Before the Public Service Commission

Niagara Mohawk Power Corporation

DIRECT TESTIMONY

of

John M. Haynes
Vice President and Treasurer

Q. Will you please state your name and business address?

A. John M. Haynes, 300 Erie Boulevard West, Syracuse, New York 13202.

Q. What office do you hold with Niagara Mohawk Power Corporation, and what are your principal duties?

A. I am Vice President and Treasurer. I am in charge of financing - both short-term and long-term, as well as investor relations programs.

Q. What is your educational and business background and qualifications?

A. I graduated from Utica College of Syracuse University in 1952 with a Bachelor of Science degree and a major in Accounting. Prior to joining Niagara Mohawk in 1961, I worked for Price Waterhouse & Co. in New York and Syracuse. After joining Niagara Mohawk that year, I worked as a senior auditor, administrative assistant in the Treasury Department of the Company, Assistant Treasurer, Treasurer and was elected to my present position on August 15, 1973.

Q. What is the scope of your testimony?

A. My testimony encompasses the following major areas:

1. Need for the requested temporary electric rate relief in 1976.
2. Financing policies, specific financings planned for 1976 and 1977 and general levels of required financing through 1979.
3. My views regarding the investment quality of the Company's

securities.

4. The Company's overall cost of capital estimated at June 30, 1977, approximately the mid-point of the first full year the requested permanent increase in rates, if and to the extent granted, would be in effect.

5. The maintenance of compensating bank balances.

Q. What do you wish to present with specific reference to the Company's request for temporary electric rate relief?

A. The requested temporary electric rate relief is required to provide immediate support for our planned financings, on reasonable terms, scheduled for October, 1976 and early 1977. During this period, debt, preferred stock and common stock are all planned for sale. Failure to achieve such relief will necessitate modifications to our program, with potentially grave consequences.

Q. What are the Company's financial policies and how are they applied?

A. In order to provide a background framework on which to evaluate our specific financing plans, an understanding of our financial policies is important.

Our goal is to maintain a sound financial program to achieve a balanced capital structure, to be achieved on a continuing basis on reasonable terms from a position of flexibility in determining the type, timing and amount of various securities issued. These securities include a range

of possibilities beyond the more traditional long-term financing of mortgage debt, preferred stock and common stock, such as short-term bank loans, commercial paper, bankers acceptances and leasing arrangements.

In arriving at a specific financing program, consideration is first given to our forecasted cash demands both from operations and from our construction program. Operations periodically give rise to short-term financing requirements while the construction program, due to the inadequacy of internally generated funds, gives rise to long-term financing. The bankers acceptances used to finance our seasonal winter storage of oil for our Oswego generating units would be an example of borrowings related to operations, and are repaid as the oil is used up. Financing related to our construction program also begins through short-term borrowings. These borrowings, however, must be repaid from the proceeds of long-term securities sales (debt and stock equities). The Company attempts to accomplish these sales on an orderly basis at reasonable intervals, remembering that such sales can only be accomplished by attracting potential investors.

Q. What is the Company's financing program for 1976 and 1977?

A. Applying the above policy to our specific 1976 and 1977 financings, I will outline the program as it presently exists. If the requested temporary rate increase is not

granted, modifications in our financing program will have to be made.

1976 Financing Program

Short-term debt at the end of 1975 is expected to be approximately $60-65 million, consisting of bankers acceptances, bank loans and commercial paper. For the first eight months of 1976, short-term debt is projected to average between $40 - $50 million, with a range of under $10 million in May and just short of $60 million in June. At August 31, 1976, the balance is projected to approximate $40 million without rate relief. In September and early October, the balance would approximate $100 million and, if not reduced by major long-term financing, rise to over $130 million by the end of the year. Based upon our experience, and looking ahead to the additional needs arising during 1977, this would be an unacceptably high level of short-term debt to carry into 1977. Instead, we propose $50 million of mortgage bonds and approximately 3.5 million shares of common stock in October, 1976, to substantially clean up all short-term debt at that time and insure our ratings for commercial paper. Sales of our commercial paper are vital to our short-term borrowing program. Any reduction in our commercial paper rating of A-2 would probably preclude any such sales. We estimate financing proceeds to approximate $93 million and thus reduce end of

1976 short-term indebtedness to about $35 - $40 million. To complete the description of our long-term financing program in 1976, we would anticipate issuance of some $16 million of common stock through the Employee Savings Fund Plan and the Dividend Reinvestment Plan.

1977 Financing Program

With a starting point of short-term debt estimated at $35 - $40 million at the end of 1976, projected cash construction requirements for 1977 aggregate nearly $250 million, up substantially from the 1976 level. During 1977, we would anticipate total public sales of $100 million of General Mortgage Bonds, $25 million in Preferred Stock and a public sale of about 3.0 million shares of Common stock. Also, our program to sell Common shares through the Employee Savings Fund Plan and the Dividend Reinvestment Plan would continue. In order to accomplish this program in an orderly fashion, these issues would be split up. Debt and either Preferred or Common stock would be issued early in the year - March or April - and the balance in September or October. Obviously, whether the requested temporary rate relief has been granted will have a bearing on this as will consideration of market conditions at the time. We would also have to consider the outlook for 1978 where construction expenditures increase, and therefore an expanded financing program is

necessary.

Q. Please explain the meaning of "reasonable terms" as mentioned in your explanation of the Company's financial policies.

A. Reasonable terms encompasses different characteristics when applied to our various securities. Taking bonds for example, two out of our last three mortgage bond issues had to be sold on seven and ten-year term bases, respectively. Normal, and what we would consider, reasonable terms would have been thirty years, more closely approximating the life of our plant facilities being financed. The cost of issuing securities on an intermediate term is costly to the rate payer, principally because the mortgage tax on a $50 million issue would add about $325,000 to the cost. Also, poorer credit risks are faced with making cash sinking fund provisions starting early; i.e., at the end of the fifth year and this reduces the average life of the issue.

Again considering reasonableness, our common stock has been selling at a price below its book value since 1973, causing unhealthy dilution in the then existing ownership interest each time it has had to be sold. At the end of 1974, the price was equivalent to approximately 50% of book value and presently (early December 1975) approximates only 75% of book value. This unhealthy situation should be corrected as soon as possible, and improved earnings

and general financial strength should achieve that end.

Q. Could you give us your views on the investment quality of the Company's securities?

A. The question of the quality of securities has become more important to investors. Utility securities ratings have been crucial not only in determining the cost of their issuance but in whether investors will buy them at all. Earnings levels for protection of the dividend is crucial to common stock quality (as is the quality of the earnings composition). Our mortgage debt securities are split rated "A"/"BBB plus" yet we must compete for investor monies with other large utilities and non-utilities which carry ratings much higher -- "AAA" and "AA". Because of our ratings and coverage ratios in the last debt issue, we were unable to qualify with several state banking departments as a qualified investment. Among these is New York State. This is also true of our preferred stock. Our preferred stocks are rated only triple "B". Clearly our ratings are too low to effectively compete for capital funds on reasonable terms. Some investors will not purchase "BBB" securities. The temporary relief is essential to protect existing ratings from slipping still further, a matter of real concern in light of the 1976 forecast. Along with subsequent permanent rate relief, the temporary relief increases the prospects for a necessary

upgrading in our quality rating.

Q. What are the Company's mortgage bond ratings by the various agencies?

A. The Company is rated "A" by Moody's and Fitch's, and "BBB plus" by Standard & Poor's. Standard & Poor's, in the fall of 1974 prior to the sale of 12.6% Bonds, down rated the Company from "A". Obviously, the higher the interest rates, the more difficult it is to maintain and improve interest coverages. Based on discussions with the rating agencies, our projections for capitalization ratios are in good order, our construction programs have been reduced to reasonable amounts that can be financed - and therefore, the main ingredient of which we are aware necessary to restore and solidify our "A" rating would be higher interest coverages.

Another point that should be made here is to emphasize the importance of maintaining, with the recognized rating agencies, the highest possible rating on the securities that we must issue from time to time. Niagara Mohawk's external financing requirements during the period 1975 - 1979 will approximate $780,000,000 of which about $372,000,000 will be raised in the form of new debt capital. Given a 1% differential between single "A" and triple "B" rated securities, our customers could be required to pay, over the 30-year bond life, an estimated additional $111,600,000 ($372,000,000 X 1% X 30 years) through higher rates as a penalty for

Niagara's low credit rating.

Q. What would the financing program you have outlined produce for capitalization ratios and cost of capital in June of 1977?

A. Based on Exhibit 11 showing the financing considerations, we have taken one-half of the 1977 financings to develop the capitalization for June which would be 51.7% debt, 13.5% preferred stock, and 34.8% common equity.

The overall cost of capital expected, including estimated interest and preferred dividend rates on the 1976-1977 financings, is 9.96% and has been used by Mr. Sanguine in calculating revenue requirements on a "permanent" basis.

Q. Is the common equity percentage of 34.8% higher than you have experienced in the past?

A. Yes. It would appear that in order to achieve and maintain the higher coverage ratios necessary to upgrade our quality ratings and to provide flexibility to finance under the varied conditions confronting the Company during each year, a larger equity ratio is necessary. This equity component may have to be increased still further to 36% - 37% or even higher in the years ahead if the presently high interest rates continue, in order to maintain adequate debt coverage.

Q. Have you had prepared under your direction an exhibit entitled "Niagara Mohawk Power Corporation, A Financial Forecast" which shows construction expenditures and sources of capital for 1976 through 1979?

A. Yes. Exhibit 12 shows our projections of direct construction expenditures during the years 1976 through 1979 totaling about $860 million plus Allowance for Funds Used During Construction of about $140 million and approximately $110 million of other costs capitalized. Together, they aggregate about $1.1 billion. It is anticipated during these years that over $600 million will need to be raised in the capital markets.

In recent months, the Company has taken significant initiatives in arranging sharings of plant construction, in part to make the construction program more manageable to finance. However, future financing requirements remain formidable since internally generated funds are expected to provide less than half of our revised cash needs. This is one important reason for the Company's proposal to include additional construction work in progress in rate base.

Q. With respect to short-term borrowings, will you please state whether or not the Company is required to maintain compensating balances in the banks with which you do business?

A. Yes. Compensating balances are required in the various banks with which the Company maintains short-term arrangements.

Q. What are the lines of credit that your Company has with its banking institution in which compensating balances are required?

A. The Company has obtained from various banks lines of credit totaling $151,100,000 for which compensating balances are required. Additional lines of credit totaling $49.5 million have been obtained by payment of fees. Fee lines of credit cannot exceed the lines of credit requiring compensating balances.

Q. What are the usual terms required by banks with respect to compensating balances?

A. Compensating balances vary from bank to bank, however, the most prevalent method is 10% of the line of credit plus 10% of the amount borrowed.

Q. Have you obtained documentation from an officer of each bank in which Niagara Mohawk maintains a compensating balance describing arrangements as applied to Niagara Mohawk?

A. I directed my assistant to request letters from the banks, and copies of these are contained in Exhibit 13. The dollars associated with these balances have been computed and provided to Mr. Sanguine.