

- 1 (9:30 a.m.)
- 2 MR. NOSEWORTHY, CHAIRMAN: Thank you and good
3 Friday morning. I can advise I had a nightmare last night.
4 I woke up in a cold sweat, woke my wife up and everything,
5 and it was the prospect of 120 days on the marginal cost of
6 service (*laughter*). With all due respect to those that are
7 here, I can't conceive of it. Anyway, good morning. I
8 would advise as well that in consideration of the schedule,
9 the panel concurred with the schedule as outlined by Mr.
10 Kennedy yesterday, and I want to thank all parties for their
11 cooperation in certainly agreeing and setting the schedule.
12 It seems to be a reasonable one. If we can tie the other, as
13 I say, loose ends in at an appropriate time before Christmas
14 to expedite the process for us all, it would be greatly
15 appreciated. I think that's it. Before we get started, Mr.
16 Kennedy, are there any preliminary matters?
- 17 MR. KENNEDY: I believe Newfoundland Power has a
18 document that they wish to file, Chair.
- 19 MR. NOSEWORTHY, CHAIRMAN: Sure.
- 20 MS. BUTLER, Q.C.: Thank you, Mr. Chairman.
- 21 MR. NOSEWORTHY, CHAIRMAN: Ms. Butler, good
22 morning.
- 23 MS. BUTLER, Q.C.: This is the response to the
24 undertaking of Mr. Larry Brockman when he testified earlier
25 in the week in relation to the (inaudible) price of Brant
26 crude oil.
- 27 MR. KENNEDY: NP-13, we've been using the designation
28 U for undertakings, but I don't know what the number is so
29 we'll just use NP-13, which is the next exhibit in the one
30 submitted by Newfoundland Power.
- 31 MR. NOSEWORTHY, CHAIRMAN: Thank you.
- 32 MR. HUTCHINGS: NP-13?
- 33 MR. KENNEDY: NP-13.
- 34 MR. NOSEWORTHY, CHAIRMAN: Thank you, Ms.
35 Butler, no further comment on this? Excuse me, Ms. Butler,
36 no further comment on this?
- 37 MS. BUTLER, Q.C.: I have no further comment, no, thank
38 you, Mr. Chairman.
- 39 MR. NOSEWORTHY, CHAIRMAN: Thank you very much.
40 Good morning, Dr. Wilson. Good morning, Mr. Browne.
- 41 MR. BROWNE, Q.C.: Good morning, Mr. Chairman.
- 42 MR. NOSEWORTHY, CHAIRMAN: I wonder if you could
43 begin when you're ready please?
- 44 MR. BROWNE, Q.C.: Good morning, Dr. Wilson.
- 45 DR. WILSON: Good morning.
- 46 MR. BROWNE, Q.C.: Dr. Wilson, can you go to page 33 of
47 your evidence please?
- 48 DR. WILSON: Okay.
- 49 MR. BROWNE, Q.C.: There on page 33, just above ... no,
50 we're not going to get into the RSP, Mr. O'Rielly, you'll be
51 pleased to know. Just above the lines dealing with the
52 RSP, you talk about CFB Goose Bay, and you state, you
53 refer to \$2.8 million revenues from the secondary sales to
54 CFB Goose Bay as a subsidy. I'm just wondering, why do
55 you refer to that as a subsidy?
- 56 DR. WILSON: As I understand it, it is revenues obtained
57 in excess of the allocated cost of service.
- 58 MR. BROWNE, Q.C.: Are revenues ...
- 59 DR. WILSON: And monies that would be, that are
60 available to apply to some other costs.
- 61 MR. BROWNE, Q.C.: So the fact that it's a subsidy, what's
62 your advice to the Board in reference to that?
- 63 DR. WILSON: My advice to the Board is that they have
64 considerable discretion on how to deal with it. One way of
65 dealing with this \$2.8 million would be to use it to bring
66 down prices to other consumers in that region. That may
67 be considered a good thing to do for various reasons, but
68 it obviously would produce rates considerably below cost
69 to consumers who already have fairly low rates. Another
70 alternative may be to take those funds and use it to offset
71 the rural subsidy generally, thereby reducing the amount of
72 funds that have to be collected for that purpose from other
73 customers, so I would say that the Board has considerable
74 discretion on how to apply those funds to the covering of
75 other costs.
- 76 MR. BROWNE, Q.C.: Do you see any inconsistency in the
77 way Hydro is treating revenues from secondary sales?
- 78 DR. WILSON: In what sense?
- 79 MR. BROWNE, Q.C.: Like for instance, the sales of
80 Interruptible B power to the industrial customers.
- 81 DR. WILSON: Not other than what I've stated in my
82 testimony, unless you have something specific you wanted
83 me to comment on.
- 84 MR. BROWNE, Q.C.: Would you consider those sales, the
85 sales from, of Interruptible B power to the industrial
86 customers also a subsidy?
- 87 DR. WILSON: If a ... what I have in mind here is a sale that
88 is generating revenues that are substantially in excess of
89 allocated cost of service, and therefore monies that are
90 available to subsidize some other costs. Now to the extent
91 that Hydro is charging other customers rates that are either
92 above or below the cost of service, it may generate similar

1 dollars that are available to cover a subsidy requirement, or
2 it may produce revenues that are inadequate to cover costs
3 and therefore require a subsidy from some place else. It's
4 my understanding that based upon cost responsibility as
5 defined in Hydro's cost of service study, CFB Goose Bay
6 is covering its allocated costs plus, and so those funds are
7 available to cover, or in effect subsidize service to some
8 other customers.

9 MR. BROWNE, Q.C.: Do you see those some other
10 customers in Labrador?

11 DR. WILSON: I think that that was one of the ways in
12 which Hydro suggested using the funds, and I have
13 suggested that the Board may wish to consider using the
14 funds on a more broadly, for more broadly based
15 requirements rather than in effect providing a windfall just
16 for consumers in Labrador.

17 MR. BROWNE, Q.C.: Thank you, Dr. Wilson. We'll move
18 to another issue. **CA-181**, it's a copy of the report to the
19 Board concerning Newfoundland Power Company's study
20 of innovative approaches to rate design based on marginal
21 cost and time of use design principles, and I'm not certain
22 if you have that, Mr. O'Rielly.

23 MR. O'RIELLY: No, sorry, I don't.

24 MR. BROWNE, Q.C.: So we'll have to go to the hard copy.

25 DR. WILSON: This is the report that I did?

26 MR. BROWNE, Q.C.: That's your report.

27 DR. WILSON: Okay, back in 1998.

28 MR. BROWNE, Q.C.: Is everyone able to locate it, I think
29 we're okay. Can I take you to page 35 of the report, sir, the
30 summary. In the second sentence of the summary, can you
31 read that into the record please?

32 DR. WILSON: I said first, the company study generally
33 estimates marginal generation costs in a reasonable way.
34 However, the company's marginal transmission costs and
35 marginal distribution costs have been estimated in a
36 manner that is at least controversial, if not altogether
37 contrary to sound economic principles.

38 MR. BROWNE, Q.C.: And what do you mean by that, if
39 not altogether contrary to sound economic principles?

40 DR. WILSON: I believe that my concerns were similar to
41 those expressed in this case, and that is the, in the case of
42 transmission, the attribution of all transmission to demand
43 and at the distribution level. In addition to ... I don't think
44 there was an NCP issue there, as best I recall just sitting
45 here, but I believe again, there was a lack of allocation to
46 energy and also a fairly large attribution of costs to the
47 customer cost category which I understood was desired for
48 stability purposes. Obviously, if you collect a lot of your

49 revenues on the basis of a fixed customer charge as
50 opposed to in relation to the amount of service that's
51 provided, you're going to have much more stable revenues
52 from month to month, and it's my recollection that
53 Newfoundland Power was proposing to recover maybe a
54 third of its total revenue requirement that way, so those
55 were the kinds of things that I had in mind.

56 MR. BROWNE, Q.C.: Where you stated that their study is
57 at least controversial if not altogether contrary to sound
58 economic principles, is that a study on which this Board, in
59 your opinion can rely?

60 DR. WILSON: I would say that it's better than nothing, and
61 keep in mind that my first statement there in that summary
62 was the company study generally estimates marginal costs
63 in a reasonable way. I did take exception on certain points,
64 but as a general proposition, I thought that there was
65 positive advancement being made, and did not intend to be
66 generally critical of the direction they were going.

67 MR. BROWNE, Q.C.: They did a study, you did a study, to
68 comment on it, do you know what the results were, if any,
69 of these two particular studies ... if there's been any
70 implementation of any of the recommendations or ...

71 DR. WILSON: I don't know that there was a hearing. I
72 don't believe that I testified on the occasion of this report,
73 so I don't know that these matters have been carried to a
74 completion in terms of a Board order related to rates. This
75 was a study that was done obviously after the 1996 rate
76 case.

77 MR. BROWNE, Q.C.: And you state on page 18 of the
78 study, if we can go to that for a minute please, in the last
79 paragraph beginning with "The substance", can you read
80 that into the record please?

81 DR. WILSON: This is the commentary on the Bond Bright
82 ...

83 MR. BROWNE, Q.C.: Sure.

84 DR. WILSON: Uh hum, the same Bond Bright criteria, I
85 think, that Mr. Hamilton had ... and probably myself had
86 mentioned in this case. I said the substance of these
87 objectives, that's the Bond Bright objectives, has not
88 changed over the ensuing three decades, although the
89 emphasis placed on the primary objectives has increased
90 significantly, most notably beginning in the late 1970's with
91 the passage of the *Public Utility Regulatory Policies Act*
92 in the US and corresponding initiatives at the provincial
93 level in Canada. The complementary goals of conservation,
94 efficiency, and equity merged as the hallmark of modern
95 electric utility rate design. I think I said the same thing in
96 my introductory remarks in the report this time.

97 MR. BROWNE, Q.C.: And you stand by these. These are

1 the three principles, conservation, efficiency, and equity.

2 DR. WILSON: Sure.

3 (9:45 a.m.)

4 MR. BROWNE, Q.C.: Moving away from that report, can
5 you go to **NP-299**, please, and at NP-299, Power posed a
6 question to you ... page 19, Dr. Wilson, discusses Hydro's
7 lack of a seasonal rate and states, in short, in order for
8 Hydro's rates to reasonably reflect costs, seasonal cost
9 variations should be reflected. Conversely, if it is argued
10 that the dominance of stored hydro generation overrides
11 justification of seasonal rates differentials, then the
12 attribution of hydroelectric capacity costs to demand and
13 the allocation of these costs based on winter peak is
14 inappropriate. Then they put this question, does Dr.
15 Wilson have an opinion as to which of these two is the
16 case, and if not, what is required for the Board to reach an
17 informed opinion on it in this case. Can you read your
18 response for the record, sir, please?

19 DR. WILSON: Yes, I said it's my opinion that Hydro's rates
20 should reflect seasonal cost variations. Even though the
21 predominance of historic hydroelectric capacity in the
22 generating mix may justify a smaller summer/winter
23 differential than would be warranted on another system
24 with correspondingly diverse seasonal load curves, the fact
25 that Hydro allocates all generation demand costs on the
26 basis of winter peak would warrant a significant winter rate
27 premium.

28 MR. BROWNE, Q.C.: Can you expand upon that at all, sir?

29 DR. WILSON: Sure, if the purpose of building stored
30 hydro capacity is related predominantly to water run-off
31 and the storage of the water, as opposed to merely meeting
32 peak demands, it's appropriate to recognize that investment
33 has an energy related investment. This ties to a point that
34 I think was made very well earlier in this hearing by Mr.
35 Osler when he talked about ... I forget what the plant was,
36 I'll call it Yukon 4, you remember the discussion about the
37 various hydro plants up in ... I think it was the Yukon and
38 there was a fourth hydro plant that was built that was for
39 the storage of ... it stored more water and permitted more
40 generation of electricity during the course of the year, but
41 it didn't really contribute to additional ability to meet peak
42 demand, and the utility involved correctly in that case in
43 my opinion allocated or classified the costs of that hydro
44 facility as energy-related. The same kind of consideration
45 is there in most cases of building major storage hydro
46 dams, so it would be appropriate to recognize the costs of
47 those as being energy-related, and therefore recoverable
48 from summer loads as well as winter loads, even on a
49 heavily peaking system.

50 Nevertheless, there is obviously a logical

51 contradiction in Hydro's proposals to allocate all of its
52 demand costs and demand costs of transmission as well as
53 distribution, not just generation, to the winter peak but to
54 have no corresponding or parallel differential between
55 summer rates and winter rates, and it seems clear to me,
56 given the very large two to one swing between the summer
57 peak and the winter peak on this system, and the fact that
58 some of this capacity is certainly peak oriented, that there
59 should be a seasonal differential between summer rates and
60 winter rates.

61 MR. BROWNE, Q.C.: Thank you, Dr. Wilson, in a similar
62 vein in **NP-300**, at page ... if we can go to NP-300, Mr.
63 O'Rielly, thank you. At page 21, Dr. Wilson discusses the
64 lack of a demand rate to Newfoundland Power and states it
65 would be far better and a more reasonable regulatory
66 procedure to calibrate Hydro's costs and wholesale rate
67 structure in this proceeding so that retail rate design in the
68 next NP case can reflect the appropriate cost-based charges
69 that NP will actually realize as its retail sales changes.
70 That's your quote. Then Newfoundland Power poses this
71 question. Since a large share of Newfoundland Power's
72 customers are served at non-demand rates themselves, why
73 would you have Newfoundland Power pay a demand
74 charge, link the revenues that Newfoundland Power
75 receives from these customers more closely to the charges
76 Newfoundland Power sees as the load changes. Can you
77 read your response please?

78 DR. WILSON: Yes, my response was, wholesale rates that
79 separately reflect demand and energy costs as well as
80 seasonal and time of use differences would enhance NP's
81 ability to improve retail cost allocation as well as rate
82 design. While it may continue to be cost prohibitive to
83 implement time of use or three part rates for small
84 customers, class cost allocations may be improved and
85 there will be greater flexibility to experiment with and
86 improve retail rate design over time if underlying costs are
87 more accurately differentiated.

88 MR. BROWNE, Q.C.: And sir, what do you mean when
89 you say class cost allocations may be improved?

90 DR. WILSON: I mean the attribution of costs at the
91 Newfoundland Power level between residential customers,
92 commercial customers, industrial customers.

93 MR. BROWNE, Q.C.: So are you, in fact, stating that
94 seasonal and time of use cost differences should be applied
95 in the residential class?

96 DR. WILSON: Sure, I would think that seasonal cost
97 differences should be and can be applied, both at the
98 Hydro level, and at the Newfoundland Power level between
99 summer and winter residential loads.

100 MR. BROWNE, Q.C.: Sure, and this is consistent with what

1 you've said in **NLH-34**, can we go to that for a moment
2 please, and there Hydro posed a question re. your
3 testimony, page 7, lines 4 to 8. To what extent does the
4 timing of the peak and the allocation method for demand
5 costs influence the need for seasonal rates, is it Dr.
6 Wilson's recommendation that the seasonally differentiated
7 rates be based on marginal or embedded cost. Can you
8 provide your response there, sir.

9 DR. WILSON: The need for seasonal rates is driven by the
10 extent to which demand costs vary by season, not by the
11 timing of the peak or the demand cost allocation method.
12 Seasonally differentiated rates should reflect marginal costs
13 and the embedded cost revenue requirement.

14 MR. BROWNE, Q.C.: And can we go to the next question,
15 **NLH-44**, where Hydro posed this question. Based on your
16 knowledge of time of use rates that have been implemented
17 in other jurisdictions, what level of relative peak to off-peak
18 costs are necessary for customers to change their usage
19 patterns by a significant amount leading to a positive
20 impact on the utility's expansion plan costs. Can you
21 provide your response there, sir?

22 DR. WILSON: My answer was, price elasticity of demand
23 varies substantially between types of customers and
24 electricity uses. For many uses, a price differential of 10
25 percent to 20 percent may have an equivalent impact, i.e.,
26 10 percent to 20 percent on demand, other things equal.
27 Cost reflective rates such as TOU rates are justified both by
28 equity and allocated efficiency considerations.

29 MR. BROWNE, Q.C.: That last sentence, when you say it's
30 justified both by equity, time of use rates, and allocated
31 efficiency considerations, can you expand upon that, sir?

32 DR. WILSON: Yes, equity, fairness, obviously a
33 judgemental issue, is typically thought of by economists as
34 being best achieved if prices reflect costs of producing
35 products. As Mr. Brickhill testified, other people may have
36 other views on that, for example, charging everybody the
37 same price regardless of what it cost to serve them, but
38 generally economists would say prices that reflect costs,
39 even if they vary by time of use or between customers, if
40 that's the way the cost varies, that's fair, and obviously
41 prices of that nature are allocatively efficient because they
42 discourage consumption. If the benefits of the products
43 are below the cost of producing it, they encourage
44 production or the benefits, the prices, the revenues that
45 can be obtained exceed the cost of production, so that
46 would be consistent with efficiency objectives as well as
47 consistent with the concept of fairness that I just
48 discussed.

49 MR. BROWNE, Q.C.: Thank you, Dr. Wilson. There has
50 been discussion concerning performance based rates and
51 incentive based programs that should be brought in.

52 You've been in this jurisdiction, back and forth here, and
53 you've been around the block, can you give us your views
54 on that, sir?

55 DR. WILSON: I think performance based rates are
56 generally a pretty good idea. You have, you obviously
57 have a different situation here in Newfoundland where
58 they, especially with a Crown company at the Hydro level.
59 If, you know, I were in the Chairman's position, if I were a
60 philosopher (inaudible), I guess I would want to set
61 incentive rates that achieved something and setting
62 incentive rates that achieved more or less revenue for the
63 government are probably not going to do what incentive
64 rates do in the private sector. In the private sector, more or
65 less profit for the stockholders is somehow supposed to
66 influence the way in which stockholders compensate the
67 management of the company, so in Hydro's case, perhaps
68 if Ms. Greene's income and Mr. Osmond's income, and Mr.
69 Hamilton's income were tied to the performance of the
70 company, there would be an incentive for the top
71 management of the company to do things that increased
72 efficiency, reduced costs, and were beneficial to customers,
73 even more than the incentives that exist now do that. And
74 so if there were a way to connect incentive returns to
75 management compensation, which I think is probably a
76 tougher political nut to crack in a government corporation,
77 certainly it would be a (inaudible) government corporation
78 in the US, but if there's a way to make that connection, the
79 way that it is made in the private sector, I think that would
80 be fine, but unless you're able to make that connection
81 between what moves and motivates the management of the
82 company, and the incentives, I'm not sure that it does an
83 awful lot of good, so that connection would be important.

84 MR. BROWNE, Q.C.: I have to say, I think you're hitting
85 the nail right on the head, because you're in private
86 business, as are we. I know I was with another law firm
87 some years ago, just by way of example, and I think we
88 were making, we were paying 50 cents to the dollar in our
89 overhead, so we reconstituted ourselves, got out and got
90 somewhere else where we're paying 35 cents to the dollar to
91 our overhead, so we could effect it immediately in our
92 pockets, as would you, but if you ... because you're dealing
93 with your overhead, and what you don't pay to overhead
94 goes to yourself and the taxman, I guess, but in a Crown
95 corporation, how can incentives be built in? I guess we
96 have to come to realize that it's not too much different than
97 a private corporation. Newfoundland Power has its
98 incentive program, and its bonus program, and I think
99 Hydro has a more modest one. If incentives are to be
100 determined as to what kind of bonus they get, and I'm
101 certainly, I don't think anyone would be against a bonus if
102 the targets were set appropriately, but how do you ensure
103 that the targets are appropriate? Do you base them on ...
104 what type of factors do you think would be appropriate?

1 DR. WILSON: I think a good answer to that question
2 would require more than me just sitting here and spouting
3 off, you know, and saying some things ...

4 MR. BROWNE, Q.C.: Well, give us your opinion.

5 DR. WILSON: Even though it's worth the air that it rides
6 on (*laughter*) ... well I think comparisons with other utilities
7 is obviously a consideration. You can't necessarily do one
8 to one comparisons because the operating conditions of
9 Newfoundland Hydro are very different than the operating
10 conditions of American electric power or BC Hydro, but I
11 think that some yard stick comparisons are a good thing to
12 have. I think progress over time is a good thing to look at,
13 you know, how are you doing today compared to how were
14 you doing a few years ago, and if progress is being made.
15 I think that would be a basis for rewards and incentives. I
16 will say that it's, also a concern that I would have is that the
17 rewards and incentives programs can get out of hand and
18 do things that are counter productive. I think that's
19 happened in recent years in the US in private industry,
20 where the rewards for successful performance have become
21 so great for top managements in some companies, and
22 whereas the penalties don't have nearly the same downside
23 potential that managements do things that are not
24 particularly wise. Enron which has been in the news lately
25 is a case in point. If the Chairman of Enron does really,
26 really, really well, he may make \$100 million. You know Ken
27 Lay got bonuses and so on of \$300 million because Enron
28 was doing so well over recent years. On the other hand, if
29 Enron does poorly, you know, he loses his job and has to
30 leave Houston. Well, if those are the, if that's the quid pro
31 quo, you'd probably take some risks that are not
32 necessarily the best thing in the world for your
33 stockholders because the difference between the reward
34 and the penalty are so stacked in that direction, so I'm not
35 arguing that the system of incentives, especially at the
36 level of executive compensation that has developed in the
37 US over the last five or six years is, you know, the way in
38 which a Crown corporation should go, but certainly having
39 a reward system would be a good thing, and I don't know
40 really what the system is that exists at Hydro. They
41 perhaps already are moving, or have moved in that
42 direction to some extent.

43 MR. BROWNE, Q.C.: You ... throughout the hearing
44 concerning the government's energy policy review, which
45 I understand is now complete and they may be moving to
46 public hearings in reference to that early in the new year to
47 get a public reaction. This is something, of course, we're all
48 interested in. Do you see any merit in the vertical
49 integration of these companies ... we're a small province of
50 534,000 and we have the Crown corporation, we have the
51 distributor, and we've had some evidence of some
52 duplications in the system, and some people argue that

53 there can be cost savings if there was integration, and
54 other people are not convinced of that. Do you have any
55 view on it yourself, sir?

56 DR. WILSON: I would say that I'd put myself in the not
57 convinced camp. Vertical integration is not generally the
58 way things are going in other places. It's rather separating
59 the generation business from the transmission business
60 and distribution business. I'm not sure that all of those
61 reasons exist to the same extent in Newfoundland as exist
62 in mainland Canada and the US but I don't, I'm not aware of
63 any compelling argument to change the structure that
64 exists here.

65 MR. BROWNE, Q.C.: You see a distribution system
66 separate from the generator, you would keep it the way it is
67 now?

68 DR. WILSON: Well, you need, you certainly need some
69 integration, either by market forces or by discretionary
70 planning. My perception is that that integration of
71 planning and the, you know, both parties, Hydro and
72 Newfoundland Power recognize they're in dependency
73 upon each other and conduct themselves accordingly. But
74 I generally don't see a problem between, about having the
75 generation business separate from the distribution
76 business. It's worked very well that way in many different
77 areas for a long period of time, and that certainly is the way
78 that it has been in Ontario and it's certainly the way it has
79 been with most public power, municipal utilities and rural
80 electric systems where the distributors are independent of
81 the generators for many years.

82 MR. BROWNE, Q.C.: And finally, sir, I'll pick your brain on
83 this one. Normally at the, at the conclusion of these
84 hearings and everything, I have always had an opportunity
85 to have discussions with the Minister of Justice
86 concerning these proceedings and ways in which they can
87 be expedited, although any recommendation I've had has
88 fallen on deaf ears thusfar, but I've got a feeling that the
89 ears might be a little wider this time around. Do you have
90 any views on that from your engagements in other
91 jurisdictions of ways to expedite this proceeding here?

92 DR. WILSON: Well, one thing that I would do, I guess, is
93 probably read the direct evidence into the record less
94 frequently than is done here. Once pre-filed evidence is
95 filed, it's in the record, and I did notice that an awful lot of
96 time is spent having witnesses re-read their evidence into
97 the record on the witness stand. I think if you go back
98 through the transcript you'll probably find a significant
99 portion of the transcript is re-reading stuff into the record
100 that's already in the record. Now that's a procedural sort of
101 thing that probably wouldn't exist in most jurisdictions in
102 the US. Obviously, this hearing has been a fairly long one,
103 but it's the first time you've had one in a long time, and it's

1 the first time that at least some of these panel members are
2 learning about and dealing with these issues, so I don't ...
3 I don't see it as a particular problem. I'd rather have them
4 spend two months on it frankly than have them spend two
5 weeks, and I think that over the longer period of time
6 they're going to learn more, and it's going ... and you're
7 going to have more reasoned and comprehensive
8 appreciation of issues in the decision than you would have
9 if they were rushing through something.

10 MR. BROWNE, Q.C.: Thank you very much, Dr. Wilson,
11 for your evidence, and for those last comments, thank you.

12 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
13 Browne, and thank you, Dr. Wilson. We'll move now to
14 Counsel on redirect please?

15 MR. KENNEDY: Thank you, Chair. Dr. Wilson, Ms.
16 Andrews was asking you some questions yesterday
17 concerning the, concerning the cost of service
18 methodology that had been selected for this hearing. I
19 wonder if we could just refresh people's memories by
20 turning to **page 44 of yesterday's transcript**, Mr. O'Rielly,
21 line 64. Ms. Andrews said, "And I take it then that your
22 evidence on a number of issues, as Ms. Butler pointed out
23 to you before the break, where you suggest to the Board
24 that they should depart from their 1993 cost of service
25 methodology are simply your indication that that would be
26 your preference if it's open for debate". And your reply is,
27 "Yes, I think that's a fair statement. I think that I have
28 presumed that the Board did not wish to foreclose or limit
29 their consideration to determinations that had been made
30 eight years ago, and that they did not want me to identify
31 areas of possible consideration and change for the future".

32 DR. WILSON: I believe you put a not in there that didn't
33 belong there.

34 MR. KENNEDY: I beg your pardon.

35 DR. WILSON: They did want me ...

36 MR. KENNEDY: They did want me to identify, sorry, areas
37 of possible consideration and change for the future. Ms.
38 Andrews continued, "However, you would agree that if the
39 Board made a determination in 2000 that the 1993 cost of
40 service methodology was still appropriate in the current
41 day rate setting environment, then in fact its opinion
42 expressed in 1993 has been reconfirmed a number of years
43 later", and I just wonder if you could read out the first
44 sentence of your reply, or the first few sentences?

45 DR. WILSON: I would have seen that more as a, you know,
46 starting point for the purposes of this hearing as opposed
47 to resolving in year 2000 the questions about cost of
48 service methodology that may be raised in the hearing. Did
49 you want me to continue?

50 MR. KENNEDY: Yeah, if you could just read the next
51 sentence.

52 DR. WILSON: But I did not see it as something that was
53 reaching final determinations on these matters with respect
54 to the hearing, but rather as giving some indication to
55 Hydro as to a, as to a starting point that would be
56 appropriate for the filing, not that modifications to that
57 wouldn't be appropriate.

58 MR. KENNEDY: Well, for your assistance, because I'm
59 going to get you to just comment again on this point, Dr.
60 Wilson, but I just need to put some sort of factual context
61 in place. The reference that Ms. Andrews is making is to
62 PU-25, 2000/2001, an order of the Board, and in the order of
63 the Board, item number two ... well item number one is
64 Hydro is ordered to file a general rate application no later
65 than May 1, 2001, the rate application using forecast data,
66 and item number two was that in preparing the rate
67 application, Hydro will use the generic methodology, that's
68 the reference. I'd like though to just again for the factual
69 context here, refer you to two passages out of the transcript
70 from the pre-hearing conference that proceeded this order,
71 and I'm wondering if the Clerk could just pass those copies
72 out. It's a transcript from October the 11th, 2000, and I
73 doubt if you would have that, Mr. O'Rielly.

74 The first passage is, that's marked there, at the
75 beginning of roughly line 14 is attributable to Mr. Young
76 appearing at this pre-hearing conference, and line 14 reads,
77 "and it is our submission that many of the other issues
78 which could ultimately be dealt with at the next phase of
79 the hearing that we're involved in today, meaning the actual
80 application, would arise under the general rate review and
81 that would include the cost of service issues, whether or
82 not it's the generic or other, whether or not there are other
83 rate setting issues which might arise, and at that time also
84 I think it would be appropriate and could possibly be
85 accommodated for any concern as to whether the existing
86 interim order was appropriate, and the existing interim
87 order, I think, is referencing the interim order to improve the
88 industrial rates for a certain period of time. Just first of all,
89 would that be consistent with your view, Dr. Wilson, as to
90 keeping, as you stated yesterday, an open mind, if you will,
91 about the cost of service methodology and that it would be
92 used as a starting point in that final determinations hadn't
93 been made?

94 DR. WILSON: Yes, it sounds like it does.

95 MR. KENNEDY: And then, in fact, it was Ms. Andrews at
96 line 67, during this pre-hearing conference which, who
97 stated that having said that the island industrial customers
98 are satisfied, as Mr. Young indicated, to have the interim
99 order extended to January 1st of 2002. In addition, the
100 island industrial customers don't feel that it is necessary to

1 conduct a review of the 1993 cost of service methodology,
2 that there is no material that is currently available to us, or
3 that has been provided by the Board that indicates that
4 there has been any quantum shift in normal methodology
5 since 1993. The hearing in 1993 was very comprehensive
6 and it was extremely expensive, and it was long, and all
7 those factors would cause us to take the position that
8 unless there is some overwhelming evidence indicating that
9 there ought to be a change or refinement of the cost of
10 service methodology that was approved in 1993, then it
11 should be considered to be the cost of service
12 methodology and that there should be no contemplation of
13 any changes at this time.

14 Now, Dr. Wilson, I think it's fair to say that the
15 industrial customers have taken a similar position in this
16 hearing, that the 1993 cost of service methodology is the
17 one that they would prefer to see employed by the Board.
18 In your experience as a cost of service expert witness,
19 testifying before previous boards, can you tell me generally
20 whether industrial customers as a group are more typically
21 in favour of an embedded cost of service methodology
22 rather than employing a marginal cost type cost of service
23 methodology? If it's not a fair question you can pass, but
24 if you have some impressions they'd be welcome.

25 DR. WILSON: I don't think that that is the driving force,
26 that it is some sort of intellectual appeal of embedded cost
27 versus marginal cost. Rather, the driving force for
28 industrial customers typically is to get as much of the cost
29 responsibility, as much of the revenue responsibility
30 reflected in demand charges as opposed to energy charges,
31 and the reason for that is quite apparent. Industrial
32 customers generally are higher load factor, more energy per
33 unit of demand, than other customers on the system, so
34 they take a lot of kilowatt hours in relation to their
35 demands. They might have 70 or 80 percent load factors as
36 opposed to 30 percent load factors, so twice as much
37 energy in relation to demand as small commercial or
38 residential customers, and consequently from the point of
39 view of their pocketbooks, the more costs that are
40 attributed to, the more costs that are attributed to demand
41 and the less to energy, the lower their bills are going to be,
42 and embedded cost studies will tend generally, they don't
43 need to, but they will tend generally to attribute a fairly
44 large portion, a large portion of the costs to charges that
45 ultimately come out as demand charges as opposed to a
46 marginal cost rate making which will tend to put more of the
47 revenue recovery on the energy side. That doesn't, it
48 doesn't have to be that way, but that generally is what
49 happens, and I think that's the driving force, and therefore
50 you're more likely to see industrial customers favouring
51 embedded cost approaches as opposed to marginal cost
52 approaches, but I think that preference is very much tied to
53 the bottom line which is, I suppose, the way that I would

54 see things if I was running an industrial company.

55 *(10:15 a.m.)*

56 MR. KENNEDY: Mr. O'Rielly, do you have the 1993 cost of
57 service methodology referral on ... I believe you do, and I
58 wonder if page 36 ... hopefully the pagination is close.

59 MR. O'RIELLY: I have an excerpt of it.

60 MR. KENNEDY: Oh, you just have the summary of
61 recommendations, do you?

62 MR. O'RIELLY: Uh hum.

63 MR. KENNEDY: Okay, well actually for the brevity of time,
64 it's in a ... this is the 1993 cost of service methodology
65 referral, and I'll just read a passage in if I could. It's
66 following a discussion of the split between hydraulic and
67 thermal plants and the methodologies for cost of service
68 employed and the Board wrote at page 36, the second full
69 paragraph, re-examination of cost of service methodology
70 has been an infrequent occurrence in Newfoundland and in
71 anticipation that this may hold in the future as in the past,
72 the Board is concerned that the methods of classification
73 will reflect change in load patterns and use of generating
74 facilities, and then it continues on about the fact that the
75 classification methods may change, and it's clear that there
76 hasn't been a major shift in the cost of service methodology
77 explored since 1993, Dr. Wilson, and I'm wondering if you
78 can comment on the timing generally of how often that
79 issue of what methodology to employ in a cost of service
80 should be entertained by a Board of Commissioners such
81 as the one here?

82 DR. WILSON: Well, certainly it has been something that
83 has been considered and looked at. It was looked at at
84 least to some extent in the 1996 Newfoundland Power case
85 which I participated in. Obviously there was a look, I don't
86 know if there was any action that was taken in 1998. I think
87 it's appropriate and generally recognized as appropriate to
88 consider methodological changes and modifications each
89 time that a cost of service study is done, in the same
90 manner that it's reasonable to look at alternative ways of
91 measuring the cost of capital each time a rate of return
92 determination is done, and I think that typically that occurs,
93 that those considerations occur in other jurisdictions, and
94 you know, when you change, you change when you
95 determine that there is more to be gained by changing than
96 not changing.

97 MR. KENNEDY: Is it fair to say, Dr. Wilson, that the fact
98 that Hydro hasn't conducted a marginal cost study since,
99 what I understand from the record, since 1984, certainly
100 doesn't provide much assistance in the way of doing a full
101 examination of comparing the embedded cost of service
102 methodology and the marginal cost cost of service
103 methodology.

1 DR. WILSON: That's a long time. I think it would be
2 desirable to make those comparisons and considerations a
3 lot more frequently.

4 MR. KENNEDY: And going forward ... the process, it has
5 been suggested by another expert on questioning that in
6 order to do an effective examination of marginal cost based
7 rates and I guess implicit in that, a re-examination of the
8 cost of service methodology itself, that it first needs to be
9 preceded, if you will, by the conducting of a marginal cost
10 study itself. You're in agreement with that, that would be
11 the first step?

12 DR. WILSON: Sure, I think that's appropriate, but as I think
13 I've indicated, I think the basics are fairly straightforward in
14 Hydro's case, and you know, there's some time that will be
15 needed for fine tuning, but I think that Hydro, from what
16 I've seen, Hydro has the people in Osmond and Hamilton,
17 and you know, some help from Brickhill perhaps, to do
18 what the Board directs, and then the other parties can
19 respond to it or make their own presentations.

20 MR. KENNEDY: And it's been suggested as well that such
21 a process would require the participation of both Hydro
22 and Newfoundland Power in order to make it effective. Do
23 you see that as a prerequisite as well, or ...

24 DR. WILSON: That would be a good thing to do, would be
25 for Hydro and Newfoundland Power to think about these
26 things so that there is consistency between the cost
27 incurrence and the ultimate price signal to the consumer.
28 I think that would be a good thing to do. I don't think it's
29 absolutely essential. If there's some reason that they, if
30 there's some institutional blockage to them working
31 together, but I think that would be a good thing to do. It
32 would be my preference to work from the production level
33 down to the distribution level. In other words, for
34 Newfoundland Power to know something about what the
35 cost structure at the Hydro level is before they start
36 deciding retail rates, so therefore either that type of
37 sequence or a collective undertaking would be a good idea.

38 MR. KENNEDY: Thank you, Dr. Wilson, that's all the
39 questions on re-direct, Chair.

40 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
41 Kennedy. Thank you, Dr. Wilson. We'll move now to
42 Board questions, Commissioner Powell please?

43 COMMISSIONER POWELL: Thank you, Mr. Chair. Good
44 day, Dr. Wilson.

45 DR. WILSON: Good morning.

46 COMMISSIONER POWELL: Or good morning. Excuse me,
47 when I first went through your evidence, it seems like years
48 ago now, but a few weeks back, I enjoyed it, but when I
49 was re-reading it last evening in anticipation of today, and

50 I appreciated it a lot more given all the things we've heard.
51 It put things in perspective and a lot of (inaudible) here. A
52 couple of things I had marked and, and I just ask you
53 about, if I can find my pages. Yeah, on page one going on
54 to page two, you note, you said, we also note that several
55 potential items underpinning Hydro's pre-filed evidence
56 were not submitted, and then you go on and you stated
57 three particular items on page two, excuse me, and the fact
58 that you've not filed any supplementary evidence, I'm just
59 wondering, have those items showed up?

60 DR. WILSON: Yes, I think those items were produced
61 through the course of discovery in the case.

62 COMMISSIONER POWELL: And you had no reason to
63 have any more comment on them, other than the fact that
64 they weren't there and they should be there.

65 DR. WILSON: Right, and I think they've been discussed
66 within the context of this hearing.

67 COMMISSIONER POWELL: Yeah, but you didn't feel the
68 need to follow up with any more evidence?

69 DR. WILSON: No.

70 COMMISSIONER POWELL: Okay, the thing that really
71 surprised me going into these hearings and doing research
72 and reading, but being new at it, that to me, from an
73 accounting perspective, cost of service is a relatively
74 simple thing. Costs are costs and allocation, while they're
75 a little bit of a judgement, but I would have thought they
76 would have been relatively easy to achieve, but reading
77 Mr. Hamilton and other cost expert's design ... or cost of
78 service experts and rate designers, that it's the tremendous
79 amount of judgement that goes into setting the rates and
80 allocating the cost of service. From your experience, is that
81 normal, I mean is that ...

82 DR. WILSON: Sure, I think you're right. I think that
83 determining the total cost level, the total revenue
84 requirement from an accounting perspective, from a
85 financial perspective is pretty straightforward. That's not
86 to say that there's no controversy. You know, there will be
87 arguments about what the rate of return should be. There
88 might be arguments about whether something ought to be
89 expensed or whether it ought to be capitalized, but coming
90 up with a correct number for the total revenue is, I think, a
91 straightforward, you know, workman like proposition.
92 Then you get into the problem of competing rationales for
93 who should be charged what, you know, who is the cost
94 causer, and that sort of thing that you see in these various
95 cost allocation or cost classification, or even
96 functionalization issues, and as I've indicated, that's a fairly
97 complicated and judgement loaded way of going about rate
98 design, but it's, it's a way in which, you know, various
99 parties can probably from their perspective best structure

1 their arguments as to what costs they should be
2 responsible for. I think there's a lot of economists that
3 would prefer to cut through that and go to the rate design
4 directly, recognizing that a kilowatt hour is a kilowatt hour,
5 and a kilowatt's a kilowatt. It doesn't matter whether it's
6 being consumed to make paper or make cheese or make
7 heat. There are differences in accordance to voltage level,
8 you know, and how much losses there are going to be, time
9 of use, those kinds of things, but the ultimate end use of a
10 kilowatt or kilowatt hour is not the thing that determines
11 cost and so the whole cost of service exercise does add a
12 level of complication and arbitrariness to rate making that's
13 not absolutely essential.

14 COMMISSIONER POWELL: And it tends to make the
15 process a little more expensive, doesn't it?

16 DR. WILSON: Oh yeah, time consuming, expensive, sure.

17 COMMISSIONER POWELL: Yeah, just looking at it from
18 a business perspective, and I can appreciate all the
19 subtleties and the arguments and what not, but I keep
20 thinking that there's got to be a simpler and quicker way to
21 get to the bottom line.

22 DR. WILSON: Well, I don't think that automobile
23 manufacturers or paper companies go through fully
24 allocated cost of service studies in order to decide what to
25 charge for a Ford, or you know, or for a ton of paper to
26 different customers. It's a peculiarity that we have in the
27 regulatory process here.

28 COMMISSIONER POWELL: Well even Hydro, the
29 interesting example is the exercise you have in Goose Bay
30 and how they set their rate up there, it had nothing to do
31 with cost, it's what the market would bear.

32 DR. WILSON: Yeah, I will say that these procedures are
33 used other places. Probably one that's of interest to the
34 paper industry right now, in the US when they have these
35 dumping cases, you know, are the Japanese bringing in
36 telecommunications equipment at below cost of producing
37 it, or are Canadian paper makers bringing newsprint into the
38 US market at below the cost of producing it. The
39 International Trade Commission will go through a full
40 history of cost studies to determine what the cost of
41 making a particular electronic component is, or what the
42 cost of making the paper is, and that's kind of a strange
43 thing for those industries to have to go through because it
44 doesn't track at all what they really do in terms of their
45 pricing, and that's the only place that I can think of that
46 these same cost allocation procedures are used in markets
47 for those products.

48 COMMISSIONER POWELL: So they would have the same
49 problem identifying their costs. It has been suggested that
50 Hydro's financial system, based on a business unit versus

51 the cost of service, it creates a certain amount of difficulty
52 in extracting numbers because they're set up for two
53 entirely different purposes.

54 DR. WILSON: Uh hum, I think that's right, yes.

55 COMMISSIONER POWELL: What are the ... reading the
56 evidence, I don't think there was any, any comments or
57 things, one of the recommendations of Hydro doing ... is
58 having common rates in Labrador, doing an interconnect,
59 where there's people up there have told us that there's two
60 separate, even though they get the power from the same
61 source, but there's two different systems. Do you think
62 just having a common interconnected rate in a place like
63 Labrador should be something that should be done simply
64 because ... the same as in the province (*phonetic*), we have
65 everybody on the same system that pays the same rate?

66 DR. WILSON: I have not carefully studied the Labrador
67 system as a general proposition. I think that moving
68 towards a common rate sounds like a sensible thing to me,
69 but I really haven't looked at it closely enough to give you
70 good detailed advice on that.

71 COMMISSIONER POWELL: Uh hum, and the
72 recommendations that you make in your summary on page
73 39, do you still stand by all those after all the evidence and
74 things you've heard, other than the...

75 DR. WILSON: Other than the interruptible industrial rate
76 which I've decided is a pretty good rate that I criticized
77 originally, I think that the rest of my conclusions are, would
78 be the same if I were to write them today, yes.

79 COMMISSIONER POWELL: Okay, thank you very much.
80 That's all, Mr. Chair.

81 MR. NOSEWORTHY, CHAIRMAN: Thank you,
82 Commissioner Powell. Commissioner Saunders?

83 COMMISSIONER SAUNDERS: Thank you, Mr. Chair.
84 Good morning, Dr. Wilson.

85 DR. WILSON: Good morning.

86 COMMISSIONER SAUNDERS: How are you?

87 DR. WILSON: I'm fine, thank you.

88 COMMISSIONER SAUNDERS: Good.

89 DR. WILSON: So far.

90 (*10:30 a.m.*)

91 COMMISSIONER SAUNDERS: So far. I only have one
92 question for you, Dr. Wilson, and it's in relation to
93 something that the Consumer Advocate brought up, and
94 your response was interesting in that I think it was
95 yesterday afternoon and in response to his question you
96 said you don't like to see costs being deferred to future

1 years. Do you recall that?

2 DR. WILSON: Yes.

3 COMMISSIONER SAUNDERS: Yes, and I think I
4 understand what you're saying. This morning the
5 Consumer Advocate referred you to page 18, amongst
6 other pages, of your report back in '98, I think it was, and
7 on there you talked about Bond Bright and some
8 secondary criteria, I guess you might call it.

9 DR. WILSON: Uh hum.

10 COMMISSIONER SAUNDERS: And number three was
11 revenue stability from year to year. Number four was
12 stability in the rates themselves with a minimum of
13 unexpected changes seriously adverse to existing
14 customers. Do you follow?

15 DR. WILSON: Yes.

16 COMMISSIONER SAUNDERS: Okay, I'm having a little bit
17 of difficulty, I guess, when I read that and trying to get
18 sorted out in my mind the RSP, what it was intended to do,
19 what it does, and the pitfalls are in terms of deferred costs,
20 inadequate signals to consumers, etcetera, and before I
21 stop and give you an opportunity to comment, I wanted to,
22 as well, get you to give me your comments on all of that,
23 giving regard to the opening statement of Mr. Wells, the
24 CEO of Hydro, when he talked about three elements of
25 costs here, and I may not have it word for word, but he
26 talked about it in terms of hundred million dollar amounts,
27 and I think one was interest, another was the amount in the
28 RSP, and another was the O & M, I believe, it was
29 something along those lines, and I'm having some
30 difficulty, I guess, giving regard to what Bond Bright said
31 about stability, and trying to sort out the difference
32 between deferring the oil costs, the fuel costs, and
33 smoothing it out, and I use that word because everyone
34 knows what that means now, and taking costs of capital,
35 for example, which was one of the three, or one of the three
36 elements that Mr. Wells mentioned, or interest costs, and
37 smoothing it out over a period of time as opposed to
38 immediate, let's say, charge to customers for recovery. Do
39 you understand where I'm going with this?

40 DR. WILSON: I think I do.

41 COMMISSIONER SAUNDERS: Well, I'm not sure I do.

42 DR. WILSON: When I think of it, this relates to, you know,
43 accounting issues that ...

44 COMMISSIONER SAUNDERS: Yeah.

45 DR. WILSON: What Commissioner Powell is particularly
46 interested in and knowledgeable about.

47 COMMISSIONER SAUNDERS: So I guess my bottom line
48 question is why do we get so excited about the deferral of

49 fuel costs when businesses generally defer many of the
50 costs that they encounter on a daily basis?

51 DR. WILSON: Generally the costs that they defer and that
52 accountants, you know, help them defer, are cost of capital
53 equipment that is used to produce product over a long
54 period of time. A hydroelectric dam is built today and it will
55 produce benefit for consumers for 30, 40, 50 years, a paper
56 plant is made and it will produce product for a long period
57 of time, so it makes sense in the pricing of the paper or it
58 makes sense in the pricing of the electricity, to spread
59 those capitalized costs out over the period of depreciation
60 of the facilities, and we defer recovery of those costs, as
61 you say, all the time, and we do it big time in the electric
62 power industry because there are a ... the big part of their
63 business is building equipment that renders service over a
64 longer period of time. Fuel is not that way. Fuel is used
65 today to produce electricity today for consumers today,
66 and then there will be additional fuel supplies that are used
67 tomorrow, so that's an expense item. That's what Mr.
68 Powell and the accountants would refer to as an expense,
69 an O & M expense as opposed to a capital expense, and I
70 think both economists and accountants are in agreement
71 that those costs ought to be dealt with as they occur rather
72 than, rather than deferred for recovery under most
73 circumstances, and so when you talk about taking today's
74 fuel costs and recovering them in three or four years, well
75 there are going to be fuel costs in three or four years, what
76 are you going to do with those. It's not the same as
77 deferring the recovery of that transmission line, because
78 you're not necessarily going to be building a new
79 transmission line in three to four years. The same
80 transmission line will continue to render service.

81 COMMISSIONER SAUNDERS: Okay, now just branch off
82 on that tangent of Bond Bright's stability point.

83 DR. WILSON: Uh hum.

84 COMMISSIONER SAUNDERS: And talk about it in
85 relation to the RSP and what it's intended to do. You've
86 already said that you don't go along with deferring costs,
87 and I understand that.

88 DR. WILSON: If you had a highly volatile situation in
89 which for some reason, let's say disruption of oil supplies
90 in the Middle East, fuel costs skyrocketed to \$100 a barrel,
91 and you expected that within some foreseeable period of
92 time they'd be coming back down to \$20.00 a barrel, you
93 might decide that you didn't want to disrupt your economy
94 and industry by tripling or quadrupling electric rates. What
95 you would rather do is accumulate or defer some of those
96 costs to the future which, you know, we're doing to a large
97 extent in the United States now as we go through
98 restructuring, and there are these, you know, stranded cost
99 burdens that are being capitalized and deferred for future

1 recovery. That would make some sense. There's some
2 logic to it. On the other hand, if you're at \$20.00 oil today
3 and you don't see the likelihood of, you know, being at
4 \$5.00 or \$10.00 in the future, that the greater likelihood is to
5 be at \$25.00 oil or \$30.00 oil in the future, there's not a
6 strong argument in deferring the recovery of today's \$20.00
7 for three or four years because you're going to have \$25.00
8 or \$30.00 oil to deal with then.

9 COMMISSIONER SAUNDERS: Yeah, would you, would
10 you consider the period of time we're in right now, and
11 what we're going through now worldwide to be stable or
12 unstable in terms of oil prices?

13 DR. WILSON: There is some instability, but I think most
14 people would think that oil prices are probably lower now
15 than they expected them to be a short time ago, and
16 probably lower now than they would be expected to be in
17 five years, so there's some instability but you certainly
18 don't have, you know, Gulf War prices for oil now. You
19 might have them next month.

20 COMMISSIONER SAUNDERS: Okay, thank you, Dr.
21 Wilson.

22 MR. NOSEWORTHY, CHAIRMAN: Thank you,
23 Commissioner Saunders. Commissioner Whalen?

24 COMMISSIONER SAUNDERS: No, Chair, I have no
25 questions. Thank you, Dr. Wilson, and we wish you a safe
26 trip home.

27 DR. WILSON: Thank you.

28 MR. NOSEWORTHY, CHAIRMAN: Good morning, Dr.
29 Wilson, and thank you very much for your evidence and
30 testimony. I found it to be very instructive and very clear
31 and concisely presented.

32 DR. WILSON: Thank you.

33 MR. NOSEWORTHY, CHAIRMAN: I have just a couple of
34 questions. The first one really, and most of these are for
35 clarification. You commented, I think, yesterday on page 45
36 of the testimony, and it was in respect to the RSP, and I
37 heard, I think, for the most part, other experts say, and
38 indeed you said as well, that the RSP has no precedent,
39 that direct precedent that you're aware of throughout
40 Canada or the US for that matter ...

41 DR. WILSON: Nothing exactly the same.

42 MR. NOSEWORTHY, CHAIRMAN: No, but you did
43 comment on, I do know of many utilities that have what are
44 known as regulatory assets or deferred revenue accounts
45 that sometimes exceed \$100 million or even a billion dollars
46 which conceptually are not terribly different from the RSP.

47 DR. WILSON: Right.

48 MR. NOSEWORTHY, CHAIRMAN: And I think will create
49 many of the same types of problems that the RSP could
50 create. Could you just elaborate on that? Are these in
51 respect of particular assets, or would they be in respect of
52 operating costs similar to the RSP, and I'm just ... it's the
53 first time I've heard any mention that there might be
54 something akin to that.

55 DR. WILSON: I would say they are more likely to be
56 associated with particular assets than with operating costs,
57 but there are some that are related to operating costs. A
58 nuclear power plant is out for an extended period of time.
59 You certainly have that in New England with the Millstone
60 units in Connecticut, big nuclear power plants that were
61 just out for extended periods and the northeast part of the
62 United States is not the cheapest place to get power if your
63 major power sources are down, replacement of power, so
64 these utilities incurred much much higher cost that was
65 anticipated in their test year cost of service to meet their
66 requirements. They ... I guess, just to pick a number, they
67 may have rates that reflected five or six cent power but with
68 the nuclear plants out and replacement power from oil
69 being produced to meet base load requirements, I mean
70 they were incurring costs that were double that amount and
71 it would not be unheard of in those circumstances to take
72 those large balances, capitalize them, and recover them
73 over some extended period of time. Today ... I'm actually
74 involved in a proceeding in Montana right now where the
75 Montana Power Company had been required by state law
76 to enter into contracts with non-utility generators, so-called
77 qualifying facilities some time ago, and to enter into long-
78 term contracts to buy power from unrelated generation,
79 independent generation providers at fairly high costs.
80 Today with competitive restructuring going on and, you
81 know, ten or fifteen or twenty years being left on some of
82 those contracts, they're tied into the payment over an
83 extended period of time of five or six or seven cents for
84 electricity when it's anticipated that the competitive market
85 price is going to be half of that, and so a proceeding is
86 underway in which it's going to be determined, an estimate
87 is going to be made of the excess costs that the company
88 is going to be forced to incur over the period of time that
89 these contracts are in place, and there are arguments about
90 what the cost levels are going to be, how much output the
91 plants are going to be able to produce, da, da, da, da, but
92 there's going to be tens of millions, if not hundreds of
93 millions of dollars of so-called stranded costs that will then
94 be capitalized, and recovery extended over ten, fifteen
95 years. That's also true with regard to planned investments
96 in many places, especially nuclear investments, where
97 companies made investments in nuclear power plants that
98 are much more costly than what is anticipated for the future
99 and through the course of restructuring, hundreds of
100 millions, or in some cases, billions of dollars of excess costs

1 associated with these plants are going to be capitalized and
2 deferred and recovered over time, and on the financial
3 statements of some of these companies, you'll see assets
4 right there on the balance sheet that it's a regulatory asset.
5 I mean, and they've actually put those things into such
6 guaranteed forms that they can, that bonds can be issued
7 on them, just as you could if you had bricks and mortar, so
8 there are large amounts of funds that have been capitalized
9 and deferred, and I would say that generally the investment
10 banking guys, moody Standard & Poors don't like these
11 kinds of assets. They tend to reduce bond ratings and one
12 is worried about them because they're not something that
13 necessarily have intrinsic value that a generating plant has.

14 *(10:45 a.m.)*

15 MR. NOSEWORTHY, CHAIRMAN: Thank you very much.
16 The other item I'd just like, and it's a little bit of a different
17 spin again, and it relates to the rural subsidy, I guess, and
18 I think what I, and I've read through this, I think, three times
19 so far, and in event, it was your explanation of the
20 assignment of the rural subsidy based on marginal cost of
21 Holyrood yesterday and I probably need to read it another
22 three times, but hopefully I'll get there eventually, the ... but
23 you did acknowledge, I think, that these types of subsidies
24 are elsewhere, that they're a fact of life to a degree, and I
25 think that ...

26 DR. WILSON: Sure, lifeline rates have been in issue in
27 public utility regulation at least, for at least 25 years.

28 MR. NOSEWORTHY, CHAIRMAN: Right. Again, where
29 they exist elsewhere, I guess, is there any sort of standard
30 on which they're addressed? Is it usually done on the
31 basis of marginal cost or some other methodology? Is
32 there any commonality, I guess, in terms of approach to
33 these things where they exist elsewhere?

34 DR. WILSON: I wouldn't say so. I don't think there's
35 something I could point to as common. I would say the
36 most, the most common approach to them is to sweep them
37 away by just bumping up everybody else's cost a little bit
38 to cover them. I think that the ... you know, there's a couple
39 of unique things here. Your rural subsidy is, tends to be a
40 somewhat larger portion of Hydro's revenue requirements
41 than lifeline subsidies are than most other jurisdictions, so
42 there is a relative size issue, and then you have a legal
43 requirement to spread that subsidy only to certain
44 customers and not to others, so not everybody gets
45 involved in paying the cost, but the ...

46 MR. NOSEWORTHY, CHAIRMAN: I was thinking more ...

47 DR. WILSON: ... recovery is all over the place.

48 MR. NOSEWORTHY, CHAIRMAN: I was thinking more of
49 the assignment of those costs, recognizing that they are
50 there.

51 DR. WILSON: There probably are other jurisdictions where
52 they're assigned entirely to the residential class but there
53 are some where it's spread to everybody.

54 MR. NOSEWORTHY, CHAIRMAN: I guess my final
55 question, being an engineer and a bureaucrat for 25 years,
56 somebody, some people would feel that that's about as far
57 from a philosopher king as you could probably get, I would
58 think, but ...

59 DR. WILSON: All philosopher kings were bureaucrats, if
60 not all the engineers.

61 MR. NOSEWORTHY, CHAIRMAN: You know, I sort of
62 think of myself over the years that hopefully the first nine
63 reasons, I think, aren't why something can't be done, but I
64 try and think of one reason why it can be, and that's sort of
65 a philosophy I try to adhere to in any event, and I've sat
66 here, I guess and listened to the whole notion, and I too,
67 Mr. Browne, hope to sit down with the Minister of Justice
68 after this is over ...

69 MR. BROWNE, Q.C.: Yes, I understand that you do as
70 well. We've all got to report on our appointments
71 periodically.

72 MR. NOSEWORTHY, CHAIRMAN: But I have heard the
73 whole notion that (inaudible) regulation and really
74 alternative dispute resolutions and incentives associated
75 with the performance based models and other ways,
76 hopefully, of consolidating and streamlining this process,
77 but most of what I've heard, and I think it's been
78 acknowledged by all experts for the most part, has been,
79 and it will dictate a transition, a fairly well thought through
80 transition. It's not likely something that is going to happen
81 or should happen overnight. It's perhaps a strategy that's
82 involved and a deliberate approach, and certainly there are
83 a lot of stakeholders, as you can see in this room, involved
84 in this process. But on reflecting back, I suppose, and
85 getting to the tail end and you being here as the cost of
86 service expert with considerable experience and knowledge,
87 I'm sort of looking back on this process and recognizing
88 that we're in the 11th week but I look back on the volume
89 of, certainly, material that's been filed in a fairly, I think,
90 expeditious fashion throughout the course of this hearing,
91 and I look back on the experts, I don't think there's ... or the
92 witnesses, I don't think there's a lot of duplication that has
93 occurred quite frankly. I look at the cost of capital and
94 even the cost of service over two weeks, and I think for the
95 most part there's not a lot of duplication, it's been very
96 informative, and I'm looking forward to, quite frankly, the
97 next week and cluing this up in the week or so in January,
98 but ... and I'm new to this, quite clearly. In your experience
99 and knowing and seeing perhaps a little bit of what you
100 have seen here, notwithstanding the alternative dispute
101 resolution and the performance base, do you feel that this

1 process has been, given the spate of issues, in my opinion,
2 that's been before us, do you feel that this process, by the
3 standards that you're familiar with, have been, have been
4 elongated, if you will? That may be an unfair question, and
5 you really don't have to answer it, but ...

6 DR. WILSON: I think that they've been fine. I will say that
7 there may be in the future opportunities for you to convene
8 settlement conferences at the outset of hearings. The
9 Federal Energy Regulatory Commission in the States does
10 that regularly now, most of the litigated proceedings before
11 (inaudible) will have several settlement conferences at
12 which the parties get together and resolve many issues that
13 then do not require an argued adjudication, and it's also not
14 uncommon for there to be commission convened study
15 groups or colloquiums, or groups to come together
16 sometimes under the auspices of an administrator to sort of
17 hold the gavel, you know, but before a proceeding to talk
18 about cost allocation and rate design matters. That may be
19 something that you want to consider to help narrow the
20 issues that really have fundamental arguments where the
21 Commission has to make a decision. There probably are
22 some things in this proceeding that Mr. Brickhill, myself,
23 and Mr. Osler, Mr. Bowman, probably would have ... I think
24 there's many areas where we have agreement. Obviously,
25 there are also areas where the interest of the parties draw
26 them in different directions and where you're going to have
27 to make decisions, but I think that conceptually settlement
28 conference, discussions, study groups would help to
29 narrow things to some extent, but I think it's been a good
30 proceeding, and it's obviously one in which the panel has
31 been highly interested and participated in, and you
32 probably have, as you say, a different level of appreciation
33 for it now than you did two months ago.

34 MR. NOSEWORTHY, CHAIRMAN: Indeed, indeed.
35 Thank you, and the other comment I think I had to mention
36 was I think this technology I think has indeed sped things
37 up hopefully, and this is ...

38 DR. WILSON: This has been very well, and you see this
39 now in US courtrooms more and more, but I think this has
40 been just extraordinary, and the gentleman that's running
41 it has been just ...

42 MR. NOSEWORTHY, CHAIRMAN: Mr. O'Rielly is worth
43 twice his weight in gold. Thank you, Dr. Wilson.

44 COMMISSIONER POWELL: You'll probably get the bonus
45 under the incentive plan (*laughter*).

46 MR. NOSEWORTHY, CHAIRMAN: Thank you, actually
47 ... thank you to all the cost of service experts, those who
48 aren't here, and those that are here, and have a safe trip
49 home, and I wish you a Merry Christmas. I'll move now to
50 questions on matters arising. Hydro please?

51 MR. YOUNG: Good morning, Dr. Wilson.

52 DR. WILSON: Good morning.

53 MR. YOUNG: Just one matter arising, you indicated that
54 accountants and economists generally do not defer
55 expenses and then you gave some examples which are
56 exceptions to that rule and they related to me, it seems to
57 me, a variety of different issues. I'm just wondering,
58 although I think you've already stated, you haven't
59 canvassed the issue of fuel adjustment charges, sort of,
60 you know, across the continent. Would this be but just
61 another exception? I mean are there other fuel adjustment
62 charges that deal with periods of recovery that are, you
63 know, less than an immediate one, or I should say longer
64 than an immediate one so it's not recovered in that month
65 or the following month, but six months or a year or longer,
66 like the other ones that you referred to this morning, as to
67 the extraordinary events?

68 DR. WILSON: Well fuel adjustment's a little different
69 because usually the fuel adjustment issue, while it involves
70 a deferral is very short term, a year or less than a year.
71 Some jurisdictions have a true-up (*phonetic*) or a rolling
72 true-up that takes place on a monthly basis, some do it
73 quarterly. I don't know of any that have a significant
74 deferred balance that they, as part of a fuel adjustment that
75 they string out over more than a year, so it's different than
76 the other types of capitalizations and regulatory assets that
77 are set up for long-term recovery. There may be some
78 things besides fuel adjustment that are also subject to
79 modification. It's not that it's only fuel, there's sometimes
80 when other issues involving running costs like weather
81 differences, or load factor differences, can work their way
82 into a fuel cost adjustment type of mechanism.

83 MR. YOUNG: Okay, so these kinds of events, or this kinds
84 of factors can also be worked into these deferred charges
85 you're referring to, these means of recovering over periods
86 of time that which is judged not to be correct to hit the
87 utility and the customers in an immediate response?

88 DR. WILSON: Well, again, I'm talking fuel adjustments and
89 weather normalizations and that sort of thing. That tends
90 to be a short-term, you know, true-up monthly, quarterly,
91 something like that, as opposed to the RSP or the
92 capitalization of stranded costs that where the recovery is
93 deferred for years, so it's two different things.

94 MR. YOUNG: That's fine, thank you, Dr. Wilson.

95 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
96 Young. Ms. Butler please?

97 MS. BUTLER, Q.C.: No questions arising.

98 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
99 Hutchings. I just want to comment your new glasses look

1 quite ... I was wondering if it was the schedule on energy
2 usage over 20 years on one page that drove you over the
3 edge or what.

4 MR. HUTCHINGS: Purely a matter of age (*laughter*).

5 MR. NOSEWORTHY, CHAIRMAN: Sorry about that. Ms.
6 Henley Andrews?

7 MR. HUTCHINGS: I asked for it.

8 (*11:00 a.m.*)

9 MS. HENLEY ANDREWS, Q.C.: Mr. Chairman, you're
10 obviously more observant than I am. Dr. Wilson, I just
11 have two questions. If we could go back to the Bond
12 Bright principles that Mr. Saunders referred to. When you
13 look at the four principles that are outlined, would you
14 agree that application of the principles themselves require
15 a certain amount of balancing for the regulator?

16 DR. WILSON: Sure.

17 MS. HENLEY ANDREWS, Q.C.: And that, for example, if
18 you look at items three and four, which is revenue stability
19 from year to year, that would be the revenue stability of the
20 utility, correct?

21 DR. WILSON: Well, I think of four as being stability from
22 a customer perspective. Say you had a hypothetical paper
23 mill ...

24 MS. HENLEY ANDREWS, Q.C.: Yes.

25 DR. WILSON: That I believe that the, you know, the rate
26 for electricity was three cents a kilowatt hour, and they
27 invested, you know, \$100 million of creating the capital
28 investment in that paper mill in a hypothetical place called
29 Corner Brook, something like that, and then all of a sudden
30 the Board changed the price of electricity from three cents
31 to six cents, and you know, knocked them out of world
32 markets. I mean if I were a Board member, I don't think that
33 I would do that if that paper mill were an important part of
34 the economy of my province, and I don't think that that
35 would be, that that would be, quote, fair, quote, equitable.
36 I think that some transition, you know, if you're going to go
37 that way, it would make more sense than breaking that
38 understanding, even though it may not be a written
39 contract.

40 MS. HENLEY ANDREWS, Q.C.: The other question is
41 when you look at the roughly \$30 million in rural subsidy in
42 relation to the \$300 million revenue requirement. Would
43 you agree that the problem in Newfoundland and Labrador
44 with respect to the subsidization is largely the magnitude
45 of the subsidy in relation to the total revenue requirement
46 which is something that you don't normally see in other
47 jurisdictions?

48 DR. WILSON: Well, the size would be the financial or risk

49 issue, I think. The \$100 million is, you know, a much bigger
50 deal and is likely to get the bond rater's attention whereas
51 \$15 million or \$20 million is not. But that's not to say that
52 the \$100 million versus the \$300 million annual revenue
53 requirement of the company is so big that it doesn't have
54 correspondence in terms of deferred assets in other
55 jurisdictions where the deferred assets can be a big
56 percentage of annual revenue requirements, but I think
57 when you get to \$100 million you are starting to look at
58 something that could be a financial issue because of the
59 size, yes.

60 MS. HENLEY ANDREWS, Q.C.: Okay, now that's with
61 respect to the Rate Stabilization Plan, but my question was
62 with respect to the rural subsidy issue.

63 DR. WILSON: Oh, I'm sorry.

64 MS. HENLEY ANDREWS, Q.C.: That's okay, it's been a
65 long two weeks ... and that is that if you look at the roughly
66 \$30 million rural subsidy ...

67 DR. WILSON: Uh hum.

68 MS. HENLEY ANDREWS, Q.C.: It's, you know, ten percent
69 of the \$300 million of revenue requirement, and in terms of
70 impact on rates for any of Hydro's customers, that the real
71 problem when you look at that type of a subsidy for
72 Newfoundland and Labrador is the magnitude of the
73 subsidy compared to the revenues, whereas in other
74 jurisdictions there may very well be some cross-
75 subsidization, but it's usually at a much lower level from a
76 revenue to cost ratio perspective?

77 DR. WILSON: I think that's true.

78 MS. HENLEY ANDREWS, Q.C.: And are you familiar with,
79 for example, how they handle these types of things in sort
80 of more northern jurisdictions like the Northwest
81 Territories, for example, where they have multiple isolated
82 systems, and they also have lifeline blocks?

83 DR. WILSON: I don't know, I would expect Mr. Osler
84 probably knows about that, but I don't.

85 MS. HENLEY ANDREWS, Q.C.: Okay, thank you. Those
86 are all my questions.

87 MR. NOSEWORTHY, CHAIRMAN: Thank you, Ms.
88 Henley Andrews. It is ten after 11:00, but I can smell the
89 end here unless somebody has an objection. Mr. Browne?

90 MR. BROWNE, Q.C.: We have no further questions, thank
91 you.

92 MR. NOSEWORTHY, CHAIRMAN: Thank you very much.

93 MR. KENNEDY: No further questions, Mr. Chair.

94 MS. HENLEY ANDREWS, Q.C.: Mr. Chairman, Mr.
95 Hutchings with his new glasses has just drawn to my

1 attention that we did not mark the section of the transcript
2 that Mr. Kennedy put in.

3 MR. KENNEDY: I believe that's the first exhibit submitted
4 by Board counsel, so it would be BC-1. Thank you,
5 Counsel.

6 **EXHIBIT BC-1 ENTERED**

7 MS. BUTLER, Q.C.: Mr. Chairman, before we break for the
8 day, Newfoundland Power has their filing in response to
9 Ms. Greene's capital budget application which is going to
10 be heard on Tuesday, so I'll just give it to the Clerk to be
11 passed out.

12 MR. NOSEWORTHY, CHAIRMAN: Thank you very much,
13 Ms. Butler. I think, unless there's anything else, that
14 concludes our work for today. Dr. Wilson, once again,
15 thank you, sir, very much, and have a safe trip home and ...

16 MR. FITZGERALD: Mr. Chairman, sorry to interrupt,
17 there's one small housekeeping matter. We have filed our
18 response to the capital budget application as well, and I
19 don't think that was said on the record, but just for the
20 record, that's been done.

21 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
22 Fitzgerald. We will reconvene at 9:30 on Tuesday morning
23 to hear the capital budget. Thank you very much, have a
24 nice weekend.

25 *(hearing adjourned to December 11, 2001)*