(9:13 a.m.)

CHAIRMAN:

Q. So before we return to Mr. Johnson, I understand there are some matters that have to be addressed?

MS. GLYNN:

Q. Yes, Newfoundland Power has some undertakings to file.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman. We have completed the undertakings from yesterday, U4, 5 and 6 have now been filed, and I believe, Ms. Glynn, they've been circulated to the Board?

MS. GLYNN:

Q. Yes.

KELLY, Q.C.:

Q. Mr. Chairman, U4 is the Response to the Request for Information that Ms. Greene, the Board's hearing counsel asked for to break out the various metricies over various ranges of rates of return in capital structure, and Ms. Perry will speak to—provide a bit of an explanation for that before we start back into the cross-examination this morning. So Ms. Perry—

Samantha, if we could bring up U4, please, on the screen? There we go. Ms. Perry, perhaps you could explain to the Board what is illustrated in U4, please?

MS. PERRY:

A. Certainly. So what you're seeing on the screen here, there's two pages within this U4 and it includes the pro forma credit metrics and the earnings coverage test for Newfoundland Power under the various ranges that we were requested to show, from 9.5 percent return down to 8.3, and at various capital structures from 45 percent down to 40. Before I just talk about the results I guess of the calculations of the coverages and the earnings test, I just want to, for the Board's consideration when they're reviewing these numbers, to understand that what we've assumed here is that we're maintaining in all of these scenarios an A credit rating. So if in fact there were any credit actions resulting from any of these scenarios, that difference in interest expense, because obviously a triple B plus rating versus an A rating would yield

different costs for the company, would have to be factored into the equation. And also, a point of interest to note is the capital structures that are identified here down the left-hand column are the allowed capital structures, and like for Newfoundland Power for example, currently we have a 45 percent capital structure. In reality we manage as close to that as we can, but this is not a precise science, so if I look back over the last couple years, what we actually have with respect to the average equity in the company is something slightly less than the 45. So even though our allowed is 45, on average we've been about 44.5. You manage to the 45; you don't necessarily get it completely right on the dot because you're basing it on forecast earnings, and then you base your dividend policy around that. So just a couple of considerations before I explain the math on this, on these metrics. So if you go to the first table which is table 1, and it's the pre-tax interest coverage, and so you will see within the range here at the top left-hand corner, so

at a 45 percent capital structure and a 9.5 percent return, the pre-tax interest coverage is 2.5 times. And so if we just migrate over to the left to 8.3, and then down to a 40 percent capital structure which is the bottom right-hand corner, the interest, pre-tax interest coverage is 2.1 times. So the range is 2.1 to 2.5. There is no specific guidance given on pre-tax interest coverage by the credit rating agencies, but it's certainly an indication for us in terms of how we're doing and how we're going to track to the earnings coverage test. And I'm going to talk about that just in a moment. Samantha, if you could just go down slightly? Thank you. So table 2, again starting with the left-hand corner at 9.5 and a 45 percent capital structure, the cash-flow interest coverage is 4 times, and if you again migrate down to the right left-hand corner—right-hand corner, sorry, with a 40 percent capital structure and an 8.3 return, it moves to 3.6 times. So the range was 3.6 to 4, and you will recall that the guidance provided by

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Moody's is actually 3.6 to 4. So under all scenarios we're within the range, but clearly we're on the bottom end of one and the top end at the other. Moving on to table 3, and that's the cash-flow-to-debt coverage, and again the top left-hand corner at 9½ percent return and 45 percent capital structure, it's 18.2 percent cash-flow-to-debt coverage and that's what we propose in this application. And again at 8.3 and a 40 percent return, it ranges to 15, and so the range is 15 to 18.2. In the Moody's report they actually have indicated that to maintain the credit that we have today, that they expect us to be at the high end of the range, between 15 and 17. So they've said that they expect us to be in the high end of that range.

CHAIRMAN:
Q. Fifteen to 17 you say?
MS. PERRY:
A. Fifteen to 17, yes.
CHAIRMAN:
Q. Okay.
MS. PERRY:

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A. Samantha, if we could go to page 2? Okay, this one is a bit more colourful. What this table 4 is, is the interest test interest coverage that we talked about yesterday and the day before, and we require a two times earnings test coverage prior to issuance of first mortgage bonds under our trust deed. So again, we've calculated what it would be under the various scenarios. And before I get into the colour coding, as you can see, in the top left-hand corner at 9.5 percent return and 45 percent equity, the number is 2.33. And then if you migrate again to 8.3 and a 40 percent capital structure, it moves to 1.93. So to help guess explain what all of these numbers mean with respect to the earnings test, I've colour coded it just to give you perspective of some thoughts of where the ranges fall. The red clearly is below 2. So if we were to achieve the actual forecast as we've presented here to the Board, and that we issue debt at exactly the cost that we've assumed, if we were that precise, we would actually be unable to issue bonds in this red zone here, but

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obviously you know this is a pro forma forecast earning test coverage, so it is based on forecast earnings and forecast debt issuance cost. And both of those are subject to the market and just the economy and everything else in between. So the yellow zone I'm going to say is, yes, it's above 2 and it's below 2.15, and it's an area that I would say is—we might not be able to issue bonds, depending on variation, reasonable variations within our forecast. And just to give you, I guess some perspective of what it would take to move these numbers, if we just have a one percent change in our debt cost, and that's not unreasonable given even within our last three bonds issuances, they've ranged from 6.6 to 4.4. So it's not unreasonable to assume that you can have variations in what we actually issue debt cost at. So with a one percent change in debt cost, and if our earnings, you know, varied from our forecast within I'm going to say the reasonable range of return that has been stated by this Board, which is about 40 basis points on

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equity, that could move this by .1. Again, none of this a precise science because it depends on the numbers at the time, but—so anything around 2.10 is a very, I'm going to say for me, an uncomfortable zone of not putting this utility in a place to be able to issue first mortgage bonds. So we're trying to set the utility up so in all economic conditions and under all scenarios with respect to what we actually issue debt that we can be reasonably assured that we can issue first mortgage bonds. So a sustainable position that allows us to issue bonds, and that's what I consider this green area which is actually, you know, 2.15 and above. And I'll note as I did yesterday that the average that we have had for the last five bond issuances have been 2.24. And even though I've done the cut-off here at 2.15 I mean I'll note that we've only done one bond issue below that amount in the last ten years. So the green area is more of the comfort zone; the yellow area we might not be able to issue bonds given the conditions; and certainly the red area is we

certainly cannot issue bonds.
KELLY, Q.C.:
Q. Thank you Ms. Perry.
CHAIRMAN:
Q. Can you just over this one percent? Did you say a one percent change in the interest rate?
MS. PERRY:
A. Yes.
CHAIRMAN:
Q. Is that what you said?
MS. PERRY:
A. Yes.
CHAIRMAN:
Q. Okay. And how did -
MS. PERRY:
A. So one –
CHAIRMAN:
Q. What does it result in terms of the numbers?
MS. PERRY:
A. So a one-percent change in debt cost –
CHAIRMAN:
Q. Yes.
MS. PERRY:
A. - plus a variance in our forecast as well

within our reasonable range of return which is approximately 40 basis points on equity.
CHAIRMAN:
Q. Yes.
MS. PERRY:
A. So if you had those two things happen, it could change it by this. So you could change the 2 or 2.1 down to 2. So with just those two things it can change it by .1 times.
CHAIRMAN:
Q. Okay. So like it could go from 2.15 down to 2.05?
MS. PERRY:
A. Zero five, yes.
KELLY, Q.C.:
Q. Exactly.
MS. PERRY:
A. Yes.
CHAIRMAN:
Q. One percent change in your interest rate?
MS. PERRY:
A. And a variability in our forecast.
CHAIRMAN:
Q. And—yes.

MS. PERRY:
A. Yeah.
CHAIRMAN:
Q. Okay.
KELLY, Q.C.:
Q. Thank you, Ms. Perry.
MS. PERRY:
A. Thank you.
CHAIRMAN:
Q. So are we back to you now, Mr. Johnson? Is that correct?
JOHNSON, Q.C.:
Q. Yes, Mr. Chairman. Of course I'm just seeing this this morning. So, no, I haven't had a chance to confer with my experts or anything regarding this document, so I certainly have some questions about.
CHAIRMAN:
Q. Sure.
JOHNSON, Q.C.:
Q. But I wouldn't want to necessarily be limited to not being able to ask Ms. Perry something about it if—once I further have a chance to absorb it.
CHAIRMAN:

Q. Oh no, absolutely.
JOHNSON, Q.C.:
Q. Thank you very much.
CHAIRMAN:
Q. No, no, we're –
JOHNSON, Q.C.:
Q. I appreciate that.
CHAIRMAN:
Q. We are seeking truth, Mr. Johnson.
JOHNSON, Q.C.:
Q. Thank you. Just a couple of questions regarding –
CHAIRMAN:
Q. And justice I was just informed by Commissioner Oxford.
JOHNSON, Q.C.:
Q. In the American way.
CHAIRMAN:
Q. Whatever that is.
MR. GARY SMITH AND MS. JACQUELINE PERRY, CROSS-EXAMINATION BY THOMAS JOHNSON, Q.C. CONT'D
JOHNSON, Q.C.:
Q. In terms of the 1.93 on Undertaking 4 that you're showing at 8.3 percent at 40 common equity ratio –

MS. PERRY:
A. Yes?
JOHNSON, Q.C.:
Q. - would you be able to provide by way of a further undertaking a detailed explanation of as to how that 1.93 is arrived at showing all items used to calculate net earnings and total interest? (request)
MS. PERRY:
A. Yes.
JOHNSON, Q.C.:
Q. Is that fine?
MS. PERRY:
A. Yeah.
KELLY, Q.C.:
Q. Can that be done?
MS. PERRY:
A. Yes, absolutely.
KELLY, Q.C.:
Q. Okay.
JOHNSON, Q.C.:
Q. Okay.
MS. GLYNN:
Q. Noted on the record.
JOHNSON, Q.C.:

Q. Thank you. And in terms of—we had a discussion yesterday regarding the choice that the directors of Newfoundland Power had as regards to the choice of earning period from meeting the test under the issuance of your first mortgage bonds. Is it true, Ms. Perry, that quite apart from pro forma, I just want to get an understanding, that the choice of allowing Newfoundland Power to use not only the preceding 12-month period, but any 12-month period within 24 –
MS. PERRY:
A. Twenty-four.
JOHNSON, Q.C.:
Q. - gives more flexibility to Newfoundland Power in terms of its ability to meet its required ration, would that be correct?
MS. PERRY:
A. I'm not sure I agree that it gives us more flexibility. I consulted with the legal folks after yesterday and I became re-familiar with, you know, the terms under the trust deed with respect to that choice, and I was brought back to memory as to why we have history went with the prior year.

These numbers ultimately have to reflect a depiction of what we expect the future to look like. And we're certifying to that, and the auditors also have to certify to the numbers that they're looking at. So the best numbers available are your most recent audited financial statements. In an extraordinary circumstance, if the audit wasn't complete or if there was some extraordinary circumstance within the last fiscal year, we have the flexibility, yes, to choose another period, but for Newfoundland Power it wouldn't and it shouldn't give that big of a variance of the earning test coverage going forward. So yes, we could choose it, and I think it provides the flexibility in the event there was some odd event within the last fiscal period. But when you're certifying to bond holders that this is—you know these are the correct numbers that represent your earnings and represent your interest, the best available information is your most recent audited financial statement. So that's why we've historically used that in the past.

JOHNSON, Q.C.:
Q. You're looking to issue long first mortgage bonds in late 2016. When are you anticipating following that to be issuing first mortgage bonds again?
MS. PERRY:
A. It depends on our capital program mainly, but right now it's probably early 2019.
JOHNSON, Q.C.:
Q. And the last issuance was when?
MS. PERRY:
A. 2015.
(9:30 a.m.)
JOHNSON, Q.C.:
Q. 2015. So in terms of the example that you were discussing with Chairman Wells, in terms of their being a one-percent change in debt cost, so what we'd be talking about there would be the bond that you're looking to issue late 2016 not being five percent, but being six percent? Is that right?
MS. PERRY:
A. Yes.
JOHNSON, Q.C.:
Q. And plus, in addition to that being a 40

basis points variation in your return on equity?

MS. PERRY:
A. Yes, that's correct.

JOHNSON, Q.C.:
Q. Before you get into red zone, is that what your—is that what I gather?

MS. PERRY:
A. Yes, this is based on pro forma earnings.

JOHNSON, Q.C.:
Q. Right.

MS. PERRY:
A. So I'm trying to give perspective as to what it would take to move that.

JOHNSON, Q.C.:
Q. Okay.

MS. PERRY:
A. To move that needle.

JOHNSON, Q.C.:
Q. So to use the 8.30, would that mean that you would earn, not 8.30, but 7.90?

MS. PERRY:
A. No, what's displayed in table 4 here is actually earning 8.3. So even earning 8.3 at a 40 percent capital structure, the

number would be 1.93.

JOHNSON, Q.C.:
Q. Okay.

MS. PERRY:
A. If our—if we achieve what we're actually forecasting.

JOHNSON, Q.C.:
Q. Okay, just let me back up then and in terms of what I—what I understood was that if there was one percent change in debt cost, and that there was also variations of 40 basis points in your return on equity from what you've –

MS. PERRY:
A. Right, yeah.

JOHNSON, Q.C.:
Q. - is pro forma –

MS. PERRY:
A. Yeah.

JOHNSON, Q.C.:
Q. - I think you'd move from 2.1 to 2? Is that—in terms of the earnings test, is that what you had indicated?

MS. PERRY:
A. Well, depending on where you're starting.

JOHNSON, Q.C.:
Q. Where you're starting, okay.

MS. PERRY:
A. Right. So if you started at 1.93, which is at the 8.3 and 40, if in fact we were to—so we can't issue bonds in that scenario, but if in fact you apply the earnings test with another change in your debt costs of one percent and a variance in your forecast, that number would even be lower at something like 1.8, 1.83.

JOHNSON, Q.C.:
Q. I see, okay. Just go to table 3 for a moment in Undertaking 4. It then indicates that at 40 percent common equity and again this makes no—this assumes no prefs are deemed in the corporate structure? This is just straightforward debt and equity? Is that right?

MS. PERRY:
A. I'm not sure I understand the question.

JOHNSON, Q.C.:
Q. Yes, the—all these tables reflect no preference shares in capital structure. This just reflects pure common equity and

debt, is that right?

MS. PERRY:
A. Yeah, so we've made an assumption that to get from 45 to 40 that we've roughly paid out that 55-million-dollar dividend that we talked about yesterday.

JOHNSON, Q.C.:
Q. Okay. I see, okay. Okay.

MS. PERRY:
A. And then we've just solved for 40 percent equity and then these various returns.

JOHNSON, Q.C.:
Q. Okay. Now in terms of the cash-flow-to-debt coverage at 40 percent common equity and an 8.3 percent return, it shows cash-flow-to-debt coverage of 15 percent?

MS. PERRY:
A. Yes.

JOHNSON, Q.C.:
Q. Okay. As I understand it Moody's 12 to 18-month forward view as of February 2016 would have that number in the 15 to 17 range, is that right?

MS. PERRY:
A. Yes, they've indicated that as a part of

maintaining the current credit that they expected us to maintain in the higher end of that range from 15 to 17.

JOHNSON, Q.C.:

Q. But just—if you just turn to Exhibit 4, Moody's Report of Volume 2, the last—the second-last page of the document. Page 4 actually is probably a better way to put it. Right, so we see here under the financial strength factor, four.

MS. PERRY:

A. Yeah.

JOHNSON, Q.C.:

Q. If we move over from item B, cash-flow pre (phonetic) working capital, the debts, three year average and over to the right-hand column, Moody's 12 to 18-month forward view would be in that range of 15 to 17 percent and that would still have a score of BAA? Is that right? Is that your understanding?

MS. PERRY:

A. Yes, that is the forward view, but if I—we could just turn back to page 2 of that report. Keep on going up, Samantha. Okay, right here. So if you look at the rating

outlook paragraph –

JOHNSON, Q.C.:

Q. Yes.

MS. PERRY:

A. - and the last sentence there, so, "We expect the regulatory environment to remain supportive to credit quality with a suite of timely recovery mechanisms along with our expectation that relatively stable cash-flow generation and the capital structure of NPI will continue to generate sustained cash-flow-to-debt at the high end of the range of 15 to 17 percent," and that's what I was referring to earlier.

JOHNSON, Q.C.:

Q. I see, but they're not certainly indicating that that—that at 15 that that would be a factor that could lead to a downgrade because there they would be talking about not only a meaningful reduction in the level of regulatory support, but then it would have to be combined with a sustained deterioration of NPI's financial metrics such as cash-flow, pre working capital to debt falling into the low teens, is that

right?

MS. PERRY:

A. Yes, that's what they said, "Of factors that could lead to a downgrade."

JOHNSON, Q.C.:

Q. That's all I have for the moment on this document, Mr. Chairman. So I'll just move if I could to Mr. Smith. Oh, I'm sorry. I'd like to refer to your Undertaking 3 that was filed yesterday, Ms. Perry. And so this was the undertaking that we ask you to provide the information further to basically CANP 263 which showed the Newfoundland Power's weighted average return on equity as compared to that of ATCO Electric, Nova Scotia Power, FortisAlberta, FortisBC Electric and Maritime Electric. So the-now that it's corrected, the average weighted—the weighted average return on equity for those companies is 3.52 percent and I understand if we want to see what you're proposing, Newfoundland Power is proposing, we go down to table 2 and where it shows the weighted average return on equity that you're proposing is 4.28 percent, is that

right?

MS. PERRY:

A. Yes, that is correct.

JOHNSON, Q.C.:

Q. And that would be predicated I take it on Newfoundland Power being an above risk—above Canadian—above-risk Canadian utility?

MS. PERRY:

A. This is what we're proposing in the application, and the 9.5 and 45 percent have both been recommended by our expert, yes.

JOHNSON, Q.C.:

Q. And that 4.28, that's justified on the basis that you are an above-risk Canadian utility, is it not?

MS. PERRY:

A. Based on the evidence of our expert, yes.

JOHNSON, Q.C.:

Q. Can we just turn up CANP 263? Just come down a little bit. I'm sorry, if you could just come up a little bit now. I'm sorry. So the second part of the question is, the second, "Please reconcile the statement by Concentric with the level of return requested by Newfoundland Power relative to the returns of these above Canadian utilities." And in the second paragraph of your answer after you point out that the FortisAlberta information should have been 8.3 percent, "Concentric's ROE and capital structure recommendation is fully supported by our risk analysis showing that Newfoundland Power has above-average risk compared to other investor-owned Canadian electric utilities." So I take it that Newfoundland Power is definitely saying to this Board that the reason that your weighted average return on equity was reasonable is because you are now an above-average Canadian—or above-average risk Canadian utility? Isn't that the case?

MS. PERRY:

A. But first I would say that this is a response from Concentric. So I think you're best to ask those questions to Mr. Coyne, but certainly we have in our evidence, as submitted by Mr. Coyne and Newfoundland Power, that the 9.5 and the 45 percent in the context of the assessment of business risk, Mr. Coyne is saying that we are above-

average risk, yes.

JOHNSON, Q.C.:

Q. Okay. Could you just turn up to the top of that page a bit more? Okay. And just if we could go back to Undertaking 3 for a moment, and just to confirm that if we look at the weighted average return on equity for ATCO, Nova Scotia Power and FortisAlberta, they're all in the 3.1 to 3.32 range and your proposal is to be 3.96, right?

MS. PERRY:

A. No, our proposal is to be 4.28.

JOHNSON, Q.C.:

Q. Oh I'm sorry. Yes, indeed it is. And the 3.96 is where you are now, even without the rate increase?

MS. PERRY:

A. 3.96 is at 45 percent and eight eighty allowed return, yes.

JOHNSON, Q.C.:

Q. Okay, all right. With that I can turn to Mr. Smith. Mr. Smith, I'd like to take a few minutes to explore some of the performance goals that are awarded by Newfoundland Power's Short-Term Incentive

Plan, the incentive program that's included in customers' rates. Mr. Smith, is it your view that all of the incentives embedded in the Short-Term Incentive Plan should be passed through to ratepayers because ratepayers benefit from the performance results for which there is an incentive?

MR. SMITH:

A. The targets that we have in our corporate programs that we've had for a number of years, up to a hundred percent I guess of the score that is built into our rates and passed on to customers.

JOHNSON, Q.C.:

Q. Okay. I understand that, but is it your view that all of the incentives embedded in the STIP should be passed through to ratepayers because ratepayers benefit from the performance results for which there is an incentive?

MR. SMITH:

A. Yes, I'd agree with that.

JOHNSON, Q.C.:

Q. Thank you. Are there any components of the STIP that provide an incentive to achieve

benefits for shareholders at the expense of customers?

MR. SMITH:

A. No, I wouldn't agree with that, no.

JOHNSON, Q.C.:

Q. Okay. Okay, I'd like to explore the impact of Newfoundland Power being successful in gaining approval for the proposed increase in the ROE that it's seeking. Would you agree, Mr. Smith, that the corresponding increase in net income if the ROE goes up will benefit shareholders?

MR. SMITH:

A. It will produce more earnings for shareholders, yes.

JOHNSON, Q.C.:

Q. Larger dividends, increased share value, that type of thing, correct?

MR. SMITH:

A. More earnings, yes.

JOHNSON, Q.C.:

Q. Okay. And you'd agree that customers will pay higher rates?

MR. SMITH:

A. Yes, they would.

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JOHNSON, Q.C.:
Q. Okay. And is it not the case that there will be nothing more spent on capital or O & M, is that right?
MR. SMITH:
A. It would be independent of those numbers, yes.
JOHNSON, Q.C.:
Q. Okay. And does that not imply that the increase in ROE will be a financial benefit to shareholders and a financial burden for customers with no off-setting benefit?
MR. SMITH:
A. No, I think the way I would interpret it is that for the company to have a sound financial position and their integrity financially, we need to have a comparable return to those utilities and an equity component that's considered fair in terms of the expert advice that we've been given, and the output of those two numbers basically creates our earnings. So it's part of being a financially sound company, and that benefits our customers in terms of lower costs of debt to finance our capital

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program.
JOHNSON, Q.C.:
Q. Okay. Now in the last year—and I just want to understand this and we—and if necessary, we can go to the record where Ms. Perry was testifying. That my understanding is that the earning target used for STI purposes by the company Ms. Perry indicated always reflected the regulated return on equity approved from time to time by the Board. Is that your understanding, Mr. Smith?
MR. SMITH:
A. Yes, that is correct.
JOHNSON, Q.C.:
Q. And Ms. Perry, you as well?
MS. PERRY:
A. I can confirm, yes.
JOHNSON, Q.C.:
Q. Okay, thank you. And I just want to be sure I understand how that works. The amount of STIP payment related to the net income or say ROE component of the STIP that's embedded in rates, that's the amount that the executives will receive if the company earns a hundred percent of that target in

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2016, right?
MR. SMITH:
A. Yes, if we under—if we achieve the earnings target, then yes, we would get a hundred percent payout.
JOHNSON, Q.C.:
Q. Okay, and if the actual net income exceeds the allowed amount, the amount of the STIP payable to executives is increased, right?
MR. SMITH:
A. That is correct.
JOHNSON, Q.C.:
Q. Okay. How much does the net income have to exceed the target for the executives' STIP payout to be increased?
MR. SMITH:
A. If you can take me to an RFI, it might be better. I can--it's hard to do it from memory, but it's a prorated number I guess.
JOHNSON, Q.C.:
Q. Okay.
MR. SMITH:
A. Once you go above the target earnings, it's a prorated number then to a maximum.
JOHNSON, Q.C.:

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Q. Okay. So the increase in the STIP that's not covered from customers, that would be borne by the shareholders I take it? Anything over the target, is that right?
MR. SMITH:
A. That is correct.
JOHNSON, Q.C.:
Q. Okay. It's a bit unclear to me what the earnings target is for 2016. We're already partway through the year. Is it—will the earnings target be the proposed rate for 2016, or will it be set retroactively to reflect whatever the Board decides in this proceeding?
MR. SMITH:
A. Yeah, I believe what's there currently is based on our proposal in this GRA and once the Board makes its decision, it would be adjusted to whatever the actual decision is.
JOHNSON, Q.C.:
Q. I see, okay. Is there a formula that determines the amount of short-term incentive pay paid to each executive based on the actual net income that Newfoundland Power realizes?

MR. SMITH:
A. I'm not sure I follow your question, sir.
JOHNSON, Q.C.:
Q. Is there a formula that determines the amount of STIP paid to each executive based on the actual net income that Newfoundland Power realizes?
MR. SMITH:
A. So if we move—if we don't hit exactly the target number, but goes above it or below? Is that what you mean?
JOHNSON, Q.C.:
Q. Yes, let's say that it goes above it for instance.
MR. SMITH:
A. Right.
JOHNSON, Q.C.:
Q. Is there a formula that indicates what an executive can expect by way of a STIP relative to how much you've exceeded the target?
MR. SMITH:
A. Yeah, there is a formula. It's basically just a straight proration of where the result is within the range.

JOHNSON, Q.C.:
Q. I see, okay. Could you turn to CANP 207? So this RFI asked to provide in a table format all compensation provided to each of the executives and senior management for the period 2012 to 2017 forecast and indicate the annual percentage of increase. So did you have a chance to see that there now, Mr. Smith?
(9:45 a.m.)
MR. SMITH:
A. Yes, I have it.
JOHNSON, Q.C.:
Q. Thank you. And the last year GRA was in 2013 and I think you would agree with me that in that General Rate Application Newfoundland Power's return on equity went to 8.8 percent, an increase from what it had been prior—from the last GRA, is that right?
MR. SMITH:
A. My memory is not good on that, but in 2013 I believe we were given a decision of 8.8.
JOHNSON, Q.C.:
Q. Right, okay. Now that year had the highest short-term incentive payout that I see

there, because I'm looking now at the STI non-regulated column. And so you've gone over what the target that was embedded in rates, but now you're into the non-regulated. So 2013 was the best out of 2011 to 2015. Is that correct?
MR. SMITH:
A. That is correct.
JOHNSON, Q.C.:
Q. Okay. Okay, are you able to provide the amount by which the higher short-term incentive payouts were a direct result of the approved increase in the return on equity? Is that possible?
MR. SMITH:
A. I certainly don't know those numbers off the top of my head.
JOHNSON, Q.C.:
Q. Okay. Could you determine them internally and provide it back as an undertaking?
MR. SMITH:
A. We could do the mathematics, I guess, sure.
JOHNSON, Q.C.:
Q. Okay.
MS. PERRY:

A. If I could clarify, Mr. Johnson. So for Newfoundland Power in 2012 we had an allowed return of 8.8, and then—so it didn't change even as a result of the GRA. The GRA, we just continued with the 8.8.
JOHNSON, Q.C.:
Q. Oh so for that—okay, I see.
MS. PERRY:
A. Yeah.
JOHNSON, Q.C.:
Q. I see. Just move way for a second –
MS. GLYNN:
Q. So do we need the undertaking, Mr. Johnson?
JOHNSON, Q.C.:
Q. Well it—I don't know if I'll need the undertaking if there was no increase there.
MS. PERRY:
A. Okay.
JOHNSON, Q.C.:
Q. Just move away from the incentive to obtain the higher ROE and look at the other incentives that result from having a net income component to the Short-Term Incentive Plan. Do variances in net income have any impact on O & M or capital spending?

MR. SMITH:
A. Variance in net income have any impact on operating cost?
JOHNSON, Q.C.:
Q. Yes, for example, if you're going through a year and it's becoming evident that you're falling short of your net income target, would it be reasonable to expect management to seek ways to reduce costs during the remainder of the year so you'll achieve your target by yearend?
MR. SMITH:
A. I think in every year that we operate the company we're always paying attention to our costs and our cost management and our efficiency. And that would be the case in each and every year, and in doing that of course we're always trying to find the right balance between what is a cost and what is the appropriate service. And when we do those types of things, we're always very conscious of the service component of what our cost is, but we are always, every single year, we're looking for ways to try to save money through efficiencies and the way we

manage our cost. So irrespective of a particular year, I guess we do it every year.
JOHNSON, Q.C.:
Q. But I guess to my question, if you saw that you were falling short of your net income target, you could take steps as regard to spending to ensure that the target was met? Is that correct?
MR. SMITH:
A. As I said, we would do it every year.
JOHNSON, Q.C.:
Q. Okay.
MR. SMITH:
A. We've had years in the past, we've had Hurricane Igor and Hurricane Leslie and Dark NL's, and in those particular years when we see an unusual event before us, we always look at our cost to try to find ways—can we do something with our costs to make sure that at the end of the year we can do a good balance between cost and service and the financial integrity of the company? Because we really believe that maintaining our earnings is a part of the financial

integrity of the company.
JOHNSON, Q.C.:
Q. Okay. So if—would it be fair to say that you would be rewarded in terms of your STIP if you reduced expenditures and increased net income provided it didn't impact negatively on your other STI measures?
MR. SMITH:
A. Well I just look at it this way, in--for example in 2015 it was a year that we started the year off with a forecast of 1.7 percent sales growth, and that would have been prepared the fall of the year before. And once last year started, we knew it was going to be a tough year. We knew the economy had been starting to turn negative, and so right out of the gate early in that year we had a hard look at our costs throughout the year, and at the end of the year our sales growth ended up being 1 percent and throughout the year we did everything that we could to manage our cost. Then we looked forward to customers. How do we build our 2016 and 2017 operating costs forecast? It was off that 2015 number. So

certainly in that year we did manage to make our earnings and that's a good thing, but then looking forward, our customers also received a benefit in that we had the ability to bring our cost down.
JOHNSON, Q.C.:
Q. Okay. Just to come back to my question, Mr. Smith, you—I understand, and correct me if I'm wrong, that you would be rewarded if you reduce expenditures and increase net income provided it does not impact negatively on your other STI measures. Can we agree on that?
MR. SMITH:
A. What I'll agree on, sir –
JOHNSON, Q.C.:
Q. Ms. Perry, your colleague is nodding in agreement. I'm wondering if you share her view.
MS. PERRY:
A. Mathematically and everything else being equal, yes, what you're saying is correct.
JOHNSON, Q.C.:
Q. Okay, thank you. So how can ratepayers be assured that this would not encourage cost-

cutting provided that the impact on other
STI measures are not significantly harmed?
MR. SMITH:
A. Could you repeat the question, Mr. Johnson?
JOHNSON, Q.C.:
Q. How can ratepayers be assured that incentive will not encourage cost-cutting provided that the impact on other STI measures are not significantly harmed?
MR. SMITH:
A. (No audible response).
JOHNSON, Q.C.:
Q. You're not following that?
MR. SMITH:
A. No, I'm not following your question, sir.
JOHNSON, Q.C.:
Q. Okay, okay. Let's put it this way, if-- you're indicating that you would be cutting where customers wouldn't feel it. Is that what you would be indicating?
MR. SMITH:
A. In a year that we're faced with challenges of our operating costs, we always do it in a way that we are very conscious of our service metrics to our customers.

JOHNSON, Q.C.:
Q. Okay. So if you suffered an unanticipated cost that you can offset by reducing other expenditures without having an impact on customers, that's what you'd do?
MR. SMITH:
A. Yeah, we do what we can to deal with our costs.
JOHNSON, Q.C.:
Q. Okay. So would that not imply that you started out with a budget that was higher than you needed if it was not going to have any impact on customers?
MR. SMITH:
A. No, I think it's just a matter of when you're faced with a year with challenges, what you can do to find flexibility in your operations. Some of these things can be short term; some of these things are more longer term.
JOHNSON, Q.C.:
Q. Yes.
MR. SMITH:
A. For example, last year when we had some people retire, we would look at when that

retirement occurred, can we go three or four months without doing the backfill? Have we got to do the backfill right away? One that comes to memory, we had a lady retire who is our office manager in Grand Falls, and when she retired, we said, "Can we cover it off out of Gander for a few months to get through?" And so some of these things are short term in nature, but eventually you have to go back and fill that position to maintain your service, but short term you could find a way to get through there.
JOHNSON, Q.C.:
Q. Yes. Mr. Smith, we went through yesterday showing you some examples of boards across the country that have decided to either not allow earning-type target pay in rates or to restrict it. And do you offer any—can you offer any observation as to what the concern might be about having an earning incentive in rates?
MR. SMITH:
A. No, sir, I cannot offer any observation on that, only the way we do it here in Newfoundland.

JOHNSON, Q.C.:
Q. Okay.
MS. PERRY:
A. And Mr. Johnson, if could just add one thing to the limit of net income and STI. This is not new. I believe even when the STI program was brought in in the late nineties right in front of this Board, at that time it was recognized that other jurisdictions do have caps on net income. The context of why they have caps--or you know, we've not done the study, but there has been a limit— there have been limitations about having certain things in the STI program in other jurisdictions long before now.
JOHNSON, Q.C.:
Q. Could we just turn to the examination regarding the components of the Short-Term Incentive Plan?
MS. PIERCEY:
Q. Sorry, Tom, what information was that?
JOHNSON, Q.C.:
Q. Number—that's –
MS. GLYNN:
Q. Eleven, I think, Components of Short-Term

Incentives.

JOHNSON, Q.C.:
Q. I think that would right.

MS. GLYNN:
Q. Number 11.

JOHNSON, Q.C.:
Q. And as previously noted, this table compares the components of Short-Term Incentive Plans in place at the utilities that are listed here. I take it you have not further looked into this chart to verify what I'm saying?

MR. SMITH:
A. That is correct.

JOHNSON, Q.C.:
Q. Okay, and the—but you can confirm that the targets and the headings for Newfoundland Power are correct for 2016? Is that right?

(10:00 a.m.)

MR. SMITH:
A. On the one that's on the screen here?

JOHNSON, Q.C.:
Q. Yes.

MR. SMITH:
A. Yes. Yes, sir.

JOHNSON, Q.C.:

Q. Okay, thank you. And we see that according to what--my information is that there's only Newfoundland Power and FortisBC that have anything for what's called "regulatory performance"? Do you see that?

MR. SMITH:
A. Yes, I see that, sir.

JOHNSON, Q.C.:
Q. So I guess, Mr. Smith, are you aware of any other utilities that have regulatory performance as a short-term incentive performance measure?

MR. SMITH:
A. I'm not aware off the top of my head, sir, no.

JOHNSON, Q.C.:
Q. Okay. And your—can you remember in Alberta whether you had it there?

MR. SMITH:
A. When I was there?

JOHNSON, Q.C.:
Q. Yes.

MR. SMITH:
A. I just don't remember.

JOHNSON, Q.C.:

Q. Okay. Were you an executive in Alberta?

MR. SMITH:
A. I was so.

JOHNSON, Q.C.:
Q. Okay. How long were you in Alberta?

MR. SMITH:
A. For four years.

JOHNSON, Q.C.:
Q. Okay. You would have received personal incentive pay for meeting targets in Alberta similarly?

MR. SMITH:
A. Absolutely, sir, eight years ago.

JOHNSON, Q.C.:
Q. Thank you. Okay, just—if we could just turn up then—and that's 15 percent weighting in Newfoundland Power and if we could just turn up PUB NPO 81. There's a question asked by Board staff, "Further to PUB MP 007 explain the criteria and process used to access the corporate performance measure regulatory performance." Okay and I'll just give you a second.

MR. SMITH:
A. Sure, I'm going to take a minute to read it.

JOHNSON, Q.C.:
Q. Sure.

MR. SMITH:
A. Yes, sir.

JOHNSON, Q.C.:
Q. Just if you look at line 16 to 17 of that reply, it indicates that—or references Newfoundland Power's 2013 GRA as a determinant of the 2014 regulatory performance evaluation. Do you see that?

MR. SMITH:
A. Yes, I do.

JOHNSON, Q.C.:
Q. Okay. Is it safe to assume, Mr. Smith, that performance in this General Rate Application will be considered for this year's evaluation of regulatory performance?

MR. SMITH:
A. Yes, it will.

JOHNSON, Q.C.:
Q. Okay and line 13 references the determinants of the measure being the company's conduct and the results achieved in regulatory proceedings. And I guess one of the results achieved might be preserving the highest

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common equity ratios in the country or one of them, right?

MR. SMITH:
A. Could you repeat your question, sir?

JOHNSON, Q.C.:
Q. One of the results achieved in this regulatory proceeding might be preserving Newfoundland Power's 45 percent common equity ratio, would that be fair?

MR. SMITH:
A. One of the results that will come out of the Board's decision is certainly what our return on equity will be and what the equity thickness of the company would be.

JOHNSON, Q.C.:
Q. That's right, so these might be indicia of performance in this GRA, correct?

MR. SMITH:
A. It might be a?

JOHNSON, Q.C.:
Q. Indicia of performance.

MR. SMITH:
A. I think the overall decision of the Board is how we will assess our performance, not just on two numbers in particular. It will be

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the overall decision of the Board.

JOHNSON, Q.C.:
Q. Yes, but certainly you would agree with me that part of the regulatory performance measure would be related to achieving a higher ROE if you were successful, would it not?

MR. SMITH:
A. No, I mean it will be part of what will be looked at. There will be many things in the Board's decision that will be considered when we look at our performance, and it's not just the result, it will be how we prepared the filing, have we been responsive to the needs of the Board, has it been timely, and was the decision a fair decision. So we'll look at many components when we evaluate.

JOHNSON, Q.C.:
Q. I see. So let us say now that you come out of this hearing at, say, 8.8, and FortisAlberta is out there, a sister company, and they're 8.3. Do you think that would be viewed favourably from a regulatory performance point of view?

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MR. SMITH:
A. Again all I'll say, Mr. Johnson, is when we get the decision of the Board, we will look at the overall decision of the Board, and that's how we will do our evaluation at the time in terms of what our performance was.

JOHNSON, Q.C.:
Q. So you don't think that would be good regulatory outcome?

MR. SMITH:
A. If we had a higher ROE?

JOHNSON, Q.C.:
Q. Yeah.

MR. SMITH:
A. It's part of what we're here before the Board to present our case to make sure we managed the financial integrity of the business, and we just need a decision from the Board that will give us that position, and once the Board makes its ruling, we will consider what that decision is in terms of our overall performance.

JOHNSON, Q.C.:
Q. I see. What are the key results coming out of this GRA, Mr. Smith?

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MR. SMITH:
A. Key results?

JOHNSON, Q.C.:
Q. Yeah.

MR. SMITH:
A. I mean, in this application we've presented many things, including our operating cost, our forecast of sales for the future, our forecast of what earnings will be, we've presented out case in terms of reliability and service, so all those things are presented in this GRA, and all those things will be considered when we look at our overall performance.

JOHNSON, Q.C.:
Q. Line 6 and 7 of this reply says, "This performance measure does not lend itself well to statistical or simple cost base analysis. As a result, it's evaluated on a subjective basis", and that's your understanding that it's subjective, right?

MR. SMITH:
A. That is correct, sir.

JOHNSON, Q.C.:
Q. Yeah, and do you agree that since regulatory

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performance is subjective, determining
whether an executive performed or exceeded
expectations is entirely at the discretion
of Newfoundland Power's Board of Directors?

MR. SMITH:
A. That would be correct, the Board of
Directors will make the ultimate decision on
the performance of the company.

JOHNSON, Q.C.:
Q. None of the other components that we see in
that component of short term incentives
document that we just discussed are
subjective, are they?

MR. SMITH:
A. In terms of the corporate targets?

JOHNSON, Q.C.:
Q. Right.

MR. SMITH:
A. Yeah, the regulatory is the only one that is
subjective with the corporate targets.

JOHNSON, Q.C.:
Q. Based upon – if we could go back to that
examination aid for a moment. Assuming the
veracity for the moment of that column,
regulatory performance, which shows

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FortisAlberta doesn't have it, ENMAX doesn't
have it, ATCO doesn't have it, and EPCOR
doesn't have it, NS Power, NB Power, Toronto
Hydro don't have it, assuming that's
correct, would you not agree that it's quite
uncommon for a regulatory performance to
show up as a corporate performance measure,
a subjective regulatory performance measure?

MR. SMITH:
A. As we talked about yesterday, I guess, that
would be your data, sir, and I can't agree
or disagree with your data, but I would say
in terms of Newfoundland Power introduced
this into our incentive program a few years
ago and it was a discussion at our Board
table, and the Board in its discretion sort
of thought that introducing a regulatory STI
component was important, in that our
regulatory filings with the Board we take
very serious, it's the cornerstone of what
we do to service our customers, and so we
thought it was appropriate to include that
as a metric in our overall performance.

JOHNSON, Q.C.:
Q. Can you tell me how much higher your bonus

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will be if the Board approves the requested
increase in ROE?

MR. SMITH:
A. No, sir, I cannot tell you that off the top
of my head, no.

JOHNSON, Q.C.:
Q. But you would expect to be provided a bonus
higher than, say, if your ROE went down,
would you not, to say 8.3 or 8?

MR. SMITH:
A. No, I think the way it works is our earnings
target basically is set once the Board makes
its decision.

JOHNSON, Q.C.:
Q. No, no, I'm talking about regulatory
performance here now.

MR. SMITH:
A. Oh, I'm sorry, go ahead with your question.

JOHNSON, Q.C.:
Q. So can you tell me how much your bonus would
be if the Board were to approve 9.5 percent
ROE versus, say, approving 7.5 percent?

MR. SMITH:
A. In the regulatory area?

JOHNSON, Q.C.:

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Q. Yeah.

MR. SMITH:
A. I certainly can't speak to the decision that
my Board will make, but they will assess the
overall decision of the Board.

JOHNSON, Q.C.:
Q. And they would view that 9.5 is considerably
more success, correct?

MR. SMITH:
A. They would view the decision of the Board to
make sure we can maintain our financial
integrity as a success.

JOHNSON, Q.C.:
Q. I see. Do you have to reach a minimum level
to get a bonus on any of your targets?

MR. SMITH:
A. I believe there's plus or minus on each of
the categories, yes.

JOHNSON, Q.C.:
Q. I see. What would be the minimum amount
that you have to achieve on earnings?

MR. SMITH:
A. Perhaps you can take me to an RFI, sir.

JOHNSON, Q.C.:
Q. I don't know if I can put my hand on it.

You don't know, do you?

MR. SMITH:

A. There is a range. I just can't say off the top of my head. I think it's the allowed range on our return is plus or minus 40 basis points, I believe is what it is.

JOHNSON, Q.C.:

Q. Yes, I see, and how about -

MR. SMITH:

A. Should we confirm that, sir, before we go on?

JOHNSON, Q.C.:

Q. Sure, yes, to ahead.

MS. PERRY:

A. There are ranges around the earnings target, and there is also a minimum threshold of if we don't get, and I believe it's 90 percent of our return on equity, then we don't get anything. So we'd have to earn, I think – if the allowed return was 8.8, we would have to earn at least 8 before any of the other STI parameters would actually kick in to be paid to the executives. So there is a minimum threshold that's in the STI plan.

JOHNSON, Q.C.:

Q. And how about safety, is there a minimum threshold on safety that you have to meet before -

MR. SMITH:

Q. There is, sir.

JOHNSON, Q.C.:

Q. Do you have that available to you?

MR. SMITH:

A. Let me see. On safety, it's a plus or minus range. I believe for the year in front of this, I can't – we have what's called the "all injury frequency rate", but what I can do off memory is more the exact number, so I think our target for this year is to have two injuries, so if we have zero, we'll get 150 percent payout, and if we have four, we'll have the minimum payout. I think that's what the range is, sir.

JOHNSON, Q.C.:

Q. And on reliability and customer satisfaction, is there a minimum that you've got to achieve?

MR. SMITH:

A. There is, sir.

JOHNSON, Q.C.:

Q. Any incentive targets that are directed to achieving results in terms of conservation and demand management?

MR. SMITH:

A. Within our reports that we send to the Board every quarter, you will see targets for conservation – what was the other one?

JOHNSON, Q.C.:

Q. Demand management.

MR. SMITH:

A. Demand management. Conservation, in particular, in know it's there, and we view those more as operational targets, and if you look at the information we provide to the Board each quarter, there are many operational targets that are in there and they would be part of – when we look at the other targets that we have for the individual component, those tend to be subjective in the areas of - Mr. Murray's performance, for example, in the area of reliability. So, anyway, the individual targets have a subjective nature to them, and when we do that evaluation, we will consider the operational targets of the

company that we do send to the Board each quarter.

JOHNSON, Q.C.:

Q. But no corporate target of the sort that we're talking about for, like, net income or safety that are actually tied to STIP, is that correct?

MR. SMITH:

A. Could you repeat your question?

JOHNSON, Q.C.:

Q. I understand you have corporate targets for net income, cost control, safety, customer satisfaction, reliability, and regulatory performance.

MR. SMITH:

A. Yes, sir.

JOHNSON, Q.C.:

Q. None of those would encompass achieving a certain target of CDM update or results, is that correct?

MR. SMITH:

A. I think where we would look for that to be reflected in the corporate target is under our customer satisfaction score, and we would expect our efforts in the CDM area to

be reflected in that score.
JOHNSON, Q.C.:
Q. And that would be, like, a satisfaction score as opposed to certain deliverables about how many people you were able to incent to do “x” or “y”, would that be fair?
MR. SMITH:
A. Well, if you take last year as an example, we did an incentive program where customers could get a rebate at the retail store for buying appliances or insulation or whatever it might have been, and in doing that, I believe in the month of November we gave something like 200,000 rebates to customers. So it’s a broad based program that many customers experience and see, and so we believe that will ultimately be reflected in our customer satisfaction score.
JOHNSON, Q.C.:
Q. Okay, but to answer my question, and I appreciate your comment, but to answer my question, there’s no target such that we see here for, you know, you have a certain target for safety, you have a certain target for reliability matters, so there’s no

metrics like that that the company is aiming for from a corporate financial incentive point of view, would that be fair?
MR. SMITH:
A. Specific to CDM?
JOHNSON, Q.C.:
Q. Yes.
MR. SMITH:
A. It’s not one of our corporate targets, but it is something we give consideration to when we do the individual executives subjective evaluation and compensation.
JOHNSON, Q.C.:
Q. Okay. Ever consider, to your knowledge, that Newfoundland Power making it a higher echelon target, such as the ones that we’re discussing in terms of short term incentives?
(10:15 a.m.)
MR. SMITH:
A. What I would say to that, Mr. Johnson, is that our performance in the area of our CDM efforts remain strong. We’re consistently beating our target, and our efforts are very well recognized within the company, and when

our Board of Directors looks at the program and its overall impact on the company and our service to customers, we believe it’s picked up right now in the customer satisfaction score appropriately, but again when we look at the individual subjective evaluations of our executive, our efforts in CDM gets picked up there.
JOHNSON, Q.C.:
Q. Once again my question was have you ever considered, formally considered making it part of the compensation – one of the short term incentive measures?
MR. SMITH:
A. I certainly haven’t recommended to our Board. Whether or not our Board has considered it in private, I couldn’t speak to, but I certainly have not recommended to the Board to make it a corporate target.
JOHNSON, Q.C.:
Q. And why is that?
MR. SMITH:
A. Again because I believe that the impacts of it are picked up in the overall customer satisfaction score, for the same reason

that, you know, answering the phone isn’t a corporate target. These are things that we do to service our customers in a broad sense, and we believe it’s picked up in the customer satisfaction score.
JOHNSON, Q.C.:
Q. Mr. Smith, yesterday you mentioned that there was one member of the executive team who came to Newfoundland Power in 2004. Who’s that?
MR. SMITH:
A. That would be Mr. Gary Murray.
JOHNSON, Q.C.:
Q. Okay, and would you undertake to provide a copy of his CV?
MR. SMITH:
A. I have no issue with that, sir.
JOHNSON, Q.C.:
Q. Thank you.
KELLY, Q.C.:
Q. That’s fine, Mr. Chair.
MS. GLYNN:
Q. Noted on the record.
JOHNSON, Q.C.:
Q. And when he came to Newfoundland Power in

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2004, he didn't come as an executive, I understand?

MR. SMITH:
A. That is correct.

JOHNSON, Q.C.:
Q. Okay. What did he do with Newfoundland Power when he first arrived and came to the company?

MR. SMITH:
A. Again I wasn't at Newfoundland Power when he first arrived. I think when he first started, he may have been in our engineering department and later moved to an operations role, but again I can't speak exactly to that because I wasn't with the company at the time.

JOHNSON, Q.C.:
Q. Does Ms. Perry know?

MS. PERRY:
A. No, I couldn't confirm either of his exact role at the time.

JOHNSON, Q.C.:
Q. Now underneath the leadership team level of yourself, Ms. Perry, Mr. Alteen, Mr. Murray, etc., we have a level of what's now termed

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"Directors", correct?

MR. SMITH:
A. That's correct.

JOHNSON, Q.C.:
Q. They used to be called "managers"?

MR. SMITH:
A. That's right.

JOHNSON, Q.C.:
Q. Twelve in number?

MR. SMITH:
A. I believe so.

JOHNSON, Q.C.:
Q. Dirty dozen.

MR. SMITH:
A. There you go.

JOHNSON, Q.C.:
Q. Just kidding. Any of these present directors come from outside directly into the director or manager role?

MR. SMITH:
A. Off the top of my head, I know Ms. McCarthy would have. Ms. McCarthy right now looks after our customer service and corporate communications functions. Off the top of my head, I would give you that name.

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JOHNSON, Q.C.:
Q. Would you undertake to provide whether there's any other of the current complement of directors who came from outside of Newfoundland Power directly into a director or manager role?

MR. SMITH:
A. I can do that. I mean, another name that comes to mind, I believe Mr. Hiscock did, our Manager of Finance, now a Director of Finance, so I believe Mr. Hiscock did. That's what I can do off the top of my head, sir.

JOHNSON, Q.C.:
Q. That's why I'm asking you for the undertaking. That's fair. Ms. McCarthy is from Newfoundland, is she not?

MR. SMITH:
A. I believe she is, sir.

JOHNSON, Q.C.:
Q. She was residing in Newfoundland prior to her taking a position at Newfoundland Power?

MR. SMITH:
A. I believe she was, sir.

MS. GLYNN:

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Q. The undertaking is noted on the record.

KELLY, Q.C.:
Q. Is that of utility to the Board, Mr. Chairman?

VICE-CHAIR WHALEN:
Q. We'll see.

KELLY, Q.C.:
Q. What?

VICE-CHAIR WHALEN:
Q. We'll see.

KELLY, Q.C.:
Q. Thank you.

CHAIRMAN:
Q. Well, I mean, I don't know if I'd want to see anybody's CV, but, you know, anyway.

JOHNSON, Q.C.:
Q. It just brings further certainty around where the gentleman came from because he was put forward as someone who came from a broader market, and that's probably the best way for me to understand how he came about coming to Newfoundland Power, that's all.

CHAIRMAN:
Q. I don't know – anyway.

JOHNSON, Q.C.:

Q. Would the normal pattern for going into the manager or director echelon would be to work up through the company like Mr. Henderson and Mr. Casey did, would that be the normal route?

MR. SMITH:

A. Mr. Henderson and Mr. Casey, that would be Jack Casey, and Lorne Henderson?

JOHNSON, Q.C.:

Q. Yes, yeah.

MR. SMITH:

A. They certainly worked their way up through the company for many years, and many of our other people at the director level, that would be true also.

JOHNSON, Q.C.:

Q. Yeah, okay, thank you. Those are my questions subject to anything later for Ms. Perry if need be.

CHAIRMAN:

Q. So I think we're over to you, Madam, are we not.

MR. GARY SMITH

MS. JOCELYN PERRY

CROSS-EXAMINATION BY GREENE, Q.C.:

GREENE, Q.C.:

Q. Thank you, Mr. Chair. Good morning, Mr. Smith and Ms. Perry.

MR. SMITH:

A. Good morning.

MS. PERRY:

A. Good morning.

GREENE, Q.C.:

Q. I will be longer, I believe, than to the break, but -

CHAIRMAN:

Q. Okay.

GREENE, Q.C.:

Q. I'm in your hands – we'll carry on. Just a few questions first for Ms. Perry with respect to Undertaking 4.

MS. PERRY:

A. Yes.

GREENE, Q.C.:

Q. I wanted to ensure that I understood your comments with respect to the cash flow to debt coverage which is in Table 3, and you did take us to the statement in Moody's in Exhibit 4, that they expect Newfoundland Power to be in the high range. I take it

from that, while you didn't colour code Table 3 as you had Table 4, if you were to do so, there would be some yellow on that table, is that correct, based on your reference to Moody's that it would be the high end of the 15 to 17 percent range?

MS. PERRY:

A. Yes, I think that's correct, you know. So when they say "high end", I'm saying 16.5 and above.

GREENE, Q.C.:

Q. So that is where you would start your colour coding?

MS. PERRY:

A. Yes, if I had to try to give some perspective of where Moody's has indicated they expect us to be, I guess.

GREENE, Q.C.:

Q. So it's your opinion that once you start getting below 16.5 percent, that may be of some concern and would cause you, as Chief Financial Officer, to have some concern?

MS. PERRY:

A. Any time there's any erosion from where we are today – Moody's will give ranges for

guidance, for a broad parameter of where they expect us to be. You never want to go backwards, I guess, from also where you are today as well.

GREENE, Q.C.:

Q. But in terms of the metrics and what they have established as the bands, I will call it, for your actual credit rating what the metrics need to be, the band is 15 to 17 percent?

MS. PERRY:

A. 15 to 17, yes, that is correct.

GREENE, Q.C.:

Q. So if it's the high end, your opinion would be anything below 16.5 would cause you some concern in terms of what Moody's is saying for the credit rating?

MS. PERRY:

A. Yeah, I look at that range as pretty simple, 17 is the high end, 15 is the low end, 16 is the middle, so 16.5 to me just rounds up to 17.

GREENE, Q.C.:

Q. And similarly for Table 1 and Table 2, I understood your evidence to be that the

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results indicated what all of the ROEs and all of the different capital structures would meet the metric requirements for Moody's for the credit rating, for an "A" rating?

MS. PERRY:

A. Yes, for Table 2 on the cash flow interest coverage, their range is 3.6 to 4, so all of these numbers are within those ranges at the bottom end and at the high end. They actually do not provide coverage for the pre-tax interest coverage.

GREENE, Q.C.:

Q. And is it fair to say that when the credit rating agencies are looking at it, and when you look at it as Chief Financial Officer, it is all of the metrics that are of interest to you, there isn't one that has more weight than the other?

MS. PERRY:

A. No, I think it's the two cash flow metrics that I would say we pay most attention to with the credit rating agencies.

GREENE, Q.C.:

Q. Okay. Thank you. Now you've had some

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discussion for the last couple of days with respect to Newfoundland Power's risk profile, and I did want to follow up with you some of the questions that Mr. Johnson has already taken you through. I first want to talk about your views as the Chief Executive officer and as the Chief Financial Officer for Newfoundland Power, your views as to Newfoundland Power's risk profile and how it has changed, if at all, from the last general rate case. I'd like to take you first to PUB-NP-086, and this follows on from questions of Mr. Johnson earlier this morning where the question relates to Newfoundland Power's own assessment of where you are with respect to your risk.

MS. PERRY:

A. Yes, so we've discussed, I guess, how the business risks have changed, and even the financial risks have changed since the last time we were before this Board, and we've highlighted two areas that we see as changes in our business, and the first is no doubt the economy, and the second is the cost – and even reliability and associated cost

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with the changes in energy supply coming. So a CFO, what I'm always concerned about is the service to customers, yes, but it's also balanced with being able to earn a fair return, and both the downturn in the economy and the significant cost increase that's coming with Muskrat Falls are no doubt placing this utility at risk for earning its return in the future. We've seen a bit of this. Mr. Smith has talked about this earlier with respect to our sales growth decline in 2015. We're expecting even further decline as you go forward, and so, yes, we were able to earn our return in the past when we've had certain hurricanes and Dark NLs, but we availed of a pretty decent sales growth over that period. When you're talking about a .1 percent sales growth, you're pretty close to having a declining sales growth environment. So as CFO, when I try to look forward with respect to how we're going to earn our return once we get out of here, because this is just a forecast, and how are we going to support the capital program going forward, how are

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we going to support any adverse condition that happened to Newfoundland Power, because I'm sure we'll have a couple along the way, that's going to be much more difficult to do in any economy that's not supportive of improving sales growth environment. So that places us in a position that earning our return in the future is riskier than it has been in the past, and then coupled with that, we have pretty significant cost increases coming for our customers, and I thin it's pretty simple with respect to if price goes up, demand will go down, and that's just the way that it works. You know, the most recent outlook is that there's going to be a 50 percent increase in the rates to our customers. Now I know that's not certain, but the fact that it's uncertain is what concerns me because if it's even around that figure, that's pretty significant for our customers, and that too will impact the future sales growth. So it's like the perfect storm; you have the economy, you have the cost, and then you have a utility that has to continue to

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operate, provide good service, continue to invest in the electrical system, but at the same time it's important that we earn a fair return. So in the context of risk, we agree with Mr. Coyne that while some of these risks always existed with respect to the Newfoundland economy and the cost coming with Muskrat, the economy is worse, we now know a little bit more about Muskrat, so the risk is just pushing upwards for us, in our opinion.

GREENE, Q.C.:

Q. And we're going to go through each of the risks, but I took you to this answer because I was unclear from your response to Mr. Johnson. My understanding of your response to this question is that Newfoundland Power's own assessment is your risks have increased, and we'll talk a little bit about each of those risks and your perspective as to the materiality of the increase, but your overall assessment is that you are an above average risk Canadian utility?

MR. SMITH:

A. That's true.

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GREENE, Q.C.:

Q. That is Newfoundland Power's assessment, not only its advisor, is that correct?

MS. PERRY:

A. I've been very keen never to be an expert, I guess, so we do look to our expert to make the overall assessment, but I couldn't dispute what he was saying with respect to our risks are increasing. So if we were average risk before, then if they're increasing from where we were in the past, then the logical conclusion for us would be that we are now an above average risk utility.

GREENE, Q.C.:

Q. I just wanted to clarify that because it wasn't – at least when I was listening, without having the benefit of the transcript, I didn't understand that the company was agreeing in its own assessment there was above average risk.

MS. PERRY:

A. Right, yes.

(10:30 a.m.)

GREENE, Q.C.:

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Q. That's a pretty significant position for Newfoundland Power to take, isn't it? To my knowledge, that's the first time that Newfoundland Power has come before the Board saying that it is an above average risk when you consider Canadian electric companies in Canada.

MR. SMITH:

A. It's again the assessment of our expert. We've looked at his information, and from our point of view it's undeniable that the economy is definitely slowing down in this province, and the price of our product is going up significantly, as Jocelyn has already said, and looking forward our customers will react to that and the ability of the customer to pay the bill, and what that will mean for revenue into the door of Newfoundland Power, and our slice of the revenue to run our business, you know, it will be at risk as customers react and do different things. I mean, we all know that the way the Muskrat Falls price is put together is that if customers decide to use less, well, the unit price has to go up to

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compensate for that because it's a fixed cost project that must be recovered.

GREENE, Q.C.:

Q. And as I said before, we will go through each of those risks. I just wanted to get your – maybe I'm starting backwards. Start from your overall assessment, which is your own assessment, as the CEO and Chief Financial Officer of the company, is that you now believe Newfoundland Power is an above average risk for a Canadian utility, and that is a change in Newfoundland Power's position, the first time that has been advocated before the Board?

MS. PERRY:

A. Yes.

GREENE, Q.C.:

Q. And the reason why that's important is one of the underlying factors, what your risk is in terms of what is the appropriate fair return for the return on equity and your capital structure, is that correct?

MS. PERRY:

A. Yes, that is correct.

GREENE, Q.C.:

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Q. So now I would like to talk about some of the individual risks, and you've already addressed some of them, but I want to talk a little bit more in detail. You've highlighted that two risks have changed, which is the economic outlook and the uncertainty arising with respect to Muskrat Falls. I wanted to talk first only very briefly about the other risks and your assessment of whether there has been any change since we were here last. One of the principal risks that Newfoundland Power refers to is your weather risk, is that correct?

MR. SMITH:

A. Yes, that's one of our risks.

GREENE, Q.C.:

Q. Okay, and can you explain why that is a risk and whether in your view that has changed in a material way since the last General Rate Application by Newfoundland Power?

MR. SMITH:

A. I believe we've had this risk for many years, and, of course, it's hard to forecast the weather, and I can remember being here

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in the past when Mr. Wells and our former CEO, Mr. Ludlow, had a discussion about the predictability of hurricanes, I believe, and there's no doubt it's difficult to project those things, but in a general sense, I mean, it's one of the risks that we have as a utility that distinguishes us from other utilities. There's no doubt we have the harshest weather in Canada, and maybe North America. We have ice storms, we have salt spray storms, we have wind storms, and these are things that we experience routine, but sometimes it's more than routine.

CHAIRMAN:

Q. It could be in one day.

MR. SMITH:

A. It can be in one day, sir, absolutely agree, and for me to sit here and say we're going to have more hurricanes or less hurricanes, I really can't do that, of course, but I can tell you that we are exposed, unlike other utilities, to the harshest weather, and maybe to tell a little story, of course, I worked in some other jurisdictions, Prince Edward Island, and Alberta, and although we

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had our series of weathers there too and storms there, but in all honesty the weather we get in Newfoundland is truly different and distinguishable, and I will say we build a strong system to sustain that, but no matter how good you build it, it is subject to the weather.

GREENE, Q.C.:

Q. So that risk is a risk that's been with you for a period of time, and you do not see any material change in that risk for you, is that correct?

MR. SMITH:

A. It's sustainability of that risk, it hasn't changed, it hasn't gone up, it hasn't gone down, it's just constant.

GREENE, Q.C.:

Q. And the risk really is the recovery of a cost that will be associated with responding to the weather, is that correct?

MR. SMITH:

A. The risk is the cost to perform to meet the need of the customer at the time, and as we've said before, if the storm happens late in the year, it's more difficult to respond

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because you have less time to try to find ways to make up the difference. If it happens early in the year, then you have several months in front of you, and you're more likely to make up the difference and deal with it. So it's a function, not just the size of the storm, but when the storm occurs.

GREENE, Q.C.:

Q. And you're speaking with respect to operating costs, are you, Mr. Smith?

MR. SMITH:

A. It's operating, but it's also capital, obviously, because when we have a storm and we're spending capital money, it's not until the next time we come before the Board to reset our rate base that we actually give that capital in the rates. The years in between it's not, of course.

GREENE, Q.C.:

Q. And, of course, that applies not only to capital for storms, but for any capital that you've – isn't that correct?

MR. SMITH:

A. This is true, yes.

GREENE, Q.C.:
Q. So your risk for weather is no different for that capital versus -
MR. SMITH:
A. And it hasn't changed.
GREENE, Q.C.:
Q. Right. If we could go to PUB-NLH-40, please.
KELLY, Q.C.:
Q. PUB-NP?
GREENE, Q.C.:
Q. What did I say?
MS. GLYNN:
Q. NLH.
GREENE, Q.C.:
Q. I can't get those four months out of my head. Sorry, Newfoundland Power.
JOHNSON, Q.C.:
Q. I understand, Ms. Greene.
KELLY, Q.C.:
Q. We sympathize.
GREENE, Q.C.:
Q. This was just to give some perspective to the cost that Newfoundland Power has experienced with respect to weather, and if

you go to Attachment "A" to this RFI.
JOHNSON, Q.C.:
Q. I'm not sure we have the right number.
GREENE, Q.C.:
Q. I must have the wrong reference written down, but I'm sure Ms. Perry will recall that over the period 2008 to 2015, which was the period – there we go, thank you, and that number is – there was an attachment. It's to illustrate that the operating cost over the period were 4.2 million, and the capital total was 9.1 million, and you can see how it varied by year with 2008, I believe, being the worst year. I'm sorry, 2010, where you had the ice storm and Hurricane Igor.
MR. SMITH:
A. I remember it well.
GREENE, Q.C.:
Q. And with respect to the capital, which was the most significant cost, how does Newfoundland Power recover those capital costs? You have the ability through your allowance for unforeseen, and also to apply for supplementary capital expenditures, is

that correct?
MS. PERRY:
A. Yes, that is correct.
GREENE, Q.C.:
Q. And, in fact, the capital cost associated with the severe weather has been recovered, is that correct?
MS. PERRY:
A. Yes, I believe so. I'm not sure if all of the capital was done via a supplemental, or whether it was through the unforeseen account. I'd have to confirm for each one.
GREENE, Q.C.:
Q. That's not necessary. The point is that Newfoundland Power did recover the capital that was expended for those severe weather events over that period of time, is that correct?
MS. PERRY:
A. Yes, and if it wasn't – it's actually recovered, Ms. Greene, as you mentioned earlier, in the next rate case because then it's built into the capital and the rate base of the utility at that time. So there could be a regulatory lag from when it's

actually recovered.
GREENE, Q.C.:
Q. Right.
MS. PERRY:
A. From when the storm occurred to when it's collected in rates.
GREENE, Q.C.:
Q. The operating expenses, I think, Mr. Smith, you already spoke a little bit. How does Newfoundland Power try to recover its operating expenses, and I think you've mentioned this briefly -
MR. SMITH:
A. In the year of the storm?
GREENE, Q.C.:
Q. In the year of the storm?
MR. SMITH:
A. As we were talking earlier with Mr. Johnson, I guess, it's a function of when it happens in the year and what you have at your disposal to deal with it. I think each and every year is different that way. It depends on where your sales are, are your sales going up or are your sales going down, how is your forecast looking. So it's a

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function, I guess, of your revenue and your cost, but like I said earlier, we do all we can each and every year to control our costs, and in a year of a large hit in terms of storm or maybe sales are declining more than you thought, then we will get our team together and do everything we can to come up with ways to deal with the cost. Again sometimes those are longer term things, you push harder on your efficiency things that may be in front of you, and sometimes there are shorter term things. You know, we have an asset management system, and inside of there we prioritize the work in different stages; one, two, three, and four, four being the less significant of the categories. An example of what we call a TD4 is there's a ground wire that comes down the pole, and the bottom six feet of that ground wire is covered up with a piece of wooden moulding to protect it. So if our inspector is out there and he sees that piece of wooden moulding damaged, it needs to be repaired, it goes on the list. If it's in the year that we're trying to do

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everything we can to control our costs, that piece of ground moulding might have to wait six months as opposed to it being done right now today. So it's a matter of prioritizing what you can.

GREENE, Q.C.:
Q. And with respect to the recovery of operating expenses in those years, you have been able to do that and still earn your authorized ROE, is that correct?
MR. SMITH:
A. We have been able to manage our cost in those years to earn our allowed return on equity, yes.
GREENE, Q.C.:
Q. Okay. The second risk that you didn't refer to as having increased is your small size, which takes into account the population growth and your service territory, is that correct, you see that as one of your risks and that it hasn't changed materially since the last rate case?
MR. SMITH:
A. Yeah, I would agree with that, yes.
GREENE, Q.C.:

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Q. Okay. Before we get to the ones that have changed, which is the economic outlook and the power supply risk, are there any other risks that you believe that are part of your risk profile that have not changed?
MR. SMITH:
A. Well, I mean, another one that we have, of course, is our demographics in the province, and I'm not going to say they have changed dramatically from the last time we were here, but obviously they continue to change. We have a declining population, and some of the oldest demographics of the population in the country, and if you just keep projecting that into the future, you have more of our customers that will be on a fixed income because they are pensioners, and when you're on a fixed income, your ability to pay the bill will become more difficult. Of course, as your population declines, eventually you will start seeing less customers. So I won't say the demographics has changed significantly, but it continues to evolve, obviously become more of a concern and more negative.

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CHAIRMAN:
Q. Well, it can't change and be demographic.
MR. SMITH:
A. Pardon me?
CHAIRMAN:
Q. Sorry, but the reproductive ratio, you can't change, nobody can change that.
MR. SMITH:
A. Again, sir, to tell stories from the past, I know you and Mr. Ludlow have had that discussion, and I think we need to be 2.1 and we're currently 1.5/1.6.
CHAIRMAN:
Q. I think it's even lower than that.
MR. SMITH:
A. And it may be lower than that, sir.
CHAIRMAN:
Q. I think it's 1.3 or 1.4, I think. I could be wrong. It wouldn't be the first time. Anyway, I'm sorry.
GREENE, Q.C.:
Q. So we come now to the two, I believe, that has already been outlined this morning in response to an earlier question, one is the economic outlook for the province, and what

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it will do for your forecast for sales growth. I wanted to ask you how, in your judgment, you determined that the decrease in sales growth was material enough that it caused you concern and how it contributed to your assessment you're above average risk. The average sales growth, I believe the evidence is, has been approximately 2 percent a year for your energy sales growth, is that correct?

MR. SMITH:
A. That seems a bit high, 2 percent per year.

GREENE, Q.C.:
Q. Two percent – if you look over the last period of time; 1 percent for 2015, and forecast at .7 percent for 2016, and .4 percent for 2017, is that -

MR. SMITH:
A. It seems a bit high to say our forecast has been 2 percent.

GREENE, Q.C.:
Q. On average when you look over the past few years, and I can take you to it on the record, if you like.

MR. SMITH:

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A. Yeah, certainly in the last few years, in particular?

GREENE, Q.C.:
Q. Yes, that's what I'm referring to.

MR. SMITH:
A. Yes, we've had – absolutely, sorry, I thought you were talking a longer term.

GREENE, Q.C.:
Q. I'm trying to see the change from the last GRA.

MR. SMITH:
A. Sure, okay.

GREENE, Q.C.:
Q. The change since the last GRA, and in 2015 it was 1 percent?

MS. PERRY:
A. One percent.

GREENE, Q.C.:
Q. And forecast at .7 percent for 2016?

MS. PERRY:
A. Uh-hm.

GREENE, Q.C.:
Q. And .4 percent for 2017?

MS. PERRY:
A. And that's before you apply the price

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impacts. So once you've applied the price impacts, then it goes lower than that.

GREENE, Q.C.:
Q. Okay.

KELLY, Q.C.:
Q. Revised to .6 and .1 percent.

JOHNSON, Q.C.:
Q. In the revision.

(10:45 a.m.)

MS. PERRY:
A. .6 and .1, yes.

GREENE, Q.C.:
Q. We'll check that at the break. I thought I had the correct numbers from the revision, but, anyway, so that's an order of magnitude, whether it's .7 or .6 for 2016?

MR. SMITH:
A. Yes.

GREENE, Q.C.:
Q. And I wanted to – again your assessment as the Chief Executive Officer and the Chief Financial Officer, how that influenced your judgment with respect to your business risk, how material that was? Could you comment on that, please?

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MR. SMITH:
A. I guess, what I would say is when you have a 1 percent sales growth, in terms of revenue into the company that looks like 6.5 million dollars, and, of course, Newfoundland Power's is about a third of the bill, so we would get about 2 million dollars of that extra revenue coming into the company. When you're down to .1 percent, obviously the numbers are 10 percent of that, so instead of having additional 2 million dollars coming into the company, you're down to something that looks like $200,000.00 coming into the company as additional revenue when your sales decline. So in terms of order of magnitude of significance of revenue coming in the door to support our programs and support our work, obviously it's less revenue.

GREENE, Q.C.:
Q. And obviously you thought it was a material reduction, is that correct?

MR. SMITH:
A. Yeah, to have a ten times change in the sales grown seems pretty significant, yes.

GREENE, Q.C.:
Q. Would you want to add anything, Ms. Perry?
MS. PERRY:
A. For me, I think we're borderlining so close to a declining sales growth, which changes the complete dynamics of how we're going to manoeuvre our way through, you know, providing service to customers and earning a fair return at the same time. Sales growth certainly assists us to continue to do what we do once we leave here, and so our costs – a lot of our cost is with respect to labour, so there are some inflationary increases that we have to deal with, and then as Mr. Smith has highlighted, and even with respect to weather related events, I'm sure we'll have some along the way. So a sales growth helps mitigate the cost increases and the unexpected occurrences that we can expect to have in a normal year. So when you're in a declining sales environment, the opportunity to actually recover our cost as we go forward becomes riskier.
GREENE, Q.C.:
Q. We've already heard evidence that there was

also a very negative economic outlook for Newfoundland during the cod moratorium of 1990s. Do you recall the discussion earlier this week?
MR. SMITH:
A. I do.
GREENE, Q.C.:
Q. Okay. At that time, did Newfoundland Power consider that the economic outlook was such that it would make it above average risk?
MR. SMITH:
A. That was certainly a long time ago, and I'm not sure what the assessment would have been of the company at the time. I know what I referred to in my opening was in those times to maintain its financial integrity some of the things the company had to start doing was spending less money, and one of the things in particular we were doing at the time is we significantly rolled back our capital program. Now at the time, I was more the junior engineer in the company, but I certainly remember on the frontlines of the types of programs that we had to stop doing, and as I mentioned in my opening,

after a few years of doing that, we saw the impacts on the reliability of our service. I think back in the late 90s, there was a request from the Board to review that, and the Board put an expert to Newfoundland Power to go through our practices, and we worked with that expert to see what we might do going forward to improve our reliability, and so that was the output of that, that we could no longer sustain our business with that small amount and not getting our work done, and so after that we had to get back into more of a normal routine of spending our capital money to improve our reliability again. So at the time, I guess, the economics that were in front of the company was one that we had to pull back on our capital program.
GREENE, Q.C.:
Q. Okay. You've already given evidence that there's two risks that have materially changed since the last GRA. With respect to this risk of the deteriorating economic outlook, if that had been your only risk change, would that have been material enough

in your judgment for you to have concluded you are above average risk?
MS.PERRY:
A. That's a hard one to answer. I do believe that the economics of this province are much grimmer than they have been in a long time, in decades, I believe that's what is stated, but I can't help but say that the fact that I understand that the province is also going to be facing on top of its current deficits the financing and cost associated with Muskrat Falls, and the people of this province are also going to, in addition to a declining economy, be faced with pretty significant costs associated with the electricity potentially. Together, that's probably what pushed us up over the average risk utility. Now again I'm going to stop back leave that up to Mr. Coyne to make the assessment, but if you were to ask me, I think that the two together sort of do make it significant enough where I agree that, you know, we're just pushing the risk of this utility upwards with these two events.
GREENE, Q.C.:

Q. Thank you, and that's what I would have thought your response would be, and a heads up, yes, Mr. Coyne will be asked similar questions. Turning then to the last remaining risk, which you have outlined in your written pre-filed evidence and here this week, a heightened risk associated with your power supply, and I'm going to categorize it as three risks, but I want to talk to you about each independently. One is the potential cost implications of Muskrat, and you just referred to that, Ms. Perry. The other is the reliability issues, and both of those deal with once Muskrat Falls is in service, and the other third risk associated with the power supply risk is reliability risk up to the in-feed, as I believe based on your application, you have highlighted those three risks. First you've just mentioned again, Ms. Perry, the cost uncertainty with respect to Muskrat Falls. At this point in time, is there any certainty with respect to what that price will be or what the cost implications will be, or how costs will be recovered from rate

payers?

MS. PERRY:

A. No, I believe that's still very uncertain.

GREENE, Q.C.:

Q. Okay. Does Newfoundland Power have any indication as to the timing as to when that information will become more certain?

MS. PERRY:

A. I would say that's still very uncertain as well.

GREENE, Q.C.:

Q. And, Mr. Smith, you've mentioned the issues that will arise with respect to reliability and your issues with respect to that. Is there anything additional – and you did already say that earlier this week. Was there anything you wanted to say with respect to why Newfoundland Power believes there are reliability issues arising with respect to the interconnection of Muskrat Falls?

MR. SMITH:

A. I mean, I did talk about it briefly earlier the week, but if I may, I can maybe expand a little bit.

GREENE, Q.C.:

Q. Sure.

MR. SMITH:

A. I mean, the information, I guess, continues to evolve and there will be further deliberations here at the Public Utilities Board later this year, but some of the things that we know already, I guess, that have been talked about is certainly the fact that the DC line to Labrador is exposed to what Hydro has categorized as a 14 day outage, and again that can be – that's their assessment, I guess, at this time of what the outage could be, and it can happen for a multitude of reasons, from ice and wind loading to again salt spray on insulators that can take the line down for all kinds of reasons. So that is one of the areas that we are concerned about the reliability. You also have to remember that the line comes through the Isthmus onto the Avalon, it's a narrow piece of land, and when it goes through that narrow piece of land, it's not just the new DC line that will be exposed to that weather event, it will be all the

lines. So we've been trying to understand, I guess, to a greater degree the reliability of that line in terms of how it's been designed, and by understanding it better, it can give us a better comfort level in terms of where that reliability assessment is going. We continue to ask questions, we continue to try to participate in that and look forward to getting more of those answers as time goes by, and it's a pretty complicated system when you think about where we're going from today to where that will be. I mean, it's submarine cables to Labrador and submarine cables to Nova Scotia. It's DC converter stations. These are new technologies for this part of the country, that's for sure, but, I mean, I will say that Hydro and Nalcor, they have a team of people working on this and they continue to work on it, but, I guess, where we are, we're waiting to get more of those answers in terms of how this system will work and how it will operate. You know, one of the things that I mentioned the other day that concerns me a bit, I guess, is the fact that once Holyrood is gone off the grid, right now today we have about 1500 megawatts of generation, and as I said the other day, that assumes every single machine we have can make its maximum output at its nameplate rating, and that very rarely happens, but once Holyrood is gone, we will have 1500 megawatts on the island as we know it today. When the DC line goes out then once that occurs, you have to rely on the backup line from Nova Scotia. Now the way I understand it, the backup line from Nova Scotia doesn't trigger automatically, it's typically going to be set up to export energy, and when you get in this backup mode, it has to import energy. So there's a delay in that backup occurring. So when that happens, and depending how much generation is on at the island, what the peak will be on the system, we will experience what's called these "under frequency load shedding events". Will we have more, will be have less remains to be seen. I really don't know. It just depends on how many machines on the island will be available at that time that's in

what we call "spinning reserve mode". I know maybe these things are very technical, but I just want to try to put out a bit of the information, I guess. So that kind of concerns me, how the backup will work, and then once you are at 1500 megawatts and the supply comes from Nova Scotia, which makes you then 1800 megawatts, and your load is already 1800 megawatts, that's what it is today, it just begs the question, it seems to me you need more generation on the Avalon to sustain that. That brings with it additional cost, and those additional costs are part of what gets flagged. When we go to Moody's and DBRS, they flag that additional cost to be one of their concerns; where is the eventual cost of this project all going to go, and the customers' ability to pay that cost. So from a reliability point of view, those are some of the issues. Once you've bored it down into more Newfoundland Power system, it will change what's called the "fault level on the system", you know, the amount of energy that goes into the ground when a wire hits the ground, and so

that will change. Newfoundland Power will have to go through its protection and control system to make sure we can sustain those fault levels. Then again, as I said earlier, Newfoundland Power's protection is what looks after the stability of the system, the synchronization of the system. So those are our relays. We'll have to make sure we go through our fleet of relays to make sure we can continue to do under frequency load shedding as required. Then when you bore it down into our hydro plants, our hydro plants have typically been dispatched to avoid fuel at Holyrood. That's one of the reasons. That will change in the future when you don't have Holyrood, so how will our hydro plants be dispatched into the system operator, and what the system operator will look like. Those are all things that we see out in the future as changes, and how all that rolls together to affect reliability, I guess, needs to be sorted out.

GREENE, Q.C.:

Q. And in those terms with respect to the

uncertainties over cost and reliability, and uncertainty on the timing as to when we will get clarity on those issues, I wanted to come back for you and the timing for this particular rate case. Would you agree that it's most unlikely we will get any clarity around any of those issues in 2016 or even 2017?

MR. SMITH:

A. I believe this year the cost of service study is waiting to go before the Board in terms of Muskrat Falls, and if that happens this year, we will get more clarity in terms of how the prices may change. Will demand costs go up, will energy costs come down, what will the fixed cost be, so I think we'll get some clarity in terms of how the cost may – whatever it is, whatever the ultimate number is at the beginning, how it will go through the system to ultimately affect rates to our customers. I think that will give us some clarity in that area, but again that remains to be seen because I don't believe that application is before the Board yet.

GREENE, Q.C.:
Q. No, or as to whether there will be specific cost information in that document about the price -
MS. PERRY:
A. Yes, that is making the assumption that specific cost information will be included.
GREENE, Q.C.:
Q. And in terms of when those costs would be passed on, that will be at the time when customers in Newfoundland start to actually receive power over the in-feed?
MR. SMITH:
A. Yes, I mean, once you get to the final numbers, those decisions will be made, but, I mean, you know, other things that I wonder about in terms of uncertainty is once you're connected to Labrador, you know, there's generation on the island which has a cost component to it, places like Bay d'Espoir. You're then connected to Muskrat Falls, which will have a cost component to it, and then behind Muskrat Falls is the Upper Churchill Project, which is another source of generation that's interconnected, so I

kind of look at it, how will Newfoundland Power's customers benefit from those three sources of generation going forward, and those are things that I see as uncertain and unclear at this time.
GREENE, Q.C.:
Q. Okay. We can certainly all agree there's a lot of uncertainty and a lot of questions to be answered before we know what the impact on rate payers will be cost-wise, and from a reliability perspective, I wanted to ask you how does that fit into this current rate application when you're asking for a rate of return for 2016 and 2017 when those costs and the recovery of the costs and the reliability issues will not arise until – I wouldn't even speculate. It certainly will be beyond 2018 at this point in time.
MS. PERRY:
A. If I could just quickly answer. When considering this rate case, I mean, you're trying to set the utility up on a sustainable basis into the future. Muskrat Falls is going to be here for a lot of years, and, yes, we have uncertainty today,

but that uncertainty is going to, I think, fall into longer than just at interconnection. As Mr. Smith said, there's a lot of uncertainty that – and even the realization of operating this new system in this area in terms of what it means, so this application is to ensure that we maintain a strong financially sound utility that can continue to provide good service and the proper service to the customers. That's what this is about. The above average risk utility and the return is not that different than what we would consider in prior rate cases. We're just trying to set it up so we can operate on a standalone basis to be focused on the things that matter to our customers, while at the same time maintaining our financial integrity. It's important to do that in every single rate case as you come forward, and so the uncertainty with the economy probably will not be over in a couple of years, and the uncertainty with Muskrat Falls, I don't actually view that as a short term uncertainty either, I could see that – it's

a game changer in the industry, and it's something that we're going to be living with for a long time.
GREENE, Q.C.:
Q. I guess, my last question before the break, I'm trying to understand why you need a higher return now to provide for a risk that will not materialize for Newfoundland Power for at least three years. Why do you need a higher return now for a risk that will not materialize for three to four years or more out?
MR. SMITH:
A. Well, I mean, it seems pretty obvious that price is going up significantly, and I would agree that the ultimate number hasn't been established and there will be some time before the number is established, but we know prices are going to go up significantly, and as we've already seen, I guess, in some of the bond rating agencies, they're picking up on it. I think the last time we were before the Board, I don't even know if Muskrat Falls was mentioned in the bond rating agencies, but now as we get

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closer to it, they're starting to flag it as a concern in terms of the future ability of the company to recover its cost and to earn its return. So, I guess, it's just a matter as you get closer to that, what does it mean to the company as the risk is getting closer.

GREENE, Q.C.:
Q. How would you respond to the statement that it's premature for you to be talking about it now, it's more for your next GRA?
MR. SMITH:
A. Well, I think you have to –
GREENE, Q.C.:
Q. Because that's when you have the risk materializing.
MR. SMITH:
A. I think you have to plan it as a company. I mean, we're a long term asset base is what we are, you know, we put poles in the ground that last 40 and 50 years, and when you're looking to go to the markets and get debt from people, they look at where's your future and where are you going, because they know they're investing that money for the

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long haul. So as we get closer to this big price increase, I guess we're just reacting and becoming more concerned to it.
GREENE, Q.C.:
Q. And before we break, I do want to clarify for the record that I did have the numbers wrong for the sales forecast. It is .6 percent in 2016, and .1 percent in 2017.
CHAIRMAN:
Q. You made a mistake!
GREENE, Q.C.:
Q. As hard as that is to believe, Mr. Chair.
MS. GLYNN:
Q. I think she just misread her own writing.
CHAIRMAN:
Q. On that shocking revelation, we'll take a break.
(RECESS - 11:04 a.m.)
(11:45 a.m.)
CHAIRMAN:
Q. So, we are back.
GREENE, Q.C.:
Q. Just before we concluded before the break, we had gone through the factors that led

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both of you or the executive management of the company to come to the assessment that you were above average risk and I wanted to ask you how is executive management responding to that assessment, that you are now above average risk? One obvious response is that you are seeking a higher return from where your current return is, the other actions that the company is taking to put itself in a position to be able to respond to these increase risks?
MR. SMITH:
A. Financially or operationally or –
GREENE, Q.C.:
Q. In all aspects.
MR. SMITH:
A. In all aspects.
GREENE, Q.C.:
Q. Because you have concluded you are now above average risk, so are there any changes you're implementing in your operations, financially or otherwise in your company, to reflect that change in risk that you have determined?
MR. SMITH:

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A. Maybe I'll speak operationally and Jocelyn can speak from a financial point of view. You know, operationally, like I said before, we will be focussed certainly on what we can do to find efficiencies in our companies and to control our costs, and at the same time, balance our service and those are things that we've traditionally done, but as we look forward and we see more pressure on our costs, then we're going to have to be even more diligent than ever to do everything we can to keep our costs down and that means we will, you know, like I said before, do what we can, but going forward we will be looking at things, even our capital budget that we would bring before the Board, our next capital budget. We will look at that from the point of view of everything we can do to bring forward a reasonable budget to make sure we are doing the capital work that's necessary, but for example, now that things are slowing down a little bit and our load growth is slowing down a little bit, are there some power transformers that we can push off a little bit? So are there things that we can do in our business to slow down our part of the cost to respond to the other increases that will occur. So I would say that from an operational point of view what the company is trying to do looking forward.

MS. PERRY:

A. Yeah, and I would say that ties into just cost management and also as a part of this particular rate case, we are setting the company up so that we can focus on running Newfoundland Power's side of the business and Mr. Smith did talk about this earlier, in terms of the risk, I'm going to say of interconnection, there's a lot that the company has to do to get ready for that, whether it be with respect to our relays or other parts of our business. This is setting us up so that we have the resources, both operational and financial to actually focus on the things that matter, so we can have our side ready as well. So we need to maintain our strength, both operationally and financially so that we can do what we need to do to service customers with all of these changes. A part of that is still cost

management. We've always been focussed on cost management; we will even be more focussed on cost management, if there's such a thing because when you're facing low sales growth and increasing costs, we have to be very, very diligent in the changes that we make as a business because we have to look at it on a very forward-thinking basis that the future is not going to be like the past, so we can't just operate a steady state. So each decision that we have to make now, we have to consider it in the context of what's coming before us.

GREENE, Q.C.:

Q. The request of Newfoundland Power in the application for the 9.5 percent return on equity and the 45 percent common equity in your structure is supported by Mr. Coyne, of course, and his overall analysis and also I assume it must be supported by the overall assessment that you earn above average risk, is that correct?

MS. PERRY:

A. Yes, that is correct, so as a part of this proceeding, the assessment of the above-

average risk, we're not asking for an increase in our capital structure, we are asking to maintain the 45 percent capital structure and the 9.5 percent is reflective of an above-average risk utility, yes.

GREENE, Q.C.:

Q. And in response to a question earlier, I don't think we need to go to the transcript, but in response to a question from Mr. Johnson, you had indicated that there had been no discussion with Mr. Coyne as to what the appropriate ROE would be if it was determined that Newfoundland Power was an average risk utility, is that correct?

MS. PERRY:

A. Yes, that is correct.

GREENE, Q.C.:

Q. In terms of your own assessment as the chief financial officer and having been involved in a number of these determinations over the years, and we will ask Mr. Coyne the same question, obviously if the Board does not agree, if the Board does not find that you are above average risk, have you considered what you believe the appropriate fair return

would be for an average risk Canadian—if Newfoundland Power is an average risk like other Canadian utilities? Have you?

MS. PERRY:

A. The answer is no and the fact that I'm, again, not an expert in cost of capital. What I would do is look across the country and I had showed this RFI in my opening with respect to the allowed ROEs in the country in terms of how we compare to others and where we are today is we're second lowest to Alberta today and so, whether it's average risk or above average risk, my analysis is really limited to how we compare to others and so 9.5, you know, seemed reasonable to me for an above-average risk utility, given that the median today is 9.15.

GREENE, Q.C.:

Q. Would you agree that if the Board does find that you're an average risk utility and that if the 9.5 percent is based on being above average, the ROE should be lower than 9.5 if it is determined you're average?

MS. PERRY:

A. It's probably a question better directed at

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Mr. Coyne, but in theory, I think I support the theory, yes.

GREENE, Q.C.:

Q. So the theory would require it to be lower, wouldn't it?

MS. PERRY:

A. Again, I would confirm that with Mr. Coyne because I'm not quite sure how it's factored into his overall opinion or recommendation of the 9.5.

GREENE, Q.C.:

Q. I wanted to turn now to Newfoundland Power's financial performance. I believe in your opening comments, Ms. Perry, you said that Newfoundland Power's performance—and you may not have used this adjective, this is my adjective, has been a solid financial performance since the last GRA, is that correct?

MS. PERRY:

A. Yes, I said it was satisfactory, yes.

GREENE, Q.C.:

Q. And the credit metrics you were able to achieve with the allowed return of 8.8 percent did not cause any concern for you or

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for the credit rating agencies, is that correct?

MS. PERRY:

A. I would say that is correct, yes, the credit metrics are within the ranges indicated by Moody's for sure.

GREENE, Q.C.:

Q. And I wonder if we could go, please, to Table 4-11 in the application at page 4-14. So this table illustrates that for 2016 with the current rates what the return on equity would be, is that correct?

MS. PERRY:

A. Yes, for 2016 it would be 8.03.

GREENE, Q.C.:

Q. And similarly for 2017 it would be lower again, is that correct?

MS. PERRY:

A. Yes, 7.3 percent.

GREENE, Q.C.:

Q. Okay, now I just wanted to go to the next table, Table 4-12 and again this table demonstrates what that ROE, if you carry down without an increase with your current rate, what your credit metrics would be, and

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I wanted to give you the opportunity to explain from your perspective why it's absolutely necessary that there be some adjustment at this time?

MS. PERRY:

A. What Table 4-12 is showing is the calculation of the company's credit metrics based on existing rates today, so that's why we had shown the prior table that reflects the return on equity of 8.03 and 7.3. So the credit metrics are within the ranges that I would say have been determined to be acceptable for Moody's for our credit rating. And that's a component of credit worthiness of Newfoundland Power. The return on equity is about a fair return, so there are two different components. Inside of a fair return standard, we need to maintain our financial integrity which we will consider such things as the credit metrics and the capital structure of Newfoundland Power, but it also has to be sufficient to ensure we have access to capital and also it needs to be comparable to other liked risk investments, so credit

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metrics are just a display of where you are from a credit worthiness perspective only and not from a fair return perspective.

GREENE, Q.C.:

Q. And so if we looked at those metrics, they would still fall within the ranges for Moody's for the A credit rating, is that correct?

MS. PERRY:

A. Yes, that is correct.

GREENE, Q.C.:

Q. Okay, so now I just wanted to go to Table 4-16, page 4-43. So this illustrates the impact on the credit metrics of your current proposal.

MS. PERRY:

A. Yes, that is correct.

GREENE, Q.C.:

Q. So, again, if you looked at those, they are again within, in fact, your cash flow debt coverage would be above the, for 2017, would be above—they're all within the, again, the range for your credit metrics. So when we look at these, the credit metrics and I guess you've already explained the point

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that it's not only the current metrics you look at, it's the authorized return that is approved, and I now wanted to look at then the ROE at different levels, so if we ask you to produce Exhibit JP-1. And would you agree that this illustrates that with maintaining the current capital structure, so maintaining it at a 45 percent equity, the metrics that would result for the various ROEs down to 8.3 percent ROE are still within the ranges that Moody's has published for an A credit rating?

MS. PERRY:

A. Yes, I can confirm that.

GREENE, Q.C.:

Q. You did indicate that at 8.3 and we talked about the earnings' test coverage, you had some concern with respect to the earnings' test coverage and I believe the concern was with respect to the ROE at 8.3, is that correct?

MS. PERRY:

A. Yes, that is correct and again, that goes back to my discussion from the undertaking No. 4 that we have provided, that we're just getting simply close to the minimum requirement, so a variation in market conditions and a variation in forecast could just drive us below that too, and then that would limit us form issuing First Mortgage Bonds.

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GREENE, Q.C.:

Q. And the test in the First Mortgage Bonds, we've already heard, is two times interest coverage and I think you did try to explain why you're concerned at 2.1, but you're not concerned at 2.2.

MS. PERRY:

A. I would never say I'm not concerned at 2.2, I mean, I look back over the debt issuances that we have done in the last ten years, there were a number of them that we've done at 2.3. It's a comfort zone because we really don't know what's going to happen with respect to market conditions and we don't know what's going to happen with respect to even Newfoundland Power's ability to earn its return and stay on forecast. So any time we are dealing with forecast, there's a risk that you're going to be off forecast, particularly as it relates to the market conditions on bond costs. So historically we've been at 2.24; on average we have been as high as 2.36. So the higher you get away from the two, yes, the more comfort I would have that we're creating a sustainable position where Newfoundland Power, in all economic conditions, can issue bonds.

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GREENE, Q.C.:

Q. In terms of, is it only a level of comfort that 2.1 is a little too close? It is above 2, 2.1 is higher than 2.

MS. PERRY:

A. Absolutely.

GREENE, Q.C.:

Q. So why is there a concern?

MS. PERRY:

A. The concern is simply, I think it's reasonable to think that we're not going to be exactly as we forecasted, so by way of example, I had provided that a 1 percent change in debt cost, which is not an unreasonable assumption, and a variation in our forecast of 40 basis points, which the Board has stated in a reasonable range of return around Newfoundland Power's return on equity, so with just those two changes, 2.10 would knock us out of the bond market, out of the first mortgage bond market. So I just want to put it in perspective, that's why I would get uncomfortable because that's not unreasonable changes to the forecast. And I guess, as I was just trying to provide some context with respect to why I would be uncomfortable in that zone.

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GREENE, Q.C.:

Q. I wanted to go to Exhibit 4, please, in Volume 2, DBRS Report. And I wanted to point out and get your comments, Ms. Perry, on the observation by DBRS in this report on the top of the second column, end of the paragraph where DBRS points out, "DBRS does not expect any material change from the DRA, but notes that"—they're talking about the current one we're now in the middle of, "but notes that a lower approved ROE is a possibility due to the current low interest rate environment and a modest decrease in the allowed ROE is not excepted to have any

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material impact on the company's operations." So presumably they were talking about that in the context of where we are right now talking about with maintaining the capital structure. So the credit rating agencies appear to be contemplating that Newfoundland Power will decrease from 8.8, would you agree that that's how we should read that statement?

(12:00 p.m.)

MS. PERRY:

A. I struggle with that statement and the fact that, I believe their statement is around that they've seen other utilities decline and they've made the assumption or the connection that it was due to the lower interest rate environment. I mean, I questioned this when they stated this in their report. We don't get to –

GREENE, Q.C.:

Q. Yes, I guess you didn't like to see that, did you?

MS. PERRY:

A. Well we don't get to change their report, but I wanted to, you know, dig in further as

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to the premise by which they were making these statements and they had seen other utilities decline and interest rates were declining, so their overall comment for a lot of utilities was that they expected there could be some modest decrease due to declining interest rates, not necessarily specifically for Newfoundland Power and the continuation of their sentence "is not expected to have a material impact on the company's operations", they're referring to that they do not believe that it will impact the, basically the cash flows materially of this company.

GREENE, Q.C.:

Q. And we've already reviewed your undertaking No. 4 which illustrates that at different capital structures and different ROEs what the impact would be on Newfoundland Power, is there anything additional you would like to say in conclusion on that undertaking?

MS. PERRY:

A. The only other additional comment that I would make is credit metrics, as I referred in my opening, is one component of the

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overall ratings' assessment. So they will consider decisions made with respect to capital structure. They will look at, as I said, you know, the timeliness of the Board order or any other variations in our regulatory mechanisms or anything within the context of the order that would give them any reason to suggest there's a change with respect to the regulatory support in this area. So credit metrics are just one component and so it's not a precise science with respect to how the rating is applied, there's a lot of qualitative factors that they will consider and certainly I expect that a part of the next ratings' assessment or even before then, we will be providing updates with respect to the latest updates on Muskrat Falls, the latest on the economy and certainly any supply issues that we face between now and even the interconnection. So there's a number of qualitative things that will go into the rating beyond just the credit metrics.

GREENE, Q.C.:

Q. And turning now to another topic,

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compensation. Mr. Smith, I wonder if you could describe for the Board the process that's followed at Newfoundland Power with respect to how executive compensation is determined?

MR. SMITH:

A. Well from the point of view of the vice-presidents, I would do an assessment of their performance and I would present that to our board of directors who makes the ultimate decision on executive compensation and in addition to that, I guess at each of our quarterly board meetings the board of directors would do their own assessment also of the performance of the executive, so it's a matter of the quarterly board meetings and my assessment and passing that on to the board of directors.

GREENE, Q.C.:

Q. If we step back further, first, the actual compensation policies that are established for Newfoundland Power, how are the determined?

MR. SMITH:

A. Again we use a consultant by the name of Hay

and Hay would recommend to the company a
compensation policy and then our board of
directors would decide to accept that or not
to accept that.
GREENE, Q.C.:
Q. Is there a member of the executive or a
director who is responsible for a
compensation policy that would work with
Hay?
MR. SMITH:
A. The ultimate responsibility would be with
the governance and HR committee, which is a
subcommittee of the complete board, so they
would have the responsibility for that.
GREENE, Q.C.:
Q. And my question is, is there an intermediary
step, does the committee of the board deal
directly with Hay or is there somebody who
would be an executive management person, or
yourself, who would be responsible for the
liaison between the board committee and Hay?
MR. SMITH:
A. Typically Hay would write their
correspondence to me and then it's a
combination of myself and Ms. Perry who

looks after HR at the company that would be
the liaison with our board of directors.
GREENE, Q.C.:
Q. Okay. So in bringing recommendations, is it
fair to say that it is yourself and possibly
Ms. Perry who would bring recommendations to
the HR committee of the board with respect
to the appropriate compensation policies for
all levels at Newfoundland Power?
MR. SMITH:
A. In particular the executive and I think the
layers below the executive into the
management layers, that really doesn't go
before our board for approval.
GREENE, Q.C.:
Q. So it's only the executive management
policy, is that correct?
MR. SMITH:
A. Yes, that's true.
GREENE, Q.C.:
Q. So for below the executive, who is
responsible for the compensation policies?
MR. SMITH:
A. That would be myself.
GREENE, Q.C.:

Q. So in your role as president and CEO, first
you would be satisfied with respect to the
selection of the peer group for the
positions below the executive, is that
correct?
MR. SMITH:
A. Again that would be the recommendation of
Hay to the company, yes.
GREENE, Q.C.:
Q. So when external consultants make
recommendations, what would be your role as
the CEO in assessing a recommendation on a
policy?
MR. SMITH:
A. I guess I would look for a recommendation
from our consultants, Hay, in terms of, you
know, the retention and attraction of the
employees that we have and that we have a
compensation policy that's fair and
reasonable in terms of what the market would
be.
GREENE, Q.C.:
Q. And I assume that you would want to satisfy
yourself that the recommendation is indeed
the appropriate one that would reflect the

pressures that you are under with respect to
attraction of employees and appropriate
compensation to ensure you attract and
retain employees, is that correct?
MR. SMITH:
A. That is correct.
GREENE, Q.C.:
Q. Similarly with respect to the executive
management, would you be involved in
bringing a recommendation to the board of
directors with respect to the appropriate
peer group for the executive?
MR. SMITH:
A. You said the executive management?
GREENE, Q.C.:
Q. Yes, the vice-presidents.
MR. SMITH:
A. Yeah, I would bring that recommendation to
the governance committee, yes.
GREENE, Q.C.:
Q. And again you would satisfy yourself that
the peer group that Hay has recommended is
indeed the appropriate peer group for
comparison purposes and is the right one for
you to bring to the board of directors?

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MR. SMITH:
A. I would rely on Hay to do that work and look at the companies that are in the group and then bring forward that to the company.
GREENE, Q.C.:
Q. And with respect to your comparative group and since you've assumed your role as the president and CEO, did you have occasion to look at the compensation policies for the executive management to determine if, from your perspective, they continue to be appropriate?
MR. SMITH:
A. In terms of what Hay has sent us, since I've been president, yes, I reviewed the information and was satisfied with it and passed it along to our board of directors.
GREENE, Q.C.:
Q. And you're satisfied that the appropriate peer group is the commercial, the median of the commercial industrial executive group for the executive?
MR. SMITH:
A. Yes, I am.
GREENE, Q.C.:

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Q. And you're satisfied that in looking at the salary compensation, you do not look at compensation for other utilities in Canada?
MR. SMITH:
A. I'm satisfied with the information that Hay brings before us and again, Hay will have to speak to exactly the companies that are in that group and why they're there and why other ones may not be there. But as I said yesterday, we certainly know that they don't include Crown corporations and they don't include other Fortis companies.
GREENE, Q.C.:
Q. And we will be asking Hay those questions as well, but in terms of your role as the president and chief executive officer who brings these recommendations to your board of directors, I'm asking whether you're satisfied and my question was your level of comfort in the fact that there are no, other than Bruce Power, which is a nuclear utility and a telcom (phonetic), that there are no utility companies in the peer group for Newfoundland Power?
MR. SMITH:

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A. Yes, I'm satisfied with Hay's work, yes.
GREENE, Q.C.:
Q. And you're satisfied that is your right peer group—not that you're satisfied with Hay, but you're satisfied that that is the right peer group for you to look at for salaries?
MR. SMITH:
A. Yes, I am.
GREENE, Q.C.:
Q. Similarly I want to talk about the short-term incentive plans for the executive and what your role is with respect to those. Could you explain that briefly?
MR. SMITH:
A. The short-term plan?
GREENE, Q.C.:
Q. The short-term plan and the individual measures, not the corporate measures at this point.
MR. SMITH:
A. Sure.
GREENE, Q.C.:
Q. Your role and how they're established.
MR. SMITH:
A. A number of the individual ones are based on

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a subjective evaluation and in setting up those particular targets and objectives, again it's a conversation that I would have with the board of directors of the company and in that conversation, we look to make sure that the individual ones are aligned with the corporate priorities of the company, and so we look for an alignment. Some of the things that you look at when we do the individual evaluation tend to run over multiple years, they're not necessarily specific to a year, so it would be my job to monitor the performance of the executive team in terms of initiatives that we take on to support our corporate goals, year in and year out, and I would do that assessment based on the abilities of the individuals to assess issues and problems and look at data and then come up with plans, and action plans to deal with it. I would assess their overall commitment to lead the team at Newfoundland Power and I would also look at their ability to drive and achieve results. So I would assess their performance in those areas.

GREENE, Q.C.:
Q. If we could go to CA-NP-343, please, attachment A. Just scroll down please. So I assume you're familiar with all of these plans, Mr. Smith.
MR. SMITH:
A. Yeah, there's a lot of paper here.
GREENE, Q.C.:
Q. Yes, and I didn't know if you needed a moment to review them, but these would be the individual objectives for 2014 for your members of your executive, is that correct?
MR. SMITH:
A. This would be for 2014, yes.
GREENE, Q.C.:
Q. Yes, and in fact, I think if you keep scrolling down, I didn't know if you wanted to look at them or in looking at them, one observation I wanted you to comment on is that other than financial results, if you look at all of the other measures and except for a limited one for reliability, the methods of evaluation are subjective, there's no target established and I wanted you to explain why that would be.

MR. SMITH:
A. Right.
GREENE, Q.C.:
Q. It's really unusual to see no objective measures, even on the corporate ones from my experience.
MR. SMITH:
A. Would you give me the leeway of do an example, maybe?
GREENE, Q.C.:
Q. Sure.
MR. SMITH:
A. And there was another RFI that you've provided that was a bit more specific than a lot of this table, which was PUB-NPO-79, so it was specific to one of the executives for one particular year.
GREENE, Q.C.:
Q. Yes, it was. This one, I just wanted to illustrate that for all of them -
MR. SMITH:
A. For all of them, it's the same way, subjective, yes.
GREENE, Q.C.:
Q. Subjective, yes.

MR. SMITH:
A. So if I could, to use one as an example which would be PUB-NPO-79?
GREENE, Q.C.:
Q. And that is the one that does have one objective measure, liability for the VP.
(12:15 p.m.)
MR. SMITH:
A. Right, so on page 3-4, so this would be Gary Murray, who is a vice-president of engineering and operations and as you can see for reliability and safety, safety in particular it's all subjective and for reliability it's a combination of subjective with some emphasis put on SAIDI and SAIFI, and so as you can see in one result reliability, I've given Mr. Murray a hundred percent; and the other one, safety, I've given him one hundred and fifty percent. So what I would do in these areas of the subjective evaluation, again, I would look at Mr. Murray's performance overall and then I would make a recommendation to our board of directors. To give it a bit of context, I guess, our reliability performance is

about half the Canadian average and there's tables in our evidence that show that and I'm sure you folks have seen it before and in the year—this is specific to 2015, yes, in that year I guess we had a SAIDI result, I believe, of 2.36 which wouldn't meet this target here of 2.3, what you see here, and in fact, 2.36 for SAIDI was the second best record we had in the history of the company and so although we didn't hit our target with SAIDI, it was a strong result and being the second best year in the history of the company at 2.36. So I would go behind that number in terms of what has Mr. Murray done to support reliability in the company besides just the ultimate SAIDI number and if we could go to some of the information in Mr. Murray's section, which would be section 3 and maybe first we'll just go to page 3-8 and so this shows the company's overall reliability over the last number of years, with again the comparison to the CEA to show that we are about half the Canadian average, and then perhaps to page 3-14, Sam, so in terms of some of the things that Mr. Murray would do to look at reliability in the company, he would do his assessment of where we are today, what is the data, where is our problems, and one of the things that we've been focussing on for a while is equipment failures and as you can see from this graph, we've got a trend line to control our equipment failures and in '15, our result is, you know modestly in the same direction. We continue to have less outages because of equipment failures. And then if you could go to the next page, which is page 3-15, there's a table here which shows the amount of plant upgrades that we do with energized equipment and as you can see, we're doing more and more work with energized equipment, albeit from ' 14 to '15 we dropped a percent. Now in the background of this, you have to remember that the workforce that we have at Newfoundland Power right now, about fifty percent of them have been with us less than 10 years and a lot of those people are in the linemen trade, or the line person trade, I should say, and so in the background of that, Mr. Murray has to be

conscious of the abilities and the capabilities of those people to do energized work and that's a big function of their training and their capability. So in this area in particular, Mr. Murray has done a good job in maintaining our ability to continue to do hotline work, which is the point I'm trying to make in this slide. And if we could go to one more, which would be page 3-16, this would show the outages as a result of scheduled outages, okay, so these would be planned outages and as you can see, we continue to bring our trend line down, so the hotline work would be behind this, but also doing things such as the engineering work to make sure we have alternate feeds. So in the background of my overall assessment of Mr. Murray would be this type of data and I call this more operational data than corporate targets because they build a support to corporate target. So my assessment of Mr. Murray in this particular year, although we didn't hit the 2.3 target, our result was 2.36, which again was the second best year in the history of the

company, I did feel it appropriate to give him a hundred percent score based on a subjective evaluation of the information that's in the background behind the 2.3. So these are the types of things that I would use to give Mr. Murray a score of a hundred percent in this particular category.

GREENE, Q.C.:

Q. For transparency, you've just taken us through these slides of how you supported your assessment and for this particular one for reliability was based on certain statistics or certain performance that you track through metrics. For the sake of transparency, why wouldn't you have that actually identified as some of the targets you are to meet in order to achieve the reliability, rather than leaving it to subjective?

MR. SMITH:

A. Right, it's a matter of in a run of a year, we'll have other ones besides these, okay, and these are just some examples that we've provided here, but in the background of Mr. Murray, there's many of these, what I'll

call operational targets that we pay attention to. They all go into my assessment of his overall capability and his performance for the year, but to focus on any particular one to say we're going to ride that one in particular, I would just caution that we may be chasing the wrong thing. Another one in the background of Mr. Murray that isn't here, for example, is our response to trouble calls, and so we have a target of 85 percent of the time within two hours, and so that would be another one in the background that drives reliability, but when Mr. Murray performs against that target and we're always very close to that 85 percent, but in any given year, I'm very cautious that there's a balance in that number between cost and service. And so, for example, if there's a crew working right now today and they're hooking up a new house and that would be one of our metrics that we also have now, to have a certain amount of time to hook up a new house and we'll have a scheduled appointment, so the crew is there working on that job. In the meantime, a

trouble call comes in, so I'm going to go—
Mr. Murray is going to go through that with his staff of what point do you leave that scheduled job, the job that you're already on and leave it to go do that trouble call, because when you leave it, there's a mob and demob cost which will ultimately drive up the price. So Mr. Murray has to be conscious of those decisions. Where is my metric on response to two-hour trouble calls? How close am I to the 85 percent? Am I willing to leave that scheduled job to do a demob and mob cost to go do that trouble call right away? If I talk to the customer and the customer is willing to wait, in terms of waiting the extra hour to get service, then that's the right decision to make, but if I'm just focussed on that metric only, I can hit the metric but it ultimately may not be least cost.

GREENE, Q.C.:
Q. Now I don't want to go through the others because there are a number of them where there are subjective evaluations, my question, another question would be how does

the individual know what they have to do in order to achieve the target, if it's subjective evaluation?

MR. SMITH:
A. Yeah, as I said earlier, a lot of these individual ones, they'd line up to support the corporate target and when you do that, these individual ones are about a long-term plan to get there and as you can see by the slide that's still in front of you on the computer screen, this is a longer-term objective to reduce scheduled outages. So Mr. Murray would have communication with me in terms of his performance during the year. What are we doing in terms of the training of the linemen to be able to do hotline work? I would also interact with the layer below Mr. Murray to get an assessment of his capability and Mr. Murray, in terms of understanding where he's supposed to go, in terms of reliability the message to Mr. Murray is we're trying to sustain where we are, get a little better if we can, but we're currently run at about 2.4 hours per hour as a SAIDI. We're not trying to get it

down to 1.4 hours. We really believe that the incremental cost to get there is really not worth the service to our customers, but if we can get it from 2.4 to 2.36 to 2.32 without increasing a whole lot of additional cost, then that's where we want to be. So Mr. Murray understands that in communication with me.

GREENE, Q.C.:
Q. A question arising from your answer, you said that the target hadn't been met for the year, even though it had been your second best year of performance.

MR. SMITH:
A. Yes.

GREENE, Q.C.:
Q. How do you establish your targets if they're not related to your past performance?

MR. SMITH:
A. The corporate target that was calculated that year, which as the corporate targets based off a historical average and so when we do the corporate targets, they run off a historical average calculation of what our performance has been. Those would be the

corporate targets.

GREENE, Q.C.:
Q. I want to now turn to the corporate targets, go to PUB-NP-095 please?

MS. GLYNN:
Q. Sorry, Ms. Greene, what was that number?

GREENE, Q.C.:
Q. PUB-095. And I just wanted to bring this up, these are your corporate performance measures, but they're not the same as what you have for your corporate—STI for your corporate objectives.

MR. SMITH:
A. Right.

GREENE, Q.C.:
Q. And I wanted to know what use do you make of this information and how is it used to develop your corporate objective and your STI plans?

MR. SMITH:
A. Right, in this presentation of information, you do see some of the corporate targets, such as the very first one which is the SAIDI, so that one would be a corporate target. You come down a few and you see

"customer satisfaction". This one would be a corporate target. You see the one called "All Injury Frequency Rate", that would be a corporate target. Then there's the "Earnings" one. The one below that is called "Gross Operating Cost Per Customer", that is not a corporate target. We use controllable operating cost per customer, so there's a difference between the two. If you go, if you're able to follow, I can go back a few, back up a couple of more now, the one that's there that's called "Trouble Call Response Within 2 Hours" is the one I just spoke to, there's another one up a couple called "Plant Availability", usually runs about 95 percent of it, again, that's another one that is not a corporate target, it's more of an operational target, and again, for example, if we have a hydro plant that goes down on a Saturday, we're not going to try to fight to meet this 95 percent if the plant does not need it to support system capacity. We'll wait until Monday and not spend the overtime on a weekend to fix the plant. We will dispatch

someone to the plant to make sure it's safe and environmentally responsible, but we won't fix the plant on overtime over the weekend if it's not needed for system capacity. So again, that's another example of how you have to be careful with the operational targets that you don't push to hit a target, but at the same time cost you more money when you don't need to. So some of these, I guess what I'm saying are the corporate targets that we use for STIs and some of these are more operational targets that have those types of limitations to it.

GREENE, Q.C.:

Q. And I want to understand how they are connected or related because when I looked at 2014, for example, for these corporate performance measures, you achieve three of what you had targeted and only three out of nine, but when we go back over now to your corporate measures in CA-NP-342 for 2014, where we don't have the same metrics, you did receive the incentive payments.

MR. SMITH:

A. And so again this is 2014?

GREENE, Q.C.:

Q. Yes. So the judgment that's used in selecting what goes into the corporate objectives, how are they determined?

MR. SMITH:

A. Sure. If you take, for example –

GREENE, Q.C.:

Q. And if we could go, please, to have it before us, CA-NP-342.

SMITH:

A. So again these would be the corporate ones, and your question is why are they different than the last ones?

GREENE, Q.C.:

Q. And how do you use judgment from what you provide to the Board as performance measures, and report to the Board on it, how you're doing with respect to what you put in and you use for the basis of short term incentives?

MR. SMITH:

A. Right. Well, again there is six of these here, and these same six will appear on the last RFI that we were just looking at. The one that's different in the way it's

presented here is the operating cost. What you see here is controllable operating cost. What you saw on the last one was gross operating cost.

GREENE, Q.C.:

Q. We don't have some of the other measures for what you call the operation metrics.

MR. SMITH:

A. Right.

GREENE, Q.C.:

Q. They're not here in your corporate plan?

MR. SMITH:

A. That's right, and your question is again?

GREENE, Q.C.:

Q. How did you make the judgment as to what you would put in as your corporate objectives and why are they different from the corporate performance measures you report to the Board?

MR. SMITH:

A. Okay. So again the ones that you see for the corporate performance that we use against our STI, these are the high level overall performance measures that we use to gauge the performance of the company. So these are the high end ones. Other ones feed into these in terms of the operational targets that I will use as part of my subjective evaluation of individual performance, but these are the six corporate ones. Most of them are back here on the last one. There's two or three that are different again, the hydro plant one, the trouble code one. Those are operational targets, and again I don't drive those the same as the corporate ones again because they are more operational in nature.

GREENE, Q.C.:

Q. And you don't believe it's appropriate to include them in the corporate, is that the conclusion I'm drawing?

MR. SMITH:

A. Absolutely. Hydro plant availability should not be in our corporate target.

GREENE, Q.C.:

Q. And that's because?

(12:30 p.m.)

MR. SMITH:

A. Of the example I just gave you. I can hit the target, I can fix the plant, but I may

be spending unnecessary money on overtime to do it.

GREENE, Q.C.:

Q. I believe it was Ms. Perry in evidence so far that said there was a minimum threshold for any incentive payment, so that no incentive payment was made unless the financial target was met. Is that correct, did I understand that correctly?

MS. PERRY:

A. Yes, that is correct.

MR. SMITH:

A. Yes.

GREENE, Q.C.:

Q. And that is set at 90 percent of the authorized ROE, is that correct?

MS. PERRY:

A. I believe it's 90 percent, yes.

GREENE, Q.C.:

Q. And we've seen that you've always earned your authorized ROE for a significant number of years.

MS. PERRY:

A. We have earned our return for a number of years, yes.

GREENE, Q.C.:

Q. So the threshold is pretty easy to meet, at least based on past experience?

MR. SMITH:

A. I wouldn't agree.

GREENE, Q.C.:

Q. The evidence would look like you've always approved – 90 percent of it isn't bad.

MS. PERRY:

A. We won't say it's easy.

MR. SMITH:

A. The end results show hard work on the part of our company and our employees to get there. That's what I would say.

GREENE, Q.C.:

Q. And my next question with respect to that, have you considered putting in minimum thresholds before any incentive payment is made with respect to other measures, such as reliability and customer satisfaction, which are two obvious areas of interest for the customer?

MR. SMITH:

A. On the customer satisfaction one, some of the data that we have in front of us, if

you'll go back to PUB-NP-095, and if you look at the customer satisfaction line, you can see in '13, we were not able to hit our target; in '14, we're not able to hit our target; in '15 -

GREENE, Q.C.:

Q. You weren't either.

MR. SMITH:

A. We're starting to come back towards our target and when we do our customer satisfaction survey, we do it independently every quarter. An outside agency does it. We give them our database, they go into our database and randomly call up customers, and there's no doubt in '13, '14, and '15, we continued to see the effect of the major system outages, Dark NL, in terms of the overall impression of our customers in terms of our performance. The numbers are what they are. We can't normalize for this because it's not within the database to do that, but we certainly believe a combination of the major system outages, and some of the industry things that you hear about Muskrat Falls are affecting the impression of our customers towards the company, and they show up in this satisfaction score that you see. So for three years in a row, we have not been able to hit that number, but again I would argue that the performance of the company has been very strong to try to turn this around. If you go to some of the years like 2014 and since, we've been very aggressive with our customer service staff to get out and talk to municipalities talk to Rotary Clubs, visit school boards, visit fire emergency services, visit the hospital boards, to talk to them about when the power goes out, this is what you can do to work with Newfoundland Power. So we've been working really hard to try to turn that number around, but I would tell you our belief, because I can't prove it in the data, is that our customers are giving a score reflective of Dark NL, and possibly even Muskrat Falls.

GREENE, Q.C.:
Q. And in terms of reliability, what would your response be, why there shouldn't be a minimum target for reliability achievement?

MR. SMITH:
A. I would suggest to the Board that our reliability performance is very good, and the methods that we currently have to score our performance and do our work, and the fact that we continue to be half the Canadian average and our costs are stable, and our reliability is stable, I would suggest to the Board that those are the places that we need to be.

GREENE, Q.C.:
Q. And you don't think it's necessary to have a minimum threshold of performance on reliability before any incentives are paid?

MR. SMITH:
A. Well, we do on reliability. There's a plus or minus factor on the target number. Again you don't see it in this table, but in each of our scores there's a plus or minus factor on earnings, controllable operating costs, the safety, the reliability, customer – on each of the corporate scores there's a plus or minus factor on every one of them.

GREENE, Q.C.:
Q. But I'm suggesting that there would be a

minimum on reliability before any incentive was paid out, not just on the -

MS. PERRY:
A. Just not on reliability?

GREENE, Q.C.:
Q. Not just on the category of reliability?

MR. SMITH:
A. Again we do it with the earnings. I do believe, and I'm doing this from memory, that we also have one on safety.

MS. PERRY:
A. If we have a fatality.

MR. SMITH:
A. Yes, if we have a fatality, we won't have a payout in safety.

GREENE, Q.C.:
Q. You mean any payout at all?

MR. SMITH:
A. Yes.

GREENE, Q.C.:
Q. Okay, no incentive payment?

MR. SMITH:
A. On the safety one, in particular, I don't know if it's the whole gamut or not.

GREENE, Q.C.:

Q. And that's what I'm asking you about is –

MR. SMITH:
A. I can't do that from memory.

GREENE, Q.C.:
Q. Would there be a minimum threshold before any payments? You have one for finance.

MS. PERRY:
A. It's just for finance.

GREENE, Q.C.:
Q. And the question is, is it appropriate?

MS. PERRY:
A. Yes, it's for finance. So even if we met our safety target somehow, but there was a fatality, there would be zero payout on safety.

MR. SMITH:
A. That's right.

GREENE, Q.C.:
Q. Okay, when you were responding to my question about initiatives the company was going to take to respond to the increased risk that they are now facing, you mentioned an emphasis on increased cost containment and cost management, is that correct?

MR. SMITH:

A. That's correct.
GREENE, Q.C.:
Q. Have you considered whether that would include any additional action with respect to compensation, particularly executive compensation?
MR. SMITH:
A. The targets that we have and the way that they're calculated and the plus or minus, at this stage I don't envision that they would change, but again that could be a conversation we could have with our Board.
GREENE, Q.C.:
Q. Thank you very much. That concludes all of my questions. Thank you.
CHAIRMAN:
Q. All right, so where am I now? Do you have any –
MS. GLYNN:
Q. I don't know whether there's any redirect from the -
CHAIRMAN:
Q. I'm sorry.
KELLY, Q.C.:
Q. I have no further questions, Mr. Chairman,

no redirect.
CHAIRMAN:
Q. Okay, do you have –
JOHNSON, Q.C.:
Q. No.
CHAIRMAN:
Q. I've just got one quick question and it's probably better for next week, but we're moving into – they're talking now – we have zero interest rate policy with all of the central banks, Ms. Perry, and now they're talking about a negative interest rate policy. Like, I just read something the other day, Japan sold 10 year government bonds at -0.024 percent. That's the way the world is heading. What does that mean for, you know, your bonds?
MS. PERRY:
A. Yes, it probably is a better question for the experts, but I said recently in the last couple of days that my time on estimating where interest rates are going to go, because I've been saying they've been going to rise for the last ten years, and between that and where interest rates in the bond

market is, it's hard to just keep up with the volatility that's happening. Even within our last issuance that we had done, the whole turmoil in Greece just seemed to have such a big impact even on a Newfoundland Power bond issue, and to make those connections just seems to be so distant, but they're real. So the way that the world market is going is absolutely impacting companies like Newfoundland Power, but where it's going and what it means ultimately, I'm not sure.
CHAIRMAN:
Q. I guess if you knew, we could all make a pile of money.
MS. PERRY:
A. We could, yeah, we could.
CHAIRMAN:
Q. Okay, well, I guess we're finished this session and we're back at it next Tuesday, is it?
MS. GLYNN:
Q. No, we're here tomorrow.
CHAIRMAN:
Q. We're here tomorrow, are we?

MS. GLYNN:
Q. Yes, Mr. Aboud from Hay.
CHAIRMAN:
Q. Oh, my, we're starting tomorrow. Okay we'll see you tomorrow.
Upon Conclusion at 12:38 a.m.

CERTIFICATE

I, Judy Moss, do hereby certify that the foregoing is a true and correct transcript of a hearing in the matter of a General Rate Application by Newfoundland Power Inc. to establish customer electricity rates for 2016 and 2017 heard on the 31st day of March, 2016 at the Public Utilities Commission office, St. John's, Newfoundland and Labrador and was transcribed by me to the best of my ability by means of a sound apparatus.

Dated at St. John's, NL this
31st day of March, 2016

Judy Moss
Discoveries Unlimited Inc.