November 10, 2009

CHAIRMAN:

Q. Now, all right, good morning everybody. We have a representative from the Seniors Resource Centre, Kelly Heisz. You're going to make a statement?

MS. HEISZ:

A. Yes, I am.

CHAIRMAN:

Q. And I'm going to swear you in. Is there anything preliminary first before we -

KELLY, Q.C.

Q. No, Mr. Chairman.

MS. KELLY HEISZ, SWORN

MS. HEISZ:

A. Thank you, Commissioners, for offering me this opportunity to speak to you on behalf of the many seniors in Newfoundland and Labrador and how this possible rate increase could impact their health and wellbeing as they move forward in their lives. I'm going to relate to you some statistics as well as some information that we have gathered and gleaned over the years through our information and referral line, which has been in existence for

the past 18 years. It's an information line that seniors, as well as individuals who provide services to seniors, family members and friends, that call to get information and also voice their concern on things that impact their life. So I'm going to relate to you a real call that came into our information line.

The person's name is Mary. She's 72 years old and she's a widow. She receives $1200 a month in old age security and guaranteed income supplement, and the guaranteed income supplement is provided to OAS pensioners who have little or no income. So basically, Mary is living below the poverty line. She lives in a rural small community. She lives in her own home, but still has a mortgage. Her house is old and not well insulated. It needs major repairs, which she cannot afford. She has considered selling her home, but she would not get very much for it. Also, there aren't many housing options for seniors in her community and she does not want to move to another community. She has several chronic health conditions and often needs to travel long distances for medical

appointments. She does not have any family nearby who can drive her to appointments, so she needs to maintain her own car. She is finding it increasingly difficult to pay her bills each month. She finds it especially hard in the winter, due to her higher electricity costs for heating her home.

Mary is one senior who represents the majority of our calls to our centre. 30 percent of our calls are of a financial nature and 50 percent regarding housing, which includes queries on energy efficiency grants and programs. Often the senior, like Mary, who calls is driven to contact us because an unexpected expense has now created extreme stress on their existing costs. So unfortunately varied costs in a senior's life, especially those on fixed incomes and those living below the poverty line, which is Mary, are stressors on their money and more importantly, on their physical and mental wellbeing.

So I just want to give you some statistics that I gathered that we generally have on hand. So the latest statistics, which

unfortunately is just from Stat Can's 2006 census, here in Newfoundland we have 182,605 or 36.7 percent of the population are people aged 50 plus, and that's how we--at the Seniors Resource Centre, that's the age that we start providing services and programs and getting information to.

So I just also wanted to mention to you that according to community accounts, about 42 percent of our population live in rural and remote communities and to give you--to break down perhaps some rural community profiles, in terms of the percentage of population of seniors in these rural communities, I just randomly selected a few communities, just to give you some idea. So in alphabetical order, I selected Arnold's Cove, who has a population of 445 seniors or 44.3 percent of their population. Burgeo has 715, again 44.5 percent of their population. Corner Brook, 10,070 and that's 37.8 percent of their population are seniors. Forteau, Labrador, 180 or 40.4 percent. L'Anse au Clair, 85 at 37.7 percent. Lawn, 225, 31.9 percent. Spaniard's Bay, 900 at 35 percent.

Springdale, 1260, 45.6 percent. St. Anthony, 965 at 38.9 percent of their population, and Trinity Bay North, 650, 42.2 percent. So as you can see, a lot of these rural and remote communities, the majority--almost the majority of their population are indeed seniors.

So our investigation has discovered, using various statistics from Statistics Canada, community accounts and the Atlantic Seniors Housing Research Alliance, we found that 66.7 percent of our seniors receive the guaranteed income supplement, more than any other province in Canada, and there are still seniors who qualify but still have not applied for the GIS. Over 60 percent of the women's income is less than $15,000 a year and only 6.6 percent live in institutions. So the majority of them do live in their own homes. Some do rent, and we find that 15 percent of seniors still have a mortgage, and speaking to a number of individuals, who do needs assessment and income assessment and check to see if they qualify for various supplements and so on and so forth, have said that, you know, years ago seniors never did carry a

mortgage and never did carry debt, but they are increasingly finding that seniors today are forced to take a mortgage in order to survive and are carrying credit card debt in order to pay expenses.

So as cited by the document, "Housing Strategy for Newfoundland and Labrador", which was commissioned and prepared by the Status of Women's Council, they said "seniors' households are also facing a growing affordability problem. The number of senior households in Canada with this problem increased by 16.3 percent from 1997 to 2000. Three of every four senior women live alone in Newfoundland and Labrador." As well, as cited by the Atlantic Seniors Research Alliance in their document "Atlantic Seniors Housing and Support Services Survey Results", not only are seniors staying in their communities, they're also staying in the same home longer. The average length of time is just over 25 years, with as many as 15.9 percent of seniors reporting they have lived in their homes over 45 years.

So choices to live anywhere else but the

home they raised their families are very limited in rural areas of our province, due to lack of other types of housing, such as seniors complexes, apartments, et cetera. With the demand for constant upkeep, maintenance and these homes being of older stock and more than likely less energy efficient, compounded by the inability to afford regular maintenance and upgrade for energy efficiency, seniors are paying far too much in heating costs that are literally escaping to the outdoors.

So these particular statistics have shown us that we have seniors who want to remain in their own communities, who want to remain in their own homes and oftentimes, we call them house poor because a lot of them are paying at least 30 percent of their costs to maintain their home, and that creates an awful lot of stress on them, especially when if their health changes and as you get older, your health does change. So there's an increasing demand on using what little money they have on things such as medication, home care services, caregivers, respite and so on and so forth.

So when you have such fluctuating costs, it's extremely difficult and the seniors that call our information line are often driven to the point that they call us and say, you know, "what do I do? Where do I go? What can I do?" and we have received a number of calls from some seniors and I've asked, since I've been speaking with Tom Jackson (sic) on this, to get some feedback from some seniors on how do you--what would you like us to say to the PUB in defence of trying to argue that perhaps this increase is not very appropriate at this time, and a lot of them have come back and said "there's really no point in even arguing, because it's going to happen."

So you have seniors who acquiesce. Seniors who often just take that brunt. But unfortunately, with our aging demographic, we're going to see an increase in the amount of seniors living in rural and remote communities and if they have no choice but to live in their own home and they cannot afford to upgrade their homes and keep them and make them more energy efficient, then they try to keep things as--try to keep their costs down, but because things fluctuate so much, it creates extreme havoc and I think that, for us, we find that it impacts severely on their physical and mental wellbeing and oftentimes that will create a burden on the health care system. A lot of them have no family that live in their communities with out migration, so they rely a lot on other individuals. So other than that, that's pretty much what I'd like to present to you, and I thank you very much for this opportunity.

CHAIRMAN:
Q. Okay. Anybody have any questions?
KELLY, Q.C.
Q. No, Mr. Chairman.
MR. JOHNSON:
Q. I have no questions.
MS. HEISZ:
A. Okay, thank you.
CHAIRMAN:
Q. Thank you.
VICE-CHAIR WHALEN:
Q. Thank you.
CHAIRMAN:
Q. So I guess now, Mr. Kelly, it's your--we're in

your capable hands.
KELLY, Q.C.
Q. Thank you, Mr. Chairman, Commissioners. At this stage, we come to final argument in Newfoundland Power's 2010 General Rate Application. As Mr. Ludlow and Ms. Perry have explained, this rate application is necessary because the combination of increased costs and decreased revenues is forecast to reduce the Company's return on equity next year from the current rate setting point of 8.95 percent to 6.45 percent. Indeed, increasing costs are forecast to reduce the company's return this year to approximately 8.62 percent or 33 basis points below the rate setting point, and Newfoundland Power faces further cost pressures in 2011.

As indicated in my opening comments, there are two principal issues in this proceeding. The first is the cost of capital, including whether to discontinue the use of the Automatic Adjustment Formula, and the second is the appropriate accounting treatment for other post employment benefits or OPEBs.

Newfoundland Power has submitted a

detailed brief of argument. The evidence is summarized in our written submissions. What I intend to do in the time I have this morning is to provide some comments to put the evidence in perspective and which may assist the Board in its decision making process in accordance with sound public utility practice.

Clearly, the major issue before you is the cost of capital, specifically what should be the rate of return on common equity used for calculating the rate of return on rate base. It is, of course, a truism to say that Newfoundland Power operates within the existing cost of service regulatory framework that's set forth in the legislation, the Board's orders and the Board's practices and procedures. The Public Utilities Act provides that rates are to be set to enable the company to recover its reasonable expenses of providing service to customers, including a just and reasonable return on the rate base, and that cost of service framework includes an excess earnings account that limits any upside opportunity to 18 basis points on the rate of return on rate base. The company remains

exposed to the risk of under earning its return. That risk is illustrated in the current year when the company will earn at the bottom of the range.

Several regulatory mechanisms provide for the recovery of certain costs, notably purchase power expense. Some mechanisms provide incentives and penalties to achieve certain objectives, such as control of peak load on the system, in the case of the demand management incentive account, and that framework constitutes the current regulatory balance that we all have to work within.

Now the Consumer Advocate has spent much time in this hearing discussing Newfoundland Power's business risk, and with the greatest respect, much of that discussion has been misguided. The evidence of all of the cost of capital witnesses, including the Consumer Advocate's own witness, Dr. Booth, is that Newfoundland Power continues to be: an average risk utility, relative to other Canadian utilities, to use Ms. McShane's phrase; a typical low risk Canadian utility, to use Dr. Booth's terminology; or a low risk transmission and distribution utility, to use Mr. Cicchetti's phraseology. No witness has said that Newfoundland Power's business risk has changed relative to other utilities. Dr. Booth himself said that he regarded business risk analysis to be of marginal importance in this proceeding. He included Newfoundland Power as simply another utility in that low risk Canadian group.

So the evidence does not disclose that there has been any material change in Newfoundland Power's business risk from what the Board has previously considered. Indeed, over the last number of years, the Board has acted in some cases to moderate increases in Newfoundland Power's business risk. For example, changes in the wholesale power pricing would have materially increased Newfoundland Power's business risk in absence of the creation of the Energy Supply Cost Variance clause, and in this hearing, the Pension Expense Variance Deferral Account will mitigate a new risk that would have arisen from the increased discount rate volatility and that account will ensure that customers

benefit if interest rates should rise. So the evidence is clear, Newfoundland Power's business risk remains essentially the same as it's been for the last number of years.

Now you've heard the evidence of the three cost of capital witnesses who came and testified before you, and I'd like to turn to that next. The fair return or the just and reasonable return must meet three tests, three things. It must be commensurate with the return on investments of similar risk, number one. Number two, it must be sufficient to ensure financial integrity, and number three, it must be sufficient to attract capital. Those are the three things. It's got to do all three of them. It's not sufficient to simply ensure that Newfoundland Power's credit worthiness is maintained, if a higher return is required to match the return on investments of similar risk.

Now Mr. Chairman and Commissioners, I think you will find considerable assistance in your deliberations on the cost of capital if you consider three propositions, and I'm going to first give you the three propositions and

then I'm going to develop each of them a bit for you.

The first proposition is that a cost of equity in 2010 will be higher than the cost of equity either last set by the Automatic Adjustment Formula or the cost of equity that would result from the application of the formula at this time. Now there is a range of reasonable disagreement on how much higher, but the evidence is, in my submission, incontrovertible that the cost of equity will be higher in 2010. That's the first proposition.

Second proposition is that maintenance of credit worthiness requires a return on equity of between nine and a half and nine and three-quarter percent. The return required to maintain credit worthiness essentially establishes a floor for the Board's consideration of the cost of equity.

And the third proposition is that the fair return, the return on investments of similar risk, on the evidence that you've heard in this hearing, falls within a range of approximately 9.8 percent to 11 percent. In

other words, the range of what constitutes a fair return is in reality relatively narrow, and I'm going to develop each of those three propositions for you now.

The first proposition, the cost of equity is going to be higher in 2010. It'll be up, not down, and this conclusion is not only supported by the preponderance of the expert evidence, it's essentially really incontrovertible. Let's look at it. Newfoundland Power's debt is fully secured against the assets of the company by first mortgage bonds. However, the equity investment in the company is an unsecured investment. The equity investor is therefore inherently subject to greater risk than the investor in the company's secured debt. For that reason, the required return on the company's equity must be higher than the return on the company's debt, self-evident proposition. Over the past year, the cost of the company's debt has risen relative to long Canada bonds yield. The spread rose to 275 basis points in the spring of 2009 at the time of the company's latest bond issue. Recently, that spread has fallen to approximately 187 basis points, but even that spread is approximately 50 to 75 basis points higher than the spreads when the company issued bonds in 2005 and 2007. So consequently, it is clear that in the current economic circumstances, debt investors have required increased returns relative to long Canada bond yields, and that's not peculiar to Newfoundland Power. It's true of the debt of other Canadian utilities and other companies.

With the cost of fully secured debt having increased, it's simply not logical to believe that the cost of unsecured equity investment has fallen. Indeed, the evidence is clear that the opposite is the case. As Ms. McShane and Mr. Cicchetti have explained, share prices have dropped as a result of the economic turmoil. As share prices fall, the dividend yield rises in relation to the share price. The equity markets thus signalled a rising cost of equity just as the bond markets signalled a rising cost of debt. While the markets have recovered somewhat from their lows, they are still well below their previous

values. The recovery is still fragile and will continue to be so in 2010. So the conclusion is inescapable, the cost of equity in 2010 will be higher than the return last set by the Automatic Adjustment Formula and will be higher than what the formula would have produced, based upon current long Canada bond yields. The higher cost of equity is borne out in the testimony of Ms. McShane and Mr. Cicchetti with respect to operation of market forces, as well as the results of their cost of capital analysis, and even Dr. Booth acknowledged that the market risk premium results are going to go up in 2010.

Now, Dr. Booth had a rather rosy view of the potential recovery, which was not shared by Ms. McShane and Mr. Cicchetti, both of whom expressed considerable uncertainty over the extent of the economic recovery. However, one got the sense, listening to Dr. Booth's overall testimony, that he wasn't focusing so much on the cost of capital in 2010 itself, but was in fact suggesting that somehow utility returns should be held relatively stable over an economic cycle, rather than

reflect changes in year-to-year financial market conditions.

Now that approach has two fundamental problems with it. First of all, it's simply not in accordance with the current cost of service regulation model that we all got to work in. That model requires rates to be based upon forecast 2010 costs, including the forecast 2010 cost of capital. That's the first point, and the second point is the company's return on equity was reduced during the strong market conditions of the past couple of years. In 2004, this Board determined the cost of equity for Newfoundland Power of 9.75 percent and as equity markets strengthened during 2005 through to 2007, Newfoundland Power's return on equity was reduced. By 2007, the 9.75 percent return was reduced to 8.60 percent, about 115 basis points down, and it's not appropriate that the company's cost of equity should be reduced in strong market conditions as it have been, but then not increase to reflect the higher equity costs which are signalled now by the current equity markets.

So that's my first proposition, the cost of equity, and we can look at it and say it's going to be higher in 2010 than it has been over the last year or so, couple of years.

Now the second of the three propositions is that the maintenance of credit worthiness, in other words ensuring financial integrity and the ability to attract debt capital, requires a return on equity of between nine and a half and nine and three-quarter percent, and essentially is kind of a floor that the Board will need to consider what's the appropriate rate of return.

The maintenance of credit worthiness is an important consideration. Maintenance of a sound credit rating is part of the power policy of the province, as set forth in the Electrical Power Control Act. Newfoundland Power has a continuing obligation to provide service to its customers year after year. In order to do so, the company must be able to issue debt in all market conditions, whether the markets are good or the markets are bad. It's not sufficient that the company be able to issue bonds only in strong market

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conditions. A good example is just this past May when the company was required to issue bonds in what can only be described as very difficult market conditions.

The Board, this Board has traditionally considered pre-tax interest coverage to be a primary indicator of credit worthiness. The Board has previously targeted a range of 2.4 to 2.7 times as an appropriate range of interest coverage for Newfoundland Power. For the 2008 GRA, the return on equity provided 2.5 times interest coverage and that's an appropriate interest coverage for Newfoundland Power. Setting a lower pre-tax interest coverage can be problematic. In issuing new bonds, the company must always meet a threshold test, not only to provide two times interest coverage on all of its existing debt, but to provide that same coverage on all the new debt that it's going to issue as well, and as Exhibit 5 filed in this case shows, in order to achieve a pre-tax interest coverage of 2.5 times, based upon 45 percent equity, Newfoundland Power would require a return on equity of between nine and a half to nine and

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three-quarter percent, and that that's the return that would maintain credit worthiness and ensure that the company is able to issue further debt to maintain service to its customers as required. So that's the second proposition.

Now, the third proposition is that the fair return or the return required on investments of similar risk, and that's the return sufficient to attract equity capital, falls within a relatively narrow range of approximately 9.8 percent to 11 percent. Let me just explain that.

First of all, each methodology for determining the cost of capital has strengths and weaknesses. Each methodology requires an element of judgment in its application. For example, in using a market risk premium analysis, judgment is required in determining the market risk premium itself, the Beta, and the risk free rate. In using a DCF analysis, judgment is required in choosing the sample of companies of comparable risk and trying to determine investors expectations of future returns, and so recognizing that there's no

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precise definitive answer is key. Determining the cost of capital involves substantial elements of judgment, something obviously not lost on the Board. So consequently, it's better to use multiple methodologies to cross check the judgmental results flowing out of the application of any single methodology. It's just kind of common sense, and that's exactly what Ms. McShane has done, and I've just put up on the screen her recommendation.

Now what Ms. McShane has done is she uses three risk premium tests, using both historic market data and DCF risk premium results. So she got three of those. She uses two direct DCF tests and she checks all of them with an examination of comparable earnings. She gives 75 percent weighting, divided equally between her equity risk premium tests and her DCF tests and a 25 percent weighting to a comparable earnings test. Her equity risk premium tests and DCF tests, when you add in 50 basis points for financing flexibility, gives a range of 10 and a quarter to 11 and a quarter percent. Her comparable earnings test shows returns for comparable unregulated

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companies of 11 and a half to 11 and three-quarters percent, and because she herself places only 25 percent weighting on her comparable earnings test, her overall recommendation is 11 percent. So for you, the Board, you know exactly what she's done and exactly the weightings she's applied to her various tests.

Now, Mr. Cicchetti uses two tests. He has a DCF test and a DCF-based equity risk premium test, and he places most of his weight on the DCF test, and from those tests, he formulates his recommendation of 9.6 percent. Now it's important to recognize that in that 9.6 percent, he's only included the equivalent of 20 to 25 basis points for the financing flexibility adjustment rather than the traditional 50 basis points used in Newfoundland and Labrador and recommended by both Ms. McShane and Dr. Booth himself, and if you adjust for that factor, that gives Mr. Cicchetti's proposed rate of return, brings it to approximately 9.8, 9.9 percent.

Now Dr. Booth uses only a market risk premium analysis, though he does check it by doing a DCF test as what he calls his reasonableness check, and then he says he applies a smell test, but he couldn't quite explain how that smell test works, how he applies it, or what weight he gives to it. Now it is worth noting right at the beginning that Dr. Booth's DCF analysis showed earned returns of 11.94 percent on equity in 2008, and from that he, Dr. Booth, derived a prospective looking forward return on equity of 9.59 percent, almost 9.6, almost the same as Mr. Cicchetti got using his samples, and combined with 50 basis points of adjustment for financing flexibility, you've got to put that in as well that Dr. Booth added to his other tests, would give you a return of about 10.1 percent, in that range. That's from his DCF test.

Now put on the screen kind of a summary of all that. So if you look at all of the recommendations of Ms. McShane and Mr. Cicchetti and we include Dr. Booth's DCF results, we end up with a range of return on common equity that's approximately 9.8 percent to 11 percent, so it spans about 1.2 percent

or 120 basis points. Now that does not obviously include Dr. Booth's recommendation of 7.75 percent based upon his capital asset pricing model. So obviously a key question is what consideration should the Board give to Dr. Booth's Cap M results. First of all, the capital asset pricing model gives inherently low results, especially for low risk companies, and that's one of its weaknesses. Dr. Booth recognizes that himself at page 33 of his report, and the capital asset pricing model requires judgment on three important variables; the market risk premium, the beta, or the relative adjustment for risk for a low risk utility, and the risk free interest rate. If you underestimate any of those inputs, you will necessarily get a low results. The output of the model is only as good as the inputs that go into it. Dr. Booth himself said if you put garbage in, you'll get garbage out. Now Dr. Booth recently told the British Columbia Utilities Commission -- he was having kind of a candid discussion with the Chairman, it's worth reading in the exhibit we filed, that the market risk premium

was 5 to 6, conceivably 7. Dr. Booth is at the absolute bottom of that range. Both Ms. McShane and Mr. Cicchetti broadly agree in their analysis that the market risk premium is in the 6.4 percent to 6.75 percent range, Ms. McShane slightly higher than Mr. Cicchetti. So that's the first point where his judgment is very low. The second is beta, and beta requires judgment. You can't observe the prospective beta for 2010. You can't just look at it and there it is. All of the witnesses including Dr. Booth recognized that the calculated historical betas over the last decade or so have been very low and they don't provide a reasonable perspective of what the future beta is going to be. So the choice of beta requires judgment. So what Dr. Booth does is he uses his own judgment. He says, I come up with .5 based on my judgment. What Ms. McShane and Mr. Cicchetti do is they rely on data from independent investment research sources to estimate their beta. Mr. Cicchetti uses US data, Ms. McShane uses both Canadian and US data. Ms. McShane considered the beta to be .65 to .7, broadly consistent with Mr.

Cicchetti's beta of .66 to .69. So what you see when you look at that is Dr. Booth's beta analysis is very low. So we now have two very low inputs going into his model. In the results what you see is that his Cap M result of 7.75 percent, first of all, it's not consistent with the testimony and the analysis of any of the other witnesses. It's not consistent with his own DCF results, and it's kind of -- doesn't even comply with logic because it's proposing a declining cost of equity at the same time that the markets tell us the cost of equity is up. So Dr. Booth's result, his Cap M result of 7.75 percent is heavily weighted by his own judgmental considerations, is inconsistent with all of the other analysis and results. So I submit it's not -- his Cap M result does not provide any meaningful assistance to the Board in its deliberations concerning the appropriate cost of capital for Newfoundland Power.

So if you take those three propositions, then you've got to ask yourself, well, okay, where do we go next. What the Board needs to do next is apply sound public utility policy and its own existing policies. There's no precise number for the reasonable rate of return on equity. As the Board has previously recognized, there's a range of reasonableness as to the appropriate return on equity, and this Board has essentially adopted a range of about 75 to 80 basis points as the reasonable range of the cost of equity, and selecting the midpoint of that range is a reasonable approach in establishing the cost of equity for rate setting purposes. That's what the Board does. It then combines that with the embedded cost of debt, and the result produces a range of rate of return on rate base that gives you plus or minus 18 basis points. That's how you get the range.

So the Board then has to exercise its judgment as to where that appropriate 75 to 80 basis point range is going to fall, bearing in mind that the evidence before you suggests that the range of reasonable recommendations in this case falls within that range of about 9.8 percent to 11 percent, a range of about 120 basis points.

Now I take it one step further because my

friend, the consumer advocate, suggests that Ms. McShane's comparable earnings analysis upon which she placed 25 percent rate should be rejected because it hasn't been used by Canadian regulators, and Mr. Cicchetti took some issue with that, and I don't want to take time to debate that point, I simply observe that the result of eliminating consideration of the comparable earnings test would be to reduce Ms. McShane's recommendation to 10.75 percent. So that would then compress this range of reasonableness that you got to approximately 9.8 percent to 10.75 percent, which starts to get very close to the range that the Board has adopted of its 75 to 80 percent, 80 basis points range of reasonableness. So at the end of the date, the appropriate range of reasonableness is a matter of regulatory judgment, and the Board then should establish that appropriate range of reasonableness from the evidence before you and set the 2010 cost of capital accordingly, and that, in my respectful submission, is the approach which the Board reasonably and logically should follow as it assesses the

evidence that's now before it in this rate case on cost of capital issue.

Before leaving the cost of capital issue, I would like to say a few words about those binders of documents on the US companies that my friend, the consumer advocate, has tried to make so much out of. First of all, how does the issue arise, how do we get into these binders. It arises because an equity risk premium based DCF test or analysis, or a direct DCF analysis, requires a group of utilities of comparable low risk investment. You got to have something to compare it with. However, being a utility of comparable investment risk is not the same thing as being a utility with the same operating characteristics as another utility. All the cost of capital witnesses have said, including Dr. Booth, each company will have its own operating characteristics. You're not going to find another Newfoundland Power, just like you'll never find another Duke Energy or another Fortis Alberta.

Ms. McShane and Mr. Cicchetti were extensively cross-examined and each

demonstrated their substantial knowledge of US utilities. They repeatedly made the point that you cannot simply look at one isolated operating characteristic of a utility. One must consider how an investor would consider the overall investment risk of the company. Each of the witnesses repeatedly affirmed the comparability of their respective samples, and no witness ever said that any of these specific companies used in their samples were not comparable.

Mr. Cicchetti was asked by the consumer advocate to provide a DCF calculation using a small subset of the specific utilities from his original group. The problem with using such a small sample is the results become subject to statistical anomalies of that small group. Mr. Cicchetti never department from his position that his original sample was the most appropriate for his DCF analysis. The appropriateness of using US companies as reasonable comparators is demonstrated by two other important pieces of evidence before you.

The first is the evidence of Dr. Booth. Dr. Booth acknowledged that unlike Ms. McShane and Mr. Cicchetti, he didn't follow US utilities. However, Dr. Booth had sufficient confidence in the comparability of US utilities that he himself used the Standard and Poor's sample of US utilities as his comparator group for his own DCF analysis which he used as his reasonable check. Many of the companies in his sample are the same companies in the samples by Ms. McShane and Mr. Cicchetti. Certainly Dr. Booth, he's a professor of finance, would not have used US utilities in his DCF analysis to check reasonableness if he thought the use of US utilities is going to give an unreasonable result, so obviously he used them, he must have had confidence that using them is going to give a reasonable check.

The second point is that Moody's in assessing Newfoundland Power's risk profile, compares the company to a peer group of utilities which is predominantly made up of US operating companies, and so put simply, the consumer advocates rhetoric on this point doesn't make up for the lack of evidentiary basis to challenge the comparator group

selected by Ms. McShane, Mr. Cicchetti, and his own witness, Dr. Booth, for their respective DCF analysis. If you're going to challenge it, you've got to have evidence from somebody to say they're different, and nobody has done that.

So Mr. Chairman, those are my submissions on the cost of capital directly itself. I do want to say a few words about the automatic adjustment formula. Newfoundland Power has proposed discontinuing the use of the formula, as we go forward. Since 2010 is a test year, the formula would not be used to set the return on rate base for 2010, in any event. The Board considers the evidence on all of the 2010 forecast costs, including the forecast cost of capital. The Board then decides, based upon the evidence before it, what is the appropriate cost of capital for the test year. The issue is whether to discontinue the use of the formula in 2011 and beyond, assuming that 2011 is not itself a test year. The Board recognized in its original 1998 order that there could be changes in financial market conditions which would suggest that the

formula is not accurately reflecting the appropriate return on equity.

It's been accepted by all of the cost of capital experts that financial market conditions which existed in late 2008, at least through to the spring of this year, were such that the trigger for a review of the formula was met. The conditions for review undoubtedly existed when Newfoundland Power filed its application in May, and because of the continuing low returns on long Canada bonds, the formula is still not accurately reflecting the appropriate return on equity today. Currently the formula would yield a return on equity of less than 8.5 percent, while the evidence, as I discussed earlier, would clearly indicate that the cost of equity has risen and that the appropriate return of equity falls somewhere in that 9.8 to 11 percent range. So what to do.

Now this Board is not the only regulator that's grappling with that question. The National Energy Board has already concluded that it should discontinue the use of its automatic adjustment formula, and other

regulators are considering the matter.

The essential difficulty is that there's significant uncertainty as to the future relationship between the return on long Canada bonds and the appropriate return on equity. Mr. Simmons, the Board's counsel, sought guidance from the experts about revising the formula and got a wide range of divergent and very tentative suggestions. Currently no one has enough visibility on the future relationship among the key components of the formula to put forward a proper proposal to revise the automatic adjustment formula. Certainly Newfoundland Power does not pretend to be able to do so at this time.

So what we've done is we've proposed discontinuing the operation of the formula to current time. The Board can then revisit this issue at whatever time it considers appropriate, and if it considers it necessary to do so. That will allow time hopefully for the financial markets to stabilize, to see what other regulators choose to do, and to enable the stakeholders before the Board to consider what, if anything, should be done.

So that, Mr. Chairman, Commissioners, is our submission with respect to the use of the automatic adjustment formula, discontinuing its use at this time until we get some stability and certainty as to conditions going forward.

Next I turn to the issue of other post employment benefits, or OPEBs. Now this issue has been before the Board on a number of occasions since 2003. The company was requested by the Board to bring forward a proposal to move to the accrual method of accounting for OPEBs. In 2008, consideration of that proposal was deferred to this general rate application because in 2008 electricity prices had been driven up by the high cost of fuel at Holyrood. Since that time, those fuel prices have declined and the price of electricity has moderated. Now accounting for OPEBs on the accrual basis is now clearly the mainstream regulatory practise in Canada. Virtually all other Canadian utilities now use accrual accounting for OPEBs, including Newfoundland and Labrador Hydro. Even Mr. Todd, the consumer advocate's expert,

acknowledged that the accrual basis for accounting for OPEBs was appropriate.

The company has put forward a balanced approach designed to mitigate the immediate rate impact on customers. The company has proposed to move to accrual accounting in 2010, but deferring consideration of the transitional obligation to the next general rate application. If we put it all together now, all in now, that would require a rate increase of approximately 2.2 percent, while the company's proposal limits the immediate rate impact to approximately 1.3 percent. it also has the benefit of freezing the transitional obligation, which would otherwise continue to grow by approximately 6 to 7 million dollars a year.

The consumer advocate has now had the company's proposal with respect to OPEBs for several years, since we originally filed the last general rate application, and has had this specific proposal since May, yet the consumer advocate brought forward no evidentiary basis supporting any alternative proposal to deal with the OPEB issue. I have

to say, Mr. Chairman, frankly it is not good enough for the consumer's witness, Mr. Todd, to simply get on the stand and suggest that the matter should be further deferred and the company should be sent off to study some ill-defined alternative that would see the change to accrual accounting and the amortization of the traditional obligation dealt with together.

Deferral of the change to accrual accounting has several difficulties. First, accrual accounting provides a better matching of costs with the provision of service. Staying on the cash methodology continues to defer today's costs out into the future to be dealt with by tomorrow's rate payers. The transitional obligation would continue to grow by approximately 6 million dollars a year, and the second problem is deferred until when. There will never be a perfect time to deal with this issue. Currently oil prices are relatively stable, but where are they going to go in the future? I don't know the answer. Hydro may be back filing a general rate application in 2010, and Newfoundland Power

has its own costs which are being discussed going out into 2011.

There's been much discussion of the fact that Newfoundland Power is conducting a benefits review, but as Ms. Perry has testified, the extent of any changes and any cost impacts from that review are unknown at this time. If there are changes, they'll be reflected in future rates, and that will be the case whether we're on the cash method of accounting or on the accrual method of accounting. The accrual method adjusts for changes annual and continually trues up. As both she and Mr. Ludlow explained, it would not be appropriate to reduce benefits or impose additional costs on existing retirees, and I'm pleased to see the consumer advocate now seems to accept that proposition since he now suggests only a prospective forward change in OPEB entitlements at page 68 of his submissions. With respect to current employees, any changes are going to require notice, may require transitional arrangements, and may result in short term costs as Ms. Perry explained, and the whole process involves collective bargaining with our units, and at the end of the day there's no benefit to rate payers in reducing OPEB costs if the reduction is offset by other costs, such as increased salaries. So that's still a work in progress going forward, the benefits review.

So, Mr. Chairman, we believe that the Board should adopt the company's proposal with respect to accrual accounting effective January 1, 2010, and then defer consideration of the transitional obligation to the next general rate application. That's a balanced and constructive approach.

Next a quick word on operating costs, and I won't say very much. Grant Thornton reviewed them in detail and found nothing that would indicate that the 2010 forecast operating expenses are unreasonable on an overall basis. Mr. Smith's evidence was that since 2004 controllable operating costs have increased by only 4.5 percent. That's a pretty good record. There's no evidence on the record that any of Newfoundland Power's 2010 forecast operating costs are unreasonable. Newfoundland Power continues to

operate efficiently, ensuring an appropriate balance between cost and service, because we not only have got to provide efficient reliable service today, we must be ready to provide that service to our customers in the future, and Mr. Ludlow and Mr. Smith have described the steps that the company is taking to manage its workforce demographics through its apprenticeship program to ensure that it has the skilled workers to continue to service our customers in the future.

Now the consumer advocate raised the issue of Newfoundland Power's executive compensation. So as a result, we filed an expert report from Mr. Aboud and he came and testified. Mr. Aboud is from the HAY Group, and his report first of all confirms that Newfoundland Power's executive compensation continues to follow the principles already approved by the Board. It confirms that it's reasonable for Newfoundland Power to use the Canadian Commercial Industrial Group as the appropriate comparator, it confirms the use of the 50th percentile level, and it confirms that the pay values are within the normal

range of variances. Indeed the evidence discloses that the cost actually borne by rate payers falls significantly below that 50th percentile. The consumer advocate has offered no evidence that Newfoundland Power's executive compensation pay policies are unreasonable. The structure of Newfoundland Power's executive compensation arrangements have not changed since 1998, and as Mr. Ludlow has indicated, over the past decade the proportion of executive compensation to total labour costs has not materially changed. It's essentially the same. So Newfoundland Power submits that its forecast 2010 operating expenses are reasonable and should be approved by the Board.

Mr. Chairman, there were a group of other issues raised by the consumer advocate, and I'll deal with each of them very briefly. First with respect to inter-corporate transactions. That's really providing hurricane relief and secondments at fully embedded cost without additional markup. That has been accepted regulatory practise. It is, in fact, a win-win situation for both

customers and the utility. With respect to hurricane relief, it's simply the right thing to do to assist others if we can do so without additional cost to ourselves, and not only is it without additional cost to ourselves, the utility recovers the fully embedded cost of those employees. As Mr. Smith testified, when we need assistance, other utilities, including other Fortis utilities, will assist Newfoundland Power in the same way. Just imagine the disruption that would be caused to our customers and to the provincial economy, as a whole, if we were to be struck by an event like the Quebec ice storm. Similarly, secondments are a win-win situation in that they provide valuable experience, while recovering fully embedded costs for providing those employees. So that's the first issue.

The second issue raised was the amortization of regulatory costs from this hearing, and that's really a matter of regulatory judgment for the Board. As a matter of principle, the regulatory costs should be amortized over the likely period between GRAs. The evidence discloses that the rates from this GRA may not be in effect for more than a year. There are a large number of other amortizations that will expire next year, and at a minimum, an application relating to those expiring amortizations will be necessary in 2010. So it will be useful to have this amortization expire with all the others so that the Board can consider all of those amortizations together as a matter of regulatory efficiency. At the end of the day on this issue, it's a matter of regulatory judgment for the Board.

The Kenmount Road issue, the piece of property, the accounting for the sale proceeds for that piece of land has been dealt with in accordance with the existing regulatory accounting practise. It's important to note that the property sold was physically part of Newfoundland Power's Kenmount Road property. Because of its size and its location, as Ms. Perry explained, it couldn't practically be sold to anybody except to the adjoining owner, and until the adjoining owner wished to buy it, as a matter of law, it simply remained used and useful as part of the company's

Kenmount Road property. This is not a case, as suggested, for example, in the consumer advocate's authorities, he has one from California, that the utility needed to be incented not to engage in real estate speculation. Well, that's not Newfoundland Power, we don't engage in real estate speculation. The proceeds were properly accounted for in accordance with the company's existing code of accounts, and no retroactive alterations are necessary or appropriate to deal with that issue.

The Mobile River issue, as I said in my opening comments, this matter is not really properly before the Board in this proceeding and shouldn't be considered. The company will be required to apply to the Board under Section 48 of the Public Utilities Act if there is to be any transfer of the Mobile River undertaking. If that should occur, then that'll be the appropriate time to deal with any issue which arises, and until that time the issue is both hypothetical and premature.

Mr. Chairman, as I pointed out in my opening comments, there are a number of

matters, including the creation of the PEVDA account, which were agreed with the consumer advocate and these are set out in Section 6 of the Settlement Agreement. I'll just put that section on the screen for you. The rationale for the operating of the PEVDA account were explained by Ms. Perry in her testimony. The remaining items are relatively straightforward. I don't intend to discuss these items further at this time, unless the Board has any questions. Our written submissions outline the evidentiary basis supporting the Board's approval of these items where such approval by the Board is required.

Mr. Chairman, I'd like to just speak very briefly about the question of the timing of the Board's order which has arisen because there's some uncertainty. Under the Public Utilities Act, of course, the utility is entitled to earn its just and reasonable return on an annual basis, and, of course, the evidence is pretty clear that next year on its current rates, Newfoundland Power will not have an opportunity to earn its just and reasonable return, it's forecast to be 6.45

percent. So that the timing of the Board's order is obviously a matter of some importance. Practically, for the company to implement changes in rates for January 1st, it would need to receive the Board's order in about a month's time from today. Newfoundland Power knows and acknowledges that it may not be possible for the Board to issue its final detailed reasons within that time period, and if that turns out to be the case, if it's not possible for the Board to get out its fully developed order and all of its reasons by that time, then there appear to be probably three alternatives that the Board can reflect on. The first would be to issue its final order with limited or abbreviated reasons with more extensive reasons to follow if the Board wishes then to have more extensive reasons. So that's certainly one option available to the Board. The Board could consider issuing an interim order, kind of in advance of its final order, or if necessary, Newfoundland Power can apply for interim relief for January 1st, and I just thought we'd frame up for you those seem to be, at least to us, the three possible ways of proceeding that the Board will need to consider if you get to the stage that there's a timing difficulty in getting the order out.

Finally, Mr. Chairman, I'm almost at the end, just a quick comment on process. This general rate application was somewhat longer than our last general rate application, but it has still been much shorter and more efficient than general rate applications of a decade or so ago. The negotiation process did resolve some important issues, and certainly helped, at least to streamline the hearing process before you. I think we're in day nine, if my accounting is correct. Newfoundland Power remains committed to facilitated negotiations as part of the regulatory process, and we'd certainly like to thank Mr. Johnson, Mr. Earle, and Mr. Simmons, for their participation and assistance in that process.

Finally, Mr. Chairman, I'm at the end of my submissions. I'd like to -- on behalf of myself, Mr. Hayes, Newfoundland Power, I'd like to thank the Board, the Board's staff for their cooperation and patience throughout the

entire application process and throughout this hearing. Thank you very much, Mr. Chairman, Commissioners.

CHAIRMAN:

Q. You should thank you computer man too, boy, he did a good job.

KELLY, Q.C.:

Q. Thanks to Mr. Comerford.

CHAIRMAN:

Q. I'm going to recommend he be put on that bonus list that all the big top guns get. Would he like that?

KELLY, Q.C.:

Q. I'll make sure that that recommendation is referred, Mr. Chairman, to the appropriate --

CHAIRMAN:

Q. That'll be at the top of the decision, you know. I guess, next do we have questions or will we go to Mr. Johnson and come back to questions afterwards?

MR. JOHNSON:

Q. Whatever the Board prefers.

CHAIRMAN:

Q. My preference is to hear Mr. Johnson, and then -- I mean, I've got some questions. I guess,

will we have a break, or what do you want to do?

MR. JOHNSON:

Q. I'm prepared to go if you want.

CHAIRMAN:

Q. Carry on, sir.

MR. JOHNSON:

Q. Okay, thank you. Mr. Kelly has been attacking my rhetoric and he hasn't heard it. I mean, I have provided a brief, I cannot do what I did in the brief, and I'll tell you that the brief was our very considered opinion on these issues, with all references to transcripts, and I'm afraid I will not be able to do justice today, but what I will be able to do is give an outline and respond to Mr. Kelly's brief to some degree, something I didn't have a chance to do and to see if I could shed any further light on the issues without repeating what was in the brief. Mr. Kelly is absolutely correct. Both of us said at the beginning that it's the automatic adjustment formula and the cost to capital which is front and center in this. That hasn't changed through all of this, and your

role is an economic regulator, and the role is to achieve an appropriate balance between the shareholders of this company and the customers, as this Board has a tradition of doing, and I'll tell you right off the start that I completely agree with what Ms. McShane had to say in 2007. When we put that evidence before her, she said that the regulatory framework is frequently viewed as the most significant aspect of risk to which investors in a utility are exposed. She was correct then, she is correct today. She said that enlightened regulation will mitigate risks that are substantially beyond management's control and provide fair compensation for risks that are left with management. She could not have been more correct. That is why it was necessary to investigate in some detail what these utilities were in these binders.

Now Newfoundland Power, the fact is that they have been left with precious little risk, very little risk, so their return must reflect that. That's only fair. With respect to my friend's at Newfoundland Power, the mistake Newfoundland Power is making is that they see the myriad of regulatory mechanisms that have been extended to Newfoundland Power over the years as not transferring risk to the customers, but that is not the case. Like the PEVDA, the pension expense uncertainty doesn't disappear. When the uncertainty is taken off Newfoundland Power's lap, the uncertainty is just passed over to 230,000 odd customers, and if you don't recognize that as a risk transfer, and I have serious reason to believe that Newfoundland Power doesn't view it as a risk transfer, well, then you find it difficult to understand why customers need to get some benefit out of being passed all these risks.

You'll note in Newfoundland Power's brief when they refer to the establishment of the PEVDA, there's no need to go there, but at page E3, lines 13 to 14, they say the uncertainty of pension expense forecasting in current financial market conditions presents potential risks for both the company and its customers. They could have also added to that, so what we are going to do is transfer all of that risk to our customers. Now that's

how these accounts operate, and we've seen through CA-NP 189 the types of amounts that we're talking about, which have been very considerable back in '04, '05, '06, '07, had that account been put in place. These regulatory accounts, the regulatory supportiveness in this regime, contribute to this very low risk environment and that will only provide benefits to the customers that I represent if the risk adjusted return reflects this lower risk that's left with the company, and the PEVDA is a changer in this company's risk profile.

The management -- the shareholders of Newfoundland Power, are to be provided fair compensation for the risks that are left with them, no more, no less, and that's in keeping with the cost of service principle. The other key principle is that the applicant bears the onus to show the reasonableness and prudency of its test year expenses. That's a second fundamental principle. The third is that the regulation of utilities is there to benefit both the customer and the utility, with neither set of interests being emphasized in

complete disregard of the interests of the others. These are the principles that permeate the discussion of each of the issues remaining in this case to be decided by the Board.

I would like first to focus in for a moment on the cost of capital as its been presented in Newfoundland Power's brief. They make a statement at page 8, which is a crucial sort of statement, and they say that, "The depths of economic analysis, methodological scope, and breadth of comparative data, underpinning Ms. McShane's recommendation, quality if to be given the greatest weight by the Board in its determination of a fair return on equity for Newfoundland Power in 2010". That is nothing but a broad conclusory statement. It's words on a page. Look at the idea that her economic analysis affords a greater weight to her report before this Board, and to her evidence before the Board. With all due respect to Ms. McShane, where is the economic analysis. I mean, I have looked at her report. It's worth your while to look at the Table of Contents in Ms. McShane's

report. There is precious little identified in the Table of Contents that gets into what the economic analysis is. It's basically bereft of economic analysis.

Mr. Cicchetti's report, I think he spends a page or two at the most talking about economic analysis. The only economic analysis, and certainly the economic analysis that had the more substance to it, it was clear to anybody who was in this hearing, came from Dr. Laurence Booth, from the Rotman School of Management, who was called by me. His report has a section called "Financial and Economic Outlook". It runs from page 8 to 30. The very first thing his report looks at is the current economic and capital market conditions. He addresses what the current market conditions are at present. He discusses that for eight or nine pages, he discusses the outlook for inflation, he discusses the interest rate forecast, he discusses what the recent state of capital markets has been, he discusses how the state of the economy affects profits and the capital market. He refers to the credit rating agency and their contributions to the financial crisis that occurred, he discusses where we are in the business cycle, he discussed whether data on profitability has implications for the fair ROE. He points that for the whole period from 1988 to 2008, the average Stats Canada corporate ROE was 9.1 percent, and the median was 9.88 percent. It's Dr. Booth's evidence that has the depth of economic analysis, not Ms. McShane, and certainly not Mr. Cicchetti.

The next statement is even harder to understand, and that is that Ms. McShane's methodological scope underpinning her recommendation qualifies it to be given the greatest weight. Now Commissioners, that would be to suggest, I presume, that Ms. McShane's use of comparable earnings somehow would entitle her to extra, like, bonus points or something before this Board. That is a ridiculous assertion. This is a test that not only has it not been accepted by the Canadian regulator in years, it's a test that Dr. Booth does not teach to his students as a valid estimation technique, and it's one that Mr.

Cicchetti says has no place in this proceeding. Now how in the world can you use that as part of the basis for giving her extra weight. Perhaps then it's her methodological scope advantage by the fact that she uses these adjusted betas. She takes the raw or McShane beta, as she put it in her evidence, and then somehow grosses it up to .65 to .70. That can't be surely what entitles her to further weight because we know from the record that that has never been accepted either by a Canadian regulator, and most recently it was said by the NEB in the TQM decision, which for the record is at CA-NP 201, that they don't buy the premise that these utilities betas revert one, and they said for that reason we don't put weight on adjusted betas. So surely Ms. McShane can't get marks for that.

So that's two of the methodologies that's been discredited. Then we have McShane's use of the DCF in her US data. She uses the DCF once with the US data, and she turns around again and uses it again as part of her risk premium analysis. I mean, it begs the question if Ms. McShane were to come up with

another way to use DCF and advise the Board, would she get more weight. I mean, these are statements that do not hold up to serious scrutiny.

What you have to consider is whether Ms. McShane gave appropriate weight to the appropriate test and whether what she had to say was useful and hung together, and I, with all respect, do not think that it did. Rather interestingly, it's the Cap M that Dr. Booth uses that the TQM decision says, yes, that's the one we think reflects a fair return for utilities. I mean, those are the facts. I'm not making that up. It's interesting, Commissioners, that even if -- even if you were to say, okay, Ms. McShane, we're going to accept your adjusted betas, and even if you were to say I'm going to accept the 6.75 percent market risk premium that has her up in the upper bubbles of Dr. Booth's survey, you would still - you would still get to 8.75 percent, plus she has to add a flotation of 50 basis points. So what does that tell you. You know what it tells me; it makes no wonder she's got to use the breadth of methodological

scope that she uses because it's the only way on Heaven's earth that you can get to the type of numbers that she recommends for Newfoundland Power, because even if you accept her huge market risk premium, accepts her adjusted betas, you just don't get there.

Now in our view, the suggestion as well that it's the breadth of comparative data - this is the third thing that Newfoundland Power says, "The breadth of comparative underpinning Ms. McShane's recommendation that also qualifies her evidence to be given the greatest weight in view of Newfoundland Power". Now presumably this is where the heavy reliance on the US data comes in. Not only does Newfoundland Power and Ms. McShane expect the Board to apply this US ROE data from these US companies, but they tell the Board that it should be applied without need to make any adjustment whatsoever. I mean, that is a rather bold assertion. In other words, Newfoundland Power does not wish for this Board to be spending any time looking at the details of these US companies. Actually, Newfoundland Power is a bit dismissive to me in their brief because they say things like, well, much time in the hearing was devoted to discussing specifics of these companies. I mean, that speaks for "you wasted our time". I didn't waste your time, Commissioners, because I do not think that this Board should be flying at 10,000 feet when its determining whether these companies are comparable to the Newfoundland Power situation, and that's exactly what we would have been doing had we not had a sensible discussion about what these US companies are, what are their non-regulated operations, what sort of accounts do they have, where do they carry on business, is their regulation supportive, the types of things that equity investors actually care about. Otherwise, all we would have been told is that, yeah, they're all pretty much rated the same way, let's get on with it. That's clearly what Mr. Cicchetti's view came to be during the hearing, and I don't believe, with all greatest respect, that the Board should accept, without testing in any serious or meaningful way, the evidence emanating out of these witnesses US samples. This is why I

find it interesting that I say that the onus is on Newfoundland Power to establish to you why no adjustments need be made to this US data, and I find it interesting that the National Energy Board in its TQM decision at page 68, for the record, stated that the Board would have benefited from additional information on the comparability of US LDCs with TQM. I mean, this is precisely the type of things that regulators have to be interested in, and we believe that this Board has been provided with the type of information that it can benefit from in determining whether this US data can be used without adjustment.

TQM also said that they found that the US companies were informative, but they also said that risk differences between Canada and the United States can be understood and accounted for. That's what they said, they can be understood and accounted for. So Ms. McShane and Mr. Cicchetti, they do not recognize that there is any risk difference between carrying on operations in Canada and the United States. So it's not much point asking them how these

differences can be understood and accounted for. They're of no assistance to the Board on that. They just say accept it, apply it, don't adjust it.

Dr. Booth, he testified -- I thought he did a tremendous job before the Board. He was clear, he was cogent, responsive, and he indicated to this Board that he's taught international finance at the University of Toronto for fifteen years, and he said it's a basic, you cannot take either interest rates or fair rates of return from one market and apply them to another without making serious adjustments. I think that that is only commonsense.

Let's put it this way, Commissioners. Let's say you have amassed $100,000.00 and you're looking to put some money away for your retirement purposes. Now you're looking at Newfoundland Power. It has the benefit of a rate stabilization account, municipal tax increases get picked up through the rates every July, weather normalization, energy supply cost variance reserve accounts, elasticity allowance factors, a forward

looking test year, pre-approval of capital budgets, a PEVDA, an excellent competition profile, no exposure to industrial customers, and it carries on under a regulatory construct that Mr. Cicchetti described as exceptional and phenomenal in terms of its regulatory supportiveness. On top of that, Newfoundland Power is a T & D type of utility which is generally seen to be the least risk among the electric utilities, and Newfoundland Power's parent, Fortis, as I indicated in my brief, has indicated that the single biggest business risk is regulatory risk. They say it right in their 2000 annual report. Now I ask you, if you were to divide up your $100,000.00 into several $10,000.00 lots, and you want to ensure yourself of making a return of 6 percent, I don't think you'd have much worry - I just use that figure, I don't think you'd have much worry about Newfoundland Power letting you down because they don't let you down, they've got so many protections. Now you think about putting it in SCANA, FPL, or Dominion, all these US vertically integrated utilities with these non-regulated sides, et cetera. Think about FPL where there's political uncertainty, where the Governor is getting rid of the Commissioners if they were to vote in favour of an increase for the utility. You have SCANA in South Carolina, 600,000 customers is what South Carolina Electric and Gas has, and they are in the midst of a share of a nuclear project of 4. 5 billion dollars, to the point that it's been said that their business risk and operating risk has been elevated on account of getting involved with this project. Or you have Dominion, who carries on operations in West Virginia, Ohio, and Pennsylvania, these SRE 3 states, which are in a category with Chile, the Czech Republic, the Estonia, and Latvia, and they're also into merchant generation.

Now you may look at this and say, look, one of these guys is going to miss the 6 percent. You going to want 8 or 9 percent from some of these guys to make up for the ones who might miss. This is how an equity investor thinks. You are going to rest on the idea that they all have the same bond ratings. You're not lending this utility this money,

you're not buying their bonds, you're buying their stock, and the experts have told you, and particularly Dr. Booth, that bond investors and equity investors march to somewhat different drums, and you hardly ever see in an equity analyst's report someone talking about the bond rating. That's the evidence that we have before us, and we can't divorce ourself by staying up at 10,000 feet and pretending that once they have the same bond rating, that it's just off to the races, they're all the same. Moody's, which rates Newfoundland Power's debt, has told us in black and white that they would only consider US utilities that are into transmission distribution as being a low risk environment, as a for instance.

Now as I've indicated, Dr. Booth has said you cannot take these figures and apply them without judgment, and I find it interesting that Newfoundland Power has indicated in their brief at page C-31 that there's no expert evidence on the record which indicates that these specific utilities are not comparable from an overall risk perspective. Now you

heard Dr. Booth say you can't take them without making adjustments, and I'm wondering what is Newfoundland Power getting at with that type of statement. I mean, it seems to me that Newfoundland Power is forgetting that this Board, like the NEB, is a specialized tribunal which is charged with determining a proper return for Newfoundland Power, and because Ms. McShane and Mr. Cicchetti won't admit that their sample might be suspect, that the Board is stuck with that. I mean, that's preposterous. That would be like three finance experts coming in here telling the Board that it should accept adjusted betas of the form that Ms. McShane develops, and you look at that and say, but in cross-examination, it was determined that no one ever uses them because of the problem. So are you bound to accept these witnesses. I mean, that's just a silly proposition.

I'd also turn to the statement that Newfoundland Power makes in its brief at page C-28, that they state that Ms. McShane and Mr. Cicchetti have indicated that current market conditions have increased utilities cost of

capital and reflected this in their recommendations on a rate of return for equity for Newfoundland Power in 2010. Now just hold on a moment now because this is another one of these statements that you've got to look at and analyze. We have seen in this proceeding Ms. McShane tell us in her report that there was a flight to quality, as they put it, which pushed the actual yield and forecast yields on long term government bonds lower during 2008, and other indications which were signalling, as she put it in her report, a higher cost of capital, and specifically she refers to the fact at page 11 of her report that between November, '07 and November '08, the yield or long term A rated utility bonds jumped 180 basis points in terms of the spread. Now we have Ms. McShane saying that at the end of March of 2009 the spreads were about 345 points, signalling a higher cost of capital. Now at the time she prepared her evidence, which was filed on May 28th, '09, she figured that by the time the hearing rolled around that the spreads would be 225 to 250 basis points by the time of the hearing, but by the

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time of the hearing the spreads on A rated bonds were down to about 170 basis points. Now do you recall how this material decrease in the A bonds spread affected her recommendation on a return of equity for Newfoundland Power in 2010; it didn't, it had nothing to do with it, it got all washed out in her variety of tests. I mean, there's a disconnect between what's put forward and what actually transpired in this case in terms of the evidence. Ms. McShane went further. She said that if by the time of the hearing the A spreads would have gone up to 350 basis points, in other words, higher than they had been in March, the fair ROE would have only increased by 6 basis points, so her recommendation would still be 11 percent. Ms. McShane is the person on the one hand who says that the bond spreads signal a higher cost to capital, but when the bond spreads come down lower, you see no change in her recommendation. She was also the witness who talked about the Montreal volatility index in her report as signalling -- that was an indicator she said of rising investor risk

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aversion and a rising market risk premium. That's what her report says. Well, lo and behold, when the hearing comes around and the Montreal volatility index is back down to levels that we've seen from 2002 to 2007, does she revise her recommendation for Newfoundland Power's cost of equity; no, it's still 11 percent. No matter what happens, it's 11 percent. This surely is not what Newfoundland Power means when they say that she has reflected current market conditions in her cost of capital and reflected this in her recommendations for a return on equity. That doesn't stand up.

Now on the point of the cost of debt being related to the cost of equity, I cannot speak any better than Dr. Laurence Booth did on this topic, and I won't presume to, but I would address the Board's attention to what he said on October 21st in the transcript at page 180, where he talked about how they marched to different drummers, and I'll just leave that there for the Board's reference. The suggestion as well that Dr. Booth puts an informada of some credibility on this US data

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because he uses it in his report to have a check, I mean, he testified before the Board that he's sort of been dragged into looking at this because he's got to confront it in hearings with all this US data coming up from the States. That's the context that he looked at.

The suggestion as well that Mr. Kelly made that even Dr. Booth said that the risk premium would increase in 2010, what Dr. Booth said would increase in 2010 was the beta, because he said you can't expect that the beta values that were present in 2009 were going to persist because once that gets -- these stocks being low risk defensive stocks, you can't expect that they'll have low betas like they had, as observed statistically in '09. That's what the man said.

I think in all seriousness, we can put very little weight on what Mr. Cicchetti said. He doesn't do much of an economic analysis, he confuses Canada with the United States when he was testifying in terms of the banking industry, the housing, he's totally wedded to this US data, you couldn't get him to -- you

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couldn't get him to point out any single one of his companies that had business risks and regulatory risks as good as Newfoundland Power. What does that tell you, what sort of confidence can you to have to just apply his numbers. The only interesting thing that comes out of his evidence is the fact that you really have to make adjustments at the end of the day, and I think it's rather interesting that when he takes his sample and brings it down to the value line one safety rating companies, how dramatically it decreases his rate of return recommendation, and he was the one who testified when Mr. Simmons was questioning him that he felt that if he did so and shrunk the sample, that he didn't view it as being a problem with the validity of what he had to say. Those were his words.

With respect as well to the interest coverage issue, I'm at a loss to understand frankly how Dr. Booth could be accused of not being adequately aware of interest coverage. Dr. Booth testified very clearly that he's not aware, and this is in an RFI, he's not aware of any financial theory that states that you

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take a particular times interest earned ratio and then key in your ROE off of that, and I find it interesting that actually when Ms. Perry was examined by Mr. Simmons on October 19th at page 135, she was quick to point out that fair return is a separate issue, and she was quick to point it out because Mr. Simmons had pointed out to her that their credit metric weren't too bad based on either the formula or eve the status quo, so, no, no, no, you know, that's a different issue now, fair return is a different issue. I mean, the evidence, Commissioners, is that Newfoundland Power at 2010E, in other words, just -- they don't get anything. They have a cash flow interest coverage of 2.8 times, just a bit below 2009's 3.1. Now Moody's anticipates that their cash flow interest coverage stays above 3. Now clearly they don't have to be anywhere near 11 percent to achieve that, and actually if -- their 8.5, if they remain on a cash basis, will achieve more than needed because you get the 3.19 as opposed to the 3 that Moody's is anticipating that they will have. So we see no reason to say that Dr.

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Booth's recommendation is problematic. We also note that Moody's has indicated that they anticipate that Newfoundland Power's CFO pre-working capital to debt ratio will remain in the 15 to 16 percent range. So already 2010E shows that they're at 13.1, and at 8.5 percent, they would be at 16.7 percent. So, you know, there is no way, if you read Moody's, that you conclude that they are indicating that they need this giant sized ROE, it's just not there. With respect to Newfoundland Power, they do not recognize what Moody's has clearly stated in black and white, and that is Moody's does not expect, nor have they expected Newfoundland Power to have the same credit metricise as their peers, full stop. Newfoundland Power would have us getting into a situation where they actually get upgraded because if you look at Moody's last credit rating, they say what would cause their rating to go up; well, if they went to 4, yeah, we might look at an upgrade. Newfoundland Power doesn't need an upgrade, full stop on that.

Regarding the AAF, the undertaking that

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was filed yesterday indicated that the AAF would provide a forecast cost of common equity of nearly 8 and a half percent, or 8. 48 percent. it was 8.6 percent in 2007, 8. 95 percent as part of a negotiated agreement in 2008, and with a strengthening economy, the yield is forecast to increase by both -- the long Canada bond yield, it's forecast to increase by both Dr. Booth and Ms. McShane, and with it the allowed ROE under the AAF. So what we are seeing is simply the impact of the business cycle, which Dr. Booth addressed with the Board. We see no valid reason to suspend the operation of the AAF. If the Board is minded to suspend the operation of the AAF, we would request that the Board consider timelines as to what will happen next so that there's some certainty brought to that piece if the Board goes there.

Referring now to OPEBs. We're not running away from OPEBs. I want to make that perfectly clear to the Board. It's not hide and seek with the Board. Every time we get close to dealing with it, we throw up another obstacle, because that's the characterization

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that I'm getting from what Newfoundland Power had to say today. What we're getting at is that there's a couple of things that's got to be considered.

The OPEBs figure, as we've indicated in the brief, just on an annual basis, is a huge figure. I mean, we've seen it increase during the course of the hearing by a huge amount, and we're looking down the road and seeing step two as being another huge figure coming. We think probably 11 million bucks a year. That is a lot of scratch and it's dangerous to start taking one step at a time without having a full appreciation for the full piece. That's our fundamental point. Grant Thornton has indicated that there is a variability with OPEBs that you've got to keep your eye on. They're dead right.

We are also indicating to the Board that it's easy for Newfoundland Power to be in a hurry when they're not the one paying the tab on the OPEBs question, and with all due respect, they are forgetting what's going to be happening in the review for 2010 and the real life implication that that has for people

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like Ms. Heisz was talking about earlier today. I mean, goodness gracious, we're talking about accruing an amount that'll have what, six-seven million dollars in rates for this OPEBs amount in 2010, when this OPEBs question for retirees is in dire need of reform. It's clear. I mean, we've said in our brief, companies have been doing it. They've either done it or are going to do it, and we have a serious objection with (a) throwing all this variability into the pot and then (b) not having a full and complete picture of what the actual true OPEBs cost is going to look like. I mean, we've indicated that if they do a relatively modest change to the future retiree OPEBs cost, you're talking two and a half million dollars per year. It would reduce the overall obligation just by doing that modest change of about 10 or 12 million dollars, as I've indicated in my brief. I mean, this is real money that comes out of real people's pockets, and at this stage of the game, make no wonder we're not in a hurry to bite off something like that, given the fact that we have every reason to believe

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that that figure is going to come down considerably once a sensible review gets done.

So I think that obviously this is a matter for the Board's determination. We respect that, but we think that there is certainly a number of countervailing considerations before rushing headlong into it, particularly given the landscape in 2010.

The intercorporate transactions. Essentially, the way we--the view that we take of this matter is that the company receiving the fully distributed cost back for all these hurricane efforts for these Fortis utilities, all that does, that's the bare minimum that you'd have to do, because all that does is protect Newfoundland Power's customers from taking a bath. I mean, you got to do that. The question that the Board has to ask itself is whether it's reasonable, given the fact that Newfoundland Power, let's face it, is a net provider of these services and we've seen years where it's been 16-17,000 hours to the benefit of Fortis and its shareholders. I mean, it's not, God bless them, the good people in Belize. It's the Fortis

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shareholders that are getting quite a lift out of this. They're getting skilled people from Newfoundland to go down and fix 'er up in the Caribbean. They're ameliorating a significant business risk of operating in the Caribbean with Newfoundland Power personnel. I mean, when we had our storm in Bonavista, we paid market rates. That's life. And I don't think, with all due respect to Newfoundland Power, that you should allow the possibility, and I must say, I would suspect it's remote, the remote possibility of a linesperson coming up from Belize or the Grand Cayman to help us, as being an indication that maybe, yeah, we'll just keep on going with this cost-based system. I don't think that that is realistic, and what bothers me is the lack of reciprocity. If I had some sense that there was going to be some reciprocity, I wouldn't feel so strongly about this. But there is not.

The same thing really goes for the secondments. In one of the paragraphs in my brief, I showed you what the line was in terms of money that was coming into Newfoundland

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Power for Newfoundland Power getting people from other companies in the Fortis family on secondment. Zero. It's dash, dash, dash, dash, dash, dash for years. I mean, we have been a net provider of Newfoundland Power personnel, and that's the fact, and frankly, I think the recent evidence is that lots of times the people who get seconded, they just keep on going on with the Fortis company. We have one example where the guy who was backfilling for the person who was gone to Fortis on secondment, he ended up going to. So the theory, and it's a nice theory, the theory that we're getting a lift because these people all come back to Newfoundland Power with these new skills is really only a theory and it's not panning out enough to just leave good enough as it is. So that's why we think we need some reform, recognizing, Commissioners, as I'm sure you do, that these intercorporate transactions provide a unique challenge because there is no real economic incentive to charge the market rate for these services.

With respect to executive compensation,

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again, as I pointed out at the beginning, this is one where the company bears an onus. It's an operating expense item, like any other, and I want to make it clear, this is not personal to any of the incumbents of the executive team at Newfoundland Power, okay. It has nothing to do with that. What is at issue in this case is whether Newfoundland Power can establish and has established that Newfoundland Power competes for its executive resources with organizations across the breadth and depth of business sectors across Canada. That's at issue, and that's a linchpin issues, as it would be if Newfoundland Power came in and said "we have got to compete across all these other utilities in other provinces for line technicians." We would go through the same analysis. We would be asking "where are you getting your line technicians from? Where are you losing them to? How are they joining your organization?" It's no different.

I'm reminded by the Hay Group report of the analogy in a Court where you see these actuaries coming in and they have a bunch of

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assumptions, and the Judges always say, well, look, we'll hear you and the report will be, at the end of the day, as good as the assumptions. If the facts support what you said to be an assumption, your report is going to be used. If it's not, forget it. And essentially, there's nothing wrong with the Hay Group and how they go about it. The problem is how it's applied to Newfoundland Power. There is simply no evidence that they actually compete in that sector for their talent. The evidence goes the other way, and when Mr. Aboud was asked on it in cross-examination as to whether he's done any testing to determine whether Newfoundland Power competes across the breadth and depth, I mean, we just got nowhere. It was bob and weave, because there is no evidence. We've seen how Newfoundland Power gets its executives. They come in at the management--they get into middle management. These people are paid, according to the cross-examination of Mr. Aboud, at the 25th--which works out to be the Atlantic Canada, which is 25th percentile of the national level, and they

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become executives. That's how it happens.

So I mean, all we're saying, we're not denying that this has been in place a long time, but I think we've had a long time to see that the underlying assumption has not been borne out in the true facts.

Finally, I guess, it's not happy for us to tell you that you have to look at what Mr. Aboud said with a lot of scrutiny, and I thought that P25 business was a good example of that, in that he would have known that the P25 figure that he brought to the Board's attention included an LTI which was a totally shareholder paid amount, but the impression was left that, you know, we were comparing apples to apples, but we were not, and that causes me, to be quite honest with you, to have grave concern about how much we can rely on Mr. Aboud's evidence.

I have also addressed in my brief the operational cost reductions and efficiencies that should be considered. This is a GRA. This is where these matters get tested. That's what we're supposed to do, and there are issues that we raise in our brief where it

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seems to us that some of these operating expenses could be moderated. I think the example of the bad collection amount, I grant you it's inexact, but the existing methodology produced large variances the last time. The brief is there to provide the references to our arguments on these matters and I won't labour them.

Similarly, the proposed one-year amortization of Board and Consumer Advocate costs relating to this application. I think John Todd did a wonderful job of explaining why it was best to amortize these over three years. I think it made perfect sense, and I commend to the Board his evidence in that regard.

The Kenmount Road property. We have provided some backup decisions from other--or references to decisions by other regulators where they say, look, these properties that go into rate base that were sort of being banked for future purposes, they can go into rate base, but at the end of the day, there's got to be some sort of fairness achieved as between the utility and the customer as to how the gain is handled, and you know, we've seen in this case that the customer paid a return on this property for years and years and years, and then when it gets sold in 2009, and 2009 is not over yet, but when it gets sold in 2009, the customer doesn't get any benefit of that, and you know, we have indicated and give some basis to the argument that there can be adjustments made above the line, as Mr. John Todd pointed out. I mean, it puts the customer in a very, very awkward situation because you're operating under the assumption that this property is used. I mean, we're not going around checking surveys and deeds and asking the question, you know, are you all using everything you got every time. So to then turn around and see that a piece of property gets sold and just booked as though it's in the normal course, it's--I think it leaves a little bit to be desired frankly, and I don't think it achieves equity and a just result with the customers.

The Mobile River Watershed dispute, I'm not going to spend too much time talking about that. My only concern, my only concern is

that at the end of the day, I'm wary of the result that we end up being in a situation where the consumer is told, b'y, thanks for paying the freight on fighting this case. It will end up, presumably, potentially benefiting the shareholder, but don't look for your cost back. That's what I'm trying to avoid. If the Board feels that that result can be avoided without setting up some sort of deferral account now, I'm all over it. But that's what I'm trying to avoid by suggesting that there be some sort of protection for the customer, because ordinarily a benefit that only goes to the shareholder should not be coming from customers' rates to actually fund the litigation to get that benefit. That's my concern.

Commissioners, you have the benefit of our brief on all of these issues. I would like to say, as a final point, that I am cognizant of the fact that the Board is under a challenging regulatory calendar, as I understand it, with some anticipated applications. From our point of view, we recognize one of the possibilities is that, as

Newfoundland Power indicates, that the Board may wish to issue a short order outlining its decision, but perhaps not with the full complement of reasons that you would normally expect. Given the present circumstances, we would not be opposed to that. You know, presumably the full reasons would follow in a reasonable amount of time. So we're not particularly opposed to that, if the Board feels that that's something that it's comfortable with doing. We presume that you'll have deliberated enough to feel comfortable to do it and if that's your comfort level, I think that's fine.

I would also be remiss if I didn't thank the Commissioners and Commission staff and my colleagues at Newfoundland Power and my colleague, Mr. Earle. I think that it's unfortunate that customers don't come in and get a chance to see this. They've got busy lives, but I think that they would have witnessed an excellent hearing, a hearing where there was a clash of ideas and perspectives put before the Board for your consideration, and I think that that bodes

well and I'd like to thank everybody for their participation in that. Thank you.

CHAIRMAN:

Q. I guess just as well to finish it off, isn't it? You got any questions or any comment?

MR. SIMMONS:

Q. No, I have nothing. Thank you, Chairman.

CHAIRMAN:

Q. Okay. Do you have any?

COMMISSIONER NEWMAN:

Q. No, I don't have any questions.

VICE-CHAIR WHALEN:

Q. No questions. Thanks to you both.

CHAIRMAN:

Q. I got some questions, I guess, and I'll seek guidance from--I note as well there's seven lawyers in the room, so I'm suitably intimidated, but with respect to this whole comparable earnings issue and the DCF, I mean, given the lack of regulatory respect that's paid to it in Canada, I mean, what's--what purpose does it serve, I suppose, to spend so much time discussing it? I mean, I guess I'd ask you, Mr. Kelly, and Mr. Johnson can certainly -

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KELLY, Q.C.
Q. I'll start, Mr. Chairman. All of the cost of
capital witnesses use various mechanisms to
both determine their initial analysis and to
then determine the reasonableness of whatever
results you get and the judgments that you do,
that you get out of it. Keep in mind that
what you're trying to capture here is the
return on investments of comparable risk. So
it does make logical sense, not only to look
at the utility market, but to look at
comparable non-regulated companies. If what
we're trying to do is to say, okay, we're
looking at a regulated situation. Well,
regulation, in economic theory, is a proxy for
getting at what the markets will otherwise
give you and if you only look at what Canadian
regulators do, and if you only looked at what
American regulators would do, you never get
behind enough of the economic theory to see,
well, what do actual financial markets
generate. So it's a useful cross check
mechanism, not only for the cost of capital
experts, but it should also be for the
economic regulators themselves to see whether

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the results that they're getting give you the
right answers.
Ms. McShane, therefore, tells you--gives
you the information, gives you, as the
regulator, the information and she tells you
exactly what weight she's put on it. So you
know exactly what factor goes into it.
Otherwise, if you simply say, well, I'm going
to do an analysis and I'm going to give some
weight to other factors, I'm going to apply
some smell test, to use Dr. Booth's
terminology, then you, as the regulator, have
no basis to be able to judge what that was
worth to get behind the concepts and to get
at, well, what would you expect markets to
give you, and Ms. McShane, in her evidence,
tells you, well, if you don't use comparable
earnings, but you've got the information, you
can work out that it'll be 10.75 percent. So
you've got all the information to say, well,
I'm going to use these results. This is what
I'll have out of it. So kind of a long way
around, but certainly the principle behind it
is that comparable earnings is ultimately what
you're trying to get at, the comparable

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earnings of what an unregulated market induced
rate would be.
CHAIRMAN:
Q. Do you have any comment, Mr. Johnson?
MR. JOHNSON:
Q. Well, just one comment in terms of the
weighting. Ms. McShane gives 25 percent to
comparable earnings. She does two DCFs,
because she explained that 75 percent of--
after you take out the comparable earnings,
there's 75 percent left, right, and then what
she basically says is that I give half to DCF
and then half to the other group, but that
also includes DCF, and I think it's--I can't
see on what basis there is an advantage to
these methodologies. Certainly, they don't
qualify for extra weight, given the fact that,
I mean, Dr. Booth doesn't teach it. Mr.
Cicchetti said don't use it, don't go near it,
and with the DCF, as you've seen, the model
hasn't been used in so many years and the GIGO
factor that Dr. Booth talks about, that's the
biggest problem. DCF is a model, but it's
GIGO.
CHAIRMAN:

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Q. Like if we were in a Court of law, would a
judge say "I don't want to hear this stuff,
because we've made a prior decision that
we're--you know, we're not interested in
comparable earnings," -
KELLY, Q.C.
Q. The answer -
CHAIRMAN:
Q. - or would he hear it or she hear it, I guess?
KELLY, Q.C.
Q. No, with respect, Mr. Chairman, the premise to
your question is incorrect, if I may.
CHAIRMAN:
Q. Okay. No, I mean, I'm just asking. I don't
understand. I'm asking questions.
KELLY, Q.C.
Q. In a Court of law, in a civil case, the Judge
is deciding strictly upon the evidence and is
bound by precedent decisions to a large
extent.
CHAIRMAN:
Q. Yes.
KELLY, Q.C.
Q. A regulatory board has the ability to decide
policy issues and to revisit--it's not bound

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

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

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

CHAIRMAN:

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

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

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

KELLY, Q.C.

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

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

CHAIRMAN:

Q. Yeah.

KELLY, Q.C.

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

CHAIRMAN:

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

MR. JOHNSON:

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

CHAIRMAN:

Q. I thought -

MR. JOHNSON:

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

CHAIRMAN:

Q. Oh.

KELLY, Q.C.

Q. I don't know if they were -

CHAIRMAN:

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

KELLY, Q.C.

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

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that question with an undertaking, if that was of assistance.

CHAIRMAN:

Q. But I want--yeah, I mean, I want your comments.

KELLY, Q.C.

Q. Just as a general proposition, what regulators in Canada are doing is are looking to the markets for the guidance as to what the appropriate return should be, but keeping in mind that regulation in Canada, all of the utilities are regulated. There's an element of circularity in it, so hence, you have to use tests like the DCF test and the equity market risk premium test to try to get that proxy, and at the end of the day, when you look at all of the evidence, that's the evidence that was brought before you. Ms. McShane looked at Canadian and US. Mr. Cicchetti looked at the US and this is the range that you get. Fortis, for example, has other interests other than simply the utility interests and it has--it's affected obviously by -

CHAIRMAN:

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Q. But which company is riskier? Is Fortis riskier than Newfoundland Power?

KELLY, Q.C.

Q. Well -

CHAIRMAN:

Q. Or is Newfoundland Power riskier than Fortis?

KELLY, Q.C.

Q. - Newfoundland Power is your typical low risk utility as the witnesses have said. The relative risk of Newfoundland Power hasn't changed relative to other utilities. It would be difficult for me to comment on the implication of your question, because you're taking it based upon a conclusion as to a number out of that report. So if you wish me to go that far, I'd prefer to do it in an undertaking response.

CHAIRMAN:

Q. Oh yeah, no, I mean, I don't understand. I mean, I'll be perfectly blunt, that's why I'm asking the question. You talked about the smell test. I mean, how--you know, when you look at Newfoundland Power and seeking a rate of return of 11 percent and then you look at Fortis, as I say, and you got these two rating

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agencies saying you're going to earn 8.3 and 8.5 next year return on equity, and they got interest coverage in one case, and this is in Fortis' annual report, I think I saw that, that the interest coverage on debt for 2008 was 1.9, and I mean, you know, how do you square that circle? I don't--and I mean, I guess that's the question I've got to you, Mr. Kelly, to tell me, you know, what is the difference? I mean, what are the credit metrics, for instance, that Fortis has versus Newfoundland Power's and why is--it appears to me that Fortis investors who own Newfoundland Power expect a higher rate of return from Newfoundland Power than they do from Fortis itself, yet it would appear to me, and as I say, appear, and I want to hear your comments on it, that Fortis is probably, because it has some non-regulated activities, would be perceived in the market as a riskier enterprise. But, apparently the investors in Fortis are satisfied with 8.5, you know, as I say, outperform, buy, hold, whatever. So I just leave it with you, but it's kind of, you know.

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KELLY, Q.C.

Q. Couple of comments. I suspect that in that number there are a number of adjustments that have to be made to make it comparable to Newfoundland Power, so that you're really comparing apples and apples. Take for example interest coverage. I'm not sure exactly which metric is being referred to in what you're saying.

CHAIRMAN:

Q. No, and I'm not either, and that's why--yeah.

KELLY, Q.C.

Q. But like, for example, if pre-tax interest coverage was 1.3 percent and Newfoundland Power had to operate with 1.3 percent, literally the lights would go out.

CHAIRMAN:

Q. Yeah.

KELLY, Q.C.

Q. Because you could never go out and issue bonds and be able to keep the lights on in the province. So you have to be very careful, Mr. Chairman, to make sure that as you're considering that sort of question, we're comparing apples to apples, and so I'd be

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happy to take your question as an undertaking and provide a written response.

CHAIRMAN:

Q. Yeah, what would be--what's the credit rating of Fortis versus the credit rating of Newfoundland Power, what are the credit metrics used. I mean, Fortis, I assume, issues bonds.

KELLY, Q.C.

Q. Most of the debt is in fact issued in the -

CHAIRMAN:

Q. An amalgamation of -

KELLY, Q.C.

Q. Well, it's issued in the operating company.

CHAIRMAN:

Q. Yeah.

KELLY, Q.C.

Q. For example, Newfoundland Power issues the debt. We are a stand-alone entity and this Board has taken considerable pains to ensure that we continue to be a stand-alone company and rightly so.

CHAIRMAN:

Q. Yes.

KELLY, Q.C.

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Q. That we are--that we stand alone from Fortis so that at no time are customers in Newfoundland and Labrador and the provincial economy at risk by virtue of the fact that we are somehow simply part of a Fortis Group. That's why, for example, the whole question of, about four or five years ago now, ensuring that Newfoundland Power's stand-alone credit rating was preserved, was maintained, this Board gave direction to us to make sure that happened and in fact, the company took steps to ensure that we are judged on a stand-alone basis and that is a critically important element because this company has to go out and be able to issue bonds to ensure that, if I can use the phrase, the lights stay on. And you'll recall one of the witnesses, I believe it was Ms. McShane, when being cross-examined by Mr. Johnson about, you know, some of the difficulties down in the States and she said, yeah, you know, you got the Enrons, which were problematic, but keep in mind there were companies--and she gave a specific example of a west coast company that all during that period, on a stand-alone basis, continued to

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be a well-structured, properly organized company. That's the ones you look at for comparison.

So my point is Newfoundland Power is, has to be, must be, the Board has directed that we should be, and rightly so, viewed as a stand-alone entity.

CHAIRMAN:

Q. Like I just note here, my last comment, market quality rating, this is for Fortis, very conservative, and their range, least risk to highest risk, very conservative is the lowest risk. So I mean, you know, these are questions that I have and, you know, as somebody once said, I'm stumped. So I leave it with you, and I want you to--I'd like to have that information and -

KELLY, Q.C.

Q. You have to compare operating company -

CHAIRMAN:

Q. Oh yeah, no, no, I understand.

KELLY, Q.C.

Q. - with operating company. Fortis is essentially a holding company.

CHAIRMAN:

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Q. Yes.

KELLY, Q.C.

Q. You've got to be very careful that you're comparing apples and apples in your analysis, but -

CHAIRMAN:

Q. And I may be, Mr. Kelly, it wouldn't be the first time, I may be totally out to lunch on this issue, but it just raises some questions in my mind and I'd like to be able to understand it before I make some kind of a decision.

KELLY, Q.C.

Q. Thank you, Mr. Chairman.

CHAIRMAN:

Q. But I am a tabula rasa, as they say. I'm a blank slate, not an empty one. So I leave it with you.

KELLY, Q.C.

Q. We'll certainly take your question under advisement.

CHAIRMAN:

Q. Is there any further comments?

MR. JOHNSON:

Q. Just for the record, I think the materials

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that the Chair is referring to, I think, were provided in a letter of materials back when Ms. McShane was testifying, I think.

MS. GLYNN:
Q. The book line values certainly were. The Bank of Montreal was actually entered as one of the consent documents, but the first document, I don't think was actually entered through the proceeding.

MR. JOHNSON:
Q. All right.

CHAIRMAN:
Q. BMO capital markets wasn't? I mean, I didn't dream -

MS. GLYNN:
Q. BMO was.

CHAIRMAN:
Q. Yeah.

MS. GLYNN:
Q. But I think the book line values -

CHAIRMAN:
Q. They weren't?

MS. GLYNN:
Q. I don't think so. I'd have to check the undertaking, or the exhibit.

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CHAIRMAN:
Q. Well, I didn't get it--I mean, it must have been. I didn't go out and get it.

MS. GLYNN:
Q. It was filed by the Consumer Advocate in advance, but I don't think we actually referred to it throughout the proceeding.

CHAIRMAN:
Q. Okay.

KELLY, Q.C.
Q. I think there were some that were not marked.

MS. GLYNN:
Q. Exactly. It wasn't used in the proceeding. I'll have to check back.

KELLY, Q.C.
Q. Take no objection to that point, Mr. Chairman, simply that if we have--we have it, I believe, from what Board counsel has been saying.

MS. GLYNN:
Q. They were filed in advance, yes.

CHAIRMAN:
Q. Now the other point I just wanted to--last point. Like when you use the discount rate for the company's pension plan for the executives, that discount rate was what? 6.75

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percent?

KELLY, Q.C.
Q. I don't recall off the top of my head.

CHAIRMAN:
Q. Or 7.75? That's what--I assume that's the rate of return at -

KELLY, Q.C.
Q. For the pension plan?

CHAIRMAN:
Q. Yes, that's the rate of return, I guess, for the company's pension plan.

KELLY, Q.C.
Q. The discount rate.

CHAIRMAN:
Q. That's what you expect to--that's the rate of return you expect in the pension plan for all investments or just for the equity portion?

KELLY, Q.C.
Q. No, Mr. Chairman, the discount rate is the interest rate used to work back the--to work the net present value.

CHAIRMAN:
Q. Okay.

KELLY, Q.C.
Q. I'm not quite sure I'm following your question.

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CHAIRMAN:
Q. Well, the company has a pension plan. Employees contribute. Employer contributes. You put the money in a pot. You got some company hired to make investment decisions and that company makes a--you know, you make a range of investments and hopefully you gain a return. That's the way it works, isn't it?

KELLY, Q.C.
Q. Yes.

CHAIRMAN:
Q. And there's an expected rate of return on the pension investments.

KELLY, Q.C.
Q. Yes.

CHAIRMAN:
Q. That's not that 6.75, is it?

KELLY, Q.C.
Q. No, Mr. Chairman.

CHAIRMAN:
Q. Okay.

KELLY, Q.C.
Q. In fact, you'll recall the testimony, I believe of Ms. Perry of the return on

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

CHAIRMAN:

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

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

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

KELLY, Q.C.

Q. Thank you, Mr. Chairman.

UPON CONCLUSION AT 12:00 P.M.

CERTIFICATE

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

Dated at St. John's, Newfoundland and Labrador this 10th day of November, A.D., 2009.

Judy Moss

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