

1 **Reference: Section 3: Finance**

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3 **Q. Further to PUB-NP-029, would any of the credit metrics at the different returns on**  
4 **equity and equity components in the capital structure cause problems with respect**  
5 **to maintaining Newfoundland Power’s creditworthiness and its ability to maintain a**  
6 **sound credit rating?**

7  
8 **A. A. Credit Ratings**

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10 The maintenance of Newfoundland Power’s creditworthiness and its ability to maintain a  
11 sound credit rating is not solely a matter of credit metrics.

12  
13 The Company’s credit ratings are determined by both Moody’s Investors Service  
14 (“Moody’s”) and DBRS.<sup>1</sup> As each of the current credit ratings from Moody’s and DBRS  
15 indicates, Newfoundland Power’s credit ratings are substantially influenced by factors  
16 other than credit metrics.

17  
18 Moody’s, for example, attributes 60% of its rating to: (i) the regulatory framework,  
19 including legislation and the consistency and predictability of regulation; (ii) the ability to  
20 recover costs and earn returns, including the timeliness of recovery of costs and  
21 sufficiency of rates and returns; and (iii) diversification, including market position and  
22 generation and fuel diversity. Moody’s explains:

23  
24 *“For rate-regulated utilities, which typically operate as a monopoly, the*  
25 *regulatory environment and how the utility adapts to that environment are the*  
26 *most important credit considerations.”<sup>2</sup>*

27  
28 In its most recent rating report for Newfoundland Power, Moody’s stated:

29  
30 *“We view the Newfoundland and Labrador Board of Commissioners of Public*  
31 *Utilities (PUB) as one of the more supportive regulators in Canada because*  
32 *regulatory decisions are timely and balanced, deferral accounts reduce risks from*  
33 *factors beyond management’s control and NPI’s 45% equity capital is among the*  
34 *highest authorized levels in Canada.”<sup>3</sup>*

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<sup>1</sup> See the 2022/2023 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Exhibit 4.

<sup>2</sup> See Moody’s Regulated Electric and Gas Utilities Rating Methodology, June 23, 2017, page 6. This is provided as Attachment A in response to Request for Information CA-NP-095.

<sup>3</sup> See the 2022/2023 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Exhibit 4, Moody’s, page 1.

1 DBRS completes both a business risk assessment (“BRA”) and financial risk assessment  
2 as part of its rating methodology. For regulated utilities, DBRS states:

3  
4 *“The quality of the regulatory regime is typically the most important BRA factor,*  
5 *as it lays the foundation for utilities’ earning capacity, cost recovery mechanisms,*  
6 *and capital structure. A supportive regulatory framework contributes to stable*  
7 *cash flow and earnings, underpinned by a fair rate of return and a full and timely*  
8 *recovery of costs.”<sup>4</sup>*  
9

10 In its most recent rating report, DBRS recognizes the Company’s stable and supportive  
11 regulatory environment and strong financial profile as key credit strengths.<sup>5</sup> Further,  
12 DBRS stated:

13  
14 *“Newfoundland Power has maintained a solid financial profile, underpinned by*  
15 *the Company’s reasonable financial leverage and stable cash flow.”<sup>6</sup>*  
16

17 It is clear that the credit rating agencies consider the existing supportive regulatory  
18 environment as a credit strength for Newfoundland Power. Further, both rating agencies  
19 recognize the Company’s longstanding 45% common equity component of its capital  
20 structure as a key credit strength. A reduction in the 45% common equity ratio could  
21 result in a re-evaluation of regulatory support by the credit rating agencies.  
22

## 23 **B. Credit Metrics**

24  
25 Both Moody’s and DBRS consider various credit metrics as part of their credit rating  
26 methodologies. Moody’s assessment of financial strength primarily relies on the debt to  
27 capitalization financial metric and various cash flow credit metrics.<sup>7</sup> DBRS considers the  
28 debt to capitalization financial metric in combination with cash flow and interest  
29 coverage credit metrics.<sup>8</sup>  
30

31 Moody’s 12 to 18-month forward view reflects a constant debt to capitalization financial  
32 metric.<sup>9</sup> A reduction in the Company’s 45% common equity ratio, as outlined in the  
33 scenarios in Request for Information PUB-NP-029, would increase the debt to  
34 capitalization financial metric and could result in a re-evaluation of financial strength by  
35 Moody’s when assessing the Company’s rating outlook.

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<sup>4</sup> See DBRS Methodology for *Rating Companies in the Regulated Electric, Natural Gas, and Water Utilities Industry*, October 2020, page 5. This is provided as Attachment A in response to Request for Information CA-NP-096.

<sup>5</sup> See the *2022/2023 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Exhibit 4, DBRS*, page 2.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid, *Moody’s*, page 8.

<sup>8</sup> Ibid, *DBRS*, page 2.

<sup>9</sup> Ibid, *Moody’s*, page 8.

1 Other than the Company's 45% common equity ratio, the cash flow to debt coverage  
2 credit metric is the only metric that either Moody's or DBRS provide specific  
3 commentary on in their rating outlooks.  
4

5 In considering the ratings outlook for Newfoundland Power, Moody's states:

6  
7 *"The stable outlook reflects the PUB's regulation of NPI which we consider*  
8 *credit supportive. We expect the regulatory environment to remain supportive,*  
9 *with the company maintaining a suite of timely recovery mechanisms, along with*  
10 *our view that relatively stable cash flow generation and the capital structure of*  
11 *NPI will generate sustained CFO pre-WC to debt in the 16-18% range."*<sup>10</sup>  
12

13 As provided in response to Request for Information PUB-NP-029, rates of return on  
14 equity ("ROE") ranging from 8.25% to 9.80%, with a 45% common equity ratio,  
15 generate cash flow to debt coverage within the range that Moody's expects for  
16 Newfoundland Power.<sup>11</sup>  
17

### 18 **C. Conclusion**

19  
20 Newfoundland Power maintains investment grade credit ratings from Moody's and  
21 DBRS. These ratings reflect the supportive regulatory environment and the Company's  
22 stable financial performance, both of which are fundamentally supported by  
23 Newfoundland Power's longstanding capital structure that includes 45% common equity.  
24 This has contributed to the Company's continued access to capital markets on reasonable  
25 terms.  
26

27 In Newfoundland Power's view, reducing the 45% common equity ratio represents a risk  
28 to maintaining its existing credit ratings.  
29

30 Further, in determining an appropriate ROE for the Company, the Board is guided by the  
31 fair return standard. In Order No. P.U. 18 (2016), the Board stated:  
32

33 *"In Order No. P.U. 43(2009) and in Order No. P.U. 13(2013), its most recent*  
34 *Order on this issue, the Board stated that 'to be considered fair the return must be*  
35 *commensurate with the return on investments of similar risk and sufficient to*  
36 *assure financial integrity and to attract necessary capital.'* This statement, which  
37 *reflects accepted regulatory principles, concisely captures the requirements that*  
38 *must be met to determine a fair return. All three requirements must be met and*  
39 *no one requirement takes precedence over the other two."*<sup>12</sup>

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<sup>10</sup> Ibid, Moody's, page 2.

<sup>11</sup> See Table 3 in response to Request for Information PUB-NP-029.

<sup>12</sup> See Order No. P.U. 18 (2016), page 10, line 44 to page 11, line 4.