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<p>1 (9:00 a.m.)</p> <p>2 CHAIRMAN:</p> <p>3 Q. Well, good morning. So before we proceed, are</p> <p>4 there any matters of procedure? No. So, Mr.</p> <p>5 Kelly, I guess I turn it over to you then, do</p> <p>6 I?</p> <p>7 KELLY, Q.C.</p> <p>8 Q. Thank you, Mr. Chairman. Mr. Chairman, the</p> <p>9 next witness this morning is Ms. Kathy McShane</p> <p>10 who is seated ready to be sworn.</p> <p>11 MS. KATHLEEN MCSHANE (SWORN) EXAMINATION-IN-CHIEF BY IAN</p> <p>12 KELLY, Q.C.</p> <p>13 KELLY, Q.C.</p> <p>14 Q. Thank you, Mr. Chairman. Ms. McShane, you</p> <p>15 prepared a report on capital structure and</p> <p>16 fair return on equity for Newfoundland Power</p> <p>17 dated May 2009, which is at Tab 10, Volume 2</p> <p>18 of the pre-filed evidence?</p> <p>19 MS. MCSHANE:</p> <p>20 A. I did.</p> <p>21 KELLY, Q.C.</p> <p>22 Q. And are there updates or revisions to your</p> <p>23 pre-filed testimony? There's one update, Mr.</p> <p>24 Chairman, which has been circulated to</p> <p>25 everybody and we can perhaps mark that first.</p>	<p>1 this proceeding?</p> <p>2 MS. MCSHANE:</p> <p>3 A. I do.</p> <p>4 KELLY, Q.C.</p> <p>5 Q. And your qualifications, Ms. McShane, are set</p> <p>6 out in Appendix G, and I'm not going to take</p> <p>7 you to those in any detail. You've testified</p> <p>8 numerous times in utility rate proceedings in</p> <p>9 Canada on cost of capital issues and testified</p> <p>10 before this Board before?</p> <p>11 MS. MCSHANE:</p> <p>12 A. Yes, I've testified in approximately 190 cases</p> <p>13 in Canada and the US, and I've testified</p> <p>14 before this Board five times previously.</p> <p>15 KELLY, Q.C.</p> <p>16 Q. Thank you. I'll just get you to start, Ms.</p> <p>17 McShane, by providing a summary of your</p> <p>18 recommendations for the Board.</p> <p>19 MS. MCSHANE:</p> <p>20 A. Thank you. I've estimated the fair return for</p> <p>21 Newfoundland Power at 11 percent, using</p> <p>22 multiple tests, including three different</p> <p>23 equity risk premium tests, three different</p> <p>24 discounted cash flow tests and a comparable</p> <p>25 earnings test. My estimate of the fair return</p>
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<p>1 MS. GLYNN:</p> <p>2 Q. That would be Consent No. 2.</p> <p>3 KELLY, Q.C.</p> <p>4 Q. Thank You.</p> <p>5 CHAIRMAN:</p> <p>6 Q. That's this one here, is it? Yeah, okay, all</p> <p>7 right.</p> <p>8 KELLY, Q.C.</p> <p>9 Q. The update, Ms. McShane, any corrections?</p> <p>10 MS. MCSHANE:</p> <p>11 A. I have one correction to make. The correction</p> <p>12 is on page 35, I'm sorry, 37 of the evidence,</p> <p>13 Table 5.</p> <p>14 KELLY, Q.C.</p> <p>15 Q. Yes.</p> <p>16 MS. MCSHANE:</p> <p>17 A. And it's in the line NP, under the column FFO</p> <p>18 to Total Debt. The number 9.1 percent should</p> <p>19 be 14.1 percent. This actually was corrected</p> <p>20 in an RFI, CA-NP-12, but I thought I would</p> <p>21 point it out here so that it's clear that it</p> <p>22 was a typo and should be corrected.</p> <p>23 KELLY, Q.C.</p> <p>24 Q. Okay, thank you. Do you adopt your pre-filed</p> <p>25 testimony and the update as your testimony in</p>	<p>1 for Newfoundland Power relies on multiple</p> <p>2 tests because in my view, no single test is</p> <p>3 sufficient by itself to ensure that the fair</p> <p>4 return standard is met. Every individual test</p> <p>5 has strengths, weaknesses, brings a different</p> <p>6 perspective to the estimation of the fair</p> <p>7 return and consequently giving weight to a</p> <p>8 battery of tests balances these various</p> <p>9 considerations.</p> <p>10 Specifically, with respect to the equity</p> <p>11 risk premium tests, all three of them are</p> <p>12 based on a forecast long-term Canada bond</p> <p>13 yield of four and a quarter percent. That was</p> <p>14 the forecast that I used initially in my pre-</p> <p>15 filed evidence and that estimate remains</p> <p>16 valid. The first equity risk premium test</p> <p>17 that I performed is one that I refer to as a</p> <p>18 risk adjusted market risk premium test and</p> <p>19 it's essentially a variant of the capital</p> <p>20 asset pricing model, where the return is</p> <p>21 equivalent to a risk-free rate plus a market</p> <p>22 risk premium times a relative risk adjustment.</p> <p>23 That test, inclusive of a 50 basis point</p> <p>24 adjustment for financing flexibility, results</p> <p>25 in a return of nine and a quarter percent.</p>

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<p>1 I also perform a risk premium test using</p> <p>2 the discounted cash flow model less the</p> <p>3 corresponding yield on long-term Government</p> <p>4 bond yields to estimate risk premiums over</p> <p>5 time. This test I perform two versions of.</p> <p>6 One, I looked at the relationship between the</p> <p>7 utility equity risk premium and long-term</p> <p>8 Canada bond yields or long-term Government</p> <p>9 bond yields in isolation and I also did a</p> <p>10 second version of it in which I looked at the</p> <p>11 relationship between utility equity risk</p> <p>12 premium long-term Government bond yields and</p> <p>13 the spread between utility bond yields and</p> <p>14 long-term Government bond yields. It was the</p> <p>15 second version of this test that I provided</p> <p>16 the update to because when I originally</p> <p>17 performed the test, spreads were considerably</p> <p>18 higher than they are today. They're still</p> <p>19 high today, relative to what they were a</p> <p>20 couple of years ago, but they are lower than I</p> <p>21 anticipated they would be, so I updated that</p> <p>22 test to reflect the somewhat lower spreads.</p> <p>23 What that test tells us is that the</p> <p>24 relationship between long-term Government bond</p> <p>25 yields and the cost of equity is not nearly as</p>	<p>1 of time and then trend toward the long-term</p> <p>2 growth in the economy. The three separate</p> <p>3 versions of the test produced a return</p> <p>4 inclusive of an allowance for financing</p> <p>5 flexibility of 11 to 11 and a half percent.</p> <p>6 My final test was a comparable earnings</p> <p>7 test, which looks at the returns that have</p> <p>8 been achieved and can reasonably be expected</p> <p>9 to be achieved over a full business cycle by</p> <p>10 relatively low risk unregulated companies. I</p> <p>11 looked at the returns over the full cycle back</p> <p>12 to the last recession in 1991 and determined</p> <p>13 that these--the returns for the sample of</p> <p>14 companies when adjusted for the somewhat lower</p> <p>15 risk of utilities would suggest a return in</p> <p>16 the range of 11 and a half to 11.75, and</p> <p>17 overall, based on all of these tests, I</p> <p>18 determined that the fair return for</p> <p>19 Newfoundland Power is approximately 11</p> <p>20 percent.</p> <p>21 KELLY, Q.C.</p> <p>22 Q. Thank you, Ms. McShane. Next, can I get you</p> <p>23 to comment on financial market conditions and</p> <p>24 the automatic adjustment mechanism?</p> <p>25 MS. MCSHANE:</p>
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<p>1 sensitive as the automatic adjustment formulas</p> <p>2 that have been in place would indicate, and</p> <p>3 the test also tells us that there is a</p> <p>4 positive relationship between the utility</p> <p>5 equity risk premium and the spread on utility</p> <p>6 bond yields. With the update and the</p> <p>7 financing flexibility adjustment, this test</p> <p>8 would indicate a return on equity of 10.1</p> <p>9 percent.</p> <p>10 And I also did an equity risk premium</p> <p>11 test in which I looked at historic utility</p> <p>12 equity risk premiums as an estimate of what</p> <p>13 investors might expect in the future, and that</p> <p>14 test indicates a return of 11 percent.</p> <p>15 I also did, as I said at the outset,</p> <p>16 three different discounted cash flow tests.</p> <p>17 Two are constant growth models where one</p> <p>18 assumes that investors expect the same growth</p> <p>19 rate to persist over the longer term and I</p> <p>20 used two different sources of growth</p> <p>21 expectations and I also did a two-stage</p> <p>22 discounted cash flow test. The two-stage</p> <p>23 discounted cash flow test is based on the</p> <p>24 premise that investors expect the growth rates</p> <p>25 that analysts forecast to persist for a period</p>	<p>1 A. Certainly. When the evidence was filed in</p> <p>2 May, capital markets were--I would</p> <p>3 characterize them as more turbulent than they</p> <p>4 may be today. It was clear at the time that</p> <p>5 the cost of corporate debt was going up.</p> <p>6 Spreads were going up. The cost of equity was</p> <p>7 rising, and at the same time, we had long-term</p> <p>8 Canada bond yields falling. So we had the</p> <p>9 incongruous and erroneous situation where the</p> <p>10 actual cost of capital in the market was going</p> <p>11 up, but the way the formula worked, the</p> <p>12 formula was suggesting that the cost of equity</p> <p>13 was going down.</p> <p>14 Since that time, have capital market</p> <p>15 conditions, have they improved? Yes, they</p> <p>16 have. We've seen signs that the economies of</p> <p>17 United States and Canada are in recovery.</p> <p>18 We've seen corporate debt spreads tighten and</p> <p>19 we've seen rebound in the equity markets and</p> <p>20 we've seen a decrease in the implied</p> <p>21 volatility of the equity market. Are</p> <p>22 conditions back to normal, whatever normal</p> <p>23 means these days? No. We are still in a</p> <p>24 situation where the recovery is what I would</p> <p>25 characterize as fragile. It's an unanswered</p>

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<p>1 question as to whether the consumer will pick 2 up where the governments have left off, in 3 terms of providing stimulus to the economy. I 4 mean, a government can only stimulate for so 5 long. At some point, recovery has to be, you 6 know, on the basis of consumer consumption and 7 investment by businesses. 8 (9:15 a.m.) 9 Spreads are still higher than levels 10 prevailing a couple of years ago. As an 11 example, I know that the other day, Ms. Perry 12 provided an estimate of the indicated spread 13 for a new Newfoundland Power debt issue today. 14 The spread, I believe, was 187 basis points, 15 as indicated. I mean, that's still higher 16 than 140 basis points for the previous debt 17 issue and still higher than the 106 basis 18 points at which Newfoundland Power issued the 19 debt prior to that, before the onset of the 20 crisis. 21 I would also note that in this 22 environment, we have a review of all of these 23 formulas in Quebec, in Ontario, in Alberta, in 24 British Columbia, and most recently, the 25 National Energy Board determined that there</p>	<p>1 A. What I thought I would do, without getting 2 into a fair amount of detail, which I'm sure 3 nobody wants to listen to, I thought I would 4 sort of do this at a relatively high level and 5 look at what I consider to be our main points 6 of agreement and perhaps our main points of 7 difference, and I thought I would start with 8 Mr. Cicchetti. 9 As far as the points I see that we have 10 in common in our testimony, first of all, I 11 think we both recognize the importance of a 12 discounted cash flow test as a estimate of the 13 cost of--a utility cost of equity. I think we 14 both agree on the relevance of US utilities as 15 proxies for Canadian utilities, including 16 Newfoundland Power. I believe that our views 17 on the sensitivity of the cost of equity to 18 long-term government bond yields is relatively 19 similar, and I think that we both recognize 20 that Beta, as a measure of risk, is somewhat 21 problematic. 22 Now in terms of the actual testimony, I 23 mean, his testimony is clearly more focused on 24 discounted cash flow than mine is. I have a 25 much broader range of estimates of the cost of</p>
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<p>1 was enough doubt as to the correctness of the 2 formula. Their formula is very, very similar 3 to the formula that's been in place for 4 Newfoundland Power. They decided that they 5 would rescind their formula and not replace it 6 with another formula at this time. So I guess 7 the bottom line for me is that, you know, 8 there's significant evidence in my mind that 9 the existing formula overstates the 10 relationship between the cost of equity and 11 long-term government bond yields. There's 12 considerable uncertainty as to, you know, 13 where the capital markets and the economy may 14 be going, and to my mind, it makes sense at 15 this point to at least temporarily suspend the 16 use of the formula, reset a fair return for 17 2010 and, you know, come back at some point 18 and see whether a new and different formula 19 needs to be put in place. 20 KELLY, Q.C. 21 Q. Finally, Ms. McShane, Dr. Booth and Mr. 22 Cicchetti have each filed testimony on cost of 23 capital. Can I get you to comment briefly on 24 their testimony? 25 MS. MCSHANE:</p>	<p>1 equity from a wider variety of tests, which I 2 think gives a broader perspective than his 3 does, and of course, we do have our 4 differences as to the proper application of 5 the DCF model itself. I think, you know, we 6 do have a number of broad areas of agreement. 7 With respect to Dr. Booth, again, we do 8 apply a similar test. He applies and largely 9 relies on the capital asset pricing model. I 10 also apply this test. We obviously don't 11 agree on the size of the market risk premium 12 or the size of the relative risk adjustment, 13 but we do agree that the capital asset pricing 14 model of a variant thereof is an important 15 input into the determination of a fair return. 16 Again, I don't think that one should 17 focus solely on the capital asset pricing 18 model. In my view, there are conceptual and 19 application issues with the test which make it 20 problematic as a test to put primarily weight 21 on. But again, it's an important input. 22 I think we both agree that historic 23 Canadian achieved risk premiums are lower than 24 they will be going forward because of the 25 change in the government bond market today</p>

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<p>1 versus historically. So historically interest</p> <p>2 rates were considerably higher than they are,</p> <p>3 more risk associated with long-term Canada</p> <p>4 bond yields historically than today. So I</p> <p>5 think that the main difference perhaps in our</p> <p>6 determination of the forward looking market</p> <p>7 risk premium is the impact, the size or the</p> <p>8 magnitude of the impact of the lower bond</p> <p>9 yields on the market risk premium going</p> <p>10 forward.</p> <p>11 KELLY, Q.C.</p> <p>12 Q. Thank you, Ms. McShane. Those are the</p> <p>13 questions I have, Mr. Chairman. The witness</p> <p>14 is available for cross-examination.</p> <p>15 MS. KATHLEEN MCSHANE, CROSS-EXAMINATION BY MR. THOMAS</p> <p>16 JOHNSON</p> <p>17 MR. JOHNSON:</p> <p>18 Q. Good morning, Ms. McShane. As you know, I'm</p> <p>19 the Consumer's Advocate here in the province</p> <p>20 and I'd like to ask you some questions</p> <p>21 regarding your evidence. Ms. McShane, as</p> <p>22 you've indicated in response to Mr. Kelly's</p> <p>23 questions, you have a fairly long relationship</p> <p>24 with Newfoundland Power as being your client,</p> <p>25 correct?</p>	<p>1 generally in that box is the equity risk</p> <p>2 premium test, the discounted cash flow and</p> <p>3 then comparable earnings, right?</p> <p>4 MS. MCSHANE:</p> <p>5 A. Yes.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. And in arriving at your fair ROE</p> <p>8 recommendation to this Board for Newfoundland</p> <p>9 Power of approximately 11 percent, do I</p> <p>10 understand that you have given a quarter</p> <p>11 weight to the comparable earnings test?</p> <p>12 MS. MCSHANE:</p> <p>13 A. Yes, approximately, yes.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. And do I understand that you have given about</p> <p>16 three-quarter's weight to the market base</p> <p>17 tests being the ERP and DCF tests combined?</p> <p>18 MS. MCSHANE:</p> <p>19 A. Yes.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Yeah, and within the two market base tests,</p> <p>22 being the ERP and DCF, you give equal</p> <p>23 weightings to each of these. Would that be</p> <p>24 correct?</p> <p>25 MS. MCSHANE:</p>
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<p>1 MS. MCSHANE:</p> <p>2 A. I have done studies for them on four</p> <p>3 occasions, I believe.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. And going back, what, to the late '90s?</p> <p>6 MS. MCSHANE:</p> <p>7 A. I believe 1998 would have been the first time,</p> <p>8 yes.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. Yeah, okay, and Ms. McShane, we'll come back</p> <p>11 and revisit the formula in due course, but in</p> <p>12 your report, at page 70, maybe we could bring</p> <p>13 it up?</p> <p>14 MS. MCSHANE:</p> <p>15 A. Page 70?</p> <p>16 MR. JOHNSON:</p> <p>17 Q. 70. I guess this is the ultimate paragraph to</p> <p>18 look to to see what your rate or your fair</p> <p>19 return recommendation is for Newfoundland</p> <p>20 Power, based on these tests which you say</p> <p>21 comes out to approximately 11 percent, right?</p> <p>22 MS. MCSHANE:</p> <p>23 A. Yes.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. And the three tests that you refer to</p>	<p>1 A. Yes.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. Okay, and your comparable earnings test</p> <p>4 produces a range that is 50 to 75 basis points</p> <p>5 beyond that which is sought by Newfoundland</p> <p>6 Power, correct?</p> <p>7 MS. MCSHANE:</p> <p>8 A. Yes.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. Yeah, and your DCF test result, when you add</p> <p>11 on an allowance for financing flexibility,</p> <p>12 produces a range that also goes beyond the 11</p> <p>13 percent that Newfoundland Power is seeking,</p> <p>14 correct?</p> <p>15 MS. MCSHANE:</p> <p>16 A. Yes.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. Yeah, and in the last rate case that</p> <p>19 Newfoundland Power filed in this jurisdiction,</p> <p>20 just two years ago, they sought an ROE of ten</p> <p>21 and a quarter percent, didn't they? Do you</p> <p>22 recall that?</p> <p>23 MS. MCSHANE:</p> <p>24 A. No.</p> <p>25 MR. JOHNSON:</p>

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<p>1 Q. You don't recall what Newfoundland Power 2 sought as their ROE in the 2007 file GRA?</p> <p>3 MS. MCSHANE:</p> <p>4 A. Not specifically, no.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. Okay. Well, subject to check, would you 7 accept that they sought ten and a quarter 8 percent in their application?</p> <p>9 MS. MCSHANE:</p> <p>10 A. I'll accept it, subject to check. It seems a 11 little low.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. Okay, but I think--I understand that your 14 recommendation for a fair return in the last 15 case, wasn't that ten and a quarter to ten and 16 a half?</p> <p>17 MS. MCSHANE:</p> <p>18 A. I'll accept that, subject to check, but I 19 haven't reviewed that.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Okay, okay, and in the case before that, which 22 led to the Board's decision and order in P.U. 23 19 (2003) I understand the record will reflect 24 that Newfoundland Power sought a return on 25 equity of ten and three-quarters percent. Do</p>	<p>1 purposes. This compares to 9.25 percent found 2 by the Board in 1998 and 9.05 percent which is 3 currently in place, based on the formula."</p> <p>4 And now, Michael, would you turn to page 47?</p> <p>5 And this is where the Board gives a summary of 6 the expert evidence which it heard on the cost 7 of equity, and the first person that they look 8 at is Ms. McShane, and you see your 9 recommended ROE, Ms. McShane?</p> <p>10 MS. MCSHANE:</p> <p>11 A. Yes, I do.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. 11.5 to 11 and three quarters.</p> <p>14 MS. MCSHANE:</p> <p>15 A. I see that.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. So well above what your client was even asking 18 for from the Board, correct?</p> <p>19 MS. MCSHANE:</p> <p>20 A. It's higher than what they asked for.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Yeah.</p> <p>23 MS. MCSHANE:</p> <p>24 A. They also, I guess -- we had Mr. Morin make a 25 recommendation.</p>
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<p>1 you recall that?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Not specifically, but I'll accept it, subject 4 to check.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. Okay. So I think the record reflects that, 7 that they were looking for ten and three- 8 quarters, but your recommendation for a fair 9 return for your client was 11 and a half to 11 10 and three-quarters percent, I think the 11 records will also reflect. Will you take 12 that, subject to check?</p> <p>13 MS. MCSHANE:</p> <p>14 A. Yes, I will take it subject to check.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. Okay. Well, maybe we could check it now, if 17 we could call up P.U. 19 (2003)? I think 18 that's just the appendix to the decision. 19 There, that's the supplementary document. 20 Yes, thank you, Michael. Would you mind 21 turning to page 46? Yeah, that paragraph 22 there right in front of us, return on equity, 23 "Newfoundland Power has proposed that the 24 Board allow a return on regulated common 25 equity of 10.75 percent for rate making</p>	<p>1 MR. JOHNSON:</p> <p>2 Q. Yeah, and as regards your use of your 3 comparable earnings test, and I think that 4 produces your biggest number, right?</p> <p>5 MS. MCSHANE:</p> <p>6 A. Yes.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. In this rate case, and I take it that probably 9 produces your biggest number in all your 10 cases, does it?</p> <p>11 MS. MCSHANE:</p> <p>12 A. Well, the comparable earnings test by virtue 13 of how it's constructed and done usually 14 indicates a higher return than the base bare 15 bones cost of equity numbers, yes.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. And why would that be, why would that fall out 18 of the way it's constructed?</p> <p>19 MS. MCSHANE:</p> <p>20 A. Well, because it's a return on the original 21 cost book value of the companies, not a return 22 on the market value, and typically over the 23 past number of business cycles, the market 24 value of companies has been considerably above 25 their book value.</p>

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<p>1 MR. JOHNSON:</p> <p>2 Q. And as regards this comparable earnings test,</p> <p>3 I take it that your replies to RFIs, your RFIs</p> <p>4 indicates that at least you're not aware of</p> <p>5 any ROE decisions by Canadian regulator in the</p> <p>6 last ten years that had given any weight to</p> <p>7 the comparable earnings test as applied by</p> <p>8 yourself in this case, are you?</p> <p>9 MS. MCSHANE:</p> <p>10 A. I believe that if you look at CA-NP-1, you're</p> <p>11 correct that they have not. I did point to</p> <p>12 the decision in 2006 by the British Columbia</p> <p>13 Utilities Commission, which said that they did</p> <p>14 not believe that comparable earnings had</p> <p>15 outlived its usefulness, that they believed</p> <p>16 that it still could have a role to play in</p> <p>17 future ROE hearings, but they concluded at the</p> <p>18 same time that in that particular case there</p> <p>19 was insufficient evidence to know whether or</p> <p>20 not a market to book adjustment results was</p> <p>21 required, and if so, how it might be</p> <p>22 accomplished, and what I attempted to do in</p> <p>23 this proceeding as well as in the subsequent</p> <p>24 proceeding in British Columbia was to address</p> <p>25 that concern and to indicate that such an</p>	<p>1 your opening in terms of where you had common</p> <p>2 ground with Mr. Cicchetti, that the DCF</p> <p>3 approach is more prevalent in the United</p> <p>4 States regulatory environment, correct?</p> <p>5 MS. MCSHANE:</p> <p>6 A. It is very prevalent in the United States.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And I guess you're aware that Boards in this</p> <p>9 country, while they hear DCF evidence, it's</p> <p>10 not typically accorded weight, is it?</p> <p>11 MS. MCSHANE:</p> <p>12 A. It hasn't been accorded weight recently. I</p> <p>13 think back in the earlier half of the 1990s</p> <p>14 Boards used to accord weight to a much broader</p> <p>15 variety of tests than they seem to have done</p> <p>16 in Canada, I guess, in the last ten years.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. And I take it you would be familiar through</p> <p>19 your readings, et cetera, that Boards have had</p> <p>20 some difficulty with the forecasters who are</p> <p>21 relied on in some instances to supply the</p> <p>22 inputs into the DCF analysis, would that be</p> <p>23 right, the analysts?</p> <p>24 MS. MCSHANE:</p> <p>25 A. Well, I think one concern that's been</p>
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<p>1 adjustment was not required.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. So outside of that sole example, I mean,</p> <p>4 you're testified a load of times, you're not</p> <p>5 aware of another single instance where a</p> <p>6 Canadian regulator has put any weight in</p> <p>7 arriving at its ROE determination on that</p> <p>8 test?</p> <p>9 MS. MCSHANE:</p> <p>10 A. I'm not aware of any regulator that's given</p> <p>11 weight to it recently, no.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. And as regards your use of the discounted cash</p> <p>14 flow test, and that uses -- of course, you get</p> <p>15 into your proxy group, et cetera, but you also</p> <p>16 get into forecast of earnings, cash flows, et</p> <p>17 cetera, but I take it you're aware as well</p> <p>18 that this Board did not rely on this test when</p> <p>19 it last decided a contested ROE case for</p> <p>20 Newfoundland Power in PU 19, 2003, correct?</p> <p>21 MS. MCSHANE:</p> <p>22 A. I believe you're correct that they did not at</p> <p>23 the time.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. And you're also aware, as you pointed out in</p>	<p>1 expressed is that there may be some optimism</p> <p>2 in the forecast. Of course, those studies</p> <p>3 that have looked at optimism have really been</p> <p>4 focused very broadly on all types of</p> <p>5 companies, have not particularly singled out</p> <p>6 utilities to see if utility forecasts are</p> <p>7 subject to the optimism that you might well</p> <p>8 see with firms whose business model like high</p> <p>9 tech firms is much less, how shall I put it --</p> <p>10 the business model of utilities is much more</p> <p>11 understood and the forecasts are much less</p> <p>12 subject to uncertainty.</p> <p>13 (9:30 a.m.)</p> <p>14 MR. JOHNSON:</p> <p>15 Q. But still utility returns, utility companies</p> <p>16 stocks are subject to this type of analysing</p> <p>17 by these analysts, right?</p> <p>18 MS. MCSHANE:</p> <p>19 A. Analysts do forecast for all types of</p> <p>20 companies, including utilities, that's</p> <p>21 correct.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. And so at -- further on in your evidence --</p> <p>24 actually, it would be earlier in your evidence</p> <p>25 at page 18, you refer to the fair return</p>

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<p>1 standard, and the quote that you've taken here</p> <p>2 from this Board actually in PU 19, 2003, is</p> <p>3 that regulated utilities are given the</p> <p>4 opportunity to earn a fair rate of return. To</p> <p>5 be considered fair, the return must be; one,</p> <p>6 commensurate with return on investments of</p> <p>7 similar risk; two, sufficient to assure</p> <p>8 financial integrity; three, sufficient to</p> <p>9 attract necessary capital. So that's the test</p> <p>10 that you adopt obviously in this proceeding?</p> <p>11 MS. MCSHANE:</p> <p>12 A. That's the fair return standard.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. Okay, and if we could go to page two of your</p> <p>15 Executive Summary.</p> <p>16 MS. MCSHANE:</p> <p>17 A. I have that.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Paragraph four, you say, "Satisfying the</p> <p>20 comparable return standard requires</p> <p>21 consideration of returns available to</p> <p>22 comparable utilities in the United States",</p> <p>23 correct?</p> <p>24 MS. MCSHANE:</p> <p>25 A. Yes.</p>	<p>1 A. Yes.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. And just to try to understand the big picture</p> <p>4 for a moment, you have utilized certain United</p> <p>5 States data for the purpose of providing your</p> <p>6 estimate of a fair return on equity for</p> <p>7 Newfoundland Power, correct?</p> <p>8 MS. MCSHANE:</p> <p>9 A. I have.</p> <p>10 MR. JOHNSON:</p> <p>11 Q. Okay, and your DCF analysis and tests are</p> <p>12 based on US company data, and there's no</p> <p>13 dispute about that?</p> <p>14 MS. MCSHANE:</p> <p>15 A. There's no dispute about that.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. Okay, and your Risk Premium Test is based, as</p> <p>18 you've noted, on three separate approaches,</p> <p>19 correct?</p> <p>20 MS. MCSHANE:</p> <p>21 A. Yes.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. The first being the risk adjusted equity</p> <p>24 market approach?</p> <p>25 MS. MCSHANE:</p>
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<p>1 MR. JOHNSON:</p> <p>2 Q. It requires it, in your view?</p> <p>3 MS. MCSHANE:</p> <p>4 A. I believe so, yes.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. Okay, and then you go on at page two to say --</p> <p>7 just go back. Same paragraph actually,</p> <p>8 paragraph four, "Satisfying the comparable</p> <p>9 return standard requires consideration of</p> <p>10 returns available to comparable utilities in</p> <p>11 the United States". Then you say, "Given the</p> <p>12 similarity of operating and regulatory</p> <p>13 environments, the integration of the two</p> <p>14 capital markets, the small number of Canadian</p> <p>15 utilities with equity market data, and the</p> <p>16 obvious circularity of comparisons, limited</p> <p>17 utilities, that are all subject to similar ROE</p> <p>18 automatic adjustment mechanisms". Now I take</p> <p>19 it that given your use of the phrase "given</p> <p>20 the similarity of operating and regulatory</p> <p>21 environments", that you have concluded, Ms.</p> <p>22 McShane, that the operating environments and</p> <p>23 the regulatory environments are similar,</p> <p>24 correct?</p> <p>25 MS. MCSHANE:</p>	<p>1 A. Yes.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. And your approach analyses historic risk</p> <p>4 premiums both from here in this country and in</p> <p>5 the United States, correct?</p> <p>6 MS. MCSHANE:</p> <p>7 A. Yes.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. And the second approach to your Risk Premium</p> <p>10 Test is the DCF based equity Risk Premium</p> <p>11 Test, have I got that right?</p> <p>12 MS. MCSHANE:</p> <p>13 A. Yes, you have.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. Okay, and here you try to estimate what the</p> <p>16 utility equity risk premium is by analysing</p> <p>17 consensus forecasts of earnings growth and</p> <p>18 expected dividend yields of a sample of US</p> <p>19 electric and gas utilities?</p> <p>20 MS. MCSHANE:</p> <p>21 A. Over time, correct.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. Over time, okay, and the third approach to</p> <p>24 your Risk Premium Test is the historic utility</p> <p>25 equity risk premiums approach, and here again</p>

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<p>1 you utilize historic US electric utility</p> <p>2 returns, US gas utility returns, along with</p> <p>3 historic Canadian utilities returns?</p> <p>4 MS. MCSHANE:</p> <p>5 A. Correct.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. Albeit for different periods of time, as your</p> <p>8 report notes?</p> <p>9 MS. MCSHANE:</p> <p>10 A. Correct.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. And then finally you have your comparable</p> <p>13 earnings, which again draws up the experience</p> <p>14 returns of both the United States and Canadian</p> <p>15 companies, correct?</p> <p>16 MS. MCSHANE:</p> <p>17 A. Yes, but the US companies are really only used</p> <p>18 in that test as an indicator of the</p> <p>19 reasonableness of the Canadian numbers.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Now just getting back to where we jumped off</p> <p>22 there a moment ago, part of the reason that</p> <p>23 this Board in your judgment is required,</p> <p>24 that's your word, to consider returns</p> <p>25 available to utilities in the United States,</p>	<p>1 Q. Okay, all right. So I don't think we disagree</p> <p>2 because my question was part of the reason</p> <p>3 that the Board, in your judgment, is required</p> <p>4 to look at these US returns, these US</p> <p>5 utilities, is the comparability of the</p> <p>6 regulatory business environment.</p> <p>7 (9:45 a.m.)</p> <p>8 MS. MCSHANE:</p> <p>9 A. Well, that's what -- it's the comparability</p> <p>10 that makes them a relevant proxy.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. Right, okay, and I understand -- if we could</p> <p>13 just go to page 16 of your report. Actually,</p> <p>14 page 23, I'm sorry. This is where you get</p> <p>15 into addressing the proxy selection, and so</p> <p>16 the proxy companies that you've selected are</p> <p>17 gas and electric utilities in the United</p> <p>18 States for these tests that we've discussed?</p> <p>19 MS. MCSHANE:</p> <p>20 A. Right.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Okay, and then I noted at page -- I think it</p> <p>23 was 580, where you're referring to at the top</p> <p>24 of line -- 580, at the top of 23, that's where</p> <p>25 you get into discussion of the Canadian</p>
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<p>1 is the similarity of operating regulatory</p> <p>2 environments, right?</p> <p>3 MS. MCSHANE:</p> <p>4 A. Well, I'm not quite sure -- and this may not</p> <p>5 be a subjective difference with what you just</p> <p>6 said, but I think the reason that they're</p> <p>7 required to look beyond Canadian borders is</p> <p>8 because -- for one reason, because investors</p> <p>9 have opportunities beyond Canadian borders.</p> <p>10 The reason for US utilities particularly has</p> <p>11 to do with the fact that the operating and</p> <p>12 regulatory environments are similar, which</p> <p>13 would not be the same if you were looking at</p> <p>14 British or Australian utilities.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. They would be different, would they?</p> <p>17 MS. MCSHANE:</p> <p>18 A. Well, they have a different regulatory model.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. Okay, and what regulatory model would they</p> <p>21 have that's different?</p> <p>22 MS. MCSHANE:</p> <p>23 A. They're not regulated on the basis of original</p> <p>24 cost, for one thing.</p> <p>25 MR. JOHNSON:</p>	<p>1 context, and you note starting at the bottom</p> <p>2 of page 22, "In the Canadian context, there</p> <p>3 are only seven publicly traded utilities.</p> <p>4 These companies are relatively heterogeneous</p> <p>5 in terms of both operations and size", and</p> <p>6 then you go on to note, "While the Canadian</p> <p>7 utilities provide some perspective, a more</p> <p>8 accurate assessment of the cost of capital for</p> <p>9 the benchmark utility can be made by reliance</p> <p>10 on a sample of comparable risk utilities". So</p> <p>11 we can only look to the Canadian landscape for</p> <p>12 some perspective, but if we really want to</p> <p>13 have an accurate picture, we've got to look at</p> <p>14 your proxies?</p> <p>15 MS. MCSHANE:</p> <p>16 A. Well, the problem with the Canadian utilities,</p> <p>17 as I indicated, is that you're really getting</p> <p>18 a very mixed cost of capital estimate because</p> <p>19 you -- well, there really aren't seven</p> <p>20 utilities, anyway, any more. Alta Gas, which</p> <p>21 was one of them, has been purchased. So now</p> <p>22 we're down to six. Pacific Northern Gas is a</p> <p>23 very small risky gas utility, so that's not</p> <p>24 really a very good proxy for an average risk</p> <p>25 Canadian utility. We've got Canadian</p>

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<p>1 Utilities Limited, which is -- about 40 2 percent of its earnings are regulated, its got 3 investments abroad, its got a fair amount of 4 unregulated generation. We've got Emera, 5 which is a vertically integrated electric 6 utility, which also has a utility in the 7 United States. It has two pipelines that it 8 has investments in. It has investments in the 9 Caribbean. You've got Embridge Inc., which is 10 diversified across all pipelines, gas 11 distribution, gas pipelines. Its investments 12 are in the United States, in Canada. Then 13 you've got TransCanada, which used to be like 14 the benchmark company that people looked to. 15 Today its main line system is a relatively 16 small part of its total. I mean, its got 17 investments in all sorts of energy projects, 18 its got an investment in a nuclear plant in 19 Ontario, big electric investments in the 20 States, its investments are -- I'm trying to 21 remember what the breakdown is, but let's say, 22 60/40 Canada/US. So, yeah, I think it's 23 important to try to pick a sample of companies 24 that are -- another sample of companies that 25 in the electric and gas distribution business.</p>	<p>1 MR. JOHNSON: 2 Q. And I noticed in your footnote 16 on the 3 bottom of page 23, you indicate that these 4 Canadian operations span all the major utility 5 industries, including electricity 6 distribution, transmission power generation, 7 natural gas, et cetera. So pretty diverse? 8 MS. MCSHANE: 9 A. Yes, in size and in type of business. 10 MR. JOHNSON: 11 Q. Okay, and so you're of the view then that the 12 US utilities that you have selected are of 13 comparable risk to Newfoundland Power, all 14 taken together? 15 MS. MCSHANE: 16 A. I would say that the utilities that I've 17 selected as a group provide a measure of 18 return that would be for a group of companies 19 of comparable risk -- 20 MR. JOHNSON: 21 Q. Yes, so -- 22 MS. MCSHANE: 23 A. On balance. 24 MR. JOHNSON: 25 Q. Yeah, okay. So they're of comparable risk?</p>
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<p>1 MR. JOHNSON: 2 Q. So what would be the specific objection to one 3 of these companies if they had interests 4 abroad and made revenues abroad? 5 MS. MCSHANE: 6 A. There's nothing -- there's nothing that is 7 inherently problematic about that. It's just 8 that when you take these six companies 9 together, it's kind of difficult to know, you 10 know, whether you're determining the cost of 11 capital for these diversified operations or 12 the regulated operations. So it's important 13 to have an alternative sample, plus because of 14 the fact that there are a very small number of 15 growth forecasts for the Canadian companies, 16 it's virtually impossible to do what I would 17 consider to be a reliable discounted cash flow 18 analysis on using Canadian companies. 19 MR. JOHNSON: 20 Q. But you mentioned the nuclear investments. 21 Just elaborate on those? One of the utilities 22 you mentioned had a big nuclear investment. 23 MS. MCSHANE: 24 A. Yes, TransCanada has investment in Bruce 25 Power.</p>	<p>1 MS. MCSHANE: 2 A. The group is, yes. 3 MR. JOHNSON: 4 Q. And one of the things that you use as sort of 5 a test of that is how Standard and Poor's 6 treats some of these companies, is that right, 7 their ratings? 8 MS. MCSHANE: 9 A. Yes, the size of -- they cannot -- they cannot 10 have a rating of lower than E- to be in the 11 group. 12 MR. JOHNSON: 13 Q. And who gives that rating? 14 MS. MCSHANE: 15 A. S & P. 16 MR. JOHNSON: 17 Q. Standard and Poor's? 18 MS. MCSHANE: 19 A. Yes, sorry, yes. 20 MR. JOHNSON: 21 Q. Okay, and -- but I just notice that, and 22 obviously you're aware of this, that 23 Newfoundland Power and Standard and Poor's 24 parted company some years ago, didn't they? 25 MS. MCSHANE:</p>

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<p>1 A. They did.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. And so why would you use Standard and Poor's</p> <p>4 when Newfoundland Power has got nothing to do</p> <p>5 with Standard and Poor's?</p> <p>6 MS. MCSHANE:</p> <p>7 A. Because if you look at who's rated, by whom,</p> <p>8 the majority of Canadian utilities are rated</p> <p>9 by S & P, so it's -- S & P has a bigger, I</p> <p>10 guess, cross border contingency, if you will.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. But does Moody's, say, rate, you know, your</p> <p>13 sample companies too?</p> <p>14 MS. MCSHANE:</p> <p>15 A. Yeah, they do.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. Yeah, yeah, and so do you make -- once you've</p> <p>18 concluded, as I think you have, that, you</p> <p>19 know, your group of US utilities, be they gas</p> <p>20 and electric, are of similar risk, do you make</p> <p>21 any further adjustments for anything, given</p> <p>22 the US context, or the legal context, the</p> <p>23 regulatory context, the TXT context?</p> <p>24 MS. MCSHANE:</p> <p>25 A. I have not made any adjustments. I have not</p>	<p>1 information from the Moody's Report to come up</p> <p>2 with your table?</p> <p>3 MS. MCSHANE:</p> <p>4 A. Yes, I do. I believe it's in Figure 5.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. Okay. That's page eight, is it?</p> <p>7 MS. MCSHANE:</p> <p>8 A. Yes.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. Okay. So -- there we go, okay. So this would</p> <p>11 be what you used to construct Table 4.</p> <p>12 MS. MCSHANE:</p> <p>13 A. Yes.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. Okay. Now --</p> <p>16 MS. MCSHANE:</p> <p>17 A. At least of columns A and Baa.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. And I note when you look at the Figure 5 that</p> <p>20 Moody's uses, they have medium/low,</p> <p>21 medium/low, medium/low, medium/low, just like</p> <p>22 you indicated that they publish quantitative</p> <p>23 guidelines for two business risks; low and</p> <p>24 medium risk, but your Table 4 just</p> <p>25 concentrates on the low, right, for A and Baa,</p>
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<p>1 considered that any adjustments were</p> <p>2 necessary.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. At page 34 of your report, Ms. McShane, if we</p> <p>5 could go there for a moment.</p> <p>6 MS. MCSHANE:</p> <p>7 A. I'm there.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Here is where you refer, line 869, that you</p> <p>10 say that Moody's publishes quantitative</p> <p>11 guidelines for utility ratings for two</p> <p>12 business risk categories; low and medium risk.</p> <p>13 The guidelines for the low business risk</p> <p>14 category, and both the A and Baa ratings</p> <p>15 categories compared to Newfoundland Power's</p> <p>16 actual metrics are as follows, and then you</p> <p>17 set up the table, and this would be Table 4,</p> <p>18 right?</p> <p>19 MS. MCSHANE:</p> <p>20 A. Yes.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Okay, and if we could turn to the Moody's</p> <p>23 document, if we could, the 2005 document upon</p> <p>24 which, I think, you base this table. Do you</p> <p>25 know where you got -- where you derived the</p>	<p>1 and that's where you get your numbers, your</p> <p>2 range from 3 to 5.7 on FFO interest coverage,</p> <p>3 for instance, in your report?</p> <p>4 MS. MCSHANE:</p> <p>5 A. That's where the range came from, yes.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. Right, and so if you looked at again Moody's,</p> <p>8 that would be taken right out of the A low</p> <p>9 column?</p> <p>10 MS. MCSHANE:</p> <p>11 A. That's right.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. That's the low business risk category, okay,</p> <p>14 and then we see for your FFO, the debt</p> <p>15 percentage, 12 to 22, and right along -- so</p> <p>16 that's where we got it, okay. Could I refer</p> <p>17 you to a paragraph that appears before Figure</p> <p>18 5, four paragraphs up from that where Moody's</p> <p>19 states financial ratios are more useful for</p> <p>20 companies, do you see that?</p> <p>21 (10:00 a.m.)</p> <p>22 MS. MCSHANE:</p> <p>23 A. Sorry, what page are we on?</p> <p>24 MR. JOHNSON:</p> <p>25 Q. Oh, page eight of the Moody's Rating</p>

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<p>1 Methodology of 2005.</p> <p>2 MS. MCSHANE:</p> <p>3 A. Right.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. So you see that paragraph, financial ratio?</p> <p>6 MS. MCSHANE:</p> <p>7 A. Yes.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. And they are saying there that financial</p> <p>10 ratios are more useful for companies operating</p> <p>11 in a low business risk environment where</p> <p>12 there's a high degree of regulated activities</p> <p>13 in a supported regulatory system. They go on</p> <p>14 to say, "This might include the UK, US</p> <p>15 transmission and distribution utilities [T &</p> <p>16 D], Canada, or many European countries.</p> <p>17 Medium business risk operating environments</p> <p>18 would include US integrated utilities". Do you</p> <p>19 see that?</p> <p>20 MS. MCSHANE:</p> <p>21 A. Yeah.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. Okay. Would you gather from this passage</p> <p>24 appearing just above the table, the Figure 5</p> <p>25 from which you derived your Table 4, that</p>	<p>1 MS. MCSHANE:</p> <p>2 A. Okay.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. Do they use the term "generally speaking"?</p> <p>5 MS. MCSHANE:</p> <p>6 A. No, but they don't say "always" either.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. No, but -- and do they, when they're talking</p> <p>9 about Canada in that paragraph, do they draw a</p> <p>10 distinction between Canada's T & Ds and</p> <p>11 generation, or do they just say Canada as</p> <p>12 being in the low risk?</p> <p>13 MS. MCSHANE:</p> <p>14 A. Well, they say Canada, however, I know that if</p> <p>15 you read the Moody's reports before they</p> <p>16 changed methodology for Fortis Alberta, for</p> <p>17 example, they've said -- Fortis Alberta is</p> <p>18 clearly a distribution only company. Moody's</p> <p>19 said that they considered it to be sort of in</p> <p>20 between low and medium risk.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Ms. McShane, this is the document that you</p> <p>23 referred to in your evidence, correct?</p> <p>24 MS. MCSHANE:</p> <p>25 A. I did, to make the table, but that doesn't</p>
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<p>1 Moody's would only put United States</p> <p>2 transmission and distribution utilities from</p> <p>3 supportive states into the low risk business</p> <p>4 operating environment?</p> <p>5 MS. MCSHANE:</p> <p>6 A. I don't know whether they would or not.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Well, what do they say in that paragraph?</p> <p>9 MS. MCSHANE:</p> <p>10 A. They're making sort of a very general</p> <p>11 statement, whether they would include some</p> <p>12 vertically integrated utilities from</p> <p>13 supportive states into low risk category. They</p> <p>14 might.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. But I thought it was rather specific. They</p> <p>17 said in that last sentence, "Medium business</p> <p>18 risk operating environments would include US</p> <p>19 integrated utilities".</p> <p>20 MS. MCSHANE:</p> <p>21 A. So generally speaking, that's where they would</p> <p>22 go, but they may have some that would not.</p> <p>23 Well, let me give you an example.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. No, no, one second now, Ms. McShane.</p>	<p>1 mean that there aren't other reports out there</p> <p>2 by Moody's that say, you know, for example,</p> <p>3 what I just mentioned about Fortis Alberta. So</p> <p>4 there are comments like this that are general</p> <p>5 in nature, and there are obviously specific</p> <p>6 circumstances where there are differences from</p> <p>7 the generalization.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. You wished a few moments ago to put in the</p> <p>10 comment "generally speaking". So I guess</p> <p>11 you'll at least agree that generally speaking,</p> <p>12 Moody's says that if you are into -- if you're</p> <p>13 a US integrated utility, that that would be a</p> <p>14 medium business risk operating environment?</p> <p>15 MS. MCSHANE:</p> <p>16 A. Generally speaking, yes.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. Yeah, and what would a US integrated utility -</p> <p>19 what does it mean if a utility is engaged in</p> <p>20 an integrated utility, if they're classified</p> <p>21 as an integrated utility? Would that mean</p> <p>22 that they're engaged in generation</p> <p>23 transmission and distribution services?</p> <p>24 MS. MCSHANE:</p> <p>25 A. Yes.</p>

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<p>1 MR. JOHNSON:</p> <p>2 Q. And could we turn, Ms. McShane, to your</p> <p>3 schedules. We'll start at 15, I guess, of</p> <p>4 your evidence.</p> <p>5 MS. MCSHANE:</p> <p>6 A. I have that.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Okay, and if we could just scroll over to</p> <p>9 bring the left margin into view, Michael.</p> <p>10 Thank you. We see a number of companies. This</p> <p>11 is your US proxy group, isn't it?</p> <p>12 MS. MCSHANE:</p> <p>13 A. Yes.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. Just identify for the Board, the</p> <p>16 Commissioners, which of these would fit under</p> <p>17 the category of a US integrated utility?</p> <p>18 MS. MCSHANE:</p> <p>19 A. Dominion Resources, Duke Energy, FPL, SCANA,</p> <p>20 Southern Company.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Okay, and, Ms. McShane, when you refer in your</p> <p>23 report, and you mention that Moody's publishes</p> <p>24 quantitative guidelines, your report doesn't</p> <p>25 refer to the fact that Moody's says just above</p>	<p>1 Standard and Poor's because it rates most of</p> <p>2 them.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. But if we are dealing here in Newfoundland and</p> <p>5 Labrador with a utility that doesn't have</p> <p>6 Standard and Poor's coverage, it has Moody's</p> <p>7 coverage, and you're aware that the very</p> <p>8 people who rate Newfoundland Power have</p> <p>9 clearly stated that US integrated utilities of</p> <p>10 the medium risk group, wouldn't that be worthy</p> <p>11 of mentioning to the Board?</p> <p>12 MS. MCSHANE:</p> <p>13 A. Well, at the end of the day, if you look at</p> <p>14 the Moody's ratings, I mean, the Moody's</p> <p>15 ratings of the sample are better than</p> <p>16 Newfoundland Power's rating.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. But there's -- but that doesn't necessarily</p> <p>19 speak to the fact that Newfoundland Power is</p> <p>20 in a low risk business environment while</p> <p>21 Moody's considers these not to be, does it?</p> <p>22 MS. MCSHANE:</p> <p>23 A. The ratings are higher at the end of the day</p> <p>24 of the sample.</p> <p>25 MR. JOHNSON:</p>
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<p>1 this table that US integrated utilities would</p> <p>2 be included in the medium business risk</p> <p>3 operating environment. Why not?</p> <p>4 MS. MCSHANE:</p> <p>5 A. Why doesn't, like --</p> <p>6 MR. JOHNSON:</p> <p>7 Q. Why doesn't your report acknowledge that</p> <p>8 Moody's publishes -- the information that</p> <p>9 you're drawing upon to create your table, that</p> <p>10 same document clearly shows that Moody's, to</p> <p>11 grant you your part, would generally speaking</p> <p>12 put these in the medium risk environment? Why</p> <p>13 doesn't your report mention that?</p> <p>14 MS. MCSHANE:</p> <p>15 A. My report didn't mention it because it wasn't</p> <p>16 one of the criteria that I used to select the</p> <p>17 companies. If you look at the business risk</p> <p>18 profile of these companies on 15, every single</p> <p>19 one of them is in the excellent business risk</p> <p>20 profile by Standard and Poor's, and Standard</p> <p>21 and Poor's, as I said before, is the rating</p> <p>22 agency which does have the most ratings of</p> <p>23 Canadian utilities. So it's, you know, easy</p> <p>24 to see what the typical business profile is of</p> <p>25 a Canadian utility, at least according to</p>	<p>1 Q. And these ratings, like, do we use ratings --</p> <p>2 ratings, aren't they a measure of credit risk?</p> <p>3 MS. MCSHANE:</p> <p>4 A. Sure.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. And so basically they're saying to the world</p> <p>7 that we think these companies should be able</p> <p>8 to honour its debts and obligations. I mean,</p> <p>9 companies --</p> <p>10 MS. MCSHANE:</p> <p>11 A. That's what an investment credit rating</p> <p>12 indicates, that there is a high probability</p> <p>13 that they'll be able to honour their</p> <p>14 obligations.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. But I'm sure, Ms. McShane, that you can think</p> <p>17 of examples of a company, say, in a</p> <p>18 competitive atmosphere, even a highly</p> <p>19 competitive atmosphere, who's out competing</p> <p>20 for business, and you know they have good</p> <p>21 years and bad years, and they have a credit</p> <p>22 rating as strong as a utility, but that</p> <p>23 wouldn't --</p> <p>24 MS. MCSHANE:</p> <p>25 A. Yes, there are some, yes.</p>

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<p>1 MR. JOHNSON:</p> <p>2 Q. But that wouldn't make the investor, the</p> <p>3 equity investor, say, well, I'll be just as</p> <p>4 happy to get the utility return as I'd get</p> <p>5 with the more entrepreneurial company?</p> <p>6 MS. MCSHANE:</p> <p>7 A. No, not necessarily. I mean, you're right,</p> <p>8 debt ratings are clearly not the only criteria</p> <p>9 one would use to select a company to be</p> <p>10 comparable, but they're one that's important.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. And your 2002 evidence before the Board, Ms.</p> <p>13 McShane, would you be able to confirm for me</p> <p>14 that -- you have extracts of that evidence.</p> <p>15 MS. MCSHANE:</p> <p>16 A. Sorry, 2002?</p> <p>17 MR. JOHNSON:</p> <p>18 Q. Yeah.</p> <p>19 MS. MCSHANE:</p> <p>20 A. Okay.</p> <p>21 MS. GLYNN:</p> <p>22 Q. Mr. Johnson, we're just going to mark that as</p> <p>23 Consent #3.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. Thank you. Could you -- I'm directing you to</p>	<p>1 risk profile of Newfoundland Power, but not US</p> <p>2 electric utilities generally, right?</p> <p>3 MS. MCSHANE:</p> <p>4 A. Yeah, I think that's fair, and, of course, I</p> <p>5 don't have all US vertically integrated</p> <p>6 utilities in here. It's those that met the</p> <p>7 criteria of being low risk.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Now, Ms. McShane, in 2007 you filed evidence,</p> <p>10 as we know, and you have that there.</p> <p>11 MS. MCSHANE:</p> <p>12 A. I have several pages from it.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. Yeah, and I thought that you made at page nine</p> <p>15 rather definitive statements about the role of</p> <p>16 a regulatory framework in which a utility</p> <p>17 operates, and in that regard, could I draw</p> <p>18 your attention to line 244 downward. Just</p> <p>19 read for the record what you -- was your</p> <p>20 expert opinion in 2007 in this issue?</p> <p>21 MS. MCSHANE:</p> <p>22 A. Sorry, how far do you want me to read?</p> <p>23 MR. JOHNSON:</p> <p>24 Q. From 244 to 259, please.</p> <p>25 MS. MCSHANE:</p>
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<p>1 page 56 of 67, to that evidence, Ms. McShane.</p> <p>2 MS. MCSHANE:</p> <p>3 A. Yes, I see that.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Just read for the record what you said about</p> <p>6 proxy utilities in that case.</p> <p>7 MS. MCSHANE:</p> <p>8 A. "That I relied on LDCs rather than electric</p> <p>9 utilities for three reasons. Newfoundland</p> <p>10 Power's primary electric distribution utility.</p> <p>11 There are a very limited number of US electric</p> <p>12 utilities whose operations are primary</p> <p>13 distribution and/or transmission. Second, the</p> <p>14 operations of electric and gas distribution</p> <p>15 have significant parallels and are frequently</p> <p>16 considered to be proxies for one another.</p> <p>17 Third, it is noted in Section 2 of Business</p> <p>18 Profile Score 3, which is likely to be</p> <p>19 assigned to Newfoundland Power is the same as</p> <p>20 that of a typical US LDC. In contrast, the</p> <p>21 typical business score of the US electric</p> <p>22 utilities is 4".</p> <p>23 MR. JOHNSON:</p> <p>24 Q. Yeah, so you were acknowledging that the LDC</p> <p>25 would be of a more - more in keeping with the</p>	<p>1 A. "The regulatory framework in which a utility</p> <p>2 operates is frequently viewed as the most</p> <p>3 significant aspect of risk to which investors</p> <p>4 in the utility are exposed. The financial</p> <p>5 community is very conscious of the regulatory</p> <p>6 environment. It's highlighted in reports of</p> <p>7 both bond rating agencies and investment</p> <p>8 analysts. Regulation has the power to expose</p> <p>9 utilities to enormous risk by permitting</p> <p>10 bypass facilities, disallowing costs,</p> <p>11 approving rate designs that are tilted against</p> <p>12 recovery of fixed costs, or returns that do</p> <p>13 not conform with informed investors</p> <p>14 perspective of risk. Alternatively,</p> <p>15 regulation can provide an environment</p> <p>16 characterized by consistency and by even</p> <p>17 handedness conducive to continued growth</p> <p>18 consistent with economic allocation of</p> <p>19 resources, affording the utility a reasonable</p> <p>20 opportunity to achieve a fair return.</p> <p>21 Enlightened regulation will mitigate risks</p> <p>22 that are substantially beyond management</p> <p>23 control and award a return that provides both;</p> <p>24 one, fair compensation for the risks that are</p> <p>25 left with management; two, incentives to</p>

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<p>1 achieve and exceed the allowed return through</p> <p>2 continued improvement and productivity".</p> <p>3 MR. JOHNSON:</p> <p>4 Q. Now, Ms. McShane, do you agree that these</p> <p>5 statements that you made before this Board in</p> <p>6 2007 are as true today as they were when you</p> <p>7 made them?</p> <p>8 MS. MCSHANE:</p> <p>9 A. Yes.</p> <p>10 MR. JOHNSON:</p> <p>11 Q. Yeah. Now as we've noted from our discussion</p> <p>12 of page 34 of your report where you made</p> <p>13 reference to Moody's publishing the</p> <p>14 quantitative guidelines for utility ratings</p> <p>15 for the two business risk categories, you were</p> <p>16 obviously, as your footnote at the bottom of</p> <p>17 that page, Footnote 30 would confirm, you were</p> <p>18 obviously anticipating that new guidelines</p> <p>19 would come out this year. So you were quite</p> <p>20 well aware of the Moody's methodology and the</p> <p>21 fact it was developing?</p> <p>22 MS. MCSHANE:</p> <p>23 A. I knew it was developing. I had no idea where</p> <p>24 it was going.</p> <p>25 MR. JOHNSON:</p>	<p>1 (10:15 a.m.)</p> <p>2 MR. JOHNSON:</p> <p>3 Q. And I think you'll agree, as Moody's states a</p> <p>4 little above this, that most of the utilities</p> <p>5 that they look at are not fully regulated.</p> <p>6 There's unregulated aspects to them too?</p> <p>7 MS. MCSHANE:</p> <p>8 A. I think that's fair. I mean, most companies</p> <p>9 have -- most of the traded companies, which</p> <p>10 are what we would use for doing cost of equity</p> <p>11 studies, have some unregulated operations.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. Okay, so Newfoundland Power would be Category</p> <p>14 1, wholly regulated, and then do you know --</p> <p>15 you're familiar with the SRE 1, 2, 3, 4?</p> <p>16 MS. MCSHANE:</p> <p>17 A. I'm familiar with them, yes.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. And that's a pretty detailed assessment of the</p> <p>20 supportiveness of the regulatory framework,</p> <p>21 isn't it?</p> <p>22 MS. MCSHANE:</p> <p>23 A. They do a relatively detailed breakdown.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. And do you know where Canada would fall in?</p>
Page 54	Page 56
<p>1 Q. Okay, and as you're probably aware,</p> <p>2 Newfoundland Power would be considered a</p> <p>3 Category 1 utility under the Moody's 2005</p> <p>4 methodology? Would you refer to that, please?</p> <p>5 MS. MCSHANE:</p> <p>6 A. You're talking about under the regulatory</p> <p>7 framework?</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Yeah, I'm talking about the qualitative</p> <p>10 factors which your report didn't go into, and</p> <p>11 I'm referring to page four where it talks</p> <p>12 about the assessment of the extent of</p> <p>13 regulation around the business.</p> <p>14 MS. MCSHANE:</p> <p>15 A. Where you say the regulatory framework fully</p> <p>16 developed?</p> <p>17 MR. JOHNSON:</p> <p>18 Q. No, I'm talking about the --</p> <p>19 MS. MCSHANE:</p> <p>20 A. Oh, sorry, I see what you're saying, the</p> <p>21 wholly regulated business.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. Right.</p> <p>24 MS. MCSHANE:</p> <p>25 A. Okay.</p>	<p>1 MS. MCSHANE:</p> <p>2 A. Generally in Category SRE 1.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. Again now Moody's doesn't use the word</p> <p>5 "generally", they say it falls in it, right?</p> <p>6 You're not quibbling with that?</p> <p>7 MS. MCSHANE:</p> <p>8 A. They put it under that category.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. And you have -- you would be aware through</p> <p>11 your client, and there are credit reports, et</p> <p>12 cetera, that Moody's has said about this</p> <p>13 regulator, in particular, that it considers it</p> <p>14 one of the more supportive regulators in the</p> <p>15 country?</p> <p>16 MS. MCSHANE:</p> <p>17 A. I'm aware of that, yes.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. That's right. So you also would know, I take</p> <p>20 it where the individual United States, and the</p> <p>21 District of Columbia, would fall within the</p> <p>22 Moody's methodology?</p> <p>23 MS. MCSHANE:</p> <p>24 A. I do not.</p> <p>25 MR. JOHNSON:</p>

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<p>1 Q. Okay. Would you turn then to -- you don't</p> <p>2 know?</p> <p>3 MS. MCSHANE:</p> <p>4 A. I've -- not under this new approach, no.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. This is not a new approach. This is the 2005.</p> <p>7 MS. MCSHANE:</p> <p>8 A. Are we still talking about the 2005?</p> <p>9 MR. JOHNSON:</p> <p>10 Q. Yeah.</p> <p>11 MS. MCSHANE:</p> <p>12 A. Well, I mean, yeah, I've looked at the</p> <p>13 different States under the old one, but I</p> <p>14 haven't memorized them.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. But do you -- take a moment to have a look at</p> <p>17 it.</p> <p>18 MS. MCSHANE:</p> <p>19 A. Okay. Do you have a page in mind that --</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Page five.</p> <p>22 MS. MCSHANE:</p> <p>23 A. Sorry. Page five?</p> <p>24 MR. JOHNSON:</p> <p>25 Q. Uh-hm.</p>	<p>1 MR. JOHNSON:</p> <p>2 Q. Was that one of the vertically integrated</p> <p>3 utilities?</p> <p>4 MS. MCSHANE:</p> <p>5 A. It is a vertically integrated utility.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. And would they carry on business in West</p> <p>8 Virginia?</p> <p>9 MS. MCSHANE:</p> <p>10 A. West Virginia?</p> <p>11 MR. JOHNSON:</p> <p>12 Q. Yeah.</p> <p>13 MS. MCSHANE:</p> <p>14 A. If they do, it's not very big. That's</p> <p>15 certainly not their major state.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. I'm referring to CA-NP-18 for a second.</p> <p>18 MS. MCSHANE:</p> <p>19 A. Yes, I have that.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Just go to the schedule, Michael, please.</p> <p>22 We'll come back to this, but --</p> <p>23 MS. MCSHANE:</p> <p>24 A. Yeah, you're right, they have some operations</p> <p>25 in West Virginia. Virginia is their big</p>
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<p>1 MS. MCSHANE:</p> <p>2 A. Oh, sorry, okay, so we have some states that</p> <p>3 are listed under SRE 2.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Yeah. Do you see what other countries Moody's</p> <p>6 puts with the SRE 3 states?</p> <p>7 MS. MCSHANE:</p> <p>8 A. I do.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. Chile, Czech Republic, Estonia, Greece,</p> <p>11 Israel?</p> <p>12 MS. MCSHANE:</p> <p>13 A. I see those. I haven't studied those</p> <p>14 regulatory models. I don't know whether</p> <p>15 they're quite different or not.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. But, I mean, you're not just reading this for</p> <p>18 the first time, Ms. McShane, are you?</p> <p>19 MS. MCSHANE:</p> <p>20 A. No, of course not.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. And, for instance, one of your companies is</p> <p>23 Dominion Resources, is it not?</p> <p>24 MS. MCSHANE:</p> <p>25 A. It is.</p>	<p>1 state, and Ohio is their second biggest state.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. Okay, we can just take that off, Michael, for</p> <p>4 the time being. So West Virginia, that would</p> <p>5 fall in SRE 3, according to Moody's?</p> <p>6 MS. MCSHANE:</p> <p>7 A. Again Virginia is their big state.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Okay, where would Virginia fall, SRE 2, still</p> <p>10 below Canada?</p> <p>11 MS. MCSHANE:</p> <p>12 A. Yes, in Moody's opinion, yes.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. Oh, yes, it's only Moody's.</p> <p>15 MS. MCSHANE:</p> <p>16 A. Well, I know, but, I mean, the fact is that if</p> <p>17 we're looking at these companies, I mean,</p> <p>18 we're not only concerned about what Moody's</p> <p>19 might think. I mean, we're looking at this</p> <p>20 from a much broader perspective.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Well, where would Ohio fall, because Dominion</p> <p>23 Resources, as you said, carries on business in</p> <p>24 Ohio as well, correct?</p> <p>25 MS. MCSHANE:</p>

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<p>1 A. They do. From Moody's perspective, Ohio falls 2 in 3. 3 MR. JOHNSON: 4 Q. SRE 3, yeah, and Pennsylvania, is that where 5 Dominion does business as well? 6 MS. MCSHANE: 7 A. And I think they have some operations in 8 Pennsylvania. 9 MR. JOHNSON: 10 Q. Yeah. 11 MS. MCSHANE: 12 A. And Moody's says 3. 13 MR. JOHNSON: 14 Q. Yeah. Is Pennsylvania -- is that where a 15 regulator once disallowed the cost of a 16 nuclear facility? Was that the Duquesne case? 17 Was that Pennsylvania? 18 MS. MCSHANE: 19 A. Yeah, I think Duquesne was in Pennsylvania. 20 MR. JOHNSON: 21 Q. They built a nuclear power facility and the 22 regulator wouldn't allow them to recover the 23 cost, is that correct? 24 MS. MCSHANE: 25 A. There was an issue with prudence, yes, I</p>	<p>1 MR. JOHNSON: 2 Q. And you also reference the S & P business risk 3 class? 4 MS. MCSHANE: 5 A. Yes. 6 MR. JOHNSON: 7 Q. But you don't reference the Moody's business 8 risk class in this reply? 9 MS. MCSHANE: 10 A. No, because I selected the companies based on 11 a criterion of the highest business -- I 12 should say the lowest business risk class of S 13 & P, who divides the companies into a fairly 14 detailed breakdown of business risk classes 15 much more so than Moody's, so that you go from 16 excellent, to strong, to satisfactory, to 17 vulnerable, and weak. So there's a much, much 18 better cleaner breakdown, and that way, I 19 mean, it's possible to make sure that you've 20 got all utilities in that top business risk 21 class where most of Canadian utilities, not 22 all of them, but most of Canadian utilities 23 fall. 24 MR. JOHNSON: 25 Q. But that's the criterion that you get to</p>
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<p>1 believe. 2 MR. JOHNSON: 3 Q. Yeah, and do you recall, Ms. McShane -- again 4 if we could bring up CA-19 -- CA-18, I'm 5 sorry, and the question first, Michael, 6 please. This is CA-NP-18A, "Please provide 7 all statistical work that Ms. McShane has 8 performed to justify the assumption that US 9 utilities are comparable in risk to 10 Newfoundland Power". So you would have 11 prepared this response, I take it? 12 MS. MCSHANE: 13 A. I did. 14 MR. JOHNSON: 15 Q. And in Part A, you say the first three lines 16 there, "Reliance on a sample of US utilities 17 as comparables was not based on statistical 18 analysis. It was based on knowledge of both 19 the regulatory and operating environments of 20 both Canadian and US utilities, and 21 understanding of the capital markets, et 22 cetera". Now that knowledge was your 23 knowledge? 24 MS. MCSHANE: 25 A. Yes.</p>	<p>1 select, right? 2 MS. MCSHANE: 3 A. I selected that, yes. 4 MR. JOHNSON: 5 Q. Yeah. 6 MS. MCSHANE: 7 A. I mean, it's a much -- as I said, it's a more 8 precise breakdown than would be available from 9 Moody's. 10 MR. JOHNSON: 11 Q. Well, then you go on to say that you carried 12 out a -- this is number five, "a review of the 13 regulatory climate in each state, including 14 the various regulatory mechanisms, see 15 Attachment A". So when did you carry out this 16 review of the regulatory climate in each 17 state? 18 MS. MCSHANE: 19 A. I keep this up to date all the time. 20 MR. JOHNSON: 21 Q. So this would be up to date as of when? 22 MS. MCSHANE: 23 A. It would have been up to date as of the date 24 this was filed. 25 MR. JOHNSON:</p>

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1 Q. And if we could just look at your Appendix A
 2 for a moment. So the first thing we notice is
 3 you've got all the list of your companies, and
 4 then the states served, okay, and then the
 5 type of utility. Now you've already addressed
 6 which ones are the vertically integrated
 7 electric companies. What are the ones that
 8 don't fit into that category?
 9 MS. MCSHANE:
 10 A. The other ones, the rest of them.
 11 MR. JOHNSON:
 12 Q. Okay, you're not going to name them, all
 13 right.
 14 MS. MCSHANE:
 15 A. Oh, you want me to actually give you the list?
 16 I mean, I'm happy to read you the names of
 17 them.
 18 MR. JOHNSON:
 19 Q. It doesn't particularly matter, if it's going
 20 to be an issue. The column about regulatory
 21 climate, what do you mean by regulatory
 22 climate?
 23 MS. MCSHANE:
 24 A. Regulatory climate is judged -- I thought I
 25 had a footnote here, actually, perhaps not.

1 A. Yes, they do.
 2 MR. JOHNSON:
 3 Q. And are they -- do you subscribe to their
 4 material?
 5 MS. MCSHANE:
 6 A. I do.
 7 MR. JOHNSON:
 8 Q. Do you contribute to this organization?
 9 MS. MCSHANE:
 10 A. What do you mean, contribute?
 11 MR. JOHNSON:
 12 Q. Contribute in terms of offer your views of the
 13 --
 14 MS. MCSHANE:
 15 A. No, I don't.
 16 (10:30 a.m.)
 17 MR. JOHNSON:
 18 Q. These people would be found on the web, I take
 19 it?
 20 MS. MCSHANE:
 21 A. I think they are -- they are part of an
 22 organization called SNL Financial, and I think
 23 you can find reference to them on the SNL
 24 Financial website.
 25 MR. JOHNSON:

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1 There is an organization called Regulatory
 2 Research Associates, which does an assessment
 3 of the regulatory climate of each of the
 4 states, and it's based on, I guess, their view
 5 of how supportive the regulator is. I mean,
 6 they look at the decisions that the regulator
 7 issues, the types of mechanisms that the
 8 regulators allow, and they rank them on a
 9 scale of -- they start with above average,
 10 average, below average, and within each of
 11 those three categories there are notches, one,
 12 two, and three.
 13 MR. JOHNSON:
 14 Q. What did you say the name of this organization
 15 was?
 16 MS. MCSHANE:
 17 A. It's called Regulatory Research Associates.
 18 MR. JOHNSON:
 19 Q. And where are they out of?
 20 MS. MCSHANE:
 21 A. I believe -- I'm going to say Charlottesville,
 22 Virginia.
 23 MR. JOHNSON:
 24 Q. And, like, do they publish this material?
 25 MS. MCSHANE:

1 Q. Do you know what SNL Financial means -- stands
 2 for?
 3 MS. MCSHANE:
 4 A. Not off the top of my head.
 5 MR. JOHNSON:
 6 Q. And so I take it -- what's their top rating?
 7 MS. MCSHANE:
 8 A. Their top rating would be above average 1.
 9 MR. JOHNSON:
 10 Q. Above average 1?
 11 MS. MCSHANE:
 12 A. Yes, that would be it.
 13 MR. JOHNSON:
 14 Q. Neither one of your companies fall into that
 15 category, I don't think, does it?
 16 MS. MCSHANE:
 17 A. No. The highest that -- there are some that
 18 are above average, but there's none that's
 19 above average 1.
 20 MR. JOHNSON:
 21 Q. So we have above average 1. That's the top
 22 shelf. Then what?
 23 MS. MCSHANE:
 24 A. Above average 2, above average 3, average 1,
 25 average 2, average 3.

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<p>1 MR. JOHNSON:</p> <p>2 Q. How many above average 2's do we have?</p> <p>3 MS. MCSHANE:</p> <p>4 A. Probably -- I mean, different companies have</p> <p>5 different numbers of assessments, depending on</p> <p>6 how many states they're in.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Okay, so -- and I see Duke is above average in</p> <p>9 North Carolina?</p> <p>10 MS. MCSHANE:</p> <p>11 A. Yes, which is a big state.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. And New Jersey Resources -- no, I'm sorry,</p> <p>14 FPL, above average 2?</p> <p>15 MS. MCSHANE:</p> <p>16 A. Yes, and so Florida is its big state.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. I see. So then what's after above average 2?</p> <p>19 MS. MCSHANE:</p> <p>20 A. Three, above average 3.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Where does average 1 fit in?</p> <p>23 MS. MCSHANE:</p> <p>24 A. After that. So there are nine --</p> <p>25 MR. JOHNSON:</p>	<p>1 climate, and it looks at all 50 of them. It</p> <p>2 studies the decisions, everything that comes</p> <p>3 out of all the regulatory jurisdictions in the</p> <p>4 United States. So this column happens to be</p> <p>5 their assessment of what the regulatory</p> <p>6 climate is.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And then we have a column going across,</p> <p>9 Moody's Reg Support, and then rating, gas</p> <p>10 only. What's that?</p> <p>11 MS. MCSHANE:</p> <p>12 A. There was a report that was issued by Moody's</p> <p>13 which -- in 2006, which looked at -- which was</p> <p>14 the gas methodology, and it provided their</p> <p>15 regulatory support assessment of the various</p> <p>16 gas distribution utilities. So these are</p> <p>17 Moody's regulatory support grades, if you</p> <p>18 will, or ratings for the relevant gas</p> <p>19 distribution operations of these companies.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Okay, and -- now the -- I take it that you're</p> <p>22 aware that the Moody's methodology that came</p> <p>23 out in 2009, that followed up the 2005</p> <p>24 methodology document. Are you aware --</p> <p>25 MS. MCSHANE:</p>
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<p>1 Q. Nine?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Nine different categories, starting with above</p> <p>4 average 1, 2, 3, and average 1, 2, 3, below</p> <p>5 average 1, 2, 3.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. So do you rely upon them as to whether this</p> <p>8 regulatory climate is above average, or is it</p> <p>9 based on your personal knowledge?</p> <p>10 MS. MCSHANE:</p> <p>11 A. Well, I read decisions.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. You just read it. It's not -- it's not primary</p> <p>14 research on your part, let's say.</p> <p>15 MS. MCSHANE:</p> <p>16 A. I'm not quite sure I understand your question.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. I mean, I take it, you are saying that these</p> <p>19 are average 1 or above average 2 by virtue of</p> <p>20 what these people say to you as opposed to</p> <p>21 your analysis of the regulatory --</p> <p>22 MS. MCSHANE:</p> <p>23 A. That's correct. I mean, these are not my</p> <p>24 assessments, these are an independent</p> <p>25 organization's assessments of the regulatory</p>	<p>1 A. Yeah, that's -- yes, well, the way I</p> <p>2 understand, there was a global electric</p> <p>3 methodology issued in 2005, which was</p> <p>4 applicable to electric utilities globally</p> <p>5 across the world. They also had a methodology</p> <p>6 for gas distribution utilities which was</p> <p>7 applicable in North America. So it covered</p> <p>8 Canadian and US gas distribution utilities.</p> <p>9 What I understand this new methodology does is</p> <p>10 combine the gas and electric together, and</p> <p>11 it's all global.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. And, Ms. McShane, you know, given the fact</p> <p>14 that you footnote the 2005 methodology report,</p> <p>15 and given the fact that you have a column that</p> <p>16 deals with Moody's regulatory support, why</p> <p>17 would you just limit it to gas only when</p> <p>18 clearly Moody's has a methodology on every one</p> <p>19 of these states?</p> <p>20 MS. MCSHANE:</p> <p>21 A. Because they gave a specific regulatory</p> <p>22 support grade, not to the state, but to the</p> <p>23 utility. So if you look, for example, at AGL</p> <p>24 Resources which operates in four different</p> <p>25 states, that Baa rating is not a rating for</p>

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<p>1 Georgia, it's a rating for the whole of AGL</p> <p>2 Resources.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. So that Moody's - that Moody's rating and</p> <p>5 regulatory support would apply wherever they</p> <p>6 carry on gas activities?</p> <p>7 MS. MCSHANE:</p> <p>8 A. No, I don't think that's fair to say. What it</p> <p>9 says is that Moody's looked at the company on</p> <p>10 an overall basis and said on overall basis, we</p> <p>11 rate it Baa on regulatory support, just like</p> <p>12 when you look at New Jersey Resources, overall</p> <p>13 we rate it Aaa on regulatory support. I mean,</p> <p>14 in that case, it only operates in one state,</p> <p>15 so, you know, logically you could say, yes,</p> <p>16 that applies to New Jersey, but where there</p> <p>17 are multiple states, that would be an overall</p> <p>18 assessment of what the regulatory support is</p> <p>19 based on, presumably, the relative size of the</p> <p>20 operations in the individual states. The</p> <p>21 interesting thing was that when you looked at</p> <p>22 this report Moody's issued, at the time there</p> <p>23 was only one Canadian utility, that being</p> <p>24 Terasen Gas, who is rated by Moody's -- not a</p> <p>25 Canadian utility, but a Canadian gas utility,</p>	<p>1 a question of, you know, how strict are -- how</p> <p>2 much scrutiny is placed on the forecast, and</p> <p>3 how much are the companies forecast actually</p> <p>4 cut back from what they anticipate. So, you</p> <p>5 know, I think there's not necessarily that</p> <p>6 much difference between today, with inflation</p> <p>7 being what it is, that much difference between</p> <p>8 a -- using historic test year with adjustments</p> <p>9 for known and measurable differences than with</p> <p>10 a forecast test year.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. Now your next one is sales and weather</p> <p>13 normalization features, and first let me ask</p> <p>14 you, why was this highlighted in this reply?</p> <p>15 Why was this addressed?</p> <p>16 MS. MCSHANE:</p> <p>17 A. Because it's one of the mechanisms that does</p> <p>18 address earnings variability from year to year</p> <p>19 and also addresses decline per customer</p> <p>20 consumption and takes account of that.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. So what -- from your knowledge of Newfoundland</p> <p>23 Power, what do they have that would fit under</p> <p>24 this rubric?</p> <p>25 MS. MCSHANE:</p>
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<p>1 and when you compare the regulatory support of</p> <p>2 all the gas utilities that fall in my</p> <p>3 comparable sample, the regulatory support</p> <p>4 factor on average for those companies was the</p> <p>5 same or higher than it was for Terasen Gas,</p> <p>6 which is regulated by another one of the</p> <p>7 regulatory boards that Moody's considers to be</p> <p>8 very supportive.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. Now your next column is the test year column,</p> <p>11 and why is that there, what are you trying to</p> <p>12 say with that?</p> <p>13 MS. MCSHANE:</p> <p>14 A. Well, people sometimes try to make the point</p> <p>15 that the test year makes a difference in the</p> <p>16 risk profile of a company, so I do keep tabs</p> <p>17 on what kind of test year these companies use.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. And what would be more advantageous from a</p> <p>20 regulatory support perspective, in your view?</p> <p>21 MS. MCSHANE:</p> <p>22 A. From a regulatory support perspective, I mean,</p> <p>23 it's really hard to say. I guess, generally</p> <p>24 speaking, you could say that a forecast test</p> <p>25 year is most advantageous, but then it becomes</p>	<p>1 A. They have weather normalization.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. And how about the energy supply cost variance?</p> <p>4 MS. MCSHANE:</p> <p>5 A. Well, that sort of falls under the next</p> <p>6 column.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Under the next one, okay, and how would you</p> <p>9 characterize the importance of Newfoundland</p> <p>10 Power's weather normalization mechanism?</p> <p>11 MS. MCSHANE:</p> <p>12 A. How would I characterize its importance?</p> <p>13 MR. JOHNSON:</p> <p>14 Q. Yeah.</p> <p>15 MS. MCSHANE:</p> <p>16 A. It's certainly important from a debt rating</p> <p>17 perspective. I don't think that from a cost</p> <p>18 of equity perspective it has much impact, if</p> <p>19 any.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. We've had some evidence here, Ms. McShane --</p> <p>22 are you aware of some evidence that was</p> <p>23 brought out in the last little bit in this</p> <p>24 hearing about what the effect of the weather</p> <p>25 normalization mechanism meant as a percentage</p>

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<p>1 of Newfoundland Power's return on equity on a</p> <p>2 yearly basis?</p> <p>3 MS. MCSHANE:</p> <p>4 A. No, I was not.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. And to be fair, that information item dealt</p> <p>7 with both the RSA and the weather</p> <p>8 normalization mechanism, and it showed that it</p> <p>9 could be a plus or minus, I think, 10</p> <p>10 something or 11 percent of the return on</p> <p>11 equity of Newfoundland Power. Would that be</p> <p>12 significant?</p> <p>13 MS. MCSHANE:</p> <p>14 A. Yes, it's a symmetric. So there are plenty of</p> <p>15 other utilities who have -- Embridge Gas, for</p> <p>16 example, who has the same kind of experience,</p> <p>17 but, yes, it would be of importance to a debt</p> <p>18 holder, but that kind of variability from year</p> <p>19 to year doesn't necessarily mean that much to</p> <p>20 an equity investor as long as there is a</p> <p>21 symmetry, an expectation that those variations</p> <p>22 will even out.</p> <p>23 MR. JOHNSON:</p> <p>24 Q. But you could be a while waiting for your</p> <p>25 symmetry under these mechanisms?</p>	<p>1 MR. JOHNSON:</p> <p>2 Q. Sorry, just continue that thought, and I have</p> <p>3 a follow up.</p> <p>4 MS. MCSHANE:</p> <p>5 A. Weather and changes in customer consumption.</p> <p>6 Do you want me to finish before --</p> <p>7 MR. JOHNSON:</p> <p>8 Q. If I could just jump in for a second.</p> <p>9 MS. MCSHANE:</p> <p>10 A. Okay.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. On Georgia, would they -- they wouldn't have</p> <p>13 weather normalization feature, though, would</p> <p>14 they?</p> <p>15 MS. MCSHANE:</p> <p>16 A. Normally wouldn't need one because if all</p> <p>17 their fixed costs are recovered in a fixed</p> <p>18 charge, their revenues are not sensitive to</p> <p>19 consumption which would be weather affected.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Okay. Sorry, I interrupted you.</p> <p>22 MS. MCSHANE:</p> <p>23 A. And I was just going to say for New Jersey and</p> <p>24 Tennessee, they've got weather normalization</p> <p>25 clauses.</p>
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<p>1 MS. MCSHANE:</p> <p>2 A. Well, I mean, it's possible that there are</p> <p>3 going to be four or five years of colder or</p> <p>4 warmer than normal weather, that's true, and</p> <p>5 again that would be of some concern to a debt</p> <p>6 holder, more so than an equity holder.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Now with respect to AGL Resources under the</p> <p>9 Sales and Weather Normalization features, what</p> <p>10 are you trying to tell us there, Ms. McShane?</p> <p>11 MS. MCSHANE:</p> <p>12 A. What am I trying to tell you? I'm trying to</p> <p>13 tell you that in Georgia, which is the AGL's</p> <p>14 big state, that their rate design is -- they</p> <p>15 don't sell gas any more. All they do is</p> <p>16 deliver gas, so they have a straight fixed</p> <p>17 variable rate design which means they recover</p> <p>18 all their fixed costs, which because they're a</p> <p>19 gas utility, would be most of them, in a fixed</p> <p>20 charge. So their rates are not -- sorry,</p> <p>21 their revenues are not that dependent on</p> <p>22 consumption. For Virginia, they have</p> <p>23 decoupling, which means their revenues are</p> <p>24 decoupled from their cost, so that they are</p> <p>25 protected from both weather --</p>	<p>1 (10:45 a.m.)</p> <p>2 MR. JOHNSON:</p> <p>3 Q. And then Con Edison in New York, under that</p> <p>4 category what are you trying to tell us?</p> <p>5 MS. MCSHANE:</p> <p>6 A. That they have revenue decoupling for their</p> <p>7 electric business and weather normalization</p> <p>8 for their gas business. So I discussed what</p> <p>9 decoupling was with respect to AGL.</p> <p>10 Decoupling is the same type of thing in Con</p> <p>11 Edison's case.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. Then we get into Dominion Resources, and I'm</p> <p>14 seeing blanks for Virginia and West Virginia</p> <p>15 and Pennsylvania under the Sales and Weather</p> <p>16 Normalization features.</p> <p>17 MS. MCSHANE:</p> <p>18 A. Right.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. What does that mean?</p> <p>21 MS. MCSHANE:</p> <p>22 A. They don't have any special features for</p> <p>23 weather normalization.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. Okay. So they would be at risk for that?</p>

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1 MS. MCSHANE:

2 A. Yeah, I mean, I think one of the things you
3 have to realize when you look at these
4 companies is -- I mean, Newfoundland Power,
5 part of the reason that it has weather
6 normalization is because it has a large
7 heating load. So for a company like Dominion
8 Resources, which probably its electric utility
9 doesn't have a large heating load, weather
10 normalization is not -- the lack of weather
11 normalization clause is not big a difference.

12 MR. JOHNSON:

13 Q. I guess they would have air conditioning load
14 in the summertime, and I guess they count on
15 that, don't they?

16 MS. MCSHANE:

17 A. Sure, they do, but for most electric
18 utilities, you don't have that same kind of
19 sensitivity to weather that you do if you got
20 a heating loading. I mean, if you look at a
21 company like ATCO Electric or Hydro One in
22 Ontario where they have very very little
23 heating load, they have very little weather
24 sensitivity to begin with, so I suppose you
25 could say that a weather normalization clause

1 A. Because again they don't really need one.

2 MR. JOHNSON:

3 Q. Do you know if they've applied for one?

4 MS. MCSHANE:

5 A. No, I don't believe they have because weather
6 is not that big an issue for electric
7 utilities who don't have heating load.

8 MR. JOHNSON:

9 Q. How about Duke Energy in Kentucky, they have
10 no weather normalization?

11 MS. MCSHANE:

12 A. I see that.

13 MR. JOHNSON:

14 Q. Nor does Duke's interest in Indiana, and South
15 Carolina?

16 MS. MCSHANE:

17 A. True.

18 MR. JOHNSON:

19 Q. Okay, and then Florida, I guess the heating
20 load is not huge?

21 MS. MCSHANE:

22 A. I would not think so.

23 MR. JOHNSON:

24 Q. Okay, New Jersey Resources has decoupling,
25 North West Natural Gas has decoupling, but

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1 for them would be like adding, what's the
2 expression, suspenders to your belt.

3 MR. JOHNSON:

4 Q. Well, let's -- remind us then as we go along
5 which of these companies would be subject to,
6 you know, the weather concern, but which do
7 not have a protective mechanism?

8 MS. MCSHANE:

9 A. So you're asking me to tell you which ones
10 would have a big heating load?

11 MR. JOHNSON:

12 Q. Well, yeah, as we go along, let's say, Duke
13 Energy in North Carolina?

14 MS. MCSHANE:

15 A. No.

16 MR. JOHNSON:

17 Q. And I take it they have no weather
18 normalization or sales features?

19 MS. MCSHANE:

20 A. They again -- they would not have a big
21 heating load.

22 MR. JOHNSON:

23 Q. No, but they wouldn't have the weather
24 normalization feature?

25 MS. MCSHANE:

1 then Washington is left blank?

2 MS. MCSHANE:

3 A. I think that's right. I can double check that
4 for you, but I think they have decoupling in
5 their big state. I thought they had something
6 in Washington, and I may have missed it, but
7 if I have, I'll let you know.

8 MR. JOHNSON:

9 Q. Okay, and NSTAR in Mass, what are you saying
10 there, generic order?

11 MS. MCSHANE:

12 A. Yes, they've -- this is a combined electric
13 and gas LDC, and the regulator passed sort of
14 a generic order saying that the utilities can
15 apply for full decoupling.

16 MR. JOHNSON:

17 Q. And have they all received full decoupling?

18 MS. MCSHANE:

19 A. I don't believe so, no.

20 MR. JOHNSON:

21 Q. So there's some of them without it now?

22 MS. MCSHANE:

23 A. Well, NSTAR doesn't have it at the moment.

24 MR. JOHNSON:

25 Q. And they would be a big supplier of energy in

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<p>1 Massachusetts, I take it?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Yes, they are.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. And they would have heating load?</p> <p>6 MS. MCSHANE:</p> <p>7 A. I doubt it. I'll double check and I'll get</p> <p>8 back to you, but there's a big gas utility</p> <p>9 there and the heating load would be served by</p> <p>10 natural gas and oil, much more than</p> <p>11 electricity.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. But they're also gas, though, right, NSTAR?</p> <p>14 MS. MCSHANE:</p> <p>15 A. Yes.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. But I thought you said -- because when I asked</p> <p>18 you about electric, you said, no, I think gas</p> <p>19 takes care of it, but they are both gas and</p> <p>20 electric?</p> <p>21 MS. MCSHANE:</p> <p>22 A. Right, sorry, you're right.</p> <p>23 MR. JOHNSON:</p> <p>24 Q. Yes, so they don't have it?</p> <p>25 MS. MCSHANE:</p>	<p>1 wouldn't have it in South Carolina?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Sorry, one second. No, I don't know off the</p> <p>4 top of my head why Piedmont doesn't have</p> <p>5 weather normalization in South Carolina, and</p> <p>6 South Carolina Electric and Gas does.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And Tennessee has nothing under Piedmont?</p> <p>9 MS. MCSHANE:</p> <p>10 A. No, Tennessee is small, though.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. Okay. When you say small, like, smaller than</p> <p>13 Newfoundland Power?</p> <p>14 MS. MCSHANE:</p> <p>15 A. I mean small relative to North Carolina and</p> <p>16 South Carolina in terms of their total</p> <p>17 business.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Okay, but in terms of -- is that Scana or</p> <p>20 Scana?</p> <p>21 MS. MCSHANE:</p> <p>22 A. I pronounce it Scana.</p> <p>23 MR. JOHNSON:</p> <p>24 Q. Okay. Now they are vertically integrated.</p> <p>25 They're both electric and gas?</p>
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<p>1 A. They don't have?</p> <p>2 MR. JOHNSON:</p> <p>3 Q. They don't have this protection we're talking</p> <p>4 about?</p> <p>5 MS. MCSHANE:</p> <p>6 A. No, not at the moment.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Right, okay. They would have how many</p> <p>9 customers?</p> <p>10 MS. MCSHANE:</p> <p>11 A. I don't know off the top of my head.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. Piedmont Natural Gas out of North Carolina, I</p> <p>14 guess they have a mechanism?</p> <p>15 MS. MCSHANE:</p> <p>16 A. They do.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. South Carolina, they don't have a mechanism,</p> <p>19 but now they're also in the Carolinas?</p> <p>20 MS. MCSHANE:</p> <p>21 A. Yes.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. They're North Carolinian cousin has one, so</p> <p>24 they must be viewed as a need up there, but</p> <p>25 not in South Carolina? Do you know why they</p>	<p>1 MS. MCSHANE:</p> <p>2 A. They are.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. And they only have weather normalization on</p> <p>5 gas?</p> <p>6 MS. MCSHANE:</p> <p>7 A. That's my understanding, yes.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Okay, so they're at risk on the electric side?</p> <p>10 MS. MCSHANE:</p> <p>11 A. Again they're not going to have a big heating</p> <p>12 load.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. Then North Carolina, Scana, customer</p> <p>15 utilization tracker, gas in North Carolina,</p> <p>16 what does that mean?</p> <p>17 MS. MCSHANE:</p> <p>18 A. If you think of decoupling, I guess, as being</p> <p>19 made up of -- potentially being made up of two</p> <p>20 pieces; one, adjustment for weather; one,</p> <p>21 adjustment for customer usage. Just to give</p> <p>22 you an example, Terasen Gas has what's called</p> <p>23 a revenue stabilization adjustment mechanism,</p> <p>24 it adjusts for both reductions in per customer</p> <p>25 usage and it adjusts for variations in weather</p>

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<p>1 in one account. The customer tracker, usage</p> <p>2 tracker that's being referred to here, is</p> <p>3 effectively the customer usage piece of that.</p> <p>4 So it doesn't adjust for weather, but it does</p> <p>5 take account of declines in per customer</p> <p>6 usage.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And then the Southern Company, they have no</p> <p>9 protections in any of their states?</p> <p>10 MS. MCSHANE:</p> <p>11 A. On?</p> <p>12 MR. JOHNSON:</p> <p>13 Q. On weather normalization --</p> <p>14 MS. MCSHANE:</p> <p>15 A. No.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. Sales and weather normalization features?</p> <p>18 MS. MCSHANE:</p> <p>19 A. No, but again, I mean, these are all southern</p> <p>20 states where there's not heating load by</p> <p>21 electric.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. And Vectren in Indiana, they have weather</p> <p>24 normalization?</p> <p>25 MS. MCSHANE:</p>	<p>1 MS. MCSHANE:</p> <p>2 A. That in the case of a gas utilities, they have</p> <p>3 purchased gas adjustment clauses, which allow</p> <p>4 pass through of the gas cost to customers, if</p> <p>5 they are electric utilities, they have clauses</p> <p>6 which allow the pass through of either a fuel</p> <p>7 cost, or in the case of utilities which</p> <p>8 purchase power, they have pass through of</p> <p>9 purchase power costs.</p> <p>10 MR. JOHNSON:</p> <p>11 Q. So they're not -- they're not put at risk for</p> <p>12 these purchases?</p> <p>13 MS. MCSHANE:</p> <p>14 A. Correct.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. Okay, and maybe -- I guess, it's close to 11.</p> <p>17 I thought, Mr. Chairman, I don't know if the</p> <p>18 Board would mind to take a small break now.</p> <p>19 (10:55 a.m.)</p> <p>20 CHAIRMAN:</p> <p>21 Q. Sure. What are we going to take?</p> <p>22 MS. GLYNN:</p> <p>23 Q. Half hour.</p> <p>24 CHAIRMAN:</p> <p>25 Q. I was told half hour.</p>
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<p>1 A. Yes.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. Is that on both -- would that be on both gas</p> <p>4 and electric? Are they gas and electric?</p> <p>5 MS. MCSHANE:</p> <p>6 A. They are both. I think -- again I'll check</p> <p>7 this, but I would have thought the weather</p> <p>8 normalization was for gas in Indiana, but I</p> <p>9 will check.</p> <p>10 MR. JOHNSON:</p> <p>11 Q. Thank you, Ms. McShane. Then Ohio is covered</p> <p>12 off for Vectren, I take it. Then we go into</p> <p>13 WGL Holdings. They got decoupling in</p> <p>14 Maryland, DC, that's blank, so what happens in</p> <p>15 DC?</p> <p>16 MS. MCSHANE:</p> <p>17 A. They have no weather normalization clause or</p> <p>18 decoupling in DC.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. And I take it just on WGL Holdings in DC, they</p> <p>21 also -- the column over, because we'll go up</p> <p>22 soon, the fuel gas cost recovery assurance,</p> <p>23 it's all "yes" all the way down. So what does</p> <p>24 that mean, that they have a guaranteed</p> <p>25 recovery of it?</p>	<p>1 MR. JOHNSON:</p> <p>2 Q. That's fine with us.</p> <p>3 CHAIRMAN:</p> <p>4 Q. There's some people I don't argue with.</p> <p>5 (RECESS)</p> <p>6 (11:30 a.m.)</p> <p>7 CHAIRMAN:</p> <p>8 Q. I understand there's one preliminary item</p> <p>9 before we get back to you, Mr. Johnson, is</p> <p>10 that correct, Madam Solicitor?</p> <p>11 MS. GLYNN:</p> <p>12 Q. Yes, we just wanted to enter Ms. McShane's</p> <p>13 pre-filed evidence from March, 2007, which was</p> <p>14 referred to by Mr. Johnson, as Consent #4.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. Thank you. Ms. McShane, we were just finished</p> <p>17 discussing WGL Holdings, and then we were</p> <p>18 going to talk about the fuel gas cost recovery</p> <p>19 assurance. This is in CA-NP-18, and what we</p> <p>20 can see there -- I guess what this indicates</p> <p>21 is that everybody has fuel gas cost recovery</p> <p>22 assurance except for Georgia, but that's not</p> <p>23 an issue because they don't sell gas anyhow?</p> <p>24 MS. MCSHANE:</p> <p>25 A. Correct.</p>

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<p>1 MR. JOHNSON:</p> <p>2 Q. Okay. Now why don't we just go in sort of</p> <p>3 reverse order then. I guess, actually we</p> <p>4 should talk about the deferral mechanisms for</p> <p>5 a moment for each of these. Let's take WGL</p> <p>6 Holdings, trackers for pension and OPEBs</p> <p>7 expenses. Is that the only deferral accounts</p> <p>8 that they would have?</p> <p>9 MS. MCSHANE:</p> <p>10 A. That's the only big one, I would say, other</p> <p>11 than what's listed in the other columns.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. And you're aware of the nature of deferral</p> <p>14 accounts that Newfoundland Power has been able</p> <p>15 to set up over the years in this jurisdiction,</p> <p>16 are you?</p> <p>17 MS. MCSHANE:</p> <p>18 A. I am.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. And would it be more expensive than WGL</p> <p>21 Holdings?</p> <p>22 MS. MCSHANE:</p> <p>23 A. I guess I sort of look at it this way, WGL</p> <p>24 Holdings has decoupling in Maryland, which is</p> <p>25 the biggest state. So they've got weather</p>	<p>1 I mean, they address short term earnings</p> <p>2 variability and they address recovery of cost</p> <p>3 over an extended period of time, so that these</p> <p>4 costs can be deferred and recovery from</p> <p>5 customers in the future.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. And I think we've heard evidence that there</p> <p>8 were a number of deferrals that were coming to</p> <p>9 expire in 2010, and that was referenced in</p> <p>10 this Board's decision and order from the last</p> <p>11 GRA. There was six or seven different deferral</p> <p>12 accounts and amortizations that were ending,</p> <p>13 and would it be you sense, in fairness now,</p> <p>14 Ms. McShane, that Newfoundland Power would be</p> <p>15 considered to have, relatively speaking, more</p> <p>16 deferral accounts than other utilities that</p> <p>17 you're experienced with?</p> <p>18 MS. MCSHANE:</p> <p>19 A. Not in relation to other Canadian utilities,</p> <p>20 no. Perhaps, you know, a few more smaller</p> <p>21 accounts relative to US utilities globally,</p> <p>22 but I think that generally speaking when you</p> <p>23 talk about the major cost categories, fuel,</p> <p>24 purchase gas cost, the weather normalization,</p> <p>25 or decoupling, that they are relatively</p>
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<p>1 protection and customer usage protection</p> <p>2 there. They have full recovery of gas costs,</p> <p>3 which are probably 75 percent of their total</p> <p>4 costs, and this tracker for pension and OPEB</p> <p>5 expenses, so, I mean, it's possible that</p> <p>6 Newfoundland Power is a little bit more</p> <p>7 protected, but clearly on the big items</p> <p>8 there's similar coverage.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. What's the significance of the deferral</p> <p>11 mechanisms column, generally speaking, Ms.</p> <p>12 McShane, in this chart?</p> <p>13 MS. MCSHANE:</p> <p>14 A. What's the significance of it? The</p> <p>15 significance of it is that deferral mechanisms</p> <p>16 do assist with assurance of cost recovery and</p> <p>17 they do address short term earnings</p> <p>18 variability. So, you know, they are an</p> <p>19 important part of the regulatory framework.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. And the protective mechanisms, would that be a</p> <p>22 fair characterization of them?</p> <p>23 MS. MCSHANE:</p> <p>24 A. Yeah, they are protected mechanisms which do</p> <p>25 address short term -- they address two things.</p>	<p>1 comparable.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. On weather normalization, you've got quite a</p> <p>4 number of yours that don't have that?</p> <p>5 MS. MCSHANE:</p> <p>6 A. Well, yes, but the ones that need it, because</p> <p>7 they have circumstances that make a weather</p> <p>8 normalization clause important, the majority</p> <p>9 of them do.</p> <p>10 MR. JOHNSON:</p> <p>11 Q. Look at FPL under deferral mechanisms, and I</p> <p>12 see rate riders for generation construction</p> <p>13 cost, including pre-construction costs,</p> <p>14 securitized storm recovery costs, deferral for</p> <p>15 pension expense.</p> <p>16 MS. MCSHANE:</p> <p>17 A. Yes.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. What are you referring to about -- FPL,</p> <p>20 they're into generation, are they?</p> <p>21 MS. MCSHANE:</p> <p>22 A. Yes.</p> <p>23 MR. JOHNSON:</p> <p>24 Q. What are you talking about there, the</p> <p>25 generation construction cost rate riders?</p>

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1 MS. MCSHANE:

2 A. They're allowed to take the cost that they
3 incur prior to construction and basically
4 surcharge base rates for those costs.

5 MR. JOHNSON:

6 Q. And in terms of these localities, are you
7 familiar with the capital budgeting process in
8 these localities?

9 MS. MCSHANE:

10 A. Not in great detail, no.

11 MR. JOHNSON:

12 Q. Can you say whether there's pre-approval of
13 capital budgets in each of these localities?

14 MS. MCSHANE:

15 A. Not in each of them, no. I mean, clearly in
16 the case of Florida where they passed
17 legislation to allow this recovery, there is
18 relatively good assurance that these costs
19 will be recovered, assuming they're proven,
20 which is true of everybody.

21 MR. JOHNSON:

22 Q. But other than Florida, you don't have any
23 specific knowledge --

24 MS. MCSHANE:

25 A. I have not studied their -- each and every

1 MR. JOHNSON:

2 Q. There's references in several areas, including
3 AGL Resources, a rider for environmental
4 remediation liabilities. I understand that
5 environmental liability in the United States
6 is quite severe for -- a severe operating
7 concern for utilities businesses, in
8 particular?

9 MS. MCSHANE:

10 A. Well, there are concerns with environmental
11 liabilities, old manufactured gas lights, for
12 example.

13 MR. JOHNSON:

14 Q. Yeah, and are you familiar with something
15 called the super fund?

16 MS. MCSHANE:

17 A. Generally, but not in detail.

18 MR. JOHNSON:

19 Q. And as I understand the broad outlines of
20 super fund, that that's a federal government
21 initiative of some years back which basically
22 allows the federal environmental regulator to
23 assign liability to companies for
24 environmental contamination regardless of
25 fault. Is that your understanding?

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1 company's capital budgeting procedures, no.

2 MR. JOHNSON:

3 Q. What would be the benefit of a utility being
4 able to pre-approve -- have pre-approval by
5 its regulator of its proposed capital
6 budgeting expenditures?

7 MS. MCSHANE:

8 A. If they were pre-approved -- well, presumably
9 up to a certain level, they would have a good
10 assurance that they would actually be able to
11 recover the cost.

12 MR. JOHNSON:

13 Q. I notice for AGL Resources, there's a rider
14 for pipeline replacement costs in Georgia.
15 Now I thought they didn't sell gas?

16 MS. MCSHANE:

17 A. They deliver it.

18 MR. JOHNSON:

19 Q. They deliver it, okay.

20 MS. MCSHANE:

21 A. So got steel mains, and those have to be
22 replaced because they get old. The costs that
23 are associated with replacing those mains are
24 included in essentially a tracker and
25 recovered from customers.

1 MS. MCSHANE:

2 A. Regardless of what?

3 MR. JOHNSON:

4 Q. Regardless of fault level.

5 MS. MCSHANE:

6 A. Fault?

7 MR. JOHNSON:

8 Q. Yeah.

9 MS. MCSHANE:

10 A. I'm not familiar with the guidelines of how
11 they assign them.

12 MR. JOHNSON:

13 Q. If that be the case, would that be considered
14 a material difference from your knowledge in
15 this jurisdiction with respect to Newfoundland
16 Power?

17 MS. MCSHANE:

18 A. It may be a distinction, but as long as the
19 companies are allowed to recover the cost,
20 which most of these companies have the ability
21 to recover environmental remediation costs. I
22 don't see that as a huge distinction.

23 MR. JOHNSON:

24 Q. Okay. Are you familiar with -- I think the
25 Obama Administration has further emission

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<p>1 controls that the utility industry in the</p> <p>2 United States is quite concerned about in</p> <p>3 terms of the cost because they're concerned</p> <p>4 about the idea of all these costs getting</p> <p>5 loaded on and what that will do their ability</p> <p>6 to charge customers rates that they can bear?</p> <p>7 MS. MCSHANE:</p> <p>8 A. Well, yes, I mean, that would be a concern</p> <p>9 there, and presumably there are emission</p> <p>10 control standards elsewhere that would be a</p> <p>11 concern. I don't see that there's any</p> <p>12 indication that regulators are not going to</p> <p>13 provide for recovery costs.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. How about regulatory penalties and fines at</p> <p>16 either the state level or federal level, do</p> <p>17 you have any knowledge of what the fining</p> <p>18 power is in the United States as regards these</p> <p>19 utilities?</p> <p>20 MS. MCSHANE:</p> <p>21 A. I believe that the regulators have the ability</p> <p>22 to assign penalties for not meeting the</p> <p>23 liability standards.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. And are you aware whether those types of</p>	<p>1 penalties, would they?</p> <p>2 MS. MCSHANE:</p> <p>3 A. No, they wouldn't.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. That would be a risk for the shareholder?</p> <p>6 MS. MCSHANE:</p> <p>7 A. Yes, it would.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. So that would be a difference?</p> <p>10 MS. MCSHANE:</p> <p>11 A. Yeah, I mean, there's going to be lots of</p> <p>12 small differences. I mean, none of these</p> <p>13 companies are identical to each other. They</p> <p>14 all have somewhat different regulatory</p> <p>15 frameworks, they have, you know, somewhat</p> <p>16 different operating circumstances. I guess,</p> <p>17 the question is at the end of the day, if you</p> <p>18 look at them from investor's perspective, are</p> <p>19 they relatively comparable to any equity</p> <p>20 investor.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. How about the political environment around</p> <p>23 rate cases in the United States, and the</p> <p>24 concern that may cause for investors because,</p> <p>25 you know, does the rate process get more</p>
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<p>1 penalties exist in Canada, for that matter?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Yes, they have been developed I know in</p> <p>4 Alberta. I'm not sure that they've actually</p> <p>5 been accepted, but certainly the same kind of</p> <p>6 reliability standards are being discussed and</p> <p>7 developed across the country.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. And you don't know if they're in force in</p> <p>10 Alberta?</p> <p>11 MS. MCSHANE:</p> <p>12 A. Well, the last I heard they were still trying</p> <p>13 to negotiate the final standards, but there</p> <p>14 would have been penalties associated with</p> <p>15 them. They would have been consistent with</p> <p>16 the standards in the states.</p> <p>17 (11:45 a.m.)</p> <p>18 MR. JOHNSON:</p> <p>19 Q. But you're not aware of any such penalty</p> <p>20 regime here in Newfoundland?</p> <p>21 MS. MCSHANE:</p> <p>22 A. No, I'm not.</p> <p>23 MR. JOHNSON:</p> <p>24 Q. And these penalties, the rate payers wouldn't</p> <p>25 have to bear the brunt of paying these</p>	<p>1 politicized than it does in this jurisdiction?</p> <p>2 MS. MCSHANE:</p> <p>3 A. It depends on the state.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Do you have any recent knowledge of anything</p> <p>6 in that regard?</p> <p>7 MS. MCSHANE:</p> <p>8 A. Yes, I mean, Illinois has been very political,</p> <p>9 and that's been of concern. There's a little</p> <p>10 bit going on in Florida right now around the</p> <p>11 Commission. You know, that's -- yeah, there</p> <p>12 are some political issues every once in a</p> <p>13 while that arise.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. The Ohio matter, what is that about?</p> <p>16 MS. MCSHANE:</p> <p>17 A. The Ohio matter?</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Yes, I thought you said that there was --</p> <p>20 MS. MCSHANE:</p> <p>21 A. No, I said Illinois.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. I'm sorry.</p> <p>24 MS. MCSHANE:</p> <p>25 A. Midwest.</p>

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<p>1 MR. JOHNSON:</p> <p>2 Q. Yeah.</p> <p>3 MS. MCSHANE:</p> <p>4 A. What is it about? It was about the ability of</p> <p>5 the electric utilities to recover their</p> <p>6 purchase gas costs and how the auction of</p> <p>7 power purchases -- power was going to take</p> <p>8 place.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. So an issue of potential risk to an investor?</p> <p>11 MS. MCSHANE:</p> <p>12 A. Yes, in that particular case it was.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. Has that been resolved?</p> <p>15 MS. MCSHANE:</p> <p>16 A. No, not entirely, and I believe the bond</p> <p>17 rating agencies have said that the political</p> <p>18 environment has improved, but, you know, let's</p> <p>19 not forget we've had political risks in Canada</p> <p>20 as well. All of the utilities in Ontario were</p> <p>21 downgraded at one point because of the</p> <p>22 political risk that was associated with the</p> <p>23 electric utility industry in Ontario.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. But no similar experience here in this</p>	<p>1 business description that it's a holding</p> <p>2 company that was established to own</p> <p>3 subsidiaries that sell and deliver natural gas</p> <p>4 and provide a variety of energy related</p> <p>5 products and services to customers, primarily</p> <p>6 in DC and the surrounding metropolitan areas,</p> <p>7 in Maryland and Virginia. They also own the</p> <p>8 shares of common stock in these other</p> <p>9 companies, and they also own, they say, three</p> <p>10 unregulated subsidiaries, that include</p> <p>11 Washington Gas Energy Services, WGE Services,</p> <p>12 Washington Gas Energy Systems, et cetera. So</p> <p>13 they do sell gas, do they?</p> <p>14 MS. MCSHANE:</p> <p>15 A. Yes, they do.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. Because your column said that they don't sell</p> <p>18 gas?</p> <p>19 MS. MCSHANE:</p> <p>20 A. No, I didn't. That was AGL.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Oh, okay, I'm sorry, that's a different one,</p> <p>23 okay. So they have these non-regulated</p> <p>24 companies, okay. I just refer you then to Tab</p> <p>25 2, and in particular, page three of the</p>
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<p>1 province?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Not to my knowledge, no.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Perhaps we could start looking at some of</p> <p>6 these binders that so many trees got</p> <p>7 sacrificed for. The WGL Holdings Inc. one</p> <p>8 would be the place to start, I guess.</p> <p>9 MS. GLYNN:</p> <p>10 Q. We're into WGL, Consent #5, please.</p> <p>11 MS. MCSHANE:</p> <p>12 A. I should let you know that I did not read each</p> <p>13 of these from beginning to end last night.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. No.</p> <p>16 CHAIRMAN:</p> <p>17 Q. You're right about the trees.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Yes, sir. Ms. McShane, as you can appreciate,</p> <p>20 I didn't know anything about these companies</p> <p>21 that you had listed, and I thought, given the</p> <p>22 fact that they were important to Newfoundland</p> <p>23 Power's application, I should find something</p> <p>24 out about them. Let's just look at WGL</p> <p>25 Holdings, Tab 1, first of all. It gives a</p>	<p>1 corporate report to shareholders. I'm</p> <p>2 referring specifically to the top left column</p> <p>3 where it says, "We've successfully concluded</p> <p>4 rate proceedings in all of our jurisdictions.</p> <p>5 With a new rate structure and weather</p> <p>6 normalization adjustments in Virginia, we have</p> <p>7 effectively eliminated 90 percent of revenue</p> <p>8 volatility in our larger service territory,</p> <p>9 combined with complete decoupling of our</p> <p>10 financial performance, some variation in</p> <p>11 customer usage in Maryland, we have</p> <p>12 neutralized the revenue effect of customer</p> <p>13 usage variances in over 80 percent of our</p> <p>14 entire service territory". So I take it you</p> <p>15 will agree that they are still at risk for</p> <p>16 revenue effect of customer usages in 20</p> <p>17 percent of their territory?</p> <p>18 MS. MCSHANE:</p> <p>19 A. Yes, that's what it says.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Okay. If I could turn to page 58, there's a</p> <p>22 section there called - there's a section</p> <p>23 there, Ms. McShane, called "Weather Risk", and</p> <p>24 you'll see that they say they're exposed to</p> <p>25 various forms of weather risk in both our</p>

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<p>1 regulated utility and unregulated business 2 segments. Now first of all, their unregulated 3 business segments, I presume, that they'd be 4 wide open on weather risk, right, nobody is 5 going to protect them from weather risk? 6 MS. MCSHANE: 7 A. The regulator wouldn't, no, but they would 8 employ different strategies to protect 9 themselves. 10 MR. JOHNSON: 11 Q. And if their strategies weren't successful, 12 that would be from their own account? 13 MS. MCSHANE: 14 A. Yes. 15 MR. JOHNSON: 16 Q. And then it talks about billing adjustment 17 mechanisms in Maryland and Virginia, which 18 apparently have billing adjustment mechanisms. 19 Then I see weather insurance again mentioned 20 where they say, "Effective October 1st, 2005, 21 Washington Gas purchased a weather insurance 22 policy designed to mitigate the effects of 23 warmer than normal weather in DC". Now, Ms. 24 McShane, are you familiar with these types of 25 weather insurance policies?</p>	<p>1 are deemed to be imprudent. 2 MR. JOHNSON: 3 Q. Okay, and so they were disallowed purchase gas 4 charges on the basis of imprudence, according 5 to this? At the bottom of that big paragraph, 6 if I can help you, it says, "During the fiscal 7 year end, September 30, 2006, Washington Gas 8 accrued a liability of 4.6 million dollars 9 related to the proposed disallowance of these 10 purchase gas charges. If the PSC of Maryland 11 rules in Washington Gas favour, the liability 12 recorded in fiscal year '06 for this issue 13 would be reversed". So they were dinged, 14 initially at least, with 4.6 million dollars? 15 MS. MCSHANE: 16 A. Yes, that's what it says. 17 MR. JOHNSON: 18 Q. And that -- if there's an imprudence found for 19 purchased gas, that would be borne by the 20 shareholders? 21 MS. MCSHANE: 22 A. Yes. 23 MR. JOHNSON: 24 Q. That would not be a risk that Newfoundland 25 Power would be subject to, would it?</p>
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<p>1 MS. MCSHANE: 2 A. I'm familiar with the concept. I mean, I've 3 not studied the details of them. 4 MR. JOHNSON: 5 Q. Do you know whether or not they would provide 6 as good a protection as a weather 7 normalization reserve like Newfoundland Power 8 has? 9 MS. MCSHANE: 10 A. It depends on the nature of the insurance. 11 Usually there's a relationship between what 12 you're willing to pay and the degree of 13 protection. So I suspect that they don't 14 offer quite the same weather protection as 15 Newfoundland Power, but without studying the 16 specifics in greater detail, I wouldn't be 17 certain. 18 MR. JOHNSON: 19 Q. If you'll turn to page 64. This is talking 20 about a disallowance of purchase gas charges 21 in Maryland. Now I thought that they had fuel 22 gas cost recovery assurance, according to your 23 column? 24 MS. MCSHANE: 25 A. Nobody has assurance of recovery of costs that</p>	<p>1 MS. MCSHANE: 2 A. Probably not to the same extent because it 3 does purchase most of its power from 4 Newfoundland and Labrador Hydro. 5 (12:00 p.m.) 6 MR. JOHNSON: 7 Q. And why would that change the water on the 8 beans? 9 MS. MCSHANE: 10 A. I'm sorry, change the what? 11 MR. JOHNSON: 12 Q. Why would that matter that they purchased it 13 all from Hydro, with the exception of that 14 which they generate? 15 MS. MCSHANE: 16 A. I guess because, you know, this regulator has 17 full knowledge of what resources are available 18 and it seems to me there's just less of a 19 possibility of a finding of imprudence. 20 MR. JOHNSON: 21 Q. Yeah. Then I see that they're subject to a 22 further investigation of asset management and 23 gas purchase practises, and it goes on to talk 24 about the Office of Staff Counsel of the 25 Public Service Commission of Maryland</p>

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1 submitted a petition to the Public Service
 2 Commission to establish an investigation into
 3 their program. Is the model of regulation in
 4 these states where they have an Office of
 5 Staff Counsel, who can make petitions, et
 6 cetera, that doesn't sound familiar to this
 7 jurisdiction.
 8 MS. MCSHANE:
 9 A. I don't understand what your question is.
 10 MR. JOHNSON:
 11 Q. This regulatory set up at the Utility
 12 Commission in Maryland, they have
 13 investigators, they can actually petition
 14 against the company. Is that common in the
 15 United States?
 16 MS. MCSHANE:
 17 A. That the Staff of the Public Service
 18 Commission can bring an investigation?
 19 MR. JOHNSON:
 20 Q. Yeah, and start investigations as to their
 21 procedures for their --
 22 MS. MCSHANE:
 23 A. Yeah, I think that's fairly common.
 24 MR. JOHNSON:
 25 Q. Now this is in Maryland where they disallowed

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1 gas charges, and this utility, Washington Gas,
 2 is challenging that. Now Maryland, and your
 3 regulatory climate, would fit in where for
 4 this company?
 5 MS. MCSHANE:
 6 A. Below average.
 7 MR. JOHNSON:
 8 Q. Below average 1?
 9 MS. MCSHANE:
 10 A. Yes.
 11 MR. JOHNSON:
 12 Q. So towards the top?
 13 MS. MCSHANE:
 14 A. Or the bottom, whichever you --
 15 MR. JOHNSON:
 16 Q. Okay, the bottom, sorry.
 17 MS. MCSHANE:
 18 A. Their other big state is Virginia, which is
 19 above average.
 20 MR. JOHNSON:
 21 Q. Okay. Ms. McShane, if I could turn your
 22 attention to another binder called "Vectren".
 23 MS. GLYNN:
 24 Q. Vectren will be Consent #6.
 25 MS. MCSHANE:

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1 A. I have that.
 2 MR. JOHNSON:
 3 Q. Okay, thank you, Ms. McShane. Now they -- at
 4 Tab 1, we'll get a little description of what
 5 Vectren is all about. They're another energy
 6 holding company, headquartered in Indiana, and
 7 they have a wholly owned subsidiary, Vectren
 8 Utility Holdings, which itself serves as a
 9 holding company for three operating utilities,
 10 being Indiana Gas, Southern Indiana Gas and
 11 Electric, and Vectren Energy Delivery of Ohio.
 12 The second paragraph, there's also a note that
 13 Vectren South, which carries on in Indiana,
 14 owns and operates electric generation to serve
 15 its electric customers and optimizes those
 16 assets in the wholesale power market. Then it
 17 goes on in the next paragraph to say that
 18 they're a low cost provider of wholesale power
 19 in Southwestern Indiana. Total generation
 20 capacity, 1425 megawatts, including 1295 of
 21 coal and gas-fired generation, et cetera. So
 22 they're into generation wholesale sales as
 23 well.
 24 MS. MCSHANE:
 25 A. They have some, yes.

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1 MR. JOHNSON:
 2 Q. Okay, and would the wholesale be regulated?
 3 MS. MCSHANE:
 4 A. I'd have to check to see if -- I would suspect
 5 so, yes.
 6 MR. JOHNSON:
 7 Q. And then the final paragraph, they talk about
 8 their non-utility group being involved in
 9 energy marketing and services, coal mining,
 10 and energy infrastructure services. So they
 11 have a component that's non-regulated as well?
 12 MS. MCSHANE:
 13 A. Yes, as do virtually all the companies one
 14 could pick, and as do all the Canadian
 15 companies one could use as proxies as well.
 16 MR. JOHNSON:
 17 Q. Okay. Just if we could turn to Tab 2, page 8.
 18 This is in a letter, I think, to the
 19 shareholders. I'm looking at the left hand
 20 column, the second last paragraph, Ms.
 21 McShane, where they're talking about the
 22 uncertainty of the economic downturn, and
 23 they've initiated aggressive cost cutting
 24 measures to manage their operating and
 25 maintenance expenses. Ms. McShane, on that

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1 point, have utilities in the United States
 2 taken a good brunt of the economic downturn,
 3 do you know?
 4 MS. MCSHANE:
 5 A. When you say "have they taken a good brunt",
 6 do you mean in terms of --
 7 MR. JOHNSON:
 8 Q. You know, generally have they been affected by
 9 the downturn in the economy?
 10 MS. MCSHANE:
 11 A. It depends on the utility.
 12 MR. JOHNSON:
 13 Q. It depends, okay. As a general comment, have
 14 they been affected more, say, than
 15 Newfoundland Power?
 16 MS. MCSHANE:
 17 A. Some of them would have been; some of them
 18 not.
 19 MR. JOHNSON:
 20 Q. Okay.
 21 MS. MCSHANE:
 22 A. It depends on where they're located.
 23 MR. JOHNSON:
 24 Q. In terms of Newfoundland Power's customer mix,
 25 I take it, the strength is the fact that they

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1 have so much tied to a stable residential
 2 market?
 3 MS. MCSHANE:
 4 A. In comparison to those that would be highly
 5 dependent on industrial customers, that would
 6 be true.
 7 MR. JOHNSON:
 8 Q. That would be true. The risk with industrial
 9 customers is that as their industry comes and
 10 goes, it can affect the utility provider?
 11 MS. MCSHANE:
 12 A. Sure, and, of course, that in itself is
 13 dependent upon the variety of the industries,
 14 who the industries are. So, you know, it's
 15 going to vary across utilities.
 16 MR. JOHNSON:
 17 Q. If I could just turn you to page 14 of the
 18 document in relation to electric utility
 19 services. It states that, "At December 31st,
 20 2008, the company supplied electric service to
 21 approximately 141,000 Indiana customers,
 22 including approximately 122,800 residential,
 23 18,400 commercial, and 100 industrial and
 24 other customers". Then below that, they talk
 25 about the principal industry served, including

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1 polycarbonate resin, plastic products,
 2 aluminum, smelting, automotive assembly,
 3 appliance manufacturing, pharmaceutical,
 4 automotive glass, and I'm not reading them
 5 verbatim, but it strikes me, Ms. McShane, that
 6 for a relatively small utility, they've got
 7 quite a number of industrial customers?
 8 MS. MCSHANE:
 9 A. They do, across a relatively broad range of
 10 industries, but what we don't know here is,
 11 you know, what the contribution of those
 12 companies are to the gross margin, and also
 13 this is just the electric utility services,
 14 and Vectren is more than half gas.
 15 MR. JOHNSON:
 16 Q. Well, let's put it this way, as between two
 17 profiles, this one with this customer makeup,
 18 and Newfoundland Power's, which one looks the
 19 safest, looks the safer?
 20 MS. MCSHANE:
 21 A. Well, I mean, we've got, as I said, you know,
 22 a broad range of industrial companies here.
 23 We've got the gas utility operations as well.
 24 So, you know, if you're looking specifically
 25 at just residential versus industrial on the

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1 electric side, maybe you'd say Newfoundland
 2 Power looks a little bit more stable, but
 3 we've got to look at the entire picture, not
 4 just the electric utility business.
 5 MR. JOHNSON:
 6 Q. But doesn't people like Moody's point to the
 7 fact in the case of Newfoundland Power, that
 8 they don't have industrial customers and
 9 that's, you know, a good thing.
 10 MS. MCSHANE:
 11 A. They do point to that as one of the strengths,
 12 but at the end of the day let's go back and
 13 look at Vectren has more diversified
 14 operations, they have an excellent business
 15 profile, they are rated Ba 1 by Moody's, which
 16 is the same rating that Newfoundland Power
 17 has. So, you know, if you're looking at the
 18 entire picture from an investor's perspective,
 19 I would say that the two would be viewed as
 20 relatively comparable.
 21 MR. JOHNSON:
 22 Q. Has the midwest been hurt in this economy? I
 23 understand the manufacturing areas have been
 24 hurt in the midwest.
 25 MS. MCSHANE:

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<p>1 A. There has been, you know, some downturn in the</p> <p>2 auto industry, in particular.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. Yes, and manufacturing?</p> <p>5 MS. MCSHANE:</p> <p>6 A. And manufacturing.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And, Ms. McShane, could you turn to page 22,</p> <p>9 and I'm referring about the middle of the page</p> <p>10 dealing with in bold, "A significant portion</p> <p>11 of Vectren's gas and electric utility sales</p> <p>12 are space heating and cooling. Accordingly,</p> <p>13 its operating results may fluctuate with</p> <p>14 variability of weather", and it goes on to</p> <p>15 say, "Vectren's gas and electricity utility</p> <p>16 sales are sensitive to variations in weather.</p> <p>17 The company forecasts on the basis of normal</p> <p>18 weather. Since Vectren doesn't have a weather</p> <p>19 normalization mechanism for its electric</p> <p>20 operations, significant variations from normal</p> <p>21 weather could have a material impact on its</p> <p>22 earnings".</p> <p>23 MS. MCSHANE:</p> <p>24 A. I see that.</p> <p>25 MR. JOHNSON:</p>	<p>1 MS. MCSHANE:</p> <p>2 A. They have a fair amount of electric utility</p> <p>3 business.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. If you could go to page 34, down under retail,</p> <p>6 that's the paragraph just below the</p> <p>7 accountants, et cetera. They talk about</p> <p>8 electric retail utility margin, and in the</p> <p>9 sentence on the third line from the bottom</p> <p>10 says, "Management estimates the year over year</p> <p>11 decreases in usage by residential and</p> <p>12 commercial customers due to weather, which was</p> <p>13 very warm the prior summer, to be 7.5 million</p> <p>14 dollars". So that wouldn't -- that's not an</p> <p>15 immaterial amount for Vectren?</p> <p>16 MS. MCSHANE:</p> <p>17 A. No.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. And just above the table, it refers to during</p> <p>20 2007, the company resolved all remaining</p> <p>21 issues related to a 2005 disallowance by the</p> <p>22 PUCO of gas costs incurred by the Ohio utility</p> <p>23 operations, resulting in additional charge of</p> <p>24 1.1 million.</p> <p>25 MS. MCSHANE:</p>
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<p>1 Q. Okay, is that consistent with your chart?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Is it consistent with my chart?</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Your schedule.</p> <p>6 MS. MCSHANE:</p> <p>7 A. Yes, it is.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Well, you have in Vectren weather</p> <p>10 normalization in Indiana.</p> <p>11 MS. MCSHANE:</p> <p>12 A. Well, that was the thing we were going -- I</p> <p>13 was going to check, right, and this -- yeah,</p> <p>14 because I'd figured that was probably for gas.</p> <p>15 It says, "Vectren does not have weather</p> <p>16 normalization mechanism for its electric</p> <p>17 operations".</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Yes, so they're at risk on that?</p> <p>20 MS. MCSHANE:</p> <p>21 A. In electric, yes.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. In electric, and while you pointed to the gas,</p> <p>24 they're not a small electric piece either,</p> <p>25 though, Vectren --</p>	<p>1 A. Yes.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. So would that be, to your knowledge, something</p> <p>4 that's, you know, a normal part of carrying on</p> <p>5 business in Ohio, that you could be subject to</p> <p>6 such a disallowance, even for something for</p> <p>7 gas costs?</p> <p>8 MS. MCSHANE:</p> <p>9 A. All gas utilities are subject to the</p> <p>10 disallowance of gas costs.</p> <p>11 (12:15 p.m.)</p> <p>12 MR. JOHNSON:</p> <p>13 Q. And can we switch to another company, Southern</p> <p>14 Company.</p> <p>15 MS. GLYNN:</p> <p>16 Q. Southern Company will be Consent #7.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. Tab 1 gives the business description of</p> <p>19 Southern Company Inc., and that's -- I guess,</p> <p>20 that's a very large utility by US standards,</p> <p>21 is it?</p> <p>22 MS. MCSHANE:</p> <p>23 A. It's big, yes.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. And it says, "They own all the common stock of</p>

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1 Alabama Power, Georgia Power, Gulf Power,
2 Mississippi Power, each of which is an
3 operating public utility company. The
4 traditional operating companies supply
5 electric service in the states of Alabama,
6 Georgia, Florida, Mississippi. Southern
7 Company owns all the common stock of Southern
8 Power, which is also an operating public
9 utility company. Southern Power constructs,
10 acquires, owns, and manages generation assets
11 and sells electricity at market base rate in
12 the wholesale market". So when they say
13 "market base rates", is that, like, whatever
14 the market is prepared to pay? Is that what
15 we take from that?

16 MS. MCSHANE:
17 A. I think a lot of it is sold into power pools.
18 Some of it may be subject to long term
19 contracts where the contracts are based on
20 market rates, but I would say that it's -- I
21 mean, it's unregulated generation.

22 MR. JOHNSON:
23 Q. Unregulated generation?

24 MS. MCSHANE:
25 A. Yes.

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1 MR. JOHNSON:
2 Q. And Southern Company also owns all the
3 outstanding common stock or membership
4 interest of Southern Link Wireless, Southern
5 Nuclear, Southern Company Services Inc.,
6 Southern Holdings, and other direct and
7 indirect subsidiaries. Do you know whether
8 those are regulated or non-regulated?

9 MS. MCSHANE:
10 A. It would be unregulated operations.

11 MR. JOHNSON:
12 Q. And then they refer to a completion of
13 construction in June of 2008. That's fine.
14 If you'll go to Tab 2, investor fact sheet, a
15 super regional power house. Did you note how
16 many megawatts of generating capacity that
17 Southern Company has?

18 MS. MCSHANE:
19 A. 35,000 regulated, 5,500 wholesale serving
20 retail customers through purchase power
21 agreements, and 7,500 in commercial operation
22 outside the service territory.

23 MR. JOHNSON:
24 Q. And the top paragraph says, "4.4 million
25 customers and more than 42,000 megawatts of

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1 generation capacity in service or under
2 construction, and a growing competitive
3 generation business". Would that be --

4 MS. MCSHANE:
5 A. That's what it says.

6 MR. JOHNSON:
7 Q. And the -- just tell us about the growing
8 competitive generation business in the United
9 States, because in this jurisdiction we don't
10 have a competitive arrangement like that?

11 MS. MCSHANE:
12 A. Okay, what is it you want to know about it?

13 MR. JOHNSON:
14 Q. The competitive generation business in the
15 United States that Southern Company is
16 involved in.

17 MS. MCSHANE:
18 A. So it would own some generating plants outside
19 its native service areas, and sell power --
20 basically sell power into the market, which
21 would be purchased by other electric
22 utilities.

23 MR. JOHNSON:
24 Q. And to the extent that they are unregulated,
25 the shareholders of Southern Company are

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1 completely at risk?

2 MS. MCSHANE:
3 A. They would be at risk for, yeah, the
4 unregulated stuff, just like the unregulated
5 operations of Canadian utility holding
6 companies.

7 MR. JOHNSON:
8 Q. And just further down on that page, it says,
9 "Strong financial performance". Do you see
10 that?

11 MS. MCSHANE:
12 A. I see that.

13 MR. JOHNSON:
14 Q. "Five year total shareholder return". What
15 was it?

16 MS. MCSHANE:
17 A. 8.9 percent.

18 MR. JOHNSON:
19 Q. Yeah, they've characterized that as a strong
20 financial performance.

21 MS. MCSHANE:
22 A. In five years.

23 MR. JOHNSON:
24 Q. Yeah.

25 MS. MCSHANE:

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<p>1 A. That's a market return.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. Okay.</p> <p>4 MS. MCSHANE:</p> <p>5 A. That's not a book return.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. Would you just turn to Tab 4, and this is an</p> <p>8 article regarding Moody's changes the outlook</p> <p>9 of Southern and three subsidiaries to</p> <p>10 negative, September 1st, 2009?</p> <p>11 MS. MCSHANE:</p> <p>12 A. I see that.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. Were you aware that they had their outlooks</p> <p>15 changed to negative as recently as that?</p> <p>16 MS. MCSHANE:</p> <p>17 A. I was.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. You were?</p> <p>20 MS. MCSHANE:</p> <p>21 A. Yes.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. Is there other companies within your proxy</p> <p>24 group that have had their rating outlooks</p> <p>25 turned to negative?</p>	<p>1 Q. And just go back to the second paragraph,</p> <p>2 they're talking about the two, in the third</p> <p>3 line, "the two new Vogtle units received an</p> <p>4 early site permit from the Nuclear Regulatory</p> <p>5 Commission last week and capital expenditures</p> <p>6 are expected to increase considerably over the</p> <p>7 next several years. Although Moody's views</p> <p>8 nuclear power as a viable long-term strategy</p> <p>9 for the utility to reduce its reliance on coal</p> <p>10 and a relatively management investment for a</p> <p>11 company of its size, building a new nuclear</p> <p>12 plant is a complex and risky endeavour during</p> <p>13 construction and may result in some modest</p> <p>14 ratings pressure over the construction period,</p> <p>15 et cetera." Ms. McShane, are you aware</p> <p>16 whether or not Newfoundland Power would be</p> <p>17 planning to engage in similarly complex and</p> <p>18 risky endeavours over the near term?</p> <p>19 MS. MCSHANE:</p> <p>20 A. No, I don't think they would be building a</p> <p>21 nuclear facility.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. And you're not aware of any other projects</p> <p>24 that would, while not nuclear, be considered</p> <p>25 relatively speaking a big deal for</p>
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<p>1 MS. MCSHANE:</p> <p>2 A. Since the evidence was filed, you mean?</p> <p>3 MR. JOHNSON:</p> <p>4 Q. Yes.</p> <p>5 MS. MCSHANE:</p> <p>6 A. None come to me off the top of my head, but</p> <p>7 that doesn't mean there weren't any. I was</p> <p>8 aware of this.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. And what's your understanding of this</p> <p>11 situation, Ms. McShane?</p> <p>12 MS. MCSHANE:</p> <p>13 A. The report says that the negative rating</p> <p>14 outlook on Georgia Power considers cash flow</p> <p>15 coverage metrics weak for its rating category</p> <p>16 than those of peer utilities, and the</p> <p>17 increasing business and operating risk profile</p> <p>18 of the company as it undertakes construction</p> <p>19 of two new nuclear units, and the other ones</p> <p>20 are Mississippi Power, and again this has to</p> <p>21 do with construction; Gulf Power, high capital</p> <p>22 expenditure requirements for environmental</p> <p>23 compliance, and -- so the Southern Company</p> <p>24 overall is related to these three subs.</p> <p>25 MR. JOHNSON:</p>	<p>1 Newfoundland Power?</p> <p>2 MS. MCSHANE:</p> <p>3 A. No, I mean they're not looking at the size of</p> <p>4 capital expenditures that this company is, but</p> <p>5 you know, again, even with this if the company</p> <p>6 is still talking about modest pressures and</p> <p>7 the ratings are still higher than Newfoundland</p> <p>8 Power's ratings.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. But this would confirm, would it not, Moody's</p> <p>11 qualitative assessment that integrated</p> <p>12 utilities are birds of another feather in the</p> <p>13 United States than T & D companies?</p> <p>14 MS. MCSHANE:</p> <p>15 A. And I would say that, you know, yeah, there</p> <p>16 are differences with them. Again, we're still</p> <p>17 looking at a company with higher ratings than</p> <p>18 Newfoundland Power.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. Yeah, but a lot more can go wrong with</p> <p>21 Southern Company though, can't it?</p> <p>22 MS. MCSHANE:</p> <p>23 A. I suppose that's possible, yes, that's -</p> <p>24 MR. JOHNSON:</p> <p>25 Q. That's what an equity investor would consider</p>

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<p>1 as well, would he or would she?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Yeah, they would consider those items, as well</p> <p>4 as the opportunities that are available from</p> <p>5 those shares.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. So if the opportunities being the fact that</p> <p>8 yeah, maybe they are taking on a bit of more</p> <p>9 risk, but that could give me a better</p> <p>10 opportunity to earn.</p> <p>11 MS. MCSHANE:</p> <p>12 A. Well, I guess, you know, when I look at</p> <p>13 Southern Company and I look at Schedule 15,</p> <p>14 for example, which has got the list of all the</p> <p>15 company risk data for the 13 companies,</p> <p>16 Southern Company has a beta that's within the</p> <p>17 range of all these other companies which</p> <p>18 include the T & D companies. It's got an</p> <p>19 excellent business profile. It's got a debt</p> <p>20 rating by S & P of A. Its Moody's ratings are</p> <p>21 A3, you know, and also you look at the safety</p> <p>22 rank compared to this group of companies, it's</p> <p>23 1, the highest safety rank of all. So, you</p> <p>24 know, if I'm looking at this within the</p> <p>25 context of this sample, it's a comparable</p>	<p>1 MR. JOHNSON:</p> <p>2 Q. And this proceeding has to do with more than</p> <p>3 just looking after Newfoundland Power's</p> <p>4 credit?</p> <p>5 MS. MCSHANE:</p> <p>6 A. Absolutely it does, it has to do with a fair</p> <p>7 return on the equity as well.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. And if we could turn to the next document,</p> <p>10 ma'am, is SCANA.</p> <p>11 MS. GLYNN:</p> <p>12 Q. And SCANA would be Consent No. 8. Are you</p> <p>13 there now, Ms. McShane?</p> <p>14 MS. MCSHANE:</p> <p>15 A. I am.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. Okay, thank you. Tab 1 again gives a business</p> <p>18 description. Just before we get to that, I</p> <p>19 haven't asked you to comment on this up until</p> <p>20 now, but you'll see there is a 52 week high</p> <p>21 and a 52 week low. Now this was printed as of</p> <p>22 the 9th, I guess, of October. 26 bucks is</p> <p>23 their 52 week low; 37.60 is your 52 week high.</p> <p>24 Would that strike you as a fair bit of</p> <p>25 volatility for a utility given, you know, say</p>
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<p>1 company.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. Just the fifth paragraph down where it talks</p> <p>4 about "the negative rating outlook in the</p> <p>5 Southern Company is prompted by the negative</p> <p>6 outlooks on three of its four utility subs and</p> <p>7 the higher overall business and operating risk</p> <p>8 resulting from nuclear and IGCC construction</p> <p>9 and difficult economic conditions through its</p> <p>10 service territory." Now, they're talking</p> <p>11 about higher overall business and operating</p> <p>12 risks, higher operating business risk than</p> <p>13 what's reflected in your evidence when it was</p> <p>14 filed, correct?</p> <p>15 MS. MCSHANE:</p> <p>16 A. True but the ratings are still--I mean, have</p> <p>17 not been reduced to below where they were.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. But the credit ratings that bond holders might</p> <p>20 pay attention to is not the whole story about</p> <p>21 Southern Company though, is it?</p> <p>22 MS. MCSHANE:</p> <p>23 A. No, it's not--obviously it's not the whole</p> <p>24 story, credit ratings are only one part of the</p> <p>25 story.</p>	<p>1 the Fortis experience, for instance?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Fortis experience.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Yeah, I mean as I understand it, like for</p> <p>6 instance, Fortis, you know, they were probably</p> <p>7 up in the high 20s and then when the market</p> <p>8 started getting pretty uncertain and other</p> <p>9 companies started taking a bit of a bath, the</p> <p>10 share price dropped back to maybe the low 20s</p> <p>11 and, but seems to be that this would indicate</p> <p>12 a bit more volatility in share price.</p> <p>13 MS. MCSHANE:</p> <p>14 A. I'd have to go back and look at that, but I--</p> <p>15 this is talking about the 52 week high and</p> <p>16 low, as opposed to, you know, looking at some</p> <p>17 particular specific point from which the</p> <p>18 shares dropped off, you know, like looking at</p> <p>19 the market as a whole and a drop off point.</p> <p>20 My recollection was that from Fortis' peak to</p> <p>21 trough was, I wouldn't say 30 percent, but I</p> <p>22 would have to double check that.</p> <p>23 MR. JOHNSON:</p> <p>24 Q. Can we discern anything from peak to trough</p> <p>25 when we're talking about these--how investors</p>

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1 perceive these companies?
 2 (12:30 p.m.)
 3 MS. MCSHANE:
 4 A. If you look at them in relative terms, yeah.
 5 I mean, you can, you know, get some sense of
 6 how investors have--how investors in the
 7 recent market environment viewed the relative
 8 prospects of the utilities during a crisis.
 9 MR. JOHNSON:
 10 Q. So a utility holding company that would be
 11 seen as a bit of a haven for investors in hard
 12 times, you wouldn't expect the same amount of
 13 volatility -
 14 MS. MCSHANE:
 15 A. As what? As the market as a whole?
 16 MR. JOHNSON:
 17 Q. And maybe for other utilities that are not
 18 seen so much as a haven, maybe.
 19 MS. MCSHANE:
 20 A. Well sure, I mean, there are going to be
 21 differences among the utilities as to, you
 22 know, the percentage decline in price you saw
 23 from the previous peak.
 24 MR. JOHNSON:
 25 Q. In terms of talking about SCANA in the

1 Q. Yeah, but like a fair amount, would that be
 2 fair?
 3 MS. MCSHANE:
 4 A. I don't know what you mean by a fair amount, I
 5 mean clearly there are core businesses,
 6 electric, utility and gas utility regulated
 7 businesses.
 8 MR. JOHNSON:
 9 Q. Yeah. But, of course, they're unregulated
 10 subsidiaries, to state the obvious, they're
 11 all at risk, the shareholder is at risk for
 12 those, right.
 13 MS. MCSHANE:
 14 A. Sure.
 15 MR. JOHNSON:
 16 Q. Sure. And just to go to the next tab, Ms.
 17 McShane, if you would. This is a news story
 18 from, but I guess Investor Contact, I don't
 19 know where this came from, to tell you the
 20 truth, Columbia, South Carolina, February
 21 11th. "South Carolina Electric and Gas,
 22 principle sub of SCANA, today received
 23 approval from South Carolina Public Service
 24 Commission on its plans to build two 1117
 25 megawatt nuclear electric generating units at

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1 business description, just down further, again
 2 SCANA, through its wholly owned regulated
 3 subsidiaries is primarily engaged in
 4 generation, so again, generation here,
 5 transmission, distribution of sale of
 6 electricity in parts of South Carolina and
 7 then the purchase, transmission and sale of
 8 natural gas in portions of both North and
 9 South Carolina, and they also, through a
 10 wholly owned non-regulated subsidiary, market
 11 natural gas to retail customers in Georgia and
 12 to wholesale customers primarily in the South
 13 East. Other wholly owned non-regulated
 14 subsidiaries provide fibre optics and other
 15 telecom services provide service contracts to
 16 home owners on certain home appliances and
 17 heating, air conditioning units and as well,
 18 they've got a service company subsidiary that
 19 provides administrative management and other
 20 services. So this company, again, would have
 21 a fair bit of non-regulated activity in
 22 amongst the regulated activity.
 23 MS. MCSHANE:
 24 A. They have some non-regulated activities, yes.
 25 MR. JOHNSON:

1 the site of the V.C. Summer Nuclear Station."
 2 So this is a big undertaking for a public
 3 utility, I take it?
 4 MS. MCSHANE:
 5 A. It's a sizeable undertaking, yes.
 6 MR. JOHNSON:
 7 Q. Yes. Just look at the fourth paragraph, Ms.
 8 McShane, particularly the last sentence talks
 9 about the total project cost.
 10 MS. MCSHANE:
 11 A. Right.
 12 MR. JOHNSON:
 13 Q. What is it?
 14 MS. MCSHANE:
 15 A. Sorry, I said right.
 16 MR. JOHNSON:
 17 Q. Oh, I'm sorry.
 18 MS. MCSHANE:
 19 A. It's 5.4 billion, the South Carolina Electric
 20 and Gas' share.
 21 MR. JOHNSON:
 22 Q. So it's a total project of 9.8 billion.
 23 MS. MCSHANE:
 24 A. Right, shared between two companies.
 25 MR. JOHNSON:

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<p>1 Q. And again, now this is just to--this is two</p> <p>2 new 1100 megawatt nuclear stations, so there's</p> <p>3 already one at the Summer--the VC Summer</p> <p>4 Station, I take it?</p> <p>5 MS. MCSHANE:</p> <p>6 A. I think they have another one, yes.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And South Carolina, the profile on the bottom</p> <p>9 there, talks about South Carolina Electric and</p> <p>10 Gas Company under profiles, is a regulated</p> <p>11 public utility engaged in the generation,</p> <p>12 transmission, distribution and sale of</p> <p>13 electricity to approximately 650,000 customers</p> <p>14 in 26 counties, in South Carolina. So that's</p> <p>15 not a huge utility when you consider</p> <p>16 Newfoundland Power has 230,000 or thereabouts,</p> <p>17 residential customers.</p> <p>18 MS. MCSHANE:</p> <p>19 A. It's not as big as some, it's a sizeable</p> <p>20 utility, it's got -</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Well just to put that into some context, Ms.</p> <p>23 McShane, you know, typically you will see</p> <p>24 capital budgets from Newfoundland Power, 55 -</p> <p>25 60 range. One year it ballooned up a bit, in</p>	<p>1 MS. MCSHANE:</p> <p>2 A. Yeah, they were downgraded to Ba 2, the</p> <p>3 unsecured rating for the SCANA Corporation and</p> <p>4 the subsidiary ratings were downgraded to Ba 1</p> <p>5 for the unsecured and A3 for the secured.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. And the rating outlook for SCANA, SCE&G, SCFC</p> <p>8 and PSNC are negative now, aren't they,</p> <p>9 according to the last sentence in the first</p> <p>10 paragraph?</p> <p>11 MS. MCSHANE:</p> <p>12 A. Yes.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. And just look at the fourth para--if you count</p> <p>15 the first line as a paragraph, it will be one,</p> <p>16 two, three, four, the fifth paragraph, "The</p> <p>17 weakened financial ratios are expected to be</p> <p>18 accompanied by a significantly higher business</p> <p>19 and operating risk profile, primarily</p> <p>20 associated with the new nuclear construction</p> <p>21 project at the VC Summer facility located in</p> <p>22 Jenkinsville, South Carolina."</p> <p>23 MS. MCSHANE:</p> <p>24 A. I see that.</p> <p>25 MR. JOHNSON:</p>
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<p>1 our perspective, to maybe the high 60s in</p> <p>2 relation to the Rattling Brook generating</p> <p>3 hydro facility that they had and that was, you</p> <p>4 know, that was considered fairly hefty capital</p> <p>5 budget by our standards. But here you have a</p> <p>6 utility about three times the size getting</p> <p>7 involved with a 9.8 billion dollar project of</p> <p>8 which their share is 5.4 billion.</p> <p>9 MS. MCSHANE:</p> <p>10 A. True, but I mean, see, you've got Newfoundland</p> <p>11 Power which has got total assets of 900</p> <p>12 million, say, and this is 7.5 billion dollar</p> <p>13 company, so I agree with you that even</p> <p>14 relative to that, it's a big capital</p> <p>15 investment, but it is a bigger, significantly</p> <p>16 bigger company to start with.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. If I could turn you to page 4, go to tab 4.</p> <p>19 MS. MCSHANE:</p> <p>20 A. Yes, I have that.</p> <p>21 MR. JOHNSON:</p> <p>22 Q. Yeah, what happened July 14th, 2009, keeping</p> <p>23 in mind the document we just covered was</p> <p>24 February '09, where they announced approval</p> <p>25 for this nuclear facility?</p>	<p>1 Q. So what I was getting at, in terms of the size</p> <p>2 of this, you know, didn't only catch my</p> <p>3 attention, but it caught the investment</p> <p>4 community's attention too, didn't it?</p> <p>5 MS. MCSHANE:</p> <p>6 A. Yes, it did.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And it wouldn't have only caught the Moody's</p> <p>9 of the world's attention, I presume it would</p> <p>10 have caught equity investors' attention as</p> <p>11 well?</p> <p>12 MS. MCSHANE:</p> <p>13 A. I think that's fair that they would have seen</p> <p>14 some--they would have seen some change or be</p> <p>15 aware of some change in--on a risk profile as</p> <p>16 a result of the planned construction. But</p> <p>17 there are certain arrangements in place to</p> <p>18 deal with the risk of the nuclear plant</p> <p>19 building and I think one of these tabs you</p> <p>20 tabbed here, showed that they were able to put</p> <p>21 these construction costs into rates</p> <p>22 immediately, so that there was not the delay</p> <p>23 in recovery of costs that we would have seen</p> <p>24 under the old styled nuclear plant, planning</p> <p>25 and construction back in the 70s and early</p>

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<p>1 80s.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. They also state in three up from the bottom -</p> <p>4 MS. MCSHANE:</p> <p>5 A. Sorry, I closed up the--what tab are we on?</p> <p>6 MR. JOHNSON:</p> <p>7 Q. Oh, I'm sorry, it's Tab 4.</p> <p>8 MS. MCSHANE:</p> <p>9 A. Okay.</p> <p>10 MR. JOHNSON:</p> <p>11 Q. The third paragraph up from the bottom, they</p> <p>12 talk about ratings could be downgraded further</p> <p>13 if the financial profiles above, SCANA and</p> <p>14 SCE&G continue to exhibit declining cash flow</p> <p>15 in relation to total debt; if there are</p> <p>16 significant cost overruns or construction</p> <p>17 delays associated with the VC Summer Nuclear</p> <p>18 expansion." What would be the problem if they</p> <p>19 ran into cost overruns or construction delays,</p> <p>20 wouldn't they get those from rate payers? Why</p> <p>21 would that be considered a risk?</p> <p>22 MS. MCSHANE:</p> <p>23 A. Well I think if there were cost overruns, they</p> <p>24 still have to show the prudence of their--the</p> <p>25 costs that they incur, as all utilities do, so</p>	<p>1 MS. MCSHANE:</p> <p>2 A. I think there's a certain amount of political</p> <p>3 risk around nuclear construction, yes.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Okay. And at Tab 6, this deals with the</p> <p>6 Williams Station facility which is the second</p> <p>7 largest fossil plant in SCE&G's system that</p> <p>8 generates 650 megawatts of electricity by</p> <p>9 burning pulverized coal in a single unit. So</p> <p>10 that's the second largest one that they have.</p> <p>11 So they're -</p> <p>12 MS. MCSHANE:</p> <p>13 A. The second largest fossil plant.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. Yes, I'm sorry, so I mean, they are not an</p> <p>16 insignificant generator.</p> <p>17 MS. MCSHANE:</p> <p>18 A. No, they're not an insignificant generator.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. Do they get all of their generated electricity</p> <p>21 from a related company or are others</p> <p>22 generating it and selling it to them as well?</p> <p>23 MS. MCSHANE:</p> <p>24 A. Sorry, you're talking about the South Carolina</p> <p>25 Electric and Gas -</p>
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<p>1 if there was a finding of imprudence, then no,</p> <p>2 they wouldn't be able to recover those costs</p> <p>3 from customers.</p> <p>4 MR. JOHNSON:</p> <p>5 Q. So would this not get a pre-approval, a</p> <p>6 project of this size?</p> <p>7 MS. MCSHANE:</p> <p>8 A. Well I suspect that it gets, yeah, it gets</p> <p>9 pre-approved, but that doesn't mean that if</p> <p>10 you run over on the cost that you project in</p> <p>11 the regulators approval are going to let you</p> <p>12 recover all those costs.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. And if they're not recovered, that's a</p> <p>15 shareholder problem?</p> <p>16 MS. MCSHANE:</p> <p>17 A. Absolutely.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Okay. And then they also talk about their</p> <p>20 concern associated with the project of</p> <p>21 regulatory and political support for the</p> <p>22 project began to show some stress as nuclear.</p> <p>23 Nuclear is political in most countries, is it</p> <p>24 not?</p> <p>25 (12:45 p.m.)</p>	<p>1 MR. JOHNSON:</p> <p>2 Q. Yes.</p> <p>3 MS. MCSHANE:</p> <p>4 A. Do they purchase any electricity? I'm not</p> <p>5 sure whether they purchase any electricity or</p> <p>6 not. I'm not sure whether they purchase any</p> <p>7 or whether it's all generated by South</p> <p>8 Carolina Electric and Gas.</p> <p>9 MR. JOHNSON:</p> <p>10 Q. What was their Standards and Poors' rating,</p> <p>11 according to your schedule 15 on this company,</p> <p>12 Ms. McShane?</p> <p>13 MS. MCSHANE:</p> <p>14 A. It was A minus.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. And Moody's was Baa 1?</p> <p>17 MS. MCSHANE:</p> <p>18 A. Correct.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. And just to turn to page 17 of their form 10K,</p> <p>21 which is at Tab 7. In particular I'm</p> <p>22 referring you to the paragraph one up from the</p> <p>23 bottom.</p> <p>24 MS. MCSHANE:</p> <p>25 A. Yes, I'm there.</p>

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<p>1 MR. JOHNSON:</p> <p>2 Q. Are you there now?</p> <p>3 MS. MCSHANE:</p> <p>4 A. Yes.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. And then indicate that--in a bold paragraph in</p> <p>7 front of that, they say "a downgrade and a</p> <p>8 credit rating of SCANA or any of SCANA's</p> <p>9 subsidiaries, including SCE&G could negatively</p> <p>10 affect their access to capital and to operate</p> <p>11 their businesses; thereby adversely affecting</p> <p>12 results of operations, cash flows and</p> <p>13 financial condition."</p> <p>14 MS. MCSHANE:</p> <p>15 A. Yes, I see that.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. Yes, and you'll note that they talk about</p> <p>18 their Standard and Poor's ratings, their</p> <p>19 Moody's rating and Fitch, which had rated them</p> <p>20 at Bbb plus, Baa 1 and A minus, respectively.</p> <p>21 And then they do go on to say, though, in the</p> <p>22 fourth line that "S&P and Fitch carry a</p> <p>23 negative outlook on each of their ratings".</p> <p>24 MS. MCSHANE:</p> <p>25 A. Yes.</p>	<p>1 MS. MCSHANE:</p> <p>2 A. Well this would have been whatever the date</p> <p>3 that this appeared, I mean, this is -</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Good point.</p> <p>6 MS. MCSHANE:</p> <p>7 A. It could have been February.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Yeah, okay. Just these 10ks, all companies in</p> <p>10 the United States have to file these or just</p> <p>11 utility companies or do you know?</p> <p>12 MS. MCSHANE:</p> <p>13 A. No, all companies file them. Well not all</p> <p>14 private companies, but ones that issue public</p> <p>15 security.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. No, okay. Okay, could we turn to the next</p> <p>18 binder please, which is the Piedmont Natural</p> <p>19 Gas Company.</p> <p>20 MS. GLYNN:</p> <p>21 Q. Okay, that will be Consent No. 9.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. If we could turn to Tab 3, this is Piedmont</p> <p>24 Natural Gas Company Inc. and if you flip in to</p> <p>25 six pages to the page that's actually numbered</p>
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<p>1 MR. JOHNSON:</p> <p>2 Q. And this would have been in their 10k document</p> <p>3 which, if you go back to the first page of Tab</p> <p>4 7, that would have been something filed with</p> <p>5 the United States Securities and Exchange</p> <p>6 Commission for the fiscal year ended December</p> <p>7 31st, 2008.</p> <p>8 MS. MCSHANE:</p> <p>9 A. Right.</p> <p>10 MR. JOHNSON:</p> <p>11 Q. And so I think, as you said earlier, was SCANA</p> <p>12 one of the ones that you thought might have</p> <p>13 been downgraded since you filed your evidence?</p> <p>14 MS. MCSHANE:</p> <p>15 A. It was one that I thought might have been, but</p> <p>16 I'm confused--actually I'm confused about the</p> <p>17 Standard and Poor's rating because at the time</p> <p>18 that this was done, their--the SCANA rating</p> <p>19 that I saw was A minus, so I'm not quite sure</p> <p>20 why there's the difference between the two,</p> <p>21 but I think they were downgraded after this</p> <p>22 evidence was prepared.</p> <p>23 MR. JOHNSON:</p> <p>24 Q. But they were on a negative outlook as at the</p> <p>25 end of 2008, according to this 10k?</p>	<p>1 No. 1 on the bottom.</p> <p>2 MS. MCSHANE:</p> <p>3 A. It's No. 1 on the bottom?</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Yes.</p> <p>6 MS. MCSHANE:</p> <p>7 A. I have that.</p> <p>8 MR. JOHNSON:</p> <p>9 Q. Okay, you'll see the third paragraph from the</p> <p>10 bottom, they talk about starting with the</p> <p>11 words "For the year ended October 31st, 2008".</p> <p>12 Do you have that, Ms. McShane?</p> <p>13 MS. MCSHANE:</p> <p>14 A. I do.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. Okay, they say "39 percent of our operating</p> <p>17 revenues were from Residential customers."</p> <p>18 MS. MCSHANE:</p> <p>19 A. Yes.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. "24 from Commercial customers".</p> <p>22 MS. MCSHANE:</p> <p>23 A. Yes.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. "12 from large volume customers, including</p>

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1 industrial power generation and retail
2 customers and 25 percent from secondary market
3 activities."
4 MS. MCSHANE:
5 A. I see it.
6 MR. JOHNSON:
7 Q. And they go to say "secondary market
8 transactions consist of off system sales and
9 capacity release arrangement and a part of our
10 regulatory gas supply management program." So
11 again, Ms. McShane, would this type of
12 business mix be a distinction between
13 Newfoundland Power, in terms of a risk
14 profile?
15 MS. MCSHANE:
16 A. It's different, I don't know that it's
17 necessarily any more risky, this says that
18 your operating revenues are -
19 MR. JOHNSON:
20 Q. They would be more subject, I suppose, to
21 downturns in the economy because you're not
22 just dealing, if you know you'd only have 24
23 percent of your operating revenues coming from
24 the Residential customers.
25 MS. MCSHANE:

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1 A. Right, but you also have a relatively high
2 growing economy, so you have upside too.
3 MR. JOHNSON:
4 Q. High growing economy in North Carolina?
5 MS. MCSHANE:
6 A. Well, yes, it's been a relatively high growing
7 service area.
8 MR. JOHNSON:
9 Q. Okay.
10 MS. MCSHANE:
11 A. It's not just tobacco anymore.
12 MR. JOHNSON:
13 Q. No, no indeed, it's Nascar. I shouldn't say
14 that. These gas companies also have bi-pass
15 risk or they can be subject to bi-pass risk?
16 MS. MCSHANE:
17 A. In the sense that a company can hook up
18 directly to the pipeline?
19 MR. JOHNSON:
20 Q. Well, in the sense that at page 4 at the
21 bottom, they say "During the year ended
22 October 31st, 2008, approximately 5 percent of
23 our margin, which is operating revenues less
24 cost of gas, was generated from deliveries to
25 industrial or large commercial customers that

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1 had the capability to burn a fuel other than
2 natural gas. The alternative fuels are
3 primarily fuel oil and propane and to a much
4 lesser extent, coal or wood. Our ability to
5 maintain or increase deliveries of gas to
6 these customers depends upon a number of
7 factors, including weather and governmental
8 regulations, the price of gas from suppliers
9 availability and the price of alternative
10 fuels." And then this is the key part, "Under
11 FERC policy, certain large volume customers
12 located in proximity to the interstate
13 pipelines delivering gas to us could by-pass
14 us and take delivery of gas directly from the
15 pipeline or from a third party connecting with
16 the pipeline. During the fiscal year, no by-
17 pass activity was experienced. The future
18 level of by-pass activity can't be predicted."
19 So would that be a further risk that they
20 would be subject to, Ms. McShane?
21 MS. MCSHANE:
22 A. So these are two separate issues that we were
23 -
24 MR. JOHNSON:
25 Q. Yes, I think you're probably right, the first

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1 issue is fuel substitution.
2 MS. MCSHANE:
3 A. Right, so yes, I mean, this would be--if there
4 were customers who could by-pass, yeah, that
5 would be a risk that would be fairly common to
6 gas distributors who have customers who can
7 attach themselves directly to the pipeline.
8 Typically what companies try to do is to
9 achieve a rate structure that would keep those
10 industrial customers on their system, rather
11 than moving directly to the pipeline.
12 MR. JOHNSON:
13 Q. But they can't control that because the price
14 of the gas, you know, the utility has no
15 control over the cost of gas, do they?
16 MS. MCSHANE:
17 A. Well that's not knowing--now that's two
18 separate issues, if you're hooking yourself up
19 directly to the pipeline -
20 MR. JOHNSON:
21 Q. I'm sorry, yes.
22 MS. MCSHANE:
23 A. You're not avoiding the cost of gas, what
24 you're doing is trying to achieve a lower cost
25 of delivery. So if, you know, you got a

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<p>1 customer who thinks he can do better by</p> <p>2 hooking up directly to the pipeline, then you</p> <p>3 try to come to an agreement with, develop a</p> <p>4 by-pass rate so that they'll stay on your</p> <p>5 system.</p> <p>6 MR. JOHNSON:</p> <p>7 Q. How about the situation with competition that</p> <p>8 this utility faces in its service area? Would</p> <p>9 the competition be a bigger risk factor than</p> <p>10 it is for Newfoundland Power? Like in</p> <p>11 Newfoundland, pretty much, you're going to</p> <p>12 boil the kettle or, you know, have dinner,</p> <p>13 you're going to be using electricity, right,</p> <p>14 and for lights et cetera and cooking and all</p> <p>15 that sort of thing. Can the same be said down</p> <p>16 there? And the reason I asked you is on the</p> <p>17 next page, Ms. McShane, where it indicates</p> <p>18 that the regulated utility also competes with</p> <p>19 other energy products, such as electricity and</p> <p>20 propane in the residential and small</p> <p>21 commercial customer markets. The most</p> <p>22 significant product competition is with</p> <p>23 electricity for space heating, water heating</p> <p>24 and cooking. There are four major electric</p> <p>25 companies within our service area." So that</p>	<p>1 MS. MCSHANE:</p> <p>2 A. Sure.</p> <p>3 MR. JOHNSON:</p> <p>4 Q. And that's a risk that Newfoundland Power</p> <p>5 doesn't have to face with its customers,</p> <p>6 especially in the residential sector because,</p> <p>7 as I said, if you want to cook dinner, you're</p> <p>8 using electricity.</p> <p>9 MS. MCSHANE:</p> <p>10 A. Well yeah, clearly in the electric utility</p> <p>11 business there is some level of service that</p> <p>12 can only be provided by electricity and</p> <p>13 there's some level of service that can be</p> <p>14 provided by alternatives.</p> <p>15 MR. JOHNSON:</p> <p>16 Q. Now in terms of whether normalization, I think</p> <p>17 this utility doesn't have protection?</p> <p>18 MS. MCSHANE:</p> <p>19 A. Yes, it does.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Oh, it does?</p> <p>22 MS. MCSHANE:</p> <p>23 A. Are we on Piedmont? I'm so straggled which</p> <p>24 one we were on, but I'm pretty sure that</p> <p>25 Piedmont has some kind of protection. Let's</p>
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<p>1 would be a material difference, wouldn't it?</p> <p>2 MS. MCSHANE:</p> <p>3 A. Well they would have some--any gas utility is</p> <p>4 going to have some competitive risk that's</p> <p>5 associated with natural gas and you can see,</p> <p>6 if you go on to read, that they say that they</p> <p>7 continue to attract the majority of the new</p> <p>8 residential construction market and indicate</p> <p>9 that the customer's preference for natural gas</p> <p>10 is influenced by factors such as price value</p> <p>11 availability and environmental attributes, et</p> <p>12 cetera, et cetera. So yes, and they do</p> <p>13 obviously have some risk with respect to other</p> <p>14 forms of energy. They indicate that natural</p> <p>15 gas appears to be, from customers'</p> <p>16 perspective, the preferred alternative.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. But the point remains though in that service</p> <p>19 district they actually have--well they</p> <p>20 actually have to deal with increases because</p> <p>21 it goes on to say at the bottom "Increases in</p> <p>22 the price of natural gas can negatively impact</p> <p>23 our competitive position by decreasing the</p> <p>24 price benefits of natural gas to the</p> <p>25 consumer."</p>	<p>1 look at the chart. It has weather</p> <p>2 normalization and a customer utilization</p> <p>3 tracker in North Carolina, which is its big</p> <p>4 service area. And interesting, Piedmont</p> <p>5 Natural Gas is a Aaa rated Moody's regulatory</p> <p>6 support company.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. Yes. Just go to page 14, Ms. McShane.</p> <p>9 MS. MCSHANE:</p> <p>10 A. I'm there.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. And they talk about regulatory commissions,</p> <p>13 that's the bottom paragraph, "regulatory</p> <p>14 commissions approve rates and tariffs that are</p> <p>15 designed to give us the opportunity to</p> <p>16 generate revenues to cover our gas and non-gas</p> <p>17 costs to earn a fair rate of return for</p> <p>18 shareholders. In North Carolina a margin</p> <p>19 decoupling mechanism provides for the recovery</p> <p>20 of our approved margin from residential</p> <p>21 commercial customers--independent consumption</p> <p>22 patterns. The margin coupling mechanism will</p> <p>23 result in semi-annual rate adjustments to</p> <p>24 refund any over collection of margin or</p> <p>25 recover any under collection of margin. Then</p>

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<p>1 they say "We have weather normalization</p> <p>2 adjustment mechanisms in South Carolina and</p> <p>3 Tennessee that partially offset the impact of</p> <p>4 colder or warmer than normal weather on bills</p> <p>5 rendered during the months of November through</p> <p>6 March for residential and commercial</p> <p>7 customers."</p> <p>8 MS. MCSHANE:</p> <p>9 A. Yes.</p> <p>10 MS. MCSHANE:</p> <p>11 A. And so, in terms of partial protection, would</p> <p>12 that be different than what Newfoundland Power</p> <p>13 had?</p> <p>14 MS. MCSHANE:</p> <p>15 A. I guess it would be slightly different, you</p> <p>16 would think that most of the weather concerns</p> <p>17 would be from November through March, I mean,</p> <p>18 those are the cold months, but there may be</p> <p>19 some leakage on the shoulder month.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. Okay. If we could turn to NSTAR?</p> <p>22 MS. GLYNN:</p> <p>23 Q. NSTAR will be Consent No. 10.</p> <p>24 MS. MCSHANE:</p> <p>25 A. I have NSTAR.</p>	<p>1 A. Of Tab 2 or tab what?</p> <p>2 MR. JOHNSON:</p> <p>3 Q. I'm very sorry, Tab 4.</p> <p>4 MS. MCSHANE:</p> <p>5 A. Sorry, page what?</p> <p>6 MR. JOHNSON:</p> <p>7 Q. 24. Again, we're into the 2008 annual report</p> <p>8 from NSTAR. And in particular I'm looking at</p> <p>9 service quality indicator.</p> <p>10 MS. MCSHANE:</p> <p>11 A. I see that.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. Yes. And I'm reading from the fourth line up,</p> <p>14 "NSTAR Electric and NSTAR Gas are required to</p> <p>15 report annually to the DPU concerning their</p> <p>16 performance as to each measure and are subject</p> <p>17 to maximum penalties of up to 2 percent, 2 and</p> <p>18 1/2 percent beginning in 2009 of total</p> <p>19 transmission and distribution revenues should</p> <p>20 performance fail to meet applicable</p> <p>21 benchmarks."</p> <p>22 MS. MCSHANE:</p> <p>23 A. I see that.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. So they--NSTAR would not be able to come</p>
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<p>1 MR. JOHNSON:</p> <p>2 Q. Yes, thank you, Ms. McShane, just on the first</p> <p>3 page, again is the business description for</p> <p>4 this firm. It's a holding company engaged in</p> <p>5 the energy delivery business. The company,</p> <p>6 through its subsidiaries is involved in</p> <p>7 serving approximately 1.4 million customers in</p> <p>8 Massachusetts, including approximately 1.1</p> <p>9 million electric distribution customers in 81</p> <p>10 communities and approximately 300,000 natural</p> <p>11 gas distribution customers in 51 communities.</p> <p>12 NSTAR derives its revenues from the sale of</p> <p>13 energy, distribution and transmission services</p> <p>14 to customers. NSTAR's operating segments are</p> <p>15 electric and natural gas utility operations</p> <p>16 that provide energy delivery services in 107</p> <p>17 cities and towns in Massachusetts. Now,</p> <p>18 according to your chart, would they have</p> <p>19 weather normalization for electric?</p> <p>20 MS. MCSHANE:</p> <p>21 A. They do not.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. Yeah. And if I could just turn you to page</p> <p>24 24.</p> <p>25 MS. MCSHANE:</p>	<p>1 before the DPU and say, you know, we're sorry</p> <p>2 about our performance without them being at</p> <p>3 risk of receiving a fairly substantial</p> <p>4 penalty?</p> <p>5 MS. MCSHANE:</p> <p>6 A. Sorry, what they couldn't come and say we're</p> <p>7 sorry without a penalty?</p> <p>8 MR. JOHNSON:</p> <p>9 Q. You know, it's not enough to say you're sorry</p> <p>10 when you miss a service quality standard, you</p> <p>11 could be fined?</p> <p>12 MS. MCSHANE:</p> <p>13 A. Sure, I mean there are lots of utilities that</p> <p>14 have service quality standards which have</p> <p>15 penalties associated with them.</p> <p>16 MR. JOHNSON:</p> <p>17 Q. And again, that would be something borne by</p> <p>18 shareholders in the United States.</p> <p>19 MS. MCSHANE:</p> <p>20 A. Well in Canada too, I mean, there are</p> <p>21 utilities in Canada that have service quality</p> <p>22 indicators. It's not an issue that</p> <p>23 distinguishes Canada from the United States.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. But is it an issue that distinguishes this</p>

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1 company from Newfoundland Power's experience?

2 MS. MCSHANE:

3 A. Sure, I mean, as I said, there are lots of

4 differences among companies, they're not all

5 identical, they got various characteristics

6 that are unique to them, just like

7 Newfoundland Power does.

8 MR. JOHNSON:

9 Q. Yeah, like some like NSTAR that has a million

10 customers in Mass, doesn't have a weather

11 normalization and they get winter, don't they?

12 MS. MCSHANE:

13 A. They get winter but they probably don't have

14 the--on an electric side, don't have the

15 heating load.

16 MR. JOHNSON:

17 Q. Probably or don't?

18 MS. MCSHANE:

19 A. I don't believe they have heating load, I

20 mean, they're gas utilities and oil are the

21 major forms of heating load in New England.

22 For the gas utility part they would have

23 heating load, so NSTAR is a combination

24 utility.

25 MR. JOHNSON:

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1 Q. I just noticed on page 28 it talks about

2 additional incentive adders.

3 MS. MCSHANE:

4 A. Yeah, the FERC adders for the transmission

5 projects?

6 MR. JOHNSON:

7 Q. Yeah, and just--tell us about that, Ms.

8 McShane?

9 MS. MCSHANE:

10 A. Well, the transmission is regulated for the

11 FERC. There was a legislation that was passed

12 that covered transmission investment, partly--

13 and other energy investment as well,

14 recognizing that there had been an under

15 investment in transmission in the U.S. and the

16 legislation provides a number of incentives to

17 the utilities to undertake the investment in

18 the transmission network that's needed and

19 those incentives include such things as being

20 able to include construction work in progress

21 in rate base, accelerated depreciation for

22 purposes of rates and various incentives on

23 ROE, hypothetical capital structures which

24 would have common equity ratios higher than

25 the actual ones underpinning the companies.

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1 All of those things to encourage investment in

2 transmission.

3 MR. JOHNSON:

4 Q. So they have an opportunity if they respond to

5 the incentive, I take it by this paragraph

6 there's a hundred basis point adder when

7 combined with FERC's approved ROE, described

8 above, which results in a 12.64 percent ROE

9 for qualified regional investments. So

10 they've got a specific incentive that's a part

11 of the landscape in the United States that

12 these companies can partake in?

13 MS. MCSHANE:

14 A. Yes, they do. And I think, you know, if you

15 look back at my testimony, I quoted from the

16 Conference Board of Canada which had, back in

17 2004 before the incentive program had started

18 being developed sort of on a piecemeal basis--

19 this is before the legislation was actually

20 passed and the Conference Board of Canada

21 noted that, you know, this big difference

22 between the allowed returns for transmission

23 operations in the U.S. verses transmission

24 operations in Canada, and one of the things

25 that they said was that investors are

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1 reluctant, you know, to put money into the

2 transmission system in Canada when the returns

3 that they can get from those transmission

4 investments are so inferior to the ones that

5 they can get in the States.

6 MR. JOHNSON:

7 Q. Is there any evidence that there has been a

8 reticence to invest in transmission assets in

9 this province?

10 MS. MCSHANE:

11 A. I don't know specifically about this province,

12 but clearly in Alberta there's been a noted

13 under investment in transmission for returns

14 that are, you know, that are similar to the

15 returns across the Country. I think

16 Newfoundland is a bit different than Alberta,

17 obviously, because the transmission system in

18 Newfoundland is built by a Crown corporation;

19 whereas the transmission system in Alberta is

20 built by investor owned companies, so there

21 is, you know, there isn't a private investor

22 in Alberta to answer to.

23 MR. JOHNSON:

24 Q. Page 34, NSTAR talks about, I guess, its

25 private investors, I guess, can look forward

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<p>1 to unregulated operating revenues that are</p> <p>2 derived from its--I'm talking about three</p> <p>3 paragraphs up from the bottom. "Unrelated</p> <p>4 operating revenues are derived from NSTAR's</p> <p>5 district energy and telecommunications</p> <p>6 operations. Unregulated revenues were 152</p> <p>7 million dollars in 2008, compared to 138</p> <p>8 million in 2007. The increase in unregulated</p> <p>9 revenues is primarily the result of the</p> <p>10 absence of a provision for a potential</p> <p>11 customer refund recorded in 2007" et cetera.</p> <p>12 So that's not an insignificant amount of</p> <p>13 unregulated revenue on NSTAR's books?</p> <p>14 MS. MCSHANE:</p> <p>15 A. 152 million compared to 3.35 billion, so it's</p> <p>16 some, but it's 3.5 billion in revenue verses</p> <p>17 152 million</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Okay, so you that's not even a consideration.</p> <p>20 MS. MCSHANE:</p> <p>21 A. Well again, you have to kind of put it in</p> <p>22 perspective. All of the companies have some</p> <p>23 unrelated operations, if we--you know, it</p> <p>24 seems to me that the issue, one of the issues</p> <p>25 that we're addressing here is whether or not</p>	<p>1 A. I don't think that if you look at the risk</p> <p>2 measures for those companies that there are --</p> <p>3 that there's a reason to make any kind of</p> <p>4 adjustment. I mean, you're looking at the</p> <p>5 ratings, you're looking at the betas. The</p> <p>6 companies that have the least amount of</p> <p>7 unregulated operations have similar betas to</p> <p>8 the ones with more unregulated operations. I</p> <p>9 don't think that there is a downward</p> <p>10 adjustment required to the cost of capital.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. But under your approach, we end up looking at</p> <p>13 holding companies like the Southern with,</p> <p>14 what, 40 odd thousand megawatts of generating</p> <p>15 capacity.</p> <p>16 MS. MCSHANE:</p> <p>17 A. And --</p> <p>18 MR. JOHNSON:</p> <p>19 Q. And nuclear projects, and no deductions for</p> <p>20 that?</p> <p>21 MS. MCSHANE:</p> <p>22 A. Not when you're looking at the entire sample,</p> <p>23 no, I don't think so.</p> <p>24 MR. JOHNSON:</p> <p>25 Q. The next one is Northwest Natural Gas.</p>
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<p>1 we need to look at U.S. utilities, one; and</p> <p>2 two, if we do or if it's appropriate--even if</p> <p>3 we don't have to, if we look at them as an</p> <p>4 alternative, I mean, do they bring us some</p> <p>5 information that's different from what the</p> <p>6 Canadian companies give us? The fact is that</p> <p>7 every one of these companies that you look at</p> <p>8 is going to have some unregulated operation,</p> <p>9 you cannot find a sample of companies that</p> <p>10 won't, and if you look at NSTAR in particular</p> <p>11 and say, well, you know, do they have a lot</p> <p>12 more unregulated operations than if I only</p> <p>13 looked at a Canadian sample, well no. I mean,</p> <p>14 if you look at the only Canadian sample</p> <p>15 available, those companies have, on average, a</p> <p>16 lot more unregulated operations.</p> <p>17 (1:15 p.m.)</p> <p>18 MR. JOHNSON:</p> <p>19 Q. But Ms. McShane, isn't it the case, though,</p> <p>20 that you've told the Board in your evidence</p> <p>21 that your sample is something that is similar</p> <p>22 on the whole to the utility that they're</p> <p>23 regulating and that they don't need to make</p> <p>24 adjustments.</p> <p>25 MS. MCSHANE:</p>	<p>1 MS. GLYNN:</p> <p>2 Q. Northwest will be Consent #11.</p> <p>3 MS. MCSHANE:</p> <p>4 A. I have it.</p> <p>5 MR. JOHNSON:</p> <p>6 Q. Okay, and again Tab 1 gives a description of</p> <p>7 the company, Northwest Natural Gas Company,</p> <p>8 doing business as Northwest Natural,</p> <p>9 principally engaged in the distribution of</p> <p>10 natural gas in Oregon, and Southwest</p> <p>11 Washington, and I'd like to refer you to Tab</p> <p>12 3, and in particular, three pages in, and</p> <p>13 under 2008 highlights.</p> <p>14 MS. MCSHANE:</p> <p>15 A. Sorry, I'm not sure I know where you are. Tab?</p> <p>16 MR. JOHNSON:</p> <p>17 Q. Tab 3.</p> <p>18 MS. MCSHANE:</p> <p>19 A. Tab 3, which is a 10Q.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. And then three pages in, it should look like</p> <p>22 this.</p> <p>23 KELLY, Q.C.:</p> <p>24 Q. We don't have it either, Tom.</p> <p>25 MR. JOHNSON:</p>

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<p>1 Q. Oh, you don't have it either. Do you have 2 Northwest -- 3 KELLY, Q.C.: 4 Q. It's at Tab 2. 5 MR. JOHNSON: 6 Q. What's that? 7 KELLY, Q.C.: 8 Q. It's at Tab 2. 9 MR. JOHNSON: 10 Q. It's at Tab 2. In mine, it's Tab 3, but 11 that's fair enough. It's the letter to the 12 shareholders where they show the 2008 13 highlights. Are we there now? 14 MS. MCSHANE: 15 A. No. Sorry, what page? 16 MR. JOHNSON: 17 Q. On mine it says page 1 of 1 up at the top 18 because they were printed separately. 19 MS. MCSHANE: 20 A. Oh, sorry, so it starts out, "Whether the 21 shareholders"? 22 MR. JOHNSON: 23 Q. Yeah. 24 MS. MCSHANE: 25 A. Okay, 150 years of service.</p>	<p>1 shareholders. In the past, we returned two- 2 thirds of any money saved on gas cost 3 purchases to customers, while shareholders 4 kept one-third of the savings. If gas costs 5 were higher than forecasted in our rates, 6 shareholders absorbed one-third of any 7 losses". 8 MS. MCSHANE: 9 A. You're right, I'm sorry. Yes, the new one is 10 a choice of 80/20, 90/10. 11 MR. JOHNSON: 12 Q. Yes, so the new agreement, as you've quoted 13 there, reached with the OPUC, "allows us to 14 select either a 90/10 or 80/20 customer 15 shareholder split". 16 MS. MCSHANE: 17 A. Right. 18 MR. JOHNSON: 19 Q. "This gives us added flexibility in managing 20 costs". 21 MS. MCSHANE: 22 A. Right. 23 MR. JOHNSON: 24 Q. But again this is very entrepreneurial of this 25 company, though, isn't it, the Northwest</p>
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<p>1 MR. JOHNSON: 2 Q. That's right, and you go to the next page 3 then, Ms. McShane, and there's a -- they talk 4 about 2008 highlights. They report a net 5 income of 69 million dollars, \$2.61 a share, 6 and then the third bullet, the reduced 7 earnings exposure through approval of a new 8 gas cost sharing mechanism in Oregon. So I 9 take it that until that was done, they were at 10 risk? 11 MS. MCSHANE: 12 A. They had some risk on gas costs. There was a 13 sharing mechanism. I think it was covered, 14 like, 80 percent of gas costs with sharing -- 15 it was an incentive plan on the remaining gas 16 costs, and I think that they replaced it with 17 a 90 percent mechanism. 18 MR. JOHNSON: 19 Q. On the next page, if we're still on the same 20 order, mine starts off at the top saying, 21 "Regulators". I don't know where that got cut 22 off. It probably got cut off -- it talks 23 about, "Regulators to revise our 20 year old 24 gas cost sharing mechanism to better balance 25 the risks and rewards between customers and</p>	<p>1 Natural Gas? I mean, it seems to me they're 2 saying, look, we're prepared to take some risk 3 here, we're going to try to manage it as best 4 we can, and we're going to see if we can make 5 some money off it. I mean, it's not just 6 here's the bill, customer, pay it? 7 MS. MCSHANE: 8 A. No, I agree that there is some incentive 9 mechanism built into these gas costs, and 10 evidentially, you know, if you look at the 11 bottom line, the company has been very 12 successful, it's got a double A rating, 13 obviously has managed its gas purchase in such 14 a way that its risk profile is quite low. 15 MR. JOHNSON: 16 Q. And by them sharing the risk, it wouldn't be 17 appropriate for them to expect a return on 18 equity that would be consistent with a company 19 that doesn't share the risk, would it? 20 MS. MCSHANE: 21 A. Again you got to look at the whole picture. 22 MR. JOHNSON: 23 Q. All else being equal? 24 MR. JOHNSON: 25 Q. If that were the only thing that were</p>

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1 different, then, yeah, maybe you'd need to
 2 make some kind of an adjustment.
 3 MR. JOHNSON:
 4 Q. Do you have a sense of how big a hit the
 5 shareholders of Northwest Natural Gas could
 6 take, for instance, under their old mechanism
 7 where --
 8 MS. MCSHANE:
 9 A. No, because you're not necessarily going to
 10 let those gas costs hang out there naked, if
 11 you will. I mean, you have the ability to
 12 contract, you have the ability to edge, so
 13 there are all sorts of risk mechanisms that
 14 you would engage in to minimize your risk
 15 exposure.
 16 MR. JOHNSON:
 17 Q. But still risk, and if you don't do a good job
 18 managing it, the shareholder takes it?
 19 MS. MCSHANE:
 20 A. Well, sure. I mean, that's true of anybody.
 21 Nobody gets compensated for bad management, at
 22 least not supposed to.
 23 MR. JOHNSON:
 24 Q. But it's not necessarily bad management if --
 25 MS. MCSHANE:

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1 A. Well, I mean, I don't want to argue about
 2 this, but if you expose yourself to risk that
 3 you don't need to because you have ways of
 4 managing it, then you certainly can't expect
 5 to come to the regulator and say, you know,
 6 I'm at risk and I don't intend to do anything
 7 about it, please give me a higher return. I
 8 mean, I don't think that that's an appropriate
 9 way to deal with regulations.
 10 CHAIRMAN:
 11 Q. It's not capitalism, is it?
 12 MS. MCSHANE:
 13 A. Not at all.
 14 MR. JOHNSON:
 15 Q. Let's go to the next one, New Jersey
 16 Resources.
 17 MS. MCSHANE:
 18 A. We're almost half way through the alphabet.
 19 MS. GLYNN:
 20 Q. New Jersey Resources will be Consent #12.
 21 MR. JOHNSON:
 22 Q. And again start off with Tab 1, with the
 23 business description, "New Jersey Resources
 24 Corp. is an energy services holding company,
 25 providing retail and wholesale energy services

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1 to customers in states from the Gulf Coast to
 2 the New England regions, including the mid
 3 continent regions and Canada. The company
 4 operates in two business segments; natural gas
 5 and distribution energy services. Natural gas
 6 distribution segment consists of regulated
 7 energy and off-system capacity and storage
 8 management operations, and energy services
 9 segment consists of unregulated wholesale
 10 energy operations, and Ms. McShane, are those
 11 unregulated pieces of significance in New
 12 Jersey Resources?
 13 MS. MCSHANE:
 14 A. Yes, I would say they're more than 5 percent
 15 of the operations, and that to me would be
 16 material.
 17 MR. JOHNSON:
 18 Q. More than 5 percent would be material. If you
 19 could flip into Tab 3.
 20 MS. MCSHANE:
 21 A. I'm there.
 22 MR. JOHNSON:
 23 Q. And six pages in. Are you coming up to a page
 24 that looks like this, or did I direct you five
 25 pages in?

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1 MS. MCSHANE:
 2 A. With the little circles on it?
 3 MR. JOHNSON:
 4 Q. Yes.
 5 MS. MCSHANE:
 6 A. Our performance model?
 7 MR. JOHNSON:
 8 Q. Yes.
 9 MS. MCSHANE:
 10 A. Yes, I'm there.
 11 MR. JOHNSON:
 12 Q. So it's the sixth page, yeah, and I'm looking
 13 at the left hand column, the second last
 14 paragraph, "Fiscal year 2008 was another solid
 15 year for our company. We achieved our 17th
 16 consecutive year of net financial earnings
 17 growth. MFE were 93.8 million dollars, or
 18 \$2.24 per basic share". Do you see that?
 19 MS. MCSHANE:
 20 A. I do.
 21 MR. JOHNSON:
 22 Q. And then if you go over -- I take it that was
 23 for the whole company, and if you go over to
 24 the next side of the page, the second last
 25 paragraph, it says, "NJRES, our unregulated

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<p>1 wholesale energy services company, had another</p> <p>2 record year. Net financial earnings were 47</p> <p>3 million dollars compared with 40.1 million</p> <p>4 dollars last year".</p> <p>5 MS. MCSHANE:</p> <p>6 A. Right.</p> <p>7 MR. JOHNSON:</p> <p>8 Q. And do you take it, as I did, that the 47</p> <p>9 million was a part of the overall 93.8?</p> <p>10 MS. MCSHANE:</p> <p>11 A. That's what I would say, yes.</p> <p>12 MR. JOHNSON:</p> <p>13 Q. So it's much more than 5 percent?</p> <p>14 MS. MCSHANE:</p> <p>15 A. No, I didn't say -- I wasn't meaning to</p> <p>16 indicate it was 5 percent. I was just saying</p> <p>17 that --</p> <p>18 MR. JOHNSON:</p> <p>19 Q. No, no, but in terms of the materiality?</p> <p>20 MS. MCSHANE:</p> <p>21 A. Yeah, no, it's material.</p> <p>22 MR. JOHNSON:</p> <p>23 Q. It's like half of the company's earnings were</p> <p>24 non-regulated?</p> <p>25 MS. MCSHANE:</p>	<p>1 MS. MCSHANE:</p> <p>2 A. That would appear to be true, yes.</p> <p>3 (1:30 p.m.)</p> <p>4 MR. JOHNSON:</p> <p>5 Q. Yeah, and at page 5 of Tab 3 -- actually, it's</p> <p>6 the seventh page in. There's reference there</p> <p>7 -- it actually is numbered page five on the</p> <p>8 bottom right hand corner. There's reference</p> <p>9 there, Ms. McShane, to our Conservation</p> <p>10 Incentive Program approved in 2006.</p> <p>11 MS. MCSHANE:</p> <p>12 A. Yes.</p> <p>13 MR. JOHNSON:</p> <p>14 Q. By the BPU.</p> <p>15 MS. MCSHANE:</p> <p>16 A. Yes.</p> <p>17 MR. JOHNSON:</p> <p>18 Q. And they go on to say, "It's designed to</p> <p>19 normalize fluctuations in New Jersey Natural</p> <p>20 Gas margins and customer bills resulting from</p> <p>21 changing weather conditions and usage</p> <p>22 patterns. Our CIP aligns the interest of our</p> <p>23 customers and shareholders by giving us the</p> <p>24 ability to serve as an ally in helping</p> <p>25 customers lower their energy bills without</p>
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<p>1 A. In that year.</p> <p>2 MR. JOHNSON:</p> <p>3 Q. Ms. McShane, this company surely can't belong</p> <p>4 in your proxy group, can it, with that type of</p> <p>5 unregulated revenue?</p> <p>6 MS. MCSHANE:</p> <p>7 A. It would belong as much in my proxy group on</p> <p>8 that basis as half of the utilities in Canada.</p> <p>9 I mean, it is one of the major low risk US gas</p> <p>10 utilities.</p> <p>11 MR. JOHNSON:</p> <p>12 Q. Go back to page two -- Tab 2, page 5 of 14.</p> <p>13 MS. MCSHANE:</p> <p>14 A. Are we still in Tab 2, or going back to Tab 2?</p> <p>15 MR. JOHNSON:</p> <p>16 Q. Go back to Tab 2, please.</p> <p>17 MS. MCSHANE:</p> <p>18 A. Tab 2, okay.</p> <p>19 MR. JOHNSON:</p> <p>20 Q. And page 5 of 14, the very last line talks</p> <p>21 about, "In March, 2008, NGR Energy Services, a</p> <p>22 subsidiary of the company, opened an office in</p> <p>23 Houston in order to expand its business", and</p> <p>24 I take it that that's the business that</p> <p>25 reported the 47 million dollars?</p>	<p>1 harming our financial performance. Thus far,</p> <p>2 the CIP has worked as intended. Through the</p> <p>3 CIP this year alone we were able to recover 22</p> <p>4 million dollars in gross margin while</p> <p>5 providing customers with annual upfront gas</p> <p>6 supply savings of 10.6 million dollars, as</p> <p>7 well as an estimated 53 million dollars in</p> <p>8 commodity savings". Is that a program by</p> <p>9 which this utility can profit?</p> <p>10 MS. MCSHANE:</p> <p>11 A. Profit in the sense that it doesn't -- without</p> <p>12 conservation measures, what happens is that if</p> <p>13 you lose load, you lose profits. My</p> <p>14 understanding is that this is something that</p> <p>15 allows the company to maintain its</p> <p>16 profitability at the same time that customers</p> <p>17 are reducing their consumption. So profit,</p> <p>18 yes, in the sense of maintaining earnings on</p> <p>19 the remaining consumption.</p> <p>20 MR. JOHNSON:</p> <p>21 Q. But they talk about 22 million dollars in</p> <p>22 gross margin. This year alone we're able to</p> <p>23 recover 22 million. So you're just saying</p> <p>24 that's really just --</p> <p>25 MS. MCSHANE:</p>

<p style="text-align: right;">Page 185</p> <p>1 A. That's my understanding. I don't read this as 2 being able to earn 22 million dollars more 3 than their return on investment, that they 4 would earn - say their return was -- allowed 5 return was 10 and a half, and it's not like 22 6 million dollars above the 10 and a half. 7 MR. JOHNSON: 8 Q. No, I grant you that, but as I read it, look, 9 this is an incentive program that this utility 10 has to go out and hustle in order to make its 11 22 million? 12 MS. MCSHANE: 13 A. Well, that's not my understanding. My 14 understanding is that this is a means of 15 getting rid of the disincentive to encourage 16 customers to conserve, because there is a 17 natural disincentive to do that, because if 18 you encourage customers to conserve without 19 being able to earn, why would you do that. 20 You want customers to consume because that's 21 how you earn your money. So it's a program to 22 get rid of that disincentive, to ensure that 23 you earn the return on your invested capital 24 at the same time that your customers are 25 reducing consumption through conservation.</p>	<p style="text-align: right;">Page 187</p> <p>1 MR. JOHNSON: 2 Q. Yes, that's fine. Thank you, Chairman. 3 CHAIRMAN: 4 Q. Okay, until 9 o'clock tomorrow morning. 5 (UPON CONCLUDING)</p>
<p style="text-align: right;">Page 186</p> <p>1 MR. JOHNSON: 2 Q. I take it, we would agree to this extent, that 3 without the efforts that this company made, 4 they wouldn't have been able to come up with 5 the 22 million. It was not guaranteed. 6 MS. MCSHANE: 7 A. Well, I think that's fair, it wasn't 8 guaranteed. 9 MR. JOHNSON: 10 Q. And they got it by their efforts? 11 MS. MCSHANE: 12 A. Sorry? 13 MR. JOHNSON: 14 Q. And they earned it by their efforts? 15 MS. MCSHANE: 16 A. I mean, I think that's fair that they had to 17 produce some effort to do it. 18 MR. JOHNSON: 19 Q. FPL. 20 MS. GLYNN: 21 Q. FPL will be Consent #13. 22 MR. JOHNSON: 23 Q. It's 1:30 now, isn't it? 24 CHAIRMAN: 25 Q. Yeah. So do we want to adjourn?</p>	<p style="text-align: right;">Page 188</p> <p>1 CERTIFICATE 2 I, Judy Moss, hereby certify that the foregoing is 3 a true and correct transcript in the matter of 4 Newfoundland Power's 2010 General Rate Application 5 heard on the 20th day of October, A.D., 2009 before 6 Commissioners of the Public Utilities Board, Prince 7 Charles Building, St. John's, Newfoundland and 8 Labrador and was transcribed by me to the best of 9 my ability by means of a sound apparatus. 10 Dated at St. John's, Newfoundland and Labrador 11 this 20th day of October, A.D., 2009. 12 Judy Moss</p>

<div>-#-</div> <div>#11 [1] 172:2</div> <div>#12 [1] 178:20</div> <div>#13 [1] 186:21</div> <div>#3 [1] 49:23</div> <div>#4 [1] 92:14</div> <div>#5 [1] 106:10</div> <div>#6 [1] 114:24</div> <div>#7 [1] 124:16</div> <div>-\$-</div> <div>\$2.24 [1] 180:18</div> <div>\$2.61 [1] 174:5</div> <div>-&-</div> <div>& [10] 36:15 37:9,9 41:15 43:10 63:2,13 132:13 133:18,20</div> <div>-'-</div> <div>'06 [1] 111:12</div> <div>'09 [1] 142:24</div> <div>'90s [1] 14:5</div> <div>-1-</div> <div>1 [30] 54:3 55:14,15 56:2 68:8,10,19,21,24 69:22 70:4,4,5,19 106:25 114:8 115:4 120:15 124:18 133:23 135:17 143:4 148:16 149:20 152:1,3 172:6 173:17,17 178:22</div> <div>1.1 [2] 123:24 162:8</div> <div>1.4 [1] 162:7</div> <div>1/2 [1] 163:18</div> <div>10 [5] 1:17 77:9 161:23 185:5,6</div> <div>10.1 [1] 6:8</div> <div>10.6 [1] 184:6</div> <div>10.75 [1] 18:25</div> <div>100 [1] 118:23</div> <div>106 [1] 9:17</div> <div>107 [1] 162:16</div> <div>10:00 [1] 40:21</div> <div>10:15 [1] 55:1</div> <div>10:30 [1] 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