Pre-filed Testimony and Exhibits of Philip Hughes for 1998 Cost of Capital hearing

NEWFOUNDLAND LIGHT & POWER CO. LIMITED

DIRECT TESTIMONY OF PHILIP HUGHES AND KARL SMITH

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1. INTRODUCTION

Q. Would you please introduce yourself to the Board?

A. My name is Philip Hughes. I live in the City of St. John's and I am the President and Chief Executive Officer of Newfoundland Light & Power Co. Limited ("Newfoundland Power" or the "Company"). I have worked in the natural gas and electrical industries for both utilities and non-utilities. Currently, I am Vice-Chairman of the Board of Directors of the Canadian Electrical Association and a member of the Board of Directors of the Energy Council of Canada.

My name is Karl Smith. I was born in Stephenville Crossing, I live in the City of St. John's, and I am a Chartered Accountant employed as Vice-President, Finance and Chief Financial Officer of Newfoundland Power.

Q. Would you please introduce the other witnesses that will be appearing on the Company's behalf and the scope of their testimony?

A. Our external expert witnesses are Ms. Kathleen McShane who is a Vice President and Senior Consultant with Foster Associates Inc., and Dr. Roger Morin who is a Professor of Finance at Georgia State University. Dr. Morin has testified before this Board on a number of occasions. Both witnesses have extensive experience testifying before utility

regulators in other Canadian jurisdictions and are pre-eminent authorities on utilities' cost of capital. Ms. McShane and Dr. Morin will provide expert evidence respecting an appropriate capital structure for the Company, the appropriate equity return for the Company, the appropriate use of a formula approach to setting the Company's rate of return, and the appropriate frequency of a full cost of capital review.

2. OVERVIEW

Q. Please provide an overview of what this proceeding means to Newfoundland Power.

A. As the principal distributor of electricity in Newfoundland, our Company is one of the most critical service providers in the province. We see ourselves as a key contributor to a successful future for this province. A reliable supply of electrical energy at a competitive price is critical to the success of our commercial customers and central to the standard of living of our residential customers. Recognizing this, our Company must continue to invest in our electrical system to enable us to improve the reliability of our service.

Today's economic environment is a challenging one. While economic indicators are improving for this province and the country as a whole, significant gains will be necessary to ensure this province's economic success.

The last several years have been particularly difficult for Newfoundland. Catastrophic job losses in the fishery have threatened the rural economy and, with it, the economic well-being of the entire province. Recently, the bad news has been tempered by some good, in the form of the successful completion of the Hibernia project and the discovery of the nickel deposit at Voisey's Bay. Yet, while these developments will affect Newfoundland in positive ways, they will not be our economic salvation.

The Conference Board of Canada is predicting that Newfoundland's Gross Domestic Product (GDP) will grow at a higher rate than any other province this year. However, this will not translate into strong employment and income growth. The reality is that the majority of the wealth generated by Hibernia, which accounts for most of the expected GDP growth, will have little effect on employment in the province. The fact that Newfoundland is the only province to experience a decline in population since the last census, a trend which the Conference Board forecasts to continue well into the future, demonstrates the effect of net out-migration due to poor employment prospects.

Newfoundland Power has also been affected by the weak economic conditions. Over the last number of years we have seen growth in energy sales stagnate, consistent with low growth in the provincial economy. A further challenge to the Company is presented when populations migrate from rural to urban areas. The cost to maintain the electrical systems in areas with a declining customer base is not reduced accordingly, as approximately the same number of poles, wires, and transformers are still required. Meanwhile, additional

capital expenditures are necessary to provide service to these customers in their new homes.

While the Hibernias and the Voisey's Bays are good news for the province, future economic success and a reasonable standard of living will most likely be achieved through the expansion and improvement of the province's business and industrial sector, which if successful will allow us to compete in an increasingly global economy, and create jobs here in the province. It is important that Newfoundland Power be in a position to support these developments by ensuring a reliable, high quality supply of electrical energy to our customers.

Ensuring the reliability and quality of the power supply is a significant challenge in Newfoundland. Our Company must contend with some of the most difficult weather and climate conditions in North America. Salt spray, high winds, and sleet storms are frequent occurences. Recent events in Quebec and Ontario have served to remind us of the havoc that severe ice storms can wreak on our electric system. A major storm can give rise to an immediate need for financing. For example, a recent storm on the Burin Peninsula caused $1,000,000 in damage to the electrical system in a single weekend. Our customers, however, depend heavily on the supply of electricity, and any outage is a significant disruption to the lifestyles to which people have become accustomed. Meeting the increased expectations of customers in this regard is only one of the significant challenges that we, as an electric utility, face on a day-to-day basis.

It is no longer sufficient merely to keep the lights on. Another challenge presented by the modern, high-technology society which Newfoundland is fast becoming is the challenge to provide better power quality. Many of our residential customers' modern appliances contain microprocessors. Personal computers have also become relatively commonplace. These items are far more sensitive to anomalies in the power supply than the electric appliances of days gone by. Our customers expect that the quality of power will conform to the new standard.

Power quality is also a growing concern for our commercial customers. For example, fish processors now employ technology which requires precise standards of energy supply with less interference. Newfoundland Power has installed, and must continue to invest in, power monitoring equipment which will be used to help detect and analyze potential power quality problems before they affect our customers and their business operations.

It is essential to the success of the communities that Newfoundland Power serves that we continue to meet these challenges. If Newfoundland is to compete in the global economy and create employment, Newfoundland Power must do what we can to level the playing field for our customers. Our service, manufacturing, and processing industries cannot compete without the same technologies that their national and international competitors are using. Some of our fish processor customers are prime examples of what can be achieved in the face of apparent adversity. When the cod moratorium fundamentally changed their businesses, the successful companies sought out other species and other

sources of supply. Technology has played, and will continue to play, a major role in their success. Our power system must be ready and able to support their endeavours.

Residential and commercial customers alike now demand greater access to information and flexibility in methods of transacting business with the Company. As other service providers offer call centres, internet services, and a range of bill payment options, our customers expect the same services from Newfoundland Power. The Company's commitment to meeting these rising expectations means that, as information technology advances, the Company must invest to keep pace. For example, the Company is currently updating the technology of our Customer Service System (CSS). This project involves an expected total capital expenditure of more than $2.3 million over three years. It will enable the Company to offer improved customer information, and will provide the flexibility necessary to meet higher customer expectations. The new technology also requires that front line customer service personnel be supplied with personal computers.

Information technology will continue to require significant investment over the next several years. Our 1998 capital budget includes a $435,000 investment for the installation of integrated technologies for the call centre. This will ensure that customer inquiries regarding service, bills, etc. can be more effectively handled, and that customers receive prompt, satisfactory service.

We believe we have improved our delivery of service. A survey of our customers carried out in December 1997 indicated that 85.5% of our customers were satisfied with overall service for the year, as compared to 70.7% the previous year. A more recent survey in March 1998 confirmed our progress by indicating an 86% satisfaction level among our customers. While surveys such as these indicate that we are making progress in meeting our customers' expectations, we are not content. We have committed to doing our job better, so our customers can focus on doing their jobs better.

As long as the electric business continues to be regulated under traditional monopoly regulation, there will be no tolerance by our customers for complacency on the part of the power company. We must understand, and respond to, our customers' needs and their expectations. Newfoundland Power recognizes this, and is working to achieve increased productivity in our operations. Through effective partnering with suppliers, contractors and other utilities, we have made gains in productivity and efficiency which will result in reduced costs. We remain committed to achieving further improvements in productivity without affecting our ability to continue to meet customer expectations.

In addition to our awareness of events and circumstances at home, we are also cognizant of developments in the rest of the world. The electric utility business is changing rapidly. Deregulation of the electrical business and convergence of the entire energy industry, particularly in the United States and in other parts of Canada, will have implications beyond any direct impact on Newfoundland Power. As the existing infrastructure is

rationalized and economies and efficiencies are achieved, the cost of energy in other parts of the continent will come down. This will present further competitive challenges for those of our customers who must compete at a national and international level.

Q. What does this have to do with the cost of capital?

A. In order to meet all of these challenges and continue to discharge our obligation to provide reliable, efficient, and high-quality service, the Company must obtain funds on reasonable terms, irrespective of market conditions. The matters to be addressed in this hearing will have a fundamental impact on the Company's ability to do so.

We take our obligations to our customers very seriously. If our customers are to succeed in their endeavours, the Company must support them with a high level of electrical service. We take our obligations to our investors seriously also. Investors have committed approximately $500 million in investment in Newfoundland Power. In return for that committment, our investors are entitled to returns on their investment that are comparable to the returns on similar companies. We cannot continue to honour these obligations if the financial integrity of the Company is undermined.

The recommendations contained in the report of Drs. Waters and Winter that has been filed as evidence in this proceeding threaten that financial integrity. As our evidence will demonstrate, the fundamental financial indicators relied upon by the capital markets to assess our Company's creditworthiness will deteriorate substantially if their

recommendations are implemented. Our expert witnesses, who are both recognized as pre-eminent authorities on utilities' cost of capital, make it clear in their evidence that the measures proposed by Drs. Waters and Winter expose the Company's credit rating to a downgrade. If this were to happen, it would substantially constrain the Company's ability to serve our customers by placing severe restrictions on our ability to attract and retain the necessary capital upon reasonable terms.

The consequences for the Company, the Company's investors, its customers, and thus the province, over the long term provide the context in which the matters at issue in this proceeding must be considered.

3. BUSINESS RISK

Q. How does business risk affect the cost of capital?

A. When a company requires new investment capital, the capital markets will assess the business risk of the company relative to other companies. If the business risk associated with a company is higher than that associated with other investment possibilities, the returns demanded by the capital markets to finance that investment will be higher, and the cost to the company of that investment capital will be greater.

The markets will assess business risk in light of the ability of a company to generate adequate revenues and manage expenses over both the short and long term. The level of

business risk associated with a company's earnings and its ability to generate cash flow will be assessed relative to other companies.

Q. What are the business risks associated with Newfoundland Power's revenues?

A. As a utility, Newfoundland Power is generally seen as having relatively stable revenues. However, this relative stability must be viewed in light of the economy in which the Company operates, and the competitive nature of its sales.

Revenue growth is important to investors because it contributes to the assurance that sufficient earnings will be available to service debt. Low growth presents the risk that future revenue may not be large enough to absorb reasonable expense increases, thereby threatening earnings.

Newfoundland Power's sales are primarily to residential customers and service producing industries. In the long term, the economic factors that will influence Newfoundland Power's revenue growth are the growth in housing starts, growth in personal disposable income, and growth in the service sector. In addition, continued net out-migration and the problems in the fishing industry will also have an impact.

Exhibit PGH-1 sets out in graphical form the Conference Board of Canada's long-term forecast of a number of key economic indicators for all provinces in Canada for the period 1997 to 2015. While the key economic indicators for Newfoundland are expected

to improve, Newfoundland's indicators, with the exception of the goods producing sector, continue to rank among the lowest in Canada. The province is forecast to have the lowest service sector growth, the highest unemployment rate, the second lowest personal disposable income per capita in Canada, and will be the only province in Canada with a declining population base.

The decline in population is the direct result of high levels of net out-migration brought on by weak economic performance and few employment opportunities. The Statistics Canada Census Data shown in Exhibit PGH-2 illustrates the impact that net out-migration has had on population in Newfoundland Power's service territory. The 1996 Census results indicate that the St. John's operating region was the only operating region in Newfoundland Power's service territory which showed an increase in population since the previous census in 1991.

Exhibit PGH-3, page 1 of 2 shows Statistics Canada's 1991 and 1996 census data for Newfoundland and Canada by age group. The chart shows that the population increased in all groups for Canada but declined in most for Newfoundland. Data for Newfoundland during the 1991 to 1996 period indicates that population in the 0-9 and 10-20 age groups declined at a significant rate. These groups are an indicator of current and future customer growth for Newfoundland Power, and the continued decline in population in these age groups will negatively impact growth in housing starts and in the service sector.

Page 2 of Exhibit PGH-3 also shows that the decline in population by age group for Newfoundland Power's service territory is similar to the province as a whole.

The impact of population decline and its effect at the municipal level as recorded by Statistics Canada is shown in Exhibit PGH-4. Exhibit PGH-4, page 1 of 2 shows that population in 80.7% of the municipalities served by Newfoundland Power decreased from 1991 to 1996. Smaller rural communities, with populations less than one thousand, are being impacted more by population change than larger urban centers. Exhibit PGH-4, page 2 of 2 shows that while the number of residential customers in 36% of these small communities declined in 1997, the number of customers in 94% of communities having a population greater than 5,000 have shown an increase. This change brings with it the requirement to invest capital to maintain aging systems where customers and future revenues are declining, while at the same time the Company is required to increase capital investment in growing communities. This will translate into increased expenditures per customer in an environment where overall population is in decline. This represents a significant risk for Newfoundland Power.

Problems in the fishery also represent a significant risk. The gradual winding down of the Atlantic Groundfish Strategy (TAGS) Program this year has already contributed to net out-migration. Although it appears likely that some form of government-funded income support program will be implemented to replace TAGS, the continued reliance of a

substantial segment of the Newfoundland labour force on income support programs will continue to compromise economic and sales growth in 1998 and beyond.

Q. How does the projected increase in Newfoundland's Gross Domestic Product in 1998 affect the Company's revenue risk?

A. The increase in the Gross Domestic Product (GDP) in 1998 is largely due to the value of oil production at Hibernia. The Conference Board of Canada's long-term forecast indicates that GDP will grow by 4.5% in 1998. If the value of oil production from Hibernia is removed from the forecast, GDP would grow by only 1.6%. The Conference Board of Canada noted, in its Provincial Forecast, Winter 1997, that only $80 million of the total real GDP of $475 million generated by Hibernia would remain in the Newfoundland economy. As a result, Hibernia will have only a relatively small impact on the local economy, and on the other key economic indicators such as housing starts, personal disposable income and service sector growth. It is these indicators that affect the revenue growth of Newfoundland Power. An excerpt from the Conference Board forecast outlining the impact of resource development is attached to our evidence as Exhibit PGH-5.

Growth in service sector GDP is more indicative of the growth potential for Newfoundland Power than growth in total GDP. As indicated on page 1 of Exhibit PGH-1, service sector GDP is forecast to grow by only 1.4% over the 1997 - 2015 period, the lowest growth rate of any province in Canada.

Q. What is the significance of sales competition to the long-term growth of Newfoundland Power?

A. Over one-half of the Company's total energy sales are to competitive end uses such as space and water heating. In the short term, the Company could absorb losses in these markets. However, in the longer term, the loss of these markets would significantly impact revenue flows and the Company's ability to meet its financial obligations. The most recent rating reports from both CBRS and DBRS continue to note competition in these markets as an issue.

Q. What are the principal expense risks of the Company?

A. The major risks associated with Newfoundland Power's expenses are purchased power from a single supplier, the evolution of the Company's business from an expansion mode to an operating and maintenance mode, and the Company's increasing effective tax rate. We will elaborate on each in turn.

Newfoundland Power obtains over 90% of its energy from a single supplier, Newfoundland & Labrador Hydro. The cost of purchased power represents about 56% of the price to the customer. Newfoundland Power has no control over these costs.

In 1995, this Board approved a change to the Company's accounting for general expense capitalized ("GEC") from a full cost method to an incremental method. This change reflected the evolution of the business from an expansion mode to an operating and

maintenance mode. The Company was allowed to phase in this change over a five year timeframe. This accounting change decreased capitalized overhead expenses over the last three years and will result in a further decrease in 1998. To offset this pressure, the Company has reduced gross operating expenses by 9% since 1995, as shown in Exhibit PGH-6. This reduced level of capitalized overhead expenses will continue to apply upward pressure on the Company's operating expenses until 1999 which is the end of the five year phase in period.

The increasing effective tax rate will put significant financial pressure on the Company in the future. There are differences in the tax treatment and the accounting treatment of a number of Newfoundland Power's expenses, principally, depreciation and GEC. Historically, the tax expense for these items was higher than the accounting expense, which helped reduce taxes in prior years at the expense of potentially higher taxes in future years. A lower effective rate could be maintained as long as growth continued to create increased tax deductions. Because this is no longer the case for Newfoundland Power, the effective tax rate of the Company has been increasing significantly on an annual basis. The increase from 1993 to 1997, and pro-forma figures for 1998 and 1999 are shown in Exhibit PGH-7. The unbooked deferred tax liability that will be realized through the increased effective tax rate over the next number of years, also shown in Exhibit PGH-7, is $87 million.

Rate increases have been kept to a minimum because Newfoundland Power has been aggressively managing its expenses, and the decline in long-term interest rates has decreased the Company's cost of capital. However, in future, the Company will be under increased cost pressure.

Q. Could the Company simply compensate for revenue and expense pressures by increasing customer rates?

A. The regulatory regime provides the Company with the opportunity to earn its allowed returns. However, a weak revenue base creates a risk to earnings that may nevertheless result in shortfalls that will not be recovered.

This dynamic was recognized in the following statement of policy contained in Order No. P.U. 6 (1991):

> While Section 3 of The Electrical Power Control Act grants public utilities the right to charge rates which will provide sufficient revenue to enable them to achieve and maintain a sound credit rating, it is not practical to implement this policy in such a way as to guarantee either a reasonable rate of return or a sound credit rating. The achievement of these objectives is subject to business risks over which neither the public utility nor the Board more particularly have the power to control. Furthermore, there is always a time lag between the time public utilities realize that their return and credit rating are in jeopardy and the receipt of Board approval for an increase in rates.

Q. How do you view Newfoundland Power's business risks in comparison to other Canadian utilities?

A. We view Newfoundland Power's business risks as being relatively high compared to other Canadian electric and gas utilities. Investors, of course, judge the risk of investing in Newfoundland Power in relation to the risk of investing in other North American utilities. Our weak provincial economy in relation to other provinces, low sales growth, net out-migration, and the pressure on Newfoundland Power to manage expenses effectively will continue to be seen by the capital markets as risks to achieving allowed returns.

The regulatory risk of Newfoundland Power has been comparable to other utilities. Decisions by Newfoundland Power's regulator have been assessed by the capital markets as consistent and fair when compared to decisions received by other Canadian utilities.

4. CAPITAL STRUCTURE

(a) Credit Ratings

Q. What objective measures of financial integrity or investment quality do investors use in making decisions ?

A. Holders of fixed income investments such as bonds, debentures, and preference shares, consider the credit ratings provided by rating agencies. In Canada, Dominion Bond

Rating Service ("DBRS") and Canadian Bond Rating Service ("CBRS") provide these ratings. For common equity holders, most brokerage services provide analytical reports containing buy, hold, or sell recommendations.

Q. How are these credit ratings determined?

A. The ratings are based on financial integrity and economic wealth. A weakness in one or the other may lead to a lowering of the credit rating. To maintain a relatively high rating, a company must demonstrate superior performance in both of these areas over many economic cycles.

Ratings are derived from the issuer's past operating history, current financial structure, liquidity position, and an evaluation of its future prospects, particularly its ability to maintain or improve its position.

Positive points in a rating include healthy coverage ratios, sound debt to equity coverage, upward earnings trend, reliable cash flow, sound liquidity, proven management, industry stability, strong market share, conservative accounting, and broad funding sources. Negative points include high debt levels, industry instability, variable cash flow, off-balance sheet commitments, sensitivity to political change, poor regulation, weak market position, narrow diversification, poor prospects, and low profitability.[1]

[1] Canadian Bond Rating Service Objectives and Rating Definitions, Rev March 1, 1986.

Q. What are the current credit ratings of Newfoundland Power?

A. CBRS and DBRS both rate the Company's debt as A stable. Both rating agencies' reports on the Company issued between October 1996 and March 1998 have been filed in this proceeding as part of the response to Information Request DMB-9. The Company's balance sheet and coverage ratios are within the range of the other investor-owned utilities. However, as a relatively small utility operating in a weaker franchise area with little growth and sales subject to competitive pressure, we are classified as having higher than average business risk.[2]

Q. What are the positives and negatives that contribute to Newfoundland Power's credit rating?

A. Both agencies refer to the Company's strong financial structure, good coverage ratios, strong balance sheet and stable earnings and cash flows as positive influences on its rating. Both see the low growth, small size, and weak economy in the Company's franchise area as negatives. Both also refer to the Company's dependence on the competitive home heating market for a significant portion of its sales as a concern.

Q. What credit rating do you believe is appropriate for the Company?

A. We believe the appropriate credit rating for the Company is an A rating.

[2] Dominion Bond Rating Service, The Electric Utilities Industry in Canada, February 1998.

Q. Why is an A rating appropriate for the Company?

A. With an A rating, the Company can continue to have competitive access to capital markets in all economic conditions. A credit rating lower than this would mean more expensive capital, particularly when bond markets are weak, and could possibly make access difficult in particularly adverse circumstances. This would result in increased costs to our customers.

Exhibit PGH-8 compares the coupon rates of Newfoundland Power's last five bond issues with the average yields on thirty year bonds of B++ utilities for the month of issue of the Newfoundland Power bonds. Exhibit PGH-8 shows that since 1989 Newfoundland Power has been able to access debt capital at rates that have been as much as 88 basis points lower than the average B++ yields.

While B++ is an investment grade rating, it is the bottom rung of the investment grade ladder. If the Company's rating were lowered to B++, and events external to the Company were to precipitate a further downgrading, the Company's debt would no longer be investment grade. This would severely restrict the Company's access to capital. Also, many institutional investors are restricted in the amount they can invest in debt of B++ rated companies.

(b) Capital Structure

Q. What does the term "capital structure" mean?

A. Capital structure refers to a company's mix of various investment securities. The two primary types are debt and equity. Preferred equity may also be part of a capital structure, although the use of preferred equity has declined in recent years.

The relative proportions of debt, common equity, and preferred equity in a company's capital structure are sometimes expressed in percentage terms as ratios.

Q. What is the Company's current capital structure?

A. The Company's capital structure as at December 31, 1997 was composed of the following ratios:

Debt	53.55%
Preferred Equity	1.93%
Common Equity	44.52%

Q. Compare Newfoundland Power's capital structure with other regulated utilities?

A. Exhibit PGH-9 shows the year-end capital structures of Canadian investor-owned electric utilities for 1996. Newfoundland Power's capital structure is reasonable compared to other Canadian investor owned electric utilities.

Exhibit PGH-9, page 2 of 3 shows the year-end capital structures of Canadian investor owned gas distribution utilities for 1996. Gas distribution companies tend to have higher debt ratios in their capital structures than electric companies.

For both electric and gas distribution utilities, the size of the company tends to have a significant effect on capital structure. Smaller companies tend to have a higher ratio of common equity than larger companies. Exhibit PGH-9 indicates that average equity ratios for electric and gas distribution utilities with less than $1,000,000,000 in assets are 3 to 7% higher than those with more than $1,000,000,000 in assets.

Q. Why do smaller utilities require higher common equity ratios in their capital structure?

A. Earnings of larger utilities are less sensitive to economic events. This is in part due to a broader customer base and potentially greater diversification of earnings. It is also due to greater diversification of debt, interest rates, maturity, and terms.

Such diversification provides a shield against single economic events such as medium-term increases in interest rates. For example, Consumers Gas with total long-term debt of $1,661 million has interest rates varying from 5.71% to 11.95% and maturities ranging from 1997 to 2026.[3] Outstanding series values range in size from $30 million to $150 million, with no single series representing more than 9 percent of total debt.

[3] Consumers' Gas Company Ltd. 1997 Annual Report.

By comparison, Newfoundland Power's long-term debt totaling $239 million has a smaller range of interest rates at 8.9% to 11.875%, and maturities ranging from 2005 to 2026. No single series, the values of which are generally about $40 million, represents less than 15 percent of the total debt.[4] As a result, a medium-term change in interest rates has the potential for a much larger effect on earnings in Newfoundland Power. A higher equity ratio reduces the magnitude of the effect.

Q. Why do gas distribution utilities have higher debt ratios than electric utilities?

A. The gas distribution industry is different than the electric industry. Gas utilities store their product when not immediately required. Therefore, gas distribution utilities are required to carry significant seasonal inventories of natural gas in their systems. This results in a greater need for short-term debt financing than an electric utility.

Exhibit PGH-9, page 2 of 3 shows the average gas in storage is about 5% of invested capital in gas distribution utilities. Removing this from invested capital for comparative purposes would increase the average common equity ratio of smaller gas utilities from 38.1% to 40.1% as shown in Exhibit PGH-9, page 3 of 3.

Q. What are the consequences of reducing a utility's allowed common equity ratio?

A. It will diminish the utility's creditworthiness. This occurred a few years ago in British Columbia.

[4] Newfoundland Light & Power Co. Limited 1997 Annual Report.

In 1993, West Kootenay Power was directed to reduce its common equity ratio to 35% by 1995.[5] In the 1994 generic hearing on return on equity before the British Columbia Utilities Commission ("BCUC"), West Kootenay argued for a common equity ratio in the range of 40 - 45%. The company argued there would be a decrease in its interest coverage resulting in a decline in its bond rating. The BCUC did not find sufficient evidence to change its 1993 decision and ordered West Kootenay to reduce its common equity to 35% by the end of 1995.

Subsequent to the 1993 decision of the BCUC, DBRS assigned a "negative" trend to all of West Kootenay's debt and gave "harsh regulatory environment" as the reason for this assignment.[6] West Kootenay's debt was downgraded to BBB in December 1995.[7] Through a negotiated settlement process, the BCUC later decided to allow West Kootenay's approved common equity ratio to increase to 40% from 35%. However, West Kootenay's bond rating has not yet returned to pre-1995 levels.

Q. Why is it appropriate for Newfoundland Power to have a range of common equity in its capital structure?

A. The capital requirements of a company are constantly changing in response to changes in working capital, capital expenditures, and earnings. The components of the capital structure, including common equity, also fluctuate. The common equity ratio varies with

5 British Columbia Utilities Commission Order No. G-125-93.
6 Dominion Bond Rating Service, December 14, 1994.
7 Dominion Bond Rating Service, December 15, 1995.

the repayment of existing debt, the issuance of new debt, the payment of dividends, the amount of retained earnings, and other factors. Therefore, it is not possible to manage to a specified common equity percentage.

Furthermore, regulated capital ratios are the average of the beginning and the year end values. This also suggests that a range for capital components, including common equity, is appropriate.

Q. What is the effect on the shareholder of a ceiling on the common equity ratio?

A. When the percentage of common equity in the Company's capital structure exceeds the permitted level, or ceiling, the return on the excess is reduced in accordance with the Board's current ruling on the matter. This Board's Order No. P.U. 7 (1996-97) provides that any common equity in Newfoundland Power's capital structure in excess of 45% will be deemed as preferred shares, which yield lower returns than allowed common equity. The practical result of this so-called "deemed dividend penalty" is the dilution of the return on equity. To be fair to its shareholders the Company must manage its common equity below the ceiling to avoid this result.

Q. What is the effect of a common equity ceiling on shareholder returns?

A. Common equity holders are entitled to a fair return commensurate with the market in similar risk investments. To hold these equity investments at lower returns than they can

achieve in the market, is to ignore the fact that the common equity investor's decision to invest was made in the expectation of common equity returns.

As the ceiling is lowered, the possibility increases that the Company may face the dilemma of having to retain equity to maintain financial stability. The possibility of incurring a deemed dividend penalty due to the retention of equity investors' capital at lower returns to maintain financial stability will likely be viewed by equity investors as an investment risk.

Q. Why has the use of preference shares declined recently?

A. With an increasing trend in the market toward retractable preference issues and the treatment of these as debt by accounting bodies and debt rating agencies, the attractiveness of these securities in regulated utilities has diminished.

The attractiveness of these securities is further diminished in companies such as Newfoundland Power with high effective tax rates. In the absence of a low effective tax rate the after-tax dividend rate on preferred shares represents costly capital.

(c) Interest Coverage

Q. What is interest coverage?

A. Interest coverage is a measure of the ability of the Company to pay the interest on its debts. Financial analysts and rating agencies express interest coverage as a ratio. Generally, the interest coverage ratio is calculated by dividing annual pre-tax earnings by annual interest payments.

Pre-tax earnings are used in the calculation to reflect the fact that interest charges are tax deductible.

Q. How do the rating agencies calculate interest coverage?

A. CBRS and DBRS calculate interest coverage ratios slightly differently.

Exhibit PGH-10, page 1 of 3 shows the CBRS calculation of actual interest coverage for the Company for 1996 and 1997 and pro forma coverage for 1998. Exhibit PGH-10, page 2 of 3 shows the DBRS calculation of actual interest coverage for the Company for 1996 and 1997 and pro forma coverage for 1998.

The principal difference in the CBRS and DBRS calculations is that DBRS reduces annual interest expense by interest capitalized during construction ("IDC") and interest

earned to arrive at *net* interest coverage. CBRS makes no similar adjustments in their calculation of interest coverages.

In addition, DBRS has employed a net after tax interest coverage ratio to compare relative coverages of regulated companies. This is to account for differing treatments of deferred taxes. Exhibit PGH-10, page 3 of 3 shows the DBRS calculation of actual net after tax interest coverage for the Company for 1996 and 1997 and pro forma coverage for 1998.

Unless otherwise indicated, the coverages referred to in our testimony are calculated using the CBRS interest coverage calculation.

Q. Why is the interest coverage ratio important?

A. The interest coverage ratio is important because it is the principal ratio used by the rating agencies to determine a company's creditworthiness.

Companies with higher interest coverage ratios are generally considered less risky by rating agencies than companies with lower interest coverage ratios. The rating assigned reflects the riskiness of the company which, in turn, is a significant factor in determining the cost of debt to that company. Generally, the higher the bond rating the lower the cost of debt to a company.

Q. How does Newfoundland Power's interest coverage compare to other regulated utilities with similar credit ratings?

A. Exhibit PGH-11 shows the interest coverage ratios for regulated businesses for the period 1992 to 1996 as calculated by both CBRS and DBRS.

The coverage ratios for Newfoundland Power throughout this period are comparable to both the average for electric utilities and the average for all investor owned utilities.

Q. Please explain why Newfoundland Power's interest coverage has decreased from 2.9 in 1992 to 2.7 in 1997?

A. The primary contributor to this decrease in interest coverage has been the decrease in return on equity in relation to the embedded cost of debt. The embedded cost of debt refers to the weighted average interest rate of all debt.

Exhibit PGH-12 shows that the Company's embedded cost of debt has decreased from 9.7% in 1992 to 9.4% in 1997 while returns on equity have decreased from 13.5% to 11% over the same period. The significant reduction in the difference between the embedded cost of debt and the return on equity has reduced interest coverage. The effect of this decrease was mitigated by an increase in the effective tax rate.

Q. Please describe the relationship between interest coverage, capital structure, and return on equity.

A. The relationship between interest coverage, capital structure, and return on equity is an arithmetic one.

The higher the debt component in a capital structure, the greater the interest expense. As the interest expense increases, net income declines. The result of this dynamic is a decrease in the interest coverage ratio.

A higher rate of return on equity creates increased income which results in a higher interest coverage.

Exhibit PGH-13 shows the interest coverage ratios for Newfoundland Power over a range of common equity ratios and allowed returns on common equity.

Exhibit PGH-13 illustrates that a common equity ratio of 40% or less places the Company's interest coverage ratio at 2.4 or less at returns on equity of up to 11%. Returns on equity of less than 10.50% combined with common equity of 40% results in interest coverage of 2.3 or less. Allowed returns in the range of Drs. Waters and Winter's recommendations of 8.25% to 9.00% would result in interest coverages of 2.2 or less.

Q. Could you explain the relationship between interest coverage and the effective tax rate?

A. The relationship between interest coverage and the effective tax rate is also arithmetic.

A company's interest expense, preferred dividends, income tax expense, and the return on common equity are added together to form the numerator of the interest coverage ratio. The denominator is the interest expense. Therefore, an increase in income tax in relation to both return on common equity and interest expense results in an increase in the interest coverage ratio. Simply stated, as the numerator increases, the ratio increases.

It is important when comparing the interest coverage ratios of various utilities to also consider the effective tax rates of those companies. Generally, companies with higher effective tax rates will have higher interest coverage ratios.

The capital markets will tolerate lower interest coverage ratios in companies which have lower effective tax rates. However, the rating agencies, and the marketplace, expect interest coverages to increase as effective tax rates increase.[8]

8 Dominion Bond Rating Service, The Electric Utilities Industry in Canada, February 1998.

Q. How would you compare the interest coverages of Nova Scotia Power, B.C. Gas Utility and Newfoundland Power?

A. Because of the differences in effective tax rates, the appropriate method of comparing these ratios would be to compare the after tax interest coverage.

Due to the lower effective tax rates of Nova Scotia Power and B.C. Gas Utility, the difference between their before tax and after tax interest coverage is relatively small. For Nova Scotia Power the before and after tax interest coverage are both 1.7. For B.C. Gas Utility the before tax coverage is 1.9 and the after tax coverage is 1.8.

Newfoundland Power's after-tax interest coverage of 2.0 is comparable to those utilities' ratios. As illustrated in Exhibit PGH-13, page 3 of 3 Newfoundland Power requires common equity in the upper end of the range of 44 - 45% to remain comparable on this measure.

Q. What is the appropriate interest coverage ratio for Newfoundland Power?

A. The Company's interest coverage ratio for 1996 and 1997, as shown in Exhibit PGH-10, page 1 of 3 was 2.7. The pro-forma interest coverage ratio for 1998 is also 2.7.
In Order No. P.U. 7 (1996-97) the Board found that an interest coverage level of 2.7 to be appropriate for the test year 1997. We believe that an interest coverage ratio of 2.7, in line with our current interest coverage ratio, should be sufficient to maintain the Company's creditworthiness.

CBRS has stated that interest coverage in the range of 2.0 to 3.2 is required by A rated utilities to maintain this credit rating.[9] In their most recent report on Newfoundland Power, which was filed in response to Information Request DMB-9, CBRS has stated that financial ratios toward the upper end of their range of financial benchmarks are necessary to maintain the Company's good quality credit standing.

The current interest coverage of Newfoundland Power is consistent with that of other A rated utilities. An adjustment that results in coverage below those of other utilities could lead to a downgrading of the Company's debt. We have discussed this matter with CBRS. Their comments on the matter are contained in the letter attached as Exhibit PGH-14.

For these reasons we believe that an interest coverage ratio of 2.7 continues to be appropriate for Newfoundland Power.

Q. What should Newfoundland Power's common equity ratio be to maintain an appropriate interest coverage ratio?

A. Exhibit PGH-13, page 1 of 3 demonstrates that the Company requires a common equity ratio of between 44 - 45% to maintain an interest coverage ratio of 2.7 .

9 Canadian Bond Rating Service, Summer 1994, Appendix IV.

(d) Capital Structure Proposal

Q. What is the appropriate capital structure for Newfoundland Power?

A. We believe the appropriate capital structure of Newfoundland Power is:

Debt	55 - 60%
Preferred Equity	0 - 2%
Common Equity	40 - 45%

The appropriateness of Newfoundland Power's common equity ratio was reaffirmed by the Board in 1996 in Order P.U. 7 (1996-97). Since the issuance of the order, there has been no change in conditions or circumstances affecting Newfoundland Power sufficient to warrant an adjustment to its common equity ratio. The credit rating reports on Newfoundland Power available at the time of the 1996 hearing rated the Company as "A stable", and there has been no change in the rating since that time.

The analyses of the Company by the rating agencies have not changed since 1996. The rating reports still refer to the strong financial position of the Company as a positive factor, and mention the weak Newfoundland economy, small size, low rate base growth and the sensitivity of sales to a competitive heating market as negative factors. DBRS, in their March 1998 report, qualify the statement on the weakness in the Newfoundland economy with a statement that it is expected to improve over the long term. However, as

indicated earlier, this will have only a slight impact on the Company's sales and relative business risk.

A common equity ratio approaching 45% is required to offset the higher business risks faced by the Company. Also, the small size of the Company and the competitive nature of the energy retailing business warrant a higher equity component than many other Canadian utilities. There has been no significant reduction in the Company's business risks that would warrant a weakening of its capital structure. In summary, this level of equity is needed to ensure the Company maintains its current bond rating.

5. RETURN ON COMMON EQUITY

(a) General

Q. What is the rate of return on common equity?

A. The return on common equity is the measure of the compensation paid by a company to those investors who hold the company's common equity. Return on common equity is the annual amount of money earned by a company expressed as a percentage of book equity.

Q. What are regulated and non-regulated returns on common equity?

A. Newfoundland Power's regulated rate of return on common equity and non-regulated rate of return on common equity are different.

The Company's regulated and non-regulated returns on common equity for 1996 and 1997 were as follows:

	1996	1997
Regulated Return on Common Equity	11.21%	11.16%
Non-Regulated Return on Common Equity	10.90%	10.99%

The primary reason for the differences between the regulated and non-regulated returns on equity indicated above is the use of deemed dividends when the common equity ratio is above 45%. Furthermore, non-regulated expenses, which are expenses attributed directly to the shareholders, are not included in the regulated earnings of the Company. These non-regulated expenses also serve to increase the regulated common equity of the Company for regulatory purposes.

Q. Is Newfoundland Power's return on common equity comparable to other regulated utilities?

A. Exhibit PGH-15 shows the earned returns on common equity for Canadian investor owned utilities for the period 1992 to 1997.

Newfoundland Power's return on common equity was comparable to those of other electric utilities throughout this period.

It is becoming increasingly difficult to compare rates of return on common equity because of the significant influence of non-regulated earnings and incentive rates in many Canadian jurisdictions. Reported earnings often include non-regulated earnings or expenses which may not be considered in regulatory practice.

The introduction of incentive rate mechanisms and settlement processes permit some utilities to earn higher rates of return than those established through the regulatory process. Furthermore, some utilities have the potential to earn more because of earnings from non-regulated activities.

Exhibit PGH-16 shows the allowed rates of return on common equity for a number of Canadian electric and gas utilities for the period 1996 to 1998. A comparison of allowed returns and earned returns on common equity can be made by reference to Exhibit PGH-15.

(b) Adjustment Formulas

Q. Please comment on annual adjustment formulas for returns on common equity?

A. The use of an annual adjustment formula to establish the allowed return on common equity is becoming popular with Canadian regulators. Such adjustment mechanisms are being used in British Columbia, Manitoba, Ontario, and by the National Energy Board (the "NEB"). The use of a formula has the potential to reduce regulatory costs and mitigate regulatory lag. Based on Canadian experience, and subject to a formula that produces returns comparable to Canadian utilities of similar risk, the Company endorses the use of a formula for adjusting the rate of return on equity.

Q. Is the use of a formula the best approach to the long-term regulation of Newfoundland Power's tolls and charges?

A. An appropriate formula may be an acceptable approach. However, we see it as only the first step toward establishing incentive rates.

The experience in other jurisdictions has been that incentive rates and negotiated multi-party settlements are a better way of setting tolls while achieving a fair return on common equity. Westcoast Energy, Interprovincial Pipeline, and West Kootenay Power are a few of the regulated companies that have moved toward incentive rates and negotiated settlements in their rate-making.

Newfoundland Power and the regulatory process in Newfoundland have not yet progressed to a stage where incentive rates and negotiated settlements are possible. Experience with a formula rate of return on equity could contribute to the advance of regulation in this direction, to the long-term benefit of our customers and investors.

Q. How important is comparability in the consideration of formulas?

A. In their Draft Guidelines on A Formula-Based Return On Common Equity For Regulated Utilities, dated March 1997, the Ontario Energy Board ("OEB") stated that, "[t]he resulting ROE should not compromise the utility's financial integrity and should be consistent with the returns being earned by other regulated utilities of similar risk."

Newfoundland Power agrees that consistency and comparability are important considerations in establishing a formula. The BCUC also clearly viewed consistency as important when they amended the formula used to set rates of return on common equity in British Columbia to one that is more consistent with those used by the NEB and The Public Utilities Board of Manitoba.

The allowed rates of return established by these formula are consistent and comparable and thereby contribute to stability in the market place. To move outside of these established formula with a mechanism that establishes rates of return on equity that are well below the average allowed rates for comparable utilities would be viewed negatively

by the capital markets and would permanently place our ability to raise capital at a disadvantage.

Q. How would a formula-adjusted rate of return on common equity affect Newfoundland Power's interest coverage requirement?

A. A rate of return on common equity which is sensitive to interest rates is noted as a challenge in the most recent DBRS bond rating report on Newfoundland Power.[10]

The risk of a formula to earnings and interest coverage arises as a result of variability of earnings in relation to a company's embedded interest costs. Under a formula approach, allowed earnings are subjected to adjustments in response to annual forecasts of bond yields, while finance costs are generally fixed and respond more indirectly to interest rate changes. This reliance on long-term bond forecasts will create some variability in both earnings and interest coverage. This influence is heightened for smaller companies with slow growth in earnings. However, the markets now have some experience with the formula approach, and we believe that a formula that is consistent with those currently in use will be considered an acceptable risk in the capital markets.

Given Newfoundland Power's small size, low growth, and non-diversified earnings, we believe that any significant decrease in the Company's earnings and coverage ratios

[10] Dominion Bond Rating Service, March 17, 1998.

caused by a formula or method not consistent with other formulas currently in use, would be seen as a weakening of the financial integrity of the Company.

(c) The Company's Experts

Q. Please comment on the evidence of the Company's expert witnesses.

A. The evidence of both Dr. Morin and Ms. McShane provide a sound analysis of the Company's comparative business risks and a thorough discussion of the factors that influence the Company's cost of capital. Both provide a fair assessment of the Company's business risk profile in comparison to comparable Canadian utilities and Dr. Morin explicitly quantifies this in his risk premium. Each expert employs their own preferred methodologies for analyzing the North American capital markets.

Because of the differences in the respective methodologies, the recommendations of Dr. Morin and Ms. McShane are slightly different. Dr. Morin's recommendation of an allowed return on common equity of 10.75% lies between the earned returns of comparable Canadian utilities and the allowed returns awarded by regulators using formula adjustment mechanisms, and is toward the upper end of the allowed returns that have been awarded by Canadian regulators. However, given Newfoundland Power's higher than average risk profile, this is a fair recommendation.

Ms. McShane's recommendations are consistent with the actual returns earned by Canadian utilities with rates of return regulated by automatic formula adjustment mechanisms. The average earned rate of return on common equity of Canadian electric utilities in 1997 was 11.7% (see: Exhibit PGH-15, page 1 of 2). Gas distribution utilities earned, on average, a rate of return of 13.1%. If the average decline in allowed returns for 1998 that is apparent in Exhibit PGH-16 results in a similar decline in average earned returns, the earned returns for 1998 will, on average, still be above 11 percent. Because Ms. McShane's recommendations reflect the earned returns of regulated utilities, we believe they are representative of the true expectations of the capital markets.

Q. How would Ms. McShane's recommendations impact on the Company's interest coverage?

A. As shown in Exhibit PGH-17, Ms. McShane's mid-point recommendation would place the Company's interest coverage at 2.7 times, a level consistent with its current coverage ratio and within the range of the coverages of comparable Canadian utilities.

Q. How would Dr. Morin's recommendations impact the Company's interest coverage?

A. Dr. Morin's midpoint recommendation of 10.75 would also place the Company's interest coverage at 2.7 times, as shown in Exhibit PGH-18.

(d) Rate of Return Proposal

Q. What does Newfoundland Power propose as an appropriate rate of return on common equity for 1998?

A. An appropriate rate of return on common equity must, first and foremost, enable the Company to maintain its current sound credit rating. This Board determined in Order No. P.U. 7 (1996-97) that interest coverage of 2.7 times was appropriate for the 1997 test year.

Investors will assess Newfoundland Power in comparison to other Canadian utilities. Therefore, an appropriate rate of return on common equity is one that is comparable to the allowed returns on common equity of other Canadian utilities of similar risk. Exhibit PGH-16 shows that the 1998 allowed returns on common equity for Canadian utilities range between 9.91% and 10.75%. Newfoundland Power believes an appropriate rate of return on common equity is within this range.

Newfoundland Power also believes that the past practice of this Board in establishing an allowed range of return on common equity should be maintained. A range provides an incentive for improved operational efficiency and cost minimization. Including an efficiency incentive in the rate of return is supported by the Company's expert witnesses and also reflects the range incorporated in the return on common equity recommended by Drs. Waters and Winter. It is also in keeping with the regulatory trend towards incentive

rate-making, which is becoming particularly evident in utilities regulated by formula adjustment mechanisms. To provide a meaningful incentive component and to reflect current regulatory trends, the Company proposes that the range be expanded from the Board's current practice of a 50 basis point range to a range of 75 basis points.

The Company believes that an appropriate rate of return should reflect the fundamental principle that customers should pay the least cost consistent with safe and reliable electrical service. The Company therefore proposes a range for its allowed return on common equity of 10.00 to 10.75%, with a mid-point for rate-setting at 10.375%. Implementation of the Company's proposed rate of return will provide the ratepayer with a tangible reduction in rates that reasonably reflects the significant movement in long-term interest rates.

Finally, as can be seen from Exhibit PGH-19, this proposal would also allow the Company an opportunity to earn within the range recommended by its expert witnesses, and the opportunity to achieve an interest coverage of 2.7 times, which the Company believes will be sufficient to maintain its current A credit rating.

Q. What is the Company's position on an annual adjustment mechanism?

A. The Company believes that the adoption of an annual adjustment mechanism based upon a 75% change in return on common equity for corresponding changes in forecast 30 year

long Canada bond yields and as supported by Ms. McShane and Dr. Morin would be appropriate.

6. FREQUENCY OF A FULL COST OF CAPITAL REVIEW

Q. What are your general views on full cost of capital reviews?

A. Full cost of capital reviews are expensive and time consuming. The reduction in this expense and time is a chief justification for adopting an automatic adjustment formula for return on common equity. Accordingly, the timing of full reviews of cost of capital should not result in simply adding back the expense and time that was intended to be saved by formula adoption.

Economic circumstances generally and the circumstances of Newfoundland Power specifically are subject to unpredictable change. This reality makes it imprudent to adopt an automatic adjustment formula without making proper allowance for these uncertainties.

Q. How frequently should a full cost of capital review be conducted by the Board?

A. We believe that there is no persuasive reason to predetermine the need for a full cost of capital review simply because of a change in interest rates.

We accept that a large change in interest rates might result in a change in economic conditions such that a review would be appropriate as suggested by Ms. McShane and Drs. Waters and Winter. However, changes in interest rates alone may not warrant a review. We note that neither the NEB nor the OEB have set such triggers and the BCUC's trigger interest rate is quite high.

Dr. Morin's recommendation of a 5 year trigger seems reasonable from the perspective that economic unpredicatibility may well result in a review being necessary by 2003. Five year reviews are also part of the Board's practice in matters of depreciation and engineered operations.

In summary, the Company's position is that a full cost of capital review should be held within 5 years or upon a change in circumstances before that time which are shown to justify a review. Such a change in circumstances could include a change in economic conditions caused by an increase in interest rates.

7. DRS. WATERS AND WINTER'S RECOMMENDATIONS

Q. Please comment on the recommendations of Drs. Waters and Winter.

A. The recommendation by Drs. Waters and Winter of an allowed rate of return on common equity for 1998 in the range of 8.25% to 9.00% on an allowed common equity of 40% is well outside the awards of Canadian regulators.

Furthermore, their recommended adjustment mechanism applying a one-to-one change in allowed return on equity in response to changes in the bond yields is not consistent with the adjustment mechanisms in use in other Canadian regulatory jurisdictions.

Drs. Waters and Winter suggest that the interest coverage of Newfoundland Power would not be adversely affected if their recommendations were implemented. In support of this assertion, they show artificially-high interest coverage ratios by applying a deemed preferred dividend to any current common equity above their recommended 40%. This presentation of resulting interest coverage is based on the false premise that common equity holders should be required to accept less than a fair return.

For these reasons, we are of the view that Drs. Waters' and Winter's recommendations are well outside the range of reasonableness, and that they are well outside the expectations of the capital markets.

Q. What would be the impact of Drs. Waters and Winter's recommendations?

A. Exhibit PGH-20 is a financial impact analysis of the recommendations of Drs. Waters and Winter on 1998 Company pro forma results.

The financial analysis outlines the impacts in 2 scenarios. The first presumes that the Company's capital structure remains unchanged and all common equity above 40% is allowed a return on a deemed divided basis of 6%. The second scenario presumes that

the Company would reduce its common equity by special dividends to achieve an average common equity ratio of 40% for 1998.

The real returns on common equity and resulting interest coverages from Drs. Waters and Winter's recommendations are simply unreasonable.

Q. Please comment on the one-to-one adjustment of allowed rate of return proposed by Drs. Waters and Winter?

A. A one-to-one adjustment offers the upside potential of larger returns as interest rates rise. However, the proposed rate of return suggested by Drs. Waters and Winter would place Newfoundland Power's earnings at a disadvantage, with an allowed rate of return significantly below other regulated utilities. If Drs. Waters and Winter's recommendations were followed, a significant increase in long-term forecasted bond yields would have to occur before Newfoundland Power's allowed return would become consistent with other utilities. In fact, the forecasted long-term bond yields would have to be much greater than 8%, which is Drs. Waters' and Winter's suggested trigger point for a review hearing, before the formula would put Newfoundland Power's allowed return on equity at a level consistent with the awarded rates under the NEB formula.

The one-to-one mechanism would also have a negative effect on Newfoundland Power's capital because its mechanics are too direct and they would increase the sensitivity of the Company's earnings to interest rates. As we have already noted, the sensitivity of return

on equity to interest rates has been noted as a challenge by DBRS. The directness of the formula proposed by Drs. Waters and Winter would only heighten this effect. Of equal importance, the sensitivity of the formula to interest rate changes would cause greater fluctuations in customer rates. The formulas used by the other Canadian regulators mitigate the acute sensitivity of earnings and rates to interest rate changes. Newfoundland Power believes that this approach reflects good regulatory judgment, and that it should be incorporated in any formula established as a result of this proceeding.

8. SUMMARY

Q. What is Newfoundland Power's position on the Board's investigation in this matter?

A. The Board's investigation into Newfoundland Power's cost of capital must yield a decision which balances the long-term interests of Newfoundland Power's customers and investors. Customers are entitled to reliable service at the lowest possible cost. Investors are entitled to just and reasonable returns on their investment. For the balance to be fair over the long term, Newfoundland Power must also be able to maintain a sound credit rating in the financial markets of the world.

Q. Please summarize Newfoundland Power's position on the issues raised in the Notice of Hearing.

A. It is Newfoundland Power's position that:

(i) an appropriate capital structure contains an average common equity ratio of 40 to 45%;

(ii) an appropriate return for 1998 is between 10 and 10.75% on average common equity and between 10.03% and 10.40% on average rate base, with a midpoint of 10.375% return on common equity to be used for rate adjustment purposes;

(iii) an annual adjustment mechanism for resetting the rate of return in 1999 and subsequent years be implemented based upon a 75% increase or decrease in the rate of return on common equity for corresponding changes in forecast 30 year long Canada bond yields; and

(iv) the appropriate timing of a full cost of capital review is five years from the Board's decision or upon a demonstrated change in financial conditions or circumstances.

Q. Why is a common equity ratio of 40 to 45% appropriate?

A. The appropriate capital structure is one which enables Newfoundland Power to maintain its creditworthiness in financial markets. With 40 to 45% common equity in its capital structure, Newfoundland Power will be able to maintain sufficient interest coverages at current returns to maintain an A credit rating. Over the long term, maintenance of the Company's current credit rating is in its customers' best interest.

Q. Why is a range of return on common equity of 10 to 10.75% appropriate?

A. An appropriate return to common shareholders is one which is comparable to that earned by investment in companies of comparable risk. Returns on common equity in regulated companies for 1998 are in a range of 9.91 to 10.75%, so the proposed range will result in returns to Newfoundland Power's shareholder being commensurate with investors in other regulated enterprises.

A range of 75 basis points is larger than typically approved by the Board in the past. However, an increase in the range is reasonable at this time in light of regulatory trends towards greater efficiency.

Q. Why is an annual adjustment mechanism based upon a 75% change in return on common equity for corresponding changes in forecast 30 year long Canada bond yields appropriate?

A. Currently in Canada, over 12 utilities are regulated with the assistance of annual adjustment mechanisms which operate on the basis of a 75% or 80% change in common equity for corresponding changes in forecast 30 year long Canada bond yields. These mechanisms have been in use since 1994 and appear to function satisfactorily. Accordingly, it seems sensible that Newfoundland avail of that regulatory experience and avoid being out of step with national practices.

Q. Why is 5 years an appropriate time for a full cost of capital review?

A. One of the chief benefits of an annual automatic adjustment mechanism for resetting rates of return is an overall reduction in regulatory costs. To implement such a mechanism and at the same time schedule full cost of capital reviews every 2 or 3 years seems to run contrary to the principal benefits of the mechanism.

In the case of a fundamental economic change or change in the Company's circumstances, an earlier review could occur upon demonstration of that change.

Q. Do you have any concluding comments?

A. Yes. This hearing presents the Board with some plain choices.

On the one hand, the Board's witnesses Drs. Waters and Winter have recommended an effective cap on the common equity ratio of 40% and a return on equity of between 8.25 and 9%. These recommendations, if accepted by the Board, would result in the return on the Company's common equity in 1998 being substantially less than other regulated utilities. Simply put, an investor in Newfoundland Power would not have the opportunity to earn a return comparable to those earned by investors in companies of comparable risk. If accepted, Drs. Waters and Winter's recommendations would reduce Newfoundland Power's interest coverage to between 2.1 and 2.2 times, which is considerably under the average for electric utilities specifically and regulated utilities generally. Such a

reduction in interest coverage would clearly threaten Newfoundland Power's credit rating. These results are not reasonable nor are they sufficient.

On the other hand, Newfoundland Power recommends a capital structure containing between 40 and 45% common equity and a return on equity of between 10 and 10.75%. These recommendations, if accepted by the Board, would result in the return on the Company's common equity in 1998 being comparable to other regulated enterprises. In addition, the Company's recommendations, if accepted, would permit Newfoundland Power the opportunity to achieve interest coverage of 2.7 times. This would likely enable Newfoundland Power to maintain its current credit rating. These results are fair, reasonable and sufficient.

There is little doubt in Newfoundland Power's view that its customers' service expectations are increasing and will continue to do so. If we cannot meet these expectations, then the quality of life, availability of technology and resulting employment prospects will be jeopardized. For Newfoundland Power to meet those expectations over the long term will require a continued focus on productivity. It will also require the continued financial integrity of Newfoundland Power.

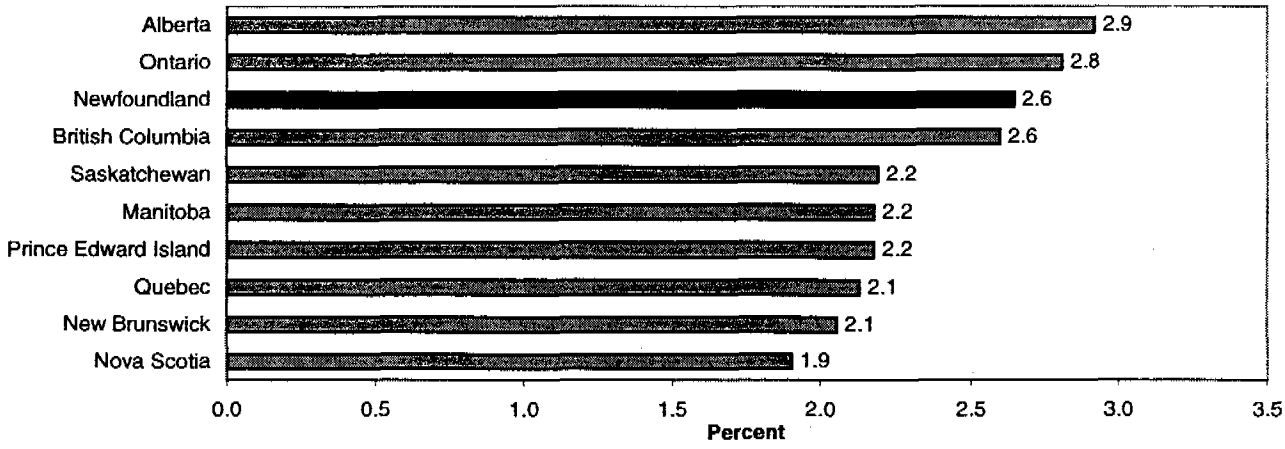
The proposals put forward by Newfoundland Power, if accepted by the Board, will result in electrical cost savings to customers in 1998 which will total approximately $2,500,000.

Q. Does this conclude your testimony?

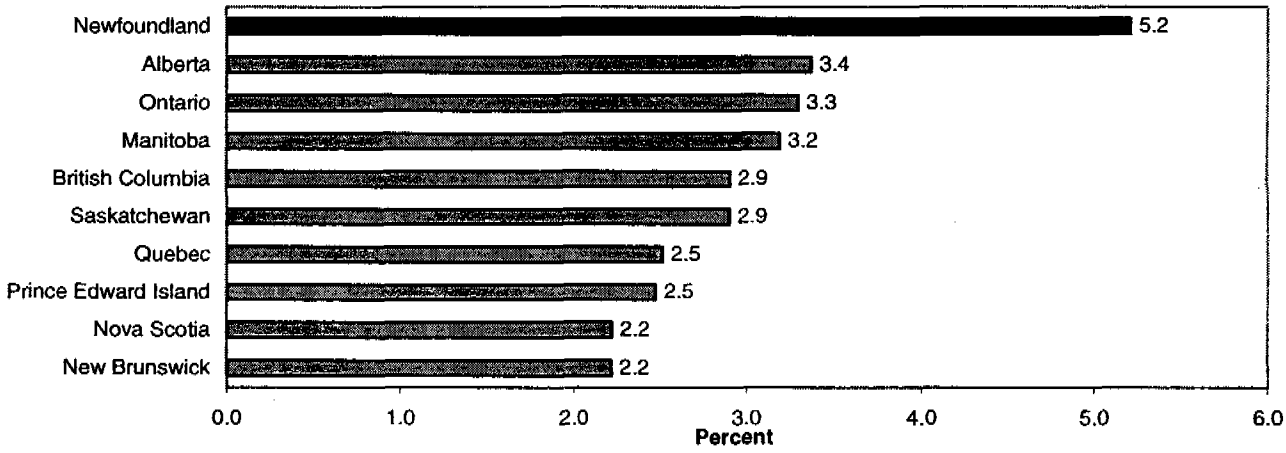
A. Yes it does.

Key Economic Indicators (1997 - 2015)
Gross Domestic Product at Factor Costs (%)
(Constant $ 1986)

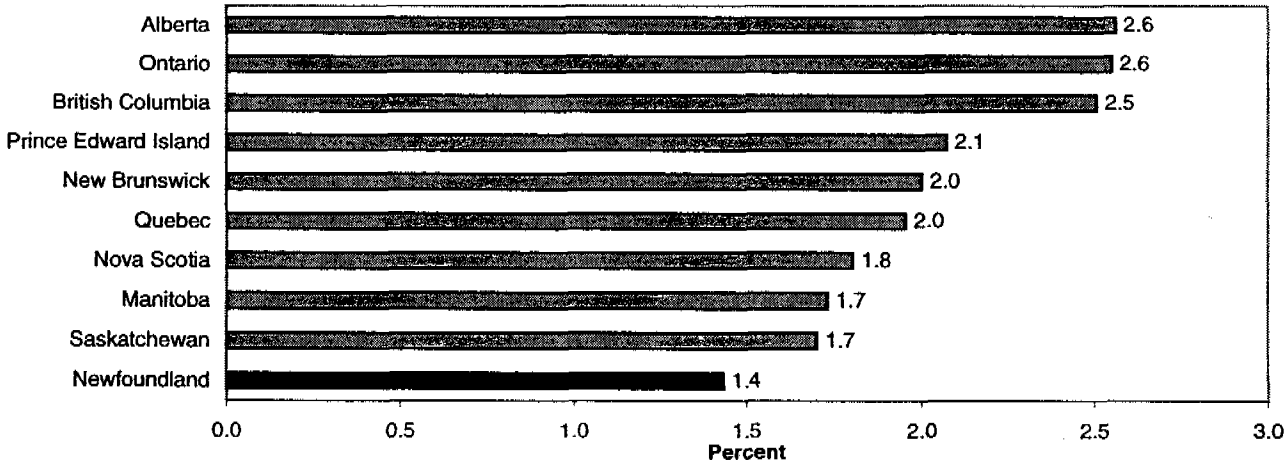
Total of All Industries



Goods Producing Industries



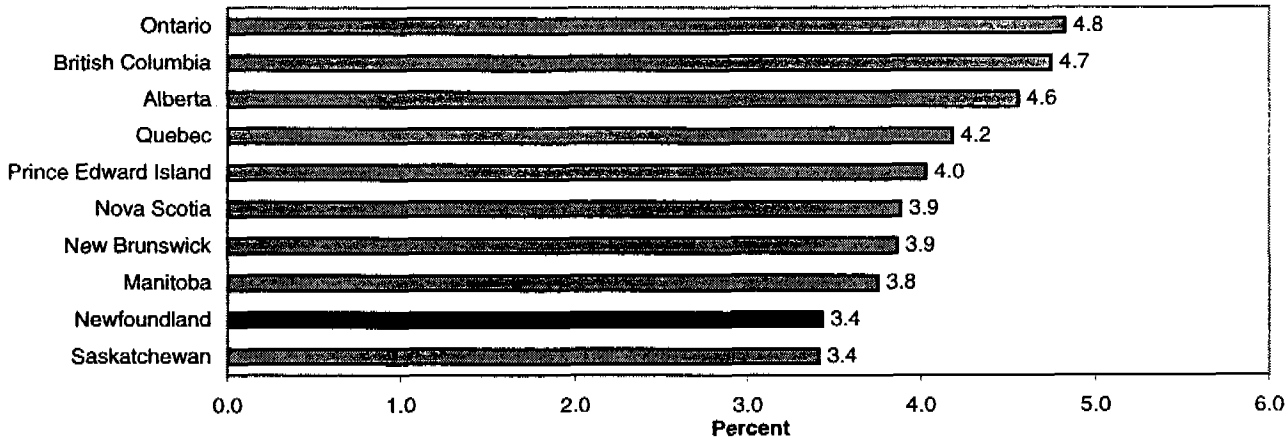
Service Producing Industries



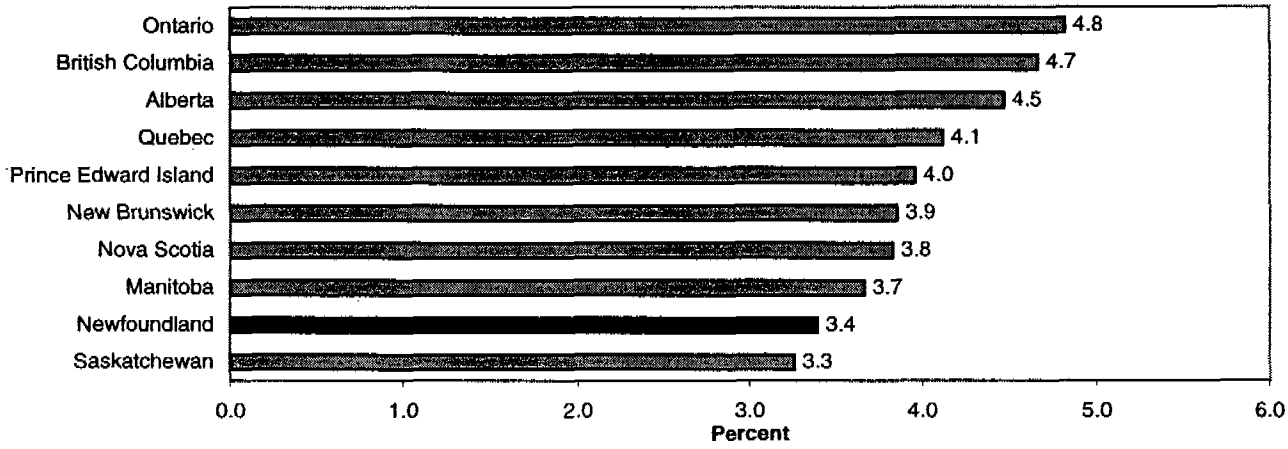
The Conference Board of Canada
Provincial Outlook: Long-Term Forecast - 1998 Edition
Forecast Completed: December 10, 1997

Key Economic Indicators (1997 - 2015)

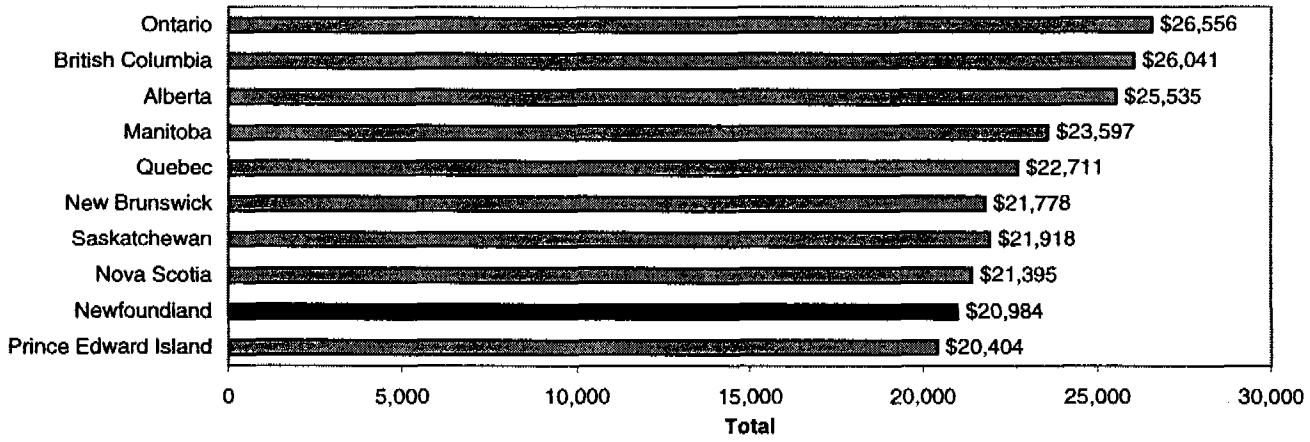
Personal Income
($ current)



Personal Disposable Income
($ current)



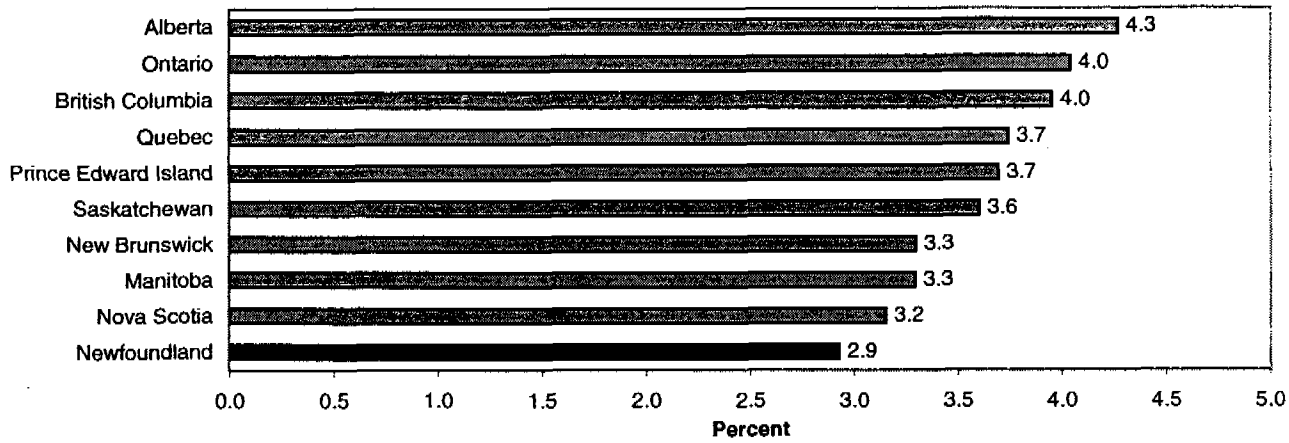
Average Personal Disposable Income Per Capita
($ current)



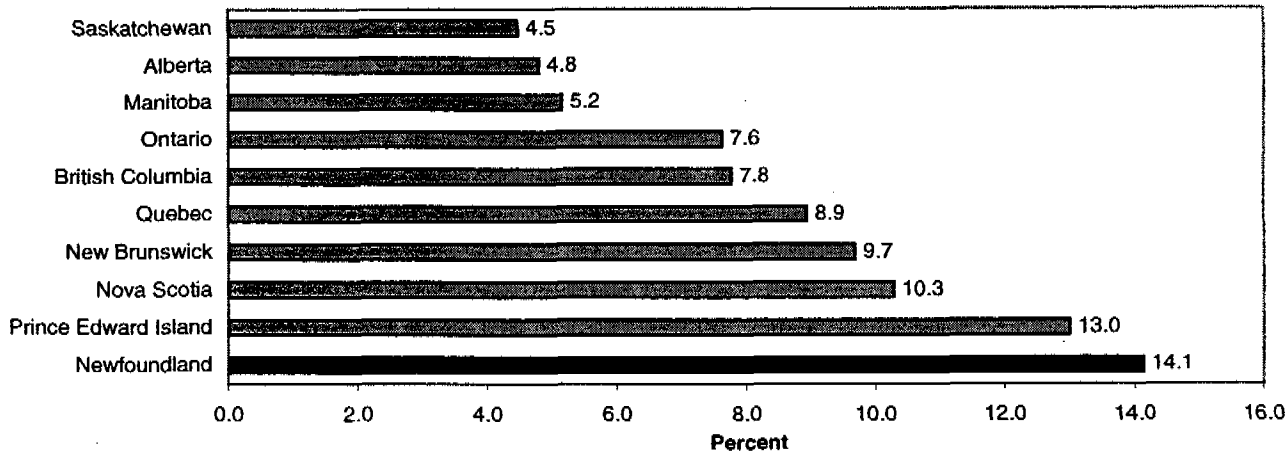
The Conference Board of Canada
Provincial Outlook: Long-Term Forecast - 1998 Edition
Forecast Completed: December 10, 1997

Key Economic Indicators (1997 - 2015)

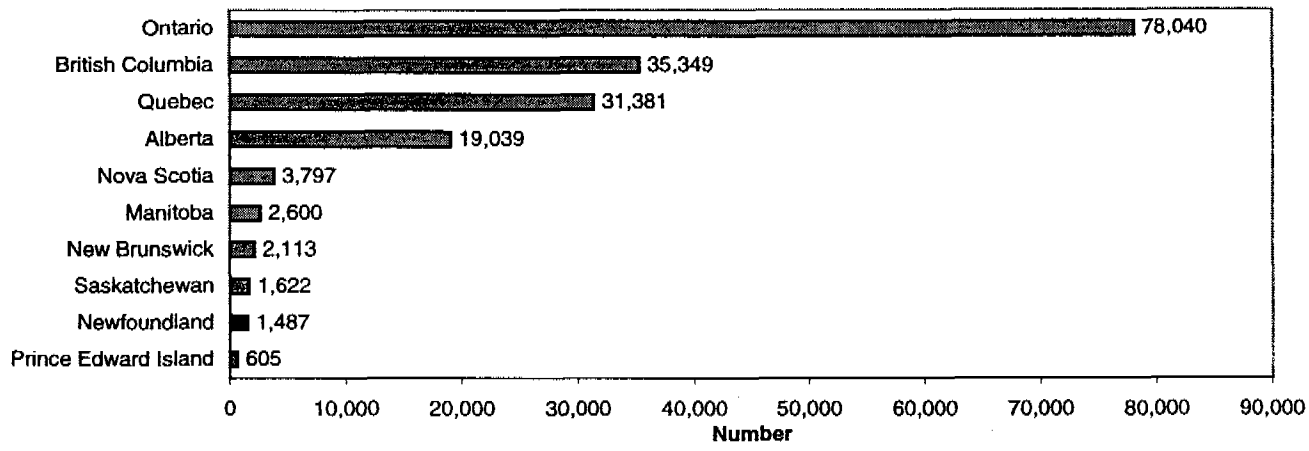
Retail Sales
($ current)



Average Unemployment Rate



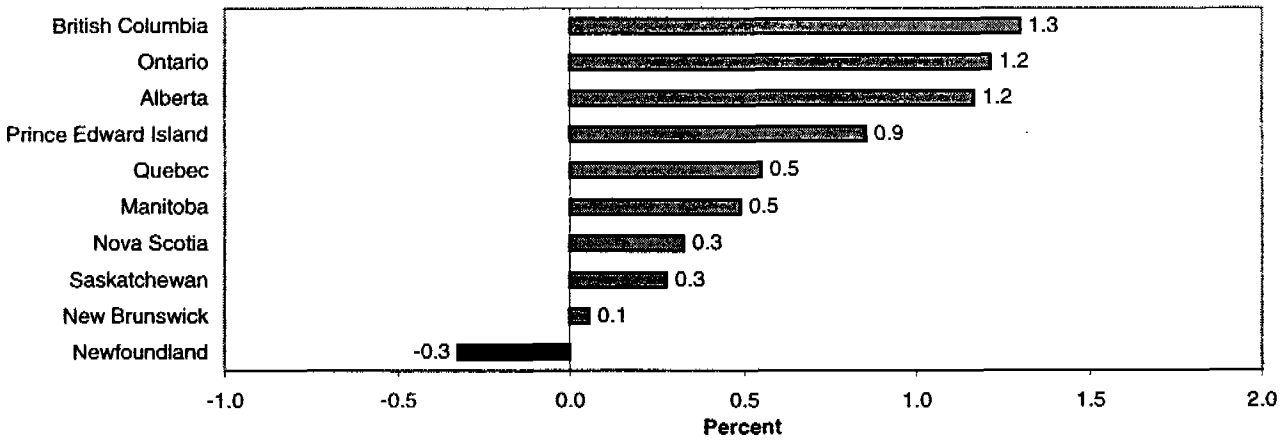
Average Housing Starts



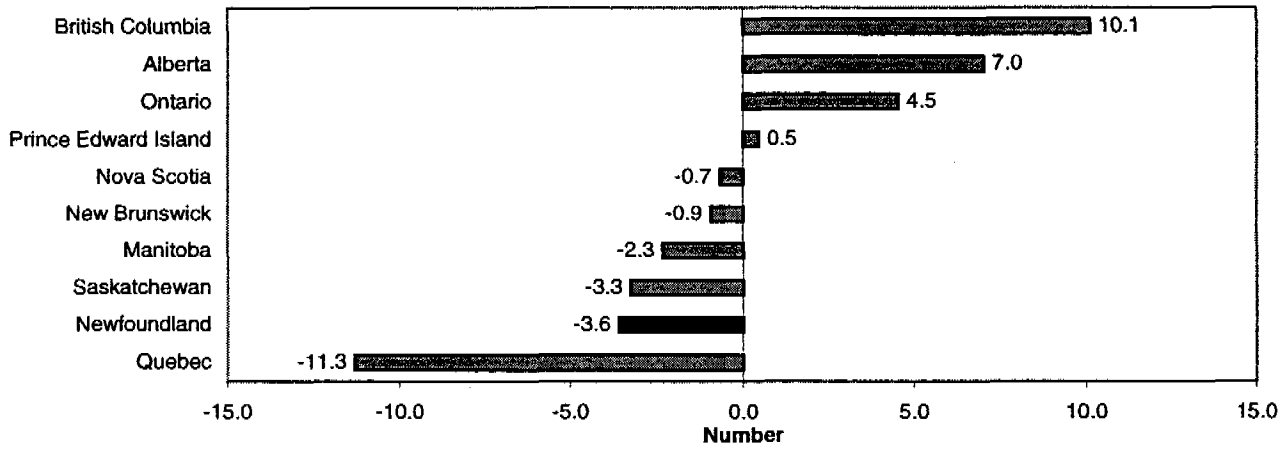
The Conference Board of Canada
Provincial Outlook: Long-Term Forecast - 1998 Edition
Forecast Completed: December 10, 1997

Key Economic Indicators (1997 - 2015)

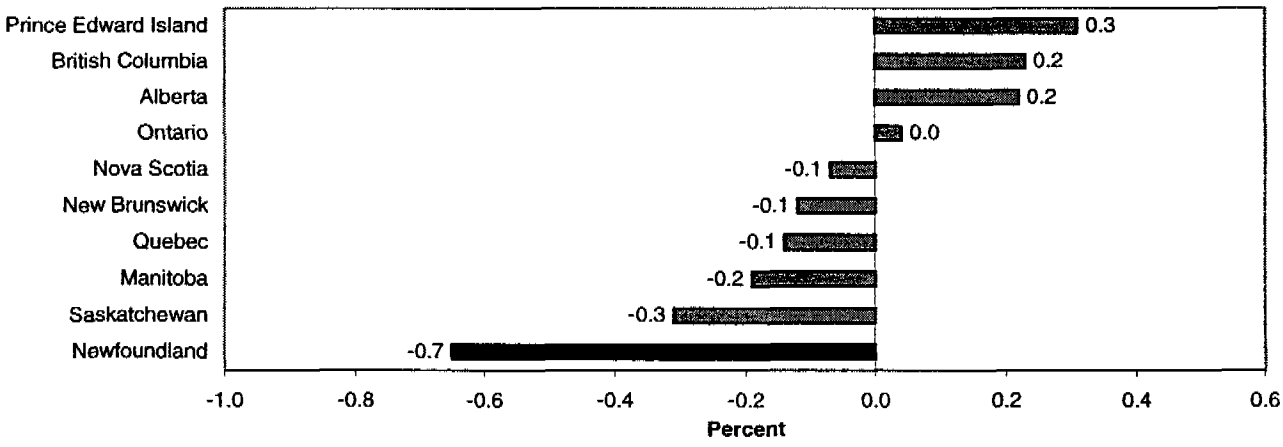
Population



Average Net Inter-Provincial Migration (000's)

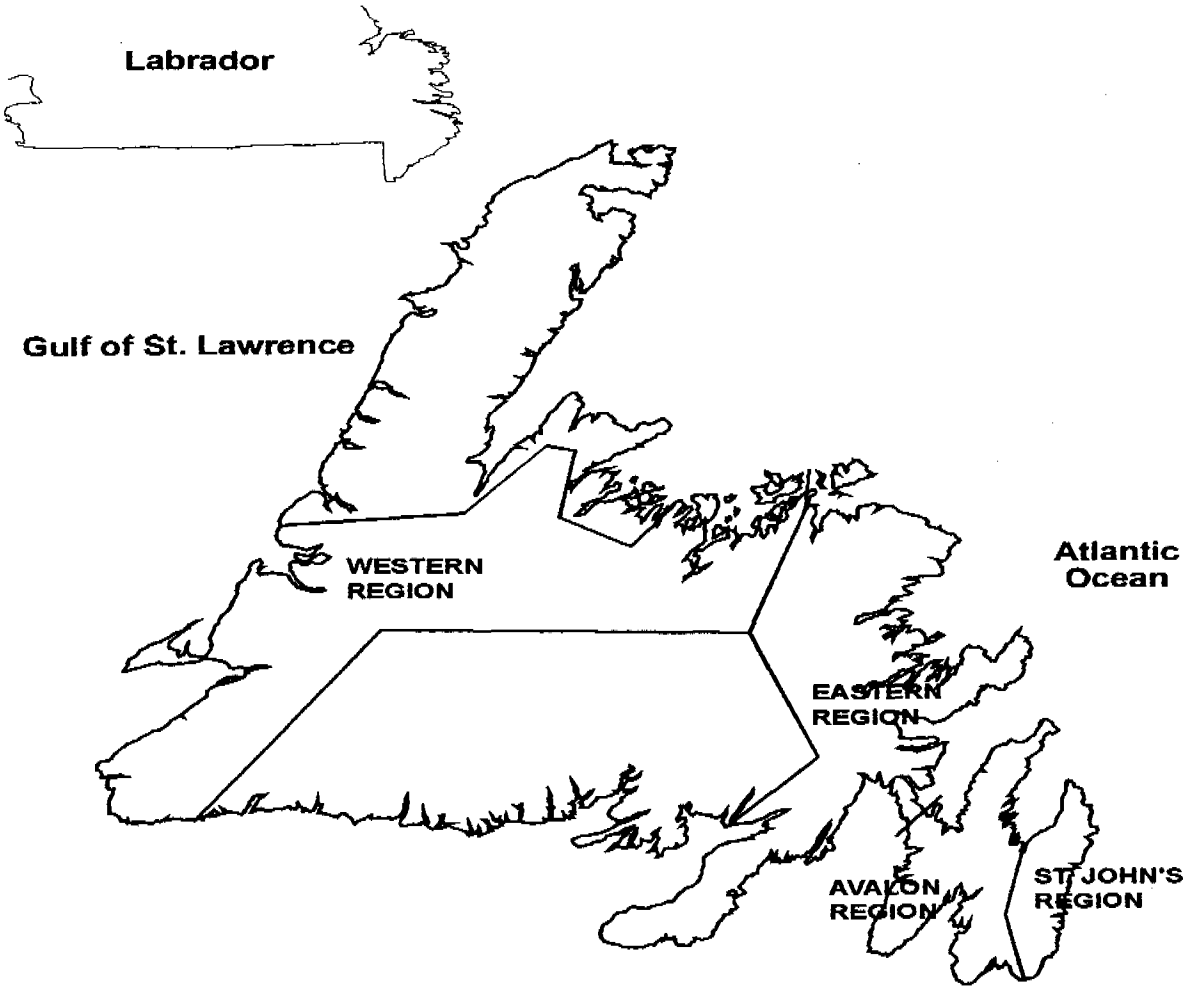


Average Net Inter-Provincial Migration as a Percent of Average Population



The Conference Board of Canada
Provincial Outlook: Long-Term Forecast - 1998 Edition
Forecast Completed: December 10, 1997

Change in Population By Operating Region

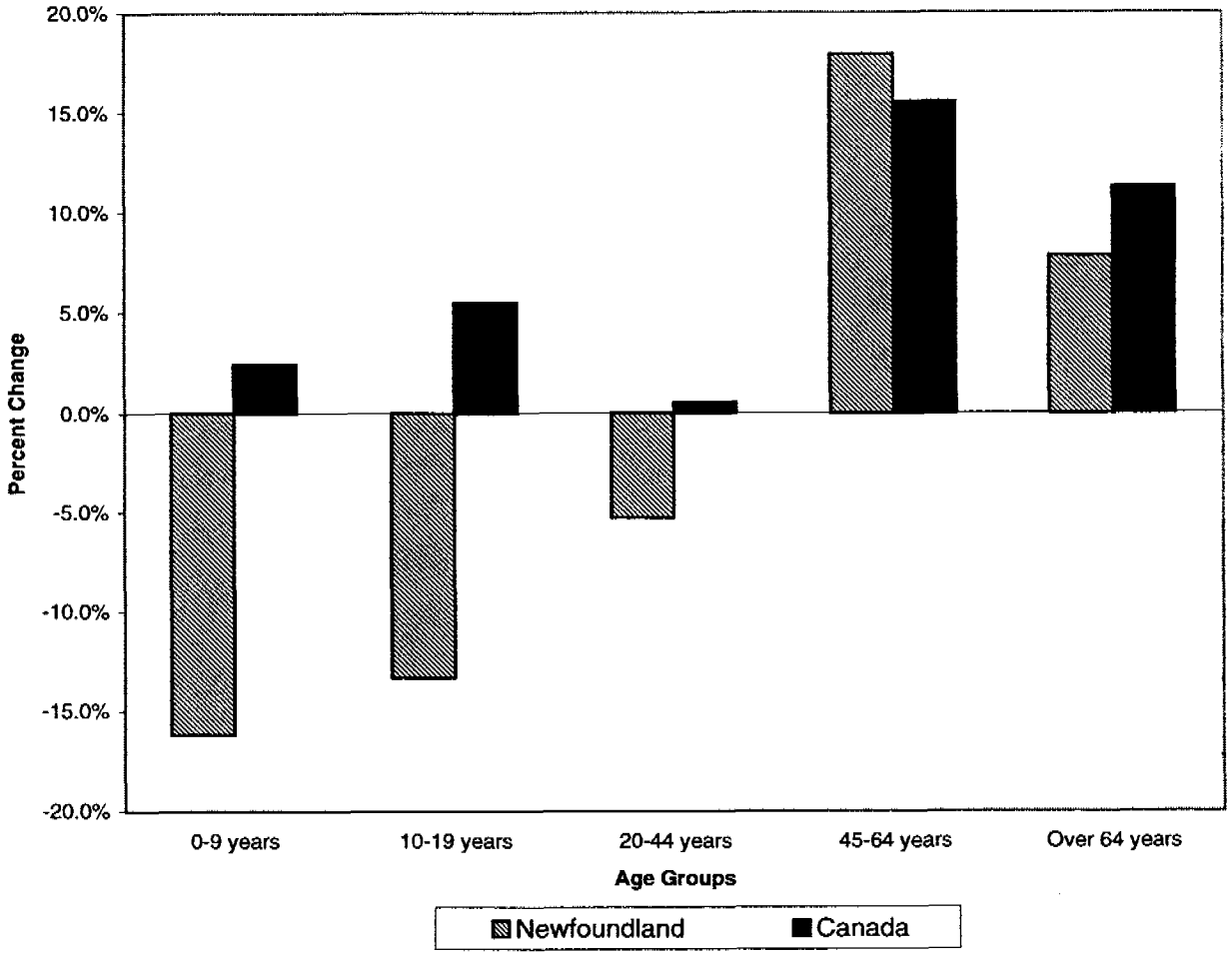


Operating Region	Population 1996	Change in Population 76 - 81	81 - 86	86 - 91	91 - 96
St. John's	183,878	5.9%	4.2%	5.4%	0.7%
Avalon	64,436	2.6%	-0.1%	-3.2%	-4.3%
Eastern	98,723	2.6%	-0.4%	-2.2%	-4.3%
Western	119,870	-2.9%	-2.7%	-2.1%	-4.0%
Total Company	**466,907**	**2.1%**	**0.6%**	**0.5%**	**-2.3%**
Other Areas (1)	84,885	0.1%	-2.4%	-2.2%	-6.3%
Total Province	**551,792**	**1.8%**	**0.1%**	**0.0%**	**-2.9%**

(1) Other areas not serviced by Newfoundland Power (including Labrador).

Source: Statistics Canada, Census Data.

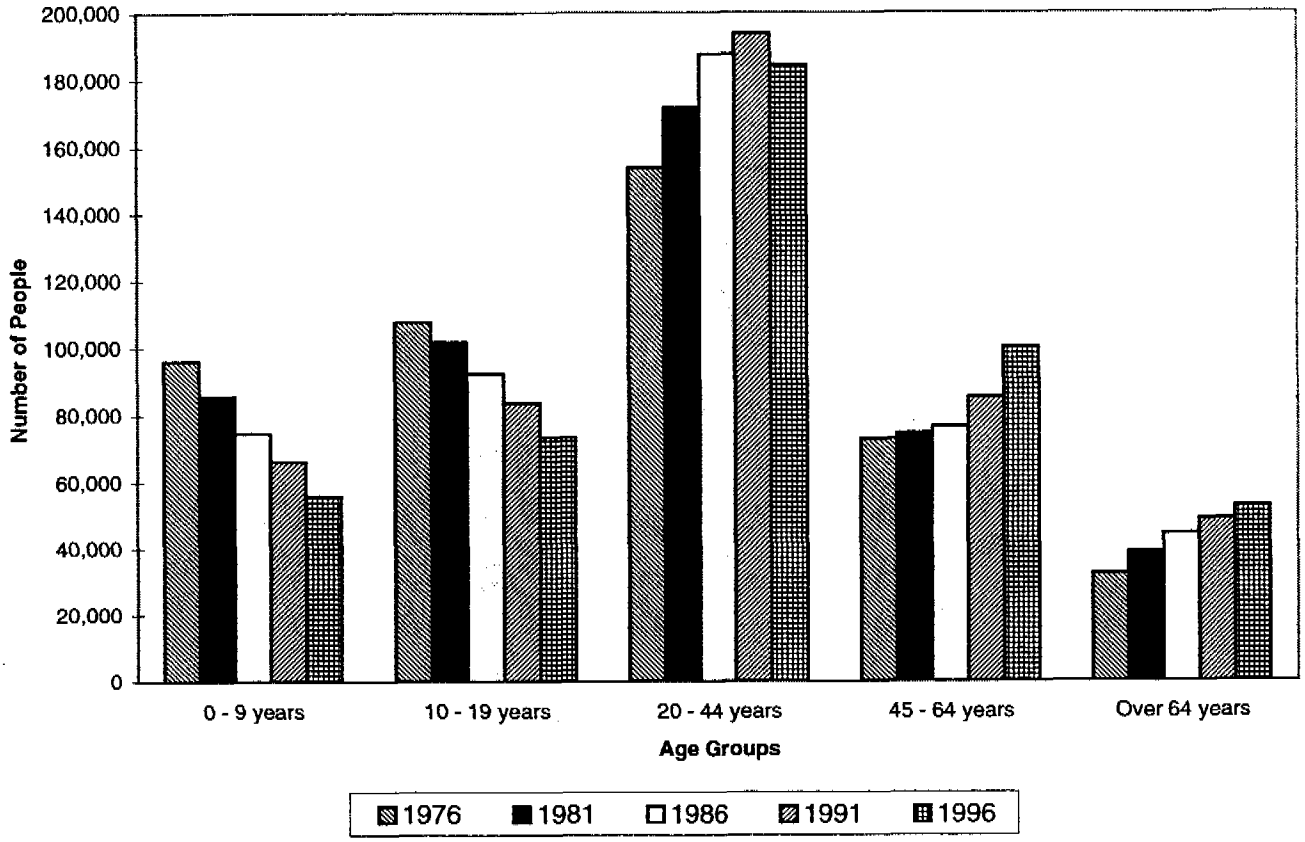
Change in Population By Age Group
Newfoundland Versus Canada



	Newfoundland			Canada		
Age Group	**1991**	**1996**	**Change**	**1991**	**1996**	**Change**
0-9 years	80,350	67,325	**-16.2%**	3,814,540	3,907,840	**2.4%**
10-19 years	101,675	88,105	**-13.3%**	3,746,650	3,952,560	**5.5%**
20-44 years	231,705	219,465	**-5.3%**	11,199,840	11,258,670	**0.5%**
45-64 years	99,580	117,420	**17.9%**	5,365,870	6,199,855	**15.5%**
Over 64 years	55,165	59,470	**7.8%**	3,169,970	3,527,850	**11.3%**
Total	**568,475**	**551,785**	**-2.9%**	**27,296,870**	**28,846,775**	**5.7%**

Source: Statistics Canada, Census Data.

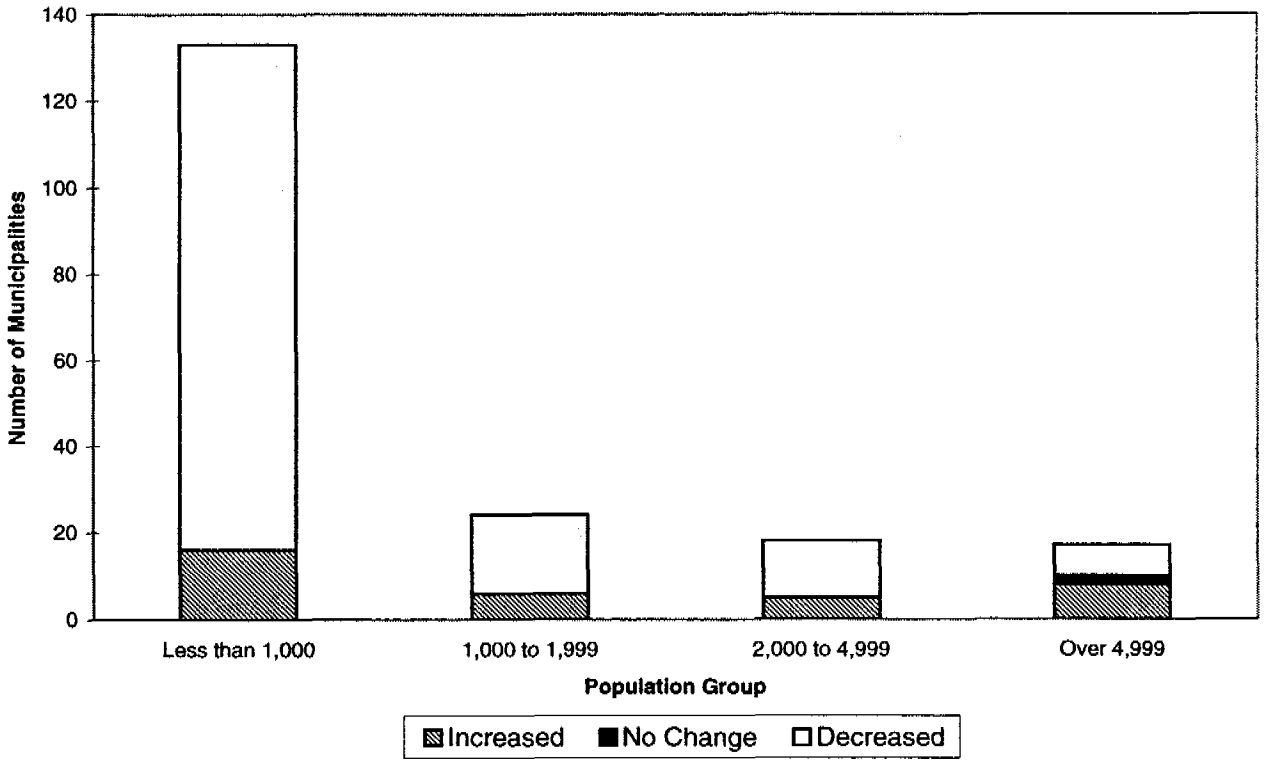
Change in Population By Age Group
Newfoundland Power Service Area



	Newfoundland Power Service Area				
	Population	Population Change			
Age Group	1996	76 - 81	81 - 86	86 - 91	91 - 96
0 - 9 years	55,941	-10.9%	-12.7%	-11.3%	-15.5%
10 - 19 years	73,474	-5.5%	-9.2%	-9.5%	-12.1%
20 - 44 years	184,643	11.7%	9.2%	3.3%	-4.8%
45 - 64 years	100,168	2.3%	2.6%	11.3%	17.6%
Over 64 years	52,681	20.6%	13.8%	10.2%	7.7%
Total	**466,907**	**2.1%**	**0.6%**	**0.5%**	**-2.3%**

Source: Statistics Canada, Census Data

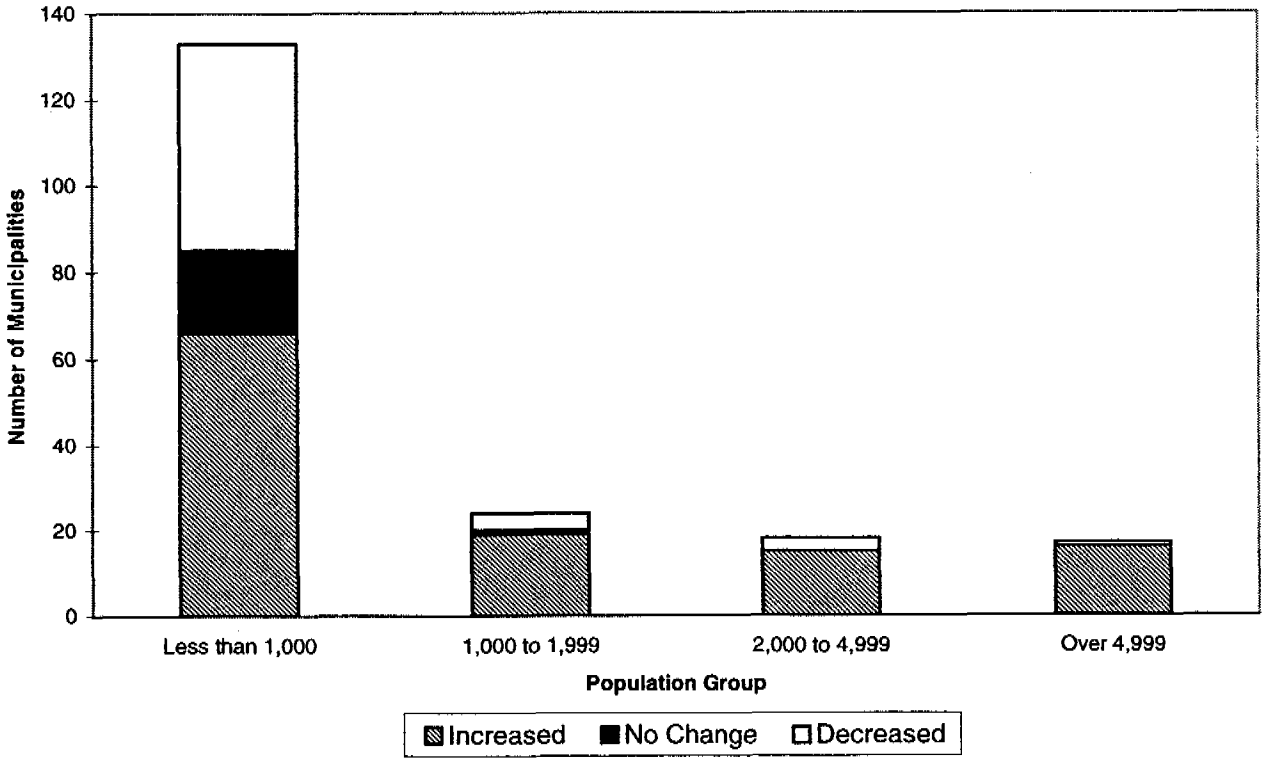
Population Change By Municipality
1991 to 1996



	Population Change by Municipality			
Population Group	**Decreased**	**No Change**	**Increased**	**Total**
Less than 1,000				
Number of Municipalities	117	0	16	**133**
Percent	88.0%	0.0%	12.0%	**100.0%**
1,000 to 1,999				
Number of Municipalities	18	0	6	**24**
Percent	75.0%	0.0%	25.0%	**100.0%**
2,000 to 4,999				
Number of Municipalities	13	0	5	**18**
Percent	72.2%	0.0%	27.8%	**100.0%**
Over 4,999				
Number of Municipalities	7	2	8	**17**
Percent	41.2%	11.8%	47.0%	**100.0%**
Total				
Number of Municipalities	**155**	**2**	**35**	**192**
Percent	**80.7%**	**1.1%**	**18.2%**	**100.0%**

Source: Statistics Canada, Census Data.

Residential Customer Change By Municipality
1997



Population Group	Residential Customer Change by Municipality Decreased	No Change	Increased	Total
Less than 1,000				
Number of Municipalities	48	19	66	**133**
Percent	36.1%	14.3%	49.6%	**100.0%**
1,000 to 1,999				
Number of Municipalities	4	1	19	**24**
Percent	16.7%	4.2%	79.1%	**100.0%**
2,000 to 4,999				
Number of Municipalities	3	0	15	**18**
Percent	16.7%	0.0%	83.3%	**100.0%**
Over 4,999				
Number of Municipalities	1	0	16	**17**
Percent	5.9%	0.0%	94.1%	**100.0%**
Total				
Number of Municipalities	**56**	**20**	**116**	**192**
Percent	**29.2%**	**10.4%**	**60.4%**	**100.0%**

Source: Statistics Canada, Census Data.
Newfoundland Power billing records.

Resource Development: Reality Check

Hibernia oil production in the year 2000 will generate approximately $475 million in real GDP for the Newfoundland economy, or approximately 6 per cent of the provincial total. Normally, a boost of 6 per cent of a total regional GDP will cause tremendous benefits to flow to the region, but that will not be the case for this project. To understand why, recall that GDP at market prices is equal to the sum of all value-added components in the economy, the wages and salaries, profits, capital consumption allowances, and indirect taxes minus subsidies. The $475 million generated by Hibernia will be distributed among the four components as follows:

1. wages and salaries	$40 million
2. profits	$75 million
3. capital consumption cost allowance	$320 million
4. indirect taxes minus subsidies	$40 million

The important question for Newfoundland is: Which of these categories of value added will remain within the province, and which will accrue to the rest of the world? Employment during the production phase is expected to be roughly 800 workers, earning salaries in 1986 dollars of $50,000 annually, which can be expected to remain within the provincial economy. The indirect taxes minus subsidies will consist of natural resource royalties, and will be paid to the provincial government, also remaining in the province. Profits will accrue to the shareholders of the companies involved in the Hibernia consortium, and the capital consumption allowance, the largest component due to the huge capital cost of Hibernia, will accrue to the shareholders of the companies that provided the funding for the project. The extent to which these last two categories remain within the provincial economy will depend on the extent to which residents of Newfoundland are shareholders of the companies involved. It is a safe bet that a very small proportion of the shareholders are actually Newfoundland residents. In the end, we can expect only $80 million out of the total $475 million in real GDP to remain within the local economy. As a result, employment and personal income growth, which is what is important for the average person, will not keep pace with growth in total GDP.

Source: The Conference Board of Canada
Provincial Forecast, Winter 1997 (Page 10)

Newfoundland Power
Other Operating Expenses &
Transfers to General Expenses Capital (GEC)
($ 000's)

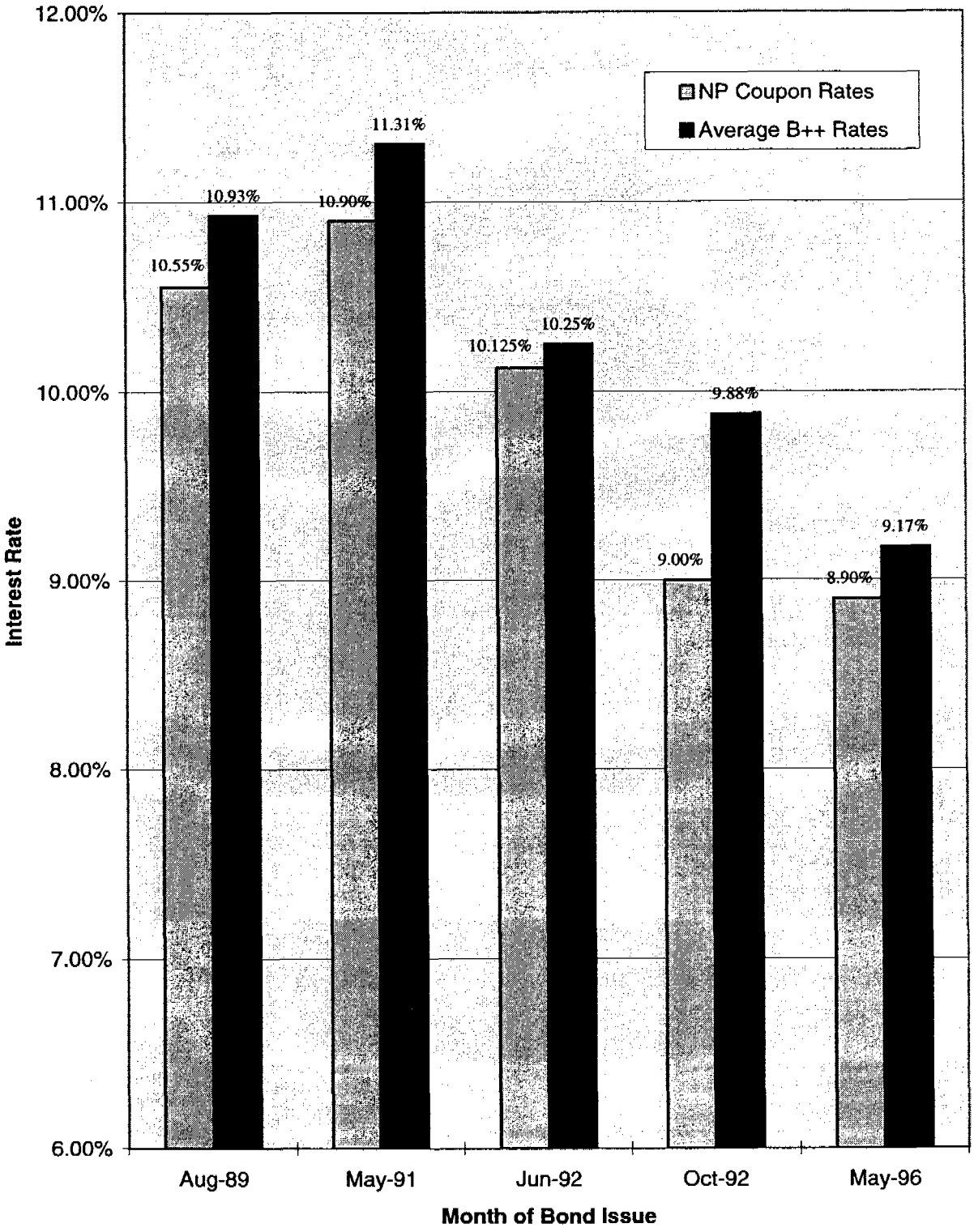
	1995	Pro-Forma 1998	Increase (Decrease) ($)	Increase (Decrease) (%)
Gross Other Operating Expenses (before transfers to GEC)	62,257	56,472	(5,785)	-9.3%
Transfers to General Expenses Capitalized (GEC)	7,392	2,822	(4,570)	-61.8%
Net Other Operating Expenses	54,865	53,650	(1,215)	-2.2%

Newfoundland Power
Calculation of Income Tax Rate
for the years 1993 - 1999

	1993	1994	1995	1996	1997	1998	Pro-Forma 1999
Statutory Income Tax Rate	**44.8%**	**44.8%**	**43.1%**	**43.1%**	**43.1%**	**43.1%**	**43.1%**
General Expenses Capital	-9.2%	-7.3%	-6.4%	-4.1%	-2.6%	-0.9%	-0.1%
Pension Funding > Expense	-1.2%	-1.7%	-11.8%	-2.7%	-4.0%	-4.3%	-0.1%
Deferred Tax	-2.9%	-5.2%	-6.4%	-3.1%	-3.6%	-0.3%	0.0%
Other (Note 1)	7.8%	10.9%	13.2%	8.7%	8.6%	7.5%	8.0%
Effective Income Tax Rate	39.3%	41.5%	31.7%	41.9%	41.5%	45.1%	50.9%
Unbooked Deferred Tax	**$ 76,000**	**$ 78,400**	**$ 84,200**	**$ 85,300**	**$ 86,700**	**$ 86,223**	**$ 83,538**

Note 1 : Other includes timing differences where PUB did not permit the provision of deferred taxes, other permanent differences between accounting and taxable income, Part VI.1 tax where applicable, the difference between large corporations tax and the corporatesurtax included in the statutory rate and any adjustments from a previous year.

A Long-Term Cost of Debt Comparison - Newfoundland Power vs Canadian Utilities Rated B++ by CBRS



Source: CBRS Historic Canadian Bond Yield Averages - Utilities

Newfoundland Power
Issues of Long Term Debt During the Last 10 Years

Issue Date	Series	Coupon Rate	Due Date	Average B++ 30 Year Bonds
Aug-89	AD	10.550%	Aug 01/14	10.930%
May-91	AE	10.900%	May 02/16	11.310%
Jun-92	AF	10.125%	Jun 15/22	10.250%
Oct-92	AG	9.000%	Oct 01/20	9.880%
May-96	AH	8.900%	May 07/26	9.170%

Source: CBRS Historic Canadian Bond Yield Averages - Utilities

Notes: Because the average bond yields are based on the close of the last trading day of each month, the monthly CBRS Average B++ rates used for comparison were as follows:

Series	Date of Issue	Comparable Month Used
AD	1-Aug-89	July, 1989
AE	1-May-91	April, 1991
AF	15-Jun-92	Average of May & June, 1992
AG	1-Oct-92	Sept., 1992
AH	7-May-96	April,1996

Newfoundland Power
Capital Structure Comparisons
Investor Owned Electric Utilities - 1996 Year End
($ millions)

Electric

	Trans Alta Utilities		Newfoundland Power		Maritime Electric		West Kootenay Power		Nova Scotia Power		Average (>1 billion)	Average (<1 billion)
Debt	1,485	47.9%	261	52.5%	72	55.8%	139	58.6%	1,868	63.8%	55.8%	55.6%
Preference Shares	271	8.8%	10	2.0%	-	0.0%	-	0.0%	200	6.8%	7.8%	0.7%
Common Equity	1,343	43.3%	226	45.5%	57	44.2%	98	41.4%	863	29.4%	36.4%	43.7%
Total Capital	3,099	100.0%	497	100.0%	129	100.0%	237	100.0%	2,931	100.0%	100.0%	100.0%
Allowed Common Equity		40.00%		40%-45%		40% (1)		40.00%		33%-35%		
Allowed Preferred Shares		10.00%		3%-6%		0.00%		0.00%		8%-10%		

Notes :
(1) Maritime Electric has a floor legislated on Allowed Equity at 40 %.
(2) For purposes of computing averages, midpoints were used for all utilities having an allowed range.

Newfoundland Power
Capital Structure Comparisons
Canadian Gas Distribution Utilities - 1996 Year End
($ millions)

Gas Distribution

	Consumers Gas Co.		Centra Gas Manitoba		Centra Gas Ontario		Union Gas Ontario		Gaz Metropolitan		Centra Gas Alberta		BC Gas Utility		Average (>1 billion)	Average (<1 billion)
Debt	1,979	68.0%	181	60.5%	553	66.6%	1,620	67.8%	875	54.4%	42	56.0%	1,074	63.8%	63.5%	61.1%
Preference Shares	6	0.2%	-	0.0%	9	1.1%	40	1.7%	-	0.0%	1	1.3%	75	4.5%	1.6%	0.8%
Common Equity	926	31.8%	118	39.5%	268	32.3%	727	30.5%	735	45.6%	32	42.7%	535	31.7%	34.9%	38.1%
Total Capital	2,911	100.0%	299	100.0%	830	100.0%	2,387	100.0%	1,610	100.0%	75	100.0%	1,684	100.0%	100.0%	100.0%
Allowed Common Equity (2)		35.00%		40.00%		36.00%		34.00%		38.50%		41.27%		33.00%		
Allowed Preferred Shares (2)		3.42%		0.00%		1.11%		4.43%		7.50%		0.67%		9.41%		
Gas In Storage		279		24		43		123		83		1		25	142	38
Investment Ratio		*9.6%*		*8.0%*		*5.2%*		*5.2%*		*5.2%*		*1.3%*		*1.5%*	*5.4%*	*4.9%*

Notes :
1) Inventory Investment Ratio : Gas In Inventory/Total Capital
2) Source : CGA Regulatory Subcommittee Table C (December 1997)

Newfoundland Power
Capital Structure Comparisons Less Inventory Investment
Canadian Gas Distribution Utilities - 1996 Year End
($ millions)

Gas Distribution

	Consumers Gas Co.		Centra Gas Manitoba		Centra Gas Ontario		Union Gas Ontario		Gaz Metropolitan		Centra Gas Alberta		BC Gas Utility		Average (>1 billion)	Average (<1 billion)
Debt	1,700	64.6%	157	57.1%	510	64.9%	1,497	66.2%	792	51.9%	41	55.4%	1,049	63.3%	61.5%	59.1%
Preference Shares	6	0.2%	-	0.0%	9	1.1%	40	1.7%	-	0.0%	1	1.4%	75	4.5%	1.6%	0.8%
Common Equity	926	35.2%	118	42.9%	268	34.1%	727	32.1%	735	48.1%	32	43.2%	535	32.2%	36.9%	40.1%
Total Capital	2,632	100.0%	275	100.0%	787	100.0%	2,264	100.0%	1,527	100.0%	74	100.0%	1,659	100.0%	100.0%	100.0%

Notes :
1) Inventory Investment Ratio : Gas in Inventory/Total Capital
2) Source : CGA Regulatory Subcommittee Table C (December 1997)

Newfoundland Power CBRS Interest Coverage Ratios Before Taxes ($000's)			
	1996	1997	Pro Forma 1998
Earnings to Common Shares	$25,144	$24,931	$24,538
Dividends Preference Shares	626	626	626
Income Taxes	18,617	18,105	20,701
Long Term Debt	24,123	25,107	24,443
Less IDC	(256)	(240)	(261)
Other Debt	1,029	722	1,669
Amortization Debt Discount	359	288	232
Adjusted Earnings	**$69,642**	**$69,539**	**$71,948**
Long Term Debt	$24,123	$25,107	$24,443
Other Debt	1,029	722	1,669
Amortization Debt Discount	359	288	232
Interest Expense	**$25,511**	**$26,117**	**$26,344**
Interest Coverage (Adj Earnings / Int Earned)	**2.7**	**2.7**	**2.7**

Newfoundland Power DBRS Net Interest Coverage Ratios Before Taxes ($000's)			
	1996	1997	Pro Forma 1998
Earnings to Common Shares	$25,144	$24,931	$24,538
Dividends Preference Shares	626	626	626
Income Taxes	18,617	18,105	20,701
Long Term Debt	24,123	25,107	24,443
Less IDC	(256)	(240)	(261)
Other Debt	1,029	722	1,669
Amortization Debt Discount	359	288	232
Interest Earned	(1,245)	(928)	(1,200)
Adjusted Earnings	**$68,397**	**$68,611**	**$70,748**
Long Term Debt	$24,123	$25,107	$24,443
Less IDC	(256)	(240)	(261)
Other Debt	1,029	722	1,669
Amortization Debt Discount	359	288	232
Interest Earned	(1,245)	(928)	(1200)
Interest Expense	**$24,010**	**$24,949**	**$24,883**
Interest Coverage (Adj Earnings / Int Earned)	**2.8**	**2.8**	**2.8**

Newfoundland Power DBRS Net Interest Coverage After Taxes ($000's)			
	1996	1997	Pro Forma 1998
Earnings to Common Shares	$25,144	$24,931	$24,538
Dividends Preference Shares	626	626	626
Long Term Debt	24,123	25,107	24,443
Less IDC	(256)	(240)	(261)
Other Debt	1,029	722	1,669
Amortization Debt Discount	359	288	232
Interest Earned	(1,245)	(928)	(1,200)
Adjusted Earnings	**$49,780**	**$50,506**	**$50,047**
Long Term Debt	$24,123	$25,107	$24,443
Less IDC	(256)	(240)	(261)
Other Debt	1,029	722	1,669
Amortization Debt Discount	359	288	232
Interest Earned	(1,245)	(928)	(1200)
Interest Expense	**$24,010**	**$24,949**	**$24,883**
Interest Coverage (Adj Earnings / Int Earned)	**2.1**	**2.0**	**2.0**

Canadian Investor-Owned Utilities
CBRS Interest Coverage Ratios Before Taxes
1992-1996

Company	Ratings: 1st Mtge Bonds	Ratings: L-T Debenture	1992	1993	1994	1995	1996	Avg. 1992 to 1996
Energy Transmission								
TransCan Pipelines	A(high)	A	1.9	1.8	1.8	1.9	2.0	1.9
IPL Energy Inc.		A	2.4	2.7	1.2	1.7	2.1	2.0
Trans Mountain Pipeline		A(low)	2.1	2.4	2.8	2.3	3.4	2.6
Westcoast Energy Inc		A(low)	0.8	1.7	1.7	1.7	1.7	1.5
NOVA Gas Transmission		A(low)	2.1	1.9	1.8	1.6	1.8	1.8
TransQuebec&Maritime Pipe	A(low)		1.6	1.6	1.6	1.9	2.0	1.7
Interprovincial PipeLine		A(high)	2.4	2.6	2.2	2.4	2.5	2.4
Alberta Natural Gas		A	2.7	4.7	3.2	3.6	5.6	4.0
Group Average			2.0	2.4	2.0	2.1	2.6	2.2
Electric								
TransAltla Utilities Corp	A+(high)	A+	3.8	3.9	3.8	3.8	4.0	3.9
Newfoundland Power	A		2.9	2.9	2.9	2.7	2.7	2.8
Nova Scotia Power		A(low)	1.4	1.5	1.6	1.6	1.7	1.6
Maritime Electric Company	B++(high)		3.7	3.6	3.3	3.6	3.1	3.5
Group Average			3.0	3.0	2.9	2.9	2.9	2.9
Gas Distribution								
Consumers' Gas Co Ltd		A	2.2	2.4	2.5	2.0	2.6	2.3
Centra Gas Manitoba		A(low)	2.7	2.8	2.8	3.0	3.4	2.9
Centra Gas Ontario		B++(high)	2.3	2.1	2.0	2.1	2.3	2.2
Gaz Metropolitain	A(high)		2.5	2.5	2.4	2.4	2.5	2.5
BC Gas Utility Ltd		B++	1.4	1.8	1.6	1.8	2.0	1.7
Union Gas Ltd		A(low)			2.2	2.2	2.3	2.2
Pacific Northern Gas		B++	1.9	2.1	2.3	2.1	2.7	2.2
Group Average			2.2	2.3	2.3	2.2	2.5	2.3
Combined Elec & Gas								
Canadian Utilities Ltd		A+	3.0	3.1	2.7	2.8	3.1	2.9
Group Average			3.0	3.1	2.7	2.8	3.1	2.9
Telephone								
Bell Canada		A(high)	3.8	3.4	3.2	2.7	3.1	3.2
BC Tel	A+(high)	A+(low)	3.6	3.8	4.1	3.4	4.1	3.8
Maritime Telegraph & Tel Co.			3.3	3.1	2.5	2.0	2.6	2.7
N.B. Telephone Co Ltd		A+(low)	3.3	3.3	3.2	3.5	3.9	3.4
NewTel Communications Inc.	A		3.1	3.3	3.4	2.8	3.1	3.1
Quebec Telephone	A+(low)	A(high)	3.7	3.9	4.0	3.7	3.9	3.8
Island Telephone Co. Ltd	B++(high)		3.3	3.2	3.1	3.2	3.6	3.3
Group Average			3.4	3.4	3.4	3.0	3.5	3.3
Grand Average			2.6	2.8	2.6	2.5	2.9	2.7

Source: CBRS Credit Analysis

Canadian Investor-Owned Utilities
DBRS Net Interest Coverage Ratios Before Taxes
1992-1996

Company	Ratings: 1st Mtge Bonds	Ratings: L-T Debenture	1992	1993	1994	1995	1996	Avg. 1992 to 1996
Energy Transmission								
TransCan Pipelines	A(high)	A(high)	1.5	1.7	1.8	1.9	2.0	1.8
IPL Energy Inc.		A(low)	2.4	2.7	1.1	1.8	2.3	2.0
Trans Mountain Pipeline		A(low)	2.4	2.5	2.3	2.5	3.1	2.6
Westcoast Energy Inc		A(low)	1.6	1.8	1.6	1.6	1.8	1.7
NOVA Gas Transmission		A(low)	2.0	1.8	1.7	1.5	1.8	1.8
TransQuebec&Maritime Pipe	A(low)		1.6	1.6	1.6	1.9	2.0	1.7
Interprovincial PipeLine			n/a	2.7	2.0	2.6	2.6	2.5
Alberta Natural Gas		A(low)	2.5	3.9	3.1	3.5	5.6	3.7
Group Average			2.0	2.3	1.9	2.2	2.6	2.2
Electric								
TransAltla Utilities Corp	AA(low)	AA(low)	3.6	3.8	3.7	3.8	3.8	3.7
Newfoundland Power	A		3.1	3.1	3.1	2.8	2.8	3.0
West Kooteney Power		BBB(high)	3.0	2.7	2.1	2.6	2.7	2.6
Nova Scotia Power		A(low)	1.1	1.5	1.5	1.7	1.7	1.5
Group Average			2.7	2.8	2.6	2.7	2.8	2.7
Gas Distribution								
Consumers' Gas Co Ltd		A(high)	2.2	2.4	2.5	2.0	2.6	2.3
Centra Gas Manitoba		A	2.7	2.8	2.7	3.0	3.3	2.9
Centra Gas Ontario		A	2.5	2.3	2.1	2.2	2.3	2.3
Gaz Metropolitain	A	A	2.5	2.5	2.4	2.4	2.5	2.5
BC Gas Utility Ltd		A	1.3	1.6	1.5	1.7	1.9	1.6
Union Gas Ltd		A	2.0	2.2	2.2	2.2	2.3	2.2
Pacific Northern Gas		BBB(high)	1.9	2.1	2.3	2.1	2.7	2.2
Group Average			2.2	2.3	2.2	2.2	2.5	2.3
Combined Elec & Gas								
Canadian Utilities Ltd		AA(low)	2.8	3.1	3.2	3.2	3.3	3.1
Group Average			2.8	3.1	3.2	3.2	3.3	3.1
Telephone								
Bell Canada		A(high)	3.8	3.4	3.2	2.7	2.9	3.2
BC Tel	A(high)	A(high)	3.4	3.8	3.9	3.3	4.0	3.7
Maritime Telegraph & Tel Co.	A	A(low)	3.4	3.2	2.6	2.1	2.6	2.8
NB. Telephone Co Ltd		A	3.8	3.7	3.4	4.0	4.6	3.9
NewTel Communications Inc.	A(low)		3.2	3.4	3.4	2.7	3.1	3.2
Quebec Telephone	A(low)	A(low)	3.9	4.2	4.6	4.2	4.2	4.2
Island Telephone Co. Ltd	BBB(high)		3.4	3.2	3.0	3.1	3.5	3.3
Group Average			3.6	3.6	3.4	3.2	3.6	3.5
Grand Average			2.6	2.7	2.5	2.6	2.9	2.7

Source: Data taken from Dominion Bond Rating Service Limited except for the following:
(1) IPL Energy Inc 1994-1996 were calculated from Annual Reports
(2) TransAlta Utilities and Newfoundland Power 1996 were calculated from Annual reports.

Newfoundland Power
Changes in Interest Coverage Factors

	1992	1993	1994	1995	1996	1997	Pro-forma 1998
Embedded Cost of Debt	9.7%	9.9%	10.0%	9.5%	9.5%	9.4%	8.9%
Return on Equity	13.5%	12.6%	12.0%	12.0%	10.9%	11.0%	10.9%
Difference	3.8%	2.7%	2.0%	2.5%	1.4%	1.6%	2.0%
Yearly Change from 1992		-1.1%	-1.8%	-1.3%	-2.4%	-2.2%	-1.8%
Interest Coverage	2.9	2.9	2.9	2.7	2.7	2.7	2.7
Effective Tax Rate	34.6%	39.3%	41.5%	31.7%	41.9%	41.5%	45.1%

Notes
(1) Return on Equity reported is the earned return before adjustments for non-regulated expenses and deemed dividends. The Regulated Return on Common would be higher than the non-regulated number.
(2) Interest Coverage calculated using CBRS method (gross interest expense).

Newfoundland Power
Interest Coverage - CBRS Method

Allowed Common Equity (%)	Allowed Return on Equity (%)												
	11.25%	11.00%	10.75%	10.50%	10.25%	10.00%	9.75%	9.50%	9.25%	9.00%	8.75%	8.50%	8.25%
47%	3.0	2.9	2.9	2.8	2.8	2.7	2.7	2.7	2.6	2.6	2.5	2.5	2.5
46%	2.9	2.8	2.8	2.8	2.7	2.7	2.6	2.6	2.6	2.5	2.5	2.4	2.4
45%	2.8	2.8	2.7	2.7	2.7	2.6	2.6	2.5	2.5	2.5	2.4	2.4	2.4
44%	2.7	2.7	2.7	2.6	2.6	2.6	2.5	2.5	2.5	2.4	2.4	2.3	2.3
43%	2.6	2.6	2.6	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.3	2.3	2.3
42%	2.6	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2
41%	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.3	2.2	2.2	2.2	2.1
40%	2.4	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.1
39%	2.3	2.3	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.1	2.1	2.0	2.0
38%	2.3	2.3	2.2	2.2	2.2	2.2	2.1	2.1	2.1	2.1	2.0	2.0	2.0

Notes :

(1) Interest Coverage = (net income + Income tax + interest costs net of interest capitalized) / gross interest cost

(2) No prefererence deeming applied. All reductions in allowed common equity replaced by debt.

(3) Debt assumed as short term at current budgeted rate of 5.1%. When short term debt is over 60 million, it is converted to long term debt with bond issues of 40 million and a interest rate of 6.75%.

(4) All expenses and capital spending based on 1998 pro-forma with adjustment to allowed capital structure at January 1 1998.

Newfoundland Power
Net Interest Coverage - DBRS Method

Allowed Common Equity (%)	Allowed Return on Equity (%)												
	11.25%	11.00%	10.75%	10.50%	10.25%	10.00%	9.75%	9.50%	9.25%	9.00%	8.75%	8.50%	8.25%
47%	3.1	3.0	3.0	3.0	2.9	2.9	2.8	2.8	2.7	2.7	2.7	2.6	2.6
46%	3.0	3.0	2.9	2.9	2.8	2.8	2.8	2.7	2.7	2.6	2.6	2.5	2.5
45%	2.9	2.9	2.9	2.8	2.8	2.7	2.7	2.7	2.6	2.6	2.5	2.5	2.5
44%	2.9	2.8	2.8	2.7	2.7	2.7	2.6	2.6	2.5	2.5	2.5	2.4	2.4
43%	2.7	2.7	2.6	2.6	2.6	2.6	2.5	2.5	2.5	2.5	2.4	2.4	2.3
42%	2.7	2.6	2.6	2.6	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.2
41%	2.6	2.6	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.2
40%	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.2
39%	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.2	2.2	2.2	2.1	2.1	2.1
38%	2.4	2.3	2.3	2.3	2.3	2.2	2.2	2.2	2.1	2.1	2.1	2.1	2.0

Notes :

(1) Interest Coverage = (net income + income tax + interest costs net of interest capitalized and interest earned) / gross interest cost .

(2) No prefererence deeming applied. All reductions in allowed common equity replaced by debt.

(3) Debt assumed as short term at current budgeted rate of 5.1%. When short term debt is over 60 million, it is converted to long term debt with bond issues of 40 million and a interest rate of 6.75%.

(4) All expenses and capital spending based on 1998 pro-forma with adjustment to allowed capital structure at January 1 1998.

Newfoundland Power
After Tax Net Interest Coverage DBRS Method

Allowed Common Equity (%)	Allowed Return on Equity (%)												
	11.25%	11.00%	10.75%	10.50%	10.25%	10.00%	9.75%	9.50%	9.25%	9.00%	8.75%	8.50%	8.25%
47%	2.1	2.1	2.1	2.1	2.0	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.8
46%	2.1	2.1	2.1	2.0	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.8	1.8
45%	2.1	2.0	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.8	1.8	1.8
44%	2.0	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.8	1.8	1.8	1.8	1.8
43%	1.9	1.9	1.9	1.9	1.9	1.8	1.8	1.8	1.8	1.8	1.8	1.7	1.7
42%	1.9	1.9	1.9	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7
41%	1.9	1.9	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.6
40%	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6
39%	1.8	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6
38%	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.5

(1) Interest Coverage = (net income + interest costs net of interest capitalized and interest earned) / gross interest cost .
(2) No prefererence deeming applied. All reductions in allowed common equity replaced by debt.
(3) Debt assumed as short term at current budgeted rate of 5.1%. When short term debt is over 60 million, it is converted to long term debt with bond issues of 40 million and a interest rate of 6.75%.
(4) All expenses and capital spending based on 1998 pro-forma with adjustment to allowed capital structure at January 1 1998.

Canadian Bond Rating Service

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May 8, 1998

Confidential

Mr. Karl Smith
Vice-President, Finance & CFO
Newfoundland Light & Power Co. Limited
55 Kenmount Road, PO Box 8910
St. John's Newfoundland
A1B 3P6

RATING COMMITTEE DECISION LETTER

Dear Mr. Smith,

With regards to your inquiry concerning the appropriate interest coverage ratio necessary for Newfoundland Light & Power to maintain its present single "A" rating, we would like to make the following comments.

In the past, CBRS has publicly made available a list of financial benchmarks, which have traditionally been used in the rating process for guideline purposes only. These financial benchmarks combined with a number of qualitative and quantitative factors such as a utility's market risk, franchise area, customer profile, competitive position, infrastructure, operating efficiency, quality of management, regulatory environment, financial position and business and financial outlook are commonly used to evaluate a utility's credit rating. With respect to its financial profile, the company's business risk should partly determine its target capitalization and coverage ratio measurements.

CBRS has rated the first mortgage bonds of Newfoundland Light & Power Co. Limited at single "A" since 1981. The good quality rating of single "A" has generally been based on the company's low competitive risk, fair regulatory environment and sound financial position. These factors helped to mitigate the risk associated with the company's relatively small size (in relation to other single "A" rated utilities), high electric rates and economically weak franchise area. The province of Newfoundland has been amongst the lowest rated provincial credit in Canada (currently rated BBB with a negative rating outlook) and the economic outlook for the province is for continued slow growth. In addition, the Newfoundland economy does not provide the company with a diversified customer base or economic growth prospects required to grow its rate base and revenue sources relative to other single "A" rated utilities.

Because of the higher risk primarily associated with the provincial economic base, CBRS favors a stronger level of financial ratios for Newfoundland Light & Power. With respect to the interest coverage ratio, CBRS would like the company to maintain a ratio measuring in the top quartile of the 2.0 times to 3.2 times range established for single "A" gas and electric utilities. When analyzing a utility's credit quality, CBRS will review a wide range of factors including its financial ratios. Therefore, should the company's interest coverage ratio deviate slightly from the top quartile of the single "A" range, this would not necessarily result in an immediate rating action from CBRS. CBRS does, however, pay close attention to developing trends which could lead to further examination. Also important to note are the significant changes that will occur in the energy industry in the near to mid term. The industry's risk profile will continue to increase as deregulation, privatization and convergence takes form. Therefore, CBRS will continue to review its financial benchmarks in accordance with such industry changes.

Should you require any further information regarding the above, please contact the undersigned, or Damian Di Perna, Vice President & Director at CBRS (416) 956-4870.

Ihor S. Kots, Co-Chairman
CBRS Rating Committee

25 Years of Service

Canadian Investor-Owned Utilities
Earned Return on Equity
1992-1997

Company	Ratings 1st Mtge Bonds	Ratings L-T Debenture	1992	1993	1994	1995	1996	1997 *	Avg. 1992 to 1997
Energy Transmission									
TranCanada Pipelines Limited	A(high)	A	14.9%	14.0%	12.9%	13.2%	12.9%	12.2%	13.4%
IPL Energy Inc.		A	16.5%	17.5%	9.6%	16.9%	14.5%	14.0%	14.8%
Trans Mountain Pipe Line Co.		A(low)	6.6%	16.3%	17.6%	16.0%	19.2%	(1)	15.1%
Westcoast Energy Inc		A(low)	-8.1%	12.0%	10.9%	11.9%	11.2%	10.6%	8.1%
Nova Gas Transmission Ltd		A(low)	14.0%	12.5%	11.4%	10.7%	11.5%	(1)	12.0%
TransQuebec & Maritimes Pipe	A(low)		11.6%	12.2%	9.4%	9.8%	11.4%	(1)	10.9%
Interprovincial Pipe Line		A(high)	19.2%	17.9%	18.5%	18.9%	17.8%	n/a	18.5%
Alberta Natural Gas		A	-1.7%	18.3%	14.6%	19.1%	20.1%	n/a	14.1%
Group Average			9.1%	15.1%	13.1%	14.6%	14.8%	12.3%	13.4%
Electric									
TransAlta Utilities Corp	A+(high)	A+	13.4%	12.3%	12.4%	12.9%	14.1%	11.1%	12.7%
Newfoundland Power	A		13.5%	12.6%	12.0%	12.0%	10.9%	11.0%	12.0%
Nova Scotia Power		A(low)	14.3%	12.0%	11.9%	11.5%	10.6%	10.6%	11.8%
Maritime Electric Company	B++(high)		13.8%	13.0%	11.0%	13.6%	14.4%	13.4%	13.2%
West Kootenay Power		BBB(high)	11.5%	10.6%	10.1%	11.9%	12.7%	12.5%	11.6%
Group Average			13.3%	12.1%	11.5%	12.4%	12.5%	11.7%	12.3%
Gas Distribution									
Consumers' Gas Co Ltd		A	15.1%	16.0%	15.4%	11.7%	15.9%	13.8%	14.7%
Centra Gas Manitoba		A(low)	12.5%	12.9%	12.2%	13.9%	16.2%	11.3%	13.2%
Centra Gas Ontario		B++(high)	13.0%	12.7%	10.7%	13.0%	12.5%	(1)	12.4%
Gaz Metropolitain	A(high)		20.4%	19.3%	19.7%	19.5%	19.9%	18.9%	19.6%
BC Gas Utility Ltd		B++	3.5%	10.9%	6.9%	8.6%	10.9%	8.0%	8.1%
Union Gas Ltd		A(low)			14.0%	13.4%	14.0%	(1)	13.8%
Pacific Northern Gas		B++	12.4%	13.0%	13.4%	11.8%	13.3%	13.3%	12.9%
Group Average			12.8%	14.1%	13.2%	13.1%	14.7%	13.1%	13.5%
Combined Electric & Gas									
Canadian Utilities Ltd		A+	13.3%	13.4%	13.7%	14.1%	14.9%	14.9%	14.1%
Group Average			13.3%	13.4%	13.7%	14.1%	14.9%	14.9%	14.1%
Telephone									
Bell Canada		A(high)	12.5%	10.3%	9.3%	6.7%	9.8%	(2)	9.7%
BC Tel	A+(high)	A+(low)	12.9%	11.8%	11.3%	8.7%	10.4%	(2)	11.0%
Maritime Telegraph & Tel Co.			12.4%	11.2%	9.1%	5.8%	8.8%	(2)	9.5%
N.B. Telephone Co. Ltd		A+(low)	13.3%	12.1%	10.4%	11.6%	12.8%	(2)	12.0%
Newtel Communications Inc.	A		11.2%	11.2%	10.8%	8.3%	9.2%	(2)	10.1%
Quebec Telephone	A+(low)	A(high)	14.6%	13.8%	13.7%	13.2%	12.9%	(2)	13.6%
Island Telephone Co. Ltd	B++(high)		12.7%	11.8%	11.0%	10.7%	11.5%	(2)	11.5%
Group Average			12.8%	11.7%	10.8%	9.3%	10.8%		11.1%
Grand Average			11.8%	13.4%	12.3%	12.5%	13.4%	12.5%	12.7%

Notes:
* 1997 ROE's were calculated from the 1997 Annual Reports using average common equity.
(1) These Utilities will not have their 1997 Statements prepared until mid May 1998.
(2) We did not calculate the ROE for the Telephone companies.

Source: CBRS Credit Analysis for all utilities except West Kootenay Power which came from DBRS Bond, Long Term Debt and Preferred Share Ratings

Canadian Investor-Owned Utilities Allowed Return on Equity 1996-1998			
Utility	1996 Allowed	1997 Allowed	1998 Allowed
Transmission & Pipelines (1)			
TransCanada Pipelines Limited	11.25%	10.67%	10.21%
Interprovincial Pipe Line Inc	11.25%	10.67%	10.21%
Trans Mountain Pipe Line	11.25%	10.67%	10.21%
Westcoast Energy Inc	11.25%	10.67%	10.21%
NOVA Gas Transmission Ltd	11.50%	10.67%	10.21%
TransQuebec & Maritimes Pipeline	11.25%	10.67%	10.21%
Electrical Utilities			
TransAlta Utilities Corp (3)	11.25%	-	-
Newfoundland Power (2)	11.00%	11.00%	n/a
West Kootenay Power (1)	11.25%	10.50%	10.25%
Nova Scotia Power	10.75%	10.75%	10.75%
Gas Distribution Utilities			
Consumers Gas Company Ltd	11.88%	11.50%	10.30%
Centra Gas Manitoba (5)	11.28%	10.58%	9.91%
Centra Gas Ontario	12.13%	11.25%	10.69%
Gaz Metropolitain Company (2)	12.00%	11.50%	10.75%
BC Gas Utility Ltd (1)(2)	11.00%	10.25%	10.00%
Union Gas Limited	11.75%	11.38%	10.44%
Pacific Northern Gas Ltd	11.75%	11.00%	10.75%
Canadian Utilities Limited (4)	11.25%	-	-
Grand Average	**11.39%**	**10.86%**	**10.34%**

Notes:

(1) Incentive rates approved

(2) Weather adjustment mechanism in place

(3) Allowed ROE for 1996 confirmed through personal contact. The ROE for years following 1996 is no longer approved by the AEUB.

(4) used the Allowed ROE for Alberta Power, 1996 number confirmed through personal contact. The ROE for years following 1996 is no longer approved by the AEUB.

(5) Centra Gas Manitoba has applied to MPUB using the above 1998 Rate of Return derived from formula. Final decision expected May 1998.

Source: Data taken from DBRS Reports, except for the following:

a) TransCanada and Trans Quebec & Maritimes 1997 Allowed ROE from NEB letter dated March 14, 1997.
b) Gaz Metropolitain 1997 Allowed ROE taken from 1997 Annual Reports.
c) 1998 Allowed ROE for TransCanada, Interprovincial, TransMountain and TransQuebec & Maritime was taken from NEB letter dated December 5, 1997.
d) 1998 Allowed ROE for Gaz Metropolitan and Consumers Gas was taken from 1997 Annual Reports.
e) 1998 Allowed ROE for West Kootenay Power, BC Gas and Pacific Northern Gas was taken from BCUC Letter (L-73-97) dated December 2, 1997.
f) 1998 Allowed ROE for Centra Gas Ontario and Union Gas from OEB Decision 493/494.

Newfoundland Power
Financial Impact Analysis
Evidence of Ms. McShane
1998 Pro-Forma - CBRS Method
($ 000's)

	Regulated Returns		
	11.50 %	11.00 %	10.50 %
Preferred Dividends	626	626	626
Earnings To Common	25,754	24,538	23,339
Net Income	26,380	25,164	23,965
Add :			
Interest On Debt [1]	26,322	26,344	26,365
Capitalized Interest	(261)	(261)	(261)
Income Taxes	21,584	20,701	19,834
Sub-Total [2]	74,025	71,948	69,903
Interest Coverage - CBRS [2/1]	2.8	2.7	2.7
Regulated Return	11.50%	11.00%	10.50%
Non-Regulated Return	11.41%	10.90%	10.39%
Return On Rate Base	10.77%	10.52%	10.28%
Average Common Equity	225,765	225,157	224,558

Notes :
1) Interest on Debt includes Interest During Construction (IDC) of $ 261,000.
2) Interest Earned in 1998 assumed to be $ 1,200,000.

Newfoundland Power
Financial Impact Analysis
Evidence of Dr. Morin
1998 Pro-Forma - CBRS Method
($ 000's)

	Regulated Returns		
	11.125 %	10.75 %	10.375 %
Preferred Dividends	626	626	626
Earnings To Common	24,816	23,937	23,019
Net Income	25,442	24,563	23,645
Add :			
Interest On Debt [1]	26,339	26,354	26,371
Capitalized Interest	(261)	(261)	(261)
Income Taxes	20,904	20,268	19,602
Sub-Total [2]	72,424	70,924	69,357
Interest Coverage - CBRS [2/1]	2.7	2.7	2.6
Regulated Return	11.12%	10.75%	10.37%
Non-Regulated Return	11.01%	10.65%	10.26%
Return On Rate Base	10.58%	10.40%	10.21%
Average Common Equity	225,296	224,857	224,398

Notes :
1) Interest on Debt includes Interest During Construction (IDC) of $ 261,000.
2) Interest Earned in 1998 assumed to be $ 1,200,000.

Newfoundland Power
Financial Impact Analysis
Newfoundland Power's Recommendations
1998 Pro-Forma - CBRS Method
($ 000's)

	Regulated Returns		
	10.75 %	10.375 %	10.00 %
Preferred Dividends	626	626	626
Earnings To Common	23,937	23,019	22,121
Net Income	24,563	23,645	22,747
Add :			
Interest On Debt [1]	26,354	26,371	26,387
Capitalized Interest	(261)	(261)	(261)
Income Taxes	20,268	19,602	18,951
Sub-Total [2]	70,924	69,357	67,824
Interest Coverage - CBRS [2/1]	2.7	2.6	2.6
Regulated Return	10.75%	10.37%	10.00%
Non-Regulated Return	10.65%	10.26%	9.88%
Return On Rate Base	10.40%	10.21%	10.03%
Average Common Equity	224,857	224,398	223,949

Notes :
1) Interest on Debt includes Interest During Construction (IDC) of $ 261,000.
2) Interest Earned in 1998 assumed to be $ 1,200,000.

Newfoundland Power
Financial Impact Analysis
Dr. Water's & Winter's Recommendations
1998 Pro-Forma - CBRS Method
($ 000's)

	Existing Capital Structure Deemed Dividends - 40 %		Average Common Equity Assumed to be 40 % Increased Debt	
	8.25%	9.0%	8.25%	9.0%
Preferred Dividends	626	626	626	626
Earnings To Common	17,490	19,087	16,384	17,924
Net Income	18,116	19,713	17,010	18,550
Add :				
Interest On Debt [1]	26,471	26,442	27,622	27,624
Capitalized Interest	(261)	(261)	(261)	(261)
Income Taxes	15,595	16,752	14,767	15,883
Sub-Total [2]	59,921	62,646	59,138	61,796
Interest Coverage - CBRS [2/1]	2.3	2.4	2.1	2.2
Regulated Return	8.25%	9.00%	8.25%	9.00%
Non-Regulated Return	7.89%	8.58%	8.09%	8.85%
Return On Rate Base	9.09%	9.41%	9.10%	9.42%
Average Common Equity	221,634	222,432	202,504	202,552

Notes :
1) Deeming Rate on Preference Shares is assumed to be 6 % .
2) Interest Earned in 1998 assumed to be $ 1,200,000.
3) Interest on Debt includes Interest During Construction (IDC) of $ 261,000.
4) Bond issue of $ 40 million issued July 1, 1998 for Increased Debt option.