(9:30 a.m.)

MR. NOSEWORTHY, CHAIRMAN: Thank you and good morning. Any preliminary items? Good morning, Mr. Kennedy.

MR. KENNEDY: Chair, Commissioners, just one item just to place on the record. The Board of Commissioners of Public Utilities received a letter from Leo Abbott, I presume it is, the Deputy Mayor of the Town of Happy Valley-Goose Bay, dated November the 9th, 2001. I believe all counsels have received a copy of that. Well, we'll be handing those out on the break to all counsel. That's the only preliminary matter I had, Chair. I don't believe there's anything more this morning.

MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr. Kennedy. Good morning, Mr. Osmond.

MR. OSMOND: Good morning.

MR. NOSEWORTHY, CHAIRMAN: Good morning, Mr. Hutchings.

MR. HUTCHINGS: Good morning, Mr. Chair.

MR. NOSEWORTHY, CHAIRMAN: I ask you to continue your cross-examination, please.

MR. HUTCHINGS: We're prepared to carry on. Good morning, Mr. Osmond.

MR. OSMOND: Good morning, Mr. Hutchings.

MR. HUTCHINGS: I think it was Commissioner Saunders who said that the RSP is sort of an early morning type of topic, so maybe we better go there and see what we can do. As you noted yesterday, there were a few of us here in 1985 when this creature was created.

MR. OSMOND: Some of us had darker hair too. *(laughter)*

COMMISSIONER SAUNDERS: Some of us had hair. *(laughter)*

MR. HUTCHINGS: It has been a while. I want to go back, I guess, to that time initially and review how the RSP began. I take it that, from what you said yesterday, that from Hydro's point of view your fuel escalation charge, fuel adjustment charge and the water equalization fund that was available at the time basically solved all of Hydro's problems as they perceived them at the time with the exception of the publicity problem or the public relations problem.

MR. OSMOND: I guess in 1985 and prior, Hydro was financing it different.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: We had a water equalization provision that we recorded. It's very similar now to what we have in the hydraulic variation, almost line for line actually, and we also had something called the FAC, which was a fuel adjustment charge, and every single month we would recover that amount from our customers, being the difference between the price of fuel we had in our (inaudible) and the actual price of fuel we actually incurred and consumed at Holyrood. The issue came about with regards to the increase in price of fuel in the, I guess the early 1980s and up to 1984 and '85, where consumers' bills, the energy charge and the fuel adjustment charge are almost one and the same. Like you could have $100, a monthly bill for energy, and the fuel adjustment could almost equal that, be pretty close to it. I can remember cases we had here in town. They were up to $200 a month for energy and a fuel adjustment charge of another $150 or $200, and not only here but all the way across the system. That seemed to, and certainly did, irritate an awful lot of our consumers. We had a lot of calls, I know Light and Power had a lot of calls, and we dealt with the Chairman at the time, Aidan Ryan (phonetic) and other people, and consumers were very upset with the fact that they couldn't budget for electricity bills, so what we had looked at then, what are other options to try and provide stability of rates to consumers as well as provide stability of rates to Hydro and protect fluctuations in Hydro's net income as well, but more importantly to try and minimize severe fluctuations or spikes in consumers' bills, and based on that we put forth an application to the Board, were included in the Rate Stabilization Plan, to mitigate changes due to things we had no control over whatsoever, such as rain and snow and water and the world price of fuel, and based on that, that's how the plan evolved. There was much discussion on it, certainly I can recall that, as to how it should evolve, how it should be priced, whether there should be a cap on it or not on it, but coming out of that hearing, it was resolved that there would be a plan with three elements in it, one being water, one being fuel and one being load, and there would also be a cap. I should say in the initial presentation we made we had three elements in it, water, load ... four, water, load, fuel and also interest coverage cap, and I think that was modified by the Board to have a load variation instead. That's generally how it evolved but try to respond too to certainly consumers' concerns and demands and the papers I know, we just gave some, as Mr. Browne alluded to the other day in the papers, there were many articles but this went on for months and months and months, not only with the public but with the politicians and with our customers calling in. I know Newfoundland Power had it the same way, concerns about the volatility in rates, to the point that we're actually averaging a fuel adjustment over a period of time but if you had, we had to recover $2 million in one month, we'd average it over a three or four-month period, and that went on as well, to try and take the spikes out of the rates, so that's generally the, how it actually evolved back in 1985.

MR. HUTCHINGS: The initial presentation by Hydro, as I recall it, didn't have an element for load variation.

MR. OSMOND: Not specifically, no. It had an item as I just referred to called interest coverage cap.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: And that was based on Hydro's overall net income, I guess a coverage cap I think we set at 1.2 or suggested to the Board, so we had a change in revenue, which would be part of load, or a change in operating costs, as long as we didn't go over 1.20. We had set a limit of 1.20. If we're going over that, then that would go into the RSP.

MR. HUTCHINGS: Well that sort of interest coverage cap had been historically part of your regulation even before that.

MR. OSMOND: We had ... yeah. It was at one point in time but 19, yeah, 1985 we had a range, I think, of 1.15 to 1.25 ...

MR. HUTCHINGS: Yeah.

MR. OSMOND: ... sort of a target of 1.20, so that's why we put the 1.20 target back in to ensure that the consumers were protected, that Hydro wouldn't bear undue, you know, increase profits because of that.

MR. HUTCHINGS: The initial presentation, I think, by Hydro involved an accumulation of amounts in the Rate Stabilization Plan over a period of up to three years, I think, between rate hearings, and then there was presentation by Dr. Colby, who was called by the consumer representative of the day, who pointed out some difficulties with that and ultimately the scheme evolved as it, essentially as it now exists.

MR. OSMOND: That's right. I should say, you just said that ... there was one thing we had, not to confuse it, we had the water equalization in place up to 1985 and I think we had a balance around $25 million. Part of the proposal was that we take that old balance and reduce or give it back to consumers over a three-year period. So that was done and then at the same time started in January '86 with a new Rate Stabilization Plan, so we actually (inaudible) to industrial customers and to Newfoundland Power the balance in that plan of $25 million over a three-year period.

MR. HUTCHINGS: Right, okay. At that time, of course, the rates of industrial customers were not part of any consideration by the Public Utilities Board at all, correct?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. So the plan evolved and was designed essentially to deal with the retail customers of, the retailers, as they were then called, Newfoundland Power and PDD.

MR. OSMOND: Yeah. Originally it was designed for Newfoundland Power. I think subsequently after that though we looked at one overall plan. I think Mr. Avery (phonetic) wrote the Board after outlining that we could segregate the plan between two, Newfoundland Power and industry, so we'd have two elements making up the overall plan balance, but the initial one was geared to the Newfoundland Power plan.

MR. HUTCHINGS: And, I mean, that's all that was at issue before the Board at the time that the hearing occurred in 1985, was the plan for retailers, correct?

MR. OSMOND: Well, I guess we're looking at an overall, what we call the Rate Stabilization Plan, to protect consumers' variations in rates as well as fluctuations to Hydro's bottom line through those three elements, and that would cover the elements associated with retail and industrial, change in water, change in fuel or change in load.

MR. HUTCHINGS: Yeah. The industrial customers were not represented ...

MR. OSMOND: No, they were not.

MR. HUTCHINGS: ... at the 1985 hearing.

MR. OSMOND: No.

MR. HUTCHINGS: And in fact there has not been a hearing until this one at which the industrial customers would have had the opportunity to scrutinize, if you will, the way the plan works.

MR. OSMOND: Correct me, but I thought the industrials had representation in the '89 or '91 hearing.

MR. HUTCHINGS: There was representation but their rates were not being set ...

MR. OSMOND: No, no, you're right.

MR. HUTCHINGS: ... in those hearings.

MR. OSMOND: Yes. They intervened. The rates weren't set till '96, you're right.

MR. HUTCHINGS: Nor would the Board at that point have had any jurisdiction to change any element of the Rate Stabilization Plan as it impacted industrial customers.

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. So essentially the Board would order or recommend in its reports in those days what the Rate Stabilization Plan would be and Hydro was then free, if you will, to use that plan in whatever way it wished in respect of the industrial customers.

MR. OSMOND: The same principles would apply.

MR. HUTCHINGS: You chose to apply the same principles.

MR. OSMOND: The same principles, yes, as the mechanics of how the plan would work applied to industrials as it did to retail customers.

MR. HUTCHINGS: Yeah. And you mentioned the letter from Mr. Abery to the then Chair of the Board, and that's attached to **IC-284E**. That may or may not be available in electronic form, the attachment. It is ... on page three of that letter there's a reference to the load element. Is it fair, Mr. Osmond, to say that there, Hydro had not put forward this type of provision with respect to variation in load at the 1985 hearing? You had put it forward instead of coverage cap ...

MR. OSMOND: Yeah, specifically to load, no, we did not. It was included as part of the overall interest coverage cap. Inherently it would have been in that by the fact that your revenue would have changed, could be by load ...

MR. HUTCHINGS: Yes.

MR. OSMOND: But we did not identify specifically as a load variation, interest coverage cap.

MR. HUTCHINGS: No. And there was no discussion in the 1985 hearing about this type of load provision, was there?

MR. OSMOND: Not to my knowledge, not to any great degree. We did have a discussion on interest coverage cap which covered part of the elements, but I don't remember specifically a discussion on the load.

MR. HUTCHINGS: I mean, for myself I could say that I was surprised when I found that the Board in fact in its report had included this element. I mean, was that a reaction at Hydro as well?

MR. OSMOND: No. I guess when we looked at the report we assumed the Board had looked at what we had proposed on an interest coverage cap and they picked an element of that, and the element of that would have been the revenue variation. The other side of that would have been the cost variation. So we presume the Board looked at the revenue variation and said, well, if that can go up or down, Hydro could benefit or lose, positively or negatively, so took that element as it was, so it wasn't a major surprise.

MR. HUTCHINGS: Okay. So the letter that is before the Board, quotes actually from the report, and the last paragraph that appears on the screen there now, and says that, "The Board recommends that any earnings variation because of the difference between the estimated load and the actual load be included in the Rate Stabilization Plan so Hydro's earnings will not vary." Would you agree with me that that was the primary intent with respect to this provision that Hydro's earnings not vary?

MR. OSMOND: This particular load variation?

MR. HUTCHINGS: Yes.

MR. OSMOND: Yes, so we would not benefit positively or negatively.

MR. HUTCHINGS: Right. And this doesn't address any issues with respect to how you meet your revenue requirement, merely that you meet it, correct?

MR. OSMOND: Yes. What it's basically saying is that once the cost of service is set, if there are any variations between the actual and the cost of service, those fluctuations, pluses or minuses, will go into the plan, so Hydro's bottom line would be neutral.

(9:45 a.m.)

MR. HUTCHINGS: Yes, okay. Now, that's where the RSP began obviously, in 1985, and that was the intent of the load provision. I think you'll agree with me that for industrial customers now as well as for Newfoundland Power the Rate Stabilization Plan charges form a significant part of the amounts that these customers have to pay for their electricity.

MR. OSMOND: Yes, it does.

MR. HUTCHINGS: Yeah. Just looking at, and I don't think we need to turn to it, **IC-191**, in 2003 it's projected that roughly 25 percent of the base energy rate, of the rate that industrial customers pay for energy, leaving aside the demand charge, will in fact be RSP.

MR. OSMOND: Yes, the RSP, that's right.

MR. HUTCHINGS: Yeah.

MR. OSMOND: But if the plan wasn't there, would have been much more significant (inaudible).

MR. HUTCHINGS: No, I quite understand what you're saying, and in terms of where this is going, from, and I don't think again we need to turn to it, but **IC-132**, we find that the 2001 industrial adjustment is $2.8 mills, and the latest projection that we got for the 2002, which is now the actual given the September results, is 5.14 mills.

MR. OSMOND: Sounds right.

MR. HUTCHINGS: So that adjustment itself has gone up by 83 percent, in excess of 83 percent in 2001, 2002, so it's clearly a subject that should be of concern to the industrial customers.

MR. OSMOND: Yes, it's a concern to us. I guess the major change there would certainly be the increased price of fuel. It's just ...

MR. HUTCHINGS: Yeah, yeah. Just to look again for a moment at the overall effect of the plan, clearly, for instance, the hydraulic variation provision is intended to compensate for problems that show up, not necessarily problems that show up but the fact that it is not necessarily possible to forecast the water levels precisely. That's one of the things that it deals with, correct?

MR. OSMOND: Yes, rainfall, snowfall, run-offs.

MR. HUTCHINGS: But the way this provision is actually written, it in fact compensates for many other things as well, because it relates specifically to whatever generation you happen to get out of your water, correct?

MR. OSMOND: Yes, based on the reservoirs.

MR. HUTCHINGS: Yes. But if, for instance, you had a maintenance problem in Bay D'Espoir and one of your units was down for a month, that effect would in fact go through the RSP as well, wouldn't it, or hydraulic production would be down?

MR. OSMOND: It'd be lesser production in hydrology on a temporary, smaller amount in hydrology. Might be a timing variance. It could be we had it down in the summertime. Hydrology for that month in July might be down, but you pick up, you'd have the same water there as long as you don't spill, you pick it up in the fall, so on average it'd work out. The key is that you don't spill.

MR. HUTCHINGS: Yes, yeah. But even if you spilled, the effect would still go through the RSP, wouldn't it? If you had a unit down and water was high and you were forced to spill, nonetheless the oil that you burned at Holyrood to replace that power would be, the cost of it would be collected through the RSP.

MR. OSMOND: The fuel side, the extra fuel at Holyrood, be impacted on the RSP. There'd be no impact on the hydrology side of the ... if we spill, we obviously had to go and use thermal, so if you use thermal, then the incremental cost on thermal above the base rate, that would have gone in the RSP.

MR. HUTCHINGS: Yes, but, I mean, the fact that you would be producing less hydraulic energy than forecast would also be compensated for through the RSP by reason of the fact ...

MR. OSMOND: Okay, yes, by the fact that it's down compared to cost of service, yes.

MR. HUTCHINGS: That you pay, you burn more fuel.

MR. OSMOND: Yeah.

MR. HUTCHINGS: And you get paid for that through the RSP, correct?

MR. OSMOND: Well, are you thinking the spill scenario or the fact that we got a unit down?

MR. HUTCHINGS: The fact that you have the unit down, I mean, whether or not you spill.

MR. OSMOND: Yeah. I guess the only thing I'm saying on the unit down, depends again if you make it up during the year. If it's down for the whole year, yes, there would be a negative variation on the RSP, but normally the maintenance would have it down for part of the year and still have that water, as long as you didn't spill, and you'd use that water at the end of the year so on average you're still back to your average hydro generation.

MR. HUTCHINGS: Yeah. But I think you'll agree with me that whatever the reason that hydraulic production is down, you're insulated from the effect because of the RSP.

MR. OSMOND: Yes, if it's down, yeah.

MR. HUTCHINGS: I'd like to look at **NP-8**, which was circulated yesterday, which is a slightly marked-up version of the April 2001 Rate Stabilization Plan Summary.

MR. OSMOND: That's the January RSP?

MR. HUTCHINGS: Yes, it's January 2001. Sorry, I thought it was ... it was in fact January 2001. I just wanted to look at a few numbers on this. Ms. Butler took you through it as it related primarily to Newfoundland Power, and, but this is the same report obviously and deals with the plan as it relates to the industrial customers as well.

MR. OSMOND: This is the one plan that covers both customers, industrial and retail.

MR. HUTCHINGS: Yeah, okay. If we look for a moment at page 12, probably other places in the report where you get the same information, but this shows the actual sales for the month of January 2001.

MR. OSMOND: Yes, it does.

MR. HUTCHINGS: Okay. And they are shown as in total for utility, both firm and secondary, a total of 515,522,528 kilowatt hours.

MR. OSMOND: That's for utility, yes.

MR. HUTCHINGS: Yeah. That's the number that Ms. Butler had marked as "A."

MR. OSMOND: Yeah.

MR. HUTCHINGS: Down below we have the total for the industrial customers, which is shown there as 107,215,277, correct?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. And with a little bit of simple arithmetic, using the total at the bottom, the 622 odd million, I show that the energy was, the total energy was divided between Newfoundland Power and the industrial customers on the basis of 82.7 percent and 17.3 percent roughly.

MR. OSMOND: I have to trust to your numbers.

MR. HUTCHINGS: Okay. That sounds about right.

MR. OSMOND: It looks about right, yeah.

MR. HUTCHINGS: Yeah, okay. So a little off of one-sixth, five-sixths.

MR. OSMOND: As far as the industrial versus the overall?

MR. HUTCHINGS: Yes.

MR. OSMOND: Yes.

MR. HUTCHINGS: Yeah, okay. Industrial versus Newfoundland Power, one-sixth, five-sixths.

MR. OSMOND: Roughly.

MR. HUTCHINGS: Roughly. Yeah, okay. If we can look then to page six, this shows the load variations, and just before we get to that, in terms of the hydraulic variation and the variation in the price of fuel, one would expect, I think, that these two variations should be divided between the two customer classes on the basis of their energy utilization. Is that fair?

MR. OSMOND: Yes.

MR. HUTCHINGS: Because, I mean, everybody shares equally in that. It means extra barrels of fuel burned. That's all it is so whatever you burn you should pay for.

MR. OSMOND: That's correct.

MR. HUTCHINGS: Yeah, okay. So if we go to look at the load variation information on page six then, the variance for Newfoundland Light and Power is shown as the number marked "C" on **NP-8**, the 28,217,884 kilowatt hours, correct?

MR. OSMOND: Correct.

MR. HUTCHINGS: Okay. And again on a simple calculation, comparing the actual to the cost of service, that's a variance of about 5.8 percent?

MR. OSMOND: Roughly, yes.

MR. HUTCHINGS: Yeah, okay. If we look down to the industrial customers, their load variance was 215,277 kilowatt hours, correct?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. And you can look at the actual versus the cost of service and by my calculation that comes out to about 0.2 percent variation, correct?

MR. OSMOND: That's right.

MR. HUTCHINGS: Okay. So in terms of the total variation, which is 28,433,161, I think you'd agree with me that Newfoundland Power is responsible for more than 99 percent of that.

MR. OSMOND: That's what it looks like.

MR. HUTCHINGS: Okay, okay. If we move then to page 16 of this report and look at the current period activity, there are two numbers, one for the retail plan and one for the industrial plan, and the total of those two numbers is four million three, seven hundred and thirty-five thousand dollars. That's not the actual adjustment for the month because you take into account the interest and the ...

MR. OSMOND: I'm sorry, which ones are you referring to, Mr. Hutchings?

MR. HUTCHINGS: The activity for January, current period, two nine four five ...

MR. OSMOND: Yes, okay.

MR. HUTCHINGS: And then for the industrial plan it's one seven nine oh.

MR. OSMOND: Yes.

MR. HUTCHINGS: Okay. You add the two of those together you get four seven three five.

MR. OSMOND: Yes. I thought you said seven three five, I'm sorry. You're right, four seven three five..

MR. HUTCHINGS: Four seven three five, yeah, okay. The actual adjustment that's referred to on the previous page is four seven one two, but that deals with the payments and the interest and ...

MR. OSMOND: Right.

MR. HUTCHINGS: Okay. In terms of the total activity in the plan for the month, it's $4,735,000, correct?

MR. OSMOND: That's correct. That's a change.

MR. HUTCHINGS: Uh hum. And if we look at the division of that activity, we'll find that 62.2 percent of that is assigned to Newfoundland Power and 37.8 percent is assigned to the industrial customers. Subject to arithmetical variation, that looks about right?

MR. OSMOND: I trust your numbers.

MR. HUTCHINGS: Okay. So it's almost two-thirds, one-third.

MR. OSMOND: Uh hum.

MR. HUTCHINGS: Okay. So we got three things going on here. We've got the fuel price, we've got the hydraulic variation, which we've agreed should be split based upon how much energy you use, and we know that the energy split, energy split between these two parties is one-sixth, five-sixths, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: At the end of the day, the total activity in the plan is split roughly two-thirds, one-third, and the only other thing that's happening here is the load variation, correct?

MR. OSMOND: And the rural rate alteration which wouldn't be major.

MR. HUTCHINGS: Yeah, which is insignificant really.

MR. OSMOND: Uh hum.

MR. HUTCHINGS: Yeah, okay. So somehow or other the load variation provision in this plan is assigning a whole bunch of costs in January of 2001 to the industrial customers, but we've just agreed that Newfoundland Power was responsible for more than 99 percent of the variation in load. Why is that?

MR. OSMOND: That's a good question. *(laughter)*

MR. HUTCHINGS: I'm glad.

MR. OSMOND: Hopefully I have an answer for you. This is up to the end of 2001 using a methodology and cost methodology we had in place, well obviously it's still in place since 1992, so what we end up doing every single month is re-doing the cost of service. In other words, used to say, if we knew now what we knew then, what would the numbers be. So we input all the new fuel numbers, the load variation, the hydrology, all of our costs that have changed during the month, and really re-do the cost of service for that month, and when you re-do the cost of service for that month, it's getting back to where you were in 1992. In other words, if we knew what these numbers were in 1992, this is the way the cost would have been assigned using a cost of service that was approved at that point in time, so we re-do it every single month, take in account the load and the change in the demands and so on, but it's re-doing it on a monthly basis as if we knew that information ten years ago. I say ten years ago, was the last cost of service that we had, so we use that same methodology every single month. You see that as you went through the February report and the March and April and so on. So ...

MR. HUTCHINGS: What ... okay, go ahead.

MR. OSMOND: I was going to say so it's assigning cost based on that approved methodology on a monthly basis.

(10:00 a.m.)

MR. HUTCHINGS: So what you're doing is reallocating costs among the two customer classes, correct?

MR. OSMOND: It's assigning the change in the month, right, based on the cost of service methodology that was approved in 1992 which took into account the AEDs, ratios, and the energy splits and all this sort of stuff, and we were just re-doing it again as if this information was known in 1992. And based on that, what would have happened? Well, this is what would have happened, these costs would have been assigned to these customers this way.

MR. HUTCHINGS: Okay. So I think the answer to my question is a yes, that you're reallocating the cost among the consumer groups, the two groups of consumers.

MR. OSMOND: Based on the cost of service, yes.

MR. HUTCHINGS: Yes, okay. Given that the intent of the load variation provision in the RSP was simply to keep Hydro's earnings unchanged, where does the authority come from to reallocate costs among consumers on an ex post facto basis?

MR. OSMOND: Well, I guess I just said, if we had to know ... in other words, if load variation, right, for industrials meant the sales went up or went down, that's the load we would have used in 1992 if we had that information, so by doing it every single month, we're using that new load and allocating it the way we would have done if we knew what those sales were back in 1992. So it's the same as the inputs that we would have had at that point in time. We would have used ... like we're using now. We're using the forecast sales for industrials, forecast sales for industry, forecast sales for Hydro rural, and that goes in the cost of service, so if we had to know those numbers, that's what we would have used, so we're re-doing it every month using the correct load or correct energy sales.

MR. HUTCHINGS: What you're effectively doing though is retrospectively setting rates through the RSP. You're going back and saying, well, our forecast didn't turn out to be right so we're not going to go with the rate that the Board set, we're going to reallocate those rates and basically create a new rate based on what actually happened.

MR. OSMOND: I don't think I'd phrase it that way. That's why I kept using the phrase to go back to 1992, and if we knew the information in 1992 that has transpired in 2001, what would we have done, and what we would have done is (inaudible) cost of service that would have given you these allocation of costs we have here in January. So it's not change in methodology, it's using the data that we have now to re-run it through the cost of service, the same logic that we used before as approved by the Board and just re-do it monthly, so customers are properly allocated their cost as if we knew those in 1992.

MR. HUTCHINGS: What's the difference between that and getting a cost of service methodology approved by the Board and then running it every year and setting your own rates?

MR. OSMOND: Well, it's only used for ... this is only run to determine what's appropriate to be charged to customers as it relates to the RSP.

MR. HUTCHINGS: Uh hum. But they ... this represents real dollars that the application of this load variation provision is reallocating and making the industrial customers pay, which, in the absence of that way of applying the provision, Newfoundland Power would pay that, correct?

MR. OSMOND: But I still go back, I'm just repeating myself.

MR. HUTCHINGS: Yeah. Can I get a yes or a no on that one first?

MR. OSMOND: I'm not sure if I can before I say what I want to say.

MR. HUTCHINGS: Okay. Say what you're going to say and we'll go back to the question.

MR. OSMOND: Yeah. And then you can ask me again because we've done this before. *(laughter)* I think you still got to go back and say if I had this information back in 1992, what would the cost have been for industry, and they would have been these costs. I know you're thinking that we're charging something to you we shouldn't be charging you, and I keep going back to the cost of service as approved in 1992. If we had your load, it's gone up now, back in 1992, what would the numbers have been? They would have been these numbers here, and that's done by re-running it every single month.

MR. HUTCHINGS: And that's what I mean by retrospective regulation. You're letting the events happen and then setting a rate on the basis of what has happened as opposed to allowing the Board to set a rate on a forward-looking basis.

MR. OSMOND: Well, I guess, we've taken the point of view the Board's approved (phonetic) methodology, reviews that from '85 on to assign, to allocate the cost of service every single year on the basis I just said, assuming that if we knew at the time what these costs are now, that's what would have happened to the customers, and that's what we've done all the way through.

MR. HUTCHINGS: But, I mean, the Board approves a methodology but nonetheless you have to bring your application on the methodology before the Board and demonstrate what rates come out of that and allow the Board to set a rate, correct?

MR. OSMOND: I'm not sure if semantics or not ... it's ... the rate ... there's an automatic adjustment, you know, at January the 1st. There's an automatic adjustment, Newfoundland Power, in July, and that's based on a consistent basis using the cost of service that was last approved by the Board, and that was 1992, to properly assign or allocate the cost to both entities without changing any logic, any rationale at all. It's done on the same basis that was approved.

MR. HUTCHINGS: Yeah, okay. When we were in the process of submitting information requests in respect of this matter, we asked for a great deal of detail, didn't we, about how the RSP worked?

MR. OSMOND: I couldn't lift it all.

MR. HUTCHINGS: No. And it took a while to produce that, didn't it?

MR. OSMOND: Some of it did, yes.

MR. HUTCHINGS: Yeah. And that's because it wasn't lying around where you could pick it off a shelf and give it to us, correct?

MR. OSMOND: Well, some of it got right back inside ... as far as the actual RSPs, that was not a problem. We supplied, I think, IC-73. I think there's four binders going all the way back to '92. But once we got into ... it's like the heart of an engine, you know, where are the pistons and the liners and all that sort of stuff. Yes, going back to reconstruct that, yes, that took some time.

MR. HUTCHINGS: Yeah.

MR. OSMOND: But the basic principles of the plan, that was not a problem responding to and providing all that to you. I think we done more than that.

MR. HUTCHINGS: But in terms of how this load variation provision actually works, I'd suggest to you that until we got the answers to all of those very detailed questions, there had never been a complete presentation to industrial customers or to the Board as to the effects of that way of doing it.

MR. OSMOND: I guess ... sorry, we didn't go to that level of detail, I agree, at all the hearings, but certainly the logic associated with it, we would have reviewed that, but by no means did we layer down, 10, 12 layers down, as to how the mechanics of the plan actually function, how they were allocated right down to the line items. The principles as to how we did it certainly is very well expounded in '85, '89, '91 and '92, but not down to the level that you're into, I agree with you. It's a lot more detail we've gotten into in the RFIs.

MR. HUTCHINGS: But, I mean, in 1985 there was no discussion at all about this provision because it was added by the Board in its report, correct?

MR. OSMOND: That's right.

MR. HUTCHINGS: Okay.

MR. OSMOND: In subsequent hearings.

MR. HUTCHINGS: Yeah. And those were hearings at which the rates for industrial customers were not being set.

MR. OSMOND: That's correct.

MR. HUTCHINGS: And they were before a board that had no power to make any order about how the industrial rates were affected by the RSP, correct?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. I just want to look at the correspondence that was sent by Mr. Sturge to Mr. Dean, and that is attached to a response which is **IC-286**. No, it's the next attachment. That's the one. Mr. Sturge was at that time the Director of Rates and Financial Planning and I suspect probably reported to you in that position, would he?

MR. OSMOND: Yes, he did.

MR. HUTCHINGS: This correspondence is obviously in response to some questions that had arisen in 1993 about how the, this particular industrial customer, and industrials customers generally, were affected by what was happening within the Rate Stabilization Plan. And if we can turn to the last page, we have there what's called "An Analysis of Current Period Activity." I take it you're familiar generally with this correspondence here.

MR. OSMOND: Generally, yes.

MR. HUTCHINGS: Okay. Essentially I guess the difficulty that Abitibi was having at the time was to try to understand why certain amounts of costs were being assigned to the industrial class and Mr. Sturge was explaining, I think, that the result was arising from the very type of thing that you and I were just discussing, which is referred to as the notion of cost sharing ratios, which is a heading that appears on the table that's in front of you, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: Is that a phrase that has been used or defined in any particular way by Hydro for the purposes of the RSP?

MR. OSMOND: Cost sharing ratios?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: I guess that's ... I guess not specifically. That's the ratios that come out of the cost of service for allocating costs to customers which includes energy or average and excess demand, those types of things, so that's the ratios that we're referring to in that context, but it's all a myriad of ratios that are used as you pare down in a cost of service for allocating for transmission, distribution, generation and so on. These are the factors.

MR. HUTCHINGS: We have all those now.

MR. OSMOND: As you and I have gone through many, many times.

MR. HUTCHINGS: Yes, yeah.

MR. OSMOND: There are a lot of ratios there that we're talking about here.

MR. HUTCHINGS: Yeah. I'm trying very hard not to have to go through them all.

MR. OSMOND: And I hope you don't.

MR. HUTCHINGS: If we look for a moment, I'm sorry, back one page to page two of the letter, can you just read into the record what Mr. Sturge says under the heading of "Cost Sharing Ratios"?

MR. OSMOND: "Cost Sharing Ratios. This component reflects the changes in energy and NCP," which would be non-coincident peak, "during the month compared to the test year forecast. In January the increases in energy for both Newfoundland Power and industrials did not cause any significant change in the energy ratios as both customer classes increased by proportionately similar quantities. The major factor resulting in the shifting of 361,000 to the industrial class was a four megawatt increase in non-coincident peak."

MR. HUTCHINGS: So what we're talking about here is an increase in demand on the part of the industrials which results in a shifting of cost from the industrial class, or to the industrial class from Newfoundland Power, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: Okay. If we can carry on now to the table on the next page, I think the effect that's described in the paragraph is in fact illustrated in the table here. Under the heading of "Cost Sharing Ratios" we have the energy amounts in gigawatt hours, which are 33 and 6, which I presume reflect Mr. Sturge's comment that they were increasing, they both increase but they increase proportionally, so that didn't shift any cost.

MR. OSMOND: That's what it looks like.

MR. HUTCHINGS: Okay. On the second line, however, in the next line, the non-coincident peak in megawatts, there was no increase on the part of Newfoundland Power, but a four megawatt increase on the part of the industrials.

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. The non-coincident peak we're talking about here, is that the non-coincident peak of the industrials as a group or the total of the individual non-coincident peaks or do you know?

MR. OSMOND: It might be the latter. I don't know. I would have thought it's the total of all of the customer class. I'd have to check that for you. I haven't been involved in this area since 1992.

MR. HUTCHINGS: Yeah.

MR. OSMOND: So I would say, yes, I can check that for you.

MR. HUTCHINGS: Yeah, okay. If nothing else, this hearing should deliver you from the area of the average and excess demand factors.

MR. OSMOND: Or most of it.

MR. HUTCHINGS: Yes, okay. If we look down then to the bottom of this table, there is a breakdown of the current activity, and the fuel cost increase or decrease and each of the two classes receives their appropriate share of the fuel cost increase, and we get to the next line, the cost sharing ratios impact. And just explain for us what that shows.

MR. OSMOND: What it shows?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: It shows a negative for Newfoundland Power of 364,000 (phonetic) and an increase for industrials of 361 based on the allocation for the cost of service, which would be the cost sharing ratios, which primarily would be, I would think, if I had the cost of service here, which I don't want to have, because of the non-coincident peak and the re-runnings of the cost of service using that new peak as if we knew that at the time in 1992 it was established, so it's a re-running of the cost of service and a reallocation of costs in the month.

MR. HUTCHINGS: Okay. And that reallocation of costs has no bearing on Hydro's earnings whatsoever, does it?

MR. OSMOND: No. It's just a reassignment.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: Proper reassignment amongst customer classes.

MR. HUTCHINGS: Okay. So why is it that the industrials therefore have to pay the extra $361,000 in respect of that month?

(10:15 a.m.)

MR. OSMOND: I'm going to get a tape. It's the same thing as I was saying before, that this goes back there every single month ... once the cost of service is approved and established, and the last one approved was 1992, then every single month in every single year thereafter, you always re-do the cost, re-run the cost of service every month for changes in fuel, hydraulic and load, change in the peak, and whatever those numbers come out to be in that month, that's as if we knew that at the last time we ran the cost of service. The cost of service then reassigns that as if it knew it at the time we did it ten years ago and assigns proportionate costs to industry and Newfoundland Power, and that's the way we try to properly assign the cost to all of our customers, fairness and equity, as if we knew all this back ten years ago.

MR. HUTCHINGS: I hear what you're saying. The Rate Stabilization Plan, however, redistributes costs on the basis of energy, doesn't it?

MR. OSMOND: Well, no, it does on the whole cost of service, not only energy, but there's also changes in demand.

MR. HUTCHINGS: Yeah. But there are no ... on your summary report, there's no reference to demand.

MR. OSMOND: You're talking about the RSP report?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: That gets you up to a certain stage and in getting to the last page, 16 I think, whatever, where we have assigned to retail and industrial, that would have gone through the cost of service to do that, which would have included the changes in demand, changes in energy and so on to do that. That's not shown specific ... that's almost an addendum to be able to show you that, as to how we assign that, and that was some of the information requests you had, Mr. Brickhill will certainly go through. So that's not shown specifically, Mr. Hutchings, there on that RSP.

MR. HUTCHINGS: Okay. So just ... this is an aside, I guess, because you mention it. In terms of any detail with respect to those information requests that deal with cost of service, you defer those questions to Mr. Brickhill?

MR. OSMOND: I think if it's a detailed cost of service question, I think it'd be more appropriate. I'd sort of be skating on it. I think it'd be more appropriate for Mr. Brickhill to go through and explain how the allocations are done as it relates to the cost of service.

MR. HUTCHINGS: Okay. And that includes the cost of service going back to 1992 and whatever ...

MR. OSMOND: Yes.

MR. HUTCHINGS: ... variations there have been in the ...

MR. OSMOND: Yeah. But generally, as I have said, that's the way it works, but generally more ... Mr. Brickhill would be more appropriate going forward. I can try to expound on some prior to that, into 1992, but it's generally as I've outlined here. On a go-forward basis he can certainly explain the mechanics of how it would work and any minor changes that we have in doing that in the cost of service.

MR. HUTCHINGS: Okay. In terms of what shows up here and the problem that Mr. Dean and Mr. Sturge were trying to address at that stage, what we have is the industrial customers, as a group at least, exceeding their forecast demand by four megawatts, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: And as a result of that, the RSP is charging them as a group $361,000 in that month.

MR. OSMOND: The group being the industrial class, yes.

MR. HUTCHINGS: Yes, okay. A couple of things arise out of that. That four megawatt excess could have been entirely the responsibility of one industrial customer, couldn't it?

MR. OSMOND: Possibly.

MR. HUTCHINGS: But under the RSP, all of the industrial customers pay or contribute to the $361,000.

MR. OSMOND: That's correct, as one class.

MR. HUTCHINGS: Okay. So that's not really a good reflection of cost causation, is it?

MR. OSMOND: I guess by class it is. You're thinking of breaking it down further but as far as class it's cost causation, by the industrial class.

MR. HUTCHINGS: Alright. The other point, and this is perhaps even the more significant point, is that the industrials then and now have a demand charge as part of their rate, correct?

MR. OSMOND: Yes, they do.

MR. HUTCHINGS: So as a result of having a higher peak, the industrials pay additional demand charges, correct?

MR. OSMOND: They have a demand charge associated with the cost of service of supplying power, demand component and energy component.

MR. HUTCHINGS: Uh hum, yeah. So whoever it was that caused that four megawatt increase in the non-coincident peak, paid the demand charge for that, didn't they, in that month?

MR. OSMOND: When you say paid, it's included in the RSP. The ...

MR. HUTCHINGS: Well, now, before you get to the RSP at all, their bill for the month is going to show a peak four megawatts higher than their power on order, right?

MR. OSMOND: Yes. Yes, they will in that context, yeah.

MR. HUTCHINGS: So they're paying for that demand on their monthly bill.

MR. OSMOND: Well, on the power on order, depends on what they declared for that year.

MR. HUTCHINGS: Well, I mean, by way of assumption, I mean, "X" hypothesis, this thing is four megawatts higher than the forecast.

MR. OSMOND: Yeah, okay.

MR. HUTCHINGS: Correct?

MR. OSMOND: Yes, alright.

MR. HUTCHINGS: So that's four extra megawatts of demand they're paying for, correct?

MR. OSMOND: If they're gone over the power on order.

MR. HUTCHINGS: Yeah. But, I mean, if they hadn't gone over the power on order, then it wouldn't be above the forecast, would it?

MR. OSMOND: No. If they hadn't they would (phonetic) have been paying the power on order.

MR. HUTCHINGS: Yeah, yeah. So this is for extra demand, the extra megawatts of demand that they're paying for in that month on their bill, paying the demand charge, correct?

MR. OSMOND: I believe so.

MR. HUTCHINGS: So why then, having paid for that four extra megawatts of demand on their bill as a demand charge, are they being asked to pay for it again with another $361,000 in the same month due to the RSP?

MR. OSMOND: I think what you'll find when you get into the cost of service is the overall demand for all the customers for the year and how all the costs should be allocated to both classes, Newfoundland Power and industry.

MR. HUTCHINGS: I'm not questioning that that's what falls out of the cost of service. What I'm questioning is whether or not that is the intent of the Rate Stabilization Plan.

MR. OSMOND: There's a reason I'm hesitating. I'm thinking of the actual bill that will go out. As far as the mechanics, the mechanics I'm quite comfortable with. The demand should be allocated and allocated to the industrial customers. I'm thinking of the actual incidents where the peak is up and whether the customers actually pay for that or not in that month.

MR. HUTCHINGS: I mean, chances are it's something like Interruptible A or some other type of power that is attracting a demand charge, correct?

MR. OSMOND: Yeah. Well, I don't think the Interruptible A is part of what we use for allocating the demands to our customers as firm energy, firm demand. I don't think we take the five megawatts, if that's what's there now for interruptible, and assign the cost in the cost of service study, in the original, 1992. I think it will all be based on firm demand.

MR. HUTCHINGS: In the original. But when you re-do it for the purpose of the RSP, you're putting it in, correct?

MR. OSMOND: The interruptible?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: I think we are up to the year 2001.

MR. HUTCHINGS: Yeah, okay. So the effect is that in additional to paying the 7 or 8 or $9, whatever it was per kilowatt of demand in that month, they're also paying another $90,000 per megawatt through the RSP for having exceeded their demand.

MR. OSMOND: I'm not sure if that's correct. I'm not sure, and I have to check the bill. I'm not 100 percent correct that they're actually being allocated the interruptible in the cost of service every month. I think it's the firm energy that's run through the cost of service and not the interruptible.

MR. HUTCHINGS: Mr. Sturge has said it's that increase in demand that's causing the allocation of that $361,000.

MR. OSMOND: A change in the peak.

MR. HUTCHINGS: Yeah.

MR. OSMOND: Yeah, but I'm not sure if that's due to interruptible.

MR. HUTCHINGS: Well, whatever it's due to, it is in fact the change in demand, Mr. Sturge has said that, that's causing the industrial customers to pay this extra $361,000, having already paid the additional demand charge associated with the increased peak.

MR. OSMOND: I have to check and see how we actually assigned it in 2000 in the cost of service study. I can get that over the break for you.

MR. HUTCHINGS: Would you agree with me that if that's what the method of allocation is doing, then there's something wrong with the method of allocation?

MR. OSMOND: I'd like to see exactly what we're doing first before I say yes or no to that.

MR. HUTCHINGS: Okay, alright. A couple of other more general questions on the RSP. Granite Canal is due to come in service sometime in 2003. In the absence of another application to the Board, what's the effect on the RSP of Granite Canal coming on stream?

MR. OSMOND: What is the generation of Granite Canal in 2003?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: Top of my head, I think it's, not exactly, I think it's around 200 gigawatt hours coming on in August of ... I think that's an annual figure, around 200 gigawatt hours in 2003.

MR. HUTCHINGS: Whatever the number is, how does that impact the RSP?

MR. OSMOND: Well, the higher ... the increased hydraulic production. So when we come back for a 2003 rate hearing, for 2004, the hydraulic, the average year would reflect a higher generation with Granite Canal added on. So right now I think we're at forty-five oh five or forty-five seventy-one. Be another 200 gigawatt hours put in for average hydrology that you compare your actuals to from that point in time.

MR. HUTCHINGS: Okay. And that would happen at the rate hearing, that the average hydraulic availability would be increased.

MR. OSMOND: The actual hydrology would take place when it comes in service, which would be August, I think it's August and I could be wrong, July or August of 2003.

MR. HUTCHINGS: Yeah, but for the purpose of the RSP.

MR. OSMOND: I think the hydrology would be increased in 2003 to show a higher number at that point in time, partway through the year, and then we set our rates, our proposal rates for the following year would show an increase in hydraulic production, reflect that in our thermal mix. But I think to answer your question, we'd have a higher hydraulic production in 2003 for a test, for that period of time, including Granite Canal.

MR. HUTCHINGS: But for the purpose of the RSP, when Granite Canal comes on, let's say, in, let's say it's on in October of 2003, when you're doing your RSP calculations for October of 2003, do you relate the actual hydraulic to the number that you've given us now or do you increase the number by the Granite Canal number and compare those two numbers?

MR. OSMOND: The latter, the latter. You would increase the actual ... you take the actual production, which would include the Granite, and compare it to what we have in the cost of service (unintelligible) now ...

MR. HUTCHINGS: Right.

MR. OSMOND: ... so it would be higher if we had an average year, (unintelligible) by the fact that Granite's come on ...

MR. HUTCHINGS: Okay. Well ...

MR. OSMOND: ... which means that would go into the plan as a positive.

MR. HUTCHINGS: Yeah, okay. So your answer previously should have been the former.

MR. OSMOND: I'm sorry.

MR. HUTCHINGS: Because you're not changing the base in the cost of service because Granite Canal comes on without coming back to the Board to do that. Is that correct?

MR. OSMOND: You're talking about the allocation of the split, the ...

MR. HUTCHINGS: No, the ...

MR. OSMOND: No. As far as the average ...

MR. HUTCHINGS: The hydraulic variation ...

MR. OSMOND: Yeah.

MR. HUTCHINGS: ... component, okay?

MR. OSMOND: Okay.

MR. HUTCHINGS: When we leave here there will be an average in the cost of service for hydraulic production.

MR. OSMOND: Right.

MR. HUTCHINGS: Now, when Granite Canal comes on and before you get back to the Board, are you going to change that number?

MR. OSMOND: The actual ... the hydrology number would change by the fact that Granite's coming on, so I think the number we have for next year is forty-two seventy-one or something like that. That would be increased based on the actual by the Granite Canal generation, which is something like 200.

MR. HUTCHINGS: Yes.

MR. OSMOND: So if that materialized in 2003, they're comparing 4,400 to 42.

MR. HUTCHINGS: Yes, okay, okay. So you don't change the cost of service number yourselves.

MR. OSMOND: Cost of service doesn't change but the amount that goes in the RSP would change.

MR. HUTCHINGS: Yes, okay, alright. If we can look briefly back to **NP-8** for a moment, at page six. We're back to the load variation here and I just want you to confirm for me what is being illustrated, as I see it, on this page with respect to the effect of the variations from cost of service by the utility as opposed to the industrial customers. In this instance, both variances are in the same direction as regards to kilowatt hours, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: So both Newfoundland Power and the industrial customers used more kilowatt hours in this month than had been in the cost of service.

MR. OSMOND: That's right.

MR. HUTCHINGS: Okay. Now when we follow off to the right-hand side of the page, in respect of Newfoundland Power, that increase in usage leads to a credit in the RSP, correct?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Down the page, however, the increase in usage by the industrial customers leads to a debit in the plan, correct?

MR. OSMOND: That's right.

MR. HUTCHINGS: Okay. So they actually move in opposite directions.

MR. OSMOND: Yes.

MR. HUTCHINGS: Okay. So if Newfoundland Power burns more or uses more electricity, money comes out of the RSP, and if the industrial customers use more, money goes in.

MR. OSMOND: Yes.

MR. HUTCHINGS: The reason for that, I presume, is simply because there is a demand and energy rate for the industrial group and just an energy rate for Newfoundland Power, correct?

MR. OSMOND: I was just going to say that, that's correct. It's the pricing. It's demand ... Newfoundland Power have a flat energy rate. They're assigned demand cost in cost of service. They have a flat energy rate of 45.31 mills and this is determined when we look at line A, from the cost of oil at Holyrood, whereas the industrial customer, they have a demand charge, as you know, and an energy charge, so the RSP calculation, we use the energy charge associated with Holyrood, I'm sorry, fuel costs associated with Holyrood minus the energy charge of 19.34 mills.

MR. HUTCHINGS: And that ... does that strike you on its face as being anomalous, that a movement in the same direction should produce movements in opposite directions depending on the customer?

MR. OSMOND: I guess the anomaly when you look at it, if you call it an anomaly, is that one has demand charge, one does not have a demand charge, and that's why the results show what they do show.

MR. HUTCHINGS: Yeah. And they will continue to do that, won't they?

MR. OSMOND: With the current pricing structure, yeah.

MR. HUTCHINGS: Yeah. And it's almost inevitable simply because the demand costs of Newfoundland Power are included in their energy rate.

MR. OSMOND: That's correct.

MR. HUTCHINGS: And the price of fuel at Holyrood will almost inevitably be in between, will produce a mill rate inevitably in between the industrial energy rate and the rolled up ...

MR. OSMOND: And that's what you can see here, the energy rate for Holyrood is pretty well the same, fuel cost at Holyrood is pretty well the same as the energy rate for the industrial customers. Light and Power, as you say, had both. They got the demand cost assigned and the energy cost. It's rolled into one rate.

(10:30 a.m.)

MR. HUTCHINGS: Okay. Would you agree with me, Mr. Osmond, that this load variation provision is in fact far and away the most complex part of the RSP?

MR. OSMOND: The actual mechanics of it, no. It's no more complex than the hydraulic or fuel.

MR. HUTCHINGS: Do we really have to go through all those ...

MR. OSMOND: No, unless you're ... no, no, unless you're going down to the ... I'm thinking of the actual first part of the plan as opposed to getting into the allocations of the cost of service.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: The derivation calculation of it is not that, I don't think that's that complex.

MR. HUTCHINGS: No.

MR. OSMOND: It's how we get the next step, to the cost of service, yes, I would agree to you, that's complex (unintelligible). The actual number, I mean, the load variation, just two numbers, cost of oil at Holyrood minus the energy rate. That's just straight math.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: But the next step, getting into the cost of service, that's a whole different ball game for, which includes the load, production, hydraulic fuel and everything else.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: But the straight mechanics of it, no, that's not overly complex.

MR. HUTCHINGS: And would you agree with me that if there were no load variation provision here, you wouldn't even need to do the split, would you? You wouldn't need two plans.

MR. OSMOND: If you didn't have a load variation?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: You'd still have the hydraulic variation, still have the fuel variation.

MR. HUTCHINGS: Uh hum. That's just distributed among all customers on the basis of energy, isn't it?

MR. OSMOND: In the future it'll be based on energy.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: The last 12 months.

MR. HUTCHINGS: Yes.

MR. OSMOND: But I think there are other factors too. You would still need to have segregated to the cost of service, especially go through the rural deficit and so on. As to what is appropriate to be allocated to Newfoundland Power and industry, I think you'd still need two separate plans.

MR. HUTCHINGS: What purpose do, would two separate plans serve if all you're dealing with was the hydraulic variation and the price of fuel?

MR. OSMOND: You're getting inside the cost of the service now and I think when you get into that I think you will find that when the cost of service allocates it, it would not, it would allocate it ... by allocating one plan, I think you'd be disproportionate. I don't think they'd be allocating the right costs to Newfoundland Power and to industry. You'd still need to have the two plans, both factors would still impact on either one of those customers. I don't think you can throw them in the one pot.

MR. HUTCHINGS: Both the hydraulic variation and the price of fuel ultimately comes down to the dollars caused to be spent by burning fuel, isn't that correct?

MR. OSMOND: Yes, it does.

MR. HUTCHINGS: It's a pure energy ...

MR. OSMOND: Fuel.

MR. HUTCHINGS: Yeah. It's a pure energy-related item, right?

MR. OSMOND: It is.

MR. HUTCHINGS: And what's to prevent that simply then being distributed on the basis of the amount of energy that customers use?

MR. OSMOND: I'm not sure that will give you that result. I'm really getting into Mr. Brickhill's area now, when it gets into cost of service.

MR. HUTCHINGS: Yeah. We can ...

MR. OSMOND: I think you will find that there are still elements there that would need to be assigned for the cost of service, but you needn't have the two separate plans, but that's something we can, Mr. Brickhill can certainly address.

MR. HUTCHINGS: Okay. Mr. Osmond, it came to light in the answer to **IC-120**, I guess, that there had been an error made in the allocation of RSP funds related to the rural deficit to the industrial customers, and that, I understand, has been corrected by a credit back to the industrial customers in August and perhaps September of 2001.

MR. OSMOND: Yeah. I think you'll find that **IC-242** where we actually explained what the mechanics were.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: And I think in the August report, I think it was August, we made an adjustment to adjust the January 1st balance, January 1st, 2001. I think it was around 862,000, off the top of my head, and we adjusted the August results year to date, I think by approximately 700,000, and from that point on we ceased allocating to industrial customers anything related to the rural deficit.

MR. HUTCHINGS: How did that error come about?

MR. OSMOND: It was just an oversight. In 1995 when we had our hearing on industrial rates, it should have been a phase-out ... I'm sorry, 1999, when we actually phased out the industrial subsidy for industry. We took that to our bottom line. Inherently there was an element in the RSP associated with the industrial customers as well, and in hindsight we should have picked that up and we just missed it, so, I mean, buck stops here, I missed it. So, you know, that should have been taken out in that point in time, so we found that now, it was raised and we've adjusted the RSP accordingly.

MR. HUTCHINGS: And how was the error actually discovered?

MR. OSMOND: How was it discovered?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: When the RFIs and plus we went back ourselves in verifying the information, the RFI raised it, and we went back and verified and determined that that was an oversight and an error, which ...

MR. HUTCHINGS: Okay. I take it that between the period of December 31, 1999, and the date of discovery of this error, Hydro was making its usual quarterly reports to the Public Utilities Board?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. And I must assume that this never came up in the course of any of your dealings with the PUB up to that time.

MR. OSMOND: No, it didn't. I would have been there and if I was aware of that we would have raised that and we certainly would have raised it with the customers, but we weren't aware of it till this process this fall.

MR. HUTCHINGS: Yeah, okay. What has happened now to the amounts that had to be credited back to industrial customers, are they being recovered in any other way?

MR. OSMOND: No. Those amounts that we adjusted for, as I mentioned earlier, and the fact that we won't be allocating those types of costs to industry beyond September or August, they fall directly out to Hydro's bottom line as a reduction in our net income for this year, and I think that's about $2.5 million for this year, so there's no recovery from any other customers. Same treatment as we gave for the elimination of the industrial deficit, the rural deficit industry were paying. Came to our bottom line until it's allocated to Newfoundland Power, if approved by the Board. Not this element, the RSP, but the allocation of the rural deficit, Newfoundland Power, effective January 1, 2002.

MR. HUTCHINGS: Okay. Can we look for a moment at **IC-272, page three of four**?

MR. OSMOND: Page three of four?

MR. HUTCHINGS: I'm afraid I have the wrong reference on that one. Just let me check. It may in fact be ... I have an **IC-272** that has two Rate Stabilization Plan Summary Reports attached to it. This is 272 A and E. I need just 272, page three of that one.

MR. O'RIELLY: That's not available.

MR. HUTCHINGS: It's not available, okay. Perhaps we'll have to get the hard copy of that one. Do you have it, Mr. Osmond?

MR. OSMOND: What were the headings? I'll see if I got it right here.

MR. HUTCHINGS: The heading is "Newfoundland and

Labrador Hydro, Rate Stabilization Plan Summary Report PUB 2002."

MR. OSMOND: Yeah. And the headings, "Hydraulic, Load and Fuel?

MR. HUTCHINGS: "Hydraulic, Load and Fuel," and then ...

MR. OSMOND: And the total at the bottom ...

MR. HUTCHINGS: ... over the next page it goes, "Recovery, Labrador Interconnected, Rural Rate Allocation and Total To Date."

MR. OSMOND: What's the total at the end? It's 155 million in brackets?

MR. HUTCHINGS: The total on the first page is 155 million ...

MR. OSMOND: I got it.

MR. HUTCHINGS: ... negative, yeah.

MR. OSMOND: I got it.

MR. HUTCHINGS: Okay, alright. My question is ... **page three of four of IC-272**. My question relates to really each of the four major or three major headings, hydraulic variation, load variation and rural, fuel variation rather, but it's illustrated, I guess, most easily under "Hydraulic," and the second column headed "Interest."

MR. OSMOND: Uh hum.

MR. HUTCHINGS: And there's an amount there of $222 million odd, and can you just explain to me why there would be an amount of $220 million odd in interest as an opening balance for 2001 in the hydraulic variation account?

MR. OSMOND: I pondered over that too when I saw it first. Now I lost my place. What that is, that goes back ... the way we have to do it, I guess, in the RSP, because you'll see the same thing applying over in the fuel variation as well.

MR. HUTCHINGS: Yeah, and it's under load as well.

MR. OSMOND: Oh, yeah. It's all the way through.

MR. HUTCHINGS: We got 11 million in load and ...

MR. OSMOND: It goes right back ... I'm sorry. It goes right back to day one when the plan was actually established and it takes into account the change just for that particular element of hydrology and the interest associated with that month by month. Some months it was up, some months it was down. It's the accumulated interest, if you like, just on that element, and to get a true fix you need to take that interest, taken off from the fuel interest, taken off from the load, which really gets you back to the net number. It's a detailed way of showing the interest associated with each one of the components, which really is an accountant's way to really confuse, I guess, but not intending to do that, but it really goes all the way back. I have to admit, even looking at it myself when I went back, it really goes back to 1985 and starts off from day one, taking the balance into the plan and monthly changes and this is what has accumulated to that point in time just for the hydraulic variation, because you can recall in the first five or six years, and I think we had some RFI the other day, but the plan was actually positive in the first four or five years, especially after '87, '88, to '92, then it went negative, so you'd see these variations here which would be very high, but the actual plan balance would be low, okay, and that's why they may look a little bit out of sync here, but you'd have to look at them in totality when you take, you know, the four *(sic)* components, hydraulic interest, load interest and fuel interest, and then let them all out (phonetic).

MR. HUTCHINGS: There is no simpler way of presenting this to us at this point.

MR. OSMOND: This is a simple way, believe it or not.

(10:45 a.m.)

MR. HUTCHINGS: Okay. Just going back for another moment to **NP-8 and page six** of that document ...

MR. OSMOND: I'm sorry, NP-8, what page?

MR. HUTCHINGS: NP-8, page six.

MR. OSMOND: Yeah.

MR. HUTCHINGS: There are a few historical anomalies on this page in the sense that there's reference to Albright and Wilson, Americas, and Royal Oak Lines Inc.

MR. OSMOND: Yeah.

MR. HUTCHINGS: Is it fair to say, Mr. Osmond, that the result of having those two companies still showing, since they were in the cost of service in 1992, is that Hydro is essentially getting paid by other industrial customers what these customers would have paid had they still existed?

MR. OSMOND: Yes. They're all part of a class and the class was established in 1992, which included them, and they wouldn't come out until the new, next cost of service goes back in.

MR. HUTCHINGS: Right.

MR. OSMOND: So the fact that they had forecast generation, forecast cost of service as kilowatt hours versus actual, then that variance would flow back to the industrials and other customers, yeah.

MR. HUTCHINGS: So until ... as long as you don't come back to the Board and have another cost of service approved, you continue to get paid for these two companies who have been gone for years.

MR. OSMOND: Until the cost of service is revised.

MR. HUTCHINGS: Yeah.

MR. OSMOND: Well, the same way would apply to the other industrial or ... you'll see Abitibi is up or down too. Abitibi forecast 16 million kilowatt hours, they're actually eight, so that really is applicable to Corner Brook and ...

MR. HUTCHINGS: But Abitibi is still here, aren't they?

MR. OSMOND: Oh, yeah, I know. I'm just saying as far as the principle, the variance still applies to the rest. I hope they stay, but that still applies to the rest, that they would be, you know, applicable to the other customers as well.

MR. HUTCHINGS: But the implication is that, you know, you're being made whole in respect of these two customers who are no longer on the system at all and haven't been for years.

MR. OSMOND: That's correct, because they're all part of the industrial class.

MR. HUTCHINGS: But I take it that now with the new cost of service, this effect will be removed after this hearing?

MR. OSMOND: If a customer is ...

MR. HUTCHINGS: No, no. I mean these two ...

MR. OSMOND: Oh, I'm sorry, yes.

MR. HUTCHINGS: These two companies will go away at least.

MR. OSMOND: Oh gosh, yes. 2002, they won't be on the list.

MR. HUTCHINGS: Yes, okay. But, I mean, as an ongoing policy, what's going to happen if a customer is added or a customer leaves?

MR. OSMOND: If a customer leaves, the same principles we have here, that still remain. A new customer comes on, they'll show as a new customer, shows a variation in load and increase in load.

MR. HUTCHINGS: So will you alter the cost of service load to ...

MR. OSMOND: No. It would just ... no, it would just change the actuals. For instance, if Albright and Wilson, if they, if they were still there now and they went next year, we'd still have to show them as a customer because it's in the cost of service. If a new one came on, we have to show that separately with zero load opposite in the cost of service because they're never there. There'll be a variance in load for that month.

MR. HUTCHINGS: Yeah, but a new customer coming on now, their entire load will show up as a variance ...

MR. OSMOND: That's correct.

MR. HUTCHINGS: ... if everybody else is equal.

MR. OSMOND: That's correct.

MR. HUTCHINGS: I think I'm just about to the end of the RSP part, at least, Mr. Chair. Perhaps if we could break a couple of minutes early, we'll be able to re-group.

MR. NOSEWORTHY, CHAIRMAN: After the RSP, a welcome break, *(laughter)* a welcome early break, Mr. Hutchings. Thank you very much.

(break)

(11:15 a.m.)

MR. NOSEWORTHY, CHAIRMAN: Thank you. Mr. Hutchings, can I ask you to continue? Are you ready, Mr. Osmond?

MR. OSMOND: Yes, I am.

MR. HUTCHINGS: Thank you, Mr. Chair. Just one further reference to the RSP, Mr. Osmond, and looking toward the future rather than the past. If we can look at **NP-202**? I don't know whether the entire answer is available electronically. Are all of the pages available, Mr. O'Rielly?

MR. O'RIELLY: No, they aren't.

MR. HUTCHINGS: Just the first page? Okay. The first page here explains what we have in **NP-202**, which is basically a restatement of the December, 2000 RSP report using the new methodology, correct?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Yeah, and the assumptions are outlined here still using the 1992 test year. The mini hydros have been thrown in for a small variance in hydraulic production. The conversion factor at Holyrood has changed. Interruptible energy is left out, and the financial charge is changed to the weighted average cost of capital as opposed to imbedded interest, as before, but the essential elements of change, I guess, are at lines 12 and 13 where the splits are based on 12 months to date, energy and the adjustment rate in the same way, correct?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. If you have the hard copy of that in front of you?

MR. OSMOND: I do.

MR. HUTCHINGS: On page 18 of 24.

MR. OSMOND: Sorry, 18?

MR. HUTCHINGS: Eighteen.

MR. OSMOND: Okay.

MR. HUTCHINGS: Just so I'm clear, this report represents what Hydro proposes on an ongoing basis as the appropriate and fair way to do the allocations under the RSP, is that correct?

MR. OSMOND: That's my understanding. It's taking 2002 and using what we're proposing for 2000 ... taking 2000 and using the proposal for 2002, yeah.

MR. HUTCHINGS: Okay, and basically this is Hydro's proposal, so it's your judgment as to the fair way of carrying on from this point, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: Yeah, okay. If we look at page 18 of 24 this is the overall summary, and I think we can see, under heading Retail Customer Plan, in the current period, if we look at total to date, there's an amount of $10,461,000 assigned to NP for the year 2000 under the plan following the new rules, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: Okay, and for the industrial customers, under that heading Industrial Customer Plan, Current Period the amount assigned is $2,220,000?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. I won't ask you to dig it out because it's buried in the depths of **IC-73**, but I'm looking at the equivalent page for December of 2000 as it was actually done, the actual report at page 16. And that shows an allocation to Newfoundland Power for the year 2000 of $8,762,000, which is $1.7 million less than the new system would allocate, would you agree with that?

MR. OSMOND: I don't have that one to refer to. You're referring to which one?

MR. HUTCHINGS: I'm referring to ...

MR. OSMOND: You're comparing the?

MR. HUTCHINGS: ... the December, 2000 Rate Stabilization Plan report as produced in **IC-73**.

MR. OSMOND: Okay.

MR. HUTCHINGS: The actuals.

MR. OSMOND: Yeah, okay.

MR. HUTCHINGS: And I mean, you're free, obviously, to look at it if you wish, but from what I'm reading off the number here in the same column as it relates to **NP-202**, page 18, is 8.762 as opposed to 10.461?

MR. OSMOND: Okay.

MR. HUTCHINGS: And on the industrial plan, again, current period total to date, $3,901,000 for the year 2000 as opposed to the $2,220,000 under the new scheme?

MR. OSMOND: Uh hum.

MR. HUTCHINGS: So I think we can conclude that the change in methodology that you're proposing for the RSP has given rise to the reallocation of cost from the industrial customers to Newfoundland Power. Is that correct?

MR. OSMOND: I guess using the new methodology, taking into account the last 12 month sales, which is what we're proposing for 2000, that's what the results show.

MR. HUTCHINGS: Yes, okay, and from Hydro's perspective, the allocation shown on **NP-202** in respect of the year 2000 is the fair approach that it wishes to adopt for the future?

MR. OSMOND: I think our sense and our feeling was to use the 12 month historical number actual was the most appropriate way to go, more accurate way of doing it, assigning the balance amongst customers.

MR. HUTCHINGS: And the result reallocates the $1.7 million from one customer class to the other?

MR. OSMOND: That's what this shows, yes.

MR. HUTCHINGS: Okay.

MR. OSMOND: In this case, for that year.

MR. HUTCHINGS: Thank you. Alright. Moving on to other topics, Mr. Osmond.

MR. OSMOND: I can put this away?

MR. HUTCHINGS: You can. You had some discussion yesterday with Ms. Butler on the subject of dividends and the debt equity ratio for Hydro. Would you agree with me that effectively neither the Board of Directors or management of Hydro has any real control over what the dividend is going to be and hence, what the debt equity ratio is going to be?

MR. OSMOND: I guess, as Mr. Wells explained, the actual dividend is determined by ... indicated by the province. The Board certainly has the responsibility to evaluate that and see what the impacts are with regards to Hydro's financial performance. If they are concerned with that they certainly have the remedy to pursue that with the province, but they do have an obligation, as we as management do, as well. But the actual dividend can be determined by the province but the Board has a responsibility too, to see if that can be accommodated within the guidelines that they set as a Board, as they did last year, I think, or in 2000, to go to 75 percent payout ratio, but to review the impact on Hydro's financial position as well.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: So you do have a responsibility. It isn't just done carte blanche.

MR. HUTCHINGS: Yeah. I mean, the policy of Hydro is, in effect, one thing, but the actual practice is something else?

MR. OSMOND: The actual determination of the number is heavily influenced by the province, yes.

MR. HUTCHINGS: Yeah, okay.

MR. OSMOND: Another little visit, I guess, to history on this subject. I don't know whether we have, in electronic form, **Consent 1** and **Consent 2**? Okay. Just scroll down there so we can see. Yes, that's the 1981 report, and **Consent 1** was pages 32 and 33 of that report, I believe. It doesn't seem to coincide with what I have here. Okay. Can you just scroll up from there? And just to the bottom of that page? Oh, I'm sorry, what you've got there is **Consent 2**, actually. Yes, as we have it marked, 1981 report. Okay. Can you go to page 27 of that one? And one page down? I'm not getting what I'm looking for there. I'll refer to the hard copy that we have and reading from page 32 of **Consent 2** extract from the PUB report, that listed document that was put to Mr. Wells when he was on the stand, and page 32 is a summary of the evidence given by the then President of Newfoundland Hydro, Mr. Victor Young, who submitted a table showing the overall financial measures of Hydro, and the table included an entry for reinvested margin as a percentage of the capital program. And going on then to page 33, the report continues with the summary of his evidence, about five lines down that page, as it was submitted, to say, "The margin represents a contribution to the capital program from consumers which reduces borrowing requirements and the associated long-term interest costs as well as enhancing Hydro's financial stability and how it is perceived by the credit rating agencies." It says, "While the benefits of reinvestment to the margin begin immediately, it will have its greatest impact in the future, particularly as Hydro moves toward the implementation of the Labrador power development strategy." Would you agree, Mr. Osmond, that this extract illustrates how the margin was regarded, both by Hydro and the Public Utilities Board, during the 1980s as it was being collected as a result of reports approved ... or submitted by this Board?

MR. OSMOND: Certainly there's consideration that we tried to finance internally our capital program and tried to maintain the equity we had through the margin as interest coverage, and we'd look at that plus our depreciation to finance the capital program, so there was a consideration of that during that timeframe.

MR. HUTCHINGS: Uh hum, yeah, and there were submissions made, at that time, you know, as to why there should, in fact, be any margin at all or why it should be as large as it was, and this was the justification that was essentially offered by Hydro is that it's going to benefit everyone in the long run by reducing borrowing requirements, correct?

MR. OSMOND: That was certainly one of the issues that were put forth.

MR. HUTCHINGS: And there was, of course, no talk or discussion at that point at all of government taking any dividend out of Hydro, was there?

MR. OSMOND: Back in the early `80s, `79, no, there was not.

MR. HUTCHINGS: No, okay.

MR. OSMOND: Well, they would have been entitled but it was a different regime at that time and things have changed.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: So but no, that was not discussed during those previous hearings.

(11:30 a.m.)

MR. HUTCHINGS: No, okay. Look for a moment at **IC-111**. This shows the actual depreciation on the island interconnected system for 1992 to 2000, plus an estimate for 2001. Can you just scroll down a line to be able to see 2001? I think we can tell from a quick look at this, Mr. Osmond, that the depreciation expense had run anywhere from 19 million to 29 million over that period, and over the last five years or so the average would probably be around 28 million, a little over 28 million?

MR. OSMOND: That looks about right.

MR. HUTCHINGS: Okay. I think you told us in your evidence that the average capital budget of Hydro over the past five years was in fact $41 million?

MR. OSMOND: Approximately.

MR. HUTCHINGS: Okay. What we have seen though in the way of increases in Hydro's capacity and the load that it's been required to meet has basically, I think, been about an increase of one percent over the ten years or so since 1992?

MR. OSMOND: In load growth?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: That's Mr. Budgell's area. That sounds about right. They haven't been the high numbers that we saw in the late `80s.

MR. HUTCHINGS: No.

MR. OSMOND: So it's probably the one percent range.

MR. HUTCHINGS: Okay. The capital budget of $41 million, that would be about a little over three percent of the rate based, rate base about $1.3 billion?

MR. OSMOND: Roughly.

MR. HUTCHINGS: Roughly, okay, so what we're doing here is adding three percent per year to the rate base which is, you know, about 10 or 12 or 13 million, I guess, more than we're taking in depreciation on average over the last five years, correct?

MR. OSMOND: In capital?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: Yeah, but there are other factors, there are other internally generated funds besides depreciation.

MR. HUTCHINGS: No, no, I understand that, yeah, but, you know, just looking at depreciation as an indicator for the time being, we're looking at the difference between the capital budget and the depreciation being roughly, on average, $13 million over the last five years?

MR. OSMOND: Roughly.

MR. HUTCHINGS: Uh hum, so that's effectively adding one percent a year to the rate base over that five year period when, in fact, there's only been a load growth of one percent over the entire ten year period from 1992?

MR. OSMOND: Looks like a Rubik's Cube. Are you trying to associate load growth with depreciation expense and the impact on our capital?

MR. HUTCHINGS: Just trying to associate the load growth with the need for Hydro to expend capital funds.

MR. OSMOND: I mean, that's really Mr. Budgell's area. He went back through that and explained what generation we had over the last five years and which projects we brought on, which nugs we actually had power contracts for, what we're going with Granite Canal as it relates to the load growth for the next three or four years, as well as ACI coming on and the Corner Brook unit. So I mean, these are assets that would have been in service. Depreciation there, that goes back to assets since day one, back to 1975.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: Plus the assets that came in, certainly, in 1990 and beyond, the Paradise Rivers and some of the other projects that we had, and they're rising because of the sinking fund method of depreciation that we have.

MR. HUTCHINGS: Yes.

MR. OSMOND: Right.

MR. HUTCHINGS: But, I mean ...

MR. OSMOND: So it's not ... I'm sorry. It's not ... when you look at those numbers, I mean, the depreciation is not necessarily driven by new generating plant, if that's what you're thinking of. We haven't put any new generating plant in, to my knowledge, since Paradise River. The last two we purchased from were the Star Lake and Rattle Brook.

MR. HUTCHINGS: No, I understand that, but I mean, the theoretical purpose of the depreciation is to allow you funds in order to replace assets that are being utilized over time, correct?

MR. OSMOND: That's correct, in theory, uh hum.

MR. HUTCHINGS: Yeah, and when you are spending more capital money than you are recovering by way of depreciation charges, one would expect there to be growth in the company to justify that?

MR. OSMOND: It doesn't necessarily have to be load growth. There's replacement of ... in addition to fixed assets we have replacement of transmission lines or we have replacement of poles, right. That ...

MR. HUTCHINGS: Uh hum. Which are all being depreciated?

MR. OSMOND: Yeah, but it's not necessarily driven by load. If we got poles to replace, I mean, that just could be poles that are deteriorated and obsolete that have to be replaced. Load doesn't drive that. It's a physical condition.

MR. HUTCHINGS: No, I understand that, but depreciation should pay for that?

MR. OSMOND: Well, the theory is that you would have in your rates sufficient monies that you would use to finance your capital, but the way most companies would normally look at it is how you finance your assets internally, look at the total source of funds that you have, depreciation, net income, plus other non cash items that are used for financing all of your activities, not specifically identified with one particular item to say you finance all of the capital out of depreciation. It's a guideline in setting your capital budget, but not necessarily used for financing your capital.

MR. HUTCHINGS: No, I understand what you're saying, and, you know, if the two numbers were reasonably closely related I guess I wouldn't have the problem that I have, but, if you have an increase in the rate base of one percent a year and the Company, itself, in terms of what it's doing, selling electricity, is only growing one percent over the whole of the ten years, there seems to be a disconnect here.

MR. OSMOND: But I guess to go back to, I mean, some of the things replaced Mr. Reeves explained, in our rural areas, some of the old units we have, the diesel units, they had to be replaced, not necessarily with bigger units, just replacing them.

MR. HUTCHINGS: Yes.

MR. OSMOND: So they could be 30 years old, some of these are probably contributed by the old PDD going way, way back. Now you got to have replacement with new dollars, no contribution, so you're not necessarily driven by load, it would just be replacement of physical assets that have deteriorated and worn out. That would drive ... that would be an increase in your capital versus what your depreciation would be.

MR. HUTCHINGS: Yes, but, I mean, if you're talking $50 million over the past five years or $55 million over the past five years, items of that nature?

MR. OSMOND: Not specifically for rural, but you have to remember too, a lot of the old rural assets we had didn't have depreciation on them.

MR. HUTCHINGS: No, I understand that.

MR. OSMOND: Because they were contributed by the REA and so on prior to that. Assets coming on now to replace diesel units are fully paid for and depreciated.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: So if you ... for instance, some of those numbers would be artificially low because we didn't have contributions in aid of construction going way, way back, as you know, 70s and 75, right.

MR. HUTCHINGS: No. I understand that. I mean, have you tried to quantify that effect?

MR. OSMOND: No, but, I mean, I just know from history that we've gone back. We knew we took over PDD back in 1989 where contributions were there as it related to the physical assets and they came over with zero value, so as you replace them you're going to have a higher depreciation number and higher capital number.

MR. HUTCHINGS: Just from the point of view of the capital budget, generally, Mr. Osmond, can you identify for us any specific items in the capital budget that were undertaken or proposed to be undertaken for the purpose of cost saving?

MR. OSMOND: For the purpose of cost saving. I mean, I don't have specifics, but I can give you some generalities. I mean, I can't go through the detailed capital budget, but I know when we review at the management committee we go through with the vice-presidents and the directors of the capital budget, just for instance, in TRO, just to look at TRO ... and we look at replacement of diesel units, the type of unit to go in, was it high speed, low speed, and what is the more efficient unit than we had previously. Cost savings are an issue in that type of case, so ...

MR. HUTCHINGS: But I mean, you don't replace the diesel unit until its life has basically expired?

MR. OSMOND: No, but you look at the economics, how many times you've overhauled it.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: And I think I'm out of my league. I mean, if we had to overhaul a unit more than four or five times it's much more cost effective to go ahead and replace it, so we look at the economies associated with that, rather than overhauling it the sixth or seventh time, and what the savings would be by getting a new unit and a more efficient unit, so that type of thing is looked at in the budget reviews.

MR. HUTCHINGS: Okay, so do you go back then on an *expost facto* basis to try to determine whether or not the projected cost savings have been actually received?

MR. OSMOND: I mean, within TRO I'm really out on a limb. Within TRO they have their own maintenance and statistics as to how the units are operating, how many kilowatt hours per litre, things of that nature. That's in the operating areas. They know on a yearly basis how the units are operating, what efficiency they should be getting, what they're actually getting.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: So that's done by line management right through TRO and to production.

MR. HUTCHINGS: But, I mean, from a management committee point of view, when you, as a management committee, approve an item in a capital budget that is projected to save X number of dollars, is there a procedure at your level to require the proponent of the project to come back to you in a year or two years time and say, yes, here are the savings that we have in this year saved, in fact, the 40 or 50 or $100,000 that we projected that we were going to save?

MR. OSMOND: No, not to come back in that context, but where we would see it is in the review of the monthly operating reports. If we have projected that we're going to have savings on fuel, for instance, and it just never materialized. We would see that in the monthly report that we present or I take to the management committee every month, and Mr. Reeves and Mr. Haynes would have to explain, so you do see that from a control point of view, reviewing your actual costs compared to your budgeted costs.

MR. HUTCHINGS: But there's no directed effort at the capital budget items, themselves?

MR. OSMOND: We don't go back line by line and say bring everyone back because that would be the VP's responsibility. They monitor monthly, and then we would flag it at a higher level when it comes back to the management committee if those numbers are higher, we would say what in the heck is going on here.

MR. HUTCHINGS: I know, Mr. Osmond, you've deferred questions as they relate to the cost of service study essentially to Mr. Brickhill, and I don't want to get into any of the detail of that study with you. Would you agree with me though that the cost of service study for Hydro is essentially the heart of the rate making process?

MR. OSMOND: It certainly is the engine, once it takes all the inputs that we get and see how that should be fairly and equably assigned to all classes of customers, so within Hydro it's a massive task, it's a massive effort, but it's an important aspect to ensure the customers are properly assigned, the costs are applicable to them for the power that we're providing.

MR. HUTCHINGS: Yeah, and it does, in fact, make the firm rates, doesn't it?

MR. OSMOND: Coming out of the cost of service, yes.

MR. HUTCHINGS: The rates are outputs from the cost of service?

MR. OSMOND: The rates are outputs from the cost of service, yeah.

MR. HUTCHINGS: Okay, and the intent of that exercise, obviously, as you say, is to fairly distribute the costs, and would you agree with me that the ultimate test of fairness, I guess, is a cost revenue ratio of one to one?

MR. OSMOND: It doesn't always flow that way.

MR. HUTCHINGS: No.

MR. OSMOND: I'm sure Light and Power have the same thing where it doesn't flow one to one.

MR. HUTCHINGS: No, I know it doesn't happen that way but that's ...

MR. OSMOND: Theoretically.

MR. HUTCHINGS: That's the theoretical idea?

MR. OSMOND: Theoretically.

MR. HUTCHINGS: Yeah, okay, all right.

MR. OSMOND: Obtaining that is something else, but theoretically I'd have to agree.

MR. HUTCHINGS: Yes, okay.

MR. OSMOND: It may not be practical.

MR. HUTCHINGS: Now, the rate that doesn't fall out of the cost of service study that affects industrial customers is the non-firm rate. Can you just explain for us how Hydro has formulated its non-firm rate?

MR. OSMOND: Now you're getting into, not a Mr. Brickhill, but really a Mr. Hamilton issue.

MR. HUTCHINGS: Okay.

MR. OSMOND: As to how that was determined.

MR. HUTCHINGS: Alright.

MR. OSMOND: And this is relating back to the non-generation, the non ... the $1.50 per kilowatt, how it was derived. I think that would be Mr. Hamilton should respond to that one.

MR. HUTCHINGS: Okay, so you defer that to Mr. Hamilton?

MR. OSMOND: I mean, I'd wing it, but I mean, he'd give you a much better answer on it. He'd give you a real accurate answer on it.

MR. HUTCHINGS: He certainly will now.

MR. OSMOND: He will now. He hasn't left the room.

MR. HUTCHINGS: Okay. If we could look for a moment at **IC-134**? And this questions the changes in assignment on the island interconnected system and the costing impact that the change has on the three customer classes. If we can go to page 2, then? I think this, in one sense, Mr. Osmond, may help you in answering Ms. Butler's question of yesterday as to what you're doing to keep the rural deficit down. If we look at the second line there, the GNP transmission assets reassigned from rural to common, that involves an allocation of something in excess of $9 million from the rural island interconnected to the common system, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: And $7.9 million of that goes to Newfoundland Power and 1.459 or 458, I guess, with the rounding, goes to the industrial customers?

MR. OSMOND: That's what it's showing.

MR. HUTCHINGS: Yeah, okay, so from the point of view of what's happening with the rural deficit, had that reallocation not occurred that extra $9 million would have shown up in the rural deficit, would it not?

MR. OSMOND: That's my understanding.

MR. HUTCHINGS: Okay, and by reason of that reallocation you're getting a contribution of $1.45 million from the industrial customers to that amount?

MR. OSMOND: Yeah. The line now, as Mr. Budgell explained, has been assigned to common.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: So it's fairly allocated to Newfoundland Power and to industry with ...

MR. HUTCHINGS: If it's properly assigned to common?

MR. OSMOND: Yes.

(11:45 a.m.)

MR. HUTCHINGS: Yes, okay. Just arising out of that, and more in connection with the general tone of the changes that are going on with Hydro as a result of legislation and other things, and moving you toward what you say is regulation such as an IOU would receive, in dealing now with capital projects such as the Great Northern Peninsula interconnection was, will Hydro, as a result of the legislative changes and the changes in this approach, change the way it evaluates projects of that nature in any way?

MR. OSMOND: I don't see why we would. We've had the same criteria that Mr. Budgell went through when he was testifying as to how we'd evaluate projects, especially in systems planning, as to the cost effective projects and what are the options we would have to review, and I don't see a change in that at all. He'd still have to do the same review, same analysis and come to the same conclusions for recommendations, so I would not see that changing within systems planning.

MR. HUTCHINGS: Okay, so the fact that you would previously be looking at revenue impacts related to an interest cover of 1.08 percent and now would be looking at rate based charges, returns on rate base and returns to equity of over 11 percent, if your proposal is accepted that doesn't change your planning criteria at all?

MR. OSMOND: It's not going to drive us to put everything on the capital, if that's what you're thinking. We'd still have to use the same criteria to justify each project.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: And Mr. Budgell would be doing that the same in the future as he was in the past.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: To make sure they were cost effective and needed to be done and needed to be done on time, so I don't see him changing that philosophy.

MR. HUTCHINGS: How do rate impacts, for instance, of projects of that nature get worked in?

MR. OSMOND: Into the analysis?

MR. HUTCHINGS: Uh hum.

MR. OSMOND: You're getting me inside his area. I think what he normally would look at is the options associated with different projects and he'd look at the cost effectives, the cost streams of each one versus the other, seeing what's most cost effective versus what the costs may be on the island and thermal, or generated thermal costs. So he'd do a cost effective analysis to compare what the options are versus the ones he's proposed to the government. Now, what comes out of that, the capital would end up in our rate base and that affects our rates, obviously.

MR. HUTCHINGS: Yeah, okay. Is it your impression that Mr. Budgell, in fact, takes into account the revenue implications?

MR. OSMOND: No, he doesn't take into account the revenue implications. He looks at the cost effectiveness of each project versus the options. Certainly, coming out of that, once he decides what the cheapest option is, then we'd certainly look at what impacts that would have on our rate base and our cost of service, but that should be ... whichever one you pick is going to end up in the rate base. Mr. Budgell would look at what is the cheapest option to pursue, and based on the cheapest option, that's the one he'd recommend. Coming out of that would be the impact on the revenue requirement and the impact on the rates.

MR. HUTCHINGS: Is it your impression that Mr. Budgell takes into account items such as depreciation in doing that analysis?

MR. OSMOND: I don't think so. I think he takes into account the cost streams associated which ... the capital costs of each project, which inherently, if you look at over time, is the depreciation over a 30 year life or a 40 years life, so you factor that into account and the operating costs associated with option A versus option B versus C or D and you look at the cost of operating each one, including the fuel costs, and come up with a recommendation as to how we should proceed. So he's not driven by depreciation, he's driven by the overall capital costs of the project versus other options.

MR. HUTCHINGS: And you're not planning to make any change in your planning strategy on the basis that you'll now be looking at trying to get a return on that rate base?

MR. OSMOND: I don't think Mr. Budgell has changed his strategy at all.

MR. HUTCHINGS: And you don't think it's appropriate for him to do so do you?

MR. OSMOND: I think he has to pursue his cost effectiveness techniques that he's used in the past, in the future. We will look at the impact on the rates, but certainly he has to continue the way I think he's done, and which is done in other utilities as well, based the cost effectiveness of projects versus other options.

MR. HUTCHINGS: Alright. Okay. I'd just like to turn, Mr. Osmond, for a moment, to the debate that has gone on here, to some extent, about the energy only rate for Newfoundland Power. From your point of view, what are the advantages and disadvantages to Hydro of an energy only rate?

MR. OSMOND: I think right now the advantages certainly are that Newfoundland Power are getting a pricing signal from Hydro with the demand costs are already included in the energy rate as well as the energy costs, and they use that rate, to my knowledge, and they already ... as Mr. Alteen might have mentioned yesterday, I think they already have that included in some of the general service customers, the demand charge and energy charge, so the rate that we're reflecting does give them the right signal that they could put forth in their energy and demand charge for their general service customers.

MR. HUTCHINGS: So you're saying the advantage to Hydro is that it passes on the proper pricing signal?

MR. OSMOND: I think it does give the proper pricing signal in the existing structure that we presently have.

MR. HUTCHINGS: Okay. Are there any, in your mind, disadvantages to Hydro for the energy only rate to Newfoundland Power?

MR. OSMOND: Not in my mind. We did review that with Light and Power at some length back in the early ... I guess late `80s and `90s, and as you started to go through it and realize some of the nuances of it it became an issue of the variations would end up in the Rate Stabilization Plan which seemed to be counterproductive as to how we should go. And I think in light of the fact that they do have the mechanism to give the signal to their customers then, you know, the system we have presently for the energy only rate is appropriate, so I don't see any major disadvantages at this stage.

MR. HUTCHINGS: Okay. What's the effect on allocation of risk as between the industrial customers and Newfoundland Power of one having an energy only rate and the other having a demand rate?

MR. OSMOND: How is one more risky than the other?

MR. HUTCHINGS: Yeah. What's the effect on the risk, who assumes what risk under those scenarios?

MR. OSMOND: I'm not sure what you mean.

MR. HUTCHINGS: Well, from the point of view of Newfoundland Power, they'll submit a load forecast to you for each year, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: And if their forecast demand is higher or lower than what they have forecast, what's the implication for Newfoundland Power?

MR. OSMOND: If their forecast is higher and lower it's (inaudible) we talked about this morning, the Rate Stabilization Plan, any variation.

MR. HUTCHINGS: No, their demand.

MR. OSMOND: Oh, the actual demand. There's no ... well, when it gets run through the cost of service, presently it affects the allocation of the balance in the Rate Stabilization Plan, take into account their recent demand versus what was in the cost of service, plus the energy change, as well.

MR. HUTCHINGS: But I mean, that's an effect that arises out of what they forecast in 1992?

MR. OSMOND: Yes.

MR. HUTCHINGS: But as regards to the effect of forecasting in 2000 for 2001?

MR. OSMOND: Yeah.

MR. HUTCHINGS: Is there any effect on Newfoundland Power at all if they are above or below their forecast?

MR. OSMOND: Other than, as I said, as you work it through the RSP.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: That would be the only impact.

MR. HUTCHINGS: Yeah, but that's an effect relative to the forecast for 1992, it's not an effect that has anything to do with the forecast as between 2000 and 2001?

MR. OSMOND: No. It takes the actual into account, the actual peaks into account for the current year.

MR. HUTCHINGS: Yes.

MR. OSMOND: So it does recognize that situation where the peak is higher or lower, and that's flowed through, so there is a recognition through the allocations to the cost of service that would affect the allocation of the RSP for retail and industrial.

MR. HUTCHINGS: Which is, as I say, an effect related to the cost of service year. Yeah, okay. What's the effect on an industrial customer of providing a forecast and determining an amount of power on order and then being either above or below that demand?

MR. OSMOND: Again, it would go through the cost of service. Depending on if the demand has gone up for the industrial class, if the demand is up that would flow through the cost of service, much as the same principle as you would have had for Newfoundland Power, and that would be you'd look at it proportionately how it's allowed again between both classes of customers. You take the actual into account, compared to what it was, and you replace that with what you had in the cost of service and run it through.

MR. HUTCHINGS: That's the RSP effect?

MR. OSMOND: Yes.

MR. HUTCHINGS: Yeah. What's the other effect?

MR. OSMOND: If the actual power on order goes up for any customer?

MR. HUTCHINGS: Yeah. If they exceed their power on order?

MR. OSMOND: Then they would pay the demand charge and the energy charge associated with that.

MR. HUTCHINGS: Yes.

MR. OSMOND: Right.

MR. HUTCHINGS: And if their demand is, in fact, less than their power on order, what's the effect of that?

MR. OSMOND: You pay based on the maximum power on order.

MR. HUTCHINGS: So the industrial customers are committing themselves to a certain level of demand in providing their power on order to you, correct?

MR. OSMOND: Yes.

MR. HUTCHINGS: And they pay for that whether or not they take it?

MR. OSMOND: They decided to go with the power on order. We did have, as you know, some maximum demand contracts.

MR. HUTCHINGS: Yes.

MR. OSMOND: And it was decided, I guess, this year and last year to go with ... a consensus of the industrials to go with power on order type of contract.

MR. HUTCHINGS: Okay. I don't think we need to get into that debate as to where it came. What I'm talking about now is the effect of the way it is, okay.

MR. OSMOND: Uh hum.

MR. HUTCHINGS: So with respect to the power on order, once determined by an industrial customer for the year, if they use less demand then they pay for the amount they have on order anyway?

MR. OSMOND: That's right. If their actual take is lower than the power on order they pay for the power on order regardless.

MR. HUTCHINGS: Okay, and if they go over they pay the additional charge?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Yes, okay, and there is no such similar effect for Newfoundland Power, simply because they don't have a demand charge, correct?

MR. OSMOND: Not on demand, that's right. They pay on the actual energy that was taken.

MR. HUTCHINGS: Okay, and you spoke earlier of Newfoundland Power having a demand rate for its general service customers. Hydro's general service customers have a demand rate too, don't they?

MR. OSMOND: Yes, we have the same rate structure for all interconnected customers, Newfoundland Power does and the same for isolated rural.

MR. HUTCHINGS: Yes. In some of the material that was provided there was discussion about the notion that having a demand rate for Newfoundland Power might lead them to use their own generation in a less efficient way. Are you familiar with that?

MR. OSMOND: I remember the comment being made. I'm not ... I'm generally familiar with the comment, yes.

MR. HUTCHINGS: Okay. I mean, what did you understand to be the rationale for that? I mean, this was put up as a deterrent to having a demand energy rate for Newfoundland Power?

MR. OSMOND: Yeah. I guess operation ... I'm not an engineer. I guess one of the concerns might have been that they may run their power plants not necessarily in conjunction with what we may have required for a peak. Right now we can call on them to turn them on. They may not be used or may not be used most effectively from the systems point of view. I think that was the response we had in the RFI.

MR. HUTCHINGS: Yes. I mean, the fear being that rather than exceed the amount of their power on order if they had that type of contract ...

MR. OSMOND: It could, they could. I'm not saying they would.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: Could run their own generation at an inopportune time, yeah.

MR. HUTCHINGS: Yes, uh hum.

MR. OSMOND: I'm sure that wouldn't happen.

MR. HUTCHINGS: No. I mean, I'm not imputing any motive to them at all, but let's assume that some rogue takes control of Newfoundland Power and ...

MS. GREENE, Q.C.: Other than the current rogues?

MR. OSMOND: Don't take it out on the witness.

MR. HUTCHINGS: You're counsel is going out on the limb on that one.

MS. GREENE, Q.C.: No, we needed some humour.

(12:00 noon)

MR. HUTCHINGS: If, in fact, as I say, some rogue took control of Newfoundland Power and did exactly that, used their generation in such a way that didn't conduce to the effective operation of the system, don't you think that would run contrary to the sections of the power policy that Ms. Butler quoted to you yesterday, that the system must, in fact, be used to produce electricity at the most, at the least cost consistent with reliability?

MR. OSMOND: Now you're getting me into legal questions.

MR. HUTCHINGS: You don't wish to comment on that, do you? Well, you talked about it yesterday, is the only reason I asked.

MR. OSMOND: Yeah, I know, very generally, yeah.

MR. HUTCHINGS: I mean, but would you not agree with me that if such an event were to occur, given that Newfoundland Power is a regulated utility, the Board would have the appropriate authority to reallocate costs or disallow costs that Newfoundland Power inappropriately put on the system?

MR. OSMOND: In that extreme circumstances, yes, I think the Board would.

MR. HUTCHINGS: Yeah. Well, I mean, any of these circumstances that we're talking about are extreme, aren't they?

MR. OSMOND: Yes.

MR. HUTCHINGS: Okay, so I'd simply suggest to you that the possibility of Newfoundland Power abusing its own generation in that way is not really a significant impediment to imposition of demand energy rate for Newfoundland Power? Would you agree with that?

MR. OSMOND: I guess it's an issue and we just hope that it would not happen.

MR. HUTCHINGS: No, and we could deal with it if it did?

MR. OSMOND: And we could deal with it if it did, yeah.

MR. HUTCHINGS: Okay. In my mind that ceases to make it an issue, but we'll argue about that later on. The other point that has been raised is this notion of volatility of earnings. I believe you referred to that yesterday?

MR. OSMOND: Uh hum.

MR. HUTCHINGS: And what is it about the demand energy rate that you feel will give rise to volatility of earnings either on the part of Hydro or Newfoundland Power?

MR. OSMOND: I guess what we're referring to there, that if we set ... if Newfoundland Power had a demand charge and we set a peak, say, of 500 megawatts and that was in the cost of service.

MR. HUTCHINGS: Right.

MR. OSMOND: And the peak actually went up to 500 ... 600.

MR. HUTCHINGS: 600, okay.

MR. OSMOND: And Hydro would be gaining by the extra 100 megawatts, or conversely went the other way, it went down, then there'd be a revenue impact on Hydro positively or negatively. The same thing would also impact on Newfoundland Power.

MR. HUTCHINGS: Okay.

MR. OSMOND: There'd be instability in earnings, and then we went through that whole process before and the options were to look at putting it into a re-stabilization plan, and that sort of defeats the whole purpose of it, it's taking away the proper signal, if you like, what it should be, but the volatility in earnings would be based on whatever you decided in the cost of service. If that varied at all, if you didn't have it going anywhere, it would impact you positively or negatively.

MR. HUTCHINGS: Uh hum, okay. Now, you said that that would impact both Hydro and Newfoundland Power positively or negatively, but if, in fact, you had a power on order type of contract it wouldn't effect you negatively, would it?

MR. OSMOND: If you had a power on order, if they exceeded that?

MR. HUTCHINGS: Yeah.

MR. OSMOND: There would be.

MR. HUTCHINGS: No. It ...

MR. OSMOND: It would be. If they went over the power on order we'd bill them for the higher amount.

MR. HUTCHINGS: Yes, but in terms of Hydro?

MR. OSMOND: Right.

MR. HUTCHINGS: If you had a power on order type of contract ...

MR. OSMOND: Yeah. If it's the lower ...

MR. HUTCHINGS: .. and they were low it wouldn't hurt you at all?

MR. OSMOND: No. Newfoundland Power, I think, would have an issue with that.

MR. HUTCHINGS: Yes. I mean, that ...

MR. OSMOND: Yeah, but for us, if it went over that ... yeah, that's correct.

MR. HUTCHINGS: Yes. What it does is to allocate the risk of forecast error to Newfoundland Power, correct?

MR. OSMOND: Well, I guess they're the one closest to what the demand should be.

MR. HUTCHINGS: Uh hum, and they then have that as a risk that they can manage, and the closer they can come to it the better off they're going to be, correct?

MR. OSMOND: Yeah. They may be able to manage, but a lot of it is due to weather conditions and so on.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: That can spike up or down.

MR. HUTCHINGS: Yeah. I mean, I don't think anyone is assuming away the Rate Stabilization Plan in this situation, so there is a number of weather elements that are looked after in that calculation, correct?

MR. OSMOND: Uh hum. In the calculation of?

MR. HUTCHINGS: Of the RSP?

MR. OSMOND: Yes.

MR. HUTCHINGS: Okay.

MR. OSMOND: Not weather, I mean, weather in the sense of hydrology.

MR. HUTCHINGS: Yes.

MR. OSMOND: Yes, okay. It's not weather adjusted.

MR. HUTCHINGS: No, it's not weather adjusted, but in the sense of the hydrology and the amount of oil that's burned?

MR. OSMOND: Water available, yes.

MR. HUTCHINGS: Alright, so beyond those two issues, in terms of the abuse of generation and the volatility, are there any other issues that Hydro sees as constituting impediments to the demand energy charge?

MR. OSMOND: Bear with me for a second. I don't see anything coming right off the page now. There are other issues I was trying to find and I couldn't find them.

MR. HUTCHINGS: Okay. I think it's dealt with in both **IC-239** and **PUB-68**, if either of those references help you.

MR. OSMOND: Yes, I see it. I see RFI, yeah.

MR. HUTCHINGS: Yes, okay. Is there anything that you wish to add on that basis?

MR. OSMOND: No.

MR. HUTCHINGS: Okay, that's fine. On another subject now, Mr. Osmond. We spoke briefly yesterday about the EPR. Were you able to get any additional information about Hydro's involvement in that overnight?

MR. OSMOND: Yeah. After we met here ... after we cross-examined, I should say, I called Mr. Wells last night just to see if there's any new information as it relates to the EPR, and what he basically said to me is that he did receive a draft copy of an EPR probably seven to ten days ago, and that was the document that he received from Mines and Energy for internal comment and it was developed ... and departmental review for comments going back to government, not necessarily the final comments before it goes out for further review, and we hadn't seen it ourselves because we've primarily been involved in this rate hearing for the last four or five months, so he had an initial draft only that he was going to review and provide initial comments just back to the Department of Mines and Energy. I don't think at this stage it has public release for comment, so that's all that I was able to obtain last night after I spoke to him.

MR. HUTCHINGS: Okay, but prior to that occurring seven to ten days ago, there had been no activity for a number of years involving Hydro?

MR. OSMOND: Within Hydro, as far as I ... not within Hydro. As far as I know, I presume the process was ongoing in Mines and Energy but that's a presumption of mine. I presume they were ongoing with that over the last three years, but there was no major activity within Hydro, to my knowledge, as it relates to the EPR.

MR. HUTCHINGS: Alright. You had some discussion yesterday with Ms. Butler about the efficiency of the Holyrood facility and the efficiency factors, and from the look on your face you remember that with some amusement?

MR. OSMOND: Yeah, I remember it, yeah.

MR. HUTCHINGS: Looking at those numbers, you know, from ... I think one of the numbers that came up as an actual in recent years was around 611 gigawatt hours per barrel versus the 605 that was on the previous cost of service, and that represents, roughly, a one percent increase in efficiency. Is that fair?

MR. OSMOND: That's correct.

MR. HUTCHINGS: Okay. Is it fair for us then to look at that one percent increase in efficiency as representing a one percent decrease in your fuel costs for Bunker C?

MR. OSMOND: I think Mr. Henderson has factored in 610 kilowatt hours into his fuel runs for 2002.

MR. HUTCHINGS: No, I understand that. I'm just trying to get the effect here.

MR. OSMOND: Oh, yes, there would be.

MR. HUTCHINGS: Okay, so if, in fact, the 622 number, which is the recent one that has been touted that has come up, I mean, that's closer to two and a half percent, isn't it?

MR. OSMOND: Yes.

MR. HUTCHINGS: Yeah, and we're talking roughly $100 million?

MR. OSMOND: For fuel?

MR. HUTCHINGS: For Bunker C in the test year?

MR. OSMOND: Yeah. The fuel is around $100 million. Conversely, if it went the other way, if we didn't get the generation that we expect at 610 back to 600 then you'd have the other, the opposite impact.

MR. HUTCHINGS: Right. No, no, I quite understand that, but, you know, this two and a half percent that we're talking about could represent two and a half million dollars?

MR. OSMOND: If we were sure that the efficiency was 622, yes.

MR. HUTCHINGS: Yeah.

MR. OSMOND: Your comparison is right.

MR. HUTCHINGS: Yeah. Has there not been recently work done on these units with a view to making them, in fact, more efficient?

MR. OSMOND: I guess we're always working on the units over the last three or four years, but as Mr. Henderson explained in the table we saw yesterday, I guess, we've looked at the operating efficiency. A lot of the efficiency is driven by how often you use the units.

MR. HUTCHINGS: Yes.

MR. OSMOND: I'm right out on a limb again now. How often we use the units, and if we have a very dry year you're using the unit ... it's like driving a car, the more you use it the more efficient it is.

MR. HUTCHINGS: Yes.

MR. OSMOND: The more it's in the driveway the less efficient it is, so if it's a very dry year the units are run more efficiently, so you'd have higher kilowatt hours per barrel.

MR. HUTCHINGS: Yeah, and ...

MR. OSMOND: If you have a very wet year it's the exact opposite.

MR. HUTCHINGS: Yeah, exactly, and you've done a five year average over the last five very wet years to come up with your 610?

MR. OSMOND: Well, 2001 has been very dry.

MR. HUTCHINGS: Yes, but that's not in there yet?

MR. OSMOND: No, but I think Ms. Butler asked for that yesterday.

MR. HUTCHINGS: No, no, I understand that, but the 610 has been an average of `96 to 2000?

MR. OSMOND: It has been.

MR. HUTCHINGS: Which are very wet years?

MR. OSMOND: Well, `96 to `99, I think. I could be wrong. Maybe it is 2000.

MR. HUTCHINGS: Okay, so it's `95 to 1999?

MR. OSMOND: `95 to `99.

MR. HUTCHINGS: I guess, if it's five years.

MR. OSMOND: I just judge by what I saw yesterday.

MR. HUTCHINGS: Yeah, okay, but you will agree with me that we're talking about, historically, five of the wettest years?

MR. OSMOND: They were wet years. I'm not sure if they were the wettest years, but they were wet years.

MR. HUTCHINGS: No, okay, but they were very wet years?

MR. OSMOND: They were wet years, yeah.

MR. HUTCHINGS: Yeah, so I mean, how is it that we should be relying on those wet years in order to come up with the number that we use in an average year?

MR. OSMOND: Well, I guess Mr. Henderson, and he certainly explained that ... will explain it better, had explained it better than I. You try to use it based on your operational efficiencies over a period of time. The five years we've looked at were the last five years which happened to be wet. It's difficult then to take the 2001 number, whatever that might be, if it's higher than that, and project that for 2002, because it's so heavily driven by the generation of the units driven by water. If we have more rain or less rain then Bay d'Espoir use the units more or less.

MR. HUTCHINGS: I mean, I understand the difficulty in projecting on the basis of a single year, but would you recognize the difficulty in using five admittedly biased years to produce an average to project?

MR. OSMOND: Well, I don't know if I would call them biased years.

MR. HUTCHINGS: Well, they're wet years.

MR. OSMOND: Yeah.

MR. HUTCHINGS: And you've just told me that the units are less efficient in wet years.

MR. OSMOND: Yeah. I think we have to use ... I think we've done that before in previous hearings, the five years of record, the most current five years of generation record.

(12:15 p.m.)

MR. HUTCHINGS: Okay. I see your position. Just on the subject of oil costs, generally. You've had some discussion, again, with Ms. Butler on that. She was attempting, I guess, to determine who ultimately was responsible for the fuel costs and how they were managed. I have one, I guess, area to deal with that in that, and that was something that you discussed with her a little bit, as well, was this question of hedging.

MR. OSMOND: Uh hum.

MR. HUTCHINGS: And you referred to options and futures in the course of your evidence about that. Can you explain, on the record, how futures work?

MR. OSMOND: Well, I guess some of the things I referred to looked at futures and swaps and options and so on, and this gets really technical. I had to go back again last night to make sure I had a general idea of what it's all about, but I guess the whole purpose to oil price hedging, and that's a group, we started that probably back in 1998 to see if there was any merit to a hedging program, and we had a small group established with our treasurer and our operations people to see if it made any sense to go forward on a hedging program, because the whole policy goal of any hedging program was to protect consumers from any adverse impact or spikes in fuel prices and to minimize any costs associated with providing electricity to them. And what we looked at, and our treasury people looked at with our financial people, were what options are out there to do that, and some were swaps, some options and some collars. And just to explain what a swap is, and some of it gets technical so I hope I don't go right over everybody's head, but the swap is really, you know, it's a private contractual agreement between two parties, and it's to exchange periodic payments in the future based on agreed to formulas, and swaps are essentially equivalent to a series of forward contracts that are packaged together, so it's trying to put a mechanism in place for protection, but we put a swap in because it's another mechanism to ensure that there's a balance of impact. What we want ... we did not want to get into speculating or trading, that's one thing we were concerned about, and the call option, I mean, that's really a right to buy or lock in a purchase price as referred to as a call option because the call buyer has the right to call the underlying assets from the buyer ... or the seller during the life of the contract. So there's financial instruments that could be used, but there's a cost and a risk associated with each one of them, and we had done what we call sort of a phantom hedge over a year or so and we have that filed with a part of our analysis, as I agreed to yesterday, just mimicking what if we had to go with this type of process, what would the advantages be and disadvantages, the risks, would you win or lose. I think you'll see in that scenario that there could be a win or lose in one particular year with the price of fuel going up or down, but inherently there's a cost associated with doing that, and I think I mentioned yesterday it's around 50 cents a barrel. I was wrong in that, it's not 50 cents a barrel, it's probably closer to five to ten cents a barrel. It's like an insurance cost, but that's just the cost of the program, but then you also you don't want to get into speculating and trying to estimate where the price of fuel is going, so that's the general theory behind the whole hedging program.

MR. HUTCHINGS: Yeah. I mean, as I understand it, you know, these are as you refer to them, financial derivative products, and they don't affect your actual purchase of oil or the delivery of oil at all? These two things go on on two separate paths, it's just that one is intended to offset financial consequences of the other?

MR. OSMOND: That's right. The delivery is not tied into that, it's the actual dollars you have to pay in putting in these measures to make sure you're doing it effectively and at the best price.

MR. HUTCHINGS: Yeah.

MR. OSMOND: Without running a risk.

MR. HUTCHINGS: But the way you're doing it now, as I understand from Mr. Henderson, is that you're paying the price that exists at the date of delivery?

MR. OSMOND: That's correct, and that's in US dollars.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: But what treasury also do at that point in time, they look forward and say, well, can we buy US dollars cheaper than that rate.

MR. HUTCHINGS: Yes, okay.

MR. OSMOND: And we've done that, and we do that.

MR. HUTCHINGS: Yeah. I mean, that's hedging your currency risk?

MR. OSMOND: Exactly.

MR. HUTCHINGS: Yeah. That's fine, that's a separate thing and that's obviously something should be done, but in terms of the price of the oil itself, you know, your system means that you are subject to the risk of whatever the price happens to be on that day that the ship arrives, correct?

MR. OSMOND: Well, not necessarily on that day. One of the things that came out of the oil price hedging review is that we averaged ... we pay now for the average in the month. We use to pay, as you said, based on the actual fuel delivery. Now whatever fuel comes in January, if we got two shipments or three it's the average for that month that we pay.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: As opposed to on that particular day.

MR. HUTCHINGS: Yeah, okay, but I mean, what the futures would allow you to do, as I understand it, would be to place your order for Bunker C in July and fix your price effectively?

MR. OSMOND: You could, you could lock in.

MR. HUTCHINGS: Yeah, okay.

MR. OSMOND: But then there's the price goes up or down, those callers that you may, you may win or you may lose.

MR. HUTCHINGS: Yes.

MR. OSMOND: That's the risk.

MR. HUTCHINGS: But you know then what your price is?

MR. OSMOND: Oh, you could, yeah.

MR. HUTCHINGS: Yeah, okay.

MR. OSMOND: If the market conditions change you may not take advantage of an opportunity.

MR. HUTCHINGS: Yeah.

MR. OSMOND: That was the big concern of risk that we are concerned about, and that's why we didn't put it in this time. We're going to continue to monitor for this year and next year and it may be an issue coming back for the 2003 hearing after we got another year behind us a to how it's actually working and whether there's merit to going that way.

MR. HUTCHINGS: Alright. I mean, I think we've both agreed that these are sort of convoluted financial instruments that we're dealing with here. I mean, do you have expertise inhouse that could deal with that?

MR. OSMOND: We have some. Certainly our treasury people and our treasurer has been involved in that quite extensively as well as in operations, and we have some contacts with our financial people as well, so I think the network is there. I think we need to be able to monitor forward and just see if there's merit to going the next step.

MR. HUTCHINGS: So in terms as things stand now of how you manage oil purchases, basically you purchase oil when you see the need to have oil on a short-term basis?

MR. OSMOND: Yeah. Mr. Henderson looks at the generation. He sees the load forecast, he sees the generation for a period of time. We have to order the fuel. I think it takes about six weeks to order it, to get it in, and based on that, then the fuel is ordered. Then we look at how it's going to be paid for. Right now we look at trying to buy forward and protect ourselves in the US dollar side.

MR. HUTCHINGS: Yes.

MR. OSMOND: And then it's purchased. We don't stock up in the summertime. We buy enough for the particular capacity for the units.

MR. HUTCHINGS: And your storage capacity, I think, is in the range of 700,000 barrels?

MR. OSMOND: I think it's about, roughly, 800,000 barrels.

MR. HUTCHINGS: Okay.

MR. OSMOND: Approximately.

MR. HUTCHINGS: And when did you last add storage capacity?

MR. OSMOND: I don't think we've had a storage capacity in my time, but I could be wrong. I think it's pretty well been 800,000 barrels back to the `80s.

MR. HUTCHINGS: Okay.

MR. OSMOND: Late `70s. I don't think that's changed but if I'm wrong I'll let you know after lunch.

MR. HUTCHINGS: Alright, so 20 years and widening?

MR. OSMOND: Yes.

MR. HUTCHINGS: Have you looked at adding capacity?

MR. OSMOND: Well, that's not in my area. I don't know if Mr. Henderson has done that or not, or operations.

MR. HUTCHINGS: Okay. I mean, would you ...

MR. OSMOND: We carry enough, I think, to try and ... it takes about six weeks. We've got enough storage there ... I think, we go through about 15,000 barrels a day at full load, so there's enough storage there to get us through the next shipment without carrying an inventory at a high level. We're trying to minimize the level of inventory but have it so we got enough for the shipments to come in, it's based on that.

MR. HUTCHINGS: So the level of your inventory is decided purely on an operational basis, not on an economic basis?

MR. OSMOND: Well, that's certainly factored in, otherwise you're going to speculate on what you should actually buy early or not and fill up your tanks. It's based on what ... the 800,000 barrels and what we expect to generate and how long it will take to get another shipment in to replace that.

MR. HUTCHINGS: Uh hum.

MR. OSMOND: Okay. In the wintertime that might be two shipments, that might be 500,000 barrels, so we got 800,000 in reserve.

MR. HUTCHINGS: So there has been no balancing of the notion of, you know, the cost of storage and the carrying costs of inventory against the potential benefits of purchasing in advance, from a price point of view?

MR. OSMOND: I haven't seen any detailed analysis on that.

MR. HUTCHINGS: Okay. I mean, would you agree with me that that would be a very different sort of analysis, say, in around the early 1980s when fuel prices were relatively lower and interest rates were extremely high and today when fuel prices are generally higher and interest rates are extremely low?

MR. OSMOND: Yeah. Well, I guess with fuel prices there's no guarantee which way they're going to go.

MR. HUTCHINGS: No.

MR. OSMOND: They're going to go up or going to go down, so you have to factor that into your equation in your analysis of putting in additional storage.

MR. HUTCHINGS: Yes, but, I mean, if you're in a position to fix an interest rate in respect of your capital cost then the only other variable is the fuel price, correct?

MR. OSMOND: That's right.

MR. HUTCHINGS: Yeah.

MR. OSMOND: And whether they want to carry that inventory.

MR. HUTCHINGS: Yeah, okay, but that ...

MR. OSMOND: You try to tailor it, I think, in operations, tailor it to what you actually require to run that plant and not have a surplus there.

MR. HUTCHINGS: You haven't approached that issue of ... in economics?

MR. OSMOND: I haven't personally, no.

MR. HUTCHINGS: And you're not aware that anyone in Hydro has?

MR. OSMOND: Not to my knowledge.

MR. HUTCHINGS: Okay. Alright. I think I may be about at the end, Mr. Chair. Can I reserve until 2:00 to tell you whether I have any additional questions?

MR. NOSEWORTHY, CHAIRMAN: Absolutely. Thank you, Mr. Hutchings. Thank you, Mr. Osmond. We'll reconvene in at 2:00.

(break)

(2:00 p.m.)

MR. NOSEWORTHY, CHAIRMAN: Good afternoon. Mr. Kennedy, are there any preliminary items? I guess there are some.

MR. KENNEDY: Yes, Chair. I believe Hydro is reporting on its position on undertakings and other matters.

MS. GREENE, Q.C.: Thank you.

MR. NOSEWORTHY, CHAIRMAN: Good afternoon, Ms. Greene.

MS. GREENE, Q.C.: Good afternoon, Chair and panel members, the first thing that I'd like to address is the list of undertakings from yesterday, November 19th, and a copy of this list of undertakings has been circulated during the break. I also have distributed a copy of a piece of paper with a heading, "price of diesel fuel used, October 31, 2001, update, and current price of diesel fuel". That is the second sheet of paper that was distributed during the break, and that sheet of paper responds to two of the undertakings that were given yesterday. You will see that the first undertaking from yesterday related to the equal billing project. The second was an undertaking given to counsel for Newfoundland Power, where she asked Mr. Osmond to advise of the price of diesel fuel that was used in the October 31st update. That was filed on October 31st. The third undertaking related to today's price for diesel fuel, and the second sheet of paper that I just referred to contains both of those pieces of information. If you look at the table in the middle you will see the price of diesel fuel as filed for 2001 in May, and as revised in October is shown along with those same figures for 2002. This sheet of paper also contains the comparable price, which is the last line, which is as of early November. The comparable price was 40 to 41 cents per litre, and that compares to the 50 cents revised in October for 2001, and the 45, or 45.5 that was revised in October for 2002. So the second, and I guess this should be marked.

MR. KENNEDY: U-Hydro No. 28.

U-HYDRO NO. 28 ENTERED

MS. GREENE, Q.C.: The next two undertakings being the efficiency factor for Holyrood and the information on the oil hedging review will be filed later, and the last undertaking related to the current status of the Energy Policy Review, and I believe Mr. Osmond advised of the ... in questioning by Mr. Hutchings this morning. The other thing that I wanted to mention at this time concerns the third document that was circulated during the break. It is an application by Hydro to deal with the proposed 2002 capital budget. You will recall that I mentioned last week that this was an issue of concern to Hydro. It is now clear that we will not finish this current proceeding prior to year end which will allow the Board to give an order prior to December 31st of this year, and we are proposing therefore to deal with certain items in the capital budget as soon as possible, and I know you will not have had the opportunity to review the application so I will not obviously review it at this time, but the intent of the application is to ask the Board to deal with those matters to which no party takes an objection, as we are aware at this time, and to delay those capital projects where a party wishes to make an argument until after. My understanding from discussions with the other counsel is that approximately 65 to 68 percent of the capital budget is not opposed by any of the other parties, but that the remaining ones, some of the parties would like to make submissions on, and of course, that depends on the party as to which projects they would like to submission *(sic)* on. So the intent of the application is to ask the Board to proceed with those matters in the capital budget that are not objected to or on which the other parties do not take a formal position. Thank you, that concludes my comments.

MR. NOSEWORTHY, CHAIRMAN: Thank you, Ms. Greene.

MR. KENNEDY: Chair, I can advise the panel, it was the intention of counsel to meet today, one of the counsel has a scheduling conflict that has made that impossible, so the earliest we're going to be able to meet is tomorrow, with the intention of trying to determine how much of a consensus there is regarding the capital budget application and also then the scheduling, the impact on scheduling that they may have, and then we'd report back to the panel on the outcome of that meeting. In light of the fact that the meeting itself won't take place until tomorrow, I won't be able to report formally back to the panel until Monday morning at the commencement of the cost of service week, if that's appropriate.

MR. NOSEWORTHY, CHAIRMAN: That's fine, in the meantime, that will give us an opportunity to review the contents in any event and consider the matter, I suppose, from a strategic scheduling point of view as well in terms of our own timing things. Okay, thank you very much. Moving ... good afternoon, Mr. Osmond. Good afternoon, Mr. Hutchings. Do you wish to exercise your prerogative to ask more questions now?

MR. HUTCHINGS: I just have one matter that I'd like to clarify with Mr. Osmond, Mr. Chairman, thank you.

MR. NOSEWORTHY, CHAIRMAN: Thank you.

MR. HUTCHINGS: Good afternoon, Mr. Osmond.

MR. OSMOND: Good afternoon, Mr. Hutchings.

MR. HUTCHINGS: I am told that you and I, at least on one point, have not made ourselves entirely clear to the assembled personages here, so we'll just go back over one very small point which is fortunately or unfortunately related to the Rate Stabilization Plan. On **IC-286**, and the, particularly the little chart at the end of that which is the last page there, and this, you will recall from this morning, is the attachment to the letter from Mr. Sturge to Mr. Deane, dealing with the activity in the Rate Stabilization Plan, specifically in the month of January of 1993. I think it's clear in the letter from Mr. Sturge that the differences shown in respect of energy on this chart, the 33 gigawatt hours for Newfoundland Power and the six gigawatt hours for the industrials, those are changes from the 1982 cost of service numbers.

MR. OSMOND: '92.

MR. HUTCHINGS: 1992, sorry, yeah. Is that your understanding as well?

MR. OSMOND: That's my understanding, yeah.

MR. HUTCHINGS: Okay, the four megawatts in the second line for non-coincident peak, am I correct in saying that that also is four megawatts over and above the number in the 1992 cost of service?

MR. OSMOND: That's my understanding, without going back to the details, both would be references to the cost of service.

MR. HUTCHINGS: Yes, so the comparison is with the 1992 cost of service as opposed to the 1993 forecast.

MR. OSMOND: Yes.

MR. HUTCHINGS: Yes.

MR. OSMOND: Yeah.

MR. HUTCHINGS: Okay, that's the only point I wanted to clarify, thank you, Mr. Osmond.

MR. OSMOND: You're welcome.

MR. HUTCHINGS: Thank you, Mr. Chair.

MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr. Hutchings. Thank you, Mr. Osmond. We'll move now to the Consumer Advocate and your cross-examination, Mr. Browne or Mr. Fitzgerald.

MR. FITZGERALD: Thank you, Chairman, actually both myself and Mr. Browne will be examining. I'll start off ... good afternoon, Mr. Osmond.

MR. OSMOND: Good afternoon, Mr. Fitzgerald.

MR. FITZGERALD: Just briefly on the area of the return on equity referring back to your evidence yesterday, and this issue of the three percent that Hydro has actually applied for. I think you've indicated that that is the application, you're applying for a three percent return on equity despite the fact that your financial advisors have given you a substantially higher figure than that.

MR. OSMOND: That's correct.

MR. FITZGERALD: That's correct, and did I understand it correctly that the rationale for not following their advice, if I could put it that way, was that you felt, or not you, but Hydro felt that the cost of No. 6 fuel was burdensome enough for the test year without compounding the problem with a request for an increased rate of return on equity. Is that a fair summation of your position on that?

MR. OSMOND: Pretty well. We felt after reviewing all the numbers, primarily the overall rate increase which is driven by the price of fuel, plus any phase-out in rural preferential rates, that with those magnitudes, and what the increase would be if we put all of those through, it was just too horrific, it would be a major rate shock, and what we then did is review what we thought would be appropriate as a temporary measure and that's how we decided on the three percent ROE. The financial advisors did recommend a much higher return, and when we looked at that, that was approximately, I think, a six percent further increase in rates if we had to go with the ROE alone, and that combined, if we had to go with a full rebasing *(phonetic)*, it would have been another, I think, 16 percent, so the numbers were very, very large, so our approach was to come in with a lower ROE just for this year, and then come back at our next application and recommend a more appropriate ROE at that point in time.

MR. FITZGERALD: Okay, that was a sensitivity to rate shock, is another way of putting that.

MR. OSMOND: Yes.

MR. FITZGERALD: Now, Ms. McShane, when she testified here, she, her advice included, and I can take you to that now, and maybe we should have it up on the screen actually, it's Ms. McShane's evidence at page 55, okay, at lines 1 to 5 here. The question was put to Ms. McShane, the Board has traditionally expressed, that's at line 2 there you'll see, the Board has traditionally expressed the allowed return on rate base in terms of a range. Is such a range appropriate for Hydro? Her answer is no. Now I'm curious. If Hydro is sensitive to rate shock for 2002, it seems to me it would be a consistent approach to have a cap, say if the rate of return drifted up during the test year, to protect against the horrific circumstances you've just described.

MR. OSMOND: I think Ms. McShane though, when she testified subsequently, talked about the cap and the fact that Hydro is going to be back in 2003, which is a little over a year away, and it is not foreseen there'd be any major event that would certainly put us beyond the three percent earnings that we're projecting for that year, and that we'd have an application in 2003 for a 2004 test year.

MR. FITZGERALD: Okay.

MR. OSMOND: So it's a one year horizon.

MR. FITZGERALD: Alright, if I could ask you to go to page 6 of your testimony, your first pre-filed version, line 12 of page 6.

MR. OSMOND: Yeah.

MR. FITZGERALD: Okay, here, this is one of the aspects of your request, or Hydro's request. You say that we ask that the Board make it clear that Hydro should be allowed the opportunity to earn an appropriate ROE as outlined by Hydro's financial advisors. Now Hydro's financial advisors, of course, have given us a figure. You have rejected that figure.

MR. OSMOND: Uh hum.

MR. FITZGERALD: However, you are asking that the Board accept some aspect of your financial advisor's advice, if I can put it that way, and what I'm asking you is whether you feel it's appropriate that the Board should do its normal thing, and that is if it does set a rate of return on equity that it be capped and be in a range.

(2:15 p.m.)

MR. OSMOND: I don't think that would be necessary. The three percent is a very low end of the range. As I mentioned earlier, that we anticipate being back in 2003 for a 2004 rate application. It's only a year away, and we do not expect events to take place in that one year that will significantly put us beyond that band of three percent.

MR. FITZGERALD: Why was the three percent figure chosen then?

MR. OSMOND: The three percent number, we had looked at that, we looked at the overall, as I mentioned, the overall revenue requirement, the impact on rates that we had to put forth the full view ... the phase-out of the rural deficit and going with the full 11 1/2 percent ROE, the increases would be, and we looked at what we thought would be appropriate as a temporary measure only, considering we'd be back in a year's time, or a year and a half's time, to come back in 2004 with Granite Canal coming on, that three percent would be a reasonable level at this point in time, which worked out to be about six percent for Newfoundland Power and ten for industry. We thought that was a reasonable level and we could get through for this year, for 2002, and carry us into 2003 for our next application.

MR. FITZGERALD: So you're suggesting that the Board should not cap with such a low request of a rate of a return of three percent.

MR. OSMOND: That's my feeling.

MR. FITZGERALD: Okay.

MR. OSMOND: I think Ms. McShane pretty well said the same thing.

MR. FITZGERALD: Hypothetically then, what if you had selected a six percent rate of return on equity, which again would be lower than your financial advisors, but presumably since you chose three percent as the figure, so it wouldn't compounded with the price of No. 6 fuel, that there must have been some thought process that a figure higher than three just might compound the problem.

MR. OSMOND: Well, if you're looking at six percent, it's a much bigger number, obviously, but I think the same events would unfold as well. You're looking at a very short timeframe, which is just one year, and looking at what we know presently with regards to ... we're going with our operating costs, we're going with our forecast load as well as fuel price. Events would have to change dramatically to have any significant impact on the return on equity. I could see it if it was a longer period of time, but one year when we're coming back is not a long period of time.

MR. FITZGERALD: Okay, well maybe it's just a philosophical difference. I think Ms. McShane at one point said if the Board chooses to put on a cap, then that might be an overabundance of caution, but she invited them to. What's your view on that?

MR. OSMOND: Well it's the Board's decision, I mean the Board at the end of the day ... I mean they're the end, they make the final decision at the end of the day whether a cap is appropriate ... also, whatever rates we have proposed, if that's appropriate as well. I was expressing my opinion with regards to Hydro, but the Board at the end of the day makes the final decision.

MR. FITZGERALD: I'd like to turn if I could, Mr. Henderson to ... sorry, I'm reading from my notes here ... Mr. Osmond. You have more hair.

MR. OSMOND: Pardon?

MR. FITZGERALD: You have more hair than Mr. Henderson.

MR. OSMOND: He's a lot younger though.

MR. FITZGERALD: It's not fair sometimes, is it.

MR. OSMOND: I won't go there.

MR. FITZGERALD: We have learned through the testimony that Mr. Henderson is responsible for the budgeting of No. 6 fuel for Hydro, that's a fact.

MR. OSMOND: Yes.

MR. FITZGERALD: And we also know it's fundamental that the price of No. 6 fuel in the test year is going to be something in the range of $104 million with the revised, Mr. Roberts' ... yeah.

MR. OSMOND: Yeah, that sounds about right.

MR. FITZGERALD: And it goes without saying, of course, that the price of No. 6 fuel is one of the main components of Hydro's rate application this year. I think Mr. Wells has expressed that clearly on the stand and in the pre-filed evidence that it's the major component of this application.

MR. OSMOND: It's the driving force.

MR. FITZGERALD: Yes, now Mr. Henderson is the Manager of Systems Operations, correct?

MR. OSMOND: Yes, he is.

MR. FITZGERALD: Now would it be fair to categorize his department or classify his department as a production department?

MR. OSMOND: Yes, in the sense that they're responsible for the generation on the island from the different facilities, generation through Hydro as well as through thermal and gas turbines.

MR. FITZGERALD: Okay, so when we look at Mr. Henderson's evidence, when he tells us that he's, he's in charge of, if I could put that way, of the budgeting of No. 6 fuel.

MR. OSMOND: Uh hum.

MR. FITZGERALD: That really is to say that he is responsible to define Hydro's need in any given year for a certain quantity of fuel, is that correct?

MR. OSMOND: Yes, he looks at the load forecast as provided to him from our industrials and Newfoundland Power customers and the requirements for that in the short-term and longer-term, more so in the short-term, and to decide where that source of energy is going to be provided from. Could it be from hydro or is it going to be from thermal. If it's from thermal then he has to look at what requirements we presently have in our tanks at Holyrood, and what timeframes he would need to get sufficient tankers in to unload to have that fuel available to supply the energy from thermal to supply our customers.

MR. FITZGERALD: So he being a more, if I can put it this way, production orientated, the actual purchase price of the No. 6 fuel is not really an issue that he needs to concern himself with, is it?

MR. OSMOND: I guess he's involved with the production side. He is aware of the price we have to pay, and that he's aware and involved in the contract with Westport. He's involved with the requirements for that Westport contract for the supply of fuel, so he's aware of the pricing, but his main emphasis would be in getting the quantities of fuel that's required for that facility on time.

MR. FITZGERALD: To keep the system going.

MR. OSMOND: To keep the system running, yes.

MR. FITZGERALD: That's his job, yeah. If I can go to yesterday's transcript at page 37, particularly line 63, I think it is on the electronic version. Okay, here, Ms. Butler on behalf of Newfoundland Power, asked you the question, "Now within Hydro then who is ultimately responsible for the purchase of fuel and minimizing the cost associated?", and your answer, "I guess, as Mr. Henderson said the other day, he is directly involved with the purchase requirements and he sees things going for the next 12 months based on load forecasts". Now if I could now ask, Mr. O'Rielly, if we can go to the transcript from October 11th, page 16, line 17 there ... or line 14 sorry, and here Mr. Osmond, I asked Mr. Henderson about this issue and I asked him, "Did I understand yesterday in your evidence that you indicated that the price of No. 6 is really not your concern, not that it's not Hydro's concern, but it's not your department?". He responds, he says, "I'm kept apprised of the price.", but if you could look at line 23 and take a moment to look at the context there, he says, "I am involved with those discussions, but it's not, it's not my decision per se". And further down in that same excerpt, Mr. O'Rielly, if we could go down to line 35, again Mr. Henderson told us, "The price that would be set on this is when you actually see the fuel there (inaudible), that's the type of business that they wouldn't be making *(phonetic)*. That would be a decision made by involving higher levels of management". So when I combine those two pieces of information, what Mr. Henderson told me, and what you indicated to us yesterday, I am wondering if you can steer me to the correct person who is actually obliged or given the task of purchasing No. 6 fuel.

MR. OSMOND: Well the actual purchasing of No. 6 fuel, the actual purchasing itself comes from our materials management department. They're the ones who are involved in the contract in conjunction with the operations people. Sorry, the actual physical contract is done through our materials management group, the purchasing group, so they actually specifically issue the tender and the prices are directed through that contract, the discounts, and they're tied in, as Mr. Henderson said, to the posted weekly price in New York and so on, and then we pay based on the monthly average of what is being received ... can you hear me better? Sorry ... so that's the process that's followed. Mr. Henderson orders it. It comes from materials management. We as finance, and I guess in my responsibility, I'm also responsible too to make sure that we have an input into it to ensure that we are buying at the lowest cost too, and our input into it too, in one aspect of it is the fact that everything is bought in Canadian dollars, so we try to look forward and, say, try to maximize the exposure on interest and we buy some of those forwards to reduce the interest cost, and the other thing, as we just talked about the other day, is that we're also looking at the oil price hedging, but I guess to answer your question, it really comes back to Mr. Henderson's area in conjunction with materials management and in finance as to the responsibility for the purchasing and the acquisition of fuel.

MR. FITZGERALD: Okay, but as I understand it, what we just spoke about, Mr. Henderson is responsibility *(sic)*, or his responsibility is limited to defining what Hydro's need is when it comes to No. 6.

MR. OSMOND: (inaudible).

MR. FITZGERALD: Okay, but he is not directly involved in the purchasing of the fuel itself.

MR. OSMOND: No, the actual purchasing itself is coordinated through the materials management department. They do the actual ordering.

MR. FITZGERALD: And is that, Mr. Henderson refers to higher levels of management, and that is up the flow chart, is it from the ...

MR. OSMOND: No, materials management is probably at the same level. It's a purchasing function, so that's headed up by a director of materials management. They would be responsible for physically ordering the fuel, once Mr. Henderson says we need so much and the timeframe for that, they actually order the fuel, and that would take probably six weeks to come in. I think what Mr. Henderson is referring to is the price will be set when ... the type of decision we make, that would be a decision made by upper levels of management. I mean the actual price is dictated by the contract and the market price at the time that the shipments are received, so we don't dictate the price. The only thing, if he's referring to the upper levels of management, there are the odd occasion we may see the price down very, very low, and we may top up our tanks. That would be decided by the next level of management.

MR. FITZGERALD: Okay, well let's talk about the current contract then. I understand from Mr. Henderson's evidence, and I don't think we have to go to it. I think it's already on the record that Hydro entered into a volume only contract for 10 million barrels of oil back in '97.

MR. OSMOND: Just bear with me. That's correct.

MR. FITZGERALD: That's correct, and he also testified, and this is actually at page 14 of his evidence, and I won't take you there now unless you have a problem with my version of it, but he said that at the end of 2000 there were 5.4 million barrels left in this volume only contract.

MR. OSMOND: Okay.

MR. FITZGERALD: Okay, and you have testified that Hydro's average annual or projected ... I shouldn't say projected, no, but their consumption annually would be in the range of three million barrels.

MR. OSMOND: I think that's what Mr. Henderson has in his forecast. For next year I think it's around 3.5 million.

MR. FITZGERALD: Okay.

MR. OSMOND: Something like that.

MR. FITZGERALD: So at the end of 2000 then, it appears that there was probably only about 5.4 million barrels left in the supply contract that you entered into in 1997. 2001 is near an end here now, so I would guess that we're reaching the end of this 10 million barrel contract, is that correct?

MR. OSMOND: It's my understanding, and this is Mr. Henderson's area, another contract would have to be going out in 2002.

MR. FITZGERALD: 2002?

MR. OSMOND: I was reading from my notes. It's pretty close to yours. I think this is June, I think, we had received 6.1 million barrels, I think that was up to June.

MR. FITZGERALD: Okay.

MR. OSMOND: And we had several shipments since then, so there's still about three million barrels that would be left. We're expecting in 2001, six shipments totalling 1.5 million barrels. That might have changed now based on the most recent forecast. These are notes I had back two months ago.

MR. FITZGERALD: Okay.

MR. OSMOND: And so that would bring you up to around 7 1/2 million, so you'd have probably two million leeway before the contract was actually sent out and exercised for 2002.

MR. FITZGERALD: Are you aware of the status of the contract then?

MR. OSMOND: I'm not, no.

MR. FITZGERALD: You're not.

MR. OSMOND: I haven't been involved.

MR. FITZGERALD: You have not been involved?

MR. OSMOND: I have not been involved in the new contract, no, and I'm not sure if that process has started, but they certainly ... if we're up to this point now, that process would have to start and have it out for 2002.

MR. FITZGERALD: Sorry, I didn't get the last comment?

MR. OSMOND: I said that process would have to start the latter part of this year in order to have it in place for 2002.

MR. FITZGERALD: Right, okay, so we're approaching the end of the year, but you're not involved in the negotiations regarding the ...

MR. OSMOND: No, I have not been, no.

MR. FITZGERALD: Could you identify for me the names of the particular individuals at Hydro who would be?

MR. OSMOND: I'd have to get that. I can tell you roughly but I would have to get it over the break. I would think it would be certainly Mr. Henderson, and our director of materials management, and I would expect the, probably the Vice-President of Production would be directly involved, and probably legal. Now there may be others, but I think at least those four. Certainly Mr. Henderson from the supply side, and our director of materials management from the purchasing side, and the VP, which would be Mr. Haynes, plus someone from the legal department. I think that's probably the four key people who would be involved at this point in time.

(2:30 p.m.)

MR. FITZGERALD: Okay, so that's Mr. Henderson, and who is the director of materials?

MR. OSMOND: That's Mr. Fogwell.

MR. FITZGERALD: Mr. Fogwell?

MR. OSMOND: Yeah, Dave Fogwell.

MR. FITZGERALD: And you said your legal department as well?

MR. OSMOND: I think there would be somebody from legal, I'm not sure who would be designated for that, but there would be somebody from legal.

MR. FITZGERALD: And the VP of production ...

MR. OSMOND: Is Mr. Haynes.

MR. FITZGERALD: Mr. Haynes, and is that, that group, is that a separate committee that's struck?

MR. OSMOND: It's not so much a committee, it's a committee ... it's a group that would be involved that are directly impacted by or would be involved in the process of acquiring fuel. Mr. Haynes (inaudible) that he's responsible for Holyrood, and Mr. Henderson is directly involved with the supply and generation for the whole island, and legal is obviously for the legal considerations, and Mr. Fogwell, because he'd be the one tendering the document.

MR. FITZGERALD: To what extent is your department going to be involved in the new contract for the acquisition of oil?

MR. OSMOND: As far as the actual acquisition, we have not been directly involved in the negotiation of the quantities. That would be an operations decision. There may be options that come out of the contract that we may have to look at for financial considerations, what are some options, but historically we have not been directly involved in the contract negotiation process.

MR. FITZGERALD: Now, I note that your counsel has indicated that there will be information forthcoming regarding the information on the oil hedging review. Do you have any idea when that would be available?

MR. OSMOND: We should have something available by the end of this week, as an update, the end of this week, certainly by early next week, an update as to the process we followed and probably showing the several examples of what we've actually looked at over the last year or so.

MR. FITZGERALD: And did I hear you correctly, you mentioned that you had a model or I think you might have referred to it as a phantom hedging?

MR. OSMOND: We went through what we call a phantom hedges, and we sort of went through and said what if we had to go with this approach, with a swap, or with a collar and whatever, how would that actually work out versus the actuals, so we did various scenarios and we tracked that over a period of a year or so. That's what we'll be filing to show what the examples showed versus the actual, and what the implication would be, whether it was a savings or a cost.

MR. FITZGERALD: Okay, and when will the data start, what would be the point of ...

MR. OSMOND: I think it was, the one we were looking at was '98 or '99 flowing into 2000.

MR. FITZGERALD: Now, I think yesterday in your testimony you described hedging as akin, to use my word, to insurance. Is that correct?

MR. OSMOND: Well there is some insurance aspects to it, but it's a whole series of financial derivative *(phonetic)* instruments you can have to put on. When you get into the issue of swaps and futures and put instruments and things of that nature. That's why I thought yesterday when we went through it, it would be useful to put something forward, and Ms. Butler had asked for it, to show what the principles were and to explain some of these terms, which you're doing, and also go give an example as to how it actually unfolded over the last year or so, so that's what we undertake to be taken and filed with the Board.

MR. FITZGERALD: And regarding the hedging mechanisms, did you describe it as a form of insurance?

MR. OSMOND: Well, I guess there is an insurance ... the reason I said that, from the financial advisors, they're saying that there is to a certain degree a cost associated with it, and they refer to it as sort of an insurance, and this is where I refer to the five cents and ten cents a barrel. It's not an insurance per se, like you'd see an insurance policy. There's (inaudible) not an insurance you'd include *(phonetic)*, so that was the reference I was making to it.

MR. FITZGERALD: Okay, and my understanding is that the risk that you're protected from is the high cost of oil, or fluctuating oil costs, is that not the risk that ...

MR. OSMOND: That's the risk.

MR. FITZGERALD: Yeah, right.

MR. OSMOND: And I guess one of the key concerns is if you want to get into trading commodities, you've got to be very carefully what you do to make sure you've got the right levels put in so you're not being overly exposed, and that's why we've gone through the sensitivity to see what could the exposures be, and does it make sense to come back with a proposal to the Board for that type of policy, and that's where we were up to this hearing, and our suggestion was not to put anything in for this year, and to come back ... if it looks viable, to come back with our next application with the recommendation to move forward or not to move forward with the hedging program.

MR. FITZGERALD: The problem with that though, I guess, is that if you're in 2002 about to embark on another supply contract for the purchase of 10 million barrels of oil, which would be what you did in '97.

MR. OSMOND: Uh hum.

MR. FITZGERALD: Then really the hedging experiment, if I can call it that, would be deferred for at least another four years, wouldn't that be ...

MR. OSMOND: I don't know if it would be out for another four years.

MR. FITZGERALD: Well, the 10 million barrels ... in just rough figures.

MR. OSMOND: Oh, I'm sorry, yeah.

MR. FITZGERALD: The 10 million barrels lasted '97 to 2001. You have indicated in your evidence that you don't intend to utilize hedging in this round of negotiations for your supply contract.

MR. OSMOND: Uh hum.

MR. FITZGERALD: Now I don't know what your supply contract is going to be. I'm just assuming that you're going to rely on your past experience and enter a contract that will guarantee you 10 million barrels of oil, No. 6.

MR. OSMOND: I'm not sure of the upper level. It probably would be in that order of magnitude based on historical practice.

MR. FITZGERALD: Right, so ...

MR. OSMOND: And we haven't started that yet, so I can't tell you for sure how many barrels they're looking for.

MR. FITZGERALD: So really there is no imminent intention whatsoever to implement any kind of hedging program for the purchase of oil.

MR. OSMOND: Not immediately, no.

MR. FITZGERALD: No, and likely not for another four years, if ever.

MR. OSMOND: Well, I guess one of the things we do have, we do have some room to be able to consider that once we go out with the actual quantities, what we require, but to do that it would have to be tailored in such a way ... well maybe I shouldn't say that ... no, we would have to come back to the Board, so yes, what we put into the contract would be what we'd require for the next year or two certainly, unless we cut the numbers to just a two year requirement as opposed to a four year to give us that flexibility.

MR. FITZGERALD: Okay, of course, you're not involved in the imminent negotiation for the purchase of oil, so what you've just indicated is speculation.

MR. OSMOND: I haven't been directly involved, that's correct.

MR. FITZGERALD: So is it more likely that the scenario would be that there is going to be an imminent contract for about ten million barrels of oil based on the past?

MR. OSMOND: I guess certainly there will be a contract. I'm not sure what the volumes would be. Certainly based on the past it could very well be in that order, 10 to 12 million barrels based on historical generation at Holyrood.

MR. FITZGERALD: The decision not to implement a mechanism like hedging is a decision ... or you can agree with this statement or not, that will push the risk, if I can put it that way, of fluctuating oil prices on to the consumer.

MR. OSMOND: Push the risk on to the consumer?

MR. FITZGERALD: For fluctuating oil prices.

MR. OSMOND: Well, I guess it depends on which way the hedge would go, if you had the program in place. There's a risk with a hedge as well.

MR. FITZGERALD: Yes.

MR. OSMOND: You can't protect all of your risk, so there could be a cost to the customer. It varies, you may have rising prices, and if the prices fall you could be exposed and not take ... there could be an opportunity that would be lost.

MR. FITZGERALD: Well is it, is it the fact that the Rate Stabilization Plan exists, does that fact alone militate against you considering entering into a hedging mechanism?

MR. OSMOND: The Rate Stabilization Plan certainly is, it certainly buffers us from any exposures. There may be other opportunities, and that's why we started to look at the oil hedging program to see if there were ways of mitigating that to ensure we had the lowest possible price of fuel required. It's not a matter of just buying the fuel and saying we've got three years and we can put it in the plan and just write it off and recover from customers, and there are other things, and that's why we started the process of having a look at the oil hedging program.

MR. FITZGERALD: But your last statement, that is in fact what's happening. There is no buffer to the consumer.

MR. OSMOND: There's no buffer, no, not with regards to the hedging program, no.

MR. FITZGERALD: Right, a hedging program might offer some buffer to the consumer.

MR. OSMOND: It could and it could be the other way. There may be some advantages, there could be some negatives as well.

MR. FITZGERALD: The decision that's been made, I guess, as outlined in your pre-filed, not to consider a hedging mechanism in the near future, was that decision made, in your estimation, in the best interests of Hydro or the best interests of the consumer?

MR. OSMOND: It was trying to consider both the interest of the consumer and of the company.

MR. FITZGERALD: Between those two groups, who would bear the higher risk, vis-a-vis, oil prices?

MR. OSMOND: Well, I guess if there was a hedging program, I haven't thought through the details, but if there's any change in costs, that still would end up in the Rate Stabilization Plan.

MR. FITZGERALD: Oh yes, the cost, but between the two entities, Hydro and the consumers, isn't it obvious that the consumer is more exposed to the risk of fluctuating oil prices than Hydro?

MR. OSMOND: I think it's both.

MR. FITZGERALD: I thought you indicated though that Hydro is buffered.

MR. OSMOND: Well, so is the consumer with the fact that, in the sense that we have the plan that's recovered over a three year period, but either way they're going to have to pay it, we're all going to have pay at the end of the day.

MR. FITZGERALD: Yes.

MR. OSMOND: This trying to buffer and take out the rate shocks, and recover it over a three year timeframe.

MR. FITZGERALD: The obvious question that sort of appears to a layman when you look at Hydro's approach to the purchasing of oil, you know, with the Rate Stabilization Plan in effect, is that Hydro really assumes no risk for the price of No. 6 oil fluctuations, and it's hard to imagine the business motivation that Hydro has to seek the lowest possible price for No. 6 oil on the market.

MR. OSMOND: I agree that we're buffered, whatever price we pay we're held indifferent *(phonetic)*, it goes in the Rate Stabilization Plan.

MR. FITZGERALD: Right.

MR. OSMOND: But I think it's incumbent upon us to make sure we can buy it at the lowest possible cost and do that, so it's not ...

MR. FITZGERALD: That's really a, if I can put it, that's really a moral commitment, isn't it, that's not an economic commitment?

MR. OSMOND: Well I think it's both moral and economic. We need to look at what options, and we have started to, that are available to be able to do that, but considering, not to get into taking on more risk, we have to do it with our eyes open to see exactly how much you would actually hedge, if we decide to go that way, and what the impacts could have on our customers, and that's why we started the, what we call the phantom hedges, to see how they actually panned out, and the two that I've seen over the last couple of years, the six month scenario, one we actually made $300,000, save the customers money, and the other one we actually lost a million, so they can go back and forth depending on the scenarios.

MR. FITZGERALD: I guess we should wait for the figures.

MR. OSMOND: I think when you see that, and we can walk you through that, you'll actually see how it unfolded and what the scenarios were, and how they actually flip-flopped over a period of six to nine months, because one thing we didn't want to get into is trading in the marketplace and gambling. We wanted to make sure we had all of our eggs in a row to make sure it made sense to do it.

MR. FITZGERALD: Well, I guess once burned twice ... because we have a foreign exchange loss that sits there in our rate base. This morning you indicated that on this issue of hedging that you've sought, Hydro has sought advice both internally and externally, did I understand that correctly?

MR. OSMOND: Well, the advice we had was certainly internal with our treasury people and with our production people, and we did have some input from some of our normal advisors that we would normally have, our regular financial advisors as to here's the approach we have looked at and what are some of the options, so we got some advice from our advisors in that regard.

MR. FITZGERALD: Okay, would that include RBC Dominion Securities people?

MR. OSMOND: I'm not sure if it was RBC specifically, it's one or two of our financial people, maybe Scotia, Scotia McLeod or whatever.

MR. FITZGERALD: So you don't have a specific recollection of any, of which financial advisor?

MR. OSMOND: I'm not sure which one. I know we did have some discussions with them with regard to the approach we're taking, and looking at them in the phantom scenario, or phantom hedges, and had some input from them as to how the collars would work, and the swaps would work, and things of that nature.

MR. FITZGERALD: Okay, I wonder if we can go to the transcript of November 1, 2001, page 8. This is Mr. Hall's testimony, line 75, I think, in the electronic version, and here I had asked Mr. Hall in another context about hedging, I asked him ... "The concept of hedging, is that an alternative that could have been presented to Hydro by RBC Dominion Securities?". His response is, "Yes, we always provide financing proposals with hedging. You should be aware that the concept of hedging is a useful one which is simply that you contract today that three or four or five years from now, that you can buy, let's use US dollars ... ", etcetera, etcetera. Now I took it from Mr. Hall's evidence that a hedging mechanism is useful in a four to five year forecasting period.

MR. OSMOND: Uh hum, and I'm not saying it isn't. I'm just saying we've just gone through the phantom ... the analysis phase, if you like to see what the options would be and what would happen if you had to (inaudible). There are a lot of good reasons to hedge, but you have to be very careful what portion you do hedge to make sure you have everything set up appropriately to make sure it works effectively and we're not trading the marketplace.

(2:45 p.m.)

MR. FITZGERALD: In your experience, Mr. Osmond, as Vice-President of Finance for Hydro, are you aware of any other enterprise with the weight and size and scale of Hydro and with the same type of need for No. 6 oil, are you aware of any enterprise or entity that operates, that as a fuel purchasing system, operates the same way as Hydro?

MR. OSMOND: Without a mechanism, a hedging mechanism, you mean?

MR. FITZGERALD: Yes.

MR. OSMOND: Well the two biggest ones, I guess, are New Brunswick and Nova Scotia, Nova Scotia Power. I think New Brunswick has a hedging mechanism, and I haven't explored, I haven't talked to them about that. Other than that, I don't know about the other utilities, whether they have the exact same formula for acquiring fuel as we have.

MR. FITZGERALD: What about local industries, say Abitibi, do you know anything about their fuel purchasing program, how they ...

MR. OSMOND: No, I don't. I don't know if they hedge or not. I haven't talked to them about it.

MR. FITZGERALD: And Mr. Osmond, I want to, related to that, ask you if you have had any communications, written or oral, with any third party since the inception of the Rate Stabilization Plan, or previous to that actually, regarding the effect of the Rate Stabilization Plan and how it may relate to the consumption of electricity by the consumer?

MR. OSMOND: I'm sorry, would you mind just repeating that?

MR. FITZGERALD: Have you had any communications, written or oral, with any third party regarding the effect of the Rate Stabilization Plan and how that plan may relate to the consumption of electricity by the end consumer?

MR. OSMOND: With any third party?

MR. FITZGERALD: It's not a trick question. It comes down to has, do you have any correspondence, any memorandum, have you discussed with any third party the effect of the Rate Stabilization Plan on the consumption of electricity?

MR. OSMOND: As in conservation measures or ...

MR. FITZGERALD: What the effect is, whether ... does it create overconsumption, underconsumption, is there a neutral effect?

MR. OSMOND: I haven't, but our economic analysis department do look at the impact on rates, including the Rate Stabilization Plan and how that factors into load and impact on customers' consumption, if that's what you're thinking of, and how the change in rates and Rate Stabilization Plan, change in fuel, does factor into customers' consumption, whether it goes up or whether it goes down. Is that what you're thinking of?

MR. FITZGERALD: Well, I'm just wondering if you have any.

MR. OSMOND: So, no, I know that's part of their normal routine and they would look at, they ... I forget the term that they use, but they look at the impact of changing in rates, changes in cost as to what impacts the patterns that customers' consumptions would change depending on the change in rate structure, be it up or down, and what that does to the load. Historically, if your rates go up, we have normally found that consumption starts to decrease because costs are getting higher, so that would be part of the economic analysis group that would look at that type of thing, it's an ongoing thing.

MR. FITZGERALD: So in this case, or in the case generally of consumers since 1992 that price really hasn't gone up.

MR. OSMOND: Other than the RSP adjustment.

MR. FITZGERALD: Which is a slower response.

MR. OSMOND: Yeah, but it's still a cost to the customer. You're right, the actual base rate from Hydro hasn't gone up, but the RSP adjustment would have changed every year, which would be a cost to the customer that may impact some of their consumption patterns.

MR. FITZGERALD: And for the record then, can you confirm that Hydro has disclosed every document in its possession, or which it has control over, related to the relationship between the Rate Stabilization Plan and its effect upon the consumption of energy?

MR. OSMOND: I'm not sure what you really mean ... every document that we've had ...

MR. FITZGERALD: Any studies that you may have, been provided to you by consultants, advisors.

MR. OSMOND: I'm shaking my head because I don't think we've had any studies specifically, other than the ones I've mentioned done internally, and that's just part of the normal load forecasting to see if costs or rates go up, what impact would that have on load patterns, so other than that I can't recall any documents that I'm aware of that would have been issued internally or externally as to the Rate Stabilization Plan.

MR. FITZGERALD: The internal documents, would I be able to find those if I waded through the RFIs?

MR. OSMOND: The internal documents I'm talking about and the load forecast?

MR. FITZGERALD: Yes.

MR. OSMOND: No, that was not in an RFI.

MR. FITZGERALD: Okay, would it be a difficult task for you to put your hands on any of these internal studies that you just referred to?

MR. OSMOND: Well, it's not so much a study, it's the economic or macroeconomics, how they actually run their load forecasts factoring in the price of fuel, factoring in the change in the rates, changing the RSP, and when they run that through their, they call it a Monte Carlo, whatever you call it, the model, it gives them impact on whether load patterns have changed, and it's just inputting data into a model to see what load patterns would change, and how they would change, up or down, depending on price elasticity, that's the term. Sorry. That's what it would be. Depending on if the price goes up or down, that will have an impact on consumption patterns, and that's what the economists would call the price elasticity, sorry, I forgot that.

MR. FITZGERALD: Have you in your position been provided a document resembling, say, an executive summary that would summarize these macroeconomic processes?

MR. OSMOND: No.

MR. FITZGERALD: You have never received any?

MR. OSMOND: I wouldn't say never, I mean I can remember ... I should say this, economic analysis used to report to me, but that's back seven or eight years ago, and that's why I was a little bit familiar with the price elasticity, but I haven't seen any recent reports, except that I would assume they're still continuing to do that type of modelling as they do their annual load forecasting, taking into account changes in the revenue streams and the changes in rates and what impact that would have on domestic customers and industrial customers. It's just, it's a data input.

MR. FITZGERALD: You haven't seen one in seven or eight years, but you believe that one would probably still exist?

MR. OSMOND: Well, the reason I say so ... I mean that's the last time economic analysis reported to me, I don't think that process would change. It would be still part of their normal process of going through the load forecasting techniques, factoring in those types of things, to see what would happen to the load, so I would expect that still to be continuing every year, as they generate a load forecast for five, ten, fifteen years, it's an input.

MR. FITZGERALD: In your estimation, would any of these analyses be helpful to this Board?

MR. OSMOND: I'm not sure it would show, it's a load forecast, and it would just be a listing of inputs into the load forecast, and there's a whole myriad of things that they put into the load forecast, GDP growth, change in rates, a whole myriad of things, and it's just inputs to the forecast to see what impact it would have in change the load up or down.

MR. FITZGERALD: So you're saying it would be no use for the Board to ...

MR. OSMOND: I don't think it would be much benefit to be honest with you.

MR. FITZGERALD: Would it be possible for you to put your hands on one of those within the context of this hearing, and have it filed?

MS. GREENE, Q.C.: I don't know ... actually, you lost me a little bit as well as to what you wanted. The load forecast has been filed with the Board. There have been some RFIs filed as to how they're prepared. You started by asking the question has there been correspondence related to the impact of the RSP on consumption of electricity, so and maybe if the Consumer Advocate could clarify what it is that ... because I don't understand at this point.

MR. FITZGERALD: Well what I'm looking, what we are looking for is, as Ms. Greene has just stated, I understand from Mr. Osmond's evidence that no such document exists so if that is the answer to the question then that should be

Mr. Osmond's answer.

MS. GREENE, Q.C.: And if the document is correspondence relating to the impact of the RSP with respect to consumption of electricity, if that's the question, I certainly can undertake with the rates people, to confirm that the answer is that there is no report. I know that I personally have not seen such a report and I think Mr. Osmond has indicated that as well, but we can undertake to check that with the economic analysis people and the load forecasting people to confirm that that is correct.

COMMISSIONER SAUNDERS: Other than fishing, Mr. Fitzgerald, what is it you're looking for? I've been listening to you for the past fifteen minutes and you've lost me, and at three o'clock in the afternoon my patience gets a little thin.

MR. FITZGERALD: Well, let's see if I can find you. The next area of, of inquiry is going to be relating to the issues of demand side management. We are very concerned, as representative of the consumers, that there is a, to be frank, a certain cloaking of the pricing signal that is occurring. Prior to your question, Commissioner Saunders, I was going to accept Ms. Greene's undertaking to us as a satisfactory answer.

COMMISSIONER SAUNDERS: I'm not sure Ms. Greene undertook to do anything, did you, Ms. Greene?

MR. FITZGERALD: I think she did.

MS. GREENE, Q.C.: Yeah, the issue as I understand it was whether we have received correspondence or a study or an analysis looking at the impact of consumption of electricity on the RSP and I indicated I personally haven't seen that and I think the witness did as well, but I undertook to check with the economic analysis people and the load forecasting people and the rates people, whoever is required to see if there is such correspondence, and if there is, we will undertake to file it.

COMMISSIONER SAUNDERS: Mr. Fitzgerald, in my understanding, has suggested that there might be a document, an internal document that might be of advantage of this Board, and if there is such a document, would you file it. He doesn't know if there is such a document, you haven't put a label, a date, or anything on it, and you're suggesting there may be one. I'm thinking that we're wasting a lot of time in suggesting that there might be a document that Mr. Osmond can put his hands on that might be of advantage to this Board. That sir, is a waste of time to me, unless you can name it, unless you can identify it, let's not go asking Mr. Osmond to pull out all the documents that he has had some control over in the past 25 years or whatever ... where are we going with this?

MR. FITZGERALD: Commissioner Saunders, I appreciate your vigilance to expediting this hearing. I hope it's consistent throughout. The question that I have put to Mr. Osmond is not an unusual question, it's not an unlawful question. It's a question that's well within the bounds of our mandate. It has been answered by Hydro's counsel, we'll see what the answer is, and we'll move on.

COMMISSIONER SAUNDERS: And you believe that it's going to be useful to the Board, you don't know what it's going to contain, but you believe it's going to be useful?

MR. FITZGERALD: I do indeed.

COMMISSIONER SAUNDERS: Carry on, Mr. Fitzgerald.

MR. FITZGERALD: Thank you, Commissioner Saunders. I just have a couple of areas left. Mr. Chairman, that might be a good place to break.

MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr. Fitzgerald, we'll break until 3:15.

(break)

(3:15 p.m.)

MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr. Fitzgerald, I'll ask you to continue please.

MR. FITZGERALD: Thanks, Mr. Chairman. Mr. Osmond, as CFO of Hydro, and you've been a Vice-President since 1985, you were obviously around when Hydro amortized its foreign exchange loss. That was around 1992?

MR. OSMOND: Do I look that old? No you're right, yeah.

MR. FITZGERALD: No more hair jokes, they're dangerous *(laughter)*. And currently that foreign exchange loss, that's ... it peaked at $92 million, I believe, I'm just speaking roughly here now and it's now included in the rate base and it's in the range of about $82 million, that's what's carrying forward?

MR. OSMOND: Yes, that's correct. It was $92 million and we've netted off, the Board in 1992 asked us to start accruing $1 million per year foreign exchange loss in anticipation of recognizing a loss in these two pieces of debt, the Swiss Franc and Yen, so the 2002 application is taking a $10 million liability being set up against the foreign exchange. The $92 million you just referred to was two pieces of debt, the Swiss Franc and the Yen.

MR. FITZGERALD: Right.

MR. OSMOND: It's about $82 million that we're amortizing.

MR. FITZGERALD: Okay, and as I understand it that's actually now a component of Hydro's rate base really by legislation.

MR. OSMOND: That's correct.

MR. FITZGERALD: Okay, now can you just give us some brief background as to why this particular loss of, this foreign exchange loss was handled in the way it was?

MR. OSMOND: If you don't mind, maybe I can go back, because it's a bit of a history for me to. If I just went back to 1975 on the Swiss Franc and explain how it happened, that'll only take a few minutes.

MR. FITZGERALD: Sure, please do.

MR. OSMOND: And the same thing on the Japanese Yen, because pre my time as being Vice-President of Finance and I found it useful when I went back through it to find out exactly what happened.

MR. FITZGERALD: Sure.

MR. OSMOND: It brought out some points to me (inaudible), I know there's a logical reason, but here it is. I guess there are two pieces of debt and one was the Swiss Franc and other was the Japanese Yen, if you don't mind I'll just go through the notes just to make sure I haven't missed anything. On the Swiss Franc, we borrowed in 1975, $75 million Swiss Franc and the equivalent of that was $28.3 million Canadian. The effective interest at the time was 8.9 percent on that particular issue, Canadian, versus 11.2 for other Canadian financing, so we actually got it approximately 2.3 percent below the Canadian rate at the time. We just completed the $25 million Canadian issue and given the size of the market we weren't able to go back into the marketplace to finance another issue, so we ended going to the Japanese, to the Swiss Franc and at a lower rate than what it would have been if we could have gotten to the marketplace, 11.2.

So accordingly that was the only foreign markets we could get into. In 1995, the Board of Directors of Hydro, and I guess the Management Committee, approved an approach to try and minimize the exposure to the Swiss Franc because it was, the exchange rate was changing against us and even though we had set up a million dollars per year specific to the Swiss Franc, there still was a potential liability coming at some point in time, so we started a phase program trying to retire 20 percent of the debt over a period of time and we did that in '95 and '96 and in 1997 we put in, what we call, "stock loss position" so that the Japanese Franc *(sic)*, sorry the Swiss Franc was going up or down, we said if it gets to this level or that level we want to get out so we're not going to be exposed to too big a loss.

So that started in 1997 and the stock losses were exercised, they actually started to come down so we had to exercise our option, and we recognized a loss on the Swiss Franc of approximately $49 million, 49.2 and that was in 1997 and we deferred that as a foreign exchange loss.

MR. FITZGERALD: '97?

MR. OSMOND: In late 1997, yeah. On the Japanese Yen, that was borrowed in December 15th, 1984, and was for 7 billion Yen. Sound like a lot of Yen, and that was worth $37.3 million Canadian and that Yen financing was part of a package which included Hydro borrowing $35 million Canadian from the Japanese at 1.2 percent below the 13.2 percent Canadian interest rate at that time. So by going with the Japanese Yen and the Canadian issue with them we actually got a lower interest rate associated with the Yen at the time so it was down by 1.2 from what we could have done in the Canadian market at that time.

That was renewed again in January, in March of '95 and again in 1995 the Board of Directors of Hydro, management approved a plan to retire 20 percent of that debt each year too, to try and eliminate that from our books, and again the marketplace in 1997, we had stock loss positions in place but we actually were taken out in those levels where the Board had approved, the Hydro Board. Once you get down to a certain level we exercise the options and we exercised and paid off the loans, and that loan was paid off in 1997 and that was approximately $47.1 million loss, it was recognized in that piece of debt. So that is a synopsis of the two pieces of debt that we had and the reasons behind. So when you combine them the numbers are right, they come out to be approximately, I think, $96.2 million minus the amount we've already accrued for the PUB.

MR. FITZGERALD: Okay, and do you recall any of the history behind the legislation whereby it was deemed expedient or appropriate for Hydro to include this loss in the rate base?

MR. OSMOND: When that Act came in it was 1996, the EPCA?

MR. FITZGERALD: Yes.

MR. OSMOND: At that point in time there were several things included as it related to Hydro, one of which the Province was aware was this issue associated with the foreign exchange and as it related back to the previous issues, I guess the legislation reflected that. It should be recovered in rates over 40, I believe it is a 40 year period, starting at the first hearing of Hydro when rates are to be revised, and this is the first hearing since 1996.

MR. FITZGERALD: Has there been any thought put to handling the current amount that's in the Rate Stabilization Plan, current amount of $67 million to handle that in a similar fashion?

MR. OSMOND: And recover over 40 years?

MR. FITZGERALD: Or amortize over some period of time.

MR. OSMOND: No. No, I think that's a completely different thing. This is a piece of debt that we had that went back to 1995. The Rate Stabilization Plan is basically, as you know, as we talked about in the last three days, two days, it's trying to mitigate changes in rates for customers and to prevent rate spikes and to recover that over a three year period. To try and recover that balance, there'd have to be something else in place in lieu of the Rate Stabilization Plan, because you're still going to find that hydrology is going to change and water is going to change and load is going to change, all of which has impact on the consumers' rates or real exposure to the Corporation.

MR. FITZGERALD: Okay, thank you Mr. Osmond. Mr. Chairman, I think Mr. Browne is going to now carry on.

MR. NOSEWORTHY, CHAIRMAN: Alright, Mr. Fitzgerald. Mr. Browne, please?

MR. BROWNE, Q.C.: Thank you, Mr. Chairman. I gave notice the other day I was going to ask you concerning the executive compensation plan and I think you filed an undertaking which is called **U-Hydro No. 12**. Can you tell me just from, in your own words the way the performance based incentive plan works, Mr. Osmond?

MR. OSMOND: Could I just have a minute to find it, Mr. Browne. Okay, that was an undertaking. Okay. I guess this was a plan that was put in by our Board of Directors in 2000, December of 2000, as it relates ...

MR. BROWNE, Q.C.: Can you speak up a little, I think ...

MR. OSMOND: Sorry about that. I'm starting to talk too low. This is a plan that was put in by our Board of Directors as a pilot project. Is that any better? As a pilot project for 2001 and it was put in for the members of the management committee as well as some senior directors, the majority of senior directors in the Corporation to try that for 2001 and if it had merit to extend it beyond the director level down to various levels below the director level in 2002. So the plan that was evolved, I guess, maybe I'll just take you down through what we have here, if that's okay?

MR. BROWNE, Q.C.: Just give it to us in your own words. You're familiar with it, you're on the management team?

MR. OSMOND: Oh yes.

MR. BROWNE, Q.C.: Okay, you're probably the person that promoted this plan after it was, came from the Board of Directors, I gather.

MR. OSMOND: Yes, we had to bring it down to our line management as well.

MR. BROWNE, Q.C.: Okay, you know about it. So give it to us.

MR. OSMOND: I'll give it to you, okay, as best I can. So as I say, we did have a pilot project and that's still underway right now for 2001. Our Board will assess that in the first part of 2002, as to the status where we are, our own Board of Directors. As far as the compensation, the total compensation or total salaries for all the employees in that plan right now totals approximately $1.9 million and that's with everybody, all the 18 directors plus the four or five management people. The total maximum payout is 6 percent. So if everybody received a 6 percent payout it's approximately $114,000, based on the objectives and the targets that we had in the incentive plan.

It's based on corporate performance objectives that we've identified for the Corporation, and also as you get down to the next layer the objectives for our own divisions and so on, are all tailored to that, and I guess there were three or four major ones. First of all is the financial performance overall of the Corporation, that was tantamount to, one of the key objectives. Improved system liability, that was the major one, to make sure that we had that as one of our key criteria to ensure we have the reliability of power to Newfoundland Power and to industrial customers and that ties in to the number of outages per year.

MR. BROWNE, Q.C.: So isn't that your job to have system reliability. Why would you get an incentive for that?

MR. OSMOND: It is, but there are other options to ensure, to make sure the system is running effectively and the little things are done, as they should be anyway, to make sure that we do meet our statistics and to continue to be in line with other utilities in Canada. Safety and health, that's an important thing for all employees, wherein you have six of the elements, and I think overall there is 16 elements, I think overall. So we're aiming to put in the safety and health program this year, six being the start and also to start rolling out a strategic planning process to all our employees and that's a process we started last year which focused on the missions, the values of the Corporation, communications and so on, and rolling that out the Corporation, rolling that to our employees as well as the corporative objectives to get them to start proceeding with the divisional objectives and corporate objectives.

MR. BROWNE, Q.C.: So under the cost and regulatory treatment, you're saying the total cost for the plan is $1.9 million, how much of that has been expended thusfar, any amount of it?

MR. OSMOND: I'm sorry, I didn't mean to interrupt you. $1.9 million is the total value of the salaries of everybody that's in the pilot project.

MR. BROWNE, Q.C.: And has anyone gotten any share of that as of yet?

MR. OSMOND: No, the maximum amount that anybody would get, first of all $1.9 is the salaries for everybody, six percent is the targeted amount that people might be able to get, which I think is $114,000. Nothing is included in the 2002 cost of service study in salaries or any other benefits for this particular pilot. So we end up paying out $114,000 strictly, what I call Hydro's bottom line, it doesn't end in the rates for customers.

MR. BROWNE, Q.C.: So how many people would share in that $114,000?

MR. OSMOND: Well there's five management committee and I think at the director level, I'm sorry there's 12 directors and 5 management, total of 17.

MR. BROWNE, Q.C.: So 17 would share in the $114,000?

MR. OSMOND: Yeah. That's assuming they met all the targets and all the objectives of the Corporation is met. That's the maximum amount that to bepaid out.

MR. BROWNE, Q.C.: I don't think consumers would object to any kind of incentive plan but I'm wondering concerning the targets you've set for yourselves. If you had set a target on the amount of fuel that is consumed at the Holyrood generating station, the 3,500,000 barrels that's consumed there annually in some years, and tried to find ways to bring down that, that intake, would that we a worthy target, do you believe?

MR. OSMOND: Conservation is always a worthy target.

MR. BROWNE, Q.C.: Well did you give any consideration to that as a target because if you brought that down, say by 10 percent, there probably would be significant savings there, wouldn't there?

MR. OSMOND: Yes, it would. That wasn't highlighted as a major corporate activity.

MR. BROWNE, Q.C.: Why not?

MR. OSMOND: But I think, maybe I should just say, I think as you get down into the divisional and departmental levels, that would have been underneath Mr. Budgell, that would have been one of his issues, that probably would have been looked at as far as conservation.

MR. BROWNE, Q.C.: But was there a target set to try to bring down the fuel that is expended at Holyrood?

(3:30 p.m.)

MR. OSMOND: The volume of the fuel certainly wasn't targeted as a reduction, to try and reduce it by a factor of 5 percent or 10 percent. Mr. Henderson is certainly looking at the operation of the system, in managing the operation of the hydro reservoirs would certainly be aware of that and try to maximize that. In Mr. Budgell's area he would be looking at the conservation and DSM issues and he has put forth, I think he put forth three or four the other day when he was on the stand as to what he is proposing for 2002. That though would not materially reduce the number of barrels at Holyrood. It would have some impact on it but you'd really be looking at a 10 or 15 percent reduction, but there is some DSM initiatives that start at Mr. Budgell's area through his economic analysis group.

MR. BROWNE, Q.C.: If you had met with the oil companies and attempted to get people away from using baseboard radiation to try to drop your intake and set specific targets, would that be something that would be worthy of consideration in terms of a performance objective under an incentive program if you could actually do that?

MR. OSMOND: You're thinking for customers on our system or for Newfoundland Power as well because we ...

MR. BROWNE, Q.C.: Well, if, this is our great dilemma. When Newfoundland Power is here you see, they say well that's Hydro's, you know Hydro is into that, you know, so you're here go to Newfoundland Power and, of course, we've all said well now you're both here so, in some form or another, so let's just look at it, someone has to take the leadership here, you're the ones that are ordering the fuel and expending the money, isn't it, wouldn't the leadership have to come from Hydro here?

MR. OSMOND: No, the only reason ... no, I appreciate your point. The only thing I was trying to raise is we did try that, I won't say our own customers, the rural customers, three or four years ago, and there really wasn't much interest from the oil companies in different areas, probably because of the remoteness.

MR. BROWNE, Q.C.: Yes, because you did it up in Labrador. You offered someone $500 or whatever it was for a furnace, if they put in a furnace up in Nain somewhere and, of course ...

MR. OSMOND: But not, I'm sorry, not only there. We did it on the GNP and believe it or not there wasn't much interest on the Great Northern Peninsula. So that's the only point I was trying to make is that we did look at it for our own customers, not our own, the Hydro rural customers, isolated customers, and there wasn't much interest in that at that point in time, with the oil companies.

MR. BROWNE, Q.C.: Or in fairness to Newfoundland Power, if you try to get people away from baseboard radiation and try to get them into convect-air or into heat pumps, would that be, you both got together to try to do that, to lessen the load that's required out in Holyrood, wouldn't that be a worthy target?

MR. OSMOND: Depending on what interest would be there with the customers, we haven't engaged upon any program with Newfoundland Power with a view to reducing electric heat or eliminating electric heat for other options, whether it be oil or whatever.

MR. BROWNE, Q.C.: As I look over these standards for you to get your modest bonuses, and in terms of financial performance, how exactly would that work? The target established was achievement of a certain level of net income on regulated activities.

MR. OSMOND: Yes.

MR. BROWNE, Q.C.: Does that mean you're going to try to sell more electricity?

MR. OSMOND: No, as it happens if we sell more electricity it just goes into the Rate Stabilization Plan. That was geared to, I think the performance levels 116, 1.16 interest coverage on a regulated basis. That's basically our cost minus our revenue, so it's control of operating costs, all of our salaries, all of our maintenance, all of our travel, interest, whatever the components are, so it is geared to a net income which equates to 1.16, so that's where that target came from, so that's what we're aiming to get. If we don't hit that, no tickie, no laundry *(phonetic)*, you don't anything for that, right.

MR. BROWNE, Q.C.: If you'd go to page 4 of 6 just for a moment, line 11, we're talking about various strategic objectives, and so on, another one of your goals and you say "if the operating expenses for the department are within the budget, the objective is met". With all due respect, wouldn't that encourage people to overbudget, what if they overbudget, it certainly would encourage them to underbudget would it?

MR. OSMOND: No, well I guess when we put in a budget that budget went through severe scrutiny so when we went through that we said this is your budget for the year, you're expected, if you're to meet anything, to come in on that budget for the year. Now if they come in and they're below that, there's an incentive they can get as well. So the six percent if they hit the budget, if they come in below that, five percent below, then they could get a nine percent performance, or an element associated with that, up to nine percent. So there is an incentive for them to bring the cost down.

MR. BROWNE, Q.C.: Does the incentive program go all the way down? Is your bargaining unit, does it apply to them?

MR. OSMOND: No, as I mentioned earlier, it's a pilot project brought in by our Board and right now it's only 17 people that are in that, five of the management committee, plus 12 directors. If it's a successful program and if the Board concurs and they're in agreement with it, the board of directors, then we'll bring it down to the next level and in turn bring it down as far as the Board would like to go with it, but it's a pilot for this year, pending the Board's decision in the spring of next year.

MR. BROWNE, Q.C.: When you brought in the Hay Group to do this, was that the first time the Hay Group has been in for a visit or are they regulars?

MR. OSMOND: We used Hay Group for different things. They do some work for us on evaluation of salaries, evaluation of positions, and rankings of positions and things like that, proper grades they should be used, so they are back and forth from time to time.

MR. BROWNE, Q.C.: And Newfoundland Power uses the Hay Group as well, I gather?

MR. OSMOND: I believe so, but I'm really not sure.

MR. BROWNE, Q.C.: And they have targets as well, I do believe, are you familiar with their targets?

MR. OSMOND: I'm not familiar with their targets. I know they do have bonus plans.

MR. BROWNE, Q.C.: The propositions I put to you, would you think they would be reasonable if we could see in real terms some progress in a troubling area? Would you think they would be worthy of consideration as financial targets?

MR. OSMOND: I'm sorry, you're thinking of DSM targets?

MR. BROWNE, Q.C.: Yes, I'm thinking of that fuel problem we have out there in Holyrood, if you could try to bring down, find ways to try to bring down the intake there.

MR. OSMOND: Yeah, there is no doubt, I mean Holyrood is a major supplier of electricity. You know the DSM that we're embarking upon that would have some impact, but certainly not a major impact to bring it down by 5 or 10 percent. What interest there would be if customers wanted to switch from oil, from electricity to oil, that has not been pursued with Newfoundland Power or that there'd be much of an interest. I know several years ago there was concern with regards to oil companies, I don't think there has been many conversions over the last several years from electric heat to oil.

MR. BROWNE, Q.C.: In the DBRS reports, you'll find them in **DH No. 1**, there's a challenge there, environmental issues related to sulphur content of Bunker C fuel. Are you familiar with that?

MR. OSMOND: The DBRS report?

MR. BROWNE, Q.C.: Yes.

MR. OSMOND: Is that the most current one?

MR. BROWNE, Q.C.: Yeah, October 2001.

MR. OSMOND: Yeah, I'm sorry, which line, environmental issues ...

MR. BROWNE, Q.C.: Related to sulphur content of Bunker C fuel.

MR. OSMOND: We have, I'm trying to think, we have a legislative requirement for emissions and I could be wrong, I think that's 25,000 tonnes per year in emissions, so environmental concerns and issues related to the sulphur content, we burn right now I think its 2.2 percent sulphur. Once you start going down to a lower level by 1 percent, I think, the cost increases significantly, probably 5 or 10 percent. So there are environmental issues that we have to address and I think one of the issues we have in the capital budget is the continuous emission monitoring system that we have, if I got that right, and that's to look at the environmental issues associated with sulphur as well. That is a legislative requirement and we're bound by it and I think this is a point that DBRS are probably making too, that we have environmental issues that will have a cost, that we have to abide by.

MR. BROWNE, Q.C.: Have you explored any type of federal funding to deal with these environmental issues pursuant to the so-called Keyoto reports?

MR. OSMOND: The reason I'm hesitating, that's not in my shop. I don't recall any federal funding being requested. I know there were discussions on the emission credits as to what could be used and sold, my understanding is there's been very little interest in that in Canada, but I'm really skating *(phonetic)* on that one, that's Mr. Budgell's area, but I don't think there's been much interest in the emissions trading aspect in Canada.

MR. BROWNE, Q.C.: It hasn't been discussed at a management meeting or an executive management meeting which you have been a party?

MR. OSMOND: As far as emissions trading?

MR. BROWNE, Q.C.: Yes, as far as the Keyoto Accords, what the possibilities might be.

MR. OSMOND: Well those types of issues have come up certainly in general, but not as far as a specific plan. Just as you just mentioned there now there are issues associated with Keyoto, other opportunities, but to my recollection there's been nothing that's been quantified with regards to what we could accomplish and (inaudible) utilities as well.

(3:45 p.m.)

MR. BROWNE, Q.C.: You were here, were you present when Mr. Bruce Pearce testified on behalf of the Conservation Corps?

MR. OSMOND: No, I think that's probably the only day that I missed, unfortunately, of all the hearing.

MR. BROWNE, Q.C.: The transcript will show that he made reference to the fact that the current administration, the Premier of the Province, has signed into the Keyoto Accord, were you aware of that?

MR. OSMOND: Generally aware of that, yeah.

MR. BROWNE, Q.C.: Yesterday your evidence, and I'll just leave the incentive plan and **VH-1** and refer you to your evidence of yesterday, November 19, page 12, line 65.

MR. OSMOND: From the transcript, you mean?

MR. BROWNE, Q.C.: Yes.

MR. OSMOND: I'm sorry, okay.

MR. BROWNE, Q.C.: Mr. Osmond at a different table, Ms. Greene and myself and John Roberts were involved in the Rate Stabilization Plan in '96 and a (inaudible) of that and the concerns that we had and the fact we had Kentucky Fried Chicken and shutting down the lights and the papers that were coming and the calls we were getting it was horrendous. I can't remember getting a call since 1986 from a customer who was irate with regards to the adjustment of the RSP and prior to that you were almost afraid to pick up the phone. Now surely it's not your job at Hydro to answer the phone, you don't do customer complaints, do you?

MR. OSMOND: You'd be surprised *(laughter)*.

MR. BROWNE, Q.C.: I realize you might have been oversimplifying here, but ...

MR. OSMOND: No, I generally meant that, the calls used to come through, I could hear them coming through customer service people and our accounts receivable people saying this person wants to talk to somebody above me, and they'd end up with me and if I couldn't handle them, they went even further. But, yeah, people were really concerned with the level of rate increase, with the level of bill changes, month to month, because of the fuel adjustment charge, so I was very sincere when I said that yesterday. We did get a lot of calls that came through, all over the Island, and I think Light and Power had the same thing, and we really had conversations as well as to how can we try and rectify the situation to ensure that the consumers see, have reasonable stability in their bills from here on in.

MR. BROWNE, Q.C.: And that may have been one of the issues, but certainly there were others at the time, do you agree with that?

MR. OSMOND: At the time we brought in the Rate Stabilization Plan?

MR. BROWNE, Q.C.: Yes, in 1985 ... that the Kentucky Fried Chicken crowd and others were complaining about.

MR. OSMOND: Oh yes, there was a whole myriad of things, I just raised that one. That certainly was an issue, but we had a lot of correspondence that came in, we had a lot of calls from politicians right across the Island, we also had a lot of concerns from the media as to what's going on and what are you doing and we also had discussions, I think you mentioned the other day, with the Torbay Action Committee, or Torbay Action Group.

MR. BROWNE, Q.C.: The Flatrock ladies.

MR. OSMOND: Flatrock, Mrs. Peddle, yes.

MR. BROWNE, Q.C.: Can you go to **CA-179**, Roman numeral IV, for a moment please, page 20 of ... and at the top of the page, Ms. Peddle there gives the objectives of what her group was trying to do, if you want to refer to the previous page, or you can trust me in that's what she's trying to do. Can you read out what the objectives are of the exercise?

MR. OSMOND: Starting with Peddle?

MR. BROWNE, Q.C.: Yes.

MR. OSMOND: To reduce the cost of electricity rates in this Province of Newfoundland and Labrador to the consumer; look into all three of the following factors, production, distribution, and regulations of electricity in Newfoundland and Labrador; (3) inquire, promote, investigate any ways or means that this can be achieved; bring pressure to bear on the government and other authorities where necessary in order to achieve these objectives; and (5) we believe that the hydro resources is our to be used to the benefit of the people rather than for the Province; (6) the final aim of this organization is to ensure that the domestic consumers of electricity in this Province of Newfoundland and Labrador are getting the best deal possible from our resources; and (7) finally we believe the people of Newfoundland and Labrador are entitled to know if we're getting the best deal now or if in fact there's a better deal to be gotten and therefore feel that an impartial, independent study be done on the whole question of electricity, both past, present and future, production, distribution, and regulations and we are requesting that our present government and this hearing to bring this study about right now.

MR. BROWNE, Q.C.: Would you agree with me that it was this particular group, the Flatrock ladies, who styled themselves under the New Lab Society, were the driving force behind the protest in 1985?

MR. OSMOND: They were certainly one of the most vocal groups, no doubt about that.

MR. BROWNE, Q.C.: And you don't see in any of those objectives the inclusion of a Rate Stabilization Plan, do you?

MR. OSMOND: No direct reference, except in one to reduce the cost of electricity.

MR. BROWNE, Q.C.: Sure, they all want the cost of electricity reduced.

MR. OSMOND: Primarily because at that time, the fuel adjustment.

MR. BROWNE, Q.C.: Although we read out the other day that that was something that perhaps they weren't advocating. I think, would you grant me that?

MR. OSMOND: I'll grant you that. But I guess, maybe you can grant me this, I guess that was in 1985, but I guess when we came back in 1988, 1989, and '90, there was nobody here from either one of those groups complaining about the establishment of the RSP, or any issues or concerns that came up from that.

MR. BROWNE, Q.C.: But they did see in 1996, a consumer group formed again, known as Consumer Power, are you familiar with that particular group, led by a Councillor Dennis O'Keefe and others.

MR. OSMOND: Okay, and that was done I think ... yeah, I do remember that, that was on not only hydro issues, that was on fuel as well.

MR. BROWNE, Q.C.: Yes. They were talking about the price of electricity, in prelude to Newfoundland Power's application, I think they were complaining about it prior to the application. They were complaining about the cost of the electricity, do you recall that at all?

MR. OSMOND: Just very generally.

MR. BROWNE, Q.C.: Are you aware that they took a petition across the Island protesting the cost of electricity at that time?

MR. OSMOND: I remember there was a petition, I don't know what it actually said. I've never seen it. Just in the news reports I would have seen it.

MR. BROWNE, Q.C.: So you wouldn't doubt that they could have had 75,000 signatures on that petition at that time. Do you know anything about that?

MR. OSMOND: I really don't know. That was in relationship to Newfoundland Power's hearing?

MR. BROWNE, Q.C.: Yes.

MR. OSMOND: Yeah, no, I really don't know.

MR. BROWNE, Q.C.: It was prior to the hearing, I think they had started up and then Newfoundland Power brought on its application and, of course, you can get the particulars on that, we don't need to look now, in Appendix

2 of the 1996-1997, PU-7. It's all there a matter of public record. Were you, did you travel with us to Labrador?

MR. OSMOND: No, I didn't get to Labrador. I got to Stephenville and I got to Grand Falls, but I did go through the 1996 rural rate hearing in Labrador in great depth, I went through that one, and also through the L'anse au Loup hearing which I think was also in 1996, so I think a lot of the issues, I read all the transcripts and I read all the presentations. When I read those through it brought back a lot of issues that were brought forward when I went through in 1996.

MR. BROWNE, Q.C.: So did you read the transcript in reference to the evidence put forward by Mr. Henry Broomfield of Nain and various complaints he made concerning electricity?

MR. OSMOND: I read his presentation, but I can't tell you exactly what it was. There were so many presentations, but I did read Mr. Broomfield's presentation.

MR. BROWNE, Q.C.: Sure, can we go for a moment to page 44 of the transcript of October 18, 2001, and in line 68, can you read that into the record, some of these complaints.

MR. OSMOND: Line 66?

MR. BROWNE, Q.C.: Line 68, sir.

MR. OSMOND: 68. If low income families cannot ...

MR. BROWNE, Q.C.: I'm sorry, I'm reading from the transcript on the hard copy, line 66, yeah, your correct.

MR. OSMOND: Okay. Economically this is ...

MR. BROWNE, Q.C.: No, the paragraph above that, sir, I'm sorry. "There are a number of concerns".

MR. OSMOND: Okay. "There are a number of concerns about Hydro's service in Nain which we want to bring to your attention. Electricity bills often display overcharges, discounts are forfeited on customer bills due to Canada Post delays. In recent years there have been staff reductions at the plant in coastal Labrador. This must be a cost saving. However, Nain customers are experiencing brownouts at night, that's the dimming and flickering of lights, response to a request for new service, repairs, etcetera, etcetera is slow and meters are often misread".

MR. BROWNE, Q.C.: Did you ever get a call from Mr. Henry Broomfield in reference to any of these matters or from people along the coast of Labrador?

MR. OSMOND: Me personally?

MR. BROWNE, Q.C.: Yes.

MR. OSMOND: No, I have not.

MR. BROWNE, Q.C.: Have any of these issues been brought to your attention or the attention of the management committee of Hydro?

MR. OSMOND: Certainly some of the issues coming back from the presentations have been brought to my attention as it relates to discounts and so on. So I'm aware of what we're doing in those particular areas.

MR. BROWNE, Q.C.: And has the management committee taken anything under active consideration in reference to those complaints?

MR. OSMOND: I think with regards to the, I can't speak to the operation ones, but with regards to discounts and so on. On the issue, I guess, of discounts, and I guess the issue of forfeited discounts also came up as well I think in Labrador, maybe we can just through it and indicate what our policy is, because there is some concern raised with regards to discounts in general and our policy is that a discount of 1.5 percent of the amount of the current bill but not less than a $1.00 will be allowed if the bill is paid within ten days after it is issued. What we also do if bills are dated for the date they are mailed, if we bill on a Friday, the billing date is set to Monday, so we're giving the customer an extra two days to extend it out rather than going with the short time frame, the longer time frame for them. The discount is set at 15 days. We give them another 15 days on top of that. When the payment is received by mail at the Head Office, we back date it 5 days previous the date it's received, excluding weekends, so that's giving another 5 days to ensure they're given the benefit of the doubt, and if a customer calls in complaining of a lost discount, the discount is automatically refunded to the customer. So we try to, if there's any area of doubt at all, we try to give the customer the benefit on the actual discount.

MR. BROWNE, Q.C.: But these policies are not new. They've been in place a while I gather.

MR. OSMOND: Yeah. I just wanted to explain what our policy actually is, and in some cases people still don't meet the discount payment period, but we try to bend over backwards for them.

MR. BROWNE, Q.C.: Yet you have Mr. Broomfield coming forward October 18, a month ago, to make these complaints. Have you updated your policy since then or attempted to address any of the specifics?

MR. OSMOND: The policy is still the same.

MR. BROWNE, Q.C.: I gather from your evidence that you're getting ready to introduce an equal billing plan for consumers, is that correct?

MR. OSMOND: That's correct. That's part of the JD Edwards, or UCIS, Utility Customer Information System, and that system will be in place in 2002. I think that was one of the questions you had the other day, but that system will be in place to provide the same type of equal billing as Newfoundland Power presently has, and it wasn't in previously because in the old system we have we didn't have the flexibility of the old customer service system. There is, there are concerns of customers. We have had inquiries as to why can't they have that. So in response to their complaints and their concerns we're in the process of doing that and will have the system in place for next year.

MR. BROWNE, Q.C.: And you call it an equal billing and another pay method study, I think you refer to a study you have on the go with that. What does it refer to other pay method study?

MR. OSMOND: I think the big one is equal payment and also other options that might be available for customers, whether it's through, I guess, online or if they can pay with a debit card, that type of thing, that's my understanding of it.

MR. BROWNE, Q.C.: So it's the same type operation Newfoundland Power has now?

MR. OSMOND: That's my understanding we're looking at.

MR. BROWNE, Q.C.: Can you go to page 33 of the Grant Thornton report, the most recent one, thank you.

MR. OSMOND: 2001?

MR. BROWNE, Q.C.: Yes, and that particular report of Grant Thornton makes reference there towards the end of that particular page you're at to $250,000, I think it is, for studies. Can you just read out that paragraph sir beginning with "increase in professional services".

MR. OSMOND: Okay. "The increase in the professional services category for 2001 is approximately $357,000 compared to 2002. The majority of this increase can be found in the information systems and telecommunications department for a rural customer survey and database update for $50,000 and an energy management system study for $175,000. The cost related to this study carry over to 2002 as well. The professional figures for 2002 continue to increase over 2001 forecast levels by $284,000 or 12 percent".

MR. BROWNE, Q.C.: It's this next sentence which has attracted my interest. Can you read that for us please?

MR. OSMOND: "These additional costs relate to an equal billing and other pay method study in the finance division for $250,000 and the installation of a true secure IP security program in the production division for $115,000".

MR. BROWNE, Q.C.: Okay, now that equal billing and other pay method study in the finance department for $250,000, how are you costing that? Was that out-sourced, was that a crowd you brought in to study equal billing and other pay methods?

MR. OSMOND: That would be a consultant. That's an external consultant and some in-house time as well.

MR. BROWNE, Q.C.: So you paid $250,000 to a consultant?

MR. OSMOND: We haven't paid it yet. We'll be going out to get a consultant.

MR. BROWNE, Q.C.: Well thank heavens you haven't, because you just told us that your going to be using pretty well the same thing as Newfoundland Power has. Wouldn't it save you just to go over and see what they have in operation? Could we save $250,000 that way?

MR. OSMOND: We did look at the UCIS system Newfoundland Power had back in 1998 and 1999 and we looked at the number and it was cheaper for us to put in our own UCIS system based on the estimate we were provided by Newfoundland Power. So this feature now is in the JD Edwards system and those costs will be expended in early 2002 which will include some consulting as well as in-house cost.

MR. BROWNE, Q.C.: Why would you need to spend $250,000 consulting in reference to an equal billing and other pay method study, when we know full well the way it operates. Up the street they got all the particulars on that, they've been doing it for years.

MR. OSMOND: Some of the mechanics are there but it's a matter of tying it to the software we presently have and JD Edwards. It's a different operating system.

MR. BROWNE, Q.C.: So it's not for the study, you come to the conclusion you have to do it but it's part of the study, is that what you're telling us? It's part of JD Edwards, it's another cost over and above what we're already paying for JD Edwards?

MR. OSMOND: It's the cost to put the equal billing system in place. The features in the JD Edwards system for our customer services ... this is a study to see how it can be accommodated within JD Edwards to provide equal billing, so it's consultant time and internal time and maybe some programming time.

MR. BROWNE, Q.C.: Why couldn't you do it internally?

MR. OSMOND: We would not have the resources to do that, the technical expertise to do it. We don't have that level to be able to put in that type of system.

MR. BROWNE, Q.C.: Let's stop there for the day and continue tomorrow. Thank you very much, Mr. Osmond.

MR. NOSEWORTHY, CHAIRMAN: Thank you, Mr.

Browne. Thank you, Mr. Osmond. Just one note. I understand that Mr. Hearn, the counsel for Labrador City will be here tomorrow and will be slotted in terms of direct examination after the Consumer Advocate and before counsel for the Board. Thank you and we'll reconvene at 9:30 tomorrow.

(hearing adjourned to November 21, 2001)