(9:06 A.M.)
CHAIRMAN:
Q. Thank you and good morning. Good morning, Ms. Newman. Are there any preliminary items before we get started?
MS. NEWMAN:
Q. No, Mr. Chairman.
CHAIRMAN:
Q. Okay, thank you. Sorry for the bit of a delay this morning. I guess, been corrected yesterday as to the time, the break is generally between 11 and 11:30 and I would just ask--that's not strict as far as I'm concerned. If anybody finds it more appropriate to go five minutes over or quit ten minutes before, that's fine. We're fairly flexible there. Just let me know and that'll be satisfactory. Having nothing else, I don't think--I think the transcript has been circulated, the hard copy. I'm advised by the Board Secretary that there are a couple of errors in terms of names and that and nobody should be offended, they'll be corrected in due course. And that's it. Mr. Kelly, good morning, and if you wish to introduce your

witness and then I'll swear him in after.
KELLY, Q.C.:
Q. Thank you. Good morning, Chair, Vice-Chair. The witness this morning is Mr. John Browne of John T. Browne Consulting.
CHAIRMAN:
Q. Welcome, Mr. Browne. Good to see you again.
A. It's a pleasure to be back.
MR. JOHN BROWNE (SWORN)
CHAIRMAN:
Q. You may begin, Mr. Kelly, when you're ready, please.
KELLY, Q.C.:
Q. Thank you, Chair. Mr. Browne, would you please explain for the Board your background and experience?
A. Yes. I'm a chartered accountant and an economist. I have over 20 years experience working with rate regulated enterprises. During that time, I've appeared before a number of Canadian regulatory tribunals and arbitration panels as an expert on accounting costing and financial issues. I recently chaired the CICA study group that produced the research report "Financial Reporting by Rate

Regulated Enterprises." More extensive discussion of my background is included in my resume, which I've included as Exhibit 1 to my report.
Q. And I understand that you have testified before this particular Board before?
A. Yes, I have.
Q. Now you have prepared a report dated September 28th, 2005, and that has been filed with this application?
A. Yes.
Q. And do you adopt that report as part of your evidence in this proceeding?
A. Yes, I do.
Q. Okay. Now let's start by just having you briefly explain what Newfoundland Power asked you to do in relation to this application.
A. Yes. To assist Newfoundland Power with its accounting policy application, Newfoundland Power asked me to address the following issues: the relationship between regulatory accounting policies and generally accepted accounting principles; the accrual versus the billed method for recognizing revenue; the treatment of unrecognized, unbilled revenue at

the end of 2005; and accounting policies related to Newfoundland Power's transition to the asset rate base method.
Q. Now I'm going to pass over the accounting matters and the adoption of the accrual method and the transitional matters related to ARBN because they're not in dispute. Let's go directly to your evidence on the treatment of the unrecognized, unbilled revenue at the end of 2005, and let's start by having you explain what is meant by unbilled revenue at the end of 2005.
A. Yes. The unbilled revenue at the end of 2005 is the revenue for services provided at the end of 2005 that are billed in 2006. That amount is estimated to be approximately 24. 3 million dollars. Now under the billed method that's currently being used, the unbilled revenue at the end of each year is recognized in the following year to reduce the revenue requirements or to cover part of the revenue requirements of that period. With the proposed transition to the accrual method, the issue is what to do with that unbilled revenue at the end of 2005.

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KELLY, Q.C.:

Q. Okay. Now you mentioned a moment ago unrecognized, unbilled revenue. Just explain what is meant by unrecognized, unbilled revenue at the end of 2005.

A. Yes. As ordered by this Board, Newfoundland Power set up the unbilled revenue increase reserve. It represents unbilled revenue that has been recognized in setting rates. So the net unrecognized, unbilled revenue at the end of 2005 will be the 24.3 million I just spoke of less the 295,000 in this account or approximately 24 million dollars.

Q. Okay. Now what principles, what regulatory principles are relevant to the treatment of the unrecognized, unbilled revenue at the end of 2005?

A. The key principles that are relevant to the treatment of the unrecognized, unbilled revenue are the cost of service standard, the principle of intergenerational equity, the principle of rate stability and predictability and the financial integrity standards. These principles and standards are discussed in my report.

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Q. How is Newfoundland Power proposing to treat the unrecognized, unbilled revenue at the end of '05?

A. Of the 24 million dollars of unrecognized, unbilled revenue at the end of 2005, Newfoundland Power is proposing that 9. 6 million be used to cover costs to be incurred in 2006. With regards to the remaining 14. 4 million, Newfoundland Power is proposing that this Board deal with the disposition of this amount at its next GRA, which is expected to occur in 2006.

Q. Is Newfoundland Power's proposal consistent with established regulatory principles?

A. Yes, it is. The proposal is consistent with the cost of service standard. The unrecognized, unbilled revenue, once it's collected, will represent cash collected from customers to cover the cost of service. For Newfoundland Power to take that into income would provide it more than a reasonable opportunity to cover its costs including a fair return, which would be contrary to the cost of service standard. In fact, what Newfoundland Power is proposing to do is to

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use the unrecognized, unbilled revenue to cover legitimate costs of providing service instead of recovering it through cash rates. Since Newfoundland Power is proposing to flow the benefits through to rate payers, its proposal is consistent with a cost of service standard.

The proposal is consistent with the principle of intergenerational equity, and in this case, what that essentially means is the rate payers who built up the unbilled revenue should receive the benefits of the unbilled revenue. From a practical point of view, that means that the unrecognized, unbilled revenue should generally be used to the benefit of rate payers as soon as is reasonable, and I'd emphasize the term reasonable. The principle of intergenerational equity is not the only principle that should be considered.

Now, Newfoundland Power is proposing that 9.6 million of the unbilled, unrecognized-- sorry, unrecognized, unbilled revenue be used to cover costs in 2006 thereby flowing through the benefits almost immediately through to rate payers. That 9.6 represents the build up

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of the unbilled revenue over the period of about the last 10 to 20 years. Now with regards to the remaining 14.4 million, I do not believe that the principle of intergenerational equity is all that significant. The reason for that is the customer base 10, 20, 30, 40 years ago is significantly different than the customer base today. So flowing through the benefits today for way back then is probably, you know, you don't have that linkage that you have with amounts that were built up recently.

(9:15 A.M.)

Now another point with regard to intergenerational equity that the Board should consider is that an amount of the unrecognized, unbilled revenue should be allocated to each of 2006, 2007 and 2008 sufficient to cover the income tax on the unbilled revenue pursuant to the tax settlement. In accordance with the principle of intergenerational equity, the cost, the income tax cost of the unbilled revenue should be covered for those rate payers that benefit from the unbilled revenue.

Page 9

MR. BROWNE:

Newfoundland Power's proposal is also consistent with the principle of rate stability and predictability. This Board should be concerned that the recognition of the unbilled revenue does not create rate instability. The use of those unbilled revenues will allow for reduction in rates, but it will eventually run out and when it does, rates will have to increase. And the Board should be concerned that that increase does not result in rate shock or rate instability. Newfoundland Power has indicated to me that it is unlikely its proposal will contribute to rate instability.

Newfoundland Power's proposal is consistent with the principle of--or the financial integrity standards. Covering costs with unbilled revenue, rather than cash rates, will decrease Newfoundland Power's cash flow and increase its financing requirements. This could jeopardize its financial integrity and increase its perceived risk. This could lead to higher interest costs, a higher cost of equity, and of course, those costs would be

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passed on to rate payers. And in the extreme case, it could even jeopardize the ability of the Utility to attract capital necessary to provide regulated service. Now Newfoundland Power has indicated that its proposal will not have materially adverse effects on its financial integrity or its ability to attract capital.

Q. What are the costs that constitute the 9. 6 million that Newfoundland Power is proposing to cover in 2006 with the unrecognized 2005 unbilled revenue?

A. The 9.6 consists of essentially three types of costs: first, approximately three million for tax on the unbilled revenue pursuant to the tax settlement; two, approximately 5.8 million for depreciation expense that was previously covered by the depreciation true up; and three, approximately 1.2 million for the increase in depreciation expense in 2006.

Q. Is it reasonable for the Board to approve the recovery of these costs?

A. Yes. Newfoundland Power's proposal to recover the specific costs that we've just discussed is reasonable. These costs are necessary

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costs of providing regulated service. For the most part, they were not contemplated in setting existing rates. By that, I mean they were not considered in developing a revenue requirement on which existing rates were based. The amounts are material and evidence supporting these costs is either being presented as part of this proceeding or has previously been provided to the Board.

Now a point I would like to emphasize, dealing with these specific costs covered by the 9.6 million in addressing them, it is not necessary to have a GRA. If the 9.6 million didn't exist, presumably this Board would accept the existing rates for 2006 as just and reasonable in covering the estimated cost for 2006, excluding the 9.6 million. And it's likely that it would arrive at that conclusion without a full GRA.

Now what Newfoundland Power is proposing, they're proposing first that the existing rates--essentially that the existing rates for 2006 cover the estimated cost for 2006, excluding the 9.6 million, essentially the same thing. In addition, they're asking the

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Board to approve the recovery of approximately 9.6 million in costs that would be recovered through the unrecognized, unbilled revenue. Certainly the Board should ensure there is adequate support for those specific costs, but in doing it, it is not necessary to look at all of the other estimated costs for 2006.

Q. I'd like to look at each of the particular cost items. Can you elaborate on the taxes related to the unbilled revenue?

A. Yes. These are necessary costs of providing regulated service. They were not contemplated in setting existing rates. They were also material. And evidence has been presented by Newfoundland Power in this proceeding to support the recovery of those costs.

Q. The depreciation previously covered by the depreciation true up, would you elaborate on that?

A. Yes, and perhaps I'll just spend a moment to explain exactly what that is. In the last GRA, Newfoundland came forward with its estimated depreciation expense. It also provided evidence to this Board that its previous estimates of depreciation expense

MR. BROWNE:
were higher than required, and it was concluded that that excess recovery of depreciation should be returned to rate payers through a reduction in depreciation expense over a three-year period ending in 2005. That reduction has been referred to as the depreciation true up. Well, as we move into 2006, that true up will no longer exist, and so what is being included in that 9.6 is the portion of the 9.--of the depreciation expense approved by the Board in the last GRA that had previously been covered by the true up.
Now this amount has been tested. The Board reviewed that depreciation fully in the last GRA. It also reviewed the true up. The amount was clearly not contemplated in setting existing rates because those rates were based on the true up which will no longer exist, and the amounts are material.
Q. Would you elaborate on the forecast increase in 2006 depreciation expense?
A. Yes. The increase in the depreciation expense is a necessary cost of providing regulated service. Now on its own, it is probably not

material but as part of the 9.6, it is. Now I'm going to come to a point that distinguishes this cost from the other two costs that I just spoke of. In dealing with this one amount, the 1.2 million, it is reasonable that the Board would want to look at the revenue shortfall of the Utility in 2006.
Now this depreciation expense was not specifically included in the revenue requirements when existing rates were set. But it relates to capital expenditures which hopefully are related to new demand, related to new revenue, and therefore it might reasonably be argued that at least some of the increase in revenues from that increased demand would cover at least a portion of this expense, and for that reason, it may be reasonable for the Board to determine whether the 1.2 million is necessary in order for Newfoundland Power to be able to recover its costs and earn a fair return.
Now Newfoundland Power has provided evidence in this proceeding that its expected earnings in 2006 will be inadequate without

the opportunity to recover this 1.2 million. That evidence is not at the level normally provided in a GRA. However, Newfoundland Power's proposal is a practical approach that allows the Utility the opportunity to cover its costs, including a fair rate of return, and avoids the cost of a full GRA. And just concluding this point, I'd like to emphasize this only applies to the 1.2 million, and certainly is it appropriate to have a full GRA and incur all those costs to deal with this 1.2 million or would more limited evidence be appropriate, a practical solution that meets regulatory objectives?
Q. Now before allowing the recovery of costs, either through rates in the period or through a deferral account, is it necessary that all costs of the period be tested in a GRA?
A. No. Boards have an obligation to ensure that rates are just and reasonable, and in carrying out their responsibilities, they should be checking the cost and testing the cost and ensuring the costs are just and reasonable before allowing them to be recovered in rates. In many cases, boards do this by having full

rate reviews, such as occurs in a GRA. But there are a number of instances where boards, including this Board, have dealt with specific costs or changes in specific costs and allowed those to flow through to rates in the period or deferred them for recovery in a future period without looking at all of the other costs in the period. Let me give you a few specific examples.
The Automatic Adjustment Formula can change Newfoundland Power's cost of capital and that can flow through to a change in its rates. Those changes would occur without a full review of all of its other costs. The rate stabilization account--I'm sorry, the--yes, the rate stabilization account. Sorry, I sometimes get the name of these accounts mixed up. It allows for a flow through of costs and changes in that flow through of costs do get reflected in rates without a full review of all Newfoundland Power's other costs in the period. Gas utilities and sometimes electric utilities now have commodity variance accounts. The difference between the estimated and actual cost of gas is put in a

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MR. BROWNE:
variance account and is allowed to be recovered through a future revenue requirement. That change in rates is done without a full review of all of the costs in which--sorry, without a full review of all the costs in the period in which the costs were incurred. So there's an ample number of examples of where boards have dealt with specific costs or changes in specific costs without having to have a full rate review.
Q. And Mr. Meyers referred to a couple of examples in his evidence. Can you comment on those?
A. I'm certainly aware they exist. I haven't reviewed them in detail, but they certainly seem quite reasonable and not out of the--from what I've heard from the discussions, do not sound to be out of line with normal regulatory practice.
Q. Perfect, okay.
A. I have not reviewed those specific decisions in detail.
Q. Good. Now the concept of deferral of recovery of a cost until a future period, explain that

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to the Board.
A. Yes. Normally with cost deferrals what happens is the cost is essentially removed from the revenue requirements of the period in which it is normally incurred or which it is incurred and moved to a future period and included in the revenue requirements of that period. From a regulatory perspective, for all intents and purposes, it is now a cost of that future period. Now certainly, boards should test that cost, ensure it's a just and reasonable cost that should be recoverable from rate payers. They can do it when the cost is deferred or when it goes into revenue requirement. Personally, I believe it's usually preferable to do it when the cost is deferred. But the key point is, is the review is limited to the cost. When the cost is finally put into revenue requirements, you don't go back to the period in which it was incurred and say "how much did they earn in that period?" and if they did very well, you say "well, we're not now going to give you an opportunity to recover that cost." On the other hand, you don't go back to that period

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and say "well, you didn't do so well, therefore we will now allow you to recover a cost we would not otherwise allow you to recover." Yes, the cost is tested, but the test is limited to the deferred cost.
(9:30 A.M.)
Q. From a regulatory perspective, do you see any problem in deferring the 9.6 million in costs rather than using part of the unrecognized, unbilled revenue to cover those costs?
A. No, I do not. For all intents and purposes, there is no difference. Yes, there's a few technical issues that have to be resolved as Mr. Meyers spoke of yesterday, but I'm sure those could be resolved. So the end result is essentially the same. Let's say the Board decided to defer the 9.6. Presumably, you would also defer the full amount of the unrecognized, unbilled revenue of 24 million. Defer revenue of 24 million, defer costs of 9.6. The net amount available to offset future revenue requirements would be the 24 less the 9.6, 14.4 million.
Now let's go back to Newfoundland Power's proposal. They're going to use 9.6 million of

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the unrecognized, unbilled revenue to deal with that 9.6 million in costs and leave 14.4 million available to offset future revenue requirements. The end result is exactly the same.
Q. Now Mr. Browne, I'd like to turn next to look at some of Mr. Todd's evidence in his report and I'd like to start with this question, on pages 34 and 35 of his evidence, Mr. Todd claims that Newfoundland Power's proposed treatment of the 2.1 million in interest revenue arising from the tax settlement is not consistent with standard regulatory policies and practices.
A. No.
Q. Do you agree with that?
A. No, I do not.
Q. Okay.
A. I believe that Newfoundland Power's proposed treatment of the 2.1 million in interest revenue arising from a tax settlement is consistent with established regulatory principles and practices, and the regulatory environment in which Newfoundland Power operates.

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KELLY, Q.C.:

Q. Just explain now your understanding of how the 2.1 million in interest revenue arose?

A. When Newfoundland Power appealed its tax reassessment related to the unbilled revenue, it was required to deposit an amount with the Canada Revenue Agency equal to half the tax in dispute plus half the interest on arrears at the time of the reassessment. When the issue was resolved, the deposit was returned along with interest on the deposit of 2.1 million dollars.

Q. As a general rule, how is interest income treated for regulatory purposes?

A. As a general rule, utilities' rates are set on a prospective basis to cover the utility's revenue requirement. That revenue requirement equals the expected cost of providing service in the test period, including financing costs, and is net of the expected amount of any associated revenues in the test period.

Now as long as the utility is charging its allowed rates, the income flows to the utility and shareholders. Therefore, as a general rule, interest income is included in

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income in the year it is earned and flows through to the utility and its shareholders.

Q. From a cost of service perspective, what are the circumstances where it may be appropriate to defer interest income of a period and include it as a deduction in the determination of future revenue requirements?

A. From a cost of service perspective, it may be appropriate to deviate from the normal practice and to defer costs in revenues that meet the following conditions: first, the cost or revenues would normally be established--I'm sorry, the cost or revenues would normally be considered in establishing the utility's revenue requirement; two, the cost or revenues or at least the extent of the cost or revenues were not contemplated in setting rates for the period; and three, the amount of the cost or revenues to be deferred are material. In addition, there is often a requirement that cost or revenues be largely outside of the utility's control. This is to provide an incentive for the utility to manage the costs and revenues in those situations where it can exert significant control.

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Q. What would be the justification for deferring revenues and expenses that meet the above conditions?

A. The primary justification will usually be the cost of service standard. As set out in Exhibit 3 of my report, the cost of service standard states that a regulated utility should be permitted to set rates that allow it the opportunity to recover its costs for regulated operations, including a fair return on its investment related to regulated operations. No more, no less. Now if a utility incurs a legitimate cost of service that was not contemplated in setting rates, in setting current rates, deferring the cost is one way of providing the utility with an opportunity to recover the cost in accordance with a cost of service standard. Similarly, on the other side, if a utility receives revenue that would normally be deducted in arriving at its net cost of service, and that revenue is not contemplated in setting current rates, deferring the revenue is one way of ensuring the utility has a reasonable opportunity to recover only its net cost of

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service in accordance with a cost of service standard.

Q. In the case of the 2.1 million in interest income, have the three conditions for deferral that you set out been met?

A. No, they have not. The 2.1 million in interest revenue meets the second condition. It was not contemplated in setting the allowed rates charged in 2005. However, there's a question of whether the 2.1 million is material, especially in light of the excess earnings account that Newfoundland Power is required to maintain, an issue I will come back to later on. Now certainly, as a general rule, a utility would deduct ancillary revenue in arriving at its revenue requirement where the income is derived from assets or operations whose costs were recovered from customers through allowed rates. Now the reason for this is that if a utility has an opportunity to recover all of its costs associated with an asset or operations and in addition is allowed to keep revenues derived from those assets or operations, it will have an opportunity to recover more than its cost

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MR. BROWNE:
of providing regulated services, including a fair return. This would be contrary to the cost of service standard. However, Newfoundland Power has not had an opportunity to recover from customers all of the costs associated with a tax reassessment. In particular, certain costs incurred in 1995 and 1996 were not included in the determination of electricity rates.
Q. Now in Mr. Todd's report, in footnote 47, he sets out an alternative premise that in the absence -
CHAIRMAN:
Q. Mr. Kelly, could you just wait until we get that up on the screen, please, if you don't mind?
MR. MCNIVEN:
Q. What page is that?
A. It's towards the end, it's footnote 47.
MR. ALTEEN:
Q. Page 31.
KELLY, Q.C.:
Q. 31. There it is.
CHAIRMAN:

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Q. Thank you.
KELLY, Q.C.:
Q. We'll just take a moment while the Board has an opportunity to have a quick look at 47. Now, Mr. Browne, in that note, Mr. Todd sets out an alternative premise that "in the absence of a GRA, total revenues are deemed to be sufficient to recover total costs and revenue charges every year and that it can be said that customers therefore bore 100 percent of all costs related to the tax dispute. If the Company's rates were insufficient to recover all of its costs, it would have been entitled to seek an increase in rates by filing a GRA." Do you agree with Mr. Todd's alternative premise?
A. No, I do not. Failure to include costs in the revenue requirement of a period does not mean the utility has had an opportunity to recover the cost from rate payers. There are a number of reasons why legitimate costs would not be included in the revenue requirement of a period. One, a utility may not have been able to anticipate certain legitimate and prudent costs of service in time to file a GRA or a

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utility may have reasonably expected that its regulator would defer certain costs. Another possibility is that the costs were not sufficiently material to justify a GRA. As the Board is well aware, GRAs are not only time consuming and disruptive to a utility's operations, they're very expensive. They can cost well in excess of a million dollars. These costs are passed on or ultimately passed on to rate payers. As a result, boards may not look favourably on GRAs to deal with relatively minor revenue deficiencies, that is relative to the cost and effort associated with a full GRA.
Q. In your opinion, would it be reasonable under the cost of service standard for this Board to defer the 2.1 million and consider this amount as a deduction in setting future revenue requirements for Newfoundland Power?
A. No. Based on Newfoundland Power's analysis, even with the 2.1 million received in 2005, it will not have had an opportunity to fully recover the costs associated with the tax reassessment. According to that information, Newfoundland Power incurred costs related to

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tax reassessment in 1995 and 1996 and that it did not have an opportunity to recover it. According to Newfoundland Power's calculations, the present value of these costs exceeds the present value of the interest related to the tax reassessment, including the net amount of interest on the tax deposits received in 2000 and 2001. It would not be reasonable to defer the 2.1 million and at the same time ignore the costs from 1995 and 1996 that Newfoundland Power has not had an opportunity to recover. The present value of these costs, net of interest income previously received, is greater than the 2.1 million.
Q. Are there any aspects of Newfoundland Power's regulatory environment that you consider significant in addressing this interest revenue issue?
A. Yes, there are, or yes, there is. Unlike most other utilities, Newfoundland Power has an excess earnings account. At the current time, whenever its rate of return on rate base exceeds 18 basis points above the mid range of its allowed return, the excess earnings are placed in the excess earnings account. Now

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MR. BROWNE:
I'd like to put that 18 basis points into context. That is less than 1.5 million dollars. It is less than five percent of Newfoundland Power's projected net income in 2005.
Now in dealing with the excess earnings account, this Board determines how that balance will be treated. For example, when Newfoundland Power received interest on its tax deposits in 2000 and 2001, the income pushed Newfoundland Power above its maximum allowed return, and in effect, a portion of the interest was added to the excess earnings account. In accordance with Board orders, the amount was subsequently rebated to customers. Therefore, it appears the Board already has a mechanism for protecting customers and dealing with revenues that are material, were not contemplated in setting rates and would normally be considered in establishing a utility's revenue requirement.
Q. Mr. Browne, does that conclude your testimony?
A. Yes, it does.
Q. Thank you.

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CHAIRMAN:
Q. Mr. Kelly. Good morning, Mr. Johnson.
MR. JOHNSON:
Q. Good morning, Mr. Chairman.
CHAIRMAN:
Q. When you're ready.
MR. JOHNSON:
Q. Good morning, Mr. Browne.
A. Good morning, Mr. Johnson.
Q. My name is Tom Johnson, I'm Consumer Advocate in these proceedings. Could I ask you to turn to page 16 of your report?
A. Yes, I'm there.
Q. I'm not. Hold on.
KELLY, Q.C.:
Q. We must wait for the Board to get there.
(9:44 A.M.)
MR. JOHNSON:
Q. Page 16 under the topic, under the heading "Cost of Service Standard", or before that, actually, under "Regulatory Principles", you note "The key regulatory principles relevant to the issue of the UUR are the Cost of Service Standard, the principle of intergenerational equity, the principle of

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rate stability and predictability and financial integrity." And you note in at least some cases these principles may conflict with the other. So, do I understand you to say that all of these principles are relevant to the proposal of Newfoundland Power to use 9.6 million of the unbilled, unrecognized revenue to reduce its revenue requirement?
A. These principles in particular dealt with how to deal with it. I believe they're also relevant to the specific costs covered by the unrecognized, unbilled revenue also.
Q. Okay. So, just to be specific, all of these principles are relevant to Newfoundland Power's proposal to use 9.6 million of the UUR to reduce its revenue requirement?
A. And the recovery of the cost also, yes.
Q. Okay. All right.
A. That's the specific cost covered by the 9.6 million we're talking about, yes.
Q. What do you mean by your last point?
A. I just want to specify the specific costs that I'm referring to. I presume that you're talking about the -
Q. Yes, the items that make up the 9.6 million.

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A. Yes. I just want to be clear on that.
Q. Okay.
A. Is there--do we have a difference on that?
A. No, no. Okay, I understand. Now, turn to page 14 of your report. Under the topic "Unrecognized, Unbilled Revenue" you note, "Newfoundland Power is proposing", and there's two bullets. The first bullet is to use 9. 6 million of the UUR to meet its revenue requirement in 2006 and that the PUB determine in a future order the disposition of the remaining 14.4 million in UUR.
A. Um-hm.
Q. Right? And then you note Newfoundland Power has asked you whether it's proposed treatment of the UUR in 2006 is consistent with established regulatory principles, and what established regulatory principles should be considered in dealing with the remaining UUR subsequent to 2006. Now, now turn to page 20. Under your conclusion you note, Newfoundland Power's proposed treatment of the UUR in 2006 is consistent with established regulatory principles. And your second--your first bullet is Newfoundland Power's recognition

MR. JOHNSON:
that the benefits of the UUR should flow to ratepayers is consistent with the Cost of Service Standard. Right?
A. Yes.
Q. And your second bullet is that its proposal to use the UUR to reduce its revenue requirement in 2006 is consistent with the principle of intergenerational equity is not expected to result in any material rate instability and is not expected to materially jeopardize its financial integrity. Now, I note that your report in that second bullet does not state that the Newfoundland Power's proposal to use the 9.6 million of the UUR to reduce its revenue requirement in 2006 is consistent with the Cost of Service Standard.
A. That was a long question, could we just go through that once more?
Q. Yeah. In your second bullet on page 20.
A. Okay, second bullet.
Q. Yeah. When you're addressing specifically your conclusion with respect to Newfoundland Power's proposal.
A. Yes. To deal with the UUR.

Q. Yes. To reduce its revenue requirement in 2006.
A. Yes.
Q. Right? I note that your report does not conclude that its proposal to do that is consistent with the Cost of Service Standard. Am I right?
A. If you focus only on the second bullet point, you are.
Q. Right. And I'm focusing on the second bullet point right now.
A. Well, I cover that in the first bullet point.
Q. The principle that benefits of the UUR should flow to ratepayers being consistent with the Cost of Service Standard. But, aren't we talking in this application, Mr. Browne, this is an application borne out of Newfoundland Power's desire to achieve what it considers to be a reasonable return on rate base in 2006, that's principally why we're here. I think we'd agree on that?
A. All right.
Q. You were here yesterday?
A. Yes.
Q. You heard the President and CEO of the

Company?
A. All right, yes.
Q. You heard him say that without these--without this revenue recognition they're going to be at 7.02 percent and they need to get up further. You recall all that evidence?
A. I was here, I didn't take notes, but I'm not disagreeing with you.
Q. And you're not disagreeing with me that really, I mean, you've read all of the application, your report is appended to the application?
A. Yes.
Q. That that is the thrust of their application, to have its revenue requirement issue, or one of the main thrusts is to have their revenue requirement situation fixed by using the UUR in 2006?
A. I would say that's part of the application. I wouldn't say that was driving the application, I wouldn't say that's the focus of the application. I would say it is part of the application.
Q. Now, coming back to your second, to your second bullet being Newfoundland's proposal to

use the 9.6 to reduce its revenue requirement in 2006, okay. I note that you say specifically that it's consistent with the principle of intergenerational equity, is not expected to result in any material rate instability and is not expected to materially jeopardize its financial integrity, right?
A. Yes.
Q. Why have you not also said in this report, in this bullet that it's also consistent with the Cost of Service Standard?
A. Because I put it in the bullet point above.
Q. But, have you really put it in the bullet above? because the bullet above talks about Newfoundland Power's recognition that the benefits of the UUR should flow to ratepayers. That's a different issue, is it not?
A. No. This, if you read my conclusion, Newfoundland Power's proposed treatment of the UUR in 2006 to use that 9.6 million to cover revenue requirement in 2006 is consistent with established regulatory principles. And I go on to say it's consistent with the Cost of Service Standard, it's consistent with these other standards.

MR. JOHNSON:
Q. But, you're not specifically stating in your report that their proposal to use 9.6 to reduce its revenue requirement is consistent with the Cost of Service Standard.
A. Could you say that again, please?
Q. You're not specifically stating in your report, Mr. Browne, as I read your report.
A. Um-hm.
Q. That its proposal to use the $9.6 million to reduce its revenue requirement in 2006 is consistent with the Cost of Service Standard. In fact, what you're stating, are you not, is that Newfoundland Power's recognition that the UUR benefits should flow to ratepayers, yes, that's consistent with Cost of Service and I understand that. But, I don't think this is a small point, Mr. Browne, because Newfoundland's proposal is to use the UUR to reduce its revenue requirement. And your report does not state specifically that that would be consistent with the Cost of Service Standard?
A. I'm sorry, Mr. Johnson, if I'm a little slow today, but, I don't follow what you're saying,

at all. My understanding is is what my report says is using the UUR to the benefit of customers is consistent with the Cost of Service Standard. What Newfoundland Power is proposing to do is to meet revenue requirement in 2006, which instead of cash rates, that's consistent with, to my mind, flowing through to the benefits of ratepayers. And the remaining amount, although the exact details are yet to be determined, Newfoundland Power is determined that they should be, flow through to ratepayers. So, my understanding is this amount is going to be used for the benefit of ratepayers. 9.6 million in cost, if it wasn't being met this way, presumably the Board would find some other way. Yesterday I believe that Mr. Smith was questioned, well, if we lived in a different world, might you have come in with a GRA. As he pointed out, we don't live in a different world, but as he pointed out, maybe that would be an option they would have had to pursue. I believe Mr. Kennedy pursued some other options yesterday. Maybe the costs would have been deferred. But, if they're deferred, they're

just going to be, have to come out of future revenue requirements from customers. So, I really don't understand what you're talking about, Mr. Johnson. And I'm sorry, it might be me, but I'm just not following where you're going.
Q. Let me just move on for a moment. You accept that Newfoundland Power's proposal to use $9.6 million of the unbilled revenue is not a proposal whereby the full revenue requirement is getting met? In the manner that they -
A. I think I see where there's a bit of a disconnect and it may not be there, but it might help going forward. When I wrote the report, if you'll notice, I don't actually reference how they're using the specific 9.6 million. As I've mentioned today, I certainly think it is supportable and justifiable. But, my report dealt with the fact that it would be used to meet revenue requirements, cost that would otherwise be recoverable through rates, maybe not this year, but in some point. So, I think you have to separate out between the principle that it's used to cover cost and the specific--and then the analysis of the

specific cost it is intended to recover.
Q. Well, let's got to JTB 3 for a moment so I can have a look at the Cost of Service Standard with you.
A. Um-hm.
Q.
MR. ALTEEN:
Q. What page, Mr. Johnson?
MR. JOHNSON:
Q. Page 2. You've noted under the topic, the title, "Cost of Service Standard" at page 2-- we're at JTB 3.
MR. ALTEEN:
Q. JTB exhibit.
A. I think they're still pulling it out. I've got my copy, but they're -
MR. JOHNSON:
Q. Yeah. We'll just wait -
CHAIRMAN:
Q. We'll just wait, please.
MR. JOHNSON:
Q. The second paragraph. Under this standard a regulated entity is permitted to set rates that allow it the opportunity to recover its costs for regulated operations including a

MR. JOHNSON:
fair rate of return on its investment devoted to regulated operations, no more, no less. And I guess my question is a simple one, Mr. Browne, in the sense that this unbilled revenue, okay, has a high degree of value for consumers, okay. You'd agree with that? It has a great utility over a transitional period, it has potential to minimize what might otherwise have to come from their pockets directly, agreed?
A. Through the rates, yes, sir.
Q. Right, okay. Now, how do we test and verify, you know, the no more, no less principle and make sure that we are not using any more of the unbilled revenue than is necessary, is absolutely necessary for the Company to meet its return without us having something more before us than the Company's estimates of its revenue requirement that we are not really able to test? That's the crux of my concern here.
A. Well, it goes back to what I said a little earlier this morning. Let's break it out, the cost. We've got the cost of 2006 excluding

those specific costs included in the 9.6, we have the income taxes related to the unbilled revenue, we have the depreciation expense related to the depreciation true up and we have the increase in depreciation expense.
(10:00 A.M.)
Now, in looking at the cost, excluding the 9.6, as I was saying, it's quite likely in the absence of those costs this Board would have considered existing rates to be just and reasonable in covering the estimated costs in 2006 excluding those costs covered by the 9.6, and they would have done so without a GRA. That is not changing in Newfoundland Power's proposal. Now, certainly, those costs included in the 9.6 should be tested. But, we've already tested the estimated costs or the costs related to 2006 excluding, or the estimated costs for 2006 or rather adequately covered and been tested in the past, you'd be- -sorry, I'm getting on a little here. But, the point is, is that in the absence of 2.6 (sic.) you probably would have been happy that rates were just and reasonable in covering those estimated costs. So, we can now look at

these other additional costs in isolation. Yes, they should be tested, but there's no need to go back and look at the other costs except in that one instance where I indicated the 1.2 million increase in depreciation expense.
Q. Let me just follow-up on that, then. Let us suppose that there was no unbilled revenue of $24 million available to dip into essentially, okay.
A. Um-hm.
Q. All right. And we were coming up on 2006 and under your premise I take it that the Board would be presuming that 2006 rates should be sufficient? Right so far?
A. Could you say that last part again?
Q. You pointed out a moment ago that we would basically be presuming that the 2006 should be -
A. Were just and reasonable?
Q. Would be just and reasonable, okay. And just remove the unbilled revenue from the picture for a moment.
A. Um-hm.
Q. Okay. Newfoundland Power comes in and says

the true up is gone, you know. Here we got this $5.7 that we've got to look at in 2006. Under your logic or at least my looking at your logic I'm asking myself the question, well, if we didn't have the unbilled revenue, why would we bother to have a GRA over that issue? I mean, the true up coming off is a known quantity, the rates for 2006 are expected to be just and reasonable in the absence of it. Why don't we just say, okay, fair enough, don't need a GRA for that, here's some rates for you to cover it off?
A. The existing rates did not contemplate the income tax cost associated with the unbilled revenue pursuant to the Tax Settlement. The existing rates did not contemplate the true up being taken away. The test period used in setting rates was 2003 and 2004. And I spoke about the depreciation expense, that's a bit of an odd one and I'll hopefully save some time by just referring back to what I said earlier. So, those are costs that Newfoundland Power should have a reasonable opportunity to recover. Now, certainly if we were going through to a GRA, that would all be

MR. BROWNE:
thrown in. But, with this--if the Board and Newfoundland Power wanted to avoid a full GRA in this year, another option would be the deferral approach that Mr. Kennedy suggested. In other words, yes, we can't meet all of it, here's a specific cost, we're happy that the absence of those specific cost rates are just and reasonable so we'll put them aside and deal with them at the next GRA. And that's an approach, by the way, that is not unique in rate regulation. For example -
Q. So, just not to get too far down a road here. But, is the essential proposition, Mr. Browne, because I think if we didn't have the unbilled revenue picture here, I take it you would agree with me that there'd be no way that Newfoundland Power would be able to come in here on, you know, a single cost item and say give me that single cost in rates, for instance, without having an overall review of the revenue requirement? I take it we'd agree on that?
A. No, we would not agree on that, sir. We see that with the RSA. The RSA, the amortization

can go up or can go down and there's an automatic flow through into rates without a full review of all the other costs.
Q. But, that's a symmetrical type of mechanism, though, isn't it, because it can go up and it can go down. It's a preset formula in advance. I mean, is that really analogous to what we're talking about happening here? Doesn't strike me as being immediately analogous.
A. I believe it is. Yes, in this particular case we're dealing with cost, but there are instances where there is windfall benefits that regulators will then grab back for customers. I referenced the CRTC decision in my report. In that case they dealt with the fact that the amounts collected for future deferred taxes exceeded the amount that was likely to be necessary as a result of the drop in income tax rates. So, after the fact they looked at the issue and said this was not just and reasonable and they required the telephone companies to return the excess to customers through a reduction in future rates. In a way we can even see the way the depreciation true

up went. You set the depreciation rates in the past, then you look back and said, well, depreciation was overstated so we're now going to give this back to you, to customers, go back and say, look, that excess amount we'll now give back. Oh, I just, I thought, Mr. Johnson, I realize that one is symmetrical. But, there are examples such as the CRTC one where they take windfall benefits. And so, I think the basic principle is, is that if this board was faced with a huge windfall benefit, a material windfall benefit that would normally be considered is a deduction in setting revenue requirements and which was not contemplated in establishing existing rates, they would very likely ask the Board to--or the utility to justify why that should not be deferred and used for the benefit of ratepayers. I mean, we talked about the issue of the 2.1 million in interest. Certainly the argument, I gather, that's being made for including it is this is a windfall benefit and we're not--and the argument that I presume is being made is that because this is sort of a large windfall benefit, it was not

contemplated in setting rates, the argument must have to be that it's very material, although that's questionable, and that's the only way I think you could argue for taking it out of where it is being earned in 2005 and deferring it. Now, for a lot of reasons that's not appropriate here, but those arguments are being used on the other side. And as I say, certainly if there was some large windfall benefit, I can't think of one offhand, but I'm sure that people would be before the Board saying, look, that's a windfall benefit, it should go back to customers, it wasn't contemplated in setting rates, so defer that and allow it to be reflected in future revenue requirements.
Q. As you're sitting here today as an expert in support of Newfoundland Power's proposals, Mr. Browne, I take it you'd agree with me that now at the end of the day you're not in a position to say to this Board that Newfoundland Power's request to use the UUR to get it up to its allowed range of return on rate base meets the no more, no less standard, are you? You're not in a position to say that?

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MR. BROWNE:
A. I'm in a position to say that the evidence I've seen that it does. Now, I am not in a position to support that evidence, but I have seen the evidence and based on accepting the information that has been provided to me I would say that it is reasonable, their proposal.
Q. But, based on the evidence that has not been really tested or anything?
A. As we go through, it's my understanding, as I explained earlier this morning, that it has all been tested or is being tested.
Q. Well, what has been tested other than the fact that we can say that these expenses are known and quantifiable?
A. Well, as I went through, in the case of the income tax expense related to the unbilled revenue pursuant to the Tax Settlement, excuse me, evidence is being presented as part of this proceeding, if we go back to the depreciation related to the previously covered by the true up. The full depreciation expense and the true up was tested at the last GRA.
Q. I think that's my point, though, Mr. Browne.

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What's been tested, and really, to be honest with you, I don't think the amount of the extra expenses is really something that's subjectable to testing in the sense that, you know, the tax hit is a known quantifiable figure, I mean, it is what it is. So, but we're not testing the overall revenue requirement, are we?
A. As I said, there was some question around the 1.2, which I have discussed this morning.
Q. Yeah, okay.
A. But, when we go back to the cost excluding the 9.6, I go back to the point is that if the 9.6 didn't exist, this Board would very likely accept existing rates as just and reasonable in covering those costs, excluding the 9.6 and they would do that without a full GRA. Up to this point I see no reason why the Board would change its position on those, the costs that are expected to be covered by existing rates.
Q. So, just to be clear. Is it actually your opinion that Newfoundland Power's proposal to use the UUR actually satisfied the no more, no less test of the Cost of Service Standard, this proposal to get it up to its required

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rate of return?
A. There's a lot in there. Could you slow down that question again?
Q. Newfoundland Power's proposal.
A. Yes.
Q. In essence, is saying to this Board, let us use $9.6 million of the unbilled revenue to get us to our, what we consider to a just and reasonable rate of return on rate base, right, in essence? Agreed?
A. I wouldn't have used those words, but I don't think I'm disagreeing with you. The wording is a little loose, but as I say, I'm willing to go along for now.
Q. Okay. And I guess what I'm asking you, is it your honest professional opinion that the proposal to use the 9.6 for the purpose of getting its, the proper rate of range of return on rate base in place for 2006 as it's being presented in this application meets the no more, no less standard?
A. As I said, there's the question where I think there's a little bit of fudge around the 1.2 million, but let's leave that aside for the discussion.

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Q. Okay. Forget the 1.2 and concentrate on the rest then.
A. I would say that their proposal is reasonable in accordance with the Cost of Service Standard.
Q. And it meets the no more, no less principle?
A. Definitely. Now, let me explain. Rates are set prospectively so that the expected revenues will equal the expected cost as determined or recognized by the regulatory process. That's been done with regards to the cost including the 9.6. And not only do the utilities have an opportunity, if they feel there's a question they're no longer just and reasonable and need to be tested, but Boards have that option. If the Board felt for whatever reason that it was necessary to test it, they could call the utility in. And this Board receives periodic information from Newfoundland Power to help monitor their performance and to see where there's a question whether there's a need for a full review of rates. So, again, if we go back to the situation where there's no 9.6, this Board very likely would have looked at the existing

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MR. BROWNE:
rates, said they were just and reasonable with regards to the costs that were expected to be recovered by those rates, the rates that were considered in developing the revenue requirement for establishing those rates. And they would come to that conclusion that they were just and reasonable without a full GRA. So, what we're left with is now moving on to the other costs, because Newfoundland Power is not being given an opportunity to recover them with existing rates. It's not being given an opportunity to recover the tax on the unbilled revenue because it was never considered in the revenue requirements when rates were set. The depreciation related to the true up. When rates were set, the test period was 2003/2004. Those rates assumed the true up would continue. So, therefore, Newfoundland Power, under existing rates, does not have a reasonable opportunity to recover that depreciation charge. And with regard to the 1.2, yes, I think the Board should concern itself of whether there is a revenue shortfall that would justify the recovery of that

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amount, but we're dealing with 1.2 million. In order to address that cost and provide Newfoundland Power with a reasonable opportunity to recover its costs including a fair return, is that worth the effort in cost of a full GRA?
Q. Is two million dollars worth the effort in cost of a full GRA?
A. It would depend on the situation. First of all, I think the key requirement is, is a GRA necessary to support it? I think two million is probably down around the range of its, probably not material.
Q. Right.
A. If there was an ongoing two million that's going to add up to, you know, ten, twenty million over the years, then perhaps it appropriate to come in. But if you're talking about a one-time cost of two million dollars, I'd say you're pretty much around the materiality. I mean, I've heard the cost of a GRA can be a couple of million dollars. So, is it really reasonable to come in for two million dollars and on top of that, you know, charge customers another couple of million

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dollars for the cost of the full GRA? I think that's probably not that reasonable.
Q. So, just so I can be very clear on this and forgive me if I'm going a bit slowly on the point, but I truly do want to understand.
A. Um-hm.
Q. You're saying that this proposal meets the no more/ no less test?
A. Yes.
Q. So, you're not saying that a lesser standard should apply than the no more/no less test in this instance?
A. I'm saying the standard should apply. I'm not too sure I want to agree with some lesser standard, because I'm not sure what you mean by a lesser standard.
Q. A standard other than no more/no less -
A. I believe this standard should apply.
Q. Yes. And if the Board, at the end of the day, in its deliberations is not satisfied that this meets the no more/no less principle that's at the heart, as you put it, of rate regulation in the cost of service standard, I take it that your recommendation to the Board would be not to approve this as framed.

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(10:17 A.M.)
A. We're dealing with a hypothetical and I have to look at all the details of it. One of the problems in regulation is that there is no standard procedures or rules or whatever that'll apply in all situations, that has to be modified to deal with the circumstances. So, I'm a little hesitant about saying, making a broad statement on a hypothetical. What I am saying is this, this is the standard the Board should apply in making its decision. Now, I think one thing that, just to emphasize -
Q. Yes, but just hold on now. This is fundamental. Are you--I would have thought that you'd say yes or no. I mean, if the Board is not satisfied that Newfoundland Power's proposal meets the no more/no less principle that's inherent in the cost of service standard and you've already said that that's the standard that should apply, I mean, isn't the fallout from that very significant that the Board ought not to exceed to the request as framed?
A. I would say the general rule, this is the principle you should apply. Now the reason

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MR. BROWNE:
I'm equivocating a bit is that in rate regulation, there's always exceptions. You've got to recognize the specific circumstances. I mean, if it was possible to set out rules and procedures that would apply in every circumstance, there'd be no need for regulatory boards. There'd be no need for the regulatory process. The rules and procedures could be set out in the legislation and regulation and you could send out a group of auditors to test whether they're followed or not. So, I don't think I'm materially deviating from or differing with you. I believe as a general rule, you should follow this principle. I'm only equivocating because you can--I'm sure somebody could throw up some situation where it would be appropriate and just and reasonable to deviate from it. I can't think of one. I think it would be very rare, but I wouldn't be surprised if someone could throw one up in front of me.
Q. So, this would not be the case where the Board should feel comfortable is deviating from the no more/no less principle.

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A. I believe that's the standard that they should apply. Now one thing I would like to clarify because I got the sense that you're misreading no more/no less as in retroactive rate making, going back and saying, well, you earned too much, we take it all back. If you read the next paragraph, it is the next paragraph, yes, let me just read that in because I think that is very important in understanding the no more/no less. "It is important to note that this standard only gives the entity the opportunity to earn a fair return. It does not guarantee it. In most cases, rates are set perspectively based on anticipated future costs. If the entity over recovers, it normally keeps the excess. If it under recovers, it bears the deficiency". In looking at this opportunity to recover, in perspective rate making, the idea is that the possibility of under earning and over earning should be offsetting. So that in the long run, it's expected the utility would earn or recover its costs and earn a fair rate of return. It's not a matter of saying, you know, any time you ever earn more, you've got

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to give it back. Because if that happened, a utility would not have a fair opportunity to cover its cost and earn a fair return.

Let me give you some numbers and excuse me if they're large numbers because they're just simpler to deal with. Let's say someone offered you an investment opportunity. This opportunity will pay in some years 0, with a 50 percent opportunity, possibility or 20 percent with a 50 percent opportunity, possibility, sorry. Well, in the long run, you're going to expect to earn about 10 percent because about the half the time you're going to earn 0, half the time, 20. That's going to average towards the 10 percent. In that case, I would say it's fair to say you have a reasonable opportunity to earn a 10 percent return. The possibility for earning less than 10 percent are offset by the possibilities for earning more. And in the long run, you'd expect to earn 10 percent.

Now, let's say the person that sold you the investment said, I only told you I was going to give you an opportunity to earn 10 percent. So, whenever you earn 10 percent,

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I'm keeping it. So, now your opportunity is possibility of 0, 50 percent and a possibility of 10 percent, 50 percent of the time because the person is going to keep any excess earnings. Well, in that case, your expected long run return is not 10 percent, it's 5 percent, that's what it will tend to. And it is virtually impossible that you'd ever earn 10 percent on average because you'd have to earn 10 percent each and every year in order to earn 10 percent. Any year you earned less than 10 percent, you'd never be able to break it back. So, the concept that you would go back and cap the earnings at the allowed return, yet force the utility to bear deficiencies, is inconsistent with the principle that a utility should be given the opportunity to cover its cost including a fair return, no more/no less.
Q. Let me ask you, Mr. Browne, let us say that out of the 9.6 it can be determined in the fullness of time that really only 7.5 million was actually required, okay.
A. What do you mean by required?
Q. Required to meet the revenue requirement of

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MR. JOHNSON:
Newfoundland Power in 2006.
A. Excuse me, sir, it sounds as though you have an understanding of regulation that deviates from my understanding. Costs, you build up, you separate, so that expected revenues equal the expected revenue requirement which are the expected costs. Then you could be said you have a reasonable opportunity to recover those costs plus a fair return. Now, here's some additional costs that were never contemplated there. You should have an opportunity to recover those costs. You don't turn around and say, well, did you over earn here and that will affect our decision on whether you get an opportunity to recover this cost. That gets back to the point I just made. You're going to be capping it, you'll never have a reasonable opportunity to recover your costs. So, the basic premise of your question, I believe, is at odds with established regulatory practices in Canada.
Q. Well, let's put it this way, Mr. Browne. I don't think anybody takes issue with the fact that with the true up coming off, with the

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extra tax expense that's going to be present in 2006, that Newfoundland Power is going to require more revenue in 2006 which the current rates will provide. Okay, I don't think that there is a huge debate about that. But is it not fair to say that there can be a debate as to the exact amount that's going to be required by Newfoundland Power in 2006 having regard to these expenses that are coming in? Would that not be fair? Because we don't fully know yet what 2006 has in store in terms of whether there might be additional revenue coming in through billing, whether certain other costs on the operating side might drop. You don't really know that. So, would it not be fair to say that we don't know for sure and we're not really able to test whether the entire 9.6 is necessary.
A. Could be break that up? There's an awful lot in there and I think I disagree with some of the things you said and agreed with some of it and I don't think I can give a final answer. So, if we can maybe go through what you've said, point by point, and maybe we could address it.

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Q. Okay. I think it's agreed that extra revenue is going to be required in 2006 by Newfoundland Power because the present rates will not be enough to absorb the true up coming off and the extra taxes. Agreed?
A. Yes.
Q. Okay.
A. And also the existing rates do not contemplate at least two of the major components of the 9.6 million.
Q. Right, okay. But what we really don't know and we don't know it because we're not testing the overall revenue requirement from Newfoundland Power in 2006 is whether they actually need the full 9.6. I thought we could agree on that too because we are not in this proceeding testing all of the forecasted substances for revenue, all of the forecasted substances for -
A. Could we just stop, maybe we got an agreement or not. I would agree with you that there's not a full testing of all of the estimated costs in 2006 excluding the 9.6.
Q. Right.
A. That is something that we've already talked

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about and agreed to.
Q. Okay. So, does that not mean that there is potential, okay, that in fact, the full 9.6 -
A. That's where I think it's the premise under which your stating it.
Q. Okay.
A. There's a number of options going forward. And I think certainly one of the options that, or a couple of the options allow the Board to avoid a GRA for 2006 which I think is certainly, and save the costs, that is costs for rate payers. One of the options is to use the unbilled revenue, accept the existing rates as just and reasonable for covering the cost excluding these large material costs that we're not contemplating in setting those rates. Accept those as just and reasonable and then, one, defer them and include them as part of the cost of future revenue requirement or two, follow Newfoundland Power's proposal and use some of the unrecognized revenue to cover those off. So, the premise seems to be that the only option is to have a full GRA and I do not believe that is the only option that is before this Board.

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MR. JOHNSON:
Q. No, no, I'm getting back to Newfoundland Power's proposal as framed, okay, doesn't get into deferrals. It gets into using the 9.6 million dollars of the unbilled revenue. And what I'm suggesting to you -
A. Can I just clarify something, to make it clear. I did not suggest that they were proposing deferral. I was saying that that was another option for addressing the issue which was, I believe, brought up by Mr. Kennedy yesterday.
Q. Okay.
A. Then I believe, as I spoke earlier, is--produces essentially the same result.
Q. Fair clarification. This application, all we have before us is what Newfoundland Power has put in these materials and has expressed in its prayer for relief, if you will, in its application, right?
A. No. There is some evidence supporting these costs in other documents, the capital -
Q. You're misunderstanding me. The proposal that this Board has in front of it is its application and its application essentially

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says, let us use 9.6 million dollars of the unbilled revenue for 2006.
A. That is part of the application, yes.
(10:30 A.M.)
Q. Yes, okay. But that's the only part of the application that deals with how we're going to offset the forecast, the increases in expenses in 2006.
A. Yes, they're not getting into deferrals, that's correct.
Q. Okay.
A. But as I said, I personally do not see a material difference between the two approaches.
Q. I know, but there's only one approach officially on the record here in terms of what's being sought by your client.
A. We agree to that, I just wanted to make sure it was clear I wasn't saying there was a problem with the approach, that's all.
Q. I don't know why it's taking us so long to clarify these things which I would have thought agreeable. And, in any event, the approach of Newfoundland Power does not guarantee to the same extent that the General

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Rate Application would guarantee, that we're not getting the 9.6 wrong. So, maybe a GRA may show, when we're looking at all the revenue requirement, all the operating expenses, and really your revenue deficiency in 2006 is not 9.6. It could be 8 million, for instance. Would that be a fair comment that the GRA would be better suited to pinpointing the deficiency in 2006? I'm not saying anything about practicality, just talking about the process.
A. The thing is that they are separated. So, the linking you have, I'm not that comfortable with. Certainly, an option is to have a GRA.
Q. That's not what I'm asking you, Mr. Browne. I know it's always an option to have a GRA. What I'm asking you is whether the GRA--leave aside the pragmatic considerations for the moments, the cost and expense, and believe me, I'm in tune to it as well. I'm asking you a simple question, what process provides more certainty as to what the overall requirement in 2006 for Newfoundland Power, in fact, will be? Is it this application or the GRA?
A. Feeling with certainty, but let's say,

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certainly if--that would give an option to test the others costs, that is true; I would agree with that.
Q. Which one gives the more certainty?
A. I'm not too--I would say that, I'm just going on--I'm not quite sure it's more certain, but I would certainly agree with you that it would give the Board an opportunity for a more extensive review of the other estimated costs in 2006.
Q. Well, if it gives you the opportunity to have a more extensive review of the costs for 2006, I take, by implication that you have more of an opportunity to get it right.
A. I think it will give them greater comfort that the amounts were appropriate. I'm not saying that--I'm not going to agree with you that the amounts are wrong, that it would give the Board more comfort that the amounts were appropriate.
Q. Okay. Assuming then, assuming, I put it to you that a GRA would give the Board, leaving aside the pragmatic considerations, but assuming that the GRA would be more able to get it right, okay, than this type of process,

MR. JOHNSON:
to really pinpoint the amount of the revenue deficiency.
A. Your wording, sir, I'm not sure we agree deep down, but I disagree with the wording you used. The concept that you're getting it wrong now with the existing rates, I would certainly agree that the Board would have more comfort that the rates were appropriately reflected the cost providing service. But I would not, in any way, imply that what they're doing now is wrong or they've got it wrong right now.
Q. Let's put it this way, if in an inappropriately high amount of the unbilled revenue is used through this process for 2006, if, what is the impact on consumers down the road in terms of their rates?
A. Well, it's the linkage that you've got, that you're--really what that is dealing with is the option and you recover the cost on those specific costs. In the proposal of Newfoundland Power, those costs are being split from the other costs covered by existing rates and you're putting that linkage in.

Now, if you go into a GRA, there will be that linkage. But in a proposal, as it stands, that linkage that you're assuming does not exist.
Q. I'm going to try it again. On the assumption that the GRA process provides a better opportunity to review the overall revenue deficiency, okay?
A. Um-hm. It would certainly be a better option to give the Board better comfort.
Q. Yes. And on the assumption that it would be a better equipped forum to determine the amount of the revenue deficiency, upon those assumptions, okay?
A. Yes, certainly if they go forward and bring these amounts together, as I say, Newfoundland Power's proposal, as it currently stands, there is not the link between these costs and the costs covered by existing rates. You're putting in a linkage there that is not in their proposal. So, you are dealing with something that is not in the Newfoundland Power proposal. I mean, I would certainly agree with you that if you do go into a GRA, this Board can get greater comfort with

regards to the cost other than the 9.6, that I would agree to.
Q. Mr. Chairman, I feel that if I took a break now, I could probably be more quick than I would otherwise be.
CHAIRMAN:
Q. Mr. Johnson, we will take our half-hour--were you just suggesting a short break or -
MR. JOHNSON:
Q. No, regular break, yeah.
CHAIRMAN:
Q. Regular break?
MR. JOHNSON:
Q. Okay.
CHAIRMAN:
Q. Okay. We'll take a half an hour now.
(10:37 A.M.)
(BREAK)
(11:10 A.M.)
CHAIRMAN:
Q. Thank you. When you're ready, Mr. Johnson.
MR. JOHNSON:
Q. Thank you for the break, Mr. Chairman. Mr. Browne, I take it that another option with the UUR that exists is to simply say let's rebate

it all to consumers?
A. Are you saying--I guess I'm--in what context?
Q. In the context of, look -
A. There's a lot of--sorry.
Q. Let's not dip into the UUR in the manner that Newfoundland Power proposes in this application, you know, the scenario being let's use--lets quantify the Unbilled Revenue and then look at the option of just rebating it all to consumers at the one time.
A. What happens to the 9.6? Were you suggesting, for example, that it be deferred?
Q. Nothing, nothing happens to the 9.6. The 9.6 gets sorted out in the future through a GRA.
A. So, in other words it's deferred and goes into the revenue requirements of a future period?
Q. Well, look, I guess what I'm asking you is one of the possible options, and I thought your report got into it in terms of its comments about rate stability and predictability. Were you not addressing there in your report the down sides of using too much of the Unbilled Revenue at one point?
A. Yes. What my concern is is that you're dealing with a hypothetical without laying out

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MR. BROWNE:
all the implications of that hypothetical and therefore without exploring that, I really, I'm not prepared to address that hypothetical. For example, just saying we're going to move this piece, when that piece is going to change everything else, well, you got to look at what are we assuming about it. If the assumption is that we can leave everything as it is and nothing changes, I don't think I can really agree to that. So, I think if--we really have to start talking about, for example, what would happen to 9.6. And one option, I think, if I could propose one to you, is that, yes, existing rates stay as they are, the cost of the 9.6 are put into a deferral account and included in the revenue requirement of a future period. If that were to happen, I think then we could perhaps deal with the Unrecognized Unbilled Revenue separately. That off the top of my head is one option with a caveat that I haven't really thought through it and if I did have a couple of days, I might find some holes in it. But, for purposes of proceeding I think that might be a starting

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discussion point. Are you willing--can we assume that?
Q. Let me go back a little bit then. Your comments in your report about rate stability and predictability, what was the aim of that discussion?
A. Yeah, the point is, is however you deal with it, with the Unrecognized Unbilled Revenue, the Board should be conscious of the fact that it could result in rate instability and rate shock and we certainly should be monitoring to, I wouldn't say necessarily, you know, put it in all cases, but it should be a consideration in the overall mix. I would say in most cases you'd want to avoid rate instability. There may be some situation where, you know, it might be virtually unavoidable, but certainly that is a consideration that the Board should take.
Q. Let me ask you just briefly about the notion of a deferral account in relation to the 2.1 million. If the Board had created an interest revenue deferral account for the interest on the tax deposits -
A. Say that again?

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Q. If the Board had created a special interest revenue deferral account for the interest being refunded from the tax deposit, from the--that arose in relation to the challenge to the Tax Court, right?
A. I don't find anything to agree to.
Q. No, no, okay. If they had done, if the Board had done that, would then under that scenario would the $2.1 million been essentially set aside for use for a later date to offset a revenue requirement in the future, would that be -
A. Again, you're dealing with a hypothetical that requires a lot of other things to change. I think we have to deal with the--I don't think we can say they just set it up and that's it. I would assume the Board would follow established regulatory principles and practices. And as I've laid out in my--earlier this morning, I think that deferring that and passing on to customers would be inappropriate in accordance with established regulatory principles and practices and, in particular, the regulated environment that Newfoundland Power faces. Elaborating on

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that, I'm referring to the excess revenue account, or excess earnings account, sorry.
Q. All right. So, while you're saying it would be inappropriate, if the Board had, in fact, dedicated a deferral account to the interest revenue, quite apart from whether you believe it's appropriate, it would have been available to offset a revenue deficiency?
A. Well, again, you're dealing with a hypothetical and what else is changing. I mean, they might have done something else somewhere. For example, they might have compensated the utility for all of its costs incurred in the tax reassessment. Then it would be reasonable to put it in a deferral account. So, I think there's all kinds of possibilities and you're giving me a hypothetical without filling in the details, therefore I think I don't have enough information to really provide any opinion.
Q. Those are my questions for you.

CHAIRMAN:
Q. Thank you, Mr. Johnson. Good morning, Mr. Kennedy.

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MR. KENNEDY:
Q. Thank you, Chair, Vice-Chair. Mr. Browne, I just have three areas that I wanted to cover and it should be fairly brief. Before I start it, though, I just wanted to get one thing clear on the record. Just during your cross there by the Consume Advocate there was one point where you said, you referred to the deferral approach and you suggested that, well, deferral approach that Mr. Kennedy had suggested. I just want to clarify the record that I hadn't actually suggested any alternative that -
A. I apologize.
Q. This was the Company's alternative, as I understand it or put forward through other witnesses. I wanted to have a--just ask a couple of questions specifically concerning this new accounting guideline, AcG-19 I think it's how it's referred to in the trade?
A. Yes.
Q. This sounds like a hip hop artist, but -
A. County Guideline 19.
Q. Yeah. Like those accountants to get wild with their -

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A. Just wild and crazy guys.
Q. Nomenclature, yeah. And at page 6 of your report under the section marked "Disclosure" towards the bottom there. That's correct.
A. Yes, I see that.
Q. And you reference that in May of this year the CICA issued AcG-19. And in the next paragraph you indicate, "The guideline will require utilities such as Newfoundland Power to disclose the nature and extent of their regulated operations, the methodologies under which they are regulated and the entities that regulate them." I'm just curious, is that new?
A. Yes, it is.
Q. AcG-19 is new, but is the requirement that the utilities disclose this information as just stated in that line, that's a new requirement of utilities?
A. Yes.
Q. By virtue of AcG-19?
A. Yes. I think it's eminently reasonable, but it has not been required and I think one of the--well, the reason I think this disclosure or county guideline was brought forward was

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the great variability in disclosure among rate-rated enterprises. Sometimes you could read the financial statements and barely realize they were rate regulated.
Q. Okay. So, there's two questions I have then that arose from AcG-19. And one was the Company--you were here yesterday and when the Company described what was, I refer to as a fifth alternative, and it concerned the deferral of the recovery of cost. Do you remember that option being discussed?
A. Yes. Again, I didn't take notes, but I remember broadly what was -
Q. Okay. And I understand the Company is actually in the process of preparing a document which we hope to file as an information item which would provide meat on the bones, if you will, or a written description of what that alternative is. But, based on your understanding of that alterative from yesterday, would that meet--the alternative that's described, the deferring of the actual recovery of the costs that have been identified, would that be in keeping with regulatory principles and specifically with

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the requirements of AcG-19?
A. A couple of things there. Just maybe clean up before getting to the heart of your question. Accounting guideline 19 does not provide any guidance on the recognition and measurement or regulatory assets and liabilities, it's only disclosure. Now, as is currently accepted as GAP it is appropriate, it would normally be appropriate to recognize the deferrals you suggested as regulatory assets so long as there was reasonable assurance that those assets would be recoverable in future rates. In other words, there will be--this Board would allow an increase in future rates from what would otherwise exist sufficient to recover that deferred cost.
Q. And -
A. And with the one caveat that there's, as I mention in my report, there's some discussion just around the whole issue of whether regulatory assets and liabilities, whether they must be condition--no, sorry, unconditional or not. I'd say right now the--generally accepted they don't require that full assurance, but their rules may change in

MR. BROWNE:
the future that would require that. And I think, for example, I've heard sometimes in the States that auditors only set up these deferrals if there is a board order that specifically states this is a deferred cost and it will be allowed to be recovered in future rates. So, there's a little bit of uncertainty out there and, but getting to the heart of what you're proposing, I believe that under currently accepted practices that a deferral account would be set up as a regulatory asset so long as there was reasonable assurance that future rates would be increased from what they otherwise would to adequately cover the deferred costs.

Q. And does that, in theory, at least, raise intergenerational issues that you're recovering the cost in a period different than when the cost was actually incurred?

A. Just for clarity, I was speaking about accounting principles. We're now moving on to regulatory principles. And certainly from a regulatory point of view, well, let's go through that. I mean, as I point in my

report, intergenerational equity is an important issue. This Unrecognized Unbilled--well, I guess we're talking about deferred cost. Well -

Q. Well, defer of the recovery of the costs, right. So I understand that the expense itself wouldn't be deferred but the expense itself as under the proposal of the Company would be recognized, but the actual recovery of that cost is what's going to be deferred under the proposal.

A. Yes. I guess terminology I would have used is the cost is being deferred for regulatory purposes, for regulatory accounting purposes. In essence, those costs would be deferred to be included in a future revenue requirement. So, I mean, it may just be semantics, but I feel more comfortable with those words.

Q. Okay. And then using those words, that raises intergeneration, potentially it raises an intergenerational issue then?

A. It does. The reason I'm quibbling a bit is, for example, on the tax liability. In 2007, 2008 they should also get a piece of the Unbilled Revenue, so if you defer it to

include some of those periods, that's--oh, I'm sorry, you're dealing with costs. Yes, it would. It's certainly a concern the Board would have broadly. And I'm sorry for fumbling, but there's some details there and probably if I had a long time to think about it, I'd probably give you a slightly different answer. But, broadly speaking, that is an important issue and I think it probably would create some intergenerational issues.

Q. On the intergenerational issue, and you discuss that in your report at roughly page 15, I think it is.

A. But have I ever--sorry, just to clarify that too. We're talking about just deferring the costs in isolation, we're ignoring the Unrecognized Unbilled Revenue at this time?

Q. Right.

A. Okay.

Q. Just turning to page 15, I was just looking at the very top of page 15. You detail the split between--or you apportioned the $24 million in Unrecognized Unbilled Revenue between the periods in which it was ostensibly unrecognized in the sense that, as I

understand this, from the period 1975 to 1995 was roughly 13 million of that 24 million when it was actually unrecognized, and then the balance of 6.4 million was, as you indicate in the last ten years, so 1995 to 2005?

A. Um-hm.

Q. Okay. Now, then over in -

A. That's referring to footnotes 25 and 26, just for clarity?

Q. Yes, yes.

A. Yeah.

Q. Yeah. Just showing the calculations themselves.

A. Yes.

Q. Right, okay. So, 13 million of the 24 million from a 20-year period starting in 1975?

A. Oh, I'm sorry, no, no, that was the 10-year period, I think. Have I got this right? Sorry. Let me just review my notes, make sure I'm doing it right.

Q. Yeah, sure, okay.

A. Yes, I'm sorry, yes, it is, that's correct, over the 20-year period, correct.

Q. So, of the total of 24 million that we now have in Unrecognized Revenue 13 million of

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MR. KENNEDY:
that arose during the period 1975 to 1995 and then 6.4 million of it rose from the period 1995 to 2005?
A. I think it's--did you say '75?
Q. Yes, 1975.
A. No, no, it's the Unbilled Revenue at, let me just check to make sure I'm doing this right. No, I think the last 20 years would be '85 to 2005.
Q. Ah, okay. 13 and 6, 20. Okay. Let's just flip over then to page 16 you start your discussion of intergenerational equity?
A. Yes.
Q. And then over at page--that probably makes more sense. Over to page 17 then you discuss this aspect of the numbers. And that paragraph starting the third one with "However"?
A. Yes, I see that paragraph.
Q. Okay. And you go, and again, this is in the context of intergenerational equity. You go, "However, there is probably a significant difference between the customer base in 2006 and the customer base in the period prior to

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1995."
A. Um-hm.
Q. As a result, in deciding the period over which the Unbilled Unrecognized Revenue should be returned to ratepayers, intergenerational equity should only be a significant factor for the portion of the balance that arose over the last 10 years to 20 years, approximately 6.4 million to 12.9 million?
A. That's correct.
Q. I'm just wondering--just leave aside the specifics of the numbers. What struck me there was the fairly lengthy period of time in which you discuss that for intergenerational issues it's significant if this regulatory asset, in a way, arose within the last 10 to 20 years.
A. If I could explain?
Q. Yeah.
A. Under the principle of intergenerational equity, ratepayers should only pay the cost of providing them with service. They shouldn't pay the cost for customers of other periods. Now, when costs are deferred from one year to the next, for example, that's sometimes used

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to ensure rate stability, etcetera, that is not that major a deviation from the principle of intergenerational equity. The customers in one year are pretty much the same as the customers in the next year and their usage of power is probably pretty much the same, at least for most of them. But, as you go back more and more years there's going to be more and more differences between the customer in the current base and those five, 10, 15, 20 years. I mean, some of the build up came from customers 40 years ago, many of whom are dead. So, that's why I say the issue of intergenerational equity is most important for the Unbilled Revenue that was built up over the last 10 to 20 years and less significant for the period prior to that.
Q. And would the treatment from an intergenerational perspective be different depending on how this regulatory asset arose or how the issue itself arose? In other words, I'll give you an example. Does it make a difference if the issue arose from a capital asset, the treatment of a capital asset that was, say, purchased versus the building up of

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a regulatory asset out of the operational side of the Company?
A. As long as they were both costs that should have been recovered in that past period, I'd say it's about the same. So that if we're talking about--yeah.
Q. Just the last question I had then was again dealing with AcG-19.
A. Um-hm.
Q. And if we could just turn to that exhibit, which is JTB 2. And looking at the second page of that under "Disclosure Principles", point No. 5. You go, "To meet the needs of financial statement users entities subject to rate regulation should disclose general information facilitating an understanding of the nature and economic effects of rate regulation as well as additional information on how rate regulation has affected the entity's financial statements. The information should be presented in such a manner as to enable a clear understanding of these effects." In your opinion, does Newfoundland Power meet this requirement at present?

MR. BROWNE:
A. We'd be referring to the 2004 financial statements?
Q. And the current disclosure of any public statements by the Company through to date?
A. Okay. I've really not reviewed any of those other statements to comment, and I did not do a detailed--not done a detailed analysis of the financial statements. They certainly provide a great deal of information about rate regulation, about the regulatory assets they have. Without reviewing, I can't give a definitive answer. I don't think they currently describe the method of regulation. That might be one. I think there's requirement -
Q. If we turn it to a negative, Mr. Browne, and ask is there anything that's been drawn to your attention or come to your attention which would give you pause to think that the Company is offside of that principle?
A. Maybe there's a misunderstanding here. They are not offside of GAP because the financial statements I looked at was before this disclosure statement came out and I haven't

looked at any other of the financial statements since then.
Q. Okay.
A. So I don't think it's fair to say that they're offside on anything. I think there's probably certain things that were done last year that are going to have to be improved going forward. There will be some changes, things I noted in my report. The other future employee benefits, that will have to probably be--appear on their balance sheet. The unrecognized, unbilled revenue is going to have to appear on the balance sheet, which wasn't there in the past, and there's a few other things, but to really answer your question, Mr. Kennedy, I have to sit down, look at it, compare it. It's probably not the sort of thing I would do in five to ten minutes. So those are broad statements off the top of my head and should be taken in that context, but I think the key one is Newfoundland Power, as far as I know, is not offside with Generally Accepted Accounting Principles.
Q. That's all the questions I have. Thank you,

Mr. Browne.
CHAIRMAN:
Q. Thank you, Mr. Kennedy. Any redirect, Mr. Kelly?
KELLY, Q.C.:
Q. No, thank you, Chair.
CHAIRMAN:
Q. Do you have any questions, Commissioner Whalen?
VICE-CHAIR WHALEN:
Q. Mr. Browne, I noted your written evidence didn't discuss this whole issue of the 2.1 million in interest. That wasn't--it wasn't raised specifically in your written, but you did reference it this morning, I think, in your--I think your response to questions from Mr. Johnson.
A. Yes, that's correct.
Q. And I was just taking notes. I'm not sure if I captured exactly what you said, but it was something along the lines of--and I think you were talking about it in the sense of how generally accepted utility practice might conflict with this idea that, you know, the windfall situations where if a company perhaps

got a windfall in a circumstance where it couldn't have reasonably been anticipated that that windfall perhaps should go--should be taken and -
A. Possibly.
Q. Possibly.
A. Subject to Board review and looking at the -
Q. Sure, yes.
A. - details of the circumstances, yes.
Q. Yes.
A. And that's from the cost of service standard perspective.
Q. Yes, and that was the context of the discussion that--but I understand after that discussion then, it's not your position that that is the circumstance we're faced with here?
A. The 2.1, no. As I went through this morning, I don't think that it meets the test of what would normally be included as a deduction in rates for the reasons I gave, and therefore, although it was not contemplated in rates, it probably would not meet the test for treating it differently than you normally would. I would also emphasize too, consideration should

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MR. BROWNE:
be given to the fact that you have this excess earnings account.
Q. And those tests would be again? Could you just -
A. Do you mind if I check my notes, to just make sure I got the same words I used this morning?
Q. Please, because your notes are better than my notes, I'm sure.
A. Okay. Where did I put that now? Yes. I would say there's three basic tests. As I said, there could be reasons for deviating from the normal approach of just letting the income be what it is, and to defer costs and revenues for recovery or reduction recovery in a future period. In other words, either add or subtract from future revenue requirement.
The three conditions are: the cost or revenues would normally be considered in establishing utility's revenue requirement. For example, a utility might have some costs, but if you wouldn't have normally recovered it, you're certainly not going to allow them to defer it. So that's the first test that has to be made. Second, the cost or revenues

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or at least the extent of the cost and revenues were not contemplated in setting the rates for the period. And third, the amount of the cost or revenues to be deferred are material. You know, someone has an unanticipated cost of $100,000. It's not very common they'd run to the Board and say "can we defer it?"
I also pointed out that in some cases, boards add an additional condition. They'll state that there is--they may state that the costs or revenues be largely outside the control of the utility's management. They would add this in order to provide an incentive to manage the costs that are--over which they can exert significant control. So that is sometimes put in place, sometimes not. That's a bit of a subjective judgment, I suppose. The key thing is that the Board be consistent in dealing both with excess revenues and excess--or sorry, not excess revenues, but unanticipated revenues and unanticipated costs.
Q. So the 2.1 million that is interest income for 2005 has the effect, when it's recorded on the

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Company's books, of moving the Company into its just and reasonable rate of return essentially, puts them up into their--what would be considered just and reasonable return?
A. I have not checked it, but my understanding is they would still be less than the maximum.
Q. Yes.
A. So there is--my understanding at this time is that no portion of the 2.1 would flow into the excess earnings account. However, that's based on information provided to me. I have not checked that.
Q. But it is also the case that no portion of that 2.1 million would flow to consumers in-- it flows to shareholders essentially?
A. It flows--my understanding is it's going to flow entirely to the shareholders, yes.
Q. Just by virtue of the--and I guess the other piece of that discussion, I'm not sure in what context it was raised, was this idea that Newfoundland Power had also incurred costs that they had not recovered in rates and that somehow there was a linkage between the fact that Newfoundland Power hadn't recovered a

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portion of those costs and that was a further justification for not looking at that 2.1 million as part of this -
A. Well, that was my point or that was my reason for saying that it didn't meet the condition, that it was a revenue that would normally be deducted in setting the net cost of service as part of the revenue requirement.
Newfoundland Power has given me information that they incurred certain costs back in '95 and '96 which weren't anticipated probably when, at that time, you know, when they first had to put deposit in and they financed that until their next rate proceeding. The amounts were relatively small and as far as I know, Newfoundland Power has never asked to have those recovered. Now we come to a situation where there's excess earnings. So--or I should probably complete the thought there. So because of those costs, Newfoundland Power has not been fully compensated for the costs associated with the tax assessment. Now some excess revenue comes in and the Board has to consider whether it should pull the revenue out of 2005 and defer

MR. BROWNE:
it. Well, they should have a good reason. And what I'm suggesting is the Board should consider the fact there were these costs back there and on a present value basis, they exceed the revenues, and is it just and reasonable to give the 2.1 million to rate payers when the utility has not yet been left whole.

Q. Does this ring of retroactive rate setting in some way, shape or form? I mean, in terms of going back to '95 and trying to justify -

A. No. No, I mean, the point is it is reasonable. Well, in a way, you're doing that, going back and pulling the interest income out of 2005. So I think the thing is that is this justified in doing it, and I think it's reasonable for the Board to say "has the utility been left whole before we take the earnings?" I mean, the argument that I would say for taking ancillary revenues and flowing them through to rate payers is that the utility receives all of the costs and a fair return already. To get the ancillary revenues on top would not be fair. For

example, when it comes to pole attachments, the utility is left whole in that it receives all the costs and the return on its investment. So to provide it with the ancillary revenues it receives from the telephone company and the cable companies would provide it with an opportunity to earn more than a fair return. But in this case, they haven't yet been fully compensated. So in evaluating whether that 2.1 million should be taken out of 2005 and deferred, I think that is information this Board should consider in evaluating whether it is really just and reasonable to do that when they haven't been fully compensated yet.

Q. In 2001, the Board dealt with an application from Newfoundland Power as a result of excess earnings being generated, and it was related to the tax case, the settlement of the GST issue.

A. Yes.

Q. And in that case, Newfoundland Power, by virtue of receiving that--and I think it was mostly interest income at the time as well--did move to the upper end of the range.

A. Yes.

Q. So--and the excess earnings, we weren't dealing with the entire amount. It was whatever amount was left once the utility reached the top of the range. Would someone--and I'm not making this argument or making the suggestion, but might somebody suggest that Newfoundland Power has been compensated by virtue of the fact that in that year -

A. It received the interest?

Q. - they did get the opportunity to earn at the top of the range?

A. Yes. I believe it's--one of the exhibits or interrogatories that were reviewed yesterday set out Newfoundland Power's analysis that showed that the cost they've incurred, the present value cost they've incurred has exceeded the present value of the interest received. That included the net interest they received in 2000 and 2001, net of the amount that had to be rebated. So the analysis saying they are not yet whole includes the net portion of that interest income they kept back in 2000 and 2001.

(11:45 A.M.)

Q. Yes, I'll have to go back and just look at that again. Is there, under the scenario that was just discussed with Mr. Kennedy, the--it's a proposal, I guess, or something that's going to be on paper soon that would outline another option of deferral of that 9.6 or whatever amount, I guess, ends up--Newfoundland Power is currently in the process of, I understand, completing a depreciation study for plant in service as of December 31st, 2005, that's the--yes. So this Board will have an opportunity to be dealing with a new depreciation study, a new set of circumstances which will update, you know, Newfoundland Power's position with respect to depreciation expense and cost as of December 31st, 2005. Is it a possibility that the 5.6 million true up piece that's missing, you know, that cost that Newfoundland Power is going to be recovering presumably under this proposal in a go-forward period could be considered as part of the consideration of whatever further true ups, plus or minus, so there could be a netting perhaps against a future--is that something that -

A. If I can elaborate on what I think you're

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MR. BROWNE:
saying, say you sort of leave this in as part of the unrecovered depreciation expense -
Q. Yes.
A. - and include it -
Q. Just that piece, not with the other pieces.
A. In principle, I don't see a problem with it. I can't think of an example where it's been done.
Q. I think what -
A. But I mean, in principle -
Q. - I think we'd all agree this is -
A. Yes. I think in principle it's all right. I'm trying to think if there's any problems-- there might be some--there's the issue that Mr. Meyers brought up yesterday around if the depreciation expense falls it could, you know, generate something, but there's ways around that. So when you put that aside, I can't think of a problem off the top of my head. The only caveat is, is that I am speaking off the top of my head without a full analysis. But on the surface, it seems something that would be reasonable in accordance with established regulatory principles and--or

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principles at least.
Q. And I guess it's only because we would be dealing with the depreciation, the recognition of depreciation expense on a go-forward basis as part of a general rate application in the context of the entire revenue requirement piece. So -
A. Yes.
Q. - there will always be these -
A. The key thing though is that the entire 5.8 -
Q. Yes.
A. - million would be considered a cost. There would be no evaluation of "oh well, what did you earn in 2005" or whatever.
Q. No, and I guess that--because the 5.8 million, there doesn't seem to be any dispute that that's not a true number, I mean, it's in our P.U. 19 and it was recognized and that's why that is the only piece that I would be talking about in that respect, but yes. That's all I have. Thanks. It was nice to see you again, Mr. Browne.
A. Thank you very much.
CHAIRMAN:
Q. Thank you, Commissioner Whalen. I just have

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one short question that may require a longer answer or no answer, I'm not sure which. Maybe I'm reluctant to ask it, given the sparring that went on between yourself and the Consumer Advocate over the 9.6 million and whether the cost of service standard applied. I understand in addition to the proposal that's outlined in the application by Newfoundland Power that you commented that, you know, another proposal that you would agree with would be existing rates stay the same and the 9.6 gets put into a deferral account. I mean, that's a possibility?
A. That is a possibility, yes.
Q. I guess one of the issues certainly, you know, that's always before the Board is not so much the application to some degree of the regulatory principles and whether proposals meet the test. It's balancing the interests.
A. Yes.
Q. And I haven't heard a lot of discussion around that, I guess, and would you care to comment on perhaps which of those proposals, or if you wish, any of the other proposals that Mr. Kennedy, you were here yesterday, put forward

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would be--and this would be, you know, a general comment, I appreciate--would meet those requirements in terms--I mean, we have to look at this from the point of view of applying the regulatory principles and which of these options would best serve those balancing of interests, I guess, and I'd like for you to pursue that a little.
A. Yes, I would. If I could make one introductory comment is I view the established regulatory principles as being there to guide the boards in determining what is just and reasonable.
Q. Yes.
A. And that means reflecting the legitimate interest of utilities and rate payers. I don't see them in conflict at all as you do one or the other. Those principles are there to guide you or to help guide you in coming to a fair, just and reasonable conclusion that appropriately recognizes each party's interest.
Q. But the challenge for us is--would be in balancing the interests.
A. Yes.

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CHAIRMAN:
Q. There's no question about that.
A. I think that the proposal put forward by Newfoundland Power does that. The deferral is--probably should refer to it as Mr. Kennedy's proposal, it's obviously not, but whatever that proposal was, seems to have the same end result. So whether we quibble about the details or not, the end result's the same and therefore I think should be as reasonable. I would say anything that denied the utility an opportunity to recover prudently incurred costs that it had not yet previously been allowed to recover would be not just and reasonable, wouldn't meet the standard. Let's see what other options are out there? I guess those are the only three on the table, so unless you give me another one, I'd be happy to address it. Just as I'm sitting here--of course five minutes from now, 20 of them will hit my head.
Q. Is there--either they both meet the standard, I guess, in terms of balancing of interest and the regulatory principles. Is there one that would perhaps tip the scales, in your view,

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one of those?
A. Well, as I said, that deferral we spoke of in Newfoundland Power's proposal -
Q. I understand.
A. - same end result, so what's the point, or what's the difference? And I'm trying to think of other ways -
Q. You didn't see a distinction between those two, in terms of -
A. Not really. I think it's a lot neater and reduces a lot of uncertainty for the Board to accept the Newfoundland Power proposal. In other words, those costs are dealt with. Here's the 14.4 million and let's move on. It seems cleaner, neater and possibly reducing uncertainty. I'm trying to think of ways--because I think all the proposals have to leave the utility--give the utility an opportunity to recover those, you know, its prudently incurred costs. Certainly, there is the option, the Board could say--adjourn something that you could propose. At this time, what I would probably need, is interim rates on January 1st. The GRA probably--you're not going to have a hearing until the

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fall, and--so rates probably wouldn't be decided until the end of the year, finalized. And of course, that would create some problems with having a GRA to deal with 2007. So that is an option I don't really--I suppose it's an option, but I think it's got an awful lot of problems with it, and creates a minor amount of uncertainly for customers because they'll have interim rates and catch up afterwards. So that option, I don't think is really all that interesting. And unfortunately, as I say, five minutes from now I'll have twenty options that will pop into my head, but right now it's--that's about all I can think of.

VICE-CHAIR:
Q. And when you mention the GRA, is that with respect to the 2006 test year?
A. Yes, I mean, it's--it is, as I say, it is possible. You could say that, but I think what you have--or I think what would be reasonable for you to do then is set interim rates on January 1st and of course, the GRA is, as you're well-aware, it's going to take about three or four months to prepare. Then from the time of submission, everyone's going

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to want about three or four months for interrogatories, et cetera and sort things out. So you're probably looking at seven to eight months before the hearing would start. And you'd come up with a decision at the end of the year. If there was a significant change in rates, I suppose you could defer that further into 2007 and create--you know, that's a possibility. And as I say, my understanding is Newfoundland Power believes it's going to need a GRA to deal with 2007. So, you're then going to have the GRAs backing up on each other.

CHAIRMAN:
Q. I appreciate all those balanced interests, I was more interested in the, sort of, the degree, I guess. Anyway, that's all I have. Do you have anything further?

KELLY, Q.C.:
Q. Nothing arising, Chair.

CHAIRMAN:
Q. Thank you, Mr. Browne, very much. I appreciate your testimony. Thank you.
A. Thank you very much.
Q. Mr. Johnson, do you need--would your witness

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CHAIRMAN:
like five minutes? I noticed he has a computer. Would you like to move the computer?
MR. JOHNSON:
Q. Yes, just -
CHAIRMAN:
Q. Pardon?
MR. JOHNSON:
Q. Just get the computer plugged in.
CHAIRMAN:
Q. Okay. Well, we'll give you five minutes to do that.
(OFF RECORD - 11:54 A.M.)
(RESUME - 12:00 P.M.)
CHAIRMAN:
Q. Thank you. Mr. Johnson, for the purposes of the record, if you could introduce your witness please?
MR. JOHNSON:
Q. Yes, Mr. Chairman, my witness is Mr. John D. Todd of Elenchus Research Associates. Mr. Todd, of course, has filed a report at the request of the Consumer Advocate, addressing Newfoundland Power's 2006 accounting policy

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application.
CHAIRMAN:
Q. Thank you. Good afternoon, I guess, Mr. Todd. Would you care to be sworn or affirmed?
MR. TODD:
Q. I'll be sworn.
CHAIRMAN:
Q. Sworn. If you could take the Bible in your right hand please? Do you swear on this Bible that the evidence to be given by you shall be the truth, the whole truth, and nothing but the truth, so help you God?
MR. TODD:
Q. I do.
CHAIRMAN:
Q. Thank you very much. So once again, when you're ready, Mr. Johnson.
MR. JOHNSON:
Q. Thank you Mr. Chairman.
A. In the interest of the truth, I should point out that it's actually Elenchus.
CHAIRMAN:
Q. Elenchus?
A. None of the councillors know that. It's from the Greek, you know.

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MR. JOHNSON:
Q. What did I say?
A. If you look it up in the dictionary.
Q. It won't come out on the transcript.
CHAIRMAN:
Q. Whatever else we are here, we are interested in the truth.
MR. JOHNSON:
Q. Mr. Chairman, Madam Vice-Chairman, I'm seeking to have Mr. Todd qualified as an expert in regulatory economics and the application of regulatory principles in the rate base regulation environment. Further to that, Mr. Todd, would you please summarize your professional experience before the Board?
A. Yes, I've specialized in work in the area of theory and practice of economic regulation for over 25 years, 25 years, plus there's actually some time before that. Well since founding my consulting firm, Elenchus Consulting Services, a year ago, we split it two parts. That's where Elenchus Research Associates came in. That's the side that I operate on now. And we also operate the Canadian Energy Regulation Service, which I know some people with the

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Board are familiar with because they're subscribers. Since 1990 in particular, the focus of my work has been on cost of service regulation in the energy and telecom sectors. Since 2000, with the completion of the transfer to essentially competitive environment and telecom, it's been a focus of essentially, entirely on the energy side of things, natural gas and electricity. My C.V. that was circulated, I think, was a bit out of date. It shows a hundred and seventy five proceedings that I've been involved in as an advisor to counsel, of which sixty five of those I prepared expert evidence and appeared, dealing with a wide range of issues from the perspective of their consistency with regulatory principles and practices.
Q. Mr. Todd, would you please provide an overview of who your clients are?
A. My clients include quite a number of regulated utilities; Terasen Gas, which has been sold recently; Enbridge Gas Distribution; Union Gas; Ontario Power Generation; Hydro One; New Brunswick Power. Over the years, I've been retained by customer groups in virtually every

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MR. TODD:
province across Canada and the Territories. Clients also include electricity generators, energy companies, the Ontario Energy Board as a regulator, it's a diverse clientele.
Q. What jurisdictions have you appeared in as an expert witness, Mr. Todd?
A. Before the energy regulators in B.C., Alberta, Manitoba, Ontario, Quebec, as well as before the CRTC on telecom matters.
Q. Mr. Chairman, with that, I seek acceptance of Mr. Todd as an expert qualified to give an opinion in regulatory economics and the application of regulatory principles in a rate based regulation environment.
CHAIRMAN:
Q. Objections?
KELLY, Q.C.:
Q. No objections. It's not usual that we go through this process, but -
CHAIRMAN:
Q. Sure.
MR. JOHNSON:
Q. Yeah.
CHAIRMAN:

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Q. You're right. We don't generally accept it. That's fair enough. Thank you.
MR. JOHNSON:
Q. Mr. Todd, would you please advise the Board what I asked you to do in connection with this application?
A. I was asked to address eight questions. Those questions are set out on pages one and two of the filed evidence. And I won't read them though until--for a moment.
Q. What did you conclude as a result of your examination of Newfoundland Power's application and the issues that were raised therein?
A. With respect to the eight questions, the first is--question was, "is the adoption of the Accrual Method of revenue recognition for regulatory purposes consistent with standard regulatory policies and practices"? The answer was yes. There's no dispute around that, so there's no need to give the reasons.
Q. And just for the record, you are now referring to page thirty three of your report?
A. That's correct. Question two was, "is Newfoundland Power's proposal to establish a

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2005 unbilled revenue account to be disposed of to the benefit of rate payers in 2005 and subsequent years, consistent with standard regulatory policies and practices"? Yes, again, that's not disputed. Third question, "is N.P.'s proposal to apply two hundred and ninety five thousand of the two hundred and-- of the 2005 unbilled revenue to dispose of the current balance in the unbilled revenue increase reserves in 2006 consistent with standard regulatory policies and practises?" Again, yes, and I believe that's undisputed as well. Question four, "is N.P.'s proposal to apply 9,579,000 of 2005 unbilled revenue to N.P.'s 2006 revenue for regulatory purposes consistent with standard regulatory policies and practises"? The answer there is no. The bottom line, because it's just a summary, and conclusions of the paper, was that, in the absence of a GRA that allows the Board to determine the revenue deficiency, allowed revenue deficiency, that it considered it reasonable, based on a full review of the Company's forecasted 2006 financial results. It would be appropriate to recognize, at most,

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sufficient revenue to offset the tax effects, being the 3.086 million. Question five, "is N.P.'s proposal to defer the decision on the disposition of the remaining 2005 unbilled revenue of approximately 14.1 million for future consideration by the Board, consistent with standard regulatory polices and practices"? Yes, subject to the caveat that the answer to the previous question would change that number from 14.1. Six, "is N.P.'s proposal to deduct the average value of the unrecognized 2005 unbilled revenue from rate base, commencing 2006, consistent with standard regulatory policies and practises"? Yes. Seven, "is N.P.'s proposed treatment of the 2.1 million in interest revenue arising from the tax settlement, consistent with standard regulatory policies and practices"? The answer there was no. The interest revenue is essentially an offset to the carrying costs that was borne to finance the income tax deposits that N.P. was require to make over the years. It is, therefore, clear that this revenue is not required to compensate the Company for costs it has incurred in order to

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MR. TODD:
provide regulated services to the customers. The Company's implicitly proposed treatment of the interest revenue for regulatory purposes violates the cost of service principle. In all years, including 2005, N.P.'s regulated rates were set by the Board at a level that allowed the Company to recover its costs and gave it the opportunity to earn its allowed rate of return on rate base. If its revenue had been included in the forecasted revenue for 2005, it would have reduced N.P.'s overall revenue requirement. And again, this is a summary, so there's more to that discussion. And the last question is about the ARBM, with an answer, yes, it's according to standard practices.
Q. Mr. Todd, now I note that in your report, questions four and seven were answered no. We'll come back to that shortly, but first I'd like to ask you whether there is a substantive difference between seeking additional revenue through a rate increase, and seeking additional revenue through recognizing UUR?
A. In my view, from regulatory principles

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perspective, and what we're dealing with here, there is no substantive difference. Both require the same due diligence to be exercised by the Board. The 2005 UUR is, in effect, a customer deposit of 24.4 million dollars. It reflects extra funds, which are being collected in January 2006, which are above and beyond what's required under the Accrual Method. Those are real dollars. An option, which has been discussed to a very small extent during this proceeding to date, would be to simply say that that's a customer money that should be paid back to them. Just cut cheques, give them the money back. The Company would not be out anything if that was done. They'd still be able to earn their allowed return in every year. But that would not be recommended by me and it's not recommended by others, because that consequence would--could create rate instability. It could have negative cash flow impacts on the Company. There are reasons for not doing it--good reasons for not doing it. It's not good for the customer. It's not good for the Company, but the point is it's real

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money, that conceptually could be paid back with no harm to the customer, or no harm to the Company. If that was done, it would be clean and if the Company was concerned about the inability to recover the depreciation, they could bring forward a GRA, as one would have thought they would have done in the absence of the tax settlement. A further demonstration that the same due diligence is required in dealing with the UUR as with the rate increase, is to start with the assumption for illustrative purposes, that if the revenue requirement, the financial forecast--the forecast was subject to a full review and a test, that the revenue part would be reduced by two million dollars, okay. Untested, they get the two million dollars; if it's tested, they wouldn't get the two million dollars. What's the implication of that? There's a cascading effect. If you've given them two million dollars up front because you didn't test the revenue requirement, you've drawn an extra two million dollars out of the 24. The 24 runs out two million dollars sooner, and that drives two million dollars in additional

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rate increases at the end of the day. You're still talking rate increases. The only difference is when. By using the UUR, if you make an error in terms of how much UUR you allow the Company, the rate increase is something that occurs in 2007 or 2008, when the money runs out, as opposed to today. But it's still a rate increase, and therefore, I fail to see why any less diligence is required by the Board now than would be required in looking at the rate increase.
Q. Does that conclude your response to that question?
A. Yes.
Q. Mr. Todd, would it be standard regulatory practice to set aside the review of the consequences of the tax case, such as happened in this instance, for future consideration, as the Board did in Order 19 in 2003?
A. This is central and key to the differences between the Company's witnesses and myself. And that is, what did the Board mean in Order 19 (2003), when it said, the Board will deal with any issues arising from the final decision for a tax case, including any

MR. TODD:
potential liabilities or benefits to rate payers once the case has been resolved.

Now, I can't tell you what the Board meant because I'm not the Board, you know, but I consider the meaning of that to be critical to the issues in this case. My interpretation takes the words directly and I read that as the Board creating a defacto deferral account to deal with the final decision of the tax case. That final decision could have been the decision from the Court, if it had gone that route. As it turns out, in retrospect, we know that it was the tax settlement. We know if we look back at the tax settlement, section--item thirteen in that settlement agreement, it sets out the liabilities the Company was faced with that were written off by changing notices of assessment.

(12:15 P.M.)

A. We know that all of those could have come due if the Company lost, and the Company is on record as saying that they would have sought additional revenues through this Board, to offset those losses. I believe that the

purpose of Order 19 in 2003, was to say we're setting that aside and we're going to give you the opportunity to come in and seek those recoveries, even thought they relate to past years, and even if the Court's decision triggers a payment that is due immediately and would occur within a year when they could not have a general rate application. So if the Court decision had happened in June of 2005, the claims the Company would have had around $16 million in costs, would be in exactly the same boat as the 2.1 million dollars in interest revenue. It would have been in a year that's already has rates set and therefore, in the absence of a deferral account, they would have no claim to say we need an adjustment for those costs. So I see a symmetry between the potential liabilities and the potential benefits of a settlement, and I think that's why the Board in its last order, in its wisdom, said "including any potential liabilities or benefits". And it simply said, we're going to put those up and we're going to look at those in terms of the flowing through to ratepayers. And I believe

that my interpretation is that applies implicitly because it has to be implicit because the Board didn't know what the settlement is going to be, applies implicitly to the interest revenue.

Now, if my interpretation is right, then it says that there is a defacto deferral account. It means that the Board, and only you can decide, if you look inside your own heads and say if we had had that and the Company had come in and asked for the $16 million, would I have given it to them? Would that have been a legitimate claim? And the way I'm looking at it, is having set up a defacto deferral account, the same decision would have to be applied to the 2.1, the simply symmetry; they're both in the same box. Now this defacto deferral account meets the three test that John Browne has talked about today about a deferral account. And remember, the deferral account was not simply about the interest revenue. The deferral account was about the tax dispute. The tax dispute had an unknown effect, that's clear. It was potentially significant, it was potentially

zero, it's potentially 2.1, but it's also potentially $16 million, and it was not in control of Newfoundland Power. It's in control of the Courts, it's in control of Revenue Canada. I mean, they're in negotiating so it's within their control to some extent, but Court cases, Court liabilities typically are addressed through deferral accounts. I mean, that's frequently done, the potential liabilities or benefits of those. So that would fit right into the box of a deferral account.

So to me, what we're dealing with today is a clearly defined box which is the effects of the tax settlement. And in looking at that concept, I'm a simple guy. I just sort of say is it reasonable? I use the reasonableness test and that fits the reasonableness test to me. And when I look at what the Board has done, it makes sense they would have gone that route because personally, I don't believe that the Board would have said you can't have your $16 million. And through its statements in its annual reports and statements through this proceeding, the Company is showing the same

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MR. TODD:
interpretation of the 16. If you don't take that interpretation, the box covering both liabilities and benefits, what you've created is a scenario of "heads, I win; tails, you lose" and that's not reasonable.

Q. Mr. Todd, as a matter of regulatory principle, does the absence of a deferral account, an expressed deferral account, limit the ability of the Board to defer the recognition of the $2.1 million in interest revenue that was paid to the Company in 2005?

A. I'm not a lawyer; I'm just a regulatory economist, so the law may be different, but certainly from the perspective of regulatory principles, from the perspective of reasonableness, the fact that the Board said what it said in the last order, does in effect create a deferral account as far as it's concerned. If it doesn't, then it would have precluded the $16 million recovery, if they gone that--if the Company had been unsuccessful.

Q. I wish to turn to your response now to question 4, where you answered no to the

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question, "Is Newfoundland Power's proposal to apply 9,579,000 of the Unbilled Revenue to Newfoundland Power's 2006 revenue for regulatory purposes, consistent with standard regulatory policies and practices." In that response, which you've noted in your report already and on the record already, you appear to draw a distinction between the reasonableness of permitting the use of UUR to offset the results of the Tax Settlement, verses using the known increase in depreciation expense. Why do you draw such a distinction?

A. The logo of my company, the box, you know, the inside box is an outside box and what we've got here, as I've been saying is there's a box that's been created by the Board's past decision. The consequences of the settlement are inside the box. Inside the box is the $3 million of taxes triggered by the settlement. Inside the box is 2.1, those are all parts of it. Inside the box is the Accrual Method and the things that that triggers. Intermingled with the consequences of the tax decision is a totally separate issue being brought forward

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by the Company. And that issue is they are forecasting a revenue deficiency in 2006 unless something is done about it. And they're saying let's find a pragmatic way to give us the opportunity to earn an allowed return. But that's totally separate from the other issues. As I've said, that essentially is a GRA issue. They're essentially coming in and saying we have a revenue deficiency, let's make it up. In normal circumstance, that would mean come in and ask for rates. They've woven it in here, you know, to take advantage of the UUR, which is a pragmatic thing to do. But in the process, they're asking to use the UUR in a way that is dependant upon a revenue deficiency which in reality is asking you to find that there is, that they require funds without testing the revenues and costs underlying that. They're asking you to take a couple of pieces out, pieces that relate to depreciation and saying, if you look at these pieces in isolation, the number happens to get us up into the range of allowed return. So let's use that as our excuse to give us enough UUR in 2006 to get us into the range. But

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really what they're asking is get us in the range and if depreciation didn't get them there, you know, I'm sure they'd be asking for something else because that's the real objective and they've made it quite clear that that's the justification. They wouldn't be asking for the depreciation offset if they were already in the range. So that is a totally separate question. And I respect and it's quite reasonable that they're saying why have a GRA, let's find a pragmatic solution. But it's a totally separate issue and I am treating them differently because certain items are in the box, depreciation is clearly outside the box and it's really not a depreciation issue, it's a revenue deficiency issue.

Q. Could I ask you to--Mr. Todd, do you feel, by the comments you've made already, that you've elaborated enough upon the reason why you felt that Newfoundland Power's proposed treatment of the 2.1 million in interest revenue is inconsistent? Probably not.

A. I'll just read my notes and say, I guess I jumped ahead, that's what happens when you

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MR. TODD:
wing it a bit. Yeah, I think we probably covered off that. What you're talking about is the other no is question 7, which is the 2.1 and I think that's been covered off by my comments.
Q. Okay. Would you care, before passing on that, to elaborate on your contention that it violates the Cost of Service principle?
A. It violates the Cost of Service principle if your starting point is it's in this box, the deferral account, okay. If the Company is right that it's not, then it wouldn't violate the Cost of Service principle, then I would agree with John Browne. So the real issue is did the Board set up a box that included both the liabilities and the benefits and if it was both, was the 2.1 in revenue one of the benefits that goes into that box.
(12:30 P.M.)
Q. Mr. Todd, would you please comment on the option that has been variously referred to in this proceedings as either Mark Kennedy's option or the fifth option, and it was referred to yesterday, of course, whereby

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Newfoundland Power would defer recovery of the depreciation expenses, those being the true up, plus the increase plant investment, and as I understand it, use the UUR in 2006 to offset the tax effects of the Tax Settlement.
A. To avoid offending Mr Kennedy, I'll definitely refer to it as the fifth option. For starters, to a large extent I agree with the comments of Mr. Browne that says there's no difference, except I would take it a bit further. Although I put the caveat in with that proposal, it's not totally clear to me what was intended in terms of the test to determine if recovery is appropriate. It may have been the intention was the recovery be automatic, if not, then you've got to do it in terms of the revenue deficiency test, do they require it, which implies--and I think this is where they are going, implies a GRA in effect for 2006, just what they're asking you to do now, they're saying find the revenue deficiency, we need the money, without testing the evidence. The alternative is you defer it and perhaps you then in the fall of 2006 look at it largely in retrospect and say is there a

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revenue deficiency. Assuming that's the intention, I have a problem with that because what you've done is you've now moved from using the excepted methodology for future test year, to in effect, using an historic test year regime to evaluate the regulatory deficiency. And as it happens, the very first case I did before a regulator like yourself, was in 1990, which was the move from historic test year to future test year for ICG. I think the last one to make that change. And there's good reasons why everybody is on a future test year. There's incentive effects, very important incentive effects. You do a forecast, you have a chance to outperform them. In an historic test year, there's no incentive to keep your costs down because at the end of the year you look at your costs and say, okay, I get them back. If you create a scenario where you have made a defacto historic test year, rate base rate of return review as the basis for recognizing those depreciation costs, I think you've made a mistake because you removed the incentive from the Company to be efficient. And therefore,

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while to some extent the two approaches, the fifth model and the Company's proposal are the same, I would say that the fifth option is inferior because it's defacto of historic test year approach that would be used, assuming you do something to assess the reality of the revenue deficiency.
Q. Mr. Todd, does that conclude your remarks?
A. Yes.
Q. Mr. Todd, would you please comment on the interplay of regulatory principles and the pragmatic concern everybody has, I think, with avoiding a cost to consumers that would arise from a General Rate Application?
A. I don't believe in all pragmatism. I believe in principled pragmatism. And I think that you have an opportunity here to implement an alternative which I would consider to be principled pragmatism. And the essence of the issue is this: under the Company's proposal they were essentially asking you to make as a finding of fact that they have a revenue deficiency of sufficient magnitude that they require 5.8 million, in addition to--to offset all the depreciation, in addition to the 3

MR. TODD:
plus million in the tax effect.
Q. And the 1.157.
A. There was--yeah, in light of the depreciation effect, all of those pieces. They're asking for that to be, that calculation to come up, but reality is they're saying there's a revenue deficiency there. If you accept their proposal, what you're doing is you are recognizing UUR in 2006 because of a revenue deficiency that's not been tested. To me, that's unprincipled, unprincipled I mean on the totally pejorative sense, I mean, contrary to regulatory principles. You have an alternative.
If you recognize UUR for another reason, i.e. on its own merits, not because of a regulatory deficiency, but strictly on its own merits as a principled approach to recognizing UUR, you could end up with essentially the same result, but in a principled way. Okay, you take a look at the alternatives that are on the table in terms of the Public Utilities Board request for information from the Company, one of those options is three-year

recognition. Three year recognition, if we were simply to step back and look at on a principled basis what would make sense, in terms of recognition of the UUR, without reference to revenue deficiencies, or requirements for money, the Tax Agreement says recognize the additional income, the unbilled income over three years, and the three years are 2006, 2007 and 2008. It would be absolutely consistent for this Board to decide we'll recognize the same way for regulatory purposes. We'll take that money, divide it by three and recognize it each year. And for good measure, we can take that $2.1 million, if you agree with my interpretation and say that should be going back to the customer too, that in effect that's part of UUR and add that on to 24, get up to 26, get up to 26.5, divide it all by three, feed it back to the customers as recognized revenue for three years. That's being done on its own merits, that's being done as simply a principled--we should have a mechanism for recognizing the revenue; this is a good mechanism for recognizing the revenue.
The concept is it's a stand alone,

therefore the chips, you let the chips fall where they may. If, having recognized the revenue that way, there ends up being, in the Company's view, a shortfall of their earnings, they have the right to come forward with a GRA. If as a consequence they end up over earning, the over earning will deal with it. But you haven't had to make a decision in the absence of testing the evidence that there was revenue deficiency. You haven't set a bad precedent that people like John Browne and I will be fighting over for the next ten years of people saying, look what the Newfoundland Board did, you know, we can do that too.
Now, as a matter of coincidence for the first year, 2006, you'd be doing a little bit less but pretty close to what the Company is asking for. They would fall a little but under the 8.5 of the range, but should that be a concern when the 8.5 is a forecast that's untested, they never brought forward for testing? Isn't there some flexibility around that range if the Company has not brought forward a GRA to have it tested? So should that be a concern? I would say not if you're

trying to adopt a principled approach to your pragmatism.
In addition, the 888 is actually a good way, in my view, to deal with the rate instability. By spreading the 24 over three years, you're probably, unless the Company wants to do a GRA over a million bucks, you're probably making it unnecessary to have a GRA for 2006. The evidence on the record suggests that in '07 the revenue deficiency may be in the 12 to 16 range, so there may be a small rate increase required for '07, you still got 8 for '08, you end up with two years with small rate increases, things go up, and then sort of the balance, you know, kicks in, in '09, where you have to catch up because you've now used up all your UUR, similar to the loss of the amortization on depreciation in this year, which will be in the same boat, you'll be hit with a rate increase unless there's something unavoidable. But it's certainly better than going, for example, ten this year, '06 and 14 and then having a huge rate increase in the third year. So it actually achieves some smoothing, so it's not bad from

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MR. TODD:
a rate stability perspective, but, of course, my primary interest is what you've done is you have achieved a pragmatic solution in a principled way, it's not identical to what the Company has done, but it's pragmatic as what they're proposing and it's close to the end result.
Q. Having said that, Mr. Todd, would you care, having regard to the circumstances that are presented in this case, to indicate what your recommendation would be to the Board?
A. I think what I could say at this point is going to be repetition, but just to make sure that I've made myself completely clear, and I've sat here for the last day and a half and I've moved from feeling on Monday evening that what you had before us was a fairly uncomplicated and simple case, to feeling like there's a lot of complexity here. As I sit here again, I sort of say, there's actually no complexity, it's a fairly simple case. What you've got are two people looking through different sides of a prism and what separates the side of the prism? Did the Board create a

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defacto deferral account or not? Most of the differences are driven by that. And you, as a Board panel, have to decide what you, the Board, meant in 2003. And if my interpretation is right, I believe the consequences are exactly what I'm talking about. If my interpretation is wrong and the Company's interpretation is right, then obviously you go with the Company's point of view.
The second issue, that's why I say it's simple, it's that issue in the second one is pragmatism. And we have two views of how to be pragmatic. One is accept the forecast of a regulatory deficiency as a finding of fact, without testing the evidence; the other is recognize the revenue the same way it's recognized for tax purposes. Both give a similar result, both are pragmatic. In my view, one is more principled than the other and therefore, I recommend that approach, recognizing the UUR over three years. And in fact, I'd say the UUR plus the revenue, the interest revenue.
Q. Thank you.

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CHAIRMAN:
Q. Thank you, Mr. Johnson. When you're ready, Mr. Kelly please.
KELLY, Q.C.:
Q. Thank you, Chair. Mr. Todd, I'd like to start by taking you to your report at page 12.
A. Let me rearrange the computer here, end of that in time for my paper.
Q. If we scroll up just a little bit more there, you'll see at the bottom of the page -
A. Yes.
Q. You refer to the decision of the Board and you point to seven regulatory principles.
A. Yes.
Q. And they are: Fair Return, Cost of Service, Fair Cost Apportionment, Efficiencies, Rate Stability and Predictability, End Result and Practical Attribute. In fact, one of them is Practicality, agreed?
A. Yes. And should I flip my computer back on and pull that up or is there a copy handy of that decision?
Q. We can come to the decision later if there's-- I'm talking an overview here now. The question I wanted to -

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A. I was thinking if I wanted to refresh, because the words that go under that heading are important.
Q. If you'd care to look at it.
A. There's a specific--it'll come back up. I'll refer to it if I have to, but it'll be ready in a few minutes.
Q. The point I wanted to put to you is this, would you agree with me that what the Board must do is find an appropriate regulatory balance in the application of these principles?
A. Yes.
Q. And that Cost of Service is one of the principles, but they got to be balanced with the others?
A. I would say that I wholeheartedly agree with John Browne who says, I believe it is the heart of rate regulation, Cost of Service, that is, principle. And it's clearly No. 2 on the Board's list and I think the order made a difference, but, yes, they have to be balanced. There are different priorities, but they balanced, I agree.
Q. And No. 1 on the Board's list is "Fair

KELLY, Q.C.:
Return". And, in fact, the concept of the opportunity to earn a fair and reasonable return is part of the Cost of Service issue itself, isn't it?
A. Yes, it is.
Q. So, some of the points we need to think about as we have our discussion here today are cost recovery, the opportunity for a fair return and balancing the interests of customers and the utility? Would you agree with those three points?
A. I agree.
Q. Would you agree with this proposition that sound public utility practice has to be applied within the context of the regulatory regime in the particular jurisdiction? In other words, we got to apply these principles in the context of the regulatory regime here in Newfoundland and Labrador?
A. Agree.
Q. Okay. And the sources of that regulatory regime we would find in the statutes, traditional decisions and in the Board's decisions itself, agreed?

A. I explicitly said I'm not a lawyer and there may be some legal argument around this, and I think you've raised that point already in this proceeding. Yes, I'm applying my perspective from my perspective, which is a regulatory expert not as a legal expert.
Q. Okay. Now, you are aware that this Board has created a range of rate of return on rate base?
A. Yes. And I will comment on that from my regulatory expertise as opposed to legal expertise, yes.
Q. But, you understand it's plus or minus 18 basis points?
A. I understand that perfectly, yes.
Q. Okay. And it would be fair to say that that's a range of reasonableness of the return?
A. In reviewing past decisions, including the decision where it was increased from, if I recall correctly, a range of 50--of, no, it's--it would increase the range in a recent decision, plus or minus 18, was it plus or minus 15 or 10? Anyway, sure. But, they increased the range. In reading that decision they were identifying an appropriate range to

allow for purposes of the automatic adjustment mechanism which said that the prospective return could fall within that range without it causing concern to the regulator.
Q. And so the range of reasonableness of the return?
A. Yeah. But, what the distinction is, prospective, retrospective. On a retrospective basis it doesn't say they have to fall in that range. On a prospective basis, I agree.
Q. Okay. Now, the Board has also set up an excess earnings account. You're aware of that?
A. That's correct.
Q. And you would agree with me that that's a mechanism to help balance the interests of the customers and the utility?
A. Yes.
Q. And you've had some familiarity, I take it, with PU-19 in 2003. I just wanted to take you to page 26 of that decision.
A. It's going to come up on the screen, okay.
Q. There you go. And the part that I'm interested in is the part that's in bold, this

is the Board's conclusion, "The Board finds that it has no jurisdiction under the Act to require payment by Newfoundland Power into a reserve account or otherwise deprive Newfoundland Power of any amount which is within the allowed return on rate base as fixed and determined by the Board pursuant to Section 80(1) of the Act", was the Board's finding?
A. Yes. Which is obviously it's a comment on its jurisdiction, which is a legal matter. I accept that statement, yes.
Q. Okay, you accept that statement. Now, if I take you next to PUB-10. Put up PUB-10?
A. Just as a caveat, of course, a deferral account is outside of that consideration, explicitly, that's what deferral accounts are.
Q. Let's leave the deferral account for a minute, we'll talk about that in a second.
A. Okay.
Q. If I take you to PUB-10, can I take you down to the second paragraph? And you'll see in that paragraph that it says "Section 5.00(j) of Newfoundland Power's Board approved system of accounts requires that interest revenue

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KELLY, Q.C.:
derived from income tax refunds be recorded as miscellaneous non-consumer revenue. The refund interest resulting from the June, 2005 Tax Settlement was recorded in this manner. Settlement of other issues in the tax dispute in 2000 and 2001 also resulted in the receipt of refund interest by Newfoundland Power in those years. The 2000 and 2001 interest amounts were also recorded as miscellaneous non-consumer revenue in the year received." So, you agree with me, first of all, that there is a system of accounts approved by the Board as to how income tax refund interest is to be applied?
A. I agree that there is--first of all, I've read this and I recognize it's the Company's position. No question of that. I understand and recognize there's a system of accounts, as in other jurisdictions, and that that treatment is specified and that barring the creation of a deferral account in my view whether it may be a legal matter as to whether it has to be created in fact or simply defacto, barring that, that would be the

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correct treatment.
Q. And so that the normal course, which is how this revenue would get treated, get credited, get applied, is it would be treated as revenue to the Company, that's the way the current system is set up?
A. In the normal course, which would be applied in the absence of a deferral account, that's the way it would be applied, I agree, yeah.
Q. Okay. And that you've heard the evidence that the inclusion of this interest revenue only puts Newfoundland Power within the lower end of its permitted range of return?
A. It only puts Newfoundland Power into the lower end of its rate of return based on an untested forecast, yes.
Q. Now, as we--I take you over to PUB-12, and we scroll up the table there, you will agree with me that all of the interest refunds have been treated in the same way since 1995?
A. Yes. And, of course, those interest refunds are not part of the box, which is the Tax Settlement referred to in 1993 Board order No. 19. But, yes, I agree that they were.
Q. It's not part of the Tax Settlement, but it's

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all part of the tax, the tax dispute and the resolution of that tax dispute which has taken place, is that not correct? Because we have the resolution of the GEC issue, now we have the resolution of the accrual issue?
A. Well, you're the -
Q. Are we in agreement?
A. You're the lawyer, so we have to be careful with words. I want to respect your profession. The Board order said the Board will deal with any issues arising from the final decision of the tax case. So, I'm simply accepting their words and I'm saying that the 2.1 is part of the final decision -
Q. You're drawing a -
A. - the other amounts are not.
Q. You're drawing a very narrow distinction then in terms of what was left of the original tax dispute in terms of then talking about it in terms of the tax case, is that the distinction you're drawing?
A. I'm not drawing a distinction. I am attempting, in my best effort, to interpret the distinction that the Board drew. Now, I'm right or I'm wrong, they're the ones that will

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decide that.
Q. But, you will agree on this, that all of the interest that was credited was treated as revenue in accordance with the existing regulatory framework approved by the Board?
A. I agree with that. And I agree that in the absence of a deferral account that is the correct way to do it.
Q. Right. And that takes us to paragraph 28 of your report, which is this reference to the deferral account. Now, the Board did not, in fact, set up any type of deferral account, did it?
A. I agree that they did not set up an explicit deferral account.
Q. Okay. And may I suggest to you that an alternative approach, an alternative interpretation of the Board's order is that the Board would review at the conclusion of the matter the Tax Settlement for prudence? In other words, is what the Company did during the management of this tax dispute prudent?
A. I would disagree with that because the purpose for setting up a deferral account is in order to set aside the costs for exactly that

MR. TODD:
purpose so you can test it for prudence. In the absence of a deferral account there is no prudence test because there's no consideration to costs and they simply flow through in the year regardless of prudence, positive or negative.
Q. Let's just see if we agree on this. I take it you do not quarrel with, at any stage, with the prudence of the Tax Settlement, how the Company handled the tax dispute?
A. No.
Q. Okay. So, if I can put these points together, we have the interest income was credited as revenue in accordance with the system of accounts with the Board orders, correct?
A. The instrument (phonetic) in the past was, yes, correct.
Q. Consistently since 1995?
A. Yes.
Q. The utility is entitled to have the opportunity to earn a just and reasonable return?
A. Yes.
Q. And that crediting the interest permits the

utility to get to the lower end of that range or return in 2005, correct, forecast?
A. On a retrospective basis.
Q. And that there are no excess earnings forecast in 2005?
A. If we're talking historic rate making, yes, that's correct.
Q. Okay. Now, you also in your report make this issue or raise this issue about whether deposits costs were fully recovered. And I take it, can we agree on this, that in 1995 and 1996 the amount of the deposit was not in electricity rates, that cost of financing that deposit, because the rates had been, had a 1992 test year?
A. In my perspective, if you haven't had a rate case, haven't had a GRA, there is nothing specifically in or out of those rates.
Q. But, it wasn't -
A. Because everything has changed. Let me finish.
Q. Sorry. Didn't mean to cut you off.
A. Everything has changed since the year-end rates were set. And if what you were to say was that what is in rates are the costs and

revenues of that past year, you would be including in rates some costs that no longer exist, which would be contrary to the Cost of Service principle. What you're saying in the absence of a test year is that you are making a call, if you want, only in the aggregate. The absence of an application from the Company says that in aggregate our revenues are sufficient to cover our cost we expect on a forecast basis and we are content not to come in and ask for higher rates. But, I don't think you can apply--you can't really apply that to any specific cost item, because if you were to have a rate case, the new costs would be offset by the elimination of old costs or additional revenues, which is why you didn't need a rate case, by definition, to offset, that's why you don't have rate case.
Q. Let me put -
A. It's only the aggregate.
Q. Let me put two prospects to you, two issues to you. You'll agree with me that these costs, because they had not yet been incurred, were not included in the 1992 test year parameters, in other words, within those tested costs?

A. In the rate case that came before the Board, they would not have been included if they didn't exist, I agree.
Q. Exactly. And in 1995, '96 if those costs were not incurred, the Company would have earned additional money if it didn't have those financing costs?
A. True of every other cost in the aggregate. And I'm simply saying you're looking through the other side of the prism and I accept that there's two sides to this prism.
Q. And so looking at it from that side of the prism those costs were borne by the Company, is that not the conclusion?
A. From that side of the prism, which is where my footnote said, "Another way of looking at it".
Q. Okay.
A. I didn't say right and wrong. I said there are two perspectives on this.
Q. Okay. Well, I think -
A. You know, that's a take.
Q. I think we're on the same page.
A. And I accept that.
Q. Now, the other--can I suggest this to you, the other consequence of your approach would be

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KELLY, Q.C.:
this, that unexpected costs would be borne by the utility but unexpected revenue would be set aside for customers even where that unexpected revenue is derived from the same event that lead to the cost. Is that not the consequence of what you're suggesting?
A. How do you get there again? Sorry, I've lost the link.
Q. The unexpected cost, in other words, the cost incurred in having to finance the deposit and this unexpected revenue, the refund interest which you say should be treated for customers, they flow from the same event, the tax dispute, do they not?
A. Okay. So -
Q. My -
A. Okay. So, just a second. So, what we're doing is let's take the premise that I'm right, we've got a deferral account, we brought this 2.1 million forward this year for review and now we're having a discussion as to how we should dispose of it, what's the merits of disposing the 2.1 to the customer versus to the Company? Is that the question?

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Q. Continue.
A. Okay. I think it's fair to say again we have two sides of a prism. That if what you are saying is the Company has done a good job of handling a tax case and based on the arguments that the Company has put forward, gee, we've done a really good job, we brought you benefits, therefore we should get the benefit of this 2.1, that is kind of in the line of a performance-based regulation incentive where you reward companies for creating benefits. We don't have performance-based regulation here except to some extent your range does create what is a defacto small performance-based regulation regime. But, in the absence of that you stick to a rigid Cost of Service principle which is recovering your cost, no more, no less.
Q. And allowing you to earn, giving you the opportunity to earn your just and reasonable return, which is part of that Cost of Service principle?
A. By definition that flows. But, you apply that within the context of tested costs. We do not go back and say the Company under earned,

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we're going to give them some additional revenue. The 2.1 was not part of the revenue, based on the evidence in this proceeding, not part of the information that the Company had when it made its decision to come in to a rate case or not. It was a fortuitous circumstance which personally I think that the Board can say it's fortuitous if they think in their minds that there's some good reason to reward the Company for the great job they did on the tax case, and they've done a good job, But, if this is an above and beyond a reward and incentive of some sort, then, fine. But, on the other hand I think they're totally entitled to say, we have it in deferral account, the statement we made in '03 was specifically to ratepayers, and we know the ratepayers carried the bulk of the cost of financing the deposits, therefore we think it is appropriate to have that 2.1 million flow back to ratepayers. It does not have any effect on the opportunity for the Company to earn their return in 2005 because the Company themselves said we have an opportunity to earn a return by not coming in with a GRA before

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2005, and they weren't counting on that $2.1 million dollars. So, as far as I'm concerned, they had their opportunity, they said so themselves by not bringing forward and application, and it's therefore up to the Board's discretion as to what they think is appropriate to do with the $2.1 million.
Q. And so you would acknowledge, then, that there is at a minimum a judgment for the Board?
A. Absolutely.
Q. Okay.
A. Whenever you have a deferral account you have it there because it's not automatic, just as with the excess revenues, the excess revenues is not an automatic flow to the customer. The Board exercises its discretion to say what should be done with these dollars. Same thing.
Q. I want to turn next to look at the question of the tax and depreciation. And if I understand your position correctly, we had up on the screen from page 34 your position with respect to the tax. And I understand you don't disagree that the application of the 3.86, 086 million to cover the 2000 tax on the Tax

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KELLY, Q.C.:
Settlement?
A. That's an inside the box number, so I can see -
Q. You're okay with that one?
A. - using that.
Q. Now, can I take you next to page 22 of your report?
A. You know, I'd flag, of course, that that is separate from the ultimate recommendation which says just dispose of the UUR, you know, in three equal instalments.
Q. I understand that.
A. So, you don't do both, right.
Q. We recognize that.
A. Okay.
Q. Can I take you to page 22 of your report?
A. Twenty-two?
Q. Yeah. And in the paragraph at line 12.
A. Yes.
Q. And I understand from that paragraph you say "while there may be sufficient information on the record," so you acknowledge here there's "sufficient information on the record of this proceeding for the Board to determine whether

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the individual cost items identified by Newfoundland Power, the impact of the conclusion of the true-up adjustment, the impact of increased plant investment, and the impact of the tax settlement and the change to the Accrual Method on income taxes have been prudently incurred" and I want to stop there. I take it you acknowledge that there's sufficient information for the Board to determine that these are prudently incurred costs? The amounts are not really in dispute.
A. If we were in a GRA and I was retained by the CA, I would say those amounts are not in dispute. Let's focus on other matters.
Q. Okay. Now can I just turn you next over to page 23, next page of your report, and your second bullet on that page, at line 8, you say "on the other hand, the evidence does lend credence to the view that it is reasonable to recognize some of the 2005 Unbilled Revenue in 2006 in order for Newfoundland Power to have a reasonable opportunity to earn its allowed rate of return." So I take it that proposition is not really in dispute, agreed?
A. In taking the statement out of context, I want

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to be clear that it's understood what's being said, which is conceptually, if the forecast of the Company for 2006 were tested, there were conceptually two findings that the Board could make. One finding is that there is a revenue deficiency which says something could be done. The other finding, potential finding of fact, is the quantum of the revenue deficiency. What I'm saying here is that the gap is large enough that it is reasonable to conclude that there is a unspecified revenue deficiency.
Q. And -
A. Which is what leads to the pragmatism in saying maybe we should find some pragmatic but principled way to address that.
Q. Okay. Now -
A. It does not have the evidence to find the quantum with respect to that, and that's what the first bullet refers to.
Q. And the quantum that you're talking about, as we've just talked about, is not the quantum of these specific costs, but you're talking about the other revenues expense issues?
A. I'm talking about the quantum that would--

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which is a revenue deficiency, which would have to be found in order to justify giving the Company additional revenues.
Q. Okay. So can I suggest this to you? The issue or the difference between us is--boils down to this, do we need to test everything in a GRA at this point in time? Is that fundamentally where we are?
A. No, I think we agreed that we don't have to test everything. I think the difference is that I'm suggesting we should test the uncertain items and you're saying we don't have to test the uncertain items. We both agree that the items that are known wouldn't be tested in GRA. The only things you test in a GRA are the costs that are debatable.
Q. And doesn't that take us though to the point that I just put to you, the real issue here is do we need a GRA at this point in time? I think we're saying the same thing, aren't we?
A. Well, unless you come down -
Q. That's the question--that's the issue.
A. - unless you come down to my bottom line, which says that if you approach the Company's concern from their side of the prism, they are

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MR. TODD:
forcing this Board to make a finding of fact without reviewing the facts. If they address the same problem with a different pragmatic solution, what they have to find is a reasonable way to recognize the unbilled revenues, and they can do that, by dividing by three. But they escape the requirement to make a finding of fact about a revenue deficiency that hasn't been tested. That's our difference.
Q. Would you agree with these propositions? First of all, the Board has an ongoing supervisory role under its enabling statute and under its jurisdiction. In other words, that role is not simply confined to a GRA?
A. I agree.
Q. And the Company is required to file, from time to time and certainly annually, substantial information with the Board to enable it to fulfil that role?
A. I agree.
Q. The Board has the right to call for additional information if it feels it appropriate?
A. I agree.

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Q. The Board has already tested the amount of the true-up depreciation in 2003?
A. That item was tested, yes.
Q. Okay. And therefore, in that sense, in the sense that it is now expiring, it is recognized in advance within the context of your report?
A. Okay. Let me go to the bottom line of the difficulty I have with the Company's position. Everything the Company says in defence of its position would apply equally well if there was no UUR. In other words, everything the Company says would apply equally to coming to the Board and saying "let's avoid a GRA. These amounts are proven. We need an additional 10 million dollars of revenue. We've got this forecast. Obviously the forecast isn't out by 10 million dollars. So let's skip the two million bucks for a GRA and just give us the 10 million dollars in rate increases." All the arguments are the same. We avoid the cost. We've got some proven numbers. All I'm saying is there's no difference between getting it from UUR and rates, and why would you say, if you're coming for rates today, say

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you have to have a GRA when all the arguments for not having a GRA apply equally well?
Q. Do you agree with me that the timing of a GRA is a matter of regulatory judgment? In other words, you could have a GRA every year if you wanted ultimate comfort. We could have GRAs on a continual basis. But the timing of when to have a GRA is a matter of regulatory judgment?
A. Well, it's primarily a matter of the Company's judgment, although that is caveated by the Board's--and I assume the rule here is the same as other jurisdictions, the Board's right on its own notice to require a GRA. So there's two sides to that discretion. But primarily, it's the Company chooses the timing.
Q. And you'll appreciate that you've heard from the Company witnesses that next year a 2000--a test 2007 test year GRA will be required. Do you accept that?
A. They certainly have made those statements.
Q. Right.
A. One of the things I don't get in my mind is under the Company's proposal, this 14 million

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dollars in UUR left over, odds are the 14 million dollars will be enough to satisfy the revenue deficiency that will be shown through a GRA next year. Given the logic being applied this year, how could you justify having a GRA next year if you can dispose of next year's revenue requirement with another disposition from the UUR? The only reason not to is the rate stability issue, that in fact you'd want to come back and use only part of the remaining UUR, next year have a small rate increase and defer others to next year, to the following year, and you're going to incur the cost of the GRA to do that. I've heard what the Company said. I have not heard the Company make a binding commitment to come in next year. I assume they would do what they said, but circumstances change. For example, if they decided that the revenue deficiency that they would show by coming in was only eight million dollars, it probably wouldn't be responsible for them to come in and drive the costs of a GRA. They'd have to stay out.
Q. Can we agree with this, that it would not be desirable to have two GRAs back to back, year

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KELLY, Q.C.:
after year?
A. I agree, which is why I'm proposing my alternative pragmatic solution to that problem.
Q. Can I take you lastly on this point to CA-39?
A. Sorry, CA-39?
Q. CA-39 PUB, to the last paragraph.
A. Oh, those are the questions of -
Q. It'll be on your screen there.
A. Yes, okay. Can you slide it up a little bit so I can see the question?
Q. Sorry. There we go.
A. Okay. These are the questions to GT, yes.
Q. Okay. And this is Grant Thornton's response in the last paragraph, "while a full review of revenue requirement is appropriate for a GRA, regulatory practice would permit the Board to hear evidence on specific issues, including individual cost items outside of a full review and render a decision based on its assessment of that evidence where it determines it is appropriate in the circumstances." Do you agree with that answer from the Board's consultants?

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A. As a generic statement, where there has been a specific issue which has been set up in advance as a stand-alone item, for example, the automatic adjustment mechanism, is established in advance as being a stand-alone adjustment item. Purchase power costs is set up as stand alone. For items which are identified, and I guess the key is where you set up a mechanism to ensure symmetry, so with the automatic adjustment mechanism, if it goes up or it goes now, you know that's going to come through the Board process and the appropriate adjustment is going to be made. What you don't want to set up is a precedent which says a company can identify selected cost items totally at the discretion of the company and come in and have those approved as pass throughs in the absence of demonstration that there is actually a revenue deficiency that is at least as large as the impact of those individual items.
Now what I'm saying I would view as a refinement of what GT has said, but I think it's important not to interpret what they're saying and just opening the door to bringing

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any item in and saying "oh, you know, I need a million bucks for this."
(1:16 P.M.)
Q. And that ultimately comes back to the Board has to determine the appropriateness in all of the circumstances. Would you agree with that?
A. The Board always has discretion over all matters. They have the ultimate wisdom. We're just trying to give them little bits of advice.
Q. Thank you, Mr. Todd. That's very helpful.
CHAIRMAN:
Q. Thank you, Mr. Kelly. Mr. Kennedy, would you be--how long?
MR. KENNEDY:
Q. I'll be very brief, Chair, so -
CHAIRMAN:
Q. Okay. So there is a possibility of concluding -
MR. KENNEDY:
Q. Yes, the benefit to the witness to be finished today then if we plow along, if that suits the Panel?
CHAIRMAN:
Q. On that basis, let's go, yes.

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MR. KENNEDY:
Q. Mr. Browne, just a couple of very quick questions arising from your -
A. Actually, I'm Mr. Todd. Mr. Browne's finished.
Q. Sorry, Mr. Todd. Arising from -
A. I know I've been agreeing with him a lot -
Q. Yes.
A. - but (unintelligible) Mr. Browne.
CHAIRMAN:
Q. Excuse me. Mr. Johnson, you look sceptical about concluding--do you have a lot on redirect or something like that?
MR. JOHNSON:
Q. No, no, no, not at all.
CHAIRMAN:
Q. Oh, no. I thought -
MR. JOHNSON:
Q. Actually, I'm delighted.
MR. KENNEDY:
Q. He's just sceptical, just sceptical, period, Chair.
CHAIRMAN:
Q. Okay. Sorry.
A. He's just worried that I'm going to go home

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MR. TODD:
tonight and he won't have me around for preparing for a final argument.
MR. JOHNSON:
Q. No, Mr. Chairman, I was just pondering the wisdom of my expert's words.
MR. KENNEDY:
Q. Sceptically. Mr. Todd, I just wanted to see if you could confirm what your proposal is regarding the 2.1 million dollars in interest income that the Company has received as a result of the tax settlement.
A. Yes.
Q. And first, you recognize that that's different from most of the other figures that we were dealing with in the sense that it's a cash figure, as opposed to a notional adjustment from an accounting policy perspective, like the unbilled revenue is?
A. Yeah. Frankly, I feel a little uncomfortable with the image created by the notional adjustment concept. I mean, with the unbilled revenue, we're talking real dollars which could go to the customers and it's the result, the freeing up of those dollars is the result

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of an accounting adjustment. But yes, I recognize that you've created those dollars from an accounting adjustment, whereas the interest revenue is a cheque that's been cut to the Company.
Q. Right. And you indicated, as I could understand it, that when you were talking about this box that you feel that the Board set up by virtue of its language in P.U. 19, that the 2.1 million would be inside of that box and then, as I could understand it, would be treated similarly to the treatment of the unbilled revenue? Is that correct? In other words, you would add to that 2.1 million to the 24 million and treat then the total 26.1 million or whatever it comes out to all the same?
A. There's a series of steps to get there. First of all, there's the interpretation of the order that says it's in the box. If it's in the box, it's subject to the Board's discretion as to what to do with it. So the first decision the Board has to make is that 2.1 should go to customers. So if it's in the box and it goes to customers, then the next

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question is, how does it go to customers? And again, we're now into pragmatic decision making. So I'm saying, you know, to be logical and consistent, since we're disposing of benefits, if you want, that are in that box, you can do them all the same way. Frankly, when you get to pragmatism, it's difficult to say what's right and wrong.
Q. And I guess from a practical perspective, under that scenario, if we took the 2. 1 million for instance and then added it to the unbilled revenue figure and then distributed that amount over the three-year period, you're talking about an extra $476,000 a year for those three years to amount to that 2. 1 million, roughly?
A. About 700,000, isn't it?
Q. Or 700,000, right?
A. Yes.
Q. Yes.
A. You didn't use your computer there, did you?
Q. Yes, yeah, it was a cheap calculator. So the 700--the extra $700,000, based on the figures that we have before us now, would you agree that it's unlikely that that's going to flip

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the Company into an excess earning position in 2006, for instance?
A. I agree.
Q. So from that perspective, and we don't know what's going to happen in 2007 or 2008, there wouldn't be a whole lot of difference between treating the 2.1 million as interest income in 2005 versus distributing it over a transition period?
A. The difference is, okay, if the Board in its wisdom were to add the 2.1, recognize it in 2006, I'd agree with you. If they were to spread it over the three years and then there's a rate case in 2007, as the Company says, then that $700,000 in revenue would get built into that GRA revenue and costs and in effect, would offset $700,000 of revenue requirement that would otherwise be there.
Q. Right. So -
A. Then it would benefit customers.
Q. Right. So the--and I guess that--ultimately that's the point I was trying to arrive at, that as alternatives that the Board could explore to deal with the 2.1 million, there's little to be gained or lost from the

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MR. KENNEDY:
consumers' perspective, if you will, on how that 2.1 million is treated unless a portion of it ends up somehow in the next test year?
A. That's correct. And clearly, the Consumer's Advocate, as opposed to myself, might come in and say it should go in a deferral account and be kept until the next GRA and be disposed of at the next GRA, because then you could guarantee the full 2.1 would go to the customer, and certainly if the Board were to say we want that 2.1 in the hands of customers, then we should put it in--we should keep it in the deferral account until a GRA. Recognizing all that the Company's talked about in terms of, you know, how it arose and we bore some of the costs and things like that, perhaps it's reasonable to treat it in a three-year way, spread across the three years, and that, in effect, gives them back some revenue in exactly the same way as they say they incurred some costs, which is in the absence of a GRA, it's ours. There's a nice symmetry there or beauty there.
Q. And the other follow up to this is you were

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indicating or you provided some testimony then regarding the possible implications for 2007 and 2008 years, and how the recognition of this, up to this point, unrecognized revenue could be used to help offset rate increases that might otherwise--the consumer might otherwise be faced with, but that even under a three-year scenario, then we're facing the prospect of problems in 2009 potentially, all else being equal. Let's just say the cost drivers continue on past 2007 and 2008 and now we have 2009 and all the unbilled revenue is gone.
A. Problem being the probability of a rate increase to recover costs and create a fair opportunity of return--to earn the return, yes.
Q. Right. So I was just going to ask you, from an intergenerational perspective, having that issue in mind, is there a transition period for recognizing the unbilled revenue which you would consider to be offside of regulatory principles? In other words, is there something inherently wrong, from a regulatory perspective, from say recognizing the unbilled

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revenue over a period longer than three years?
A. No. The only reason for three is because that's the way it's recognized for tax purposes and so there's a--it's an easy and natural period of time for the Board to latch onto.
Q. Right.
A. But they should do what they consider to be the most appropriate, balancing all the considerations.
Q. That's all the questions I have, Chair, for the witness. Thank you, Mr. Todd.
CHAIRMAN:
Q. Thank you, Mr. Kennedy. Any redirect?
MR. JOHNSON:
Q. Nothing arising.
CHAIRMAN:
Q. Commissioner Whalen?
VICE-CHAIR WHALEN:
Q. No, I don't have any questions. Thank you, Mr. Todd. It was nice to meet you.
CHAIRMAN:
Q. I don't have any questions, Mr. Todd. Thank you very much for your testimony.
A. It's been a pleasure. I apologize for

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bringing the snow with me, by the way.
VICE-CHAIR WHALEN:
Q. You can take it with you when you go.
A. I'll try.
CHAIRMAN:
Q. I think it was coming anyway. Don't worry about it.
A. I thought the implication was I'm going be gone by the weekend and you want to go golfing on the weekend.
Q. Thank you. Timing was good, around 1:30. I guess we have one witness remaining, Mr. Brushett, from Grant Thornton, tomorrow, starting at 9:00. I just wanted to raise the issue of final argument and throw this out. Would you be ready--would the parties be ready for final argument tomorrow afternoon?
MR. KENNEDY:
Q. Chair, there was one date discussed -
CHAIRMAN:
Q. So it has been discussed, has it?
MR. KENNEDY:
Q. Which was Tuesday coming.
CHAIRMAN:
Q. Okay.

MR. KENNEDY:

Q. And I actually hadn't heard about the Board's availability for that day. So that was still considered to be tentative from the parties' perspectives, I think. There has been some discussion about whether people would be prepared to make their final argument tomorrow, and I think what we said was we were going to wait to see where we were at the end of today and judge whether that was reasonable prospect. I haven't had an opportunity to canvas the parties.

CHAIRMAN:

Q. Well, if you could do that, you know, either-- from our perspective, either tomorrow afternoon or had talked about Tuesday. I wasn't aware of the fact that it had been raised, but I'll leave it to you to work it out.

MR. KENNEDY:

Q. And I'll certainly report back to the Panel then.

CHAIRMAN:

Q. And you can report back, sure. Yes, that's fine. Okay. Thank you very much. We'll see

you tomorrow at 9:00.

CERTIFICATE

I, Judy Moss, hereby certify that the foregoing is a true and correct transcript in the matter of the accounting policy of Newfoundland Power Inc. concerning revenue recognition and matters related thereto, heard on the 8th day of December, A.D., 2005 before the Board of Commissioners of Public Utilities, Prince Charles Building, St. John's, Newfoundland and Labrador and was transcribed by me to the best of my ability by means of a sound apparatus.

Dated at St. John's, Newfoundland and Labrador this 8th day of December, A.D., 2005

Judy Moss