(10:43 A.M.)

CHAIRMAN:

Q. Thank you, and good morning. Looks like we made the right decision on Tuesday, the wild day it was yesterday, we probably would have been revising the schedule here this morning of some sorts otherwise. Ms. Newman, is there anything to be dealing with?

MS. NEWMAN:

Q. Good morning, Mr. Chairman, Vice-Chair. Yes, I did just want to mention that apparently there are a couple of errors in the transcripts from both Monday and Tuesday. I won't reference them specifically because I think there's a few of them, but they have been identified and the transcriber will be providing revised copies and circulating them to everybody.

CHAIRMAN:

Q. Thank you. Time wise seems to be a hearing where we try to be as flexible as we possibly can. I understand that there may be an opportunity, depending on how it goes this morning, to conclude by lunchtime. And I would view lunchtime as being anywhere up to

and including around 2:00. If we don't seem to be on that track later on, I would suggest that we take a break for lunch, perhaps an hour or so, and then reconvene after that. It all depends on, I guess, how it proceeds over the next little while. And if it's okay with you, we'll play it by ear, see how it goes and make the call a little bit later on, depending on the cross-examination. That okay? Thank you. Good morning, Ms. Butler. Would you like to introduce your witness, please?

BUTLER, Q.C.:

Q. Thank you, Mr. Chairman. This is Mr. Bradbury, of course, who has to be sworn.

CHAIRMAN:

Q. Good morning, Mr. Bradbury, and welcome.

MR. MARK BRADBURY (SWORN)

CHAIRMAN:

Q. Thank you. You look like you're ready, are you, Mr. Bradbury?

A. Yes, I am, Mr. Chair.

Q. When you are, Ms. Butler, please?

BUTLER, Q.C.:

Q. Thank you, Mr. Chairman. Mr. Bradbury, you are corporate controller and treasurer of

Newfoundland Hydro?

A. Yes, I am.

Q. And does the finance and accounting evidence which was pre-filed in this case, including the exhibits MGB-1 to 3, represent your pre-filed testimony?

A. Yes, it does.

Q. As well as the finance portion, of course, of the revised application in December of 2006?

A. That's correct.

Q. And do you adopt this pre-filed testimony as your evidence today?

A. I do.

Q. Now the terms of the automatic adjustment mechanism appropriate for Newfoundland Hydro is one of the few issues left unresolved in this hearing, and these terms were proposed in your Exhibit MGB-1, is that correct?

A. That's correct.

Q. Referring to the exhibit generally, can you tell the Board whether your proposed automatic adjustment mechanism was modelled on the formula that the Board had approved for Newfoundland Power?

A. It was.

Q. With what differences?

A. Well there were three principal differences, I guess. The first is that the manner in which the regulated return on equity is calculated. The Board has ordered in the past that Hydro's rate of return on equity would be equal to our incremental cost of long-term borrowing, whereas in Newfoundland Power's case theirs is based on a risk premium methodology, so there is some difference there. And secondly, with respect to the annual review process the basis on which the days, the trading days on which the long-term borrowing yields on the Government of Canada's would be determined. We are suggesting that we would look at the average of the first ten trading days in October of each year whereas in Newfoundland Power's case I believe it's the last five in October and the first five in November. And that's simply to allow them time to process any rate changes that might result from a change in rates that comes from a review of the formula. And I guess the last difference is in the trigger point for the automatic review of the formula.

Q. Okay, now in your original exhibit you had shown the calculation of the allowed return on rate base by example. Have you revisited that example using figures from the revised filing?
A. Yes, we did. We revised those calculations in Schedule A to our revised filing.
Q. Okay, so look at Schedule A, page 5 of 6, please? And I think this actually shows a comparison, doesn't it, to the, yes, the August filing against the December filing?
A. Yes, it showed the changes that we put through with respect to the weighted average cost of capital, first of all. In our original filing it was based on a cost of debt and equity of 8.39 percent and 5.2 percent respectively. And based on our debt-to-capital ratio and capital structure, that flowed through to a 7.74 percent weighted average cost of capital. And in our December filing, those figures had changed such that the cost of debt was reduced to 8.26 percent and the cost of equity to 4.47 and that translated through to 7.53 percent weighted average cost of capital. And then applying those numbers through to the rate of return on rate base on page 6 of 6 you can see

how we did that. The rate of return on rate base in the August filing was at 7.63 percent, whereas the December filing, that was reduced to 7.44 percent, thereby establishing an allowed range of plus or minus 15 basis points or a range of between 7.29 percent to 7.59 percent in terms of a rate of return on rate base.
Q. Just scrolling back to 5 of 6 for the moment. Can you confirm for the Board, Mr. Bradbury, that the cost rate applied to debt, which is now the 8.26 percent, there is a test year embedded cost of debt for -
A. That's correct.
Q. Okay, for Hydro. And that that is similar to the mechanism currently in place for Newfoundland Power?
A. Yes, basically.
Q. And relative to all other dependent variables of the proposed formula, do you propose use of 2007 test year variables for other than the return on equity?
A. That's correct.
Q. And that is also similar to Newfoundland Power?

A. Yes, it is.
Q. Okay, the other difference that you pointed out when I asked you the differences between yourself and Newfoundland Hydro (sic.) was the trigger point. Can you explain the trigger point difference for the Board, please?
A. Yes, well basically, you know, we looked to past Board guidance with respect to reasonableness and took our cue, I guess, from the rate of return, the range of return that had been allowed by the Board in P.U. 40 (2004) in terms of our range of return on rate base. And as was indicated in the page 6 of 6, the allowed range is plus or minus 15 basis points. So we took that as our starting point and did a determination of what that meant in terms of a return on equity. So we increased our range of return on rate base by 15 basis points and then looked at what the impact of that was on our return on equity, all other things being equal, and determined that that was about 100 basis points.
Q. Okay, and the calculation for that, just for point of reference, is in Table 4 on page 8 of Exhibit MGB-1?

A. That's correct.
Q. Go to that and we'll just see. Table 4, there you go.
A. Okay, and this is where we did our calculation utilizing the most recent numbers we had at our disposal at the time. And basically an increase in the return on rate base translated into, in dollar terms, about 2.2 million. And when we applied that to our average regulated equity, it came out about at 103 basis points. So that's how we determined a range of 100 basis point increase in return on equity would be deemed as acceptable. Now this is a little bit different from Newfoundland Power's. Newfoundland Power's approved trigger point right now is at 50 basis points in terms of an increase on return on equity. So in order to determine that in the context of what we were suggesting we did the similar calculation for--using Newfoundland Power's numbers, and that was done in Table 5. And here we looked at their approved range of return, which is plus or minus 18 basis points and we determined that in dollar terms an 18 point increase in their return rate base was somewhere in the

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vicinity was 1.3 million, and applying that to their equity base that translated into 41 basis points. So 41 basis points we thought was reasonable in the context of the 50 basis points that had been approved by the Board. So in both cases I think the trigger point that we are suggesting is reasonable when viewed in the context of the capital structure and equity base of the two companies.

Q. Okay, so in all other respects relative to the proposal that you've made for an automatic adjustment mechanism for Hydro, the period of operation of your formula and the submissions that the utility would have to make to the Board relative to the operation of the formula, your proposal is modelled on that approved for Newfoundland Power?

A. Yes, it is.

Q. Okay. Can we just focus on Dr. Cannon's evidence at page 2, please, in which he confirms that he was retained by the Consumer Advocate to provide an opinion on your proposal. Lines 32 to 37. There you go. He expresses two views. The first is that your automatic adjustment mechanism should be based

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on an up-to-date estimate of your embedded cost of debt for the test year?

A. That's correct.

Q. And you've already done that?

A. We did that, as I showed there in Schedule A.

Q. Okay. In table--the table that showed the new embedded cost of debt at 8.26 percent?

A. That's correct.

Q. Is it your understanding that. Dr. Cannon actually agrees with that figure?

A. It is.

Q. Okay, now his second view stated there is that your proposed automatic adjustment mechanism should incorporate in the year-by-year calculation of the range for the allowed return on rate base a WACC value that is as close as possible to the WACC likely to be experienced in each future year. So that would be '08, '09 and '10?

A. Right.

Q. Okay, so just to focus in on what the difference is between your proposal and Dr. Cannon's view, can we have a look at Schedule A, page 5 of 6? And the bottom part of that table where you suggest 8.26 percent is the

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new embedded cost of debt?

A. Right.

Q. For clarity, it's Hydro's position that that rate would be used in the formula and it would not vary?

A. That's correct.

Q. And it's Dr. Cannon's view that that figure in the formula would vary every year for '08, '09 and '10?

A. Yes, based on a forecast that we would do now.

Q. Right, okay. Now does Hydro accept Dr. Cannon's proposal in that regard?

A. No, we don't.

Q. Okay. And in explaining why can we look at Hydro's response to an RFI, 219, please, CA-219? Now generally this RFI question basically asks for rate-making principles which we've addressed in our answer. But it's question E I just want to focus on for the moment. Here you're asked to explain why not using test year values for the cost of equity would not also be contrary to rate-making principles which are based on test year values. So can we look at the answer that you gave here and see if this provides clarity?

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Okay. Perhaps you might just read that, Mr. Bradbury, for ease?

A. Sure. "Hydro believes that its proposed automatic adjustment mechanism is consistent with the rate-making principles established in this jurisdiction and outlined in the answer to B above. It proposes to adjust only the rate of return on equity based on the province's marginal cost of debt and to use single test year values for all other dependent variables of the formula. The province's marginal cost of debt is a rate that can be readily determined in an objective fashion in a non-test year, thus rendering automatic the computation of a revised cost of equity. In comparison, the projection of the embedded cost of Hydro's debt beyond the test year is predicated on financial assumptions, referring to Table 1 in our answer to CA-218 NLH that have not been subject to the same scrutiny as test year forecast values."

Q. Okay. So let's look at 218. And it's the table, I think, that we have to look at. There you go. Just can you enlarge it just slightly, Mr. O'Rielly? Maybe not. I'm

interested in the numbers at the bottom of the screen, the bottom of the table there. There you go. Okay, so here in 218 Hydro was asked to calculate the embedded cost of debt forecast for '08, '09 and '10 and you calculated it at 8.23, 8.20 and 8.21, is that correct?
A. That's correct.
Q. Okay.
A. Using our long-term model.
Q. All right. Now can you just lead us through the assumptions that lie behind the calculation of the embedded cost of debt in this table?
A. Okay, sure. Well basically the embedded cost of debt is the product of a couple of principal inputs, one relating to the assumed balances that will result in both the long and short-term debts, as well as the interest costs that we expect to incur on those balances. And there are a number of assumptions or inputs, as you can see on this screen, that go into that, the balances that we are assuming in terms of our various pieces of our long-term debt, the balances as it

relates to our promissory notes, sinking funds and so on and then the interest associated with each of those. I guess one of the concerns that we have is that the inputs that you see in the revised 2007 column have been subjected to regulatory scrutiny by this Board as part of a regular test year review whereas the inputs in the columns 8 through 10 have not. And there are some variables that can come into play that will alter these numbers. For example, if you look at the Series F there, that's an assumed refinancing that is going to take place in 2008. And there are a couple of assumptions here, one is the face value that we are going to do that at, which is $200 million and the other assumption that's being made it that it will be done at 4.48 percent.
(11:00 A.M.)
Hydro's determination of that 4.48 percent was done based on an average of the forecast of our financial advisors and I believe Dr. Cannon has proposed a different number there based on a use of the implied rates in the forward curve. Another variable is the

promissory notes. There are assumptions in terms of what the interest cost we will incur on those promissory notes and on that there is some slight difference between ourselves and Dr. Cannon, as well. The other thing in the promissory notes that can change, if you will, is the actual balance of the promissory notes. The 94.7 million that you see in the 2007 column is really the product of a number of assumed cash inflows and outflows and all of those cash inflows and outflows, if you will, have been subjected to regulatory scrutiny by this Board. If you go up to my page 2 in this same schedule, or I'm sorry, in Schedule A, page 2. That's it. I mean, here you see a number of the assumed cash inflows that will drive that ultimate promissory note balance that you saw in 2007. For example, in salaries we are projecting salaries for 2007 of 58.5 million, systems equipment maintenance, 20.6 million. All of these numbers have been reviewed by this Board and subjected to review by all of the intervenors. If you could go back now to the Table, please, Terry? So all of those assumptions basically

drive where our promissory note balance is going to actually end up in 2007. It's based, for example, on the 2007 approved capital budget that this Board has approved. This is not the case, I guess, for the promissory note balances that you see in 2008, 9 and 10. None of the inputs that are driving those ultimate balances in those years have been subjected to the same regulatory scrutiny. And so I guess this is where we have some concern that rates would be set based on those types of assumptions. And I guess the other, the last point I would like to make is that really to do that really is tantamount, in our mind, to looking at multiple test years and we're concerned about the regulatory costs that would be associated with that and that really at the end of the day we're not convinced that the ratepayer would benefit.
Q. Okay, now, Mr. Bradbury, before concluding your evidence, examination-in-chief, sorry, you had prepared a calculation which is tied into this table, in a sense. Oh, sorry, Mr. O'Rielly, I didn't mean to get you to remove it. The table from Schedule A again? Sorry.

If you look at the bottom there, the difference between the embedded cost of debt which Hydro has calculated now in its revised filing, 8.27 percent, I think there's a footnote on this explaining why it's off by one percent or .01 percent?

A. Yes, there's footnote 4 explaining that. This table was produced by our long-term model that doesn't use the same iterative process that our more intense treasury model uses with respect to the calculation in the test year. So we use a monthly iteration whereas a longer term model uses an annual iteration model, so that's the reason for the difference.

Q. Right. So the figure we are using is 8.26, correct?

A. 8.26 is what is in our application, yes.

Q. And just to explain the actual difference on earnings of using 8.26 in the automatic adjustment mechanism that you proposed and the actual embedded cost of debt, for example, of 2010 coming in at 8.21 percent, have you prepared a simple one-page schedule that reflects this?

A. Yes, I did, I prepared a schedule to try to

give the Board an indication of what the impact of that would be.

Q. I'm just going to get Mr. Young to help me pass that out.

A. Okay.

Q. It was sent overnight to, I believe, the Consumer Advocate for Dr. Cannon's commentary.

MS. NEWMAN:

Q. Is that going to be an exhibit? So that will be MGB No. 1.

HUTCHINGS, Q.C.:

Q. That might be a bit confusing with the existing Exhibit MGB No. 1.

MS. NEWMAN:

Q. MGB No. 4.

A. So basically all I did here was try to recast the calculations that were presented in pages 5 of 6 and 6 of 6 in Schedule A. And really, the only number that I changed was the debt number from 8.26 to 8.21. I kept all of the other numbers constant. And so where before we had using 8.26 calculated a weighted average cost of capital of 7.53, using 8.21 percent embedded cost of debt translated into a weighted average cost of capital of 7.49.

And when we flowed that down through to the return on rate base which before in our December filing is at 110.7 million, using an 8.21 percent embedded cost of debt, it translates into a return on rate base of 110.2 million. So the impact of using the 8.21 percent cost of debt versus the 8.26 that was in our December filing is roughly $600,000. And then all I did then was put that into context of the revenue requirement which is 431 million, so it's about one tenth of one percent of the total revenue requirement.

BUTLER, Q.C.:

Q. Thank you, Mr. Chairman. That's the examination-in-chief for Mr. Bradbury.

CHAIRMAN:

Q. Thank you, Ms. Butler. Good morning, Mr. Johnson.

MR. JOHNSON:

Q. Good morning, Mr. Chairman. Just for the record, Mr. Cannon, Dr. Cannon is joining me this morning, having got in a little late last night. And I appreciate the late start time this morning, or at least later start time.

CHAIRMAN:

Q. Welcome Dr. Cannon.

DR. CANNON:

Q. Thank you, very much.

MR. JOHNSON:

Q. Mr. Bradbury, if we adopt the proposal that Hydro has put forward for the automatic adjustment mechanism as explained and put forward in MGB-1, I'm right that we'd never scrutinize the applicability of the test year embedded cost of debt rate for subsequent years, would we, there'd be no scrutiny of that issue at all?

A. Well I'm not sure I would agree with that because we did propose a review mechanism each year whereby the actual embedded cost of debt that Hydro incurs for the year in question would be compared to the embedded cost of debt that is in the automatic adjustment mechanism. And we were suggesting that part of the formula process would involve a report to the Board outlining those difference.

Q. Okay, but that review would be truly and only ex postfacto?

A. That's correct.

Q. It wouldn't--go ahead.

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A. I was just going to say that it would provide the Board with information that the Board could make decisions on if it wished.
Q. But there would be no opportunity in advance to have any debate or discussion or analysis or on a perspective basis as to the applicability of the embedded test year, embedded cost, embedded cost of debt that we determined in the test year for those later years, true?
A. Well that's true, but it's really true of all the changes that take place within the range of return on rate base that has been approved for Hydro. And a number of things can change from what was anticipated in the test year, and I guess that's why the Board has approved a range where within which these changes are expected to occur. But it has set an outside parameter that really dictated when Hydro is deemed to over earn, and that is 15 basis points above the approved rate of return on rate base.
Q. Now let me just step back for a moment and ask you about the genesis of Newfoundland and Labrador Hydro's proposal to bring forward

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this automatic adjustment mechanism for the Board's consideration, what was the genesis of that?
A. I guess the genesis is to provide a mechanism whereby adjustments can be made to rates in the event that there is a change in a known variable that all parties can agree on as to its calculation, and in this case we determined that that was the rate of return on equity.
Q. Let me refine my question. The genesis, as I understand it, was that in the last, the last time Newfoundland and Labrador Hydro was before this Board, there had been some discussion about an automatic adjustment mechanism at that time, but it hadn't been fully fleshed out. The Board, the hearing counsel, as I understand it, said there's more to know about this and then the Board suggested to Hydro, directed Hydro, in fact, to come back to the Board with some sort of proposal.

BUTLER, Q.C.:
Q. Oh, I'm sorry, Mr. Chairman, the question that had been put was in relation to Newfoundland

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Power. Is that a mistake?

MR. JOHNSON:
Q. No. The genesis for the automatic adjustment mechanism proposal that's being put forward in this case.

BUTLER, Q.C.:
Q. For Newfoundland Hydro?

MR. JOHNSON:
Q. For Newfoundland Hydro.

BUTLER, Q.C.:
Q. Sorry, you asked -

MR. JOHNSON:
Q. Did I say Newfoundland Power?

BUTLER, Q.C.:
Q. Yes.

MR. JOHNSON:
Q. I'm sorry if I said that. I didn't think I had, frankly, but -

BUTLER, Q.C.:
Q. I thought you had, sorry.

MR. JOHNSON:
Q. Am I right as to that's how we come to see MGB-1 in the file documents?
A. That's my understanding, yes.
Q. Right. Now in that process who devised this

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formula in MGB-1, who had the hands in that?
A. I guess I would consider myself to be the principal architect.
Q. Okay, and did you have any other people at Hydro assist you with that?
A. Only members of the finance team.
Q. And who would they consist of?
A. I would have had input from our assistant controller, for example.
Q. Who would that be?
A. That would be Mrs. Stratton.
Q. Anybody else?
A. Probably some input from our rates people.
Q. Mr. Mitchell?
A. Mr. Mitchell probably had some input with respect to our financial advisors, had some discussions with them with respect to it.
Q. And would the discussion with the financial advisors, would that have been about picking the time in the month when you'd observe what was happening on the bond market?
A. Yeah, mostly, trying to understand, you know, how we could determine a methodology that the Board would be comfortable with in terms of the determination of those yields.

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Q. Yeah, now did anybody consider--would it be fair to say that internally at Hydro you said we have a template here, we have an automatic adjustment mechanism that Newfoundland Power has and we'll just build upon that, would that be more or less a fair characterization of where your heads were on the development of this automatic adjustment mechanism?
A. Well we certainly reviewed the discussion that had taken place in respect to the Newfoundland Power mechanism. We reviewed the various inputs that had been provided by the various intervenors and tried to consider all of the concerns and considerations that they had raised and basically looked at the conclusions that the Board had reached with respect to what made sense for this jurisdiction and determined our way forward on that basis.
Q. And would it be fair to say that Newfoundland Power's formula provided the template?
A. Yes, that's correct.
Q. And would it also--and you've indicated that you tried to--that there was concerns of intervenors about the formula. Who were the intervenors that you're talking about?

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A. Well my recollection was that the concerns were in relation to various ways in which the interest rate forecasts were determined and what would be appropriate there.
Q. Could you elaborate?
A. Well I understand that there were some suggestions with respect to the use of consensus forecasts versus the use of actual yields at a given point in time, for example.
Q. Were there any other concerns of intervenors brought to bear other than those that you just referred to?
(11:17 A.M.)
A. Yes, there were concerns with respect to movements in the embedded cost of debt.
Q. And -
A. Between, you know, reviews.
Q. And what intervenors raised that issue?
A. I don't recall, I'm sorry.
Q. I think you indicated that you went about attempting to address the concerns of intervenors. In what fashion did MGB-1 address that concern that you've just spoke about, of that particular intervenor?
A. Well, you know, to that we looked at the

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conclusions of the Board and the Board had concluded that an appropriate way to address that concern was the production of an annual report on the movements in the embedded cost of debt with an explanation as to what had caused those movements.
Q. And I take you understand that Dr. Cannon's proposal does not take objection to the idea of reporting to the Board and the trigger?
A. That's my understanding.
Q. Yeah, now I'll come back to this theme a little later, but I want to next turn to some particulars. Mr. O'Rielly, if you could turn up CA-218 again? And what we're seeing--yeah. What we're seeing here at the top of Table 1 in CA-218 shows an AA, double A series debenture whose year of issue was 1998 and that has a year of maturity of 2008, correct?
A. That's correct.
Q. And that's not the first time in this proceeding that Hydro has indicated that it has a double A series debenture coming due, $200 million in 2008, because that also appears in the five-year financial projections that Hydro filed in this proceeding, correct?

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A. That's correct.
Q. Right. Now according to Hydro's and Hydro's advisors' best estimate for the interest rate, Hydro will have to pay, in order to refinance that $200 million issue of long-term debentures coming due in 2008, is found at the bottom where it says "F" under the column "Series" and you move of to the right and it says 4.48 percent, correct?
A. That's correct.
Q. And that is based on your financial advisors' forecast of the Canada Bond yield and a provincial credit spread for the last quarter of 2007, correct?
A. It's based on the credit spread today. We don't have forecast for credit spreads in terms of what they are going to be in 2008. But it is based on the forecast Government of Canada yield, yes.
Q. And for the record, would you confirm the date upon which Hydro received this Request for Information from the Consumer Advocate?
A. I don't recall, sorry.
Q. Would you disagree with me if I said that it was provided on December 19th, 2006?

A. No, I'm not going to disagree with you.
Q. And would you disagree with me if I said that this response was provided on or about January 12th, 2007?
A. I'm not going to disagree with you on that, either.
Q. Okay, now the corresponding long-term refinancing rate that Dr. Cannon forecast in his response to NLH-22 CA, which there's no need to turn to at the moment, but was 4.40 percent for that refinance rate for that $200 million debenture in 2008, correct?
A. That's correct.
Q. So your financial advisors' very recent estimate as filed on January 12th, 2007 at 4.48 and Dr. Cannon's estimate which was 4.40 leaves not a very great spread between those two figures, correct?
A. That's correct.
Q. So there's no very little difference, at least on that point, between Hydro and Dr. Cannon?
A. That is correct.
Q. Now based on your financial advisors' forecast, then, the estimated annual interest cost for the $200 million new debenture issue

plan for 2008 will be about $8.96 million, is that correct?
A. That sounds about correct, yes.
Q. And we would derive that by 4.48 percent times $200 million equals 8.96 million. Now the existing debenture which is going to mature in 2008 had a coupon interest rate currently of 5.50 percent, correct?
A. That's correct, yeah.
Q. Yeah, and that's line 1 in Table 1 on page 2 of CA-218 NLH?
A. Right.
Q. And so presently the interest cost to Hydro is $11 million annually?
A. Correct.
Q. Correct, right. Which is derived again by five and a half percent times 200 million, you come to $11 million?
A. Yeah.
Q. So once the refinancing takes place in 2008 there is expected to be an interest cost saving to Hydro of more than $2 million annually according to your financial advisors' forecast, right?
A. That's correct, that's our forecast.

Q. Now isn't the real issue before the Board how the benefit of these lower costs is to be passed on to consumers, isn't that the real issue?
A. Well I guess to try to answer that question -
Q. Let me put it this way to you, if that -

BUTLER, Q.C.:
Q. Well, I think he should try and answer it first.

MR. JOHNSON:
Q. Well let me put another one to you and you can try to answer both.

BUTLER, Q.C.:
Q. Well I don't think that's fair. I think he could answer the one that you've just put to him if you give him a moment.

CHAIRMAN:
Q. Okay.
A. Well I was just going to say that, you know, we're all interested in passing the benefits on to the customers of any savings that we can realize, I guess, in terms of effectiveness with respect to Hydro's operations, and I guess that's why the Board approves a range for Hydro to work within whereby we can pursue

those operational efficiencies. And to me this is just another variable that may or may not come to pass. I mean, just because we both agree that 4.48 percent or 4.4 percent is our forecast for 2008 doesn't necessarily mean that that's going to come to pass. And so really at the end of the day what we're concerned about is that if we get into a discussion of, you know, the figures that are making up the 2008 through 10, as I indicated previously, we're into a situation where we may be talking multiple test years and the consumers may actually be on the losing end if we get into incurring additional significant regulatory costs associated with the implementation of the formula.

MR. JOHNSON:
Q. But at least we'd be starting off with a formula that tries to be realistic as to what forecasters, including the Company's own forecasters are saying that's likely to happen, which is contained, for instance, in financial reports they could file with the Board, correct?
A. Well, you know, forecasts may be wrong. I

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mean, we've seen in the past, you know, the effects of that. I mean, I believe in our original filing, we had a forecast from our financial advisors of 5.2 percent, for example, and now that has changed to 4.5 percent, and so, you know, we can even see changes in forecast, just as you can see that, you know, the actual results could be different again from the forecast. So there are no guarantees that these forecasts that you see here for 2008 through '10 are actually going to come to pass.

Q. But you will agree with me that this forecasted or estimated expected two million dollar plus interest cost saving, that this is reflected in the embedded cost of debt figure--that's not reflected in the embedded cost of debt figure that Hydro proposes to use for 2008, 2009, 2010? I think that's pretty clear.

A. Well, you know, I mean, you're categorizing the two million dollar saving as if it's, you know, in the bag, and it isn't. You know, like I said, the forecast can be wrong, and in addition to that, there's no guarantee that

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we're actually going to be doing a face value of two hundred million dollars in terms of our refinancing. I mean, that's really predicated on a promissory note balance of 70.6 million. If, for example, our promissory note balance comes out to be something more or less than that, that could impact on the amount of refinancing that we actually do. So instead of doing 200 million, we might do something less than 200 million, or something more than 200 million. I guess this is my point is that, you know, promissory note balance, for example, is 70.6 million dollars is predicated on a number of assumptions with respect to cash flows that the Board has really had no input into or any of the intervenors at this particular point in time, as they have, for example, in the 94.7 for 2007.

Q. Well, Dr. Cannon is an expert retained on behalf of an intervenor and has had an opportunity, Mr. Bradbury, to pass upon, review what those projections are. Is that not some scrutiny of the type you're speaking of?

(11:30 a.m.)

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A. Well, Dr. Cannon has certainly, I guess, agreed with the methodology that we've employed, but I guess he's not really in a position to comment on whether or not, you know, the inputs that make up those promissory notes, I don't think he has specifically commented on that. In other words, I don't think he has specifically scrutinized the assumptions we are making with respect to our 2008 capital program, for example, which is basically a cash flow that would drive that 70.6 million dollar balance.

Q. Let us assume, and walk us through this scenario, okay. Let us assume we use the 2007 embedded cost of debt throughout '08, '09, and '10, and let us further assume that just as forecasted, that 200 million dollar debenture comes due in 2008 and lo and behold, you manage to get it refinanced for the 4.48 percent instead of the 5.50 percent that it's currently at, and let us assume that causes Hydro to over earn on its equity by the additional two million bucks. Okay, are you with me so far on those assumptions?

A. I am. I don't think that that alone would

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cause us to over earn on our equity, because as I indicated in Table 4, the 100 basis point range, I guess, that has been permitted or that we are suggesting would be permitted in terms of an increase in our return on equity would be something just north of two million dollars.

Q. Yes, but just walk us through now the protections that should make my clients, you know, the consumers of the province content with your proposal.

A. Well, I guess -

Q. So that, you know, they can feel good about ignoring the two million dollar saving.

A. Okay. Well, I guess coming back to, first of all, the concern that we have with respect to the approval of the formula in the first instance. We can't see the Board or the intervenors automatically accepting the numbers that we have put forth with respect to our forecast for 2008 through 2010, without some scrutiny, just as they have wanted to scrutinize the numbers that we put forth with respect to our 2007 numbers. So we do feel that in order to enter into that kind of

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scrutiny, there's going to be a cost associated with that. We don't know what that cost would be, but we suspect that it would be significant.
Q. What cost are you talking about?
A. The cost of a regulatory process to examine the inputs and assumptions that are driving those 2008 through 2010 numbers.
Q. So we're here now and we're talking about them.
A. Yes, we are, but I mean, you know, with respect to the numbers that are in the 2007 column, for example, we've answered something like six or--there's been six or seven hundred RFIs received and answered with respect to the numbers and assumptions that are driving that column. There have been no--there hasn't been that same scrutiny associated with the 2008 through 2010 numbers, for example. So we think that there would be a cost associated with doing that, and I guess the other thing is that, you know, just as -
Q. But Mr. Bradbury -
BUTLER, Q.C.:
Q. He should be allowed to finish his answer.

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CHAIRMAN:
Q. Yes, could he just finish his answer, Mr. Johnson, please?
MR. JOHNSON:
Q. Yes.
A. Just as we've indicated that, you know, there could be a $600,000 reduction in our embedded cost of debt during this term, likewise that could just as easily turn around, as we've indicated that, you know, forecast and actuals don't always turn out to be the same way and there are a number of other things, I guess, that could happen. For example, diesel fuel prices might come out to be something different than what we had anticipated. Our efficiency at Holyrood, for example, could be something other than what we had anticipated. So you know, I guess, this is all part and parcel of the Board's view that we should be trying to work within a range and trying to operate and find efficiencies in our operation such that we can live within that range, to the benefit of all ratepayers.
Q. You just raised an issue about the level of RFIs on the issue. If, as Dr. Cannon I

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anticipate will say that he doesn't really have much fault with the manner in which you forecasted the embedded cost of debt for 2008, 2009 and 2010, surely you don't expect us to fill up the record asking further questions about it, Mr. Bradbury, right?
A. Well, I don't know that--what your intentions are in that regard, to be honest with you.
Q. Well, you've indicated that, you know, there hasn't been enough RFIs on those issues. I thought Hydro was generally in favour of less RFIs, but do you understand my point? If, as Dr. Cannon is going to indicate, he doesn't have a big problem with your forecast, you wouldn't expect more RFIs on the point.
A. Well, you know, that's in relation to the forecast for the interest rates, for example, although I know that Dr. Cannon did have some question with respect to the methodology that we employed and he has suggested a different methodology, for example, in the calculation of the refinancing rate on the series F, and I know that in the Newfoundland Power hearing, there was considerable discussion with respect to forecast methodology and what would be

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appropriate. So that alone, I think, would take up considerable time, but not only that, but I come back to the balance of the promissory notes, which is basically predicated on a number of assumptions as they relate to Hydro's costs and cash flows and, you know, I don't understand why you or anybody else would be comfortable with just accepting a promissory note balance that's predicated on a 2008, '09, or '10 capital budget program, for example, that hasn't been subjected to scrutiny by the Board.
Q. But, but -
A. Any changes in any of those cash flows, for example, could impact on the ultimate promissory note balance in any of those years.
Q. But the capital budget amounts are anticipated, I take it, to stay at historic levels?
A. Well, I mean, you know, the capital budget amounts that are contained in the 2008, 2009, 2010 years could include any number of initiatives that Hydro might be contemplating with respect to the maintenance of its plant and assets, and as we know, the Board in the

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past has had wanted to have input with respect to some of those expenditures that we were contemplating, and in some cases, those expenditures have been deferred. In some cases, they've been rejected.
Q. But nonetheless, what we see here, that's still on the screen, in terms of the forecast that was delivered on January 12th represents the very best and most up-to-date forecast estimate of Hydro and its advisors, correct?
A. They do.
Q. We're still in agreement on that.
A. They do, but so did our original submission, when we made that, and as you can--as you're aware, there were a number of changes that resulted from the regulatory process, from our original submission to our submission in December as a result of negotiations that took place, changes in forecast with respect to interest, changes in forecast with respect to fuel prices, for example.
Q. But this -
A. You know, I guess my point is that -
Q. But this was -
A. - the regulatory process can result in a

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number of changes to an initially presented forecast.
Q. Yes, but this was, and still does, represent Hydro's very best forecast for this period of time?
A. Yes, it does, as did our original submission, like I say, for the 2007 test year.
Q. Okay. Now if at the conclusion of the hearing, the Board were to adopt Dr. Cannon's recommendation and incorporate in Hydro's automatic adjustment mechanism figures for the embedded cost of debt for 2008, 2009, and 2010 that differed, even if they differed slightly, from the 8.26 percent value that you forecasted for 2007, would Hydro try any less to find the lowest possible cost of financing for Hydro's operations during these post GRA test year years? Would you try less hard for lower financing costs?
A. No, we wouldn't.
Q. No, obviously you wouldn't. That wouldn't affect it one way or the other.
A. No.
Q. And would it--did the production of this forecast produce for Hydro an administrative

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hardship, as to making these forecasts and estimates in this case, bearing in mind that you provided them on January 12th, having just been asked for them prior to Christmas?
A. No, no, it's part of our long-term planning process.
Q. Yes, and would it impose an administrative hardship on Hydro, presuming that the Board were to, at this hearing, set and establish what the embedded cost of debt figures should be for the purpose of the formula, would it cause an administrative burden on Hydro to implement that yearly in the operation of the formula?
A. No, I don't believe it would. No more than, you know, just the ongoing administration of the formula using test year values.
Q. Yes, okay. Now Mr. Bradbury, we're focusing on a mechanism that you've put forward by which we are, in essence, planning, according to your proposal, to adjust the return on equity annually, but keep the debt rate constant for four years, correct?
A. That's correct.
Q. And what proportion of the overall return on

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rate base of Hydro will be subject to adjustment by only adjusting the allowed return on equity, as per your proposal?
A. What I believe in the schedule that I had--we had provided to you last night, I believe Dr. Cannon made some additional calculations on that, I don't know if that's available on the schedule that you have.
Q. Maybe it's a good time to -
A. It is on the one that I have.
Q. Yes. Mr. Chairman, Madam Commissioner, this morning, I circulated a further document which builds upon Exhibit MGB No. 4.

MS. NEWMAN:
Q. We have that. We want to label it?

MR. JOHNSON:
Q. Yes. Have you had a chance to -
A. I have.
Q. - to review it, and I take it, Dr. Cannon explained to you what the calculations were within the box that was added?
A. Yes, he did.
Q. And just for the record, what's added in the box is Dr. Cannon's work. Everything else is identical to MGB No. 4, and now having had the

benefit of this document, let me just go back and ask you the question. Can I now ask you what proportion of the overall return on rate base will be subject to adjustment by adjusting just the allowed return on equity, as per your proposal?
A. It's somewhere in the vicinity of 92 to 93 percent is subject to debt, so on the equity portion, I guess you're looking at somewhere around seven or eight percent.
Q. Right. I'm advised that it's less than eight percent, because if you look at the bottom of the column, the debt would account for 92. 61 percent of the overall return on rate base.
A. Um-hm.
Q. Do you accept that mathematics?
A. That's correct.
Q. Okay, and would you be able to adopt this as being representative of what the respective proportions are of equity and debt is to the total return on equity for Newfoundland and Labrador Hydro?
A. Yes, I think that's a fair representation.
Q. Return on rate base, I'm sorry. You would?
A. Yeah, that's a fair representation, yes.

Q. Okay.
MS. NEWMAN:
Q. So that would then be marked as MGB No. 5.
(11:45 a.m.)
MR. JOHNSON:
Q. So basically what you're proposing is that more than 92 percent of the overall return on rate base will not be subject to any adjustment, by virtue of your proposal, by virtue of your proposal to fix the embedded cost of debt for four years.
A. Well, you know, I guess -
Q. Is that the take away?
A. I guess, when you're a utility with a less than five percent return on equity, you know, you have to be very concerned about any movements, I guess, that are going to impact on your bottom line, and granted, it represents a small portion of the total return, but it's nevertheless important to us with a net income of only eight million dollars.
Q. Now I'd like to revisit an earlier topic with you. In your direct testimony with Ms. Butler, Ms. Butler asked you a question, "was

it modelled after Newfoundland Power's formula?" Your answer was yes, and then you pointed out three differences. Number one was the ROE was tied to the cost of long-term borrowing for Hydro, which of course is different than Newfoundland Power as an investor-owned utility.
A. Right.
Q. And number two, the difference was you're using different trading days than Newfoundland Power uses?
A. Right.
Q. Basically for ease of application of the formula, I take it?
A. Yes, that's correct.
Q. Right, and number three, you're proposing a different trigger mechanism?
A. Not mechanism, trigger point.
Q. Trigger point, I'm sorry, okay. Now was there any thought, as you were developing this formula internally, as to whether it's really enough to use the Newfoundland Power formula as a template and only provide these very modest modifications to it, having regard to the fact that in the case of Newfoundland

Hydro, we are proposing to change less than eight percent of your overall return on rate base and leave over 92 percent constant, which is nowhere near the circumstance that Newfoundland Power has, right? And could I get your comments on how truly nuanced this proposal is to the realities of Hydro, other than those that you've indicated you've accounted for in those slight changes?
A. Well, like I said, you know, the margin that the company is currently permitted is tied to our incremental cost of long-term borrowing, and so that really introduces some risk to Hydro in that we don't have the same margin to withstand changes that may occur that we had not anticipated, with respect to business risk. So we have to be very careful of how-- of risks that are proposed or posed to that margin. I guess the other point that I'd want to make is I would harken back to the comments that were made by our CEO where he indicated that we are endeavouring to improve our capital structure. We have a target of 80/20 and I believe we are moving in that direction. We've made some changes, I guess, in terms of

our dividend policy, and we are endeavouring to move to a more robust capital structure that has more equity in it. He's also indicated, I guess, that it is our intention to revisit the question of return on equity for Hydro at our next hearing, and so really, I think, as time goes on, you know, the seven or eight percent that you're referring to could possibly grow. I don't know that it would grow to the same extent that Newfoundland Power has equity in their capital structure, but we do suspect that, you know, the amount of equity in our capital structure, we are forecasting that that will grow to a larger degree than it is right now.

Q. But in fairness, Mr. Bradbury, and I take your point, but in fairness, you're proposing a formula to run out to the 2010 period. I mean, we're not reasonably expecting changes to Newfoundland Hydro's capital structure that will take away much over that period of time from my observation that, you know, we're still talking 92 percent of your overall rate of return or your overall return on rate base being held constant. I mean, we're not really

talking about significant changes over that period of time, life of this proposed formula?

A. Well, you know, I guess, to me, it's a mechanism whereby that we proposed that we feel can be agreed on by the Board as a mechanism or a means by which some risk management can be introduced into Hydro's management of its bottom line and some protection of our relatively small margin that we have right now. We certainly don't see it as an administratively burdensome process. We think the formula is certainly, as we said, modelled under Newfoundland Power's mechanism, so it has already been subjected to a certain amount of regulatory scrutiny. So we feel that it's appropriate that it be implemented now.

Q. Okay, and would you agree with me that the material found in the box on M--which is now MGB No. 5, this is all predicated upon a move to 8.21 percent as being the embedded cost of debt percentage, right? Let me -

A. Well, yeah, I mean, what we are trying to do, I guess, was put it into context for the Board, so that they could get an appreciation

of what the impact of that kind of a change would be, in terms of dollars and cents.

Q. Okay. But, and I never expressed myself very clearly, the 92.61 percent that we see at the bottom of that column -

A. Yes.

Q. - that's predicated on a move to 8.21 percent, correct?

A. I believe so.

Q. Yes.

A. I think Dr. Cannon was using the 110.2 number, yes.

Q. Right, and so we can take from that and you'd agree that if we stick at the 8.26 percent figure and have that embedded and used in the formula for the next three or four years, that it's--we're not talking about 92.61 percent any more. We're talking about a figure higher than that, correct, slightly higher?

A. Yes, it would be slightly higher.

Q. Yes, so we'd be keeping constant an even greater proportion of the amount that--of the overall return on rate base?

A. That's correct.

Q. Okay. Can I ask you, Mr. O'Rielly, to turn up

NLH-32 P.U.B? In response to question B, asks for a comment, or "please indicate whether Dr. Cannon's recommendation would be contrary to rate making principles which are based on test year values." And the answer struck me, from Grant Thornton, I believe, under B. "It is our understanding that in reaching its decision, the Board weighs and considers all relevant principles in the context or circumstances of the evidence presented at a hearing the current regulatory environment." Okay?

A. Right.

Q. And I take it that you would agree that that's what the Board should do?

A. Yes.

Q. Right, and I take it that you would agree that the context and the circumstances of Newfoundland and Labrador Hydro are materially different from the context and circumstances of Newfoundland and Labrador Hydro--or Power, I'm sorry?

A. There are differences and there are similarities.

Q. But there are very material differences

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between those two utilities, correct, in terms of capital structure, return on equity, proportion of debt?
A. Those factors are different, yes.
Q. And they are materially different?
A. Material is a matter of interpretation, but if it's your interpretation that they are material, then I'm okay with that.
Q. But it's not my--it's not what I say matters. It's what you say matters, and would you view those differences as being material?
A. I have no context in which to say that they are materially different or not, but they are significantly different, yes.
Q. I have no further questions. Thank you very much, Mr. Bradbury.
CHAIRMAN:
Q. Thank you, Mr. Johnson. Mr. Hutchings, good morning.
HUTCHINGS, Q.C.:
Q. I just have one point to clarify with the witness, your honour, or Mr. Chair. Mr. Bradbury, I'm not sure if I heard you correctly in indicating that it was Hydro's intention to revisit the issue of the ROE at

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the next rate hearing?
A. I believe that's what our CEO said, but I'd have to check the transcripts on that.
Q. Okay.
A. I know that in his initial statements, he had indicated that it was something that we were currently examining, in the context of previous rulings by the Board and looking at it in the context of those rulings.
Q. Yes. I understood his remarks here to be consistent with the written evidence, which was that Hydro intended to bring the issue to the Board for reconsideration in the future.
A. In the future, okay, my mistake.
Q. But are you aware whether or not there has been a decision taken to deal with ROE at the next rate hearing?
A. No.
Q. Okay.
A. I'm not aware of any decision made in that regard.
Q. Thank you. That's all I had, Mr. Chair.
CHAIRMAN:
Q. Thank you, Mr. Hutchings. Good morning, Mr. Kelly.

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KELLY, Q.C.:
Q. Thank you, Chair. I just have a couple of questions, Mr. Bradbury. Mr. Bradbury, interest costs are just one component of Hydro's cost of service. That's correct, isn't it?
A. That's correct.
Q. There are a bunch of others, and without being exhaustive, we have things like fuel, agreed?
A. We do.
Q. Depreciation?
A. Yes.
Q. All of Hydro's operating expenses, including salaries, transportation expense, etcetera?
A. That's correct.
Q. So if you change the interest from the test year value, you don't--that's only one component of a whole myriad of other things that will change from year to year, correct?
A. That's correct.
Q. And some of those things will actually increase in expense, correct?
A. Some of those things can increase, yes.
Q. Yes. In fact, we've heard some evidence of, for example, the pressure on salaries as Hydro

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goes forward.
A. Right.
Q. So can I just take you back to CA-218, I think it is, for a second and the table, and Mr. Johnson asked you some questions with respect to whether this represents the best forecast of going forward. If I understood your evidence in its totality though, this table has built into it a whole bunch of assumptions, correct?
A. It does.
Q. And one of those assumptions, if I follow it correctly, is that it doesn't adjust for the future capital expenditures that Hydro will incur from year to year. Did I follow that correctly?
A. I'm sorry, could you repeat that?
Q. In other words, your interest cost in any year is dependent not simply on what your current outstanding bonds are, but also the capital expenditures that Hydro will make from year to year. That capital expenditure has to be financed, has to be paid for?
(12:00 noon)
A. Yes. I mean, that's the point that I was

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trying to make with Mr. Johnson, is that the promissory note, the balances that you see there in the '08 to '10 years are really the product of those types of cash flows.
Q. Right, and this table doesn't even really attempt to forecast that going forward? It simply bases it on kind of the current status quo. Did I not follow that correctly?
A. I'm not sure that that would be correct. You know, I would--and Mr. Mitchell's department is in charge of the longer term financial planning, so I might be speaking a little out of turn now, but I do think that with respect to the projections for '08 through '10, they do make projections with respect to what they anticipate the operating costs will be. They probably make anticipation with respect to what the capital expenditures will be.
Q. I see.
A. We have longer term capital expenditure plans as well that are probably incorporated into this.
Q. But I take it those plans are certainly not fixed and fluid the further out you go.
A. Oh, most definitely.

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Q. Right. So would it be fair to conclude, in a nutshell, that the one thing we know with certainty is that when we actually get there, it will not look exactly like this picture?
A. I think that's a very good assumption to make.
Q. Thank you. Thank you, Mr. Bradbury.
CHAIRMAN:
Q. Thank you, Mr. Kelly. Ms. Newman, do you have any questions?
MS. NEWMAN:
Q. Yes, I do have at least one question on the automatic adjustment formula, and then I'd also have a few questions, as I have indicated to counsel for Hydro, on Exhibit MGB-3, which is property and assets review document that was filed.
The first question I have is a very basic question, and one is, has Hydro filed an actual document that is the proposed automatic adjustment mechanism that sets out the formula, sets out the definitions of each of the items included within the formula, to your knowledge?
A. We haven't filed a formula per se. The report that was filed was outlining the conceptual

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approach, if you will, but a formula could be designed around the contents of that report fairly easily.
Q. So are there variables that would be outstanding for Hydro to determine before the formula could be set up or is it very clear from the report?
A. I think it would be pretty clear from the report. The formula is really to all intents and purposes contained in the tables in the report whereby we outline the calculation of the weighted average cost of capital, and the subsequent impact of that in terms of its return on rate fees.
Q. Would it be possible for Hydro to provide that? Could you give us an undertaking in the next short while to provide a copy of what the actual proposed formula with definitions would be.
A. We certainly could do that.
Q. Mr. Bradbury perhaps could indicate how long it would take to produce that? I mean, is that something that can be done this afternoon, tomorrow, or next week?
A. I would think that it's something that we will

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produce next week.
Q. Thank you. I'd like to move on to the exhibit, MGB #3, to your testimony. That's a report that was prepared and mentioned in Board Order as referenced here, P.U. 14-2004 prepared by Hydro and submitted to the Board this past year in 2006, July. I wonder if you could give just a brief explanation of the process that was followed in undertaking this review, and some of the items that I would like for you to address in this process is whether there was outside consultants, how long it took for you to complete, how many people were involved, what was the approximate cost, I don't need details, just an order of magnitude there, was there any actual physical inspection. So that sort of discussion of what was done so we can understand how it came to be that you filed this report.
A. Okay. Well, I guess, the process really consisted of the formation of a team to initially compile the listings of the equipment records and our fixed asset records. As we indicated in our report, we at the time were maintaining two separate databases; one

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that contained records with respect to our units of property and our fixed assets, if you will, and the other one which was -- sorry, that first one was maintained in large measure by our Finance Department. The second one contained the equipment record database which was utilized by the field for their maintenance activities. I guess, the first order of business was to compile the listings of those databases in a manner that could be examined by the asset managers in the field. So the assistance of those asset managers was solicited, I guess, in an attempt to integrate those two databases into one and thereby eliminating duplicate records and duplicate administrative work. There were conversion routines that were written, I guess, to try to automate that integration to the extent that we could. Subsequent to that there was a work flow process designed whereby we -- that was done, I guess, using a Lotus Notes Platform whereby changes to the asset records going forward are controlled and emanate from the asset manager now and flow through to Finance. I guess, the other aspect of the process was

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to review the hierarchy that had been assigned to our asset records in our database to make it easier to drill down to find a particular asset.

Q. Were outside consultants hired to do this or was it all Hydro personnel?

A. No, there were not. We did have an outside resource, I believe, from X-Wave to assist in the building of the work flow program, but other than that the entire effort was managed by Hydro team.

Q. And how long did it take from start to finish approximately?

A. It was a rather lengthy process. Off and on it spanned two/two and a half years.

Q. Has Hydro attempted to quantify the approximate cost of the review?

A. Well, like I said, off and on. There were times when the project was dormant because in order to do the integration of the records the timing was a factor. With respect to the cost tracking, there weren't specific costs tracked with respect to that project. This initiative, I guess, was one of many initiatives that were conducted under Hydro's

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former BPI process. So it was viewed as a normal part of business improvement.

Q. Okay. Did it involve an actual physical inspection of the assets?

A. What we did was compiled the listing of the assets in the various areas and, in particular, the assets that were under the jurisdiction of a particular asset manager. So those listings were then circulated to each asset manager for their review. They examined those records in the context of the fixed asset record versus their equipment record, and they also examined them in the context of their knowledge of their own asset base. So there were instances they had determined where there were assets that were no longer in service, and as a result of that, there were some retirements that were highlighted.

Q. I see at Table 1, Page 7, that sets out the total to date under net book value 6,221,384.00 and what does that figure represent?

A. That figure represents the net book value of the assets that were identified as no longer being in service and that were written off

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over the years noted.

Q. So the number -- the assets identified as continuing to be used and useful in this process, were the net book value of those then used as a basis for determining the rate base that was proposed by Hydro in this application?

A. Yes, they were.

Q. And did this review also involve setting up any processes for future practises in terms of identifying how an asset might be determined to be no longer used and useful?

A. Yes, it did actually. There's a number of things, I guess, improvements that have resulted from this review. First of all, you know, we've tried to focus control and responsibility for the asset records with the asset manager. We've done that. We've compiled listings of the assets that are under their jurisdiction and those listings have been circulated to them with an understanding that that is now their responsibility. We've also structured the Lotus Notes Program in such a manner that any and all changes to asset records, with the exception of the

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computation of depreciation expense which is done by Finance, but all other changes to those records must now come from the asset manager and are under the control of the asset manager. So if there are any problems with those records, it's the asset managers responsibility. That's the thing that we've done and we take some comfort in. We've also conducted now going forward annual rotational spot checks of our asset records to the assets in the field. We conducted such a spot check, our first one, in the fall of last year in the Bay D'Espoir area and there were no significant discrepancies noted as a result of that review.

Q. So is it Hydro's position now that this review having been done and the value of the assets having been incorporated into the calculation of the value of the property for the determination of the rate base calculation, that the rate base accurately reflects the used and useful net book value of Hydro's property?

A. Yes, we are confident in that regard.

Q. And is it Hydro's position then that a

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valuation under Section 64 of the Public Utilities Act of Hydro's property is not necessary at this time?

A. We don't consider it necessary. We feel that we've improved the controls over our asset records. We should point out, I guess, that even with respect to the controls that were previously in place with respect to our records to have resulted in a six million dollar write-off on an asset base of in excess of 1.4 billion dollars is an error rate of something less than one half of one percent. So we consider the controls to have always been in place over our asset records. We've simply improved them.

MS. NEWMAN:

Q. Thank you, Mr. Bradbury. Those are all my questions.

CHAIRMAN:

Q. Thank you, Ms. Newman. Ms. Butler, any redirect?

BUTLER, Q.C.:

Q. Mr. Bradbury, forgive me if I recorded a question differently than the way it was asked. I'd be guilty of it at least twice if

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I did, but I had a little bit of confusion with respect to the reference to the intervenor's concerns. When you had indicated that you had addressed the intervenor's concerns, were you talking about the concerns expressed by the intervenors during Newfoundland Power's hearings when the formula was first approved and later after it had been in place for three years?

A. Yes. Basically, the concerns I was referring to was with respect to the changes in the imbedded cost of debt, and the fact that the Board had considered the evidence that had been presented in that case and had determined that an annual report with respect to the changes in the imbedded cost of debt would be appropriate and necessary.

BUTLER, Q.C.:

Q. Mr. Chairman, I'm a little uncertain about the rules of order in this, but I do have a question for Mr. Bradbury that I'm curious whether, in fact, I'm allowed to speak to him about first before I bothered to get into the question and then hit him with something that's going to come at him cold flowing from

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the two million dollar difference that Mr. Johnson has raised on the difference between the $200,000,000.00 debenture at 5.5 and the one of the same amount at 4.8. I'll just take your guidance on that.

MS. NEWMAN:

Q. I would suggest that we hear from other counsel and see if they are willing to give leeway to counsel for Hydro on this.

MR. JOHNSON:

Q. It's unorthodox, I'll say that.

BUTLER, Q.C.:

Q. Actually I don't know if it's unorthodox. That's what I'm asking.

MR. JOHNSON:

Q. It must have been because you didn't know if you could do it.

MS. NEWMAN:

Q. No, not normally we wouldn't contemplate consultation with witnesses during testimony, but --

BUTLER, Q.C.:

Q. Well, that's fine. If, in fact, that is the understanding, then I'm just going to pose the question.

Mr. Bradbury, the reference that was made by Mr. Johnson between the $200,000,00000 debenture at 5.5 versus the $200,000,000. 00 debenture at 4.48, I must say I'm confused now with respect to that $2,000,000.00 difference vis a vis the $600,000.00 difference that you calculate on your exhibit MGB #4, which is reflected by the difference between using the imbedded cost of debt at 8.26 and the imbedded cost of debt in the year 2010 coming in at actually 8.21. Can you just help me reconcile the difference, please?

A. The $2,000,000.00 difference to which he was referring to was the change in the interest costs that are going to occur with the refinancing of the 5.5 percent bond. So you've got a $200,000,000.00 bond. It's currently attracting interest at the rate of 5.5 percent. We are forecasting that will drop to 4.5 percent, a one percent drop on $2,000,000.00. That's a $2,000,000.00 change in the interest cost. That change has been factored into our calculation of the imbedded cost of debt for 2008. You don't see -- you're not really comparing apples and apples

between that and the $600,000.00 that we saw before. That was assessing the impact of a five basis point change in the imbedded cost of debt overall.

(12:16 P.M.)

Q. So as long as the factoring in of the difference in the bond rate has, in fact, been carried forward into your imbedded cost of debt for 2008?

A. Oh, yes, that's incorporated into the 2008 number. If you go down to the bottom of that screen, you'll see the 8.23 percent. That incorporates the impact of that $2,000,000. 00 change in debt cost on the refinancing. Of course, it also incorporates all of the other changes that are inherent in those 2008 inputs.

BUTLER, Q.C.:

Q. Thank you very much, Mr. Chairman.

CHAIRMAN:

Q. Do you have any questions, Ms. Whalen.

VICE-CHAIR WHALEN:

Q. I just have one question, Mr. Bradbury, and it's in respect of the automatic adjustment mechanism that you've put forward. In putting

forward that proposal or preparing that proposal, did Hydro look to any of the other jurisdictions in Canada that also use similar mechanisms; BC, NEB, Ontario, to see if any aspects of those existing mechanisms would be applicable or not in this jurisdiction for your circumstance?

A. We didn't conduct an exhaustive analysis, no, but we did peruse some of the mechanisms in other jurisdictions, and for the most part, we were unable to find a mechanism that was similar to the one that's in place in Newfoundland. I guess, our focus on what would be appropriate for this jurisdiction.

Q. So your starting point was at the time and still continues to be Newfoundland Power's formula modified to fit the --

A. That's correct.

VICE-CHAIR WHALEN:

Q. That's fine. Thank you very much.

CHAIRMAN:

Q. I just have a couple of questions, not necessarily directly related to the formula, Mr. Bradbury, but some of the other things in your direct evidence more relating to the

expenditures and things of that nature. I explored this just a little bit with your CEO, and also I think with Mr. Haynes, and it's the use of targets and corporate targets and objectives within the organization, and while -- again I appreciate what's been done here in relation to the historical sort of trending. I don't see anything here in the evidence that's been presented in terms of actual forecasting and trend analysis or anything like that in terms of expenditures, and I understand from your CEO that, I mean, with regard to things like the return on equity, for example, there are action plans within the organization that have to be put in place and I respect that. How do you do your own financial forecasting analysis and what targets, I guess, do you use because they're not necessarily evident here in this particular application? Again I'll ask you the same question I asked Mr. Haynes, how does that get sort of translated to you by virtue of corporate priorities and corporate objectives, if you will?

A. Well, you know, we're certainly -- it really

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starts with our budget process, and, you know, basically the starting point for the budget is naturally the previous budget for the previous period, but, you know, we are always interested in how our operating costs are trending in relation to an inflation adjusted number. We certainly feel that we should be beating inflation and that if we're not, then that's an indication that we should be trying harder with respect to operational efficiencies and effectiveness. The budget process really, as Mr. Martin had pointed out, one of the large drivers, I guess, in our operating budgets is our maintenance and what his focus is right now is to construct a maintenance planning exercise whereby our maintenance plans are really driven by considerations in our engineering and operations divisions as to what the absolute necessity is with respect to our maintenance practises, and that that will drive cost. So that is certainly a large factor for us in respect to our planning and our budgeting. The budgets, as they come back, have to go through a scrutiny from the business unit

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manager, through the department manager, through the vice resident, and ultimately to the CEO. Again when it reaches those levels, we are looking at those operating costs in the context of history, in the context of inflation adjusted figures, and to the extent that they are outside of those parameters, then obviously we have to go back and resharpen our pencils. The budget itself, once it's finally approved, becomes a target, and our CEO has made that clear in no uncertain terms that the budget is the number that we are going to be held to. We've recently implemented a change in our approval structure with respect to forecast of our operating cost, such that now our business unit managers are empowered to work within their operating budgets as a means by which the administrative, I guess, costs associated with budget management can be reduced, but at the -- but to the extent that they are forced to go outside that budget, they are required to find that money somewhere else, from another department manager, from another vice president, from another division. To the

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extent that they are unable to do that, and we actually end up in a situation where it's resulting in an increase in the overall corporate budget as was originally approved by the leadership team and the board, that then has to go to the leadership team for approval. So, I mean, an increase in our operating cost that take us above budget right now, our CEO has made it quite clear that that's a very significant event.

Q. Apart from setting your budgets and your operating costs and what have you on the basis of historic sort of trend analysis and to ensure that they don't exceed inflation, is there any consideration of -- perhaps this is an unfair question to you, but I'm just trying to understand, I guess, where this may be going in the future. Is it fair to say that where Hydro is going and some of the impacts that you might be facing over the next three to five years, adjustment of ROE, for example, that that translates into considerations into your financial forecasting and objectives. Perhaps I can clarify a little bit where I'm coming from. One of the concerns that we

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have, and notwithstanding the actual situation that exists right now where there is no rate increase, certainly from the Board's perspective, we have to be concerned. One of our regulatory principles in trying to weigh all this stuff is rate stabilization and rate stability, if you will, and, I guess, Mr. O'Rielly, if you could just bring up Schedule I of Mr. Bradbury's evidence, page 1 of 10. I'm just looking at the proposed 2007, I guess here, and I'm forgetting the revenue requirement for the moment. I'm looking at things like, you know, interest going into the 2007 test year increasing, notwithstanding, I think -- there was a comment in there that the forecast debt had gone down from 2003 to 2007 by about $136,000,000.00, somewhere that's in your evidence. I'm looking at depreciation, and I think there's a comment in there that the result of your depreciation will be a greater burden, for example, a greater financial burden on the organization looking at the future again. Fuel, I recognize, to some degree is a non-controllable cost. Then it comes to operating expenses, and I'll just come back to that in a moment. If you look at the retained earnings of the 5.20 where it is now, I just look at the sensitivity of that, I'm not a financial person in any way, shape or form, but I look at all other factors being equal sort of a 1 percent increase, for example, in the rate of return on regulated equity, and maybe that's a naive way in looking at it, but it seems to me that you're looking at about a net income of somewhere in the order of 2.5 million dollars for every increase in 1 percent change and return on equity. So to the extent you're moving forward on a plan there, it seems to me that that will have to be found somewhere within the organization. I'm looking at operating cost, and I'll come back to that. We talked about an increased labour component. I think your CEO talked as well about, for example -- I believe Mr. Haynes said three engineers are hired on, you're looking at maintenance planning and putting in a fairly refined process, if you will, of looking at what your maintenance cost will be in the future and focusing on your aging assets and things of

that nature. Then there's Holyrood is another sort of cost component that's there, and we can see a cost increase in that area as well. I guess, what I see here is a lot of potential to a degree, and I'm -- and beyond the 2007 sort of forecast, if you will, I don't know -- you know, there's nothing in the application which will give me any sense of what's going to happen beyond that in terms of financial projections, financial targets, etc. Perhaps you could comment in general terms, I'm not looking for anything specific, on any of that, I suppose?

(12:32 P.M.)

A. The projections beyond 2007, of course, are contained in the five year plan that we would have filed with the Board. I believe that was CA 212. I guess, if you want to go to the income statement there, it would give some indication. This, I guess, gives you some indication of what to expect in the future in terms of our costs. As you can see, we certainly are anticipating increases in expenses from 432 in 2007 to 465 in 2011. In large measure, the increase in 2011 is based

on fuels. Certainly all of these factors will have an impact and will create rate pressure, there's no question about that. The same factors will -- many of the same factors will cause rate pressures in Newfoundland Power and many other utilities as well. I guess, in terms of giving you a sense of the planning process that Hydro is currently engaged in, we have enhanced our planning process in the last couple of years in that we've set very clear corporate goals with respect to aspects of safety, environment, and in particular, operational excellence. Operational excellence, I guess, is certainly one that impacts a lot of people in the company because each department manager now is challenged to consider initiatives that they can undertake in their own sphere of influence, if you will, that will complement the corporate goal as it relates to operational excellence. So each department manager now is obliged to prepare their own departmental plan that's a complement to the corporate plan. To that extent, you know, we have operationalized the corporate plan such that each department

manager now is held to that departmental plan, which includes a goal five and includes a number of initiatives, I guess, that they are expected to deliver on. All of those initiatives are supposed to be toward or geared towards enhancing Hydro's operational excellence. I think another thing that we've done this year that we really haven't done a very good job on in the past, and we're probably still not 100 percent of the way there, but all of the department managers this year have been talking to each other with respect to their own department plans. Like, for example, in my own area we are considering some initiatives that will involve ES personnel. So what we've done is we've communicated to our IS Department what our plans are for 2007 in terms of the initiatives that we want to undertake under the heading of operational excellence to ensure that the resources are there for us when the time comes, as has every other departmental manager. I think our IS Department Manager, in particular, is being inundated with a number of initiatives from other department managers that they are considering taking. The hope is that at the end of the day we'll do a better job of execution. I mean, it's great to have great plans, but if the resources aren't there to execute on those plans, then you don't accomplish what you had hoped that you would. So we're trying to put some realism around the plans that we have with respect to operational excellence, in particular, such that when the time comes to execute on them, the resources are there.

Q. Thank you. In fairness to your CEO, I think what he was saying with regard to things like ROE that he'd be coming forward, whether it's in the context of the next application, or indeed prior to that, or after that, I guess, with a plan in that area. I did get the sense by way of process that there were corporate objectives being set and they are moving toward coming up with specific general corporate objectives there that they could share at some point in time, I think, with the Board beyond what might be contained within this particular statement, for example. With regard to the 80/20 capital structure, do you

have any notion of a time frame for that at all, or is that something that --

A. I believe again that would be something you might see in the corporate five year plan. I believe there might be a table in there -- yes, Figure 2 here shows the anticipated debt to capital ratio. So we're anticipating, at least based on the assumptions that were contained in this plan, that we would be going in the 79 to 80 percent range in 2010.

Q. Just by way of clarification more than anything, I think it's recognized within the evidence that the whole issue of inter-corporate and inter-company transactions may be one in terms of an issue in future that will become more profound in terms of tracking cost, given other aspects of your business and other focuses of Hydro. With regard to the labour cost and the element that is noted in the evidence, would executive and management time and all that be tracked and incorporated within those costs, do you know?

A. Yes, they are. In our original filing we had made allowances for what we anticipated those charges would be. It's very difficult

naturally to try to determine with certainty what they're going to be, especially at the time when we had done these numbers. As time goes on, I think we'll have a better understanding of it because each individual in the company is aware of the importance of encoding (phonetic), you know, time to non-regulated operations in the event that someone in the regulated side of the business actually is doing work in that regard, and as time goes on, I guess, we'll have more history -- we'll be able to, I guess, make estimates based on historical context.

Q. So you see that as being part and parcel of tracking inter-corporate transactions within the organization?

A. Most definitely. I mean, we have now created non-regulated business units within our financial structure and individual cost with respect to those non-regulated activities are tracked across business units in that regard. So any individual who is doing work on non-regulated aspects of the business is obliged to prepare a timesheet in that respect.

CHAIRMAN:

Q. That's all I have. Thank you very much, Mr. Bradbury, for your testimony. It is twenty to one. Can I just canvas perhaps how long we might be with Dr. Cannon?

MR. JOHNSON:

Q. I would expect to be twenty minutes on direct.

CHAIRMAN:

Q. Ms. Butler.

BUTLER, Q.C.:

Q. Oh, I'm sorry, Mr. Chairman, I had indicated previously I thought I'd be an hour.

CHAIRMAN:

Q. If that's the case, then I think what we'll do is take our lunch break. We've been at it now since 10:30, so that's a couple of hours. If we were to just break for twenty minutes, we'd go well beyond -- I'm at your pleasure.

MR. JOHNSON:

Q. We're fine with rolling on through, subject to a short break so we can use the washroom and things like that.

BUTLER, Q.C.:

Q. Mr. Chairman, Mr. Bradbury is certainly going to be helping me with Dr. Cannon, so in fairness I'd like to have at least the twenty minutes, if not until 12:10, and I'm prepared to sit all afternoon if it means that Dr. Cannon is able to be relieved.

MS. NEWMAN:

Q. Mr. Chairman, at least a half an hour I would suggest so that people can gather some sustenance and their thoughts, probably would be well advised.

CHAIRMAN:

Q. Oh, yes, I was going to make it a half an hour, if not longer. Why don't we come back around 1:15. Thank you.

(12:40 P.M. - RECESS)

(1:15 P.M. - RESUME)

CHAIRMAN:

Q. Good afternoon. Anything before we start, Ms. Newman?

MS. NEWMAN:

Q. No, Mr. Chairman.

HUTCHINGS, Q.C.:

Q. Mr. Chairman -

CHAIRMAN:

Q. Mr. Johnson, if you could just introduce your witness, please?

HUTCHINGS, Q.C.:

Q. Mr. Chairman, I'd just like to note that I may have to leave a few minutes early, because relying on the schedule, I made another appointment.

CHAIRMAN:

Q. Okay.

HUTCHINGS, Q.C.:

Q. So if I disappear, don't worry about me; Mr. Coxworthy will be here.

CHAIRMAN:

Q. Fair enough, Mr. Hutchings. Okay. Mr. Johnson.

MR. JOHNSON:

Q. Mr. Chairman, Vice-Chair, on the stand now is William T. Cannon.

CHAIRMAN:

Q. Dr. Cannon, good afternoon.

DR. CANNON:

Q. Good afternoon.

CHAIRMAN:

Q. And welcome. This your first visit to the Province?

DR. CANNON:

Q. No, I was here 39 years ago for a couple of days visit. I remember I had an enjoyable

afternoon spent out at Petty Harbour, which I gather is just south of here.

CHAIRMAN:

Q. Oh yes, Petty Harbour is still there. It's probably just as enjoyable as ever. I don't know on a day like this now in the meantime, but did you arrive yesterday after the storm?

DR. CANNON:

Q. Yes, and I thought that perhaps my arrival brought the good weather that we had subsequently.

CHAIRMAN:

Q. I guess yesterday evening was as good as it got for the day, for sure. Anyway, welcome.

DR. WILLIAM T. CANNON (SWORN)

CHAIRMAN:

Q. Thank you very much. Mr. Johnson, when you're ready please.

MR. JOHNSON:

Q. Thank you. I should say that by reason of biological impossibility, I have no recollection of events when you were in Petty Harbour. Dr. Cannon, as you noted, this is your first time in this jurisdiction and I would just like to lead you down through

certain of your background, if you wouldn't mind, for a few minutes. You are the Chair of the Faculty Board of the School of Business and a Commerce Teaching Fellow in Finance at Queen's University School of Business in Kingston, Ontario?

A. That's correct.

Q. And you're the Chair of the Pension Committee of the Board of Trustees at Queen's University?

A. Yes, that's also correct. I've been in that position for about six years now.

Q. For six years, and you've been teaching finance courses at Queen's for 32 years, and you received your Ph.D in business economics from Harvard in June of 1976, that correct?

A. That's all correct, yes.

Q. Okay, and for the Board's viewing, at Appendix A is a more detailed CV. I want to touch first on some of your experience. Is it correct that you've presented written and oral rate of return and capital structure evidence before Canadian regulatory boards for the past 25 years?

A. That's correct.

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Q. And you've advised the Ontario Energy Board staff and special counsel over that period of time or at least some periods of that time?
A. Yes.
Q. And you've appeared before the OEB in numerous rate hearings since 1982?
A. That's correct.
Q. And you've appeared before and presented evidence to the National Energy Board on behalf of the BC Petroleum Corporation and CanWest Gas Supply Inc. in four west coast energy hearings?
A. That's also correct.
Q. And you've testified on behalf of the Ontario Ministry of the Environment and Energy before the National Energy Board?
A. Correct.
Q. And you've testified before the B.C. Utilities Commission in several hearings in the 1980s as well?
A. That's right.
Q. And in June of 2003, I understand that at the request of Ontario Energy Board staff, you presented written evidence as part of the OEB's review of its 1997 draft guidelines on a

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formula based return on common equity?
A. That's correct.
Q. And I understand that these guidelines include procedures for an annual automatic adjustment of gas distribution utilities allowed equity returns during years when there's no general cost of capital hearing?
A. That's correct.
Q. And I understand that, as stated in the summary portion of your more detailed CV, that you've also delivered cost of capital papers at CAMPUT/Queen's Conference on Energy Regulation both in July of '05 and July of '06?
A. Yes, I have. Yes, I did.
Q. I note that there's a reference, as I have already noted, that you are the Chair of the Pension Committee of the Queen's Board of Trustees. Can you advise us of what that position entails?
A. Yes. Queen's has a 1.4 billion dollar pension fund, which is overseen by the Board of Trustees, and the responsibility of my committee is to choose the investment managers that manage the money in this pension fund and

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to monitor them frequently as to their performance and to evaluate whether they're doing a proper job or not. So I and my committee are in contact with numerous investment managers frequently during the year, updating ourselves with respect to things like interest rate forecasts, new products that might be available for the pension fund to possibly improve return or reduce risk, going off to conferences and meetings with these investment managers and so, I've seen it over the years, I've actually been on the pension committee since 1991, but I've been chair of it since 2000, I've seen this as an opportunity to keep myself up to date on what's going on in the financial community, with respect to different equity and debt products and alternative investments and, you know, I find that a great opportunity and I'm able to bring that knowledge, not only to the classroom, but to regulatory hearings.
Q. Dr. Cannon, did you file testimony in this Hydro General Rate Application dated October 27, 2006?
A. Yes, I did.

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Q. And do you now confirm that you adopt the same as your evidence in this proceeding?
A. Yes, I do.
Q. Dr. Cannon, as your pre-filed evidence indicates, you were retained by the consumer advocate to, amongst other things, evaluate and provide an opinion on the appropriateness of Hydro's proposed automatic adjustment mechanism, as outlined in Hydro's Exhibit MGB-1. In a nutshell, would you provide your evaluation?
A. Well, as I indicated in my pre-filed evidence, I think that the automatic adjustment mechanism should, number one, be based on an updated, the most up-to-date estimate of the embedded cost of debt for the test year, 2007, and importantly the formula, the automatic adjustment formula should incorporate, in the year-by-year calculation of the range for the allowed rate of return on rate base, in that formula should be incorporated the best expectation of the expected or the embedded cost of debt and the weighted average cost of capital, the best expectation we can make today of what those values will actually be in

the years beyond the test year, in other words, for years 2008, 2009 and 2010.
Q. Dr. Cannon, you were also asked to recommend changes to the proposed automatic adjustment mechanism put forward in MGB-1, where appropriate, to better meet the purpose of the automatic adjustment mechanism. Again, in a nutshell, what do you recommend?
A. Well, this is set out at the bottom of page four of my pre-filed evidence. I'm recommending, again, two things. One, that Hydro be asked to estimate, during the current hearing, what it's likely embedded average cost of debt will be in each of the years going forward to the end of the life of the--or initial life of the automatic adjustment mechanism, and indeed Hydro has done this for us, and based on the forecast provided by their two lead underwriters. And secondly, I'm recommending that this forecasted embedded cost of debt for each of the years beyond the test year, 2008, 2009 and 2010, that these forecasted values, which I think at this point Hydro and I basically agree on, that these forecasted values be approved in this hearing,

recorded in this hearing and pre-established, be established as components of the weighted average cost of capital portion of the automatic adjustment formula that would be used in 2008, 2009 and 2010. In other words, what our best estimate today is of the embedded cost of debt should be factored into the formula.
Q. Dr. Cannon, in CA-218 NLH, the Consumer Advocate asked Hydro to provide a detailed calculation for Hydro's most recent forecast of its embedded cost of debt for 2007, '08, 2009 and 2010, which Hydro has answered as of January 12th, 2007. If we could have CA-218 Table 1 just brought up briefly?
(1:30 p.m.)
A. And there it is.
Q. Okay. In that table, Dr. Cannon, Hydro provides its most recent or most current forecast of its embedded cost of debt for those years. What is your comment upon these forecasts now provided by Hydro for these years?
A. Well, I do not disagree with the numbers that Hydro has arrived at here, particularly the

expected embedded cost of debt of 8.23 percent for 2008, 8.20 percent for 2009 and 8.21 percent for 2010. I don't disagree with these values, but I think I have to point out, Mr. Johnson, that these were not the first values that the company came up with for the embedded cost of debt and that these numbers have been arrived at as the result of a considerable testing process during this hearing. The initial numbers that the company came up with, based on information that was available I presume last summer, were much higher than this, and we challenged them and felt that the company, if they incorporated more recent advice from their financial advisors, that these numbers would come down, and indeed, that's what they have done. So I would consider that these numbers, which we now can basically agree on, there's slight differences, you know. I've suggested that the cost of short-term debt might be lower in 2009 and 2010 than the company's figures, but their number for 2008 is lower than the number that I used. So I think, at this point, considering that there are slight differences

in our forecast, I'm content to agree with these as the best available forecast for Hydro's embedded cost of debt for the years beyond 2007, but they've been arrived at after a considerable testing process.
Q. Dr. Cannon, as your pre-filed testimony evidence and as you've said, you're recommending that Hydro's--that should the Board decide to approve an automatic adjustment mechanism for Hydro that it be improved and you recommend that Hydro be asked, as you've said, to estimate its likely embedded average cost of debt for each of the years '08, '09 and 2010, based on the relevant interest rate forecast for these years by its two lead underwriters and either approved or amended by this Board in light of the testimony here from all the proceedings. I'd like to ask you, Dr. Cannon, in your opinion, should this place an administrative burden upon Hydro to make these estimates?
A. Well, I don't think it places any extra administrative burden on them. The company, as Mr. Bradbury acknowledges, goes through this kind of estimation process, creates the

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same numbers that are required for estimating the embedded cost of debt in its own five-year financial planning cycle. So as we've seen, it didn't appear to strain the company's resources to come up with the answer to CA-218 NLH and the numbers incorporated in this Table 1, presumably largely came out of the company's internal financial planning process. So I don't think that coming up with an estimate of the expected cost of--embedded cost of debt going forward that doing that at each general rate application doesn't add any additional administrative burden on the company.

Q. If your recommendation were to be followed, would this provide an economic disincentive for Hydro to work hard to find the lowest cost of financing for Hydro's operations during these post 2007 years?

A. No, not at all. Generally speaking, if Hydro can arrange for cheaper financing than the embedded cost of debt that is incorporated in the automatic adjustment formula, they'll want to go ahead and do this because in doing so, they can achieve a higher return on equity. So

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let's just assume that the company's coming to refinance the 200 million dollar debenture issue that matures in 2008, and we've built into--supposing the Board accepts my proposal--we will have built in, into the embedded cost of debt, the expectation that that refinancing rate will be 4.48 percent. I can't imagine that if Mr. Bradbury can find a bond issue that he can refinance that at less than 4.48, they'll have every incentive to do that because any amount that he can achieve below the 4.48 percent will go directly into the bottom line of Hydro and would increase Hydro's achieved return on common equity.

Q. And Dr. Cannon, do you know the reason why Hydro has brought forward this proposal in MGB-1, forward to this general rate application for the Board's consideration?

A. Yes. Very briefly, in the previous--in Hydro's previous general rate application, which I guess started in 2003 and the decision came in 2004, there was considerable discussion about an automatic adjustment mechanism and the Board chose, at the time, because it felt that it didn't have enough

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information and the proposal, specific proposal, I guess, had not been put forward at that time, the Board basically ordered Hydro to come back at this hearing, the next general rate application, with a proposed automatic adjustment mechanism, and that's what Hydro has done.

Q. Dr. Cannon, in NLH 26 CA, in that RFI, you were effectively asked whether at the time of the filing of your pre-filed evidence, you were aware of the history of Newfoundland Power's automatic adjustment mechanism, and the question goes on "specifically, was Dr. Cannon aware that the Board had approved the use of a fixed/embedded cost rate for debt in comparison to a forecast cost rate for equity in Newfoundland Power's automatic adjustment mechanism?" For the record here today, Dr. Cannon, can I have your pre-say response to these queries?

A. Yes. By reading the material from that earlier Newfoundland Power hearing, it was clear to me that both the consumer advocate and Grant Thornton had some reservations with respect to Newfoundland Power's automatic

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adjustment mechanism, reservations in particular with respect to the fixed embedded cost of debt throughout the life of the mechanism. However, the remedies that were proposed at the time, which would have involved annual readjustments of that number, the Board did not accept for reasons that frankly I can sympathize with. I mean, the Board felt that if the embedded cost of debt were, in fact, reexamined each year and adjusted each year after the general rate application, that this might be possibly a disincentive for the company to seek out the lowest cost of financing on the theory. Actually, I suspect the company would still have looked for the lowest cost of financing. It's in a corporate treasurer's blood to look for the lowest cost of financing, but the idea that well, if the company can only enjoy the benefits of the lower cost of financing for six months or a year until it gets adjusted in the formula, well, why try so hard? But, and then the other reason that the Board gave, and I'll just quote was, it would seem contrary to the purpose of having an automatic adjustment

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mechanism if once a formula had been established, the Board were to use variances from forecasts of requirements, and then to adjust various formula components as they change. So these were the Board's stated two objections to the remedies provided in that Newfoundland Power hearing.

Well, my proposal, recognizing that the Board had concerns about these, I specifically designed my proposal so as not to offend either of those concerns or not to offend either of those principles. As Mr. Bradbury has acknowledged, if the embedded cost of debt is set ahead of time, even if it's set at some number that isn't a fixed number for the four years, he will still have every incentive to try to finance at the lowest possible rate. So there's--my proposal doesn't involve any disincentive for the company to seek the lowest cost of financing, and secondly, my proposal doesn't involve any coming back and revisiting the issue and looking for new evidence and asking the Board to make new decisions in non-GRA years. I mean, once this Board has set what the embedded cost of debt

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is going to be in the formula for the years 2007 through 2010, then there will be no changing of that number during the life of the formula. There will be no need to adjust various formula components as they change. The embedded cost of debt values will be set upfront, and by the end of this hearing.

Q. Dr. Cannon, could I refer you to MGB No. 5, and I want specifically to draw your attention to the information that was provided and generated by Hydro in respect of this exhibit, not that which appears in the block.

I take the purpose of these figures as basically saying, look, we're dealing with a small figure of $600,000 in terms of the estimated impact, you know. Is it really worth the candle to look at another type of mechanism, such as the one that Dr. Cannon is providing? Do you have any comments in that regard?

A. Yes, I do. On the face of it, $600,000 a year may not seem like very much, but if I'm a Hydro ratepayer, I'm asking myself why should a formula be designed that builds in a $600,000 bias each year, or at least possibly

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as much as $600,000 each year, a $600,000 bias toward Hydro's over earning it's allowed return on equity, and the 600,000 is a number that it's not just a one year number. It's that amount or something maybe somewhat less than that, would be an over earning or a potential over earning for Hydro for each of the three years beyond the test year, and I guess, the larger issue in my mind is Hydro is coming before the Board here to ask for--admittedly, the Board encouraged them to do this--an automatic adjustment mechanism, and there's every likelihood that if the Board approves one, that it will be in place for many, many years, not just the first three or four years. It could be in place for decades, and so I think it's especially important for the Board to approve a design of this automatic adjustment mechanism in a way that where the Board gets it right, right from the start. There's no point in sort of building in a bias that then encourages the intervenors to complain in, you know, future years and want to adjust a formula. I mean, my gut feel would be to say let's get it right, right at

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the start and then this won't be something that we have to fight about in future years.

(1:45 p.m.)

Q. Dr. Cannon, could I have Mr. O'Rielly turn up NLH 32 P.U.B? And I'll just leave that there for a moment, because I think it has some relevance, but the implication of several RFIs that were directed to the consumer advocate in relation to your evidence, and which were answered, was whether it was reasonable for the Board--was that it is reasonable and really only reasonable for the Board to order the same formula as Newfoundland Power has, and otherwise you'd have unacceptable asymmetry. Would you provide your observation as to that implication?

A. Yes. I was comforted to see the response that Grant Thornton made to Hydro's question where they were--Hydro was, I guess, suggesting that my recommendation was contrary to rate making principles and as has been, I think, read into the record before, Grant Thornton said that their understanding of the Board's roles was that the Board should make decisions that weigh and consider all the relevant principles in the context of and in the circumstances of the evidence presented at the hearing, and it's presumably the evidence about the applicant, in this case the evidence about Hydro, Newfoundland and Labrador Hydro. And it's my view that to start with Newfoundland Power as the template for an automatic adjustment mechanism and, without further justification, to assume that, you know, the basic framework of the mechanism that Newfoundland Power uses would also be appropriate for Hydro, I think that this just doesn't wash. This is not appropriate.

Hydro and Newfoundland Power are not comparable when it comes to the treatment of the embedded cost of debt within the automatic adjustment formula. As has been pointed out, Hydro, in Hydro, the debt represents a far larger proportion of the overall capital structure, you know, 83-84 percent in the case of Hydro, whereas for Newfoundland Power debt, it's only approximately 55 percent of the regulated capital structure. Similarly, for Hydro, the regulated return on equity is dramatically lower, you know, by design than

the allowed return for Newfoundland Power, right, and these two differences between Hydro and Power are, in my view, very, very material differences that affect the appropriateness of keeping the embedded cost of debt constant in the formula.

Because of these two differences, the embedded cost of debt, as has already been put in evidence, the embedded cost of debt basically determines 92 percent of the overall return on rate base for Hydro, whereas the return on equity determines only somewhat less than eight percent of the required return on rate base. For Newfoundland Power, this split is more like 50/50, instead of 92 to eight. So it seems to me to sort of undermined the purpose and the credibility of Hydro's proposed automatic adjustment mechanism to, on the one hand, fix, at a constant rate for four years, fix at a constant rate for the life of the automatic adjustment mechanism, the cost rate on that component that makes up 92 percent of the return on rate base, but to allow year-by-year adjustments through the adjusting the return on equity for that

component that accounts for only eight percent of the total return on rate base, and these proportions are dramatically different than those that are true for or experienced by Newfoundland Power, and therefore, I think that whether or not having a constant embedded cost of debt is appropriate for Newfoundland Power, that's an issue to be discussed some other time. Whether or not it's appropriate for them, it's not appropriate for Newfoundland Hydro to basically say, you know, we got an automatic adjustment mechanism, but guess what, we're not going to adjust 92 percent of it, by definition. We're going to keep 92 percent of it absolutely the same, even if we view that there will be some changes in the future, even if we both agree that the embedded cost of debt is likely to trend downward after the test year. We're going to ignore that. We're going to keep that 92 percent absolutely constant and only adjust that smaller eight percent portion. Indeed, that smaller eight percent portion could go up or down. We don't know which way long-term bond rates might go in those years,

but the one thing that we seem to be able to agree on is that the embedded cost of debt will trend downwards slightly beyond the test year and it's my view that the Board should not ignore this and that ratepayers would be unhappy if they felt that the formula that was going to be approved and perhaps perpetuated in future hearings was going to be a one that built in ignoring the decrease in the embedded cost of debt that we both agree is more likely to happen than not.

Q. And Dr. Cannon, finally, I take it that you would not have any objection to the reporting mechanism and the trigger mechanism that also found as components within the proposal put forward by Hydro?

A. No, I have no objection to that at all. It provides a degree of comfort to, for example, your clients, to the ratepayers. I guess it's open to debate how much protection it implies, how much wiggle room Hydro has within that, the range of that triggering mechanism. We saw this morning that Hydro could achieve an interest cost savings of two million dollars without possibly triggering a review of the

formula.
Q. Thank you very much, Dr. Cannon. That's my direct.
CHAIRMAN:
Q. Thank you, Mr. Johnson. Ms. Butler?
BUTLER, Q.C.:
Q. Mr. Chairman, we do have a couple of handouts which were provided to the Consumer Advocate last evening. So perhaps for the record, we'll just get those circulated now.
CHAIRMAN:
Q. Looks like everybody had a busy day yesterday, notwithstanding the storm.
BUTLER, Q.C.:
Q. Dr. Cannon, before we get too deeply into your cross-examination, and relative to the acknowledgement you've made already this afternoon that you have no quarrel with the revised figures that have been put forward by Newfoundland Hydro in CA-218, to avoid confusion at a later date, can I just clarify with you that these numbers, the 8.27, 8.23, 8.20 and 8.21, are now adopted by you to update those that were originally calculated by you in NLH 22?

A. Yes, I agree with that.
Q. Okay. We'll just have a peak at NLH 22, just to make sure that we're all on the same page, and there's a table there. Now the figures, of course, don't all appear on the same page. There's like three of nine. There you go. So for example, I think this is 2007, is it, that's on the screen? Yes.
A. Yes.
Q. And the figure that you had originally calculated there was 8.36. So what we're essentially saying is that these figures that were in that exhibit, you now accept are closer to the ones that are on the revised CA 218?
A. Yes, I accept the company's forecast for the embedded cost of debt for years 2008 through 2010 as incorporated in CA 218. It's based on, obviously, updated information that was provided through a--subsequent to the settlement in, I think, December the 6th.
Q. Yes, thank you. 2007 is also in there though.
A. Yes. I assumed we weren't fighting over 2007.
Q. That's fine, as long as we're clear.
A. Yes.

Q. Now Mr. Bradbury's exhibit that he had worked on yesterday and which we also provided to you overnight, which is now Exhibit MGB-4 and for which you did a revision yourself, added the table to the right and that has now been entered as MGB-5, do I understand that you also agree with Hydro's calculations as set out in that exhibit?
A. Yes, I do.
Q. Okay. Now just one other preliminary issue, Dr. Cannon. In your evidence at page one, lines 34 to 38, you refer to your presentation of written evidence as "part of the OEB's Review of its 1997 draft guidelines on a formula based return on common equity, which included procedures for an annual automatic adjustment of equity return in years when there is no general cost of capital hearing."
A. That's correct.
Q. So one of the things I was curious about was whether in fact I had properly located those guidelines and that is that first handout. So could you just confirm for me, please, that these March 1997 Ontario Energy Board draft guidelines are the ones referred to in your

evidence?
A. Yes, that's correct.
Q. Okay. I wonder if that can be marked Information No. -
MS. NEWMAN:
Q. 5.
BUTLER, Q.C.:
Q. - 5, thank you. On Information No. 5, your written pre-filed evidence also refers to the fact that you gave written evidence to the OEB on this. Now I know that you weren't able to produce that today, because I asked you for that too late yesterday. Can I just ask you a very high level question then, please, Dr. Cannon? And that is, relative to the written evidence that you gave on these guidelines, would that written evidence on these draft guidelines have any relevance at all to the recommendation you're making today in Hydro's case, namely to fix today the embedded cost of debt to be used in the proposed formula for '08, '09 and '10?
A. I don't think there's anything that I incorporated in that evidence, but I don't have it in front of me, and it's four years

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ago, that bears on whether the embedded cost of debt should be fixed or should change each year. In Ontario, I believe it does change each year, because new information is brought to the Board, not in a hearing process, but as part of the updating of the return on equity.
Q. Yes.
A. The general information that's brought to bear on that is also used, I believe, in updating the debt cost as well. I'm sure the Board understands that the situation in Newfoundland is quite different than the other jurisdictions in Canada. In Newfoundland, the procedure has been to regulate the return on rate base, and whereas in the other jurisdictions, the focus has been on the return on equity. So the work that I did on the return on equity isn't directly transferable to return on rate base. I mean, the background material about forecasting interest rates and looking at capital structures of utilities and the impact on revenue requirements and all of that carries over, but the specific formula is different in Ontario and at the NEB than it is in

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Newfoundland.
(2:00 p.m.)
Q. Yes, okay. So I'm going to accept what you've indicated and that is that going by your memory, you do not believe that there was anything in the written evidence which is referred to in the pre-filed here today that would have touched on the recommendation that you're making with respect to the embedded cost of debt for Newfoundland Hydro?
A. I believe that's true.
Q. Can I also ask you then, finally on that point, given that these were marked draft guidelines and that you actually made written submissions, written evidence submissions relative to their review of it, is it also your understanding, Dr. Cannon, that at the end of the day, the OEB released an order and the one I found was in relation to Union Gas and Embridge Gas, which essentially confirmed the draft guidelines without change?
A. That's correct.
Q. Okay. So -
A. If I can give just a little background on that, the draft -

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Q. Before you do though, can I just make the point then that the one that we've just entered, Information 5, would be in effect today, as far as you know?
A. Yes. Yes, I believe that's true. I have to qualify that because I was involved in advising the Ontario Energy Board with respect to the original 1997 draft guidelines.
Q. Yes.
A. And curiously, the word "draft" stayed on that, it seemed, forever. Then I was asked to come back as one of the participants in the hearing in 2003 to basically the utilities themselves initiated that hearing because as interest rates were coming down, they felt that they were being pinched and they wanted to revisit the issue, and the Board asked me if I would come and revisit what I had done before. So we batted around a couple possible suggestions, but in the end, as you noted, the Board decided to make no change in the formula. They were happy with the procedure. Now, I believe that during 2006 they also initiated another review. And they also asked me would I come back and look at my own work

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for the third time. And it happened at a time when I just wasn't available. So, I believe that they have another review of this, but I'm not aware of decision that has come out of that.
Q. The decision that came out of the review which is referred to in your own evidence filed here today, I gave you this morning just for information purposes, and you're satisfied that that was the right order, the one that I showed you?
A. Yes, but I'm satisfied that the Board made no change, the Ontario Energy Board made no change in 2003.
Q. Thank you very much. So, I'm going to return to Ontario and other jurisdictions a little later in my cross-examination. Thank you. Dr. Cannon, do you accept that historically, in this Province, unique as we are, that Utilities does not have their costs reviewed every year, but under normal circumstances, every two to three years?
A. Yes, I'll accept that.
Q. For example, the rates currently in place for my client are rates that were based on a

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revenue requirement that was estimated in 2003 for the test year, 2004.
A. Yes, as far as I know.
Q. And of course, the revenue requirement is based on forecast costs?
A. Correct.
Q. I wonder, to be specific, can we look at Schedule 3 of Mr. Bradbury's original evidence, page 2 of 2. The reason why I pick this, Dr. Cannon, is because it does show a comparison of '04 and '07 test year costs.
A. Which exhibit is this, please?
Q. Sorry. It's on the screen, but feel free to find your hard copy. Schedule 3 of Mark Bradbury's original evidence.
A. Okay, I'll take what's on the screen. Yes.
Q. If at any time during my cross, though, you wish to refer to a hard copy for your own notes or whatever, please let me know.
A. Thank you.
Q. So, the test year revenue requirement, 2004, first column -
A. Yes.
Q. - was based on expenses, the category is indicated there, operating expenses, forecast

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for 2004.
A. Yes.
Q. Do you agree with that?
A. Yes, yes.
Q. And a capital structure as well that was forecast for 2004.
A. Yes.
Q. Forecast rate base for 2004.
A. Yes.
Q. And forecast return on rate base for 2004.
A. Yes.
Q. Okay. Now, Mr. Bradbury revised the 2007 numbers which are shown there and the comparables in his evidence at Schedule A, page 2 of 2, that's the December filing. So, this is the one I want to focus on.
A. Okay, yes, I see those.
Q. He's just comparing the August to the December. In the category of operating expenses, to be clear, notwithstanding that Newfoundland Hydro did not come back for a rate increase between '04 and '07, it would have had to live within the revenue requirement which was established the 2004 test year forecast, correct?

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A. Yes.
Q. Now, here on line 26, we have the return on rate base figure. For the revised test year figures, it's 110,707,000?
A. Yes.
Q. To understand where that figure comes from, I wonder if we can just look at page 5 of 6 of Mr. Bradbury's evidence.
A. Okay, this was the original filing?
Q. No, this is the revised -
A. Oh, the revised December filing, yes.
Q. I'm just going to see if we can reconstruct where that hundred and ten million comes from. Okay. So, the forecast imbedded cost of debt which is in the December filing now just down below shown at 8.26 percent -
A. Yes.
Q. - a figure that you now agree with -
A. Yes.
Q. - is applied against the forecast debt, which is to the far left.
A. Far left?
Q. I'm sorry; I've gone ahead of myself. The forecast imbedded cost of debt is applied to the forecast debt for the test year to give a

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weighted cost of debt at 6.9.
A. Yes, I see that.
Q. Okay. And in turn, of course, we have the forecast, embedded cost of capital applied to retained earnings, right?
A. Yes.
Q. Now, going to the next part which is 6 of 6.
A. Yes, I see that.
Q. The 6.9 percent is carried forward.
A. Yes.
Q. And it is applied to the forecast rural assets.
A. Something, okay, 6.9 percent was what we saw on the previous--yes, okay.
Q. Applied to the forecast rural assets.
A. Yes.
Q. Okay, to get an allowed return and added to the forecast weighted average cost of capital to the other rate assets, et cetera, to get the revised allowable--I'm sorry, the rate of return on rate base and then the revised allowable range.
A. Alright.
Q. The figure that you see there to the far right, the 110.8 -

A. Yes.
Q. - is slightly off because of rounding of the two numbers above it.
A. Yes, okay, it should be 110.7.
Q. Right. In any event, that 100.7 or 8 finds its way back into line 26, the earlier Schedule A. The Schedule A, yes.
A. Yes, I see that.
Q. Okay, right there. So, in terms of the effect on the Utility between test years, Dr. Cannon, my point is only that not only does the Utility have to live with the figures between tests years for their operating expenses, that have been approved by the Board, but to the extent that the 110.7 appears here, it also has to live with the forecast it has made for the other factors that we just saw on pages 5 and 6?
A. That's correct, but at least, just for the test year. It's proposal would not have it live with its expected imbedded cost of debt for the years after 2007. The proposal would be to keep that number at 826 when the expectation is the imbedded cost of debt might be somewhat lower than that. So, it will live

with, I assume, that they'll, the company will have to live with the 110.7 million for the test year. It is not contemplating living with the expected imbedded cost of debt for the years beyond that.
Q. Well, my point is though, Dr. Cannon, that until Hydro comes back to the Board for a review of the revenue requirement which is on that schedule, the rates that are established using the test year are based upon the forecast operating costs, the forecast capital structure, the forecast rate base and the forecast return on rate base for a single test year.
A. That's correct, under the current regime, yes.
Q. Under the current plan. Now, do you acknowledge the benefits to rate payers of this type of regulation in only have rates set once every two or three years.
A. I acknowledge the benefit of reducing the costs that are associated with having annual hearings and by not having annual hearings we save a lot of money and the Board's time that perhaps can be spent in other productive activities. If it were not for those hearing

related costs, of course, economic efficiency would suggest an improved result, if indeed, rates and user rates were adjusted annually to reflect changing circumstances. So, it's the- -I certainly support the reduction in administrative costs and headaches and confusion and all that that comes with, if one can avoid having hearings every year, that's the primary benefit to the rate payers, to the extent that it exposes the company to risk or similarly, flip side of that, rate payers to risk that they are paying perhaps more than is necessary. Well, that's not a benefit to anybody.
Q. Do you accept, Dr. Cannon, that this Board in previous decisions for Newfoundland Hydro and Newfoundland Power has indicated three benefits essentially. The first, the one that you've just addressed. The second, rate stability.
A. Yes, certainly I would acknowledge rate stability as a benefit.
Q. And third, the opportunity for the Utility to achieve operating efficiencies during non test years.

A. Yes, but I would hope, as I've already suggested Mr. Bradbury would do with respect to financing costs, I would hope that all of Hydro's employees would be looking for efficiencies every time they turn the corner. I mean, I hope it's in the nature of people who are working for the utility to always be coming up with suggestions on how to improve things and reduce costs.
Q. Well, I wonder could we just go to the order P.U. 19 (2003), page 68 where this is discussed, it's a little further down. Yes, just before the bold print there, you'll see-- about five lines down, Mr. O'Rielly, thank you--the Board does not want, however, to discourage Newfoundland Power from continuing to seek efficiencies to lower cost and will focus primarily on those components that remain outside the control of the Utility. And then, of course, we've already acknowledged earlier today in your evidence the monitoring mechanism that the Board imposed on Newfoundland Power. So, are you disagreeing with what the Board has said there?

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A. No, not at all.
Q. Now, in the automatic adjustment mechanism that you proposed, relative to Mr. Bradbury's Schedule A to the December 2006 filing and again that Line 26 item, to the extent that the imbedded cost of debt found its way into that figure which we just went through from Tables 5 and 6 or pages 5 and 6 of Mr. Bradbury's revised evidence, you are suggesting that we substitute in there figures that we would forecast today for '08, '09 and '10, is that correct?
A. Yes. Well, for their respective years going forward.
Q. Yes, but in every other sense of this schedule you are not suggesting that we make any substitution or forecast for any other operating expense or other element that comprises the cost of service.
A. Well, first of all, I wasn't retained to examine the other items, the other lines on this exhibit. I was asked, by the Consumer Advocate, to evaluate the automatic adjustment formula whose impact is solely on the return on rate base. So, my focus was on that 110.7

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million and on what would likely happen to that number going forward. The company, in their response to CA 218, acknowledged that the cost base of that number was likely to be somewhat less in the years beyond 2007 and this, one of the major elements making that cost less was the expectation that we both have that when the major 200 million dollar refinancing comes about in 2008, that the rate on the new debentures that are issued will be, in all likelihood, significantly lower than the 5.5 percent that the company is currently paying. And we know for sure that there's going to have to be financing in 2008. That's something we know now. And we can make with the help of the company's financial advisors and partly, I guess, based on the forecast that I've made, we can make a reasonable estimate about what the refinancing will cost. We can, the company says four eight percent, I have forecasted 4.4 percent, Mr. Bradbury suggested that we aim at this through slightly different methodologies, but my bet is that their financial advisors used very similar methodologies to the ones that I used looking

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at the forward curve and seeing what the consensus forecast was in the marketplace.
So, this is something that we nowhere can reasonably forecast today that I think we shouldn't ignore. I think that we can, we ought to build that into the formula and build it in today and without any expectation that we're going to go back and revisit it in non-GRA years. Rather than building in an expectation that the company may over earn to the tune of somewhere between, let's say, 600,000 and possibly as much as two million in each of those years beyond 2007.
Q. I have two points following up from that answer, Dr. Cannon, if I might. First of all, if we can go back to my Schedule A please with Line 26 on it. Your point is well taken relative to the terms of your engagement. And that you were only asked to address, of course, one component of this, but isn't that, in fairness, exactly what Mr. Bradbury was saying when he suggested that the other numbers for the other years have not been subject to the regulatory scrutiny and thus, they are not test year numbers?

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A. The numbers above, line 23 and above.
Q. Yes, for the other years.
A. Yes, they, I gather, have not been subject to that regulatory scrutiny, although, I mean, I presume these numbers are part of the company's five year financial projection that's presented to the Board and if the Board had any questions about it or thought that they were unrealistic numbers or they couldn't base their planning, the old capital structure planning, on these numbers, the Board would ask you to refine the numbers and that sort of thing. But the point I made was that with respect to the item that I was asked to address, the components that go into the return on rate base, those forecasts for the embedded cost of debt have been subject to regulatory scrutiny. I worked over those numbers late into the evening, many evenings, asking myself how do I calculate them and are the company's calculations reasonable or not reasonable and we came back and dispute the numbers and the company came back and provided updates schedules. So I think this embedded cost of debt number has been given about as

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much regulatory scrutiny at this point as any number that would be used in this hearing for setting the rates, the consumer rates for the next for years--or at least setting the rates now that will stay in effect, subject to a triggering mechanism being triggered.

Q. However, the other components, they're shown on the screen, my point is have not been subject to the same regulatory scrutiny for '08, '09 and '10, they are not test year numbers, Dr. Cannon.

A. Well, I guess I could be sorry about that, but that wasn't--it's up to you guys to decide how much scrutiny you give to these numbers and how far you do in advance. What you're asking the Board to approve, though, is a formula that is going to apply to the weighted average cost of capital and the rate of return on rate base, and that formula is going to apply, unless circumstances change quite dramatically, that formula is going to apply for four years. And I think it's reasonable for us to look forward those four years and ask are the inputs to that formula reasonable? And I'm saying that a single number of 8.26

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percent for the embedded cost of debt, looking forward for four years, is not as reasonable a number as incorporating in the formula the expected embedded cost of debt that the company and I have basically come to an agreement on.

Q. Well, I'll leave it with that, just to make the one slight clarification on what you just indicated, that of course what you and Mr. Bradbury have agreed upon is that based on what you know today, your best forecast for '08, '09 and '10 are these numbers, not what you know will actually happen in those three years.

A. Yes, I accept that.

Q. Now is your proposed methodology, though, akin to setting separate revenue requirements for '08, '09 and '10, with the only number being changed here on the screen, being the embedded cost of debt?

A. No, I think the company's proposed automatic adjustment mechanism is going to involve a change in the return on equity as well.

Q. Well we know that that is what it's aimed to do, of course, so aside from that, is it akin

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to having three other test years with the only factor changing being the embedded cost of debt?

A. No, I don't think that's a fair analogy. It's--we're setting today, we're establishing today, looking forward three years, what we think the embedded cost of debt--or looking forward four years, the embedded cost of debt is going to be. I don't think--it's terminology to say, you know, that that's--it certainly isn't--yeah, it's just semantics to call that three test years or four test years. We're setting up a formula for four years, why not input into that formula our best estimate of what the important numbers are. And I think we pointed out that to sort of have one component of the return on rate base, the return on equity component which amounts to seven to eight percent, only seven to eight percent of that number, to allow for that to be flexibly adjusted based on events as they unfold and to pretend that the 92 percent is going to be constant for that period of time, when our expectation is that indeed it will come down a little bit, really undermines the

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whole point of an adjustment formula. If you had said, all right, we think we ought to have an adjustment formula for transportation costs, all right, and you know, it's going to be set up this way, well then--not that that's my area of expertise, but I mean, we could have tested that too. The Board has asked Hydro propose an adjustment formula, an automatic adjustment formula, for line 26. They didn't ask for all these other lines. It's up to the Board. This isn't my area, but I mean, they could have asked for adjustment formulas there too, but the one that they asked for and the one that I've been asked to evaluate is the one that refers to line 26. The fact that the numbers in those other lines may be higher or lower in future years than the test year numbers, is something that apparently the Board hasn't seen fit to ask for more input on.

(2:24 P.M.)

Q. Well, I don't know, but anyway I hear your answer and I think I've very clear in terms of what you're asking the Board to do. Now, can you tell me whether the recommendation that

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you're making relative to the embedded cost of debt, is it something that you have recommended to any other regulator in Canada?
A. No, because it wasn't an issue before any other regulator where I was asked to evaluate the adjusted--asked to evaluate the automatic adjustment mechanism. I've only been asked to evaluate the automatic adjustment mechanism in Ontario and there is no issue with respect to whether the embedded cost of debt will be a fixed number or a number that changes each year. It's a number that changes each year.
Q. I have the Ontario draft guidelines here, the Information 5, and on page 1 of that and the paragraph which is headed up "The Adjustment Mechanism" and it says "Once the initial ROE has been set for each of the utilities as per the steps above, then a procedure must be put in place to automatically adjust the allowed ROE for changes in long-term Canada yield expectations." So as I understand it, they were just adjusting the ROE.
A. Within the formula for return on common equity, that's right. They were only focusing there on the return on common equity.

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Q. And they confirm on page 2 that they don't adjust the capital structure either for what it may be in the years between test years?
A. Can you refer me to the -
Q. Yes, certainly, I'm sorry. Page 2, the sentence that starts, "The capital structure should be reviewed only when there's a significant change."
A. That's correct, yes.
Q. Okay. Now, I don't purport to have your level of knowledge with respect to other jurisdictions, Dr. Cannon, but can you tell me relative to how others operate, is it true that other jurisdictions in Canada regulate on return on rate base and some on return on equity?
A. I don't know any that regulate on the basis of return on rate base. All the ones that I'm familiar with, it's return on common equity.
Q. One Newfoundland regulates on -
A. Yeah, well I acknowledge that earlier, yes.
Q. I wonder whether in fact--I thought I saw a reference to Alberta Pipelines as being regulated on return on rate base, you're not familiar with that?

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A. Alberta Pipelines, is there a company called Alberta Pipelines?
Q. I'm sorry, Alberta Balancing Pool.
A. No, I'm not familiar with their situation.
Q. Not familiar with that one, okay. All right, so we know that there are different ways of regulating and that we have to be careful from what jurisdiction we're drawing our information in order to be the most helpful to the Board, which I'm going to suggest to you is why Hydro went with the only approved formula that exists in this province for the other utility as a starting point. We also sent you yesterday the RBC capital markets, research industry comment from November of '05?
A. Yes, I have that.
Q. And because it's only for information purposes, can I just have it marked as Information 6?

MS. NEWMAN:
Q. Number 6.

BUTLER, Q.C.:
Q. In this information or commentary they discuss other formula based return on equities and

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specifically on the first page they're talking about the National Energy Board, BCUC, the AE, that's Alberta Energy Utilities Board, Generic ROE and, of course, Newfoundland Power's?
A. Yes, I see that.
Q. Okay. Are you familiar with any other jurisdictions in Canada that have automatic adjustment mechanisms?
A. Oh, yes, I'm familiar with all of the named jurisdictions here along with Ontario, but much more familiar with Ontario. When I was asked to evaluate Ontario's automatic adjustment mechanism for the return on common equity, I referred to the practices in the other jurisdictions. And while I don't have it here in front of me, we had a little spreadsheet, if you will, that showed the similarities and the differences across the different jurisdictions and some of those differences became debating points and I know how the Ontario Energy Board came down on those issues. I couldn't, without that spreadsheet in front of me, just tell you what the differences are between, let's say, BC and Alberta.

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Q. Okay, that's grand. What we do know, though, as being a difference that exists between different formulas is that some jurisdictions use forecasts in terms of their adjustment and others use actual.
A. Okay.
Q. You agree with me?
A. Right off the top of my head I can't tell you any jurisdiction that uses actual. I thought they were all forecast.
Q. Well Newfoundland uses actual.
A. All right. All right.
Q. You agree with that, for Newfoundland Power?
A. Well based on setting the return on common equity it's the -
Q. Trading.
A. It's the provincial credit spread added on top of the actual Government of Canada yields for particular -
Q. Dates?
A. Dates, yeah. Okay.
Q. Relative to your experience and in Canada can you tell me, in your 25 years of doing this kind of work -
A. Now I know I'm being set up here.

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Q. Have you ever seen a regulator determine a revenue requirement for a single test year but adjust the embedded cost of debt for subsequent non-test years only and not adjust the other factors that go into the revenue requirement?
A. Can you try it again, just the question again?
Q. Have you known of a regulator that determines the revenue requirement for a single test year, as we do, but adjusts the embedded cost of debt for subsequent non-test years?
A. No, I'm not familiar with--I haven't looked at anyone where I can say, yes, that's what they were doing.
Q. I want to talk a bit about Newfoundland Power's formula. Are you aware that this Board does not rely on forecasts of interest rates when it sets the ROE for Newfoundland Power using its automatic adjustment mechanism, the point I was making a moment ago?
A. Yes.
Q. Okay, and I wonder if we can look at P.U. 19, please? 49 to 50 is the pages where this is discussed. I'm sure from your answers to some

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RFIs, Dr. Cannon, that you had a chance to look at this. Would you agree with me that this Board concluded that using forecasts was not a superior model to using actual yields?
A. I have to admit that this was not a topic that I focused on. I don't recall reading about that debate, I was never directed toward that debate, so I just, I can't comment on that.
Q. Okay. Can we just scroll down, Mr. O'Rielly, please, to see if we can get to the end of this discussion. Yeah, the next page, please. I don't know if I can find an exact sentence there, but okay, that's fine if you didn't focus on it. Would you agree with me, Dr. Cannon, that past experience has demonstrated that actual interest rates can turn out to be different from forecasts?
A. Yes, obviously.
Q. And in the same order, P.U. 19, at page 66 that the Board compared forecasts and actuals between 1999 and 2002. Now, for example, in 1999 the Board is showing here in its table that all forecasts were less than actual, as it happened, and in--yeah, the next year, all forecasts exceeded the actual yields?

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A. Agreed.
Q. Okay, so forecasts made today by yourself and Mr. Bradbury relative to the embedded cost of debt for '08, '09 and '10, as good as both of you are, could, in fact, be off?
A. They could, in fact, be off, yes.
Q. Now I understand your concern for the potential for over earning by the utility. And this is addressed at page 6 of your testimony, lines 15 to 22.
A. Yes, I have that.
Q. Okay.
A. Page 6 I think you--didn't you reference page 6? Is this page 6 here? Oh, yes, it is, okay.
Q. And this is why Mr. Bradbury very kindly did that one-page schedule that you addressed this morning, the MGB-5 in which he showed that even if, despite the fact, as we've just indicated, that even the best forecasters in the world could be off in terms of yields, even if the cost, the embedded cost of debt for 2010 does come in at 8.21 instead of 8.26 which we want to embed, it would mean that the utility in that year would have $600,000 more

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in earnings?
A. Yes.
Q. Okay. My point is that relative to--I'm sorry, Terry, can you go back to that screen, please? The total revenue requirement of 431 million, I mean, that really is a drop in the bucket, isn't it, Dr. Cannon?
A. Well this example talks about a deviation between the fixed test year cost of 826 and 821.
Q. Yeah, assuming it actually happens to be?
A. Assuming that. Which is not insignificant, but it's not an enormous number. But I thought the whole point of our discussion here was establishing the proper formula, the justifiable formula for perhaps many years in the future. And just because the forecast--the difference between our forecast and the test year embedded cost of debt is five basis points for 2010 doesn't mean that in some future year that difference might be much larger and the impact on the company's earnings might be much larger, might be a much greater over earning. So my concern, I think we talked earlier, I mentioned earlier that if

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I'm a ratepayer, 600,000 is 600,000 and if that doesn't have to be built into my rates, I don't want it built into my rates. But I think the bigger issue is the principle, the bigger issue is let's get the formula right and so that when the differences are greater one way or the other--remember, I'm contemplating that it might very well be in years beyond the term of the automatic adjustment mechanism we're talking about right now, it might be that all of the witnesses agree that the embedded cost of debt will start going up, right, and it would penalize Hydro to have a fixed rate. And I don't think the Consumer Advocate or anybody else wants Hydro to be penalized, to be squeezed in that situation where we know ahead of time that the embedded cost of debt is going up but we can't incorporate it in the revenue requirement and therefore Hydro is forced to cut back and on other, you know, necessary maintenance or whatever to stay within the revenue requirement. So my proposal cuts both ways. It just happens that in the current situation the expected embedded cost of debt is on a

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small downward trend, our best expectation, at least. In some future general rate application it might very well go in the opposite direction.
Q. I understood perfectly from your answers to Mr. Johnson's questions that you were concerned about the future, Dr. Cannon. And I want to focus you back on the reality of this application. And I want to ask you, relative to this $600,000 potential difference in earnings, even if the embedded cost of debt in 2010 did come in at 8.21 percent, is it at all relevant to you that Hydro's margin, based on the rate application, is like $8 million with a return of approximately four percent?
A. Well again, I wasn't engaged to look at that broader picture of what kind of safety margin Hydro should have or would not have and what, you know, deferral accounts that they might have available to them to cover unexpected expenses and breakdowns and that kind of thing, so it's really not something that I was asked to adjudicate. I don't feel comfortable saying, you know, give Hydro a freebie 600,000 so that they can make up for unexpected things

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in other areas.
Q. I accept your answer. But it wouldn't take much, would it, based on your 25 years of experience in this business, for a utility to have a bump of $600,000 in any given year?
A. That's correct.
Q. In the same order, P.U. 19 (2003) Mr. O'Rielly. As I think you've already acknowledged, the Consumer Advocate and Grant Thornton, on behalf of the Board, did express some concern relative to how Newfoundland Power's formula had operated in the three years prior. And at page 68 the Board made its conclusion, you'll see it there in bold print, that instead of doing what you're suggesting now, and that is embed a cost of debt for future years beyond the test year, it would require Newfoundland Power to modify the schedule filed as part of its annual return specifying the causes of variations in the actual embedded cost of debt from the cost forecast for the test year period. Now I know you've already said today you agree with that reporting mechanism?
A. Oh, I said it would provide some, but perhaps

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only limited comfort to the ratepayers. And it's an after the fact adjustment, it puts the Board to a lot of extra work and if the Board decided that the differences were significant enough to act on, the rate adjustments and that sort of thing are bound to come 18 months after the fact, and it's a messy protection, I would think. Much better to anticipate that it's likely to happen and to force--or reduce the chances that this will happen by building in our best forecast of what the embedded cost of debt will be.

Q. Okay, so I know you're not saying that this is something that you simply accept. You acknowledge that it's okay for Hydro to do it as well, but -

A. Yes.

Q. - my question is, given that the Board, in light of the same concerns being stated to them in Newfoundland Power's hearing and with the benefit of three years experience in which Newfoundland Power had, in fact, had lower embedded cost of debt than what had been in the formula, for purposes of regulatory consistency and fairness why shouldn't the

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Board make the same order for Hydro?

A. Well two responses to that. First of all, the Board, as I understand it, can only deal with the evidence and the suggestions that are put to it at the time. And the remedies that were offered at Newfoundland Power's, you know, 2003 general rate application were ones that did offend two of the Board's principles, and so I sympathize with the Board saying, no, we don't want to go with those remedies. So I've offered a different remedy that I believe doesn't offend those principles, does not ask the Board to come back and hear new evidence and act in years that are outside of the general rate application years. So that's one reason why I think that the decision that the Board made in 2003 isn't necessarily, doesn't carry over today. And the other is that decision was with respect to Newfoundland Power, whose circumstances, you know, in terms of capital structure, in terms of return on equity are different than Newfoundland and Labrador Hydro. So I emphasized before that I believe the Board ought to make its decision on Hydro's automatic adjustment mechanism in

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the light of Hydro's circumstances, Hydro's capital structure, Hydro's return on equity. The proportion of the return on rate base that is determined by the embedded cost of debt, which we've agreed is in excess of 92 percent of the number, and Newfoundland Power is another case for another hearing.

Q. Okay, well two questions flowing from that and I think I'm finished. First of all, you seem to have taken from P.U. 19 (2003) that the Board was concerned about having to modify the formula annually by what you say is coming back and revisiting the issue as opposed to another possible interpretation of their concern about having to modify the formula by embedding now forecasts for '08, '09 and '10 So I'm not certain that your interpretation is correct.

(2:45 A.M.)

A. Well I took my interpretation from the words that said automatic adjustment mechanism "if once a formula has been established," all right, "the Board were to use variations from forecasts." I'm not asking the Board to use any variations from forecasts of requirements.

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"To adjust various formula components as they change." I'm not asking the Board to adjust anything as variances happen or as things change. I'm asking the Board to adopt the best forecast that we can make this year that Hydro and I have, you know, expressed some agreement on and build that into the formula and that would be the formula and there wouldn't be any adjusting things as variances appear. The formula would stay in place until and if the triggering mechanism was triggered.

Q. Well I won't belabour the point, but there are some, me included, who might argue that that's worse, because now you're trying to embed into the formula something which may happen four years away.

A. Well the alternative is to embed into the formula the assumption that nothing is going to change.

Q. Yeah, that's right, which is -

A. And that may a worse evil.

Q. Well, at least it's consistent. The other thing that flowed from your answer, Dr. Cannon, was the point that you make about the difference in the capital structure between

the two utilities. And let me ask you this, is that not reflected in the difference in the early trigger point that Mr. Bradbury discussed?
A. Oh, that's a completely separate issue. I acknowledge and applaud the Company for recognizing that the trigger point for Hydro would have to be different than the trigger point for Newfoundland Power to--otherwise if they used the same trigger point as Newfoundland Power, the triggering mechanism would fire off, if you will, more frequently than I think would be desirable from the Board's point of view.
Q. Yeah, but it is related to the fact that they have different capital structures?
A. Yes, that's the source of the problem there, as well.
Q. Okay. Thank you, very much, Dr. Cannon.
A. Thank you.
Q. Those are my questions, Mr. Chairman.
CHAIRMAN:
Q. Thank you, Ms. Butler. Mr. Coxworthy, do you have any cross-examination in the absence of your colleague?

MR. COXWORTHY:
Q. No questions for Dr. Cannon. Thank you, Mr. Chair.
CHAIRMAN:
Q. Thank you. Mr. Kelly?
KELLY, Q.C.:
Q. Thank you, Chair. Dr. Cannon, I take it from your answers to Ms. Butler that you were really asked to look at only one rather narrow question here about this question of embedding the cost of debt. That's correct, am I?
A. No. I was originally asked to look at a broader set of issues, but I believe the only one of those issues that wasn't settled was the issue of the automatic adjustment mechanism and whether the embedded cost of debt would be a constant number or not.
Q. Fair enough. But in relation to that issue you really haven't addressed yourself to the implications of what you're suggesting for the whole regulatory process itself. Would you agree with that? In other words, you haven't looked at if we go down this road of modifying one component of the revenue requirement, what the implications are for the regulatory

framework in this jurisdiction?
A. Well when I was doing my reading, I early became aware of the fact that regulating utilities on the basis of the return on rate base involved a different set of considerations than regulating the utility on the basis of return on common equity. But yes, I did not--I was not asked to investigate should the non-capital cost components of the revenue requirement be managed in some other way. That's not my expertise at all.
Q. But you weren't asked, you didn't do it, which is fair?
A. Yeah, I didn't look beyond the capital cost components.
Q. Okay. In questioning from Mr. Johnson you talked about the fact that the interest rates from Hydro's first filing to what now are in the--now is in the evidence, have changed, and you suggested that that was part of the testing process which had gone on. Did I get your answer essentially correct?
A. Yes, that's right.
Q. Okay. Can I suggest to you, though, that what really happened was not that Hydro has done

something different with its interest forecasting now versus what it did six or eight months ago, but those interest forecasts changed over that six or eight month period?
A. I can't swear to that being the only thing that went on inside the financial department at Hydro, but that would certainly be a major aspect of it, that over that period of time the forecasts from their financial advisors and others were coming down.
Q. Right, so over a period of six or eight months we had a substantial change. And it is certainly not inconceivable and perhaps even probable that six or eight months out from now interest rates will be different than what we're forecasting today?
A. Yes, that's possible.
Q. Now you understand that in this jurisdiction we have a forward test year regulatory framework, correct?
A. Yes.
Q. And interest costs or debt costs would be only one of those components of a revenue requirement?
A. Yes.

Q. So that if theoretically one is going to start adjusting debt costs by trying to forecast out next year and the year after, one could apply that same principle, that same approach, to forecasting other expenses, couldn't one?
A. Yes, conceivably.
Q. In other words, one could start trying to forecast what your depreciation expense will be in '08, '09, '010, etcetera?
A. Yes.
Q. One could do the same for fuel?
A. Yes.
Q. One could do the same for salaries and operating expenses?
A. That's certainly conceivable.
Q. Right. So if we went down that road, then the regulatory process, if we tried to do that for each and every one of them, then when we come in to one of these general rate applications, we would be trying to not only do one test year, but we would be trying to forecast out any number of years into the future, correct?
A. I guess that's, yes, that would be correct, yes.
Q. And some jurisdictions, for example, have

taken the approach, well, we'll apply some escalator to expenses, don't they?
A. I think so. I'm not familiar with which ones, though.
Q. Right, and I take it from your answer to Ms. Butler you're not familiar with the recent Ontario Energy Board report on cost of capital released in December of 2006?
A. Yes, I haven't see that.
Q. No, okay. And I take it from all your answers to Ms. Butler that there is no jurisdiction in Canada that you're aware of that actually tries to forecast out for the purpose of its adjustment formula a future cost of debt?
A. That's because their adjustment formula doesn't include the cost of debt, it's the adjustment formula is forecasting the return on equity.
Q. Right, and I don't want to get into a debate with you as to what BC does and Alberta does and Ontario does. But none of those formula approaches actually try to change the--forecast a future cost of debt for inclusion in their formulas?
A. That's correct.

Q. All right. Okay. Thank you, Dr. Cannon, those are my questions.
CHAIRMAN:
Q. Thank you, Mr. Kelly. Ms. Newman?
MS. NEWMAN:
Q. I just have one question and it follows up on questions of my learned friend, Mr. Kelly. You've just agreed that in no other jurisdiction is this happening that you're aware of and you've stated that that probably is in part due the fact that we regulate on rate base rather than equity and I accept that.
A. That's correct.
Q. And we also, you know, it's obvious that this is--will be the first year for the implementation of an automatic adjustment mechanism for Hydro. So this would place, to my mind, us in a bit of a unique circumstance right now. And I'm wondering if you could comment as to whether you think there's any merit in the Board adopting something that it is familiar with, that has been tried in this jurisdiction, that has been used for a number of years, albeit in the context of

Newfoundland Power, but is there any merit that you can see in the Board using that formula as the guideline and moving forward perhaps considering the suggestion that you have?
A. When you say that the Board is familiar with the formula, it's familiar with it with the other utility and it has an opportunity to design and approve a unique formula for its other utility, for Hydro, in this case. And I think the choice boils down to building in a value today that we believe is not the best value for the debt cost going forward as opposed to building a value that we think is a better estimate of that debt cost going forward. And it just, it's just building it in today, it's just recording four numbers instead of recording one number. And the actual numbers, as everybody has emphasized, could deviate that--deviate from the four embedded cost of debt numbers that I'm recommending on either side, could be higher, could be lower. But in my view by building in instead of a constant or fixed embedded cost of debt for those four years, if we build in

the 826, the 823, the 820 and the 821, my belief is that the chance that those numbers prove to be wrong, there's an equal chance that those numbers will be too high and an equal chance that they'll be too low, rather than building a bias toward having Hydro over earn its allowed return on equity. So Hydro's a unique situation, Hydro, so much of the return on rate base is determined by that one number, to sort of pretend that that one number is going to be the same for four years as opposed to trying our best to estimate what that is for the four years is a little bit like burying our heads in the sand. I guess there's some comfort in saying well, we'll just--the one number we know or that we think we've got a better handle on is the test year number, and we'll not think about the numbers after that, but if you're going to design a formula that's going to be in place for four years, I'd want to think about what those four numbers are going to be, if they amount to 92 percent or more of the required return on rate base.

Q. Thank you. Those are all my questions, Mr. Chairman.

CHAIRMAN:

Q. Thank you, Ms. Newman. Mr. Johnson, any redirect?

MR. JOHNSON:

Q. Yes, thank you, Mr. Chairman. Dr. Cannon, who do you understand Grant Thornton to be?

A. I gather it's an accounting consulting firm that advises the Board on whatever the Board asks to be advised on.

Q. And do you understand that they're the Board's own independent financial consultants?

A. Yes, yes.

Q. And is it your understanding, Dr. Cannon, because there's been some discussion in the cross-examination by Mr. Kelly and Ms. Butler, that all we're interested in doing is adjusting for line 26 and forgetting the rest, but is it your understanding that Grant Thornton put forward a proposition for the Board as to that would work within the rate base regime in Newfoundland and Labrador, in terms of alternative suggestions as to how to go about the automatic adjustment mechanism?

A. Yes, and I specifically read about the ones that were put forward in 2003, I guess.

Q. Yes, and one of the alternatives that they put forward for the consideration of the Board was a revisitation annually of the embedded cost of debt? Is that your understanding?

A. Yes, that's right.

Q. And other than the issue of that involving a hearing and a process then each and every year, how does Grant Thornton, the financial consultants to the Board, possible suggestion to this Board differ from the one that you're putting forward to the Board?

A. Well, Grant Thornton's suggestion would have involved the Board receiving evidence and evaluating evidence each year, as I understand it, and making a decision each year. My proposal involves the Board hearing that evidence once, in this hearing, hearing the debate over what the interest rates are going to be for the next four years and making the one decision and the Board and the company and the ratepayers then live with that decision for the four years, unless the mechanism is triggered, adjustment is triggered.

(3:00 p.m.)

Q. Thank you very much, Dr. Cannon.

CHAIRMAN:

Q. Thank you, Mr. Johnson. Commissioner Whalen?

VICE-CHAIR WHALEN:

Q. Yes, I think most of my questions have actually been covered. I just have--in terms of the principle, and I thought I heard you say a while ago that it's the principle that's important here. In terms of the principle, if the embedded cost of debt numbers that we're looking at today, forecast out to 2010 or so, were 8.26, 8.69, 8.75, 9.21, would you still be putting forward this proposal to this Board?

A. I certainly would, because if we really believed that in rolling over the company's debt it was going to have to be rolled over at a higher interest rate and their revenue requirements for those years didn't reflect it, then I'm sure the company would be put in a bind, having to cut back on other necessary expenditures, maybe you know, short circuits on safety concerns or cut back on some needed capital spending that would be in nobody's interest. You wouldn't want to put them in

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that kind of bind. So to save money to pay the higher interest cost they had to, you know, stray from their budgets and the required capital spent.

Q. And also, in terms of the whole issue of fixing in a 2007 test year revenue requirement essentially go-forward numbers then for each of the next three or four years, would it also be true though that as we get closer to the end of 2007, we'll have a better idea as to whether the 8.23 is going to be 8.5 or 8.0? I mean, you know, that's what happened--we saw happen in this instance, the interest rate numbers were actually revised downwards. Because I'm just speaking more too to the point that you want us to approve or fix, somehow fix in this order a number to be put in a formula to be implemented in each of the next four years, but you want us to approve that number now. You don't want us to look at it on an annual basis?

A. No, because that runs afoul of what the Board felt was inappropriate in making the decision in Newfoundland Power three years ago, and it's true that as time goes on, everyone will

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get a better feel for how accurate the forecasts that were made in this hearing are going forward. I would not expect, just my view of what's going to happen to interest rates, very little changes in Newfoundland and Labrador Hydro's balance sheet until some time in 2008, when that refinancing takes place. So unless short-term interest rates skyrocketed up or went down, I think the forecast, up until halfway through 2008, is--the actual is not going to deviate very far from the forecast. It's what happens with this refinancing in mid 2008, and today, virtually everybody's expectation would be that those bonds could be refinanced for less than five and a half percent, but in a year's time, maybe we would not be so sure of that. But that to make adjustments then goes back into the Board basically having a mini hearing every year during the life of the mechanism.

Q. I'm not sure if this is what you were requested to review, but did you actually provide an opinion on whether or not an automatic adjustment formula was appropriate for Hydro's circumstance in this jurisdiction,

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or were you just commenting on the proposal itself?

A. I was mostly commenting on the proposal, and given that the Board had asked for a proposal to be put forward, I was mostly asked to evaluate that proposal rather than the issue of can we do without one. But when I look at it, if Newfoundland--I mean, I'm generally in favour of not having a hearing every year, which means you need some kind of automatic adjustment mechanism and I like to make that mechanism as realistic as possible. But if the Board were to adopt Hydro's proposal, how much adjustment is in that automatic adjustment mechanism is really, you know, problematic. I mean, only eight percent of the return on rate base is going to be adjusted. Over 92 percent of it is going to be fixed at a cost rate of 8.26. So the difference between, in that situation, between having no automatic adjustment mechanism and the one that Hydro is proposing is not all that great.

Q. Because the reality is, in the absence of an automatic adjustment mechanism for Hydro, the

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8.26 percent embedded cost of debt will be in place until Hydro comes back for another GRA. So whether we're talking 8.23 or 21 or 9 is irrelevant until they decide to come back, right.

A. Yes.

Q. So the automatic--this is only in the context of an automatic adjustment formula being established and put in place?

A. Yes, that's right, and my point was, if we're going to have one, let's do it right.

Q. Sure, okay. I appreciate that. Thank you very much.

CHAIRMAN:

Q. Thank you, Commissioner Whalen. I have no questions, Dr. Cannon. Anybody have any follow up on Ms. Whalen's?

MR. JOHNSON:

Q. Nothing arising, Mr. Chairman.

CHAIRMAN:

Q. Thank you very much, Dr. Cannon, for your testimony, and wish you a safe trip home. Hopefully it won't be another 39 years before you get back.

A. I hope not as well.

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Q. I suspect your visit this afternoon wasn't as enjoyable as 39 years ago in Petty Harbour in the meantime. Anyway, have a good trip back.
A. Thank you very much.
Q. Thank you. This brings to a close, I guess, this part of the proceeding here for this week. Tentatively, we have January the 29th, which is a Tuesday, set aside for a deadline for written submissions and February the 1st, Thursday, for oral submissions. We do have three requests from Labrador for presentations to us, in terms of public participation. We are in the process, I think it's fair to say, Ms. Blundon, that we're in the process of trying to talk to these three parties with a view to perhaps a more cost effective, to be honest with you, a more cost effective manner in which we might receive those presentations, as opposed to travelling to Labrador, and we're hoping that that's going to be sorted out relatively quickly, meaning this afternoon or tomorrow morning. It may be that we'll require some flexibility in terms of those dates in relation to that, depending on what we're able to work out. So if I could just

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reserve, at this point in time, a final consideration in any event of that until we see what we might be able to sort out.

We're talking about somewhere in the order, for those three presentations, about 20 to 25,000 dollars to travel to Labrador, if indeed everybody were to--I think, you know, all the parties perhaps, with the exception of the Industrial Customers, who wouldn't want to travel. So in any event, we're looking at some other avenues that we might be able to, like I said, receive those presentations.

So we will be getting back to you as quickly as possible on those, given that I recognize it doesn't provide much time between now and Tuesday and Thursday for those final submissions.

Any comment on that at all?

MR. JOHNSON:

Q. We'll just wait and see, from our perspective.

CHAIRMAN:

Q. Yes, okay. Want to thank you for your participation, I guess, during the week and certainly your cooperation. I think everybody has worked together with regard to timing, and

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like I said, there's a fair bit of work, I think, took place yesterday to get this through today. So, I thank you for your cooperation and indeed, we'll be in touch as quickly as possible, recognizing that your interest in trying to finalize this schedule, and we'll see you, one way or another, next week. Thank you.

(CONCLUDED AT 3:10 P.M.)

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CERTIFICATE

I, Judy Moss, do hereby certify that the foregoing is a true and correct transcript in the matter of Newfoundland and Labrador Hydro's Revised 2006 General Rate Application heard on the 25th day of January, A.D., 2007 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, NL this
25th day of January, 2007
Judy Moss