LIST OF UNDERTAKINGS

October 9, 2003

CHAIRMAN:

Q. Thank you and good morning. Good morning, Ms. Newman, do you have preliminary matters before we start?

MS. NEWMAN:

Q. I'm not aware of any, Chair.

CHAIRMAN:

Q. Thank you. Good morning, Mr. Wells.

A. Good morning, Commissioners.

CHAIRMAN:

Q. Day three of your testimony, probably a good time to remind you that Thanksgiving is a couple of days away in any event. Good morning, Mr. Kelly, when you're ready to begin your cross-examination, please do.

KELLY, Q.C.:

Q. Thank you, Chair. Good morning, Mr. Wells. When we left off yesterday, or on Tuesday, we had looked at your proposal to government for a 50 percent dividend policy that you had sent them in March and the fact that government had not responded to that proposal. And I want to continue with the questions on dividend by taking you next to Mr. Brushett's report on

the 2003 rate hearing at page 14. In the middle of the page there is a table, there we are, that shows Hydro's regulated equity during the period from the year 2000 through to 2004 forecast. And if we come down to the average equity line, Hydro's regulated equity has in fact dropped by 76 million dollars; from 278 million down to 202 million during that period. Do you agree with that? See that line?

A. That's correct.

Q. And in fact if we look at the period, just to go up a line to 1999 and then go over to the 2004 forecast, the drop from '99 to 2004 is even greater at approximately 84 million, you agree with that?

A. That's correct.

Q. If we go back to page 11 of Mr. Brushett's report, and the table there, the result of the payment of dividends during that period has taken Hydro down to a forecast debt for 2003, a ratio of 86.4 percent for debt?

A. Yes.

Q. You see that in the debt line?

A. Um-hm.

Q. And even in 2004, that will still have only improved to 85.8 percent, so well below the 80 percent targeted ratio that Hydro has had with the Board since at least the early 90s, would you agree with that?

A. Yes, the figures that you state are correct.

Q. Now in 2002 Hydro paid out a dividend to government of 65.7 million dollars and in your discussion paper that you sent to government you pointed out to them that that was 675 percent of the regulated net operating income; in other words, it's well above the targeted 75 percent level. Can I just get you to explain how the payment of a dividend so large as that came to be made?

A. The dividend payment came as a result of a request from the shareholder, government.

Q. And I take it Hydro's Board reviewed that request?

A. They did.

Q. And on what basis did Hydro's Board determine that it was in the best interest of Newfoundland Hydro to make that payment to government?

A. I think I can only tell you the conclusion of

MR. WELLS:
a Board decision, I can't talk about the discussions that went on internally amongst Board members with respect to whatever decision they arrived at. But in response to the government's request, they passed a resolution that authorized that payment.
Q. And that payment then would have been not only contrary to Hydro's Board dividend policy, but contrary to the stated objectives of Hydro before this Board, since at least the early 1990s to have an 80 percent debt equity ratio.
A. The Board of Directors, in passing the resolution approving the payment, altered their--amended--they weren't acting in contrary to their own resolution, they passed a specific resolution and they re-confirmed, as we have filed in this evidence, what their objective is. And it's also reported here in the paper to which you've referred.
The Board's position is a payment of dividends up to 75 percent of net income subject to the effect that it would have on the overall position of the company. I might

add that if you look at page seven of the submission to which you first referred, that it outlined since 1995 the debt pattern, and you will see that other than the year 2000 and the year 2002, the payments of dividends were less than the Board policy of 75 percent. Payout of net dividends, 64, 47, 39, 42, 10 and 82 in 2001 and 172 and 675 in the--but a very small figure in 2000. As I mentioned earlier, on Hydro's retained earnings, the shareholders, taken in total now on a regulated activity, 35 percent of Hydro's retained earnings in the form of dividends.
Q. If we go back to page 11 of Mr. Brushett for a moment, despite that comment though, Mr. Wells, the debt ratio at Hydro since 1991 has actually dropped from--or gone up from 80. 4 percent to a forecast for 2004 of 85. 8 percent?
A. That's correct.
Q. Can I get you next to go to Mr. Roberts' schedule 9, I think there's a first revision of that as well. And if we look at the 2003 column, Mr. Wells, there's a dividend payment provided for in 2003 of 5.56 million dollars?

A. Yes.
Q. And I thought I understood from evidence that you gave earlier, that there is no payment of a dividend in 2003 and I wonder if you could-- did I misunderstand that or is there -
A. Well, it may deserve some explanation. The five point--our fiscal year and the government's fiscal year are not the same. Ours is January to December and the government's is April to March. So, therefore, the 5.5 million dividend there is between the January, March period. What I had said the other day was that the government in its budget, which came out in April, going forward this year, has no provision in the budget for dividends from Hydro's regulated activity.
Q. So it is still contemplated then that in 2003, even if the payment was in January to March, that Hydro will have paid a dividend of 5.564 million, is that correct?
A. That's correct, okay.
Q. That's correct, okay. Now, then if I go back up two lines, Mr. Roberts is forecasting a loss of 7.8 million dollars. Can you explain

to the Board on what basis there will be a payment of a dividend in a year in which there is a loss; in other words, I would have thought 75 percent of a loss means no dividends.
A. The commitment to the payment of the dividend is part of the government's previous budget which would have come out in March or April of 2002. So, that payment there reflects dividends related to the previous budget of government, not the current budget.
Q. Do I add then the 65.7 million from 2002 and this 5.5 million as somehow all tied into one fiscal year of government?
A. No, but you have to appreciate that there is a difference between the government's fiscal year and Hydro's fiscal year. So the government's fiscal year going through to March and in their budget, and they advise us of their expectations with respect to their budgeted position. And therefore, they're operating on a 12 month basis which overlaps Hydro's fiscal year. And Mr. Roberts can give you a better understanding of the allocations.
Q. So in those two years we have a total of 71.3

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KELLY, Q.C.:
million dollars which will have been paid out in excess of the dividend policy between 2002 and 2003 combined.
A. No, the figures that we're stating for our fiscal year are correct.
Q. But you've lost me. If you go back to Mr. Brushett's table and report at page 11 -
A. Yes, Mr. Brushett refers in that report to the year 2003, is that -
Q. No, if you go to the bottom of the page, line 33, he's talking about the 2002 payment of 65.7 million in 2002.
A. Yes.
Q. And then we just looked at Mr. Roberts' schedule 9 where he has 5.56 million for 2003, those are your fiscal years. So over those two fiscal years of Hydro -
A. Okay, I understand.
Q. Do you follow me?
A. Add them, yes.
Q. Yes, that Hydro has paid out 71.3 million in excess of Hydro's dividend policy, is that not correct?
A. In two fiscal years of Hydro. This 5. 5

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million falls in the 2003 year.
Q. Yes, that's the current year we're in.
A. Yes.
Q. Right. And so over 2002 and 2003 -
A. Yes.
Q. - there will be 71.3 million in dividends paid.
A. Yes, but not in excess of the Hydro Board's policy of up to 75 percent. I'm sorry, okay, yes, because of the loss.
Q. Because you got a loss in 2003 and you overpaid in 2002, so we got two years together where Hydro's dividend policy has not been followed. Are we agreed?
A. That's correct.
Q. Now, in 2004 if we just stay on the schedule 9 for a second, Hydro proposes that there will be another 15.8 million dollars worth of dividends, in the middle of the page there?
A. That's correct.
Q. Now, that number I understand is calculated at a 9.75 percent return on equity?
A. Yes, it's based on our submission of the test year for this application.
Q. Why, if Hydro is targeting an 80 percent debt

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ratio and we just looked at the fact that 71 odd million dollars have been paid out over 2002, 2003, why would Hydro propose to pay out another 15 million dollars in 2004 as opposed to rebuilding that equity?
A. The proposal, the test year is filed for 2004, reflects all of the figures, including the assumptions and the return on equity and what a dividend payment would be and reflective in that calculation.
Q. Yes.
A. That doesn't--that's in contemplation of if things--if a dividend is required from government in 2004 which we have as yet, no idea, none of that may occur. But it's just the arithmetical calculation of a dividend.
Q. Now the phrase that you use there is "a dividend is required by government". Does government give you some kind of notice during the run of a year that here is what will be requested from Hydro by way of dividend? How does that process work?
A. There's an exchange of information between the Department of Finance and Hydro through our Vice President of Finance usually and the

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people in the Finance Department. And I might say, with respect to that table of dividend payout that is at page two of seven of this report on dividends to government, the government had indicated to Hydro and therefore, the Board of Hydro, as early as 1996, that depending on circumstances, they may require some special dividend payment from government, but that they would not call upon Hydro if it were not necessary.

So, I think that what you see here is the government by its restraint in terms of requests from '96, '97, '98, '99, was done in anticipation that at some other future date, they may call upon Hydro for a greater dividend payment. So, in other words, they were leaving equity within the company and obviously assessing their own circumstance and then taking the extra dividend from Hydro.
Q. On that basis, Mr. Wells, would it be fair to say that it is government who is effectively determining how fast Hydro progresses to an 80/20 debt equity ratio?
A. In a sense, but the issue of the dividend, you have to be mindful of the fact that even with

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those figures as we see them, and they speak for themselves, that in terms of Hydro's retained earnings on its regulated activity, the total taken out is 35 percent of the retained earnings, in total. Now, you obviously have 2002 characterized as a special dividend and it was, that's the way we all speak of it. We're not sure going forward because we haven't had a response to the letter or the submission to government. All we know at this point in time is that in 2003 budget of the government, which will go into the 2004 Hydro fiscal year, because of the overlap, that government has not made any provision to take any dividend. And what will happen in future with future--with government, one doesn't know. But up till now with successive governments, the policy has, with respect to the taking of dividend with the exception of the special dividend in 2002, has really not been a significant factor in reducing Hydro's retained earnings.

Q. Now, can I take you this question and that is the borrowing guarantee. That borrowing

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guarantee from government remains in place.

A. It does.

Q. And Hydro in the 2003 year will pay a fee of approximately 14.4 million for that borrowing guarantee?

A. Yes, it will pay the debt guarantee fee.

Q. Okay. And if I just scroll back for a moment to schedule 9 of Mr. Roberts, that guarantee fee of 14.4 million dollars is only a million, million four approximately less than the dividends which are forecast to be paid at, assuming a 9.75 percent rate of return? Because you've got 15.8.

A. That would be the comparator of the two figures, or comparison of the two figures.

Q. And if the Board allowed only a three percent return on equity, the combination of a three percent return and the guarantee fee would in fact exceed the return on 9.75 percent if you just compared those two numbers. Do you agree with that?

A. Well, no, you're now mixing two different things entirely. You're talking about the debt guarantee fee and the return on equity and they're absolutely, totally dissimilar

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sources of income and put in place for different--entirely different reasons. On our capital structure--I'm going to have to expand on that point, if you would permit me. We're looking at the cost of the capital structure and the debt guarantee fee is actually very advantageous to Hydro's customers and all electricity consumers. Because what it means is that Hydro can finance on the equity markets of the world at the government rate and if we did not have the government guarantee, we would have to have, to match say Newfoundland Power's borrowing rate, 40 percent equity, which would be an enormous burden on consumers if we had to suddenly move to a 40 percent equity to get a triple B rating, say in the bond market. So I thought that it was clearly understood at our last hearing that the debt guarantee fee by government is very advantageous and it allows Hydro to have a much lesser equity, and since debt is cheaper than equity, or it should be, then you have a situation where this is advantageous to everyone including Hydro's industrial customers, Newfoundland Power and

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all electrical consumers. It is what I would term a very good thing because the alternative would be that we would have to spend much more money in raising our bonds if the guarantee fee weren't there and we would pay a premium, or else we'd get our equity. And the whole point that Hydro makes at this proceeding is that there are advantages to the customers of Hydro and all consumers because of our current set up in the sense that we get a very good bond rate for our debt because of the government guarantee that only costs us 12 million and you can almost count it like interest on the debt. That's very good. Because our equity is low, the return on equity is not big in dollars. It's very little. It's only 14 percent of our capital structure so the dollar value of the equity-- now the only other argument of contention is the percentage of that return and all I can say to the Commissioners is then you look at the dollar that's in equity and it's at risk and that risk is subordinate to the debt.

So, if you compare ourselves with Newfoundland Power for a moment, they have 60

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percent debt, 40 percent equity, and the Board regulates that position. You keep the equity at 40 percent. And the holders of the debt know that in the total enterprise, their debt stands before equity. So they say if the owners got that much in, since we only have 60 percent of the capital structure, we're relatively safe and the market will then price the cost of their debt. On their equity, which is at greater risk, that's why they ask for 9.75 percent return, actually, the ask for me and I agreed with that, they didn't get it. So when you look at Hydro, you have to understand that the government as even different than the shareholders in an investor owned utility, the government is at risk for its equity, as is a shareholder in another utility, an investor owned utility. The government though is also entirely at risk for the debt.

So, by having the Crown corporation, it's a huge advantage to the electrical consumers in the province of Newfoundland and Labrador, and I don't understand why everybody is not

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cheering about this and asking all these questions as though there's something untoward here. Our capital structure costs are very, very good indeed, in that sense, because of the participation of government.

Q. But I do extract from the answer that you just gave, Mr. Wells, this comment, or this observation, correct me if I'm wrong, that given your existing capital structure, that borrowing guarantee, including the payment to government, is necessary to enable Hydro to borrow.

A. Without the government guarantee we would have to pay premiums on our debt because who would accept the risk with such a small amount of equity in the company.

Q. Exactly.

A. Yes that's the whole point isn't it.

Q. Exactly. Now, can we just move to the next point here. One of the observations the Board made about the status of Hydro as an investor owned utility in the last decision was that Hydro does not pay income taxes, and I take it there is currently no proposal for Hydro to pay income taxes?

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A. That's correct.

Q. The next question is, Hydro, in this hearing, has not put forward any proposal to incorporate either a range of rate of return on rate base or any proposal for an automatic adjustment formula because of changes in interest rates and the effect on that on return on equity.

A. That's correct.

Q. In fact if we go to have a look at--we go first to NP 105. And we put the question of the automatic adjustment mechanism and the response was "Hydro is of the view that an automatic adjustment mechanism may be appropriate at such time as the rate structure permits the indicated change in revenue requirement to be easily distributed across rate classes." That answer kind of puzzled me because the return or your equity or return on equity or return on rate base is part of your cost of service that is already spread, divided among classes, and I'm just wondering if you can help us understand this answer.

A. Well I think it actually is a very good answer but it reflects some of the complexities that

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may ensue. What we have proposed and I need to just step back one moment here so it will make sense coming forward. In our first fully regulated rate application to the Board, we proposed a nominal return on equity because of the big doubling of fuel and rates, which we thought was a one time event and after 12 years and that adjustment, what could we do. And fully prepared to accept the consequence of that decision which we are accepting as we speak today. Hydro is incurring expenses which will never be recovered from rate payers. To that extent, the rate payers are getting a contribution from Hydro. Very little thanks, but a big contribution.

So, the issue--when we said to the Commissioners the last time that you should try to--or we hoped that you would make a statement, and you did, that this three percent was not normal and nobody was confirming that to be normal, but you wouldn't want to make a determination on what the appropriate rate would be for Hydro until some future time. I think that we have to look at it in the light that we're coming forward and

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MR. WELLS:
asking for the same rate of return as you just ruled on with respect to Newfoundland Power for the dollars of government that are at risk as equity. Not as debt, but as equity. And your message is not going to be to either Hydro or to government or even to the customers of Hydro; your message is going to be to the financial markets in Canada or the world, as to what this jurisdictions Public Utilities Board believes is a fair return for dollars at risk. And they are the ones that are going to be listening and they're going to be listening because they want to be assured that Hydro's financial integrity will be protected by the Public Utilities Board. And that they can see that the government, which is backing the debt, and that the utility itself is operated in the eyes of the Board providing a service on which it gets a legitimate return and that they should not worry about the financial integrity of Hydro.
And as we have submitted in this application, that this is the issue. You know, I've never said that Hydro is an

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investor owned utility. In my evidence the last time around I said it's more akin to an investor owned utility for various reasons, which we have again put out in the evidence in this application because of the amendments to the legislation in '96. The legislature obviously expected something different of Hydro than previous to that and we've outlined once again the changes in that legislation. So the issue, again, becomes, and our evidence on this point, is really Ms. McShane, it's the degree of risk to which the equity dollars are exposed. There's nobody in their right mind would ever say that three percent is the appropriate risk factor there. It is something other than that. Now the Board hasn't expressed an opinion. When the Board is reviewing that, as they did with Newfoundland Power previously, we then have to address the issue of whether automatic adjustments can be made with respect to that, so that we don't have to spend all our time trying to get, you know, an adjustment change--the rate of return changed. But the first hurdle is a pronouncement by the Board in

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Newfoundland that we believe in this circumstance, that the Newfoundland and Labrador Hydro is entitled to X as a return on equity. And then we're going to have to, in the course of the proceeding, you know, figure out or after, how is that going to be handled over time, in the same sense as what are we going to do with the rate stabilization plan over time.
Q. But if, hypothetically, Mr. Wells, the Board said well 9.75 is appropriate, when would Hydro propose to bring forward a proposal for an automatic adjustment mechanism and a range of rate of return?
A. Well, the Board, could, I mean I think the Board has the jurisdiction to declare what the rate of return will be and also put parameters around it with respect to adjustments. They may want to--or request Hydro to make proposals with respect to that. I'm speculating now and I'm going to stop.
Q. But Hydro itself has not brought such a proposal forward in this hearing.
A. No, it has not.
Q. Can we have a quick look at NP 234 which deals

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with the range of rate of return. In fact, in this answer Hydro expresses that it remains of the view that it is premature to establish a range of return on rate base. So would that -
A. It's similar to the previous answer, isn't it?
Q. Well, one dealt with range of rate of return, the other dealt with the automatic adjustment -
A. Okay, yes.
Q. So, would you agree that it's premature? Is that the position that Hydro is taking here?
A. I always stand, Mr. Kelly, behind the Hydro answer.
Q. Okay. Now, if we look at all of those issues together, Mr. Wells, can I suggest to you that--especially looking at government dividend policy and the effects on capital structure and a number of these other items that we looked at, that government itself, your shareholder has not yet seen fit to move Hydro any further than the last hearing towards the operating characteristics of an investor owned utility? Would you agree with that?
A. I don't think I can agree with the way you

MR. WELLS:
phrased that. They haven't given any indication to Hydro that we could pass on to anyone as to what their views are for the future beyond the fact that we know that in the 2003 budget, there was nothing put in there with respect to our regulated activity. And we have no response further than the letter than is filed from the Minister on this. So, I don't know what the government's position, indeed in the circumstances in the province today, I mean, things may change. We just don't have an answer; we're not sure.
Q. And, of course, at this stage we're in an election process that is taking place, in any event, further complicating the issue of what government's response might be.
A. I agree there's an election in process.
Q. Okay. I'd like to leave that area, Mr. Wells. That's perhaps a good note to leave it on. And I want to go to something entirely different now and talk about--have you talk about the changes in the system over the last approximate decade. And I'd like to start this discussion by going to Mr. Brockman's

evidence, Exhibit LBB-3 in particular, to help us. Page 1 of 1 towards the end, Mr. O'Reilly, Exhibit LBB-3. There we go. And I don't know if you can pick that so that we get the two tables together on the page, Mr. O'Reilly? Will you just make it a big smaller? There you go.
Now, what Mr. Brockman has done here, Mr. Wells, is he has put on one page for us, the evidence from the 1990 hearing as to what was forecast for system growth over the period 1990 - 1999. And he's also put, at the bottom of the page, from Hydro's evidence in this proceeding, Hydro's current forecast from 2003 - 2012. And if we just look at some of the numbers first. For example, if we look at the 2003 year in the bottom table, we will see that the demand has really only reached approximately the level of '92/'93 as was forecast in the early '90s. Do you see that?
A. Yes, I see the numbers, yes.
Q. Okay. And if we go down to the 2012 forecast, Hydro's 2012 forecast really only comes to about the level of forecast for 1996, that was being forecast in 1990. Do you see that

number?
A. I see it.
Q. Okay. So, the growth in demand has been much less than was forecast in the 1990 period. And I wonder if you can help the Board to understand the circumstances that led to that change?
A. Only from, in terms of the corporate evidence, like the filings we make with respect to economic outlook. That was part of the corporate evidence in our last application and in this application. The '90s obviously didn't turn out as they had been anticipated at the end of the '80s. We had the moratorium. We've had, without being political, substantial out migration and the, you know, the general downturn in the economy through the '90s, I would say, generally, with respect to the particular of the load grow, I would defer to Mr. Haynes.
Q. Okay. So, in the 1990 decade, we started in 1990 with forecasting 2.63 percent growth in demand, whereas now in 2003, Hydro is projecting an annual growth rate in demand of 1.01 percent.

A. That's correct.
Q. Okay. Now, if we come over to the energy column and look at some numbers there. The energy actually, while it grew less than forecast, grew a bit faster than the demand forecast. If we look at the 2003 year, for example, that ties back to approximately the '95/'96 level from the original 1990 forecast.
A. That's correct.
Q. And similarly, if we go down to the 1999 level, for example, in our top forecast, it now translates to approximately 2011/2012 on the bottom, correct?
A. That's correct.
Q. And the growth rate in energy, projected growth rate, has dropped from 2.21 percent to 1.09 percent. Can you shed any light for the Board on the factors that would cause the growth in energy to have been larger than the growth in demand over the period. Do you follow my question?
A. Yes.
Q. In other words, both reduced, but energy grew more than demand.
A. Well, the only explanation I could give that

MR. WELLS:
would, that's not exclusive or total is there's been the increase that we've referred to earlier in electric heat for space heat has used up more energy. But again, you know, on these types of questions, I would defer to Mr. Haynes who can examine the peaks and the load growth and the elements of demands that our systems planning department deal with. But I'm not surprised to see higher energy figures on energy consumption. And we have talked about that before in terms of the island interconnected system and the demand for space heating.
Q. So, the drop--I won't say the drop, but the growth in the peak demand has been less over the period of time than the growth in energy and that's not something that surprises you as the CEO when you look at this table. It's what you would have expected, is that correct?
A. Well, you know, the Board will appreciate that when it comes to the review of the electrical system, the components, I mean, don't get me into coincident peaks, please -
Q. No, I won't get you there.

A. So, I mean, I defer to Mr. Haynes on those type of things, but from my simple understanding of the matter, the energy, in terms of gigawatt hours, has grown laterally. And my understanding of that again, at my level of sophistication in this area, is that it's electrical space heating and I'm not surprised.
Q. Okay. And that has driven energy more than peak demand?
A. Well, no, I think that you have to look then back at the forecasts for the demand--you got to meet both the capacity and the energy requirements of the system. And therefore, our own system planning department will specify in relation to the demand for capacity and the demand for energy. And again, I would defer to Mr. Haynes on this.
Q. Okay. Can I get Mr. O'Reilly to scroll back to page 11 in Mr. Brockman's testimony, page 11. There we go, scroll up the table. The table is actually extracted from Mr. Haynes' evidence and Mr. Brockman has put in, in bold you'll see at the 2009 line, that is where Hydro's system in the future will become

energy constrained, is that correct?
A. You start to have some, yes, get close to deficits.
Q. Okay. And if you come down to 2011, the criteria that you used for demand constraint starts to kick in, in 2011. The loss of load hours -
A. The loss of load hours, yes.
Q. Okay. So, as currently forecast, Hydro's system is forecast to become energy constrained before it becomes demand constrained?
A. Well, as these figures, as they phase in, yes, they're never, my understanding of that is that they're never exactly in sync, by any stretch.
Q. Okay. Now, in the current application, one of the things that Hydro is proposing to do, is to discontinue the interruptible B rate for the Stephenville mill. And just for the Board's recollection, that's 46 megawatts of interruptible power at $28.20 per megawatt per year for 1.3 million, sorry, kilowatt per year, for 1.3 million approximately, in total, is that correct?

A. I'm sorry, was that a question?
Q. Well, I just want to be sure we understand the concept first, Mr. Wells. And if I haven't expressed it correctly, would you just explain what the interruptible B for Stephenville was intended to be?
A. The interruptible B would have supplied Hydro with respect to peaking requirements of the system. And the contract was not renewed because in looking forward, at least in the short term or longer term, whatever your figures are, that is not thought that this interruptible contract supply is required because we have sufficient capacity within the system. And since consumers have to pay the cost of that, we would be charging consumers for something we may not use. And that's why--that's a simple explanation as why it wasn't renewed.
(9:45 a.m.)
Q. So, at this stage, Hydro sees no value in paying Stephenville for the ability to take 46 megawatts off the system, of demand, when peak isn't countered?
A. That's right, because of the margins are that

MR. WELLS:
now available to us with the new sources of supply.
Q. Okay.
A. Granite Canal and the two NUGS that have come on in 2003, it is highly unlikely that you would ever have the opportunity for some period of time to avail of the 46 megawatts interruptible power contract. It's not of any particular, it's not the issue of the value to Hydro, it's the issue of the value to the customers of Hydro. You're paying money for something that you don't really need. If you don't have a house, why would you buy fire insurance for a house that you don't have? You know, that's about it.
Q. If we go to answer, IC 194, this is the question which was posed by the Industrial customers and the answer in the middle of the page referring to the table that we looked at from Mr. Haynes' evidence indicates that deficits and capacity are not forecast until 2011. And on this basis, Hydro has decided not to renew the interruptible B contract at this time. Now, that essentially mirrors the

answer which you just gave?
A. Yes, it just says it a little better than I said it, but they're better at this than I am.
Q. Can I get you to go NP-140, Mr. Wells? And in NP-140 we asked Hydro to reproduce that table that we looked at from Mr. Haynes' evidence to reflect what the loss of load hours would be with that additional 46 megawatts of interruptible power available. And if we go to the table at the bottom, we have the same two years in which the system becomes energy constrained and demand constrained. Would you agree with me that it doesn't change the years in which both energy constraints and demand constraints would exist as forecast?
A. I'll accept your statement. I don't have the advantage of the other table at the time, but let's assume that that's correct, the figures haven't changed.
Q. Now, can I take you next to NP-154. And I'll give you a moment just to read that question and answer. What the question posed was how much reduction in demand at system peak hours required of Newfoundland Power assuming no energy reductions to defer the next plant

addition? And the answer, in essence, indicates that a reduction in peak only with no associated energy reduction would not defer the next plant. So, it may impact on which option would be considered least cost at that time and beyond.
So, changing the system demand peak does not affect Hydro's plan in terms of when a plant would have to be added? Is that correct?
A. The answer is correct, yes.
Q. Okay. And in terms of trying to figure out which options would be least cost, cost options--and I appreciate this is a question that, in terms of when you would be doing this, you're talking about add ons in 2009 and 11 which are a long way away--but in order to determine which options would be the least cost options, at some stage in that process between now and then, would you agree that Hydro would have to look at a marginal cost study to have a look at those options?
A. Not necessarily. You can find out what the alternatives available to you are, through a request for proposals, advertising that you're

looking for sources of supply and we went through that exercise in 1997.
Q. Let's assume that Hydro was going to build it, itself, would you--would a marginal cost analysis be of assistance to Hydro in determining its least cost options then in the future?
A. Hydro does not make any decision with respect to determining the new source of supply to supple the Island-interconnected system. The jurisdiction rests with the Public Utilities Board or Government. And Hydro could advance its own, I mean, we have, as the evidence indicates, possible development or potential development in the Bay D'Espoir system, which may be very economically competitive, but we don't know by 2009 what other possibilities exist for alternative sources of supply that may be of better advantage to consumers.
Q. That's because 2009, I take it from the answer you gave, is still a significant period away and gosh knows what developments we may have between now and then. Is that the -
A. Well two or three years for planning purposes, remembering that you have to allow for

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MR. WELLS:
construction period, so the decision will be made in advance of 2009, but it's not Hydro's decision to make. Hydro can vet proposals, it can provide to the Board, if the Board is deciding what it has and other people can decide, or maybe government will decide. But what we're looking for is the best next source, you know, the best source of power that will give you the capacity and the energy that the system requires.
Q. Now, Hydro currently has an information program called "Hydro Wise"?
A. It does.
Q. And that's essentially an information, a program to provide information to consumers so that they can make appropriate choices, is that correct?
A. Yes. It explains, it's the wise use of electricity, therefore, Hydro Wise, and advising consumers of the issues and what can be done, so that's the sum -
Q. Apart from that information program, does Hydro have any programs currently, on the Island-interconnected system now, I'm not

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concerned about Rural here, but on the Island-interconnected system, to actually reduce demand and do they have a demand side management program?
A. No.
Q. If I could take you to NP-188 for a moment, Hydro has no immediate plans to implement any DSM for the Island-interconnected customers?
A. So you knew the answer already?
Q. Yeah, I wanted to see how much you knew. Here's my follow-up question, Mr. Wells, as one of those types of programs that theoretically could be available is some kind of water heater program, control program. I take it Hydro is not contemplating doing a water heater control program?
A. No, well to the extent that we've filed evidence in this area, the evidence has been filed. You're talking about the Island-interconnected system?
Q. Yes.
A. Yes, please appreciate that we are, in terms of customers, a very small portion of the Island-interconnected system; not to say that we would not want our customers to use their

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energy wisely, but I don't think that the next requirement for capacity and energy to satisfy the Island-interconnected system is not going to be driven by the requirements of Hydro's Rural customers on that Island-interconnected system. One would logically think it's going to be driven by the 220,000 plus customers of Newfoundland Power.
Q. But you wouldn't propose, I wouldn't think, that Hydro's customers on that system, if there was benefits in reducing demand, you wouldn't think that Hydro's -
A. Oh, by all means, no.
Q. - customers would be any different.
A. No, no, we would have every interest to help consumers with the wise use of electricity.
Q. And if Hydro thought there were some benefit in reducing that demand, I'm assuming that Hydro itself, would bring forward demand side management control, correct?
A. Yes. The issue would be the efficacy of the program against the set objects, you know, how effective are these programs and what would you intend to achieve by the program and what would it cost, with respect to that program,

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as we've discussed earlier, it's come up during my period of testimony about the new government initiative, there's ongoing work on that, the Hydro Wise program of Hydro and the other utility may have plans as well. But you have to assess these particular programs with respect to what you intend to achieve or how much you can achieve for what dollar and effort you put into it.
Q. Right. It's got to be cost effective?
A. It should be.
Q. Correct, okay. Now, just picking that point up, you were asked some questions on this in your testimony in 2001 on September 26. And it's a short passage, page 21, the answer which you gave and if Mr. O'Reilly can find it, you say, "and I think that if you ask people more conversant with the subjects, that we would waste a lot of money trying to do time of use studies and demand side management and the end result would be just because of our system, would be very little". Can I get you to elaborate on that? It's down at line 96/97, Mr. Wells, page 21, do you see that there, beginning at line 96?

MR. WELLS:
A. Yes, my--again, what I was trying to reflect at that time was that my understanding in discussions, internally or externally, with various people in the electricity industry, that how well have demand side programs worked. Now, I'm not saying that what I'm saying is true. I'm just saying what I've been told, that the history of demand side management programs hasn't been that successful, but that's hearsay evidence, isn't it?
Q. One of the observations you made was because of our system, and I took that to be your system characteristics, can you just explain to the Board what you mean by that?
A. Well, I think that--the tenor of that point was if you had time of use rates, for instance, could you convince people to all run their washing machines or dryers between 2 a.m. and 6 a.m. or something like that. And that, again, I have no expertise. As I recall that, that there had been people and within Hydro or elsewhere that in looking at this, that the issues within our system, would we

have much effect in influencing people to change their habits. And my understanding was that it's not likely that you would have much opportunity to achieve gains in this are. But I caution you, this is not gospel. This is just as I understood at that time.
Q. And would one of the reasons for that, Mr. Wells, be that in supplying that energy, that whether it is taking place 5:00 or taking place at midnight, it is essentially Holyrood that's going to be supplying that marginal cost?
A. That was one of the points raised, that type of point.
Q. Discussion.
A. Yes.
Q. Okay.
A. We have to go back to the same source in any event.
Q. And the cost of Holyrood is the cost of Holyrood regardless of when, in fact?
A. That's right. In our system, the cost of the energy would not change as a result.
Q. Now, you talked a few moments ago about demand side management and it's need to be cost

effective. Can I take you to NP-167 for a moment? And we posed the question, does Hydro believe that DSM options should be evaluated on marginal cost or an embedded cost basis. And the answer is "DSM should be evaluated on a marginal cost basis with the constraint being revenue loss, et cetera". So, that is the same sort of answer that you gave a moment ago, that it has to be determined to be cost effective, but looking at the marginal impact on the system.
A. Um-hm.
Q. Correct?
A. That's correct.
Q. And in order to do that, in order to know its impact against the marginal cost of the system, one of the things that Hydro would need to do, is to perform a marginal cost study, if it was to look at demand side management?
A. One could do that. I know what you want me to say, Mr. Kelly.
Q. I'm just trying to get the facts to the Board here, Mr. Wells.
(10:00 a.m.)

A. Well, if every--the issue of a marginal cost study can be performed, it's going to cost probably $300,000.00 Canadian. We can do it, its just the cost, if we need it, if somebody thinks that this is necessary to deal with the issues of the day, in this proceeding, and there's a lot more expert testimony--well, in this area, there's expert testimony to come on these points other than me.
Q. Yes, but I'm trying to understand it at a high level, at this stage. Now, the next area I was to explore a little bit, Mr. Wells, is this question of the demand energy rate. And I'd like to start by looking at some testimony that you gave on September 26 last year or in 2001 rather at page 22 at line 65. And when you look at what you said there, you say, "no, we don't have to have a demand charge with Newfoundland Power for Newfoundland Power to have demand charges within its system. And those demand charges within its system would send the pricing signals to the customers. That's the theory, us sending pricing signals to Newfoundland Power is really, I mean, Newfoundland Power as a utility and we their

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major supplier, they knowing the system, they should know what, you know, why would we have to send signals on the use of power". And a little bit further down at 78, "they can do that without the issue of the demand charge with Newfoundland Power and the issue of sending signals to consumers as to whether they should have this or have that. And you don't have to have the one to have the other. They're not necessarily connected".
A. Yes, that witness is stumbling around, isn't he? Definitely not his area of expertise. You know, I have--sorry, you were going to ask -
Q. I was going to ask a question.
A. Yes.
Q. My question is this, first of all, Newfoundland Power itself, apart from the small use, is not the end user of electricity, is it, it's a retailer, correct?
A. It's a retailer.
Q. Okay. And that was true in 2001 and it's true today, correct?
A. That's true.

Q. So, that if you want to influence the use of electricity, it's ultimately the end use by consumers that needs to be impacted, correct?
A. That's true.
Q. Okay. Now, come with me--do, I understand, first of all, do I understand that Hydro has changed its view of a energy only wholesale rate versus a demand energy rate since 2001?
A. I think so. And much the same as, I guess, that Newfoundland Power changed its view from 1992 to 2002 because I'm a more informed witness than I was back then. And I understand that at one point, back in time, Newfoundland Power was proposing a demand charge and, not an energy only rate. We had, at the last hearing and our first regulated hearing, thought that the imposition of a demand charge with respect to Newfoundland Power and we had reported jointly, I think, and we had some discussion with Newfoundland Power, and that was the position taken in the 2001 rate application. And the Board, as the proceeding unfolded, with the expert witnesses, had directed us to look into this matter a little further. And as you know, we

had a consultant do a report, and while we have submitted this application on the basis of an energy only rate to Newfoundland Power, we have, in submitting the report of the consultant to the Board, said that the charge or demand charge for Newfoundland Power for capacity as well as energy is appropriate, but that there are a number of issues that would have to be sorted out, if you were to put in a demand charge with respect to Newfoundland Power, such things as like the weather normalization and things like that, and there's some volatility for both utilities.
The real question for the Commissioners here is that the increasing--the need to supply new sources of energy at ever higher costs does affect consumers, and as the Consumer Advocate, you know, in probing at me the other day, how do you handle this thing, and my other understanding since the 19 or 2001 application is I understand that a utility retailer the size of Newfoundland Power would be unique in some respects in this area in North America by not having a demand charge. So you know, the question, I think

we've fulfilled our responsibilities to the Board. We have a report outlining how a demand charge could be applied. We have some issues to deal with in its application, but there's absolutely no reason why there could not be a demand charge and it may very well have some effect in influencing, because Newfoundland Power's reaction to that can go directly to its customers and we could, looking out over time because restrain the enthusiasm for the use of electricity unwisely by consumers, or give them legitimate choices of other options, which they don't necessarily have today, as has been outlined by the Consumer Advocate, because he says he doesn't think they're aware of the fact that oil prices affect electricity or if they use more electricity that the next source of generation is indeed going to bring up our average costs.
Q. Mr. Wells--sorry, I don't want to cut you off. Are you finished? Mr. Wells, if Hydro wants to affect the reactions of Newfoundland Power's customers and Hydro's own customers who are also on Newfoundland Power rates throughout the Island Interconnected system,

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has Hydro performed any study of the retail rate designs, and do you have any views as to how they ought to be changed to achieve the results that you somehow seem to be suggesting?
A. No, and not in the context of this application, but in terms of my exposure to these issues, like in the areas of the energy policy review and what position and, you know, the issue of having a production. Like the block of power, we could be something like Quebec, I suppose. They have a heritage block and for a certain level of consumption, everybody pays the same price, and then you stack your power prices and that would pass right through the retailer directly to the customer. You pancake on that your transmission cost and then you could have Newfoundland Power as the retailer, regulated solely on the basis of its activity of distribution, and the cost related to distribution. Right now, they're in the position where they take the power from us, mark it up and sell it. The more power that

goes through the system, the more money they're going to make obviously. And that would be a disincentive to restrain the use of power.
So my limited understanding of this, I don't want to mislead the Board, but there are rate designs out there that can send clear signals through to the consumer as to what the cost of production is, what the cost of transmission is, and indeed, what the cost of distribution is, and if we had such a system, it probably would be far more effective in influencing consumers as to what their choices and options are.
Q. But Hydro, neither Hydro nor its consultants have done any study to determine what changes you would want to make in the ultimate retail signal to be given. In other words, what changes you would propose to make in the retail prices to consumers?
A. In the Stone Webster study, you mean?
Q. Or in Hydro's internal analysis. Hydro hasn't--it hasn't been done, has it?
A. No.
Q. No, okay. Now, can I take you next to the

Stone and Webster report which is at Exhibit RDG No. 2? No, we need--it's in Volume 3, Mr. O'Reilly, sorry. And I want to go to page three of that report, there you go, the key issue. Now Mr. Wells, Stone and Webster, in its report, identified a number of what they called key issues, and the first that they identified was to send a correct price signal to all parties, and it says "from the inception, a continuing concern has been the ability to encourage DSM," in other words, demand side management. "In this report, DSM is viewed in a broad and all encompassing sense. DSM includes not only energy efficiency and energy conservation, but also peak demand control programs. Therefore, in this study, the term load management is used to refer to these activities." Now one of the demand control or demand limiting programs that Hydro already has is the Interruptible B program that we talked about with Stephenville. There seems to, on the face of it here, to be some difference in approach between Hydro here on this issue. In other words, on the one hand, you're talking about

the need to encourage DSM and peak demand control, but you're discontinuing the Interruptible B to Stephenville. Can you help the Board with that?
A. Yes, I think I can, because there's no inconsistency in the positions that you've set up. This is a Stone and Webster paragraph. But all we're saying, as I understand it, and as I understand it is very important, the Interruptible B contract, were we to enter renew it, it would be another one million dollars plus in the rate base to be costed to all consumers, at a time when we are not going to require it, because we have sufficient capacity and energy, at this point in time, going forward. Now this will dissipate over time, the surpluses in capacity and energy until we get to the point we have to have new sources of capacity and energy. But the issue for Hydro, because it is simply the question that when you put the facts before the Board, how could we justify paying that extra million dollars plus for an interruptible contract, which highly unlikely that we would need to avail of for the purposes it was intended. I

MR. WELLS:
mean, that is simply it. And if we added it in, I think we would be questioned on it by--I could get the reverse questioning sort of coming at me from the Consumer Advocate, "what are you doing? Where are the interests of consumers being protected by entering into that contract, which by the evidence you've submitted, it doesn't like you're going to need it?"
Q. And we talked about DSM and the need to be cost effective there as well, and we looked at the fact that Hydro is not proposing to do any DSM at this point in time, for the same reasons that you've just explained, but if in fact -
A. Well other than--like our Hydro Wise program in -
Q. Information.
A. - a sense is demand size management, isn't it?
Q. Now, but if in fact that there's a long term desire to control peak and to look at DSM, then if you take the Interruptible B for a moment, the question of whether there is any long term value in that, would you not need to

evaluate that issue, just as you would need to evaluate DSM issues, by performing a marginal cost study to determine what, if any, is the value on a long-term basis? How would you address that?
A. That wouldn't be an untoward action. You could do, as you've suggested, but others may have a view that you don't really need to do that in this circumstance. But I'm not saying that what you're saying is not a--couldn't be an appropriate course of action, but there are also other courses of action which may be equally as appropriate.
Q. Such as?
A. Well, as I understand it, and again, you know, when you're going to get into the system operation, as I understand it, you don't need to do a marginal cost study to implement a demand and energy program for Newfoundland Power at this time. But that's not to say that the Board might not order one or want one or that the resolution of the issues may--we end up in that. Hydro submitted the Stone Webster report, which has made its recommendations that everybody has, and all

Hydro said was subject to the resolution of the issues that we have outlined, that you could have--you could implement a demand energy system with Newfoundland Power. Now the issues, as I understood it, there's some risks for Hydro. There's the weather normalization has to be dealt with. There's an issue with respect to Newfoundland Power generation, and there's the issue of the cost and billing issues. But I'm not the--I'm really not the witness to go any further than that. This is the issues that are in play and the people in our organization and your client's organization and the consultants and the expert witnesses will deal with that issue.
(10:15 a.m.)
Q. But as the CEO, Mr. Wells, this is a rather fundamental change that is being proposed in the structure between--in the wholesale rate structure between Hydro and Newfoundland Power with important implications, and I think it's fair that some of these issues I explore with you.
A. I don't--no, Hydro, I will assume the

responsibility in the sense of Hydro, but you've got to remember, it's no more fundamental an issue when you Newfoundland Power had a different view and had the other side of the coin in the past.
Q. Certainly.
A. So obviously the management of both companies, we had a view, we were--the last time round, that with respect to the demand charge for Newfoundland Power, there was a lot of--if you look to the testimony of the experts the last time, the last hearing, and the Board acted or reaction to that directed us to take certain action, which we've done, and it seems, and I'm told in our organization, that this can be done. There are issues there that have to be resolved in the doing of it, but it looks as though it may be one shoulder to the wheel, another shoulder to the wheel, to get across in our system the cost with respect to electricity, and to influence consumers, and I'm also told, and I said that before, that we apparently are quite unique, between the producer of electricity like Hydro, or the bulk seller, and the distributor. Normally

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MR. WELLS:
distributors of the size of Newfoundland Power are operating in a system, have a demand charge. So I guess we're not following what's going on in other jurisdictions and they're coping with the same problem, I would suggest.
Q. Can I take you to PUB-148? This was a question by PUB staff that said "supposing that Hydro and NP were an integrated utility, would Hydro have employed a different strategy over the past decade to pass through demand price signal to NP customers?" If so, what would the strategy be? Paraphrasing. And in other words, the thrust of the question, Mr. Wells, appeared to be, well, if Hydro was directly pricing to customers, what different rate structure would you need if you were trying to have some different system or different signal? And the answer is "due to the absence of either the experience of the hypothetical utility or data to support an alternative, no different strategy can be surmised." Can you tell us what sort of data you think would be needed to improve any of Newfoundland Power's retail signals to its

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customers, its price signals? Because we already have demand energy rate structures for our large general service customers.
A. Well, you have to appreciate now, that is not my answer, but I'll stand behind it. And it is a hypothetical question. I don't know, you know, how you--you can't deal with a hypothetical question in these proceedings, in that sense, and that's what the answer is.
Q. But can I -
A. So I don't know if the line of the hypothetical utility or data to support an alternative, you're trying to read something into that answer that is, to me, saying that we don't have the absence or due to the absence of either the experience of the hypothetical utility, so we have no track record or history, or any information expressed as data to support an alternative, no different strategy could be surmised. I don't know any other way we could answer that question.
Q. Well, Hydro would already have access to all of Newfoundland Power's retail rate structures to its customers. I mean, they're a matter of

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public record. And the only other data that we would know that one could have to devise better pricing retail rate designs would be a marginal cost study, and so I keep coming back to the question -
A. I know -
Q. - is that--what other data would Hydro suggest there ought to be other than a marginal cost study?
A. But as I understand it, in the--we have sufficient information on the demand side because there's a demand component in your energy only rate, and I'm really getting out on black ice here, but there is a demand component, and our people have talked about it, it's in our evidence, and within the existing rate of Newfoundland Power. The rates that I was talking about earlier about the blocks of energy rate and of course, if you had different levels of consumption related to a block of energy, then you would get the result of the marginal price at the higher consumption level, so that people who consume more electricity would be automatically paying more for it, and that,

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since that would be the marginal block of electricity being consumed, it would reflect the cost of what is supplying that marginal block, and that would be your higher cost electricity. You could get a clear signal through that. But you know, I am not the witness that can confirm that there must be a marginal cost study before proceeding further on this issue. I am told that this is not necessary, that we could do what is recommended by Stone and Webster without a marginal cost study. I'm told that. And that there is sufficient there and while Newfoundland Power may have concerns about a demand charge, we have our concerns as well, and we've expressed them and said we got to sort this out, but if the Board wants to move in that direction, it can be accommodated. That's, I think, the Hydro view. We can accommodate this issue.
Q. Now can we just go back to RDG No. 2 for a moment? The next issue--we looked at the first issue about demand side management and peak control. We talked about that. The next item that Stone and Webster identified was to

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ensure that all parties, Hydro and Newfoundland Power, remain revenue neutral and avoid earnings revenue volatility, and then there are some subsets, avoiding a windfall or penalty for weather, protecting rate payers from artificial or short term cost increases, and minimizing revenue volatility. Did Hydro perform any analysis of the impact on revenue volatility for Newfoundland Power and its customers?
A. On Newfoundland Power?
Q. Yes.
A. I'm not sure. Now we have--there are obviously, within Hydro, and with respect to rates, there are people who are involved in this issue and having to deal with it, but I don't know of any specific study, I mean, with respect to Newfoundland Power rates or variabilities in Newfoundland Power rates, but I'm sure that witnesses coming behind me can speak to that issue.
Q. Did Hydro conduct any study as to what the rate volatility for Newfoundland Power's customers and Hydro's customers who follow

track Newfoundland rates, what their rate volatility would be?
A. It hasn't been discussed with me.
Q. Okay. If I take you to NP-162, Hydro has not yet undertaken any studies to demonstrate the extent to which implementing a demand energy rate will increase system load factor or defer new capacity.
A. Yes, you have a lot of answers, don't you?
Q. Well, okay. Take you back again to the RDG No. 2. The point in--if I go down to number three, "provide NP an incentive to minimize the island peak," and we talked about this to some extent already, "a demand rate can provide NP with a direct incentive to reduce peak through the use of its own generation during peak." If I just stop there for a moment, first, is it not the case, Mr. Wells, that Hydro already has--Hydro and Newfoundland Power already cooperate to ensure the availability of capacity at peak times?
A. Yes, definitely cooperation, yes.
Q. And in fact, Hydro has the ability to call upon Newfoundland Power's generation capacity at peak times?

A. That's correct.
Q. And then, if I come back to the Stone and Webster one, it says "through the use of a demand rate, NP in turn can provide incentives to its customers to reduce peak through rates or other cost effective means." How would Hydro propose that Newfoundland Power provide incentives to its customers to reduce peak?
A. You're quoting now from the Stone Webster report, and you're asking me questions of that in a technical area that I'm going to defer to Mr. Banfield or our expert witnesses.
Q. Well -
A. You know, that's by far more effective to the Commissioners than me getting down into the details of rate design. I don't think that advances the cause whatsoever. Nobody's going to regard me as an expert on that point whatsoever.
Q. Well, one of the ways that we could incent our customers to reduce peak is we could try to put in curtailable rates, you know, we could try to expand that program. But I'm puzzled with the dichotomy then of encouraging Newfoundland Power to control peak in that

fashion, at the same time that Hydro itself is seeking to eliminate 46 megawatts of curtailable power.
A. But do we not have an understanding, Mr. Kelly, that that 46 megawatts of curtailable power comes at a cost?
Q. As would not curtailable rates for Newfoundland Power customers?
A. Yes, but the issue is in going forward what are the measures you're going to put in to reduce the demand for capacity and energy. That's the whole purpose, as I understand it, of demand charges and you got to take a much longer term view, because we are not forecasting, for the moment, with respect to the Island Interconnected system, any deficits in capacity or energy until the 2009, 2011 period. So I would not expect that something's going to happen overnight here. We've already now committed to new sources of supply, and these new sources of supply seem to give us a sufficient margin in capacity and energy at this time. So the issue for us in our rate application, going forward, is what are the costs that we should legitimately

MR. WELLS:
incur in supplying the service, and should we add another million dollars plus for that 46 megawatts of curtailable power and charge it to consumers in 2004, when the circumstances seem to be that that would not be a prudent cost? We don't need it. That may make a lot of sense in 2010, but this is 2004 we're dealing with.

Q. And Mr. Wells, wouldn't that answer be equally true of costs imposed upon the system for Newfoundland Power to put in curtailable rates for Newfoundland Power to try to do demand side energy management programs? Wouldn't one have to know the costs of doing those things against the value to the system in 2009 or 2011, before being able to make a determination that those are appropriate, just as, in your situation, one has to determine the value of interruptible B now versus 2009 and 2011. Isn't that the same issue?

A. I think the issue, in this jurisdiction, and for the Commissioners, is--because they influence the issue of the Stone Webster report, it's a response to the Board, the

question is when do we start or had we done this back twenty years ago, would we be reaping a benefit with this? So if we don't use this now, when do you get it in, work out the kinks and make sure it's in the system, or you decide that there's going to be something else or you don't need it. The initiator in this area is the Stone--the study was done in response to the Board. The words we're reading on the screen are those of a consultant. Everybody has an equal opportunity to review the consultant's report and draw conclusions, and all I'm saying, at my level within Hydro, is that I'm told that there are risks here for Hydro, but if the PUB, you know, if the Board decides that this is appropriate and helpful to the system, which is the Board's decision, then we can accommodate it and we're prepared to work with all parties to ensure that it can come in and have, presumably, some benefit to the system, and the pay off may be some time down the road.

(10:30 a.m.)

Q. Mr. Wells, can I take you next to, in RDG No.

2, to page 13, and this is a point you alluded to a few minutes ago. I just want to come back and discuss it with you. Page 13. Should be at the bottom of the page. There we go. Recommended rate treatment. It reads "this report does not recommend an actual demand rate to NP, but rather a demand rate structure that is based on the principles set out in this section using the preferred Option A outlined in Section 4," and that's a discussion about generation credit, which I won't get into with you. "Using these principles, it is recommended that Hydro run cases to carefully determine measures for such things as the appropriate demand energy balance, variations in its revenue stream, et cetera. It is also recommended that the results of various cases be shared with NP and that the proposed demand rate be based on discussions between both utilities." Now that process has not happened yet, has it?

A. I don't know. I don't think that there's--I know that there have been discussions with respect to a demand rate, and it was a subject matter, as I understand, during the mediation

process and there may be discussions ongoing, but again, the work underneath here, in relation to this, is--I mean, how far advanced, I don't think that these particular things have been undertaken yet, and you'd have to have a better understanding of where we're going with this before you'd start to get into the cost of trying to make it work. Again, I come back to the thing that we are prepared to accommodate this position, if that's where everybody can go with it, and as I indicated earlier, there are risks to be assumed by Hydro. This is not just a Newfoundland Power situation. There are risks here for Hydro and there's going to be work here for Hydro. But if the Board were to accept the consultant's report and recommendation, Hydro is there and we will do our best to accommodate it, and we also are of the belief that we can have a demand rate for Newfoundland Power.

Q. Hydro has not yet run these case studies that are referred to in Section 6.3, have they?

A. I'm not sure if they have or what the extent of the work that staff has done in this area.

KELLY, Q.C.:
Q. Okay. Let me take you to NP-126 for a few minutes. I won't read through the whole answer with you, Mr. Wells, but in line 7, there's a reference that--or line 6, "before a demand energy tariff can be implemented for Newfoundland Power, the following areas will need to be explored by all parties" and then there's a list, and if we scroll down through the main headings, one is the demand energy balance. Two, on the next page, is the treatment of Newfoundland Power's generation. Three is Hydro's risk, and if I could just stop there before we go on to four, in Hydro's risk one of the issues is the impact on revenue to Hydro as a result of moving to a demand energy rate, correct?
A. Yes.
Q. In fact, as you see in item C, Hydro is proposing that its degree of revenue variation be limited for demand to 98 percent. So Hydro will have a two percent limit on the loss of revenue from demand. Are you familiar with that?
A. I have--I am familiar to the extent that I

have read that answer. I have a copy of here, and there, at my level, but I am not engaged in the discussion of the designs and the things that will have to be put in place in those terms with respect to the rates on a constant basis. When you're involved in a rate hearing such as this and you're thrown together with your rates committee and the discussion, you hear a lot of discussion going on, and our answers and our responses, I think that I have captured the position of where Hydro is, in terms of corporately. Now if you want to examine our rates, you know, on our rates, Mr. Banfield is going to be coming in the course of the proceeding and he can deal with all of these issues in much more particular than I can.
Q. But this is a very high level because this goes right to Hydro's revenue and how the process would even theoretically work. If in fact demand were to fall, if in fact somehow all these peak controls and DSM were to result in a drop in demand, then once we got to 98 percent, the system would essentially require Newfoundland Power, beyond that, if it

continued to drop, to pay for demand that was no longer being used in that year. That's how Hydro's revenues would be protected. Is that not -
A. Well, that's how demand works. If you create a demand on a system, we all have demand--I mean, there are other demand charges we have with our own customers in general service. So if you create the demand, you have to pay for it, whether you use it or not.
Q. But if the demand were to drop -
A. That's the nature of it, isn't it?
Q. - if the demand were to drop, it becomes take or pay beyond two percent for Newfoundland Power, even though it's our customers whose demand would be dropped. Is that -
A. But that's how the system works.
Q. Okay.
A. Is that not the case? You're asking now whether it's 98 percent or 97 or two, that's the mechanics of it, but there's an issue there and all I can say, and I've said it now for more than 15 minutes, that the degrees of risk to be assumed by Hydro would have to be discussed with other parties. Stone Webster

recommends discussion and they--we've gone through the list of what they say has to be dealt with, the issues that have to be dealt with. We've supplied answers on it. The only policy issue here for me, again to the Board, is that there's an opportunity here to proceed with the demand energy rate. There are risks to Hydro. We're prepared to undertake whatever is necessary, if the Board wishes to proceed in this area, on those points, and it can be done.
Q. So let's just look at the corollary, Mr. Wells. If the demand went up in a year, then Newfoundland Power would have to pay Hydro for that extra demand and that would be additional revenue then that Hydro would earn in that year, correct?
A. Yes.
Q. And Hydro is not proposing any cap on that extra revenue?
A. I'm not--I don't think that we're into the detail of that. That's part of the discussion. But let me just say -
Q. That's part of the discussion -
A. - let me just say this, that -

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KELLY, Q.C.:

Q. - that needs to take place?

A. - that we apparently, and I don't--I can't-- this is not--I can't back up these facts, but I am told that--and I think it's somewhere in the evidence though, that the demand energy rate or demand charges for a larger retailer of electricity are far more the norm than they are not, and the issues that I'm being asked about now are how you work that out. I mean, they've done it in every other jurisdiction. Surely, in Newfoundland, we may be able to do the same thing. There are retailers who are exactly in the same position as Newfoundland Power would be. There are wholesalers exactly in the same as Newfoundland and Labrador Hydro. Somehow, in 98 out of 100 circumstances, they managed to do this. So I think that these details, and albeit they're serious issues and serious for us as well as Newfoundland Power, all I'm saying is that I'm informed, in Hydro, we have an issue here to deal with. It can be dealt with. We can accept this report and recommend this report to the Board, and that is about as far as I

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can take you on the issue.

Q. Mr. Wells, just stay with my question for this one though. We talked about demand rising. Now most of Newfoundland Power's customers are residential customers and I don't think anybody is suggesting that it is cost effective to put in demand meters for all of Newfoundland Power's customers. If, in fact, demand goes up in a year, because the system grows, then how does Newfoundland Power recapture that expense that it has to pay to Hydro, short of then having to come back in a rate hearing? In other words, does this not create a volatility issue for customers?

A. It may create a variety of things, Mr. Kelly, but somehow, in other jurisdictions, retailers have survived, and I'm given to understand that that is more the case than it is not. That this is the common thing in other jurisdictions, that the retailer has a demand and energy component in the rates. You know, and we have the benefit of the consultant's report, there may be any number of things arising in the implementation of this, but it's been done elsewhere and I assume that the

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risks that anybody has undertaken, wholesaler or retailer, are -

Q. Can we scroll--if you're finished, we'll scroll up to number four. This is the weather normalization one, and in this particular answer, Hydro is proposing a joint technical assessment group to be created to address this issue, and that has not yet been done, has it?

A. No.

Q. No. And so if we go back through the four answers, the four points that Hydro addressed in this answer, we had the appropriate demand energy balance, the treatment of the generation credit, Hydro's risk, and weather normalization. Can I suggest to you, Mr. Wells, that out of the discussion we just had, that there are a number of other issues which must be addressed that we talked about? Number one is Newfoundland Power's revenue volatility risk issue. Would you agree that that's an issue that needs to be addressed?

A. Well, I've heard that issue stated and it may very well need to be addressed. Yes, there are issues, I'm sure, for Newfoundland Power here, as well as Hydro. So I don't want to

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diminish the issues that Newfoundland Power would put forward.

Q. And would you agree that there is a question of rate stability for Newfoundland Power's customers, as well as Hydro's customers, that needs to be addressed?

A. There may be, but how that would work and the variations of that in the particular, I can't comment on that.

Q. That's fair. Would you agree that there needs to be an analysis of how rates to customers would have to be modified to try to achieve the objectives, assuming these are objectives that one ought to try to meet? In other words, you need to look at -

A. That may very well be, and I'm sure that our rates people would be onto that fact.

Q. Okay. And the final one that we've talked about, as to whether there's a need or not, is the potential need for a marginal cost study.

A. And again, that may or may--I'm not the expert there. I'm told that it's not necessary, but if you did one, that wouldn't be the most startling event that would take place in those circumstances.

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KELLY, Q.C.:

Q. Okay. Now bear with me a moment. I take you to NP-141. There was a question posed as to whether Hydro has completed a marginal cost study or a time differentiated embedded cost study since 1992. Hydro has not performed one, Mr. Wells, and I'm advised that the last time Hydro did one was in 1984. Would you be able to confirm that?

A. No, I'm sorry, I can't confirm. 1984, the answer there says -

Q. The question posed was have you done one since 1992. Can you tell us the last time Hydro, on its system, did a marginal cost study?

A. No, I'm sorry, I can't give you the exact year, no.

Q. Can I take you to 185--sorry, IC-185. And there was a question posed by the Industrial Customers to indicate the extent to which Hydro's bulk cost of generation and transmission on the Island Interconnected system vary on a time-of-use basis under normal conditions. Indicate likely peak and off peak periods during the seasons, et cetera. I'll let you read the question. And the answer that came back was, "in the absence of a recent marginal cost study, the requested information is not available."

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A. That's correct.

Q. So this is another reason why, can I suggest to you, that a marginal cost study now needs to be done by Hydro? Would you agree with that, to provide this information?

A. That may be one of the arguments advanced, that one should be done, and if one is absolutely essential to be done, it can be done.

Q. All right. Thank you, Mr. Wells. Those are all the questions that I have.

(10:45 a.m.)

CHAIRMAN:

Q. Thank you, Mr. Wells. Thank you very much, Mr. Kelly. Would you like to--good morning, Mr. Hutchings--take a little break now and start up afresh or would you like to go for the next 15 minutes? I'll leave that -

HUTCHINGS, Q.C.:

Q. We could probably use up the next 10 or 15 minutes, and keep our break at the normal time.

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CHAIRMAN:

Q. That'll be fine. Is that okay with you, Mr. Wells -

A. Fine.

Q. - or would you wish some respite? Okay, proceed.

HUTCHINGS, Q.C.:

Q. Good morning, Mr. Wells.

A. Good morning.

Q. I just want to, in the few minutes we have before the break, to deal with a question that you were recently discussing this morning, to some extent, with Mr. Kelly, and that's the issue of the demand side management activities of Hydro. I take it from your answers to Mr. Kelly that you do view demand side management as essentially a long-term type of tool for use by Hydro, not necessarily one that is going to, you know, turn a cost benefit in every year of a particular program. Am I reading you correctly on that?

A. Well, I think that, yes, you could construe that from my remarks thus far, as response to questions. Like the Hydro Wise program is designed to be a longer term program and over time, you would hope that it will produce results, but you don't expect, in such a program like that, that you're going to change something immediately or say within a--and our thought is, on this, and Mr. Banfield can speak to it, is that by taking a longer approach and looking at it in a longer term, it would be probably be more effective than target initiatives that have taken place in the past. It's a very difficult area in dealing with consumers, but that's substantially our approach at the moment.

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Q. And the ultimate goal, presumably, is the deferral of the construction of new capacity, correct?

A. That would be one of the objectives, yes, because that would be of benefit to consumers, otherwise their costs will definitely increase.

Q. Yes. I mean, it's like your newly constructed Granite Canal plant. You've told us, in the evidence, that the financing costs on that alone for a year are $11 million. If you could have put that off for another year, that would be 11 million in real savings, wouldn't

HUTCHINGS, Q.C.:
it?
A. Yes, that would be 11 million less additional costs of the system.
Q. And that's not just a deferral. I mean, you're deferring the hundreds of millions or hundred odd million that you have to pay for the plant, but the 11 is a real saving, isn't it? It's money you'll never have to spend?
A. That's correct.
Q. Yes, okay. Mr. Wells, what do you know of the operation of integrated pulp and paper mills, such as Corner Brook and Stephenville?
A. What do I know of them?
Q. Yes.
A. Well, I'm a former employee of the mill in Corner Brook, and -
Q. I don't think that was in a managerial position, was it?
A. No, I was very much in a subordinate position, I must say, about the bottom of the barrel there. But I am aware of the paper mills in Corner Brook and in Stephenville, and indeed Grand Falls. I grew up, in part, in a paper town. I know the importance of the paper

mills to the province. And I'm aware of the background and situation of issues related to Stephenville and the history of Stephenville, with respect to the mill that's currently operated there by your client.
Q. I was thinking more of the technical operation, in terms of whether you're familiar with thermal mechanical pulp and, you know, how the pulp operation feeds into the paper machine and the product is ultimately produced.
A. I worked at various aspects in the Corner Brook mill, and if part of that process is loading rock into a wheelbarrow and putting it up to the tower for the sulphur content, yes, I'm aware of that aspect of it.
Q. They also serve who load rock. So in terms of what's closer to the issues here, do you -
A. The use of electricity, I think you're--is it?
Q. Yes. In terms of what, for instance, the impact of the existence of the interruptible B contract would have been on the operations of the Stephenville mill, do you have any knowledge of that at all?
A. Yes, and it would be a shortfall from the mill

in Stephenville's perspective of income.
Q. Yes, it would be that, and you're aware that it's essentially the pulping operation that would be shut down in the event of an interruption under the interruptible B contract?
A. In the mill process?
Q. Yes.
A. Yes.
Q. The paper machine could continue with 46 megs down. Did you understand that?
A. Yes, I understood that.
Q. Yes, okay. So you understand that the existence of that interruptible B contract and the ability of Hydro, on an hour's notice, to take away 46 megs of power does affect the way that that mill can operate, correct?
A. Did you say does or doesn't?
Q. Does.
A. Does affect?
Q. It does affect it, yes.
A. Yes.
Q. I mean, you have to be ready to deal with, on an hour's notice, a complete shutdown of your pulping operation and, you know, you create

storage possibly or you use your storage and you plan your operations in such a way as to use, you know, potentially produce lower quality product for different reasons. You understand that all of those things are associated with the interruptible B contract?
A. Yes, I understand that. I understand that and have heard those sentences in different context.
Q. Okay. And that contract having been in place now for ten years, Stephenville is used to it. They have composed themselves in such a fashion that they can handle that interruption on an hour's notice. Are you aware of that?
A. Yes, I would expect that they--and that's why the contract was proffered and over time, you would have a capability to deal with the eventuality and protect the mill.
Q. You have now people in the mill, as operators, who are trained and understand what the procedures have to be when you get the phone call from Hydro saying that your power is gone in an hour, correct?
A. Yes.
Q. Yes, okay. Would you recognize also that, in

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HUTCHINGS, Q.C.:
the absence of that, the mill could operate differently in that it would no longer need to have these procedures in place, operators trained to deal with those facilities, and perhaps not the same need for storage capacity for pulp, as it would have had with this 46 megawatt hammer hanging over its head?
A. Yes, there would be differences.
Q. Okay. So should matters progress such that in 2007 or 2008 when you're planning your next generation addition you find that you can defer that addition for a year if you can access, let's say, 46 megawatts of interruptible demand, would you not in that situation expect to go perhaps to Stephenville and ask whether or not an interruptible B type contract might be something they'd be interested in?
A. That might very well be one of the options explored, depending on circumstances.
Q. Yes. And it might save the whole system $ 11 million, like Granite Canal would have if we could have deferred that for a year?
A. Well, that's possible or theoretic, I mean.

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Q. But if Stephenville replies to you in 2006 or 2007, "listen, we've let our storage capacity go down. We don't have the people to do this any more. I'm sorry, we'd like to help you, but there's nothing we can do," then that's an opportunity lost to Newfoundland Hydro, isn't it?
A. That could very well be.
Q. And potentially a loss of the 11 million, shall we say, that might have been saved?
A. Given that we don't know the circumstances what's going to be driving the new sources of capacity or energy and what's required and the amount of energy, the interruptible contract might help in a peaking purpose, but it might do nothing in terms of the energy requirement for the system. So for instance, if we were in a situation where the only solution to the issues for capacity and energy on the system are a fourth unit at Holyrood, because you need a significant amount of energy, then you wouldn't give any consideration to trying to renew the interruptible B contract. Your circumstances would be different, and it's, for both you and I, very difficult to

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determine what exactly will take place at that time, but that does not mean that there's not a possibility for what you have described, but who knows.
Q. In the long term, almost inevitably there will come a time when the system will be demand constrained? Isn't that correct?
A. Yes.
Q. And this is a long-term program? Any DSM matter like this should be considered as a long-term program?
A. You're viewing it over a period of time, yes.
Q. And it's not unlike, to some extent, a system of insurance. If the circumstances come around in the way that I've proffered that they might, then you'll be very happy to have had your insurance, would you not?
A. Definitely.
Q. Yes, okay. Maybe we can take the break there, Mr. Chair.

CHAIRMAN:
Q. Appreciate that. Thank you very much, Mr. Hutchings, Mr. Wells. We'll reconvene at 25 after.
(BREAK AT 10:56 A.M.)

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(11:29 a.m.)

CHAIRMAN:
Q. Thank you. You're looking at me, Ms. Newman, as if you have something.

MS. NEWMAN:
Q. How very perceptive, Chair. Yes, indeed, I have a consent document to file. The parties are filing as Consent No. 1 a document entitled "Parties Agreement on Cost of Service and Rate Design Issues for the Consideration of the Board." Copies have been circulated and it's been filed with the clerk.

CHAIRMAN:
Q. Okay. I'd like to indeed thank the parties for their effort in this regard. Mediation reports like this, in my opinion, do translate into improving regulatory efficiency and recognize, I guess, that some efforts are going to be probably more successful, quite frankly, than others, but we do appreciate the parties willingness to get together on these matters in a way of streamlining, I guess, the process, or hopefully streamlining the regulatory process for us. So, the Panel will certainly be taking these recommendations and

CHAIRMAN:

issues into account in our decision. And once again I thank the parties for their efforts in this regard. You ready to start up again, Mr. Wells? When you're ready, Mr. Hutchings, please?

HUTCHINGS, Q.C.:

Q. Thank you, Mr. Chair. Mr. Wells, in your evidence on Monday you made some comparisons between rates in Newfoundland and Labrador and rates in other Atlantic Canadian jurisdictions. At page 140 of the transcript of October 6, 2003 you said, starting at line 8, "Now, in other jurisdictions they have far more advantages other than a straight comparison of hydro power. We have a very large territory. We operate from McCallum to Nain in hydro. We operate isolated diesel systems." And you go on to talk about 21,000 customers, 180 communities and so on. Would any of these factors that you've referred to there, the size of the territory, the 21, 000 customers and so on have any impact on rates for Industrial Customers?

A. I'm trying to get the context of the remarks.

But you're saying do any of our rural customers on the interconnected system have an impact on Industrial Customers?

Q. Well, you brought up the point in terms of comparing rates here with rates in other parts of Atlantic Canada that the territory is very large, you had difficult operating area, you know, from McCallum to Nain, as you say, and isolated diesel systems and so on. But -

A. Speaking with respect to our costs?

Q. Yes.

A. And service, yes.

Q. Um-hm.

A. That's what I was speaking to.

Q. Yes, right. But none of those items should affect the rates paid by Industrial Customers in Newfoundland and Labrador, should they?

A. Well, in terms of the island interconnected systems, the costs that go into the system that are assigned through the Cost of Service Study to our Industrial Customers there is a linkage.

Q. But the Industrial Customers pay only--share in the common costs and not in the Hydro rural costs, correct?

A. That is correct.

Q. And any costs that are specifically assigned to them?

A. Yeah. That's really--you're right, yes, it's the -

Q. Yeah. So what happens -

A. And there's been some change in assignment of costs, yes.

Q. Sure, yeah. So what happens in McCallum or happens in Nain doesn't affect the Industrial Customers at all?

A. No.

Q. No. And it's essentially just the backbone of the grid, you know, leaving out things like transmission line on the Northern Peninsula that cause cost for the Industrial Customers?

A. That is correct.

Q. Right, okay. You mentioned at page 74 of the transcript that--at line 19 that the Holyrood thermal generating station which consumes No. 6 fuel provides approximately 38 percent of Hydro's average annual energy. When was the figure of 38 percent experienced?

A. When was it experienced?

Q. Um-hm.

A. I think that, because that was in my direct evidence at the starts of the hearing, would be based on 2002 experience.

Q. Okay. And that was, I think, a particularly cold winter, as I understand?

A. Yes, leading into 2003.

Q. Yes. And so that was also prior to coming into service of Granite Canal and the initiation of the two new power purchase contracts, correct?

A. In the 2002 year, yes, these sources weren't available.

Q. All right. So 2002 was a year when the demands on Holyrood were greater than normal. Would you agree with that?

A. Depended on normal, we had a lower than average water year and that's--and we had a higher consumption. And therefore, Holyrood operated to meet the system supply and demand, Holyrood operated--produced more electricity than, say, in other years. But you have to look at your hydraulic circumstance and the load.

Q. Right.

A. And it will vary.

HUTCHINGS, Q.C.:
Q. Of course. If we could put up for a moment IC-151? Page 2 of 2 shows the, among other things, the breakout of the Holyrood generation from the other thermal and the hydroelectric generation?
A. Yes. The supply to the island interconnected system.
Q. Um-hm. Okay. And using the numbers that are shown here for Holyrood as a percentage of total energy supply calculated that on average since 1992 Holyrood has been producing 24.2 percent of the energy supply. Would you agree with that number?
A. Is that your number or are you looking at it on this?
Q. No, it's not on that piece of paper. It's calculated using -
A. Using those totals?
Q. Using those totals, yeah.
A. Well, I would--not having done it, but I mean, if you done it -
Q. Yeah. But would you -
A. - and you're mathematically inclined, it might be right.

Q. Would you accept that as being the proper order of magnitude?
A. Well, that could very well be. But I -
Q. All right. If we could look then for a moment to RDG 1, the Cost of Service Study. And it's just one little number, so we don't have to be too afraid of it at this point. Page 17 of 107. That shows the 2004 forecast cost of service and shows the total sales for the island at 6,477,675 megawatt hours. If one deducts from that the average energy production of the hydraulic sources and the power purchase contracts from Mr. Haynes' Schedule 2, we show up a percentage of 23.2 percent of the annual--of the energy forecast to be sold in 2004 as being generated from Holyrood. Is that a number that you would regard as being in the right range?
A. Well, the projections that we've made for 2004 in the sources of supply are in the evidence.
Q. Yes.
A. And that would be correct.
Q. Okay. So as opposed to the 38 percent figure which you used which was for an abnormal year, both the average and the projection for 2004

would put thermal production at Holyrood in the range of 23 to 24 percent. Do you agree?
A. There are three intervening factors, the new sources of supply, which are, two of them hydraulic, and then it depends on our own reservoir standings and then it will depend on the load that we've experienced.
Q. Right.
A. And because in 2003 it's been greatly influenced by the use of Holyrood by, you know, our hydraulic situation and the very cold winter, January, February, March, which is not part of what you had asked me earlier about 2002.
Q. Right.
A. But Holyrood has been up in the range of three terawatt hours.
Q. Um-hm. Okay. I didn't see figures that would allow us to do very much in terms of doing a calculation for 2003, but we had the average over the past 10 years at 24.2 percent and your projection for 2004 at 23.2 percent. So I think those are reasonable figures to use in terms of the hydraulic thermal split on an historical basis. Is that fair?

A. Well, we will stand by--and Mr. Haynes will be far more conversant with the issue to talk to you about our projections with respect to hydraulic supply, the purchases from outside sources and the role that Holyrood will play in 2004.
Q. But you recognize 2002 at the 38 percent as being an abnormal year?
A. Now, when you say "abnormal", the system worked as it should, that Holyrood was able to meet the demand and supply the energy related to our own hydraulic situation and so the system worked as it should. But the dependency on Holyrood can be reduced to some extent by the new sources of supply, even though our costs for fuel are going up and the overall costs are going up. But, you know, in terms of the supply to the system and the components of that supply and what's projected by our own systems, then that is Mr. Haynes' domain.
Q. Sure. No, I understand. I'm not suggesting there was anything improper done in 2002. That's what Holyrood is there for, is to supply the energy, obviously. But,

HUTCHINGS, Q.C.:
presumably, you know, as hydro capacity is added, hydroelectric capacity is added, then the reliance on Holyrood goes down for a period of time?
A. Yes, can diminish, yes.
Q. Yeah. And then as the reliance builds up to a point where it gets to a stage where demand or energy is constrained, then new resources are added to the system and the reliance on Holyrood goes down again. That would be a typical cycle, would it not?
A. Well, you have to be cautious with respect to the issue of capacity and the energy side, because we have additional requirements for capacity and energy in the system.
Q. No, I understand.
A. And Holyrood is still there.
Q. Yeah. And Holyrood as regards planning issues largely, while it does provide significant capacity, is more significant, I guess, in terms of the energy that it supplies through the system?
A. Very significant.
Q. Yeah.

A. It's part of the base load.
Q. Yeah, okay. Now, in terms of the costs on the system, I think the evidence shows that the cost of the kilowatt hour coming out of Holyrood is about 5.1 cents. Is that a number that you recall?
A. That would be what's in the order, but I--it's not in my head until you just mentioned it, yes.
Q. Okay.
A. But in that order.
Q. All right. Do you know what the average cost of a kilowatt hour produced in Bay d'Espoir is?
A. In Bay d'Espoir it would be somewhat less than that, but I haven't seen a calculation of the Bay d'Espoir system costs recently. A number of years ago we were looking at that for some reason, but--because the resource rent benefit of Bay d'Espoir just goes to consumers anyway, so it's not a big issue on our mind. But it would certainly be less than five cents a kilowatt hour to produce in Bay d'Espoir.
Q. Yeah. Significantly less?
A. Yes. I mean, that's one of the benefits of

our system.
Q. Yeah. I mean, quite frankly, Bay d'Espoir is your greatest asset, isn't it?
A. To the people of Newfoundland and Labrador it's a great asset, yeah.
Q. Yeah, okay. You can't tell us, at least off the top of your head, what the cost of producing a kilowatt hour of electricity there is?
A. No. I would think it's more likely to be a three. But maybe Mr. Haynes can give you more definitive.
Q. Yeah. No, I'm just trying to get -
A. Yeah. It is our best price. As each system comes on stream the costs are higher. It's like Granite Canal is coming in at five and a half.
Q. Um-hm.
(11:45 p.m.)
A. And that was our next best source. Island Pond is another source we have in Bay d'Espoir, but it will be more than five and a half.
Q. Yeah. I'm just trying to come around to your comparisons with Atlantic Canada. And, you

know, you made one effort in your evidence to compare the systems and the operating conditions and so on. Do you know what percentage of the power produced by Nova Scotia Power comes from hydraulic sources?
A. No, I don't.
Q. So you didn't look into that prior to making any comparison with Atlantic Canada, did you?
A. No, the comparisons made with Atlantic Canada prices are the published prices for Nova Scotia Power or New Brunswick Power or Maritime Electric. These would be the published prices of their energy rates that I didn't collect but that within Hydro we ascertained that information. It would be open to the public.
Q. Okay. No, I just checked on Nova Scotia Power's website and it appears that their production is probably 90 percent and 10 percent hydraulic. Does that fit in with your general view of what likely goes on in Nova Scotia?
A. That's most likely.
Q. Yeah, okay. Do you have any information on New Brunswick Power in terms of their

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HUTCHINGS, Q.C.:
hydraulic and thermal/nuclear split?
A. Not as the split, but unlike Nova Scotia, there's a more of a percentage basis for hydraulic and then thermal as well as atomic. They have a diversity of sources of supply.
Q. Yeah. Their website indicated they were about 23 percent hydraulic, which would leave 77 in the thermal and nuclear categories. Does that sound about your--consistent with your impressions?
A. I have no impression of it. I know that they have hydraulic, thermal and atomic.
Q. Okay. Do you know of any utility in Canada that has a similar percentage of hydraulic capacity as Newfoundland and Labrador Hydro? And when I say "similar percentage", I'm talking in the 75, 76, 77 percent range.
A. No, I can't be precise on that. Manitoba Hydro is a very much--it's hydraulic. B.C. Hydro, Hydro Quebec, obviously. Saskatchewan would be less. And Ontario, as a percentage, I'm not sure, but there's significant dependence on atomic and thermal. But, you know -

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Q. Yeah. No, I think you probably struck the best comparison in your first answer in that my basic investigation showed that Manitoba Hydro has about 85 percent of its capacity as hydraulic.
A. It would have more hydraulic capacity as a percent of their system than we would have.
Q. Yes. But their percentage of hydraulic would be a lot closer to yours than either Nova Scotia Power's or New Brunswick Power's, correct?
A. That's correct.
Q. Yeah, okay. If we could look for a moment then at IC-17, the first revision, August 26th, 2003? There's a table attached to that which has some actual and forecast industrial rates for 2001 through 2007. Now, Manitoba Hydro's rate for 2003 is shown at the top there, a demand charge of $5 and 75.1 cents per kilowatt hour per month and an energy charge of 0--of 1.975 cents, basically, per kilowatt hour which if compared to Newfoundland and Labrador Hydro's which in your proposal for 2004 is shown at the bottom, that's in the shaded portion there, is $6.49

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for the demand charge and 3.799 cents for energy. You see those figures?
A. Yes. At the bottom under the 2004 column?
Q. Yes.
A. Yeah.
Q. Yeah, okay. Now, I do the simple calculation just picking out one of the Industrial Customers in Newfoundland who had a demand of 30 megawatts and an energy requirement of 101.3 gigawatt hours per year, and applying the rates that you produced here in IC-17, we find that that customer in Manitoba would be paying 52 percent of what they're paying in Newfoundland for that level of consumption. Does that surprise you?
A. I would be expect that the industrial rates or the retail rates even in Manitoba would be lower than on our island interconnected system. Our comparison was to the Atlantic Provinces.
Q. Yes.
A. Manitoba has one of the cheaper rates because of their high percentage of hydraulic production.
Q. Yeah. Which is -

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A. They have a fairly significant amount of exports, and I don't think that supplying their local load is all that big an issue.
Q. Their hydraulic capability is something less than 10 percent more than your own, according to the numbers that we produced. Wouldn't you agree with me that a comparison with Manitoba with that almost similar amount of hydraulic production, which is obviously cheaper, is a better comparison than comparing to Nova Scotia where they only have 10 percent hydraulic?
A. The issue is that in Manitoba, if you--you want to talk about the rates that they have in Manitoba compared to Newfoundland and Labrador, you have to look at the total system and what their costs are and what their sources are and the whole structure of costs that would go into their cost of service study, for argument sake. You could say the same thing about Newfoundland or Nova Scotia. The only issue that we point out with respect to our industrial rates, we are on an island, we have few options, we have no interconnections and in Atlantic Canada we

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said that our industrial rates are competitive with the rates in other provinces in Atlantic Canada, and no more than that. But in our situation to the extent that we have any advantages at all, and we don't have all that many other than like Bay d'Espoir was certainly a help, we remain competitive. We're not trying to say that there are jurisdictions where there are indeed even more advantages than that may be available to Newfoundland and Labrador.
Q. But you've taken it upon yourself both in your evidence and in your testimony here to make the comparison with Atlantic Canada. My suggestion to you is that the systems are so totally different that this is not a useful comparison to make at all. Is there some reason why you make that comparison?
A. Well, one of the things that one would look at in Atlantic Canada is--which is important to our whole economy is do we have relatively competitive electricity rates. That's important. That affects the whole of the industrial, commercial and quality of life in

Newfoundland and Labrador, it's very important, if you have cheaper energy rates. The point of the comparison in the local area is that if there's going to be industry attracted into Atlantic Canada it appears that our industrial rates are competitive. The issue of how we got that way, it was our luck to have Bay d'Espoir. Nova Scotia has very few hills or water on top of it, so they have a natural disadvantage. What they did have though as a natural advantage compared to hydraulic was they had an enormous amount of coal in Nova Scotia at, you know, at one time. So the argument that you may use one way or the other, we didn't intend any more than to state a fact that in this area of the country the rates that we have for Industrial Customers are lower than the rates in other parts of Atlantic Canada, and no more than that.
Q. I'd suggest to you that if Nova Scotia or New Brunswick had 75 percent hydraulic capacity at their beck and call, then their rates would obviously be considerably lower?
A. Of course. And you should--it's like if you

have access to Churchill Falls Power, we supply the mines in Labrador west at a very competitive rate of power because the facility is there and the resources are there and you're able to do it.
Q. On the basis on which you compare these utilities on filling in the additional facts relative to the comparators, I'd suggest to you that we should be looking at rates in Newfoundland that are 50 or 60 or 70 percent of those in Atlantic Canada. And can you explain to me why we're not seeing those?
A. That wouldn't make any sense at all. I have no idea how you could possibly make that statement and then look at the cost of service that we're being supplied on the island interconnected system. You cannot make those statements that the percentage of hydrology somehow translates into a lesser cost for the individual units of electricity that are produced either in Bay d'Espoir or Upper Salmon or Cat Arm and the transmission systems that are used to connect them and deliver them over what territory. I mean, one of the advantages that Manitoba has in its domestic

supply is that a lot of Manitobans happen to live in Winnipeg and very high concentration of the population. I don't accept either the premise of your thesis or the thesis itself. That will not be helpful to the Commissioners in making a determination on the costs of electricity in this jurisdiction.
Q. You will agree with me that the cost of producing a kilowatt hour of electricity from Bay d'Espoir is probably about 60 percent of producing one from Holyrood?
A. Sixty percent of Holyrood?
Q. Yes.
A. No. The Holyrood's cost would depend on there's fixed and variables, and then there's the price of fuel. Holyrood, because it's an old plant and it's written down, actually produces on a kilowatt hour basis very competitively priced electricity. It's -
Q. Yeah. Mr. Wells -
A. It can sustain a fair increase in the price of oil, in terms of cents per kilowatt hour, and still give a result.
Q. I'm just harkening back to our first discussion where we were talking about

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Holyrood at about five cents and Bay d'Espoir at about three cents. That's 60 percent, correct?
A. Holyrood's cents per kilowatt hour rate will depend on how the plant is used.
Q. And we're talking averages, correct? And that's all that we every talk about in terms of the cost of producing a kilowatt hour of electricity. So on average, the cost of producing a kilowatt hour of electricity from Bay d'Espoir is 60 percent, roughly, of what it costs to produce one in Holyrood. Do you agree with that or not?
A. Give or take a plus or minus, construction estimate, desktop, 25 percent one way or the other or 10 percent. You're asking me to confirm a statement that I'm just not prepared to confirm. Although you're, you know, relatively in the ball park.
Q. Okay. I want to look, Mr. Wells, for a moment, at some of the charts that you've included with your evidence. Chart No. 1 is on page 8. Not the schedule, I'll get to the schedule, but looking at some of the charts

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first. And that's the revised one from August 12th of 2003. And this is a comparison of the index of inflation and Hydro's core wage expense. Now, what I can read from this document, I take it 2002 were the last actuals that we have for the purpose of this chart?
A. That's correct.
Q. Yeah, okay. And that shows, if I can estimate, the core wage expense index as being about 1.125 and the inflation index as being a little over 1.15?
A. 1.20.
Q. No, a little over one point--one, one, five for 2002?
A. Oh, I'm sorry, 2002, I'm sorry, yes.
Q. Yeah. So, those two figures are--and you can see it on the chart, obviously, pretty close to one another at that stage?
A. In 2002?
Q. Yes.
A. That's correct.
Q. Yeah, okay. And the years to the right of the line, 2003, 2004, those are simply forecasts of where you hope to be in those years, is that correct?

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A. That's correct.
(12:00 p.m.)
Q. Okay. Would you agree with me also that this chart is essentially totally dependent upon the year in which you choose to assign the 100 index to? I mean, the way this chart looks is dependent entirely upon the year that you choose as your starting point. Would you agree with that?
A. Yeah, you would get different results with different, with different timings. The chart is intended to go back to 1992 and come forward.
Q. Yes.
A. Yes.
Q. And that shows, you know, other than in 1993 when the two lines are--'93, '94 the two lines are almost the same, that your core wage expense line shows up below the inflation line right throughout the period, correct?
A. That's correct.
Q. Okay. And I think the point is illustrated if you look at Chart No. 3 which is the same index, same two indices, if you wish, but starting in the year 2000, so on this chart

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the core wage expense actually goes up over the inflation line in 2002, correct?
A. That is correct.
Q. Okay. And would you agree with me also, sir, that if you started this chart at 1997, that for the entire period, your core wage expense would be in excess of the inflation index?
A. I don't have that chart. I'm not prepared to accept that statement, I'd have to see a chart prepared to accept that, but the issue there, in 2002, as I had tried to state earlier to the Commissioners when questioned on the same thing, as to the bubble there on salaries and fringe benefits was there was one million dollars for overtime for capital projects, and a million plus, roughly a million dollars which were the severance cost for the 46 positions that were eliminated in 2002, which provides for that 2002 blue line going over the red on your screen.
Q. I understand that. I wonder if you might undertake to have this chart reproduced with year one at the one hundred index being 1997, so we can see where that chart would go?
A. It can be done. You're not going to throw out

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the '92 to '95 chart, are you?
Q. No, not at all.
A. Or the 2000 to 2001?
Q. No, they all have valid purposes, I'd just like to -
A. Because the bottom line here is that for the period that we took, and to what extent it's any help to the Board to keep throwing charts at them, is that inflation over that period was much, much higher, as the evidence states, then the core wage expense increase, which was 7.5 percent, compared to 19 percent for inflation. And we also have the evidence that there's 211 positions net, taken out in that period, and that means that there has been a substantial potential cost taken out of the system. And the charts, in that connection, just show that the staffing levels, the core wage expenses, inflation, and we could take a chart that starts with '92, '93, '94 and ' 95 and the math will give us the picture, but the real picture and what we stand on is 211 positions over the period, and a total wage bill that beats inflation by 14 percent. End

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of story.
Q. I understand exactly what you're saying, Mr. Wells and someone within your organization chose to start the chart at 1992. I'd just like the Board to see one alternative picture, which would start the chart at 1997. And it's just more information that helps the Board see what's happened in the last five-year period.
A. We did go back to 2000, but we can do the chart, somebody can do that.
Q. Okay, thank you. Looking over then to page 12 of your evidence, Chart 5, this is the index of inflation and Hydro's total controllable costs, and they are almost equal in 2002, is that correct?
A. That's correct because of the influence of the salaries and wages and the two factors that increased them by 2.6 million in 2002.
Q. Uh-hm, and again the -
A. That's 63 percent of the cost, we're looking at here.
Q. I understand that, yes. Again, the years to the right of the line are forecast or maybe highest hopes as to where these costs and inflation will end up in the future years,

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correct?
A. Well with respect to inflation, it's just forecast that our people would get from appropriate sources on the prediction for inflation. The salary and wage cost is our projection, relatively holding the line flat through to 2004.
Q. Okay, while we're on the subject of Hydro's total controllable costs, can you just explain for us what steps that Hydro took in order to respond to the Board's direction in P.U. 7 that Hydro be subject to a productivity allowance of $2,000,000.00 on its controllable costs?
A. Well, the planning for the year 2002 and what we were doing internally and the arrangements that were made in 2002, were well in advance. The Board's order, well the first indication of an order before it became final, but where the Board was going, I think came out in June of 2002. Our internal programs were carrying on over into 2002, you know, what we had in place then and the resulted fact was that in 2002, in the fall, we eliminated 46 positions which you could say is roughly equivalent, if

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not more so than the Board's $2,000,000.00 productivity allowance, but you can't directly relate it to the productivity allowance.
Q. Can we look at Mr. Roberts' Schedule 2? The costs that we're talking about, as I understand it, Mr. Wells, are those under the heading "Other Costs" here, starting at line 15 and going down through 26?
A. Yes.
Q. Okay, now the test year approval for salaries and fringe benefits was $61,926,000.00?
A. That's correct.
Q. And the actuals were $64,559,000.00?
A. That's correct.
Q. So there were no savings in the salary component?
A. No, nor were there savings--well, there was savings--there were no savings in relation to the Board's final test year if you compare the two numbers, but the issues that took place there, that 64 million dollars includes the dollars that we expended with respect to the severance payments for the 46 positions, which the Board would not have contemplated as, I mean, or it's not related in that sense, but

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the 61,926 could not have been achieved, I would suggest, and we still spent--the million dollars extra spent in 2002 on capitalized, the expense to which I just referred, as well as the expense related to the elimination of the 46 positions, which if of benefit, I mean, the cost savings are achieved now in the year 2003.
Q. Okay, I just want to focus on the productivity allowance, you know, the other costs that are here under the heading "2002 Final Test Year Revenue Requirement", they are totalled $96,243,000.00, correct?
A. That's correct.
Q. Okay. If you took out the productivity allowance, that total would be $98,243,000.00, correct?
A. That's correct.
Q. Okay, so what did you understand the Board to be telling you by putting in that productivity allowance? What were you supposed to do as a result of that direction of the Board?
A. What I understood the Board to be telling us that they did not have a means by which to

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measure our performance and that in the absence of that, they imposed a productivity allowance which reduced our other cost category by $2,000,000.00 and they left it up to Hydro to deal with it, you know, in terms of where and what it could do with it. The Board did not state that this was taking a scalpel to our costs in any particular, and carving out the costs that really were--where it should not be there. The Board in effect, as I understood it, was not making a comment as to whether our costs were appropriate or not, they were saying that we can't determine whether the costs are appropriate or not, so in effect, they imposed the allowance. And having acknowledged that fact, we have made sure, in this Application, that the Board has the means by which to assess the performance.
So I don't think there's any--the Board at the time of making the order with respect to the productivity allowance, didn't know exactly whether that would be going into a group of costs that really could take that productivity allowance, or whether they could not. It was not a precise thing. It was just

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an approach that was intended to send a message to Hydro that we have to be able to explain, to their satisfaction, where we are on performance. And they didn't break it down as to whether it was salaries and fringe benefits, system equipment maintenance or insurance and other costs under "insurance" there, down to line 25.
Our experience, remember the Board spoke, as I said in June, we were halfway through the year, our plans were in place. We incurred a million dollars of expense in severance pay that the Board had no information on, absolutely none. We incurred another million dollars in capitalized overtime that the Board, at that time, had no information on. In system equipment maintenance, the cost came out and as I've said at some extent, keep saying to everyone that I can talk to and here in these proceedings, that system equipment maintenance is not a cost that we really control in a sense, we can try and influence it and indeed we do, but if the system requires it, we do it. And I don't think the Board wanted us to put the whole of the two

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million dollars against system equipment and maintenance, then we get to our other costs, you'll see that insurance went from 977 in the cost of service, to 1198. And that's really--we don't control the cost of insurance, so there was a huge expense that came against us that what were we to do about it, reduce our insurance, not cover things or keep our insurance as best we could? So we had to take those--the other costs, really, there's not much there that one can talk about, so the only opportunity, the only opportunity to save the two million dollars, I would suggest in reason, was take it out of salaries and fringe benefits and 46 positions, or roughly, 50 positions say at an average of 50--if we take $50,000.00 which is a reasonable figure to assume for a position and counting, and ten positions therefore is $500,000.00, we'd have to take out 40 positions to get $2,000,000. 00 and we already were into the process in June, July, August, September, October of taking out 46 positions, and to find another 50 positions, you know, in the last six months of the year and not only get them out of the

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system, but at no cost, is an impossibility. So we did not have an opportunity to take $2,000,000.00 out of salaries and fringe benefits, which would be recorded in the year 2002.

We did, in fact, take out $2,000,000.00 of salary costs for 2003, but we did it by taking action in 2002. To meet the Board's requirement on salaries and fringe benefits in 2002, we would have had to have started working on that back in early 2001.

Now we were, obviously, working on being more efficient, more effective within the organization and getting more performance on productivity gains, which was reflected in the 46 positions. But even if we had, after the Board's order in June, said, okay, let's take out another 50 positions, we would have had to have come up with another million dollars of severance pay and we wouldn't have saved a year's salary. We'd have to take out, at that point, maybe 2 or 300 positions to try to meet the requirements of the Board's order when it became available to us.

(12:15 p.m.)

Whether I'm right or wrong, and I do it in good faith, I keep cautioning the Board that the system equipment maintenance is not somewhere where we can arbitrarily--now we could, I mean, if I had no concern about Hydro and at my age, I mean, you know, how long am I going to be around. I don't mean leaving the planet now, but with Hydro, sure I could say let's take out $3,000,000.00, cut out that, we're not going to fix up the things that needed to be fixed in Holyrood, and arbitrarily and capriciously and without thought and ignoring the advice of a lot of good people, take it out of system equipment maintenance. I'm not prepared to do that. I will never be prepared to do that.

So I only had one choice. I couldn't get it out of insurance, obviously, it went up a million dollars. There's no other area to get two million dollars, other than people, and you can't do it halfway through the year and record the benefit. I could only get--half a year's salary, if you let a person go in June and you had to pay him a year's salary to let

him go, so what did we gain? So what I'm suggesting to you, Mr. Hutchings, is that--and I appreciate what the Board said, I certainly got the message and then the staff of Hydro and management of Hydro, we reacted to ensure--now, what the Board didn't know at the time, which Grant Thornton has subsequently confirmed, is that we were working acidulously through 2001, and in through the hearing in 2002, working on all the issues related to performance and more importantly, establishing performance measures within the organization and ones that we could take to the Board. So we were onto that before we heard anything about the Board, and it was unfortunate maybe we didn't say anything, but my position to you on this is that if we took it out of system equipment maintenance, I don't, the unintended consequences of that, whether right or wrong, I'm certainly not prepared to live with.

So on salaries and wages, the only other place to get that two million, unfortunately, you know, you've got to give at least some--and then there's a question of whether their positions are there. You just can't

arbitrarily and capriciously say we're going to take out positions like that. We're reviewing every part of our process, we're reorganizing. We've never eliminated positions without having something change to accommodate that circumstance. So the savings weren't there in that. Long speech, wasn't it.

Q. Obviously something you've given a lot of thought to, Mr. Wells. And rightly so, because, you know, it could be made to appear that Hydro did not respond to the Board's introduction of the productivity allowance. I mean, as I understood what the Board said, Hydro was putting up 98.243 million of controllable costs. The Board said, we don't know where the cut should be. We don't know whether it should be in system equipment maintenance and we're not going to micro-manage Hydro and put the lights out, potentially, by telling you you've got to take two million here or there, but they said, find the two million. And even granting you that you didn't get the order until halfway through the year, instead of finding two million or

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even one million, given that you only had half a year, you actually spent 5.8 million more than the 98 that the Board wasn't happy with. I don't know whether you can add anything to your previous speech in response to that.
A. Oh you'd be surprised. I'll restrain myself, but when you're dealing with the salaries thing, I won't bore everybody with it, but you'd have to have a lead time in planning and we have said earlier that we target the expense and to get the savings in the next year. So the 46 positions, the full saving accrue immediately for the 2003 costs. So taking out anybody beyond that in 2003, assuming one had the proper organization and planning done for the extra, we wouldn't have realized the costs. So what that says to me is it drives the issue of how to get savings down to the other two category of costs, system equipment maintenance or the other. We did also, as I've said now three times, and it was the sheet I lost earlier, you know, we added--there was a million dollars extra in costs there for overtime related to capital

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products that was incurred there, as well. So there's an explanation for the final cost that we incurred in the 104,119, compared to the Board's order. One thing you did say, though, in your last remark, that the Board thought that there was two million dollars in cost savings there. I don't think the Board ever expressed the comment, they did not know whether it was there or not. They certainly challenged us, but supposing we had gotten it right and our costs were spot on what we had said, the Board, you know, put a task against us that might have been inappropriate, for argument sake. The Board didn't say that we weren't being cost effective. They just said we don't know. And since you haven't told us, we're going to give you a bit of a lesson here, in effect, and put our feet to the fire. But we certainly, far from ignoring that order, you go a little greyer over these things and we carried on with the program that we were into, with respect to salaries and fringe benefits. The overtime, we had to take; the million dollars extra we knew would drive that figure further. System equipment

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maintenance, it just wasn't there in our opinion and that's all I can say. And if you look at the other costs which we have some influence over, to take two million--to find two million there, it would be quite a challenge, in light of the fact that our insurance costs went up by a million; our office supplies and expenses are spot on; buildings, rental and maintenance was up by 300,000; professional service was up a bit, that was related to the hearing; our travel expenses are actually down; our equipment rentals are down; miscellaneous expenses are very close. And then you've got your productivity allowance. And then there's the loss on disposal of fixed assets, $2,769,000.00 against our budget of 890 and I think that was the fire in Rencontre--we didn't predict in our budget that the plant in Rencontre East was going to burn. I apologize for that.
Q. And that's understandable.
A. So where was the flexibility?
Q. I notice that the increase in miscellaneous expenses is $276,000.00 which is more than the

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increase that you said was the big hit in insurance, which was only 221,000.
A. Yes, and Mr. Roberts, if you want to probe that, he can give you the answer.
Q. Okay, so when we get over to the 2003 estimate, your salaries and fringe benefits expense is below the 2002 actuals, but still not down to the 2002 test year requirement, is it?
A. No, that is correct.
Q. And on the total basis, your estimate for 2003 is still a hundred million, which is two million more than the Board would have approved, even if it hadn't put in the productivity allowance, correct?
A. That is correct.
Q. Okay. And how have you regarded the productivity allowance in respect of 2003? I see the estimate just doesn't refer to it, nor is there any reference to it after 2002. I mean, do you still regard that productivity allowance as being applicable?
A. What we regard as being applicable is to ensure that we keep our costs to an absolute minimum and continue with the service that

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we're required to provide. And to that end, -
Q. I mean, that obligation was before--existed before the Board issued any order.
A. And we always meet that obligation. I keep trying to point out the 211 positions that don't exist in the organization and that area of costs over which we have some influence, which I think, on any reasonable assessment, has been well managed.
Now, in 2003, we had the full benefit of the 46 positions eliminated. In 2003, we also eliminated approximately somewhere in the order of two million dollars worth of expense in the figures in 2003, with a reduction in temporary and seasonal employment and that again comes from a change in approach, in terms of our operations, and so we have worked very hard in keeping that figure in 2003 as low as reasonably possible. And that's why-- and that's reflected in the 2003--and that will carry through to 2004 and we have plans in relation to 2004.
In the meantime, I might point out that under our collective agreements, and for

people not covered by collective agreements, for those that remain after the downsizing, salaries, individual salaries are increasing by 5 percent, at a two and a half, two and a half in each of those years--I'm sorry, in each of the years 2002, 2003. In 2004, we have already concluded as part of the collective bargaining, a three percent increase for the bargaining unit in 2004, effective some, I think it's April of 2004.
So there's a number of things happening here. We're keeping our wages for those positions that remain with us, competitive, but not excessive, but competitive, so we're meeting that challenge. We're avoiding labour disputes and disruptions, except we had disruptions from a lot of people who thought they mightn't have work with Hydro this year and did not achieve it for the reasons I mentioned earlier, and we're bringing our-- despite inflation and everything else, in 2003, at 63,605 and in 2004, 63,237. And that's what we've laid out in the test year, we'll have to stand on it, and I think that that, as we have stated in the Corporate

evidence, is ample evidence of performance gains occurring within Hydro, through organized programs that are targeting all of our activity and where we can reorganize-- which we are doing, and it's an ongoing thing. And when we can take advantage of things, like the meter reader study when it's ready, we implement. With our customer services, we implement; with other reorganizations, when it's ready, we'll implement it, and it's an ongoing process. So in this period, maintaining a competitive wage position with our peer group, which is very, very important, we've been able to reduce our overall costs.
Now, system equipment maintenance is holding, through 2002, that 17 million dollar figure; 2003 we expect to, we hope to get out with the 17 million dollar figure. We're projecting it for 2004, but if the manager in Holyrood calls tomorrow and says something has gone wrong, then we're going to have to fix it and it's on the strength of a call like that, you find out what's going to happen to you in the year.
Q. As I understand your evidence in response to

Mr. Kelly's questions, your suggestion now to the Board is that a productivity allowance need not be considered, given the status of your key performance indicator system, is that essentially correct?
A. That is correct. Our position is that the Board was right, it didn't know what we were carrying on, but that was our fault not to talk about it. They didn't have the benefit of the 2001 and 2002 year activity that the financial consultants, Grant Thornton, have now supplied. And we do have the means by which to measure performance and what I would say on behalf of Hydro is that based on the evidence that we have filed with respect to our costs that we can have some influence on, that in the absence of evidence, that there has to be some other evidence now, before one would arbitrarily say these costs need to come down, with no evidence as to how and why they should come down. There has to be some evidence, I would suggest, so that we can make rational decisions. The Board shouldn't push us to an irrational position. Now if there's evidence led that says that there's some great

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savings here that we have missed, and I'm sure the Board will ensure that we get it, but my understanding, and the Board will, I'm sure, correct me if I'm wrong, was that it was the lack of being able to look at what Hydro was--or measure what Hydro was doing was their concern. And now they have, not my or Hydro's position on it, but they have Grant Thornton's review of the thing and the recommendation with respect to performance measures for Hydro.
(12:30 p.m.)
A. Either presumably, you know, the Board, I don't know if they will accept it in whole or in part, but it's certainly a start as to how the Board wants to proceed forward in the regulation of Hydro, as a utility.
Q. Can you tell us what the current status is of the implementation of the key performance index system?
A. The key performance indicators system is in place in terms of the online, real time system, is that the one to which you refer?
Q. Yes, in your evidence at page 20, right at the

top, you talk about, "to improve performances measured through the development of process metrics and implementation of key performance indicators".
A. Yes, and these are the big over arching indicators that we have with respect to performance, related to the areas that are critical to us, as we've described in the evidence, such as our operations, our reliability, our safety record and environmental performance and our customer satisfaction survey.
Q. In the Grant Thornton document, there's discussion of KPIs proposed to be reported to the Board. Have any of these new KPIs been reported to the Board at this point?
A. We filed quarterly reports to the Board, with the Board. Are you referring to--I just want to make sure that we're on the same -
Q. I'm looking at the Board of Commissioners of Public Utilities Report on Regulatory Performance Measures for Newfoundland and Labrador Hydro, Grant Thornton, that's filed here. I think it has a number designating it, number 4. And just from looking at the Table

of Contents of the document, you can see there are KPIs currently reported to the Board and KPIs proposed to be reported to the Board.
A. On page 6?
Q. Yes.
A. And then the recommendation on page 11 of the key performance indicators to be reported to the Board.
Q. Yes. So, my question is, how far that has gone and specifically have any of these new indicators, to date, been reported to the Board at all?
A. Well, the SAIDI safety (unintelligible) capability factor, the customer satisfaction index, when that comes out is reported. Whether we have put in the thermal and hydraulic conversion to date, I'm not sure or whether that would go into the third quarter report. I'd have to come back to you on that. But what is, for me, the issue now is that we have an understanding with respect to our review of indicators that the Board would have interest in. We consulted with Grant Thornton and they with us, as directed by the Board and Grant Thornton has made the recommendation.

So, we will be reporting on the KPIs that have been indicated in the report and then the latter part of the report talks about the KPIs currently reported to the Board and there are more because we didn't have the overall performance factor before.
So, in any event, the information, as per the time frame it covers and when you can change it, will be provided to the Board.
Q. Now, I guess my concern is that to the extent that the KPIs could perform the same sort of function that productivity allowance did, one needs some history of them to see where they are going over time, in order to be able to determine whether or not the performance indicators are being met, whether they're getting better or getting worse.
A. Well, as you go forward you'll see, you start to build a directive, won't you?
Q. Yes, but what's that's going to do for us for 2004, I guess, is the question?
A. Well, in 2004--we operate on the basis of forecast. So, we've forecast certain, the cost of the results of the year and now we have to go through the year before you can say

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what the performance for the year has been. We're going to have to live through the year. We operate on the basis of forecast cost for setting a test year requirement.
Q. In terms of an incentive for Hydro to save on its controllable costs, I'd suggest the KPIs are only really going to be valuable after 2004 because then there'd be at least a year of history to compare them to.
A. And what do you--you take a position, I take it, Mr. Hutchings, that a utility, somehow has to be incentivized to operate in an appropriate and proper manner, that the facts before you, that the salaries and fringe benefits with all the information that's supplied in this application, that are holding at 63.237 is somehow something that the Board would say now is absolutely untoward. Is that -
Q. Mr. Wells, you know better than I that you don't get to ask the questions at this point.
A. Right on. I'll accept that. Let's cut the conversation to this, we have clearly stated and I have stated on behalf of Hydro, that

under the current circumstances, the productivity allowance, based on what are costs that were capable of influencing which have all been delineated, would be a punitive action and not an incentive.
Q. Just consistent with our discussion that arose out of the charts that we looked at earlier, if we could look for a moment at your schedule 1? You're showing here the percentage change in utility operating maintenance and administration expense. I take it there's no implicit suggestion here that there is sufficient similarity among all of these utilities that this is a particularly useful comparison to make between all these utilities or is there?
A. It's--again, the information speaks for--what it shows is that in our estimation without our peer group, that the cost incurred by integrated utilities have had this experience and that we, in that group, have had an experience. And our experience would not, on a review of it, cause one to have great alarm or cause one to say, what is the explanation here with respect to this particular utility.

It would be akin to our safety statistics which are based on CEA averages. And as long as we can be better than the CEA averages and we are going to have a safety record that would not raise someone's brow, you never get them 100 percent perfect in safety, but we want to stay in the, in terms of like, the bond rating agencies in the top quartile. And our experience with respect to safety is outline in the evidence here. In the same way, that if you look at the other utilities which range from 1992 to 2002, with respect to inflation and their costs, some were a little better than us, some were--I mean, you don't draw a position here that something is gone wrong in any one of the others. But what it does indicate to those who look at it, is that Newfoundland and Labrador Hydro's percentage here, relative to its peers, would not cause one to think that there's a problem. As a matter of fact, you would think that things are going rather well.
Q. And so, from your point of view, the bottom line of this chart which shows that Hydro's operating maintenance and administration

expenses is growing at twice the level of inflation doesn't cause you any concern?
A. All expenses that we have to be accountable for are a cause of concern. Some we have some influence over, some we have absolutely no influence over. So, the issue is that it doesn't seem that in '98 to 2002, any one of the other utilities got down to our level with respect to inflation and that's all that one can read into that. And some have had pretty heavy experience related to--but you know, the issue is looking at Hydro's performance and the cost which each--all of the costs are clearly outlined in the application. So, the question is, what of these costs can we do something about and what is reasonable? And have we not demonstrated that we've taken action with respect to our salaries and fringe benefits? And when you look at that category of costs, the only place that we can do anything significant to reduce the costs is in salaries and fringe benefits. And the only we can do anything there is to let people go. And we can't do that in a capricious and arbitrary fashion. We have to be able to

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MR. WELLS:
ensure that our systems operate and that we go the right people in the right places. And if you want us to save more money, it's going to come out of salaries and that means jobs. And you will see, I think, reductions in staff in the future, as we reorganize and take advantage of what we're doing as we've described earlier. But that's the only place that you can really get substantial savings. It's not going to come out of system equipment maintenance.
Q. Okay. Just getting back to your schedule 1 for a moment. You would agree with me also, I take it, that these percentages, again are dependent upon which beginning year you choose to calculate your figures from? For instance, if it was calculated from 1997, it would be a 25 percent increase instead of a 16 percent increase.
A. Well, the other thing is, if you look at some of the other percentages there, that does not mean that any one of those utilities is not having a very good year or a very good performance.

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Q. No, exactly. So, there's -
A. You can't draw a conclusion there because you don't know the circumstances surrounding their position as to what they had to contend with.
Q. So, I think we're agreed there's somewhat limited information that you can take from that, probably discussed that so far as we can at this point. Mr. Wells, moving onto another topic, you were speaking on the 6th, on Monday, at page 119 of the transcript about the issue of Hydro's equity and the return to which Hydro should be or government should be entitled, page 119, line 12, you said, "the issue is what dollars are deployed by the shareholder to provide the service, poles and the moving of equipment, the wires and all that", and at that point you took out your loonie and talked about whether or not it should or should not be in a sock. Can you tell us, Mr. Wells, where the current equity balance that exists on the balance sheet of Hydro came from?
A. The equity in the Corporation is represented by retained earnings.
Q. Why are those retained earnings there? Where

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did they come from?
A. They came from profits in the conduct of the business of the organization over time.
Q. So, they represent dollars that were paid by rate payers for electric service since Hydro was initiated?
A. They represent revenues net of expenses in providing the service.
Q. Okay. There are no--within the regulated operation of Hydro, there are no dollars of equity contributed by government, are there?
A. No, I don't think so, no.
Q. Okay. And you're aware, I take it, that prior to 1996, Hydro was regulated, to some extent by this Board and is revenue requirement determined on the basis of providing Hydro with a margin over interest coverage in order to ensure that it could meet its debt obligations. You're familiar with that?
A. Yes.
Q. Yes, okay. And are you familiar with the assurances which your predecessors, Mr. Young and others gave us from approximately where you are there now, that this payment of margin into Hydro was a good thing because it would

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reduce Hydro's requirement for borrowings int the future for capital works?
(12:45 p.m.)
A. Am I familiar with those statements of -
Q. Yes.
A. No.
Q. You -
A. Unless you brought this up at the last rate hearing, I think we're going down the same road though.
Q. Well, the road turns on occasion, Mr. Wells. Have you reviewed the decisions of this Board and the evidence given previously in hearings where rates were determined for Newfoundland and Labrador Hydro?
A. I have not reviewed the decisions, not in depth, and certainly not--before the last rate application, I reviewed certainly back to 1992 and coming forward, the decisions of the Board because it was pertinent to this rate application, but back through the '80s and -
Q. Okay. So, you don't know what justifications were offered by Hydro for the collection of this margin over interest cover in previous hearings, do you?

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MR. WELLS:
A. I'm not conversant with that. The other issue, of course, now is that, in my experience before that, in the general rate application of Hydro, we're regulated on rate base. So, it's an entirely different approach.
Q. No, I quite understand that. When was it that government first began to take dividends out of Hydro?
A. 1995.
Q. Okay. So, prior to that time, any monies in excess of costs that were paid by the rate payers, stayed within the Corporation as retained earnings, correct?
A. That's correct.
Q. Okay. So, the benefit of those monies now to the extent that they haven't been left in Hydro as retained earnings, has simply gone onto government, is that correct?
A. Well, government has taken, in the form of dividends, retained earnings from Hydro.
Q. And as your predecessors did predict and we can go back to the old transcripts if you want, I don't think it's really necessary,

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had those monies been left in Hydro, rather than taken out by government, Hydro's borrowing requirements would have been considerably lessened, correct?
A. Well, we would have had more equity in the Corporation and you would be looking for a larger block of money to have a return on equity. So, -
Q. No, I understand that, that's the second part. Okay, but the first part, I think you'd agree with me is that -
A. Well, there would be less borrowings, but you--yes, the debt equity structure would be altered.
Q. Yes.
A. Yes.
Q. Okay. So, to the extent that rate payer paid this money into Hydro in the expectation of radiate borrowings by building up equity in the company, that didn't happen fully, shall we say?
A. I can't imagine that anybody would have suggested it in the way you've put it. When you have a debt equity structure, you're going to have to deal with the cost of your capital

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and your result in weighted cost of capital from debt and equity. And the question then is what are those comparative costs for your debt and for your equity. Is there any other approach one could take to it?
Q. We may be hearing some before we're concluded here. So -
A. So, I should have said, you know, a rational approach to it.
Q. The effect then has been that the rate payers funds have become retained earnings of Hydro and Hydro, now, is asking the rate payers to pay to Hydro a return on those funds, correct?
A. We have been through this before and if you take that same approach, Mr. Hutchings, then all the purchases I've made on Canadian Tire over the years, somebody owes me--I got a lot of equity in Canadian Tire. All the Hydro customers got from Hydro was electricity. And they received the electricity and they've paid for it. Now, to come up with some concoction, and that's the only way I can describe it, that somehow that if you buy product from a company, that you get to increase your equity. I doubt if there's a university, school of

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business or any--where is this coming from? It is so far out a proposal that buying a product from a company that you would get to own the equity in the company.
Q. Does Canadian Tire have its prices set by some regulatory board?
A. No, but a lot of utilities in North America and elsewhere in the world have their prices set by a regulatory board and they have a return on equity for their investment. We have on in our own jurisdiction before this Board.
Q. Um-hm. And whose money was put in to create the equity in Newfoundland Power as it was prior to Fortis, just leave that out for -
A. There was some--there may have been and I'm not stating facts about this--there may have been some contribution of capital by shareholders, but a lot of their equity now would also reflect retained earnings.
Q. Yes. So, when shareholders bought shares, okay, Newfoundland Power had its common share issuance and shareholders bought shares and put their own money into Newfoundland Power, they would expect to get a return on that

HUTCHINGS, Q.C.:
money, correct?
A. Of course.
Q. And that return would go into the company as retained earnings, correct?
A. Yes.
Q. And if it stayed in the company, then they'd get a return on that too, right?
A. A return on their equity?
Q. Yes, and--but if they took out some of those retained earnings as dividends, then they wouldn't be getting a return on that, would they?
A. Return on what? The dividend is the return.
Q. Yes, once the dividend comes out, the retained earnings are reduced, correct?
A. They can be, yes.
Q. Yes. I mean, that's where dividends generally come from, isn't it, retained earnings?
A. Yes.
Q. Okay. So that once the dividend comes out, then obviously it's not within the retained earnings and there's no return on it.
A. You've already used the money.
Q. Right, exactly, but if you leave it in, then

you're entitled to a return on that?
A. Yes.
Q. Because it's retained earnings, correct?
A. I'm not even sure if we're on the same planet at the moment. The--yes, there was -
Q. Okay, I -
A. - a return on dividends, the equity in the company, a return on your equity, otherwise it's a gift. And if you take out the return on your equity or you take out your retained earnings, one or the other, if I take the money out of the bank, I no longer get interest on it; if it's in the bank, I get interest on it. Is that what you're asking?
Q. Let's take the situation where Newfoundland Power is about to start up operations in the province of Newfoundland and they make an IPO, an initial share offering, okay. If I decide to invest a thousand dollars in this new company, I expect to get a return on my investment, correct?
A. Hopefully.
Q. Yes. And assuming that it's a successful company, they earn some money and their profits become retained earnings, correct?

A. Yes.
Q. Yes, okay. And if I get a dividend, then I've taken some of that out and the retained earnings go down, right?
A. That's correct.
Q. Yes. To the extent I leave it in there and retained earnings expand, then I'm entitled to a return on that too, right?
A. Yes.
Q. Okay. But it all goes back to my initial investment, correct?
A. Yes, and the initial investment in Hydro by government was government didn't put the dollars in, but it was on the strength of the government's commitment and risk that Hydro starting its operations. Government backed the first dollar of debt and there have been many businesses started without putting in--you don't have to go and put your own money in to start a business. You can go and if you can get the debt from the bank, you can start your business at 100 percent debt and then over time, you work up an equity position in your business.
So, if you're saying that because

government didn't put in $100.00 or $10,000.00 or, you know, that somehow the revenues that that business attracts should be treated differently than any other shareholders' revenue is, to say the least, I mean, I'm absolutely startled.
Q. Yes, I mean, we went through this before and we won't spend a lot of time on it, but you're aware that when Hydro started, it was, in fact, in deficit, correct?
A. Hydro started backed by the government which was standing behind a debt that Hydro was creating in building the system.
Q. Yes, but Hydro took over from the Power Commission and the Power Commission was in deficit when Hydro took it over.
A. Whatever, yes.
Q. Yes, okay.
A. So, the government had already made a substantial investment, hadn't it?
Q. And lost it. If the company was in deficit. In the real world, people lose as well as gain.
A. Well, the thing was still working. There's a lot of companies that are in deficit for a

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MR. WELLS:
period.
Q. Okay. So, government at this stage is being paid for it guarantee of the debt, correct?
A. For the guarantee of debt, that's correct.
Q. Okay. So, what's happening now, I guess, with respect to the return that Hydro is seeking, is the fund is being created which government may draw on as dividends, is that fair?
A. A fund is being created?
Q. The retained earnings of Hydro.
A. Retained earnings are there, yes.
Q. Yes. And as you told Mr. Kelly this morning, when government needs funds, it can come to Hydro and request a dividend and it gets it.
A. Well, the government has recently, since 1995, that's when the dividends came into being, have taken varying amounts of dividends from Hydro which come out of retained earnings, yes, and we have the figures, yes.
Q. Okay. So, from the point of view of Hydro, as you told me, I think, last time, Hydro has a sound credit rating now and will continue to have one as long as it has a guarantee from the government of Newfoundland.

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A. Hydro does not--Hydro's capital structure would not allow it to have any kind of credit rating really. We couldn't borrow on the markets at 14 percent equity. We go out there, we would be hammered. We need at least a triple B rating to get a reasonable rate on a debt issue. And the reason that -
Q. We're not talking about a stand alone entity. I'm asking you -
A. As a stand alone entity, if we had to borrow -
Q. I'm not talking about a stand alone entity, okay. I'm talking about Hydro as it exists today.
A. Yes.
Q. With a bond rating that says this is a flow through of the rating of the Government of Newfoundland and Labrador.
A. That's right.
Q. Right. Because -
A. For our debt, yes.
Q. - because the Government guarantees the debt, and that's not going to change, correct?
A. Hopefully not. Well, that's where public policy would come in as to what you want the position to be. Depending on the shareholder,

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you could move Hydro, take a while, to get to say a 60/40 debt equity ratio, that would take some time. But as far as I know, and that's only maybe until the October, the position of the Government is to guarantee the debt of Newfoundland and Labrador Hydro, which is of great benefit to your clients.
Q. Yes, I accept that the benefit of the Government guarantee is there, and in fact, with the Government guarantee in place, Hydro has a sound credit rating in the markets of the world, correct?
A. We get a favourable credit rating.
Q. Yes, okay.
A. Well, we get a favourable term on our debt.
Q. Yes.
A. The issue of the credit rating of the entity, well, anyway, I'm--let's accept what you've said.
Q. And would you agree with me also that, to the extent the return on equity, the dollar amount of the return on equity for Hydro is increased, then the costs of electricity in the Province of Newfoundland and Labrador increases?

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A. The cost of that would go into the cost of service.
Q. Yes.
A. The rate base.
Q. Yes. So the higher the return on equity, the more the customers pay, correct?
(1:00 p.m.)
A. Correct, that goes into the cost, yes.
Q. Yes, okay.
A. But if you took your equity to zero and had 100 percent debt, the cost of the replaced equity by debt would also go into the rate base.
Q. I understand that. And to this date, the level of debt in Hydro's capital structure has not had a negative impact on Hydro's operations or on its credit rating? Is that correct?
A. Because of the guarantee, yes.
Q. Yes, okay. All right. We had some discussion earlier on the question of the interruptible B rate, and that is a part, I guess, of a subject that I want to talk to you a little bit about now, in terms of Hydro's long range plans. Is it fair to say that with the

HUTCHINGS, Q.C.:
generation that you have in place now, Hydro, you know, subject to changes in fuel prices and things like that, is essentially looking at a fairly stable operation over the next five years or so?
A. In terms of sources of supply?
Q. Yes.
A. Yes.
Q. Okay. Really the next significant increase in load that you would be planning for, according to Mr. Haynes' schedule, is in the year 2012?
A. Well, the load is increasing at 1.1 percent a year, whatever it will -
Q. Yes. I mean, that's if you include the large increase in 2012, I mean, it's a little more than half a percent a year, I think, up to 2011.
A. Yes.
Q. So it's just a very gradual increase up to this point in 2011, which you have enough plants essentially to deal with, correct?
A. That's correct.
Q. Okay. When do you anticipate making a decision on your next source of generation?

A. Well, within Hydro, it would depend on what systems planning, as we go forward each year. They renew the load forecast and look at the requirements to meet that forecast and calculate the loss of load hours and other things and they will factor in the timing with respect to how much lead time you need to put what's required in place. That type of activity goes on and will go on.
Q. I understand that. I mean, you're looking at deficits potentially in 2009, 2010, and 2011. Given that you have to have, as you mentioned this morning, a period of time allowed for construction and a period of time allowed for design and decision making and so on, I mean, when do you really need to sit down and say "we need now to plan what our next source is going to be."
A. I would think Mr. Haynes should answer the question, but you know, certainly in the end of 2004 and into 2005, this is certainly an issue that you would be watching closely and looking at, you know, however the procedure is going to go. To build something like a Granite Canal, if you were doing that, you'd--

starting the process from scratch and going right through, if we had to get approval from the Public Utilities Board and all that entails and maybe other intervenors and people with other projects, you're looking at a five-year time frame to run through something like that, but you know, that would -
Q. Five years before you start construction?
A. Five years before you would require it, you know, yes.
Q. Wait now, okay. So not five years before you start construction? Five years -
A. Five years--yes, let's say Granite Canal was roughly three years involved in the construction or in three calendar years. So it depends entirely on the nature of the projects, what's available and the load forecast. So if you'd like, Mr. Haynes could take you through that process. It's in his area.
Q. Okay. Now I'm just concerned that at a high level, I guess, to see where this is taking us, and from what you say, it's only going to really be a couple of years before we may have to face some decisions about new sources of

supply?
A. Yes, it could be that soon, reasonably, yes.
Q. Okay. I was a little bit puzzled here by your remark this morning to Mr. Kelly, which I thought was to the effect that Hydro won't make the decision about the new source of supply. Either the Board will decide or Government will decide. Can you explain to me if I've got that right at all, and if so, what -
A. That was correct, yes. Hydro is not the decision maker. We may make representations with respect to the new source of supply, but it's not Hydro's, in our authority. It's under the statutory authority to ensure that the island's energy--or the Province's provincial energy requirements are met are set out and it's the Public Utilities Board jurisdiction. They can decide and Government could, by Order-in-Council, decide, but not Hydro. It's not us to decide that it's going to be Island Pond or Granite Canal or anything else. It's not our decision.
Q. Would not the utility normally make decisions about acquisition of new sources of supply in

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HUTCHINGS, Q.C.:
order to meet its projected load?
A. Not in our jurisdiction, not under our Electrical Power Control Act. It's not our decision. This affects other--such as Newfoundland Power. There's non-utility generators out there that might have rights to certain small hydro projects or otherwise, so to ensure that the system is best served, the issue if it has to be determined is determined and authorized by the Public Utilities Board, or as I say again, Government has already reserved the right or certainly acted on it to date with respect to that, but it is not Hydro's choice.
Q. I mean, if you are projecting that you need new generation, two, three, four years hence, is not the onus on you to come before the Board and say, you know, we're going to have this deficit and we need to have -
A. Yes.
Q. - a new project -
A. We certainly take it upon ourselves -
Q. - approved?
A. - because we have the systems planning people

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and Hydro has always fulfilled that role, that we would advise the Public Utilities Board and do report to the Public Utilities Board when we see a situation emerging with respect to capacity or energy deficits, and we have done that in the past and would continue to do so.
Q. I would have thought that any utility--I mean, if Newfoundland Power, for instance, saw that three years down the road it was going to have a requirement for more power, presumably it could sit down and say "well, we can either buy that from Hydro or we could go out and if we have a little river somewhere, we could set up another plant on it, and perhaps generate our own power that way." Is that not the way a utility would normally approach that issue?
A. They could--I can only describe what the legislation in the province says and what the requirement is, and we're governed by the legislation here.
Q. I understand that. I mean -
A. So the authority rests, in the legislation, with the Public Utilities Board.
Q. But I mean, that would be part of your capital budget, would it not?

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A. Yes, if we had an approved project, if we are given a go ahead, like Granite Canal, we get it approved, and--now in the case of Granite Canal, by Order-in-Council, it was exempted from the purview of the Public Utilities Board. If it had not been, we would have had to--you know, we would have appeared before the Board and said "here's what we have," and we would have also, if we were aware, would talk about alternatives. Some other proponent or applicant could come in and say "look, I can supply this power to the grid."
Q. Just assuming for the moment that the Government leaves you alone, and you know, you're facing a need for additional power at a certain point in time, is it not Hydro's decision to determine whether they will issue a request for proposals for the supply of this additional energy, or come up with a project of their own and bring it before the Board in a capital budget?
A. We would, in the first instance, and this hasn't--the procedure, the total procedure we've described has not taken place as yet, since the legislation changed, but we would

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keep the Board abreast of the requirements of the system and if there was obviously a need for a new source of energy, we would marshall our own resources, what is it that we could bring to the party, and I'm sure that, in the interest of all consumers, that if there were other alternatives out there of supply that could provide least cost power, as required by the legislation, the Board would certainly want to know about that. They either may issue a request for proposals or they could ask us to do a request for proposals. We find out what is out there, who wants to be involved or put forward a project, and then the Board would choose amongst the proposals put forward which would be in the best interest of consumers and reliable, least cost power to match the requirements of the system at the time for both energy and capacity, what would be the best deal for consumers.
Q. I mean, presumably the process would be--I mean, assuming that you didn't call for proposals for supply of this energy from other people, presumably you would put together a project and bring it before the Board, and if

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HUTCHINGS, Q.C.:
there were intervenors who thought they could do it cheaper, they'd be in here before the Board opposing your capital plan.
A. Well, I'm not sure. I think that we would have direction from the Board. You know, with respect, I don't know because all we can do is keep the Board advised. The Board has the authority and whether Hydro--Hydro has--what I'm trying to say here is that Hydro has no advantage or preference over other parties with respect to supplying the grid. We have to come with competitively priced projects, and the projects that should be selected are those that are in the best interest of the electricity consumers of the province, and that's how I read the legislation. I don't think it's just me. I think that's the situation, you know.
Q. I mean -
A. Am I not on your area of your question or am I off?
Q. Well, I guess, it may be just a question of expression in the sense that I would have thought that either Hydro would propose a

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capital project to the Board, which the Board could approve or not approve, or Hydro would propose entering into a power purchase contract, which the Board would either allow or disallow in Hydro's costs, as opposed to the Board making a decision as to what route was appropriate to go.
A. Well, okay, I mean, the decision will be the Board. But if the Board turned down our project as not being in the best interests of consumers and there's nothing else on the go and we're running out of time, you know, to get something built, it would seem to me that you would try to marshall, you know, if there's any available, what are the prospects, what are our options, what is the best for the consumer and all I'm saying, the Board will make a decision, and we will follow whatever instructions the Board--because the Board has the authority under the legislation to call us in and say "well, where are you on this?" you know.
Q. Oh yes, no question about that.
A. Or anybody else.
Q. I mean, the Board will either -

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A. It's the Board's responsibility in the legislation. I can't say anything more than that.
Q. The Board will either approve your capital project or not?
A. Yes.
Q. The Board will approve a power purchase agreement or not? That's basically what the Board is going to do.
A. Full authority is with the Board.
Q. Yes, okay. I wasn't clear, after your discussions earlier on the wind power project, whether there was an expectation that there would be wind power in the system in 2004. Do we know that now or not?
A. Not exactly. We're in the process of negotiating on that, with a view to concluding an agreement, which could lead to a wind power development.
Q. But we don't know when the power might start to flow?
A. Well, if the agreement is concluded, you know, it could certainly start within the 2004 calendar year.
Q. Okay. But there is nothing in your cost of

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service that relates to that at all at this point?
A. No, we couldn't put anything in when we filed, and until we know exactly what the costs are and have an agreement concluded, to know (a) the cost, and (b) when it would come into service. But it is, I think, again I'm just told, is that technically and physically possible to start construction and have some turbines operable within the next calendar year, if not, you know, if not the whole farm, but that's possible.
(1:15 p.m.)
Q. Okay. Mr. Wells, if we could look for a moment at IC-28, the revision? This is a question dealing with fuel prices and I note in the answer that an exchange rate of 1.5184 Canadian dollars per US dollar was used, and if my numbers are correct, I think that's the exchange rate that's used for the purpose of the cost of service study at this point as well, is it?
A. I think it is.
Q. Yes, okay. My question is -
A. I'll be corrected if it's not, but I think it

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MR. WELLS:
is.
Q. Yes. No, my question, I guess, is just a simple one in terms of where the Canadian dollar is today and where it's projected to be a year hence. Will there be a change in that in the revised cost of service that we're going to see?
A. We will, in the revised cost of service, we will operate on the best forecast available, the most updated forecast.
Q. Okay. And you know, I ask the question to you simply because if we're looking at a 1.35 rate, we're talking about $9 million in the difference.
A. Well, if the exchange -
Q. Yes.
A. - if the rate moves around, yes, it will have results.
Q. Yes.
A. Yes.
Q. Okay.
A. It's the same as the cost of fuel itself.
Q. All right. You're not in a position to give us any indication now about what the rate

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might be, are you?
A. No.
Q. Okay. Very briefly, Mr. Wells, on the issue of the Great Northern Peninsula, I take it from the filings that Hydro has now agreed that the transmission assets on the Great Northern Peninsula should be assigned specifically to Hydro Rural, transmission not generation?
A. If we agreed to that.
Q. Well, that's what I understand from your evidence.
A. You already know the answer, because we filed the answer, and I'll stand by it.
Q. I just wanted to make sure that we're on the same page here, Mr. Wells. So that's--are you in a position to explain why Hydro is taking that position? And I ask you these questions only because there has been evidence filed that -
A. And the -
Q. - questions this.
A. - without, and I'm not trying to be--you know I'm not an evasive type witness. All of that issue on the assignment of costs and plant and

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everything, we have expert witnesses that deal with those issues, and they will be appearing and you will be able to question them on it. You know, to the extent if I can help you on anything, but really that's not my--I don't get into the issues and the arguments with respect to the assignment of costs, in terms of--I mean, we have the experts. We have our own staff and they will answer questions on that. Unless there's some--I don't know how I can help you in this area or its efficient use of the time here with the Commissioners.
Q. I guess it's telling me something in terms of the significance of the issue, which is obviously large from our client's point of view, but you're not in a position to -
A. Oh, that is appreciated, and I don't mean to say that I'm not--I sit in with the rates committee and others and various aspects of the organization, and I've heard a lot of discussion and talk about with respect to these issues and arguments about the assignments of plant and all that sort of stuff and what's common and not, but I--in terms of trying to influence anybody, that's

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not my expertise, and that's why we have expert evidence and all intervenors will have--you know, you will have your own expert witnesses. We will have ours and we have, amongst Hydro witnesses, better witnesses than me on this point, for sure.
Q. Okay. I guess I'll have to leave that there.
A. There was one point, Mr. Hutchings, earlier this morning, before we broke, you just mentioned the interruptible B and I had--and asked me whether interruptible B could have saved Granite Canal under circumstances and postponed $11 million, and I wasn't correct in my answer in saying yes to that, because the interruptible B contract would not, in any way, duplicate the energy that Granite Canal is putting into the system. If that were required at a time that interruptible B contract, which is really a peaking thing, very temporary, would not delay a project that was going to supply base load for either deficit or capacity or energy deficits. It just wouldn't happen. And there will be others coming behind me who will make that point crystal clear. But really, I spoke too

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MR. WELLS:
quickly in trying to accommodate your question.
Q. And, you know, just so we're clear, I guess, Granite Canal was nothing more than an illustration -
A. As an illustration, yeah, but a base load supply, I mean, in reason, it's--I don't have to be an engineer to know that, would not, you can't replace base load supply for capacity and energy deficits by an interruptible contract.
Q. No, you can't replace a base load, I understand that, but the interruptible B type of contract does affect your LOLH, correct?
A. Yes, but--well it may be, but I should stay away from those areas and make sure that you ask Mr. Haynes that question.
Q. I mean, we are agreed that the intent of the interruptible B contract is to provide peak incapacity?
A. It makes more energy available to the rest of the system for that time, at the level of 46 megawatts, that's what it does, yes.
Q. Yeah, okay.

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A. But it can't be dependant upon, for, you know, as a term for base load, you still have to take that back and run your mill.
Q. I understand exactly what you're saying. If we can look, just for a moment, at IC-1C which is the 2002 actual cost of service for the total system and we're looking at page 3 of 98. We have to go back a little bit. I want to get into a lot of detail with this, Mr. Wells, but the revenue to cost coverage column on the far right-hand side, can you explain the significance of the revenue to cost ratio in respect of any given customer?
A. Well the figures, it's just you have the relative comparison of the cost and the revenue received related to the cost and what did you want me to -
Q. No, I just wanted you to address the concept of what revenue to cost is?
A. Well the concept is, well when you supply a service at a cost, you come up with a figure and that was the cost of the service and then you look at the revenue received from those who received that service, and then you'll find the result that you see on that seventh

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column, based on the revenues in the second column and the cost of service, as calculated, the credits and the deficits, and the revenue requirement after deficit and revenue credit allocation. And then if you look at the L'Anse-au-loup system, for argument sake, we're taking in, on that chart, 51 percent in revenue, the cost of supplying the service.
Q. Yes, okay, I think that's very helpful. And if we look at, for instance, Newfoundland Power, the revenue to cost coverage is 1. 16 and one expects that to be in excess of 1 because of the effect of the rural deficit, correct?
A. That's correct.
Q. Okay, what should the Island Industrial customer revenue-to-cost coverage be?
A. Well I guess I know what the customer would like it to be, but this is a derivative of the cost of service as approved in 2002. So the costs are approved by the Board, relative to the service.
Q. Yes, so the revenue--what you are looking to get in your cost of service for the Industrial customers is a revenue-to-cost ratio of 1.00,

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isn't it?
A. Well no, it depends on what goes into the cost of service and there are no costs that are being put to the Island Industrial customer that are not following normal regulatory principles, with respect to the allocation of costs in the cost of service.
Q. If we can look at Exhibit RDG-1, Revision 1, page 3 of 107. This is your forecast cost of service for 2004 in which rates are set, correct?
A. Yes.
Q. And if you look at the revenue-to-cost coverage on the right-hand column, you're setting rates with a view to getting 1.17 times Newfoundland Power's costs for Newfoundland Power, correct?
A. That's what the figures show, yes.
Q. Yes, and you're setting rates with the intention of getting 1.00 times the cost for the Industrial customers, correct?
A. Correct.
Q. So that's where you want to get to.
A. Well that's what the Cost of Service Study is putting out on that end after all the

MR. WELLS:
assumptions and figures that got to go into the Cost of Service Study are applied.
Q. But as a matter of principle, each customer group should pay their own costs and no more, correct?
A. That is not the principle, as I understand it now, of utility regulation. There's various--you'll never get it exactly right and there's over -
Q. You never get it exactly right, but as a matter of principle, that's where we should be and our system is, as Mr. Kelly is apt to point out at great length, skewed by the fact that there's a Rural deficit that adds cost to Newfoundland Power that's not assigned to it, correct?
A. Yeah, but you know, with respect on that, it's only because of the nature of our system.
Q. No, no, I understand that.
A. No, I'm saying more than that because there is--there are assets deployed by Newfoundland Power, the same as ours in Rural areas, that the cost of service is not recovered for those assets. There's an averaging within

Newfoundland Power -
Q. I understand.
A. - as well as ours. If we had one utility, we'd never be talking about the 19 million dollar Rural Inter-connected deficit.
Q. No, I understand all of that and the Rural deficit is not what I'm interested in, except to the extent that it explains why the revenue to cost coverage for Newfoundland Power is more than one, which it does, correct?
A. Yes.
Q. Yes, but your target is to get to 1.00 for the Island Industrial customers?
A. You're saying that that's no more of a target than the target of Newfoundland Power, the figures and the allocation of costs, subject to the rulings of the Board, dictate the result that you see on the screen. That's my understanding of the cost of service. You make a lot of my people nervous when you got me around the cost of service.
Q. It says something about people who are comfortable with the cost of service, Mr. Wells.
A. Well they have so much more intimate knowledge

of the workings of the cost of service study. It takes some time to produce these things.
Q. I understand that. But in terms of, I see IC which we were looking at, we're showing a revenue-to-cost coverage for the Industrial customers of 1.13, and I would suggest to you that the implication of that is that Island Industrial customers have in fact paid more for electricity in 2002 than the amount of costs properly assigned to them under the cost of service? Do you agree or not?
A. Well what that shows here in--I don't think I'm in a position to answer you on that in the sense that the 2002, the actual cost of service and what we were allowed to get from our customers was determined by the Board, so it must be appropriate cost and the Board had approved that.
Q. Okay, I guess we'll have to -
A. I don't want to mislead you, but, you know I'm going to know about this in about five minutes, that is the result of the order of the Board with respect to cost of service for 2002.
Q. That's definitely a correct answer. I think

this is probably a good place to break, Mr. Chair.
CHAIRMAN:
Q. Thank you, Mr. Hutchings, Mr. Wells. Do you have any idea, notion, Mr. Hutchings, on how much longer you may be on cross-examination?
HUTCHINGS, Q.C.:
Q. I would hope to be less than an hour.
CHAIRMAN:
Q. Less than an hour. Mr. Kennedy, do you have any notion at all at this stage?
MR. KENNEDY:
Q. No more than a couple of hours, Mr. Chair.
GREENE, Q.C.:
Q. Mr. Commissioner, I was just doing my quick math and if that's three hours for Mr. Wells, I was wondering if the Board would be willing to sit late tomorrow beyond the 1:30 deadline in order to finish Mr. Wells, because if the estimates are as indicated, there is the possibility of Mr. Wells being finished before the Thanksgiving Weekend. And that's why I'm wondering if the Board would consider sitting a little bit later in order to accomplish that, if that indeed appears to be a

reasonable possibility.

CHAIRMAN:

Q. If nobody has any particular objections, we will certainly do everything we can, given how things proceed tomorrow morning, to try and accommodate that, if at all possible with a reasonable extension, given that we're going into a long weekend, but I'm sure Mr. Wells would like to get rid of this -

A. You will find a most reticent witness tomorrow.

Q. Anyway, thank you, see you all in the morning.

Upon conclusion at 1:30 p.m.

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 rate commencing January, 2004, heard on the 9th day of October, 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 9th day of October, A.D., 2003

Judy Moss Lauzon