Page 1

(January 10, 2013)

CHAIRMAN:

Q. Good morning everybody. This is the Newfoundland Power 2013 General Rate Application hearing. My name is Andy Wells and I'm joined by my colleagues, Dwanda Newman and James Oxford. Glenda Gibbons from Discoveries Unlimited is assisting Cheryl Blundon with the transcripts of today's hearings. Our schedule for today's evidence should continue until about 1:30 today with a half-hour break between 11 and 11:30. As for tomorrow, we will just have to wait and see what the Good Lord sends us.

Before we get started, could the panel introduce yourselves.

KELLY, Q.C.:

Q. Thank you, Mr. Chair. Ian Kelly here representing Newfoundland Power. Joining me is Gerard Hayes, Newfoundland Power, and Chris Wells who is assisting us with the documents.

CHAIRMAN:

Q. That's a good name.

MR. JOHNSON:

Q. Tom Johnson here, Mr. Chair, on behalf of the

Page 2

consumer. Here with me is Dr. Lawrence Booth and counsel, Greg Kirby. Thank you.

CHAIRMAN:

Q. Okay. We will pass it on to Ms. Jacqueline Glynn to get things started.

MS. GLYNN:

Q. Thank you, Mr. Chair. Good morning to the panel and to everybody who has joined us here this morning. On September 14th, the Board received a General Rate Application from Newfoundland Power to establish new rates for its customers.

Newfoundland Power is requesting that the Board approve, among other things, an overall average increase in current electricity rates of six percent as of March 1st, 2013, which includes proposed increases ranging from 0.6 percent to 6 percent for commercial customers and proposed average increases of 7.2 percent for residential customers.

The Board held a pre-hearing conference on October 11th, 2012 to identify the registered intervenors and to set the procedures and schedule for this public hearing. Following the pre-hearing

Page 3

conference, time was allowed for Requests for Information to be submitted and responses to be filed. Time was also allowed for the parties to retain experts as required.

The Board requested the parties to participate in a Board facilitated settlement process to discuss the issues contained in the application. This negotiation process, as indicated by the Chair, was held the week of December 17th and a resulting settlement agreement was filed with the Board on December 21st. All parties have a copy of this agreement and it will be entered onto the record as Consent Exhibit No. 1. I'd like to take a moment just to review the issues which have been agreed upon by the parties.

The parties have agreed that the Board may rely upon the Customer Energy and Demand Forecast dated August 2012 which was submitted with the Application. Changes to the calculation and amortization of the defined benefit pension expense have also been agreed to. The deferral and amortization of conservation program costs over a seven-year period have been agreed to. However, the

Page 4

Consumer Advocate has reserved the right to cross-examine on the actual program costs. The parties agreed to changes in the Weather Normalization Reserve Account. The parties agreed to cost recovery for existing deferral accounts, the hearing costs and a revenue shortfall for 2013. The Forecast Average Rate Base for 2013 and for 2014 will be used for rate making purposes, subject to any adjustments from the Board's determination on issues that have not been settled. Proposed changes to the rate design and rate structure have been agreed to and proposed changes to the Rate Stabilization clause have also been agreed to. The remainder of the issues in the Application will be examined throughout this hearing.

Notice of the start date for this hearing was published in papers throughout the Province started on December 15th, 2012. The only remaining deadlines are for public participation. Requests to make an oral submission must be submitted by noon tomorrow, Friday, January 11th. Any written letters of comments must be submitted by Friday, January

18th.

The Board's financial consultants, Grant Thornton, submitted a report on November 9th, 2012. The parties have agreed to accept this report without the necessity of a representative from Grant Thornton appearing to adopt it and neither party wishes to cross-examine on that report. Again, the parties already have a copy and that will be entered onto the record as Consent Exhibit No. 2.

Evidence will start today with the company witnesses. Cost of Capital is scheduled for next week and depreciation evidence for the end of the following week.

As the Chair has indicated, the normal sitting schedule is from 9 to 1:30 with a half-hour break at 11. However, during the Cost of Capital evidence, we have agreed to sit at least an hour later, until 2:30. An additional break may be required on those sitting days. And of course, again, the storm may put some changes into that schedule.

Mr. Chair, I confirm that the Application has been properly filed and appropriate notices published. There are no preliminary



matters which I have been made aware of. You may ask the parties for their opening statements.

CHAIRMAN:

Q. Okay. Newfoundland Power can proceed, sir.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman. As Ms. Glynn has already explained, agreement has been reached with respect to many of the Company's proposals contained in this Application. The settled issues are set out in the agreement which has been entered, Consent 1. I won't go through them now. The Company's witnesses will not specifically speak to those settled issues in their testimony. However, they will, of course, be happy to answer any questions that the Board may have.

In this hearing, Newfoundland Power is requesting an average increase in customer rates of approximately 6 percent. That 6 percent breaks down into essentially three components. The largest component, 2.6 percent, is simply the rebalancing of the 2013 and 2014 energy supply costs. That increase would have flowed through to customers in any



event through the Energy Supply Cost Variance mechanisms. So this Application is really about the other 3.4 percent of the proposed increase.

The second component is the Return on Equity. It amounts to 1.8 percent. Now it's important to remember that customer rates went down in 2011 when the allowed return was reduced from 9 percent to 8.38 percent through the operation of the Automatic Adjustment Formula. But rates did not go back up in 2012 when the allowed return was increased to 8. 8 percent. It was already June of 2012 when that occurred, so the recovery of that increase was deferred. Only the return of 8.38 percent is currently embedded in customer rates. The 1.8 percent increase covers the difference between that 8.38 and the 10. 4 percent based upon the evidence in the Company's Cost of Capital witnesses. And of course, the final percentage will obviously depend upon the determination of the Board as to the appropriate Return on Equity.

And the final 1.6 percent represents everything else which is a relatively modest



increase, percentage wise, over the 2010 year test year costs. So the principal issues in this case are the cost of capital issues, return on equity, capital structure and the use of an automatic adjustment formula.

In relation to capital structure, the Board has consistently approved a capital structure for Newfoundland Power of 45 percent equity. We believe that capital structure should be maintained. The Board has recognized that Newfoundland Power's 45 percent equity ratio is an important factor which sustains Newfoundland Power's overall average risk profile. In relation to the formula, the company is again proposing discontinuance of the automatic adjustment formula. The purpose of the formula was to reduce regulatory burden, promote regulatory efficiency and reduce costs. Those objectives have not been achieved over the past several years. The abnormal capital market conditions which existed in 2009 continued throughout 2010, 2011, 2012 and are continuing in 2013. Maintaining the formula since 2010 has increased the number of regulatory hearings and added to regulatory cost rather than promoting efficiency. So Newfoundland Power continues to believe that the best approach is to discontinue use of the formula until financial markets return to more normal conditions and a regulatory consensus emerges as to the utility of a formula in the new economic order.

With respect to the other costs, as Ms. Greene and Ms. Glynn have referred to, Grant Thornton has conducted a detailed review of Newfoundland Power's operating costs, the amortization and deferred recoveries, the demand forecast, rate base and other matters. Grant Thornton has filed a comprehensive report in which it found no basis to conclude that there was anything unreasonable with any of these items. The Board, I think, can take comfort from Grant Thornton's analysis and conclusions with respect to the overall reasonableness of the company's operating costs and these other items.

I'd also like to mention that in preparing its test year costs, Newfoundland Power has built into those estimates certain



labour force efficiency assumptions. Newfoundland Power will serve 1.3 percent more customers with 1 percent less in labour costs. Customers will receive the benefits of those productivity assumptions whether or not the company succeeds in achieving those operational efficiencies.

The only other item I wanted to address at this time is the depreciation issue. This is an issue which has been raised by the Consumer Advocate. He challenges the depreciation methodology, not simply the application of that methodology to the current assets. The Board determined the appropriate methodology and ordered the implementation of what's called the Equal Life Group or ELG methodology over a five-year period from 1977 to 1983. The Board has ordered updated depreciation studies based upon that methodology every four or five years since then. The company completed the most recent update in 2010 using the approved methodology and experience has demonstrated that the Board's decision to adopt the ELG depreciation methodology was correct. Reducing



depreciation, as the Consumer Advocate proposes, increases the rate base which in turn adds to the required return on that rate base. Customer rates are approximately 3.7 million dollars less today because of the Board's decision to adopt ELG. Reversing that process would result in a current reduction in rates at the expense of higher rates in the future and that would not be in the interests of the long -- the long terms interests of Newfoundland Power's customers.

And on this point, Mr. Chairman, I observe that in a GRA, which is where we are now, the Board examines the company's test year costs for reasonableness and prudency. That's the test to be applied. And as our Court of Appeal has pointed out, management is entitled to exercise judgment in running the company and is entitled to a presumption of good faith. That applies to determining depreciation expense. So the practical burden here lies upon the Consumer Advocate to demonstrate that the depreciation expense for the test year is not reasonable and prudent.

Mr. Chairman, let me next turn to the



witnesses that you'll hear in this proceeding. Newfoundland Power intends to call six witnesses. Mr. Earl Ludlow, the president and chief executive officer, will testify first and subject to tomorrow's weather, the next witness will be Ms. Jocelyn Perry, the vice-president finance and chief financial officer of the company. She will deal with the financial evidence, including depreciation expense, insofar as it affects financial parameters. During the cost of capital phase, you'll hear the expert testimony from Ms. Kathleen McShane and Mr. James VanderWeide. Mr. John Wiedmayer of Gannett Fleming will testify with respect to depreciation. And finally, Mr. Gary Smith, Newfoundland Power's vice-president of customer operations and engineering will answer questions with respect to operating costs.

Mr. Chairman, those are my opening comments, unless you have any questions. Thank you.

MR. JOHNSON:

Q. Mr. Chairman and Commissioners, Newfoundland Power is back before this Board seeking a rate increase which in significant measure is driven by a wholly unrealistic request for its return on equity. It expects, to put this in context, to earn a net income of 36 and a half million dollars in 2012. But in 2013, it wants this Board to set rates high enough to let it earn 42 and a half million dollars. That's just in 2013. And in 2014, rates high enough to let it earn 44 million dollars in net income. It seeks a return on equity of 10.4 percent in 2013 and 2014. This would put Newfoundland Power at the highest allowed return in Canada for any regulated utility, whether electric, gas or anything else. In my respectful submission, this is a gross overstatement of Newfoundland Power's fair return.

I'll repeat what I said at the 2009 General Rate Application of Newfoundland Power which Mr. Ludlow agreed with at the time, and that is, Newfoundland Power has been and will continue to be a very well protected, stable, predictable, conservative, low risk utility operating in a very supportive regulatory environment where the company enjoys moderate,



yet fairly steady customer growth, free from any significant competition. With only a small amount of generation, Newfoundland Power is predominantly poles and wires. In essence, it is very low risk. That's what I said in 2009 and the same remains.

The fact is that Newfoundland Power is risk adverse. It has a penchant for mechanisms that transfer risk to its customers. Indeed, since the last hearing before this Board in 2009, two further deferral accounts have kicked in. One totally removes the risk of forecasting pension expense and the other set up in 2011 totally removes any risk to the company associated with forecasting costs of other post-employment benefits.

Newfoundland Power is left with next to no risk and in order for customers to benefit from the low risk environment that has been set up, the return on equity that is used in setting Newfoundland Power's rates must reflect the lower risk to which the company is exposed and the commensurate higher risk that its customers face.



Newfoundland Power is once again making a case for a higher return based largely on cost of capital witnesses from the United States who say, in essence, that Newfoundland Power is comparable to their US utilities and that its return, in essence, should be similar. Now we went down this road already with Newfoundland Power in their last General Rate Application and what did the Board conclude in its decision? It concluded as follows, and I quote: "The Board believes that in this type of analysis it is not enough that the chosen comparables are the best available. If this data is to be relied on, it must be shown to be a reasonable proxy or that reasonable adjustments can be made to account for the differences. The evidence showed significant differences in virtually all of the comparables including significant levels of non-regulated and non-utility business, as well as riskier generation projects, earnings volatility, more competition and less regulatory support. While it was argued that on balanced, the US comparables are reasonable proxies, the Board notes the overwhelming



evidence of a lack of balance as it was clear that on almost every measure, Newfoundland Power would have to be considered less risky than the US comparables."

Mr. Chairman and Commissioners, as the great Yogi Berra said, it's like deja vu all over again. For what did Newfoundland Power do in the face of these clear admonitions from the Board? Did they change their approach? No. In fact, they doubled down on it, hiring not one US cost of capital witness, but two, at considerable expense. These witnesses use the same approach where once again they say to the Board that companies such as Consolidated Edison, Southern and Vectrin are comparable to Newfoundland Power and that the Board should get on with it, rely on the financial results from these US companies without adjustments in determining Newfoundland Power's fair return on equity. Mr. Chairman and Commissioners, these companies were not comparable in 2009 and they are not comparable today.

What's more, in this case begs the question with the doubling down on cost of capital witnesses by Newfoundland Power is do

Page 17

we really want to go down the road of scrapping the automatic adjustment formula as Newfoundland Power proposes it and replacing it with nothing? They say the formula doesn't work. Yet, they bring forward no constructive suggestions at all as to how it may be modified. One of the features of it, besides reducing the frequency of general rate applications, is to provide an incentive to pursue productivity gains in the non-GRA years. This Board held in its last GRA Order that the automatic adjustment formula was "fundamental to the multi-year regime in place in this jurisdiction." Those words were as true then as they are now.

What is no longer a good incentive is to reward Newfoundland Power's executives and management team through customer funded short term incentive pay which is tied to the amount of profit Newfoundland Power can make for its shareholders. While this has been the practice for some years, it is time to end it in this hearing. The primary beneficiary of more company profit is the shareholder, not the company, and that's not deniable.

Page 18

Accordingly, it is the shareholder who should pay all the salary and associated costs of incenting the executives and managers to achieve the profit targets.

CHAIRMAN:

Q. Mr. Johnson, I'm going to stop you here just for one second. I'm sorry, sir, that's not permitted in here. I'll ask you to leave with that placard.

PROTESTOR:

Q. It's just a -

CHAIRMAN:

Q. No, no, sir, you're not allowed to speak. I'm sorry. I will ask you to leave. Well, I'll ask you to take down the placard. We'll adjourn for a couple of minutes and if you don't leave, sir, I probably will call the police.

(OFF RECORD)

(10:00 a.m.)

CHAIRMAN:

Q. We shall recommence our proceedings, ladies and gentlemen. If there is any further disruptions of our right to peacefully proceed with this application, we shall deal with it.

Page 19

I just want to state for the record that we have a right to be here. Newfoundland Power has a right to make an application. The Consumer Advocate has a right to be here. It has nothing to do with this other issue that is a matter of concern to the protestors, the strikers and it's deeply disrespectful of people's right to peacefully assemble and go about their business to have to be subjected to this kind of interruption and harassment and if it reoccurs again, all I can tell all of the parties is that we shall deal with it and deal with it resolutely. We're not going to tolerate any interruptions in our right to peacefully proceed with the business that is before this tribunal. So, Mr. Johnson, I think I'm back to you.

MR. JOHNSON:

Q. Mr. Chairman and Commissioners, our contention in this hearing is that in relation to the short term incentive pay aspect of the company's executives and managers compensation, it is very clear that the primary beneficiary of more company profit is the shareholder, not the customer, and

Page 20

therefore, it is the shareholder who should pay all of the salary and associated costs of incenting the company's executives and managers to achieve profit targets.

We also look forward in due course to examination of the company's operating costs in the coming days, in particular during the phase when we'll be hearing from Newfoundland Power's vice-president of operations, Mr. Smith.

In this proceeding, the Consumer Advocate will be calling two expert witnesses. The first expert witness I will be calling will be Dr. Lawrence Booth. Dr. Booth is a professor of finance at the Rotman School of Management at the University of Toronto where he holds the CIT Chair in structural finance, a chair that he's held since 1999. His research interests centre on the cost of capital international corporate finance and capital markets theory. His teaching area is in domestic and international finance. Incidentally, Dr. Booth also serves on the governing council of the pension -- the Pension Committee of the Governing Council of the University of Toronto, and as such, brings a realistic perspective on the returns that are being forecasted on equities and bonds. Dr. Booth has testified widely in Canada and previously, as I alluded to, testified before the Board of Commissioners at Newfoundland Power's 2010 GRA. Dr. Booth will testify as to a fair and just return for Newfoundland Power and in relation to the automatic adjustment formula.

As regards depreciation, the second witness I will call is Mr. Jacob Pous, who is a principal of the firm, Diversified Utility Consultants in Austin, Texas. He's a professional engineer and has participated in well over 400 utility rate proceedings in both the United States and Canada. He's also completed a series of programs in relation to depreciation and has testified extensively on matters of depreciation amongst other utility issues. He's testified on behalf of the staff of five State regulatory commissions and one Canadian utility regulator. Mr. Pous was retained by the Consumer Advocate to address the level of depreciation expense and rates



proposed by Newfoundland Power based on its 2010 Gannett Fleming depreciation study filed as part of this General Rate Application. In the first place, Mr. Pous will challenge the company's depreciation witnesses, average service lives in relation to several categories of property and assets of Newfoundland Power and he also challenges the company's Equal Life Group calculation procedure in favour of the average life group procedure that is in wide use in both Canada and in the United States in the utility context.

To conclude, Mr. Chairman and Commissioners, we look forward to representing the customers of Newfoundland Power in this rate proceeding and to getting on with the hearing. Thank you very much.

CHAIRMAN:

Q. Back to you, sir.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman. The next witness, or the first witness will be Mr. Earl Ludlow. The witness is ready to be sworn, Mr. Chairman.



MR. EARL LUDLOW, SWORN, EXAMINATION-IN-CHIEF BY IAN KELLY, Q.C.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman. Good morning, Mr. Ludlow. You are the president and chief executive officer of Newfoundland Power?

MR. LUDLOW:

A. Yes, that's correct.

KELLY, Q.C.:

Q. And you will introduce this General Rate Application on behalf of the company. Do you adopt Section 1, the introduction, as your testimony?

MR. LUDLOW:

A. Yes, I do.

KELLY, Q.C.:

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

MR. LUDLOW:

A. No.

KELLY, Q.C.:

Q. First of all, how long have you been the president and CEO of Newfoundland Power?

MR. LUDLOW:



A. Since 2007 and I've also served as a director of Maritime Electric Company and also Fortis Ontario, and prior to 2007, I held senior positions in Fortis Utilities in Prince Edward Island, Alberta and British Columbia.

KELLY, Q.C.:

Q. Mr. Ludlow, in this application, Newfoundland Power is proposing an average rate increase of approximately 6 percent. Would you explain to the Board the key drivers for this increase?

MR. LUDLOW:

A. Yes. As you indicated, Newfoundland Power is requesting a 6 percent average increase in customer rates. If we look at Exhibit EAL-1 -

KELLY, Q.C.:

Q. And that can perhaps be marked, Mr. Chairman, for the record. Thank you.

MR. LUDLOW:

A. - you'll see that there are three principal components of this increase. Rebalancing of the 2013-2014 energy supply costs accounts for approximately 2.6 percent. As you indicated in your opening comments, these costs would have been recovered to the energy supply cost variance mechanism if there had not been a

Page 25

general rate application.

As second part of the increase relates to the return on equity. The application proposes a return -- a rate of return of 10. 4 percent. Current electricity rates reflect a return on equity of 8.38 percent. This difference accounts for approximately 1. 8 percent of the increase in customer rates.

A third component, 1.6 percent, represents all the other costs. Changes in operating costs do not play a large part in this rate increase, especially bearing in mind the significant cost pressures in the Newfoundland economy. This demonstrates to me the efficient nature of our operations at Newfoundland Power.

So this proceeding is really about the appropriate return for Newfoundland Power and a relatively small increase in other costs.

Our residential customers will experience a somewhat larger rate increase at 7. 2 percent. The increase for our smallest general service customers will only be 0. 6 percent. These changes correct long standing cost recovery issues and ensures that all

Page 26

customers bear an equitable share of the cost of service.

KELLY, Q.C.:

Q. Next, would you give us a brief overview of Newfoundland Power's current operations?

MR. LUDLOW:

A. Certainly. Our operational focus at Newfoundland Power has two main components: operational efficiency and customer responsiveness. I believe our operations are efficient and well managed. The assets that make up our electrical system are in reasonably good condition. Currently, our operations provide reliable, electrical service to our customers, so our system operations are in good shape.

Our customer satisfaction remains high. We continue to adapt to changes in our customer service expectations. A good example of this is the expanded customer energy conservation portfolio. Customers are looking for ways to save energy and lower their electricity bills. Our response increase our costs but reduces our customers' bills and reduces oil consumed at Holyrood. So I

Page 27

believe we're doing a reasonable job with meeting our customers' expectations.

Our workforce is a key factor in maintaining operational efficiency and customer responsiveness. We are managing our workforce to ensure that we provide safe, reliable service, not only today but into the future. As you know, skilled workers are in high demand in today's economy. We have increased our recruitment and training to ensure that we have the ability to provide efficient and reliable service for our customers.

So, I think we're focused on the right things. The things that provide least cost reliable service to our customers.

KELLY, Q.C.:

Q. You've indicated that Newfoundland Power's rate of return on equity is one component of the proposed increase. Can you place this aspect of the application in context for us?

MR. LUDLOW:

A. Yes, I can. In the company's last General Rate Application in 2009, Newfoundland Power sought a higher return than the approximately

Page 28

7.5 percent indicated by the formula. The company also sought suspension of the formula. The Board ruled that a 9 percent return on equity was reasonable and that the formula should continue in use. For 2011, the formula reduced our return on equity to 8.38 percent, which I understand was the lowest allowed return for an investor owned utility in North America. For 2012, the formula indicated a further reduction in the company's return on equity to 7.85 percent.

(10:15 a.m.)

Now in late 2011, the company applied to suspend operation of the formula for 2012 and following a further application, Newfoundland Power's 2012 return on equity was set at 8.8 percent.

In this application, Newfoundland Power is again requesting that the Board establish a fair return on equity for 2013 and 2014 and discontinue the use of the formula.

KELLY, Q.C.:

Q. In Newfoundland Power's last rate order from the Board, the Board concluded that Newfoundland Power continues to be an average

Page 29

risk Canadian utility. How do you see Newfoundland Power's current risk profile?

MR. LUDLOW:

A. I believe Newfoundland Power's risk profile is substantially the same as it was in 2009. We face some unique challenges. We are a small utility. We operate in an isolated system in a harsh weather environment and the demographics of our service territory are changing. Our operational challenges may be greater than that of many other Canadian utilities. As this Board has observed in the past, these challenges are offset by our strong capital structure. We also have a generally supportive regulatory environment similar to other utilities in Canada. So, on balance, we still consider our self an average risk utility.

KELLY, Q.C.:

Q. Would you comment on Newfoundland Power's relative operational risks?

MR. LUDLOW:

A. As I've indicated earlier, I've served as a director or officer of Fortis utilities in four provinces, in addition to Newfoundland

Page 30

and Labrador. Newfoundland Power certainly has the most difficult weather conditions and today being no exception, I might add, Mr. Chairman. Of any of the five provinces I've had the privilege of working in, Newfoundland and Labrador has the most severe wind and ice conditions in populated regions of Canada. Maintaining reliable service in these conditions is a particular concern since so many of our customers rely on electric heat to heat their homes.

Newfoundland Power has the most challenging customer demographics I've encountered. Newfoundland and Labrador is the only Canadian province in which population has declined over the past two decades. It is also the only Canadian province in which population is forecast to decline over the next two decades. And in addition, Newfoundland and Labrador has one of the most rapidly aging populations in Canada. The movement of population from rural Newfoundland to urban centres requires that we maintain service in rural communities while at the same time providing for growth elsewhere. We have

Page 31

an aging workforce at a time when skilled workers are in high demand in other sectors of this economy.

In the coming years, our customers will face higher costs due to increases in Newfoundland Power's purchase power expense as a result of the Labrador infeed, the retirement of Holyrood and other capital expenditures by Hydro. Those cost changes will pose challenges for Newfoundland Power.

KELLY, Q.C.:

Q. Would you comment on the regulatory support in this jurisdiction?

MR. LUDLOW:

A. Newfoundland Power has reasonable regulatory support. However, this is not out of step with the rest of the country. All distribution utilities I have worked with have full supply cost recovery flow-through mechanisms through regulatory mechanisms. It is also common to have regulatory mechanisms which permit recovery of future benefit costs. It is not unusual for there to be differences in details from province to province. For example, I know from my experience as an

Page 32

officer of Fortis Alberta that storm damage exceeding $100,000 was automatically deferred for future recovery. By comparison, the increased operating costs for Newfoundland Power of approximately 1.8 million dollars resulting from Hurricane Igor in 2010 were never the subject of a deferral application.

But Newfoundland Power also has some relative strengths, including its stronger capital structure which contribute to it being an average risk utility on an overall basis.

KELLY, Q.C.:

Q. Why is a cost of capital important for Newfoundland Power's customers?

MR. LUDLOW:

A. Newfoundland Power is first and foremost a service company. Our primary obligation is to provide safe, reliable, least cost service to our customers. Our ability to provide service to our customers depends upon continued investment in long-life utility assets. The money or capital required to fund this continuing investment is a key aspect of Newfoundland Power's provision of safe, reliable service to our customers.

The capital to fund this investment comes from debt and equity markets. The annual cost of that capital is a substantial component of the price our customers must pay for the service we provide. So cost of capital is important for Newfoundland Power's customers because it is fundamental to the reliability of the service they receive and the price they must pay for that service. The return on equity must be fair to Newfoundland Power and also to its customers.

KELLY, Q.C.:

Q. Why does fairness matter?

MR. LUDLOW:

A. Equity investors in a regulated utility expect a fair return. Equity investors commit capital to fund long-lived utility assets which typically are in service for decades. This capital is essentially captive. In my experience, there are relatively few differences among electric utility operations. For example, an electricity utility pole installed in British Columbia would not be materially different than one installed right here in Newfoundland and Labrador. Capital



markets are not provincial. There isn't a Newfoundland and Labrador capital market and a British Columbia capital market.

Now in this proceeding, we have filed the expert opinions of Ms. Kathleen McShane and Dr. James Vanderweide. These experts indicate that a fair return on equity for Newfoundland Power is in the order of 10.4 to 10.5 percent.

KELLY, Q.C.:

Q. What are the implications of not having a fair allowed return on equity?

MR. LUDLOW:

A. Newfoundland Power's management has an obligation to maintain the company's financial integrity. This is consistent with least cost delivery of safe, reliable service to our customers over the long term. Maintaining Newfoundland Power's financial integrity requires it to achieve a fair and reasonable return on common equity and equity investors expect to earn a fair return. So, as CEO, I have an obligation to both our customers and to our equity investors to try to achieve an appropriate return. If Newfoundland Power is not allowed the opportunity to earn a just and



reasonable return on equity, then management would be in the difficult position to having to consider reducing other costs. Reductions in costs might not have an immediate impact on service levels. However, the need to earn a fair return could eventually result in deterioration of the service provided by Newfoundland Power to its customers.

KELLY, Q.C.:

Q. Can you give us an example of that, of how the need to earn a fair return can have a long term impact on service?

MR. LUDLOW:

A. Yes, I can. In the early 1990s, following the fisheries moratorium, economic conditions resulted in Newfoundland Power cutting its annual capital investment by as much as half. This was done to ensure the continued financial integrity of Newfoundland Power in difficult economic conditions. These capital cost reductions did not have an immediate impact on the service received by our customers. However, the cost reductions did have longer term impacts on reliability of service. By 1998, a review of the company's



quality of service and reliability of supply by the Board's engineering consultant indicated that it was important that the company seek to improve its reliability performance. So in the early 1990s, Newfoundland Power reduced its cost to ensure its financial integrity. This didn't impact service to customers immediately. However, within five years or so, these cost reductions had clearly impacted the service provided to the company's customers.

KELLY, Q.C.:

Q. Could that logic apply today?

MR. LUDLOW:

A. Yes, it could. Currently, Newfoundland Power has increased its recruitment of skilled and technical labour to address workforce demographics. These efforts, which are aimed at maintaining customer service levels over the long term, tend to increase the company's costs. If Newfoundland Power were to curtail these increased recruitment efforts to maintain the company's financial integrity in the short term, there may not be an immediate impact on the service received by our customers. However, such cost reductions could certainly have negative impacts on the service received by our customers in the future. The point here is a simple one. Newfoundland Power's operations are focused on long term, sustainable improvement in service to customers while earning a reasonable return. It's a balance and establishing rate making returns that are too low can affect that balance.

KELLY, Q.C.:

Q. Does Newfoundland Power believe that those kind of steps would be necessary?

MR. LUDLOW:

A. No, we do not. The Public Utilities Act provides that Newfoundland Power is entitled to the opportunity to earn a just and reasonable return each year in addition to its reasonable costs. This entitlement reflects the essential balance between the competing interests of utility investors and customers. In Newfoundland Power's view, the balance of these competing interests should not include placing the management of Newfoundland Power in a position where it has to choose between



reducing either its service levels or its financial integrity. Either choice would be inconsistent with the power policy of this province.

KELLY, Q.C.:

Q. Mr. Ludlow, Newfoundland Power, in this proceeding, has again proposed discontinuing the use of the automatic adjustment formula. Why has the company adopted that position?

MR. LUDLOW:

A. The purpose of the formula was to reduce hearings, increase regulatory efficiency and reduce costs. It largely fulfilled that function until 2008. Since then, it has not. Everyone seems to agree that since 2008, capital markets have not been normal and everyone seems to agree that they're still not normal today in 2013. Since the last hearing, the formula has added to the regulatory complexity, not lessened it. In 2012, the company had to go through a regulatory process because the formula did not yield a reasonable result. For a small utility like Newfoundland Power, these processes take time away from the critical job of running the company. I don't



have any confidence that anyone has proposed a better formula that will give reliable and reasonable results in current market conditions. Ms. Perry will address that point as we follow through in different parts of this proceeding. From my perspective, the better approach is to leave the question of a formula for another day. There is currently no consensus among regulators as to whether a formula should be used. The Board can revisit this issue at a future time when financial market conditions return to normal and a regulatory consensus emerges.

KELLY, Q.C.:

Q. Mr. Ludlow, the next issue I want to turn to is depreciation. The Consumer Advocate has raised some issues concerning depreciation in this proceeding. Can you give us your views on depreciation?

MR. LUDLOW:

A. I view this discussion very simply. If you reduce depreciation, the rate base grows. The return on rate base is a cost to our customer. Increasing the rate base adds to our customers' costs over the long term. Yes, you



can get a short term reduction today by reducing depreciation, but it comes at the price of higher rates tomorrow and on into the future. So I do not believe these changes are in our customers' best interest. The Board examined this issue many years ago and adopted the current ELG depreciation methodology. From everything I've seen, that seems to be the best approach. It best matches the expenses with the life of the asset. Our rate base would be significant higher if we had stayed on the ALG methodology and our customers would be paying approximately 3.7 million dollars in higher electricity rates today. So I think it's very clear that the Board made the right decision in adopting ELG. I see no reason to depart from a policy that has proven to be in the long term interest of our customers.

KELLY, Q.C.:

Q. Mr. Ludlow, does that conclude your testimony?

MR. LUDLOW:

A. Yes, it does.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman.

CHAIRMAN:
Q. Mr. Johnson.
(10:30 a.m.)
MR. EARL LUDLOW, CROSS-EXAMINATION BY MR. THOMAS JOHNSON
MR. JOHNSON:
Q. Good morning, Mr. Ludlow, again.
MR. LUDLOW:
A. Good morning.
MR. JOHNSON:
Q. You talked in your direct with Mr. Kelly about Newfoundland Power's returns over the last few years since the rate case, but I take it that you would confirm, Mr. Ludlow, would you not, that Newfoundland Power itself believes that its financial performance since the last general rate application through to 2012 has been absolutely consistent with the company's financial integrity, correct?
MR. LUDLOW:
A. I would agree, Mr. Chairman, that we have performed very well in the past two or three years and it has not had any negative impact on the financial integrity of the company.
MR. JOHNSON:
Q. And 2012 similarly, 2012 was a good year for



Newfoundland Power in terms of its results?
MR. LUDLOW:
A. Well, the books aren't closed on that one yet, Mr. Chairman.
MR. JOHNSON:
Q. In terms of what you're predicting or estimating, you're estimating, as I understand it from Exhibit 3, which is in your Volume 2, and referring to line 28, Mr. Ludlow, that you are forecasting -- and this has not been changed -- forecasting net income of north of 36 and a half million dollars for 2012. That's correct, right?
MR. LUDLOW:
A. That's correct. That's our forecast.
MR. JOHNSON:
Q. Okay. And in line 35, you're forecasting making a regulated return on book equity of 8.81 percent for 2012?
MR. LUDLOW:
A. That's our forecast, yes, that's correct.
MR. JOHNSON:
Q. And as you admitted, that financial performance, just like all the other years since your last GRA, would be consistent with



Newfoundland Power's financial integrity. Now, let us examine for a moment how much profit Newfoundland Power wishes to make from its customers in 2013 and 2014 by turning to Exhibit 6, line 25 in the 2013 proposed column. So you're proposing, are you not, that in 2013 that net income will go to 42.5 million dollars and in 2014, under the proposed column, go to 44 million dollars in 2014? That's correct, right?
MR. LUDLOW:
A. Those are the correct numbers according to the schedule, yes.
MR. JOHNSON:
Q. And then, as per line 32, that would be reflective of this Board allowing you a rate increase sufficient for Newfoundland Power to make a 10.4 percent return on its regulated equity, correct?
MR. LUDLOW:
A. That is correct.
MR. JOHNSON:
Q. And just to put the return on regulated -- the regulated return on common equity into some sort of perspective, could I ask you to turn



up the CA-NP-401?
MR. LUDLOW:
A. Just bear with me now. I'm going to use the paper, if you don't mind. 401?
MR. JOHNSON:
Q. Yes, sir. And I'm looking in particular at Table 2, Mr. Ludlow.
MR. LUDLOW:
A. Yes.
MR. JOHNSON:
Q. Which shows -- which focuses on the period over 2011 to 2012 forecast and then forecast for 2013 and 2014, right, and as between the difference between 2012 forecast and 2013 forecast, you're looking for a return in millions of dollars, an incremental return of 8.4 million dollars, right?
MR. LUDLOW:
A. That is according to Table 2, yes, that's correct.
MR. JOHNSON:
Q. And by percentage wise, that is what percentage greater than 2012 for 2013?
MR. LUDLOW:
A. According to the table, the third line?

MR. JOHNSON:
Q. Yes.
MR. LUDLOW:
A. Show 24.1 percent.
MR. JOHNSON:
Q. Greater than 2012?
MR. LUDLOW:
A. That's correct.
MR. JOHNSON:
Q. And just to be clear, 2011 when the company made -- just made slightly more than what you are projected to make in 2012, that was a fair return in 2011 and preserved the financial integrity of the company?
MR. LUDLOW:
A. 2011?
MR. JOHNSON:
Q. Yes.
MR. LUDLOW:
A. Our return, as stated, as I said earlier, was whatever I -- what we were saying earlier, it was reasonable at that point in time, yes.
MR. JOHNSON:
Q. Okay. And in 2014, you want more onto the -- in addition to, relative to 2013 forecast, you



want another 1.6 million dollars through 2014 to bring you up to about 45 million in net income or the regular return on common equity. Is that correct?
MR. LUDLOW:
A. According to the table, that is correct. Mr. Chairman, what I would say as well, is that -
MR. JOHNSON:
Q. That table, was that -
MR. LUDLOW:
A. Just as I said earlier, according to the table and what's been promoted, that is correct. The earnings that we have had during the past number of years, questionable whether we met them. It dealt with a lot of management and cost management within the business to perform and execute. As I said in my opening statement, this takes -- there's only so much room within the utility to work and that allowed return is key to giving us opportunity to work within that band to earn a reasonable return and what we have done here is we've promoted and come forward with cost of capital experts who are recommending a 10.4 percent and that's basically where we are, Mr.



Johnson.
MR. JOHNSON:
Q. And in fact, that 10.4 percent return, Mr. Ludlow, that would, would it not, put Newfoundland Power amongst the very highest in Canada in terms of its allowed return on equity, correct?
MR. LUDLOW:
A. As I've looked at the Canadian utilities, I think the range now would go to about 9.9 percent as to the highest in British Columbia, that is correct.
MR. JOHNSON:
Q. And that would be the highest that's known to you, but others are getting 8.7 -- other Fortis companies, I believe, are getting even lower than 8.7, are they not?
MR. LUDLOW:
A. Other companies are getting lower than 9, but at the same point, all companies are based on different characteristics of operating, business, regulatory and as well financial risk characteristics. What we have done on that point is again, we've engaged the expert witnesses of McShane and VanderWeide where



their expert testimony which you will hear hopefully next week, if we can get past this weekend, and that was the basis upon which we have engaged those experts.
MR. JOHNSON:
Q. So, just for the record, I know that's what Ms. McShane and Dr. VanderWeide have put forward which would put you at the highest, but is it your contention as the president and CEO of Newfoundland Power that you really need to be at the highest? I mean, do you personally believe that as president of the company?
MR. LUDLOW:
A. Mr. Chairman, I look at a lot of factors when we put a rate case together. We look at where we're going. We look at a whole bunch of factors, and as I said earlier, striking that balance is a key one to hit. So, I'm not a cost of capital expert, that I can assure you. So, we go out, we find the best we can find and we put those numbers together and we look at it and instead of me turning around and casting my wand over it, I don't like this or I don't like that, there's parts I do and

Page 49

there's parts I don't, we have accepted the expert testimony of McShane and VanderWeide and that's what we filed and that's what they will present here next week, and I'm sure that's what the debate will continue on. There's parts of this case I like and parts I don't like as well.

MR. JOHNSON:

Q. Pardon me?

MR. LUDLOW:

A. That's correct.

MR. JOHNSON:

Q. I didn't hear the last part. There's parts you -

MR. LUDLOW:

A. My point was, as we put this case together, there's a lot of debate in the case around operating expense and where we're moving and you know, when I look at this, I rely totally on my experts as I come forward with this number.

MR. JOHNSON:

Q. Did it surprise you at all that these two people that Newfoundland Power hired happen to pitch on the same number which would be well

Page 50

in excess of what the highest utility in the country is getting?

MR. LUDLOW:

A. No, not really. I think it's a matter of consistency. How an expert looks at something, I would be greatly concerned if they were multiple basis points apart. That's the way I'd look at experts. I look for consistency in where they're going.

MR. JOHNSON:

Q. I think as you acknowledged in your opening that the key issue in this case is the cost of equity issue and in the letter which accompanied your application to the Board, it was described as a central issue of the application, you'd agree with that, and yesterday I sent to you two documents and you'll recall that I did the same thing last time. I sent you your company's media release and I sent you, as well, the Power Connection document that you sent to customers in the month following the filing of the general rate application and if we could bring up the media release first.

MS. GLYNN:

Page 51

Q. Mr. Johnson, we need to enter that onto the record.

MR. JOHNSON:

Q. Oh, I'm sorry.

MS. GLYNN:

Q. That's fine. So we'll enter that as Information Item No. 1, please.

MR. JOHNSON:

Q. Thank you. You're familiar with this document, Mr. Ludlow?

MR. LUDLOW:

A. Yes, I am.

MR. JOHNSON:

Q. Okay. What was the purpose of this document?

MR. LUDLOW:

A. It's a media release that we issue to all media outlets in Newfoundland and Labrador announcing that we are filing or have filed a 2013 general rate application effective September the 4th as we were ordered to do by this Board, and it would lay out the various components of that.

MR. JOHNSON:

Q. And one thing that strikes me about your media release is that it -- you know, it talks to

Page 52

commitment of investing in rural areas. It talks to energy supply costs. It talks to the amount of money that's been invested over the past five years of 350 million, and you indicate "establishing a fair and reasonable future return on investment is another component of the rate increase." That's what's said in the release. So that's the sentence, is it, that is supposed to tell the media and customers what the central issue is to cost of equity? Is that where they're supposed to get this information from, that sentence?

MR. LUDLOW:

A. This media release panel was issued on the 14th to give the general public an overview of what had transpired when we filed a general rate application and as you read this application or this media release, it will show you the three key parts that are driven, and actually there's a fourth part that's highlighted very, very clearly here well about the additional increase to residential customers of this province. So it was brought down into the various areas of supply, return

Page 53

and also the other operating costs. Those that wish to have additional detail down to the decimal point or the levels, and I'm not demeaning your point there, there's a direct link for the full application on our website which is still there, still live.

MR. JOHNSON:

Q. Would you not at least concede that the -- there's no mention obviously of what the return on equity is and there's certainly no mention that it's going to put you at the highest in the country, correct?

MR. LUDLOW:

A. There is no mention of the number, but there is a mention here about establishing a fair and reasonable return, which is the central case or one of the key points of this hearing, one of the three.

MR. JOHNSON:

Q. Did you make it any clearer in your Power Connection? So maybe we could turn to the next document.

MS. GLYNN:

Q. And that would be entered as Information Item No. 2.

Page 54

(10:45 a.m.)

MR. JOHNSON:

Q. And this is a document dated October 2012 that was sent out to all your customers.

MR. LUDLOW:

A. Correct. This is an attachment, both electronically and paper, that we would have sent to all 250,000 customers.

MR. JOHNSON:

Q. And you'll confirm for me that there is no direct mention here at all to your customers of what your proposal is for the return for the company or the company's profit, right?

MR. LUDLOW:

A. I'm missing your point. Are you asking me if 10.4 is in here?

MR. JOHNSON:

Q. I'm asking you -- well, I'm asking you that question. It's not in there, is it?

MR. LUDLOW:

A. What's not in here?

MR. JOHNSON:

Q. Well, the 10.4.

MR. LUDLOW:

A. Fair and reasonable return is what we're

Page 55

talking about, which is similar to the media release.

MR. JOHNSON:

Q. Okay. So essentially, the customer who you communicated with in October is not really told anything different than what you sent out to the media previously in relation to what the central issue is in the case?

MR. LUDLOW:

A. Mr. Chairman, I'm going to take a little bit of different tact here than the Consumer Advocate is putting forward because as I look at that, I would agree to the fact that the actual number is not included into the Power Connection or into the media release. However, what we did decide, and there's a lot of thought goes into this, our customers are interested in price, rate increases. Do we go with the average or do we directly point out what are the impacts on the different rate classes? And that's what we sent to our customers here. We laid out the various proposals in the case. They will be argued and that's what we're here for today. But we felt that it was essential that we put out the

Page 56

impact that the bottom line on the bill of our customers will be highly clarified for them and that's what we put out here.

MR. JOHNSON:

Q. I'm not quibbling with the fact that you put the bottom line in there in terms of the customer impact. What I'm quibbling with is why in the world -- why in your covering letter to the Board, you say cost of equity is a central issue, but you don't say it to customers and you don't say it to the media? That's the simple question I have for you.

MR. LUDLOW:

A. But we have said just that, cost of equity and a fair return is a point of this and a central point of this hearing.

MR. JOHNSON:

Q. Now you made reference to the weather conditions of Newfoundland and Labrador and just to be clear, I understand that the events of 2010, when we had the storm -- there was two storms, was it not? There was an ice storm and then there was Igor?

MR. LUDLOW:

A. Correct. There was a March ice storm that

Page 57

impacted the Bonavista and probably the Bonavista North and as well down through Grate's Cove area and then September 21st, Hurricane Igor decided to bless us with its appearance.

MR. JOHNSON:

Q. Right, indeed. And the ice storm that we're talking about, that was the worst storm in 25 years, I take it. I think that's what your materials disclosed.

MR. LUDLOW:

A. The ice storm?

MR. JOHNSON:

Q. Yes.

MR. LUDLOW:

A. It may be. Every ice storm -- I just -- I don't know where that reference is. If you can show me, I'd appreciate it.

MR. JOHNSON:

Q. Okay. Maybe I'll come back to it.

MR. LUDLOW:

A. It was a bad ice storm.

MR. JOHNSON:

Q. Indeed. But in any event, it didn't keep Newfoundland Power from earning its allowed

Page 58

return, did it?

MR. LUDLOW:

A. Are you referring to the ice storm or both storms or the year?

MR. JOHNSON:

Q. Both storms. Let's say the ice storm and Igor.

MR. LUDLOW:

A. Okay. Take us back to 2010 for a minute. March ice storm, an ice storm by its very nature -- and again, I'm hoping this is not what's going to happen this weekend, but we'll see what happens. An ice storm by its nature has a tendency to be capital intensive, broken poles, that type of damage, whereas in a hurricane and a wind storm, combined with rain that hit with Igor -- and Igor by far was one of the worst storms we've had in multiple decades -- has a tendency to more drive towards the operating conditions of the company, trees, vegetation, response, those types of things, downed wires. So March, there was a subsequent capital adjustment made and there was some operating conditions or operating funds off that. The details of

Page 59

that, by the way, Mr. Smith will be more than happy to take you through. As we went through Igor, as I said in my chief, we were looking at a five-day period from Tuesday to Saturday and just that area alone cost an additional, I would suggest in the range of 1.8 million operating dollars.

So, we're now at September. What have we got left? We're running in this year, sales were in decent shape. We've also got four months to readjust and manage and bring in this company at a reasonable financial condition. So what we decided to do is rather than come before this Board for a deferral, we said: look, we're in such condition, we can try it. It means that some work will not get done because of sheer resource limitations, both capital and operating. Can we push, can we push for three or four months? So that's what we did and we pushed them over into another year. We took the 1.8 and basically took it on rather than coming before this Board. And that's the basis. It's a combination of good luck, good management -- and by the way, I'd put the management of that

Page 60

storm against anyone. We were there before the military showed up, I might add, Mr. Chairman, and we were complete the day they showed up. That's what we're here for, is to keep those lights running. By the time we got past that Saturday, we then started to kick in gear and say: how do we do this without additional cost onto the customer? That's how we managed it. That's how we got through 2010.

MR. JOHNSON:

Q. And so to answer my question, you made your allowed return in 2010?

MR. LUDLOW:

A. We did so.

MR. JOHNSON:

Q. Notwithstanding an event that happened late in 2010 that you didn't plan for?

MR. LUDLOW:

A. It happened in September. Had that been in December, it would be a different story.

MR. JOHNSON:

Q. But you don't expect tropical storms in December, which are more operating intensive, I guess.

MR. LUDLOW:
A. Mr. Chair, the way the weather conditions here are changing and continue to change, I don't know what to expect any more, and you know, like today, this has a tendency, this could blow up into ice, wind, snow. I can handle wind. I can handle snow. I just can't handle ice and wind and that's the difference that happens. September is a key in Igor. Time to react.
MR. JOHNSON:
Q. And I guess, you know, the tropical storms, they happen up and down the Eastern Seaboard. They hit Nova Scotia. They hit PEI. They hit a lot of different places, those tropical storms, don't they?
MR. LUDLOW:
A. We've had ten. In 2010 we had one. We had Hurricane Earl by the way. I don't take much pleasure in that one, I might add, Mr. Chairman, but it blew up and blew up through the west coast of Newfoundland. We had another one came in on the same day and time and fizzled out in Trepassey. So its becoming a regular occurrence these days.



MR. JOHNSON:
Q. I hope Earl doesn't fizzle out.
CHAIRMAN:
Q. You mean more hurricanes are becoming a regular -
MR. LUDLOW:
A. Seems to be moving that way. In the last five years, we've had substantive weather patterns, particularly in September.
MR. JOHNSON:
Q. But they're not unique to Newfoundland?
MR. LUDLOW:
A. I agree with you.
MR. JOHNSON:
Q. Right.
CHAIRMAN:
Q. But evidence worldwide, that's not the case. I'm not going to argue here with you guys, but -
MR. LUDLOW:
A. Certainly it seems to be what's happening in this area, but I would agree it is not unique to Newfoundland.
CHAIRMAN:
Q. The hurricane intensification in the United



States is there's been no change over the past 80 years.
MR. LUDLOW:
A. I can't quite go back that far, Mr. Chairman, but I can go back 35 and I've seen more hurricanes in the last ten than I did in the previous 20.
CHAIRMAN:
Q. I'll send you an e-mail.
MR. JOHNSON:
Q. I just want to move off and perhaps we'll revisit some other areas after the break, but just to start a new theme for a moment. I want to bring you to CA-NP-440.
MR. LUDLOW:
A. Yes.
MR. JOHNSON:
Q. And I raise this in connection with the incentive targets. This obviously shows the 2012 salary policy and incentive targets for the executives and managers, right?
MR. LUDLOW:
A. That is correct.
MR. JOHNSON:
Q. Okay. And in addition to the base salaries



that we're seeing there for yourself and executives and managers, there's obviously a column there that allows incentive pay on top of that. So in your case, it would be 50 percent of your base salary of 400 and so you could get another 200 by incentive pay, correct?
MR. LUDLOW:
A. Not 100 percent correct. Basically, the incentive target is 50 percent. There is a band around that that could increase above the 50 percent, but there's only 50 percent in rates to the customer.
MR. JOHNSON:
Q. Okay. Now these incentive target amounts for executives and managers, these require, do they not, the meeting of both individual targets as well as corporate targets, right?
MR. LUDLOW:
A. That is correct.
MR. JOHNSON:
Q. Okay. So not only does the company have to perform, but the individual executives have to achieve a certain performance as well. Now, by my calculation, and you can take this

Page 65

subject to check, I know you don't have a calculator and I don't want you to do that, but by my calculation, just to know what we're talking about, if 100 percent of the corporate and individual targets are met, then a total of $474,000 in incentive target payments will be paid to the executive members in 2012. Do you accept that, for argument purposes? And if I'm wrong that can be corrected on the record.

MR. LUDLOW:

A. I have no idea where your calculation -- show me how -- tell me how you're doing your calculation and I'll agree with your methodology.

MR. JOHNSON:

Q. I'm taking the base salaries and then I'm taking the incentive target percentages in the right-hand column and then I'm adding those up to come to about 474.

MR. LUDLOW:

A. I'll agree with the methodology.

MR. JOHNSON:

Q. And similar methodology is applied when I look at the managers and as a group, again subject

Page 66

to check, when I do that, I come to $200,970. Now if we look for a moment at 449, what we have here is a table from 2004 to 2011 which sets out the non-regulated STI payouts. Now the non-regulated, so that would mean if you -- if the company and the executives went above target, the shareholder picks up those costs and pays it, not the rate holder -- not the rate payer, right?

MR. LUDLOW:

A. Correct.

MR. JOHNSON:

Q. Okay. And if we look at that period, I guess we can deduce that over that period, the president, yourself -- well, and your predecessor, and at least some of the vice-presidents and at least some of the managers obtained STI payments in excess of 100 percent that the customer pays for, right?

MR. LUDLOW:

A. Make sure I've got your point. Would you repeat it, please?

MR. JOHNSON:

Q. Sure. By merit of the fact that we know that over those years there were non-regulated

Page 67

payouts to the president, the vice-presidents and the managers, we know that more than 100 percent target is met, correct?

MR. LUDLOW:

A. Correct.

MR. JOHNSON:

Q. Okay. Now and we are in agreement that in forecast years 2013 and 2014 that it's reasonable to expect that at least 100 percent of the targets will be achieved and in fact, your GRA filing is premised on 100 percent being met for the company and the executives and managers. Is that correct?

MR. LUDLOW:

A. That's correct.

(10:45 a.m.)

MR. JOHNSON:

Q. In terms of the revenue requirement?

MR. LUDLOW:

A. Okay.

MR. JOHNSON:

Q. And we know, we alluded to the fact that anything over 100 percent, that's non-regulated and the Board has said anything over 100, that's non-regulated. We understand that

Page 68

from P.U. 19, right, (2003).

MR. LUDLOW:

A. Yes.

MR. JOHNSON:

Q. Not necessarily -- okay. Now if I could just go to the corporate targets for a moment by bringing you back to 443, Mr. Ludlow, and in particular, page three of four. And I just want to look at Table -- Table 5 has to do with the corporate targets for 2012, okay. So we see the category of reliability and there is a specific measure that's required to be met for SAIDI at 2.58 and that's given a 15 percent weighting and we see customer satisfaction which has two measures, being percentage of customer satisfied first call resolution, that's given a weighting of 7. 5 percent each, and then we have safety, the all injury frequency rate which again we have to meet 1.56 incidents for number and it's 15 percent weighting, and then financial as a total is controllable operating cost per customer which is given a 20 percent weight and then earnings which is given a 35 percent weight. So out of the corporate targets for

2012, the earnings get the biggest weight, right?
MR. LUDLOW:
A. The earnings receives 35. Financial receive 55. That point I would agree.
MR. JOHNSON:
Q. Yes, the 55 includes the 20 for controllable operating.
MR. LUDLOW:
A. Financial.
MR. JOHNSON:
Q. Understand, okay. And that's pretty much in line with how the targets have operated over the last number of years?
MR. LUDLOW:
A. Pretty much, yes.
MR. JOHNSON:
Q. Yeah, okay. So then so assuming that these corporate targets are met, I'd like to look at the individual targets of the executive members and managers. So if we could go to the personal targets at 451? And in particular, we see at Table 1, this is the target percentage payouts, we see for the president and CEO, the previous target was 40



percent while the current target is 50 and everybody has gone up from the previous target to the current target. So we understand that. And in Table 2, we see that for the president and CEO, your corporate weighting was 75 percent and your individual was 25 and that has had a slight change too. Can you explain why that change took place?
MR. LUDLOW:
A. Okay. Are you asking me to explain both changes or the second change?
MR. JOHNSON:
Q. The second change.
MR. LUDLOW:
A. Okay. Second change from the split between corporate and personal, it was done as a result -- let me explain the way it would operate, first of all. For any change to be made to this STI program, it's through our Board of Directors upon recommendation from our governance and HR committee. That would go -- this one in particular would be a recommendation from me to the Board, to the Committee, and if they're in agreement, they would take it forward. The way I look at this



is I'm running a fairly tight ship right now with three vice-presidents, down from numbers that were much higher in the past. So, I decided upon looking at incumbents, contribution and impact, to take a recommendation to the governance committee of reducing the personal component or the corporate component and raising the individual and bringing it on a 50/50 split for the vice-presidents and it was just a slight adjustment of five percent on mine from 75 to 70, 75/25 to 70/30. And it was based upon where we are, the basis of our operation, and the contributions that three versus I guess at one point in the past could be as high as six or seven executive members. So it was a personal thing, my professional judgment, that I decided to take that forward on that basis, Mr. Chairman.
MR. JOHNSON:
Q. Okay. And just -
MR. LUDLOW:
A. Would you like me to explain the top one?
MR. JOHNSON:
Q. Sure.



MR. LUDLOW:
A. I shouldn't be doing this, but I did it anyway. The top adjustment was made as a result of recommendation of the HAY consultant that we've been using now for 20 years to bring us in line with the compensation policy of the corporation, which is a 50th percentile of the Canadian industrial commercial, and it was felt that the change in targets should be made and that was a recommendation from HAY and he had also went through the corporate governance and subsequently to the Board of Directors.
MR. JOHNSON:
Q. Mr. Ludlow, if I could direct your attention to 443 once more, and into the -- well into the document, about 15 or 16 pages in, gives the 2012 short term incentive plan performance targets for yourself and the other members of the executive team, and indeed the managers.
MR. LUDLOW:
A. 2012?
MR. JOHNSON:
Q. Yes, sir. And just to look at your one for a moment, do we have yours up there? Yes. So

Page 73

as I understand it, in terms of the financial results, particularly tied to the earnings, the only executives whose results are tied to earnings on a personal basis would be yours and Ms. Perry's. Is that correct?
MR. LUDLOW:
A. Bear with me a minute. I haven't got them all committed to memory. That is correct.
MR. JOHNSON:
Q. Okay. And one of the corporate targets that we saw previously was the -- that fell under a financial target was controllable costs and there's nobody personally is impacted by the controllable costs other than through the corporate target?
MR. LUDLOW:
A. Not directly.
MR. JOHNSON:
Q. Not directly.
MR. LUDLOW:
A. But everyone inclusively.
MR. JOHNSON:
Q. Everyone inclusively by virtue of it being a corporate target?
MR. LUDLOW:

Page 74

A. Correct.
MR. JOHNSON:
Q. Okay. So you have an individual stake through the STI in the company's earnings, but you don't have an individual stake in the company's controllable costs and nor does Ms. Perry?
MR. LUDLOW:
A. I'm -
MR. JOHNSON:
Q. Let's put it this way -
MR. LUDLOW:
A. I'm trying to answer your question and trying to be helpful here.
MR. JOHNSON:
Q. And I'm not putting it properly either, so I'll just back up.
MR. LUDLOW:
A. So we'll agree on that.
MR. JOHNSON:
Q. We'll agree on that. What I'm asking you is in relation to your short term incentive plan target, your individual targets, while it includes company earnings, does not include controllable cost?

Page 75

MR. LUDLOW:
A. Not directly. That is correct.
MR. JOHNSON:
Q. Okay. And in terms of the managers, they have a stake as well by virtue of the corporate target in the company's earnings as well, right?
MR. LUDLOW:
A. Yes, they would.
MR. JOHNSON:
Q. Yes, okay. And I guess, Mr. Ludlow, to come to the point, when we consider the matter of earnings in the company and so for instance, for 2012, if we look at yours, to achieve the 100 percent payout for financial results, it says subjective with minimum earnings of 31.5 million and what does the subjective mean?
MR. LUDLOW:
A. The way that this would be presented to our governance committee is we would look at the year and if it was just a slam dunk that 31. 5 million fell out without effort, this combines personal contribution. It involves what we've had to do. If I want to go to Igor, let's go back there on the topic. Subjected in meeting earnings means that there was a lot of work had to be done to manage the organization for four to five years to readjust, rejiggle, do what we could to make things happen. So it's not just about a number falling out. It's about a reflection on the year. It's about the effort and it's about did this group perform the way they should have been performing to get that number, not just happenstance.
MR. JOHNSON:
Q. But if it's expressed as a minimum, can't you say well, look, gee, I met the minimum?
MR. LUDLOW:
A. You can say a lot of stuff, Mr. Johnson, but I'm going to tell you something, that when this is presented and I have to debate on behalf of Ms. Perry or Mr. Alteen or Mr. Smith, I can assure you when I look at this, the fact that it's 31 don't automatically mean they get it. It means that without it they won't get it.
MR. JOHNSON:
Q. But in point of fact, say for 2013 and 2014, you are assuming, for the purposes of your



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Page 77

revenue requirement, that that target is met, are you not?
MR. LUDLOW:
A. When we prepared the rate filing, the revenue requirement, we had to have a basis and 100 percent is target. It's not over the target or under the target. It should be reasonably attainable. And that's the basis upon which we decided to include in our revenue requirement the 100 percent STI payment for the executives and managers of Newfoundland Power. So we put the 100 percent in and that's the basis of it.
MR. JOHNSON:
Q. So if anybody is wondering whether their rates in 2013 and 2014 would reflect, for instance, yourself and Ms. Perry -- not to pick on you, but you're the two individuals -
MR. LUDLOW:
A. Okay, I'm used to that.
MR. JOHNSON:
Q. - are going to achieve that target, the answer would be yes, that they can assume that because that's what the revenue requirement is based on?

Page 78

MR. LUDLOW:
A. I'll take a little exception to that. I would agree on the basis that it is what the revenue requirement is based on. Everyone is entitled to draw their own assumptions. The fact that it's in there don't mean that it will be paid. That I can assure you.
MR. JOHNSON:
Q. Now as between the shareholders and the customers, I take it it's a truism that shareholders are the ones with the primary -- are the primary -
CHAIRMAN:
Q. Mr. Johnson, just -- are you going to be going on much longer?
MR. JOHNSON:
Q. No, I'm wrapping up.
CHAIRMAN:
Q. Okay.
MR. JOHNSON:
Q. I'm going to be wrapping up in about five minutes on this one.
CHAIRMAN:
Q. Okay.
MR. JOHNSON:

Page 79

Q. I'm easy to break as well.
CHAIRMAN:
Q. Let's break.
MR. JOHNSON:
Q. Okay.
MS. GLYNN:
Q. We'll come back in?
CHAIRMAN:
Q. How long have we got?
MS. GLYNN:
Q. Half an hour.
CHAIRMAN:
Q. Half an hour.
(11:15 a.m.)
(BREAK)
(11:47 a.m.)
CHAIRMAN:
Q. I think we're back to you, Mr. Johnson.
MR. JOHNSON:
Q. Thank you, Mr. Chairman. Mr. Ludlow, in terms of the earnings of Newfoundland Power, the primary beneficiary of the earnings is the shareholders of Newfoundland Power, not the customer. Would you grant me that?
A. No, I would not agree to that statement, Mr.

Page 80

Chairman. I think there's a balance that needs to be struck, particularly in the earnings, financial integrity. If we want to take that and go to the operating conditions that needs a focus to be brought, so I think overall there is a balance in there.
Q. I thought the question was very - called for a very obvious reply, Mr. Ludlow, that shareholder profit, that which turns into dividends to go back to shareholders, while there may be some aspect of benefit to customer in some sense, the primary beneficiary of the earnings is that of the shareholder, is it not?
A. There's no question that the financial integrity or the earnings of the company go back to the - obviously, the common equity shareholders, yes, but in getting that and creating that earnings is a separate issue.
Q. Yeah, but the primary beneficiary of the earnings would be the shareholders?
A. The dollars, yes.
Q. Yes, and I guess then you would have an incentive, your executive team would have an incentive to make the company's earnings as


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Page 81

high as possible, right?
A. We would look at maximizing earnings in tandem with various other aspects of the company, and that includes customer service, reliability, safety, and all those factors and that's effectively what's built into the STI Program. To maximize earnings, I can crater either one or the two of the others, and that is unacceptable under any circumstances.
Q. But your - but the incentive, nevertheless, there is an incentive to make the company's earnings higher, not lower? That's very clear, right?
A. The earnings of the company as laid out in the STI is set based on the allowed earnings as laid out before this Board. The whole STI Program that we're discussing basically should ensure and will ensure earnings of a company - I'm not going to sit here and say we should not make money, we make money. We look after the customers of this company, we also do our best to keep the lights on under less than ideal circumstances. You put all that in the pot, sound financial management is core to running a solid business under any

Page 82

circumstances.
Q. And you've done all that without a 10.4 percent return over the last few years, correct?
A. We have not earned 10.4 percent in many years.
Q. And in terms of - just to get a sense of this, Mr. Ludlow, would you be able to provide us by way of an undertaking with what it would mean to yourselves and the executives and managers in terms of extra compensation if you were to be allowed the 10.4 percent return on equity by this Board? Would you provide that in an undertaking?
KELLY, Q.C.:
Q. We've answered numerous requests for information on the STI Program, all of which are based upon the company's application, which is 10.4 percent built into it. So I have no idea what precisely this request would be, so I'm not agreeing to an undertaking of that, especially when that 10.4 percent has been built into it. We've been through a rigorous program of answering RFI's on what the current application is. No, I do not accept the undertaking.

Page 83

MR. JOHNSON:
Q. This witness has testified that the executives have a stake in - and the managers have a stake in the earnings of the company, and he's testifying here that the Board has got to keep in mind some sort of balance, which I'm sure the Board will, but I think it's material to know what it means to this witness and to the executives and managers of Newfoundland Power in terms of their compensation if this Board were to accede to what Newfoundland Power is telling this Board it requires by way of a return on equity, which is 10.4 percent. I think it is a perfectly legitimate question.
KELLY, Q.C.:
Q. And that tells me nothing more, Mr. Chairman, than all the questions which have previously been asked, and if my friend is looking for some piece of information which he has not asked, which I can't figure from the question, then he should have put it in an RFI at the appropriate time. I do not accept the undertaking.
CHAIRMAN:
Q. I think you're asking a what if question, is

Page 84

that what you're saying, if the Board agrees to the 10.5 percent ROE, what does that mean to the compensation which will be paid to the executives of Newfoundland Power. That is your - that's the question?
MR. JOHNSON:
Q. That's the question.
CHAIRMAN:
Q. And you're not agreeing to answer that question?
KELLY, Q.C.:
Q. We have already answered a whole series of questions which effectively encompass that question, and if my friend was looking for something more -
CHAIRMAN:
Q. I think I'm going to turn it over to our solicitors to - do you have any insight into this?
GREENE, Q.C.:
Q. Yes, Mr. Chair. My name is Maureen Greene, and I am Board Hearing Counsel. I wasn't introduced before, but I believe most people in the room know who I am.
CHAIRMAN:

Q. That was grievous omission.
GREENE, Q.C.:
Q. As I said, I'm sure most people know who I am. With respect to the request, the request, and the objection, as I understand the request, the Chair has properly summarized what the information requested by the consumer advocate is. The objection, as I understand it from Mr. Kelly, is that it's too late, it should have been asked in an RFI process. I don't believe that particular question in that was asked in the RFI process, we cannot turn to the record and see if that particular piece of information isolated. I would point out for the Commissioners that from time to time during the hearing process it does arise that new information is requested and undertakings are given, so I don't - with respect to the objection that it's simply too late in the process, I would point out to the Commissioners that in the past it has been a common practice for undertakings to be provided for answers to questions that arise during cross-examination. So unless Mr. Kelly had some other basis for his objection-



KELLY, Q.C.:
Q. I do not agree that it is new information. That's the fundamental objection.
GREENE, Q.C.:
Q. Well, if that's the case, can you point to the RFI where that answer is.
KELLY, Q.C.:
Q. I can't point to the RFI because there's no precision in even what this undertaking is that we are being asked to answer. If my friend wants to put this forward, the first thing he should do is commit it to a specific written request as to what the undertaking is that he's looking for.
CHAIR:
Q. Presumably, Mr. Johnson is saying that if we allowed it, it would be an additional revenue stream, and you're saying that this revenue stream would fall directly to - all other considerations aside, it would fall to corporate compensation, is that what you're saying?
MR. JOHNSON:
Q. Yes.
CHAIRMAN:



Q. And you want to know what that amount is?
MR. JOHNSON:
Q. That's right.
KELLY, Q.C.:
Q. The revenue stream that's put forward already includes the 10.4 percent. That's already in the revenue stream. It's there. That's the problem I'm having. What is the question precisely?
MR. JOHNSON:
Q. Well, we could certainly get at the difference between what's currently there versus what the 10.4 would mean.
KELLY, Q.C.:
Q. Well, now we're asking another question. That's the problem I've got with this whole process. If you start giving loose undertakings, then the company is off trying to figure out what the heck the question means. So if my friend has a specific written question, he should put forward a specific written question that we can then take under advisement.
MR. JOHNSON:
Q. Mr. Chairman, if it will bring clarity to it,



I'd be happy to devise the question and present it to the Board for the Board's consideration.
GREENE, Q.C.:
Q. Mr. Chair, the consumer advocate has agreed to do that, and that is fine for moving this process forward, but again for the future part of the hearing, as long as the question is very clear, it has not been the practice in the past to require written questions before undertakings are given during the examination of witnesses, but we have agreed for this particular one to move forward in this way.
KELLY, Q.C.:
Q. I don't want to get into an argument with Board Hearing Counsel, but there have always been in terms of undertakings, Mr. Chairman, two factors. One, clarity is required, and two, necessity and reasonableness to assist the Board is required. So the simple basis which Ms. Greene may suggest that if a question is proposed, that some undertaking therefore automatically follows, I don't accept that proposition because that would turn hearings into endless undertakings which

is not appropriate, and that's never been the practice in the 15 odd years that I've been here. Now I don't wish to engage in argument on that. We can move forward.

GREENE, Q.C.:

Q. I don't either, and I don't want to delay the process. I do agree that obviously it has to be relevant to matters before the Board, and it also has to be a clear question. I think for the -

CHAIRMAN:

Q. I mean, it shouldn't be hard to generate a number with the - say, the current ROE, and assuming 10.5 or whatever it is, that number should be very - that shouldn't be hard to find that number. I think that's basically the number that Mr. Johnson is looking for.

KELLY, Q.C.:

Q. And is that for total executive compensation or -

CHAIRMAN:

Q. Well, you better ask him that. I'm just trying to -

KELLY, Q.C.:

Q. Well, that's my problem. That's why you got



to have clarity in the question. I think we should move on and have the question put into some written form.

MR. JOHNSON:

Q. I'll provide the clarity, Mr. Chairman.

CHAIRMAN:

Q. Okay.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman.

MR. JOHNSON:

Q. Mr. Ludlow, in terms of getting workers, skilled workers at Newfoundland Power, I take it that you have a full complement, you're content with the complement that you have in terms of your ability to attract the skilled workers that you need?

A. That's a very difficult question. It changes by the day, Mr. Chairman. Our complement, I think is changing a little bit as we go forward. Our ability to attract fully skilled workers has changed dramatically. Our approach to having future skilled workers has had to move from a hiring of, I'll use the PLT or mine person scenario, we can no longer attract Red Seal with full journeyman status.



We can get some, but not a lot. Now we're into the apprenticeship programs. So, you know, our complement is changing slightly because of workforce changes that's happened. The workload is changing as well in St. John's as it is coming down and up in other areas - up here, sorry, down in other areas. So overall our ability to look forward and to forecast, we're always at that on a regular basis.

Q. In terms of the challenges of obtaining skilled workers that everybody is finding, I guess that's a reflection of the economy. How would you describe the local economy, would you consider it strong from your perspective where you sit?

A. I would look at the Newfoundland economy in total as being strong in many pockets, and when I say that, I would say when I look at the developments in Labrador, Vale in Long Harbour, or Hebron, and the oil industry in general and you can see the bustle around the city here, but that's contrasted very heavily as you move into a lot of what I would call the smaller areas of this province. So the



economy of the province in total today is strong. In the foreseeable future, there will continue to be challenges.

(12:00 p.m.)

Q. In terms of - I guess, looking at it from the point of view of your customer growth since the last general rate application, how would you describe it?

A. Again, Mr. Chairman, I'd look at our customer growth - we look at gross. We use the term, gross new connections. What does that mean? That means the number of new houses, or I don't know, garages and things that have been hooked up. We've connected record numbers particularly in the St. John's, Avalon, and the major centres. Conversely, we have seen a retraction, not of numbers, but of sales in a lot of the rural areas. So it's - again I've used the balance on a couple of pieces. We're seeing this urbanization which is not unique to Newfoundland, but it's happening. We're also seeing an impact of new workers coming in. So right now that's where we're to. The economy in this local area is pretty hot right now.

Page 93

Q. And the workers coming in, what are you seeing in that regard? You mentioned you're seeing the workers coming in. On projects and things?
A. When I say I see them coming in, I'm reading newspapers, and seeing what I see in the local economy, it would be primarily the larger centres again, driven around major projects is what I'm hearing, and what I do envision or see, it's not that I can write numbers to it or quote actual details. There are some coming in, but as I look to 2017 to 2030 - now I rely pretty heavily again back on long haul forecasters, and even short to medium term forecasters. I can comment that the population is forecast to decline substantially by late 1920s - er, 1920s, you know, 2030, and combine that with the dynamics and the demographics within that population is changing a lot as well, both on shift and age. Huge things happening out there right now.
Q. In terms of the concentration of your reach for electricity into the market, it's basically around 9 out of 10 new construction go with electric for heat, I take it, and

Page 94

where is the other 1 out of the 10 ending up, on the oil furnace, wood stove in a new house - it's harder to think that they rely fully on that, but what are you - what's your sense of that?
A. My sense is that a lot of new homes are heading towards, unless it's - I'll use the term approximately 90 percent. The balance are still heading towards oil, some propane, still heading a little bit of wood/oil combinations is happening out there, and that's roughly how I would see it, Mr. Johnson.
Q. Your 90 percent, what are you counting as the 90 percent? In terms of the new customer, is that the customers who's relying on you for heating load?
A. When I look at new customers, when I say - I said earlier that we have roughly 5,000 plus gross new connections. In there you've got everything from garages, and there might be power supplied boxes for, I don't know, Rogers, Aliant, and what have you, but the majority of the homes would be relying on us for heating supply. There's no question about

Page 95

that.
Q. Just to clarify, that's the 90 percent?
A. Yes.
Q. All right. I want to ask you a question and this goes back to the introduction. Because cost of capital is so central here, Mr. Ludlow, as I pointed out in my introduction, the Board's comments from PU-43 where they talked about the fact that it's not enough that the chosen comparables be the best available - you heard that introduction, and they noted, you know, that nearly on every indicator the Board noted the overwhelming evidence of the lack of balance, as it was clear on almost every measure Newfoundland Power would have to be considered less risky than the US comparables. Can I ask you, you know, were you concerned, are you concerned as the CEO of Newfoundland Power by the Board's findings in that regard? Can you expand on that?
A. I don't have a whole lot that I can add to that commentary. You know, we took the Board's order, we look at it, we read it, and we apply it. There's not a lot of explanation

Page 96

or broadening that I can add at this point.
Q. Were any steps taken for the purpose of this rate application to ensure that the Board's concerns were addressed in relation to that key finding in its last decision?
A. Can you just explain that a little further, what the key finding and what your question is, please?
Q. Well, I view it as a pretty key finding that first of all it's not enough to just - it's not enough to say that the comparables are the best available, and that if the data is to be relied on, it must be shown to be a reasonable proxy or that reasonable adjustments can be made to account for the differences, and then the Board noted that the evidence showed that on balance the US comparables - on balance, the Board noted that the overwhelming evidence was of a lack of balance as it was clear on almost every measure Newfoundland Power would have to be considered less risky than the US comparables. So that was the chief concern, and my question, did you or your team take any steps to ensure that the Board's concern was met for the purpose of this rate application?

A. Mr. Chairman, the whole area of cost of capital and comparators is something that once we get into the details and what I would call the specifics of risk, in my opinion it would be much better dealt with with our expert evidence, experts when they come by. Similarly, Ms. Perry may be able to add some basis to this, but it would be much more helpful than what I can add to this discussion at this time.
Q. Well, are you aware of any instruction from either yourself or your executive team to cost of capital witnesses in terms of being responsive to what the Board's concerns were that I just addressed with you?
A. I did not instruct our expert witnesses to make change, pro or con, on any of the basis of numbers. We basically engage expert witnesses. They are provided with the information on our business and to put forward the testimony that you have seen here today.
Q. Would you believe, Mr. Ludlow, from sitting in the customer's perspective that it would be fair for Newfoundland Power for cost of capital purposes to compare itself to



companies that would on nearly every measure more risky than Newfoundland Power? Would that be fair to you?
A. Mr. Chairman, this is where I get a little confused. I have worked in a lot of businesses across this country, and in particular as I look at the Canadian environment, and I'll go there for a minute, we know where Newfoundland Power - we talked about business risk, regulatory risk, and we look at the financial risk. You put all that in a pot and I think it's been clear, clear from this Board that we remain an average regulatory risk - average risk utility. Now we can go out and we can look at other businesses, and I've work in them, and they will have pros and cons. Some will have, as I said earlier, a deferral account for storms. They will not have an excess earnings account. So it's not a matter of me sitting here and saying this one is better or less or up or down. What I'm saying is when we get to that average point, which I think is where we are - I mean, I can tell you I can pull out things that - look at the weather today, this is



reality, it's something I've got to deal with and I'm trying to stay focussed on what I'm doing here today while I'm wondering whether Burin is going to stay on tonight. That is a reality of my business. That operating conditions is key. So when I look at the various components of our business and a business risk profile, business risk regulatory and financial, yeah, I would put us in the average risk category. That's how I would see us.
Q. Okay, now if you could answer my question, and that would be do you believe it would be reasonable for Newfoundland Power to ask for a cost of capital in relation to companies that would be on nearly every measure more risk than Newfoundland Power? Would that be reasonable to you?
A. The premise for the question, I think would be better addressed to other individuals. From my perspective, I don't know all the pieces of all those other businesses. When we look at an average risk utility, then I would suggest if we're average risk, we should be treated as average risk. That's the way I would see it.



Q. So anything about these companies in your expert sample, essentially you have to rely totally on what your experts are telling you?
A. Mr. Chairman, we brought in expert witnesses for a reason. They are experts. I have not had the privilege of working with hundreds of different utilities or being around them. I know five. Now I can speak to that from a CEO perspective, a Senior Vice President's perspective, and a Vice President of Engineering and Operations. I look at the markets, I rely heavily on Ms. Perry, on her recommendations and where we are, and then we go and get experts in the field, and that's what we've done. That's what we will put before this Board and are doing in this hearing.
Q. The five companies that you know the most about are the companies that you've been associated with either as a Director or an Executive or worked for generally with Fortis, I take it?
A. Yes.
Q. And those companies would be what, Mr. Ludlow?

Page 101

A. They would be BC, Alberta, Ontario, Prince Edward Island. That's the four I would use.
Q. What BC one are you talking about?
A. I'm talking about the former West Kootenay Power, which is now Fortis BC Electric.
(12:15 p.m.)
Q. Okay, and how about Alberta? That would be Fortis Alberta?
A. That would be Fortis Alberta.
Q. And Ontario?
A. That would be Fortis Ontario.
Q. And PEI is the Maritime. Now you referred to financial risk. What do you mean by that, Mr. Ludlow?
A. Financial risk that I refer to would be the structure, the financial structure, debt equity structure of the business.
Q. And in terms of the debt equity structure of the business, what is the risk that you're referring to?
A. The risk I refer to is we currently would run on a 45/55 debt equity - equity debt split. So if that were to be reduced and we were to dividend out substantive funds and increase the debt equity ratio, now all of a sudden our

Page 102

fixed costs are implied. That basically is the financial risk area that I would look at, so the basis under which - the detail of that, Mr. Johnson, I think I would defer beyond that point to Ms. Perry.
Q. But generally, your understanding of financial risk would be the more debt and less equity in the capital structure, the more financial risk?
A. Correct.
Q. So on that measure, you would have less financial risk than any other Fortis company in the country, would you not?
A. I'm not certain I would go as far as to say that I have the less risk. I would suggest to you -
Q. Less financial risk?
A. I have 45 percent ratio, and as such we have strong regulatory support here in this province, and it's been reflective of the small size of our utility and that's been stated multiple times.
Q. But, Mr. Ludlow, I'm trying to focus on something. You mentioned financial risk and then you tied financial risk to the amount of

Page 103

equity in your capital structure, and I take it that you wouldn't disagree with me that a company that has higher common equity in its financial structure is seen to have less financial risk than one that has lower common equity in its financial structure? We don't disagree on that, do we?
A. I'm certainly not going to disagree, but what I am going to say to you is you posed the question, or the question was posed, Mr. Chair, that we are one of the highest in Canada.
Q. Well, let me put it this way. Your common equity component in your company's capital structure is the highest certainly of all the Fortis companies, is it not?
A. I don't know the details of all the Fortis companies, Mr. Chair. I really don't.
Q. Could I refer you to the MDNA of Fortis, which was filed as an information item, just so we can be confirmed on what the capital structures of the other Fortis companies are. That would be -

KELLY, Q.C.:
Q. Mr. Chairman, the witness has already

Page 104

indicated many of these questions would be better posed to Ms. Perry, and I notice that the document that the witness (sic) proposes now to put to Mr. Ludlow is one which was provided for Ms. Perry's examination. So I think we need to be fair to the witness as well.

MR. JOHNSON:
Q. The witness worked for these companies and he was a Director of all of them, would that be right?
A. My role was - that is not correct. I was the Vice President of Engineering for Fortis Alberta, Senior Vice President in British Columbia, and Vice President of Engineering and Operations for Maritime Electric.
Q. And you weren't a director of any of those companies?
A. I was a director of Maritime Electric, or am a director of Maritime Electric, and a director of Fortis Ontario.
Q. You would be aware, would you not, that Maritime Electric is 40 percent common equity?
A. I honestly don't know the number off the top. If you wish, we can get it, and I'm sure it's

in the somewhere. I just don't know what it is.
Q. Let's put it this way -
A. Sorry, as a director, Mr. Chair, I don't know all the - I can tell you the details and work with it, but I just don't have it at the top of my -
Q. Let's put it this way, if the record will disclose, okay, that Newfoundland Power has higher common equity in its capital structure than any other Fortis company in Canada, would that not mean that Newfoundland Power has less financial risk than any other Fortis company in Canada?
A. As I look at that question, on the surface I would be inclined to say yes, but before I'm too definitive on that, I do want the input of my CFO and that would be Ms. Perry, and that question would be better directed in that direction. On the surface, I would say, yes.
Q. You're saying yes to what?
A. Your question.
Q. So you're saying, yes, that Newfoundland Power would seem to have less financial risk than the others, correct?



A. Mr. Chairman, our equity stake is at 45 percent. We said we've had strong regulatory support on that side of the financial matrix. That's been very clear. I don't know what all the details are of the equity debt structure of all the companies that I work on or have worked on, or if they've changed. If the capital structure, the credit ratings and so on - I'm sure there are other items in there that has financial risk implications, but from my perspective, I would be willing to say that the equity component that we have in Newfoundland Power of 45 percent represents a strong regulatory support in this environment. Beyond that, I think our conversation would probably be much more articulated by my CFO, Ms. Perry.
Q. You cannot be - maybe you are saying this, that as the CEO of Newfoundland Power, and as a corporate director of one of the largest investor owned utility in Canada, that you cannot agree that if your company, in fact, has more common equity in its capital structure than another company, that that does not mean that your company has less financial



risk? Is that what you're saying?
A. Mr. Chairman, it sounds like I'm getting myself into an argument, and I don't mean to be, okay. I'm agreeing that we have a higher financial structure at the 45/55. If there are other implications within that financial risk, I just don't know what they are at this point in time. If it's based solely on capital structure, from where I sit, as I said earlier, we are high at 45, high being not relative to the others, but given the other parameters of us being a small utility, that I would agree. With respect to what else are in the financial risk categories, I don't know what they are and I'm not basically an expert to talk about them.
Q. Now you are aware, Mr. Ludlow, that - I'll ask you the question, I won't lead it. What company does Newfoundland Power consider in Canada that it's comparable to?
A. What company? Utility, I assume you're referring to.
Q. Yes, for cost of capital purposes.
A. That's an interesting question because as I look at it, I would have to look across all



the variables. I would put us in, as I said earlier, an average risk category, and what other ones fall in that average risk category remains to be seen. Again that's a debate you can have. I can talk through all those various risk areas of business and so on with you. To put a peg on it, I don't think I can actually give you a company that I can compare myself to.
Q. Could be bring up PUB-NP-014. In this question, Board staff asked, "How does the comparison of the allowed returns for other Canadian regulated utilities reconcile with the position that Newfoundland Power is an average risk utility", and the answer is, "Current allowed returns on equity for Canadian regulated electric utilities range from a low of 8.75 percent, Alberta Electric Utilities, to a high of 9.90 percent, Fortis BC. The utility with the current allowed return on equity of 9.9 percent is Fortis BC. Fortis BC appears to Newfoundland Power to be a comparable average risk utility". So does that refresh your thinking on the subject?
A. I mean, it is what it is. I've just - if you

ask me directly to a question are Fortis BC utilities on an average risk basis, I would agree with that. If I didn't, I wouldn't have filed it.
Q. So the Fortis BC company, that's one that you worked with?
A. That is correct.
Q. And Fortis BC is what sort of company, Mr. Ludlow?
A. Fortis BC is a transmission, distribution, customer service, and they have some hydro production facilities. The electric utility portion of it does.
Q. And do you accept the proposition that Newfoundland Power is a poles and wires company, a transmission and distribution company?
A. With a small amount of generation, yes, I would agree to that.
Q. But for purposes of, for instance, how Moody's characterizes you, they say, look, we treat them like a T & D, right? Are you aware of that?
A. By far the majority of our assets are in distribution, roughly 9,000 kilometres,



another couple of thousand would be transmission, and we would have roughly 28 small hydro and generating plants. So on the balance, I would say, you know, the total of our assets would be small on the generation side.
Q. And would you not accept that transmission and distribution are seen to have less, let's say, business risk than an integrated utility, one that's into both generation, transmission, and distribution?
A. Possibly so, yeah. I think I could go there, each unique to their own, but, yeah, that's fair.
Q. And in the case of Fortis BC, that would be considered a vertically integrated company, right?
A. Fortis BC would also be a much different company than we are. Fortis BC would also be buying energy on the markets through an integrated market system. So they operate plants, but they don't generate all their own. So they as well have a majority of distribution and transmission out there in their service territories in the areas of



Kelowna through to - across Boundary Country and into Creston.
Q. So they're much different than Newfoundland Power?
A. That was the point I was making earlier, Mr. Chairman. When we talk about average risk and we talk about business risk, working in Nelson and down through Boundary Country, white cap on the lake was seen as a windy day. They have no idea around wind or ice. So the operating conditions are different. They basically have - their pole infrastructure are nowhere near the stresses and strains we would go through. Their demographics, the mobility of their people, that's all different. Electric heating, that's different. So everything changes, and I guess that's the point I'm making.
Q. So could I ask you, do you believe that the business risk for Fortis BC is higher than Newfoundland Power's, or equal, or lower?
A. This whole discussion, Mr. Chairman, higher or lower is irrelevant. We have to look at the three parts.
Q. No, I'm talking about business risk.



A. I understand, but what I'm saying is we have to look at it even as we look at the business risk. As I look at our business risk components, I'll just run there for a little bit and then I'll go back to BC, I talk about the demographics, decline, and aging. That is reality, that's what we're into. We talk about weather and operating conditions. That's different, it's known, and it's changing. Cost flexibility; we're less than 10 percent or running about 10 percent ability to manage our operating cost now on total revenue streams. Our management ability is declining. We talk about Igor, that's continuing to decline, our ability to adjust and make short term movement. We also run on a single future supply, sole source. Now I'll go to BC. I moved out of BC about five years ago - no, it's not now, my goodness, seven years ago. So they have a plant, a utility that was designed by a mining company, Teck Cominco. It had large blocks of customers that were in areas of Kelowna, Osoyoos, and down through the Okanagan. The plant, much older. They have some generating plants.

Population, increasing, not decreasing. Workforce, not an issue. So there's a whole lot of parameters. I'm not really in a position to say, yes or no, higher or lower. I mean, if I look at all those factors, I know I'm facing a lot of challenges in the next four to five years. BC, as I speak to them from time to time, anecdotally, their ability to attract workers don't appear to be a big issue at this point. Their ability - their load, median load, buying on the market and multiple sourcing, they don't seem to have those issues, and that's all I can say, Mr. Johnson. Maybe there are things, but I don't know them.

(12:30 p.m.)

Q. Do you have a sense as between - well, no, I'll pass on this, actually. Mr. Ludlow, there's reference made to Fortis Alberta earning a return of 8.75 percent, and Fortis Alberta, they're under service quality standards, I take it? Are you aware of that?

A. I'm not familiar with the details, but I do believe they are. There are some service - Mr. Smith might be able to help you with those



later on.

Q. Okay. In terms of PBR, for instance, do you know whether or not that would be expected to subject you to at least a greater risk than a pure cost of service regime?

A. I read the risk document out of Alberta, and when I was finished, I have no idea what the answer was, whether it's riskier or not, to be quite honest with you in Alberta. They've just embarked on the PBR process, and the details I don't know, and I honestly do not know the pieces of it.

CHAIRMAN:

Q. What's PBR?

A. It's Performance Based Regulation.

MR. JOHNSON:

Q. I guess, if I could ask you, would you be able to encapsulate for me why it is you believe that it's appropriate to compare Newfoundland Power with Fortis BC, just put a bow around that question for me.

A. Can I assume you're referring to the document we had here earlier?

Q. Right.

A. Okay. When we look at average risk, what



would we say. I've already laid out the operating conditions or the business risk. I would look at market out there, pro and con, whether they've got multiple suppliers. That's not necessarily a good thing, not necessarily a bad thing, but it's a different place to work. I do know that they have also worked in a PBR regime that didn't work so well and they're rebuilding that company back from where it was in the mid 90s, early 2000s. I look at the people, the dynamics, I see the heating load different because of gas. So I guess the point that was being made as I look here, there are so many variables that are changing. There's no such thing as you take Newfoundland Power and say line it up perfectly against Fortis BC or Fortis Alberta, but on a whole, when you bring all the factors together, the regulatory environment in British Columbia with the BCUC - it's again fairly supportive, and when I look at where the average risk from my perspective back against BC, those are the factors, I think, that I would take in, Mr. Johnson.

Q. Mr. Ludlow, I asked a recent RFI #682, having



to do with your company's in depth workforce assessment. If we could bring that up.

A. The number again, please?

Q. 682.

A. I'm sorry, I don't have the paper copy which I prefer to read by because -

Q. Yes, I understand.

A. Thank you.

Q. Mr. Ludlow, I guess the question came from a reference in the annual report of Newfoundland Power, where it stated that, "In early 2011 the company conducted an in depth workforce assessment in which we projected retirements for the next five years, reviewed workload plans, and identified human resource strategies to guide the company in the future", and just tell us about how that exercise came out, what spurred it on?

A. I think we looked at the exercise as one step in multiples of exercises. I'm going to go back a little bit here and, you know, when this - we have a large number of our employees that are coming through - were hired in the 60s, the 70s, and the early 80s, and we've got - the demographic bubble, without getting into specifics, is coming at us. We've seen it, we're looking at it, and how do we get ready as we go to the future. I would suggest that it's pretty much a regular event that I would have, look, where are we now, where were we, where are we going, what are the skills we will require, and these aren't global, these aren't down to a unit or a position in Port Aux Basques, it's what are - like, the impact of technology, it's the impact of location, it's the rural versus urban, do we need more in St. John's or not, and those types of thinking. That's one way we look at this. So typically that type of an exercise would be driven through HR, our Human Resources area, and also through our Operations group, which basically makes up for most of the bodies, as it were, within the organization. Likewise to that, what is it we're doing that we don't need to continue doing. Now I'm back to how can we continue to improve, operating cost reductions, cost per customer, and I won't go back into that, but that's the type of thinking that comes to bear. That can happen on a fairly regular basis. The reference here



was done in early 2011, and we looked across the organization and those are the types of things that we then in turn build back in, pro and con, into a proceeding like we're doing here today as we build our costs.

Q. How long did the process take?

A. I have no idea. This could be running for days, weeks - it could be weeks, and it's not a group of people sitting in a boardroom pontificating with things. It is about an actual work in process leading into budgetary allowance and budgetary discussions is the way we would go at this.

Q. But there would have to be some - I don't know about pontificating about things, but at least meeting and figuring out, okay, what's our objectives here, how are we going to go about it. There must have been that type of approach taken.

A. Those are what I just gave you, panel, it's how do I ensure that this company is in good hands from a human resource standpoint in five and ten years time. I mean, I'd look at engineering staff, I'd look at P & C, Protection and Control, civil, mechanical, I'd



look at age, demographics, I'd look at locations, and that would be the type of thinking that's going on all the time throughout the HR of my business.

Q. Okay, and I understand that, but this got special highlight in the company's annual report, that the company conducted this in depth workforce assessment, and one part of my question was if any reports were produced from the assessment, if you could provide a copy, and there must have been reports or memos or something generated from a process that would merit the attention of specific mention in the annual report, Mr. Ludlow, was there?

A. I do believe there's a feeling that everything we do has to have long meetings and bureaucracy wrapped around it. This whole process, having HR involved, having my VP Operations or his designate involved, no, we will not create multi-bound documents. It just don't happen. I'm not a tendency to sit down and write emails and memos. I just don't do it. I do know, though, that I will need "x" number of individuals at this location, are we ready, when are they leaving, what are



the criteria for thinking about this, and that's all laid out and I'm not avoiding your question. If there was a report, we would have filed it. That's the basis. When this request came in - and I talk to my Board on a regular basis with this, Mr. Chairman, regular, every Board meeting I'm talking about are we ready, what's the impact of Muskrat, what's the impact of Vale, are you able to retain, are you losing, and, yes, we're losing, but that's the balance that's fluid, Mr. Johnson, throughout this process.

Q. But surely the Board would have said, Mr. Ludlow, you've embarked on this in depth workforce assessment, do you have the results of that assessment that you could share with us. It wouldn't work like that?

A. I do not have a management board, Mr. Chairman. I have a governance board.

Q. Okay. Well, surely - didn't you have to have some sense of - because you didn't conduct this assessment yourself, correct?

A. Correct.

Q. And didn't you have to find out, okay, ladies and gentlemen, what did you come up with? How

Page 121

would you have known?
A. How I would know would be through regular ongoing discussions, debates, with my executive team, and that's the reason I have a VP Operations. It's not about whether I need three line personnel in Stephenville or in Port Aux Basques, or whatever. It's about where are we going, what's our hot spots, how is it working, and that's the basis upon which we do, and we run that company on a regular basis like that, and, no, it's no more than that. I do not take a multi-bound report and go through it or even a small report. It's not the way it works.
Q. You don't mean to tell me that when you're having these debates and discussions, that there would be no paper in terms of what the analysis showed or where the numbers are? I mean, that can't be, is it, Mr. Ludlow?
A. I don't like the insinuation of that question, Mr. Chairman.
Q. But it just strikes me as odd that - I mean, if you're going to have a meeting and talk about results and that sort of thing, I don't mean to insinuate, but it just strikes me as

Page 122

unnatural that there wouldn't be something to discuss and say, you know, here's what we came up with, but if -
A. When you asked whether or not there's a memo or an email from Gary and I talking back and forth, back then there may have been, but that does not constitute a report for filing. I mean, that's the way we operate. I mean, a lot of it is talking, discussion, working. I mean, that's the basis upon which we run and we always have. Out of that process, we filed with our capital budget the whole AMR strategy. That AMR strategy removes a fair number of positions out of our company by 2017. That's a formal document, formal report filed with this Board, and that's the basis upon which we go forward.
Q. So to sum it up, if you went looking for a report in your organization, you would not be able to find one arising out of this in depth workforce assessment?
A. We were asked to provide reports that were produced from this assessment. If we had them, we would have produced them.
Q. Mr. Ludlow, you spoke of operating efficiency

Page 123

and your introduction materials that you sponsored spoke of the operating efficiency of Newfoundland Power, and we asked the question whether you had information on the operating efficiency of other Canadian utilities, and in reply to CA-NP-143, we were advised that you do not have information on the operating efficiency of other Canadian utilities. Would that be correct?
(12:45 p.m.)
A. Let me just check what we're saying here. 143?
Q. Yes, sir. The very first line says, "Newfoundland Power does not have information on the operating efficiency of other Canadian utilities".
A. I agree with that.
Q. Okay. So, I guess, it's - you can't say then, obviously, whether Newfoundland Power is doing a good job or not relative to other utilities when it comes to operating efficiency. That would have to be correct, I take it?
A. That is correct.
Q. And at page 224 of your Application at line 12 and 13, the statement is made that overall

Page 124

Newfoundland Power's operating costs reflect improved labour productivity of approximately 1 percent per year, and so when we saw that, we asked a question in CA-NP-142 referring to this line and asking - CA-NP-142. We asked, "How do Newfoundland Power's labour cost and improved labour productivity compare to electric distribution companies elsewhere in Canada", and again you indicated Newfoundland Power does not have data with which to make the comparison requested, right?
A. Correct.
Q. And so again we logically then don't know - we don't have a relative basis to look at your efficiency at Newfoundland Power. That's the bottom line, right?
A. I think the statement on 12 and 13 is very clear, Mr. Chairman, and says that our improved labour productivity of approximately 1 percent per year is not a relative or a comparator, and I don't know if that's your point.
Q. Yeah.
A. It's more about the way we look at it and benchmark, and what we've been trying to do to

continuously improve on our operating expense lines.

Q. And even - is there no effort to compare baselines, for instance, with your other sister utilities, for instance, if you're all part of the one family?

A. Some time back we looked at some of these comparators. My goodness - unless it's me as an individual who's working on utilities, it gets so convoluted as to where things are charged, how is it charged, how things are actually run, that they become meaningless. One of the RFIs, I think it's 243 here, we talk about some of the matrix we look at like SAIFI and SAIDI, we'll look at a safety statistics, but they're driven on a national basis and we will look at those, but we won't draw specifically on those. So, you know, if I were to compare myself to Newfoundland and Labrador Hydro, two different businesses, two different environments. I can look at Maritime Electric, two different businesses, and that becomes, I think - I'm trying to lay out the differentials between companies, and that's the reason that - I don't know if there



out there. We haven't got them and we don't use them, or I do not compare myself to BC. Example, BC runs a fully defined - full fledged defined benefit pension plan. We do not. It closed in 2003/2004. So what's our comparators. There's a million anomalies in all these little companies that you get into, and that's the reason, Mr. Johnson, we don't do it.

Q. But you compare yourselves to them for return on equity?

A. Because when we look at risk, risk is much more global, and we look at the three components of that risk, and as I explained - you very correctly pointed out the BC piece, and we could look at it on that basis, but if I get down to operating expense lines, no, can't do it.

MR. JOHNSON:

Q. I think those are my questions for Mr. Ludlow.

CHAIRMAN:

Q. Okay.

MR. EARL LUDLOW - EXAMINATION BY MAUREEN GREENE, Q.C.:

Q. Good afternoon, Mr. Ludlow.



A. Good afternoon.

Q. I'm sure that you and everybody will be happy to hear that my questions are reduced from what they were when I started this morning because Mr. Johnson did pursue a couple of areas where we did have some questions, but I still have two or three areas I'd like to cover with you. The first one does relate to risk, and the risk of Newfoundland Power, and that's been covered in detail, I'm not going to repeat it at this point, but I did have a couple of follow-up questions with respect to your discussion with Mr. Johnson about risk. I believe that you have confirmed that in Newfoundland Power's view, you are an average risk Canadian utility as found by the Board in the last rate case, is that correct?

A. That is correct.

Q. And in your opinion, there's been no material change in the risk that Newfoundland Power faces since the last rate case?

A. That is correct.

Q. In terms of stating that Newfoundland Power is an average risk utility, it does imply that usually there would be somebody higher and



somebody lower if you are average, and I wanted to explore that a little bit with you. In response to questions from the Consumer Advocate with respect to how Fortis BC, for example, I believe in your answer you said it's the total risk that should be looked at, which is the business risk, the financial risk, and the regulatory risk. So I do agree you do consider all of those, and I did want to talk to you about that in terms of the total risk and I'm talking about all of those as the total package. So Newfoundland Power is an average risk utility, I believe, is the position of Newfoundland Power, and I'm only talking Canadian utilities for this discussion, and I believe you agreed that Fortis BC could also be considered to be an average risk Canadian utility, is that correct?

A. That's correct.

Q. I want to explore from your perspective as CEO, and with your experience as you've already outlined for us in four other provinces, from your perspective looking at that total risk package, what Canadian utility would you consider to be higher than average risk?

A. I've thought about that question and that's the one I struggled with because I'm struggling to find one that's lower or above as well, Mr. Chair, and at the risk of sounding evasive, I looked at each of them individually and the various risk categories and instead of trying to weight them and bring them up, which I couldn't do, I found it very difficult to do it, I found myself pro and con on all of them. I look at Nova Scotia Power and I look at where their regulatory is and their reliability and how it sits. I look at Maritime Electric and their dependence upon everything from shale gas to nuclear in their supply mix, and how that factors in. So to say that I would have a specific question of one that would be higher and one that would be lower, I don't have an answer for your question, I'm sorry.

Q. Is this the type of discussion that's ever occurred with the Executive, between yourself and your Chief Financial Officer as to who your comparators are and who would be



considered to be riskier than you?

A. I have not had that discussion with Ms. Perry, but maybe she's had them with different agencies. I'm not certain.

Q. So we can defer that question to Ms. Perry.

A. Please.

Q. Turning to an operating question, recently the agreement between Newfoundland Power and Bell Aliant was approved by the Board for the sale of the joint use support structures about a year ago, so Newfoundland Power now has more than a years experience with the new arrangement with respect to the ownership of the support structures and the maintenance, and what has your experience been since the new arrangements became effective?

A. Well, I guess we're early days, we're into it is what I would suggest, a year in now. So far, so good. I would suggest a lot of things have, I think, gone very well. For example, calls that would come in during - I keep going back to weather, but normal day to day circumstances which come through our call centre, we automatically are - our set systems in now that they're diverted directly over to



Bell to avoid multiple calls, multiple calls. I mean, they're responding on their pole setting. We're maintaining the 60/40 split. The costings and the financial that we put forward were within - there's no material differences from what was anticipated to where we are at this stage. One thing has happened in the middle of all this is Aliant has embarked on a massive fibre op program, and we've taken on a fair amount of third party work, and it's obviously billable out to them, and that's assisted. So things have gone, I would suggest, pretty much as we had forecasted in the filings and on the approval basis of what we had anticipated.

Q. With respect to maintenance, and the fact that Newfoundland Power performs maintenance for the joint use support structures, about a year ago it wasn't clear as to how long that practice would continue. Has there been any further discussions with respect to ongoing maintenance beyond the initial period that had initially been agreed upon?

A. I am not - I don't have the detail of where we are on it. I know there was a discussion that



we'd keep doing it if we could strike the deal with them. Mr. Smith would be more than capable of addressing where we are on that at this point in time, Ms. Greene.

GREENE, Q.C.:

Q. Thank you. Those are all the questions that I have.

(1:00 p.m.)

MR. EARL LUDLOW - EXAMINATION BY THE CHAIRMAN

Q. Just a couple of questions on demographics, Mr. Ludlow. You said the company projects population declines for the next 20 years or so.

A. Yes.

Q. Is that right?

A. That is correct, Mr. Chair, yes.

Q. How do you - what sources do you use for making your demographic projections?

A. We use the Conference Board of Canada as the prime source, as we would with any of our - pretty much our forecasting, and we temper that with anything we can see, but the prime is the Conference Board.

Q. And would you do your own calculations on demographics?

Page 133

A. We have a forecaster, and forecasters by their very nature will do calculations on everything, but we wouldn't go out and be serving customer bases on average ages or anything of that type. I guess the answer would be, no.
Q. How would you calculate population decline then or growth, what number do you use there, do you know?
A. The same - population growth - I'm sorry?
Q. Well, like, I've read on demographics, you know, to keep your population stable, you need a reproductive ratio of 2.1.
A. 2.1.
Q. Newfoundland, I think now is at -
A. 1.4, I do believe, Mr. Chair.
Q. 1.4 or 1.3, I read. So what number are you using? Are you using 1.4, for instance?
A. Again I don't know, but we would be using probably a much higher level number than that, looking at what's being said and forecasted by the forecasters, you know, on total base, and if they're using 1.4, and whether that's going to increase, I don't know, but again the average age is increasing as well, so - I

Page 134

would think that would come right from the Conference Board, Mr. Chairman.
Q. Have you filed any numbers about what you expect with the Board over the next 20 years?
A. I think we have given an indication of what we would expect to see regarding percentage drop in population of Newfoundland and Labrador. It's a - tangle is an awful word, but we're seeing an average increase and a decline in some areas, and a growth in others, and I referenced the urbanization earlier. So what we've got going on is we've got a contraction in some areas. A lot of people still keeping the houses as summer residences. Now pulling into the urban centres of Mount Pearl, St. John's, and I've got to mention my namesake, Paradise, that you're growing the system and pushing a force on the system here; at the same time, trying to maintain that service level in -
Q. But there's two aspects. There's service levels and there's population. Like, right now, I think you said there's 250,000 customers?
A. Correct, approximately.

Page 135

Q. Which means we've got approximately one service for every two people in the province, say, 500,000?
A. Pretty much.
Q. How's that likely to change with the demographics? Do you have any information on that?
A. Well, anecdotally, Mr. Chair, I think the way I would look at that is a lot of these homes in a lot of the smaller communities are older homes, and I'm going to be a pessimist, I'm from rural Newfoundland, proud of it, and I will say that as I look out and look at the future of rural Newfoundland, unless something happens, a lot of those older houses are not going to be maintained. I'm looking 20 years. I don't want to be a fear-monger. I'm being very careful of that because, you know, I look at the place I come from, they've registered something like a 12 percent decline in population since the last census. Not the community, but the general area.
Q. Because I understand that one of the things, I mean, in this forecasting business is - if you know anything about forecasting, it's pretty

Page 136

unreliable after three or four years on anything, but demographics because of the nature of - I mean, demographics you can predict with some accuracy.
A. One of the scariest things we look at is the age. Even the age cohorts and how things are moving through, there's a graph here that shows the average age and how much it's increasing, and that's probably more concerning or at least equally as concerning because as - let me put it another way. As I get older, and if I live in rural Newfoundland, my call for service and reliability will increase. It's almost like the medical system when you look at it in some way, right, and, you know, as we see that happening - we're trying to keep an eye on it. There's not a lot you can do about it, I guess.
Q. That's your -
A. We structure around that, by the way.
Q. The reproductive ratio would capture that, wouldn't it?
A. You would think.
Q. I think Ms. Greene covered off this business

of average risk. You say we got a generally supportive regulatory environment. Generally means that it's okay, it's not great. I mean, generally I'm a pretty nice guy, but some people, you know - generally doesn't mean a heck of a lot. I mean, what else would you think we could do to make the regulatory environment more than generally supportive? Tell us where we're inadequate. We're not sensitive.

A. I thought we were very positive with generally supportive.

Q. I don't know what generally means there, you know.

A. I guess the point, Mr. Chair, with that is compared to other areas, there's differences between regulatory regimes.

Q. Uh-hm.

A. You know, like - to be quite honest, we've structured our business and if you look at the Executive structure of my business, you will see that I have a Vice President Regulatory and he handles IT, and that's seen as an area that we bring focus to. We look at it on that basis. So our ability to be responsive and



meet deadlines and work with the Board, that's something we take very seriously. Now in there, there are rulings that are different here than they would be out west. Am I looking for something else; no, I'm just saying they're different. Like, the excess earnings account, we're hearing numbers here of Alberta earning 8.75. That's their allowed. We don't know what they're going to earn because they might earn nine and a quarter or nine and a half. I know that I've got a 40 basis point spread on my allowed ROE. If I go above that, it goes into an excess earnings account. Now am I knocking that; it's just the basis under which I run.

Q. Uh-hm. I guess, on this business of capital markets, we can leave that to your CFO, but you said capital markets have not been normal and I was wondering when is the last time you thought they were normal?

A. I would go back to 2007, early 2008.

Q. Before the bailouts?

A. Yeah, and, you know, I thought long and hard about that, not anticipating your question, but, you know, you can't pick up the paper



today but there's something wrong or there's something going on in Europe and its impact here. What does that all translate to? We talk about infrastructure and governments injecting money to markets, I don't believe, and this is me as an uninformed engineer looking at it, would say the markets haven't been able to be a market, there's a lot of influences out there, all over. The volatility is all over the place. Bond yields are down to 2.39. I think the last time we were here they were 4, and we said they'll never go to 2.

Q. You've given no indication, sir, that you're uninformed, but how do you think capital markets are going to get back to normal?

A. That's going to be the big question.

Q. Because you could make a pile of money if you knew that one.

A. I wouldn't be here.

Q. We could all retire.

A. Yes.

Q. Maybe we'll leave it for Mr. Booth. The only other question I had is on this recurrent issue of Executive compensation. You quoted



HAY. HAY is pretty well accepted across the country as one of the major companies with respect to this whole compensation issue. I think you said that you're at the 50 percentile. So in the survey that HAY did for your company, half the company's paid more, half paid less. Is that the way that would work?

A. There's a policy line set and where the policy line, Mr. Chairman, is set to is a group of companies called the Canadian Commercial Industrial, and there's been a policy line set by our Board that we would target 50 percent of that grouping, and that was the basis, not of all companies, but of that particular group of companies. So that was the adjustment that was made to the STI portion for the Executive members to bring that a little closer in line.

Q. Uh-hm.

A. And that's the basis. Like, that policy may move by the markets moving a bit, but the policy line was set on that grouping.

Q. That would be total compensation, would it? It wouldn't be compensation paid for by rate payers, it would be total compensation?

A. It would look at total compensation, that is correct, and it would look at cash and indirect -
Q. And in that calculation, would there be a comparison between total compensation and compensation paid by rate payers? Is there a ratio there that - in other words, I guess I'm asking you in your total compensation compared to your study group or the control group, are you - are the rate payers in Newfoundland paying more than, say, the average in the group? Are we at 50 percent in terms of contributions from rate payers to your Executive compensation?
A. That would not be in or part of this study, and again this could range, Mr. Chairman, from - just any kind of a company is what's in there. You know, it's not just electrics, it could be - I don't think retailers. Retailers might be in there - there's other companies in that mix. So your answer is, I do not have that visibility from HAY at all.
Q. Uh-hm. I think what would concern the Board is what percentage of your compensation is paid for through rates, and what the



shareholders decide to do for you people is entirely up to them, I would presume.
A. Well that's -
CHAIRMAN:
Q. Okay, let me just--I think that is all that I have. So we're finishing up a little bit early. Do you want to adjourn for the day, or do you want to try and get our CFO going. What do you want to do?
KELLY, Q.C.:
Q. Perhaps if we're finished with the witness, the witness can -
CHAIRMAN:
Q. Oh, yeah, I'm going to dismiss him. I mean, we're finished with you. I don't think there's anything else.
KELLY, Q.C.:
Q. Then we could perhaps have a quick conversation as to the timing. I take it the Board only intends to sit until 1:30, in any event, Mr. Chairman. It wouldn't make sense to start on that basis.
CHAIRMAN:
Q. Look, I'm - I mean, I'm easy. I don't know - what do you want to do, do you want to carry



on or adjourn? I mean, what do you think.
MS. GLYNN:
Q. Can we just go off the record?
CHAIRMAN:
Q. Yes, go off the record.
(OFF RECORD)
(1:23 p.m.)
CHAIRMAN:
Q. I understand we're going to deal with our next witness.
KELLY, Q.C.:
Q. Press ahead, Mr. Chairman.
CHAIRMAN:
Q. Press ahead. Generally forecasts are reliable, but we don't know.
KELLY, Q.C.:
Q. The consensus forecast is we'll go through Ms. Perry's evidence in chief.
THE CHAIRMAN:
Q. And I also understand that if the weather doesn't materialize, we will convene tomorrow. Has everybody agreed to that?
KELLY, Q.C.:
Q. I'm agreeable.
MR. JOHNSON:



Q. Yes.
CHAIRMAN:
Q. So we'll see what it's like at, say, 8 o'clock in the morning, something like that, is that all right?
MR. JOHNSON:
Q. It's kind of like calling the Regatta, Mr. Chair.
CHAIRMAN:
Q. It's like calling the Regatta. So tomorrow it depends on the wind, boy. Madame, do you swear to tell the truth, the whole truth, and nothing but the truth, so help you God.
MS. PERRY:
Q. I do.
MS. JOCELYN PERRY (SWORN) EXAMINATION-IN-CHIEF BY KELLY, Q.C.:
Q. Thank you, Mr. Chairman. Ms. Perry, you are the Vice President of Finance and Chief Financial Officer of Newfoundland Power?
A. Yes, that's correct. I've held this position since 2005.
Q. And do you adopt Section 3 of the Finance testimony and the company's rebuttal evidence as your testimony in this matter?

Page 145

A. Yes.
Q. Are there any changes you wish to make to any of the pre-filed testimony and exhibits?
A. No, not at this time.
Q. Now Ms. Perry, we'll go through four matters. One is financial performance and financial integrity. Two is cost of capital and capital structure. Three is the automatic adjustment formula, and four is depreciation. We'll talk about those four. Let's start with the company's financial performance and financial integrity. Can you start with that?
A. Certainly. I'd like to start with a brief overview of the financial performance since the last rate case. If we could please go to page 1 of Exhibit 3. This exhibit includes the company's actual financial results for 2011 - 2010 and 2011, and the most current financial forecast for 2012, 2013, and 2014. Let's look at the first two columns which are the actual results for 2010 and 2011. On line 35, you'll see that our rate of return on equity was 9.21 percent for 2010, and 9 percent for 2011. In both those years, we were within our allowed range of return. So

Page 146

now moving on to the third column, this is our 2012 forecast. Newfoundland Power's 2012 rate of return on rate base is set based on a return on equity of 8.8 percent. As you can see from line 35 again, we are forecasting a return on equity of 8.81 percent. At line 37, our interest coverage is 2.3 times. At line 38, our cash flow interest coverage is 3. 2 times, and on line 39, our cash flow to debt is 15.7 percent. While our 2012 matrix are consistent with maintaining Newfoundland Power's financial integrity, as you can see they have deteriorated since 2010.
Q. Next would you provide the Board with an overview of Newfoundland Power's financial outlook for 2013 and 2014?
A. Yes. The 2013 and 2014 forecast are shown in the last two columns on this exhibit. The 2013 and 2014 forecasts excludes the proposals in this Application, and is based on the 8. 38 percent cost of equity currently in customer rates. So moving down to line 35 again, the forecasted return on equity is 7.57 in 2013, and 6.89 percent in 2014. So based on the current financial outlook, Newfoundland Power

Page 147

will not have an opportunity to earn a reasonable return in either year. Lines 37 through 39, they contain the key credit matrix that flow out of these returns. You'll note that all key matrix are forecast to erode from where they are today, and these financial results are not consistent with the maintenance of the company's financial integrity.
Q. Next can you please comment on Newfoundland Power's creditworthiness?
A. Newfoundland Power continues to be creditworthy. Our first mortgage bonds are rated A by DBRS, and A2 by Moody's Investor Services. These ratings have not changed since our last general rate order. Both DBRS and Moody's recognize that Newfoundland Power's creditworthiness is dependent upon decision making by this Board. Moody's latest exhibit, latest report, I believe Chris is going to bring up on the screen - last page. Okay, right here, Moody's latest report indicates that the company's rating would likely be downgraded if we perceived a meaningful reduction in the level of

Page 148

regulatory support combined with weaker liquidity and a sustained deterioration in the company's financial matrix.
(1:30 p.m.)
KELLY, Q.C.:
Q. What do credit rating agencies consider as regulatory support?
A. Credit rating agencies typically look to predictability and Board decision making, and Newfoundland Power's opportunity to recover its cost in a timely manner, and earn its return as the key components of regulatory support. As an example, the company's 45 percent common equity ratio has consistently been singled out by credit rating agencies as a financial strength. The maintenance of this ratio is a prominent feature of this Board's regulatory support of the company's financial integrity.
Q. Could this Application have implications for the company's future creditworthiness?
A. Yes, it could. When I consider the combined proposals as put forward by the consumer advocate, which include; one, a reduction in the equity capital structure from 45 percent

to 40 percent; two, a reduction in the return on equity to 7.5 percent; three, a decrease in accrued depreciation recovery of approximately 10 million per year, I do have serious concerns about a downgrade in the company's credit rating.

Q. Let's discuss capital structure first. Can you explain to the Board the practical effects of changing the capital structure for Newfoundland Power?

A. Yes. Well, a reduction in the common equity by 5 percent would have significant consequences for the company. First of all, it would prompt a capital divided payout of approximately 42 million dollars. That amount would have to be borrowed and Newfoundland Power's financial risk would increase, and its matrix would again decrease. Second, and equally important, such a change could lead to a reevaluation of the regulatory support as perceived by the credit rating agencies. This could lead to a reduction in Newfoundland Power's current credit ratings in these circumstances.

Q. Now I want to take you to a piece of Dr.



Booth's evidence. He's proposed, if we go to page 80, at lines 11 to 12, that Newfoundland Power's 45 percent common equity ratio be reduced to 40 percent, and the 5 percent be replaced with retractable preferred shares. Do you agree with that proposal?

A. No, I do not.

Q. Could you explain to the Board why not?

A. Well, Newfoundland Power is a small issuer in the financial markets. I seriously doubt that we could issue retractable preference shares, and if we could, what the cost might be. Second, retractable preference shares would likely be considered debt by the credit rating agencies. The preference shares would not be assigned any equity value for the purpose of assessing Newfoundland Power's credit rating. So from a credit rating perspective, issuing 42 million in retractable preference shares would be the same as issuing 42 million in additional debt.

Q. Let's turn next to the return on equity. Do credit rating agencies typically assess whether the allowed utility returns are fair?

A. Not directly. Credit rating agencies appear



to respect that the determination of whether returns are fair or not rests with the utility regulators, but the returns allowed by regulators affect the financial matrix. So allowed returns are, therefore, relevant to the credit rating agencies assessment of our creditworthiness. The return provides a margin of safety for debt holders that interest will be paid in the future. So for this very reason, a reduced return could very well impact the company's creditworthiness.

Q. I want to take you next to Dr. Booth's evidence at page 90, lines 20 and 21, and Dr. Booth has indicated that Moody's has implied that a lower allowed ROE is warranted for Newfoundland Power because of its 45 percent common equity ratio. Has Moody's ever indicated that to you?

A. No. I speak or meet with each credit rating agency two or three times each year. Neither Moody's nor DBRS has ever indicated that Newfoundland Power's allowed ROE should be lower because of its capital structure. I would be surprised if Moody's or DBRS were to indicate an appropriate level of ROE for



Newfoundland Power one way or the other. What Moody's has indicated quite clearly is that Newfoundland Power's financial matrix are somewhat weaker than those of its peers, which they state are Fortis Alberta, Connecticut Light and Power, Orange and Rockland Utilities in New York, and Public Service Electric and Gas in New Jersey, and as I mentioned earlier, Moody's has quite clearly indicated that sustained deterioration in the company's financial matrix could result in a ratings downgrade.

Q. Does the 2013 return on equity of 7.5 percent as recommended by Dr. Booth appear fair to you?

A. No.

Q. Explain to the Board why not?

A. The 7.5 percent return on equity recommended by Dr. Booth is significantly below the return of any investor owned electric utility in North America. It is less than the 7.85 percent return on equity indicated by the formula for 2012, which led to the suspension of the formula, and it's also not materially different than the 7.53 percent return on

Page 153

equity indicated by the formula for 2013. A 7.5 percent return on equity is simply not fair to Newfoundland Power. We have filed expert reports from Ms. McShane and Dr. Vanderweide that consider an appropriate return on equity for Newfoundland Power.

Q. Now I want to turn a little bit to the automatic adjustment formula. Can you explain to the Board the effect on Newfoundland Power of the continuation of the automatic adjustment formula since the 2009 hearing?

A. Yes. I understand the purpose of the formula was to set a fair return on equity between test years. This was intended to provide for regulatory efficiencies, which in turn would reduce cost associated with these proceedings. Since 2009, this has not been the result. As previously stated by Mr. Ludlow, the experience has been that the formula has produced unfair returns and increased regulatory process, taking considerable time and resources away from the daily operations of Newfoundland Power.

Q. In 2011, the formula indicated an estimated return on equity of 8.38 percent. Why didn't

Page 154

Newfoundland Power seek to suspend the operation of the formula for 2011?

A. Well, first of all, Newfoundland Power did not think the 8.38 percent return on equity in 2011 was a fair return. It was significantly lower than the returns of other investor owned utilities. Newfoundland Power chose, however, not to seek to suspend operation of the formula for 2011 for a number of reasons. Most notably, in late 2010, Newfoundland Power was negotiating the terms of the Bell Aliant repurchase of the joint use support structures pursuant to a 2001 agreement. The negotiated terms of the repurchase would have affected the company's rate base and future cash flows. So this created a significant degree of uncertainty in the company's financial outlook. Newfoundland Power chose instead to focus on managing this project and the financial uncertainty associated with it. The company also considered the fact that a November 2010 Application would have been filed approximately 11 months after the Board's decision in 2009. The expense associated with a full review of the cost of

Page 155

capital so soon after the last examination factored into the company's mind set. Finally, the 8.38 percent was the result of financial market conditions reducing forecast long Canada Bond yields. Given the degree of volatility in the financial markets at that time, Newfoundland Power was mindful that long Canada Bond yields could increase by the time the formula operated again. So all of these considerations influenced the company's decision in November, 2010, not to apply to suspend the operation of the formula in 2011.

Q. Now in this hearing, Newfoundland Power is proposing that operation of the automatic adjustment formula be discontinued. Would you please explain why?

A. Well, I think we all agree the existing formula is not working in current financial market conditions. The formula has not produced fair returns and has increased the regulatory process. The modified formulas which currently exist in Canada take into account both the change in long Canada Bond yields and the change in spreads between utility and long Canada Bond yields. The

Page 156

addition of the spread is an attempt to limit the exposure to changes in long Canada Bond yields. So generally speaking, I simply have no confidence that the formula or either of the modified formulas would result in a fair return for Newfoundland Power in current financial market conditions.

Q. We have two proposals that have been put forward here; Mr. MacDonald's and Dr. Booth's. So would you please comment on the operation of modified formulas as proposed by each of Mr. MacDonald and Dr. Booth, please?

A. Yes. While neither Mr. MacDonald nor Dr. Booth has provided full details on a proposed formula, I did attempt a pro forma analysis of how these formulas might operate. Let me say to you first that as a fundamental principle, a formula should produce a change in the ROE if there has been a change in circumstance. If conditions haven't changed, the ROE should remain the same. So now let's take a look at Mr. MacDonald's proposed formula first. If we could display Exhibit JP #1, please.

Q. We pre-filed that as marked.

MS. GLYNN:

Page 157

Q. And we'll enter that into the record. Thank you.

KELLY, Q.C.:

Q. Thank you.

A. So for this pro forma analysis, I have assumed the financial markets remain the same. This exhibit simply shows the pro forma operation of the formula to estimate the 2014 return on equity based on that assumption. So first we'll start on line 4 with the 2013 return on common equity of 8.91 percent as proposed by Mr. MacDonald, and this return assumes a risk free rate of 3.04. Next Mr. MacDonald proposes the return on equity be adjusted by 50 percent of the change in long Canada Bond yields, and this starts on line 6. Assuming the financial markets remain unchanged, the long Canada Bond consensus forecast is 2.59 percent, and this was based on the November, 2012 consensus formula and - that consensus forecast, and that's essentially the same as what it is today, and this can be found on line 7. On line 8, the base forecast for long Canada Bond yield proposed by Mr. MacDonald again is 3.04. So the 0.23 percent reduction on line

Page 158

11 is the difference between the 2.59 percent and the 3.04 percent multiplied by 50 percent. Next the proposed formula adjusts the return on equity by 50 percent of the change in the utility bond spread, and as I mentioned earlier, the utility bond spread is the difference between utility bond yields on 30 year A rated utility bonds, and long Canada Bond yields. Mr. MacDonald does not specify the base or the starting utility bond spread to incorporate in the formula. So I've made the assumption that the base utility bond spread is the current spread of 1.45 percent. With no change in utility bond spread, no adjustment is required to the return on equity for this component. So moving down to line 21, the 2014 estimated return on equity is 8.68 percent. This would be the 8.91 percent, less the .23 percent as indicated on line 11. The .23 percent reduction would technically fall within Mr. MacDonald's proposed 25 basis point deadband, but you'll note that if long Canada Bond yields fell by 6 basis points, our return would drop by more than .25 percent. On the other hand, a 75 basis point increase

Page 159

in forecast long Canada Bond yields would not result in an increase in Newfoundland Power's return on equity. We would still be under Mr. MacDonald's deadband. So the formula appears unbalanced. Based on the pro forma analysis, the difficulties we've just discussed are a direct result of the parameters used in the formula.

Q. Thank you. Can you go next to Dr. Booth's proposed formula and take us through that one?

A. Yes. Despite apparent similarities between Dr. Booth's proposed formula and Mr. MacDonald's, the operation of the two formulas is quite different. If we could go to Exhibit JP #2, and we can discuss Dr. Booth's proposed formula.

MS. GLYNN:

Q. And we'll enter that one into the record as well. Thank you.

(1:45 p.m.)

KELLY, Q.C.:

Q. Thank you. So again starting on line 4, we start with the return on equity of 7.5 percent as proposed by Dr. Booth. This proposed return on equity assumes a 3.8 percent risk

Page 160

free rate. On line 6, Dr. Booth proposes the return on equity be adjusted by 75 percent of the change in long Canada Bond yields above the 3.8 percent. My understanding of Dr. Booth's evidence is the 3.8 percent is viewed as a floor to be applied in this formula. So assuming the financial markets remain unchanged, the long Canada Bond forecast is 2.59 percent, and that's the same as Mr. MacDonald's formula, and this can be found on line 7. Given the current long Canada Bond forecast is below the 3.8 percent indicated by Dr. Booth, no adjustment is required to the return on equity for this component. Next the proposed formula adjust the return on equity by 50 percent of the change in the utility bond spread. This is the same as Mr. MacDonald's proposed formula as well. However, in Dr. Booth's evidence, the base or the starting utility bond spread to incorporate in the formula was based on the Scotia Capital Bond Index, and the base utility bond spread referenced by Dr. Booth was 1.8 percent. However, when I looked at a number of answers to requests for information,

Page 161

my understanding is Dr. Booth agrees with using the Bloomberg 30 year A rated utility index, and this again is consistent with Mr. MacDonald's formula. So going to lines 15 and 16, the current and base utility bond spread is 1.45 percent. With no change in the utility bond spread, no adjustment is required for this component. So moving down to line 21, the 2014 estimated return on equity is 7.5 percent. So based on how I interpret Dr. Booth's formula, there will be no change in Newfoundland Power's 2014 return on equity if financial markets remain the same. However, given Dr. Booth applies a 3.8 percent floor on the long Canada Bond yields at a time when the forecast is 2.59 percent, the yield forecast would have to increase by more than 1.2 percent before the formula would signal an increase in the company's cost of equity for changes in long Canada Bond yields, and it would be reasonable to assume that the utility bond spread would decline if long Canada Bond yields were to increase by that amount. So, therefore, the operation of the formula could signal a reduction in Newfoundland Power's

Page 162

2014 cost of equity at a time when bond yields are rising. Given this, I'm not clear how the proposed formula is logically reflecting changes to Newfoundland Power's cost of equity for changes in financial market conditions.

Q. Ms. Perry, what is your overall assessment of the formulas proposed in this proceeding?

A. Simply speaking, Newfoundland Power did not propose a formula, given the lack of consensus on the relationship between long Canada Bond yields in current financial market conditions and the utility's cost of capital. I believe the proposed formulas demonstrate that lack of consensus. The 1.2 percent increase in long Canada Bond yields in Mr. MacDonald's proposed formula would almost certainly increase Newfoundland Power's forecast cost of equity. However, a 1.2 percent increase in Dr. Booth's proposed formula would either leave Newfoundland Power's forecast cost of equity unchanged or could potentially reduce it.

Q. Now let's turn next to depreciation. What financial impact will the consumer advocate's proposals have on customers?

A. Well, a prominent feature of the consumer

Page 163

advocate's depreciation proposals include the transfer of approximately 70 million dollars net of tax that has been collected from customers in the past to the customers in the future. Transferring such a large cost to future customers causes me concern. This amount will have to collected from customers at some point in the future as Newfoundland Power's costs are not changing. The proposals have the short effect of reducing annual depreciation expense and the revenue requirement by approximately 10 million dollars. Newfoundland Power's rate base and its return on rate base will increase as a result of these proposals, again costing future customers more. So effectively, this becomes a current rate reduction at the expense of higher cost for customers in the future.

Q. What are the financial effects of that for the company?

A. From a financial perspective, if the consumer advocate's depreciation proposals are approved, in the short term the company's cash flow from operations and financial matrix

Page 164

would be reduced. I do not believe that this is in the long term interest of either our customers or Newfoundland Power.

Q. Ms. Perry, have you assessed the impact on the company's financial integrity if the Board implemented both the depreciation recommendations of Mr. Pous, and the ROE and capital structure recommendations of Dr. Booth?

A. Yes, I have, and when you combine the impact of both recommendations, the financial impact to Newfoundland Power is very serious. If we could go to Exhibit JP #3, please.

MS. GLYNN:

Q. And the same, that will be entered onto the record.

KELLY, Q.C.:

Q. Thank you. This exhibit shows the company's forecasted key financial matrix for 2014. The first column shows the matrix based on existing rates prior to any proposals in this Application, and this was shown on Exhibit 3 in the evidence. Now as I said earlier, the matrix shown here are not consistent with the maintenance of Newfoundland Power's



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creditworthiness. The middle column shows the forecasted matrix proposed by Newfoundland Power in this Application. Finally, the last column is showing the impact of the consumer advocate's recommendations, particularly the reduction in the capital structure, the reduction in the return on equity to 7.5 percent, and the depreciation recommendations. So simply looking at the financial matrix alone, based on the consumer advocate's recommendations, if you go to line 6, our interest coverage would be 2.1 times; on line 8, our cash flow to interest would drop to 2.7 times; and then on line 11, our cash flow to debt ratio would be 11 percent. These matrix are at or lower than our existing matrix under column 1, and are also at or below the bottom of the range indicated by Moody's that may warrant a credit downgrade. Moody's has indicated that Newfoundland Power would likely be downgraded if they were to perceive a meaningful reduction in the level of regulatory support combined with the sustained deterioration in financial matrix. These proposals disregard the requirement that the



company maintain a sound credit rating in the financial markets. As CFO, I believe that these proposals would negatively impact our credit ratings.

Q. Does that conclude your testimony?

A. Yes, it does.

KELLY, Q.C.:

Q. Thank you.

CHAIRMAN:

Q. I think we'll adjourn and we'll make a decision as to proceeding tomorrow early in the morning, and the parties will be advised of the Board's decision.

MS. GLYNN:

Q. We received emails and phone numbers for all the parties, but just for the record to make sure that we'll be putting out a media advisory as well as the public will be advised.

CHAIRMAN:

Q. Okay, we're adjourned.

KELLY, Q.C.:

Q. Thank you, Mr. Chairman.

(1:53 p.m.)

(UPON CONCLUDING)



CERTIFICATE

I, Judy Moss, hereby certify that the foregoing is a true and correct transcript in the matter of Newfoundland Power's Inc.s General Rate Application, heard on the 10th day of January, A.D., 2013 at the Board of Commissioners of Public Utilities, 120 Torbay Road, St. John's, Newfoundland and Labrador and was transcribed by me to the best of my ability by means of a sound apparatus.

Dated at St. John's, Newfoundland and Labrador this 11th day of January, A.D., 2013

Judy Moss

## -B-

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## -H-



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