

1 (9:30 a.m.)

2 MR. NOSEWORTHY, CHAIRMAN: Thank you and good
3 morning. We'll go directly to Board counsel for any
4 preliminary matters, Mr. Kennedy.

5 MR. KENNEDY: Chair, I believe counsel for Hydro has a
6 quick preliminary matter.

7 MR. NOSEWORTHY, CHAIRMAN: Sure.

8 MS. GREENE, Q.C.: Good morning.

9 MR. NOSEWORTHY, CHAIRMAN: Good morning.

10 MS. GREENE, Q.C.: I do have one minor preliminary point.
11 I wanted to correct something that I said late yesterday
12 afternoon when I circulated the revised 2002 cost of service
13 and supplementary information. I indicated at that time that
14 it included actuals to the end of August and forecast to the
15 end of August. There is one exception to that and that is
16 interest. The documentation circulated does include
17 forecast for interest expense done in September and that is
18 the only exception. Everything else would be as of the end
19 of August, and the reason that was able to be done is that
20 interest is one of the last inputs in what is initiative
21 process, so they were able to include a more recent forecast
22 for interest expense and that is the only one that's post
23 August 31st, and that will be, they were done in September
24 for the forecast for interest. That is the one correction I
25 wanted to make to what I said yesterday when I circulated
26 the revised evidence.

27 MR. NOSEWORTHY, CHAIRMAN: Thank you for that
28 clarification, Ms. Greene. Good morning, Mr. Hall.

29 MR. HALL: Good morning.

30 MR. NOSEWORTHY, CHAIRMAN: I believe, Mr.
31 Hutchings, you indicated late yesterday afternoon that you
32 may have some more questions in the morning.

33 MR. HUTCHINGS: I do have a few more, Mr. Chair.

34 MR. NOSEWORTHY, CHAIRMAN: You do have a few?
35 Okay. I'll ask you to proceed, please.

36 MR. HUTCHINGS: Thank you. Good morning, Mr. Hall.

37 MR. HALL: Good morning.

38 MR. HUTCHINGS: I wanted to just explore a little bit
39 further the discussion we had yesterday which involved
40 the questions of what you and I were referring to when we
41 talked about various types of risks that are associated with
42 Newfoundland and Labrador Hydro or utilities generally.
43 I guess the issue came up in the context of whether or not
44 in your parlance you would include regulatory risk as part
45 of the business risk, and I took it from you that that was
46 probably not something you'd do. Is that fair?

47 MR. HALL: I believe I agreed that if you split the types of
48 risks that a company is exposed to into two categories for
49 ease of categorization that, and therefore there were
50 business and financial risks, that I agreed that you could
51 put that into the business risk side.

52 MR. HUTCHINGS: Okay. So regulatory risk is part of the
53 business risk.

54 MR. HALL: Yeah. We actually think of it as a separate risk
55 but in order to make it just the two, yes.

56 MR. HUTCHINGS: Okay, alright. No, no. I'm trying to get
57 from you how you normally approach it. So you would
58 normally say there are three classes of risk then.

59 MR. HALL: Well, actually we get carried away and there's
60 more, but business and financial risk, those are the two.
61 Regulatory is part of business. I would agree with that.

62 MR. HUTCHINGS: Those are the two, excuse me?

63 MR. HALL: Those are the two categories. Regulatory
64 would be part of business risks.

65 MR. HUTCHINGS: Okay, alright. What other categories of
66 risk have you normally addressed?

67 MR. HALL: Within business risk, well it becomes specific
68 to the company itself. In other words, there are risks that
69 a company is exposed to which would be subcategories of
70 the business risk, commodity risk, market risk, but again
71 those are parts of what I would consider business risk.

72 MR. HUTCHINGS: And is it your view that any part of the
73 risk associated with a utility such as Hydro changes as the
74 capital structure changes?

75 MR. HALL: Any part of the overall risk, I presume you
76 mean.

77 MR. HUTCHINGS: Yes.

78 MR. HALL: Yes. If the financial risk goes up or goes down
79 because of a change in capital structure, which is I assume
80 what you're alluding to, that doesn't affect the business risk
81 side of that balance so that the overall risk will go up or go
82 down.

83 MR. HUTCHINGS: Okay. So if I'm reading you correctly,
84 the capital structure will affect the financial risk but not the
85 business risk per se.

86 MR. HALL: Yes. You are reading me correctly although I
87 would recall Ms. McShane's comments that there are on the
88 edges. There are impacts on the business risk side, in other
89 words the operational risk of the company, if their financial
90 risk gets too high, but outside of the margins, I think that's
91 correct.

92 MR. HUTCHINGS: So looking at the financial risk then,

1 how does that change as the capital structure changes?

2 MR. HALL: Okay. To the extent that a company increases
3 their obligation for fixed expenses, which is typically
4 interest, but it's also lease payments, anything that they
5 have an obligation to pay, to the extent that they increase
6 the proportion of fixed obligations they're increasing the
7 risks because they have to generate sufficient cash flow to
8 meet those obligations or else they will be in default, and
9 so most companies try to operate their business with a
10 minimum of fixed costs and the balance being in variable
11 costs so they can adjust to the market conditions that they
12 see. So on the financial side, to the extent that you have
13 more debt on your balance sheet, you have more fixed
14 obligations depending of course on the structure of the
15 debt, and that increases the risk to that company.

16 MR. HUTCHINGS: That increases the financial risk.

17 MR. HALL: Yes.

18 MR. HUTCHINGS: Okay.

19 MR. HALL: And therefore the overall risk.

20 MR. HUTCHINGS: Okay. So you view the business and
21 the financial risk as being additive or is one part of the
22 other?

23 MR. HALL: Without getting into what the subtlety of
24 additive means, yes. I think there are, yes, there are
25 separate risks that are complementary. You have to look at
26 both when you're looking at a company. You can't look at
27 one in isolation of the other but they're not the same risks,
28 no. They're complements to each other. I think in my
29 testimony I suggested that there are companies that have
30 such high business risks in terms of the volatility of their
31 earnings and their outlook that they don't have any
32 financial risk in the sense of debt-equity ratios at least,
33 because they can't stand to add those financial risks to the
34 business risks that they already have, and there are
35 companies that can take a considerable amount of financial
36 risk, i.e. leverage, fixed charges as we call it, because of the
37 stability of the cash flows that they have.

38 MR. HUTCHINGS: The business risk in itself arises out of
39 the nature of the operations of the business, is that fair?

40 MR. HALL: Yes.

41 MR. HUTCHINGS: Okay. And absent financial distress, if
42 you will, that risk stays the same notwithstanding whatever
43 capital structure is chosen. Is that fair?

44 MR. HALL: Yes. It's fair as far as it goes but well before
45 you get to a level of financial distress there are going to be
46 concerns on the business side if you have too much
47 leverage. By example, a company that has not filed for
48 CCRA, CCWA, sorry, or, you know, has not gone to their

49 creditors and said I'm in trouble but is rumoured to be at
50 that level, in other words it has financial risks that it's
51 exposed to that is now obvious, generally finds out that
52 they can't buy supplies and they can't get trade terms and
53 they can't lease office buildings because nobody thinks
54 they're good credit, and so it's not just financial distress,
55 it's a spectrum that gets close to that end of the ...

56 MR. HUTCHINGS: Okay. I wasn't intending to indicate
57 that the only indicators of financial distress would be
58 bankruptcy or receivership or something like that but I
59 would regard financial ... the intent of my question was,
60 financial distress to mean that there were financial factors
61 that were affecting the business operation such as you
62 described.

63 MR. HALL: Yes, I agree with that.

64 MR. HUTCHINGS: Yeah, okay. Returning then to our
65 discussions of yesterday about the benefits of treating
66 Hydro as a commercial entity, if you will, I took it generally
67 that your position would favour the benefits of a
68 commercial outlook in the sense that there would be
69 competitive pressures and incentives for the Company to
70 perform well in that sort of situation. That's sort of a
71 general impression I was taking from what you said
72 yesterday. Is that an accurate one?

73 MR. HALL: Yes, I believe there are benefits from having a
74 clear set of instructions, a focused management team, yes.

75 MR. HUTCHINGS: And you feel that a "commercial
76 operation" is more likely to have that attitude, if you will,
77 than a government-run organization.

78 MR. HALL: Yes.

79 MR. HUTCHINGS: Okay. What are the essential
80 characteristics of that commercial operation which give rise
81 to that sort of attitude on the part of management?

82 MR. HALL: You want me to dig the same hole I did
83 yesterday.

84 MR. HUTCHINGS: Just a little deeper.

85 MR. HALL: Yeah, okay. Generally speaking companies,
86 the management of companies has a pretty clear mandate as
87 to what it is that's considered to be a proper outcome for
88 their activities, and that is profits, earnings, dividends to
89 shareholders, and so they're quite comfortable with the, if
90 you will, the marching orders that they have from the
91 shareholders of that company and they are prepared to
92 accept other directions that typically come from
93 governments in the regions that they work in but those are
94 explicit instructions that come probably through their
95 shareholders, or at least come very publicly. So there's a
96 comfort in the management team as to what it is that is the
97 result of "good behaviour" or good work in terms of their

1 business. In a Crown corporation it's a much more
2 challenging environment for a management team, simply
3 because the shareholder is a political entity and therefore
4 doesn't have one focus, doesn't have one direction, which
5 is to generate earnings, but rather has a myriad of different
6 influences on that shareholder. It's also true, and it's a
7 challenge again for the management of any Crown
8 corporation, that there is no one shareholder, because of
9 the democratic process that we live in in this country, there
10 are a number of influences within any government, and so
11 it requires the management team to be very much aware of
12 areas that typical managements of commercially-run
13 companies don't have, and to that extent it is much more
14 focused, the commercially-run business is much more
15 focused than a Crown corporation management is allowed
16 to be.

17 (9:45 a.m.)

18 MR. HUTCHINGS: Okay. Can you explain for me how the
19 suggestions that you're making to the Board to make Hydro
20 into a more commercially-oriented company are going to
21 have the effect of changing the situation in which
22 management works from that of a Crown corporation to a
23 private company?

24 MR. HALL: I couldn't give you specifics because they're
25 all very specific to the situation of course. I could point
26 you to Sask Power and as an example of a company that
27 has been asked some time ago in an NDP environment, if I
28 recall, certainly it is now, to operate the business on
29 commercial terms, to have a balance sheet that's roughly
30 60/40, as I've recommended here, and it's quite clear to the
31 management of that company that their job is to run Sask
32 Power as a commercial enterprise with normal outcomes.
33 They still have the challenges of being a Crown
34 corporation and therefore what I just described earlier, but
35 they're far more able to focus on single criteria for their
36 management. I'd also refer you to Hydro One and Ontario
37 Power Generation, which is the Ontario Hydro spin-off
38 companies, and because that's a more recent example. In
39 the last year they were created, given capital structures
40 which are again very consistent with what I'm
41 recommending here, and they were told quite explicitly to
42 run those operations as commercial entities except that they
43 happen to be owned by the Province of Ontario. They
44 have to calculate income taxes as if they paid income taxes,
45 although they do not pay income taxes in a normal sense
46 because they're Crown corporations, but they literally have
47 to fill out tax forms just like everyone else does, and the
48 message that those companies are getting from their
49 shareholder in those cases is operate the business as if you
50 were in direct competition to other energy providers, make
51 it a business, do the best job that you can, and if we have
52 other instructions for you we'll let you know, so that at the

53 end of the year, when the management of that company
54 reports their results to their shareholder, they know
55 essentially what the criteria of success have been, and I
56 think that gives them a better ability to do the job that they
57 are hired to do.

58 MR. HUTCHINGS: Okay. So these two cases in, both in
59 Ontario and in Saskatchewan, were in fact policy decisions
60 of the Government itself, were they not?

61 MR. HALL: I'm more familiar with Ontario, but, yes, I
62 believe they both were.

63 MR. HUTCHINGS: Yes, okay. And to your knowledge has
64 the Government or, well let us say the Government in
65 Newfoundland, made that sort of policy decision here?

66 MR. HALL: Not being a lawyer I can't interpret the
67 subtleties of the legislation that's in place and because I'm
68 not a lawyer then I can just read it for what I think it says,
69 and I think that's what it says.

70 MR. HUTCHINGS: Okay. But would you agree with me it
71 certainly doesn't say that as explicitly as it was said in
72 Ontario?

73 MR. HALL: It's pretty clear to a non-lawyer what it says
74 here. There hasn't been a restructuring of this company
75 but then I'm not sure that that's necessarily making it any
76 more clear.

77 MR. HUTCHINGS: Well, I mean, the Government hasn't
78 said that there should be a 60/40 debt-equity ratio in Hydro
79 here, either legislatively or by fiat, correct?

80 MR. HALL: Not to my knowledge, no.

81 MR. HUTCHINGS: No, okay. And the Government
82 certainly hasn't directed that Hydro fill out tax forms or pay
83 any amount in lieu of taxes?

84 MR. HALL: No. That's not the case in Saskatchewan
85 either.

86 MR. HUTCHINGS: No, no, but it is in Ontario.

87 MR. HALL: Yeah.

88 MR. HUTCHINGS: Okay. And, I mean, I guess the
89 (unintelligible) case is actually the one we discussed
90 yesterday which is Nova Scotia Power which was actually
91 privatized.

92 MR. HALL: Yes, although it ran for ten years prior to its
93 privatization as a commercially-run corporation with a
94 mandate as I've, generally speaking, as I've described.

95 MR. HUTCHINGS: But it is left to this Board in the context
96 of this application to determine on the basis of its own
97 good judgement what the appropriate debt-equity ratios are
98 and the other parameters which will govern Hydro insofar

1 as this Board has jurisdiction over it, correct?

2 MR. HALL: That's my understanding, yes.

3 MR. HUTCHINGS: In terms of the corporate culture, if you
4 will, that we're talking about creating here, would you agree
5 with me that, essentially no matter what the financial results
6 of Hydro are, there will always be a Newfoundland and
7 Labrador Hydro?

8 MR. HALL: I'm sorry, I don't understand that.

9 MR. HUTCHINGS: I mean, as long as there are people in
10 Newfoundland, there will presumably be a need to provide
11 electricity to them?

12 MR. HALL: Okay. That's a different question. I agree with
13 that one.

14 MR. HUTCHINGS: Yes, yeah, okay. And presumably
15 that's going to happen through some entity like a
16 Newfoundland and Labrador Hydro.

17 MR. HALL: Or Newfoundland Power.

18 MR. HUTCHINGS: Yes, okay.

19 MR. HALL: Yes.

20 MR. HUTCHINGS: Yeah. So that in comparison with a
21 private sector company, Newfoundland Hydro will never
22 really face the possibility of bankruptcy and disappearing
23 off the map. Is that fair?

24 MR. HALL: No, that's not fair. I mean, this is a company
25 that has to operate its business in an efficient manner. I
26 mean, I would assume that you as taxpayers of this
27 province would assume that if this company doesn't do the
28 proper job that they can be relieved of their duties and
29 those tasks given to somebody else.

30 MR. HUTCHINGS: But there will nonetheless be power
31 generated at Bay d'Espoir and transmitted and distributed
32 in Newfoundland.

33 MR. HALL: That was the other ... that was the earlier
34 question which I agreed to, yes.

35 MR. HUTCHINGS: Yeah, yeah, okay.

36 MR. HALL: There is a need for energy, yes.

37 MR. HUTCHINGS: Yeah. But, I mean, a private sector,
38 pure private sector company has in fact the real risk of not
39 being able to carry on business and disappearing, isn't that
40 correct?

41 MR. HALL: Yes, but not any more so than this company.
42 The electric utilities and the way that we structured them in
43 this country, in this continent, largely speaking are still
44 regulated monopolies, not all but largely speaking they are
45 and so they are protected to some degree from folding up

46 their tent and going home, but all companies are subject to
47 changes to their business risks which means that they'll no
48 longer be in business, and this company, I believe, is no
49 different.

50 MR. HUTCHINGS: So you foresee a real possibility of a
51 policy decision on the part of the Government of
52 Newfoundland which would see the end of Newfoundland
53 and Labrador Hydro.

54 MR. HALL: No.

55 MR. HUTCHINGS: No, okay. In terms, going back for a
56 moment, in terms of the attitude of the management and the
57 way it approaches its task in the operation of
58 Newfoundland and Labrador Hydro, what difference does
59 the debt-equity structure make?

60 MR. HALL: I'm not sure quite where your comment is
61 going. The debt-equity structure tends to influence the
62 risk profile to the Company and therefore to the
63 shareholder more than it does to the management, so I'm
64 not quite sure I understand.

65 MR. HUTCHINGS: No. I understood that part of your
66 presentation to the Board in the overall suggestion that
67 Hydro be run as a commercial entity included the notion
68 that it should have a 60/40 debt-equity ratio.

69 MR. HALL: Yes.

70 MR. HUTCHINGS: But that is not a factor that's going to
71 impinge upon how management does their job or is it?

72 MR. HALL: I'm sorry, I'm still not quite there. The 60/40
73 debt-equity ratio that I recommended is because that is a,
74 by example of other similar corporations, a reasonable
75 financial structure for a company with that business risk to
76 operate under. I don't think it affects the management of
77 the Company's day-to-day decisions except for their
78 concern about the amount of fixed charge, fixed charges
79 they have to pay on a year-to-year basis.

80 MR. HUTCHINGS: Alright. So if you reach the initial
81 conclusion that Hydro should be treated as a commercial
82 entity, then that takes you to the 60/40 debt-equity ratio in
83 your submission.

84 MR. HALL: Yeah. It's consistent with running it as a
85 commercial entity because that's the way commercial
86 entities do operate their businesses.

87 MR. HUTCHINGS: But as I understand it though, your
88 principal reason for suggesting that there's value in being
89 a commercial entity is that it will affect how management
90 runs the company.

91 MR. HALL: No, I don't think that's my principal reason. I
92 think that's an outcome. I think the principal reason is the
93 philosophical one which is that governments have

1 responsibilities and roles for social policy in this
2 environment and one of those is not necessarily to own an
3 electric utility, and that's clearly evidenced by other
4 jurisdictions where they don't own electric utilities, and so
5 to the extent that this government chooses to own an
6 electric utility in competition with a privately-held one, I
7 think it's appropriate for that government to run their
8 electric utility the same way the other one does. That's a
9 philosophical view that I start with.

10 MR. HUTCHINGS: Okay, that's fine. Your company, your
11 organization, is also financial advisor to the Government of
12 Newfoundland, is it not?

13 MR. HALL: Yes, it is.

14 MR. HUTCHINGS: Would you recommend to the
15 Government of Newfoundland that it invest some equity in
16 Newfoundland and Labrador Hydro?

17 MR. HALL: Of three percent? I'm sorry, I'm not supposed
18 to ask questions. *(laughter)* I did that yesterday too, I'm
19 sorry. Given the philosophical position that I just made, I
20 would have trouble suggesting that the Province of
21 Newfoundland take taxpayers' money and invest it in a
22 business that can be operated and the services delivered
23 by others. I just don't happen to have that philosophy and
24 my company does not either.

25 MR. HUTCHINGS: Okay. So while you're suggesting that
26 the equity in Hydro move toward 40 percent, you're
27 suggesting that that be attained by retaining earnings?

28 MR. HALL: I think that's a practical way to get to the 40
29 percent, yes.

30 MR. HUTCHINGS: You've recommended here a range of
31 return on equity of 10 to 12 percent for Newfoundland and
32 Labrador Hydro.

33 MR. HALL: Yes.

34 MR. HUTCHINGS: If that recommendation was accepted,
35 would you then recommend to Government that it invest
36 money in Newfoundland and Labrador Hydro?

37 MR. HALL: My philosophy wouldn't have changed, so the
38 only reason that I would recommend that the Province
39 invest in Newfoundland and Labrador Hydro is if there was
40 a perceived need to get there more quickly than retained
41 earnings would allow the Company to get there, and I don't
42 foresee that at the moment.

43 MR. HUTCHINGS: Wouldn't ...

44 MR. HALL: It's an ... sorry, in Ontario, to go back to that
45 example, when the companies were restructured to provide
46 them with financial structures that were appropriate to the
47 businesses that they operated in, in effect, although I don't
48 believe directly, but in effect that's what happened, is that

49 the Province of Ontario converted what was debt of
50 Ontario Hydro into equity in the new companies that were
51 formed. In an indirect way I suppose that's investing in
52 them, although the money was already there, but I'm not
53 recommending that.

54 MR. HUTCHINGS: Would not the Government get a good
55 return from investing in Newfoundland and Labrador
56 Hydro if only by reason of the fact that it can borrow
57 money presumably at 7.35 percent, pay off, inject that
58 money into Hydro, have Hydro pay off its debt, which
59 reduces the Government's guaranteed debt, and then
60 Government on your recommendation would be getting a
61 10 to 12 percent return on that money, only paying 7.35 for
62 it.

63 MR. HALL: The math works. The concept is, can be
64 extended to the level of silliness. For example, if that's the
65 case, then why don't they buy Fortis where they can get a
66 good return on their investment in owning Fortis and we
67 can borrow the money at 7.35 percent and buy Fortis? So
68 why not own all the electric utilities in this province and
69 then let's go on and buy something else?

70 MR. HUTCHINGS: Has Government guaranteed Fortis'
71 debt at this point?

72 MR. HALL: No.

73 MR. HUTCHINGS: No.

74 MR. HALL: But they could earn a very good return on the
75 investment in Fortis if they bought it. Governments are ...

76 MR. HUTCHINGS: Yeah, but ...

77 MR. HALL: ... not supposed to do that, in my opinion.

78 MR. HUTCHINGS: Yeah, but, I mean, that means the
79 Government is incurring new debt if it's going to invest in
80 Fortis, correct?

81 MR. HALL: Yes.

82 MR. HUTCHINGS: Yes. But in investing in Newfoundland
83 and Labrador Hydro while it's incurring new debt, it's
84 paying off debt it's guaranteed.

85 MR. HALL: Yes, but it's guaranteed it. It's not ... the
86 Province of Newfoundland is not exposed in the credit
87 rating agencies' review to the debt of Newfoundland Hydro
88 at the moment. If they converted they would be.

89 MR. HUTCHINGS: But the consolidated statement of the
90 Province would not change, would it?

91 MR. HALL: Yes, it would. The consolidated statement of
92 the Province ... well, sorry, depends on ... are you talking
93 accounting or otherwise? From the credit rating agencies'
94 perspective, which I apologize, is where I think, they don't
95 consolidate the debt of Hydro into the Province's

1 consolidated financial obligations unless there's a problem
2 with financial self-sufficiency.

3 MR. HUTCHINGS: But, I mean, their rating of the debt, and
4 we looked at this yesterday, when they talk about long-
5 term debt, says, "Issued/guaranteed by the Province,
6 includes Newfoundland and Labrador Hydro and
7 Newfoundland Municipal Financing (phonetic)
8 Corporation."

9 MR. HALL: Yes, they do guarantee it, yeah.

10 MR. HUTCHINGS: Uh hum. And that's reflected in the
11 rating.

12 *(10:00 a.m.)*

13 MR. HALL: It's not reflected in the rating of the Province
14 of Newfoundland and Labrador except in the way I
15 described yesterday in terms of their concern whether this
16 has got a financial self-sufficiency exposure. Absent that
17 influence on the Province of Newfoundland and Labrador,
18 I believe if you ask the rating agencies do we tell the
19 Deputy Minister of Finance that he has a problem because
20 the overall debt, including that of Hydro, is too high, I
21 would suggest he would say as long as Hydro is operating
22 in a financially self-sufficient basis, I'm not constrained by
23 what they do.

24 MR. HUTCHINGS: I mean, obviously if Newfoundland and
25 Labrador Hydro had this high level of equity, which would
26 be an asset on the books of the Province, because it would
27 own the equity ...

28 MR. HALL: Yes.

29 MR. HUTCHINGS: ... then Newfoundland and Labrador
30 Hydro would continue to be quite self-supporting.

31 MR. HALL: Oh, yes. Newfoundland Hydro would be a far
32 more financially stable and secure company with 60/40
33 debt-equity ratio and an adequate return on that equity
34 than they would today, yes.

35 MR. HUTCHINGS: Yeah, okay.

36 MR. HALL: But that doesn't suggest that they need to
37 invest in that to get there.

38 MR. HUTCHINGS: So Government, you're suggesting, is
39 as well off by choosing to guarantee the debt and getting
40 the one percent guarantee fee.

41 MR. HALL: No, I'm sorry, I'm not suggesting that either.
42 I'm saying ... I'm suggesting that the Government is better
43 off to allow the retained earnings to grow to 60/40 and get
44 an adequate return on the investment of the retained
45 earnings that they have in the Company.

46 MR. HUTCHINGS: Okay, that's all I have. Thank you, Mr.
47 Hall. Thank you, Mr. Chair.

48 MR. NOSEWORTHY, CHAIRMAN: Thank you very much,
49 Mr. Hutchings. We'll proceed on now with the Consumer
50 Advocate. Good morning, Mr. Fitzgerald.

51 MR. FITZGERALD: Thank you, Mr. Chairman. Good
52 morning, Mr. Hall.

53 MR. HALL: Good morning.

54 MR. FITZGERALD: Mr. Hall, in your **pre-filed evidence at**
55 **page two** you indicate that your firm, RBC Dominion
56 Securities, has acted as an underwriting and financial
57 advisor to Hydro, and you mention there 50 years. I take it
58 50 years means Hydro's predecessor, I guess, or ...

59 MR. HALL: Yes.

60 MR. FITZGERALD: Yeah, okay. Can you just describe
61 briefly how this underwriting works for me, not an elaborate
62 description but just what do you mean by the definition of
63 underwriting?

64 MR. HALL: Sure. It's actually an insurance term that we've
65 pirated for our business, but an underwriter in our parlance
66 is a company that undertakes to find investors for debt
67 securities of the Province or of Hydro, that we negotiate
68 with those potential investors and with the company, the
69 issuing company, what the price of that debt security
70 would be, the coupon or the yield to the investors, and we
71 enter into an underwriting agreement, which is why we
72 stole that term, with the company whereby we undertake as
73 usual a group of dealers to purchase the bonds from
74 Hydro, use that, at a certain price, a slight discount to the
75 issue price, which is the commission that we keep for
76 ourselves, and we re-offer those bonds to the public at the
77 yield that we agreed to. We act as what we call
78 intermediaries in the sense that although we do buy them
79 and own them, it's our job to not own them as quickly as
80 possible, and so we sell them on to investors and hopefully
81 at the price that we thought we were going to be able to do
82 so, and if we're able to do that then we keep the
83 commission that was the difference between what we paid
84 the company and what we received from the investors.

85 MR. FITZGERALD: Thank you. In that process, when you
86 communicate with the market regarding your client, Hydro,
87 would it be fair to say that you would promote the debt
88 security of Hydro?

89 MR. HALL: Do you mean do we tell them why they should
90 buy that?

91 MR. FITZGERALD: Yes.

92 MR. HALL: Absolutely.

93 MR. FITZGERALD: Okay. So would you say that in that
94 circumstance, and just going back to what you said, you
95 don't want to hang on to these too long, you want to make

- 1 sure that you sell these securities.
- 2 MR. HALL: Yes.
- 3 MR. FITZGERALD: Okay. It's not in your interest for you
4 not to sell them.
- 5 MR. HALL: We're not an end investor. We don't want to
6 own bonds. It's not our business.
- 7 MR. FITZGERALD: So you would ... obviously there's
8 rules of ethics, and of course I'm not suggesting that you
9 or your firm would breach those, but is it in your firm's
10 interest to cast the Hydro debt securities in a favourable
11 light?
- 12 MR. HALL: Yes.
- 13 MR. FITZGERALD: Now, would you agree with me then,
14 or maybe I have this wrong, but you're presenting evidence
15 here before this Board on behalf of Hydro.
- 16 MR. HALL: Yes.
- 17 MR. FITZGERALD: Okay. Can the Board assume that you
18 are completely impartial to the affairs of Hydro?
- 19 MR. HALL: No, I don't think they can assume that I am
20 completely impartial because I'm not. I think that it's
21 important in all of these situations to have transparency, in
22 other words, to disclose adequately what my job is and
23 what I do and what my company does and then have the
24 Board and you, for that matter, determine whether the
25 testimony that I would provide and the comments are
26 reasonable. To suggest that they're biased in any
27 inordinate way would be inaccurate but I certainly do have
28 the interests of the Province, which I also am an
29 underwriter of, and the interests of Hydro in mind.
- 30 MR. FITZGERALD: So you would say that there's no
31 inordinate bias but there is a natural bias. Is that a fair
32 summation of what you've said?
- 33 MR. HALL: No, I don't think there's even a natural bias.
34 The comments that I've made and the testimony I've filed I
35 believe does not evidence any bias towards Hydro. I think
36 you asked me whether I am interested in the outcome of
37 Hydro's financial results and the answer was yes, because
38 they're my client ...
- 39 MR. FITZGERALD: Okay, yes.
- 40 MR. HALL: ... but that doesn't mean that my testimony is
41 biased in any way.
- 42 MR. FITZGERALD: The words "impartial" then, are you
43 impartial to the outcome?
- 44 MR. HALL: In the very narrow sense, yes, I am impartial to
45 the outcome because to the extent that this company
46 continues to be financially self-sufficient and in need of
- 47 capital, I will continue to have the job that I do now, which
48 is to provide them with that capital. In a perverse way, one
49 could suggest that to the extent that this company is not
50 allowed to earn an adequate rate of return, they'll need more
51 external capital, but we don't think that way.
- 52 MR. FITZGERALD: Okay. If this Board was to assess a
53 more favourable rate of return, would it not make your job
54 easier to sell the debt security of Hydro ultimately?
- 55 MR. HALL: No.
- 56 MR. FITZGERALD: It wouldn't?
- 57 MR. HALL: No.
- 58 MR. FITZGERALD: Can you explain why it would not?
- 59 MR. HALL: Because of the provincial guarantee. Until
60 such time as the Company has evolved their financial
61 structure to the point where they don't require the
62 provincial guarantee, bond holders who look at this
63 company are purchasing the bonds of Hydro on the basis
64 that it is an obligation of the Province, not of Hydro.
- 65 MR. FITZGERALD: So are you suggesting that the rate of
66 return is an irrelevant consideration?
- 67 MR. HALL: Within a reasonably wide range of outcomes,
68 yes.
- 69 MR. FITZGERALD: So why should the Board bother then
70 in setting a range for rate of return in this case?
- 71 MR. HALL: That's not for me to say. I thought the Board
72 had instructed that rate of return on rate base methodology
73 was appropriate and that's why we're here.
- 74 MR. FITZGERALD: I'd like to refer you, if I could, Mr. Hall,
75 to **DH-1**. If you have that there, in the centre of the
76 document there is a reference to considerations regarding
77 Newfoundland and Labrador Hydro's commercial paper and
78 short-term debt ratings.
- 79 MR. HALL: Yes.
- 80 MR. FITZGERALD: The heading, "Challenges," you see
81 the second bullet there, it says, "High realized foreign
82 exchange losses."
- 83 MR. HALL: Yes.
- 84 MR. FITZGERALD: Now, we understand that RBC
85 Dominion Securities has been working for 50 years with
86 Hydro and its predecessors?
- 87 MR. HALL: Yes.
- 88 MR. FITZGERALD: And I won't take you to it now unless
89 we have to but I would suggest to you that, suggest to you
90 it's a fact that Mr. Roberts has testified in his pre-filed
91 evidence that the unamortized foreign exchange loss is

1 being carried right now or it's projected in the 2002 test year
2 at \$84 million.

3 MR. HALL: I'll accept that.

4 MR. FITZGERALD: Okay. Just for your reference, that is
5 at **Schedule 11 of Mr. Roberts' testimony**. We don't need
6 to go to it. I think we're all familiar with that number. Can
7 you explain to the Board briefly what your understanding
8 or how your understanding is of how this foreign exchange
9 loss occurred?

10 MR. HALL: Yes, and not on any specific numbers and
11 details because you would be better to ask Mr. Roberts
12 that, but ...

13 MR. FITZGERALD: Okay.

14 MR. HALL: ... in concept the Company, like many, many
15 companies in Canada, looks to various sources of capital
16 when they're raising money and a number of companies
17 borrow money in the US markets, and indeed in other
18 markets, and therefore borrow it in different currencies, and
19 to the extent that they have borrowed funds in another, in
20 any currency other than Canadian dollars, there is exposure
21 to foreign exchange risk on the repayment, and in most
22 cases companies would only do that where they believe
23 that there is some economic rationale for doing so, and that
24 can be access to capital in the sense that the Canadian
25 market is not as large as other markets, which I don't think
26 would be too much of an issue here, and also when they
27 think that the savings of the actual coupon, the actual yield
28 that's required on those bonds is sufficiently lower than the
29 yield on the Canadian bonds to justify taking on some of
30 that, some foreign exchange risk. I believe that's the case
31 here.

32 MR. FITZGERALD: Briefly the parameters of when this
33 amount accrued, is that possible to nail down when you,
34 when it first started appearing?

35 MR. HALL: Yes, it's very possible but not for me. I'm
36 sorry, I don't know.

37 MR. FITZGERALD: No estimation?

38 MR. HALL: No.

39 *(10:15 a.m.)*

40 MR. FITZGERALD: Was RBC Dominion Securities
41 involved in advice given to Hydro regarding the foreign
42 exchange risk?

43 MR. HALL: That's a reasonable question but not one I can
44 answer directly in the sense that one of my partners is the
45 one who does the actual financings for the Province and
46 for Hydro but I can tell you what is typical of our work with
47 companies like this. We would provide alternatives to all
48 companies that are looking to raise capital. We provide

49 them with choices, if you will, different structures, different
50 markets, and we provide them with analysis support as to
51 the impact of the differences, but we don't, and I would be,
52 well I'd be surprised if I'm wrong here, we don't recommend
53 particular ways of going with financings. We offer
54 alternatives.

55 MR. FITZGERALD: Okay. I guess you're going to tell me
56 that you don't know the alternatives that were offered to
57 Hydro to avoid this large accumulation of debt.

58 MR. HALL: No, I can't tell you all of the alternatives. It's
59 very clear that one of the alternatives would have been to
60 borrow on the Canadian markets. That goes back to your
61 question about the timing of these exposures because it's
62 quite possible that in, and it's true in Canada certainly that
63 there are certain times when the financial, sorry, the
64 availability of capital in the Canadian market is constrained
65 because of economic conditions.

66 MR. FITZGERALD: The alternatives that you mentioned,
67 would they have been less risky than borrowing in the US
68 market?

69 MR. HALL: I couldn't judge that without knowing the
70 specific time of the issue and what the impacts were but I
71 assume Mr. Osmond could tell you that.

72 MR. FITZGERALD: Okay. The concept of hedging, is that
73 an alternative that could have been presented to Hydro by
74 RBC Dominion Securities?

75 MR. HALL: Yes. We always provide financing proposals
76 with hedging. You should be aware that the concept of
77 hedging is a useful one which is simply that you contract
78 today that three, four or five years from now that you can
79 buy, let's use US dollars, that although you borrow in US
80 dollars today, you can contract immediately for the
81 purchase of US dollars out three or four or five years from
82 now so that you know exactly what it's going to cost you
83 to repay that obligation in that period of time, so hedging
84 does make sense but the ability of the markets to hedge
85 becomes less and less easy, that's the wrong word, sorry,
86 as you go out farther, so to the extent these are long
87 obligations, generally speaking it's tough to hedge out
88 there.

89 MR. FITZGERALD: So is it your evidence then that
90 hedging in these circumstances would not have avoided
91 the \$84 million loss that we're carrying forward?

92 MR. HALL: No, because I don't know the circumstances of
93 the particular bonds, as I said, but I would also not ... you
94 shouldn't get excited by the fact that there is a foreign
95 exchange loss because, as I said before, there has probably
96 been a coupon savings all the way through the period of
97 time that that bond was outstanding, and the accounting
98 for the Company is that the coupon is, whatever it is, it is

1 paid, and the benefit of that reduced coupon is available all
2 during the years and the foreign exchange loss sits as a big
3 lump that makes everyone get nervous and look at it and
4 say did you make a mistake. Not necessarily at all, if you
5 see what I'm saying, is that if you've got a lower coupon all
6 the way through the period and a foreign exchange loss,
7 that's not necessarily bad for the Company.

8 MR. FITZGERALD: Do you know specifically, in your
9 opinion as an investment banker, whether a mistake was
10 made in this case?

11 MR. HALL: No, I'm quite sure there has been no mistake
12 made but I don't know the specifics.

13 MR. FITZGERALD: The foreign exchange loss sits in the
14 rate base and I know, or you may know as well, that there
15 is a section of *The Hydro Act* that allows that to occur.
16 Absent that legislation, would such a large foreign
17 exchange loss be an appropriate thing for a company to
18 include in its rate base?

19 MR. HALL: Yes, it's a cost of financing the assets that the
20 Company needs to run their business.

21 MR. FITZGERALD: Hydro as a Crown corporation, in your
22 experience, do you believe it's appropriate for Hydro to be
23 taking on a foreign exchange risk?

24 MR. HALL: Yes.

25 MR. FITZGERALD: It is no different than between a
26 privately-owned company and a Crown corporation
27 regarding the type of risk that they're, they should take on?

28 MR. HALL: No. I think you will find that Hydro's financial
29 strategy is influenced, if not directed, by the Province of
30 Newfoundland and Labrador, and to the extent that the
31 representative of the shareholder is intimately involved
32 with the financings, I don't see why that's inappropriate.

33 MR. FITZGERALD: I'm not sure if any of us are familiar
34 with all the objects of this corporation that is Hydro, but is
35 the taking on of foreign exchange risk part of the business
36 of the Hydro Corporation?

37 MR. HALL: I really don't know the answer to that.

38 MR. FITZGERALD: But you believe that's an appropriate
39 area of business for Hydro.

40 MR. HALL: Yes. I mean, Hydro is in the foreign exchange
41 business every day. They buy commodities, they buy fuel
42 oil to burn in the, in their stations, and that fuel oil doesn't
43 come from Canada, so they're in the currency markets all the
44 time, they are in business.

45 MR. FITZGERALD: Mr. Hall, if I could ask you to now turn
46 to your **pre-filed evidence at page two**? Line 26, you were
47 asked a question, says, "What areas will your evidence

48 cover?" That's a question that is put to you. And then at
49 line 28 and 29 you say, "Consistent with the focus on rate
50 base in this hearing I will be commenting on," and then
51 Item 4, "the cost of equity and various related matters."
52 Now does your qualifier or does your choice of your words
53 there, "comment," in any way qualify your evidence or is
54 the evidence that you're giving unequivocal?

55 MR. HALL: The word "comment" is because I am not
56 providing a specific recommendation for the cost of equity
57 because Ms. McShane did that and because the Company
58 is not requesting, did not request that I do so, so it's not a
59 recommendation that this Board approve 10 to 12 as a rate
60 of return on equity but rather a comment on the direction or
61 the target, in other words, the structural framework for how
62 regulation by this Board should proceed.

63 MR. FITZGERALD: Okay. Let me try to understand this
64 now. You have at page nine of your evidence, I believe,
65 line 18, you said, "It seems reasonable" ... now, there's
66 another word here. It's not a comment, not evidence ...
67 "reasonable to suggest that an appropriate level of ROE
68 should be in the range of 10 to 12 percent."

69 MR. HALL: Yes.

70 MR. FITZGERALD: So this is your ... is it your evidence
71 that you're suggesting this or is it the Board is to take this
72 as your evidence that the appropriate ROE for Hydro is
73 between 10 and 12 percent, your recommendation, your
74 evidence?

75 MR. HALL: My recommendation or my evidence?

76 MR. FITZGERALD: Which is it, yeah?

77 MR. HALL: Okay. It is my evidence I believe that a rate of
78 return in that range would be considered to be appropriate
79 by the capital markets, but I'm not specifically
80 recommending a number because Ms. McShane has done
81 that on behalf of the Company.

82 MR. FITZGERALD: So your word that you're ... your
83 words that you're commenting on the rate of return should
84 not detract in any way from the strength and the weight
85 that your evidence should be given by this Board.

86 MR. HALL: Well, yes, I think it should because the
87 strength, I'm sorry, the emphasis that this Board puts on
88 my evidence with respect to the cost of equity in my
89 opinion should be considerably lighter than the strength of
90 that evidence recommended by Ms. McShane, because
91 she's done significantly more work on that subject matter
92 than I did.

93 MR. FITZGERALD: Okay, fair enough. Page nine, you
94 don't have to flip to that right now, but you just indicated
95 that your recommendation to this Board, that the ROE for
96 Hydro should be between 10 and 12 percent. That's a

1 given. That's what you've said.

2 MR. HALL: That's what I've suggested is reasonable, yes.

3 MR. FITZGERALD: Okay. And you heard Ms. McShane,
4 I believe you were present for her evidence, where she had
5 indicated that she would put her mid point recommendation
6 at 11 percent now.

7 MR. HALL: Yes.

8 MR. FITZGERALD: And are you familiar with Dr.
9 Kalymon's (phonetic) pre-filed evidence where he has
10 recommended an appropriate range of between 8.75 percent
11 and 9.25 percent?

12 MR. HALL: Yes, I've read his work.

13 MR. FITZGERALD: Okay. And I also understood from
14 your evidence yesterday, and indeed from what you've just
15 said, that while Ms. McShane had indicated that she ran
16 particular tests, if I could refer to it that way, a comparable
17 earnings test, risk premium test, discounted cash flow test,
18 and in analyzing the rate of return, you've done, you've
19 performed no similar type analysis.

20 MR. HALL: That's correct.

21 MR. FITZGERALD: Just bear with me for a minute. Mr.
22 Hall, at page nine, if I could ask you to ... still there? Line
23 18, there's one question I had regarding your reference
24 there to, "In view of these considerations and given the
25 higher operating risks that the Utility must deal with,"
26 could you briefly describe for the Board what you perceive
27 as the higher operating risks are of Hydro?

28 MR. HALL: I'm just flipping here to some comments that
29 were provided by, actually it's Ms. McShane, but for
30 Newfoundland Power, and describes the business risks or
31 the operating risks that are here on the island, if you will,
32 and that's the relatively small size of this economy, the lack
33 of economic diversity, influences like that that cause the
34 isolation of this Utility from the grid, which is pointed out
35 as being a great thing from a competitive perspective
36 because there's no gas alternative, but what it means to this
37 company is that there is no interconnection to another
38 utility company, so to the extent that there is a problem in
39 the system they have nowhere to go. Those are influences
40 that cause electric utilities operating in Newfoundland and
41 Labrador to have, in my opinion, higher risks, operating
42 risks.

43 MR. FITZGERALD: Between the two utilities, say,
44 Newfoundland Power and Hydro, did I understand you
45 correctly to say that you view Hydro's risk in that context
46 a little less than Newfoundland Power's?

47 MR. HALL: No. I believe what I said yesterday is that I
48 agreed that the existence of the RSP mitigated the risks of

49 Hydro sufficiently that I would generally agree with the
50 position that the operating risk, sorry, the overall risk of
51 Hydro could be the same or slightly lower than
52 Newfoundland Power, not the fundamental risks but the
53 existence of the RSP to mitigate those risks.

54 MR. FITZGERALD: So there is a slightly less risk, is that
55 what you've just said, Hydro encounters?

56 MR. HALL: There is slightly less risk to Hydro because of
57 the existence of the RSP, yes. Is that what you want?

58 MR. FITZGERALD: Yeah. *(laughter)* It's what I need.

59 MR. HALL: Okay.

60 MR. FITZGERALD: No. Comparable to Newfoundland
61 Power.

62 MR. HALL: No, I'm sorry, I believe that Hydro is exposed
63 to higher business risks than Newfoundland Power is
64 because Newfoundland Power is largely, although not
65 totally, a distribution utility, and Hydro is a generation
66 utility within ranges of definition, and it's generally true,
67 and I believe it is true here, that a generating utility is
68 exposed to higher risks than a distribution utility. I keep
69 harkening back to Ontario, and I apologize for that, but
70 OPG is a generation utility and Hydro One is a distribution
71 utility and their financial structures are quite different
72 because the perceived business risks are quite different,
73 but then I went on to say that because of the existence of
74 the RSP in this particular circumstance, that a lot of that
75 incremental risk that Hydro would be exposed to has been
76 mitigated by their ability to pass variability, changes in
77 their cost structure on to the customers over a period of
78 time and that the net of that RSP on their overall risk meant
79 that they were comparable or slightly lower.

80 MR. FITZGERALD: Than Newfoundland Power.

81 MR. HALL: Than Newfoundland Power, sorry, yes.

82 MR. FITZGERALD: Okay. Now I understand that your,
83 much of your evidence, particularly regarding the ROE, was
84 or in coming to your conclusion you relied on the ROE
85 outlook for 2001, which is Schedule 4 appended to your
86 evidence. You did rely upon this document.

87 MR. HALL: I included that document as an indication of
88 the expectations of the capital markets because that's the
89 world I live in. I didn't rely on it in a sense of being right
90 because it is a research report that is forecasting the future
91 from somebody outside of the business, being our research
92 analyst. I mean, I think the easiest way to figure that out is
93 that it's dated October of 2000, so you can look at the
94 actual results and you'll find that they're not the same as
95 our research analyst was expecting, but that's the nature of
96 forecasting.

1 MR. FITZGERALD: So this ROE outlook which is isolated
2 to pipelines and gas electric utilities, is it fair to say you use
3 this as some kind of guideline to come up with your
4 suggestion, comment, recommendation, whichever it is,
5 regarding the rate of return of 10 to 12 percent for Hydro?

6 MR. HALL: I used it as context in which to determine
7 whether a 10 or 12, 10 to 12 percent range would be
8 reasonable to suggest to this Board.

9 MR. FITZGERALD: Okay.

10 MR. HALL: And that's looking at the historical returns that
11 are reported in there and the expectations of the capital
12 markets at that time for what the year 2001 would hold. I
13 didn't use it as a specific reference for recommending to
14 this Board any ROE because I didn't do that.

15 MR. FITZGERALD: Okay. If I can direct you to that
16 document now, page one, it's on the screen there, I believe,
17 if you could just read into the record, please, the boldface
18 portion of paragraph one?

19 MR. HALL: Yes. This is the overview dated October of
20 2000. "We believe that allowed ROEs in 2001 will generally
21 be 25 to 30 bases points lower than the levels allowed for
22 2000."

23 MR. FITZGERALD: Is that still a true belief of RBC
24 Dominion Securities?

25 MR. HALL: No. We have the benefit of history actually.

26 MR. FITZGERALD: Okay. This is true at the time, October
27 31, 2000, obviously.

28 *(10:30 a.m.)*

29 MR. HALL: Yes, it was Ms. Howe's firm belief at that time
30 when she wrote this report, yes. Do you understand that
31 the, a number of utilities in Canada have regulation that's
32 based on formulas, which you will know ...

33 MR. FITZGERALD: Yeah.

34 MR. HALL: ... and those formulas are largely driven off of
35 interest rates, and so to the extent you can forecast interest
36 rates you can get a pretty good approximation of where
37 allowed return on equities would go in the next year.

38 MR. FITZGERALD: So the market understood what the
39 returns were going to be.

40 MR. HALL: Well, no. I think, as I say, the, I haven't done
41 this but I think if you look at her actual numbers company
42 by company, they're not right. In other words, history
43 doesn't not prove that she was exactly right but that's, as
44 I said, the nature of it.

45 MR. FITZGERALD: Let's look at the document itself then,
46 if we could look at page six, please, of your **Schedule 4**.

47 Just if you can have an opportunity to look at that table
48 there and review it. You see in the far two right-hand
49 columns you have a column for the allowed ROE, and
50 allowed by the regulator, I'd suggest, and the next column
51 is 2001, which is the forecast ROE. Now is this ... I wasn't
52 quite sure if ... is this a forecast that the regulator allows or
53 is this a forecast of RBC Dominion Securities, the furthest
54 column over?

55 MR. HALL: That last column that's entitled "2001 Forecast
56 ROE" is my partner's estimation of what the allowed return
57 on equity for those utilities would be for the year 2001 by
58 the regulators.

59 MR. FITZGERALD: Okay. So, alright. So this is not
60 market driven, this is what she expects individual regulators
61 would pay, if I could use that term, the ROE for 2001.

62 MR. HALL: Yes.

63 MR. FITZGERALD: Okay. Well would you agree that, you
64 know, with the exception ... before I ask you that, I'm
65 wondering, if you look at the information that's provided in
66 that table for Trans Alta, and if you follow across you'll see
67 that the forecast allowed rate of return is 10 1/4. Do you
68 have any current information regarding Trans Alta's
69 allowed rate of return?

70 MR. HALL: I'm sorry, I don't have it with me. I could
71 certainly get it for you at the break.

72 MR. FITZGERALD: Okay. I wonder could you undertake
73 to provide that information? Okay. With the exception
74 then of Trans Alta and Canadian Utilities, it appears to me
75 that it's forecast that these utilities will be allowed a range
76 (phonetic) return between 9 1/4 and 9.66, 9.71, sorry. That's
77 the range, it appears, with the exception of Trans Alta and
78 Canadian Utilities, correct?

79 MR. HALL: Yes.

80 MR. FITZGERALD: Specifically if you look at the forecast
81 allowed rate of return for Newfoundland Power, we see
82 that's forecast at 9.59?

83 MR. HALL: Yes.

84 MR. FITZGERALD: We understand that Hydro's a slightly
85 lower risk than Newfoundland Power because of the RSP?

86 MR. HALL: I think you want me to say it's slightly less. Is
87 that what you said?

88 MR. FITZGERALD: Yes.

89 MR. HALL: Oh, okay, yes.

90 MR. FITZGERALD: Thank you.

91 MR. HALL: The same or slightly less, I think is what I
92 concurred with.

1 MR. FITZGERALD: Okay. Well, do you know if, where the
2 forecast allowed rates of return are currently for these
3 companies?

4 MR. HALL: No. That's what I said, I could certainly
5 provide that at the break, to the extent that they're
6 available, that they've been published.

7 MR. FITZGERALD: Now, if I could ask you now to turn to
8 **page 12 of the RBC Dominion Securities Report, page 11,**
9 I'm sorry. You'll have to forgive me, Mr. Hall. You're going
10 to get dizzy looking at your screen there. It's actually **page**
11 **12 of your schedule.** That's the right document that we
12 have up there now. I won't ask you to ... okay. Now here
13 is your, or your analysis, I say RBC Dominion Securities'
14 analysis, recommendations regarding the utilities that we
15 were just looking at and their rates of return, and would
16 you agree that there are no utilities there that are, how
17 would you describe, poor performance, under-performing,
18 I guess, besides Trans Alta?

19 MR. HALL: So of nine there's one that's under-performing,
20 and I would agree that there's only one that says that, yes.

21 MR. FITZGERALD: Yeah. With the forecast allowed rate
22 of return on equity.

23 MR. HALL: Yes.

24 MR. FITZGERALD: That your analyst had indicated ...

25 MR. HALL: Yes.

26 MR. FITZGERALD: ... with ...

27 MR. HALL: Although Trans Alta is one of the ones that
28 has the high one, if you recall.

29 MR. FITZGERALD: Yeah. We'll have to check that and
30 see just exactly where they are. So doesn't this indicate to
31 you that the market is accepting of the forecast allowed
32 rates of return and they're in the range of 9.66, 9.71 percent?

33 MR. HALL: No. You know, you have to ... well, you do
34 understand how the market works. They don't have a
35 choice of accepting or not accepting what is available to
36 the company, that's determined by boards like this, so they
37 react to those results or those decisions that are made. The
38 recommendations here are within the utility sector. Ms.
39 Howe, my partner, sorry, determines recommendations
40 within the utility sector but above that the utility sector is
41 determined to be either positive or negative in the overall
42 context of the market itself, and so what she's saying here
43 is that within the survey group of utilities within Canada,
44 Trans Alta is one that isn't particularly favoured, for
45 various reasons, and Atco (phonetic) is one that is
46 particularly favoured for other varied reasons, but I don't
47 think you can read into this that they like it or they don't
48 like it because it is what it is.

49 MR. FITZGERALD: But they're not recommending to sell
50 any of these.

51 MR. HALL: Well, investment dealers have a very big
52 concern about the word "sell." You can translate under-
53 perform into that four-letter word if you wanted to.

54 MR. FITZGERALD: Well, I'm, you know, I'm left with the
55 word "under-perform." What about the words, "strong
56 buy, out-perform"? I mean, what does that signal?

57 MR. HALL: Those mean what they mean.

58 MR. FITZGERALD: Yeah, sure.

59 MR. HALL: Yeah.

60 MR. FITZGERALD: They certainly don't mean sell.

61 MR. HALL: They do not mean sell.

62 MR. FITZGERALD: So certainly the rates of return of
63 those companies have been allowed, it's not affecting their
64 marketability.

65 MR. HALL: The rates of return to those utilities, and you
66 have to be unfortunately very careful about that, Atco is a,
67 considered a utility but it has a whole bunch of things that
68 are, or has had a bunch of things that are not very utility-
69 like, in other words, non-regulated businesses that it has,
70 so each one of these stocks is a larger entity than a pure
71 utility as we're looking at here, so reading into the stock
72 market reaction to anything in particular is difficult. There's
73 also, you know, underlying issues of change of control.
74 The third one on your list is West Coast Energy, and you
75 will recall reading two weeks ago I guess that West Coast
76 Energy was just purchased by Duke Power, and so there
77 are influences in stock prices and therefore in
78 recommendations from our analyst that go well beyond the
79 regulator environment here, but if you are asking are the,
80 do the capital markets generally accept the level of returns
81 that regulatory boards in Canada have provided, yes,
82 because they have no choice. They just adjust the stock
83 price accordingly.

84 MR. FITZGERALD: They don't have to buy it, do they,
85 and they could sell it if a company became regulated and
86 they weren't happy with the rates of return, then they don't
87 have to accept it like she ...

88 MR. HALL: No, no, and they do buy and sell.

89 MR. FITZGERALD: And none of these, and they're all
90 based on particular pegged (phonetic) ROEs, none of these
91 are classified as a sell. In other words you ...

92 MR. HALL: Okay.

93 MR. FITZGERALD: ... would you recommend to your
94 clients to maintain these in their portfolio, that was their
95 business?

1 MR. HALL: Well, unfortunately I'm going to complicate
2 your life a little more, but you ...

3 MR. FITZGERALD: It's impossible.

4 (10:45 a.m.)

5 MR. HALL: But you asked. To go back to that overall
6 concept that I mentioned, we look at the economic outlook
7 for the country and indeed for North America and we
8 determine what is the best place to be in the economic
9 circumstances in which we find ourselves, and by that I
10 mean do we buy technology stocks, do we buy Microsoft,
11 do we buy utility stocks, just to take a fairly wide range of
12 volatilities, and within the context of our overall view of the
13 direction of interest rates and the economic uncertainties
14 that we're faced with at any point in time, we will determine
15 that there's a certain amount of money that should go into
16 utilities, and generally speaking we don't vary that number
17 very far, and within the utility portion of one's portfolio,
18 this is the sort of recommendation that we would give so
19 that if a client came to us and said, okay, I hear you and I
20 think I should have 10 percent of my assets invested in
21 utilities and I look at this list and are you telling me that I
22 should by Atco and I should consider that Trans Alta is
23 going to under-perform, then I would say, yes, that's what
24 those recommendations mean, but what I'm trying to give
25 you is the context in which we look at utility stocks is not
26 related solely to the activities in this room but is related to
27 the outcome of the economy and the outlook for interest
28 rates and the troubles in the Middle East and all sorts of
29 things that cause investors to want to invest in more stable
30 securities like utilities.

31 MR. FITZGERALD: And that's actually happening, isn't it,
32 recently, utilities ...

33 MR. HALL: Oh, yeah, yes. Utility stocks are attractive
34 because of the stability, yeah, which has nothing to do
35 with the fundamentals of the business itself but to do with
36 the nature of the capital markets.

37 MR. FITZGERALD: I guess what I'm interested in is your
38 comments regarding, you know, your recommendation,
39 suggestion, of a 10 to 12 percent rate of return for
40 Newfoundland and Labrador Hydro, and, you know, that's
41 what I'm interested in. If I look at page six of your report,
42 your analysis (*sic*) report, again looking at this table, here
43 we have in the table, here we have the regulator identified
44 as NEB, National Energy Board, that your analyst forecast
45 them allowing these utilities a rate of return forecast, 2001,
46 9.66 percent, correct?

47 MR. HALL: Yes.

48 MR. FITZGERALD: Now ...

49 MR. HALL: Sorry, our analyst is not recommending that.

50 They're anticipating that that's what ...

51 MR. FITZGERALD: Anticipating that, I'm sorry. Sorry for
52 that. So that's what they've analyzed. If you look at **page**
53 **11 in the "Conclusions and Recommendations"** portion of
54 this document, paragraph three, fourth line, it says, "The
55 NEB's formula appears fair and unbiased in its approach to
56 establishing the annual multi-pipeline ROE."

57 MR. HALL: Yes.

58 MR. FITZGERALD: So what is this Board to think of that?
59 I mean, that appears to me to endorse than an allowed rate
60 of return in that range is fair and reasonable.

61 MR. HALL: I believe that what that says is that the formula
62 utilized is fair and reasonable, appears fair and unbiased
63 actually is what it says ...

64 MR. FITZGERALD: Yeah.

65 MR. HALL: ... as between companies. It goes on to say
66 that, if I may do this, "That the formula utilized by the
67 Board of Commissioners of Public Utilities in
68 Newfoundland to set Fortis' ROE are the least attractive and
69 penalize these companies relative to their Canadian peer
70 group."

71 MR. FITZGERALD: Uh hum.

72 MR. HALL: So I didn't actually want to read that part into
73 the record ...

74 MR. FITZGERALD: Yeah, okay.

75 MR. HALL: ... right here, but, I mean, it's an indication that
76 she believes the 9.66, for a gas pipeline by the way, is
77 based upon a fair and unbiased formula.

78 MR. FITZGERALD: Okay. Well, if we look at the schedule,
79 page six again, we have Newfoundland Power's forecast
80 allowed rate of return of 9.59 percent, which is what, seven
81 bases points below the others.

82 MR. HALL: Yes.

83 MR. FITZGERALD: So is that in your opinion substantial?

84 MR. HALL: Yes.

85 MR. FITZGERALD: That's a substantial spread?

86 MR. HALL: No. The spread is not substantial but it's my
87 opinion that, and I believe it's my partner, Ms. Howe's
88 opinion, that the 9.59 is not fair and unbiased relative to the
89 business risks of Newfoundland Power when you compare
90 it to the business risks of the gas pipelines above. If you
91 ... if she was here in lieu of me she would be saying 10 to 12
92 percent would be fair.

93 MR. FITZGERALD: Well, she's not here.

94 MR. HALL: No, but you did ask.

1 MR. FITZGERALD: She (unintelligible). I'm left, I guess,
2 just with a question, and again this may be repetitive,
3 however, if your analyst has indicated that 9.66 percent is
4 a fair and unbiased, or the approach in arriving at such a
5 rate of return is a fair and unbiased approach, why are you
6 suggesting, recommending or commenting to the Board
7 that in your view it should be 10 to 12 percent?

8 MR. HALL: I'm reluctant to get drawn into the business
9 risk distinctions between gas pipeline companies and
10 electric utilities, but there is a difference that's recognized
11 by, I think, most expert witnesses, and it's certainly
12 recognized by the capital markets, that the business risks,
13 i.e. the volatility of earnings of gas pipeline companies is
14 lower than the business risks of electric utility companies,
15 largely because gas pipelines are conveyors of the gas and
16 usually have very long-term contracts for that service, and
17 electric utilities, as you know, are subject to business risks
18 of end-use customers, so it's generally perceived that
19 electric utilities are slightly higher in business risk profile
20 and therefore should have a slightly higher return on
21 equity. You also ... don't know that it's there ... generally
22 speaking again, the leverage on a gas pipeline is a bit
23 higher than the leverage on electric utility because of that,
24 because the stability of cash flows is higher. So I ... sorry,
25 I think it's very comparable or very useful to look at the 9.66
26 expectation but my bias would be to increase that because
27 we're talking about an electric utility, not a gas pipeline.

28 MR. FITZGERALD: Well, what is Trans Alta, is that a
29 pipeline or ...

30 MR. HALL: No. Trans Alta is an electric utility which in
31 the last year or so has made a determination to move
32 towards a generating company and ...

33 MR. FITZGERALD: Okay. So ...

34 MR. HALL: Yeah.

35 MR. FITZGERALD: ... subject to your undertaking, we will
36 see what an electric utility, and then, is doing besides
37 Hydro, we'll see what their rate of return is.

38 MR. HALL: Yeah. I mean, you can see that 10 1/4 is higher
39 than 9.66 and that's consistent with my view of the world,
40 but I will give you the numbers as I've ...

41 MR. FITZGERALD: Yeah. If I suggest to you that it's
42 probably at 9 1/4 right now, would that shock you?

43 MR. HALL: No, not at all, because this is an expectation
44 that was determined in October of 2000 with an interest rate
45 forecast and I don't imagine that my partner, because I sure
46 didn't, foresee the interest rate outlook that we now have
47 over, or not over, sorry, a year later.

48 MR. FITZGERALD: Just getting back to, I asked you
49 whether you considered Newfoundland Power's

50 recommended forecast or forecast recommended rate of
51 return of 9.59 as differing substantially from the other gas
52 pipelines, 9.66, and I believe your response was, yes, you
53 did consider that significant.

54 MR. HALL: No, I was not considering the differential
55 between 9.66 and 9.59 significant. I was considering the
56 difference between 9.66 and what an electric utility should
57 get, let's say 10 1/4 to electric utilities that have those
58 numbers on the same screen, that is significant. In other
59 words, the significance to me was the direction, not the
60 difference.

61 MR. FITZGERALD: Mr. Chairman, I wonder if I could ...
62 break time here now. I may have a few more questions but
63 won't be much longer.

64 MR. NOSEWORTHY, CHAIRMAN: That's fine. Mr.
65 Fitzgerald. We'll break now and reconvene at 11:15, or,
66 yeah, 11:15.

67 *(break)*

68 *(11:20 a.m.)*

69 MR. NOSEWORTHY, CHAIRMAN: Thank you. Mr.
70 Fitzgerald, if you could continue please? Are you ready,
71 Mr. Hall?

72 MR. HALL: Yes, I am, thank you.

73 MR. FITZGERALD: Thank you, Mr. Chairman, I just have
74 a few more questions. Before the break, Mr. Hall, I was
75 asking you if you knew what Trans Alta, the Alberta
76 electric utility was trading, or sorry, what their rate of return
77 was, allowed return was, and in fact, we have discovered it
78 in the pre-filed evidence, and oh, you have it as well.
79 Thank you, could you tell the Board for the record?

80 MR. HALL: Yes, in Ms. McShane's testimony, it might be
81 somewhere else as well, in Schedule 19, page 2 of 2, and
82 there it is.

83 MR. FITZGERALD: And for the record, the rate of return
84 is?

85 MR. HALL: It's 9 1/4, which was ...

86 MR. FITZGERALD: Over at page 13 of the Schedule 4, that
87 is RBC Dominion Securities ROE Outlook, we were looking
88 at this morning, page 11, I'm sorry, Mr. O'Reilly. In the third
89 paragraph there, your company's conclusions and
90 recommendations, your analysts say in the third paragraph,
91 it says, "With respect to the attractiveness of various
92 formulas, we view the formula implemented by the AEUB,
93 for the Alberta generation units covered by the power
94 purchase agreements as the most attractive of those
95 views". Is that true?

96 MR. HALL: That's what ...

1 MR. FITZGERALD: Do you endorse that comment, I
2 should ask you that?

3 MR. HALL: I'm sorry, I don't have enough specifics about
4 the formulas with respect to the power purchase
5 agreements themselves to comment on that, but it certainly
6 is the view of my partner, yeah.

7 MR. FITZGERALD: That's your partner's view, and you're
8 saying it's not your view, is that ...

9 MR. HALL: I'm saying I don't have a view because I
10 haven't read the formula that's based on those power
11 purchase agreements as opposed to the companies
12 themselves.

13 MR. FITZGERALD: For our purposes then, do you know
14 whether the formula implemented by the AEUB is the same
15 regulatory body that arrived at the allowed rate of return for
16 Trans Alta in 2001 of 9 1/4 percent?

17 MR. HALL: I believe the AEUB is the same party that
18 arrived at it, but to my understanding, it was not based on
19 that formula that's referenced.

20 MR. FITZGERALD: Do you know that?

21 MR. HALL: That's what I've been told, yes.

22 MR. FITZGERALD: So, okay, you have been told that.
23 Can the Board rely on your ... I know hearsay evidence is
24 allowed in this forum, are you suggesting to the Board that
25 the formula was different and they're to accept that
26 evidence?

27 MR. HALL: Well let me tell you what I do know from a
28 capital market perspective, if that's alright with you, and
29 then I can get the specifics of that particular hearing to find
30 out exactly what occurred, but from the perspective of
31 Trans Alta as a utility, the decision when they came out
32 with the 9 1/4 percent was a shock to the company, and it
33 was a shock to the investment community, and so my
34 presumption, and it may be inaccurate, but I don't think so,
35 is that it was not based on the formula that could have
36 been anticipated. The company subsequently declared
37 their intention to get out of the regulated utility business
38 because of the inadequacy of that return, amongst other
39 reasons, and the stock market, as I alluded to earlier today,
40 will adjust the valuation of companies to the regulatory
41 returns rather than make comments in any other way, and
42 the stock for Trans Alta went down significantly when this
43 result came out, but my understanding was it was not
44 based on a specific formula that could have been
45 anticipated.

46 MR. FITZGERALD: And you are suggesting that there ...
47 I'm sorry, in your last statement you said that they, as a
48 result of the 9 1/4 finding of the regulatory board, what was
49 Trans Alta's response?

50 MR. HALL: It wasn't totally the result of that particular
51 decision, it was a strategic decision of Trans Alta, I believe,
52 two years ago now, to move towards a generating
53 structure, and to move out of the integrated regulated
54 utility structure that they had in the past, and that this
55 presumably was an influence that probably accelerated
56 their decision to move in that direction.

57 MR. FITZGERALD: That's a different answer though.
58 Probably accelerating and causing ...

59 MR. HALL: No, I said it was in part, I believe, not that it
60 caused it.

61 MR. FITZGERALD: What part, could you give me an
62 estimation?

63 MR. HALL: Without interviewing the chief financial
64 officer, no, I couldn't tell you what part.

65 MR. FITZGERALD: Okay, so the decision to get out of the
66 regulated business for Trans Alta was made two years ago?

67 MR. HALL: That's my recollection, and certainly within
68 that range, yeah.

69 MR. FITZGERALD: Okay, and this recommended rate of
70 return is really only from one year ago.

71 MR. HALL: Yes, that's correct, yeah.

72 MR. FITZGERALD: Now, I believe that you indicated this
73 morning, and I won't be much longer, Mr. Hall, the ... I think
74 you had indicated when we went through the table at page
75 6 of Schedule 4 of the ROE outlook, and correct me if I'm
76 wrong, but the Board of Commissioners in Newfoundland,
77 and the Newfoundland Power column ... and it's not a
78 column, I guess, the reference there ... you had, we had
79 identified the 2001 forecast recommended ROE at 9.59
80 percent, and I believe you indicated that ... well what was
81 your word, was it inadequate?

82 MR. HALL: No, I think I was quoting my partner's
83 comment about the formula.

84 MR. FITZGERALD: Okay, and that comment was, and
85 reading from this, it was ... this is page 11. It says, the
86 formula utilized by the Board of Commissioners of Public
87 Utilities in Newfoundland to set Fortis' ROE are the least
88 attractive and penalize these companies relative to their
89 Canadian peers. That's what your partner has said, or your
90 analyst.

91 MR. HALL: Yes.

92 MR. FITZGERALD: Just turning then to page 12 of the
93 schedule for the ROE outlook, we look at your analysis
94 recommendation for Fortis, and it's classified as a neutral
95 company.

96 MR. HALL: Yes.

1 MR. FITZGERALD: Is that different, is that a different
2 categorization than say a company that your analysis
3 would classify as a cell company?

4 MR. HALL: Yes.

5 MR. FITZGERALD: And would that, would it be fair to say
6 that what's been achieved with Fortis is a balance between
7 what a shareholder can expect the rate of return and what
8 a ratepayer should pay?

9 MR. HALL: No, and unfortunately my complicated real
10 world comes back into play. Fortis is a public company
11 that owns Newfoundland Power, as you know, but it also
12 owns Maritime Electric, and it also owns Belize Utility, and
13 it also has an investment in the Caribbean and some
14 investments in Ontario, and so from the capital market's
15 perspective, from my investment analyst's, partner's
16 perspective, Fortis as a company ... and sorry, it also has
17 real estate holdings, as you know, in Atlantic Canada, she
18 would look at the entire company and its outlook, and in
19 particular what are the prospects for the growth of Fortis as
20 a company in this business environment, and she's not
21 considering the growth prospects for Newfoundland Power
22 to be particularly high, but does give the company credit
23 for the initiatives that they've taken in other jurisdictions in
24 order to grow that company, and so the combination of all
25 of those factors, and the outlook for their results for the
26 next year, she would come up with a neutral rating. It has
27 something clearly to do with how Newfoundland Power is
28 operating and how it's being regulated, but it is by no
29 means a direct connection between that neutral comment
30 and the results of this Board.

31 MR. FITZGERALD: Is there any direct connection between
32 Newfoundland Power's success, if I may call it that, excuse
33 me, and Fortis' position?

34 MR. HALL: I'm sorry, you're going to have to rephrase
35 that.

36 MR. FITZGERALD: Okay, I'll rephrase that. Of the many
37 enterprises that you mentioned that are under the Fortis
38 umbrella ...

39 MR. HALL: Yes.

40 MR. FITZGERALD: ... how does Newfoundland Power
41 rank as a credit-worthy element of that?

42 MR. HALL: Oh, it's clearly the largest portion of Fortis, the
43 percentage, I don't know, but it's very high. If
44 Newfoundland Power was not doing well, the stock of
45 Fortis would not do well, it's that large.

46 *(11:30 a.m.)*

47 MR. FITZGERALD: Okay, so when we look at your
48 analysis, your recommendation of Fortis as a neutral, I

49 think that you just indicated that there was no relationship
50 between the ROE that is being allowed for Newfoundland
51 Power, and that neutral position of Fortis?

52 MR. HALL: No, I didn't say that, I'm sorry. I said that there
53 was not a direct connection that you could establish
54 between those two so that when one moved the other
55 moved, but there is a clear connection and a significant
56 influence.

57 MR. FITZGERALD: The other operations under Fortis'
58 umbrella, would you have any knowledge whether they're
59 making any money?

60 MR. HALL: Bit by bit, in other words, piece by piece, I
61 wouldn't be able to quote numbers, but it's certainly my
62 understanding from reading the materials and
63 conversations with that company, that they're all making
64 money. It's a question of how much money they make and
65 how much they contribute to the bottom line. That is the
66 question I don't know the answer to.

67 MR. FITZGERALD: Okay, in your experience then, with
68 your knowledge of what's going on there, would you rate
69 Newfoundland Power as the strongest performer
70 underneath that umbrella of Fortis?

71 MR. HALL: In terms of the income contribution to the
72 company and in terms of the stability of that income, yes,
73 but not in terms of the outlook for growth, no.

74 MR. FITZGERALD: Thank you, Mr. Commissioner, those
75 are my questions. Thank you, Mr. Hall.

76 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
77 Fitzgerald. I think now, Mr. Kennedy, your cross please?

78 MR. KENNEDY: Thank you, Chair. Mr. Hall, I don't know
79 if it's a comment on the issues themselves or hopefully not
80 your testimony, when I went to go prepare my cross, I
81 found myself going around in circles somewhat in trying to
82 design the cross, so you'll have to forgive me if I end up
83 backtracking over some of these issues, but I'd like to start,
84 if I could, with some questions concerning the DBRS
85 reports and one that we can use, I guess, is **NP-6**, which
86 was the exhibit handed out yesterday, I believe, and I just
87 wanted to ask you a couple of general questions, first, Mr.
88 Hall, concerning the DBRS reporting methodology, and as
89 I believe it's already been established by, I believe it was
90 counsel for Newfoundland Power, in her cross-examination
91 of you, that some of the numbers that we see in this DBRS
92 report concerning the financial position of Newfoundland
93 and Labrador Hydro, are not reflected one for one in the
94 documentation that's been filed by Newfoundland and
95 Labrador Hydro, and that's a result of DBRS looking at the
96 entire company of Hydro, versus just its regulated
97 activities, is that correct?

1 MR. HALL: That's what I understand, yes.

2 MR. KENNEDY: And so when DBRS looks to its analysis
3 of the financial position of Newfoundland and Labrador
4 Hydro, it considers the entire company and all its asset
5 base?

6 MR. HALL: Yes.

7 MR. KENNEDY: I believe, and this is in keeping, if you
8 will, with your comment of yesterday that for the purposes
9 of DBRS, they treat Hydro as a ... they treat the regulated
10 activities, if you will, of Newfoundland and Labrador Hydro
11 as if it was a wholly owned subsidiary of Newfoundland
12 and Labrador Hydro, and that that's the reason why any
13 net income of the subsidiary is treated as revenue as
14 opposed to the dividends paid, am I getting that right?

15 MR. HALL: You might be, but you lost me.

16 MR. KENNEDY: Okay, and let's just turn ... and this is the
17 reason why I wanted to just get a clarification, if we could
18 go to the transcript of yesterday, Mr. O'Rielly, October 31,
19 page 20, and I think maybe what I'm doing is confusing the
20 rating of the province with the rating of Hydro, and this is
21 the reason I just wanted a clarification. It's line 54.

22 MR. HALL: Yes.

23 MR. KENNEDY: And it was in regards to some questions
24 by Ms. Butler and at 54, you say, "That's my
25 understanding, the Province records the dividend that it
26 receives and not the net income, but Dominion Bond
27 Rating Service considers this to be a wholly owned
28 subsidiary of a company and therefore it's entitled to the
29 entire net income of the company, the way a normal
30 corporation would account, so they've made an
31 adjustment", and so is that DBRS considers Newfoundland
32 and Labrador Hydro a wholly owned subsidiary of
33 government?

34 MR. HALL: Yes, that's what I was referring to.

35 MR. KENNEDY: Okay, and so even though Hydro may
36 pay less than the dividends at a given point, DBRS
37 considers all of it to have been paid, all of the net income?

38 MR. HALL: Not paid, but earned.

39 MR. KENNEDY: Earned.

40 MR. HALL: In other words, DBRS considers the province
41 to be the shareholder and owner of Hydro and as the
42 shareholder and owner of Hydro it's entitled to all of the
43 earnings that Hydro generates, and typically in a corporate
44 setting, that earnings would be consolidated with the
45 holding company, with the main company and reported as
46 net income in the consolidated reports of the holding
47 company. This is what would happen, for example,
48 between Fortis and Newfoundland Power, and DBRS makes

49 that change to the accounting because the government
50 only treats the dividend as income.

51 MR. KENNEDY: Okay, so let's just leave aside for a
52 moment the dynamic between Hydro and the province, and
53 just if we can, I'd like to focus on the dynamic of the
54 companies within the Hydro group of companies
55 themselves.

56 MR. HALL: Okay.

57 MR. KENNEDY: And in this same DBRS report on the
58 page 5, the **NP-6**, on page 5. Up in the top right-hand
59 corner, under the liabilities and equities as at December 31,
60 for 1998 it shows the shareholders equity of 568.6, and that
61 would be million presumably, while the key is over
62 underneath the balance sheet there, so it's \$568.6 million in
63 shareholders equity, and that would be the entire
64 shareholder equity of the entire group of companies owned
65 by Newfoundland and Labrador Hydro?

66 MR. HALL: Yes, I would assume so, but before you go
67 any further, it looks like the title is wrong, so not to get
68 anyone confused, at the top it says 1998/1999, again, and
69 so when you're reading that, the left-hand column should
70 be 2000, if that's okay. Do you see what I'm saying?

71 MR. KENNEDY: Well, actually if you go to **IC-197**.

72 MR. HALL: Sorry, I wasn't answering your question.

73 MR. KENNEDY: No, no, that's okay ...

74 MR. HALL: Just clarification.

75 MR. KENNEDY: Page 2, and this was an exhibit that we
76 have seen before as well, and I guess what I was comparing
77 it to was if you look under 1999, the retained earnings of
78 the company, there's one line retained earnings, and there's
79 left, CF(L)Co. retained earnings, and adjustment for non-
80 regulated activity, and then utility only retained earnings,
81 so the retained earnings line under the employee future
82 benefits, I matched up for 1999, or at least that was what I
83 was trying to do, was match up this retained earning line
84 with the DBRS retained earning line, but they don't jive,
85 and would you know why that they don't match?

86 MR. HALL: Well, they're pretty close if you can jump back,
87 but 1999 was \$586 million?

88 MR. KENNEDY: Oh, wait a minute ...

89 MR. HALL: And it's \$568 million, yeah, it doesn't jive
90 exactly.

91 MR. KENNEDY: So again, you wouldn't, you wouldn't
92 have any knowledge as to why they don't, they don't jive,
93 do you?

94 MR. HALL: No, not only am I not a lawyer, but I'm not an
95 accountant either, sorry.

1 MR. KENNEDY: Lucky for you.

2 MR. HALL: Yeah.

3 MR. KENNEDY: Okay, in the same DBRS report, **NP-6**, at
4 page 3, underneath the financial profile, towards the bottom
5 there, Mr. O'Rielly ... "significant decline". I just want to
6 read that passage out and then get you to explain
7 something to me. "A significant decline in operating cash
8 flows, combined with a sharp increase in dividends paid to
9 the provincial government in 2000 resulted in a growth free
10 cash flow deficit which the utility financed with short-term
11 debt, promissory notes increased to \$121.2 million, as at
12 December 31, 2000, from \$54.4 million the previous year".
13 So in the case of DBRS, when they look at the dividends
14 paid out to the provincial government, do they make a
15 distinction between whether those dividends are paid from
16 the Hydro regulated or the Hydro, if you will, unregulated
17 portions of its business?

18 MR. HALL: Not to my knowledge, no.

19 MR. KENNEDY: Okay, so just turning back to **IC-197**, if
20 we could please, Mr. O'Rielly, so just looking at this, in the
21 case of the 2001 and 2002 columns, the retained earnings
22 for Hydro are stated to be \$526 million, I think it is, in 2001,
23 and then \$478 million in 2002.

24 MR. HALL: Yes.

25 MR. KENNEDY: And the utility only retained earnings are
26 \$269,367,000, and then it drops to \$28,830,000, and as we
27 know, as part of this application material, and it's been
28 questioned extensively during the hearing, Hydro is being
29 called upon by the government to pay a dividend of
30 approximately \$70 million in the 2002 year?

31 MR. HALL: Yes.

32 MR. KENNEDY: And so that dividend, as we also know by
33 virtue of the application, is being paid out of the utility only
34 retained earnings?

35 MR. HALL: Yes.

36 MR. KENNEDY: From an investment banker's perspective,
37 or DBRS's perspective, would it make any difference
38 whether those retained earnings are paid out of the utility
39 only retained earnings, versus the retained earnings of the
40 entire company of Hydro?

41 MR. HALL: From an investment banking perspective, or an
42 analyst's perspective, looking at the company, the business
43 that generated the cash flow usually is the business that
44 dividends (sic) out, or sorry, that funds the dividend
45 payment to the shareholders, and so they wouldn't be
46 surprised to see that the regulated utility portion of Hydro
47 which generates cash flow would be the one that would be,
48 that ... which would be the one where the company

49 accounts for that dividend payment from, but normally
50 speaking, an investment dealer wouldn't see that statement
51 and would just see the overall shareholder, or shareholder
52 equity, sorry.

53 MR. KENNEDY: And the fact that the \$70 million dividend
54 is proposed to be paid out of the regulated retained
55 earnings is not reflected in the DBRS reports themselves,
56 because they don't make a distinction between what's
57 regulated and what's not regulated?

58 MR. HALL: I think that's fair, yeah.

59 MR. KENNEDY: And among other things, a potential
60 buyer of bonds issued by Newfoundland and Labrador
61 Hydro would look to this DBRS report as part of its due
62 diligence in making that decision about whether to invest
63 in Hydro in the form of bonds?

64 MR. HALL: Yes, I think that's right.

65 MR. KENNEDY: When a bondholder buys bonds in
66 Hydro, they are in effect taking, if I can oversimplify it, sort
67 of a mortgage-like security on the assets of Hydro as
68 security for the bond that they're taking?

69 *(11:45 a.m.)*

70 MR. HALL: Well they have an obligation, if you will, a
71 promissory note sort of obligation from the Company to
72 pay them back. They don't have a specific mortgage
73 charge on the assets that would encumber any particular
74 plant or vehicle or anything like that.

75 MR. KENNEDY: So there's no general back debenture that
76 Hydro would issue as security for the bonds that they
77 float?

78 MR. HALL: No, they are issuing general obligations of the
79 company backed by the guarantee.

80 MR. KENNEDY: Okay, and so in the event of a default on
81 the bond, the bondholder would have the right to call upon
82 the assets of Hydro?

83 MR. HALL: Yes.

84 MR. KENNEDY: And as far as you're aware, is there any
85 distinction made anywhere that would tell a bondholder
86 that you're only allowed to realize on the regulated assets
87 of Hydro versus the non-regulated assets of Hydro?

88 MR. HALL: No, not to my knowledge, no.

89 MR. KENNEDY: So, for instance, if one of the, one of the
90 wholly owned subsidiaries of Hydro was to falter, and
91 cause the default on its convenance, then that would
92 theoretically place in jeopardy the assets of the regulated
93 portion of Hydro?

94 MR. HALL: No.

1 MR. KENNEDY: Could you explain to me why?

2 MR. HALL: A subsidiary company, sorry, has assets of its
3 own, liabilities of its own, and shareholders equity of its
4 own, and to the extent that Hydro owns that company, and
5 that company, the underlying subsidiary has financial
6 problems and declares bankruptcy, let's say, the creditors
7 to the subsidiary company typically, and what I mean by
8 that is in the absence of a guarantee of some kind, can only
9 look to the assets of that company for their redress. To the
10 extent that there are insufficient assets available to meet the
11 liability obligations, the creditors of that company are out
12 of luck because it does not come back, except for the
13 amount of retained earnings, in other words, except for the
14 economic value of the assets within the subsidiary, it does
15 not come back up to the parent.

16 MR. KENNEDY: Are you aware if it is the habit of Hydro,
17 or in turn, a condition of the bondholders to require a
18 cross-corporate guarantee?

19 MR. HALL: It's not a condition of the bondholders, and to
20 my knowledge, the company does not do that.

21 MR. KENNEDY: So just so we're clear then, a bondholder
22 purchasing a bond in Newfoundland and Labrador Hydro
23 purchases a bond on the entire company of Newfoundland
24 and Labrador Hydro?

25 MR. HALL: Yes.

26 MR. KENNEDY: Okay, and that includes its regulated and
27 unregulated activities?

28 MR. HALL: Yes.

29 MR. KENNEDY: And that DBRS and, in turn, bondholders
30 themselves, would not necessarily make a distinction
31 between the regulated versus the unregulated portions of
32 the business for that purpose of lending money to the
33 company?

34 MR. HALL: No, they would make a distinction, because
35 that would be one measure of credit strength of the
36 company, by which I mean to the extent that a company is
37 entirely consisting of regulated businesses. They would
38 perceive the credit risk to be lower probably because of the
39 stability of cash flows, than if the company had 90 percent
40 of their business in unregulated competitive market
41 conditions, and only 10 percent in regulated, so the
42 proportion of regulated to unregulated would be something
43 they would consider in assessing credit quality.

44 MR. KENNEDY: Okay, now there seems to be, when you
45 read the DBRS report, a certain merging, if you will, of the
46 two aspects of Hydro in regards to its regulated and non-
47 regulated activities. In one line they may reference the
48 business risk exposure of Hydro itself, and the next lines
49 speak to the risk involved in the Churchill Falls

50 development.

51 MR. HALL: Yes.

52 MR. KENNEDY: And so I guess what I'm trying to
53 determine is, for the purposes of DBRS, and for in turn, the
54 purposes of people buying bonds on the strength of the
55 DBRS report, among other things, that they in turn look at
56 that as a merged interest. They will look specifically to the
57 different aspects of the business, but ultimately look to the
58 whole business?

59 MR. HALL: Yes.

60 MR. KENNEDY: I wonder if we could just turn to ... oh yes,
61 one more thing. In your pre-filed evidence, Schedule 2,
62 now would this be the schedule, is this a schedule that
63 would be normally attached to a DBRS report itself, like the
64 one we have under **NP-6**, or is this a different document
65 that DBRS generates?

66 MR. HALL: No, it's a different document they produce,
67 what they call a Canadian Electric Utility Industry Study,
68 which I believe is done once a year. My understanding is
69 it's done once a year and it's done after the financial results
70 for the prior year are available, and it compares the utilities
71 across Canada on various measures of efficiency and
72 financial structure and so on.

73 MR. KENNEDY: And in the case of 1999, for instance,
74 there are two lines, Newfoundland and Labrador Hydro,
75 63.1 and Churchill Falls, 49.4, so Churchill Falls itself, is that
76 treated as a separate item by DBRS from Hydro itself,
77 because I don't see that in their reports per se, and I see
78 this in the schedule, and I was just wondering if you could
79 just give me some comment as to why there's two there and
80 not two anywhere else?

81 MR. HALL: I know that the owner of the rating agency
82 really likes to go to Churchill Falls occasionally, so that
83 may be part of the reason it's there. It's a significant asset
84 and it is identifiable separately because there are numbers
85 that they can analyze. My understanding is that that
86 would be the only reason that it would be separated,
87 because as I say, I believe it's inside the Hydro numbers in
88 that same chart.

89 MR. KENNEDY: Yeah, because in, for instance, in 6 in the
90 DBRS report there's comment made about Churchill Falls
91 being a very low cost provider of electricity, and one of the
92 most efficient in North America.

93 MR. HALL: Yes.

94 MR. KENNEDY: So DBRS treats it as part of the Hydro
95 group of companies that they're lending money to, or
96 bondholders that lend money to.

97 MR. HALL: Yes, that's correct.

1 MR. KENNEDY: Okay, and you just indicated you're not
2 a lawyer, so I won't refer you to the Hydro Act itself, but
3 would you agree with me that the determination of what's
4 considered to be part of the regulated aspects of Hydro
5 versus the non-regulated aspects of Hydro is determined
6 by the legislative abilities of government through the
7 Hydro Act itself?

8 MR. HALL: Yes, it's my understanding that the distinction
9 between regulated and non-regulated is driven from a
10 legislative direction, but being not a lawyer, I look at it more
11 practically and say that it's one of the things this Board
12 would presumably do on a regular basis is look at the
13 business activities of Hydro and determine which should
14 be regulated and which are outside of the regulation.

15 MR. KENNEDY: Okay, and I'm ...

16 MR. HALL: That's a more dynamic process than the
17 legislation.

18 MR. KENNEDY: No, I understand. I guess I'm speaking
19 specifically to the fact that under the Hydro Act, no wholly
20 owned, or no subsidiary of Hydro can be included in the
21 rate base of Hydro for the purposes of regulation, and so
22 therefore, if it's a subsidiary of Hydro, it's outside the
23 regulatory environment of Hydro. If we could turn to your
24 pre-filed evidence at page 11, line 28. I think this may have
25 been referred to already. I just have a question of my own.
26 Line 28, the key to Hydro's potential impact on the credit
27 rating of the province is its ability to operate on a
28 financially self-sufficient basis. Now when you refer to
29 Hydro there, are you referring to the regulated Hydro?

30 MR. HALL: It's not often, I can't remember how I defined
31 the word "Hydro" in there. I believe that in all of that filed
32 testimony I was talking about the regulated aspects of
33 Hydro only.

34 MR. KENNEDY: Would the ... as far as we're aware, or as
35 far as you're aware, there's no plan by DBRS to issue
36 separate reports, for instance, on the rating strength, if you
37 will, of the regulated aspects of Hydro versus it's overall
38 outlook, or versus its not regulated, or versus its non-
39 regulated business?

40 MR. HALL: No, DBRS is actually a business that operates
41 in the marketplace selling its services to creditors who are
42 interested in that information and because the regulated
43 portion of Hydro is not an issuing company that would
44 impact on the capital markets, I don't think there would be
45 anyone that would be willing to pay their fee.

46 MR. KENNEDY: Right, and so just jumping out for a
47 second, in the case of Newfoundland Power, although
48 they're a wholly owned subsidiary of Fortis, Newfoundland
49 Power is in itself subject to its own specific DBRS report,
50 because it in itself floats bonds.

51 MR. HALL: Correct.

52 MR. KENNEDY: Alright, but in the case of Hydro, it
53 doesn't break out for the purposes of floating bonds, its
54 regulated versus its non-regulated business, and in turn,
55 DBRS doesn't break out its regulated versus non-regulated
56 parts of its business for that same reason?

57 MR. HALL: Right.

58 MR. KENNEDY: And we see that Hydro itself as an overall
59 company has a debt to equity ratio that is already below
60 your stated target for the short term for the regulated
61 portion of Hydro.

62 MR. HALL: Well the debt equity ratio of ...

63 MR. KENNEDY: The entire company.

64 MR. HALL: Yeah, I don't want to say Hydro because ...
65 okay, the debt equity ratio of the entire company is not, is
66 not under consideration here, the same way that the debt
67 equity ratio of Fortis is not under consideration at a
68 Newfoundland Power hearing.

69 MR. KENNEDY: No, but the, your recommended target for
70 a debt equity ratio for the regulated portion of Hydro is 75
71 percent in the short-term.

72 MR. HALL: Yes.

73 MR. KENNEDY: And the debt equity ratio of Hydro total
74 is already below that number of 75 percent, correct?

75 MR. HALL: Yeah, mathematically that is correct.

76 MR. KENNEDY: And bondholders, DBRS does not look to
77 the regulated portion of the utility but to the total company
78 and, in turn, bondholders look to the total company.

79 MR. HALL: Yes, that's true.

80 MR. KENNEDY: Okay, so if DBRS is, as far as we're aware,
81 always going to look at the total company, and in turn
82 bondholders will always look to the total company in
83 determining the risk element of their investment in bonds
84 floated by Hydro, how will this Board ever know whether
85 its regulation of the utility, whether by virtue of setting
86 capital structure targets, or interest coverage ratio targets,
87 or rate of return, whether any of that is having any impact
88 on the rating of the regulated portion of Hydro?

89 *(12:00 noon)*

90 MR. HALL: Well, it's a challenge, there's no question
91 about that. The purpose of regulation, in my opinion, has
92 always been to take a monopoly company such as this and
93 simulate commercial terms, or simulate competition, in order
94 to provide guidance or parameters for this company to
95 work under, and that means that you're making
96 hypothetical, or making assumptions, a hypothetical

1 situation out of something that isn't there, and it's not
2 something though that regulators are not uncomfortable
3 with. There was too many N's in that. I think the regulators
4 are comfortable with that process because it certainly
5 occurs in many jurisdictions, so will you ever have a direct
6 connection between the impact of the decision of this
7 Board on the regulated portion of Hydro, and the capital
8 market's reaction to that in terms of bond ratings ... no, for
9 a couple of reasons. One is the one you're working me
10 through, which is the other businesses that Hydro is
11 involved with, and the other, of course, is the guarantee, so
12 that the connections are reasonably remote at the moment
13 and probably will be that way. But it doesn't prevent
14 regulators across the continent from simulating, comparing
15 to other jurisdictions, making estimates, and having expert
16 witnesses assist them in that.

17 MR. KENNEDY: Mr. Hall, I just have a quick question, if
18 you will, about your views on the competition issue.
19 Again, in the DBRS reports themselves on Hydro, it's noted
20 as one of the strengths, it seems to be repeated in all of
21 them pretty much, that the geographic isolation and
22 unavailability of gas minimizes competitive pressures,
23 impact of industry deregulation, and it's an accepted fact
24 that there is no alternative insofar as gas being used,
25 natural gas being used as a heating source, and that
26 because of our geographic isolation, it's unlikely that we'll
27 move to industry deregulation at any point because we're
28 not connected to the main grid of North America, so we
29 only can get our energy from Hydro and Newfoundland
30 Power, and whatever the small non-utility generators are
31 about.

32 MR. HALL: Yeah, the form of deregulation in this
33 environment would have to be different because of that. It
34 doesn't mean you couldn't do it, but it would be different.

35 MR. KENNEDY: Yeah, but I was interested in some of your
36 comments concerning the presence of competition and the
37 positive impact that that would have on the company, and
38 I'm wondering if I gathered from you correctly that you
39 seem to suggest that you consider the presence of
40 competition in the marketplace to be a good thing for a
41 company?

42 MR. HALL: I can't recall my specific comments. I do
43 believe that, yes, that it sharpens the mind.

44 MR. KENNEDY: As an unbridled capitalist you would
45 encourage competition in the marketplace?

46 MR. HALL: I do indeed, although I thought my references
47 were to, the connection was not so much to the
48 competition that comes from that, but the reliance of the
49 utility on the next-door neighbour to provide energy in the
50 case of a problem. I thought that's what I was referring to.

51 MR. KENNEDY: Okay, so then maybe I'm going down a
52 different path. I was assuming that you were suggesting
53 that the presence of competition would have, would have
54 a positive impact on Hydro insofar as it would, it would
55 force it into responding to that competition to become more
56 operationally efficient itself?

57 MR. HALL: No, I don't, I have not found, although I
58 fervently believe that myself, I have not found any
59 statistical information or studies, or anything that can be
60 conclusive that that happens.

61 MR. KENNEDY: Intuitively it's accepted wisdom, if you
62 will, that competition generally lowers the price of a
63 commodity?

64 MR. HALL: If that was a statement, I would agree with it.
65 If it's a question, I'll try and answer it.

66 MR. KENNEDY: It's a statement and I ask you to agree
67 with it?

68 MR. HALL: Yes, there's a letter of competition that tends
69 to drive down the cost, at least in the short-term. Unbridled
70 competition, as you've described my philosophy, is a little
71 inappropriate because, for example, in the electrical
72 business, there is unbridled competition in Argentina
73 which has caused so much generating to be constructed
74 that there is chaos in the market for everybody, and I'm not
75 sure that the state of Argentina is well served by that any
76 more than a jurisdiction already served by not allowing
77 competition.

78 MR. KENNEDY: I actually said you were an unbridled
79 capitalist.

80 MR. HALL: Did you? I would agree with that, yeah.

81 MR. KENNEDY: On the strength that, that the objective,
82 if you will, is to encourage Hydro to move towards the
83 lowest cost energy provider, the lowest possible cost
84 energy provider, and that normally competition is seen as
85 at least one mechanism to encourage that, by the presence
86 of providing an alternative to customers, and that would
87 normally be good for the ratepayer then, and that we know
88 that that's not the case in Newfoundland per se, other than
89 as we've discussed, some small generation projects here
90 and there by some of the other players, and that right now
91 the Public Utilities Board is the only surrogate, if you will,
92 for competition in the process of this hearing, and I'm just
93 wondering if you have any views as an unbridled capitalist,
94 on what other approaches could be entertained to
95 introduce the, a surrogate for competition in this
96 environment that would encourage greater operational
97 efficiency on Hydro?

98 MR. HALL: I have the view that, as I've expressed it
99 yesterday and possibly this morning, that operating this

1 company in the same way that the Board allows
2 Newfoundland Power to operate is in itself useful, and to
3 treat the two companies on a so-called level playing field,
4 I think is an appropriate action. To simulate competition
5 specifically, I don't have any magic bullets that would allow
6 that to occur.

7 MR. KENNEDY: That's all the questions I have, Chair.

8 MR. NOSEWORTHY, CHAIRMAN: Thank you very much,
9 Mr. Kennedy. We have 20 minutes left. I'll move to re-
10 direct from Hydro?

11 MS. GREENE, Q.C.: I have no questions in re-direct, thank
12 you, Mr. Chair.

13 MR. NOSEWORTHY, CHAIRMAN: In that case we'll move
14 to Board questions. Commissioner Powell?

15 COMMISSIONER POWELL: You want me to start now?
16 Okay. Thank you, Mr. Hall. I've got a few notes and a few
17 other notes that I've taken listening to everybody this
18 morning, so let's hope I can keep it from running too much
19 ... just as a curiosity more than anything else, I know that
20 when I'm looking at the Dominion Bond Rating Service, the
21 2000 and the 2001 updates, that in 2001 the Hydro analysis,
22 in addition to having a CFA, they had a professional
23 engineer in 2001. Is there any significance to that, the
24 change in staff?

25 MR. HALL: I didn't even notice that. No, I don't think
26 there's any significance in that. I think that just happens to
27 be his educational background.

28 COMMISSIONER POWELL: Yeah, they normally would
29 have engineers on ... there's no reason to think that they
30 finally wanted to get somebody that understood Hydro to
31 do an analysis of the process, is it?

32 MR. HALL: Nothing so radical as that, sir, no, I don't think
33 so.

34 COMMISSIONER POWELL: No, it just struck me, I did
35 notice that each year that there was one CFA constant with
36 the province and Hydro, both years, although they had a
37 different team in addition to, with Hydro in the province.

38 MR. HALL: The CFA is a chartered financial analyst
39 designation, as you know, and that has become sort of a
40 badge of entry for financial analysis. That's an educational
41 designation that's useful for that particular context, and
42 that's why you keep seeing it.

43 COMMISSIONER POWELL: In 2000 they only had one
44 CFA and the other person didn't seem to have any
45 professional designation, but in 2001 they had a
46 professional engineer.

47 MR. HALL: Yeah.

48 COMMISSIONER POWELL: Part of your evidence, and it
49 has been brought up before by other witnesses, the issue
50 of sending signals, sending messages of Hydro's operating
51 as an investor owned utility, at the same time there are
52 certain social obligations and kind of blending the two of
53 them together. So sometimes getting signals, but actually
54 getting the message mixed up, or at least I can get the
55 wrong message from what I think is the wrong signal, but
56 I'd just like to work you through something to see if I can
57 give you an example of what I'm thinking about and you
58 can tell me whether I'm getting the right message. When
59 we, the last couple of weeks we spent time going
60 throughout the province listening to ratepayers and
61 interested taxpayers about the issues of the application,
62 and one of the more interesting presenters we had was a
63 chap on the 23rd day of October, Mr. Barker ... draw up that
64 testimony, the transcript? We don't have that?

65 MR. O'RIELLY: (inaudible).

66 COMMISSIONER POWELL: Oh okay, sorry, you'll have to
67 trust me that I'm reading this right.

68 MR. O'RIELLY: (inaudible).

69 (12:15 p.m.)

70 COMMISSIONER POWELL: The 23rd of October
71 transcript, yeah. Yeah, on page 14, line 63, 62 to 63. Yeah,
72 Mr. Barker, he made a very short presentation and the first
73 part reads, he said, "Here in Central Newfoundland the
74 consumers get their power from Bay d'Espoir power plant
75 which generates its own power. As a consumer I protest a
76 Newfoundland and Labrador rate increase for the central
77 part of the province because we don't have to use Bunker
78 C", and Bunker C is what we use in Holyrood, which is not
79 too far from here, and it adds a significant cost to Hydro's
80 application.

81 MR. HALL: Yes.

82 COMMISSIONER POWELL: As a matter of fact, the
83 Chairman has gone on record, or the CEO has gone on
84 record saying that one of the fundamental reasons why
85 (inaudible), and on the next page, 15, I asked him some
86 questions and on line 10, Mr. Barker said, "Not only gas
87 but furnace fuel and everything we were told that was
88 because of the high price of transportation", and he's
89 talking about why ... I had asked previously why the price
90 of fuel has been high here, and that's what he says, the
91 cost of transportation, and from an electrical point of view
92 that's distribution, freight. Now the answer to that, of
93 course, is that we have the same, we are all interconnected
94 here in the province, or the island portion of the province
95 and we pay a common rate, and that's part of, considered a
96 social policy of government as it relates to Hydro as we
97 have (inaudible). Would the shareholders of Hydro, being

1 the government, and to assist Mr. Barker in his fuel prices,
2 his gas and his home fuel, set up a commissioner, and that
3 commissioner decided that we should have 18 zones, I
4 think, or 17 zones throughout the province, to set prices for
5 fuel oil and gas for the consumer. So the factor being the
6 transportation, so that's a signal, they're sending to the oil
7 companies, and they're sending to the consumer that
8 they're interested in paying costs. So as a regulator,
9 should I take that as a signal, the shareholder of Hydro
10 saying that we should regulate electricity rates the same
11 way and set up 18 zones, or 17 zones, or am I getting the
12 wrong message?

13 MR. HALL: I always get nervous when I'm trying to
14 interpret signals from government just like you do, so I'm
15 not sure I'm going to help you too much. It certainly has
16 been a principle of the electrical business in Canada that
17 there are common rates across jurisdictions, and the fact
18 that Mr. Barker happens to live near a lower cost facility is
19 fortuitous to him but he shouldn't benefit from that because
20 others live in other jurisdictions, or other parts of the
21 province, and so it would be going against, certainly the
22 way that the industry has been set up across North
23 America to do that. One of the effects of having zones and
24 pricing energy by zone is to send your own signals about
25 where ... I'm sorry, not yours, government would be
26 sending signals about where they want people to live,
27 because to the extent that energy costs and other social
28 services by extension were priced differently in different
29 regions, you would be giving signals to the population that
30 you would rather them live here than there, and that may
31 get the government into more concerning problems than
32 they probably want to be in, so if I was a, in your position
33 I would not want to take that as a signal for zoned rates for
34 electricity but rather wait for something far more explicit
35 from the government if they choose to do that.

36 COMMISSIONER POWELL: But you agree sometimes that
37 the signal and the message, you have to be careful when
38 you send a signal that you may be giving the wrong
39 message?

40 MR. HALL: Yes, that's why I really prefer to have a system
41 where there is a clear direction to a company like Hydro,
42 and then very clear signals, or messages sorry, your
43 terminology ... very clear messages given to them so that
44 they're not potentially confused by the sort of thing you've
45 described.

46 COMMISSIONER POWELL: The Consumer Advocate, or
47 the solicitor for the Consumer Advocate this morning, **NP-**
48 **6**, under one of the challenges brought up the issue of the
49 high realized foreign exchange losses and you rightly said
50 that you had to look at that in context with the coupon rate
51 in terms of the loss. When you analyze the whole thing it
52 may not be as great as it appeared to be. When the

53 Dominion Bond Rating Service is doing these rating
54 services, do they have any inter-reaction with RBC? I mean
55 would you have any input, would they talk to you about ...
56 or your people, not necessarily you, about the problems
57 with performance and Hydro performance and get
58 information?

59 MR. HALL: No, they don't.

60 COMMISSIONER POWELL: So they do that
61 independently?

62 MR. HALL: Yes, they're an independent company that
63 does this sort of analysis and they charge for it.

64 COMMISSIONER POWELL: So they wouldn't talk to you
65 about, to confirm figures or thoughts (*phonetic*).

66 MR. HALL: No, they would talk to the company and the
67 province to confirm figures. They tend to believe in their
68 own thoughts so they don't normally discuss ...

69 COMMISSIONER POWELL: So these comments, a high
70 realized foreign exchange loss, so we'd almost take that as
71 if that's the (inaudible) not the coupon issue then?

72 MR. HALL: No, I think what they're referring to there was
73 that the accounting for the foreign exchange losses in this
74 particular company didn't allow it to amortize those
75 exchange losses against the lower coupon that probably
76 occurred at the time that the bond was issued. In other
77 words, they weren't, the foreign exchange impact wasn't
78 booked year by year, sorry, and so that it sits out there as
79 a large number. I think that's probably what they were
80 referring to, that this company has a large foreign exchange
81 loss number that's a little different than other utilities
82 because of the accounting, not because of the underlying
83 business principles, but because of the accounting.

84 COMMISSIONER POWELL: So do you have any opinion
85 whether this should have been just charged right to
86 retained earnings as opposed to ... and get it off the books,
87 as opposed to charging this to the ratepayers going down
88 in the future? The concept being match revenue against
89 expenditures, or expenditures against revenue.

90 MR. HALL: As I said, I'm not an accountant certainly so
91 accounting opinions are ... take what you will out of them,
92 but the principle of amortizing the cost against the benefit
93 is something that I agree with, and so amortizing the benefit
94 of the lower coupon against the cost of the exchange
95 exposure makes sense to me but having said that, there is
96 always, usually a distinction between the accounting
97 treatment of these things, and the regulatory treatment of
98 these things, and I wouldn't presume to get into that
99 aspect.

100 COMMISSIONER POWELL: I'd like to ... page 9, lines 9 ...
101 that section is on 9 to 20. You say my firm has

1 considerable experience in reviewing the financial
2 performance of electric utilities, and you go on and you get
3 down with a conclusion that you should be into the range
4 of 10 to 12 percent.

5 MR. HALL: Yes.

6 COMMISSIONER POWELL: Okay, so when you say your
7 firm has, that your recommendation, that's not only your
8 recommendation but that's the knowledge of relying on
9 other experts within your firm to help you arrive at that
10 conclusion ... you don't go off in your little corner and do
11 this and say here it is, RBC, or do you?

12 MR. HALL: Well, we don't have a recommendation there,
13 as we discussed this morning, that's a reasonable
14 suggestion ...

15 COMMISSIONER POWELL: Okay, it's a reasonable ...

16 MR. HALL: An appropriate return ...

17 COMMISSIONER POWELL: Weasel words, as I would call
18 it.

19 MR. HALL: Yeah, what I did is I discussed with my
20 partners, who do this sort of work ...

21 COMMISSIONER POWELL: Uh hum.

22 MR. HALL: And got their views and put them into the
23 context of Hydro, but no, we don't have a specific team that
24 would sit down and make a firm recommendation, which is
25 why it's like that?

26 COMMISSIONER POWELL: Yeah, but at the same time,
27 when you're compiling this, I mean you just didn't go at the
28 dart board and throw numbers, you sort of got your people
29 in a ... if it's not a detailed review, you drew on a lot of other
30 expertise within your firm.

31 MR. HALL: Yes, that's correct.

32 COMMISSIONER POWELL: Because you didn't say ...
33 there's not much point in your firm having experience if you
34 don't use it to derive at a number, right?

35 MR. HALL: Right.

36 COMMISSIONER POWELL: Okay, good, Schedule 4,
37 that's the ... you have this Maureen Howe. I presume she's
38 a pretty competent professional person in her field?

39 MR. HALL: Yes, she is.

40 COMMISSIONER POWELL: And she is one of the many
41 experts and competent professionals that RBC do have
42 within their stable of people.

43 MR. HALL: Yes.

44 COMMISSIONER POWELL: Stable is probably not a very
45 good word, but within their human resource complement.

46 So no reason to think that her recommendations on things
47 are no better or no worse than your recommendation on
48 things, from a professional point of view. I mean any given
49 day, her recommendation in her field is probably as good or
50 better than your recommendations in your field?

51 MR. HALL: Well, she has a different context, I mean she's
52 not recommending to boards or to companies how to live
53 their lives. She's recommending to investors.

54 COMMISSIONER POWELL: No, I'm saying within her
55 field.

56 MR. HALL: Yeah, her knowledge and expertise of the
57 utility business, I'll have to be careful because she'll
58 probably read this transcript, and in case she does, I will
59 say that it's probably much better than mine.

60 COMMISSIONER POWELL: Okay, that's fair enough. I'll
61 take that. I just want to go quickly, before we go to break
62 here, because there's a number of comments that she makes
63 and some of them we've touched on, but on page 7, under
64 the assessing the formula section, she says that we believe
65 using a formula preferable to the (inaudible) preferably to
66 the regulator subjectively decreeing the rate of return,
67 prefer some form of (inaudible), and in the bottom part she
68 goes down, the last section, she says, the Board of
69 Commissioners of Public Utilities of Newfoundland using
70 spot rates results in one of the lowest allowed rate of
71 returns among Canadian pipelines and gas utilities during
72 1999. Then on page 8, down in the third paragraph, she
73 uses the ... and the formula utilized by the Board of
74 Commissioners of Public Utilities in Newfoundland who set
75 forth this rate of return are the least attractive ... the rate of
76 returns implied by the application of this (inaudible) are
77 consistently the lowest across the various interest levels.
78 So she's not too flattering.

79 On page 11, in the bottom, which was referred to
80 before, the form to be utilized by the Board of
81 Commissioners of Public Utilities in Newfoundland to set
82 forth this rate of return are the least attractive and penalize
83 these companies relative to the Canadian peer group. So I
84 went to Schedule ... page 12 of 13, and you looked at the
85 outlook for 2001 for Fortis, and she has, you have a price
86 rate of 34.50, and with all the returns and everything
87 factored in, she estimated a one-year target of 33.75 at a
88 return of 3.2 percent. Now when I was looking at this last
89 evening, I picked up The Telegram October the 31st, a year
90 later, and Fortis is trading at 43.57 which quick little math
91 told me if I factored in the dividend, it would be a return of
92 roughly 32 percent, so it was about ten times what she
93 anticipated. Now I realize forecasts are forecasts, but I then
94 said to myself, I went back to your page nine and said
95 here's a very common professional, she did a forecast, she
96 crunched the best numbers, and she didn't think the Public

1 Utilities Board had done a very good job in allowing their
2 rate of return, but the market said, gee, we're happy with it,
3 we're happy that in conjunction with Fortis, and you've
4 already said Newfoundland Light and Power is the
5 dominant part of Fortis, so she missed almost ten times, so
6 I look at your range of 10 to 12 percent and I say maybe
7 then Mr. Hall is as good as Ms. Howe, so maybe then I
8 should look upon that range of one to 120 percent. How do
9 you respond to that?

10 MR. HALL: Oh, I wish she was here. The influences on a
11 stock price are broader than the Public Utility Board
12 decision, and I guess to start with that, I believe that her
13 comments are on the application of the formula that this
14 Board has chosen to use for Newfoundland Power, not so
15 much the form of regulation, and it's by no means the
16 quality of the process or the people, but just the
17 application of the formula. She states that formulas are a
18 useful way for regulation for both the company and the
19 regulators because it provides some consistency and
20 predictability and therefore when she's looking at the
21 formula, she's looking for formulas that allow some, again,
22 some consistency of approach, and I believe with, subject
23 to her telling me otherwise, that the principal concern that
24 she would have with the formula-based approach to
25 Newfoundland Power is probably with respect to the
26 determination of the interest rate in such a narrow period of
27 time which, if memory serves, is right now, and that that
28 can result in a ... because the capital markets do this, it can
29 result in an inordinately high or inordinately low interest
30 rate environment that doesn't last very long but impacts on
31 the company for an entire year, so as a research analyst
32 looking at that formula, she would be concerned about the
33 variability that the formula could cause to the earnings of
34 the company, so I think that's where her comments are
35 coming from in terms of the formula.

36 COMMISSIONER POWELL: I appreciate that but the
37 ultimate judge is the market and the market said well the
38 formula may be wrong, but they ...

39 MR. HALL: The markets, unfortunately ...

40 COMMISSIONER POWELL: ... they didn't get penalized
41 for it.

42 MR. HALL: Well, the markets unfortunately have a whole
43 bunch of things pushing on them and not just regulatory
44 issues, and there's been a significant move towards stable
45 interest sensitive companies because of the terrorist
46 attacks, and because of the economic slowdown that was
47 occurring in any event before that. Interest rates have
48 gone down significantly in the last little while, and when
49 that happens, companies like Fortis, the stock goes up, and
50 the value of a bond goes up for the same reasons, because
51 interest rates are going down, so I think you will find that

52 a significant amount of the mistake, if you will, that Ms.
53 Howe made in terms of forecasting the price for Fortis a
54 year out, can be attributed to the interest rate environment
55 that we now have versus the interest rate environment we
56 had a year ago and her inability to see the impact of a
57 significant economic downturn and so on, so I don't
58 (inaudible) too much.

59 COMMISSIONER POWELL: If you were preparing that
60 analysis today and that range that you have there, would
61 you change it now ... this obviously was prepared many
62 months ago, that 10 to 12?

63 MR. HALL: It's reasonable to suggest an appropriate level,
64 so I could probably say no, I wouldn't change it, although
65 if your question is is the bias down now because interest
66 rates have fallen, yes, the bias is down, and I mean Ms.
67 McShane has already indicated, I believe, yesterday, that
68 in today's world her number would be less than she filed
69 and probably the same would be the case here, but my
70 intention was to be directional rather than specific so I
71 couldn't tell you how much down.

72 COMMISSIONER POWELL: One percent, probably two.
73 I guess we should break for lunch, I have one more
74 question.

75 MR. NOSEWORTHY, CHAIRMAN: You have some other
76 questions, Commissioner Powell, thank you very much.
77 We will break for lunch. Just looking forward, because I
78 can see that we may conclude with Mr. Hall early this
79 afternoon, would you be in a position Ms. Butler to
80 introduce your ... which I believe in terms of the cost of
81 capital would be the next expert witness, Mr. Browne?

82 MS. BUTLER, Q.C.: Uh hum, yes, Chairman, Mr. Browne is
83 ready to take the stand as soon as Mr. Hall is finished.

84 MR. NOSEWORTHY, CHAIRMAN: Okay.

85 MS. BUTLER, Q.C.: And I'll take about a half an hour to go
86 through his evidence in a general way with you and then
87 he will be subject to cross.

88 MR. NOSEWORTHY, CHAIRMAN: Okay, thank you, we'll
89 reconvene at 2:00.

90 (break)

91 (2:00)

92 MR. NOSEWORTHY, CHAIRMAN: Thank you, very
93 much, and good afternoon. Before we continue with the
94 questions from Commissioner Powell are there any
95 preliminary matters, Counsel?

96 MR. KENNEDY: I believe Hydro has some preliminary
97 matters.

98 MR. NOSEWORTHY, CHAIRMAN: Okay, thank you. Ms.

1 Greene?

2 MS. GREENE, Q.C.: Yes, thank you. Good afternoon. We
3 have the issue of the undertakings from yesterday. So I
4 have a copy of the list of undertakings to distribute at this
5 time. And you will see from the list, when it's distributed,
6 there was only one. So at this time I'm going to distribute
7 the list of undertakings, as well as the response to that
8 undertaking. You will see from the first sheet, which is
9 titled Undertakings, October 31, that there was only one
10 undertaking provided yesterday, and it was in response to
11 a request from counsel for the Consumer Advocate for Ms.
12 McShane to provide a calculation showing her calculation
13 of the ... her recommended cap on earnings. And the
14 second document that was distributed was that calculation,
15 as requested, as we understood the request to be.

16 MR. HALL: U-Hydro No. 13.

17 **EXHIBIT U-HYDRO NO. 13 ENTERED**

18 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
19 Kennedy. Thank you, Ms. Greene. I'll ask Commissioner
20 Powell to continue with his questioning, please?

21 COMMISSIONER POWELL: Just a couple of items, Mr.
22 Hall. I was looking at DH No. 1, the second page, and
23 under regulation in the second block there you talked
24 about the application and (inaudible) at an ROE of three
25 percent. Then down in four it's a variety of other matters,
26 including the PUB's endorsement for moving to an ROE.
27 It's not my understanding that we've been asked to endorse
28 a rate of return other than three percent. Do you have any
29 comments on how they would have arrived at that?

30 MR. HALL: Yes, I can obviously just interpret. But the
31 request that the Company has filed here, that certainly I
32 have recommended, is a move towards an ROE more
33 comparable to industry norms and a debt equity ratio of
34 60/40. And that's what they're quoting there is not an
35 endorsement for that particular structure, but the words say
36 an endorsement for moving to an ROE. And I believe all
37 they're doing is picking up what the application specifically
38 asks for and what we're recommending. So they are
39 anticipating a positive signal from this Board as to the form
40 of regulation of the Company.

41 COMMISSIONER POWELL: So you say a signal is an
42 endorsement?

43 MR. HALL: No. They use that word endorsement, and I
44 can't comment as to why, but it's endorsing the move
45 towards ...

46 COMMISSIONER POWELL: When we get down in
47 considerations they talk about the strength of Hydro, and
48 in the second one they say, "The utility recently filed its
49 first quarter rate base application which includes, among

50 other things, requests for a long-term approval of ROE of
51 11 percent." Unless I missed something in the application,
52 and I missed something from Hydro witnesses, including
53 Mr. Wells, that there's no request for a long-term ROE of 11
54 percent.

55 MR. HALL: No, Commissioner Powell, you didn't miss
56 anything. You're right, and that must have been the
57 engineer who wrote that part.

58 COMMISSIONER POWELL: So the engineer and the CFA
59 have something in common with Mrs. Howe in the sense
60 they don't necessarily always get it right. So this is either
61 10 percent right or 120 percent wrong?

62 MR. HALL: No, I don't think so. I think that was just a
63 shorthand by the Dominion Bond Rating Service because
64 they're challenged by the size of the page that they're
65 allowed to put in the rate survey, and they just would have
66 chosen the wrong word there.

67 COMMISSIONER POWELL: Okay. On page 2, line 4 you
68 mention that RBC has acted as underwriters and financial
69 advisors to Hydro in the province for 50 years. I'm not sure
70 if you've been asked this. But, what kind of a financial
71 voice would you give Hydro and the province?

72 MR. HALL: Well, over the years our company, I guess if
73 you would call it our bread and butter business, is
74 underwriting, which I described this morning as being the
75 raising of capital for our clients, but we also are financial
76 advisors. And financial advisory work, in a normal
77 corporation, would also include mergers and acquisitions
78 advice, which we obviously wouldn't do here. But there are
79 many instances where the Province, in particular, will ask
80 our opinion on various matters that relate to capital markets
81 and relate to financial situations that are brought before the
82 government. A more recent one, just to give you some
83 sense of that, is the deliberations that the Company and the
84 Province are having with respect to development of the
85 Lower Churchill, and we are providing financial advice to
86 Hydro and the Province on that aspect, which is not
87 underwriting, it's financial advice.

88 COMMISSIONER POWELL: Would any of that advice be
89 dependent upon the Board's approval of the Hydro
90 application as presented?

91 MR. HALL: No.

92 COMMISSIONER POWELL: Okay. One other item, page
93 10, lines 15, 17, when you talk about, "If, on the other hand,
94 the Board provides a degree of assurance to Hydro that its
95 decision is caused by unusual circumstances that are
96 expected to disappear shortly and that the Utility's financial
97 ratio will be allowed to return to more acceptable levels in,
98 say, five years, I would expect no immediate adverse
99 reaction from credit suppliers." I presume that's the bond

1 market. In taking that into consideration would the Board
2 not have to temper any unusual circumstances that they
3 may want to articulate that may cause the Province more
4 harm than Hydro good in terms of sending a signal and
5 somebody interpreting the message?

6 MR. HALL: If I understand your point there, the unusual
7 circumstances that I am referring to there are ... were
8 specific to the need to raise rates in the province on a
9 staged basis so that the customers don't have what we call
10 rate shock or a reaction to significant changes, and that has
11 resulted in a request for only a three percent return on
12 equity. The unusual circumstance, in my view, would be if
13 this Board decided that a three percent rate was just fine
14 and determined that that would be the case for the
15 foreseeable future. That would cause a concern amongst
16 credit suppliers in the same way that the rate that I referred
17 to this morning of Trans Alta, that was much lower than
18 had been anticipated, caused a concern to those investors.

19 COMMISSIONER POWELL: So in this context your only
20 unusual circumstances would be a rate shock?

21 MR. HALL: Well, that's the one that's in front of us now,
22 yes. But what I was trying to say there that if the Board
23 evidences a consistent approach to regulation, which you
24 have, in my understanding always done with this Board,
25 have had a consistency in the way that you regulate
26 utilities in this jurisdiction, and if you continue to do that,
27 by example, saying that the kinds of regulatory overview
28 that you would have in this company would be the same as
29 the regulatory overviews you had in Newfoundland Power,
30 then that would cause credit suppliers to be comfortable.

31 COMMISSIONER POWELL: The reason why I brought
32 that up, I gave the example this morning of signals a
33 message, the ratepayer/consumer in Central Newfoundland
34 was wondering why, and the example of the shareholders
35 of Hydro sending a signal out, maybe somebody may get
36 the wrong message because of that signal. But one of the
37 other messages that we got that we, as a Board, will have
38 to look at in terms of when we finally get all the evidence in,
39 that there was a representation made by ratepayers and
40 consumers who were worried about the continued
41 existence of one of the largest employers in the province if
42 the application goes forward as specified. So if the panel,
43 in its decision decided that we could not approve the rate
44 increase because of the effect it would have on, and we
45 were to articulate that is why, we said everything else is
46 great but, based on our view ... wouldn't that be the wrong
47 signal to send to the bond market, because the implications
48 would be much greater for the province than whether
49 Hydro got the increase or not?

50 MR. HALL: Yeah, I would say that the capital markets
51 would consider that to be a less than efficient way of

52 dealing with that particular problem. They would much
53 prefer this Board to regulate on the basis of established
54 principles. And then if it was necessary ... I presume this
55 would actually be the Province doing this, if it was felt
56 necessary to subsidize one particular customer for regional
57 employment purposes, then they would do that overtly by
58 providing a subsidy directly to that company through the
59 legislative process of government and not have that effect
60 delivered by telling this Crown corporation to do it. That's
61 what the capital markets would rather the government did,
62 because then it becomes very clear and very explicit what's
63 going on and why you're doing it. But, as I say, I would
64 have thought that would have been the Province that
65 would be better suited to do that or to implement that
66 subsidy rather than the Board.

67 COMMISSIONER POWELL: So where would the signal
68 come from to the Board to say the Province is going to deal
69 with that problem, because the application does not
70 indicate that?

71 MR. HALL: Well, as I say, Commissioner Powell, I would
72 have thought that the Board would not need to be looking
73 for that signal, but would rather regulate on the basis of the
74 best financial result for the Company and allow the
75 Province, as they have the ability to do, to direct subsidies
76 on top of any decision that you made, rather than as part of
77 any decision.

78 COMMISSIONER POWELL: So that should go towards all
79 subsidies, then?

80 MR. HALL: Well, yes, it's my view that that's the way it
81 should be done, only for transparency. Then everybody
82 knows what you're doing.

83 COMMISSIONER POWELL: Okay. That's all my
84 questions.

85 MR. NOSEWORTHY, CHAIRMAN: Thank you,
86 Commissioner Powell. Commission Saunders?

87 COMMISSIONER SAUNDERS: Yes, thank you, Mr. Chair.
88 Good afternoon, Mr. Hall.

89 MR. HALL: Commissioner Saunders.

90 COMMISSIONER SAUNDERS: On a couple of occasions,
91 I guess more than a couple of occasions, when we began
92 this hearing I think one of the first witnesses we heard from
93 was Mr. Wells and then he was followed by Mr. Reeves, I
94 believe, and then Mr. Henderson, and on a number of
95 occasions during the onset of the evidence, which by the
96 way, in all three cases was adopted by each of the
97 witnesses, some of the questions that were asked by the
98 parties were referred to witnesses that followed. For
99 example, Mr. Wells referred some questions off to Mr.
100 Reeves, who referred some questions off to Mr. Henderson,

1 which was quite acceptable, and the questions were picked
2 up as the witnesses were presented. When you took the
3 stand here, I think it was yesterday, you adopted your
4 evidence. What did you understand you were doing when
5 you adopted your evidence?

6 MR. HALL: To me, adopting the evidence is confirming
7 that that is my evidence and that it's the basis upon which
8 you will be questioning what I have to say.

9 COMMISSIONER SAUNDERS: So, okay. Now we go to
10 Schedule 6, I think it was ... no, Schedule 4, I'm sorry, which
11 from what I can understand, was a paper put together by a
12 Ms. Maureen Howe?

13 MR. HALL: Yes.

14 COMMISSIONER SAUNDERS: Yeah, and on a few
15 occasions during questioning, I remember, by Mr.
16 Fitzgerald and others, you escaped, if you like, from the
17 question, by saying that it was her opinion, not yours?

18 MR. HALL: Yeah, I think that's right.

19 COMMISSIONER SAUNDERS: Okay. So I wonder where
20 do I go, as a Commissioner sitting on this application, with
21 respect to what weight I place on your evidence. Can you
22 see my dilemma? For example, before you answer, Mr.
23 Powell asked you a question at the beginning of this
24 afternoon in relation to this DBRS report, which all of a
25 sudden it appears there's an error in. You would not have
26 stated what's contained here that Mr. Powell referred to, in
27 the way that it's stated here, in respect of the 11 percent. Is
28 that fair?

29 *(2:15 p.m.)*

30 MR. HALL: I don't think there's an error in ... at least, I
31 haven't discovered an error in the DBRS material. It's a
32 question of how they disclose information that's different.
33 But the 11 percent that Ms. McShane is talking about in the
34 Company is not in relation to that particular document, that
35 is correct. It's 11 percent of a different number.

36 COMMISSIONER SAUNDERS: So you would not have
37 stated it exactly the way it's stated there?

38 MR. HALL: That's correct.

39 COMMISSIONER SAUNDERS: Had you noticed it would
40 you have pointed it out to the Board in your direct
41 testimony?

42 MR. HALL: I don't believe it was an error. Although I may
43 be on the wrong spot.

44 COMMISSIONER SAUNDERS: But didn't you agree with
45 Mr. Powell that it wasn't stated properly?

46 MR. HALL: I don't think so. I think I agreed that it was
47 stated different, that it was a reconciliation ...

48 COMMISSIONER SAUNDERS: I don't want to get into an
49 argument over that with you.

50 MR. HALL: Okay.

51 COMMISSIONER SAUNDERS: I got the impression from
52 your answer that the DBRS report, in referring to what the
53 Applicant was seeking, was not stating it properly. The
54 Applicant is not seeking 11 percent at this stage, a long-
55 term approved ROE of 11 percent at this stage?

56 MR. HALL: Oh, I am sorry, I was back on the financial
57 numbers and the table. I thought that's what you were
58 referring to.

59 COMMISSIONER SAUNDERS: No, I'm referring ...

60 MR. HALL: Yes, that summary that said that you were
61 seeking a long-term approved rate is inaccurate in the
62 DBRS statement, yes.

63 COMMISSIONER SAUNDERS: So I go back then ... when
64 Ms. Greene asked you at the outset if you were adopting
65 this evidence what were you intending to convey to us
66 when you said you were adopting it?

67 MR. HALL: That I was adopting the written material that
68 I provided, and in assistance in that written material I had
69 referred to several schedules of information, some of which
70 I had obtained from outside sources, and that all of that
71 material would be relevant to what I had written.

72 COMMISSIONER SAUNDERS: I gather that Ms. Howe is
73 not going to be called in this matter?

74 MS. GREENE, Q.C.: No, Commissioner Saunders. I don't
75 know if it would be helpful if I added a few comments here.
76 What Mr. Hall has filed as schedules to his evidence were
77 things that he would have reviewed in forming his opinion
78 and the evidence that he did provide. The DBRS report is
79 not written by RBC Dominion Securities.

80 COMMISSIONER SAUNDERS: I realize that.

81 MS. GREENE, Q.C.: But it certainly is something that RBC
82 Dominion Securities would look at to determine what the
83 expectation in the market is. So we are not offering it for
84 the total correctness of what's provided in it, but for the
85 fact that it is reviewed by investment, people who provide
86 investment advice, and that's the context in which Mr. Hall
87 has provided it to this Board. And I think he also explained
88 the process in which who DBRS is and what their role is
89 and how they provided the opinions. So I don't know if
90 that's helpful. And in terms of Ms. Howe, no, that was not
91 ... actually, I don't think it's not ... it's not an essential
92 element of our application. It was information as to what
93 was considered to be a forecast of one point in time of a
94 forward period that has now past.

95 COMMISSIONER SAUNDERS: I'm not suggesting that it's

1 necessary to call Ms. Howe. I'm wondering, and this is
2 why I started out my questioning of your witness, that in
3 times previous to this witness any questions that were
4 referred off to witnesses to follow were picked up by the
5 witnesses that followed. When Mr. Hall refers to Ms.
6 Howe that's where it ends. We don't have any access to
7 Ms. Howe.

8 MS. GREENE, Q.C.: No, that's correct.

9 COMMISSIONER SAUNDERS: That's right.

10 MS. GREENE, Q.C.: And I guess if the Board were to
11 determine that they did and asked the Applicant to require
12 that Ms. Howe attend, obviously that's something we
13 would seriously consider in light of the request from the
14 Board. But from our perspective, what Ms. Howe may have
15 provided is a forecast of interest rates on 2000 for 2001 is
16 not essential to this particular application. No, I had not
17 intended to call her.

18 COMMISSIONER SAUNDERS: Okay. No further
19 questions, Mr. Chair.

20 MR. NOSEWORTHY, CHAIRMAN: Thank you,
21 Commissioner Saunders. Commissioner Whalen?

22 COMMISSIONER WHALEN: Thank you, Chair. Mr. Hall,
23 thank you. I have no questions on your evidence. I just
24 have a follow-up on Commissioner Saunders question.
25 Whether or not there is an ROE outlook report for 2002
26 ready and whether or not that report ... I just noticed that
27 October 31st, 2000 has come and gone and I wonder if there
28 is a next edition of that report available?

29 MR. HALL: It hasn't been published yet, Commissioner
30 Whalen, but because of that coincidence in dating I expect
31 it to be out any time.

32 COMMISSIONER WHALEN: Would that be something
33 that could be made available to us?

34 MR. HALL: Certainly.

35 COMMISSIONER WHALEN: Okay. Thank you. That's all
36 I have, Chair.

37 MR. NOSEWORTHY, CHAIRMAN: Thank you,
38 Commissioner Whalen. Good afternoon, Mr. Hall. I just
39 have a couple of questions. These are very much along the
40 lines of the questions that I would have asked Ms.
41 McShane yesterday because I do see a number of parallels,
42 I guess, which is not really unexpected, between your
43 evidence and Ms. McShane's.

44 MS. BUTLER, Q.C.: Excuse me, Mr. Chairman, I wonder
45 can you move your mic?

46 MR. NOSEWORTHY, CHAIRMAN: Oh, I'm sorry. I was
47 reiterating the fact that my questions will be few, and I see

48 some parallels between Mr. Hall's evidence and Ms.
49 McShane's and so consequently, some of the questions
50 will be exactly following along the same lines, I guess. One
51 of Ms. McShane's responses to one of my questions
52 yesterday concerning the role of the Board in setting
53 principles referred to, and so from my perspective Ms.
54 McShane said those would be the same principles that
55 should apply, and in that case she was referring to the
56 order of PU 16, '98, '99 in relation to Newfoundland Power
57 that should apply in these circumstance. And specifically,
58 then, "I don't think that the Board needs to, at this juncture,
59 set a specific number for a return, but wait until such time
60 as Hydro requests a full normal rate of return and at that
61 point I think that the Board should do what it did in the
62 case of Newfoundland Power, which is then to look at all
63 the individual tests and to determine what indeed it
64 believes is a return that's consistent with those principles?
65 And if I have been listening to you correctly over the last
66 little while I think you would have no hesitation in agreeing
67 with that?"

68 MR. HALL: No, I'd agree with that.

69 MR. NOSEWORTHY, CHAIRMAN: And I think, if
70 anything, there are probably a couple of points of
71 departure. One, that you would probably not wish this
72 Board to wait for the next normal rate of return to establish
73 the specific quantitative parameters, perhaps, around the ...
74 fashion numbers around the principles. Is that ... would I
75 be interpreting your stance in that regard correctly?

76 MR. HALL: We always like to reach for the moon,
77 Commissioner. But I would think certainly I would be, as a
78 capital market person, be more than satisfied if this Board
79 confirmed the direction and the structure of the rate
80 oversight that you would provide and would not feel
81 inadequate if you didn't have it under. So I would agree
82 with Ms. McShane in terms of establishing the principles
83 or confirming the Newfoundland Power principles would be
84 a reasonable outcome in this.

85 MR. NOSEWORTHY, CHAIRMAN: Okay. So there are
86 really no points of departure, then, in essence?

87 MR. HALL: I'm sure I have something that I don't agree
88 with her on, but not that.

89 MR. NOSEWORTHY, CHAIRMAN: In reaching the debt
90 to equity ratio, I think on a couple of occasions you refer to
91 the fact that Hydro would do that through retained
92 earnings, which is the ... from my understanding, in any
93 event ... and certainly I'm not an accountant, I'm an
94 engineer.

95 MR. HALL: Oh, oh. You see, I wasn't totally briefed by
96 counsel before.

97 MR. NOSEWORTHY, CHAIRMAN: In part, an engineer.

1 The retained earnings, to me, to some degree, is the flip
2 side of the issue on dividends, I guess, and the dividend
3 policy, and I heard Ms. McShane comment on the fact that
4 there should be, I think, a predictable and stable dividend
5 policy, and I seem to interpret, from your remarks, that
6 indeed there should be a no dividend policy or at least a
7 policy where there are no dividends in terms of achieving
8 the equity ratio as quickly as possible. Am I interpreting
9 that incorrectly?

10 MR. HALL: No, you're not. If I had my way, which I don't,
11 the shareholder of this company might decide to either
12 defer the payment of dividends to which they might
13 otherwise be entitled or to pay those dividends and recycle
14 the money back into the company in order to establish a
15 proper debt equity ratio under the structure that I think is
16 appropriate. But that's a decision for the shareholder, in
17 this case the Province of Newfoundland, and we have to
18 deal with what we have in front of us.

19 MR. NOSEWORTHY, CHAIRMAN: Uh hum.

20 MR. HALL: So, yes, I would prefer that the retained
21 earnings are built up more quickly than they are.

22 MR. NOSEWORTHY, CHAIRMAN: Okay. I guess my
23 final question would relate to, Ms. McShane again referred
24 to a number of proxies. I believe she, in response to my
25 question, defined those proxies as a series of low risk
26 electric utilities in the U.S. and those that are publicly
27 traded in Canada. I guess in relation to Mr. Kennedy's, one
28 of Mr. Kennedy's questions this morning in regard to the
29 notion of competition he referred, I think, to this Board as
30 the surrogate for competition and how, I think the question
31 was along the lines of what this Board would do to try and
32 encourage that with regard to Hydro, and I don't have the
33 transcript because it was only this morning, but I wrote it
34 down, and you said operating this company similar to
35 Newfoundland Power, I believe, and trying to make it a
36 level playing field, essentially. Am I ...

37 MR. HALL: Yes.

38 MR. NOSEWORTHY, CHAIRMAN: ... generally along the
39 lines?

40 MR. HALL: Yes.

41 MR. NOSEWORTHY, CHAIRMAN: Okay, and this
42 question, again, probably is a little bit of an expansion on
43 my question to Ms. McShane yesterday. What do you see
44 the role in moving in that direction, what do you see as the
45 role of the Regulator, what is it that we need to do, what is
46 it that Hydro needs to do and what is it that the
47 shareholder needs to do to move to this? I think Ms.
48 McShane referred to it as investor based model, and I think
49 you're simply going to, as a surrogate, Newfoundland
50 Power?

51 MR. HALL: Yeah, that's exactly correct, Newfoundland
52 Power just happens to be the same province (*sic*), in the
53 same business, so it's a nice reference point. What do you
54 want me to do? The Company, in my opinion, or at least in
55 my understanding of discussions with them, is more than
56 prepared to operate under the basis of a level playing field
57 with the other utility in this province. So I don't think you,
58 as a Board, need to do anything to get them ready for that
59 kind of an environment. I think the management team in
60 place is more than qualified to do that. I think that the
61 Board might consider providing a set of principles for
62 regulation, which has been recommended here, and be
63 explicit as to what those general parameters of regulation
64 are going to be, and in other words, what is generally
65 expected from Hydro in the future in terms of their
66 operations and then provide that statement of principles to
67 the government, and presumably the Board itself could do
68 that, and say this is the way we feel, do you agree. So that
69 you can have some buy in by the province, as the
70 government of the region, but also the Province as
71 shareholder, that these are reasonable principles under
72 which the Board can conduct reviews of their operations
73 and affairs. And if the government agreed to that basic set
74 of principles, then I think you're getting there, because you
75 have now stated the way it will be done and you've had the
76 government explicitly say that sounds right to us. That
77 would give enough direction, in my view, to the
78 management of the Company to get on with implementing
79 what you have given them direction to do.

80 (2:30 p.m.)

81 MR. NOSEWORTHY, CHAIRMAN: Do you acknowledge
82 the ... I discussed this with Ms. McShane, as well, and I
83 think she would have concluded in relation to setting the
84 debt equity ratio versus ... in setting the capital structure,
85 I guess, versus addressing the dividend policy, per se, that
86 our role certainly would be to look at the capital structure,
87 but indeed it was very difficult to do that and establish that
88 without, in some way, shape or form, defining the dividend
89 policy, which is really the responsibility, I guess, of the
90 shareholder or the right of the shareholder, if you will. And
91 I heard you say earlier that, certainly from your perspective
92 we should be directing the structure, which would be
93 established by Hydro, the financial structure. And
94 certainly in relation, and in doing that government would
95 have to address subsidy issues and it would force subsidy
96 issues to be addressed in an overt fashion. And I see sort
97 of an analogy there with the dividend policy, per se.
98 Again, we aren't, I don't think this Board are creators or
99 setters of public policy, so in doing that are we not doing
100 what you're suggesting, are we not, then, leaving
101 government no choice, I guess, in respect of the subsidy
102 policy that is before it in dealing with it? And I guess my
103 question to Ms. McShane, I was having difficulty in

1 reconciling the two, between the dividend policy and the
2 capital structure, per se. And I guess I'm having somewhat
3 similar difficulty in relation to this particular aspect. And I
4 was just wondering if you could comment and elaborate on
5 it a little bit more?

6 MR. HALL: If I understood you correctly, I mean, it isn't an
7 issue that needs some careful manoeuvring on your part.
8 It seems to me that there are social policies, if you will,
9 directives that can be implemented by this Board without
10 any reference to government. So I'm trying to make a
11 distinction between social policies, and one of those is the
12 universal application of rates across the province, as we
13 were discussing a little earlier with Commissioner Powell.
14 I mean, that is something that is very typical for a
15 regulatory board to define as being something appropriate
16 and to just do it, and so you don't need, you wouldn't need
17 to refer to governments for that sort of direction. But do I
18 think it's appropriate for you to isolate the government and,
19 if you will, force them to make more overt decisions on
20 other aspects of social policy, let's say regional
21 employment or subsidization of a business that needs
22 lower costs in order to continue in operation, yes, I do. I
23 think that that is not ... the best venue for doing that is not
24 in front of this Board, but rather, at the government level
25 where it's clear what they're doing and it's clear what the
26 results will be. I mean, I don't ... I emphasize, in a strong
27 way, with the concern that you have with respect to the
28 dividend payment, because it is ...

29 MR. NOSEWORTHY, CHAIRMAN: I haven't reached that
30 point yet where it's a concern. It's an issue.

31 MR. HALL: Alright, fair enough. Then I emphasize with
32 the issue, because it is an issue. And I don't have an easy
33 solution for it, save to say that if the policy is clearly
34 defined by this Board that a 40 percent equity ratio is
35 appropriate or whatever number you chose to come up
36 with, then it's pretty clear that you've put that back to the
37 shareholder and said this is what we think.

38 MR. NOSEWORTHY, CHAIRMAN: Okay. That's all I
39 have. Thank you, Mr. Hall, very much. I'll call upon
40 Newfoundland Power now to ask any questions arising,
41 please?

42 MS. BUTLER, Q.C.: Mr. Chair, we have no questions
43 arising from the panel's questions.

44 MR. NOSEWORTHY, CHAIRMAN: Industrial Customers?

45 MR. HUTCHINGS: A couple of points, Mr. Chair. Mr. Hall,
46 in response to the Chair you indicated that you would
47 prefer that the retained earnings in this company were built
48 up more quickly?

49 MR. HALL: Yes.

50 MR. HUTCHINGS: Do you imply by that that the market
51 would prefer that the retained earnings were built up more
52 quickly?

53 MR. HALL: No. I was speaking for myself as a
54 philosophical point because, as you know, the market, by
55 which I presume you mean the capital markets and
56 providers of lending to this company, are reliant upon the
57 provincial guarantee.

58 MR. HUTCHINGS: That's fine. The other point that gave
59 me a concern was the suggestion that the Board state its
60 principles for regulation and then provide those principles
61 to government, both in its role as legislator and as
62 shareholder, and ask government if it agreed with those
63 principles. Is it appropriate for a regulator to ask the
64 shareholder of a regulated utility if it agrees or doesn't
65 agree with the principles established by the Board?

66 MR. HALL: I knew when I was answering that question I
67 was stepping into heavy traffic. I don't know if ... I
68 honestly don't know the answer to that question. I
69 presumed that the Board would take that comment and do
70 with it as they thought was appropriate. That's what I
71 would do, but I tend to wear my heart on my sleeve. It may
72 not be appropriate.

73 MR. HUTCHINGS: But, I mean, it seems to run totally
74 contrary to the notion you were trying to sell us on
75 yesterday, as I understood, that, you know, this Board
76 should go ahead and regulate as if the Crown were just any
77 other shareholder. Is that correct?

78 MR. HALL: Oh, I certainly continue to believe that, and I
79 don't think it's inconsistent with that. If the other regulated
80 utility in this jurisdiction decided to pay out inordinate
81 dividends, inordinate in the perception of the Board, I
82 would assume that this Board would feel very comfortable
83 in getting in touch with the parent holding company who
84 demanded that dividend and make their views known. So
85 I don't think that's inconsistent at all. What I did say was
86 that it was within the purview of the holding company to
87 make that decision and that's still true. But it's certainly
88 within the range of the regulator of the business to point
89 out implications of that.

90 MR. HUTCHINGS: Okay. Just from a procedural point of
91 view, though, would it not be simply appropriate for this
92 Board to make its order and if government has a problem it
93 has the power, under Section 5.1 of the Act to do
94 something different?

95 MR. HALL: Well, I would defer to your knowledge of
96 procedural implementation much more than mine, so I'll
97 agree.

98 MR. HUTCHINGS: Well, I just ... I really did have a
99 problem with the notion of the Board going somewhat hat

1 in hand to government and asking for its approval of
2 something the Board has done, but I think we've covered
3 the point. Thank you, Mr. Chair.

4 MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.
5 Hutchings. Mr. Fitzgerald, please?

6 MR. FITZGERALD: Thank you, Mr. Chair. No, we have no
7 questions arising.

8 MR. NOSEWORTHY, CHAIRMAN: Counsel for the
9 Board?

10 MR. KENNEDY: Nothing arising, Mr. Chair.

11 MR. NOSEWORTHY, CHAIRMAN: Any redirect, Ms.
12 Greene?

13 MS. GREENE, Q.C.: No, Mr. Chair, I have nothing arising.

14 MR. NOSEWORTHY, CHAIRMAN: Thank you, very
15 much, Mr. Hall, for your at times candid comments and
16 testimony. Thank you. I'll call upon Mr. Butler, Mr.
17 Browne?

18 MS. BUTLER, Q.C.: Thank you, Mr. Chairman. Yes, Mr.
19 Browne is available whenever the seat is empty.

20 MR. HALL: I'm going, I'm going.

21 MS. BUTLER, Q.C.: Mr. Chair, can I say while my college
22 is passing out some revised pages for Mr. Browne's
23 testimony, Mr. Browne is being called at this time
24 specifically at the request of at least on or the other co-
25 counsel for Intervenors who felt, when we had met on
26 preliminary days as a group of counsel, that his evidence
27 should be called with that of the other cost of capital
28 experts. Now, technically Newfoundland Power takes the
29 position he could have been called at the end. He's not
30 being called to address the same sort of issues that you've
31 heard addressed by Ms. McShane, Mr. Hall, and the others
32 that will follow. However, I must say, following the last
33 question or two that you put to Mr. Hall maybe it turns out
34 to be a good fit after all. Mr. Browne will, of course, be
35 addressing regulatory issues. So I'd ask that he be sworn.
36 And I'll take about a half an hour or so.

37 MR. NOSEWORTHY, Q.C.: Thank you, Ms. Butler. Good
38 afternoon, Mr. Browne, and welcome. Could I ask you to
39 take the Bible in your right hand, please? Do you swear on
40 this Bible that the evidence to be given by you shall be the
41 truth, the whole truth, and nothing but the truth, so help
42 you God?

43 MR. BROWNE: Yes, I do.

44 MR. NOSEWORTHY, CHAIRMAN: Thank you, very
45 much. Ms. Butler, I'd ask you to proceed, please?

46 MS. BUTLER, Q.C.: Thank you, Mr. Chairman. Mr.
47 Browne, could you please, for the record, state your full
48 name and address for the Board?

49 MR. BROWNE: Yes. My name is John Thomas Browne.
50 I live at 2045 Lakeshore Boulevard West in Toronto,
51 Canada.

52 MS. BUTLER, Q.C.: Now, Mr. Browne, you, like all the
53 others before you, filed testimony in advance of this
54 hearing in August of 2001, and in addition you provided
55 direct replies to some information with that, specifically
56 Newfoundland and Labrador Hydro 53, 54 and 55?

57 MR. BROWNE: That is correct.

58 MS. BUTLER, Q.C.: And the Consumer Advocate 188 and
59 189. Do you adopt all of these as your evidence in today's
60 proceedings?

61 MR. BROWNE: Yes, I do.

62 MS. BUTLER, Q.C.: And can you tell the panel, please,
63 whether there are any changes to be made to the pre-filed
64 testimony for typographical or any reason?

65 MR. BROWNE: Yes. There have been some changes made
66 to **Exhibit JTB-2**. Subsequent to filing our report we redid
67 some of the numbers in more detail and there were a
68 number of changes made to the numbers. Most of them
69 related to rounding errors. In a couple of cases there was
70 some slight reclassification. The only impact that actually
71 hits the report itself is on page 22.

72 MS. BUTLER, Q.C.: And perhaps Mr. O'Rielly can put that
73 on the screen? No, in the actual body of his testimony.
74 Thank you. Page 22. Okay.

75 MR. BROWNE: There's a number 144 percent on line 1.
76 That number should be 158.

77 MS. BUTLER, Q.C.: And I wonder could we just scroll
78 back, Mr. O'Rielly, to the bottom of the page before so you
79 can see how it runs together? So, just reading the
80 sentence, if you could, Mr. Browne, for the private sector
81 utilities?

82 MR. BROWNE: Yes. "For the private sector utilities the
83 five year average payout ratio range from 54 percent to"
84 what used to say "144 percent" should now state 158
85 percent.

86 MS. BUTLER, Q.C.: Mr. Chair, we will provide a new page
87 for the purpose of electronic entry, but I thought for
88 today's purposes we could just make a note of the number.

89 MR. BROWNE: One thing that, Ms. Butler, is the changes
90 have no impact on the report itself, any conclusions or
91 opinions presented in the report.

92 MS. BUTLER, Q.C.: Thank you. Now, in terms of the
93 revised **Exhibit JTB-2**, pages 1 to 4, can you just assist the
94 Board with the changes that were made from the original,

1 which is on your screen?

2 MR. BROWNE: I haven't had them identified, but certainly
3 the full changes are in the new document Mr. Alteen has
4 passed out.

5 MS. BUTLER, Q.C.: Okay. Can you just, perhaps, give us
6 an example?

7 MR. BROWNE: I don't ... yes. I think if you look at 1996
8 for Union Gas under, I believe was the total equity ratio,
9 Table 1, I believe the number previously was 34, it's now 35.

10 MS. BUTLER, Q.C.: That's correct, okay. Mr. Browne, you
11 testified before this Board, maybe not constituted in this
12 fashion, but the Public Utilities Board for Newfoundland
13 previously?

14 MR. BROWNE: Yes, I did, in May of this year.

15 MS. BUTLER, Q.C.: And at that time you provided your
16 credentials as well as the credentials which are attached in
17 the resume, which is **JTB-1** of your testimony today?

18 MR. BROWNE: Yes, I did.

19 MS. BUTLER, Q.C.: Can you just summarize for us, please,
20 your general credentials, and perhaps Mr. O'Rielly could
21 put **JTB-1** up for us?

22 (2:45 p.m.)

23 MR. BROWNE: Yes, I have a Bachelor of Commerce
24 Degree and a Masters Degree in economics. I'm also a
25 chartered accountant and a certified management
26 consultant. Over the last 17 years I've directed and worked
27 on a wide range of studies for rate regulated enterprises
28 dealing with issues such as the methods of rate regulation
29 and their interpretation, the implementation ... I'm sorry.
30 The implications of regulations for the operations of a
31 utility, product costing and pricing, management reporting,
32 issues of rate based determination and cost of capital. I've
33 appeared as an expert witness over that period before a
34 number of Canadian regulatory boards dealing with issues
35 ... dealing with accounting and financial issues. Further
36 details on my experience are set out in the resume in **JTB-1**.

37 MS. BUTLER, Q.C.: While we have that on the screen, Mr.
38 Browne, I note under the section which is there towards the
39 bottom committees and publications, there you go, that
40 you are currently Chairman of the Canadian Institute of
41 Chartered Accountants Study Group, Financial Reporting
42 by Rate Regulated Enterprises. Can you explain to the
43 Board what this group is doing?

44 MR. BROWNE: Yes. The purpose of the study group is to
45 review the issue of accounting by rate regulated
46 enterprises, such as Newfoundland and Labrador Hydro
47 and Newfoundland Power. In particular, it's addressing the
48 issue of whether these companies should account for the
49 impacts of rate regulation, and if so, how.

50 MS. BUTLER, Q.C.: And what is the status of the group's
51 work?

52 MR. BROWNE: Basically finished. We're just finishing the
53 last words of the report now.

54 MS. BUTLER, Q.C.: Okay. Mr. O'Rielly, I wonder if we
55 might turn to page 2 of Mr. Browne's direct testimony, pre-
56 filed. And lines 18 to 24, Mr. Browne, outline the issues
57 that you'll be addressing. Can you just review those for us,
58 please?

59 MR. BROWNE: Yes. I've been asked by Newfoundland
60 Power to address a number of issues related to
61 Newfoundland and Labrador's current rate submission. In
62 particular, regulatory control, regulatory reporting, return
63 for a public sector utility and two specific accounting
64 issues, namely, intercorporate charges and further
65 employee benefits.

66 MS. BUTLER, Q.C.: Now, while we still have that on the
67 screen can I ask you, Mr. Browne, please, to address each
68 of these in the order that they're presented? So, first of all,
69 regulatory control, can you just basically summarize for the
70 benefit of the Board your position on regulatory control as
71 an issue before this Tribunal?

72 MR. BROWNE: Uh hum, yes. Regulatory boards are
73 created to help ensure that regulatory objectives are
74 achieved, such as the policy objectives set out in the
75 *Electrical Power Control Act*. In this regard boards have
76 a control rather than a management role. A utility should
77 have the flexibility to manage the operations as it sees fit.
78 A regulatory board should then determine whether the end
79 result is consistent with regulatory objectives. Its ultimate
80 control is the ability to establish what can be recovered
81 through allowed rates. In carrying out its control role, a
82 board should seek to be both effective and efficient. It
83 should ensure that there is an appropriate trade off between
84 the benefits of greater regulatory control and the
85 associated costs.

86 MS. BUTLER, Q.C.: Mr. Browne, how do regulators
87 achieve this objective?

88 MR. BROWNE: In seeking to be efficient, I believe that
89 boards should focus on policies and procedures of the
90 regulated enterprise including compliance procedures,
91 rather than detailed reviews of individual transactions,
92 decisions and accounts. You, as a Board, can never get
93 away from detailed reviews, especially in an initial
94 proceeding where you're testing the reasonableness of
95 policies and procedures. However, where there are
96 effective policies and procedures they can give a board,
97 such as yourself, sufficient comfort to significantly reduce
98 the level of those detailed reviews. Focusing on policies

1 and procedures and ensuring that they exist also result in
2 more effective control since a board could never go
3 through all of the details itself.

4 MS. BUTLER, Q.C.: Mr. Browne, what, specifically, are you
5 recommending to this Board on the issue of regulatory
6 control?

7 MR. BROWNE: Going forward, I would recommend that
8 this Board focus upon policies and procedures, rather than
9 getting caught up in details. It should encourage Hydro to
10 present its policies ... excuse me, just getting over a cold.
11 It should encourage Hydro to present its policies and
12 procedures as they relate to the achievement of regulatory
13 objectives.

14 MS. BUTLER, Q.C.: Mr. Browne, the second of the two
15 issues that your pre-filed evidence addresses is that of
16 regulatory reporting, and I wonder, similarly, whether you
17 could summarize your evidence to the Board on this issue?

18 MR. BROWNE: To exercise its regulatory control, a board
19 needs information. A very important part of that
20 information is financial reports on the operations being
21 regulated. The financial reports are necessary for ongoing
22 monitoring of the utility by the board. The financial results
23 ... or the historical financial results are often an important
24 input in analysing the forecast costs which then get built
25 into the allowed rates. Based on what Hydro has provided,
26 it appears that there is some difficulty in providing that
27 information.

28 MS. BUTLER, Q.C.: Can you advise the Board, in your
29 experience, how it is that other utilities achieve this?

30 MR. BROWNE: In many cases, enterprises with both
31 regulated and non-regulated operations set up a separate
32 company to manage the regulated operations. This makes
33 it easier to focus on those operations and to generate
34 financial reports for them. Now, Hydro may have some
35 very good reasons for not placing its regulated operations
36 in a separate company, and I believe that this Board should
37 not impose needless costs on Hydro. However, at the very
38 least, it should require of Hydro to have a clear written
39 definition of its regulated operations and it should require
40 them to maintain separate financial reports for its regulated
41 operations as if they were carried out by a separate
42 company.

43 MS. BUTLER, Q.C.: And again, Mr. Browne, can you be
44 specific in terms of what you are recommending to this
45 Board on the issue of regulatory control ... I'm sorry,
46 reporting?

47 MR. BROWNE: Uh hum. To assist in exercising its
48 regulatory control, I would recommend that this Board
49 require Hydro to do three things. First of all, provide a
50 clear written definition of what constitutes its regulated

51 operations. Two, maintain separate financial accounts for
52 its regulated operations as if they were provided by a
53 separate company. Three, provide financial reports on
54 those operations to this Board.

55 MS. BUTLER, Q.C.: Mr. Browne, the third area that your
56 pre-filed testimony addresses is referred to as return for a
57 public sector utility?

58 MR. BROWNE: Yes.

59 MS. BUTLER, Q.C.: Can you tell us, please, whether there
60 is a cost associated with the Province's equity investment
61 in Hydro?

62 MR. BROWNE: Un hum. There is an opportunity cost
63 associated with public sector investments, including
64 investments in public sector utilities. From an economic
65 perspective, it is a cost the same as wages or fuel. Now,
66 there are a number of cases where public sector utilities
67 have not sought full recovery of its cost. This does not
68 mean the cost does not exist, just they did not seek to
69 recover it, something that they are normally allowed to do.

70 MS. BUTLER, Q.C.: It's already been the subject of a lot of
71 evidence from other people, Mr. Browne. Can you explain
72 to the Board, and perhaps express your opinion on whether
73 a public sector utility, such as Hydro, should be regulated
74 the same as an investor owned utility?

75 MR. BROWNE: In principle, a public sector utility should
76 be regulated the same as an investor owned utility unless
77 there is legislation to the contrary. It should be allowed to
78 establish its cost of capital in the same manner as an
79 investor owned utility and it should have an opportunity to
80 recover that cost through allowed rates. However, like
81 other utilities, it should be allowed to recover only its
82 prudently incurred costs necessary to provide regulated
83 service. Now, governments often own utilities so as to
84 pursue social or public policy objectives. Where this
85 results in costs that are not necessary to provide regulated
86 service they should be removed from the determination of
87 the revenue requirement recovered through allowed rates.
88 In effect, they should be treated as a shareholder cost.

89 MS. BUTLER, Q.C.: And again, Mr. Browne, specifically,
90 what are you recommending here?

91 MR. BROWNE: Consistent with the principles I just laid
92 out, on a going forward basis, Hydro should be asked to
93 identify the public policy objectives that it is pursuing and
94 determine the related costs to the extent they are not
95 necessary to provide regulated service. This Board will
96 then be in a position to determine whether those costs
97 should be recoverable through allowed rates.

98 MS. BUTLER, Q.C.: Mr. Browne, have you, yourself,
99 derived an estimate of Hydro's cost of equity?

1 MR. BROWNE: No, I have not. Newfoundland Power, the
2 company that commissioned my testimony, does not object
3 to the three percent return on equity that Hydro is
4 requesting, nor does it object to Hydro moving to an
5 allowed return on equity similar to what it is allowed. What
6 it is concerned about is that the Board focus, not only on
7 the allowed return, but also the other policy objectives set
8 out in the *Electrical Power Control Act* such as rates that
9 are reasonable and not unjustly discriminatory.
10 Newfoundland Power would like these issues addressed
11 concurrently with any moves by Hydro to a commercial rate
12 of return.

13 MS. BUTLER, Q.C.: In your opinion, is a just and
14 reasonable return the same as the opportunity cost of
15 capital?

16 MR. BROWNE: Usually it is, but not necessarily. The
17 opportunity of cost of capital is a very real cost. However,
18 I believe that you have to consider the specifics of a
19 situation in determining whether it is just and reasonable to
20 allow a utility the opportunity to recover that cost. In the
21 case of Hydro, I believe that you should consider the rural
22 deficit. Now, cross subsidization among utilities is
23 common, it does occur. However, as previously recognized
24 by this Board, the rural deficit that Hydro passes on to
25 some of its customers is unusually large. This deficit has
26 been directed by the owner of Hydro. Given this, the Board
27 should consider whether it is just and reasonable to change
28 the basis for setting the return that Hydro can recover
29 through allowed rates while retaining this unusually large
30 subsidy.

31 MS. BUTLER, Q.C.: Specifically, Mr. Browne, what is it
32 that you are recommending on this issue?

33 MR. BROWNE: Going forward, as this Board considers
34 whether Hydro should be allowed to recover a commercial
35 rate of return it should consider whether to effectively treat
36 part of the rural deficit as a return to the owner.

37 MS. BUTLER, Q.C.: Mr. Browne, what is your
38 recommendation to the Board with respect to Hydro's
39 proposed dividend from regulated operations of \$70 million
40 in the test year?

41 MR. BROWNE: Consistent with the Board having a
42 control, rather than a management role, Hydro should have
43 the flexibility to determine the dividends it pays and to
44 manage its capital structure as it sees fit. That is a
45 management function. However, where the Board believes
46 that this results in excess cost to ratepayers, it can deem a
47 capital structure so as to protect ratepayers from these
48 excess costs. This is consistent with its control role
49 ensuring that rates are just and reasonable. Where the
50 Board decides that Hydro's allowed return should be
51 constrained until issues such as undue discrimination are

52 fully addressed, it should also consider whether it should
53 allow Hydro to partially avoid the constraint by paying out
54 the \$70 million dividend. In such a case, the Board could
55 deem a capital structure equal to what would exist if a
56 dividend had not been taken.

57 MS. BUTLER, Q.C.: The fourth and final issue that your
58 pre-file testimony addresses, Mr. Browne, is labelled
59 Accounting Issues, of which there are two. The first is
60 intercorporate charges. Why is it, in your opinion, that this
61 is an important issue for the Board?

62 (3:00 p.m.)

63 MR. BROWNE: Intercorporate charges are an important
64 issue because Hydro has non-regulated affiliates and other
65 non-regulated operations. And if you don't mind, I'll refer
66 to it just as non-regulated operations going forward,
67 because it gets to be a bit of a tongue twister. The amount
68 of the charges between regulated and non-regulated
69 operations can affect the rates that customers pay, and
70 therefore should be subject to regulatory review as part of
71 this Board's control role in ensuring that rates are just and
72 reasonable. While regulated operations undercharge ... I'm
73 sorry. Where regulated operations undercharge non-
74 regulated operations or are overcharged by them, there will
75 be an increase in the revenue requirement and increase in
76 the rates that customers will be required to pay.

77 MS. BUTLER, Q.C.: How is it that intercorporate charges
78 should be established for regulatory purposes?

79 MR. BROWNE: Intercorporate charges should reflect what
80 would be established in an arms length transaction. The
81 best measure of this amount is market price. Regulatory
82 boards normally prefer that intercorporate charges reflect
83 market price. Unfortunately, there is often not a market for
84 the services provided by a regulated operations to non-
85 regulated operations or vice versa. In such situations
86 where market prices are not practical, regulatory boards
87 generally rely on cost based pricing. These prices should
88 reflect the cost of providing the good or service including
89 a fair return.

90 MS. BUTLER, Q.C.: Mr. Browne, through the request for
91 information process what have you learned about Hydro's
92 treatment of intercorporate charges?

93 MR. BROWNE: In response to Newfoundland information
94 request number 187 ...

95 MS. BUTLER, Q.C.: Okay. As you deal with these I'm
96 going to ask that they be put on the screen.

97 MR. BROWNE: Okay.

98 MS. BUTLER, Q.C.: That is **NP-187**?

99 MR. BROWNE: That's correct.

1 MS. BUTLER, Q.C.: A.

2 MR. BROWNE: Hydro indicated that there are no charges
3 made to Gull Island Power Company, Lower Churchill
4 Development Corporation Limited and Twin Falls Power
5 Corporation Limited since at least 1992. In response to NP-
6 147 ...

7 MS. BUTLER, Q.C.: Just wait now until we get that up.
8 Thank you.

9 MR. BROWNE: Hydro indicated that it did not have any
10 formal, written policies for transactions with non-regulated
11 operations. In response to NP-11(b) Hydro provided an
12 executive summary of an internal report that it prepared for
13 its operating costs recovered from Churchill Falls
14 Corporation Limited. Now, some of what I read in the
15 executive summary certainly appeared to be very
16 reasonable, such things as allocating executive salaries
17 based upon time reports. However, there was not enough
18 information in what we received for me to form an opinion
19 or to evaluate the reasonableness of their policies and
20 procedures. However, this is not the primary purpose of
21 my testimony. It is to advise the Board on how it should
22 exert regulatory control over issues such as intercorporate
23 charges.

24 MS. BUTLER, Q.C.: And again, Mr. Browne, to be as
25 helpful as we can to the Board, specifically what are you
26 recommending on the issue of intercorporate charges?

27 MR. BROWNE: As a first step Hydro should identify the
28 goods and services it provides to or acquires from its non-
29 regulated operations and the nature of these goods and
30 services. This is necessary if the Board is to understand
31 the issues it will have to address with intercorporate
32 charges. It should ask that Hydro develop policies and
33 procedures for determining the transfer prices in cost
34 allocations to cover all transactions with non-regulated
35 operations, not just those with Churchill Falls. The
36 procedure should include compliance procedures for
37 ensuring that the policies and procedures are followed.
38 These policies and procedures should be subject to
39 regulatory review and approval. If there is a need to
40 change these policies and procedures in the future Hydro
41 should present the changes to this Board for approval
42 before implementation. Now, these policies and procedures
43 should have sufficient detail to allow for unambiguous
44 application and subsequent verification. Now, this is an
45 example of what I was discussing earlier under regulatory
46 control. This Board should focus on the policies and
47 procedures for intercorporate charges rather than to get
48 mired down in a detailed review of the individual
49 transactions. This is not only more efficient, but gives the
50 Board more effective regulatory control. For example,
51 without good policies and procedures it's not very likely

52 that you're going to catch all the intercorporate
53 transactions.

54 MS. BUTLER, Q.C.: The second of the two accounting
55 issues, Mr. Browne, and the last of the issues addressed in
56 your pre-filed testimony is that of employee future benefits.
57 And once again, could you summarize your evidence on
58 this point for us, please?

59 MR. BROWNE: Yes. Hydro has decided to change from
60 the cash to the accrual method for dealing with employee
61 future benefits other than pensions. Now, these benefits
62 programs, what they normally include are such things as
63 dental plans provided to retired employees. This change
64 that Hydro has proposed is consistent with the new
65 accounting recommendations that have been set out in the
66 CICA Handbook that is maintained by the Canadian
67 Institute of Chartered Accountants. The recommendations
68 in the CICA Handbook establish what constitutes generally
69 accepted accounting principles in Canada, and therefore,
70 what companies must follow in preparing their financial
71 reports. According to the new recommendations, Canadian
72 companies must account for employee future benefits on
73 an accrual basis. They must estimate the cost of the
74 benefits that they will have to pay in the future as a result
75 of employee services provided in the current year. That
76 amount is expensed and set up as a liability. In the past,
77 most companies used the cash basis, or what was
78 sometimes called the pay as you go approach. They
79 expensed the amounts when paid even though the
80 payments were for retired employees and the obligation
81 arose from services provided 10, 20, 30 years on the past.

82 MS. BUTLER, Q.C.: Mr. Browne, do regulatory boards,
83 such as the Newfoundland Public Utilities Board have to
84 follow the CICA recommendations?

85 MR. BROWNE: No, I believe it's important for this Board
86 to realize that the recommendations in the CICA Handbook
87 are designed to support good financial reporting, not
88 necessarily just and reasonable rates, and regulatory
89 boards are usually not required to follow the CICA
90 Handbook recommendations. Now, in most cases, the
91 financial reporting recommendations in the CICA
92 Handbook are consistent with just and reasonable rates,
93 but there have been a number of cases where regulatory
94 boards have decided to follow different principles for rate
95 setting purposes, including this Board. Now, the point I
96 wanted to make is that this Board has options in
97 establishing what it believes are just and reasonable rates.
98 It is not bound by the CICA Handbook recommendations.
99 It should certainly consider those recommendations and
100 the implications for inter-generational equity. It should
101 also consider the impact on rates in a period in which
102 Hydro is proposing new rates that would increase the retail
103 rate to Newfoundland Power's retail customers by

1 approximately seven percent.

2 MS. BUTLER, Q.C.: Thank you, Mr. Browne. Mr. Chair,
3 that is the direct evidence of John Browne on behalf of
4 Newfoundland Power.

5 MR. NOSEWORTHY, CHAIRMAN: Thank you, Ms.
6 Butler. We'll break now for 15 minutes. We'll return 25
7 after, please?

8 *(break)*

9 MR. NOSEWORTHY, CHAIRMAN: Thank you. I would
10 ask Hydro, the Applicant, to begin their cross-examination
11 of Mr. Browne please.

12 MS. GREENE, Q.C.: Thank you Mr. Chair, and I would like
13 to point out that Mr. Osmond, who's the Vice-President of
14 Finance, is sitting with me here at Counsel table and I seek
15 the permission of the Board for Mr. Osmond to sit here to
16 offer assistance if required.

17 MR. NOSEWORTHY, CHAIRMAN: Sure.

18 MS. GREENE, Q.C.: Good afternoon, Mr. Browne.

19 MR. JOHN T. BROWNE: Good afternoon.

20 MS. GREENE, Q.C.: The first major topic covered in your
21 evidence is the topic of regulatory control.

22 MR. JOHN T. BROWNE: Yes.

23 MS. GREENE, Q.C.: And I had a number of questions
24 concerning that that I'd like to address with you first. The
25 first question is to seek clarification of some statements
26 you made in your pre-filed evidence, if you could turn to
27 page 5 please of the pre-filed, and if you could look at lines
28 13 to 14, well that paragraph really. It starts on line 13 and
29 I'd like to read two lines and then I'm going to ask you if
30 you could further elaborate on both of them for me please.
31 Beginning at line 13 the second sentence that begins in
32 that line, "in considering new controls or in evaluating
33 existing controls a regulatory board must weigh the
34 benefits against the associated costs", and then down
35 further beginning on line 17, "therefore the imposition of
36 regulatory controls should consider the direct dollar cost
37 to impose to comply with the controls, cost borne by both
38 utility and the regulator, it should also consider other costs
39 of imposing the controls including the loss of management
40 flexibility", and I wonder if you can elaborate on the
41 principle that you've expressed there, which as I take it is a
42 board considering the implementation control must weigh
43 the cost of that control with the benefit to be obtained from
44 imposing the control.

45 MR. JOHN T. BROWNE: The statement is made in the
46 context that regulatory boards are created to help ensure
47 the achievement of regulatory objectives. Those
48 objectives recognize the legitimate interest of customers

49 and the utility and they should certainly consider, for
50 example, looking at the customer side, their benefits to
51 regulatory control for the customers, but for the most part
52 they're going to end up paying the cost so clearly it doesn't
53 help customers to put in controls where the benefits don't
54 outweigh the cost of them, and I went on to indicate that
55 there is more than just dollar costs involved. Utilities have
56 legitimate rights and certainly management should have
57 flexibility in managing the utility. So, however, I believe it's
58 not just the utility that benefits from management flexibility
59 but also customers. Management must be, have the
60 flexibility to manage the utility in the most efficient manner
61 possible. I believe that if you've got very detailed heavy
62 regulation where it's very difficult for management to
63 actually make any management decisions you're not going
64 to have efficient management. That's not going to help the
65 regulated customer. It was in that context that the
66 statement was made.

67 MS. GREENE, Q.C.: So if I could summarize your answer,
68 the Board should not impose a control if the cost of the
69 control weighs more than the benefit to be derived from the
70 imposition of the control.

71 MR. JOHN T. BROWNE: Yes. There should be a cost
72 benefit analysis.

73 MS. GREENE, Q.C.: Could you give us an example, a
74 practical example of that?

75 MR. JOHN T. BROWNE: I think as, always difficult on the
76 spot, certainly I was thinking in the context of if you go
77 back to my evidence, I said we should be, the Board should
78 focus on policies and procedures... in other words, set out
79 the policies and procedures under which a utility can
80 operate and give it the freedom to operate as opposed to
81 heavy controls where all their decisions are being second-
82 guessed and they can't seek out or have the flexibility to
83 seek out more efficient ways to operate. I think when we
84 look at things like the development performance based
85 regulation, the whole idea of that is that management gets
86 more flexibility and the incentives to find more efficient
87 ways to provide service, so I think, see that as an example.

88 MS. GREENE, Q.C.: Another practical example, I believe, in
89 your testimony before the Board in June when you were
90 here on the Newfoundland Power application for approval
91 of the poles, one of the issues that was raised was whether
92 the cost of tracking non-joint use poles was so great that
93 it would be a factor to be taken into account whether they
94 should be included in the rate base or not.

95 MR. JOHN T. BROWNE: Certainly.

96 MS. GREENE, Q.C.: Turning to page 6, again this is on the
97 same topic of regulatory control, on lines 19 to 20 and again
98 over later, page 8, you reference the fact that where a

1 number of years have passed since the last full proceeding,
2 the Board should require more detail, and I think over on
3 page 8, lines 13 to 14, you used the phrase "significant
4 period" but the same thought is expressed and I wanted to
5 explore with you, what do you mean by a number of years
6 and a significant period?

7 MR. JOHN T. BROWNE: If for example, a utility hasn't
8 been before a board in ten years, the board probably is not
9 going to have a lot of knowledge of the utility as of then,
10 certainly not as much as where a utility is coming in, let's
11 say every two to three years, and because it lacks that
12 knowledge and the experience with how the utility is being
13 operated it is reasonable to expect that the board would ask
14 for more information, more detailed information. We go
15 back to what I said earlier, the Board should focus on
16 policies and procedures. You as a Board want to make sure
17 that these policies and procedures are there and are in
18 effect. If you have an ongoing relationship with the utility
19 where it's in every two or three years, you're going to be
20 familiar with them, you're going to see how they operate.
21 If there's been a period, let's say ten years since they were
22 last in, you're probably going to want to go back to square
23 one just to see what the policies and procedures are.

24 MS. GREENE, Q.C.: You also mentioned the first full rate
25 hearing, and as you know this is Hydro's first hearing as a
26 fully regulated utility, so I thought that, I had thought you
27 may have included Hydro there, but you've talked about
28 the significant period, you said ten years in your view is
29 significant.

30 MR. JOHN T. BROWNE: Actually is in both comments,
31 both contexts. I understand that there was a hearing in
32 about '92. I realize that Hydro wasn't fully regulated but
33 certainly they were before the Board, so I was looking at in
34 the two contexts, one is this their first hearing under the
35 new legislation; and secondly, it's been ten years, almost
36 ten years since they were in. So I would say under both
37 those criteria, you'd probably want a little more detail, not
38 a little more, you'd want more detail than you would
39 normally want.

40 MS. GREENE, Q.C.: Are you aware that Hydro has filed
41 evidence that its current plan is that it would be back
42 before the Board in two years?

43 MR. JOHN T. BROWNE: I've heard that they have said
44 they're planning to.

45 MS. GREENE, Q.C.: Because of significant major capital
46 expansion that's occurring it would be required to be
47 included in rates.

48 MR. JOHN T. BROWNE: I have heard that they indicated
49 that they will. The specific details and reasoning I would
50 not be able to attest to.

51 MS. GREENE, Q.C.: So if Hydro is here in two years time,
52 based on the, what you just outlined, should I, or should
53 we expect that the amount of the information request will be
54 two-tenths or 20 percent of what they are now and the
55 length of the hearing will be 20 percent and can we get an
56 undertaking from other counsel that it works that way?
57 *(laughter)*.

58 MR. JOHN T. BROWNE: Well, that's a very good point
59 and it comes back again to what I said earlier about
60 focusing on policies and procedures. If Hydro is able to
61 put before you policies and procedures which you believe
62 are effective in helping to achieve the regulatory controls,
63 and if you believe there is enough evidence to indicate
64 those policies and procedures are in force and being
65 applied, then certainly one would expect there should be
66 less information provided, but if those policies and
67 procedures aren't put before you, if you have reason to
68 believe those policies and procedures are not being
69 followed, then one would expect probably even more
70 questions.

71 MS. GREENE, Q.C.: But in the normal course of events you
72 would have thought that it would be less information so
73 you've agreed with me that two years would probably be
74 less of a review than it would be for ten years. Is that
75 correct?

76 MR. JOHN T. BROWNE: With all due respect, Ms. Greene,
77 we haven't agreed. My previous answer, I think, stands
78 and states that if you have not put forward policies and
79 procedures, if you've not

80 MS. GREENE, Q.C.: I was assuming that that had been
81 done. I was accepting your answer. Assuming that that
82 has been done, in the normal course, the review after two
83 years should be less, because it's less of a period. Is that
84 correct?

85 MR. JOHN T. BROWNE: If you have put forward policies
86 and procedures which this Board believes is appropriate,
87 and have supported the existence and compliance with
88 those procedures, then I would certainly expect this Board
89 to look for less detail.

90 MS. GREENE, Q.C.: What about four years?
91 Newfoundland Power hasn't been back before the Board
92 since '98, it will be more than four years. What about four
93 years?

94 MR. JOHN T. BROWNE: I think what you have to start
95 looking at is how well the policies and procedures are being
96 supported. I think even if you come back four years later,
97 if you lead your proposal by saying here's our policies and
98 procedures, here's our compliance program that give you
99 assurance those policies and procedures are being met,
100 here's how our polices and procedures help you ensure

1 that the regulatory objectives are being met, I think that,
2 yes, in place of a situation like that, the Board should
3 expect less detail.

4 MS. GREENE, Q.C.: Alright, so your comments that I
5 referred you to on page 6 and page 8 need to be qualified,
6 it really isn't the length of the time alone, is it?

7 MR. JOHN T. BROWNE: Time is not the only factor, no.

8 MS. GREENE, Q.C.: In the discussion that we've just had
9 and in the section in your pre-filed evidence on regulatory
10 control, the focus that I took from reading your pre-filed
11 evidence, and even from your comments just now, is in the
12 context of a full public hearing. The control that you speak
13 of takes place in the context of a public hearing before the
14 Board on a general rate application.

15 MR. JOHN T. BROWNE: The comments that I've made
16 have been certainly my mindset was that of a public
17 hearing, but I wouldn't say that it's limited to that. I would
18 say going forward where Board's place certain requests on
19 a utility, they may rely on various policies and procedures
20 to perhaps delay hearings.

21 MS. GREENE, Q.C.: Are you familiar with the other forms
22 of regulatory controls that are in place in the province for
23 the Board to regulate a utility?

24 MR. JOHN T. BROWNE: I'm not yet following you, it's, I'm
25 aware of the way that the Board regulates Hydro and
26 Newfoundland Power, I'm not sure what others or
27 regulatory methodologies they employ.

28 MS. GREENE, Q.C.: I wasn't speaking about methodologies
29 so much as the form of control, and perhaps if I gave you
30 some examples. Are you aware that there is an annual
31 financial audit of Newfoundland Hydro by the Board's
32 financial consultant done each year?

33 MR. JOHN T. BROWNE: I have, I understand that Grant
34 Thornton does a review and I have certainly gone through
35 those, some of those reports.

36 MS. GREENE, Q.C.: Are you aware that the Board has
37 ordered two operational reviews of Hydro in the last ten or
38 eleven years?

39 MR. JOHN T. BROWNE: Ten or eleven years?

40 MS. GREENE, Q.C.: There's been two in the last, and that's
41 why I said, I'm not sure if its 10 or 11 year now without
42 checking the date, but there's been two operational
43 engineering reviews done of Hydro at the direction of the
44 Board.

45 MR. JOHN T. BROWNE: I'm not aware of those reports.

46 MS. GREENE, Q.C.: Are you aware that Hydro files
47 quarterly reports before the Public Utilities Board on all

48 aspects of Hydro's operations?

49 MR. JOHN T. BROWNE: The reports I saw would not have
50 met your qualification or your description. I have seen a
51 report that was filed but it was for the consolidated
52 company and did not identify the regulated operations. So
53 I would not think that it would have met the criteria that
54 you set out in your question.

55 MS. GREENE, Q.C.: But you are aware that there have been
56 reports filed on Hydro's operations each quarter since
57 Hydro became regulated in '96.

58 MR. JOHN T. BROWNE: Again, I'm aware of the reports,
59 but I would certainly question ...

60 MS. GREENE, Q.C.: You would question some of the
61 content, but you are aware that there is a quarterly report
62 done?

63 MR. JOHN T. BROWNE: I'm aware there's a quarterly
64 report, but it would appear to me that it is not a report on
65 the regulated operations.

66 MS. GREENE, Q.C.: But it is a report on all aspects of
67 Hydro, including regulated and unregulated.

68 MR. JOHN T. BROWNE: Regulated and unregulated,
69 consolidated, but I did...

70 MS. GREENE, Q.C.: That's all ...

71 MR. JOHN T. BROWNE: Okay.

72 MS. GREENE, Q.C.: And I guess we'll come to the issue of
73 the regulated and the unregulated. Are you aware that
74 there are quarterly meetings between senior management of
75 Newfoundland Hydro and the Board to discuss those
76 quarterly reports.

77 MR. JOHN T. BROWNE: I wasn't specifically ...

78 MR. BROWNE, Q.C.: Excuse me, can you repeat the
79 question, I didn't hear it?

80 MS. GREENE, Q.C.: Are you aware that there are quarterly
81 meetings that, between senior management of Hydro and
82 the Board to review those quarterly reports which are
83 transcribed and a public record is kept?

84 MR. JOHN T. BROWNE: I wasn't specifically aware of the
85 ones of Hydro, although I'm not surprised, since I was
86 aware that Newfoundland Power had such meetings.

87 MS. GREENE, Q.C.: Are you aware that there is an
88 immediate reporting of all significant events at Hydro to the
89 Board such as power outages affecting a significant
90 number of customers or major safety incident?

91 MR. JOHN T. BROWNE: I'm not aware of specific reports,
92 but I'm not surprised by it. It does seem to be common
93 practice.

1 MS. GREENE, Q.C.: In your view are they, the types of
2 activities that I just described, are they also forms of
3 regulatory control by the Board?

4 MR. JOHN T. BROWNE: They are forms of regulatory
5 control, yes, whether they are sufficient is another matter.

6 MS. GREENE, Q.C.: So that with respect to Hydro, there
7 has been ongoing regulatory controls over the past, at
8 least since Hydro became fully regulated in '96.

9 MR. JOHN T. BROWNE: It's the way you put it. There are
10 controls, is it adequately controlled is another matter.

11 MS. GREENE, Q.C.: Apart from the ongoing reports,
12 reporting type functions that I've just described, there are
13 other activities that occur before the Board. You are aware
14 that Hydro is required to have its capital budget approved
15 annually, are you?

16 MR. JOHN T. BROWNE: I assumed that since
17 Newfoundland Power has its capital budget approved.

18 MS. GREENE, Q.C.: You are aware that...

19 MR. JOHN T. BROWNE: Although I understand that there
20 are some exceptions. I believe it was the Granite Canal is
21 not subject to review by this Board.

22 MS. GREENE, Q.C.: And do you understand why that is
23 so?

24 MR. JOHN T. BROWNE: I understand that the, it was
25 mandated by the government.

26 MS. GREENE, Q.C.: Through legislation.

27 MR. JOHN T. BROWNE: Yes.

28 MS. GREENE, Q.C.: Are you aware that capital borrowings
29 have to be approved by this Board, bond issues?

30 MR. JOHN T. BROWNE: Not specifically, but again that's
31 quite a common practice among regulated utilities, yes.

32 MS. GREENE, Q.C.: And again those last two items which
33 are not specific types of reports, are forms of regulatory
34 control as well, is that correct?

35 MR. JOHN T. BROWNE: They would be forms of it, yes.

36 MS. GREENE, Q.C.: Going back to the first question, the
37 first discussion we had, looking at the cost of a control
38 being imposed versus the benefit. Have you done any
39 analysis or looked at the cost of control for utilities?

40 MR. JOHN T. BROWNE: A specific study, I have not done
41 adding up the cost of regulation, no.

42 MS. GREENE, Q.C.: Do you have any recommendations to
43 make to the Board as to how they should determine the
44 value of those types of controls that I have just outlined in
45 terms of the benefits to be derived for the ratepayer from

46 the controls.

47 MR. JOHN T. BROWNE: I think that some of them are
48 going to be obvious, for example, having basic financial
49 reports on the regulated operations. I don't think you're
50 going to need to do a full analysis to determine that the
51 benefits are worth the costs, since I don't think you can do
52 an effective job of rate regulation without those reports. In
53 other cases, certainly, as, well if we step back, I believe it is
54 the utility that should come forward saying here's the
55 policies and procedures we have. The utility should be
56 putting forth the evidence saying this is what is
57 appropriate and should be doing the cost benefit analysis
58 and if someone comes in and proposes something different
59 certainly they should be justifying the benefits against the
60 cost. So certainly I think it should be done and I would
61 think that if you follow the process of utilities manage,
62 regulators control, utility should be putting forward the
63 policies and procedures, the Board should be reviewing
64 them. As I mentioned in my opening comments about the
65 control over intercorporate charges, as I suggested the
66 utility should be putting forward the policies and
67 procedures, the utility should be deciding what is most
68 appropriate and should be considering these cost benefits.
69 They should put the information before you, part of that
70 information, I think, quite justifiably should include the
71 cost so the Board does have the information to make an
72 appropriate conclusion.

73 MS. GREENE, Q.C.: So you say the emphasis is on the
74 utility and the Board doesn't have any obligation to review
75 the value of the cost?

76 MR. JOHN T. BROWNE: No, that's a misunderstanding of
77 what I said. What I said is the utility is the manager, they
78 should be putting forward the proposed policies and
79 procedures, they should be deciding initially where the
80 cost benefits are, they should make sure the Board is aware
81 of what the costs are so that the Board has the information
82 to make that decision.

83 MS. GREENE, Q.C.: In reading your evidence as I
84 mentioned earlier, I got the impression that you were only
85 talking about the fact of a general hearing and that I got the
86 impression that you didn't think that Hydro had been
87 subject to any regulatory controls since Hydro became
88 fully regulated in 1996. That's not correct then I take it.

89 MR. JOHN T. BROWNE: No, if you go back to my
90 evidence, what I'm saying is I believe the Board should be
91 focusing on policies and controls. I did indicate a couple of
92 areas in my evidence where I, where there seemed to be
93 indications where control could be improved. For example,
94 as I've mentioned already, the reporting on the utility
95 operations, policies and procedures to cover all
96 intercorporate transactions.

1 MS. GREENE, Q.C.: Looking to your section on regulatory
2 reporting, you mention actually, you mentioned it on page
3 13, lines 9 to 10, and again....

4 MR. JOHN T. BROWNE: Excuse me, just slow down a bit.

5 MS. GREENE, Q.C.: Page 13.

6 MR. JOHN T. BROWNE: Yes.

7 MS. GREENE, Q.C.: Lines 9 to 10.

8 MR. JOHN T. BROWNE: Yes.

9 MS. GREENE, Q.C.: And again in your direct evidence
10 today that Hydro should be asked to provide a definition
11 of regulated operations and I'd like to take you now first to
12 JCR, which is the pre-filed evidence of Mr. Roberts, page 1,
13 please. Page 1 of JCR, pre-filed evidence. Towards the
14 bottom of the page, I'd ask you to read the question and
15 then the answer beginning on line 24.

16 MR. JOHN T. BROWNE: The question reads, "How is
17 Hydro's revenue requirement determined"? The answer,
18 "Schedule 1 of my evidence shows all of the components
19 making up the revenue requirement including margin, but
20 excluding non-regulated costs, donations and costs related
21 to Muskrat Falls, the effect of export sales by Hydro to
22 Hydro Quebec and Hydro's investments in subsidiary
23 companies. The cost of service allocate certain costs to an
24 unregulated industrial customer and as a result projected
25 margin from this customer has been included in the revenue
26 requirement calculation".

27 MS. GREENE, Q.C.: So in the context of the definition of
28 regulated operations, would that not meet what a definition
29 of a regulated, of what is regulated and what is not
30 regulated.

31 MR. JOHN T. BROWNE: Aah, the comment that I've made
32 there arose from our preparation when we reviewed some of
33 the information requests from Hydro. There are a number
34 of instances where it was confusing, what was regulated
35 and what wasn't regulated. One report, one schedule we
36 looked at had I believe it was the cost for IOCC and another
37 didn't. We looked at schedules and it appeared that they
38 couldn't indicate exactly what was regulated...

39 MS. GREENE, Q.C.: But in this definition, and I'd like now
40 to go a second one, **IC-259**. Information request, **IC-259**.
41 I'd like to deal first with what is a definition and then
42 secondly I would deal with what, how you should, the
43 financial reports to show what regulatory operations are.
44 At this time I'm only dealing with the definition of regulated
45 versus non-regulated.

46 MR. JOHN T. BROWNE: Uh-hum.

47 MS. GREENE, Q.C.: You'll have the opportunity to
48 comment on the financial report. Here the question was

49 "List all activities of Newfoundland and Labrador Hydro
50 that are considered to be non-regulated", and I wonder if
51 you could drop down to the answer please on the screen
52 and could you read that answer please Mr. Browne.

53 MR. JOHN T. BROWNE: "Hydro's non-regulated activities
54 include its investments in subsidiary companies, consisting
55 of Churchill Falls Labrador Corporation Limited, CF(L)Co;
56 Gull Island Power Company Limited, GIPCo; and Lower
57 Churchill Development Corporation Limited, LCDC; and
58 sales of power and energy by Hydro to Hydro Quebec and
59 IOCC".

60 MS. GREENE, Q.C.: And if you could just go on, Mr.
61 O'Rielly to drop down the screen. Right. If you'll continue
62 Mr. Browne.

63 MR. JOHN T. BROWNE: "It also has some non-regulatory
64 costs for donations as well as costs related to Muskrat
65 Falls in Labrador".

66 MS. GREENE, Q.C.: Cause when I read your comments and
67 heard them again I went back to review it and I thought that
68 between **JCR** page 1 and **IC-259**, there would be a
69 definition of what is regulated for Hydro. We will get to the
70 issue how its illustrated financially, but just in terms of
71 what are the regulated activities of Hydro. Can you please
72 advise the Board what could be added to **JCR**, page 1 or
73 **IC-259**, to make clearer.

74 MR. JOHN T. BROWNE: It's not so much what's added, it's
75 what should be presented to the Board.

76 MS. GREENE, Q.C.: In terms of a definition now.

77 MR. JOHN T. BROWNE: Yes.

78 MS. GREENE, Q.C.: Not in terms of financial reports.

79 MR. JOHN T. BROWNE: What I am stating is that a utility,
80 especially one that has a lot of non-regulated and regulated
81 all mixed within the same company, should clearly come
82 before the Board with a written description that says this is
83 our regulated operations for approval by the Board. Now
84 if you're saying it's already here, it's just a matter of putting
85 it before the Board so the Board can rule on it.

86 MS. GREENE, Q.C.: That's what was confusing to me. I
87 thought at least the definition was there. You're saying
88 now that there's nothing that you can suggest in terms of
89 a definition of what the regulated activities are that Hydro
90 should provide to more clearly define what they are other
91 than what they've done on page 1 of **IC-259**. The question
92 now is approval by the Board.

93 MR. JOHN T. BROWNE: I'm not in a position to determine
94 if that definition is adequate or not. It is a definition. I
95 believe that the Board should be reviewing what the
96 operations are and have a very clear definition that this is

1 regulated, this is non-regulated. Certainly it should start
2 with the utility putting it before you and justifying why
3 certain items are not going to be in regulation. If it's
4 reasonable you should approve it. Then there'd be a formal
5 definition approved by the Board.

6 MS. GREENE, Q.C.: I think it might be helpful while this is
7 up on screen, it doesn't relate specifically to this line of
8 questioning but to another line I'll be pursuing, I guess,
9 tomorrow morning. Do you know what are the activities of
10 Gull Island Power Company Limited?

11 MR. JOHN T. BROWNE: My understanding it was inactive
12 at the current time.

13 MS. GREENE, Q.C.: What about Lower Churchill
14 Development Corporation Limited.

15 MR. JOHN T. BROWNE: My understanding that was
16 inactive.

17 MS. GREENE, Q.C.: And you are aware that CF(L)Co or
18 Churchill Falls Labrador Corporation Limited is the only
19 active subsidiary of Newfoundland Hydro, are you?

20 MR. JOHN T. BROWNE: Yes, I'm, have not, I'm not aware
21 of just exactly what is in these companies and that's my
22 understanding. I certainly couldn't attest to what is
23 included in them.

24 MS. GREENE, Q.C.: Mr. Chair, I will be going into a number
25 of financial types of statements that I wouldn't be able to
26 conclude in five minutes. I don't know if this would be a
27 appropriate time to stop.

28 MR. NOSEWORTHY, CHAIRMAN: Ten or fifteen
29 wouldn't help you would it? *(laughter)*. No, we'll...

30 MS. GREENE, Q.C.: I wouldn't be finished my cross-
31 examination in ten or fifteen minutes. No, that's what you're
32 asking. *(laughter)*. Maybe, possibly not even this subject.

33 MR. NOSEWORTHY, CHAIRMAN: Okay, thank you very
34 much. We'll adjourn until 9:30 tomorrow morning.

35 *(hearing adjourned to November 2, 2001)*