Q. (Application Volume 1, page 3-12) Table 3-9 shows that NP's cost of debt declined in 2020 and will continue declining in 2021, 2022 and 2023. With no material change in business risk, is this decline in the cost of debt an incentive to shift the equity-debt ratio in favour of more debt? Has NP considered this option? Why did NP eliminate its preference shares?

A. No, the decline in the cost of debt is not an incentive to increase the Company's debt to total capitalization ratio. An appropriate capital structure should be determined by applying the fair return standard.[1]

In February 2020, Newfoundland Power redeemed all of its issued and outstanding First Preference Shares totalling approximately $9 million and refinanced them with debt, which lowered overall costs to customers.[2] Preferred shares are typically considered debt instruments by credit rating agencies.[3] As a result, redeeming the Company's preferred shares in favour of lower cost debt financing was viewed as neutral by both Moody's and DBRS.[4]

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1 See the *2022/2023 General Rate Application, Volume 1, Application, Company Evidence and Exhibits, Section 3.3: Cost of Capital.*

2 The issuance of preferred equity is not current Canadian electric utility practice. The Company last issued preference shares in 1981.

3 For example, Moody's Investors Service treated Newfoundland Power's preferred shares as debt and dividends on preferred shares as debt charges in calculating its key credit metrics for the Company, including the debt to total capitalization ratio. Historically, DBRS Limited's debt ratings for Newfoundland Power included the Company's preferred shares (cumulative, redeemable) at a rating of Pfd-2.

4 See response to Request for Information CA-NP-086.