(9:03 a.m.)
CHAIRMAN:
Q. Thank you and good morning. Winter out here this morning. It'll be chewed up and gone before long. Good morning, Ms. Newman. Are there any preliminary items before we get started?
MS. NEWMAN:
Q. Not that I'm aware of, Chair.
CHAIRMAN:
Q. Okay, thank you. Good morning, Dr. Kalymon.
A. Good morning, sir.
Q. How are you this morning?
DR. BASIL KALYMON (SWORN)
CHAIRMAN:
Q. Thank you, sir. You may be seated. Mr. Fitzgerald, when you're ready, please. Good morning.
MR. FITZGERALD:
Q. Good morning. Thank you, Mr. Chairman. Good morning, Dr. Kalymon.
A. Good morning.
Q. You've filed certain pre-filed evidence with this Board on or about the 14th of August, 2003. Is that correct?

A. Yes.
Q. And you adopt this evidence?
A. I do.
Q. Do you have any revisions to your evidence as filed?
A. Yes, several. I'll start with the trivial. There's a typo on page 31 that I thought I just did want to correct it for the record. On page 31, on line 10, the year 2000 should read 2002. It's my discussion of Fortis and its recent performance and that line 10 number should be 2002. That was just a typo.
Beyond that, much more substantively, I would like to update the numbers for long-term Canada bonds. The long-term Canada bonds which I was using, the rate at the time of the preparation of the case was 5.53 percent and as of last week, I have some pages that are going to be distributed, that rate was 5.26 percent. It has moved slightly. As of yesterday, it was 5.34 percent, but whether we take last week's or this week's or this current number, the interest, the long-term 30-year Canada bond has dropped in yield since the preparation of my case. Because I apply

various tests, not just the risk premium test, but various other tests, I have concluded that that shift would not change my recommendation. It changes some of the results. If you take literally the risk premium test results, it lowers them, but I do not feel that it lowers it sufficiently materially to change my recommendation, so that my recommendation on equity will remain 8.5 to 9 percent, and that is--okay, that is my update with regard to the long-term Canada bond.
I have, as a consequence of that drop in long-term Canada bonds, I would like to point out that what appears on page 16, where I discuss the cost of debt to Hydro. At page 16, line 5, I stated that as of August 14th, the trading yield of long-term bonds for the Province of Newfoundland was 6.03. I would revise that to a current number of about 5.83. Given the provincial guarantee, that basically implies that that's the effective borrowing costs for this company for long-term funds.
On the same page, at line 21, I discuss the cost of short-term funds to Hydro, and the number that I quote there is 2.81. This is at

line 21 on that page. That short-term cost of funds is currently at 2.70. So just like long-term funds, short-term funds have decreased somewhat from the time of the preparation of my evidence.
In addition, the company filed a revised application subsequent to the preparation of my testimony and there are revisions that are required to page 15, which I believe were distributed.
Q. Yes. Mr. Chairman, actually I distributed a new page 15 among counsel. I've given copies of that to the Board secretary this morning.
MS. NEWMAN:
Q. That has been circulated. It should be in your books, I understand. Everybody should have a copy of that.
CHAIRMAN:
Q. I have a copy, yes.
MR. FITZGERALD:
Q. Thank you. Go ahead.
A. Can I assume that everybody has a -
Q. Yes, we're speaking of the new revised page 15 now.

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CHAIRMAN:
Q. Everybody has a copy?
MR. FITZGERALD:
Q. It's filed.
A. Oh, I see.
CHAIRMAN:
Q. It has been distributed, Dr. Kalymon.
A. Okay. It's not on my screen.
MR. FITZGERALD:
Q. No, that's -
A. It's just in hard copy, right?
Q. That's correct.
A. Okay. First of all, they're really trivial changes because--or immaterial changes because the 86.13 goes to 86.14. There is a slight change in the cost of the debt, 7.04 to 7.28, and the changes in the equity from a 12.15 to 12.14 and a guarantee 26.13 to 26.14. So those are relatively immaterial. The consequence of those changes is that the return that I'm recommending on rate base is modified from 7.873 to 8.017. Now I did make a revision to make it clear that this refers to the rate base, excluding Rural Interconnected and Isolated assets. So it's

the return on rate base with, I've added the phrase, "excluded Rural Interconnected and Isolated assets" to make it clear, and it modifies the implied coverage of my recommendation slightly from a 1.3 on line 16 originally to a 1.28 in the revision, and I will point out that my recommended return on rate base should be compared to the revised return on rate base applied for by Hydro of 8.322 percent.
Now that number is on the assets excluding the Rural Interconnected. Because if you look at the application including that, then the return on rate base is slightly lower, but this number of 8.322 is the figure in the revised company application that applies to the rate base, excluding Rural Interconnected and Isolated assets.
Because of those changes to page 15, I've also circulated a revision to page 39 of my testimony, which because of the changes--the main change on page 39 is that line 9, the target return on rate base, and again, I've modified it to make it clear that it's on the Rural--excluding Rural Interconnected and

Isolated assets, the return, my recommended return is 8.017 percent, as compared to the previous 7.873 percent which appeared in my original testimony. So I believe that page was also distributed, Mr. Fitzgerald?
Q. Yes, it was.
CHAIRMAN:
Q. Yes, it has been.
MR. FITZGERALD:
Q. Confirm that.
A. Correct. With that, that concludes my revisions and updates.
Q. Okay. Yesterday you were present and you may recall the Chairman asked Ms. McShane what key factors may have changed since the Board's decision earlier this year regarding Newfoundland Power's rate of return, and Ms. McShane did note the drop in the Canadian bond yield. Do you have any comments regarding that question?
A. Yes, I do. I think--well, first of all, I believe the rate of 9.75 was set on the assumption that the long-term Canada rate was 5.65 percent. I believe that was the assumed rate. I would point out that it has dropped--

the long-term Canada bond rate has dropped materially at least 30 basis points from the time.
I think there is another very major market move that has to be recognized. The equity markets are pricing utility shares at historically high values. My sample of regulated utilities in Canada are now trading at almost twice book value. Now this is a very major shift from last year, because the markets basically--utility shares haven't been priced this way for a long time and they are--in fact, they've never been priced this high. Traditionally, they used to be--when I say traditionally, I mean, decades ago, they were in the 1.2 range. Then they started to creep up in the early--a decade ago, they were about 1.4. Now they've crept up to almost two times. Now despite the fact that they do have some regulated activity--sorry, non-regulated activities, it's patently obvious that the market for low risk utility shares in Canada is signalling that these companies are earning well in excess of their cost of capital and I think this market movement is a marked change

Page 9

DR. KALYMON:
from a year ago. So I just want to put that on the record as part of my evidence.
MR. FITZGERALD:
Q. Thank you, Dr. Kalymon. Mr. Chairman, that concludes our direct examination.
CHAIRMAN:
Q. Thank you, Mr. Fitzgerald. Good morning, Ms. Greene.
GREENE, Q.C.:
Q. Good morning, Mr. Chair, Commissioners, Dr. Kalymon. I wonder first if we could look at page two of your evidence to discuss with you the terms of reference for your evidence, and beginning there with line 6. In line 7, you set out that you have been asked to deal with the current financial structure, and that will be the current financial structure for Hydro, I assume?
A. In all of these cases, yes.
Q. Right, okay. And that you have been asked to provide various evidence with respect to, for example, the current financial structure, the cost of debt and the guarantee fee for Hydro, the appropriate rate of return, common equity

Page 10

and the target financial structure. So that was what you were asked to provide in this evidence. Is that correct?
A. Yes, that's correct.
Q. And then looking at line 12 that in order to answer or to come up with your recommendations on these topics, you applied what you would view as standard financial theory?
A. Yes, that is correct.
(9:16 a.m.)
Q. You then discuss the general economic conditions which I didn't plan to review with you, but I would like to talk to you a little bit about the risk, as you have outlined it for Hydro, and that begins on page eight of your evidence.
A. Yes.
Q. And I won't go through with you your analysis of the business risk facing Hydro, but I would like to take you to page ten, beginning at line 21, which is where you summarize your opinion with respect to the business risk facing Hydro. And I wonder if you could read into the record there, beginning at line 21, what your opinion is?

Page 11

A. It states on, starting on line 21, "on balance of factors, it would be my overall assessment that the business risks of Hydro--the business risk of Hydro"--I notice a grammatical error, "the business risk of Hydro has not changed materially from the last hearing and are similar to that of other electrical utilities, such as New Brunswick Power, Nova Scotia Power and Newfoundland Power, which enjoy effective regulatory monopolies within smaller and less diversified economies."
Q. So I gather from that that your view of the business risk facing Hydro, that we would be similar to the utilities you've mentioned there? Is that correct?
A. Yes, in general.
Q. Okay. Now the next statement I wanted to take you to is page 13, line 11, where after your discussion of capital structure, you talk about the overall risk of Hydro, beginning there at line 11.
A. Correct. "Under such an assumption," which-- and the assumption is the precedent is the deemed capital structure of basically 60/40 debt and equity, "the overall risk of Hydro

Page 12

would be comparable to that of the average utility and somewhat below that of Newfoundland Power, in particular."
Q. And we asked you an information request with respect to that, and I wonder now, Mr. O'Reilly, if you could bring up RFI NLH-84 CA? And I just wanted to point for you to read your last sentence in your answer.
A. Can I just read the question?
Q. Sure.
A. Just to make sure that I'm answering in context.
Q. Definitely, yes.
A. Thanks. Yes. It says "however, the differential"--the last sentence is what you'd like me to read -
Q. Yes.
A. - into the record? "However, the differential and risk with Newfoundland Power would not be material and the investment risk is still comparable."
Q. So in terms of your opinion, Dr. Kalymon, is it fair to say that in terms of business risk, based on your conclusion on page ten of your evidence, you believe that the business risk

GREENE, Q.C.:
that faces Hydro is similar to that of New Brunswick Power, Nova Scotia Power and Newfoundland Power and that with respect to the overall risk, again with respect to Newfoundland Power, the differential is not material and the investment risk is comparable to Newfoundland Power?
A. Yes, but remember my qualifier, that it's under the assumption of 60 percent debt.
Q. Yes, I -
A. That I am saying the overall risk would be comparable. Now, the actual debt is much higher, but the risk is compensated by the guarantee. So I treat it effectively like a 60/40.
Q. Okay. And I was going to come to the capital structure. With respect to the capital structure, if we could just go back now to page 11 of your evidence. Page 11 of your evidence commencing there on line 6, where you discuss the current capital structure of Hydro and I take it from your evidence, particularly line 7, that without the Provincial guarantee, it would be your opinion that Hydro's

financial structure would not be financially viable? Is that correct?
A. That is correct.
Q. However, in light of the guarantee, I believe you state that it is acceptable and within the range of other Crown owned utilities, and I would point out here your evidence starting on line 13. Is that correct?
A. Yes, with the provincial guarantee, I have no concerns about the financial viability of this company.
Q. And that in fact, it is similar to that of other Crown owned utilities in Canada?
A. Well, it is, but I'm not relying on that, because the range is so wide that there is really no proper comparability. It's really almost arbitrary. Once you put in a provincial guarantee, each provincially guaranteed utility almost arbitrarily chooses its capital structure. I mean, you see organizations with 100 percent debt and you see organizations with 60 percent debt. So, you know, on average it's 80. That doesn't mean much to me. I think the truth is that the capital structure becomes rather arbitrary

once you put in a guarantee and that's what you see across the comparisons.
Q. The 100 percent you mentioned is for New Brunswick Power? Is that correct?
A. Yes, that's correct.
Q. And would there be other Crown utilities in that range in the past five years?
A. Like I say, there's large variability. I think the answer is no, but there's large variability. They are still--New Brunswick is still viable. Simply once you put in a provincial guarantee, the amount of equity that's really in the organization is different than in a situation where there's no guarantee.
Q. I did want to talk to you about your table on page 15, and it is helpful you filed a revised table because it eliminated some of my questions. We were having difficulty understanding some of the calculations there. But I still have a couple of questions for you with respect to the revised table, which is different than the one on the screen. The remaining questions that I have for you, since you've filed the revision, relate to the 1.71

percent that is illustrated there on line 9, which in your revision is now 1.47. I wonder if you could explain how that is derived?
A. That is derived as the differential between the amount that I consider a reasonable return on equity, or fair and reasonable return on equity of 8.75 percent.
Q. And that would be a current rate for equity, I gather, is it?
A. It is the cost of equity currently. This is my current recommendation for the cost of equity, 8.75. If you deduct--and my assumption is that it's fair for--if the company is to be treated as a privately owned utility, it is fair to earn 8.75 on the deemed equity component. If you look at the funded cost of 7.28, the differential is 1.47. So that is the differential between what I think is a reasonable provision for the implied equity and the actual funded cost, which I have calculated at 7.28 percent. The differential is the 1.47 that you see.
Q. And I think the purpose of that you explained in NLH-109 CA? Is that--I'll give you a moment there to read it.

Page 17

DR. KALYMON:
A. Yes, my answer to 109, I use the number 1.71, which has dropped to 1.47 because of my revision.
GREENE, Q.C.:
Q. That's correct.
A. But other than that, my answer stands as I stated it. Just for clarification, I would just add that what I am trying to do with this 1.47 amount is to effectively grant the company 8.75 on the full amount of equity which I have implied, which is the total of the 12.14 and the 26.14. So it effectively provides Hydro with a return of 8.75 on both those amounts, because they're being granted the 7.28 on the funded debt and then the premium brings that up to a full 8.75. So the result is giving a full 8.75 on the equity component that I have deemed.
Q. And in order to do that, you deducted the current cost of equity for the embedded cost of debt and the current cost of equity? Is that correct?
A. Yes.
Q. The 8.75 is the current cost of equity for Hydro and the 7.28 is Hydro's embedded cost of debt after the guarantee?
A. Correct.
Q. I'd like you to comment on whether you think it would be appropriate to use the marginal cost of debt in that calculation instead of the embedded cost of debt, because you're applying it against the current cost of equity?
A. I think that would be incorrect and inappropriate because if I am going to deem the organization to have only 60 percent debt, the equity returns should be at current rates. This would be the way a company which is funded in a more conventional capital structure, without the use of a guarantee, would have to function and so what I'm calculating is an appropriate return that would be reasonable and very comparable to what a privately owned organization would be allowed under such a circumstance. They would be allowed effectively current equity rates on approximately 40 percent or just under 40 percent of the equity, in my assumption, and they would be allowed to recover their cost of

Page 18

Page 19

debt. So this most closely parallels--this calculation most closely parallels what would be permitted in a privately owned utility. So my answer is no, my calculation stands and I would not use the differential to current debt.
Q. I wanted to move on now, Dr. Kalymon, to your next area, which after the debt and the guarantee fee, and I gather from your evidence you have no difficulty with the value of the guarantee fee that's presently paid, to look at beginning on page 18 and then--actually, beginning on page 17, you start your analysis to determine your recommendation with respect to the cost of common equity for Hydro, and beginning on page 18, you set out, beginning on line 7, the three tests that you have used to come up with your recommendation, and these are the risk premium method, the adjusted comparable earnings test and the discounted cash flow approach. Is that correct?
A. Madam, I just have to--there was a very long preamble in which there was a statement which I disagree with.
Q. Sorry.

Page 20

A. And the statement was that you have no problems with the current guarantee fee.
Q. The value.
A. Yes, and I have to make comment on that because I disagree with that preamble to the introduction, and the reason I say that is I explain my opinion about the guarantee fee on page 16.
Q. Yes.
A. I do not consider the one percent excessive, if it is recognized that it is within the context of overall compensation for the equity. It is excessive, in my opinion, if it is granted and on top of that an equity return is granted that ignores the calculations that I have provided. In other words, I do not consider an 80/20 an efficient capital structure. One has to look at what an efficient capital structure would look like. Under an efficient capital structure, a one percent fee would be excessive. However, in the context of overall compensation for the capital provided, the one percent could be permitted as long as the return on rate base, in total, is not excessive, and that--so that

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Page 21

DR. KALYMON:
is an important distinction. On a stand-alone basis, I don't think it is necessarily appropriate but in an integrated compensation package, then it may be appropriate.

GREENE, Q.C.:
(9:31 a.m.)
Q. Yes, and I only made my statement in a very narrow context, you had not objected in your evidence to the one percent guarantee fee.
A. Within the total context, that's correct.
Q. So if we come back to page 18.
A. Yes.
Q. And the three tests that you use, you have described, beginning there on line 7, that "these three tests are extensively applied in regulatory proceedings and are well established." That's why you use the tests, I would take it.
A. Yes, that is correct.
Q. And I won't review with you your test, but the recommendation that you derive from it with respect to the recommendation on common equity, which is on page 39, line 7, which you revised this morning. While you revised page

Page 22

39, you have not revised your recommendation with respect to the return on equity. This was your recommendation following the application of the test that you outline in the previous pages of your evidence? Is that correct?
A. Correct.
Q. And this is the same rate of return on common equity that you recommended in the Newfoundland Power hearing that concluded earlier this year?
A. I believe so.
Q. Now I wanted to look for a moment with you at the returns that Crown owned utilities have actually earned, and here, you attached a schedule to your evidence, Schedule 34.2. Bit hard to get on the screen, I think, when it's enlarged, but these are--I just wanted to review with you, these are the actual returns on common equity. Do you have it there, Dr. Kalymon?
A. Yes, I do.
Q. For the years indicated for the Crown owned utilities in Canada? Is that correct?
A. Yes, that is correct.

Page 23

Q. This is based on their actual results, I gather, for the years indicated? Is that correct?
A. Yes, that was the attempt.
Q. Okay. And now I wanted to take you to the response to PUB-46 NLH, which was a response from Hydro, so I'll give you a moment to review it. And if you look at the following page, this includes the allowed return that had been allowed by the regulator as well. So if you'd go to page two, Mr. O'Reilly.
A. Can I finish reading -
Q. Sorry.
A. - the reference here?
Q. The question was for Hydro to provide the earned returns for Crown owned utilities, and the answer is that the 2001 and 2000 earned returns, as well as the allowed return, was provided.
A. Yes.
Q. If we go to the--and I just wanted to point out here that your schedule provided the actual returns for the same--for the majority of the group there that are listed as provincially owned for the same years, but in

Page 24

addition, we have included or there is included another column that besides the actual return, you have the allowed returns.
A. Yes.
Q. So that the returns for Crown owned utilities in Canada, for the allowed return for the two-year periods that are shown there, have been in excess of nine percent for the allowed returns in all cases for 2001 and '02, for the allowed one first?
A. Well, I can't testify to these numbers, because they're not my numbers. I will take them, subject to check.
Q. Okay. Certainly. That's fine.
A. But these are not my numbers.
Q. And then, as is normal then the actual returns actually vary based on the actual results, but again, they're illustrated there for 2001 and '02? Is that correct?
A. Well, I said I didn't develop that table. I developed this table, but in both cases, these numbers are higher than what I consider to be the cost of capital, yes.
Q. Now I'd like to look at NLH-136 CA, which was a question to you dealing with your

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GREENE, Q.C.:
recommendations over the past period of time, and I guess Mr. Fitzgerald took Ms. McShane through similar type of evidence yesterday with respect to Ms. McShane's recommendations and here, Hydro had asked for you to provide your recommendations in your last five appearances.
A. Right.
Q. And your last five appearances would be four here in Newfoundland and one here in Nova Scotia in 1995. Is that correct?
A. That is correct.
Q. We'll leave aside Hydro's last case, because I think we'll all agree that was a bit of an anomaly where Hydro asked for the three percent, but -
A. If you insist, I will leave it out.
Q. - but where you made a recommendation in the other cases, I guess, what was actually allowed by the regulator in all cases was higher than what you recommended?
A. It was 25 basis points above my range in the first case. It was half a--50 basis points above my range in the second case. It was 25

basis points above the top of my range in the third case, and the worst performance would have been the last one, which is 75 basis points above the top of my range.
Q. And these are all of your appearances in regulatory boards since 1997 where you made a recommendation with respect to the cost of capital for a utility? Is that correct?
A. That is correct.
Q. Thank you, Dr. Kalymon. That concludes our questions.
CHAIRMAN:
Q. Thank you very much, Ms. Greene. Good morning, Mr. Kelly.
KELLY, Q.C.:
Q. Good morning, Chair. I have no questions for Dr. Kalymon.
CHAIRMAN:
Q. You have no questions. Thank you very much. Good morning, Mr. Hutchings.
HUTCHINGS, Q.C.:
Q. Good morning, Mr. Chair. I just have one brief point, Dr. Kalymon, to pursue with you. Are you familiar with the operation of the load variation provision of the Rate

Stabilization Plan that Newfoundland and Labrador Hydro has?
A. The current one.
Q. You are familiar with that, are you?
A. Yes.
Q. And do you know whether or not Newfoundland Power has a similar provision for their benefit?
A. Could you just repeat the question because I'm not sure which company we're talking about, let me keep these clear or try to keep these clear in my mind.
Q. Okay, all right. My first question related solely to Newfoundland and Labrador Hydro, the Applicant here, and I asked you if you were aware of the operation of the load variation provision within the Rate Stabilization Plan?
A. Yes, I have reviewed that and I discussed it in my testimony in general terms, yes.
Q. Yes, okay. And were you aware as to whether or not Newfoundland Power had a similar type of provision acting for their benefit in their rate scheme?
A. The answer is I believe they do, yes.
Q. So the evidence that you have given here is

based on the assumption that there is a load variation provision in the Newfoundland Power rate schedule, similar to that in the Newfoundland Hydro rate schedule, is that correct?
A. Well, frankly it's irrelevant to me, I mean, the only issue on the table here today is the issue for Hydro. Newfoundland Power is not in front of this Board, so, you know, maybe my memory is cloudy on the details of what's happening in Newfoundland Power, but the only thing of relevance in this hearing and the only thing that I'm assuming in this hearing is how the Rate Stabilization Program affects Hydro. How it affects Power is a different-- is a completely different set of issues, so it's totally irrelevant and has nothing to do with my assumptions here.
Q. Your evidence is to the effect that on the basis of the information that you had, the risk--the total risk for Newfoundland Power was similar to that of Newfoundland and Labrador Hydro?
A. Yes, in an overall sense, yes.
Q. Okay, thank you, Dr. Kalymon. That's all I

HUTCHINGS, Q.C.:
have, Mr. Chair.
CHAIRMAN:
Q. Thank you, Mr. Hutchings. Good morning, Mr. Kennedy.
MR. KENNEDY:
Q. Good morning, Chair, Commissioners. Dr. Kalymon, I too only have a couple of questions.
A. I'm glad I changed my plane reservations.
Q. Page 12 of your pre-filed report, Dr. Kalymon.
A. Yes.
Q. And I just wanted to, similar to the line of questioning that I pursued with Ms. McShane, I just wanted to touch on the point of departure, if you will, from your own approach and a determination of an appropriate rate of return for, in this case, Newfoundland and Labrador Hydro, versus that of Dr. Waverman. I assume you've had a opportunity to look at Dr. Waverman's report?
A. Yes, I have.
Q. Okay. And at line 13 there, in your report at page 12, you indicate, "The current mandate for the regulation of Hydro requires that it

be treated similarly to a privately-owned utility."
A. That is my understanding and that was the basis for my evidence.
Q. Okay, and again, that's your understanding and I was just wondering is there anything that you could point to that's actually required by legislative intent or otherwise, or is that an inference that you're making as a result of the regulatory framework?
A. Well, I'm not a lawyer, so I can't offer a legal opinion, but my reading, my lay reading of the mandate of the Act, as it was revised, was that it was to be--that Hydro was to receive a return that was similar to that of privately-owned utilities. So I have developed my testimony with my understanding of that, of that mandate. Whether that is legally correct, I don't know, but that's the basis of my testimony and if that's incorrect, the obviously they shouldn't get these returns.
Q. Okay, thank you, Dr. Kalymon. That's the only question I have. Thank you, Chair.
CHAIRMAN:

Q. Thank you very much, Mr. Kennedy. Excuse me. Do you have any re-direct Mr. Fitzgerald?
MR. FITZGERALD:
Q. I have no re-direct.
CHAIRMAN:
Q. Any questions? I just have one question and I guess, you commented on the fact that with the capital structure the way it is presently and with the government guarantee, you have no difficulty, I think, with the risk associated with Hydro, in terms of, I guess it's ability to borrow. Ms. McShane identified a number of negative impacts, I guess, on Hydro if the capital structure does not improve over the next period of time, yesterday. Do you have any comment, Dr. Kalymon on that?
A. Well, one of the usual impacts of these situations is that they can impact negatively on the credit risk of the Province. This is a concern that I have seen expressed in other context and certainly credit reports on provincial finances. It doesn't per se create a risk to this Company. It creates a potential problem for the shareholder because it potentially could impair their own

borrowing or it could impair their own credit rating, but I don't see that as a risk to Hydro. If we're talking about Hydro specifically, that is something that the Province, as a shareholder, may want to avoid and it is a common recommendation by many financial experts for provinces to avoid situations in which the debt in its utilities are so excessive that they impair on the credit of the province. But in itself, that is not a real risk for this Company. It's a concern for the Province, rather than the Company. Beyond that, I guess if the debt ratio gets too extreme, there could be a situation where there would be a direct risk because the Company would have to actually utilize the Province's guarantee in some fashion because they would be unable to meet payments, and therefore, require some support. And that is not a condition that I think is very positive and clearly would create some financial distress. So if you push those debt ratios much beyond 80 percent, I think you start creating that potential if you have an adverse fluctuation. But still, with the

DR. KALYMON:
borrowing capacity that is available, such emergencies can generally be met and this is well established in many different provincial context, again, at the risk ultimately of maybe creating some credit problems for the provincial owner. But in general at the levels that I see, I don't have any concern about the financial stability of the Company because of the Provincial guarantee; otherwise, I'd be very concerned.

CHAIRMAN:
Q. Any questions?

HUTCHINGS, Q.C.:
Q. No questions.

CHAIRMAN:
Q. Thank you very much, Dr. Kalymon for your testimony. Thank you, sir. I guess surprisingly we're--surprise to me anyway, we're a little bit ahead this morning of where I thought we'd be. Mr. Kennedy, does your witness require a few minutes to get ready?

MR. KENNEDY:
Q. In light of the timing, perhaps a five-minute break, Chair, just so he can get organized.

CHAIRMAN:
Q. That's fine. We'll reconvene in five minutes.
(BREAK)
(9:58 a.m.)

CHAIRMAN:
Q. Good morning, Dr. Waverman. Trust you were able to change your flight. Would you like to introduce the witness, Mr. Kennedy?

MR. KENNEDY:
Q. Thank you, Chair. Commissioners, this is Dr. Leonard Waverman, he hails from the London Business School in London, England, and I'd ask, Chair, if you could swear the witness in.

DR. LEONARD WAVERMAN (SWORN)

CHAIRMAN:
Q. You can being, Mr. Kennedy, when you're ready. I'm hesitant to predict any time, but we'll certainly go through until 11:00 and then we'll see where we are at that time.

MR. KENNEDY:
Q. Thank you, Chair. Chair, in light of the fact that this is Dr. Waverman's first time testifying before the Board, I thought I would just bring him through a little bit of his background for the benefit of the

Commissioners. Dr. Waverman, you're a special advisor to the National Economic Research Associates, is that correct?
A. That's correct.
Q. You obtained your Ph.D in Economics from M.I.T in 1969?
A. I did.
Q. And your MA in Economics was gained at the University of Toronto?
A. That's correct.
Q. You're currently a full professor of Economics at the London Business School?
A. I am, I'm also a professor emeritus still at the University of Toronto.
Q. You hold several other positions as well, I understand?
A. Yes.
Q. And for the benefit of the Board, Dr. Waverman's full r sum is attached as an exhibit, LW-1, filed with the Board as well, and that provides the full listing. Could you, Dr. Waverman, describe your experience in Cost of Capital determinations?
(10:00 a.m.)
A. Yes, my experience is as a board member, not

as an expert witness. I was a part-time member of the Ontario Energy Board for two years, from May 1978 through May 1980. And in that capacity, I took part in several hearings involving Consumers Gas and Ontario Hydro and took part in Rate of Return determinations for Consumers Gas. I was a member of the Ontario Telephone Service Commission for five years, between 1989 and 1994, and again, we looked at Rate of Return issues as the board. I am presently, since June of 2002, an non-executive board member of the Gas Electric Market Authority which is the UK's gas and electric regulator. Now the setup in the UK is quite unique in that regulatory boards are not set up similar to a corporation and controlled by a board with a majority of non-executive members. And all final issues, all determinations, all approvals are done by the board sitting together. And I currently, for example, although we don't do much Rate of Return analysis in the UK, it's mainly a price caps basis now. I do sit on the Transmission hearings which are just beginning and where we will be using a Rate of Return in those

DR. WAVERMAN:
hearings.
MR. KENNEDY:
Q. Thank you, Dr. Waverman. Dr. Waverman, you filed a report with the Board that was dated September 5th, 2003, subsequently filed with the Board on September 22nd, 2003, is that correct?
A. That's correct.
Q. And did you make any or file any changes to this original report since September 22nd?
A. I have not.
Q. Are there any changes that you wish to make to your testimony at this present time?
A. There are two small typos or errata I would like to correct this morning. The first is on page 7 on line 20 where the fourth last word in line 20 is "the", "as a level of the marginal cost", it should be "as the level of Hydro's marginal cost", so for the word "the" substitute the word "Hydro's". And the second errata is on page 13 in line 7 where I say, "Both Hydro and the Province are rated BB from Standard and Poors", that's incorrect, they're rated BB from DBRS, Dominion Bond Rating

Service.
Q. Dr. Waverman, do you adopt your pre-filed expert's report dated September 5th, along with the changes that you have just outlined?
A. I do.
Q. Dr. Waverman, could you provide us with a synopsis of the opinion that you provide in your report, and if you could, while doing that, indicate how it differs from the approach and methodology employed by Ms. McShane and Dr. Kalymon in their reports?
A. Certainly. I was asked by the Board, I guess on page 2 of my testimony, to consider whether as a Crown Corporation--that's on lines 13 and 14--Hydro enjoys the lower cost of capital that is consistent with its ability to raise funds under Provincial debt guarantees. Really to go back to first principles, because I think this is the first time the Board is really, I think, struggling with the issue of what is the appropriate rate of return on the retained earnings component of the rate base. And so, I went back to first principles and let me begin by showing the differences--enormous similarities between my position and

those of Ms. McShane and Professor Kalymon which is the embedded cost of debt, there is no dispute. The amount of retained earnings, there is no dispute. The valuable use of the approaches, capital asset pricing model, discounted cash flow, comparable earnings, there is no dispute. I don't--I think those are very valuable tools. What I question is whether they're valuable in this--in these circumstances and the cap, for example, capital asset pricing model asked the following question. If you are a private investor--take Ms. McShane or Professor Kalymon, and you have a portfolio, a broad-base market portfolio, what would be the required return to compensate for the systematic risk of adding another stock to that portfolio? That is what a capital asset pricing model does. And the answer is, you take the risk free rate of return, the risk premium and the beta coefficient, which is co-variance between the riskiness--the systematic riskiness of that stock and the broad-based market portfolio. And that is a well-know, the people who found this got nobel prizes, so

it is--there's no disputing the methodology. The question is and as Professor Kalymon said this morning, the capital structure for Hydro is arbitrary, it consists not of equity traded in markets. Professor Kalymon, Ms. McShane and I cannot buy stock in Hydro. We cannot add it to our portfolio, so it's intrinsically totally different from the equity of a private-investor owned utility which is traded and where the rate of return is based on these calculations. The Act says that Hydro should earn just and reasonable returns and what we have to determine is just and reasonable compared to what? And the comparator I use is that Hydro does not issue capital, it does not have capital that's traded in stock markets. There are no private investors in Hydro and therefore, as a Crown Corporation, at the margin, that Crown Corporation issues debt. It does not issue capital. And so the cost of capital of unretained earnings is at the margin. If you had a dollar less of retained earnings, you would issue a dollar more of debt and so the rate of return required on the capital component called retain earnings in

MR. WAVERMAN:
the rate base, is the marginal opportunity cost of debt. So that is the big--that is the substantive difference between myself and Ms. McShane and Professor Kalymon, is that I question the use of these tools which are used for IOU's to determine the Cost of Capital. I question their validity for a Crown Corporation which does not have capital that's traded in stock markets where private investors do not buy and sell shares, and where the whole basis of the Cost of Capital in these models has been derived on the basis that they are for private investors at the margin, buying and selling shares, adding them to a market portfolio does not exist here. And so I therefore say that as a Crown Corporation which enjoys lower debt through the guarantee, that Crown Corporation also enjoys a lower Cost of Capital because the retained earnings, as Professor Kalymon said this morning, that's arbitrary and it does not have to tax itself and look at the comparable earnings of an investor-owned utility, even one in the same province, as a basis for

judging what the citizens that are shareholders should be earning on the retained earnings left in Hydro. So that is the basis of my opinion.
Q. Thank you, Dr. Waverman. Chair, that's all the questions I have on direct. The witness is available for cross-examination.
CHAIRMAN:
Q. Thank you, Mr. Kennedy. Ms. Greene?
GREENE, Q.C.:
Q. Good morning, Dr. Waverman. I would like to ask you and I think you actually touched upon it in your direct-examination with Mr. Kennedy, what it was that you were asked to provide an opinion on, because it appears to be different than what Ms. McShane and Dr. Kalymon was asked to provide an opinion on. So if you could go to page 2 that you briefly referred to in your direct, there on line 19, you refer to the fact, key questions that you were asked to discuss.
A. Yes, it's also up in line 11.
Q. I was going to come up to line 11 and I was going to ask you the actual key question or the specific question was phrased for you or

framed for you by Board staff, is that correct? And I was going to get you then to ask you the specific question, as opposed to what a fair return for Hydro is.
A. Yes, that's correct.
Q. And I'm correct in saying you said the Board, but I assume you meant Board staff?
A. Board staff, that's correct, not the panel.
Q. So Board staff asked you as to whether--looking there at line 12, well I guess it begins on line 11, specifically the question was because Hydro was a Crown, it would enjoy the lower cost of capital. So that was the specific question that was put to you by Board staff?
A. Well, it was really the line above, whether Hydro's cost of shareholder's equity should be assumed to be equivalent to that of an investor-owned electric utility companies, that's the basic question.
Q. And your opinion, you've summarized verbally just then in your direct-examination, but in your pre-filed is found on page 3, beginning on line 7, is that correct?
A. That's correct.

Q. And as you mention, you do agree that Hydro should recover the embedded cost of debt, including the debt guarantee fee, which is there, beginning lines 7 to 9. And the other portion of your opinion is that "Hydro should be allowed"--and I'm reading now from line 9, "to recover the opportunity cost for the Province"--who is the shareholder, I assume, "for the portion of Hydro's capital structure represented by shareholder's equity, which is retained earnings."
A. Correct.
Q. And that's what I wanted to explore with you a little bit. And in your, I gather from your pre-filed, as well as your evidence a few moments ago, the fact that Hydro does not have common stockholders or common stock equity that is publicly traded is an extremely significant point for you, that causes you to approach the analysis differently than Ms. McShane or Dr. Kalymon?
A. Correct.
Q. Now, you mention that the shareholder is the Province, is that -
A. That's correct.

MR. KENNEDY:
Q. And with respect to it, you're saying that the marginal cost or the opportunity cost for Hydro to compensate for the retained earnings or the shareholder's equity, which is retained earnings for Hydro, is the opportunity cost of debt. And I believe you explained it this morning and correct me if I have it wrong, you mentioned that was because that if retained earnings were reduced, Hydro would have to borrow more, and therefore, the opportunity cost would be the cost of the new borrowing, is that correct?
A. Yes, since Hydro does not issue stock, it issues debt, then the opportunity cost of the retained earnings would be the opportunity cost of debt, yes.
Q. And that's because if the retained earning were reduced, Hydro would have to borrow more and that's how we got to the opportunity cost of debt?
A. Not so that they would have to borrow, just that is how they raise capital. They don't raise capital by issuing stock, publicly traded on markets.

Q. I wonder if we could look at the response to NLH-173. I'll give you the opportunity to review it.
A. Yes.
Q. The way you explained it this morning was actually the way I had understood it when I read your pre-filed evidence at the beginning, but I've done Economics many, many years ago, an undergraduate, I won't tell you how many years ago, and when we received the answer to this question, NLH-173, where we asked you was it because they would have to borrow more and therefore, that's why retained earnings were reduced, that's why you had used the opportunity cost of debt. I would like you to read the answer and explain, because to me, it appears to be somewhat in conflict with what you have just said this morning.
A. Yeah, okay. No, it is based on the opportunity cost of incremental and new debt capital assuming that Hydro's retained earnings remain in place. In a special case where Hydro raised debt capital to replace its retained earnings, that opportunity cost of debt would likely be higher as Hydro's

financial integrity would be weakened, retained earnings were to be replaced with debt. What I'm--returns should be just and reasonable. One has to compensate for the true opportunity costs, and so what I'm trying to suggest is that if there is a large additional debt that is raised, then one would want to look at the incremental cost of debt debt and not simply the embedded cost of debt.
Q. Could you repeat that, I'm not sure I actually heard the last part of the answer.
A. If there is a large amount of debt to be raised, then the opportunity cost for just and reasonable returns for Hydro, would be the incremental cost of that debt, not the embedded cost. One would have to price that in the market.
Q. But in this particular answer to the question where we asked is it because if retained earnings were reduced, we would borrow more, that's why you chose the opportunity cost of debt, the answer was, the opportunity cost of debt would be higher as our financial integrity would be weakened if the retained earnings were to be replaced with debt. So

are you saying that the marginal cost of debt for Hydro would then be higher than it otherwise would be?
A. Yes, it could be.
Q. Now, this is the--do you view this as the return to the shareholder for leaving retained earnings in the company?
A. That is--yes, I see that as the opportunity cost of those earnings.
Q. In terms of who the shareholder is for Hydro, I wonder if we can go to NLH-167. I'll give you a moment to read it, but there we asked the question with respect to the shareholder, who the citizens were. And in your previous testimony in answer to questions, you say that the problems with the shareholder in Hydro representing the province's citizens, is that correct?
A. That's correct.
Q. Okay. So, if the return is the return to the shareholders and the shareholders are citizens, I guess--we asked you another question which I'd like you to bring up now, NLH-195. If the true shareholders are the citizens of the province, from a theoretical

MR. KENNEDY:
perspective, wouldn't it make sense to look at the opportunity cost of debt for the real shareholders, the citizens? And this was the question in NLH-195.
A. I think that's totally wrong.
Q. I notice in your answer, you said, it was outside the realm of feasibility, but from an academic perspective in terms of rates of return to the shareholder, the Province represents the true shareholders, the citizens, and the citizens have another opportunity cost of debt, everything from their mortgage to their credit card, why, from an academic perspective, couldn't you look at the opportunity cost for the real shareholders in Hydro?
A. Because the opportunity cost is not that equivalent to a private investor who's buying and selling shares in Newfoundland Power or in investor owned utilities. It's simply very different. That's why we have a Crown Corporation -
Q. I accept that they're different.
A. - so we don't have to tax ourselves that way.

Q. I accept that they're different. I was just assuming your theory that if it is the return to the shareholder and is the opportunity cost of debt, and if the shareholder is the citizens -
A. Yes.
Q. - why wouldn't it be the opportunity cost of debt for the citizen?
A. Because it is, as a Crown Corporation, I mean, I don't think we should go behind and look at the ultimate citizen and say, well, they may have to issue their own debt, what is their debt rate. That is really beyond the realm of feasibility or academic correctness. This is a corporation and as a corporation, we don't go beyond a vale.
Q. You had said yourself that the real shareholders were the citizens of the Province.
A. They have banded together and say, we want a Crown Corporation. We don't have an investor owned utility and therefore, they have advantage of not have paying taxes on the earnings, of not having a threat of bankruptcy, having a debt guarantee, they have

a much lower risk. And for that, they have the benefit of having a lower cost of capital.
Q. It wouldn't be because of the opportunity cost of debt for the real shareholders, the citizens, would be too high, is it, that you -
A. No.
Q. Because I guess, we'll have to agree to disagree because in theory, I believe that the shareholders are the citizens and its a return to the shareholders, then you can look at the opportunity cost of debt to the real shareholders in Hydro.
I wanted to move now to another point which recommendations that you, yourself have made as an expert witness with respect to the cost of capital. And I know Mr. Kennedy explored this with you briefly. And we also asked you a question about that, NLH-161. We asked you the question, but I guess the response was that you didn't have the information available to determine or you didn't have the records to be able to provide what your specific recommendations had been.
A. That's correct.
Q. Okay. And I took it from your answer to NLH-

161, as well as to Mr. Kennedy this morning, and I may be wrong, have you, as an expert witness, made any recommendations with respect to the cost of capital for an electric utility in Canada?
A. I have not.
Q. Okay. Whether Crown owned or privately owned.
A. That's correct, I have none.
Q. As a member of the Ontario Energy Board, did you participate in any decisions where the cost of capital for an electric utility was discussed?
A. Yes, I sat on two hearings involving Ontario Hydro, but in those days, there was no rate of return, it was a net income basis. So, there was no -
Q. So, this basically wasn't there.
A. No rate of return was ever discussed.
Q. Would your theory about the marginal or the opportunity cost for the shareholder in a Crown Corporation, being the marginal cost of debt, apply to any Crown owned utility where there was no common stock publicly traded? And I guess to help you here, we could bring up NLH-163 where we asked you that question

Page 53

MR. KENNEDY:
and where you had said yes, in principle, it would. I'm sorry, that was where -
A. Yes, I -
Q. There was another question -
A. Before that, yeah. Maybe we could go to 162.
Q. That just said that they are the same except for BC Hydro possibly. Yes, that's what Doctor Waverman has asked for. That is with respect to the shared capital of the Crown Corporations and whether it was publicly traded. Would you agree that your principle should apply equally to other Crown owned corporations in Canada where there is no common stock publicly traded?
A. Correct.
Q. Have you looked at the allowed returns for Crown Corporations in Canada?
A. I did not at this point, but I have seen them since, including this morning.
Q. Okay. And perhaps again, if we bring up PUB-46, I'll give you a moment. I don't know if you want to read page one first, Doctor Waverman. Mr. O'Reilly.
A. Yeah, okay.

Page 54

Q. If you'd go to page 2 now and you'll see the list of Crown Corporations in Canada on the first top part of that chart.
A. Correct.
Q. And the first column, 2001 and the second column, 2002 shows the actual returns. Whereas, over further, we see what the allowed return by the regulator was.
A. Correct.
Q. Would you be in a position to comment as to whether these returns would be in excess of their marginal cost of debt?
A. I would say, yes, they would be in excess of marginal cost of debt. The returns, I don't know if those are on consolidated or unconsolidated basis, as well, but the allowed return on equity certainly would be above that cost of debt at the margin.
Q. Have you done any analysis to see how your recommendation would be compared to what other regulators have allowed or what the experience of other Crown owned utilities in Canada has been?
A. Well, in BC, there is a direction in '92 from the Province to the Board saying that, for BC

Page 55

Hydro, they have to take their best comparable investor-owned utility, which is BC Gas, and give a similar rate of return as an investor-owned utility. So, that is the direction from the Province.
Q. And so the other utilities?
A. In the other utilities, I have not examined those as to why they come up with those rates, but they certainly are above the marginal cost of debt. It could well be that they have not gone back to first principle and asked themselves what is the basis of a Crown Corporation and what is the basis of equity in a Crown Corporation.
Q. And in answering that very specific question that was put to you by Board staff, did you review, to determine whether there were any regulatory decisions dealing with the cost of equity for a Crown Corporation where the regulator accepted that the opportunity cost of debt would be appropriate return?
A. I didn't do so, on purpose. And the reason is that in a regulatory rate setting, we don't want circularity and take in what other regulators do. We want to ensure that we are

Page 56

outside that circularity, which is why we use all these other comparable tests, the proxy groups, et cetera. So, I did not want to start it off by doing that. After I filed the evidence, I then saw these returns. I looked in BC, I have spoke to Northwest Territories, for example.
Q. Lawyers are very much bound by precedents and looking at what others have done. So, it wouldn't surprise you if I told you that we did go and we did look for a decision, we could find no decision of any regulatory authority that accepted your theory.
A. I don't think -
Q. Or even referred to it.
A. I think that the Board staff should be commended for taking an approach which says, this is the first time we've been asked to look at whether Hydro should be treated as comparable to investor-owned utility. And what is the basis for doing that and I think these other jurisdictions should have done that as well.
Q. So, the other thing is with respect to any academic articles or journals that also

MR. KENNEDY:
reference opinion. Again, if I told you that we also did that search and could find none, would you be surprised? In fact, can we bring up now NLH-193 PUB.
A. That's correct.
Q. And you yourself have not done the analysis to determine or, what the actual allowed returns are in other Crown Corporations versus the opportunity cost of debt, but you have acknowledged this morning that it would appear that the allowed returns as well as in most cases, the actual earned returns will be higher than the marginal cost of debt for those Crown Corporations. Is that correct?
A. That's correct.
(10:31 a.m.)
Q. Those are all the questions that I have for Doctor Waverman.
CHAIRMAN:
Q. Thank you, Ms. Greene, Doctor Waverman.
MR. FITZGERALD:
Q. No questions, Mr. Chair.
CHAIRMAN:
Q. Okay. Mr. Kelly.

KELLY, Q.C.:
Q. I just have one question, one small are, Chair. Doctor Waverman, can I just take you to page 15 of your report for a moment. I just have one specific question. At line 6 through 8 you deal with what the marginal cost for long term opportunity cost of new debt is based upon Ms. McShane's testimony, would you agree that if the Board were to adopt your overall approach, that would need to be reflected as what the current numbers would be?
A. That's correct.
Q. Yes, and I won't take you to those numbers. We had some testimony from Doctor Kalymon this morning at 5.83 and there's another RFI, would that be about the current range as you would understand it?
A. That's what I understand from this morning and then we would have to add, at some point, the one percent premium to that.
Q. Okay. And what's your view, if I just take you at one percent fee issue on the bottom of the page, line 19, what--could you just explain your view on where that fits in?

A. Well, I was just trying to be clear that one doesn't want to add in twice, one doesn't want to, say, the marginal opportunity cost of debt is 6.8--5.85, add in one percent. And then when the debt is actually issued, another one percent is added in. So, it makes it then to 7.85. So, I want to make sure we don't double count the cost of the premium.
Q. Thank you, Doctor Waverman.
CHAIRMAN:
Q. Thank you, Mr. Kelly. Mr. Hutchings?
HUTCHINGS, Q.C.:
Q. Thank you, Mr. Chair. Doctor Waverman, just one question that I wanted to explore with you and it arises out of the answer the NLH-167. The last sentence of your answer there and this was up a few minutes ago. It says, "however, assuming that most of the Province's citizens use Hydro's service, there does not appear to be a meaningful distinction between rate payers, those who pay the bill, the citizens, all of whom benefit from the service". I think most of what we've heard in terms of the need to ensure return to Hydro over the years has revolved around the notion

that there are, in fact, two classes, rate payers and tax payers and they have to be treated separately. Is it your position that we don't need to make that distinction between rate payers and the shareholders or citizens in this instance?
A. Could you amplify that slightly for the context?
Q. Yes. I guess what we have been discussing here and in previous hearings as well, to some extent in this one, I guess, is the necessity of ensuring fairness between rate payers and shareholders. So that the rate payers are paying to the shareholders, effectively, an appropriate return, so that their investments in the company is properly compensated and that the thrust of getting the appropriate rate of the return is to make sure that those two groups are both fairly treated. I take it from your answer that you may regard these two groups as essentially one, so we don't have to worry about that distinction. Am I reading too much into what you say?
A. Yes, I think you're reading too much. I think--there's this balance between just and

Page 61

DR. WAVERMAN:
reasonable returns to the shareholder and just and non-discriminatory rates and we have to have that balance.
HUTCHINGS, Q.C.:
Q. Okay. If, in fact, the rate payers and the shareholders were one of the same, we could regard the retained earnings as zero cost capital, couldn't we?
A. No, I don't think we could because I think it does have an opportunity cost and we have to ensure that the investments that follow from whether an opportunity cost is done correctly. So, I don't think it would be zero. I think it would still be at the marginal opportunity cost of debt.
Q. Okay. Thank you, Doctor Waverman. That's all I have, Mr. Chair.
CHAIRMAN:
Q. Thank you, Mr. Hutchings. Any re-direct, Mr. Kennedy?
MR. KENNEDY:
Q. No, Chair, nothing on re-direct.
CHAIRMAN:
Q. Commissioner Saunders?

Page 62

COMMISSIONER SAUNDERS:
Q. I do have one, yes.
CHAIRMAN:
Q. Go ahead.
COMMISSIONER SAUNDERS:
Q. The relationship that you discussed with Ms. Greene between the citizens and the Province or the government, I'm trying to weigh that off against the relationship between the shareholders of Newfoundland Power, if you like, and the Company. Is there any similarities or differences here that you'd want to -
A. Well, the shareholders of Newfoundland Power are those people who are buying the stock as an investment, looking at the comparable stocks, trading off risk and return. And that's a very different group than the Province of Newfoundland and Labrador which is the ultimate owner of Hydro. And on that basis, I thought about what is then--what should the citizens charge themselves for the cost of the retained earnings left in the company. And I see that that as not being the same as an investor owned utility such as

Page 63

Newfoundland Power which has attract shareholders all over the world and we use these tests to determine what that rate of return is. So, I think there is a fundamental difference between a Crown Corporation and an investor owned utility which should come out in having a very different cost of capital.
Q. Okay, thank you.
CHAIRMAN:
Q. Thank you, Commissioner Saunders. Commissioner Whalen?
COMMISSIONER WHALEN:
Q. No, no questions. Thank you, Mr. Waverman.
CHAIRMAN:
Q. Thank you, Doctor Waverman. I just have one question and it's the same as I asked the other two expert witnesses in this area. You indicate that with any, I guess, it's important for Hydro to maintain an investment grade bond rating, any further increase--increases in the debt ratio will place additional pressure on that and that's from page 13 of your evidence, line 19 to 21. Do you see any other, again, negative impacts on Hydro other than that, in terms of sustaining

Page 64

its current bond rating or sorry, sustaining its current capital structure or, indeed, the deterioration in that capital structure?
A. All the recent reports by Moody's and Standard and Poor's and everyone that discusses that even at the 86 to 14, 86 percent debt, that they view the Newfoundland Hydro self supporting and not a drag on the Province. The debt of Hydro is about, I think, 11, between 11 and 12 percent of the Province's debt. And so I think it would have to be a, kind of a big increase in the debt of Hydro before the Province would actually suffer. There's nothing in the market at the moment which suggests that 86 percent is excessive because of--the guarantee has never been used. They view the company as self supporting and well managed and well regulated. And so I don't see a big risk from having some increase or maintaining the current structure.
Q. Thank you very much. I have no further questions. Thank you for your testimony, Doctor Waverman.
Any questions arising?
GREENE, Q.C.:

Page 65

Q. No, Mr. Chair.

CHAIRMAN:

Q. Thank you. It is twenty to eleven. I guess that concludes our planned activities for today. I would like to thank all the cost of capital experts who appeared here and have a safe trip home. And I guess at this point in time, we have a scheduled day off tomorrow at least in relation to the recent schedule and we'll commence on Monday morning at 9:00 with our public participation in St. John's. It's my understanding at this point in time that we only have one presenter at this stage. We are indeed--is that correct? We are indeed, advertising again or certainly putting a notice in the paper of the public participation days and we may, on Monday, and we may have additional presenters at that point in time. In any event, we'll see and, I guess the remaining schedule has been circulated by Ms. Newman and I don't know if there's any particular issues or problems associated with that for next week and following into the following -

MS. NEWMAN:

Page 66

Q. No, I understand that's agreeable to most.

CHAIRMAN:

Q. Okay. Thank you once again. Thank you, Doctor Waverman and we'll see you on Monday morning at 9:00.

Upon concluding at 10:40 a.m.

Page 67

CERTIFICATE

I, Judy Moss Lauzon, hereby certify that the foregoing is a true and correct transcript in the matter of Newfoundland and Labrador Hydro's 2003 General Rate Application for approval of, among other things, its rates commencing January, 2004 heard on the 4th day of December, A.D., 2003 before the Board of Commissioners of Public Utilities, Prince Charles Building, St. John's, Newfoundland and Labrador and was transcribed by me to the best of my ability by means of a sound apparatus.

Dated at St. John's, Newfoundland and Labrador this 4th day of December, A.D., 2003

Judy Moss Lauzon