

1 Q. Reference: *Fair Return for Newfoundland Power (NP)*, Evidence of Laurence
2 D. Booth, September 28, 2021, page 43, lines 13-15.

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4 *“In financial terms NP’s actual ROE stochastically dominated the LTC bond*
5 *in the sense that no investor would have held the LTC bond if they could*
6 *have earned NP’s actual ROE.”*

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8 **In Dr. Booth’s opinion, what considerations does an investor give to**
9 **investment in a LTC bond compared to an investment characterized by**
10 **regulated utility operations?**

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13 A. The statement is a statement of fact that in terms of the ROE earned by NP
14 versus the interest paid by the Government of Canada NP’s ROE stochastically
15 dominates that on the long Canada bond. Unfortunately, the investor cannot
16 earn the ROE earned by NP, they have to buy utility shares and suffer market
17 risk.

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19 The closest security to NP’s common equity available in the capital market is
20 high quality preferred shares. The following is an extract from my textbook
21 based on a table from the Bank of Montreal’s Preferred Share Statistics (May
22 2015). Once you equalise the term and characteristics of the preferred shares,
23 BMO compared them to equivalent term Government of Canada debt and the
24 major factor they looked at was taxes. Dividends are preferentially taxed in
25 Canada whereas Interest is fully taxed both at the corporate and retail investor
26 level. For the traditional “straight” preferred shares with no maturity date, at
27 that time BMO compared them to the long Canada yield and calculated the
28 after tax spread for corporates versus retail investors. What investors are
29 interested in is the after tax yield and there have been times when the
30 preferreds yielded *less* than the yield on long Canada bonds before tax, but still
31 had a positive after tax spread. It is why for a long time I measured the fair
32 ROE based on a premium over preferred share yields to offset the tax bias of
33 comparing them to tax penalised long Canada bonds yields.

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35 So according to BMO the main issue is taxes.

TABLE 19-3 Preferred Share Yields, April 30, 2015

Straight Preferreds	(%)
Dividend yield	4.81
Long Canada yield	2.18
After-tax spread yield for corporate at 30%	3.28
After-tax for individual at top tax rate	2.08
Retractable Preferreds	(%)
Dividend yield	3.80
Mid Canada yield	0.98
After-tax spread yield for corporate at 30%	3.11
After-tax spread for individual at top tax rate	2.02
Floating Rate Preferred Shares	(%)
Dividend yield	3.63
BA (3-month)	0.93
After-tax yield for corporate at 30%	2.98
After-tax yield for individual at top tax rate	1.93
Source: Data from BMO, <i>Preferred Share Statistics</i> , May 2015.	