Mortgage Sinking Fund Bonds. An assessment of the Moody's rating is provided in this section.

B.1 The Moody's Rating

The Baa1 rating is considered an investment grade rating by Moody's. Moody's rating is based on an assessment of the current financial metrics of the Company.

To assist in interpreting the rating, the Moody's rating scale has been provided in Table 1 of Schedule B.

B.2 Operational and Financial Independence

Moody's Credit Opinion and Analysis deals directly with the operational and financial independence of Newfoundland Power.

Moody's view of the operational and financial relationship of Newfoundland Power with its parent, is clear:

> *"The Baa1 rating and the stable outlook reflect credit strengths that include: ...NPI's operational and financial independence from its parent, Fortis Inc. (not rated) and its affiliates"*[1].

To strengthen its financial independence from its parent, on January 21, 2005, Newfoundland Power entered into a committed credit facility agreement with a syndicate of banks for a $100 million revolving term credit.[2] Moody's recognized the committed credit facility as a material element in the stand alone status of Newfoundland Power.

Moody's stated:

> *"NPI's bank credit agreement contains covenants which prohibit affiliate loans and guarantees and place meaningful restrictions on other affiliate transactions. These provisions include a requirement that debt/capitalization not exceed 65% (currently approximately 56%), prohibitions on loans and guarantees to affiliates, and meaningful restrictions on all affiliate transactions."*[3]

C. CREDIT RATING SUMMARY

The First Mortgage Sinking Fund Bonds of Newfoundland Power are currently rated: A by DBRS; A- by S & P; and Baa1 by Moody's.

Both DBRS and Moody's rate Newfoundland Power and Fortis separately.

[1] Moody's Investor Services Credit Opinion: Newfoundland Power Inc., June 9, 2005.
[2] The PUB approved the facility in Order No. P.U. 1(2005).
[3] Moody's Investor Services Credit Opinion: Newfoundland Power Inc., June 9, 2005.

Only S & P's corporate credit ratings for investor-owned utilities are equalized with those of their holding companies (i.e., the consolidated rating approach).

Current credit ratings of Canadian investor-owned utilities and their utility holding companies are set out in Schedule C.

D. CURRENT SUMMARY OF INITIATIVES

In the 2003 Order, Newfoundland Power was directed to take all appropriate steps necessary to preserve the financial integrity and independence of the utility. In response to the Board's direction, Newfoundland Power has comprehensively reviewed its operational and financial management with a view to more completely ensure its stand-alone status.

As a result of its review, the Company has:

(i) Reviewed and updated its practices and procedures in relation to inter-corporate transactions and developed a formal policy to reflect the principles set out in the 2003 Order;

(ii) Modified its inter-corporate reporting practices to ensure that the operational relationship between Fortis and Newfoundland Power remains fully transparent;

(iii) Reduced the level of inter-corporate activity between Fortis and Newfoundland Power to reduce the perceived complexity and integration of the relationship on an operational level;

(iv) Entered into a committed credit facility agreement for a $100 million revolving term credit. Shifting from demand operating lines to a committed credit facility provides greater certainty of credit availability thus strengthening the Company's financial independence; and

(v) Obtained a stand-alone credit rating from Moody's on the First Mortgage Sinking Fund Bonds of Newfoundland Power.

To date, Newfoundland Power has fully complied with the Board directions in the 2003 Order on this matter. The Company will continue to take all appropriate steps necessary to preserve the financial integrity and independence of the utility.

Schedule A

Moody's Credit Opinion and Analysis

Global Credit Research
Credit Opinion
9 JUN 2005

Credit Opinion: Newfoundland Power Inc.

Newfoundland Power Inc.

Canada

Ratings

Category	Moody's Rating
Outlook	Stable
First Mortgage Bonds -Dom Curr	Baa1

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Key Indicators

Newfoundland Power Inc.

	2004	2003	2002	2001
Funds from Operations/Adjusted Debt [1]	14.4%	13.6%	15.1%	17.1%
Retained Cash Flow/Adjusted Debt	10.8%	11.1%	12.5%	11.7%
Common Dividends/Net Income available for Common	45.8%	32.2%	33.0%	65.8%
(Funds from Operations + Adjusted Interest)/ Adjusted Interest [2]	2.8x	2.6x	2.9x	3.1x
Net Income available for Common/Common Equity	9.8%	9.8%	10.3%	11.1%
Adjusted Debt/Capitalization	55.6%	56.1%	56.4%	57.3%

[1] Adjusted Debt includes preferred shares [2] Adjusted Interest includes dividends on preferred shares & capitalized interest

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Credit Strengths

-First mortgage security over NPI's property, plant and equipment

-Low risk, cost of service regulated monopoly, predominantly T&D utility

-Lack of competitive pressure due to dominant position in a small, isolated and relatively low growth market

-Stable & supportive regulatory regime

-Moderate leverage - constrained by 65% debt/capitalization bank covenant

-Sufficient liquidity under NPI's $100 million syndicated committed revolving credit facility

-Manageable debt maturity profile

-Operational and financial independence from parent, Fortis Inc., and affiliates

-Expectation of low restructuring risk

Credit Challenges

-Declining trend in FFO/Debt in recent years

-Slightly free cash flow negative

-Relatively small company serving a historically weak economy

-Rising electricity rates due to flow through of rising purchased power costs

Rating Rationale

The Baa1 rating and the stable outlook reflect credit strengths that include: the FMB's first mortgage security over NPI's property, plant and equipment; NPI's low business risk as a cost of service-regulated monopoly utility with predominantly transmission and distribution operations; the lack of competitive pressure due to NPI's dominant position in a small and isolated market with relatively low growth; the stable supportive regulatory regime which includes measures that largely eliminate NPI's exposure to commodity price and volume risk, moderate leverage which is constrained by the maximum 65% debt/capitalization covenant in NPI's credit facility; sufficient liquidity under NPI's $100 million syndicated committed revolving credit facility which has a 364 day extendible term and automatically converts to a one year term loan if not extended; NPI's manageable debt maturity profile; NPI's operational and financial independence from its parent, Fortis Inc. (not rated) and its affiliates; and Moody's expectation that Newfoundland's electricity market is unlikely to undergo any significant restructuring in the foreseeable future.

The rating and outlook also reflect credit challenges that include recent declines in the ratio of funds from operations to total debt (FFO/Debt) due to the impact of lower regulated depreciation on revenues, and the expectation that NPI will operate with a modest free cash flow deficit in the near to medium term due to lower depreciation and continued rate base growth. Moody's analysis also considers the fact that NPI is a relatively small company operating in a jurisdiction whose economy has been relatively weak and whose population continues to shrink. The rating also reflects the possibility that recent and possible future increases in the cost of electricity purchased from provincially owned Newfoundland & Labrador Hydro, driven largely by escalating global oil prices, could negatively impact electricity demand.

The rating also considers NPI's status as a subsidiary of Fortis, Inc., and that the parent could seek to increase upstream dividends from NPI if that is beneficial for its financial strategy. However, consistent with Fortis' philosophy of operating its utility subsidiaries on a stand-alone basis, NPI is operationally and financially independent of Fortis and the level of dividends has not historically been stressful for NPI. The company's financial agreements illustrate this financial strategy. NPI's bank credit agreement contains covenants which prohibit affiliate loans and guarantees and place meaningful restrictions on other affiliate transactions. These provisions include a requirement that debt/capitalization not exceed 65% (currently approximately 56%), prohibitions on loans and guarantees to affiliates, and meaningful restrictions on all affiliate transactions. Moody's also expects that NPI will continue to pursue a dividend policy that will ensure that it remains at or near the maximum 45% equity allowed by its regulator, the Board of Commissioners of Public Utilities (PUB).

In January 2005, NPI strengthened its liquidity by establishing a $100 million 364-day syndicated committed revolving credit facility. The facility is extendible at the option of the lenders but NPI could fully draw the facility and convert the outstandings to a one-year term if the 364-day period is not extended. The bank facility will be utilized in part to fund NPI's capital expenditure program of approximately $50 million annually. NPI expects to periodically issue additional FMBs to refund borrowings under the syndicated credit facility.

Consistent with most electric utilities, it is expected that NPI will continue to be modestly free cash flow negative after capital spending and dividends for the foreseeable future. This reflects its moderate but steady cash flow, a significant ongoing capital expenditure program, and its dividend pay-out. NPI's debt maturity schedule appears to be quite manageable, with the next significant maturity of $35 million occurring in 2007. Moody's notes that availability of liquidity under NPI's syndicated credit facility could be constrained in adverse circumstances due to the existence of a Material Adverse Change (MAC) clause. However, Moody's believes that the potential impact of the MAC clause is somewhat muted by the fact that there is a specific carve-out for adverse weather conditions, which is one of the most likely events that could negatively affect the company's performance.

Rating Outlook

The rating outlook is stable

What Could Change the Rating - UP

The rating could be positively impacted if NPI could demonstrate expectations for a sustained improvement in financial ratios, such as FFO to Interest Coverage above 4.0x and FFO/Debt above 20%. This level of improvement in NPI's credit metrics could result from an increase in equity in the capital structure or the equity risk premium utilized by the regulator to automatically adjust the allowed rate of return on rate base between full cost of capital hearings

What Could Change the Rating - DOWN

The rating could be negatively impacted by expectations for a sustained weakening of NPI's financial measures, such as FFO to Interest Coverage below 2.5x and FFO/Debt below 15%.

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*This Analysis provides a discussion of the factors underpinning the credit rating/s and should be read in conjunction with our Credit Opinion. The most recent ratings, opinion, and other research specific to this issuer are provided on Moodys.com. **Click here to link.***

Analysis

CANADA
Americas

July 2005

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Newfoundland Power Inc.

Newfoundland Power Inc.'s (NPI) Baa1 rating (senior secured) and stable outlook reflect the following key credit strengths and challenges:

Credit Strengths

- First mortgage security over NPI's property, plant and equipment
- Low risk, cost of service regulated monopoly, predominantly T&D utility
- Lack of competitive pressure due to dominant position in a small, isolated and relatively low growth market
- Stable & supportive regulatory regime
- Moderate leverage - constrained by 65% debt/capitalization bank covenant
- Sufficient liquidity under NPI's $100 million syndicated committed revolving credit facility
- Manageable debt maturity profile
- Operational and financial independence from parent, Fortis Inc., and affiliates
- Expectation of low restructuring risk

Credit Challenges

- Declining trend in FFO/Debt in recent years
- Slightly free cash flow negative
- Relatively small company serving a historically weak economy
- Rising electricity rates due to flow through of rising purchased power costs

Moody's Investors Service
Global Credit Research

Credit Strengths

FIRST MORTGAGE SECURITY OVER NPI'S PROPERTY, PLANT AND EQUIPMENT

NPI's first mortgage bonds (FMBs) are secured by a first fixed and specific charge on property, plant and equipment owned or to be acquired by the company as well as a floating charge on all other assets. The FMBs also benefit from a general sinking fund which is to be funded annually in an amount equal to 1% of the original principal balance of the FMBs. The FMBs represent virtually all of NPI's debt with the exception of its unsecured bank lines which are comprised of a $100 million syndicated committed revolving term facility and a $20 million demand facility.

LOW RISK, COST OF SERVICE REGULATED MONOPOLY, PREDOMINANTLY T&D UTILITY

Moody's considers NPI's business risk to be relatively low, reflecting the fact that it is predominantly a transmission and distribution utility that is regulated on a cost-of-service basis by the Board of Commissioners of Public Utilities of Newfoundland and Labrador (PUB). The 144 MW of generation owned by NPI, two thirds of which is small hydro, represents approximately 10% of NPI's total assets and generates roughly 10% of the electricity that NPI delivers to its customers. NPI purchases the balance of the electricity consumed by its customers from provincially-owned Newfoundland & Labrador Hydro (Hydro). The cost of power purchased from Hydro is a flow through to end use consumers.

LACK OF COMPETITIVE PRESSURE DUE TO DOMINANT POSITION IN A SMALL, ISOLATED AND RELATIVELY LOW GROWTH MARKET

NPI has a dominant market position on the island of Newfoundland serving 225,000 or approximately 85% of the on-island customers (the balance of on-island customers are directly served by Hydro). The island of Newfoundland is an isolated and relatively low-growth market which acts as an effective barrier to competitive entry. In addition, as noted below, Moody's believes that market restructuring and the introduction of competition are unlikely to occur in the foreseeable future.

STABLE & SUPPORTIVE REGULATORY REGIME

NPI operates under a cost of service return on rate base regime that is overseen by the PUB. NPI benefits from the existence of a Rate Stabilization Account (RSA) which captures volatility in the price of power purchased from Hydro that reflects fluctuations in the cost and quantity of fuel oil burned by Hydro. The PUB reviews the RSA and adjusts NPI's rates annually in July to permit NPI to recover or refund RSA balances from ratepayers. In addition, the PUB has approved the use of a Weather Normalization Reserve (WNR) to adjust for the financial impact of weather on demand patterns and of hydrology on purchased power requirements. While NPI's short-term cash flows can be impacted by variations in weather, hydrology and purchased power costs, the existence of the RSA and WNR provide NPI with the ability to ultimately recover these costs from ratepayers.

MODERATE LEVERAGE - CONSTRAINED BY 65% DEBT/CAPITALIZATION BANK COVENANT

NPI has moderate leverage with FFO/Adjusted Debt of approximately 14% and Adjusted Debt/Adjusted Capitalization of about 56% according to Moody's calculations. NPI's leverage is constrained by the covenant in its bank credit agreement which limits its debt to capitalization to 65%. At Q1 2005, NPI's debt to capitalization ratio calculated in accordance with the covenant was 54%, leaving adequate headroom under the covenant. Also, Moody's expects that NPI will continue to pursue a dividend policy that will ensure that it remains at or near the maximum 45% equity allowed by its regulator.

SUFFICIENT LIQUIDITY UNDER NPI'S $100 MILLION SYNDICATED COMMITTED REVOLVING CREDIT FACILITY

In January 2005, NPI established a $100 million 364-day syndicated committed revolving credit facility. The facility is extendible for additional 364 day periods with the consent of the lenders. However, if the lenders do not extend the maturity date, NPI has the option to draw down the full amount of the facility and convert it to a one year term loan. Moody's expects that, together with retained cash flow, this facility will be adequate to support the company's ongoing capital expenditure requirements of approximately $50 million annually. NPI expects to periodically issue additional FMB debt to reduce the amount outstanding under the revolving credit facility. Moody's notes that the availability of funds under NPI's revolving credit line could be constrained in adverse circumstances due to the existence of a Material Adverse Change (MAC) clause. However, Moody's believes that the potential impact of the MAC clause is somewhat muted by the fact that there is a specific carve-out for adverse weather conditions, which is one of the most likely events that could negatively impact the company's performance.

MANAGEABLE DEBT MATURITY PROFILE

NPI's sinking fund payment and maturity schedule is manageable. Sinking fund payments over the next five years are scheduled to be less than $4 million annually. First Mortgage Bond Series AC matures in 2007 ($32.7 million currently outstanding) following which the next maturity occurs in 2014.

OPERATIONAL AND FINANCIAL INDEPENDENCE FROM PARENT, FORTIS INC., AND AFFILIATES

Consistent with Fortis' philosophy of operating its utility subsidiaries on a stand-alone basis, NPI is operationally and financially independent of Fortis and the level of dividends paid to Fortis has not historically been stressful for NPI. The company's financial agreements illustrate this financial strategy. NPI's bank credit agreement contains covenants which prohibit affiliate loans and guarantees and place meaningful restrictions on other affiliate transactions. These provisions place prohibitions on loans and guarantees to affiliates and meaningful restrictions on all affiliate transactions.

EXPECTATION OF LOW RESTRUCTURING RISK

Moody's expects the risk of electricity market restructuring in Newfoundland to be relatively low. While there was discussion in the past about the possibility of provincially-owned Hydro acquiring NPI, after studying the situation, the government announced in February of 2004 that it was not the government's intent to pursue the ownership of NPI by Hydro.

Credit Challenges

DECLINING TREND IN FFO/DEBT IN RECENT YEARS

Recent declines in the ratio of funds from operations to total debt (FFO/Debt) reflect the impact of lower regulated depreciation on revenues. Following a depreciation study conducted in 2002, the company was required to reduce the amortization of its assets by $5.8 million annually during each of 2003, 2004 and 2005. All else being equal, Moody's expects amortization for rate making purposes to increase by approximately $5.8 million commencing 2006, which should have a positive impact on FFO/Debt and other cash flow metrics. The recent declines in FFO/Debt also reflect the increase in the amount of outstanding debt, which has tracked the steady growth in NPI's property plant and equipment.

SLIGHTLY FREE CASH FLOW NEGATIVE

Consistent with most electric utilities, it is expected that NPI will continue to be modestly free cash flow negative after capital spending and dividends for the foreseeable future. This reflects NPI's moderate but steady cash flow, its significant ongoing capital expenditure program, and its expected dividend pay-out. As previously noted, Moody's expects that NPI will continue to pursue a dividend policy that will ensure that it remains at or near the maximum 45% equity allowed by its regulator. As a result, Moody's expects an increase in NPI's dividend payout in the near term.

RELATIVELY SMALL COMPANY SERVING A HISTORICALLY WEAK ECONOMY

NPI is a relatively small company with total assets of less than $1 billion serving a customer base of approximately 225,000. It operates in a jurisdiction whose economy has been relatively weak and which continues to be more dependent upon the cyclical natural resource sector than the country as a whole. While the province's population continues to decline, NPI has benefited to some degree from the relocation of a portion of the population from small remote communities to larger urban centres such as St. John's.

RISING ELECTRICITY RATES DUE TO FLOW THROUGH OF RISING PURCHASED POWER COSTS

NPI has experienced material increases in the cost of power purchased from Hydro, largely due to the escalating price of fuel oil which fires Hydro's largest thermal generating station. While the cost of purchased power is a flow through to the ratepayer, rising electricity rates could negatively impact electricity demand.

Related Research

Credit Opinion:

Newfoundland Power Inc. June 8, 2005

Rating Methodology:

Global Regulated Electric Utilities, March 2005(91730)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Related Websites

Moody's Canada Inc.

www.moodys.ca

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Schedule B

Moody’s Rating Scale

Table 1
Moody's Rating Scale

Category	Rating
Investment Grade	Aaa Aa1 Aa2 Aa3 A1 A2 A3 Baa1 Baa2 Baa3
Speculative Grade	Ba1 Ba2 Ba3 B1 B2 B3 Caa1 Caa2 Caa3 Ca C

Schedule C

Credit Ratings of Canadian Investor-Owned Utilities

Credit Ratings of Canadian Investor-Owned Utilities				
	DBRS Rating	Standard & Poor's Ratings		Moody's Rating
		Corporate	Debt Issue	
Electric Distribution Utilities				
Newfoundland Power Inc.	A	BBB+	A-	Baa1
Maritime Electric Co. Ltd.	-	BBB+	BBB+	-
Nova Scotia Power Inc.	A (low)	BBB+	BBB+	Baa1
FortisBC Inc.	BBB (high)	-	-	Baa3
FortisAlberta Inc.	A (low)	-	-	Baa1
Great Lakes Power Limited	A (low)	-	-	-
Gas Distribution Utilities				
Enbridge Gas Distribution	A	A-	A-	-
Union Gas Ltd.	A	BBB	BBB	-
Terasen Gas Inc.	A	BBB	A-	A2
Pacific Northern Gas Ltd.	BBB (low)	(1)	(1)	
Combined Gas & Electric Utilities				
Canadian Utilities Limited	A	A	A-	-
Gas Transmission Utilities				
Westcoast Energy Inc.	A (low)	BBB	BBB	-
TransCanada Pipelines Ltd.	A	A-	A-	A2
Trans Quebec & Maritimes Pipeline Inc.	A (low)	BBB+	BBB+	-
Utility Holding Companies				
Gaz Metro Inc.	A	A-	A	-
Fortis Inc.	BBB (high)	BBB+	BBB	-
Emera Inc.	BBB (high)	BBB+	BBB	Baa2
Enbridge Inc.	A	A-	A-	A3
Atco Ltd.	A (low)	A	n/a	-
Terasen Inc.	A (low)	BBB	BBB-	A3
Duke Energy Corporation	BBB (high)	BBB	BBB+	Baa1
Brascan Power Inc. (2)	BBB (high)	BBB	BBB	-

(1) Rating withdrawn after Pacific Northern Gas Ltd. was acquired by Duke Energy Corporation.

(2) Name change from Great Lakes Power Inc. Moody's rating withdrawn.