(9:30 a.m.)

CHAIRMAN:

Q. Well, full house. Well, good morning everybody. I do not have very many opening remarks to make. I think everybody here is well attuned to the rules of engagement, as they, and everybody, I believe, was introduced when we had our initial meeting earlier, I guess it was sometime in June, was it? I haven't got the exact date, but a settlement agreement was filed on some of the issues on September the 24th and now we're ready to proceed with the remainder of Newfoundland Power's application. Everybody knows, of course, Vice-Chair Darlene Whalen on my left and Dwanda Newman, our other commissioner, on my right.

I want to acknowledge the presence, among others, of our newest member of the Board, Jim Oxford, who's at the back. Stand up, Jim. Jim is on, of course, a very steep learning curve, but knowing him in his previous incarnation as Works manager at the City of Mount Pearl, I have no doubt that he will be an asset to the Board, and a newcomer as well

to the Board, but certainly not to most of you here, is of course our engineering consultant, Sam Banfield. Sam is at the back as well. Stand up, Sam, so everybody know--they all know you, don't they? Late of Newfoundland Hydro.

So I think all the Board staff has been introduced, so I don't need--I don't think necessary to go over that. We have--I acknowledge the presence of Michael Comerford, an employee of Newfoundland Power, who will be assisting us with the electronic reproduction of the evidence. It's quite interesting how things change. I counted the volumes of evidence and testimony and questions filed. I have 24 binders in my office and I got it on-- all of that has been reduced to one little disk that you can take anywhere with you, you know. If you're not doing anything on Saturday night, you can start reading Mr. Johnson's evidence, you know, which I do, among other things.

Discoveries Unlimited, Judy Moss and Glenda Gibbons, with the assistance of our Board secretary, Cheryl Blundon, will be

transcribing the proceedings and I think everybody knows, except for--that we'll be sitting from 9 to 1:30, a half hour break from 11 to 11:30. So now I will turn it over to our solicitor, Jackie Glynn, to confirm the issue of public notices and start the proceedings off.

MS. GLYNN:

Q. Thank you, Mr. Chair. Good morning to the Panel and everybody else who has joined us here this morning. I can confirm that on May 28th, the Board received a general rate application from Newfoundland Power to establish new rates for its customers. Notice of this application was published in newspapers throughout the Province, starting on June 3rd, 2009. A settlement agreement was filed on some of the issues with the Board on September 24th, 2009, and a revised application was then filed by Newfoundland Power on September 28th. Notice of the revised application and the start date for the hearing was published in papers throughout the Province starting on October 3rd, 2009.

There is one remaining deadline, which I

would like to note, and that is October 23rd, 2009, and that is the date for written submissions or requests to make an oral presentation from the public.

The only preliminary matter is to introduce the settlement agreement as a Consent document, which we'll mark as Consent No. 1. Everybody already has a copy of that, so we do not need to circulate it at this time.

EXHIBIT ENTERED AND MARKED CONSENT NO. 1

MS. GLYNN:

Q. The application and the revised application have been properly filed and as there are no other preliminary matters which I am aware of, the Board is able to commence hearing of the application.

CHAIRMAN:

Q. So I turn it over now to Newfoundland Power, I believe. Is that correct? So sir, you may proceed.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman. Mr. Chairman, first let me just take a moment and introduce the people at Newfoundland Power's table. My name is Ian Kelly and with me is Gerard Hayes. As you've already noted, Mike Comerford is operating the electronics for this hearing and in the back today, Mr. Peter Alteen, Mr. Lorne Henderson, Diane Whalen and Mr. Bob Pike, as well as Mr. Earl Ludlow, who will be testifying and Jocelyn Perry, who will be testifying. I think you--the Consumer Advocate, Mr. Johnson and Mr. Earle, as well as Mr. Geoff Young, of course, for Newfoundland and Labrador Hydro are in attendance.

With that introduction initially, Mr. Chairman, let me begin, if I may, by taking a few minutes to introduce the rate application itself. Newfoundland Power has filed an amended application and updated evidence to reflect changes in the Customer Energy and Demand Forecast for 2010, the decline in the discount rate and some other items. The amended application seeks an average 7.2 percent increase in customer rates. As has already been noted, a settlement agreement has been reached with the Consumer Advocate with respect to some of the issues in this rate

case and the agreed issues are summarized at paragraph six of the settlement agreement, which is now on the screen.

The settled issues are explained in more detail in paragraphs 7 to 28 of the settlement agreement and I'll just take a few moments to walk you through some of those. The Board will be familiar with most of the items in paragraph six from previous hearings. These items are consistent with the existing current regulatory practice and are, of course, supported by the record that's already filed.

If we start, the first item is the 2010 Energy and Demand Forecast and you'll note at paragraphs eight and nine, Mike, if we could scroll down to eight and nine, that revised forecast has been filed with the Board and at paragraph nine, the parties are agreed that the Board may accept and rely upon the revised forecast.

The next item are the 2009 conservation costs and you'll note at paragraphs 12 and 13 that these are to be amortized over the remaining four years out of the five-year energy conservation plan, beginning in January

2010. So that's an agreed item as well.

The third item is the Energy Supply Cost Variance clause and that was to be subject to review at this hearing, and you'll note at paragraph 16 that the parties have agreed that the Board should approve the continued use of the Energy Supply Cost Variance clause until further order of the Board.

The next item is the Demand Management Incentive account and that's dealt with at paragraphs 19 and 20 of the settlement agreement. The parties have agreed that for this application no changes should be made to the Demand Management Incentive account and Newfoundland Power has agreed that it will provide a further report on the operation of that account for the next general rate application and there are a number of items that the Consumer Advocate has asked that we address and we've agreed to address those items in the next report as well.

The next item is the Pension Expense Variance Deferral account, and I'll just take a quick minute on that one. That's a new matter. Over the past year, there has been

much volatility in the discount rate, which is the key factor in calculating pension expense, and this is explained in the Company's evidence as well as at pages seven and eight of Grant Thorton's July 31st 2009 report. Grant Thorton notes that the Pension Expense Variance Deferral account will limit the variability of pension expense due to changing assumptions, in particular discount rates, and Ms. Perry will further explain this mechanism when she testifies.

So you'll note at paragraph 22 that the parties are agreed with the creation of the Pension Expense Variance Deferral account. The language is set out at paragraph 23 and it's also been incorporated into the amended evidence and application and that's to be implemented in paragraph 24, effective January 1, 2010.

The next issue is the Depreciation Study. Ordinarily that would be in December 31st, 2010, and you'll see at paragraph 26 that the parties have agreed that Newfoundland Power will file its next depreciation study relating to plan in service as at December 31st, 2009, and that's for the purpose of the IFRS transition.

Next is Capital Structure. The parties are agreed on the capital structure as presented in the application and that's essentially as in past hearings, 45 percent equity component, and finally, a housekeeping matter, the Retail Rate Design Study schedule in paragraph 28 is to be extended to make appropriate adjustments for the fact that this GRA is taking place, not contemplated the Board need do anything to extend that schedule. That matter, I think, can be simply dealt with by the parties themselves.

So Mr. Chairman, those are the matters which have been resolved. Next, I'd just like to say a few words about the principal issues which remain for the Board now to consider in this application, and there are really two of those. You can divide them into two items.

(9:45 a.m.)

The first is the cost of capital, including whether to continue the use of the Automatic Adjustment Formula until the next general rate application. And the second

principal issue is other post employment benefits or OPEBs. In addition to those two principal issues, the Consumer Advocate has indicated in his issues list that he will raise a number of other issues, including the following: the one-year amortization of hearing costs; executive compensation issues; intercorporate transactions; whether operation cost reductions and efficiencies should be considered by the Board; issues surrounding the Kenmount Road property; and finally, some issues surrounding the Mobile River watershed dispute with the City of St. John's.

So let me next--first of all, I'll introduce the witnesses that you will hear, then I'll come back and deal with the issues. Newfoundland Power will be calling the following witnesses in this application: Mr. Earl Ludlow, who's the president and chief executive officer of Newfoundland Power; Ms. Jocelyn Perry, the VP Finance and chief financial officer; you'll hear from Ms. Kathy McShane of Foster and Associates with respect to cost of capital; Mr. Karl Aboud of the Hay Group; Mr. Gary Smith, who is the vice-

president of engineering and operations with Newfoundland Power; and if necessary, Mr. Lorne Henderson, who is the manager of rates and regulation.

Mr. Ludlow and Ms. Perry will sit as a panel. Mr. Ludlow will provide you with an overview of the company's operations, as well as the company's proposals in this application. Ms. Perry will address the financial matters, including OPEBs and some explanation of the Pension Expense Variance Deferral account, and the panel will respond to questions relating to most of the issues raised by the Consumer Advocate. As I said, Ms. McShane will deal with cost of capital. Mr. Aboud will deal with issues surrounding executive compensation. A report has been filed from the Hay Group. Mr. Smith will address customer operations and he will also respond to questions regarding whether operational cost reductions and efficiencies should be considered. Mr. Henderson's testimony relates to the Demand and Energy Forecast and rate issues and while we understand that these items are not in

dispute, Mr. Henderson will be available to answer questions from either the Consumer Advocate or the Board.

Mr. Chairman, let me next say a few words about the two principal issues. Ms. McShane has conducted a cost of capital analysis on behalf of the company. Based on that analysis, the company is proposing that rates be set to provide the company with an opportunity to earn a return on equity of 11 percent. That yields 9.13 percent as the midpoint of the range of rate of return on rate base.

In 1998, the company proposed the adoption of an automatic adjustment formula with respect to the return on rate base. In its 1998 order, the Board noted that there could be changes in financial market conditions which would suggest that the formula is not accurately reflecting the appropriate return on equity, and we believe that is the position that we're in today. Since the last general rate application, the company's cost of debt, cost of borrowing, has increased. But at the same time, we have historic 30-year low--low 30-year Canada bond yields which would reduce the company's return on equity through the current operation of the automatic adjustment formula.

Utilities and regulators across the country are now grappling with what should be done to address the operation of automatic adjustment mechanisms. You may know, of course, that late last week, the National Energy Board released its ruling discontinuing its decision RH294 with respect to its automatic adjustment mechanism, and that's now filed as part of PUB NP-14 in the first revision.

So in these circumstances, the company is proposing discontinuing the operation of the automatic adjustment formula until the next GRA or until a further hearing to be called by the Board, as the Board deems most appropriate. In this proceeding, the Board can simply determine the rate of return on rate base and establish customers rates, discontinuing the operation of the formula. That will allow the Board to revisit this issue, if necessary, once there is further

experience with market conditions and hopefully some emerging consensus regarding automatic adjustment mechanisms into the future.

Next, let me address other post employment benefits, or OPEBs. The appropriate financial treatment of OPEBs has been before the Board over the last several general rate applications. The issue is whether Newfoundland Power should continue to account for OPEBs on a cash basis or change to the accrual method of accounting. The cash method records the expense only when the expenditure is made. The accrual method records the expense as it accrues, recognizing that it is a real cost of employing personnel and providing service today, notwithstanding that the payment will occur in the future. Accrual accounting provides a better matching of revenue and expense and promotes intergenerational equity.

Accrual accounting for OPEBs is now the predominant regulatory approach in Canada. Over time, virtually all other Canadian utilities have changed to the accrual method

of accounting for OPEBs. There are now only two utilities still remaining on the cash basis, and Newfoundland and Labrador Hydro already operates on the accrual basis.

At the time of the last general rate application, customers were under substantial rate pressure, driven by the high cost of fuel at Holyrood. So at that time, the company agreed with the Consumer Advocate that it was appropriate then to give more weight to the rate impact on customers of increases in the cost of electricity and to principle of intergenerational equity. The parties agreed to maintain cash accounting for OPEBs until the next GRA, which is obviously now, at which time the matter would be further considered by the Board.

Since then, oil prices have retreated and electricity rates are essentially now at 2006 levels. Nevertheless to minimize the customer rate impacts, the company has proposed a two-step approach in this movement. First, in 2010, the company proposes to change to accrual accounting, freezing the transitional obligation at approximately 46.2 million

dollars. That approach will limit the rate impact at this time to approximately 1.3 percent. The company will deal with the amortization of the transitional obligation at the next general rate application.

The Consumer Advocate has indicated that he wishes to discuss the extent of the benefits provided to the company's retirees and, in particular, whether retirees should have to co-pay the cost of their medical benefits. Medical benefits cannot be looked at in isolation. They are part of an overall approach to employees' earnings, pensions and benefits. Newfoundland Power's management exercises managerial judgment in how it structures its employment and retirement arrangements, including medical benefits.

As Ms. Perry will explain, the company has already agreed with its union to review benefits in 2010. The extent of any changes in benefits and costs is currently unknown. However, the accrued cost of future benefits constantly changes over time, as a result of various factors, including, for example, changes in the discount rate used to determine the present value of such costs. The benefits review should not affect the method of accounting for OPEBs costs.

At this time, there's only one of the Consumer Advocate's issues that I would like to speak to and that is the Mobile River Watershed dispute. The Consumer Advocate has raised the following issue in his issues list, whether a deferral account should be established to capture the liabilities and benefits associated with the litigation and ultimate resolution of the Mobile River watershed dispute with the City of St. John's. That matter is at an early stage in the process and is currently before the Supreme Court of Newfoundland and Labrador. There has been a preliminary ruling by the arbitrators with respect to valuation principles, which is found at CA-NP 264 and that's the decision which is currently subject to review by the Supreme Court of Newfoundland and Labrador.

This matter ought not to engage the Board at this general rate hearing. Newfoundland Power cannot transfer the Mobile River undertaking and receive any funds without the

prior approval of this Board under Section 48 of the Public Utilities Act. It will be some considerable time before the issues arising from the arbitration are determined. Once there is a determination of the preliminary issues currently before the Courts, there are essentially two possibilities that could occur.

First, the City could purchase the undertaking from Newfoundland Power and pay compensation as determined by the Board of Arbitration. Under Section 48 of the Public Utilities Act, this Board would have to first approve the transfer of the Mobile undertaking to the City. The second possibility is that the City and Newfoundland Power could reach agreement on the continued operation of the facility by Newfoundland Power.

So it's unclear at this stage whether there will be a transfer of the facility and payment of compensation by the City to Newfoundland Power, let alone the amount of such compensation, and the Board will, of course, readily understand that numerous issues would have to be resolved before the

City could acquire and operate the Mobile undertaking. Just think, for example, issues of power production coordination, wheeling rights for power transmission. There are a number of other issues, and like any such commercial transaction, the company could not receive any payment for the Mobile undertaking unless and until the company receives all necessary regulatory approvals, including, in this case, the approval of the Board permitting it to transfer the undertaking to the City.

So there will be an ample opportunity to address any issues that arise in an appropriate application before the Board at an appropriate future time. It is not necessary to deal with this issue in this general rate proceeding, especially while the matter is currently before the Courts.

So Mr. Chairman, those are my introductory comments and Newfoundland Power is ready to proceed with the application when the Board is ready. I don't know if-- ordinarily the Consumer Advocate may have--and other parties may have some opening comments.

CHAIRMAN:

Q. Oh, okay. Thank you. Mr. Johnson.

JOHNSON, Q.C.:

Q. Thank you, Mr. Chairman, Commissioners. With me this morning is my junior counsel, Randell Earle, and both of us are very pleased to represent the interests of general and domestic electricity consumers in this hearing, but we would have been more pleased to be doing so in 2010, as I thought would be the case after the Board filed its last Newfoundland Power general rate decision not 22 months ago.

In the past, Mr. Chairman, Commissioners, Newfoundland Power has used its considerable ingenuity to bring on stand-alone applications when it met its purposes. Did we really need a GRA in order to set up a PEVDA-like mechanism to recover 2010 pension expense? Did we really need a GRA to deal with OPEBs at this time? Did we really need a GRA to deal with variances in energy costs? The main thing this application is truly about is Newfoundland Power's return on equity, it's ROE. But first, I do want to say a few words about OPEBs. I think even my children know what OPEBs stand for nowadays, other post employment benefits.

Newfoundland Power has proposed that it adopt the accrual method of accounting for OPEBs costs for regulatory purposes effective January 1st, 2010, and as the Board is aware, the expectation was that this matter not be reviewed in a--would be next reviewed in a 2011 GRA filed in 2010, but here we are.

OPEBs, or other post employment benefits, are composed of retirement allowances for retiring employees, as well as health, medical and life insurances for retirees and their dependents. Presently, Newfoundland Power recognize these costs on a cash basis, whereby the annual expense is equal to the retirement allowances and insurance premiums actually paid in the year. In 2010, on a cash basis, these costs would be 1.7 million dollars. Under the accrual method, OPEBs costs are recognized as an expense as employees earn the benefits they will receive after retirement. Therefore OPEBs cost are accrued, rather than being recognized when benefits are paid.

In 2010, on an accrual basis, the OPEBs costs will be 8.4 million dollars. Beyond the large annual impact of accrual, there are large transitional obligations associated with this change in accounting policy. The transitional obligation, as Mr. Kelly noted, associated with the company's adoption of the accrual method of accounting for OPEBs in 2010 is 46.2 million dollars. That comes in stage two. Now consistent with the company's wish to accrue this hearing's costs over one year, that might give us an indication of how soon we'll be asked to deal with that transitional obligation. Very quickly, I would submit.

Back in the early 2000's, when Newfoundland and Labrador Hydro applied to this Board to switch to the accrual method, Newfoundland Power's expert, John Brown--and this is on the record in this proceeding at CA-NP 365--testified that where there is a transitional obligation, a Board may decide that it is more just and reasonable to retain the cash method. It still remains for the Board to make this determination, but this matter is made all the more vexing by the fact

that in our submission, Newfoundland Power has been imprudent in getting its group related costs and its arrangement with retirees under control and in keeping with currently modern employment benefit trends.

(10:00 a.m.)

Whether viewed on a cash basis or an accrual basis, the essential fact remains that from an operating expense perspective, Newfoundland Power gives group health benefits and other post retirement benefits for free to its retirees once they reach age 65. How in the world can you hope to control the cost of an item that is given away for free? The problem is that when the company gives something for free, it's not the shareholders who pay. It is the customers, and there is no way, in our respectful submission, to justify requiring customers to pay the full cost of benefits which retirees do not make any contribution towards. It doesn't happen at Newfoundland and Labrador Hydro and it doesn't happen with the Provincial Government. Newfoundland Power has been too slow to get with the modern trend. The very last thing

this Board should do is to allow Newfoundland Power to keep this practice up and then get them on an accrual basis as the figures will become large enough to blind you. So far, the mantra seems to be let the customers pick up the tab.

So now back to the main driver, the return on equity. It's an extravagant request, an excessive request, that could not come at a worst time. As consumers, many of whom are on limited incomes, face another heating season, as workers in our fish plants are struggling to get sufficient weeks of work to obtain EI benefits, as laid off paper workers wonder if they'll ever see a dime of their hard-earned pensions, and as our mobile work force anxiously awaits a return to Alberta, Newfoundland Power seeks an 11 percent return on equity, having just approved a 10.4 percent raise in 2009 alone for its president, Mr. Ludlow, that being on top of a 6.3 percent increase for Mr. Ludlow in 2008. Now in and of itself, his 10.4 percent increase which may equate to 50 grand or 50 odd grand on his base salary and on his short term incentive package alone may not have a big rate effect, but it's not the effect on rates that irks. It's the casting of salt into an open wound when this increase is seen as an indicator of Newfoundland Power's disregard for the real economy in which it operates.

In this general rate application, the key issue is the return on equity and the future of the automatic adjustment formula or mechanism. Newfoundland Power has been and will continue to be a very well protected, stable, predictable, conservative, low risk utility operating in a very supportive regulatory environment where the company enjoys moderate, yet fairly steady customer growth, free from any significant competition. With only a small amount of generation, Newfoundland Power is predominantly poles and wires. In essence, it is very low risk.

We are quite familiar with the factors that make it very low risk. Indeed, many of the factors that make it low risk were not accidental, but rather by design. Whether it be the weather normalization reserve, the fact

that its capital budgets are approved in advance of the projects being undertaken, the energy supply cost variance account, the demand management incentive account, or the new pension expense variance deferral account, all such protections have done an excellent job of reducing risk for Newfoundland Power.

Newfoundland Power has also enjoyed the ability to come to the Board for accounting type applications and other cost deferral applications on a stand-alone basis. Mr. Chairman, Commissioners, Canada in general is world recognized for its regulatory support to utilities and within Canada, this Board is seen as being one of the more supportive regulators in the country. Customers expect to receive the benefits of the utility being low risk. Investors cannot expect to earn a return on equity commensurate with a utility exposed to greater risks.

But for purpose of having its ROE determined, Newfoundland Power wants to say that it is comparable to several United States electricity and natural gas utilities because, in the United States, ROEs are higher.

Newfoundland Power and its cost of capital expert will be saying, and not for the first time, that Newfoundland Power is comparable to US utilities which are alleged to operate in similar operating and regulatory environments and possess comparable risk to Newfoundland Power. The onus is squarely upon Newfoundland Power to prove to the satisfaction of this Board that these US firms are truly comparable. Only when this Board is confident that it can conclude that these US companies and their operating and business environments are comparable should it even consider the use of such data. We do not believe that this onus can be discharged.

Now the Board has retained its own independent expert in this case, Mr. Cicchetti, to provide evidence on Newfoundland Power's cost of capital. Mr. Cicchetti himself has utilized only US company data in his analysis in providing his ROE recommendation to the Board. Accordingly, the Board will have to determine whether in light of all of the circumstances and evidence it feels comfortable with relying on Mr.

Cicchetti's approach. We would observe that Mr. Cicchetti's ROE recommendation more or less comes up the middle between the Consumer Advocate expert, Dr. Lawrence Booth's recommendation, and that of Newfoundland Power's expert Ms. McShane. But just because one is recommending something near the middle does not mean that one is correct. With respect to Mr. Cicchetti, we find that his approach of looking only to US firms' data to ground his analysis leads to an ROE recommendation that is simply too high for Newfoundland Power.

As regards the automatic adjustment formula, this Board ordered the use of an automatic adjustment formula in 1998 to set an appropriate rate of return on rate base for Newfoundland Power on an annual basis. The Board stated at the time that there was merit to a formula in light of the cost of a full cost of capital hearing and the potential savings to consumers that could be realized. At the time, the Board also said that the adoption of an automatic adjustment mechanism will create greater predictability which will

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reduce the risk of regulatory uncertainty.

In PU-19 2003, the Board said that there was continued--there was merit in the continued use of the formula. Less than two years ago, the Board again agreed that the continued use of the automatic adjustment formula was appropriate. Back in 1998, the Board stated, in PU-16, that it would call a hearing if circumstances changed so as to render the use of an automatic adjustment mechanism inappropriate. The Board has not called a hearing into this issue, but Newfoundland Power has applied to discontinue the use of the formula in this application.

Frankly, we feel that the existing formula, which if applied as at September 11th 2009 would have resulted in a fair--in a rate of return on equity of 8.39 percent to be generous as it is for this company. To date, there has been neither deterioration in the financial strength of the company, nor fundamental changes in the business risk of the company. If anything, Newfoundland Power has become relatively less risky because all of its protections, like PEVDA, the Energy

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Supply Cost Variance, and other matters that have been introduced since 2003. Nor do we see a basis for using the unprecedented events that occurred in the markets in late '08 and early '09 as a justification for this Board to discontinue the use of a formula between test years.

Newfoundland Power doesn't like the formula because it produces a result that is too low for its liking, and we get that. But that is more a reflection of Newfoundland Power's unrealistic views of what the ROE should be, rather than a reflection of the need to throw out the formula. No disrespect to any of the cost of capital witnesses that'll testify in this case, but the prospects of seeing repetitive and expensive cost of capital evidence is not an attractive proposition. Formula or no formula, Newfoundland Power is the lowest risk electrical distribution utility that you're likely to find.

Mr. Chairman, Commissioners, as Mr. Kelly noted, there are other issues on our witness list. I won't get into those now. I think

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we're all anxious to get on with the hearing. I would, however, like to acknowledge the efforts of Mr. Simmons in assisting the parties with the settlement agreement that was reached and I look forward to a productive hearing of this application. Thank you.

CHAIRMAN:

Q. Does Newfoundland Hydro have any comments, Mr. Young?

MR. YOUNG:

Q. I'll be very brief, Mr. Chairman, Commissioners. As you are aware, Newfoundland and Labrador Hydro has intervened in this matter largely as an observer. We have not filed information requests. We do not expect or plan to cross-examine witnesses, though we would ask that if the appropriate circumstances arose requiring that we be given that opportunity. We don't have any present intention on advocating any particular disposition of the matter, and the Board's probably aware, we did not participate in the settlement process.

We would ask the indulgence of the Board, however, that we be allowed to sort of come

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and go as we might, on the basis of the issues that are before the Board and the testimony that we'd like to be present for. Also, there will be times when there'll be some familiar faces from Hydro in the back of the room observing the process and perhaps some unfamiliar faces I might like to introduce the Board to from time to time, some new staff, and we would ask that we be permitted to do that in the usual fashion. But that's all Mr. Chairman.

CHAIRMAN:

Q. I don't think there are any other intervenors, are there, that wish to have any opening remarks. Is that correct? Okay, I guess then it's back to you, sir.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman. Mr. Chairman, we're ready to proceed. Mr. Ludlow and Ms. Perry will sit as the panel, so if they get seated, we'll proceed. Mr. Chairman, while the panel is getting seated, there is one exhibit which we have handed out. It's information which is already in the record, but we put it on one piece of paper and it'll come up on the screen in due course, and we've also provided paper copies as well of various exhibits which are already in the record, but Ms. Perry will speak to in her presentation. So perhaps while the Panel is getting seated, we can formally mark Exhibit EAL-1 and then we'd be ready to proceed.

EXHIBIT ENTERED AND MARKED EXHIBIT EAL-1

CHAIRMAN:

Q. Good morning.

MR. LUDLOW:

A. Good morning, Mr. Chairman.

CHAIRMAN:

Q. I guess you folks have to be sworn.

10:15 AM

CHAIRMAN:

Q. I presume, Mr. Ludlow, you're going to proceed first.

MR. LUDLOW (SWORN)

CHAIRMAN:

Q. I guess I'll do you, Ms. Perry as well.

MS. PERRY (SWORN)

CHAIRMAN:

Q. Mr. Kelly, you're off to the races, sir.

KELLY, Q.C.:

Q. Mr. Chairman, I expect this initial presentation will take about 45 minutes to an hour, so we can probably run to the end of that and take the break. Mr. Ludlow, you are the President and Chief Executive Officer at Newfoundland Power?

MR. LUDLOW:

A. Yes, that's correct.

KELLY, Q.C.:

Q. And, Ms. Perry, you are the Vice President of Finance and Chief Financial Officer of Newfoundland Power.

MS. PERRY:

A. Yes, I am.

KELLY, Q.C.:

Q. Mr. Ludlow, you will introduce the amended application on behalf of Newfoundland Power. Do you adopt Section 1, the introduction, as your testimony in this matter?

MR. LUDLOW:

A. Yes.

KELLY, Q.C.:

Q. Ms. Perry, you will speak to the finance rate base and revenue requirement sections. Do you adopt Sections 3 and 4 of the pre-filed

evidence as your testimony in this matter?

MS. PERRY:

A. Yes, I do.

KELLY, Q.C.:

Q. Are there any changes that either of you wish to make to the pre-filed testimony and exhibits at this time?

MR. LUDLOW:

A. No.

MS. PERRY:

A. No, there isn't.

KELLY, Q.C.:

Q. Mr. Ludlow, perhaps we can begin by having you provide the board with your assessment of the company's current services?

MR. LUDLOW:

A. Yes, I'd be happy to. Newfoundland Power is first and foremost an electricity, delivery, and service company. The market we serve is mature, with annual growth in customers and sales of 1 to 2 percent. The company's primary focus is serving our customers, and over the past few years electricity service to customers has been reliable. The price of that service has been reasonably stable, and

customer's overall level of satisfaction with Newfoundland Power's service has remained consistent in the 88 to 89 percent range. It's my assessment that current service levels to our customers are reasonably satisfactory.

KELLY, Q.C.:

Q. Has Newfoundland Power service delivery changed since the company was last before the board in 2007?

MR. LUDLOW:

A. Yes, it has, there's a number of reasons for this. One is that our customer's expectations have evolved. For example, we have seen increased customer interest in energy conservation over the past few years. We have responded by increasing our efforts in energy conservation, in particular, in the programming side for our customers. This initiative has been undertaken jointly with Newfoundland and Labrador Hydro to ensure the least cost delivery across the province. It also aligns with the Provincial Government's 2007 energy plan. Like many businesses, Newfoundland Power is addressing its workforce demographics. Our workforce is getting older.

We have focused our efforts in workforce management by recruitment and training of skilled trades, technologists, and engineers, and this is necessary to ensure the long term provision of safe and reliable service to our customers. As a result, we have a slightly larger workforce than a few years ago, and we expect this to continue into the future. We've also seen increased customer growth, particularly in the North East Avalon. This has required increased capital expenditure to serve that growth, and we expect this to continue into the foreseeable future as well.

KELLY, Q.C.:

Q. Has the company's cost of providing service changed since 2007?

MR. LUDLOW:

A. Yes, it has. The capital cost to serve customers have increased capital expenditure to year end 2010, and that's expected to be 37 million dollars, or 16 percent higher than was anticipated in 2007. The vast majority of this increase relates to growth in the number of new customers. This has added significantly to our capital costs. Customer

energy conservation costs have increased by over 2 million dollars from 2008 to 2010. These expenditures increase Newfoundland Power's costs. However, in the long run, they will reduce overall electricity costs for our customers by reducing production costs.

Pension expense is forecast to increase by approximately 5 million dollars from 2008 to 2010. This is driven by financial market conditions. This has two effects on Newfoundland Power's cost to service. The additional pension expense increases the company's operating costs and our customer's rates in the near term. However, the increased pension expense will also reduce the company's rate base, and this will tend to moderate our customer's rates over the longer term.

The financial market conditions are also affecting the company's cost to capital. The company's short term debt costs are at historic lows, and its long term debt costs have increased. As Ms. McShane's evidence filed in this case indicates, financial market conditions are also increasing the company's

cost of equity.

KELLY, Q.C.:

Q. How are changes in the company's service delivery and its cost of service reflected in this rate case?

(10:30 a.m.)

MR. LUDLOW:

A. In this rate case, Newfoundland Power is requesting a 7.2 percent average increase in customer's rates. Mike, could we bring up Exhibit EAL #1 to the screen, please. This is a table indicating the principal components of the 7.2 percent average increase in customer rates. Four items account for most of this requested increase. The company is proposing a return on equity in 2010 of 11 percent. Currently the company's rates reflect a return on equity of 8.95 percent. This difference accounts for approximately 2.2 percent increase in customer rates.

Increased operating costs in 2010, particularly increased customer energy conservation costs, and pension costs, account for approximately 1.9 percent. Approximately 1 percent relates to increased energy supply

costs from Hydro in 2010. If the company had not filed a rate case for 2010, these costs would have been recovered in 2011 through the Energy Supply Cost Variance Mechanism. Finally, approximately 1.3 percent relates to the adoption of accrual accounting for other post employment benefits, or OPEBs, in 2010. The company currently recovers OPEBs costs on a cash basis. Mainstream regulatory practice is to account for OPEBs on an accrual basis. The remainder of the requested rate increase relates to a variety of items, including amortizations and increased costs associated with the company's growing rate base.

KELLY, Q.C.:

Q. Would you explain why it was necessary for Newfoundland Power to file a rate case for 2010 instead of 2011?

MR. LUDLOW:

A. Since the Board's Order on the company's 2008 rate case in late 2007, Newfoundland Power's circumstances have changed. In the second half of 2008, increased volatility developed in the financial markets. By year end, 2008, it was apparent that these market conditions would directly impact Newfoundland Power's pension expense in a material way.

In late 2007, the company was forecasting 2010 pension expense at approximately 1. 5 million dollars. The company's current forecast for 2010 pension expense is just over 8 million dollars. In addition, the increases in capital expenditure I described earlier have the practical effect of increasing costs, such as depreciation. The company's current forecast for 2010 depreciation is approximately 1.2 million dollars higher than it had forecast in 2007. Cost increases of this magnitude are material to Newfoundland Power.

By late 2008, Long Canada Bonds began to trade at prices below a 4 percent yield, and they continue to do so today. At such yields, Newfoundland Power's Cost of Equity, as determined by the Automatic Adjustment Formula, would be reduced. This would result in a reduction in revenue in 2010. The combination of increased costs and decreased revenues indicated that the company's return on equity would fall to approximately 6. 45

percent in 2010. That is why it was necessary for Newfoundland Power to file a rate case for 2010. Ms. Perry will take you through the details of the company's financial forecast shortly.

KELLY, Q.C.:

Q. Now in this Application, the company is proposing improved returns. Would you comment specifically on this aspect of the application?

MR. LUDLOW:

A. Safe and efficient day to day customer operations have been, and will continue to be a priority for Newfoundland Power. However, our business is capital intensive, so cost of capital is a key component of the company's cost of service. The original capital cost of Newfoundland Power's assets in the field today is approximately 1.3 billion dollars. Every year we must invest to fulfil our obligation to serve our customers. These assets have long arms. On average, the company's assets have a useful life of approximately 30 years. The distribution pole installed to provide service in a subdivision in 2010 can be

expected to continue to provide service past 2040. The cost of financing assets in the field through their service lives is a primary influence on the rates that our customers have to pay.

These attributes of Newfoundland Power's business make the maintenance of long term financial integrity essential to least cost of service. Both today's customers and future customers benefit from Newfoundland Power's ability to access capital on reasonable terms in all market conditions. Newfoundland Power is seeking a 2010 return on equity of 11 percent in this application. This compares to 8.95 percent return on equity currently used for rate making purposes. This increase is largely based upon capital market conditions.

KELLY, Q.C.;

Q. Changes to accounting for Other Post-Employment Benefits, your OPEBs, are also proposed in this application, and in addition, the consumer advocate has raised the issue of medical benefits for retirees aged 65 years and older. Would you comment on these aspects of the application?

MR. LUDLOW:

A. Current regulatory practice for OPEBs is relatively clear. Accrual accounting is the mainstream in Canada today. Practically, Newfoundland Power must address this issue at some point. The proposal contained in this application is a first step towards adoption of accrual accounting for OPEBs. It is part of a balanced approach to ensuring that current customers pay the current cost of OPEBs.

I'd like to make two observations on our current practice of fully funding the medical benefits of retirees, aged 65 and older. First, as for our current retirees, Newfoundland Power does not believe that changes are reasonable or justified. The current level of medical benefits for these retirees is limited, and when considered in the context of overall retirement benefits provided to these former employees, they are reasonable. Today the average pension paid to our retirees, aged 65 and older, is less than 14 thousand dollars per year, and it is not unreasonable that these former employees are provided with limited medical benefits without

requiring a payment on their part.
Second, Newfoundland Power expects to review its benefits programs over the course of the next year. The current practice of fully funding medical benefits for retirees aged 65 and older will be part of this broader review. This may result in changes for future retirees on a go-forward basis. Ms. Perry will deal in greater detail with this issue shortly.

KELLY, Q.C.:
Q. Mr. Ludlow, executive compensation is also an issue raised by the consumer advocate in this application. Can you provide us with your comments on this aspect of the proceeding?

MR. LUDLOW:
A. Later in the hearing Newfoundland Power will call Mr. Karl Aboud, a compensation consultant from the HAY Group, to give detailed evidence on this matter. I can, however, make some broad observations which may be helpful to the Board. Newfoundland Power's overall executive compensation reflects the broad Canadian commercial marketplace. This has been the case for over a decade, and over that decade the

proportion of executive labour cost to our total labour cost has not materially changed. Currently a significant portion of Newfoundland Power's total executive compensation is actually borne by our shareholders, not our customers. Long term incentives in the form of stock options have never been considered a cost for rate making purposes. In addition, short term incentive payments which exceed targets are similarly treated as a shareholder cost. Overall, I believe that the level of executive compensation costs borne by our customers is reasonable.

KELLY, Q.C.:
Q. Finally, Mr. Ludlow, do you have any observations on the process aspects of this application?

MR. LUDLOW:
A. Mr. Chairman, this is my fourth appearance as a witness in a Newfoundland Power rate case. In this rate case, the consumer advocate and the company, with the assistance of Board's counsel, have been able to resolve a number of issues. Some are fairly complex, such as the

proposed deferral mechanism to deal with variations in annual pension expense. The effect of these agreements have been to limit the number of issues and to hopefully reduce the overall amount of hearing time. This improves the efficiency of the overall regulatory process. Newfoundland Power has been, and will continue to be supportive of initiatives which have this result.

KELLY, Q.C.:
Q. Thank you, Mr. Ludlow. Ms. Perry, can we turn to you next. You've been the Vice President of Finance and the Chief Financial Officer at Newfoundland Power since 2005?

MS. PERRY:
A. Yes, for about four years now.

KELLY, Q.C.:
Q. And you have a Bachelor of Commerce Honors Degree from Memorial University, and you are a member of the Institute of Chartered Accountants of Newfoundland and Labrador.

MS. PERRY:
A. Yes, that is correct.

KELLY, Q.C.:
Q. Ms. Perry, in your testimony, I understand

you'll deal with three matters. First, the company's financial position. Second, Other Post-Employment Benefits or OPEBs, and third, the Pension Expense Variance Deferral Account. Let's begin by looking at the company's financial position. Would you please provide the Board with an overview of Newfoundland Power's current financial position?

MS. PERRY:
A. Certainly. Mike, if we could please go to page one of Exhibit 3. This exhibit is the company's most current financial forecast. Page one includes forecast statements of income for 2009 and 2010. I'll start first by taking a look at our 2009 forecast. Newfoundland Power's 2009 rate of return on rate base is set based on a rate of return on equity of 8.95 percent. If you'll look at the third column on Exhibit 3, you'll see our forecast results for 2009. Mike, if you could scroll down. As you can see on line 35, we are currently forecasting a rate of return on rate base of 8 percent. At line 36, we are forecasting a regulated rate of return equity of 8.62 percent, and at line 38, our interest

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coverage is forecast to fall to 2.3 times.

KELLY, Q.C.:

Q. Ms. Perry, next would you provide the Board with an overview of Newfoundland Power's financial outlook for 2010?

MS. PERRY:

A. Yes. The 2010 forecast is shown in the last column on Exhibit 3, but excludes the proposals in this application. It does, however, reflect the forecast effect on 2010 revenue of the operation of the Automatic Adjustment Formula. At a 3.9 percent Long Canada Bond Yield, and a forecast cost of equity of 8.39 percent, 2010 revenues would be reduced by approximately 3 million, and this is reflected in the forecast revenue line shown on line 1. At line 18, operating expenses for 2010 are forecast to increase by 1.9 million over 2009. This reflects the impact of inflation and approximately 500 thousand in increased customer energy conservation costs in 2010. At line 19, pension costs for 2010 are forecast to increase by 5.5 million over 2009. As Mr. Ludlow explained earlier, this is due to

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financial market conditions over this past year.

If we could move down the screen, Mike. At line 36, the resulting regulated return on equity for 2010 is 6.45 percent. Lines 38 through 40 contain the key credit metrics that flow out of this return. All of these metrics show a material erosion from 2009. You'll note that the interest coverage has fallen to two times. Based upon the current financial outlook, Newfoundland Power will not have an opportunity to earn a reasonable return in 2010. These financial results are not consistent with the maintenance of the company's credit worthiness.

KELLY, Q.C.:

Q. Ms. Perry, would you explain to the Board the effect of the company's proposals in this application?

MS. PERRY:

A. Yes. Mike, if we could please go to page 1 of Exhibit 11. This exhibit compares the company's forecast results for 2010 that we just looked at in Exhibit 3, with the results based on the proposals contained in this

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application. Page 1 on the screen now contains comparative 2010 statements of income. The current financial outlook is titled "Existing", and the results, including the proposals contained in this application, are titled "Proposed". I'll take you through the material difference between these two financial scenarios.

At line 1, 2010 electricity sales are shown in gigawatt hours. The difference between existing and proposed is a reduction of 45 gigawatt hours. This reflects the elasticity impacts of the higher customer rate proposed in this application. Higher customer rates tend to reduce electricity consumption. At line 3, revenue from rates is increased by 35.9 million under the proposed scenario. This is the result of the requested 7.2 percent average increase in customer rates. At line 5, transfers from the Rate Stabilization Account are shown as approximately 5.3 million under the existing scenario, and nil under the proposed scenario. Under the existing scenario, the Energy Supply Cost Variance Mechanism would operate to

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permit recovery of this amount in 2011. Under the proposed scenario forecast 2010 supply costs are recovered in 2010, and this flows from the fact that 2010 is a test year. At line 8, purchase power expense is shown as approximately 4.2 million less under the proposed scenario. This again reflects lower purchase power costs due to elasticity impacts.

At line 19, operating expenses are approximately 1.1 million higher. This reflects the proposed amortization of third party hearing costs and conservation costs in 2010. At line 20, employee future benefit costs are approximately 6.8 million higher. This results from the proposal to adopt accrual accounting for Other Post-Employment Benefits, or as we call them, OPEBs. At line 27, income taxes are approximately 8.9 million higher, and this increased income tax is primarily the result of the increase in return on equity from 6.45 percent to 11 percent.

The proposed scenario will permit Newfoundland Power the opportunity to earn a return on rate base in 2010 of 9.13 percent.

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This is shown on line 36, and this reflects an underlying return on equity of 11 percent. Such financial results are consistent with the maintenance of the company's credit worthiness.

KELLY, Q.C.:

Q. Now in August of this year, Moody's Investor Services upgraded Newfoundland Power's First Mortgage Bonds from BAA 1 to A2. How does this reflect on the company's credit worthiness?

MS. PERRY:

A. The Moody's August upgrade of the company's First Mortgage Bonds reflects favourable on our credit worthiness. Prior to the upgrade the company's First Mortgage Bonds were rated A by Dominion Bond Rating Service or DBRS, and BAA1 by Moody's. Now both DBRS and Moody's rate our First Mortgage Bonds at the same relative rating. While the company believes Moody's upgrade of its bonds is positive, it is mindful that the upgrade was largely driven by methodology changes at Moody's, and that Newfoundland Power's issuer rating has been rated as BAA1.

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KELLY, Q.C.:

Q. Ms. Perry, would you describe for the Board the company's financial outlook beyond 2010?

MS. PERRY:

A. Mike, can we please go to page 1 of Attachment "A" to CA-NP-43. Thank you. Attachment "A" is Newfoundland Power's five year financial forecast through 2013. This five year financial forecast is based upon the proposed scenario that I described earlier, and it assumes all of the company's proposals in this application will be approved by this Board. At line 43, revenue shortfalls are forecast for each from 2011 through 2013. A revenue shortfall is simply the change in the forecast financial result expressed in terms of revenue that would be required for the company to recover all of its forecast cost, including its cost of capital. This indicates that for 2011 and 2012, the company is forecasting a revenue shortfall of just under 4 million per year. This translates into approximately two thirds of 1 percent in return on equity. As you can see on line 38, the 2010 regulated return of 11 percent is reduced to 10.32

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percent in 2011. In 2013, the revenue shortfall is approximately 5 million dollars. Approximately half or 1.8 million of the forecast revenue shortfall in 2011 is the combined result of two factors.

First, the conclusion of a number of revenue and cost amortizations approved by the Board following Newfoundland Power's 2008 rate case. Second, the conclusion of the one year amortization of hearing costs proposed in this application. The remaining two million is associated with various cost increases. It may be possible to deal with the expiring amortizations through some form of regulatory relief. The remaining shortfall of 2 million, however, presents a challenge to the company.

(10:45 a.m.)

Consequently, the customer rates approved as a result of this application may not be in effect for more than one year. Changes in circumstances over the next six to nine months may affect this outlook. This outlook is the basis of the company's proposal to amortize third party costs associated with this application over one year.

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KELLY, Q.C.:

Q. Ms. Perry, in this application, Newfoundland Power is proposing discontinuing the use of the Automatic Adjustment Formula in current financial market conditions. Can you describe for the Board the financial market conditions that Newfoundland Power has experienced?

MS. PERRY:

A. Yes. Financial market conditions have had differing impacts on Newfoundland Power's cost of debt and its forecast cost of equity. In May, 2009, the company issued 30 year First Mortgage Bonds at an interest rate of 6.61 percent. At that time, Long Canada Bond yields were about 3.86 percent, which indicated a credit spread at the time of issue of 2.75 percent. This credit spread was approximately two times the credit spread on Newfoundland Power's 2007 30 year bond issue, and approximately 2.5 times the credit spread on Newfoundland Power's 2005 30 year bond issue. The 2009 credit spread was significantly higher than 2007 or 2005, and indicated an increasing cost of debt for Newfoundland Power in current financial market

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conditions.

Meanwhile, Long Canada Bond yields are currently at approximately 3.9 percent and had been lower over the past year. At current Long Canada Bond yields of 3.9 percent, the Automatic Adjustment Formula would give a 2010 cost of equity of 8.39 percent. This is lower than the 8.95 percent used to establish Newfoundland Power's current customer rates. So on the one hand, 2009 financial market conditions have increased the cost of debt for Newfoundland Power, and on the other hand, the Automatic Adjustment Formula yields a decreasing return on equity. This highlights the practical deficiencies of the operation of the formula in current market conditions. Ms. McShane describes in detail how the Automatic Adjustment Formula results are inappropriate in these financial market conditions.

KELLY, Q.C.:

Q. Ms. Perry, next talk next about OPEBs, and perhaps we can start by having you describe for the Board Newfoundland Power's proposals in this particular case?

MS. PERRY:

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A. The company provides retirement benefits to its employees, including retirement allowances and medical and life insurance for retirees and their dependants. In 2000, the Canadian Institute of Chartered Accountants incorporated accrual accounting for OPEBs into generally accepted accounting principles. Newfoundland Power still uses the cash method of accounting for OPEBs costs for regulatory purposes. Newfoundland Power is proposing to adopt the accrual method of accounting effective January 1, 2010. The company is also proposing that the transitional obligation related to the adoption of accrual accounting for OPEBs be addressed at a future hearing.

The transitional obligation reflects the difference between accrual accounting and cash accounting from 2000 to 2009. The transitional obligation is forecast to be 46.2 million dollars as of January 1st, 2010, and this is expected to grow by over 6 million annually over the next several years if we continue to use the cash method of accounting.

KELLY, Q.C.:

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Q. What are the customer effects of these proposals, Ms. Perry?

MS. PERRY:

A. Newfoundland Power's proposals with respect to OPEBs have two primary effects on our customers. One effect is an increase in 2010 OPEBs cost of approximately 6.8 million dollars. This accounts for an approximate 1.3 percent increase in customer rates. The second effect is on the company's rate base which is financed by customer rates. The additional money that the company receives on the accrual basis will reduce the company's rate base. This will tend to moderate our customer rates over the long term. In this respect, the cash flow benefits of accrual accounting for OPEBs are passed on to customers.

KELLY, Q.C.:

Q. Why is it appropriate for Newfoundland Power to adopt the accrual method of accounting for OPEBs at this time?

MS. PERRY:

A. Newfoundland Power's accounting for OPEB has been before the Board on a number of

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occasions. In Newfoundland Power's 2003 rate case, this matter was first considered by the Board. At that time, regulatory accounting practice was not consistent across Canada. In the company's 2008 rate case, the matter was further considered by this Board. At that time, there were approximately 25 percent of Canadian utilities still using the cash method of accounting for OPEBs. In the settlement agreement on the 2008 rate case, the matter was deferred to the company's next rate case. Consumers were experiencing increasing electricity rates at that time as a result of the high price of fuel at Holyrood. Currently there are only two utilities other than Newfoundland Power still using the cash method of accounting for OPEBs. Since 2000, accrual accounting for OPEBs costs have become the mainstream regulatory practice in Canada. Accrual accounting generally provides a better matching of current cost and revenues. Let me give you an example. Our powerline technicians today provide service to our customers today. The cost of their retirement benefits is a cost of providing service today. Today's

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customers should, therefore, may for those costs. Hydro already operates on this principal.

KELLY, Q.C.:

Q. Why is Newfoundland Power proposing to address the transitional obligation related to OPEBs at a future hearing?

MS. KELLY:

A. Newfoundland Power's transitional obligation is forecast to be 46.2 million as of January 1, 2010. For Newfoundland Power to fully address its OPEBs obligations, including its transitional obligations, would result in increase in customer rates of approximately 2.2 percent. This compares to the 1.3 percent proposed in our application. Addressing the disposition of the transitional obligation at a future hearing will allow for effective phasing in of the recovery of the accrued OPEBs liability. This will help moderate the immediate impact of the accounting change on customer rates.

KELLY, Q.C.:

Q. Ms. Perry, what Post-Employment Benefits does Newfoundland Power currently provide for its

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retirees?

MS. PERRY:

A. Newfoundland Power's Post-Employment Benefits fall into two board categories; Pension Plan, and Other Post-Employment Benefit Plan. In terms of Pension Plan, Newfoundland Power maintains both defined contribution and defined benefit plan. The Other-Post Employment Benefit provided by the company to its employees include allowances paid at retirement and medical and life insurance benefits for retirees and their dependants. Up to age 64, retiree benefit are similar to those provided to active employees. At age 65, benefit levels are reduced. Newfoundland Power's Post-Employment Benefits are a component of the company's overall Employee Compensation Package.

This package provides a level of benefits and costs which are reasonable for employees, reasonable for the company, and our customers.

KELLY, Q.C.:

Q. What OPEBs benefits does Newfoundland Power provide to retirees that are age 65 years or

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older?

MS. PERRY:

A. Newfoundland Power provides life insurance benefits of $10,000.00 and health insurance coverage of up to $5,000.00 per year.

KELLY, Q.C.:

Q. Who pays for these employee's retirement benefits?

MS. PERRY:

A. The cost of retirement benefits is typically shared between the company and our employees. Our Pension Plans provide for company and employee contributions. For other retirement benefits, such as medical insurance, the cost is also shared between the company and employee up to the employee reaching age 65. After an employee reaches age 65, the company currently pays the full cost of retirement benefits.

KELLY, Q.C.:

Q. Now the consumer advocate has raised an issue in his issues list as follows; the extent to which rate payers ought to bear the burden of Other Post-Employment Benefits expense, including liability for the transitional

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obligation, in all of the circumstances, including the fact that post age 65 retirees are not required to make any contributions to the premiums cost. Can I get you to comment on this issue?

MS. PERRY:

A. Yes. The first comment I have is that currently rate payers bear the cost of Newfoundland Power's OPEB in rates today. Those costs reflect the cash payment paid by the company in each year for the benefits. In this application, Newfoundland Power is seeking to change the basis of accounting for OPEBs. This only changes the timing of recovery of OPEBs costs. The second comment I have is that the company's funding of OPEBs benefits for existing retirees aged 65 years and older is considered reasonable.

KELLY, Q.C.:

A. Would you explain for the Board why you concluded that the company's current funding of benefits for retirees aged 65 and older is reasonable?

MS. PERRY:

A. Medical benefits account for most of

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Newfoundland Power's OPEB cost for retirees age 65 and older. When this issue arose during the course of this proceeding, Newfoundland Power undertook a general comparison of its Medical Benefits Plan for retirees, age 65 and older, with the Provincial Government Plan offered by Newfoundland and Labrador Hydro.

There are three key differences between Hydro's Plan and our Plan. Hydro has no benefits cap; we have a $5,000.00 annual cap. Hydro offers dental benefits; we do not have a dental plan. Hydro cost shares medical on a 50/50 basis, and cost shares dental on a 75/25 basis with the retiree paying 25 percent of the cost, and we pay the full cost of medical premiums.

So to establish the cost of an alternative benefit plan substantially similar to that provided by Hydro, the premium cost of these benefits to Newfoundland Power were estimated. The results of this comparison are found in response to Request for Information, CA-NP-345. Mike, if we could go to Table 2 on page 3 of that response, please.

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(11:00 a.m.)

This table shows a comparison of the average annual cost for post age 65 retiree medical benefits under Newfoundland Power's current plan, and the estimated cost to Newfoundland Power for a plan similar to that provided by Hydro. Under the current plan, the average annual premium cost to Newfoundland Power is shown as $2,580.00. Under the alternative plan, the estimated average premium cost to Newfoundland Power is shown as $2,320.00. The Newfoundland Power premium reduction under the alternative plan is $250.00. However, the additional cost to our retirees over 65 years is approximately $2,000.00 per year. Newfoundland Power's existing retirees age 65 and older receive relatively modest pension benefits. The current annual pension benefit is just $14,000.00 per year. The extra $260.00 paid by the company in average annual premium cost for existing retirees is reasonable when considered in the context of overall retirement benefits.

KELLY, Q.C.:

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Q. Does Newfoundland Power expect that it will always fully fund post age 65 retiree benefits on into the future?

MS. PERRY:

A. Not necessarily. In March, 2009, Newfoundland Power agreed with its union to review the Group Benefit Program affecting current employees of the company. While retiree benefits are not a part of this review, it is our intention to review all group benefits concurrently with this review. This will include retiree benefits for those 65 years and older. Any change in retiree benefits could only reasonably affect future retirees. In addition, any potential changes would need to be considered in light of a number of factors.

One is the effect of the change on overall benefit levels relative to the labour market. Another is the appropriate notice to employees of modification to give them a reasonable opportunity to adjust their retirement plan. Another factor would be whether any transitional arrangements are warranted.

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We expect this review to be completed by the end of 2010.

KELLY, Q.C.:

Q. How would changes to OPEB benefits affect annual OPEBS expense?

MS. PERRY:

A. Any change in OPEB benefits can be expected to result in a change in annual OPEB expense. Increasing benefits will tend to increase the expenses, decreasing benefits will tend to decrease the expense, but that is no different than changing any other factor that affects the accrual of future OPEBs cost. For instance, the discount rate, which is the interest rate used to present value the cost of these future benefit payments is determined at December 31st each year. This affects the OPEBs expense in the following year. A 1 percent change in the discount rate changes the annual OPEBs expense by approximately 1 million.

Consequently, any change in OPEB benefits which result from the 2010 review will affect OPEBs expense. The extent of the expense effect will depend on the extent of any benefits change.

KELLY, Q.C.:

Q. Why is the company proposing to adopt accrual accounting for OPEBs in 2010 prior to the completion of the benefits review?

MS. PERRY:

A. I see the accounting proposal and the benefits review as two separate issues. The company's accounting proposal is a first step in adopting accrual accounting for OPEB. There's really no dispute that accrual accounting for OPEBs has become accepted regulatory practice in Canada.

The benefits review in 2010 may affect future OPEBs expense. However, that will be the case regardless of the accounting policy. The cost of OPEB benefits inevitably changes over time. Such cost changes should not determine the appropriate accounting policy. At this stage, we do not know the extent of any changes, nor their overall cost implications, and any changes to OPEB benefits will take time to negotiate and implement.

In addition, if we do not adopt accrual accounting in 2010, the transitional

obligation will continue to grow over the next several years. This will mean a larger transitional obligation that will have to be recovered from customers in the future. In the circumstances, Newfoundland Power considers it appropriate to proceed to adopt accrual accounting for OPEBs in 2010.

KELLY, Q.C.:

Q. Finally, Ms. Perry, I'd like to deal with the Pension Expense Variance Deferral Account. As Mr. Ludlow has indicated, this mechanism to deal with variations in annual pension expense has been resolved with the consumer advocate. Would you explain this mechanism for the Board, please?

MS. PERRY:

A. Yes. Another feature of financial market conditions over this past year has been increased volatility in the discount rate used to value future pension obligations. The December 31st discount rate is used to determine annual pension expense for the next year. From 2007 to today, the discount rates has ranged from 5.25 percent to 8.5 percent, a variability of over 3 percent. A change of

only 1 percent in the discount rate will vary Newfoundland Power's pension expense by between 2.3 and 3.4 million.

Given this volatility and the impact on pension expense, the company proposed that a deferral mechanism by adopted to ensure that the amount of pension expense recovered in rates reasonably reflects the actual expense. The mechanism will operate to true up actual defined benefit pension expense incurred in a year to that used for rate making purposes by way of an annual July 1st adjustment through the Rate Stabilization Account.

The adoption of this mechanism benefits customers by ensuring that the company only recovers the pension expense it actually incurs.

KELLY, Q.C.:

Q. Thank you, Ms. Perry. Mr. Chairman, that's the evidence in chief from the panel. So we're ready to proceed subject to adjournment if you wish to take the break now.

CHAIRMAN:

I commend you for your timing. It's five after 11, so we'll adjourn for half an hour.

(RECESS)

(11:40 a.m.)

CHAIRMAN:

I assume, Mr. Kelly, you're complete, at least with this stage.

KELLY, Q.C.:

Yes, Mr. Chairman.

CHAIRMAN:

At least at this stage, and I guess I'll now turn it over to Mr. Johnson. The floor is yours, sir.

MR. JOHNSON:

Q. Thank you, Mr. Chairman. Good morning, Mr. Ludlow.

MR. LUDLOW:

A. Good morning.

MR. JOHNSON:

Q. Mr. Ludlow, could you provide us an encapsulation of your responsibilities and duties as the President and CEO of Newfoundland Power?

MR. LUDLOW:

A. Yes. Mr. Chairman, I think as the CEO of Newfoundland Power, I have a responsibility to our customers, our employees, and to our

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shareholders. That balances out in many ways. With customers, it's the supply of electricity, the costing of that, the least cost service, and safe operations. The employees again would be a balance of fair, equitable, and a good workplace. To the shareholders, it would be a fair return on their invested capital. That would be a very high level approach, Mr. Johnson.

MR. JOHNSON:

Q. And you referenced the supply of least cost service to customers, and how do you go about, as President and CEO, of ensuring that the least cost service is provided?

MR. LUDLOW:

A. Well, the first thing I do, Mr. Chairman, is to ensure that I have a very solid team around me, people with expertise in the area of finance; such as Ms. Perry; operations, such as Mr. Smith; legal, like Mr. Alteen. With that then, we have to look at the long haul. As I said in my direct this morning, our assets are typically 30 year assets, and the balance between today and 30 years out; supply of proper approaches, purchasing,

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installation, and how the market and how we finance those is how basically we will put that package together.

MR. JOHNSON:

Q. And, of course, it's important to have a team, but what would be your role in driving the least cost service for the customer?

MR. LUDLOW:

A. My role would be to make sure that the team functions and to ensure that we're not off base, that we're following good regulatory practice, and that would follow just what we're dealing with here today in the area of OPEBs. We will be looking at today, we'd look at the future. I would look at the provincial as well as the national developments in how I would bring all that to bear back into my utility, Mr. Chairman.

MR. JOHNSON:

Q. So how would that manifest itself then in the day to day, day in the life of Earl Ludlow at Newfoundland Power?

MR. LUDLOW:

A. Well, Mr. Chairman, I hope you've got a long time because a day in my life seems to be very

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long these days. Mr. Chairman, a day in my life can range from a plan that would start at 7:30 in the morning, to dealing with financial issues, to operational issues, to employee issues, and customer issues. In a typical day, I would be speaking with customers. You will find that my line is never ever unapproachable by customers. It's published. Also my connection with community, my connection with the various constituents that are within the customer base.

It comes down many times to where we're going on a strategic front, and many times down into the tactical front as well as we look at the broad business. So long answer, but it varies from day to day, but I will tell you that it tends to walk from every portion of the utility.

MR. JOHNSON:

Q. I understand that you've been in a previous position in a non-regulated environment. Would that be accurate?

MR. LUDLOW:

A. That is correct, Mr. Chairman.

MR. JOHNSON:

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Q. And how would the non-regulated environment compare to the regulated environment in terms of finding cost opportunities, cost saving opportunities?

MR. LUDLOW:

A. Well, I would have to -- if I were to do a comparison of both jobs, they're totally opposites. In the non-regulated utility, Fortis Properties, is a growth driven utility with assets in nine Canadian provinces and in different countries. So you're always at that front. The actual driving of costs and revenues are basically driven on a property by property basis. As we look at a regulated front, it's much broader, it's much longer in term, in that to change a utility, you're always, always, always looking for continuous improvement opportunities in cost lines, organizational lines, and in particular in environment and safety, and that is a fundamental difference is the time frames in which we talk.

MR. JOHNSON:

Q. And in terms of -- I mean, we're in a regulated environment here, Mr. Ludlow, and I take it the bulk of your career has been as well in the regulated environment?

MR. LUDLOW:

A. Yes, that's true.

MR. JOHNSON:

Q. And in terms of the application, I think you're familiar with the fact that the Board's financial consultants, Grant Thornton, filed a report initially on your initial application?

MR. LUDLOW:

A. Yes, I am.

MR. JOHNSON:

Q. Mr. Ludlow, could I ask you to turn up page 29 of Grant Thornton's July 31st, 2009 report.

MR. LUDLOW:

A. I have to get it from my binder box here. That was page 29, is that correct?

(11:45 a.m.)

MR. JOHNSON:

Q. Yes, that's right. At the top, the Board's financial consultant says, "Based on the evidence included in Exhibit 7 of the company's prefiled evidence, combined with the elasticity impact noted in the company's response to CA-NP-66, Newfoundland Power has

indicated it requires an increase in revenue requirement of approximately 34.7 million in 2010. This increase is based on the proposals that the company has put forward relating to the accounting treatment of items summarized in our report, a rate of return on average rate base of 9.15 percent, a rate of return on common equity of 11 percent, and an interest coverage of 2.72 times. The factors contributing to the increase can be summarized as follows", and then Grant Thornton proposed to give a breakdown of the rate change, which at that time was the 6.1 percent increase, correct?

MR. LUDLOW:

A. That's correct.

MR. JOHNSON:

Q. And at the time, we were looking at a 34.7 million dollar proposed increase in revenue requirement, right, and that's borne out at line 10 of Grant Thornton's components of the 2010 proposed rate change?

MR. LUDLOW:

A. That's correct.

MR. JOHNSON:

Q. Now that has been updated, with the same format used pretty much, but it's been updated in CA-NP-66. Could I ask you, Mr. Ludlow, to refer to that document?

MR. LUDLOW:

A. Yes, I have it. I have it here, it's coming on the screen.

MR. JOHNSON:

Q. And again using a similar format, there is a Table 1 shown, which is the components of the 2010 proposed rate change, and if I just could draw your attention first to the return on rate base, 2.8 percent is referenced in that line, and would I understand from your amended application that 2.2 of that 2.8 is attributable to your company's request to be permitted to earn 11 percent as opposed to the present 8.9 percent currently in customer rates? Would that be your understanding?

MR. LUDLOW:

A. I'm going to have to ask you to repeat that one more time because I can explain what the 2.8 represents.

MR. JOHNSON:

Q. Well, maybe you could proceed in that fashion

then. That's okay.

MR. LUDLOW:

A. Okay, well, if we look at CA-NP-66, Mr. Chairman, and Commissioners, this is a comparison of the proposed application, and the comparator is the forecasted 2010 situation that's been presented in this case. In summary, 2010, we are forecasting a return on equity of 6.45 percent. The proposal or the actual CA-NP-66 compares that to an ROE of 11 percent. The presentation I gave earlier this morning, and the 2.2 percent there, is the reference or the change between the 8. 95 percent return on equity which is currently in rates, and the 11 percent which has been proposed. So, Mr. Johnson, I hope that clarifies.

MR. JOHNSON:

Q. It does, and I think what falls out of that then is that to get to the 2.8, that brings you from where you would have been without anything happening at all in 2010, to what the return on rate base would look like provided that you got everything that you're looking for with your rate application, including your

11 percent return on equity?
MR. LUDLOW:
A. That's pretty much current.
MR. JOHNSON:
Q. And you would only need, as I understand it, because you used a figure of 2.2 percent, when you'd only -- 2.2 is what would be -- rather, .6 would be what's required to go from where you'd be without anything at all happening in 2010, to an 8.95 percent return on equity in 2010. Would that be accurate, and the balance of the 2.2 is just to go from 8.95 to 11 percent?
MR. LUDLOW:
A. I think there's a point that needs to be clarified here. If you look at CA-NP-66, the percent change, I think you also have to include the income tax line as well, so it's 2.8 plus 1.7. I'm getting into the details of the numbers. I'll go so far, Mr. Johnson, so I can help, and then Ms. Perry will help, but 2.8, the increase in the income tax is 1.7, will give you an increase of 4.5 percent on CA-NP-66. Do you see that line?
MR. JOHNSON:

Q. No, I'm afraid I don't.
MR. LUDLOW:
A. Okay, well, if we go the actual return of rate base, 2.8 percent.
MR. JOHNSON:
Q. Right.
MR. LUDLOW:
A. Come on down to the income tax line, the additional 1.7.
MR. JOHNSON:
Q. Uh-hm.
MR. LUDLOW:
A. The income tax on the additional revenues. So that change is 4.5 percent in total. Going from 6.45 to 11 will cause a total increase of 4.5 percent, according to that table.
(Power Failure)
MR. JOHNSON:
Q. So your Exhibit EAL 1, Mr. Ludlow, would show the 2.2 percent return on equity impact. Is that supposed to encapsulate all the extra income tax expense as well that arises from moving from 8.95 percent to 11 percent?
MR. LUDLOW:
A. Yes, it would.

MR. JOHNSON:
Q. Now I'd just like to put -- as I understand your company's evidence, there's no suggestion that your expected return, anticipated return, in 2009, would be to cause a financial shakening, if you will, of the company's integrity. Would that be accurate? You're not complaining about 2009 here?
MR. LUDLOW:
A. No, sir, the observations being made is that we moved to 2010. It's clear we're seeing the Automatic Adjustment Formula activating, we're seeing a decline in revenues, an increase in cost, and an REO of 6.45 percent. That's my evidence that we present.
MR. JOHNSON:
Q. And if I could turn you to CA-NP-68 for a moment, and in particular I'm interested in focusing in on Table 1, which shows your regulated return on common equity from 2004 to 2010 forecast. That 2010 forecast column, that would include all your proposals that you're making in the amended application, would that be correct?
MR. LUDLOW:

A. The 2010 forecast of 42.941 on the regulated return is based on 11 percent return on equity, that's correct?
MR. JOHNSON:
Q. Okay, and your 2009 forecast, your regulated return on common equity would be about 32.48 million in 2009?
MR. LUDLOW:
A. That is correct, and that's based on an 8. 62 ROE.
MR. JOHNSON:
Q. That's on a 8.62 ROE. I take it that there's no disagreement that to go from 32.48 million in 2009 to 42.941 million for 2010, that that would amount to 32.2 percent increase in Newfoundland Power's after taxes return on equity year over year?
MR. LUDLOW:
A. I'd be subject to check, and I do believe Ms. Perry would better address the actual tax positioning there, but the 32.2 number you've referenced is correct as per the number on the screen.
MR. JOHNSON:
Q. Okay. I just want to be clear on this, that

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the amended application of your company expressly states and acknowledges that the period from 2007 through 2009 Newfoundland Power's financial performance will have been consistent with the continued financial integrity of the company. That's as a matter of stated record on the part of the company, right?

MR. LUDLOW:

A. The whole area of financial integrity, I will defer to Ms. Perry. However, in 2009, we've been able to raise that in the spring, and our financial integrity to this point looks okay.

(12:00 p.m.)

MR. JOHNSON:

Q. Now, Mr. Ludlow, to end up with your 42. million dollars after taxes, as I understand it, you will need to earn 66.1 million dollars in income before taxes, and if need be, perhaps we could refer to Exhibit 11, line 26. Can you confirm that that is accurate, that you'd need to earn 63.1 million nearly as income before taxes in order to arrive at the figure that we just discussed of 42 or 43 million?

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MR. LUDLOW:

A. The connections between the two tables, I need to be clear on, because the Exhibit 11 is actually compiled on includes non-regulated expenses as well, and there's a point of clarification that Ms. Perry may be able to clarify that a little better for you, Mr. Johnson.

MR. JOHNSON:

Q. Okay, that's fair. I see the net income line from line 29 in Exhibit 11, and I take your point, but it's in that ball park.

MR. LUDLOW:

A. It would be there, yes.

MR. JOHNSON:

Q. And if I could just ask you to turn to CA-NP-65, Attachment "A", and I'm dealing with page 1 of 9. Are you there, Mr. Ludlow?

MR. LUDLOW:

A. Yes, I am, Mr. Johnson.

MR. JOHNSON:

Q. Okay, thank you. At page 1 of 9, line 26 purports to show the company's income before income taxes for forecast 2009, and the figure -- and again subject to some clarification on

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the point with Ms. Perry, but the income before income taxes line shows 47.656 million as forecast for 2009. Would that be accurate?

MR. LUDLOW:

A. That's correct.

MR. JOHNSON:

Q. And as we have discussed, what you're proposing is that before income tax in 2010, like we just discussed a moment ago, you go to 63.1 million dollars in income before taxes?

MR. LUDLOW:

A. Correct.

MR. JOHNSON:

Q. So that's about 15.5 million dollars more in 2010 income before taxes than 2009's forecast?

MR. LUDLOW:

A. Subject to check on your numbers, I have no calculator here this morning.

MR. JOHNSON:

Q. Just to go back then for a second to the OPEBs expense at CA-NP-66, and that, in particular, is not a line numbered item as such.

MR. LUDLOW:

A. Just bear with me one second. Okay, OPEBs.

MR. JOHNSON:

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Q. It's under the line, additional OPEBs expense.

MR. LUDLOW:

A. Yes, I see it.

MR. JOHNSON:

Q. Okay, and this again runs off the table that Grant Thornton initially constructed, but that would be 1.3 percent of the rate change. We're in agreement on that figure as well.

MR. LUDLOW:

A. We're in agreement on the fact that the number presented in this table, if we keep in mind the comparison that the table is based on, which is the differential between 6.45 ROE and 11 percent ROE, then I would agree.

MR. JOHNSON:

Q. But I didn't think the OPEBs expense changed because of return on equity change, though, Mr. Ludlow.

MR. LUDLOW:

A. That's fair game, that's fair game.

MR. JOHNSON:

Q. And that 6.8 million dollars, just to be perfectly clear, that's the additional OPEBs expense over and above what the cash expense would be in 2010. Is that your understanding?

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MR. LUDLOW:
A. That is my understanding.
MR. JOHNSON:
Q. Now, Mr. Ludlow, as you are aware, OPEBs has been a topic of discussion before the Board before, and in terms of your bringing forward this OPEBs application now, I take it that there's common ground between us that there was no Order of the Board saying that this had to be dealt with in 2010. That's correct, we're okay on that?
MR. LUDLOW:
A. I think we agree on that one, yes.
MR. JOHNSON:
Q. So from a business perspective of Newfoundland Power, was there any reason to bring that forward, you know, at this time, as opposed to a later time?
MR. LUDLOW:
A. Well, I think Mr. Chairman, there's two reasons that OPEBs has been brought forward in 2010. Number one, is that in the settlement agreement of 2007, there was an agreement that at the next general rate application, we would bring forward a proposal. This is the next

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general rate application and we're bringing forward a proposal, albeit there was a general sense that we could make it to 2011. That's one. The second point that further supports bringing OPEBs forward now is that in 2007, we were looking at $150 barrel oil, subject to check, Mr. Johnson. It might have been 120-130, but it was in those ranges, and prices were increasing at that point.
As I sit here now, and I say, well, what will the world be like in 2011. I don't know. But I do know that there are factors and some of those factors, number one, oil price again is uncertain. Two, it appears that Newfoundland and Labrador Hydro will be before this Board within the next 12 to 18 months. That's what I'm understanding. And thirdly, we're already showing pressures in 2011 as Ms. Perry put forward in her direct this morning.
So from a business perspective, no, we did not have to--OPEBs are not committed, but we were committed to bring forward a proposal. I think what's needed, Mr. Chairman, is we need some, out of this proceeding, even a direction or timing or something regarding

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accrual would be very helpful, but that's the basis of the whole story, Mr. Johnson.
JOHNSON, Q.C.:
Q. And you know, just interesting, and we realize the rates went down on July 1st and of course, Newfoundland Power had no control or say over that happening, and but it still also strikes me that it is true to say that since 2004, if Newfoundland Power gets its proposed increase as filed, starting January 2010, that rates will have increased by 28 percent since 2004, and that's borne out at CA-NP-81, isn't it?
MR. LUDLOW:
A. Mike, could you bring CA-NP-81 to the screen, please? Mr. Chairman, as the Consumer Advocate has stated, assuming that all items proposed in this rate application come through, there will be roughly an 8.9, 8.6 and an 8.1 percent increase. My math is a bit rough. I would give it whatever that number totals to, 26-27 percent roughly, Mr. Johnson, I think you used.
JOHNSON, Q.C.:
Q. Yeah, I'm referring to lines five to seven of the company's response.

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MR. LUDLOW:
A. Yeah.
JOHNSON, Q.C.:
Q. That states "assuming Newfoundland Power's proposed rates, tolls and charges are approved as filed, customer rates will have increased by approximately 28 percent since 2004, as of January 1st, 2010, on a compounded basis."
MR. LUDLOW:
A. So that is correct. The point that I think also needs to be brought out in this table, Mr. Chairman, is as we look at the first line in Table 1, up to 2009, Newfoundland Power's total contribution was roughly--my math is getting a little bit rough here this morning, but I'm going to say about 1.6. So I do believe, Mr. Johnson, in totality, the 28 percent is an accurate number, but our contribution is also there as well. That's a pretty good track record.
JOHNSON, Q.C.:
Q. But I guess, you have to--the consumer doesn't care who's making a contribution though, right. We're in agreement on that?
MR. LUDLOW:

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A. At the end of the day, a rate increase is never a good circumstance. That I would agree to.

JOHNSON, Q.C.:

Q. And just to go back then again though to CA-NP-66, that first revision, we see there that we have the Energy Supply Cost Variance Adjustment which is responsible for one percent of the overall 7.2 percent, and so there was no need--was I right in my opening, Mr. Ludlow, to say that obviously there was no need for you to have an application this year to recover energy supply cost variances?

MR. LUDLOW:

A. We would have recovered those costs in 2011. However, when we file a general rate application, all costs should be tested and that's the understanding of the regulatory construct under which we operate, Mr. Chair. So therefore, the reason that the energy supply cost variance has been included is to rebase or rebalance those costs. So that is the explanation, Mr. Johnson, on that point.

JOHNSON, Q.C.:

Q. The idea, as I understood it, Mr. Ludlow, was,

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for instance, that the energy supply cost variance which first got proposed and implemented at the last case, that you know, it was supposed to be an automatic pickup mechanism for the purpose of avoiding, you know, general rate applications and to allow Newfoundland Power to pick up its prudently incurred supply costs and so, you know, I guess there it is. You're here and you need those funds in 2010?

MR. LUDLOW:

A. Well, Mr. Chairman, you know, it is confirmed that we would have collected those funds in 2011 as the Consumer Advocate has articulated. However, when we're here with a general rate application, the cost should be tested and rebased and hence, the reason they are, in fact, in the filing, Mr. Johnson.

JOHNSON, Q.C.:

Q. And still on CA-NP-66, we have the MTA line. That's the municipal tax adjustment line. That's point two?

MR. LUDLOW:

A. Correct.

JOHNSON, Q.C.:

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Q. And again, would I be correct in saying that you would have picked up that in the normal course of events as well, even had Newfoundland Power did nothing in 2010?

MR. LUDLOW:

A. Just bear with me one second. The MTA line, municipal tax, I do believe that is correct, and again, I would defer to Ms. Perry on this one in particular. In there, that part is an area that I'm not quite 100 percent familiar with. I would say it that way too.

(12:15 p.m.)

JOHNSON, Q.C.:

Q. Okay. That's fair. I guess there was also no need to file a general rate application to ask the Board whether you could file your depreciation study in light of the IFRS earlier than they had previously ordered?

MR. LUDLOW:

A. That's correct.

JOHNSON, Q.C.:

Q. And would you please turn to CA-NP-76, Mr. Ludlow? And I'm referring in particular to the June 2009 Power Connection issue that I guess we all received, and customers received.

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This is your newsletter for customers of Newfoundland Power, it indicates on the top, and I take it this would have been sent out very shortly following the filing of the general rate application?

MR. LUDLOW:

A. That's correct.

JOHNSON, Q.C.:

Q. And what struck me is the fourth paragraph where you indicate, "for January 1st, 2010, the company is proposing an overall average increase to current electricity rates of 6.1 percent. This increase is proposed in our 2010 General Rate Application, GRA, which will involve a full review of Newfoundland Power's costs and customer rates. As a regulated utility, Newfoundland Power is required to periodically file a GRA with the PUB." Now we know, Mr. Ludlow, that the PUB didn't require you to file this GRA, correct?

MR. LUDLOW:

A. That is correct.

JOHNSON, Q.C.:

Q. And do you see how someone reading this could reasonably conclude that it was the PUB that required Newfoundland Power to file a GRA at this time?

MR. LUDLOW:

A. It's a matter of semantics, and I can assure the Chair that if people read it that way, that was certainly not the intent. There is no question why we are in front of this Board and we have said that clearly. We've said it in press releases, in press releases that we even debated whether we'd put out there. We're here because of our declined return in 2010 and the expenses and the revenue decrease. So if you read it that way, I guess you possibly could, but I could just as easily read it the other way. It was not intentionally worded so.

JOHNSON, Q.C.:

Q. And then to go on into the fifth paragraph, where you're talking about, you know, how "we work hard to manage our controllable operating costs," etcetera, and "over the past five years alone, we've invested over 300 million in capital projects, resulting in a 25 percent decrease in the number of outages per customer over the same period, although we have been

able to maintain the same level of operating costs for the past five years. Current market conditions are placing upward pressure on our costs" and then you make the statement, "the main cost drivers behind this GRA include an increase in the cost associated with the delivery of electricity to our customers, changes in accounting practices for retirement costs and the company's return on equity." Would it not be a reasonable reading of this for a customer to say, you know, "they must have to come in, for instance, to deal with changes in accounting practices for retirement costs, because this is a main driver." But that's not true, is it? If someone were to conclude that that was a reading of this document, it's not true, in fact, that you had to come in to deal with the accounting costs.

MR. LUDLOW:

A. Mr. Chairman, I particularly take exception to the word "not true." This is presented as to the main drivers of the 6.1 percent that was filed in May and it laid out what the main drivers behind the 6.1 percent were and it is very clear that it was the cost associated

with the delivery of electricity. It was also changes in the accounting practices, not in the benefits, but changes in the accounting practices for OPEBs and the company's return on equity, and that's very clear and it was worded that way specifically.

JOHNSON, Q.C.:

Q. Well, it says the main cost drivers behind this GRA, which is general rate application.

MR. LUDLOW:

A. Correct.

JOHNSON, Q.C.:

Q. I just found it, with passing, odd that you'd refer to this as a driver, which to my mind would be a means of telling people, look, we have to be in here. We're being driven in here. Yet OPEBs in fact is not really a driver and, you know, energy supply cost variance is not really a driver. The MTA is not really a driver. Isn't the real driver here ROE, Mr. Ludlow, which gets third billing in this paragraph, and by the way, and the company's return on equity?

MR. LUDLOW:

A. I'm sorry, that was a long question, and if

you could break it down for me, please?

JOHNSON, Q.C.:

Q. Yeah, well, it seems to me that the lead is buried in this Power Connection. You know, the main cost drivers behind this GRA include an increase in the cost associated with delivery of electricity to our customers. That's one. Changes in accounting practices for retirement costs, and third, the company's return on equity. But wouldn't you say that the real driver is the cost on equity? That's bigger than OPEBs, bigger than the delivery cost to customers.

MR. LUDLOW:

A. Mr. Chairman, there's no question why we're in this room. My evidence has been repeated on two or three occasions. We're looking at a 6.45 ROE in 2010 and that's being contributed by declining revenues and increase in expenses. I've already agreed with the Consumer Advocate regarding the OPEBs, and this is a process, we're meeting orders and we're going to continue to do so. The energy supply cost variance mechanism likewise. We're here to test costs and they need to be rebased. So if you want to take exception, Mr. Johnson, to the order, I'm sorry, I can't change what's already done, but I did approve that letter.

JOHNSON, Q.C.:

Q. Now I understand that there is increase in 2010 conservation program spending costs Newfoundland Power has undertaken, and in 2009, as I understand it, Mr. Ludlow, your rates did not include monies to undertake the 2009 conservation spending initiatives either, right, and the company applied to the Board, did it, in 2009, to cover that off?

MR. LUDLOW:

A. That is correct.

JOHNSON, Q.C.:

Q. Okay, and what was the purpose of that application, as you understand it, Mr. Ludlow, in late 2008?

MR. LUDLOW:

A. Well, Mr. Chairman, the application that came before the Board for the, I guess, the whole conservation issue, we've been moving in this direction since 1992. Public policy clearly stated in 2007, September, in the Energy Plan,

a move towards conservation. We've jointly come together with Newfoundland and Labrador Hydro and with the Provincial Government. So a proposal was put to the Board with the plan and then subsequently for the actual accounting and amortizations accordingly and that's where that came from, Mr. Johnson.

JOHNSON, Q.C.:

Q. Okay, but, and I take it wasn't a rationale that the company put forward at the time, Mr. Ludlow, was that either you can do--give us a deferral of these expenditures or the other alternative is to trigger a GRA in order to have our rates reflect the 2009 conservation cost expenditures? Wasn't that the position?

MR. LUDLOW:

A. I guess there was another position that we not do it, which just didn't seem right as well.

JOHNSON, Q.C.:

Q. But the alternative to asking for an account to be set up to cover these 2009 costs and have them amortized later would be to avoid a GRA?

MR. LUDLOW:

A. I would agree with that.

JOHNSON, Q.C.:

Q. And so I guess my question is for 2010, was there a necessity to--because in 2010, you're going to be spending a bit more on conservation, which is not included in your rates, was it not also possible to seek a similar deferral account so that the show could go on and you could deliver these programs to customers?

MR. LUDLOW:

A. Sure, it was a possibility in the conservation side, but again, all we're doing is pushing costs ahead, and the whole area around conservation and details and that side, Mr. Chairman, Mr. Smith will be prepared to deal with any of the details on that as well, so I'd just add that piece.

JOHNSON, Q.C.:

Q. But would it be fair on my part then though, Mr. Ludlow, to assume that when Newfoundland Power was back before--was before this Board back in the fall of 2007, that you did not anticipate being back now, correct? You anticipated being back in 2010?

MR. LUDLOW:

A. That I would agree with, yes.

JOHNSON, Q.C.:

Q. Okay, and back in 2007, you also would have anticipated a roll out of the conservation program portfolio in both '09 and '10?

MR. LUDLOW:

A. That's a possibility, but to the level and to the detail design, no, I would have no idea. The other thing that's happened since 2007, we cannot overlook the market, the market volatility, the situation that's happened in that front. So if we want to talk about what's happened in 2007 versus what's happening in 2009, looking forward to 2010, conservation, conservation we were on a plan. We were looking forward. We were trying to pull together with Newfoundland and Labrador Hydro which has worked very, very well, I might add, with the nltakecharge.ca, but there's a lot of other factors come into play and hence the reason we're here today and not in 2010 for 2011.

JOHNSON, Q.C.:

Q. Let me just then turn, Mr. Ludlow, to this PEVDA, and you've spoken and I think Ms. Perry

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has spoken as well about the volatility in the discount rate, and let's see if we've got this right. If your discount rate goes up, that means the amount of pension expense goes down, correct, in general terms?

MR. LUDLOW:

A. That's my understanding.

JOHNSON, Q.C.:

Q. Okay, and as well, in addition to what the discount rate's effect on pension expense will be, you also have pension expense affected by what's happening to the value of the assets in the pension portfolio, if you will? Would that be -

MR. LUDLOW:

A. I'm going to say subject to check, Mr. Chairman, but I do know that the whole area of pension expense, discounts and all those areas is beyond the mind set of an engineer, I have to say that. Hence the reason I have a very talented CFO here. But you know, with respect to PEVDA, if you have a question there, I would address, Mr. Johnson.

JOHNSON, Q.C.:

Q. Okay, and that's fair. I mean, as your

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predecessor, Mr. Smith, used to like to remind me, he didn't like going in over his waders and that's all right.

MR. LUDLOW:

A. I'm in there.

JOHNSON, Q.C.:

Q. But let me tell you what I'm driving at, Mr. Ludlow. I heard the evidence this morning about volatility, and we all know there's been volatility in '08 and '09, and what it was doing to discount rates and anybody who has any investments knows what's happened. It seems to me that it would have been perfectly viable and possible for Newfoundland Power, on one of its stand alone applications, to come before the Board and say "Board, you wouldn't believe the volatility that's out there with these discount rates. It's unbelievable. You should see what's going to happen between 2008 and 2009. We are proposing a PEVDA and that will capture what the pension--the real actual pension expense will be in case the real actual pension expense in '09 is different from what's embedded in rates in 2008." Now do you follow me so far?

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MR. LUDLOW:

A. I'm trying. I'm doing okay so far.

JOHNSON, Q.C.:

Q. And what I'm getting at, Mr. Ludlow, is that's not a far fetched application for Newfoundland Power to make, is it?

(12:30 p.m.)

MR. LUDLOW:

A. Mr. Chairman, the pension expense of 5.5 million dollars that's included in this file is the difference between nine and ten. Nine is not a tested number and we came before this Board, I do believe it was 2005 or 2006, with a depreciation application, and we were declined because it was not a tested series of numbers. So really, I don't think we had a choice and hence the reason we've included it. What PEVDA will do is if, as proposed, the discount rate of 6.5 is included in rates, if that discount rate goes to 7.5, it'll flow through PEVDA and clear itself through the RSA in a subsequent year or in that year. Again, that's the activation of the account and it's about the testing of the expense and the fact that these have not been tested in front of

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this Board.

JOHNSON, Q.C.:

Q. But 2008 pension expense got tested, right?

MR. LUDLOW:

A. The whole point here, I said to you, sir, that's the basis upon which we've included it.

JOHNSON, Q.C.:

Q. And I don't understand it, so I just wanted to plum a little bit further with you, Mr. Ludlow, and at some point, if you say "I've had enough of you, address it to Ms. Perry," fine, but what I want to understand though is 2008, Newfoundland Power's pension expense got tested and got approved. We're in agreement on that?

MR. LUDLOW:

A. I think I can go there, yes.

JOHNSON, Q.C.:

Q. Okay, and had a PEVDA account been set up, say, to capture variance for say 2009, you would have, at some point, seen what the actual 2009 pension expense was and then say well, that's either less or more than the 2008 tested pension expense that's in rates. So let's flow that through a July 1st mechanism, a PEVDA. That's all I'm getting at.

MR. LUDLOW:

A. I'm in over my waders, Mr. Chair, to quote the Consumer Advocate.

JOHNSON, Q.C.:

Q. Okay, that's -

MR. LUDLOW:

A. I will not agree with his position. However, we basically began this process in March or January--March, I guess it was, late March for the filing and there was no question as we looked out where we were going, and the ROE forecast for 2010 was simply unacceptable, and that combined with the activation of the AAF, that's the reason we're here today. All the individual pieces, the testing of it, Ms. Perry will be able to speak to that later, but at the same point--and if not, the whole concept of pension expense for next year is to basically get rid of the market volatility into the future and that's basically the reason it's been filed.

JOHNSON, Q.C.:

Q. Well, it doesn't get rid of the market volatility obviously, but in any event, let's

address it with Ms. Perry. Mr. Ludlow, just to turn to another theme for a moment, and we've touched on it tangentially, I suppose, but 2008 and 2009 were pretty challenging years in terms of the global recession and millions of layoffs, foreclosures, companies retrenching, going under, etcetera, and through that period, I take it Newfoundland Power has been pretty insulated in that regard. Would that be fair to say?

MR. LUDLOW:

A. No, we've seen the impacts of a change in our distribution systems, in customer growth from rural to urban. We've got effectively two service territories. Expectations on reliability. No, we have not been isolated on those fronts.

JOHNSON, Q.C.:

Q. But what are you referring to when you're talking about the urban and rural aspect?

MR. LUDLOW:

A. Well, let's go back to--and Mr. Chairman, you in particular would know this. As we look at the City of St. John's and the robust growth that's happened in 2008, 2009, we've connected

probably roughly 5,000 houses over forecast from 2007. The same time as I look at what's happening in 2009, and I'm going to use the word "rural" and I say that in a positive tone, I'm from there myself. That area has effectively stopped growing. So we've got very little growth in the rural. That's what I'm talking about two service areas totally. So we have not been isolated. While we speak, we have 20 PLTs transferred from across this island working in St. John's trying to keep up with work today.

JOHNSON, Q.C.:

Q. But I guess I'm interested in the tie in to the--you know, what we've seen in the recession, because as I understand it, Mr. Ludlow, and you can correct me if I'm wrong on this, but that trend towards metro predates '08/09.

MR. LUDLOW:

A. Not at the same level. It was growing fast, but we've seen--robust is a word I don't use very often, but it's been robust in the last two years, far outstripping any forecast.

JOHNSON, Q.C.:

Q. Okay, so better than forecast?

MR. LUDLOW:

A. Much higher than forecast.

JOHNSON, Q.C.:

Q. Okay, and in terms of let's personalize though the effect. Newfoundland Power has not had to lay anybody off because of economic conditions. Is that correct?

MR. LUDLOW:

A. We have not laid off any people, that's correct.

JOHNSON, Q.C.:

Q. And in fact, you've added fairly significantly to the staff complement at Newfoundland Power. Would that be correct?

MR. LUDLOW:

A. The demographics and the workforce of our company, in particular in the areas of conservation and in the trades, specifically in the area of power line technicians, technologists and engineers, we're addressing a workforce demographic issue, which has also been presented in our evidence.

JOHNSON, Q.C.:

Q. Just if I could refer, Mr. Ludlow, to the

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company's amended application at page 213, and I'm referring in particular to Table 2-2, and I guess this is what I'm referring to in terms of the addition of--well, it's expressed here as FTEs, full-time equivalents, at Newfoundland Power. You know, from '08, we had 628. 2009 forecast, 641, and then 2010 forecast, 651. Just give us a sense of what that translates to in terms of actual human beings that are working with Newfoundland Power?

MR. LUDLOW:

A. Oh, you're into Mr. Smith's evidence.

JOHNSON, Q.C.:

Q. Okay.

MR. LUDLOW:

A. That will be able to take this right down to detail for you, but just, if I may, FTEs are full-time equivalents whereby we calculate the number of hours worked by individuals and divide it out rather than individual bodies, if I may, as a point of explanation.

JOHNSON, Q.C.:

Q. I was sort of interested in how many full-time staff do you have, you know, how many -

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MR. LUDLOW:

A. And the point behind using the FTE is to normalize that across the company. It can change. We had people that'll move and shift and we may not replace, but the FTE is a more consistent barometer. That's the basis for that presentation. But Mr. Smith can take you through and will, and very capably take you through the FTE line, the costing lines and the numbers of full times.

JOHNSON, Q.C.:

Q. Okay, now you became president and CEO of Newfoundland Power on April 30th, 2007, Mr. Ludlow?

MR. LUDLOW:

A. I did.

JOHNSON, Q.C.:

Q. Okay, and I guess, and you heard what I had to say at the beginning, in terms of that Newfoundland Power has been and will continue to be a very well protected, stable, predictable, conservative, low risk utility operating in a very supportive, regulatory environment where the company enjoys moderate, yet fairly steady customer growth, free from

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any significant competition. Do you take any issue with that characterization of Newfoundland Power, Mr. Ludlow, as its present CEO?

MR. LUDLOW:

A. Sounds to me like that would be a quote from a ratings agency somewhere, probably Moody's or something of that type. But at the same point, the only piece I would say there is that we do have low growth and we're projecting further continued low growth, moderate at best, at one, one and a half percent, and that's been consistent. We are a small utility. So when I look at the business risks, those would be the two factors I would put in there. I take no exception with those quotes.

JOHNSON, Q.C.:

Q. And do you have a sense of how, you know, Newfoundland, your territory in terms of customer growth, because you've explained it's robust, not a word you use much, but it's robust around this neck of the woods. Not so in others. But overall, Mr. Ludlow, given all the hard times, do you have a sense of how

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you're doing relative to others, say in United States, for instance, what's happened to their customer growth?

MR. LUDLOW:

A. Do I personally?

JOHNSON, Q.C.:

Q. Yes.

MR. LUDLOW:

A. I look at Canadian utilities generally, is how I would look through my involvement in the boards of different associations, and see how things are progressing in different parts of the country. You know, I've worked in four Canadian utilities, Mr. Chairman, now. Many of them had growth much higher than where I'm working today. Generally, on par, I would suggest. Over the last year or two, we've borne out reasonably well.

JOHNSON, Q.C.:

Q. And Mr. Ludlow, in terms of your position, I'd also referred in my opening comments to your salary increase, and if we could turn to CA-NP-246? We're looking at Table 1, which shows your base salary, 2007 was 315,000, and 2008, you receive a 6.3 percent increase in your base and 2009, you received a 10.4 percent increase in your base to 370. Mr. Ludlow, are you expecting the base to go up again in 2010?

MR. LUDLOW:

A. Mr. Chair, I have no idea where that base salary will go. I have not received--I have not tracked the market in the Canadian industrial, so the answer is I just don't know. It's too late in the--too early in the year yet, and it will be another month or two to see what happens.

JOHNSON, Q.C.:

Q. Let's put it this way. If Hay were to turn around and say "we think it ought to go up 10 percent in 2010," I mean, will we see 10 percent in 2010?

MR. LUDLOW:

A. Mr. Chairman, that question and the process that we follow is I do not set my own salary. The salary that I am paid is based on the 50th percentile of the commercial industrial. It is basically presented to the HRN governance committee of our Board, as I present the other executive members. There is no discussion on my salary in that room. Their subsequent

recommendation goes to the Board of Directors. I am a member of that Board. I am excused from any discussion on my salary or executive salaries in that room. It will be to the Board's discretion.

JOHNSON, Q.C.:

Q. So if we could turn to CA-NP-122? In this request for information, I asked for Newfoundland Power to provide a copy of Newfoundland Power's current manager and executive group salary policy and incentive targets, and Mr. Ludlow, we see that this is current for 2009. It shows a base salary again of 371,600 and then an incentive target of 40 percent, which is a percentage of base pay. That's what you're under. Is that right?

MR. LUDLOW:

A. That is the salary policy. My salary is not 371,600. It's 370,000.

JOHNSON, Q.C.:

Q. Okay, but the 40--but you would expect to receive 40 percent if targets are met of your base salary, as part of the incentive target?

MR. LUDLOW:

A. That is correct.

JOHNSON, Q.C.:

Q. And if you--and that target of 100 percent, that's all paid by customers. There's no quibble about that?

MR. LUDLOW:

A. That is correct.

(12:45 p.m.)

JOHNSON, Q.C.:

Q. Okay, and so that would come to compensation of about 518,000 in terms of the base salary, because you say it's 370, and that's fair, plus an incentive target.

MR. LUDLOW:

A. The actual number, I haven't done the calculation, but it would be 370,000 plus 40 percent of base if targets are met, whatever that calculation is, Mr. Chairman.

JOHNSON, Q.C.:

Q. And what would the targets--what are the targets for 2009, Mr. Ludlow?

MR. LUDLOW:

A. Those targets have been presented. I do believe you did request them, Mr. Johnson, in an IR. Bear with me a second. CA-NP- 124

presents the short term incentive plan, corporate targets.

JOHNSON, Q.C.:

Q. And you're referring to attachment A?

MR. LUDLOW:

A. I'm sorry, Table 2, and that is the corporate targets. The incentive plan is formed from two parts. One is a corporate target. Second is a personal target series. 75 percent of the weighting, in my case, would be applied to the corporate targets and 25 percent would be applied to the personal targets, and those are another attachment in this same IR.

JOHNSON, Q.C.:

Q. And I think from previous figures that we've already talked about, in terms of Newfoundland Power's forecast earnings, you should expect in 2009 to meet your target, because the target for earnings for the company is 31.7 million, but we're forecasting higher than that, right?

MR. LUDLOW:

A. The actual number being forecasted, I haven't--I did the calculation, it was too rough. Could I just--bear with me one second, please.

It's actually 31.4 million is the earnings.

JOHNSON, Q.C.:

Q. You're talking about the earnings under your target?

MR. LUDLOW:

A. Correct, as per Exhibit 3, Mr. Chairman.

JOHNSON, Q.C.:

Q. So you got to find 300 grand. Now, and I also note, Mr. Ludlow, in CA-NP-122, that it gives--the rest of the leadership team is listed there as well, and just to take VP Engineering and Operations, that's Mr. Smith. His base is 250,400 plus an incentive target of 30 percent, okay. Now if you could turn to 287, Attachment B? And I understand that this is part of a notice to shareholders and a management information circular. It's dated March 11, 2009, but it provides information concerning the annual and long-term compensation earned for services rendered by the named executives of Newfoundland Power as at December 31st, 2008. Would that be correct?

MR. LUDLOW:

A. That is correct.

MR. JOHNSON:

Q. And so we see that there are several columns going across the top. We have Salary, which we've already talked about, that's the base salary, correct?

MR. LUDLOW:

A. Right.

MR. JOHNSON:

Q. Now these are old figures, but -

MR. LUDLOW:

A. No, that's fine. Yes, that is correct.

MR. JOHNSON:

Q. Okay, and then we have option based awards and for you, that's $169,228 and is that the Stock Option Plan?

MR. LUDLOW:

A. That is a Stock Option Plan that is based on 300 percent of my wages.

MR. JOHNSON:

Q. And that's paid for by the shareholders?

MR. LUDLOW:

A. That is correct.

MR. JOHNSON:

Q. Okay, and then we have the Annual Incentive Plan and the plan for you was 160,000 and that's, I take it, a reflection of your percentage of your base, if you will, your incentive part that we've already discussed, is that right?

MR. LUDLOW:

A. That is correct, it's a short-term incentive.

MR. JOHNSON:

Q. Okay, so for 2008, did you go above your target? Because I think that Option Based Awards is slightly above the target, slightly above the 100 percent, I'm sorry.

MR. LUDLOW:

A. Sorry, could you just repeat your question please?

MR. JOHNSON:

Q. Yes, I see 169,228 and I'm wondering if that represents more than 100 percent of your incentive for 2008?

MR. LUDLOW:

A. Mr. Chairman, I think the Consumer Advocate is getting a couple of things confused here. To walk across this table, this is a management information circular, as correctly pointed out. Line 1 is the base salary of 335 and that ties back into a previous IR. The next column entitled "Option Based Awards", that's a Stock Option Plan that is based upon certain percentages of salary. In my case, my Stock Option Plan is 300 percent of base wage and the value applied here is--and now I'm really going in over my waders, Mr. Chairman, that is a future based--present worth of a future based share. Black-Sholes is what's being used. Jocelyn or Ms. Perry can explain that a little further, but that's what that one applies to. So here I was awarded 300 percent of my base wage in share options valued at a given point in the day.

MR. JOHNSON:

Q. I think you're doing well.

MR. LUDLOW:

A. Thank you. Then we go to the Annual Incentive Plan -

MR. JOHNSON:

Q. Mr. Ludlow, I think I've got you. I mixed up the two columns.

MR. LUDLOW:

A. Okay, thank you.

MR. JOHNSON:

Q. I thank you for correcting me on that. Then I

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take it we have the Annual Incentive Plan, which is 160,000 and the reason I'm wondering whether that one went above 100 percent of target is because from the previous RFI, 122, I thought it showed that 40 percent for you would be 148,640 and that was based on the 3716 policy base. So I'm just wondering did you do better than 2008 than 100 percent on your short term incentive or your Annual Incentive Plan?

MR. LUDLOW:

A. Yes, I did.

MR. JOHNSON:

Q. Okay, yeah. And to the extent that you did better than 100 percent, the shareholders picked that up?

MR. LUDLOW:

A. That is correct.

MR. JOHNSON:

Q. Okay. And then you talk about the pension value and just explain to us the $55,650, would this not represent actual monies paid to you in that year for your retirement purposes?

MR. LUDLOW:

A. No, it do not. There's two items included in

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here. One is I am not part of the Defined Benefit Plan of Newfoundland Power. It closed in 2004 and throughout my career, I've been indifferent companies. So when I returned to Newfoundland Power in 2007, my pension plan is a DC Plan or Direct Contribution Plan. And the way it is basically set is that up to the CRA limit, there's a matching of 6.5 percent and beyond the CRA limit, there's a notional account and again, I'm going to defer to Jocelyn to explain the concept of notional accounts, but there's no monies transferred to me. It is an amount held in future promise and that's based on 13 percent of the amount above the CRA limit.

MR. JOHNSON:

Q. Okay, thank you for that, Mr. Ludlow. And then under "All Other Compensation", there's $4,038 and as I see the footnote there, footnote 4, it says it includes, number one, the dollar value on imputed interest benefits from loans provided to named executive officers and the dollar value of insurance premiums paid by the Company with respect to life insurance, and then the other line deals

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with Mr. Smith. So this would be all other compensation that you received, would that be--that would fit footnote 4?

MR. LUDLOW:

A. Yes.

MR. JOHNSON:

Q. And I'm just wondering how about, you know, the fact that the Company provides you with a vehicle and pays for the insurance and registration and gasoline and maintenance, does that figure into any of these tables?

MR. LUDLOW:

A. When we speak about the M.I.C., there are certain rules--again, Mr. Chairman, I can't even begin to explain, but there are rules governing the Management Information Circular as to what goes in and don't go in and so on. But I am supplied with a vehicle and fuel and I pay the appropriate tax based on that as per CRA.

MR. JOHNSON:

Q. Okay, and I note though, keeping on that footnote, actually, there's an amount there for Mr. Smith, Gary Smith of 20,329. And that footnote indicates that of that amount,

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$19,017 dollars received by Mr. Smith was received by Mr. Smith as a relocation allowance relating to the commencement of his employment with the Company, effective July 1st, 2008. And so that's when he joined Newfoundland Power?

MR. LUDLOW:

A. That's correct.

MR. JOHNSON:

Q. Okay, and he, I understand from footnote 7 that Mr. Smith had been, up until that date, vice president of operations and engineering for Fortis Alberta Inc., until that date?

MR. LUDLOW:

A. That's correct.

MR. JOHNSON:

Q. And would that relocation allowance have been--is that a regulated expense, Mr. Ludlow?

MR. LUDLOW:

A. Subject to check, but I do believe it is.

MR. JOHNSON:

Q. And why was it that we had to fill a position at Newfoundland Power in terms of the vice president of engineering and operations' position on July 1st, 2008?

MR. LUDLOW:
A. Because I lost my vice president of engineering and operations at the same time. I had a vacancy.
MR. JOHNSON:
Q. Was that Mr. Phonse Delaney?
MR. LUDLOW:
A. Yes, it was.
MR. JOHNSON:
Q. And how did you lose Mr. Phonse Delaney?
MR. LUDLOW:
A. Mr. Delaney basically, I guess, saw the bright lights of the west coast and decided to go to Alberta and he became the vice president of operations in Alberta.
MR. JOHNSON:
Q. Are you talking about the vice president of operations for Fortis Alberta Inc.?
MR. LUDLOW:
A. Yes, I am.
MR. JOHNSON:
Q. Would that be the very same position that Mr. Smith held prior to coming to St. John's?
MR. LUDLOW:
A. Yes, it would.

MR. JOHNSON:
Q. And would I be right in assuming that the good people of Alberta paid the relocation costs for Mr. Phonse Delaney in going to Fortis Alberta?
MR. LUDLOW:
A. I'm not in a position to comment on what the relocation and how it was treated in Alberta was for Mr. Delaney, Mr. Chairman.
MR. JOHNSON:
Q. I see under Option Based Awards that Gary Smith received nothing under Option Based Awards in that summary compensation table and I note Mr. Ludlow that there is a footnote, footnote 7, which explains that Option Based Awards do not include the value of options granted to Mr. Smith in 2008 under the Fortis Stock Option Plan while he was an officer of Fortis Alberta Inc., that's your understanding, that's why that's blank?
MR. LUDLOW:
A. That's what the footnote says, Mr. Chairman.
MR. JOHNSON:
Q. Okay, and would that also mean, that logic, would that also be applied in respect of Mr.

Smith to the Annual Incentive Plan column, i.e. that is to say that Mr. Smith's Annual Incentive Plan, column of 90,000, that that would not include amounts granted to Mr. Smith in 2008 while he was an officer of Fortis Alberta Inc.?
(1:00 p.m.)
MR. LUDLOW:
A. I'm just thinking here. Your observation on the Option Based Awards is correct and that is something granted by Fortis Inc.'s governance and HR committee and the STI, which was paid--or the Annual Incentive Plan, Mr. Chairman, I'm sorry, I'm getting the terminologies mixed up, that was paid to Mr. Smith was a reflection of a full year's work here. The second part of that equation though, is there is no entry, nor was there any compensation paid to Mr. Delaney for his first six months' work at Newfoundland Power.
MR. JOHNSON:
Q. What I understood is that Mr. Smith, I think the record reflects previous--well the record shows right here, in base salary, his base was 118,000, but are you telling me that his

Annual Incentive Plan would have been based on a full year's base salary?
MR. LUDLOW:
A. What I am saying, Mr. Chairman, is that the salary, as highlighted here, is $118,000 references, it reflects the time spent at Newfoundland Power from July 1st onwards. The decision was made or I made the decision that basically Mr. Delaney worked from January to June, his salary is not in that table. The STI or the Annual Incentive Plan, rather than include six months for Mr. Delaney and six months for Mr. Smith, a decision was made that we would compensate Mr. Smith based on an annual salary at Newfoundland Power and not compensate Mr. Delaney for any time spent at Newfoundland Power.
MR. JOHNSON:
Q. So Mr. Smith got Mr. Delaney's bonus? Is that the upshot -
MR. LUDLOW:
A. Is that a question or -
MR. JOHNSON:
Q. Is that the upshot of this?
MR. LUDLOW:

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A. No, the upshot of this is that basically we looked at the year and I looked at the corporate performance and I looked at how we moved through the year and in effect, rather than pay Mr. Delaney for a half year and do those things, we decided to move in this direction, and that's basically the way these calculations were done.

MR. JOHNSON:

Q. Just let me understand this point and then I'll have a look at the record transcript and see if I can figure it out a bit better, but the $90,000 shown in that Annual Incentive Plan under Mr. Gary Smith's name, that money was actually paid to Gary Smith, right?

MR. LUDLOW:

A. That is correct, Mr. Chairman.

MR. JOHNSON:

Q. Okay.

MR. LUDLOW:

A. Sorry to confuse you.

MR. JOHNSON:

Q. And just subject to check, but that would be-- that amount would be 76 percent of what he earned by way of base salary at Newfoundland

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Power in 2008, would that be correct? Would that be just about right?

MR. LUDLOW:

A. Your mathematics are correct, but the foundation of the principle is not.

MR. JOHNSON:

Q. Well you still have time just to explain to me why my understanding of the principle is not correct.

MR. LUDLOW:

A. Okay, let's try again, Mr. Chairman. For the year 2008, I had a vice-president of engineering and operation at Newfoundland Power. The first six months, that position was held by Mr. Phonse Delaney; the last six months, it was held by Mr. Gary Smith. The compensation or the STI for the position was $90,000. Mr. Smith came on board with us on July 1st. His salary took over at that point and he was paid a base salary of 118,000. Rather than take the year where corporate targets were nowhere defined or nearing closure in July, what we did was we said, look, we will take the short-term salary incentive and pay the vice-president of

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engineering, which is Gary, at year end and the Alberta situation, what they do out there, they will handle that accordingly. And that's the basis under which that $90,000 is in that table.

MR. JOHNSON:

Q. Okay, Mr. Ludlow thank you for that.

MR. LUDLOW:

A. You're welcome.

MR. JOHNSON:

Q. As we've already confirmed, the increase, if as granted as proposed by this Board based on the proposals in your amended application, would result on a compounded basis, a 28 percent increase since 2004. And I'd just like, if we could, to put this rate proposal in historical context for a moment. And perhaps if we could look at CA-NP-70. And this would be what the Board, I guess, could have reference to, Mr. Ludlow, if they were looking at, you know, what does this proposal mean in terms of a dollar impact, relative to previous requests in revenue from rates, would that be accurate, they could point here?

MR. LUDLOW:

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A. Yes.

MR. JOHNSON:

Q. And then, so this would be certainly the largest, you know, requested increase in a dollar basis in revenue from rates going back to 1990. Do you know, Mr. Ludlow, how it would compare to rate requests prior to 1990?

MR. LUDLOW:

A. No, I would not.

MR. JOHNSON:

Q. And if you could look to CA-NP-69?

MR. LUDLOW:

A. Just bear with me for one second, please.

MR. JOHNSON:

Q. Certainly. This is where we ask for a table showing the proposed and Board allowed average increase for each rate class in Newfoundland Power's prior GRA since and including 1990. And then I first note on page one of two in the second paragraph there's a caveat where the Company says, first of all in the first paragraph it goes on to say that Table 1 shows the proposed and approved average changes for each class in Newfoundland Power's GRAs from '90 to '97. And Table 2 shows the same information for GRAs from '99 to 2008, but then the Company points out in that second paragraph that the average increases indicated for the 2008 GRA, as for this application, are based on final rates, which include the rate stabilization and municipal tax adjustments. The average increases indicated for GRAs prior to 2008 GRA were based on rates that excluded the rates stabilization and municipal tax adjustments, but again, this is what the Board would take a look at if they wanted to put this proposal of Newfoundland Power into a percentage increase perspective, would that be right?

MR. LUDLOW:

A. Yes.

MR. JOHNSON:

Q. Now Mr. Ludlow in my opening, I expressed to the Board some concern on part of customers who were on limited incomes because to tell you the truth, I've often wondered whether fixed incomes is really key because some people's fixed incomes are pretty decent. But I'm asking you about the idea of customers that I represent who are truly on limited

incomes bearing the brunt of paying for, for instance, your group benefits and Ms. Perry's group benefits and the other executives and managers when you reach age 65, because I find that's the best way to put this into some perspective. And I know that these age 65 OPEB benefits apply to others too, but I'm just, you know, in essence aren't you asking for customers and other seniors who have no pensions, no group plans, et cetera, private plans, to pay the total cost of your OPEB benefits when you reach age 65?

MR. LUDLOW:

A. Are you speaking me, personally, or the Company, Mr. Johnson?

MR. JOHNSON:

Q. Well the Company.

MR. LUDLOW:

A. Okay, well if you're speaking to me, well let's speak about that. Mr. Chairman, you know, Ms. Perry has spoken very clearly as to where we are and how we see moving forward. We've already spoken to unions in particular have brought forward the benefits, benefit review and what we've said is that in March

this decision was made that we'd move out. Do I personally anticipate retiring with benefits covered? I don't know, I sincerely--I look at this and I say where are we, will times change? Times are changing, I acknowledge that and hence the reason we're looking at this. I do have and I take great issue and we're here talking about people on a $14,000 or a $6,000 pension, that's where I have some difficulties. The existing post 65 retirement members, I take great exception to any suggestion that that should be changed, that's me, personally. As we look forward, we said we would look at it and we will have that review done in 2010. Now what will it bear? Will it bear increases for current employees? Possibly. Will it change future OPEB expense? Possibly. Will it change the funding arrangements for retirees that are coming up? Possibly. And if it changes it, how will it be transitioned if decisions are made on financial--financial decisions of retirement are obviously very important and all factors are taken into account. That's the way, Mr. Johnson, I would look at the whole story of

OPEBs.

MR. JOHNSON:

Q. Mr. Ludlow, I think it was in Ms. Perry's presentation, she explained in response to a question from Mr. Kelly, that you have to look at the issue of the Group Benefit Plan, the retiree benefits as a separate piece from the accrual piece, and I get that, but I hope you understand why I can't really see it as not being intermingled, okay, in light of what's facing us in terms of your 2010 proposal, okay? And if in making this point, I'd just like to address No. 326 with you. And in this -

MR. LUDLOW:

A. Bear with me, please.

MR. JOHNSON:

Q. I'm sorry.

MR. LUDLOW:

A. 326, I'm old fashion and I like paper.

MR. JOHNSON:

Q. Well there's enough to go around.

MR. LUDLOW:

A. I would agree to that too. Okay.

(1:15 p.m.)

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MR. JOHNSON:
Q. Yes, Mr. Ludlow in this Information Request, we asked "Please provide the impact on the calculations respecting OPEBs as set out in the application of all retirees to pay one half of the premium." And then the Company's response was "Newfoundland Power's OPEB Plan requires the Company to pay a hundred percent of premiums for retirees over the age of 65. This has been included in the OPEB valuation as at December 31st, 2008. An updated valuation would be required to reflect a reduction in the assumed claims cost beyond age 65 in consideration of the retirees paying one half of the premium." And then you indicated that Newfoundland Power hadn't asked your actuary to do that for you. And so then just to follow along because, of course, in our position, we're trying to get a handle on what the numbers are going to look like, transitional obligation, annual pension, OPEB expense. So then we followed up with No. 337 and in this question--and actually let's stay on the second revision, that's fine. We asked further to CA-NP-326 which we just went

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through, "Please provide the information requested so that the impact of all retirees paying one half of premiums on the calculations respecting OPEBs, may be set out or may be ascertained." And the Company then came back with a pro-forma impact based upon certain assumptions that the Company had made in answering our question, correct?
MR. LUDLOW:
A. Correct.
MR. JOHNSON:
Q. And just run us through what the Company's assumptions were in providing this pro-forma impact?
MR. LUDLOW:
A. Mr. Chairman, I'm going to again just say that I'm getting into an area here that Ms. Perry is much more qualified to speak on on pro-forma impacts of OPEBS and the calculation in dealing with the actuaries. Mr. Johnson, I would prefer to defer that to Ms. Johnson please.
MR. JOHNSON:
Q. Okay. We can raise that with Ms. Perry if that's your wish, Mr. Ludlow.

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MR. LUDLOW:
A. Thank you very much.
MR. JOHNSON:
Q. I would like to ask you though, Mr. Ludlow, a few questions regarding your Company's approach in the area of these group benefits. And I would like to raise with you a statement that appears at CA-NP-293 and that statement appears in a report that Newfoundland Power's benefit consultants provided to Newfoundland Power, I think in 2005. And specifically I'm referring to page 9 of that report. In particular, just to put this report in some context, Mr. Ludlow, I take it you're familiar with this report?
MR. LUDLOW:
A. I am, but not to the level of detail--I am familiar with the Aon Consulting Report, yes, leave it at that.
MR. JOHNSON:
Q. Okay, and you're familiar enough to confirm that Newfoundland Power went out and asked its benefit consultants to review its benefits for employees and retirees, correct?
MR. LUDLOW:

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A. That I'll agree, yes.
MR. JOHNSON:
Q. And they reported to you in December of 2005 or to your Company.
MR. LUDLOW:
A. To our Company, yes.
MR. JOHNSON:
Q. Okay, and just to get your comment on page 9 where it indicates that Newfoundland Power does not have a formal statement of benefits plan philosophy. Who would be responsible for Newfoundland Power having a formal statement of benefits plan philosophy?
MR. LUDLOW:
A. Ms. Perry.
MR. JOHNSON:
Q. Okay, and does Newfoundland Power today have a formal statement of benefits plan philosophy?
MR. LUDLOW:
A. Not that I'm aware of, Mr. Chair.
MR. JOHNSON:
Q. And I note the next line, it says, "Newfoundland Power provides benefits to employees in order to attract and retain its workforce and to provide competitive total

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compensation. Newfoundland Power desires to provide benefits at the 75th percentile or above." And do you know how that percentile was stuck upon?

MR. LUDLOW:

A. No, I do not; however, I would suggest that's closer to the 50th percentile today as a 2005 report.

MR. JOHNSON:

Q. Okay. Are you aware of discussions at the leadership table of saying, look, we have now moved away from a 75th percentile to a more moderate approach?

MR. LUDLOW:

A. No, we would not, you know, this is the type of thing that takes times, this report has been worked on, there's been substantive progress in a lot of areas of this report. There's continuous discussion with Jocelyn, myself and others at, I'd call it the leadership table, but the group, the executive team and there's a lot of factors come to bear, so we think about the appropriateness and where we should be positioned, the 50th percentile is roughly where we are--or is

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we're thinking we're heading.

MR. JOHNSON:

Q. That's where you're thinking you're heading?

MR. LUDLOW:

A. That's where we are, it's 50 to 70 percentile. I mean, it's 75th percentile here, I mean, I, for example, do not see us at a 95th percentile, that's not where we are.

MR. JOHNSON:

Q. Okay, and you referenced a few moments ago that the Company, that you're on a DC Plan, there's no Defined Benefit Plan for you and new entrants since 2004 and Mr. Ludlow, I understand that switching for new entrants, for instance, from Defined Benefit to Defined Contribution hasn't affected Newfoundland Power's ability to attract and retain people, would you confirm that?

MR. LUDLOW:

A. To a large effect, I would say that is the case; however, I will tell you as people see what's happening in the markets, there's more and more interest in Defined Benefit Plans and this is again anecdotal, Mr. Chairman, more than actual--those are the types of questions

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that we're getting more and more. It hasn't affected our ability.

MR. JOHNSON:

Q. Okay, and I take it, Mr. Ludlow, are you aware of what the general trend has been in terms of these benefits as recorded by your benefits consultant, Aon?

MR. LUDLOW:

A. Which benefits are you referring to?

MR. JOHNSON:

Q. In terms of how other major employers or big employers are looking to get a handle on health and group benefit costs.

MR. LUDLOW:

A. Generally I would say yes, I am. Am I an expert in this area? No, I'm not. I do defer in this area pretty heavily to Ms. Perry and her expertise in the HR field. So, yeah, I mean, I keep track and that's part of my job is to monitor things that happen across the country in different areas. One of the big steps we did make was closing that DB plan and that took many, many hours, months and years to close a DB plan and that included unionized and non-unionized staff.

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MR. JOHNSON:

Q. In your continuing, the monitoring of these matters, what have you observed is happening, Mr. Ludlow?

MR. LUDLOW:

A. I would suggest, Mr. Chairman, that there's been moves on the pension plans, some have gone DC. I've seen a couple reactivating if my memory serves right, in the DB plans and I just can't remember what ones, but there's been moves in those fronts.

MR. JOHNSON:

Q. How about -

MR. LUDLOW:

A. Sorry?

MR. JOHNSON:

Q. No, I'm sorry, continue with your addressing this to the Chair.

MR. LUDLOW:

A. Well as we look at health plans, you know, health plans in particular, there's rising costs and are being driven in different areas and there's been moves afoot; hence the reason we've agreed with our unions that we will embark on this investigative approach through

2010, you know, should we be moving? We should be moving in some direction. I just don't know where the end of that road is and I think that's the concern I have right now.

MR. JOHNSON:

Q. Mr. Ludlow, let me follow up on that, you mentioned that Newfoundland Power has agreed with its union or its unions, did the unions come to Newfoundland Power with this review proposal?

MR. LUDLOW:

A. We went through a very exhaustive and exhausting negotiation process last year, it was contract renegotiations and one of the items in there that was key was the Defined Benefit Plan and enhancement of benefits, it just wasn't happening, wasn't on. Coming off that was the health benefits and just other benefits. Subsequent to that there was a decision struck between the union and the management. Who brought what to whom is really immaterial in this discussion in that we've agreed, as a group, to come together and review our plans over the next year and that has been expanded as well in March to include

management and retirees.

MR. JOHNSON:

Q. Now retirees, is it your understanding, Mr. Ludlow, the retirees wouldn't have any collective agreement rights, whether they be current retirees who have not yet reached age 65 or retirees who have reached age 65?

MR. LUDLOW:

A. Mr. Chairman, I'm going to answer this question and then I'm going to bow out of the OPEBs discussion I think is the best place for me to go. It is my understanding that there is no contractual, written contractual document to our retirees. Whether there's a moral obligation or an ethical obligation or whether there's an unwritten contract, that's for legal minds greater than mine to determine.

MR. JOHNSON:

Q. But wouldn't it be in your collective agreements for -

MR. LUDLOW:

A. No, it's not there, Mr. Chairman.

MR. JOHNSON:

Q. Well I'm afraid if we're looking for legal

minds, we're in trouble again, I suppose. But anyway, Mr. Ludlow -

EARLE, Q.C.:

Q. Thanks.

MR. JOHNSON:

Q. Thanks, yes, the hour is nearly here -

CHAIRMAN:

Q. No objections from -

MR. JOHNSON:

Q. The hour is nearly here and maybe I can recollect my thoughts, Mr. Chairman.

CHAIRMAN:

Q. Sure. What's he telling me.

MS. GLYNN:

Q. Start again tomorrow.

CHAIRMAN:

Q. You mean you're finished?

MR. JOHNSON:

Q. For this afternoon.

CHAIRMAN:

Q. Yes, okay. I call it adjournment. So we adjourn until tomorrow morning at 9:00. Thank you.

Upon conclusion at 1:30 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 14th day of October, 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 14th day of October, A.D., 2009.

Judy Moss

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