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<p>1 November 10, 2009</p> <p>2 CHAIRMAN:</p> <p>3 Q. Now, all right, good morning everybody. We</p> <p>4 have a representative from the Seniors</p> <p>5 Resource Centre, Kelly Heisz. You're going to</p> <p>6 make a statement?</p> <p>7 MS. HEISZ:</p> <p>8 A. Yes, I am.</p> <p>9 CHAIRMAN:</p> <p>10 Q. And I'm going to swear you in. Is there</p> <p>11 anything preliminary first before we -</p> <p>12 KELLY, Q.C.</p> <p>13 Q. No, Mr. Chairman.</p> <p>14 MS. KELLY HEISZ, SWORN</p> <p>15 MS. HEISZ:</p> <p>16 A. Thank you, Commissioners, for offering me this</p> <p>17 opportunity to speak to you on behalf of the</p> <p>18 many seniors in Newfoundland and Labrador and</p> <p>19 how this possible rate increase could impact</p> <p>20 their health and wellbeing as they move</p> <p>21 forward in their lives. I'm going to relate</p> <p>22 to you some statistics as well as some</p> <p>23 information that we have gathered and gleaned</p> <p>24 over the years through our information and</p> <p>25 referral line, which has been in existence for</p>	<p>1 appointments. She does not have any family</p> <p>2 nearby who can drive her to appointments, so</p> <p>3 she needs to maintain her own car. She is</p> <p>4 finding it increasingly difficult to pay her</p> <p>5 bills each month. She finds it especially</p> <p>6 hard in the winter, due to her higher</p> <p>7 electricity costs for heating her home.</p> <p>8 Mary is one senior who represents the</p> <p>9 majority of our calls to our centre. 30</p> <p>10 percent of our calls are of a financial nature</p> <p>11 and 50 percent regarding housing, which</p> <p>12 includes queries on energy efficiency grants</p> <p>13 and programs. Often the senior, like Mary,</p> <p>14 who calls is driven to contact us because an</p> <p>15 unexpected expense has now created extreme</p> <p>16 stress on their existing costs. So</p> <p>17 unfortunately varied costs in a senior's life,</p> <p>18 especially those on fixed incomes and those</p> <p>19 living below the poverty line, which is Mary,</p> <p>20 are stressors on their money and more</p> <p>21 importantly, on their physical and mental</p> <p>22 wellbeing.</p> <p>23 So I just want to give you some</p> <p>24 statistics that I gathered that we generally</p> <p>25 have on hand. So the latest statistics, which</p>
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<p>1 the past 18 years. It's an information line</p> <p>2 that seniors, as well as individuals who</p> <p>3 provide services to seniors, family members</p> <p>4 and friends, that call to get information and</p> <p>5 also voice their concern on things that impact</p> <p>6 their life. So I'm going to relate to you a</p> <p>7 real call that came into our information line.</p> <p>8 The person's name is Mary. She's 72</p> <p>9 years old and she's a widow. She receives</p> <p>10 \$1200 a month in old age security and</p> <p>11 guaranteed income supplement, and the</p> <p>12 guaranteed income supplement is provided to</p> <p>13 OAS pensioners who have little or no income.</p> <p>14 So basically, Mary is living below the poverty</p> <p>15 line. She lives in a rural small community.</p> <p>16 She lives in her own home, but still has a</p> <p>17 mortgage. Her house is old and not well</p> <p>18 insulated. It needs major repairs, which she</p> <p>19 cannot afford. She has considered selling her</p> <p>20 home, but she would not get very much for it.</p> <p>21 Also, there aren't many housing options for</p> <p>22 seniors in her community and she does not want</p> <p>23 to move to another community. She has several</p> <p>24 chronic health conditions and often needs to</p> <p>25 travel long distances for medical</p>	<p>1 unfortunately is just from Stat Can's 2006</p> <p>2 census, here in Newfoundland we have 182,605</p> <p>3 or 36.7 percent of the population are people</p> <p>4 aged 50 plus, and that's how we--at the</p> <p>5 Seniors Resource Centre, that's the age that</p> <p>6 we start providing services and programs and</p> <p>7 getting information to.</p> <p>8 So I just also wanted to mention to you</p> <p>9 that according to community accounts, about 42</p> <p>10 percent of our population live in rural and</p> <p>11 remote communities and to give you--to break</p> <p>12 down perhaps some rural community profiles, in</p> <p>13 terms of the percentage of population of</p> <p>14 seniors in these rural communities, I just</p> <p>15 randomly selected a few communities, just to</p> <p>16 give you some idea. So in alphabetical order,</p> <p>17 I selected Arnold's Cove, who has a population</p> <p>18 of 445 seniors or 44.3 percent of their</p> <p>19 population. Burgeo has 715, again 44.5</p> <p>20 percent of their population. Corner Brook,</p> <p>21 10,070 and that's 37.8 percent of their</p> <p>22 population are seniors. Forteau, Labrador,</p> <p>23 180 or 40.4 percent. L'Anse au Clair, 85 at</p> <p>24 37.7 percent. Lawn, 225, 31.9 percent.</p> <p>25 Spaniard's Bay, 900 at 35 percent.</p>

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<p>1 Springdale, 1260, 45.6 percent. St. Anthony, 2 965 at 38.9 percent of their population, and 3 Trinity Bay North, 650, 42.2 percent. So as 4 you can see, a lot of these rural and remote 5 communities, the majority--almost the majority 6 of their population are indeed seniors. 7 So our investigation has discovered, 8 using various statistics from Statistics 9 Canada, community accounts and the Atlantic 10 Seniors Housing Research Alliance, we found 11 that 66.7 percent of our seniors receive the 12 guaranteed income supplement, more than any 13 other province in Canada, and there are still 14 seniors who qualify but still have not applied 15 for the GIS. Over 60 percent of the women's 16 income is less than \$15,000 a year and only 17 6.6 percent live in institutions. So the 18 majority of them do live in their own homes. 19 Some do rent, and we find that 15 percent of 20 seniors still have a mortgage, and speaking to 21 a number of individuals, who do needs 22 assessment and income assessment and check to 23 see if they qualify for various supplements 24 and so on and so forth, have said that, you 25 know, years ago seniors never did carry a</p>	<p>1 home they raised their families are very 2 limited in rural areas of our province, due to 3 lack of other types of housing, such as 4 seniors complexes, apartments, et cetera. 5 With the demand for constant upkeep, 6 maintenance and these homes being of older 7 stock and more than likely less energy 8 efficient, compounded by the inability to 9 afford regular maintenance and upgrade for 10 energy efficiency, seniors are paying far too 11 much in heating costs that are literally 12 escaping to the outdoors. 13 So these particular statistics have shown 14 us that we have seniors who want to remain in 15 their own communities, who want to remain in 16 their own homes and oftentimes, we call them 17 house poor because a lot of them are paying at 18 least 30 percent of their costs to maintain 19 their home, and that creates an awful lot of 20 stress on them, especially when if their 21 health changes and as you get older, your 22 health does change. So there's an increasing 23 demand on using what little money they have on 24 things such as medication, home care services, 25 caregivers, respite and so on and so forth.</p>
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<p>1 mortgage and never did carry debt, but they 2 are increasingly finding that seniors today 3 are forced to take a mortgage in order to 4 survive and are carrying credit card debt in 5 order to pay expenses. 6 So as cited by the document, "Housing 7 Strategy for Newfoundland and Labrador", which 8 was commissioned and prepared by the Status of 9 Women's Council, they said "seniors' 10 households are also facing a growing 11 affordability problem. The number of senior 12 households in Canada with this problem 13 increased by 16.3 percent from 1997 to 2000. 14 Three of every four senior women live alone in 15 Newfoundland and Labrador." As well, as cited 16 by the Atlantic Seniors Research Alliance in 17 their document "Atlantic Seniors Housing and 18 Support Services Survey Results", not only are 19 seniors staying in their communities, they're 20 also staying in the same home longer. The 21 average length of time is just over 25 years, 22 with as many as 15.9 percent of seniors 23 reporting they have lived in their homes over 24 45 years. 25 So choices to live anywhere else but the</p>	<p>1 So when you have such fluctuating costs, it's 2 extremely difficult and the seniors that call 3 our information line are often driven to the 4 point that they call us and say, you know, 5 "what do I do? Where do I go? What can I do?" 6 and we have received a number of calls from 7 some seniors and I've asked, since I've been 8 speaking with Tom Jackson (sic) on this, to 9 get some feedback from some seniors on how do 10 you--what would you like us to say to the PUB 11 in defence of trying to argue that perhaps 12 this increase is not very appropriate at this 13 time, and a lot of them have come back and 14 said "there's really no point in even arguing, 15 because it's going to happen." 16 So you have seniors who acquiesce. 17 Seniors who often just take that brunt. But 18 unfortunately, with our aging demographic, 19 we're going to see an increase in the amount 20 of seniors living in rural and remote 21 communities and if they have no choice but to 22 live in their own home and they cannot afford 23 to upgrade their homes and keep them and make 24 them more energy efficient, then they try to 25 keep things as--try to keep their costs down,</p>

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<p>1 but because things fluctuate so much, it 2 creates extreme havoc and I think that, for 3 us, we find that it impacts severely on their 4 physical and mental wellbeing and oftentimes 5 that will create a burden on the health care 6 system. A lot of them have no family that 7 live in their communities with out migration, 8 so they rely a lot on other individuals. So 9 other than that, that's pretty much what I'd 10 like to present to you, and I thank you very 11 much for this opportunity.</p> <p>12 CHAIRMAN: 13 Q. Okay. Anybody have any questions? 14 KELLY, Q.C. 15 Q. No, Mr. Chairman. 16 MR. JOHNSON: 17 Q. I have no questions. 18 MS. HEISZ: 19 A. Okay, thank you. 20 CHAIRMAN: 21 Q. Thank you. 22 VICE-CHAIR WHALEN: 23 Q. Thank you. 24 CHAIRMAN: 25 Q. So I guess now, Mr. Kelly, it's your--we're in</p>	<p>1 detailed brief of argument. The evidence is 2 summarized in our written submissions. What I 3 intend to do in the time I have this morning 4 is to provide some comments to put the 5 evidence in perspective and which may assist 6 the Board in its decision making process in 7 accordance with sound public utility practice.</p> <p>8 Clearly, the major issue before you is 9 the cost of capital, specifically what should 10 be the rate of return on common equity used 11 for calculating the rate of return on rate 12 base. It is, of course, a truism to say that 13 Newfoundland Power operates within the 14 existing cost of service regulatory framework 15 that's set forth in the legislation, the 16 Board's orders and the Board's practices and 17 procedures. The Public Utilities Act provides 18 that rates are to be set to enable the company 19 to recover its reasonable expenses of 20 providing service to customers, including a 21 just and reasonable return on the rate base, 22 and that cost of service framework includes an 23 excess earnings account that limits any upside 24 opportunity to 18 basis points on the rate of 25 return on rate base. The company remains</p>
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<p>1 your capable hands.</p> <p>2 KELLY, Q.C. 3 Q. Thank you, Mr. Chairman, Commissioners. At 4 this stage, we come to final argument in 5 Newfoundland Power's 2010 General Rate 6 Application. As Mr. Ludlow and Ms. Perry have 7 explained, this rate application is necessary 8 because the combination of increased costs and 9 decreased revenues is forecast to reduce the 10 Company's return on equity next year from the 11 current rate setting point of 8.95 percent to 12 6.45 percent. Indeed, increasing costs are 13 forecast to reduce the company's return this 14 year to approximately 8.62 percent or 33 basis 15 points below the rate setting point, and 16 Newfoundland Power faces further cost 17 pressures in 2011.</p> <p>18 As indicated in my opening comments, 19 there are two principal issues in this 20 proceeding. The first is the cost of capital, 21 including whether to discontinue the use of 22 the Automatic Adjustment Formula, and the 23 second is the appropriate accounting treatment 24 for other post employment benefits or OPEBs. 25 Newfoundland Power has submitted a</p>	<p>1 exposed to the risk of under earning its 2 return. That risk is illustrated in the 3 current year when the company will earn at the 4 bottom of the range.</p> <p>5 Several regulatory mechanisms provide for 6 the recovery of certain costs, notably 7 purchase power expense. Some mechanisms 8 provide incentives and penalties to achieve 9 certain objectives, such as control of peak 10 load on the system, in the case of the demand 11 management incentive account, and that 12 framework constitutes the current regulatory 13 balance that we all have to work within.</p> <p>14 Now the Consumer Advocate has spent much 15 time in this hearing discussing Newfoundland 16 Power's business risk, and with the greatest 17 respect, much of that discussion has been 18 misguided. The evidence of all of the cost of 19 capital witnesses, including the Consumer 20 Advocate's own witness, Dr. Booth, is that 21 Newfoundland Power continues to be: an average 22 risk utility, relative to other Canadian 23 utilities, to use Ms. McShane's phrase; a 24 typical low risk Canadian utility, to use Dr. 25 Booth's terminology; or a low risk</p>

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<p>1 transmission and distribution utility, to use 2 Mr. Cicchetti's phraseology. No witness has 3 said that Newfoundland Power's business risk 4 has changed relative to other utilities. Dr. 5 Booth himself said that he regarded business 6 risk analysis to be of marginal importance in 7 this proceeding. He included Newfoundland 8 Power as simply another utility in that low 9 risk Canadian group.</p> <p>10 So the evidence does not disclose that 11 there has been any material change in 12 Newfoundland Power's business risk from what 13 the Board has previously considered. Indeed, 14 over the last number of years, the Board has 15 acted in some cases to moderate increases in 16 Newfoundland Power's business risk. For 17 example, changes in the wholesale power 18 pricing would have materially increased 19 Newfoundland Power's business risk in absence 20 of the creation of the Energy Supply Cost 21 Variance clause, and in this hearing, the 22 Pension Expense Variance Deferral Account will 23 mitigate a new risk that would have arisen 24 from the increased discount rate volatility 25 and that account will ensure that customers</p>	<p>1 then I'm going to develop each of them a bit 2 for you.</p> <p>3 The first proposition is that a cost of 4 equity in 2010 will be higher than the cost of 5 equity either last set by the Automatic 6 Adjustment Formula or the cost of equity that 7 would result from the application of the 8 formula at this time. Now there is a range of 9 reasonable disagreement on how much higher, 10 but the evidence is, in my submission, 11 incontrovertible that the cost of equity will 12 be higher in 2010. That's the first 13 proposition.</p> <p>14 Second proposition is that maintenance of 15 credit worthiness requires a return on equity 16 of between nine and a half and nine and three- 17 quarter percent. The return required to 18 maintain credit worthiness essentially 19 establishes a floor for the Board's 20 consideration of the cost of equity.</p> <p>21 And the third proposition is that the 22 fair return, the return on investments of 23 similar risk, on the evidence that you've 24 heard in this hearing, falls within a range of 25 approximately 9.8 percent to 11 percent. In</p>
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<p>1 benefit if interest rates should rise. So the 2 evidence is clear, Newfoundland Power's 3 business risk remains essentially the same as 4 it's been for the last number of years.</p> <p>5 Now you've heard the evidence of the 6 three cost of capital witnesses who came and 7 testified before you, and I'd like to turn to 8 that next. The fair return or the just and 9 reasonable return must meet three tests, three 10 things. It must be commensurate with the 11 return on investments of similar risk, number 12 one. Number two, it must be sufficient to 13 ensure financial integrity, and number three, 14 it must be sufficient to attract capital. 15 Those are the three things. It's got to do 16 all three of them. It's not sufficient to 17 simply ensure that Newfoundland Power's credit 18 worthiness is maintained, if a higher return 19 is required to match the return on investments 20 of similar risk.</p> <p>21 Now Mr. Chairman and Commissioners, I 22 think you will find considerable assistance in 23 your deliberations on the cost of capital if 24 you consider three propositions, and I'm going 25 to first give you the three propositions and</p>	<p>1 other words, the range of what constitutes a 2 fair return is in reality relatively narrow, 3 and I'm going to develop each of those three 4 propositions for you now.</p> <p>5 The first proposition, the cost of equity 6 is going to be higher in 2010. It'll be up, 7 not down, and this conclusion is not only 8 supported by the preponderance of the expert 9 evidence, it's essentially really 10 incontrovertible. Let's look at it. 11 Newfoundland Power's debt is fully secured 12 against the assets of the company by first 13 mortgage bonds. However, the equity 14 investment in the company is an unsecured 15 investment. The equity investor is therefore 16 inherently subject to greater risk than the 17 investor in the company's secured debt. For 18 that reason, the required return on the 19 company's equity must be higher than the 20 return on the company's debt, self-evident 21 proposition. Over the past year, the cost of 22 the company's debt has risen relative to long 23 Canada bonds yield. The spread rose to 275 24 basis points in the spring of 2009 at the time 25 of the company's latest bond issue. Recently,</p>

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<p>1 that spread has fallen to approximately 187 2 basis points, but even that spread is 3 approximately 50 to 75 basis points higher 4 than the spreads when the company issued bonds 5 in 2005 and 2007. So consequently, it is 6 clear that in the current economic 7 circumstances, debt investors have required 8 increased returns relative to long Canada bond 9 yields, and that's not peculiar to 10 Newfoundland Power. It's true of the debt of 11 other Canadian utilities and other companies.</p> <p>12 With the cost of fully secured debt 13 having increased, it's simply not logical to 14 believe that the cost of unsecured equity 15 investment has fallen. Indeed, the evidence 16 is clear that the opposite is the case. As 17 Ms. McShane and Mr. Cicchetti have explained, 18 share prices have dropped as a result of the 19 economic turmoil. As share prices fall, the 20 dividend yield rises in relation to the share 21 price. The equity markets thus signalled a 22 rising cost of equity just as the bond markets 23 signalled a rising cost of debt. While the 24 markets have recovered somewhat from their 25 lows, they are still well below their previous</p>	<p>1 reflect changes in year-to-year financial 2 market conditions.</p> <p>3 Now that approach has two fundamental 4 problems with it. First of all, it's simply 5 not in accordance with the current cost of 6 service regulation model that we all got to 7 work in. That model requires rates to be 8 based upon forecast 2010 costs, including the 9 forecast 2010 cost of capital. That's the 10 first point, and the second point is the 11 company's return on equity was reduced during 12 the strong market conditions of the past 13 couple of years. In 2004, this Board 14 determined the cost of equity for Newfoundland 15 Power of 9.75 percent and as equity markets 16 strengthened during 2005 through to 2007, 17 Newfoundland Power's return on equity was 18 reduced. By 2007, the 9.75 percent return was 19 reduced to 8.60 percent, about 115 basis 20 points down, and it's not appropriate that the 21 company's cost of equity should be reduced in 22 strong market conditions as it have been, but 23 then not increase to reflect the higher equity 24 costs which are signalled now by the current 25 equity markets.</p>
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<p>1 values. The recovery is still fragile and 2 will continue to be so in 2010. So the 3 conclusion is inescapable, the cost of equity 4 in 2010 will be higher than the return last 5 set by the Automatic Adjustment Formula and 6 will be higher than what the formula would 7 have produced, based upon current long Canada 8 bond yields. The higher cost of equity is 9 borne out in the testimony of Ms. McShane and 10 Mr. Cicchetti with respect to operation of 11 market forces, as well as the results of their 12 cost of capital analysis, and even Dr. Booth 13 acknowledged that the market risk premium 14 results are going to go up in 2010.</p> <p>15 Now, Dr. Booth had a rather rosy view of 16 the potential recovery, which was not shared 17 by Ms. McShane and Mr. Cicchetti, both of whom 18 expressed considerable uncertainty over the 19 extent of the economic recovery. However, one 20 got the sense, listening to Dr. Booth's 21 overall testimony, that he wasn't focusing so 22 much on the cost of capital in 2010 itself, 23 but was in fact suggesting that somehow 24 utility returns should be held relatively 25 stable over an economic cycle, rather than</p>	<p>1 So that's my first proposition, the cost 2 of equity, and we can look at it and say it's 3 going to be higher in 2010 than it has been 4 over the last year or so, couple of years.</p> <p>5 Now the second of the three propositions 6 is that the maintenance of credit worthiness, 7 in other words ensuring financial integrity 8 and the ability to attract debt capital, 9 requires a return on equity of between nine 10 and a half and nine and three-quarter percent, 11 and essentially is kind of a floor that the 12 Board will need to consider what's the 13 appropriate rate of return.</p> <p>14 The maintenance of credit worthiness is 15 an important consideration. Maintenance of a 16 sound credit rating is part of the power 17 policy of the province, as set forth in the 18 Electrical Power Control Act. Newfoundland 19 Power has a continuing obligation to provide 20 service to its customers year after year. In 21 order to do so, the company must be able to 22 issue debt in all market conditions, whether 23 the markets are good or the markets are bad. 24 It's not sufficient that the company be able 25 to issue bonds only in strong market</p>

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<p>1 conditions. A good example is just this past</p> <p>2 May when the company was required to issue</p> <p>3 bonds in what can only be described as very</p> <p>4 difficult market conditions.</p> <p>5 The Board, this Board has traditionally</p> <p>6 considered pre-tax interest coverage to be a</p> <p>7 primary indicator of credit worthiness. The</p> <p>8 Board has previously targeted a range of 2.4</p> <p>9 to 2.7 times as an appropriate range of</p> <p>10 interest coverage for Newfoundland Power. For</p> <p>11 the 2008 GRA, the return on equity provided</p> <p>12 2.5 times interest coverage and that's an</p> <p>13 appropriate interest coverage for Newfoundland</p> <p>14 Power. Setting a lower pre-tax interest</p> <p>15 coverage can be problematic. In issuing new</p> <p>16 bonds, the company must always meet a</p> <p>17 threshold test, not only to provide two times</p> <p>18 interest coverage on all of its existing debt,</p> <p>19 but to provide that same coverage on all the</p> <p>20 new debt that it's going to issue as well, and</p> <p>21 as Exhibit 5 filed in this case shows, in</p> <p>22 order to achieve a pre-tax interest coverage</p> <p>23 of 2.5 times, based upon 45 percent equity,</p> <p>24 Newfoundland Power would require a return on</p> <p>25 equity of between nine and a half to nine and</p>	<p>1 precise definitive answer is key. Determining</p> <p>2 the cost of capital involves substantial</p> <p>3 elements of judgment, something obviously not</p> <p>4 lost on the Board. So consequently, it's</p> <p>5 better to use multiple methodologies to cross</p> <p>6 check the judgmental results flowing out of</p> <p>7 the application of any single methodology.</p> <p>8 It's just kind of common sense, and that's</p> <p>9 exactly what Ms. McShane has done, and I've</p> <p>10 just put up on the screen her recommendation.</p> <p>11 Now what Ms. McShane has done is she uses</p> <p>12 three risk premium tests, using both historic</p> <p>13 market data and DCF risk premium results. So</p> <p>14 she got three of those. She uses two direct</p> <p>15 DCF tests and she checks all of them with an</p> <p>16 examination of comparable earnings. She gives</p> <p>17 75 percent weighting, divided equally between</p> <p>18 her equity risk premium tests and her DCF</p> <p>19 tests and a 25 percent weighting to a</p> <p>20 comparable earnings test. Her equity risk</p> <p>21 premium tests and DCF tests, when you add in</p> <p>22 50 basis points for financing flexibility,</p> <p>23 gives a range of 10 and a quarter to 11 and a</p> <p>24 quarter percent. Her comparable earnings test</p> <p>25 shows returns for comparable unregulated</p>
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<p>1 three-quarter percent, and that that's the</p> <p>2 return that would maintain credit worthiness</p> <p>3 and ensure that the company is able to issue</p> <p>4 further debt to maintain service to its</p> <p>5 customers as required. So that's the second</p> <p>6 proposition.</p> <p>7 Now, the third proposition is that the</p> <p>8 fair return or the return required on</p> <p>9 investments of similar risk, and that's the</p> <p>10 return sufficient to attract equity capital,</p> <p>11 falls within a relatively narrow range of</p> <p>12 approximately 9.8 percent to 11 percent. Let</p> <p>13 me just explain that.</p> <p>14 First of all, each methodology for</p> <p>15 determining the cost of capital has strengths</p> <p>16 and weaknesses. Each methodology requires an</p> <p>17 element of judgment in its application. For</p> <p>18 example, in using a market risk premium</p> <p>19 analysis, judgment is required in determining</p> <p>20 the market risk premium itself, the Beta, and</p> <p>21 the risk free rate. In using a DCF analysis,</p> <p>22 judgment is required in choosing the sample of</p> <p>23 companies of comparable risk and trying to</p> <p>24 determine investors expectations of future</p> <p>25 returns, and so recognizing that there's no</p>	<p>1 companies of 11 and a half to 11 and three-</p> <p>2 quarters percent, and because she herself</p> <p>3 places only 25 percent weighting on her</p> <p>4 comparable earnings test, her overall</p> <p>5 recommendation is 11 percent. So for you, the</p> <p>6 Board, you know exactly what she's done and</p> <p>7 exactly the weightings she's applied to her</p> <p>8 various tests.</p> <p>9 Now, Mr. Cicchetti uses two tests. He</p> <p>10 has a DCF test and a DCF-based equity risk</p> <p>11 premium test, and he places most of his weight</p> <p>12 on the DCF test, and from those tests, he</p> <p>13 formulates his recommendation of 9.6 percent.</p> <p>14 Now it's important to recognize that in that</p> <p>15 9.6 percent, he's only included the equivalent</p> <p>16 of 20 to 25 basis points for the financing</p> <p>17 flexibility adjustment rather than the</p> <p>18 traditional 50 basis points used in</p> <p>19 Newfoundland and Labrador and recommended by</p> <p>20 both Ms. McShane and Dr. Booth himself, and if</p> <p>21 you adjust for that factor, that gives Mr.</p> <p>22 Cicchetti's proposed rate of return, brings it</p> <p>23 to approximately 9.8, 9.9 percent.</p> <p>24 Now Dr. Booth uses only a market risk</p> <p>25 premium analysis, though he does check it by</p>

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<p>1 doing a DCF test as what he calls his 2 reasonableness check, and then he says he 3 applies a smell test, but he couldn't quite 4 explain how that smell test works, how he 5 applies it, or what weight he gives to it. 6 Now it is worth noting right at the beginning 7 that Dr. Booth's DCF analysis showed earned 8 returns of 11.94 percent on equity in 2008, 9 and from that he, Dr. Booth, derived a 10 prospective looking forward return on equity 11 of 9.59 percent, almost 9.6, almost the same 12 as Mr. Cicchetti got using his samples, and 13 combined with 50 basis points of adjustment 14 for financing flexibility, you've got to put 15 that in as well that Dr. Booth added to his 16 other tests, would give you a return of about 17 10.1 percent, in that range. That's from his 18 DCF test.</p> <p>19 Now put on the screen kind of a summary 20 of all that. So if you look at all of the 21 recommendations of Ms. McShane and Mr. 22 Cicchetti and we include Dr. Booth's DCF 23 results, we end up with a range of return on 24 common equity that's approximately 9.8 percent 25 to 11 percent, so it spans about 1.2 percent</p>	<p>1 was 5 to 6, conceivably 7. Dr. Booth is at the 2 absolute bottom of that range. Both Ms. 3 McShane and Mr. Cicchetti broadly agree in 4 their analysis that the market risk premium is 5 in the 6.4 percent to 6.75 percent range, Ms. 6 McShane slightly higher than Mr. Cicchetti. 7 So that's the first point where his judgment 8 is very low. The second is beta, and beta 9 requires judgment. You can't observe the 10 prospective beta for 2010. You can't just 11 look at it and there it is. All of the 12 witnesses including Dr. Booth recognized that 13 the calculated historical betas over the last 14 decade or so have been very low and they don't 15 provide a reasonable perspective of what the 16 future beta is going to be. So the choice of 17 beta requires judgment. So what Dr. Booth 18 does is he uses his own judgment. He says, I 19 come up with .5 based on my judgment. What 20 Ms. McShane and Mr. Cicchetti do is they rely 21 on data from independent investment research 22 sources to estimate their beta. Mr. Cicchetti 23 uses US data, Ms. McShane uses both Canadian 24 and US data. Ms. McShane considered the beta 25 to be .65 to .7, broadly consistent with Mr.</p>
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<p>1 or 120 basis points. Now that does not 2 obviously include Dr. Booth's recommendation 3 of 7.75 percent based upon his capital asset 4 pricing model. So obviously a key question is 5 what consideration should the Board give to 6 Dr. Booth's Cap M results. First of all, the 7 capital asset pricing model gives inherently 8 low results, especially for low risk 9 companies, and that's one of its weaknesses. 10 Dr. Booth recognizes that himself at page 33 11 of his report, and the capital asset pricing 12 model requires judgment on three important 13 variables; the market risk premium, the beta, 14 or the relative adjustment for risk for a low 15 risk utility, and the risk free interest rate. 16 If you underestimate any of those inputs, you 17 will necessarily get a low results. The 18 output of the model is only as good as the 19 inputs that go into it. Dr. Booth himself 20 said if you put garbage in, you'll get garbage 21 out. Now Dr. Booth recently told the 22 British Columbia Utilities Commission -- he 23 was having kind of a candid discussion with 24 the Chairman, it's worth reading in the 25 exhibit we filed, that the market risk premium</p>	<p>1 Cicchetti's beta of .66 to .69. So what you 2 see when you look at that is Dr. Booth's beta 3 analysis is very low. So we now have two very 4 low inputs going into his model. In the 5 results what you see is that his Cap M result 6 of 7.75 percent, first of all, it's not 7 consistent with the testimony and the analysis 8 of any of the other witnesses. It's not 9 consistent with his own DCF results, and it's 10 kind of -- doesn't even comply with logic 11 because it's proposing a declining cost of 12 equity at the same time that the markets tell 13 us the cost of equity is up. So Dr. Booth's 14 result, his Cap M result of 7.75 percent is 15 heavily weighted by his own judgmental 16 considerations, is inconsistent with all of 17 the other analysis and results. So I submit 18 it's not -- his Cap M result does not provide 19 any meaningful assistance to the Board in its 20 deliberations concerning the appropriate cost 21 of capital for Newfoundland Power.</p> <p>22 So if you take those three propositions, 23 then you've got to ask yourself, well, okay, 24 where do we go next. What the Board needs to 25 do next is apply sound public utility policy</p>

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<p>1 and its own existing policies. There's no 2 precise number for the reasonable rate of 3 return on equity. As the Board has previously 4 recognized, there's a range of reasonableness 5 as to the appropriate return on equity, and 6 this Board has essentially adopted a range of 7 about 75 to 80 basis points as the reasonable 8 range of the cost of equity, and selecting the 9 midpoint of that range is a reasonable 10 approach in establishing the cost of equity 11 for rate setting purposes. That's what the 12 Board does. It then combines that with the 13 embedded cost of debt, and the result produces 14 a range of rate of return on rate base that 15 gives you plus or minus 18 basis points. 16 That's how you get the range. 17 So the Board then has to exercise its 18 judgment as to where that appropriate 75 to 80 19 basis point range is going to fall, bearing in 20 mind that the evidence before you suggests 21 that the range of reasonable recommendations 22 in this case falls within that range of about 23 9.8 percent to 11 percent, a range of about 24 120 basis points. 25 Now I take it one step further because my</p>	<p>1 evidence that's now before it in this rate 2 case on cost of capital issue. 3 Before leaving the cost of capital issue, 4 I would like to say a few words about those 5 binders of documents on the US companies that 6 my friend, the consumer advocate, has tried to 7 make so much out of. First of all, how does 8 the issue arise, how do we get into these 9 binders. It arises because an equity risk 10 premium based DCF test or analysis, or a 11 direct DCF analysis, requires a group of 12 utilities of comparable low risk investment. 13 You got to have something to compare it with. 14 However, being a utility of comparable 15 investment risk is not the same thing as being 16 a utility with the same operating 17 characteristics as another utility. All the 18 cost of capital witnesses have said, including 19 Dr. Booth, each company will have its own 20 operating characteristics. You're not going 21 to find another Newfoundland Power, just like 22 you'll never find another Duke Energy or 23 another Fortis Alberta. 24 Ms. McShane and Mr. Cicchetti were 25 extensively cross-examined and each</p>
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<p>1 friend, the consumer advocate, suggests that 2 Ms. McShane's comparable earnings analysis 3 upon which she placed 25 percent rate should 4 be rejected because it hasn't been used by 5 Canadian regulators, and Mr. Cicchetti took 6 some issue with that, and I don't want to take 7 time to debate that point, I simply observe 8 that the result of eliminating consideration 9 of the comparable earnings test would be to 10 reduce Ms. McShane's recommendation to 10 11 percent. So that would then compress this 12 range of reasonableness that you got to 13 approximately 9.8 percent to 10.75 percent, 14 which starts to get very close to the range 15 that the Board has adopted of its 75 to 80 16 percent, 80 basis points range of 17 reasonableness. So at the end of the date, 18 the appropriate range of reasonableness is a 19 matter of regulatory judgment, and the Board 20 then should establish that appropriate range 21 of reasonableness from the evidence before you 22 and set the 2010 cost of capital accordingly, 23 and that, in my respectful submission, is the 24 approach which the Board reasonably and 25 logically should follow as it assesses the</p>	<p>1 demonstrated their substantial knowledge of US 2 utilities. They repeatedly made the point 3 that you cannot simply look at one isolated 4 operating characteristic of a utility. One 5 must consider how an investor would consider 6 the overall investment risk of the company. 7 Each of the witnesses repeatedly affirmed the 8 comparability of their respective samples, and 9 no witness ever said that any of these 10 specific companies used in their samples were 11 not comparable. 12 Mr. Cicchetti was asked by the consumer 13 advocate to provide a DCF calculation using a 14 small subset of the specific utilities from 15 his original group. The problem with using 16 such a small sample is the results become 17 subject to statistical anomalies of that small 18 group. Mr. Cicchetti never departed from 19 his position that his original sample was the 20 most appropriate for his DCF analysis. The 21 appropriateness of using US companies as 22 reasonable comparators is demonstrated by two 23 other important pieces of evidence before you. 24 The first is the evidence of Dr. Booth. 25 Dr. Booth acknowledged that unlike Ms. McShane</p>

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<p>1 and Mr. Cicchetti, he didn't follow US 2 utilities. However, Dr. Booth had sufficient 3 confidence in the comparability of US 4 utilities that he himself used the Standard 5 and Poor's sample of US utilities as his 6 comparator group for his own DCF analysis 7 which he used as his reasonable check. Many 8 of the companies in his sample are the same 9 companies in the samples by Ms. McShane and 10 Mr. Cicchetti. Certainly Dr. Booth, he's a 11 professor of finance, would not have used US 12 utilities in his DCF analysis to check 13 reasonableness if he thought the use of US 14 utilities is going to give an unreasonable 15 result, so obviously he used them, he must 16 have had confidence that using them is going 17 to give a reasonable check.</p> <p>18 The second point is that Moody's in 19 assessing Newfoundland Power's risk profile, 20 compares the company to a peer group of 21 utilities which is predominantly made up of US 22 operating companies, and so put simply, the 23 consumer advocates rhetoric on this point 24 doesn't make up for the lack of evidentiary 25 basis to challenge the comparator group</p>	<p>1 formula is not accurately reflecting the 2 appropriate return on equity.</p> <p>3 It's been accepted by all of the cost of 4 capital experts that financial market 5 conditions which existed in late 2008, at 6 least through to the spring of this year, were 7 such that the trigger for a review of the 8 formula was met. The conditions for review 9 undoubtedly existed when Newfoundland Power 10 filed its application in May, and because of 11 the continuing low returns on long Canada 12 bonds, the formula is still not accurately 13 reflecting the appropriate return on equity 14 today. Currently the formula would yield a 15 return on equity of less than 8.5 percent, 16 while the evidence, as I discussed earlier, 17 would clearly indicate that the cost of equity 18 has risen and that the appropriate return of 19 equity falls somewhere in that 9.8 to 11 20 percent range. So what to do.</p> <p>21 Now this Board is not the only regulator 22 that's grappling with that question. The 23 National Energy Board has already concluded 24 that it should discontinue the use of its 25 automatic adjustment formula, and other</p>
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<p>1 selected by Ms. McShane, Mr. Cicchetti, and 2 his own witness, Dr. Booth, for their 3 respective DCF analysis. If you're going to 4 challenge it, you've got to have evidence from 5 somebody to say they're different, and nobody 6 has done that.</p> <p>7 So Mr. Chairman, those are my submissions 8 on the cost of capital directly itself. I do 9 want to say a few words about the automatic 10 adjustment formula. Newfoundland Power has 11 proposed discontinuing the use of the formula, 12 as we go forward. Since 2010 is a test year, 13 the formula would not be used to set the 14 return on rate base for 2010, in any event. 15 The Board considers the evidence on all of the 16 2010 forecast costs, including the forecast 17 cost of capital. The Board then decides, 18 based upon the evidence before it, what is the 19 appropriate cost of capital for the test year. 20 The issue is whether to discontinue the use of 21 the formula in 2011 and beyond, assuming that 22 2011 is not itself a test year. The Board 23 recognized in its original 1998 order that 24 there could be changes in financial market 25 conditions which would suggest that the</p>	<p>1 regulators are considering the matter.</p> <p>2 The essential difficulty is that there's 3 significant uncertainty as to the future 4 relationship between the return on long Canada 5 bonds and the appropriate return on equity. 6 Mr. Simmons, the Board's counsel, sought 7 guidance from the experts about revising the 8 formula and got a wide range of divergent and 9 very tentative suggestions. Currently no one 10 has enough visibility on the future 11 relationship among the key components of the 12 formula to put forward a proper proposal to 13 revise the automatic adjustment formula. 14 Certainly Newfoundland Power does not pretend 15 to be able to do so at this time.</p> <p>16 So what we've done is we've proposed 17 discontinuing the operation of the formula to 18 current time. The Board can then revisit this 19 issue at whatever time it considers 20 appropriate, and if it considers it necessary 21 to do so. That will allow time hopefully for 22 the financial markets to stabilize, to see 23 what other regulators choose to do, and to 24 enable the stakeholders before the Board to 25 consider what, if anything, should be done.</p>

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<p>1 So that, Mr. Chairman, Commissioners, is 2 our submission with respect to the use of the 3 automatic adjustment formula, discontinuing 4 its use at this time until we get some 5 stability and certainty as to conditions going 6 forward. 7 Next I turn to the issue of other post 8 employment benefits, or OPEBs. Now this issue 9 has been before the Board on a number of 10 occasions since 2003. The company was 11 requested by the Board to bring forward a 12 proposal to move to the accrual method of 13 accounting for OPEBs. In 2008, consideration 14 of that proposal was deferred to this general 15 rate application because in 2008 electricity 16 prices had been driven up by the high cost of 17 fuel at Holyrood. Since that time, those fuel 18 prices have declined and the price of 19 electricity has moderated. Now accounting for 20 OPEBs on the accrual basis is now clearly the 21 mainstream regulatory practise in Canada. 22 Virtually all other Canadian utilities now use 23 accrual accounting for OPEBs, including 24 Newfoundland and Labrador Hydro. Even Mr. 25 Todd, the consumer advocate's expert,</p>	<p>1 to say, Mr. Chairman, frankly it is not good 2 enough for the consumer's witness, Mr. Todd, 3 to simply get on the stand and suggest that 4 the matter should be further deferred and the 5 company should be sent off to study some ill- 6 defined alternative that would see the change 7 to accrual accounting and the amortization of 8 the traditional obligation dealt with 9 together. 10 Deferral of the change to accrual 11 accounting has several difficulties. First, 12 accrual accounting provides a better matching 13 of costs with the provision of service. 14 Staying on the cash methodology continues to 15 defer today's costs out into the future to be 16 dealt with by tomorrow's rate payers. The 17 transitional obligation would continue to grow 18 by approximately 6 million dollars a year, and 19 the second problem is deferred until when. 20 There will never be a perfect time to deal 21 with this issue. Currently oil prices are 22 relatively stable, but where are they going to 23 go in the future? I don't know the answer. 24 Hydro may be back filing a general rate 25 application in 2010, and Newfoundland Power</p>
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<p>1 acknowledged that the accrual basis for 2 accounting for OPEBs was appropriate. 3 The company has put forward a balanced 4 approach designed to mitigate the immediate 5 rate impact on customers. The company has 6 proposed to move to accrual accounting in 7 2010, but deferring consideration of the 8 transitional obligation to the next general 9 rate application. If we put it all together 10 now, all in now, that would require a rate 11 increase of approximately 2.2 percent, while 12 the company's proposal limits the immediate 13 rate impact to approximately 1.3 percent. it 14 also has the benefit of freezing the 15 transitional obligation, which would otherwise 16 continue to grow by approximately 6 to 7 17 million dollars a year. 18 The consumer advocate has now had the 19 company's proposal with respect to OPEBs for 20 several years, since we originally filed the 21 last general rate application, and has had 22 this specific proposal since May, yet the 23 consumer advocate brought forward no 24 evidentiary basis supporting any alternative 25 proposal to deal with the OPEB issue. I have</p>	<p>1 has its own costs which are being discussed 2 going out into 2011. 3 There's been much discussion of the fact 4 that Newfoundland Power is conducting a 5 benefits review, but as Ms. Perry has 6 testified, the extent of any changes and any 7 cost impacts from that review are unknown at 8 this time. If there are changes, they'll be 9 reflected in future rates, and that will be 10 the case whether we're on the cash method of 11 accounting or on the accrual method of 12 accounting. The accrual method adjusts for 13 changes annual and continually trues up. As 14 both she and Mr. Ludlow explained, it would 15 not be appropriate to reduce benefits or 16 impose additional costs on existing retirees, 17 and I'm pleased to see the consumer advocate 18 now seems to accept that proposition since he 19 now suggests only a prospective forward change 20 in OPEB entitlements at page 68 of his 21 submissions. With respect to current 22 employees, any changes are going to require 23 notice, may require transitional arrangements, 24 and may result in short term costs as Ms. 25 Perry explained, and the whole process</p>

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<p>1 involves collective bargaining with our units, 2 and at the end of the day there's no benefit 3 to rate payers in reducing OPEB costs if the 4 reduction is offset by other costs, such as 5 increased salaries. So that's still a work in 6 progress going forward, the benefits review. 7 So, Mr. Chairman, we believe that the 8 Board should adopt the company's proposal with 9 respect to accrual accounting effective 10 January 1, 2010, and then defer consideration 11 of the transitional obligation to the next 12 general rate application. That's a balanced 13 and constructive approach. 14 Next a quick word on operating costs, and 15 I won't say very much. Grant Thornton 16 reviewed them in detail and found nothing that 17 would indicate that the 2010 forecast 18 operating expenses are unreasonable on an 19 overall basis. Mr. Smith's evidence was that 20 since 2004 controllable operating costs have 21 increased by only 4.5 percent. That's a 22 pretty good record. There's no evidence on 23 the record that any of Newfoundland Power's 24 2010 forecast operating costs are 25 unreasonable. Newfoundland Power continues to</p>	<p>1 range of variances. Indeed the evidence 2 discloses that the cost actually borne by rate 3 payers falls significantly below that 50th 4 percentile. The consumer advocate has offered 5 no evidence that Newfoundland Power's 6 executive compensation pay policies are 7 unreasonable. The structure of Newfoundland 8 Power's executive compensation arrangements 9 have not changed since 1998, and as Mr. Ludlow 10 has indicated, over the past decade the 11 proportion of executive compensation to total 12 labour costs has not materially changed. It's 13 essentially the same. So Newfoundland Power 14 submits that its forecast 2010 operating 15 expenses are reasonable and should be approved 16 by the Board. 17 Mr. Chairman, there were a group of other 18 issues raised by the consumer advocate, and 19 I'll deal with each of them very briefly. 20 First with respect to inter-corporate 21 transactions. That's really providing 22 hurricane relief and secondments at fully 23 embedded cost without additional markup. That 24 has been accepted regulatory practise. It is, 25 in fact, a win-win situation for both</p>
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<p>1 operate efficiently, ensuring an appropriate 2 balance between cost and service, because we 3 not only have got to provide efficient 4 reliable service today, we must be ready to 5 provide that service to our customers in the 6 future, and Mr. Ludlow and Mr. Smith have 7 described the steps that the company is taking 8 to manage its workforce demographics through 9 its apprenticeship program to ensure that it 10 has the skilled workers to continue to service 11 our customers in the future. 12 Now the consumer advocate raised the 13 issue of Newfoundland Power's executive 14 compensation. So as a result, we filed an 15 expert report from Mr. Aboud and he came and 16 testified. Mr. Aboud is from the HAY Group, 17 and his report first of all confirms that 18 Newfoundland Power's executive compensation 19 continues to follow the principles already 20 approved by the Board. It confirms that it's 21 reasonable for Newfoundland Power to use the 22 Canadian Commercial Industrial Group as the 23 appropriate comparator, it confirms the use of 24 the 50th percentile level, and it confirms 25 that the pay values are within the normal</p>	<p>1 customers and the utility. With respect to 2 hurricane relief, it's simply the right thing 3 to do to assist others if we can do so without 4 additional cost to ourselves, and not only is 5 it without additional cost to ourselves, the 6 utility recovers the fully embedded cost of 7 those employees. As Mr. Smith testified, when 8 we need assistance, other utilities, including 9 other Fortis utilities, will assist 10 Newfoundland Power in the same way. Just 11 imagine the disruption that would be caused to 12 our customers and to the provincial economy, 13 as a whole, if we were to be struck by an 14 event like the Quebec ice storm. Similarly, 15 secondments are a win-win situation in that 16 they provide valuable experience, while 17 recovering fully embedded costs for providing 18 those employees. So that's the first issue. 19 The second issue raised was the 20 amortization of regulatory costs from this 21 hearing, and that's really a matter of 22 regulatory judgment for the Board. As a 23 matter of principle, the regulatory costs 24 should be amortized over the likely period 25 between GRAS. The evidence discloses that the</p>

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<p>1 rates from this GRA may not be in effect for 2 more than a year. There are a large number of 3 other amortizations that will expire next 4 year, and at a minimum, an application 5 relating to those expiring amortizations will 6 be necessary in 2010. So it will be useful to 7 have this amortization expire with all the 8 others so that the Board can consider all of 9 those amortizations together as a matter of 10 regulatory efficiency. At the end of the day 11 on this issue, it's a matter of regulatory 12 judgment for the Board.</p> <p>13 The Kenmount Road issue, the piece of 14 property, the accounting for the sale proceeds 15 for that piece of land has been dealt with in 16 accordance with the existing regulatory 17 accounting practise. It's important to note 18 that the property sold was physically part of 19 Newfoundland Power's Kenmount Road property. 20 Because of its size and its location, as Ms. 21 Perry explained, it couldn't practically be 22 sold to anybody except to the adjoining owner, 23 and until the adjoining owner wished to buy 24 it, as a matter of law, it simply remained 25 used and useful as part of the company's</p>	<p>1 matters, including the creation of the PEVDA 2 account, which were agreed with the consumer 3 advocate and these are set out in Section 6 of 4 the Settlement Agreement. I'll just put that 5 section on the screen for you. The rationale 6 for the operating of the PEVDA account were 7 explained by Ms. Perry in her testimony. The 8 remaining items are relatively 9 straightforward. I don't intend to discuss 10 these items further at this time, unless the 11 Board has any questions. Our written 12 submissions outline the evidentiary basis 13 supporting the Board's approval of these items 14 where such approval by the Board is required.</p> <p>15 Mr. Chairman, I'd like to just speak very 16 briefly about the question of the timing of 17 the Board's order which has arisen because 18 there's some uncertainty. Under the Public 19 Utilities Act, of course, the utility is 20 entitled to earn its just and reasonable 21 return on an annual basis, and, of course, the 22 evidence is pretty clear that next year on its 23 current rates, Newfoundland Power will not 24 have an opportunity to earn its just and 25 reasonable return, it's forecast to be 6.45</p>
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<p>1 Kenmount Road property. This is not a case, 2 as suggested, for example, in the consumer 3 advocate's authorities, he has one from 4 California, that the utility needed to be 5 incented not to engage in real estate 6 speculation. Well, that's not Newfoundland 7 Power, we don't engage in real estate 8 speculation. The proceeds were properly 9 accounted for in accordance with the company's 10 existing code of accounts, and no retroactive 11 alterations are necessary or appropriate to 12 deal with that issue.</p> <p>13 The Mobile River issue, as I said in my 14 opening comments, this matter is not really 15 properly before the Board in this proceeding 16 and shouldn't be considered. The company will 17 be required to apply to the Board under 18 Section 48 of the Public Utilities Act if 19 there is to be any transfer of the Mobile 20 River undertaking. If that should occur, then 21 that'll be the appropriate time to deal with 22 any issue which arises, and until that time 23 the issue is both hypothetical and premature.</p> <p>24 Mr. Chairman, as I pointed out in my 25 opening comments, there are a number of</p>	<p>1 percent. So that the timing of the Board's 2 order is obviously a matter of some 3 importance. Practically, for the company to 4 implement changes in rates for January 1st, it 5 would need to receive the Board's order in 6 about a month's time from today. Newfoundland 7 Power knows and acknowledges that it may not 8 be possible for the Board to issue its final 9 detailed reasons within that time period, and 10 if that turns out to be the case, if it's not 11 possible for the Board to get out its fully 12 developed order and all of its reasons by that 13 time, then there appear to be probably three 14 alternatives that the Board can reflect on.</p> <p>15 The first would be to issue its final order 16 with limited or abbreviated reasons with more 17 extensive reasons to follow if the Board 18 wishes then to have more extensive reasons. 19 So that's certainly one option available to 20 the Board. The Board could consider issuing 21 an interim order, kind of in advance of its 22 final order, or if necessary, Newfoundland 23 Power can apply for interim relief for January 24 1st, and I just thought we'd frame up for you 25 those seem to be, at least to us, the three</p>

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<p>1 possible ways of proceeding that the Board</p> <p>2 will need to consider if you get to the stage</p> <p>3 that there's a timing difficulty in getting</p> <p>4 the order out.</p> <p>5 Finally, Mr. Chairman, I'm almost at the</p> <p>6 end, just a quick comment on process. This</p> <p>7 general rate application was somewhat longer</p> <p>8 than our last general rate application, but it</p> <p>9 has still been much shorter and more efficient</p> <p>10 than general rate applications of a decade or</p> <p>11 so ago. The negotiation process did resolve</p> <p>12 some important issues, and certainly helped,</p> <p>13 at least to streamline the hearing process</p> <p>14 before you. I think we're in day nine, if my</p> <p>15 accounting is correct. Newfoundland Power</p> <p>16 remains committed to facilitated negotiations</p> <p>17 as part of the regulatory process, and we'd</p> <p>18 certainly like to thank Mr. Johnson, Mr.</p> <p>19 Earle, and Mr. Simmons, for their</p> <p>20 participation and assistance in that process.</p> <p>21 Finally, Mr. Chairman, I'm at the end of</p> <p>22 my submissions. I'd like to -- on behalf of</p> <p>23 myself, Mr. Hayes, Newfoundland Power, I'd</p> <p>24 like to thank the Board, the Board's staff for</p> <p>25 their cooperation and patience throughout the</p>	<p>1 will we have a break, or what do you want to</p> <p>2 do?</p> <p>3 MR. JOHNSON:</p> <p>4 Q. I'm prepared to go if you want.</p> <p>5 CHAIRMAN:</p> <p>6 Q. Carry on, sir.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Okay, thank you. Mr. Kelly has been</p> <p>9 attacking my rhetoric and he hasn't heard it.</p> <p>10 I mean, I have provided a brief, I cannot do</p> <p>11 what I did in the brief, and I'll tell you</p> <p>12 that the brief was our very considered opinion</p> <p>13 on these issues, with all references to</p> <p>14 transcripts, and I'm afraid I will not be able</p> <p>15 to do justice today, but what I will be able</p> <p>16 to do is give an outline and respond to Mr.</p> <p>17 Kelly's brief to some degree, something I</p> <p>18 didn't have a chance to do and to see if I</p> <p>19 could shed any further light on the issues</p> <p>20 without repeating what was in the brief. Mr.</p> <p>21 Kelly is absolutely correct. Both of us said</p> <p>22 at the beginning that it's the automatic</p> <p>23 adjustment formula and the cost to capital</p> <p>24 which is front and center in this. That</p> <p>25 hasn't changed through all of this, and your</p>
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<p>1 entire application process and throughout this</p> <p>2 hearing. Thank you very much, Mr. Chairman,</p> <p>3 Commissioners.</p> <p>4 CHAIRMAN:</p> <p>5 Q. You should thank you computer man too, boy, he</p> <p>6 did a good job.</p> <p>7 KELLY, Q.C.:</p> <p>8 Q. Thanks to Mr. Comerford.</p> <p>9 CHAIRMAN:</p> <p>10 Q. I'm going to recommend he be put on that bonus</p> <p>11 list that all the big top guns get. Would he</p> <p>12 like that?</p> <p>13 KELLY, Q.C.:</p> <p>14 Q. I'll make sure that that recommendation is</p> <p>15 referred, Mr. Chairman, to the appropriate --</p> <p>16 CHAIRMAN:</p> <p>17 Q. That'll be at the top of the decision, you</p> <p>18 know. I guess, next do we have questions or</p> <p>19 will we go to Mr. Johnson and come back to</p> <p>20 questions afterwards?</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Whatever the Board prefers.</p> <p>23 CHAIRMAN:</p> <p>24 Q. My preference is to hear Mr. Johnson, and then</p> <p>25 -- I mean, I've got some questions. I guess,</p>	<p>1 role is an economic regulator, and the role is</p> <p>2 to achieve an appropriate balance between the</p> <p>3 shareholders of this company and the</p> <p>4 customers, as this Board has a tradition of</p> <p>5 doing, and I'll tell you right off the start</p> <p>6 that I completely agree with what Ms. McShane</p> <p>7 had to say in 2007. When we put that evidence</p> <p>8 before her, she said that the regulatory</p> <p>9 framework is frequently viewed as the most</p> <p>10 significant aspect of risk to which investors</p> <p>11 in a utility are exposed. She was correct</p> <p>12 then, she is correct today. She said that</p> <p>13 enlightened regulation will mitigate risks</p> <p>14 that are substantially beyond management's</p> <p>15 control and provide fair compensation for</p> <p>16 risks that are left with management. She</p> <p>17 could not have been more correct. That is why</p> <p>18 it was necessary to investigate in some detail</p> <p>19 what these utilities were in these binders.</p> <p>20 Now Newfoundland Power, the fact is that</p> <p>21 they have been left with precious little risk,</p> <p>22 very little risk, so their return must reflect</p> <p>23 that. That's only fair. With respect to my</p> <p>24 friend's at Newfoundland Power, the mistake</p> <p>25 Newfoundland Power is making is that they see</p>

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<p>1 the myriad of regulatory mechanisms that have 2 been extended to Newfoundland Power over the 3 years as not transferring risk to the 4 customers, but that is not the case. Like the 5 PEVDA, the pension expense uncertainty doesn't 6 disappear. When the uncertainty is taken off 7 Newfoundland Power's lap, the uncertainty is 8 just passed over to 230,000 odd customers, and 9 if you don't recognize that as a risk 10 transfer, and I have serious reason to believe 11 that Newfoundland Power doesn't view it as a 12 risk transfer, well, then you find it 13 difficult to understand why customers need to 14 get some benefit out of being passed all these 15 risks.</p> <p>16 You'll note in Newfoundland Power's brief 17 when they refer to the establishment of the 18 PEVDA, there's no need to go there, but at 19 page E3, lines 13 to 14, they say the 20 uncertainty of pension expense forecasting in 21 current financial market conditions presents 22 potential risks for both the company and its 23 customers. They could have also added to 24 that, so what we are going to do is transfer 25 all of that risk to our customers. Now that's</p>	<p>1 complete disregard of the interests of the 2 others. These are the principles that 3 permeate the discussion of each of the issues 4 remaining in this case to be decided by the 5 Board.</p> <p>6 I would like first to focus in for a 7 moment on the cost of capital as its been 8 presented in Newfoundland Power's brief. They 9 make a statement at page 8, which is a crucial 10 sort of statement, and they say that, "The 11 depths of economic analysis, methodological 12 scope, and breadth of comparative data, 13 underpinning Ms. McShane's recommendation, 14 quality if to be given the greatest weight by 15 the Board in its determination of a fair 16 return on equity for Newfoundland Power in 17 2010". That is nothing but a broad conclusory 18 statement. It's words on a page. Look at the 19 idea that her economic analysis affords a 20 greater weight to her report before this 21 Board, and to her evidence before the Board. 22 With all due respect to Ms. McShane, where is 23 the economic analysis. I mean, I have looked 24 at her report. It's worth your while to look 25 at the Table of Contents in Ms. McShane's</p>
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<p>1 how these accounts operate, and we've seen 2 through CA-NP 189 the types of amounts that 3 we're talking about, which have been very 4 considerable back in '04, '05, '06, '07, had 5 that account been put in place. These 6 regulatory accounts, the regulatory 7 supportiveness in this regime, contribute to 8 this very low risk environment and that will 9 only provide benefits to the customers that I 10 represent if the risk adjusted return reflects 11 this lower risk that's left with the company, 12 and the PEVDA is a changer in this company's 13 risk profile.</p> <p>14 The management -- the shareholders of 15 Newfoundland Power, are to be provided fair 16 compensation for the risks that are left with 17 them, no more, no less, and that's in keeping 18 with the cost of service principle. The other 19 key principle is that the applicant bears the 20 onus to show the reasonableness and prudence 21 of its test year expenses. That's a second 22 fundamental principle. The third is that the 23 regulation of utilities is there to benefit 24 both the customer and the utility, with 25 neither set of interests being emphasized in</p>	<p>1 report. There is precious little identified 2 in the Table of Contents that gets into what 3 the economic analysis is. It's basically 4 bereft of economic analysis.</p> <p>5 Mr. Cicchetti's report, I think he spends 6 a page or two at the most talking about 7 economic analysis. The only economic 8 analysis, and certainly the economic analysis 9 that had the more substance to it, it was 10 clear to anybody who was in this hearing, came 11 from Dr. Laurence Booth, from the Rotman 12 School of Management, who was called by me. 13 His report has a section called "Financial and 14 Economic Outlook". It runs from page 8 to 30. 15 The very first thing his report looks at is 16 the current economic and capital market 17 conditions. He addresses what the current 18 market conditions are at present. He 19 discusses that for eight or nine pages, he 20 discusses the outlook for inflation, he 21 discusses the interest rate forecast, he 22 discusses what the recent state of capital 23 markets has been, he discusses how the state 24 of the economy affects profits and the capital 25 market. He refers to the credit rating agency</p>

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<p>1 and their contributions to the financial 2 crisis that occurred, he discusses where we 3 are in the business cycle, he discussed 4 whether data on profitability has implications 5 for the fair ROE. He points that for the 6 whole period from 1988 to 2008, the average 7 Stats Canada corporate ROE was 9.1 percent, 8 and the median was 9.88 percent. It's Dr. 9 Booth's evidence that has the depth of 10 economic analysis, not Ms. McShane, and 11 certainly not Mr. Cicchetti.</p> <p>12 The next statement is even harder to 13 understand, and that is that Ms. McShane's 14 methodological scope underpinning her 15 recommendation qualifies it to be given the 16 greatest weight. Now Commissioners, that 17 would be to suggest, I presume, that Ms. 18 McShane's use of comparable earnings somehow 19 would entitle her to extra, like, bonus points 20 or something before this Board. That is a 21 ridiculous assertion. This is a test that not 22 only has it not been accepted by the Canadian 23 regulator in years, it's a test that Dr. Booth 24 does not teach to his students as a valid 25 estimation technique, and it's one that Mr.</p>	<p>1 another way to use DCF and advise the Board, 2 would she get more weight. I mean, these are 3 statements that do not hold up to serious 4 scrutiny.</p> <p>5 What you have to consider is whether Ms. 6 McShane gave appropriate weight to the 7 appropriate test and whether what she had to 8 say was useful and hung together, and I, with 9 all respect, do not think that it did. Rather 10 interestingly, it's the Cap M that Dr. Booth 11 uses that the TQM decision says, yes, that's 12 the one we think reflects a fair return for 13 utilities. I mean, those are the facts. I'm 14 not making that up. It's interesting, 15 Commissioners, that even if -- even if you 16 were to say, okay, Ms. McShane, we're going to 17 accept your adjusted betas, and even if you 18 were to say I'm going to accept the 6.75 19 percent market risk premium that has her up in 20 the upper bubbles of Dr. Booth's survey, you 21 would still - you would still get to 8.75 22 percent, plus she has to add a flotation of 50 23 basis points. So what does that tell you. 24 You know what it tells me; it makes no wonder 25 she's got to use the breadth of methodological</p>
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<p>1 Cicchetti says has no place in this 2 proceeding. Now how in the world can you use 3 that as part of the basis for giving her extra 4 weight. Perhaps then it's her methodological 5 scope advantage by the fact that she uses 6 these adjusted betas. She takes the raw or 7 McShane beta, as she put it in her evidence, 8 and then somehow grosses it up to .65 to .70. 9 That can't be surely what entitles her to 10 further weight because we know from the record 11 that that has never been accepted either by a 12 Canadian regulator, and most recently it was 13 said by the NEB in the TQM decision, which for 14 the record is at CA-NP 201, that they don't 15 buy the premise that these utilities betas 16 revert one, and they said for that reason we 17 don't put weight on adjusted betas. So surely 18 Ms. McShane can't get marks for that.</p> <p>19 So that's two of the methodologies that's 20 been discredited. Then we have McShane's use 21 of the DCF in her US data. She uses the DCF 22 once with the US data, and she turns around 23 again and uses it again as part of her risk 24 premium analysis. I mean, it begs the 25 question if Ms. McShane were to come up with</p>	<p>1 scope that she uses because it's the only way 2 on Heaven's earth that you can get to the type 3 of numbers that she recommends for 4 Newfoundland Power, because even if you accept 5 her huge market risk premium, accepts her 6 adjusted betas, you just don't get there.</p> <p>7 Now in our view, the suggestion as well 8 that it's the breadth of comparative data - 9 this is the third thing that Newfoundland 10 Power says, "The breadth of comparative 11 underpinning Ms. McShane's recommendation that 12 also qualifies her evidence to be given the 13 greatest weight in view of Newfoundland 14 Power". Now presumably this is where the 15 heavy reliance on the US data comes in. Not 16 only does Newfoundland Power and Ms. McShane 17 expect the Board to apply this US ROE data 18 from these US companies, but they tell the 19 Board that it should be applied without need 20 to make any adjustment whatsoever. I mean, 21 that is a rather bold assertion. In other 22 words, Newfoundland Power does not wish for 23 this Board to be spending any time looking at 24 the details of these US companies. Actually, 25 Newfoundland Power is a bit dismissive to me</p>

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<p>1 in their brief because they say things like, 2 well, much time in the hearing was devoted to 3 discussing specifics of these companies. I 4 mean, that speaks for "you wasted our time". 5 I didn't waste your time, Commissioners, 6 because I do not think that this Board should 7 be flying at 10,000 feet when its determining 8 whether these companies are comparable to the 9 Newfoundland Power situation, and that's 10 exactly what we would have been doing had we 11 not had a sensible discussion about what these 12 US companies are, what are their non-regulated 13 operations, what sort of accounts do they 14 have, where do they carry on business, is 15 their regulation supportive, the types of 16 things that equity investors actually care 17 about. Otherwise, all we would have been told 18 is that, yeah, they're all pretty much rated 19 the same way, let's get on with it. That's 20 clearly what Mr. Cicchetti's view came to be 21 during the hearing, and I don't believe, with 22 all greatest respect, that the Board should 23 accept, without testing in any serious or 24 meaningful way, the evidence emanating out of 25 these witnesses US samples. This is why I</p>	<p>1 differences can be understood and accounted 2 for. They're of no assistance to the Board on 3 that. They just say accept it, apply it, 4 don't adjust it. 5 Dr. Booth, he testified -- I thought he 6 did a tremendous job before the Board. He was 7 clear, he was cogent, responsive, and he 8 indicated to this Board that he's taught 9 international finance at the University of 10 Toronto for fifteen years, and he said it's a 11 basic, you cannot take either interest rates 12 or fair rates of return from one market and 13 apply them to another without making serious 14 adjustments. I think that that is only 15 commonsense. 16 Let's put it this way, Commissioners. 17 Let's say you have amassed \$100,000.00 and 18 you're looking to put some money away for your 19 retirement purposes. Now you're looking at 20 Newfoundland Power. It has the benefit of a 21 rate stabilization account, municipal tax 22 increases get picked up through the rates 23 every July, weather normalization, energy 24 supply cost variance reserve accounts, 25 elasticity allowance factors, a forward</p>
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<p>1 find it interesting that I say that the onus 2 is on Newfoundland Power to establish to you 3 why no adjustments need be made to this US 4 data, and I find it interesting that the 5 National Energy Board in its TQM decision at 6 page 68, for the record, stated that the Board 7 would have benefited from additional 8 information on the comparability of US LDCs 9 with TQM. I mean, this is precisely the type 10 of things that regulators have to be 11 interested in, and we believe that this Board 12 has been provided with the type of information 13 that it can benefit from in determining 14 whether this US data can be used without 15 adjustment. 16 TQM also said that they found that the US 17 companies were informative, but they also said 18 that risk differences between Canada and the 19 United States can be understood and accounted 20 for. That's what they said, they can be 21 understood and accounted for. So Ms. McShane 22 and Mr. Cicchetti, they do not recognize that 23 there is any risk difference between carrying 24 on operations in Canada and the United States. 25 So it's not much point asking them how these</p>	<p>1 looking test year, pre-approval of capital 2 budgets, a PEVDA, an excellent competition 3 profile, no exposure to industrial customers, 4 and it carries on under a regulatory construct 5 that Mr. Cicchetti described as exceptional 6 and phenomenal in terms of its regulatory 7 supportiveness. On top of that, Newfoundland 8 Power is a T & D type of utility which is 9 generally seen to be the least risk among the 10 electric utilities, and Newfoundland Power's 11 parent, Fortis, as I indicated in my brief, 12 has indicated that the single biggest business 13 risk is regulatory risk. They say it right in 14 their 2000 annual report. Now I ask you, if 15 you were to divide up your \$100,000.00 into 16 several \$10,000.00 lots, and you want to 17 ensure yourself of making a return of 6 18 percent, I don't think you'd have much worry - 19 I just use that figure, I don't think you'd 20 have much worry about Newfoundland Power 21 letting you down because they don't let you 22 down, they've got so many protections. Now 23 you think about putting it in SCANA, FPL, or 24 Dominion, all these US vertically integrated 25 utilities with these non-regulated sides, et</p>

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<p>1 cetera. Think about FPL where there's 2 political uncertainty, where the Governor is 3 getting rid of the Commissioners if they were 4 to vote in favour of an increase for the 5 utility. You have SCANA in South Carolina, 6 600,000 customers is what South Carolina 7 Electric and Gas has, and they are in the 8 midst of a share of a nuclear project of 4. 5 9 billion dollars, to the point that it's been 10 said that their business risk and operating 11 risk has been elevated on account of getting 12 involved with this project. Or you have 13 Dominion, who carries on operations in West 14 Virginia, Ohio, and Pennsylvania, these SRE 3 15 states, which are in a category with Chile, 16 the Czech Republic, the Estonia, and Latvia, 17 and they're also into merchant generation. 18 Now you may look at this and say, look, 19 one of these guys is going to miss the 6 20 percent. You going to want 8 or 9 percent 21 from some of these guys to make up for the 22 ones who might miss. This is how an equity 23 investor thinks. You are going to rest on the 24 idea that they all have the same bond ratings. 25 You're not lending this utility this money,</p>	<p>1 heard Dr. Booth say you can't take them 2 without making adjustments, and I'm wondering 3 what is Newfoundland Power getting at with 4 that type of statement. I mean, it seems to 5 me that Newfoundland Power is forgetting that 6 this Board, like the NEB, is a specialized 7 tribunal which is charged with determining a 8 proper return for Newfoundland Power, and 9 because Ms. McShane and Mr. Cicchetti won't 10 admit that their sample might be suspect, that 11 the Board is stuck with that. I mean, that's 12 preposterous. That would be like three 13 finance experts coming in here telling the 14 Board that it should accept adjusted betas of 15 the form that Ms. McShane develops, and you 16 look at that and say, but in cross- 17 examination, it was determined that no one 18 ever uses them because of the problem. So are 19 you bound to accept these witnesses. I mean, 20 that's just a silly proposition. 21 I'd also turn to the statement that 22 Newfoundland Power makes in its brief at page 23 C-28, that they state that Ms. McShane and Mr. 24 Cicchetti have indicated that current market 25 conditions have increased utilities cost of</p>
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<p>1 you're not buying their bonds, you're buying 2 their stock, and the experts have told you, 3 and particularly Dr. Booth, that bond 4 investors and equity investors march to 5 somewhat different drums, and you hardly ever 6 see in an equity analyst's report someone 7 talking about the bond rating. That's the 8 evidence that we have before us, and we can't 9 divorce ourself by staying up at 10,000 feet 10 and pretending that once they have the same 11 bond rating, that it's just off to the races, 12 they're all the same. Moody's, which rates 13 Newfoundland Power's debt, has told us in 14 black and white that they would only consider 15 US utilities that are into transmission 16 distribution as being a low risk environment, 17 as a for instance. 18 Now as I've indicated, Dr. Booth has said 19 you cannot take these figures and apply them 20 without judgment, and I find it interesting 21 that Newfoundland Power has indicated in their 22 brief at page C-31 that there's no expert 23 evidence on the record which indicates that 24 these specific utilities are not comparable 25 from an overall risk perspective. Now you</p>	<p>1 capital and reflected this in their 2 recommendations on a rate of return for equity 3 for Newfoundland Power in 2010. Now just hold 4 on a moment now because this is another one of 5 these statements that you've got to look at 6 and analyze. We have seen in this proceeding 7 Ms. McShane tell us in her report that there 8 was a flight to quality, as they put it, which 9 pushed the actual yield and forecast yields on 10 long term government bonds lower during 2008, 11 and other indications which were signalling, 12 as she put it in her report, a higher cost of 13 capital, and specifically she refers to the 14 fact at page 11 of her report that between 15 November, '07 and November '08, the yield or 16 long term A rated utility bonds jumped 180 17 basis points in terms of the spread. Now we 18 have Ms. McShane saying that at the end of 19 March of 2009 the spreads were about 345 20 points, signalling a higher cost of capital. 21 Now at the time she prepared her evidence, 22 which was filed on May 28th, '09, she figured 23 that by the time the hearing rolled around 24 that the spreads would be 225 to 250 basis 25 points by the time of the hearing, but by the</p>

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<p>1 time of the hearing the spreads on A rated 2 bonds were down to about 170 basis points. 3 Now do you recall how this material decrease 4 in the A bonds spread affected her 5 recommendation on a return of equity for 6 Newfoundland Power in 2010; it didn't, it had 7 nothing to do with it, it got all washed out 8 in her variety of tests. I mean, there's a 9 disconnect between what's put forward and what 10 actually transpired in this case in terms of 11 the evidence. Ms. McShane went further. She 12 said that if by the time of the hearing the A 13 spreads would have gone up to 350 basis 14 points, in other words, higher than they had 15 been in March, the fair ROE would have only 16 increased by 6 basis points, so her 17 recommendation would still be 11 percent. Ms. 18 McShane is the person on the one hand who says 19 that the bond spreads signal a higher cost to 20 capital, but when the bond spreads come down 21 lower, you see no change in her 22 recommendation. She was also the witness who 23 talked about the Montreal volatility index in 24 her report as signalling -- that was an 25 indicator she said of rising investor risk</p>	<p>1 because he uses it in his report to have a 2 check, I mean, he testified before the Board 3 that he's sort of been dragged into looking at 4 this because he's got to confront it in 5 hearings with all this US data coming up from 6 the States. That's the context that he looked 7 at. 8 The suggestion as well that Mr. Kelly 9 made that even Dr. Booth said that the risk 10 premium would increase in 2010, what Dr. Booth 11 said would increase in 2010 was the beta, 12 because he said you can't expect that the beta 13 values that were present in 2009 were going to 14 persist because once that gets -- these stocks 15 being low risk defensive stocks, you can't 16 expect that they'll have low betas like they 17 had, as observed statistically in '09. That's 18 what the man said. 19 I think in all seriousness, we can put 20 very little weight on what Mr. Cicchetti said. 21 He doesn't do much of an economic analysis, he 22 confuses Canada with the United States when he 23 was testifying in terms of the banking 24 industry, the housing, he's totally wedded to 25 this US data, you couldn't get him to -- you</p>
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<p>1 aversion and a rising market risk premium. 2 That's what her report says. Well, lo and 3 behold, when the hearing comes around and the 4 Montreal volatility index is back down to 5 levels that we've seen from 2002 to 2007, does 6 she revise her recommendation for Newfoundland 7 Power's cost of equity; no, it's still 11 8 percent. No matter what happens, it's 11 9 percent. This surely is not what Newfoundland 10 Power means when they say that she has 11 reflected current market conditions in her 12 cost of capital and reflected this in her 13 recommendations for a return on equity. That 14 doesn't stand up. 15 Now on the point of the cost of debt 16 being related to the cost of equity, I cannot 17 speak any better than Dr. Laurence Booth did 18 on this topic, and I won't presume to, but I 19 would address the Board's attention to what he 20 said on October 21st in the transcript at page 21 180, where he talked about how they marched to 22 different drummers, and I'll just leave that 23 there for the Board's reference. The 24 suggestion as well that Dr. Booth puts an 25 informada of some credibility on this US data</p>	<p>1 couldn't get him to point out any single one 2 of his companies that had business risks and 3 regulatory risks as good as Newfoundland 4 Power. What does that tell you, what sort of 5 confidence can you have to just apply his 6 numbers. The only interesting thing that 7 comes out of his evidence is the fact that you 8 really have to make adjustments at the end of 9 the day, and I think it's rather interesting 10 that when he takes his sample and brings it 11 down to the value line one safety rating 12 companies, how dramatically it decreases his 13 rate of return recommendation, and he was the 14 one who testified when Mr. Simmons was 15 questioning him that he felt that if he did so 16 and shrunk the sample, that he didn't view it 17 as being a problem with the validity of what 18 he had to say. Those were his words. 19 With respect as well to the interest 20 coverage issue, I'm at a loss to understand 21 frankly how Dr. Booth could be accused of not 22 being adequately aware of interest coverage. 23 Dr. Booth testified very clearly that he's not 24 aware, and this is in an RFI, he's not aware 25 of any financial theory that states that you</p>

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<p>1 take a particular times interest earned ratio 2 and then key in your ROE off of that, and I 3 find it interesting that actually when Ms. 4 Perry was examined by Mr. Simmons on October 5 19th at page 135, she was quick to point out 6 that fair return is a separate issue, and she 7 was quick to point it out because Mr. Simmons 8 had pointed out to her that their credit 9 metric weren't too bad based on either the 10 formula or eve the status quo, so, no, no, no, 11 you know, that's a different issue now, fair 12 return is a different issue. I mean, the 13 evidence, Commissioners, is that Newfoundland 14 Power at 2010E, in other words, just -- they 15 don't get anything. They have a cash flow 16 interest coverage of 2.8 times, just a bit 17 below 2009's 3.1. Now Moody's anticipates 18 that their cash flow interest coverage stays 19 above 3. Now clearly they don't have to be 20 anywhere near 11 percent to achieve that, and 21 actually if -- their 8.5, if they remain on a 22 cash basis, will achieve more than needed 23 because you get the 3.19 as opposed to the 3 24 that Moody's is anticipating that they will 25 have. So we see no reason to say that Dr.</p>	<p>1 was filed yesterday indicated that the AAF 2 would provide a forecast cost of common equity 3 of nearly 8 and a half percent, or 8.48 4 percent. it was 8.6 percent in 2007, 8.95 5 percent as part of a negotiated agreement in 6 2008, and with a strengthening economy, the 7 yield is forecast to increase by both -- the 8 long Canada bond yield, it's forecast to 9 increase by both Dr. Booth and Ms. McShane, 10 and with it the allowed ROE under the AAF. So 11 what we are seeing is simply the impact of the 12 business cycle, which Dr. Booth addressed with 13 the Board. We see no valid reason to suspend 14 the operation of the AAF. If the Board is 15 minded to suspend the operation of the AAF, we 16 would request that the Board consider 17 timelines as to what will happen next so that 18 there's some certainty brought to that piece 19 if the Board goes there. 20 Referring now to OPEBs. We're not 21 running away from OPEBs. I want to make that 22 perfectly clear to the Board. It's not hide 23 and seek with the Board. Every time we get 24 close to dealing with it, we throw up another 25 obstacle, because that's the characterization</p>
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<p>1 Booth's recommendation is problematic. We 2 also note that Moody's has indicated that they 3 anticipate that Newfoundland Power's CFO pre- 4 working capital to debt ratio will remain in 5 the 15 to 16 percent range. So already 2010E 6 shows that they're at 13.1, and at 8.5 7 percent, they would be at 16.7 percent. So, 8 you know, there is no way, if you read 9 Moody's, that you conclude that they are 10 indicating that they need this giant sized 11 ROE, it's just not there. With respect to 12 Newfoundland Power, they do not recognize what 13 Moody's has clearly stated in black and white, 14 and that is Moody's does not expect, nor have 15 they expected Newfoundland Power to have the 16 same credit metricise as their peers, full 17 stop. Newfoundland Power would have us 18 getting into a situation where they actually 19 get upgraded because if you look at Moody's 20 last credit rating, they say what would cause 21 their rating to go up; well, if they went to 22 4, yeah, we might look at an upgrade. 23 Newfoundland Power doesn't need an upgrade, 24 full stop on that. 25 Regarding the AAF, the undertaking that</p>	<p>1 that I'm getting from what Newfoundland Power 2 had to say today. What we're getting at is 3 that there's a couple of things that's got to 4 be considered. 5 The OPEBs figure, as we've indicated in 6 the brief, just on an annual basis, is a huge 7 figure. I mean, we've seen it increase during 8 the course of the hearing by a huge amount, 9 and we're looking down the road and seeing 10 step two as being another huge figure coming. 11 We think probably 11 million bucks a year. 12 That is a lot of scratch and it's dangerous to 13 start taking one step at a time without having 14 a full appreciation for the full piece. 15 That's our fundamental point. Grant Thornton 16 has indicated that there is a variability with 17 OPEBs that you've got to keep your eye on. 18 They're dead right. 19 We are also indicating to the Board that 20 it's easy for Newfoundland Power to be in a 21 hurry when they're not the one paying the tab 22 on the OPEBs question, and with all due 23 respect, they are forgetting what's going to 24 be happening in the review for 2010 and the 25 real life implication that that has for people</p>

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<p>1 like Ms. Heisz was talking about earlier 2 today. I mean, goodness gracious, we're 3 talking about accruing an amount that'll have 4 what, six-seven million dollars in rates for 5 this OPEBs amount in 2010, when this OPEBs 6 question for retirees is in dire need of 7 reform. It's clear. I mean, we've said in 8 our brief, companies have been doing it. 9 They've either done it or are going to do it, 10 and we have a serious objection with (a) 11 throwing all this variability into the pot and 12 then (b) not having a full and complete 13 picture of what the actual true OPEBs cost is 14 going to look like. I mean, we've indicated 15 that if they do a relatively modest change to 16 the future retiree OPEBs cost, you're talking 17 two and a half million dollars per year. It 18 would reduce the overall obligation just by 19 doing that modest change of about 10 or 12 20 million dollars, as I've indicated in my 21 brief. I mean, this is real money that comes 22 out of real people's pockets, and at this 23 stage of the game, make no wonder we're not in 24 a hurry to bite off something like that, given 25 the fact that we have every reason to believe</p>	<p>1 shareholders that are getting quite a lift out 2 of this. They're getting skilled people from 3 Newfoundland to go down and fix 'er up in the 4 Caribbean. They're ameliorating a significant 5 business risk of operating in the Caribbean 6 with Newfoundland Power personnel. I mean, 7 when we had our storm in Bonavista, we paid 8 market rates. That's life. And I don't 9 think, with all due respect to Newfoundland 10 Power, that you should allow the possibility, 11 and I must say, I would suspect it's remote, 12 the remote possibility of a linesperson coming 13 up from Belize or the Grand Cayman to help us, 14 as being an indication that maybe, yeah, we'll 15 just keep on going with this cost-based 16 system. I don't think that that is realistic, 17 and what bothers me is the lack of 18 reciprocity. If I had some sense that there 19 was going to be some reciprocity, I wouldn't 20 feel so strongly about this. But there is 21 not. 22 The same thing really goes for the 23 secondments. In one of the paragraphs in my 24 brief, I showed you what the line was in terms 25 of money that was coming into Newfoundland</p>
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<p>1 that that figure is going to come down 2 considerably once a sensible review gets done. 3 So I think that obviously this is a 4 matter for the Board's determination. We 5 respect that, but we think that there is 6 certainly a number of countervailing 7 considerations before rushing headlong into 8 it, particularly given the landscape in 2010. 9 The intercorporate transactions. 10 Essentially, the way we--the view that we take 11 of this matter is that the company receiving 12 the fully distributed cost back for all these 13 hurricane efforts for these Fortis utilities, 14 all that does, that's the bare minimum that 15 you'd have to do, because all that does is 16 protect Newfoundland Power's customers from 17 taking a bath. I mean, you got to do that. 18 The question that the Board has to ask itself 19 is whether it's reasonable, given the fact 20 that Newfoundland Power, let's face it, is a 21 net provider of these services and we've seen 22 years where it's been 16-17,000 hours to the 23 benefit of Fortis and its shareholders. I 24 mean, it's not, God bless them, the good 25 people in Belize. It's the Fortis</p>	<p>1 Power for Newfoundland Power getting people 2 from other companies in the Fortis family on 3 secondment. Zero. It's dash, dash, dash, 4 dash, dash, dash for years. I mean, we have 5 been a net provider of Newfoundland Power 6 personnel, and that's the fact, and frankly, I 7 think the recent evidence is that lots of 8 times the people who get seconded, they just 9 keep on going on with the Fortis company. We 10 have one example where the guy who was 11 backfilling for the person who was gone to 12 Fortis on secondment, he ended up going to. 13 So the theory, and it's a nice theory, the 14 theory that we're getting a lift because these 15 people all come back to Newfoundland Power 16 with these new skills is really only a theory 17 and it's not panning out enough to just leave 18 good enough as it is. So that's why we think 19 we need some reform, recognizing, 20 Commissioners, as I'm sure you do, that these 21 intercorporate transactions provide a unique 22 challenge because there is no real economic 23 incentive to charge the market rate for these 24 services. 25 With respect to executive compensation,</p>

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<p>1 again, as I pointed out at the beginning, this</p> <p>2 is one where the company bears an onus. It's</p> <p>3 an operating expense item, like any other, and</p> <p>4 I want to make it clear, this is not personal</p> <p>5 to any of the incumbents of the executive team</p> <p>6 at Newfoundland Power, okay. It has nothing</p> <p>7 to do with that. What is at issue in this</p> <p>8 case is whether Newfoundland Power can</p> <p>9 establish and has established that</p> <p>10 Newfoundland Power competes for its executive</p> <p>11 resources with organizations across the</p> <p>12 breadth and depth of business sectors across</p> <p>13 Canada. That's at issue, and that's a</p> <p>14 linchpin issues, as it would be if</p> <p>15 Newfoundland Power came in and said "we have</p> <p>16 got to compete across all these other</p> <p>17 utilities in other provinces for line</p> <p>18 technicians." We would go through the same</p> <p>19 analysis. We would be asking "where are you</p> <p>20 getting your line technicians from? Where are</p> <p>21 you losing them to? How are they joining your</p> <p>22 organization?" It's no different.</p> <p>23 I'm reminded by the Hay Group report of</p> <p>24 the analogy in a Court where you see these</p> <p>25 actuaries coming in and they have a bunch of</p>	<p>1 become executives. That's how it happens.</p> <p>2 So I mean, all we're saying, we're not</p> <p>3 denying that this has been in place a long</p> <p>4 time, but I think we've had a long time to see</p> <p>5 that the underlying assumption has not been</p> <p>6 borne out in the true facts.</p> <p>7 Finally, I guess, it's not happy for us</p> <p>8 to tell you that you have to look at what Mr.</p> <p>9 Aboud said with a lot of scrutiny, and I</p> <p>10 thought that P25 business was a good example</p> <p>11 of that, in that he would have known that the</p> <p>12 P25 figure that he brought to the Board's</p> <p>13 attention included an LTI which was a totally</p> <p>14 shareholder paid amount, but the impression</p> <p>15 was left that, you know, we were comparing</p> <p>16 apples to apples, but we were not, and that</p> <p>17 causes me, to be quite honest with you, to</p> <p>18 have grave concern about how much we can rely</p> <p>19 on Mr. Aboud's evidence.</p> <p>20 I have also addressed in my brief the</p> <p>21 operational cost reductions and efficiencies</p> <p>22 that should be considered. This is a GRA.</p> <p>23 This is where these matters get tested.</p> <p>24 That's what we're supposed to do, and there</p> <p>25 are issues that we raise in our brief where it</p>
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<p>1 assumptions, and the Judges always say, well,</p> <p>2 look, we'll hear you and the report will be,</p> <p>3 at the end of the day, as good as the</p> <p>4 assumptions. If the facts support what you</p> <p>5 said to be an assumption, your report is going</p> <p>6 to be used. If it's not, forget it. And</p> <p>7 essentially, there's nothing wrong with the</p> <p>8 Hay Group and how they go about it. The</p> <p>9 problem is how it's applied to Newfoundland</p> <p>10 Power. There is simply no evidence that they</p> <p>11 actually compete in that sector for their</p> <p>12 talent. The evidence goes the other way, and</p> <p>13 when Mr. Aboud was asked on it in cross-</p> <p>14 examination as to whether he's done any</p> <p>15 testing to determine whether Newfoundland</p> <p>16 Power competes across the breadth and depth, I</p> <p>17 mean, we just got nowhere. It was bob and</p> <p>18 weave, because there is no evidence. We've</p> <p>19 seen how Newfoundland Power gets its</p> <p>20 executives. They come in at the management--</p> <p>21 they get into middle management. These people</p> <p>22 are paid, according to the cross-examination</p> <p>23 of Mr. Aboud, at the 25th--which works out to</p> <p>24 be the Atlantic Canada, which is 25th</p> <p>25 percentile of the national level, and they</p>	<p>1 seems to us that some of these operating</p> <p>2 expenses could be moderated. I think the</p> <p>3 example of the bad collection amount, I grant</p> <p>4 you it's inexact, but the existing methodology</p> <p>5 produced large variances the last time. The</p> <p>6 brief is there to provide the references to</p> <p>7 our arguments on these matters and I won't</p> <p>8 labour them.</p> <p>9 Similarly, the proposed one-year</p> <p>10 amortization of Board and Consumer Advocate</p> <p>11 costs relating to this application. I think</p> <p>12 John Todd did a wonderful job of explaining</p> <p>13 why it was best to amortize these over three</p> <p>14 years. I think it made perfect sense, and I</p> <p>15 commend to the Board his evidence in that</p> <p>16 regard.</p> <p>17 The Kenmount Road property. We have</p> <p>18 provided some backup decisions from other--or</p> <p>19 references to decisions by other regulators</p> <p>20 where they say, look, these properties that go</p> <p>21 into rate base that were sort of being banked</p> <p>22 for future purposes, they can go into rate</p> <p>23 base, but at the end of the day, there's got</p> <p>24 to be some sort of fairness achieved as</p> <p>25 between the utility and the customer as to how</p>

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<p>1 the gain is handled, and you know, we've seen 2 in this case that the customer paid a return 3 on this property for years and years and 4 years, and then when it gets sold in 2009, and 5 2009 is not over yet, but when it gets sold in 6 2009, the customer doesn't get any benefit of 7 that, and you know, we have indicated and give 8 some basis to the argument that there can be 9 adjustments made above the line, as Mr. John 10 Todd pointed out. I mean, it puts the 11 customer in a very, very awkward situation 12 because you're operating under the assumption 13 that this property is used. I mean, we're not 14 going around checking surveys and deeds and 15 asking the question, you know, are you all 16 using everything you got every time. So to 17 then turn around and see that a piece of 18 property gets sold and just booked as though 19 it's in the normal course, it's--I think it 20 leaves a little bit to be desired frankly, and 21 I don't think it achieves equity and a just 22 result with the customers.</p> <p>23 The Mobile River Watershed dispute, I'm 24 not going to spend too much time talking about 25 that. My only concern, my only concern is</p>	<p>1 Newfoundland Power indicates, that the Board 2 may wish to issue a short order outlining its 3 decision, but perhaps not with the full 4 complement of reasons that you would normally 5 expect. Given the present circumstances, we 6 would not be opposed to that. You know, 7 presumably the full reasons would follow in a 8 reasonable amount of time. So we're not 9 particularly opposed to that, if the Board 10 feels that that's something that it's 11 comfortable with doing. We presume that 12 you'll have deliberated enough to feel 13 comfortable to do it and if that's your 14 comfort level, I think that's fine.</p> <p>15 I would also be remiss if I didn't thank 16 the Commissioners and Commission staff and my 17 colleagues at Newfoundland Power and my 18 colleague, Mr. Earle. I think that it's 19 unfortunate that customers don't come in and 20 get a chance to see this. They've got busy 21 lives, but I think that they would have 22 witnessed an excellent hearing, a hearing 23 where there was a clash of ideas and 24 perspectives put before the Board for your 25 consideration, and I think that that bodes</p>
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<p>1 that at the end of the day, I'm wary of the 2 result that we end up being in a situation 3 where the consumer is told, b'y, thanks for 4 paying the freight on fighting this case. It 5 will end up, presumably, potentially 6 benefiting the shareholder, but don't look for 7 your cost back. That's what I'm trying to 8 avoid. If the Board feels that that result 9 can be avoided without setting up some sort of 10 deferral account now, I'm all over it. But 11 that's what I'm trying to avoid by suggesting 12 that there be some sort of protection for the 13 customer, because ordinarily a benefit that 14 only goes to the shareholder should not be 15 coming from customers' rates to actually fund 16 the litigation to get that benefit. That's my 17 concern.</p> <p>18 Commissioners, you have the benefit of 19 our brief on all of these issues. I would 20 like to say, as a final point, that I am 21 cognizant of the fact that the Board is under 22 a challenging regulatory calendar, as I 23 understand it, with some anticipated 24 applications. From our point of view, we 25 recognize one of the possibilities is that, as</p>	<p>1 well and I'd like to thank everybody for their 2 participation in that. Thank you.</p> <p>3 CHAIRMAN:</p> <p>4 Q. I guess just as well to finish it off, isn't 5 it? You got any questions or any comment?</p> <p>6 MR. SIMMONS:</p> <p>7 Q. No, I have nothing. Thank you, Chairman.</p> <p>8 CHAIRMAN:</p> <p>9 Q. Okay. Do you have any?</p> <p>10 COMMISSIONER NEWMAN:</p> <p>11 Q. No, I don't have any questions.</p> <p>12 VICE-CHAIR WHALEN:</p> <p>13 Q. No questions. Thanks to you both.</p> <p>14 CHAIRMAN:</p> <p>15 Q. I got some questions, I guess, and I'll seek 16 guidance from--I note as well there's seven 17 lawyers in the room, so I'm suitably 18 intimidated, but with respect to this whole 19 comparable earnings issue and the DCF, I mean, 20 given the lack of regulatory respect that's 21 paid to it in Canada, I mean, what's--what 22 purpose does it serve, I suppose, to spend so 23 much time discussing it? I mean, I guess I'd 24 ask you, Mr. Kelly, and Mr. Johnson can 25 certainly -</p>

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<p>1 KELLY, Q.C.</p> <p>2 Q. I'll start, Mr. Chairman. All of the cost of</p> <p>3 capital witnesses use various mechanisms to</p> <p>4 both determine their initial analysis and to</p> <p>5 then determine the reasonableness of whatever</p> <p>6 results you get and the judgments that you do,</p> <p>7 that you get out of it. Keep in mind that</p> <p>8 what you're trying to capture here is the</p> <p>9 return on investments of comparable risk. So</p> <p>10 it does make logical sense, not only to look</p> <p>11 at the utility market, but to look at</p> <p>12 comparable non-regulated companies. If what</p> <p>13 we're trying to do is to say, okay, we're</p> <p>14 looking at a regulated situation. Well,</p> <p>15 regulation, in economic theory, is a proxy for</p> <p>16 getting at what the markets will otherwise</p> <p>17 give you and if you only look at what Canadian</p> <p>18 regulators do, and if you only looked at what</p> <p>19 American regulators would do, you never get</p> <p>20 behind enough of the economic theory to see,</p> <p>21 well, what do actual financial markets</p> <p>22 generate. So it's a useful cross check</p> <p>23 mechanism, not only for the cost of capital</p> <p>24 experts, but it should also be for the</p> <p>25 economic regulators themselves to see whether</p>	<p>1 earnings of what an unregulated market induced</p> <p>2 rate would be.</p> <p>3 CHAIRMAN:</p> <p>4 Q. Do you have any comment, Mr. Johnson?</p> <p>5 MR. JOHNSON:</p> <p>6 Q. Well, just one comment in terms of the</p> <p>7 weighting. Ms. McShane gives 25 percent to</p> <p>8 comparable earnings. She does two DCFs,</p> <p>9 because she explained that 75 percent of--</p> <p>10 after you take out the comparable earnings,</p> <p>11 there's 75 percent left, right, and then what</p> <p>12 she basically says is that I give half to DCF</p> <p>13 and then half to the other group, but that</p> <p>14 also includes DCF, and I think it's--I can't</p> <p>15 see on what basis there is an advantage to</p> <p>16 these methodologies. Certainly, they don't</p> <p>17 qualify for extra weight, given the fact that,</p> <p>18 I mean, Dr. Booth doesn't teach it. Mr.</p> <p>19 Cicchetti said don't use it, don't go near it,</p> <p>20 and with the DCF, as you've seen, the model</p> <p>21 hasn't been used in so many years and the GIGO</p> <p>22 factor that Dr. Booth talks about, that's the</p> <p>23 biggest problem. DCF is a model, but it's</p> <p>24 GIGO.</p> <p>25 CHAIRMAN:</p>
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<p>1 the results that they're getting give you the</p> <p>2 right answers.</p> <p>3 Ms. McShane, therefore, tells you--gives</p> <p>4 you the information, gives you, as the</p> <p>5 regulator, the information and she tells you</p> <p>6 exactly what weight she's put on it. So you</p> <p>7 know exactly what factor goes into it.</p> <p>8 Otherwise, if you simply say, well, I'm going</p> <p>9 to do an analysis and I'm going to give some</p> <p>10 weight to other factors, I'm going to apply</p> <p>11 some smell test, to use Dr. Booth's</p> <p>12 terminology, then you, as the regulator, have</p> <p>13 no basis to be able to judge what that was</p> <p>14 worth to get behind the concepts and to get</p> <p>15 at, well, what would you expect markets to</p> <p>16 give you, and Ms. McShane, in her evidence,</p> <p>17 tells you, well, if you don't use comparable</p> <p>18 earnings, but you've got the information, you</p> <p>19 can work out that it'll be 10.75 percent. So</p> <p>20 you've got all the information to say, well,</p> <p>21 I'm going to use these results. This is what</p> <p>22 I'll have out of it. So kind of a long way</p> <p>23 around, but certainly the principle behind it</p> <p>24 is that comparable earnings is ultimately what</p> <p>25 you're trying to get at, the comparable</p>	<p>1 Q. Like if we were in a Court of law, would a</p> <p>2 judge say "I don't want to hear this stuff,</p> <p>3 because we've made a prior decision that</p> <p>4 we're--you know, we're not interested in</p> <p>5 comparable earnings," -</p> <p>6 KELLY, Q.C.</p> <p>7 Q. The answer -</p> <p>8 CHAIRMAN:</p> <p>9 Q. - or would he hear it or she hear it, I guess?</p> <p>10 KELLY, Q.C.</p> <p>11 Q. No, with respect, Mr. Chairman, the premise to</p> <p>12 your question is incorrect, if I may.</p> <p>13 CHAIRMAN:</p> <p>14 Q. Okay. No, I mean, I'm just asking. I don't</p> <p>15 understand. I'm asking questions.</p> <p>16 KELLY, Q.C.</p> <p>17 Q. In a Court of law, in a civil case, the Judge</p> <p>18 is deciding strictly upon the evidence and is</p> <p>19 bound by precedent decisions to a large</p> <p>20 extent.</p> <p>21 CHAIRMAN:</p> <p>22 Q. Yes.</p> <p>23 KELLY, Q.C.</p> <p>24 Q. A regulatory board has the ability to decide</p> <p>25 policy issues and to revisit--it's not bound</p>

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1 in the same technical sense to a previous
2 decision. Now that having been said, there is
3 a certain regulatory basis that regulators
4 don't want to be going off willy-nilly
5 changing their minds every week, because
6 otherwise we'd have so much uncertainty, you'd
7 never know what you do, but certainly boards,
8 unlike a Court, which is bound by, you know,
9 higher authorities, has the ability to look at
10 previous decisions and to say, well, we think
11 the circumstances have changed and therefore
12 it's appropriate to modify principles
13 accordingly.

14 Just if I can follow that point along a
15 little. Take for example the discussion of
16 the use of DCF analysis. Well, why has DCF
17 analysis in Canada not been used as much in
18 recent years? Well, the answer has been
19 because regulators have looked to the market
20 risk premium method because it nicely fits in
21 with a model that you can then use for an
22 automatic mechanism, but okay, just step back
23 from that for a second. We're now at a stage
24 where the use of that automatic formula has
25 become questionable, has become--it just isn't

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1 giving the right results. So what regulators
2 should do and are, in my respectful
3 submission, doing is they're stepping back and
4 saying, okay, let's look at what else is out
5 there, not only simply market risk premium,
6 not only simply CAPM, but what are DCF
7 analysis telling us? What is happening in the
8 market itself? Which takes you back to like
9 what is the market itself generating, because
10 at the end of the day, what regulation is all
11 about, it's a regulatory proxy at getting at
12 what an appropriate unregulated return on
13 investment of comparable risk would be, and
14 that's the economic theory behind regulation.

CHAIRMAN:

16 Q. Okay. Well, I'm looking at what's happening
17 in the market, and I'm looking at--I don't
18 know where we got this, the Blue Book of
19 Canadian Stocks, and Fortis is rated very
20 conservative and return on equity expected is
21 8.3 percent. I'm looking at Bank of Montreal
22 capital markets, BMO, and they're rating
23 Fortis as outperform and their ROE expected
24 for 2010 is 8.5. These are numbers that I've
25 generated myself, so I'm not putting any--you

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1 know, I'm going--I want--when I finish up,
2 I'll ask you to provide me with the-- but I
3 looked at Fortis, one of Fortis' credit
4 metrics and I think that the interest coverage
5 is only 1.9. So I mean, I have to ask myself
6 the question, you know, you people are saying
7 you need somewhere around 11 percent return on
8 equity. Fortis is recommended here as a very
9 conservative stock, outperform the market or
10 hold it and buy it. I mean, these are very
11 good recommendations. Fortis looks to me like
12 a very good stock. Why is Fortis--why is
13 Light and Power more riskier than Fortis? I
14 mean, if you want a higher return on equity,
15 you're telling me that Light and Power is
16 riskier than Fortis itself.

17 Secondly, if you want to do comparable
18 earnings, why wouldn't you include Fortis as
19 one of your companies that's comparable? I
20 mean, surely there's a--the Fortis Group
21 itself is a valid comparison with Newfoundland
22 Power, on a stand-alone basis. So what's your
23 response to those questions?

24 KELLY, Q.C.

25 Q. Well, unfortunately, Mr. Chairman, I don't

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1 have the particular documents. We'd be happy
2 to take them and analyze them.

3 CHAIRMAN:

4 Q. Yeah.

5 KELLY, Q.C.

6 Q. And respond, if you would want an undertaking
7 To -

8 CHAIRMAN:

9 Q. Well, these weren't tabled at the hearing,
10 were they?

11 MR. JOHNSON:

12 Q. They were filed by me, but I don't -

13 CHAIRMAN:

14 Q. I thought -

15 MR. JOHNSON:

16 Q. - don't know if they were identified.

17 CHAIRMAN:

18 Q. Oh.

19 KELLY, Q.C.

20 Q. I don't know if they were -

21 CHAIRMAN:

22 Q. You don't have them, do you?

23 KELLY, Q.C.

24 Q. Well, I certainly don't have them right in
25 front of me. I'd be happy to try to answer

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<p>1 that question with an undertaking, if that was</p> <p>2 of assistance.</p> <p>3 CHAIRMAN:</p> <p>4 Q. But I want--yeah, I mean, I want your</p> <p>5 comments.</p> <p>6 KELLY, Q.C.</p> <p>7 Q. Just as a general proposition, what regulators</p> <p>8 in Canada are doing is are looking to the</p> <p>9 markets for the guidance as to what the</p> <p>10 appropriate return should be, but keeping in</p> <p>11 mind that regulation in Canada, all of the</p> <p>12 utilities are regulated. There's an element</p> <p>13 of circularity in it, so hence, you have to</p> <p>14 use tests like the DCF test and the equity</p> <p>15 market risk premium test to try to get that</p> <p>16 proxy, and at the end of the day, when you</p> <p>17 look at all of the evidence, that's the</p> <p>18 evidence that was brought before you. Ms.</p> <p>19 McShane looked at Canadian and US. Mr.</p> <p>20 Cicchetti looked at the US and this is the</p> <p>21 range that you get. Fortis, for example, has</p> <p>22 other interests other than simply the utility</p> <p>23 interests and it has--it's affected obviously</p> <p>24 by -</p> <p>25 CHAIRMAN:</p>	<p>1 agencies saying you're going to earn 8.3 and</p> <p>2 8.5 next year return on equity, and they got</p> <p>3 interest coverage in one case, and this is in</p> <p>4 Fortis' annual report, I think I saw that,</p> <p>5 that the interest coverage on debt for 2008</p> <p>6 was 1.9, and I mean, you know, how do you</p> <p>7 square that circle? I don't--and I mean, I</p> <p>8 guess that's the question I've got to you, Mr.</p> <p>9 Kelly, to tell me, you know, what is the</p> <p>10 difference? I mean, what are the credit</p> <p>11 metrics, for instance, that Fortis has versus</p> <p>12 Newfoundland Power's and why is--it appears to</p> <p>13 me that Fortis investors who own Newfoundland</p> <p>14 Power expect a higher rate of return from</p> <p>15 Newfoundland Power than they do from Fortis</p> <p>16 itself, yet it would appear to me, and as I</p> <p>17 say, appear, and I want to hear your comments</p> <p>18 on it, that Fortis is probably, because it has</p> <p>19 some non-regulated activities, would be</p> <p>20 perceived in the market as a riskier</p> <p>21 enterprise. But, apparently the investors in</p> <p>22 Fortis are satisfied with 8.5, you know, as I</p> <p>23 say, outperform, buy, hold, whatever. So I</p> <p>24 just leave it with you, but it's kind of, you</p> <p>25 know.</p>
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<p>1 Q. But which company is riskier? Is Fortis</p> <p>2 riskier than Newfoundland Power?</p> <p>3 KELLY, Q.C.</p> <p>4 Q. Well -</p> <p>5 CHAIRMAN:</p> <p>6 Q. Or is Newfoundland Power riskier than Fortis?</p> <p>7 KELLY, Q.C.</p> <p>8 Q. - Newfoundland Power is your typical low risk</p> <p>9 utility as the witnesses have said. The</p> <p>10 relative risk of Newfoundland Power hasn't</p> <p>11 changed relative to other utilities. It would</p> <p>12 be difficult for me to comment on the</p> <p>13 implication of your question, because you're</p> <p>14 taking it based upon a conclusion as to a</p> <p>15 number out of that report. So if you wish me</p> <p>16 to go that far, I'd prefer to do it in an</p> <p>17 undertaking response.</p> <p>18 CHAIRMAN:</p> <p>19 Q. Oh yeah, no, I mean, I don't understand. I</p> <p>20 mean, I'll be perfectly blunt, that's why I'm</p> <p>21 asking the question. You talked about the</p> <p>22 smell test. I mean, how--you know, when you</p> <p>23 look at Newfoundland Power and seeking a rate</p> <p>24 of return of 11 percent and then you look at</p> <p>25 Fortis, as I say, and you got these two rating</p>	<p>1 KELLY, Q.C.</p> <p>2 Q. Couple of comments. I suspect that in that</p> <p>3 number there are a number of adjustments that</p> <p>4 have to be made to make it comparable to</p> <p>5 Newfoundland Power, so that you're really</p> <p>6 comparing apples and apples. Take for example</p> <p>7 interest coverage. I'm not sure exactly which</p> <p>8 metric is being referred to in what you're</p> <p>9 saying.</p> <p>10 CHAIRMAN:</p> <p>11 Q. No, and I'm not either, and that's why--yeah.</p> <p>12 KELLY, Q.C.</p> <p>13 Q. But like, for example, if pre-tax interest</p> <p>14 coverage was 1.3 percent and Newfoundland</p> <p>15 Power had to operate with 1.3 percent,</p> <p>16 literally the lights would go out.</p> <p>17 CHAIRMAN:</p> <p>18 Q. Yeah.</p> <p>19 KELLY, Q.C.</p> <p>20 Q. Because you could never go out and issue bonds</p> <p>21 and be able to keep the lights on in the</p> <p>22 province. So you have to be very careful, Mr.</p> <p>23 Chairman, to make sure that as you're</p> <p>24 considering that sort of question, we're</p> <p>25 comparing apples to apples, and so I'd be</p>

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<p>1 happy to take your question as an undertaking</p> <p>2 and provide a written response.</p> <p>3 CHAIRMAN:</p> <p>4 Q. Yeah, what would be--what's the credit rating</p> <p>5 of Fortis versus the credit rating of</p> <p>6 Newfoundland Power, what are the credit</p> <p>7 metrics used. I mean, Fortis, I assume,</p> <p>8 issues bonds.</p> <p>9 KELLY, Q.C.</p> <p>10 Q. Most of the debt is in fact issued in the -</p> <p>11 CHAIRMAN:</p> <p>12 Q. An amalgamation of -</p> <p>13 KELLY, Q.C.</p> <p>14 Q. Well, it's issued in the operating company.</p> <p>15 CHAIRMAN:</p> <p>16 Q. Yeah.</p> <p>17 KELLY, Q.C.</p> <p>18 Q. For example, Newfoundland Power issues the</p> <p>19 debt. We are a stand-alone entity and this</p> <p>20 Board has taken considerable pains to ensure</p> <p>21 that we continue to be a stand-alone company</p> <p>22 and rightly so.</p> <p>23 CHAIRMAN:</p> <p>24 Q. Yes.</p> <p>25 KELLY, Q.C.</p>	<p>1 be a well-structured, properly organized</p> <p>2 company. That's the ones you look at for</p> <p>3 comparison.</p> <p>4 So my point is Newfoundland Power is, has</p> <p>5 to be, must be, the Board has directed that we</p> <p>6 should be, and rightly so, viewed as a stand-</p> <p>7 alone entity.</p> <p>8 CHAIRMAN:</p> <p>9 Q. Like I just note here, my last comment, market</p> <p>10 quality rating, this is for Fortis, very</p> <p>11 conservative, and their range, least risk to</p> <p>12 highest risk, very conservative is the lowest</p> <p>13 risk. So I mean, you know, these are</p> <p>14 questions that I have and, you know, as</p> <p>15 somebody once said, I'm stumped. So I leave</p> <p>16 it with you, and I want you to--I'd like to</p> <p>17 have that information and -</p> <p>18 KELLY, Q.C.</p> <p>19 Q. You have to compare operating company -</p> <p>20 CHAIRMAN:</p> <p>21 Q. Oh yeah, no, no, I understand.</p> <p>22 KELLY, Q.C.</p> <p>23 Q. - with operating company. Fortis is</p> <p>24 essentially a holding company.</p> <p>25 CHAIRMAN:</p>
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<p>1 Q. That we are--that we stand alone from Fortis</p> <p>2 so that at no time are customers in</p> <p>3 Newfoundland and Labrador and the provincial</p> <p>4 economy at risk by virtue of the fact that we</p> <p>5 are somehow simply part of a Fortis Group.</p> <p>6 That's why, for example, the whole question</p> <p>7 of, about four or five years ago now, ensuring</p> <p>8 that Newfoundland Power's stand-alone credit</p> <p>9 rating was preserved, was maintained, this</p> <p>10 Board gave direction to us to make sure that</p> <p>11 happened and in fact, the company took steps</p> <p>12 to ensure that we are judged on a stand-alone</p> <p>13 basis and that is a critically important</p> <p>14 element because this company has to go out and</p> <p>15 be able to issue bonds to ensure that, if I</p> <p>16 can use the phrase, the lights stay on. And</p> <p>17 you'll recall one of the witnesses, I believe</p> <p>18 it was Ms. McShane, when being cross-examined</p> <p>19 by Mr. Johnson about, you know, some of the</p> <p>20 difficulties down in the States and she said,</p> <p>21 yeah, you know, you got the Enrons, which were</p> <p>22 problematic, but keep in mind there were</p> <p>23 companies--and she gave a specific example of</p> <p>24 a west coast company that all during that</p> <p>25 period, on a stand-alone basis, continued to</p>	<p>1 Q. Yes.</p> <p>2 KELLY, Q.C.</p> <p>3 Q. You've got to be very careful that you're</p> <p>4 comparing apples and apples in your analysis,</p> <p>5 but -</p> <p>6 CHAIRMAN:</p> <p>7 Q. And I may be, Mr. Kelly, it wouldn't be the</p> <p>8 first time, I may be totally out to lunch on</p> <p>9 this issue, but it just raises some questions</p> <p>10 in my mind and I'd like to be able to</p> <p>11 understand it before I make some kind of a</p> <p>12 decision.</p> <p>13 KELLY, Q.C.</p> <p>14 Q. Thank you, Mr. Chairman.</p> <p>15 CHAIRMAN:</p> <p>16 Q. But I am a tabula rasa, as they say. I'm a</p> <p>17 blank slate, not an empty one. So I leave it</p> <p>18 with you.</p> <p>19 KELLY, Q.C.</p> <p>20 Q. We'll certainly take your question under</p> <p>21 advisement.</p> <p>22 CHAIRMAN:</p> <p>23 Q. Is there any further comments?</p> <p>24 MR. JOHNSON:</p> <p>25 Q. Just for the record, I think the materials</p>

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<p>1 that the Chair is referring to, I think, were 2 provided in a letter of materials back when 3 Ms. McShane was testifying, I think. 4 MS. GLYNN: 5 Q. The book line values certainly were. The Bank 6 of Montreal was actually entered as one of the 7 consent documents, but the first document, I 8 don't think was actually entered through the 9 proceeding. 10 MR. JOHNSON: 11 Q. All right. 12 CHAIRMAN: 13 Q. BMO capital markets wasn't? I mean, I didn't 14 dream - 15 MS. GLYNN: 16 Q. BMO was. 17 CHAIRMAN: 18 Q. Yeah. 19 MS. GLYNN: 20 Q. But I think the book line values - 21 CHAIRMAN: 22 Q. They weren't? 23 MS. GLYNN: 24 Q. I don't think so. I'd have to check the 25 undertaking, or the exhibit.</p>	<p>1 percent? 2 KELLY, Q.C. 3 Q. I don't recall off the top of my head. 4 CHAIRMAN: 5 Q. Or 7.75? That's what--I assume that's the 6 rate of return at - 7 KELLY, Q.C. 8 Q. For the pension plan? 9 CHAIRMAN: 10 Q. Yes, that's the rate of return, I guess, for 11 the company's pension plan. 12 KELLY, Q.C. 13 Q. The discount rate. 14 CHAIRMAN: 15 Q. That's what you expect to--that's the rate of 16 return you expect in the pension plan for all 17 investments or just for the equity portion? 18 KELLY, Q.C. 19 Q. No, Mr. Chairman, the discount rate is the 20 interest rate used to work back the--to work 21 the net present value. 22 CHAIRMAN: 23 Q. Okay. 24 KELLY, Q.C. 25 Q. I'm not quite sure I'm following your</p>
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<p>1 CHAIRMAN: 2 Q. Well, I didn't get it--I mean, it must have 3 been. I didn't go out and get it. 4 MS. GLYNN: 5 Q. It was filed by the Consumer Advocate in 6 advance, but I don't think we actually 7 referred to it throughout the proceeding. 8 CHAIRMAN: 9 Q. Okay. 10 KELLY, Q.C. 11 Q. I think there were some that were not marked. 12 MS. GLYNN: 13 Q. Exactly. It wasn't used in the proceeding. 14 I'll have to check back. 15 KELLY, Q.C. 16 Q. Take no objection to that point, Mr. Chairman, 17 simply that if we have--we have it, I believe, 18 from what Board counsel has been saying. 19 MS. GLYNN: 20 Q. They were filed in advance, yes. 21 CHAIRMAN: 22 Q. Now the other point I just wanted to--last 23 point. Like when you use the discount rate 24 for the company's pension plan for the 25 executives, that discount rate was what? 6.75</p>	<p>1 question. 2 CHAIRMAN: 3 Q. Well, the company has a pension plan. 4 Employees contribute. Employer contributes. 5 You put the money in a pot. You got some 6 company hired to make investment decisions and 7 that company makes a--you know, you make a 8 range of investments and hopefully you gain a 9 return. That's the way it works, isn't it? 10 KELLY, Q.C. 11 Q. Yes. 12 CHAIRMAN: 13 Q. And there's an expected rate of return on the 14 pension investments. 15 KELLY, Q.C. 16 Q. Yes. 17 CHAIRMAN: 18 Q. That's not that 6.75, is it? 19 KELLY, Q.C. 20 Q. No, Mr. Chairman. 21 CHAIRMAN: 22 Q. Okay. 23 KELLY, Q.C. 24 Q. In fact, you'll recall the testimony, I 25 believe of Ms. Perry of the return on</p>

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1 investment. For example, what's happened in
 2 the current refiling is that the discount rate
 3 has gone down since last fall, but offset by
 4 improved return within the pension plan, and I
 5 think they worked that out about 12 percent
 6 for the numbers which are currently before the
 7 Board in the current year. But you can't take
 8 that average over a short period of time and
 9 draw any meaningful conclusion out of that,
 10 which is comment number one that I'd make.
 11 And comment number two that I'd make is even
 12 looking at pension plan returns are a little
 13 bit different because you're looking at
 14 different bond rates that are--you're not
 15 comparing apples and apples, if I can put it
 16 that way.

17 CHAIRMAN:

18 Q. Well, we can leave that one alone. All right.
 19 Well, I think that concludes the proceeding,
 20 and I'd like to thank everybody. I think it
 21 was very good, and I don't think that we're
 22 going to tarry in our decision, so with that,
 23 I will adjourn the session.

24 I want to acknowledge our computer expert
 25 over there again. I think he did a great job.

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1 And we'll have a decision as
 2 expeditiously as we can. So the hearing is
 3 adjourned. Thank you very much.

4 KELLY, Q.C.

5 Q. Thank you, Mr. Chairman.

6 UPON CONCLUSION AT 12:00 P.M.

CERTIFICATE

1 I, Judy Moss, hereby certify that the foregoing is
 2 a true and correct transcript in the matter of
 3 Newfoundland Power's 2010 General Rate Application
 4 heard on the 10th day of November, A.D., 2009
 5 before Commissioners of the Public Utilities Board,
 6 Prince Charles Building, St. John's, Newfoundland
 7 and Labrador and was transcribed by me to the best
 8 of my ability by means of a sound apparatus.
 9 Dated at St. John's, Newfoundland and Labrador
 10 this 10th day of November, A.D., 2009.
 11
 12 Judy Moss

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