Page 1

(10:00 a.m.)

CHAIRMAN:

Q. Good morning, everybody. I'm not sure whether utility hearings bring on winter or winter brings on utility hearings, but it seems there's a relationship between the two somewhere. And I don't think we've gone through a utility hearing yet that we're not balancing schedules as a result of weather conditions or what have you, and I guess this is no exception. Anyway, I would like to welcome everybody here in attendance today at these proceedings. My name is Bob Noseworthy, and I'm Chair and CEO of the Public Utilities Board. And I guess for purposes of this hearing I'm serving as the Chair of the Panel of two who have been assigned responsibility to hear this application. And my colleague joining me on the Panel, as I think most of you know, is the Vice-Chair, Darlene Whalen. And the staff to my far left, I guess, would be Dwanda Newman, who is the Board counsel and Cheryl Blundon who is Board secretary.

The public hearing by the Board is for the purpose of deciding on the application of

Page 2

Newfoundland Power, who are proposing certain changes in the Company's accounting policy for revenue recognition for regulatory purposes. These changes are being proposed following the conclusion of a long-standing tax case involving Newfoundland Power's historical policy of revenue recognition for income tax purposes and the Applicant, Newfoundland Power, is seeking to change its accounting policy for revenue recognition from the bill method which is currently used and recognizes revenues as customers are billed to the accrual method, which is more in keeping with practices followed by other Canadian public utilities and recognizes revenue at the time the electric service is delivered to customers. The principal focus of this change is proposed to take effect in 2006 and subsequent years and the change gives rise to a number of transitional issues which also require Board consideration during this hearing. And based on the decisions affecting the accounting treatment of Newfoundland Power revenues and the related issues, the Board has also been requested in the application to

Page 3

revise values for rate base and invested capital which are part of the formula used to set electrical rates for customers of Newfoundland Power.

The Board is hearing this application pursuant to its appropriate authorities and regulations contained in the Public Utilities Act.

And I'd ask at this point that the persons really seated at the tables who are formally participating in the proceedings, if you could each introduce yourself, indicating whom you represent and in what capacity you will be participating in the hearings. And I'd start off with the Applicant, Newfoundland Power, please.

KELLY, Q.C.:

Q. Thank you, Chair, Vice-Chair. My name is Ian Kelly and I'm counsel for Newfoundland Power. And with me is Mr. Peter Alteen.

CHAIRMAN:

Q. Thank you. Consumer Advocate?

MR. JOHNSON:

Q. Good morning, Mr. Chairman, Vice-Chair Whalen. My name is Thomas Johnson. I'm the appointed

Page 4

Consumer Advocate in respect of this application. And seated with me is Mr. John Todd, who've come from Toronto had has been, is going to provide testimony for the Board, as well. Thank you.

CHAIRMAN:

Q. Welcome. Good morning, Mr. Kennedy.

MR. KENNEDY:

Q. Good morning, Chair, Vice-Chair. Mark Kennedy, capacity as the Board hearing counsel. I have no one with me.

CHAIRMAN:

Q. Thank you. Welcome everybody. At this juncture I do provide generally a short overview of the Board and the process we'll be following throughout the duration of the hearing. And I guess in looking at the attendance here this morning, this descriptive may be a little bit redundant, so in the interests of time I'm going to dispense with those explanations this morning. With regard to the evidence itself, in addition, I guess, to the paper copies of the documents which you see below the Board has posted this information on its website and all the

CHAIRMAN
documentation, including daily transcripts, will be available throughout the course of the hearing on our website as well. And I understand Ms. Jennifer Walsh, who is an employee of Newfoundland Power, I understanding working in their information systems area will be assisting during the hearing with electronic recall of the evidence as directed by the various counsel and Panel. Welcome, Ms. Walsh. And indeed, thank you for agreeing to this assignment. The electronic filing we're hoping would enhance the public access to the information before the Board and hopefully improve the overall efficiency and decision making process following the hearing itself, certainly. Those Are just my more general remarks.

There are a number of housekeeping items. I guess the seat assignments have been provided and if there are any issues in terms of the creature comforts in the room, layout, supplies, files or records you may wish to bring this to the attention of the Board secretary, Ms. Blundon. The proceedings are

being recorded by Discoveries Unlimited under the auspices of Judy Moss and the supervision of the Board secretary, Ms. Blundon, and we will receive transcription, my understanding, they will be available in the morning, I guess, and will be transcribed throughout the evening following the hearing. Is that correct?

MS. BLUNDON:
Q. Hopefully this evening.

CHAIRMAN:
Q. Okay. So, that will certainly be timely. I guess despite the later start this morning because of the prospect of inclement weather, the daily sitting times we will maintain are 9:30 to 1:30 with a view to having a break at 11 to 11:30. And I would ask the parties to adhere to those times. I guess for purposes of today given our 10:00 start, what we'll--I understand there has been some agreement that we'll add on a little bit toward the end, if necessary. I'll look at about 11:45, perhaps, to break to see if that's suitable time to do that. We'll take a half-hour break at that time and continue on to two or thereabouts as

necessary. Everybody in agreement with that?

KELLY, Q.C.:
Q. That's quite acceptable, Chair.

MR. JOHNSON:
Q. That's fine, thank you.

CHAIRMAN:
Q. Thank you. For the purposes of the transcription service, you may refer to either of us, I guess, by name or certainly Chair and Vice-Chair. The binders that you see in front of you here represent the official version of the documents for the hearing and these will be used for reference purposes only in the event of inconsistencies or problems with the electronic record called upon the monitors. And that's about, I think, all the items I have. I'll ask Ms. Newman now to enter the matter before us, confirm the issuance of notices and advise of any other preliminary items. Good morning, Ms. Newman.

MS. NEWMAN:
Q. Good morning, Mr. Chairman. Thank you, very much. The application which is the subject of this hearing starting today was filed on September 29th, 2005 and specifically seeks an

order of the Board approving--pursuant to Section 67 of the Act, adoption of the accrual method of revenue recognition commencing in 2006; pursuant to Section 69 and 80 of the Act, the recognition of, for regulatory purposes of $9,579,000 of the 2005 unbilled revenue as 2006 revenue; pursuant to Section 69(3) and 80 of the Act, the application of 295,000 of the 2005 unbilled revenue in 2006 to dispose of the current balance in the reserve; pursuant to Section 78 and 80 of the Act, that the average value of the unrecognized 2005 unbilled revenue be deducted from rate base commencing in 2006; pursuant to Section 78 and 80 of the Act, 2006 forecast for rate base of 744,326,000 and a 2006 forecast for invested capital of 745,752, 000 to be used in the formula for the calculation of 2006 return on rate base. And finally such further or other alternate matters which may upon the record of the proceeding in respect of the application appear just and reasonable in all the circumstances.

I can confirm that notice of this application was published in the Telegram on

MS. NEWMAN

November 12, 2005 and by the publishing of this, by the receipt and the publishing of this notice the Board does have due authority to hear this application and proceed this morning.

In response to this notice we did receive one Notice of Intervention from the Consumer Advocate, who is here today, and confirmation from Newfoundland and Labrador Hydro that they would not be intervening.

I would also wish to enter into the record today as Consent No. 1 the parties' agreement on certain issues, which is a document which I'm entering for the consideration of the Board in its deliberations setting out certain matters which the parties do agree upon. And I also note for the record that responses to two RFIs have been filed this morning. And I don't believe there's any other preliminary matters.

CHAIRMAN:

Q. Thank you, Ms. Newman. I was in receipt of, I guess it's Consent No. -

MS. NEWMAN:

Q. One.

CHAIRMAN:

Q. One, this morning, which is really the joint proposal indicating the parties' agreement on certain issues. And I think we would have just received this 20 minutes or so before coming in this morning, so we haven't had a lot of time to dwell on it or deal with it or review it, for that matter. I would like to, however, commend the parties certainly for focusing on issues where there can be agreement. From our perspective, I guess, it facilitates the time and expense of dealing with these throughout the course of the hearing and I think any time this can be achieved prior to a hearing is a good thing as far as everybody is concerned, particularly the consumers and customers who have to pay for these proceedings. Just my review of the issue, we will take this into consideration, certainly in due course. My only, I guess, point I would note with regard to item 2 on page 2, it talks about the accounting accrual forecast to arise from the change in Newfoundland Power's accounting policy to the

accrual method should be dealt with over a transition period. And I guess, you know, a transition period would be normally defined in terms of process and/or time. Maybe there might be some clarity to that brought by the parties throughout the course of the proceeding just for my edification, if nobody else's. In any event, that's my only comment on that at this point in time. Do you have any comment, Ms. Whalen? Thank you. I understand Mr. Kelly, you would be making an opening statement which may consume ten minutes or so, it's my understanding, and Mr. Johnson, I understand that you'll be making a short opening statement, as well. Mr. Kennedy, you're not -

MR. KENNEDY:

Q. No, no, opening statement.

CHAIRMAN:

Q. - intending to do that. We'll proceed with that, if that's okay, Mr. Kelly, and Mr. Johnson, and then we'll have the swearing in of the witnesses and introduction, if that's okay.

KELLY, Q.C.:

Q. That's acceptable, Chair.

CHAIRMAN:

Q. Thank you. You may begin when you're ready.

KELLY, Q.C.:

Q. Thank you, Chair, Vice-Chair. Let me first say that we've distributed this morning some hard copies of various information requests that the Panel will refer to in their evidence just so you've got a hard copy in front of you, as well. It will come up on the screen, but we've provided that for ease of reference as well.

Chair, let me begin by indicating that the application which you have before you today has essentially three components. The first is the adoption of the accrual method of revenue recognition for 2006. The second is the transitional provisions with respect to the adoption of the asset rate base method of determining the rate of return on rate base. And the third is the use of a portion of the accrued unbilled revenue to offset additional income tax and increased depreciation expense in 2006.

Grant Thornton has accepted that the

KELLY, Q.C.

Company's proposals with respect to the adoption of the accrual method and the transitional provisions with respect to ARDM are reasonable. The Consumer Advocate also has accepted those aspects of the application.

The Company's proposal with respect to the use of a portion of the accrued unbilled revenue has itself three elements. The first is 3,086,000 of accrued unbilled income would be applied in 2006 to offset the income tax effects of the tax settlement, 3,086,000. The second is 5,793,000 of the accrued unbilled revenue would be applied to offset the conclusion of the true up adjustment with respect to depreciation. And finally, the third item is 1,157,000 of accrued unbilled revenue would be applied to offset additional depreciation expense resulting from increased plant investment.

(10:15 a.m.)

These are three specific cost items. The additional tax is a known identifiable amount arising from the tax settlement. The amount is not in dispute. The application of a

portion of the accrued unbilled revenue to offset this expense appears largely to be accepted in the evidence. The amount of the depreciation true up was a fully tested amount in the last general rate hearing. And the amount of additional depreciation arising from increased plant investment flows directly from capital expenditures approved by the Board and depreciation rates set forth in Board orders. So, all three are specific and determined cost items.

Grant Thornton has stated in its report at page 16 as follows, "We believe the appropriateness of Newfoundland Power's proposal must be assessed based on whether they provide the opportunity to earn a just and reasonable return in 2006", and we agree with that statement. The adoption of the Company's proposals results in a forecast rate of return on rate base for 2006 of 8. 56 percent, near the lower end of the approved rage of rate of return on rate base of 8. 50 percent to 8.86 percent. Newfoundland Power believes that this resolution for 2006 represents a reasonable balance of the

interests of the Company and its customers in the particular set of circumstances at this time. It is a practical approach and it permits an orderly regulatory process as follows: First, it deals with the accrual and transitional issues. That's one advantage. Second, it maintains existing customer rates. And third, it provides Newfoundland Power with the opportunity to earn a just and reasonable return in 2006. And that in turn then clears the way for a transparent and focused general rate hearing in 2006 based upon a 2007 test year. So, from the Company's perspective this is a logical sequence approach.

There is one other issue that the Board will need to consider in its decision. An issue has been raised with respect to the interest refund received in 2005 as a result of the tax settlement. That interest is approximately $2.1 million. The interest has been recorded in the normal course as miscellaneous revenue in the Company's system of accounts in accordance with existing Board orders. It has been included as revenue for the purpose of calculating the forecast rate

of return on rate base of 8.57 percent for 2005. In order P.U. 19 (2003) the Board indicated that it would deal with any issues arising from the final decision of the tax case including any potential liabilities or benefits to ratepayers once the case was resolved.

The Company recognizes that it is proper and appropriate for the Board to review the prudence of the Company's management of the tax dispute and its settlement. That power was recognized by the Newfoundland Court of Appeal in the decision in the Stated Case, subject, of course, to the presumption of managerial good faith. The Company's management of the income tax dispute, the successful resolution of the GEC issue with the CCRA and the current settlement with respect to the accrual issue had been a huge success for Newfoundland Power's customers. The original reassessments were set aside resulting in no additional taxes, interest or penalties. A net present value analysis of the costs and benefits demonstrates that customers have received benefits estimated at

Page 17

KELLY, Q.C.

approximately $19 million from the Company's management of the tax issue. That benefit has been achieved at a net cost to the Company itself of approximately 1.7 million after receipt of the 2005 refund interest. The Company is very pleased to have been able to achieve such a satisfactory resolution of this issue for its customers.

Mr. Smith, Newfoundland Power's President and CEO, and Mr. Meyers, Newfoundland Power's Treasurer, will address the management and settlement of the tax dispute in their evidence. Mr. Meyers will explain to you in detail the customer benefits which have been attained.

In balancing the interests of Newfoundland Power and its customers, there is no basis to disturb or change the normal recognition of refund interest in accordance with existing Board orders. Indeed, from a legal perspective, the issue would only become relevant in accordance with the decision in the Stated Case if the Company was to exceed the upper limit of the permitted range of rate

Page 18

of return on rate base. With the inclusion of the refund interest in 2005 the Company is only forecast to earn a rate of return on rate base of 8.57 percent toward the lower end of the permitted range. However, more importantly, from a policy perspective the evidence demonstrates that the recognition of the refund interest in 2005 in the normal manner and in accordance with existing Board orders is appropriate for cost recovery, is necessary to enable the Company to earn a just and reasonable rate of return and provides balance to the interests of Newfoundland Power and its customers. Consequently, it is in accordance with generally accepted public utility practice.

Now, as I indicated, the evidence before you will be primarily from Mr. Smith, the Company CEO and Mr. Meyers, the Treasurer. In addition to their testimony Mr. John Browne, who sits behind me, will testify as an expert in regulatory accounting policy. Mr. Chairman, those are my opening comments.

CHAIRMAN:

Q. Thank you, Mr. Kelly. Good morning, Mr.

Page 19

Johnson.

MR. JOHNSON:

Q. Good morning again, Mr. Chairman. A pleasure to be here with you again this morning. I'd like to start my opening by posing a very simple question, and that is what is his hearing all about.

Newfoundland Power says that the application arises because of the settlement of a long-standing tax dispute, and I think, Mr. Chairman, your words this morning confirm that interpretation. Indeed, in their overview to the application, and for the record, I'm referring to page 1 of the Company's evidence, Newfoundland Power says, and I quote, "Since 1998 Newfoundland Power's Revenue Recognition Policy has been before the Board on a number of occasions. The Board has indicated its intention to review that policy and any issues arising from the tax dispute, including potential liabilities or benefits to customers following resolution of the dispute. This application addresses the Company's current accounting policy for revenue recognition for regulatory purposes and

Page 20

purposes it be changed."

We would not be here today except for the fact that the tax case has been settled and the dispute had ended. Finally it is safe to talk about revenue recognition again as the topic had been off limits in previous proceedings for fear of prejudicing an ongoing tax case. In the Company's application the Board will already have noted, I suspect, that there are issues related to the tax settlement contained in the application and there are issues that are not related to the tax settlement. I'd go further and I'd say to you that there are indeed issues totally unrelated to the tax settlement. Oddly enough, there are issues, while there are issues totally unrelated to the settlement of the tax case raised in the application, the application on its face omits to deal with an issue that is totally and completely an issue that arises from the tax case, and that being the $2.1 million of interest revenue. That issue arose really for the first time by way of a Request for Information from Board staff.

Now, the non-tax settlement related issue

MR. JOHNSON

is the depreciation true up and the increased plant investment depreciation expense. These non-tax settlement issues have nothing to do with the tax settlement, nor is there treatment necessary in this application in order for Newfoundland Power to switch over to an accrual method of revenue recognition for regulatory purposes. Nor is it a transition issue. These non-tax-related issue should not be addressed here at all in this application. They should be addressed, in my submission, as part of the Company's next general rate application whenever the Company chooses to file it.

The reason for our submission on this point is that depreciation and the claim to have revenue offset an anticipated increase in depreciation expense, it belongs in a GRA simply because the customers' money is no less worthy of protection because it is sitting in an unbilled revenue account than it would be if it was sitting in the customers' wallets and Newfoundland Power came forward looking for a rate increase. This is fundamentally a

revenue increase for 2006. And they're seeking these revenues from customer funds.

My submission is that issues such as that should be properly tested in a procedure which allows it to be tested and which allows one to review the overall revenue requirement, and that is why I would submit that Grant Thornton in their report noted the relative lack of comfort that the Board might feel by being asked to look at issues outside of the context where an overall revenue requirement review can be undertaken.

Now, what are the issues left that are related to the tax settlement? It is my view there are two boxes: tax settlement issues and non-tax settlement issues. And with the tax settlement issues I put them into two categories: ones that don't seek additional revenue and ones that do seek additional revenue. The ones that don't seek additional revenue are non-contentious from the point of view of the Consumer Advocate, those being the switch to the accrual method itself, the identification and quantification of the amount of the unbilled revenue, that

commencing in 2006 Newfoundland Power should adopt the Asset Rate Base Model and use the same for the calculation of its rates pursuant to its next GRA and that Newfoundland Power should apply the amount of 295,000 of the unbilled revenue in 2006 so as to dispose of the current balance in the unbilled revenue increase reserve.

(10:30 a.m.)

Because technically, at least my consultant tells me, that that is not a draw down upon the unbilled revenue, because the 295,000 is already recognized and the 295 is a means of actually quantifying what the unbilled revenue actually is. And the 495,000 figure referred to the application is further a statement as to the additional revenue that appears in 2006 by way of operation of the accrual method of accounting.

So, the contentious issues are the true up of 5.793 million and the impact of the increased plant investment on depreciation at 1.157 million. Then we have the tax of 3,086,000 and the $2.1 million in interest on the tax case deposit. As I've said, the true

up and the increased plant deposit are clearly outside of the tax settlement box and these are GRA issues.

With respect to the $2.1 million we say that this is clearly an issue over which this Board has retained jurisdiction in stating that it would review any issues after the conclusion of the tax case and should be--and those issues pertaining to the $2.1 million should be dealt with in this application as part of the promised review that the Board indicated that it would take upon itself once the tax case was over. In our view, this is the promised review. We say that the Board should deal with the 2.1 million in this application and order that the GAAP rules do not dictate its disposition for regulatory purposes and we say that the disposition of the $2.1 million is to be put in a reserve for the disposition to the benefit of consumers. And we'll get into, in final argument, as to the Stated Case and our views on that.

And with respect to the 3.86, 3,086,000, that too is clearly a direct upshot of the tax cases settlement and should be dealt with in

Page 25

MR. JOHNSON
this application as well because that is clearly within the box of tax settlement issues.
With those opening statements, I shall allow the evidence to be heard and I shall be pleased to make final argument at the conclusion of the case.

CHAIRMAN:
Q. Thank you, Mr. Johnson. Mr. Kelly, I'd ask you to introduce your witnesses, please, and following that I'll swear them in.

KELLY, Q.C.:
Q. Thank you, Chair. The witnesses this morning will be, our first two witnesses will sit as a Panel. We have Mr. Carl Smith, who is the President and CEO of Newfoundland Power.

CHAIRMAN:
Q. Good morning, Mr. Smith, and welcome.

KELLY, Q.C.:
Q. And with him is Mr. Robert Meyers, who is the Treasurer of Newfoundland Power.

CHAIRMAN:
Q. Good morning, Mr. Meyers, welcome to you, too.

MR. CARL SMITH (SWORN)

Page 26

MR. ROBERT MEYERS (SWORN)

CHAIRMAN:
Q. You may begin, Mr. Kelly, when you're ready.

KELLY, Q.C.:
Q. Thank you, Chair. Mr. Smith, you are the President and CEO of Newfoundland Power?

MR. SMITH:
A. That's correct.
Q. I understand that from 1995 to 1999 you were the Vice-President Finance and Chief Financial Officer of Newfoundland Power, from 1999 to the end of 2003 you were the Vice-President Finance and the Chief Financial Officer of Fortis Inc., and you assumed your current position with Newfoundland Power on January 1, 2004, is that -

MR. SMITH:
A. That's correct.
Q. Okay. Mr. Meyers, you are the Treasurer of Newfoundland Power?

MR. MEYERS:
A. Yes, I am.
Q. I understand that from 1999 to 2004 you were the manager of internal audit at Newfoundland Power, from June of 2004 to June of 2005 you

Page 27

were the Vice-President Finance and Chief Financial Officer of Fortis, B.C., and you assumed your current position as Treasurer with Newfoundland Power on July 1, 2005?

MR. MEYERS:
A. Yes, that's correct.
Q. Mr. Smith, I'd like to start by having you provide the Board with an overview of the tax settlement.

MR. SMITH:
A. I'd be happy to, thanks. In June, 2005 the Company settled its long-standing tax dispute with the Canada Revenue Agency. Resolution of this dispute is a good news story for consumers. It is the settlement of this dispute which is the primary catalyst for this application.
In 1995 the federal tax authorities reassessed Newfoundland Power's income tax returns for the years 1988 to 1993 inclusive. The amount of tax and interest involved in these original reassessments totalled approximately $33 million. There were two primary issues involved in the original reassessments. The largest issue concerned

Page 28

the Company's treatment of capitalized general expenses for tax purposes. And in 2000, following detailed negotiations the federal tax authorities withdrew the reassessments on this issue. The Board will recall that it was the settlement of the capitalized general expenses issue that gave rise to Newfoundland Power's 2001 application to rebate excess earnings to our customers. There were further rebates related to settlement of the issue as a result of the Board's order on Newfoundland Power's 2003 general rate application. In total, $8.8 million has been rebated to customers.
The second issue in the original reassessments concern the Company's policy of revenue recognition for tax purposes. This issue could not be resolved in 2000 and as a result the federal authorities issued new tax reassessments. By 2004 the amount of tax and interest involved totalled approximately $16 million. By early 2005 the dispute was being prepared for trial in the Tax Court of Canada. In June of this year Newfoundland Power reached settlement on the revenue recognition

Page 29

MR. SMITH
issue with the federal authorities and this settlement represents the final resolution of the Company's long-standing income tax dispute.
Q. How does the resolution of the issue of revenue recognition for tax purposes relate to this application?
MR. SMITH:
A. The Company's Revenue Recognition Policy has been before the Board on a number of occasions. The uncertainty created by the tax dispute made it difficult to fully consider the appropriate Revenue Recognition Policy for the Company until now. The settlement provides the necessary certainty to both the Company and this Board to now consider the appropriateness of the Company's Revenue Recognition Policy. In the Board's order on the Company's last general rate application the Board indicated its intention to review the Company's Revenue Recognition Policy following resolution of the dispute with the federal tax authorities. In addition, the Board indicated that it would deal with any

Page 30

issues arising from final resolution, including the potential benefits or liabilities to customers. This application provides the appropriate forum for consideration of these potential benefits and liabilities.
Q. Let's start with the benefits. What are the benefits of the tax settlement for Newfoundland Power's customers?
MR. SMITH:
A. The benefits for Newfoundland Power's customers of the settlement and overall conduct of the tax dispute are significant. In our responses to the Request for Information filed in response to questions from the Board staff and from the Consumer Advocate we outline in detail the benefits and the costs relating to the tax dispute. And Mr. Meyers will take you through those very shortly. I believe that we have clearly demonstrated that Newfoundland Power's customers have already received substantial benefits as a result of the Company's management of this tax dispute. The Company's actions resulted in savings of $33 million

Page 31

with respect to past rates. As well, our customers' future rates will be lower than they otherwise might have been as a result of the $24 million in unbilled revenue.
Q. And were there any potential liabilities for Newfoundland Power's customers from the tax settlement?
MR. SMITH:
A. As mentioned, the Company avoided the payment of any tax or any interest in respect of its historical tax practices. Therefore, the final tax settlement created no potential liabilities for Newfoundland Power's customers. In actual fact, it eliminated that.
Q. Let's go next to the accounting policy change. Just explain what the proposed accounting policy change for revenue recognition that's being made by Newfoundland Power in this application?
MR. SMITH:
A. Newfoundland Power is proposing that it adopt the accrual method of revenue recognition for regulatory purposes commencing in 2006. This proposal is consistent with regulatory

Page 32

practice in Canada currently. In addition, it is consistent with generally accepted accounting principals. Due to these reasons, the implementation of the proposed policy change has been agreed to by the Consumer Advocate, Board staff and the Company.
Q. Can you comment generally on the settlement of some of these issues which was reached by the Consumer Advocate, the Board staff and the Company?
MR. SMITH:
A. Newfoundland Power looks very favourably upon negotiated settlement as a means of assisting in the resolution of issues that come before the Board or for its consideration. The costs associated with the regulation are costs which our customers must pay and any reasonable means of minimizing these costs is worth pursuing. In this application we believe the constructive cooperation of all parties has reduced the number of issues and the complexity of the proceedings. In future we anticipate similar approaches as a means to resolve issues in dispute.
Q. And the next area I want to look at is this

Page 33

MR. JOHNSON
concept of the 2005 unbilled revenue. So, let's start by having you explain the nature of that 2005 unbilled revenue?
MR. SMITH:
A. Certainly. The primary issue that arises from the Revenue Recognition Policy change is the forecast accounting accrual of approximately $24 referred to as the 2005 unbilled revenue. It essentially represents the value of electricity delivered in the last two months of 2005. Under the existing bill method by contrast, this revenue would not be recognized until 2006. In order to change to the accrual method of revenue recognition the Company will have to recognize, for regulatory purposes, the unbilled revenue of $24 million. Because the amount is so large the Company is proposing to phase in the recognition of this amount. The 2005 unbilled revenue is not cash, so the extent to which it can be used in any one year to offset revenue from rates may be limited.
Q. Now, describe for the Board the Company's proposal with respect to the 2005 unbilled

Page 34

revenue?
MR. SMITH:
A. In this application the Company is proposing that a portion of the unbilled revenue be used to offset additional income tax and additional depreciation expense anticipated in 2006. This is a very pragmatic customer-friendly proposal. The additional tax flows directly from the tax settlement. The increased depreciation is primarily caused by the conclusion of a three-year true up adjustment. The resolution of the tax dispute provides the Company and the Board with means to deal with these items without affecting customer rates. By recognizing a portion of the 2005 unbilled revenue in 2006 these cost items can be addressed without a rate increase.
Q. Mr. Smith, I just want you to clarify a point for the Chairman. When you were talking about the meaning of the 2005 unbilled revenue, you referred to that as the electricity delivered in the last two months, I believe is the phrase you used.
MR. SMITH:
A. I'm sorry, that should be two weeks.

Page 35

Q. So, it's the last two weeks of December. I just wanted to be sure we had that correct.
MR. SMITH:
A. Thank you.
Q. Now, come back to the Company's proposal. Just explain next why the Company's proposal is being dealt with in this accounting policy application instead of in a general rate application?
MR. SMITH:
A. Newfoundland Power's last general rate application established customer rates for 2004 and these rates are the basis of the Company's current customer rates. It's been known for some time that depreciation expense would increase significantly in 2006 and that the Company would have to address the consequential revenue shortfall. Normally this would result in an application for increased rates.
(10:45 a.m.)
The settlement of the tax dispute, however, provides the Company with an alternative to filing a general rate application. It provided the certainty necessary to address

Page 36

the Company's Revenue Recognition Policy. In turn, this permitted the Company to file the accounting application in order to deal with the change in accounting policy and related transitional matters while at the same time dealing with the forecast increase in depreciation and tax cost in 2006. This avoids an increase in customers' rates and produces a measure of rate stability and overall lower costs for customers. Dealing with the change in the Company's Revenue Recognition Policy at this time also reduces the complexity of the next general rate application. Therefore, next year's hearing will be far more efficient, effective and transparent than a general rate application in 2005 would have been. The process adopted is the most practical and cost-efficient option in the circumstances. It facilitates an orderly prospective review of customer rates within the next year, an accurate forward-looking information available at that time.
KELLY, Q.C.:
Q. Would you comment generally on the other proposals before the Board concerning the

KELLY, Q.C.
forecast 2006 tax and depreciation expense?
MR. SMITH:
A. Yes. Both Grant Thornton and Mr. Todd, in their evidence, seem to indicate that recognizing a portion of the 2005 unbilled revenue to offset the income tax effects of the tax settlement is acceptable. Grant Thornton characterizes the overall proposal as reasonable. Mr. Todd indicates it would be appropriate to recognize only enough of the 2005 unbilled revenue to offset the approximately 3.1 million dollars in tax effects. It seems that the principal point of disagreement on the issue of recognizing the 2005 unbilled revenue relates to the amount, if any, to be recognized in respect of increased depreciation expense.
Grant Thornton indicates that a distinction should be made between the increase in depreciation expense caused by the conclusion of the true up versus the incremental increased depreciation expense caused by the increase in plant investment. In addition, both identify deferral of costs

as an alternative to the accrual of 2005 unbilled revenue as a means of disposing of this part of the application. From the Company's perspective, there is little practical difference between the Board approving an accrual in respect of the increased depreciation expense and the Board ordering a deferral of the recovery of the increased depreciation expense.
Mr. Todd's evidence on addressing the increased 2006 depreciation expense seems clear. He recommends that no accrual of unbilled revenue could be justified without a general rate hearing for 2006. From the Company's perspective, and I believe the customer's perspective, a general rate hearing would be the least desirable course of action to deal with the increase in 2006 depreciation.
The depreciation true up of approximately 5.8 million dollars is a known value and was tested at the Company's last general rate application. It's conclusion is also an accepted fact. The Company's request to deal with this in this proceeding is, from a

practical perspective, quite reasonable. While there is no preexisting mechanism to deal with the conclusion of the true up, it is known what this change in depreciation expense will be in 2006. Dealing with the matter of the true up now is not, in the Company's view, subject to any practical constraints.
Mr. Todd appears to draw a distinction between the past true up commodity costs and the increased 2006 depreciation expense resulting from the conclusion of the true up. Newfoundland Power does not agree that the distinction is practically valid nor that a full rate review is necessary to deal with the conclusion of this true up. Similarly, the additional depreciation with respect to new plant investment flows directly from the Board's approved capital expenditures and depreciation rates that have been established by existing Board orders.
Q. I want to turn next to look at this question of the 2005 interest refund. Let's start by having you comment generally on Mr. Todd's evidence regarding the 2005 interest refund.
MR. SMITH:

A. Mr. Todd's evidence suggests that allowing Newfoundland Power to retain the 2.1 million dollars in interest revenue in 2005 violates cost of service principles. The Company disagrees with this conclusion for a number of reasons. In general terms, Mr. Todd's conclusion suggests a focus on cost recovery of specific items. The Company, on the other hand, focuses on overall cost minimization. Although the difference may appear subtle and ethos of overall cost management is more likely to produce results that benefit customers in the long term. In specific terms, Mr. Todd suggests that only customers incurred the cost of the tax dispute. In actual fact, the Company financed the initial deposit in 1995 and 1996. While the final resolution of the tax dispute clearly provides net tangible benefits to customers, it was at a net cost to the Company.
The Company has treated the 2005 interest revenue in the normal course. It is consistent with Board approved past practice for treatment of interest revenue. In past years, the recognition of interest revenue

MR. SMITH

resulted in excess earnings which was refunded to customers. The consistent treatment of interest revenue in 2005 will not result in excess earnings. On the contrary, it only allows the Company to earn a rate of return on rate base that is within the approved range.

A range of return on rate base is a key aspect of regulation in Newfoundland and Labrador. This Board has recognized that a range of allowed return on rate base can serve as an important incentive to effective management. This has served customers well. In circumstances where effective management of tax has resulted in benefits to customers, it hardly seems appropriate, from a policy perspective, to remove the incentive to the Company after the matter has been resolved.

Q. I'd like you to elaborate on the comment that you made a few moments ago with respect to effective cost minimization in the context of the management of the tax dispute.

MR. SMITH:

A. When confronted with the original tax reassessments in 1995, Newfoundland Power was

faced with a choice. They could accept the tax reassessments as levied or could dispute them. It would have been easy to simply write a cheque for the tax reassessments. If Newfoundland Power was more focused on cost recovery as opposed to cost minimization, that might have been the choice it made. But Newfoundland Power believed that the reassessments were inappropriate. They presented a substantial potential liability for both the Company and our customers. Therefore, the Company made the correct decision to contest the reassessments. In the result, the customers of Newfoundland Power clearly benefited from this decision. Whether Newfoundland Power would have been allowed by this Board to recover all the tax and interest costs if it chose to pay the original reassessments, it is uncertain and I'm glad we didn't have to deal with that situation.

It is a fair observation that the historical tax practices which were in dispute did not provide any benefit to Newfoundland Power in terms of increased returns. Newfoundland Power's conduct of the tax

dispute resulted in lower historical rates for customers. It will also result in lower future rates. Income tax, like any other utility cost, must be managed. Newfoundland Power's effective management of income tax costs has had a positive impact on customers' rates, similar to our effective management of other costs.

Q. Mr. Meyers, would you, first of all, describe for us the alternatives that were available to Newfoundland Power when faced with the tax reassessments in 1995 and the legal requirements with respect to contesting the reassessments?

MR. MEYERS:

A. Yes, certainly. I'd like to begin where Mr. Smith left off. The Company chose in 1995 to contest the tax reassessments, simply because it was the right thing to do for customers. Having made that decision, the company was legally required to place one half of the reassessed amount on deposit with CRA. This deposit was therefore a necessary and unavoidable cost associated with contesting the reassessments. The Company could have

chosen to place the entire amount on deposit. However, depositing the minimum amount minimized the associated financing costs. Because the reassessments had been abandoned by CRA as a result of the tax settlements, all assessment interest has also been avoided, including the 7.7 million dollars of arrears interest included in the original reassessments.

Q. Mr. Meyers, I'd now like to take a closer look at the Company's response to CA-23, and would you start by explaining the approach taken by the Company in analysing the costs and the benefits related to the tax settlement?

MR. MEYERS:

A. CA-23 deals with a matter that spans approximately ten years. To provide a fair and meaningful assessment of the costs and benefits related to the tax settlement, we have provided, in the response to CA-23, a present value or NPV analysis. A present value analysis is generally used to quantify in current dollars, costs and/or benefits which occur over a relatively long period of time. The present value analysis in CA-23

Page 45

MR. MEYERS
provides a reasonable estimate of the impact to customers and to Newfoundland Power of costs and benefits associated with the tax settlement from 1995 to 2005 expressed in 2005 dollars.
NPV analysis is a tool that has been relied upon by the Board to evaluate appropriateness of capital expenditures, for example, and operating expense reduction initiatives such as the Company's early retirement programs. The NPV analysis in CA-23 includes all appropriate costs borne in respect of the tax dispute. Income tax related to the revenue in question would ultimately be payable in any event. For that reason, we have not included the tax itself in the cost benefit analysis. What we have included are the financing costs and legal fees that have been incurred as a result of the tax dispute and the arrears interest that has been avoided through resolution of the tax case. There are other financial benefits to customers arising from the tax settlement that have also not been included in the core cost

Page 46

benefit analysis contained in CA-23. They are noted in the response and I will refer to them further in a moment. In order to remain conservative in estimating the customer benefits and in order to simplify the analysis, these benefits were excluded. The net benefit to customers resulting from Newfoundland Power's settlement of the tax dispute is therefore actually higher than the analysis in CA-23 demonstrates.
In order to make this analysis more robust, the Company has used three discount rates for purposes of calculating the net present values. A discount rate is intended to reflect the time value of money or the interest effects, if you will, over the analysis period. The three rates used in the analysis in CA-23 are; 6.9 percent or Newfoundland Power's after-tax weighted average cost of capital; 8.5 percent or Newfoundland Power's weighted average cost of capital; and 10.8 percent or Newfoundland Power's pre-tax weighted average cost of capital. Arguments are sometimes made which suggest that one of these rates may be more

Page 47

appropriate than the other. In preparing present value analysis to evaluate revenue requirement impacts, Newfoundland Power has traditionally used a discount rate that is equivalent to its weighted average cost of capital, or in this case, the 8.5 percent. Using the three rates indicates a range of sensitivity upon which the Board should be comforted.
In the case of this net present value analysis, using either of the three rates provided results in the same conclusion. Regardless of the discount rate used, this analysis clearly demonstrates the positive economic benefit to customers resulting from Newfoundland Power's pursuit and resolution of the tax dispute.

Q. Now with that overview, I want you to take us through the detailed financial analysis provided in the Company's response in CA-23.

MR. MEYERS:

A. Yes. I would like to highlight--take some time and highlight some of the main points of our analysis for the benefit of the Board. To assist, I'll refer to the handouts that have

Page 48

been passed out here this morning, which include copies of requests for information CA-23 and PUB-12, as well as Exhibits NP-6 and NP-15.
The first component of the analysis identifies the financial benefit to customers as a result of Newfoundland Power's management of the tax dispute. This analysis is set out in Section 3.1 on page two of the response, and Ms. Walsh has put that up on the screen for us.

(11:02 A.M.)

In 1995, when CRA reassessed Newfoundland Power's income tax returns for the years 1988 through 1993, it took the position that the Company was liable for interest on the unpaid taxes. This is referred to as arrears interest. The principal financial benefit included in the analysis stems from the fact that arrears interest has been avoided as a result of the tax settlement. As mentioned a moment ago, additional benefits associated with delay payment of income tax itself has not been included in this analysis but would serve to increase the benefit to customers if

Page 49

MR. MEYERS
it were included. Avoiding the payment of arrears interest means that customers will bear no cost associated with arrears interest related to the tax dispute. The present value to customers of the avoided arrears interest is calculated in Attachment A to the response.
Q. In Attachment A, okay. Now please explain the amounts that are shown in Attachment A.
MR. MEYERS:
A. As we see on the screen, arrears interest assessed by CRA in 1995 in the amount of 7.7 million dollars is shown in the first column to the right of the year 1995. Because arrears interest charged by CRA is not tax deductible, the revenue requirement must be tax effected in order to arrive at the total avoided cost to customers. The amount of approximately 5.6 million dollars shown in the next column to the right represents the income tax effects in 1995, based on an income tax rate of 42 percent. The amount shown in the column to the far right, $13,276,000, is the sum of the two previous amounts. This is the total avoided revenue requirement related

Page 50

solely to the issue of arrears interest in 1995 dollars as a result of Newfoundland Power's decision to contest the tax reassessments.
The numbers shown at the bottom of the table indicate the net present value of this avoided revenue requirement based on the three discount rates that I referred to earlier. The net present value of the avoided revenue requirement at a discount rate of 8.5 percent is shown to be approximately 30 million dollars.
Q. Okay. Now the next section in the response to CA-23 is entitled Customer Costs. Just explain that next.
MR. MEYERS:
A. Yes. Section 3.2, beginning on page three of the response, addresses the cost to customers associated with financing the tax dispute that were included in the customer rates. The cost referred to in this portion of the analysis are the financing costs associated with the income tax deposit and legal fees incurred by the Company in dealing with the tax dispute. Another important component of the rate impact

Page 51

on customers in this case is the rebates to customers in 2001 and 2003. These are also included in the analysis and details of the analysis are provided in Attachment B to the response.
Q. Okay. Just continue.
MR. MEYERS:
A. Attachment B, on the screen, shows that financial costs and legal fees associated with the tax dispute were not reflected in customer rates until 1997. In this table, the estimated financing costs, legal fees and for 2001 and 2003, rebates to customers, are shown for each year. The net present value of these costs, based on each of the three discount rates, is shown at the bottom of the table.
Q. What's the result of the analysis of the customer costs?
MR. MEYERS:
A. Attachment B shows that the present value of customer costs related to the tax dispute and included in customer rates is approximately 10.7 million dollars, at a discount rate of eight and a half percent.
Q. Okay. What's the next step in the analysis

Page 52

then?
MR. MEYERS:
A. To this point, we've reviewed both the customer benefits associated with the avoided payment of arrears interest and the customer costs related to the tax dispute. The next step then is to calculate the net benefit to customers of settling the dispute. This simply involves offsetting the benefits and the costs that I've indicated thus far.
This is done in Section 3.3 of the response on page four. We see here Table 3 titled Net Customer Benefits. Table 3 nets the customer benefits shown in Attachment A, which we've just talked about, against the customer costs shown in Attachment B, and Table 3 shows that the net economic result of Newfoundland Power's management of the tax dispute is a positive one for customers. At a discount rate of 8.5 percent, the net economic benefit to customers on a present value basis is approximately 19 million dollars within a range of 16.2 million to 24.7 million dollars.
Q. Now you mentioned earlier that there are a number of other financial benefits to

Page 53

MR. JOHNSON
customers associated with the tax dispute that were not included in the analysis. Could you just explain those in a bit more detail?
MR. MEYERS:
A. These other benefits to customers can be found in Section 3.4 of the response beginning on page four. This section summarizes these other substantial benefits to customers as a result of Newfoundland Power's actions in disputing CRA's position. These benefits have not been included in the net present value that we've just reviewed. The first of these benefits relates to the tax deposit amount.
As I said earlier, while Newfoundland Power could have deposited the full amount of the tax with CRA and thereby avoided further accumulation of arrears interest, the Company chose instead to deposit the minimum required amount or one half of the reassessment. This reduced the financing costs borne by customers and was the least cost option available.
The second benefit relates to changes in income tax rates over the period from 1995 to 2008. Payment of income taxes has been

Page 54

delayed as a result of the Company's decision to contest the reassessments. Those taxes will now be determined based on tax rates that are lower than those which were in effect in the 1990s when the reassessments were first issued. It's noted here on page four, the tax rate in effect for 2006 to 2008, when these taxes will be calculated, is forecast to be approximately 36 percent. This compares to a higher average tax rate of approximately 43 percent for the period 1993 to 2005. The estimated benefit to customers related to the lower tax rates is shown to be approximately 3.1 million dollars. This estimated amount has not been present valued. If it were, the benefit would be greater.
The third benefit to customers, which has also not been included in the NPV analysis, is the positive impact to customers resulting from delayed payment of the tax itself. The delayed payment of tax results in a lower present value cost. This benefit has been reflected in lower customer rates.
As I've mentioned, neither of these three tangible benefits has been included in the NPV

Page 55

analysis set out in response to CA-23. Including them would increase the significant benefit to customers that this NPV analysis already demonstrates.
Q. Okay. So that's the benefits to customers. Now the next section in this report, Section 4 of the response, refers to Newfoundland Power costs. Would you explain to the Board what those costs are?
MR. MEYERS:
A. Yes, Commissioners. Section 4 begins on page five of the response and addresses the financing costs and legal fees related to the tax dispute that were not included in customer rates. When I referred to Attachment B a moment ago, I indicated that no costs associated with the tax dispute were included in customer rates for '95 or '96. Effectively, the Company bore the financing and legal costs in those years.
If we look at Attachment C of the response, we see here the financing costs and legal fees associated with the tax dispute for 1995 and 1996 in the first two rows with the total of these amounts shown in the net cost

Page 56

column to the far right. In 2000, 2001 and 2005, we see the after-tax interest benefits which Newfoundland Power retained related to tax refunds in those years. The 2005 amount of 1.35 million dollars represents the after-tax value of refund interest received from CRA in 2005.
This analysis of the cost borne by Newfoundland Power in relation to the tax dispute shows that even with inclusion of refund interest in 2005, the Company incurred a net cost as a result of its efforts in contesting and resolving the tax reassessments. The present value of that cost, as shown on Attachment C at a discount rate of 8.5 percent, equates to approximately 1.7 million dollars.
Q. So you've already taken that 2.1 million in interest into account in calculating the 1.7 million cost, correct?
MR. MEYERS:
A. Yes, that's correct.
Q. Okay. Now let's go next to summarize the results of the analysis set out in CA-23.

Page 57

MR. MEYERS:

A. The analysis in CA-23 clearly shows that the net impact of the tax dispute, including the cost of financing the tax deposit, has provided a substantial economic benefit to customers. That benefit is shown in Table 3 on page four of the response. The benefit to customers on a present value basis ranges from 16.2 million to 24.7 million dollars. Again, as I mentioned previously, these indicated benefits do not include any amounts related to the three other financial benefits to customers mentioned in Section 3.4 of the response.

The analysis in CA-23 also shows that the taxes dispute resulted in a net cost to Newfoundland Power. This net cost is shown in Table 4 on page five. The net cost to Newfoundland Power on a present value basis is estimated to be in the range of 1.2 million dollars to 2.4 million dollars, even with the refund interest received in 2005 included as revenue to Newfoundland Power in 2005.

In Newfoundland Power's 2003 GRA Order, the Board disagreed with an intervenor's

Page 58

suggestion that the Company's pursuit of the tax dispute was not beneficial to customers. The NPV analysis in CA-23 provides clear confirmation that pursuing and resolving the tax dispute has, in fact, materially benefitted customers.

(11:15 A.M.)

Q. Okay. Now that's the net present value analysis in CA-23, and a few minutes ago you referred also to PUB-12 and I'd like to go there next. And the Company's response to PUB-12 provides a separate analysis of the benefits to customers of Newfoundland Power of refund interest received from the Canada Revenue Agency as a result of settling the tax case, and I'd like you to explain this analysis to the Board.

MR. MEYERS:

A. The response to PUB-12 provides an alternative view of the benefits received by customers and by Newfoundland Power with respect to refund interest. It shows that of the 10.8 million dollars in total benefits realized from refund interest, customers have received 8.8 million dollars or approximately 82 percent. This

Page 59

supports the view that customers have been the major beneficiary of Newfoundland Power's pursuit and settlement of the tax dispute. Customers receive benefits through rebates in 2001 and 2003 as a result of excess earnings in 2000 and 2001. These excess earnings resulted on the receipt of refund interest related to the tax dispute. The refund interest received by Newfoundland Power in 2005, as Mr. Smith indicated earlier, has been recorded in the normal course. It has been recorded in accordance with generally accepted accounting principles and with the Company's Board approved system of accounts. Finally, it has been recorded in a manner consistent with the manner in which previous refund interest has also been recorded. The difference being between 2005 and the years 2000 and 2001 is that no excess earnings are forecast for 2005, which would result in a customer rebate.

Q. Grant Thornton indicated in their report that the Board may want to consider whether the interest income arising from the tax settlement should be incorporated with the

Page 60

transitional issues noted in this application. Can I get you to comment on that, explain that?

MR. MEYERS:

A. Yes. The interest income received in 2005 is not a transitional issue. The interest income and the transitional issues in this application are two separate issues. The interest income is revenue which has been recorded by Newfoundland Power in the normal course. The transitional issues in this application, on the other hand, are all about dealing with prospective changes in regulatory accounting policy and about providing an appropriate means by which customers should receive the 24 million dollars in additional benefit arising from Newfoundland Power's prospective adoption of the accrual method of revenue recognition for regulatory purposes.

Q. I want to look now at the Company's proposal to apply part of the 2005 unbilled revenue in 2006. Let's start by looking at the Company's forecast financial picture in the absence of its proposal.

MR. MEYERS:
A. The Company's forecast financial results for 2006, in the absence of its proposal to apply a portion of the 2005 unbilled revenue in 2006, have been provided in Exhibit NP- 15 under the heading 2006 Existing. This shows a forecast rate of return on rate base for 2006, on line 31, of 7.02 percent. This rate of return is well below the current approved range of 8.50 percent to 8.86 percent.
Q. So that's if nothing was done?
MR. MEYERS:
A. If nothing was done.
Q. Okay. Now would you explain the Company's proposal to apply part of the 2005 unbilled revenue in 2006?
MR. MEYERS:
A. The Company is proposing that a portion of the 2005 unbilled revenue be used to offset a forecast increase in depreciation expense of approximately seven million dollars and a 3. 1 million dollar forecast increase in income tax related--of tax effects related to the transition to the accrual method of revenue recognition for income tax purposes. To

offset these two amounts would require that approximately 9.6 million of the 2005 unbilled revenue and approximately 460,000 of incremental 2006 unbilled revenue be recognized for regulatory purposes in 2006. This would not provide Newfoundland Power with any additional cash revenue.
Q. Okay. Just elaborate now on the forecast increase in depreciation expense for 2006. Explain that for the Board.
MR. MEYERS:
A. The seven million dollar increase in depreciation expense results primarily from the known conclusion of a depreciation true-up adjustment that reduced depreciation expense by 5.8 million dollars in each of the three years from 2003 to 2005. This true up provided benefits to customers through a reduction in annual revenue requirement of approximately nine million dollars in each of these years. The remaining forecast increase in depreciation expense of approximately 1.2 million dollars is the result of an increase in Newfoundland Power's investment in property, plant and equipment. The increased

investment has been the subject of capital budget applications by the Company which have already been approved by the Board. The depreciation rates used to forecast depreciation expense for 2006 are those which were approved by the Board in 2003.
Because depreciation is essentially a non-cash expense and because recognizing a portion of unbilled revenue as proposed provides no additional cash revenue, using one to offset the other has no cash flow impacts and simply represents the substitution of one accounting accrual for another.
Q. What are the income tax effects of the Company's proposals?
MR. MEYERS:
A. As shown in Exhibit NP-6, if cash revenue from customer rates was used to offset the increase in depreciation expense and the tax effects related to the tax settlement, that additional cash revenue would attract additional income tax. Therefore, the amount that would be required from customer rates, as shown on line 18 of Exhibit NP-6, would increase from ten million to 15.7 million dollars. As long as

unbilled revenue is used to offset the increase as proposed, no additional income tax will be triggered and income tax effects in 2006 will be limited to the 3.1 million in taxes payable under the tax settlement.
Regardless of the amount of unbilled revenue recognized for regulatory purposes in 2006, the income tax effects will not change. The Company will be required to record 2006 income tax expense of 3.1 million dollars related to the tax settlement.
Q. Now what are the forecast financial results if the Board accepts these Company proposals?
MR. MEYERS:
A. Forecast financial results for 2006, should the Board accept the Company's proposal, have also been provided in Exhibit NP-15, this time under the heading "2006 Proposed". This shows a forecast rate of return on rate base for 2006, again on line 31, of 8.56 percent. This rate of return is within the lower end of the current approved range.
Q. With the adoption of the proposals, the rate is 8.56 percent, correct?

Page 65

MR. MEYERS:
A. That's correct.
Q. Okay. Now Grant Thornton, in its report, suggested an alternative accounting treatment based on deferring some of the costs which are the subject of Newfoundland Power's proposals, but that in doing so, the Board should also consider the tax effects of such a deferral, and I'd like you to explain that suggestion, and just take your time with this, because it's a bit hard to understand, especially for me.
MR. MEYERS:
A. The Company's response to PUB-14 indicates that deferring depreciation expense per se has unfavourable income tax effects. Grant Thornton suggests that these unfavourable tax effects should be considered in the event that a deferral of depreciation expense is deemed by the Board to be appropriate. Newfoundland Power agrees. As an alternative, if the Company were to record depreciation expense for 2006 as forecast and were the Board to order a cost recovery of an equivalent amount be deferred for consideration in the context

Page 66

of Newfoundland Power's next test year costs, deferred cost recovery, as opposed to the deferral of depreciation expense, would have no unfavourable tax effects.
Q. Okay. Now are there examples where the Board has permitted the recovery of specific costs without effecting customer rates and without a general rate hearing?
MR. MEYERS:
A. Yes, there are. As noted in the Company's response to CA-12, the Company is aware of at least two previous occasions when the Board approved a change in accounting policy and at the same time allowed for cost recovery in a way that did not have an immediate impact on customer rates and without a general rate proceeding.
In 1979, the Board approved an application by Newfoundland Telephone to fully amortize its income tax accounting. The resulting cost increase was offset by what would otherwise have been excess revenue in each of the succeeding five years.
In 1995, the Board approved an application by Newfoundland Power to change

Page 67

its accounting policy for allocating general expenses to capital. At the same time, the Board approved the Company's proposal for special pension funding. Income tax deductions resulting from the increased funding were used to offset costs associated with the accounting policy change in 1995 and other cost increases in operating expenses for 1995. This again was done without a general rate proceeding.
In these cases, the recovery of forecast increases in expense is circumstances which did not immediately affect customer rates. Both of these situations are conceptually similar to the Company's 2006 accounting policy application in which it seeks to change an accounting policy and provide for recovery of increased costs without affecting customer rates.
Q. Thank you, Mr. Meyers. Does that conclude the Panel's evidence?
MR. SMITH:
A. Yes, it does.
MR. MEYERS:
A. Yes, it does.

Page 68

CHAIRMAN:
Q. Thank you very much, Mr. Kelly. Mr. Johnson, when you're ready, you can begin your cross, please.
(11:28 A.M.)
MR. JOHNSON:
Q. Good morning, gentlemen.
MR. MEYERS:
A. Good morning.
MR. SMITH:
A. Good morning.
MR. JOHNSON:
Q. I take it from the introduction of your counsel's opening statements and your comments, Mr. Smith, that there's no debate here that the impetus and driving force behind this application is the tax settlement resolution and the issues arising from that. Would that be fair?
MR. SMITH:
A. Generally speaking, it's fair. I would define it as being the catalyst versus the driving force and that may seem to be splitting hairs, but catalyst in the sense that it cleared the way to deal with the Revenue Recognition

Page 69

MR. SMITH
Policy which in turn cleared the way to deal with the other issues that we've brought forward to the Board.
MR. JOHNSON:
Q. Let me put it this way. In tort law, there's a test called the "but for" test. Would it be fair to say that but for the resolution of your tax case, that you would not have been bringing on an accounting application such as you've brought on?
MR. SMITH:
A. You're getting me a bit over my waders when you start talking about tort law.
MR. JOHNSON:
Q. No, the but -
MR. SMITH:
A. However -
MR. JOHNSON:
Q. - but for, dwell on the but for, never mind the tort reference.
MR. SMITH:
A. The but for? Just let me take you through our thinking a little bit in terms of the accounting application. As I mentioned in my

Page 70

opening comments, we've all known for a while, the Board included, that the depreciation true up would end in 2006. So we clearly had an issue that we knew had to be dealt with in 2006. The question then becomes, how do you deal with that issue? And there's always a number of options that are available. In this particular case, I think there's probably two options. One was to bring forth a general rate application to deal with it. The other option was present it to us and this is my comment about the catalyst. The other option was to present it to us by resolution of the tax case. The tax case allowed us to get on with changing the Revenue Recognition Policy which resulted in non-billed revenue which presented us with an alternative to deal with particular cost arising in 2006 that had been set in motion back in 2003.
Q. Let me put it this way, actually, I thought that I was going to receive an affirmative answer to the question because it seemed to me based on the long entangled history of this tax case that discussions in this forum with respect to revenue recognition and switched to

Page 71

Accrual Methods, et cetera was, essentially, off limits because it would have been prejudicial to your case. So, I'm suggesting to you that but for the resolution of your tax case, that you would never have to come on in here and brought on an accounting application such as you've been bringing on. Fair statement?
MR. SMITH:
A. I think what we'll continue to agree to disagree.
Q. No, but just understand me. Let us suppose that you did not reach a settlement in your tax case in June of 2005. And your case is percolating through the system in the Tax Court of Canada, ready to go to trial in February of 2006, right. I take it you would agree with me that we--you would never have brought on an application while your tax case was going on to ask for a switch to the Accrual Method.
MR. SMITH:
A. I do agree with that comment.
Q. Okay.
MR. SMITH:

Page 72

A. But it needs some clarification though in this sense. You refer to it as being off limits and I think that's a mischaracterization. It wasn't so much off limits as much as it was a collective decision. And by collective, I mean, through the Company and the Board to take a prudent decision not to deal with it until the tax case was resolved. And I think that's a fair characterization of why it's dragged on as long as it has. And I think also now with the benefit of hindsight, the decision turned out to be the appropriate decision to take, not so much for the Company, although it has benefitted the Company, as Mr. Meyers pointed out, but particularly for the benefit of the customers. So, to get back to your question, would we have been here with an accounting application absent the resolution of the tax case? Probably not, but we would have been here in some fashion to deal with the costs that are coming on board in 2006.
Q. And in fact, would it also not be the case that in the past when the Board ordered that your Revenue Recognition Study be filed at a certain date, that your Company took steps to

Page 73

MR. JOHNSON
have the order amended because of the concern that you didn't want to be getting into filing a Revenue Recognition Study while your litigation was ongoing, correct?
MR. SMITH:
A. That's absolutely correct.
Q. Okay. Now, clearly the--I think you would agree with me, I would invite you to, that the disposition of the 2.1 million dollars is an issue arising from the tax dispute.
MR. SMITH:
A. I hate to get off on the wrong foot with you here and continue to disagree, but I do disagree. I think it's a separate thing altogether as indicate in Mr. Meyers' opening comments. It's not a transitional issue that arises from disposition of the tax case. There is a connection to the tax case obviously. It was resolved satisfactorily, therefore we got some interest revenue back. The accounting and recording of that interest revenue then, I think, reverts back to normal course. Normal course is exactly how we accounted for it this year.

Page 74

Q. But surely the statement that this Board made back when it made its order in 2003 and it said that we will review any issues arising from the tax dispute including--and they say "any issues" arising from the tax dispute including potential liabilities or benefits to customers following resolution of the dispute. Surely, within the ambit of those words, the question of what happens to the 2.1 million dollars in interest revenue falls. Would that be fair?
MR. SMITH:
A. I think that would be fair because I think the Board has ultimate jurisdiction and authority to look at all of those types of matters, absolutely.
Q. Okay. Now, so I can understand the Company's evidence on this point, and I'm a little bit at a disadvantage because the 2.1 million dollar issue was raised as a result RFI's as opposed to being presented in the application. And so there is a dearth of written Company evidence analysing what the Company's position is in the application. But do I understand you to mean that because the interest refund

Page 75

was received in 2005 as opposed to 2006, that that would impact upon this Board's right to make a disposition in relation to the 2.1 million in favour of the consumers?
MR. SMITH:
A. No, that's not my position. My position is that the Board has the right to look at it regardless which year it falls in. My additional point is that the year in which it falls in really has little bearing upon it. If it was recorded in 2000 or 2001 or 2005, the interest revenue should be treated and has been treated exactly the same.
MR. MEYERS:
A. Mr. Johnson, if I might add, the Company has a Board approved system of accounts that has been in place for a number of years. And one of the items in that approved system of accounts is an account called Miscellaneous Non-Consumer Revenue. And it clearly states in that approved system of accounts that this account should include interest revenue derived from income tax refunds. So, when we said earlier that this has been recorded in a normal course, that means that it's been

Page 76

recorded in accordance with our Board approved system of accounts which states that that's the way we are required to record that interest.
Q. Now, the tax settlement agreement, if we could bring that up. This was an agreement negotiated over some period of time, but I understand, Mr. Smith, that certainly by May month, it was known that it was going to be resolved along these terms. Would that be a correct statement?
MR. SMITH:
A. Yes, it would. May, things started to look very positive.
Q. Okay. And I note that the Agreement is structured so that essentially the refund of the interest, although the Agreement is silent on it, but because your tax case was resolved in June 2005, I think we've followed that you get the refund from the interest and deposit back in 2005, but would you agree with me that the way the Agreement is structured that the interest comes back to you in 2005, but the tax hit does not start until 2006 and then 2007, 2008 in terms of how much money you got

Page 77

MR. JOHNSON
to attribute to 2006, 2007, 2008 in switching to the Accrual Method. Would that be a fair comment?
MR. SMITH:
A. That is correct. That is how the settlement was orchestrated. They just provided a context around that though.
Q. Yes.
MR. SMITH:
A. When we sat into negotiations with Revenue Canada on this, our conclusion was that likely we had to change our Revenue Recognition Policy for tax purposes. Without a doubt that was going to happen. So, our objective going into it was to accomplish two things. One was to have a settlement that resulted in prospective rather than retroactive change. That was accomplished by having the so-called tax hit take place in the subsequent three. That was accomplished. The second objective was to make sure that or try to achieve some kind of transition period to give the Company and its customers an opportunity to deal with the change over a period of time. So, that's

Page 78

why it's set up the way that it is.
Q. Could I refer you, Mr. Smith, to CA-18 and in particular, page 2 of the Company's response to CA-18. And for the record, in CA-18 I'm asking the question, "as part of the out-of-court settlement, did Newfoundland Power propose this time frame for inclusion of the unbilled revenue and income. And if so, why"? That would be 2006, 2007, 2008. You would note--the Company notes in its response to me, in the second last paragraph on page 2 of the reply, that Newfoundland Power was also informed by confidential information it received from another Canadian Utility and I'm not going to ask you, at this point, to divulge that. It goes on to say, "Newfoundland Power was informed by this Utility that they had reached an agreement with Federal Tax Authorities, the transition to the Accrual Method of revenue recognition over a three-year period which included the year of the Agreement". Now, I take it that it would be reasonable for me to expect assume if the Minister was prepared to reach that sort of agreement with another Canadian

Page 79

Utility, that it would have been prepared to reach that sort of deal with Newfoundland Power, had Newfoundland Power requested it?
MR. SMITH:
A. A reasonable assumption on your part, yes. I'd like to think it was that easy, but it wasn't.
Q. But in fact, I mean, the Minister would have an interest, it seems to me, in having you do things more quicker, more quickly than less quickly. That's usually the way the tax man operates.
MR. SMITH:
A. I would agree with that.
Q. Yes. So, they would have been indifferent to, if you wanted to adopt that sort of proposal along the lines of the other Canadian Utility wanted.
MR. SMITH:
A. You would think they should be. I don't know if anybody has had the luxury or the pleasure of negotiated with the Federal tax authorities, but what we found, even during the course of our negotiations, that as the people changed, the positions changed along

Page 80

with them. So, I can't speak to what their intentions would be; I can't speak to what their preferences would be, but I know during the course of the negotiations, things did move around quite a bit and change from time to time.
Q. Did Revenue Canada ever ask you to pay later, you know -
MR. SMITH:
A. No, but they asked us to pay a lot earlier.
Q. Mr. Smith, I take it Newfoundland Power did not ask to be treated like this other Canadian Utility in this Agreement?
MR. SMITH:
A. Well, I need to seek some clarification; in what sense?
Q. In terms of the timing. Because in the other Canadian Utility's case, they had reached an agreement with the Federal tax authorities to transition to the Accrual Method of Revenue Recognition over a three-year period which included the year of the agreement.
MR. SMITH:
A. Yes.
Q. Right. Did you seek to have that sort of

Page 81

MR. JOHNSON
treatment for Newfoundland Power or did your people seek it?

MR. SMITH:
A. Explicitly, no. We knew that sort of established the playing field for us, three years and three years became our objection very early in the game.

Q. Well, I'm given to understand that, Mr. Smith, that had Newfoundland Power adopted--and by the way, when did you find out this information about the other Canadian Utility?

MR. SMITH:
A. The other Canadian Utility? I'm going from memory, but it would have been back in the early days of starting negotiations or starting discussions with Revenue Canada. A particular year, late '90s, mid '90s, mid to late '90s. Also relevant though is, as indicated, there were two aspects. In the early years we focused on the general expenses capitalized which is where most of the money was. And the strategy there was that these were two very different issues, so we wanted to separate them to increase the chance of

Page 82

success on each of them. So, in the early years of discussions and negotiations, a lot of the focus was on the general expenses capital, which as you see, took to about the year 2000 to resolve.

Q. I'm given to understand, Mr. Smith, that had Newfoundland Power reached the equivalent deal of this other unidentified Canadian Utility, that the result would have been that Newfoundland Power would have received the 2.1 million dollars in June of 2005 and would have had to pay the $3,086,000.00 in tax in 2005. Would that be your understanding of that would have operated?

MR. SMITH:
A. Given the hypothesis that you set up, yes, I think that would be the case.

Q. So, the customer wouldn't have been asked to pay to the three million eighty six thousand in 2005, would that be correct?

MR. SMITH:
A. But the customer hadn't been asked to pay the three million -

Q. Eighty six thousand because you had not been coming in for rates. You had settled your

Page 83

case in 2005, let's assume the same facts.

MR. SMITH:
A. I'm having some difficulty though setting up a hypothetical situation and trying to deal with it because like the Application in front of us today, I mean, this is a dynamic situation with moving parts and moving pieces. And you have to deal with them in the context as they're presented to you, not in some other context. So, that's why I'm having some difficulty with that. Consistent with our tactics with Revenue Canada, we were always looking for prospective and minimum three years. We wanted the three years to be able to deal with the impacts. We wanted perspective to be able to deal with the impacts, rather than be facing it with a situation similar to what we're face with now. Later in the year, you get the impact of this and then you have to try to deal with it. So, I think the outcome is consistent with what we set out to accomplish and to sit here and try to say, what if this and what if that, I have difficulty with. Because I can only deal--in running a business, we can only deal with the

Page 84

circumstances in the dynamic that they present themselves in the current day circumstances. So, that's why I'm having a little bit of difficulty.

Q. Mr. Chairman, you indicated when you started that we could probably break at 11:45. It's 11:50. If you wouldn't mind, I'd like to take a break.

CHAIRMAN:
Q. You want to take a break? Sure, okay, we will reconvene at, just after 12:15. Thanks.

(BREAK - 11:48 A.M.)

(RECONVENE - 12:15 P.M.)

CHAIRMAN:
Q. Thank you. Just before we begin, I guess, just with regard to time and what we might finish up today. I'm quite prepared to go-- it's an appropriate time to break between 2:00 and 2:30, depending if that's okay with everybody. I think at that time, it's a non-account and my head will be full and my stomach will be empty probably. It's not a good combination for that hour in the day. So, if we'll just play it by ear, if everybody is in agreement, then we'll see where we are

Page 85

CHAIRMAN
at around that hour. Thank-you. Mr. Johnson, when you're ready, please.
MR. JOHNSON:
Q. Thank you, Mr. Chair. Mr. Smith, I don't mean to pick on you, Mr. Meyers can jump in too, if he knows the answer. Is there any practical impediment standing in the way of this Board recognizing the 2.1 million dollars for regulatory purposes, say, in the next GRA and then to have the 2.1 treated as part of the revenue and when it's making its revenue requirement determination. Is there any practical impediment to that happening?
MR. SMITH:
A. I don't know if there's a practical impediment, but it would, in our view, be the improper thing to do.
Q. Improper why?
MR. SMITH:
A. As Bob, Mr. Meyers has pointed out earlier, the nature of the item, the interest revenue, no different than past practices of interest revenue. We've treated it normal course. It results in the Company earning a fair and

Page 86

reasonable return in 2005. And to treat it differently than that, I would think would be out of the ordinary and unusual.
Q. Now, am I correct in understanding that with the 2.1 million included in 2005 you make your allowed rate range of return, would that be correct?
MR. MEYERS:
A. Actually there's an RFI on the record, Mr. Johnson, PUB-11. And what the table here on PUB-11 shows is that for 2005 with the refund interest included, the Company earns a rate of return on rate base of 8.57 percent which is within the allowed range. And if we exclude the refund interest, our rate of return on rate base drops to 8.38 percent which is below the current approved range.
Q. So, I just take it from that, that Newfoundland Power would have had the opportunity in 2005 to earn its proper rate of return on rate base by the rates that were set in respect to 2005. There's no issue with thaT?
MR. SMITH:
A. Well, going into the year, the rates have been

Page 87

established. They were the ones that we were operating under in 2005. Like any other year, there's always a number of things that you never anticipate or can ever anticipate. And so to say that we had an opportunity to earn just and reasonable return, I think in a regulatory parlance is absolutely correct, absolutely.
Q. Yes, okay, that was my only point. Mr. Smith, I noticed this morning that PUB-15 was circulated and attached to that is Attachment A to the response to PUB-15 showing the income statement of the period ending September 30, 2005 filed with the Board as part of the third quarter report updated to include the actual results as of October 31, 2005. Now, I note on Attachment A--thank you for bringing that up for me--on Attachment A, it indicates in the far right column, the forecast for 2005. Correct? Do you see that?
MR. MEYERS:
A. The number in the far right column would have been our original plan for 2005.
Q. Okay, I'm sorry, just to the left of that column.

Page 88

MR. MEYERS:
A. Would be our forecast for 2005, yes.
Q. Okay. And the footnote 3, states that "as filed in Exhibit NP-14 of the 2006 Accounting Policy Application: -
MR. MEYERS:
A. Yes, that's correct.
Q. And, of course, that application was filed with this Board in September of 2005.
MR. MEYERS:
A. Yes.
Q. And do you know when the financial numbers would have been generated, as of what date for putting in that NP-14 of the 2006 Accounting Policy Application?
MR. MEYERS:
A. I can't recall the exact date. I'm thinking it was some time around early September maybe.
Q. Have there been any further updates since early September in respect of the forecast for 2005?
MR. MEYERS:
A. I believe there was also an RFI on that as well.
Q. I think though, I believe--because I thought

Page 89

MR. JOHNSON
that too, but I think the RFI was in relation to updated forecasts for 2006, not 2005
MR. MEYERS:
A. You may be correct, I'd have to check. But I can tell you that the forecast for 2005, as you see here, hasn't changed from what was filed in NP-14 which is provided here. We're still operating on the same forecast.
Q. It hasn't changed, is that because you haven't put your minds to coming up with a new forecast or is it because you put your minds to coming up with a new forecast and you've determined what the forecast is, but the numbers don't change.
MR. MEYERS:
A. The process that we go through, on a fairly regular basis, would involve looking at various aspects of the forecast from time to time and there's nothing in this forecast--what we see in terms of year-to-date changes, we see as mostly timing things right now that wouldn't affect our overall forecast for the year.
Q. Would it be a reasonable request of mine and

Page 90

forgive me if it's not and it's six months work, but would it be possible to provide an updated forecast, say as of the end of October in keeping with your updating the other information to October 31, 2005, in keeping with PUB-15?
MR. MEYERS:
A. The forecast that we have here would have been our October 31 updated forecast which is the same as what was in the Application. As I said, indifferences would be strictly timing differences.
Q. Okay, I understand your point. Yes, what I don't understand about that, maybe I moved on a bit too quickly, but if that forecast for 2005 was prepared, say September of 2005, you obviously didn't have 10 months of actuals, right, obviously?
MR. MEYERS:
A. No, that's right.
Q. Now, we've passed October, passed November, now we've got 11 months of actuals, so can't that be updated and then you'd be basically forecasting what December would look like. Would that be possible?

Page 91

MR. MEYERS:
A. Again, I think, you know, it would be the same forecast because the differences would be strictly one of timing.
Q. Okay, all right. Let me just--I got a little off topic there for a moment, but I want to go back to any practical impediments to the Board treating this 2.1 million dollars, for regulatory purposes as part of the next, say, GRA. Okay. Is it a problem in the Company's view that the Public Utilities Board did not expressly set up an expressed deferral account in respect of interest, tax deposits interest back some years before 2005?
MR. SMITH:
A. Is that a problem for us?
Q. Yes.
MR. SMITH:
A. No, absolutely not.
Q. All right. And would it also be hectically possible, in the Company's view, for this Board now to set up a deferral account for 2.1 million dollars that we're talking about in this Application?
MR. SMITH:

Page 92

A. It's technically possible for the Board to do that as it would with any other cost or revenue item, but my point is, it maybe technically possible, but I still think it would absolutely improper.
Q. And I want to plumb a little bit deeper into that. What makes it improper--give me a list, if you wouldn't mind.
MR. SMITH:
A. Well, let's put it in context first because when we start getting into lists and specific things, we lose the big picture. And the big picture is really what I think what we should be focused on today. This particular item is not unprecedented. It has been anticipated, these types of things will come up from time to time. The system of accounts has been established in anticipation of that to deal with it. The regulatory construct has been established to deal with earnings in any given year and whether or not there are excess earnings in any given year. There's been a range--a range has been established. So, I think that the regulatory circumstances that exist, anticipated and deals with the interest

Page 93

MR. SMITH
revenue in a fashion that is not a surprise to anybody. And has been dealt with properly, given the rules that we currently operate under. And part of our point is consistency and doing things the same from year to year. And also not changing the rules after the fact, so to speak.
Q. What I don't understand about that is how can you say that it's, it would be inappropriate for the reasons that you've outlined in the context of this Board, you know, at least a couple of times, say, and certainly in the last GRA decision, that once this case is over, we're going to assess all of the benefits and all of the potential liabilities. I can't track the wording, I don't have it directly in front of me. You know, in light of the Board having said that, I'm surprised that you would find it inappropriate that the Board would now put in place a mechanism to give effect to its determination of what should happen with the monies.
MR. SMITH:
A. I think my answer is consistent with the

Page 94

Board's statement back then. The Board indicated that it would be review the resolution of the tax case, the resulting liabilities, the resulting benefits, that's what we're talking about here today. They've been laid out very clearly. None of that suggests, in my mind, that the Board anticipated that they would deal with the interest revenue any differently that has been dealt with already, any differently than it was dealt with in 2000 or 2001 when they had interest revenue then associated with a tax case. This is not the first time we dealt with this question or the first time the Board has dealt with the question. So, I think what I'm saying is consistent with the Board's comments.
(12:30 p.m.)
Q. But, you're not backtracking at all, I don't think, from the notion that what should happen to the $2.1 million in interest comes under the ambit of any and all potential benefits and liabilities?
MR. SMITH:
A. No different than any other item that the

Page 95

Board views with respect to our financial numbers. No different than the cost associated with the early retirement program that you see in front of you, for instance. The Board has to purview, to examine all of these things. And the statement that the Board made back at the last GRA I think are just consistent with that broad purview.
Q. Now, just to ask you a couple of questions about the past refunds that were made to consumers. That, strictly speaking, was not a refund of the tax itself, that was an operation of the excess earnings account, right?
MR. MEYERS:
A. Yes, that's right.
Q. Right. So, but for the fact that you, if you had not exceeded your range, I guess the Company's position is that the customers wouldn't have got it in those two years?
MR. MEYERS:
A. Generally speaking, yes.
Q. Yeah, okay. Could I bring you to CA-23, Attachment C? And you've referred to this, Mr. Meyers, earlier. And I just want to dwell

Page 96

on, for a moment, the years 1995 and 1996, because as I understand your evidence, you're saying that's the only years that the Power Company bore these costs of the tax dispute. Am I correct?
MR. MEYERS:
A. That's correct, yes.
Q. Okay. Now, my understanding for the reason that the Power Company is saying that it bore those costs itself in those years is because you didn't have a rate case for those years? Is that--they weren't specifically figured into the rate. Would that be a correct assumption?
MR. MEYERS:
A. Yeah, the tax deposit that these financing costs relate to and the legal fees that are referred to here would not have been included in the forecast costs that were used to set rates for '95 and '96. The first time they were used in the forecast to set rates would have been in 1997.
Q. And in the 1997, that's when it first got involved in the rate case, the issue came up in terms of the purposes of the rate case,

MR. JOHNSON
would that be right?
MR. MEYERS:
A. That's when they would have first been reflected in the forecast used to set rates, yes.
Q. If you had had a rate case in 1996, would these have been included in the forecast?
MR. MEYERS:
A. Likely so, yes.
Q. And then your decision to apply for a rate case, you would have considered that issue?
MR. MEYERS:
A. When we look at options available to us, there are a number of alternatives available at any given time. The GRA may have been one back then. But, to suggest that we would come forward requesting--come forward with a GRA to recover an additional $500,000 or $1 million knowing that the cost of actually going through a rate proceeding can be several million dollars and those would be additional costs that would be passed on to customers.
Q. So, you know, presumably then in the years before 1997, and specifically 1995 and 1996,

your rates were producing sufficient revenues to compensate Newfoundland Power for all the Company's costs, including these costs. Would that be a fair statement?
MR. MEYERS:
A. The rates were established based on forecast costs which did not include these costs. And, you know, to go back and pick out one specific item and say that, you know, this cost was up or this other cost was down and therefore it was or wasn't included in rates, I don't think is really appropriate.
Q. Well -
MR. MEYERS:
A. We manage this business on an overall.
Q. But, do I understand you to say that you did, in fact, earn your expected rate of return in '95 and '96?
MR. MEYERS:
A. We earned a just and reasonable return in those years, yes.
Q. I mean, really, I mean, I'm just trying to understand the point. And there's no particular magic in the financing costs or the legal costs, but there could be any item that

might pop up in a year that you're not going into a rate case. I mean, at the end of the day -
MR. SMITH:
A. Such as interest revenue?
Q. No. In terms of a cost, something that pops up that wasn't specifically identified for the purpose of making the rate in that particular year.
MR. SMITH:
A. Absolutely. And that could apply to any year and it applies to every year. But, the thrust of your question, I think, is should we have--and I'm sort of conjecturing here. But, should we have called a rate case to deal with these specific costs? And I think the answer is absolutely not. But, that's an actual extension of the question, in my mind, and it belies the fundamental point that as soon as rates are struck and as soon as rates are set based on a forecast, the forecast is out the window and everything that happens after that is a case of management. And how do you manage your way through any particular year, given the rates that you have, or do you make

the decision that the rates and revenue isn't enough to get to manage through that year and then you make that decision whether or not you go to a rate case or not. There's always deminimus, there's always the cost associated with a GRA, and all those things have to be put into that decision making process.
Q. Now, don't confuse me for suggesting that I thought you should have had a GRA for that, please.
MR. SMITH:
A. Okay.
Q. This is, what are we talking, $29,000 in legal fees and obviously the financing costs were higher. But -
MR. SMITH:
A. If that's the case, we agree.
Q. That's not my point, Mr. Smith.
MR. SMITH:
A. Okay.
Q. My point is that in '95 and '96 you didn't under earn?
MR. SMITH:
A. That's correct.
Q. Right.

Page 101

MR. SMITH:
A. Nor did we over earn.
Q. You earned a just and reasonable rate of return?
MR. SMITH:
A. I think so.
Q. Just move on a little bit and talk about depreciation for a moment. If your tax settlement had not come about, had not occurred and the case was still outstanding, obviously your depreciation issues would still be there, for instance, the conclusion of the true up and that sort of stuff. In fact, if you were remaining on the bill method, the depreciation, the conclusion of the depreciation true up would still be there. You agree with that?
MR. SMITH:
A. I do.
Q. Okay. Now, can I ask you to turn to Table of Contents to your application, specifically part 3? At the Table of Contents, part 3, under Section 3.2 we see transitional issues. And I take that to be transitional issues arising from the change in accounting policy,

Page 102

ie, the switch over from bill to the accrual method. That's what we're really talking about in terms of transitional issues?
MR. SMITH:
A. Yes, we're talking about transitional issues that arise out of a change in the accounting policy and what can be done there.
Q. Now, the depreciation issue had this independent life, right? And I'm struggling with the idea or the labelling of the depreciation expense in 2006 as being a transitional issue for the switch from the bill to the accrual method. I frankly don't see it. Can you explain how -
MR. SMITH:
A. Oh, okay.
Q. - that is some sort of transitional issue? I mean, I can see setting up a reserve or an account for the unbilled revenue and I can see quantifying the unbilled revenue as being a transitional issue. But, for the life of me I can't see how the 2006 depreciation expense is a transitional issue.
MR. SMITH:
A. Okay. I understand the confusion. And

Page 103

transition, when we said the transitional issues, our thinking and our view was probably somewhat broader than the approach that you're taking with respect to it. As we said earlier, the story doesn't stop necessarily when you set up the unbilled revenue account because I think that would be an incomplete picture at current day circumstances. The depreciation expense in 2006, as we've indicated, is something that we knew was coming, was canvasses at the last GRA. So, it was a problem that was hanging out there. This particular application and changing the accounting policy leads to the unbilled revenue which then leads to, in our view anyway, the solution to solving that depreciation expense issue in 2006. So, transitional related, I think we're talking about semantics rather than substance. And so, in our view that's the logic behind it and that's why it fits with this application or flows out of this application or flows out of the accounting policy change.
Q. Okay. So, under that approach to the term transitional anything that you're bringing

Page 104

forward to offset with this unbilled revenue would be, you know, a transitional issue for Newfoundland Power as you've defined it?
MR. SMITH:
A. Bringing forward, sorry, I don't understand the question.
Q. Let us say you were bringing forward another forecast increase in expense in 2006 and said, listen, you know, let us offset that too with some unbilled revenue. That too would be equally, under your definition, a transitional issue?
MR. SMITH:
A. Not from my perspective it wouldn't be. And we're not trying to hide behind anything here. We're certainly not trying to hide behind any words. We're saying this is a real-life circumstance that the change in accounting policy provides a solution to. We're just bringing forward an application that we think is comprehensive, that we think is customer friendly and we think is very pragmatic. So, the point I'm making is that I'm less concerned about the semantics and the definitional issues as I am with the outcomes

Page 105

MR. SMITH
and what's best for customers.
(12:45 p.m.)
Q. But really, isn't the real issue here that you need some way, the Company needs some way to get, as is outlined in Exhibit NP-15 to your application, if you wouldn't mind bringing it up. The real issue here that you need, the Company needs some way to get from its existing forecast for 2006 of a 7.02 percent rate of return on rate base up to somewhere in your approved range? I mean, that's the bottom line. I mean, that's what's driving the inclusion of the depreciation true up and increased plant investment as being claimed under the unbilled revenue?
MR. SMITH:
A. And let's be very careful here. Is it a real issue? Absolutely it's a real issue. This Company has the right to earn a just and reasonable return. We all agree, I think, that that's in the best interests of the customers and the Company. So, we're not trying to avoid that at all. There is a revenue shortfall in 2006. What is the solution is the big question. The proposal that we're bringing forward provides a solution to that that doesn't cost any money. That is, as I said earlier, practical and so on. We're not trying to hide from that at all. There is a revenue shortfall in 2006. We've identified the couple of issues that it mainly results from. We think we've put forward a proposal that adheres to the regulatory construct that we have in place here and doesn't break, it doesn't even bend any rules associated with that. So, I'm not trying--I'm not disagreeing with you at all, but I think it's important that we put it in the right context and talk about it properly. The accounting policy application provides a vehicle and a very appropriate vehicle to address some significant cost increases arising in 2006, absolutely.

Page 106

Q. So, I take it from that that you would agree with me that if your forecast for 2006 was that you were going to be within your range, you would never be coming before this Board suggesting that they should use unbilled revenue in 2006?

Page 107

MR. SMITH:
A. I agree with the general principal, but again, we have to deal with--it's a nice theoretical discussion. What I'm trying to keep getting back to is the practical circumstance that we're faced with. We would not be asking for any more revenue than is necessary to earn a just and reasonable return. That's is the fundamental principal.
Q. Okay. So, that addresses the practical scenario. If the practical scenario, what was happening on the ground was that you were looking at 2006 and forecasting the rate of return on rate base that was coming within your approved range, you would not be asking this Board to allow you to bring in unrecognized or unbilled revenue for 2005?
MR. SMITH:
A. As a matter of fact, if we were to--if we were forecasting a just and reasonable return in 2006, I think it would be absolutely inappropriate for me to be here asking for any additional revenue. That's not what--we're not here to do that.
Q. Could you turn to PUB-5? And Attachment A, in particular. Line 32, and it shows your 2004 test year versus the 2006 forecast. Line 32. And I should say for the record that this purports to be operating expenses by breakdown, 2004 test year versus 2006 forecast. With respect to the 2004 test year the net operating expenses 52,434,000 and the 2006 forecast, 54,153,000 and so it shows an increase in operating expenses forecasted for 2006 of about $1.7 million?

Page 108

MR. SMITH:
A. That's correct, yes.
Q. Okay.
MR. MEYERS:
A. In saying that, though, I'd like to qualify it a little bit, if I could.
Q. Sure.
MR. MEYERS:
A. First of all, maybe we can go back to 2003 when we were before this Board in our GRA. And we presented the Board at that time with a forecast of what 2006 was going to look like. And it showed the increase in depreciation expense that time and everybody recognized at that time that there was going to be a problem

Page 109

MR. MEYERS

in 2006. But, everybody also recognized that this tax case was out there and it was, there could be some, you know, possible benefit to customers if that thing was resolved. And there were also some other things out there that people recognized back then. At that time we said one of the things that might happen is that we might introduce or implement some cost reduction initiatives over the period. And what was looked at back then and what we're looking at here is kind of a breakdown of what our operating costs are. And we generally look at what the subtotal of those costs is before we talk about things like pension costs and those types of things which are largely driven by things that are outside of our control. So, if you were to look at line 25, for example, which is kind of a subtotal of what we consider to be our more controllable operating costs, you'll see that our 2006 forecast is actually about $1.2 million below what our test year forecast was. So, we have introduced some cost cutting initiatives since 2003 and we have settled the

Page 110

tax case, and that puts us in the position we are now.

Q. I guess where I'm driving at, Mr. Meyers, is at least in the present question is not to query you on what specific measures have been put in place since the last case, but, rather, another point. We see about a $1.7 million higher forecast for 2006 over your 2004 test year in respect of operating expenses. Given what you've said about, you know, the practicalities of using or, not you said, Mr. Smith has said practicalities of using the unbilled revenue in order to achieve the fair and reasonable return on rate base. Perhaps I should thrown back to Mr. Smith, but if you're comfortable, fine. Would it not be just as legitimate in the context of this application to include a request for a portion of the unbilled revenue to offset a heightened operating expense estimate for 2006 if to do so would have the result of bringing you within your just and reasonable rate of return in 2006?

MR. SMITH:

A. Obviously, obviously we don't think that's the

Page 111

appropriate thing to do, because we brought forward this application to do it this way. I think that doing it that way would create certain difficulties. If I can use the terminology what we're asking for here is probably pure from a regulatory perspective. And Mr. Meyers has talked about that, he's talked about the depreciation expense and true up and the fact that that's been canvassed and tested and so on, that the additional tax flows out of the tax settlement. So, those are finite, known values. And again, if I go right back to the genesis of our application and trying to come up with a practical solution, the solution that you're alluding to here probably adds some more complexities and it's somewhat more difficult from a regulatory perspective to deal with it that way, I think.

Q. Might I suggest to you that it gets a little bit more tangly, if I could use that expression.

MR. SMITH:

A. That's a nice expression.

Q. When you're dealing with an increased forecast. And forgive me if I'm--the words

Page 112

may not string together here. But, it gets a bit more tangly for increased, in the case of operating expenses, because they are simply less certain than what we have in terms of the removal of the true up and the depreciation amount for the 1.157 million?

MR. SMITH:

A. They're less--they're more difficult to define. And whereas the depreciation is much easier, you know, the calculations flow naturally, they flow naturally from past Board orders and so on. So, the two are different from that point of view. The other thing that distinguishes them, of course, is that the depreciation is non-cash, whereas the operating expenses would be cash. So, again, we think there's a symmetry between using unbilled revenue to compensate for depreciation expense. In that senses they're both accounting accruals.

Q. If we were into a situation, okay, we were not, we were not facing the conclusion of the true up, but what we were facing was in 2006 a ballooning of a certain forecast of one of the items under your operating expenses, say, by

Page 113

MR. JOHNSON
$4 million and it was sufficient, the effect of that would be sufficient to deprive the Company of its ability to earn its just and proper return on rate base in 2006, would the Company suggest in the context of an application such as this that we should, say, use the unbilled revenue from 2005 to deal with it?

MR. SMITH:
A. You keep trying to drag me to this hypothetical ground, which I have some difficulty with. I mean, this is the application that we think makes the most sense and it makes the most sense for the reasons that we've already cited. If there was a different set of circumstances, would there be a different proposal from the Company? I think the answer to that has to be yes, potentially that would be the case. But, all I can deal with is the circumstance that we're faced with now. And we think we've brought forward a very straightforward, pragmatic proposal to deal with that.
Q. But, this application does, I think you will

Page 114

concede, deprive this Board of the opportunity and deprive the parties of an opportunity, as well, to fully and thoroughly review the Company's overall revenue requirement. Would that be a fair statement?

MR. SMITH:
A. No, I don't think it is. First of all, deprive is a very strong word. I mean, there's nothing--the Board is not being deprived of assessing the application that's in front of them and the aspects of the application that's in front of them. So, I have difficulty accepting the comment that the Board is being deprived of anything.
Q. But, let us just go back then NP-15, if we might. Would it be fair to say, let's just look at Line 15, that the numbers express both in the 2006 existing column and the 2006 proposed that that number really can't be certain and can't be tested in the context of this proceeding as framed? Would that be a fair statement?

(1:00 p.m.)

MR. SMITH:
A. The fair statement is that they're not being

Page 115

asked to be tested, absolutely.
Q. And but this, the mechanism that we're here engaged with and your Company's application, it's not really designed, is it, to test and be certain about any of the lines in this, you know, in these columns. I mean, where in this process, for instance, do we get an opportunity to test and be certain about line 15? We don't, really, do we?

MR. SMITH:
A. The Company is not asking for anything to be tested other than--the only things we're being asked the Board to assess is the proposals that we've brought forward. There's no doubt that we've fashioned this as an accounting application. We've come forward with very specific proposals. That's what we're asking for. We're not asking for anything to be tested. And I think the critical difference between the scenario that you're setting up is that if the Company was asking for additional rates or additional money from customers, then in that forum more than likely we would be coming in with costs to be tested. What we're suggesting here is something that's a little

Page 116

bit out of the ordinary, potentially, because the circumstances are somewhat out of the ordinary.
Q. Going back, though, let's say line 31, your rate of return on rate base, 702 (sic.) percent versus 7.56 percent with your proposals. I mean, if we can't test the other lines on this chart, we really can't test whether you need the money you say you need from the unbilled revenue in order to get you to 8.56 either. I mean, isn't that a necessary implication?

MR. SMITH:
A. Does judgment have to be exercised here? Absolutely judgment has to be exercised here. But, surely, it's within the ability of all the parties, the Board included, to look at a return on rate base of 7.02 percent and say that chances are the Board is not going to--or the Company is not going to earn a just and reasonable return. So, I think the context is absolutely critical.
Q. Yeah.

Page 117

MR. SMITH:
A. Because in a relative sense what you're suggesting is very easy to ascertain. We'd have to reduce our operating expenses by something in the order of -
MR. MEYERS:
A. $10 million.
MR. SMITH:
A. $10 million. That's certainly--we're not asking for anything that I think can be judged as on the surface being unreasonable. So, once we get into the category of or the position where is this a reasonable request, then I think we can focus on the issues and the points that we're actually specifically asking for. So, yeah, the first step is, is it a reasonable request. And I think the answer to that is yes. And then once we get into that, okay, let's look at the specifics of the request itself and deal with those, which is what we're trying to do here.
Q. Okay. Let me just put it to you this way just to follow-up, Mr. Smith, on something you said a moment ago, that you drew a distinction between coming in looking for rates and using

Page 118

a portion of the unbilled revenue, correct?
MR. SMITH:
A. Yes.
Q. And just to be clear, what is the distinction that you draw?
A. Reference was made to--in the regulatory parlance, a general rate application. This is not a general rate application.
Q. Understood.
MR. SMITH:
A. This is not a general rate application. This is an accounting application and we're making a request for a certain disposition of an accounting accrual. That's where I think the important distinction lies.
Q. So is the fact that you were looking for a portion of the unbilled revenue as opposed to coming in and looking for rates to offset the depreciation true up and the increased plant expense and the extra tax money, does that make it okay to employ any less scrutiny of your overall revenue requirement than as would apply in a normal rate case?
MR. SMITH:
A. I think that's the case.

Page 119

Q. Why?
MR. SMITH:
A. Again, you have to go back to the--the logic is linear. There will be a revenue shortfall in 2006. How does that get addressed? And then I think--and let's just talk--I'm going to make my comments in reasonable terms, okay. There is a revenue shortfall in 2006. The primary reason for the revenue shortfall is the depreciation true up and the income tax arising out of the tax settlement. This has cleared the way to change a Revenue Recognition Policy which has been in play for a long time. All these things come together in a very dynamic stew, so to speak. How do we address the revenue shortfall in 2006? There is an alternative whereby we ask for rates, the customers to pay for that. We've decided that that's not the appropriate place to go. The unbilled revenue that arises from the change in the Revenue Recognition Policy, 24 million dollars, is at our disposal, collectively our disposal, to deal with this revenue shortfall. So what we're suggesting is that because the items that we're asking

Page 120

for compensation for, so to speak, the depreciation, change in depreciation and the tax, are very clearly defined. The unbilled revenue is there to be able to use some of that to apply to. They're both accounting accruals. There's a natural symmetry is what we're suggesting, a pragmatic symmetry to the application and therefore it makes sense.
Quite frankly, with that at our disposal, I think it would be inappropriate for the Company to trigger a broader application, consume millions of dollars in costs, to get to likely--what would likely be the same result anyway, because the unbilled revenue, if we were looking at this more broadly, surely, in my view anyway, we would come back to that and say this is an opportunity that doesn't require an increase in rates to customers and why don't we take advantage of it.
Q. And -
MR. SMITH:
A. So, you know, our views differ on that point. There's no question about it.
Q. And I'm--I don't wish to be painted into a

Page 121

MR. JOHNSON
corner of being termed impractical and non-pragmatic, Mr. Smith, you know, with respect. Because I -
MR. SMITH:
A. I promise I won't do that.
Q. I know, and I'm attuned to what regulatory proceedings cost, okay, and I want to make that very clear. But I am also attuned to comments from the Board's independent consultant where Grant Thornton questions the level of comfort where the Board is not given an opportunity to look at the overall revenue requirement, which is odd. That is odd, right?
MR. SMITH:
A. Well, I wouldn't say it was odd. I'd say it's not normal. It's out of the ordinary, but the circumstances are out of the ordinary.
MR. MEYERS:
A. And it has happened before is the other point, I guess, that we would make. The two previous occurrences that I referred to in my opening remarks were exactly that.
Q. And that's exactly where I'm going to go and I think that that would conclude my questioning, just on that point. The precedents that you referred to, being the Newfoundland Tel case and the P.U. 3 (95/96) case, first of all, I must confess that I do not have a hard copy of P.U. 28 (1979), but I do have a hard copy of the latter. But we'll see from your response whether I need to get a hard copy.
The Newfoundland Tel case, would you agree that the Board's Order in that case did not result in a revenue increase to the company, at least until they went to a general rate application?

Page 122

MR. MEYERS:
A. What it did do, from my understanding, is that it avoided what otherwise would have been excess earnings to the company, which would have been somehow gone back to customers in some fashion, depending on how the Board would have chose to do that.
Q. So my understanding is right that the Board's Order did not result in a revenue increase to the company?
MR. MEYERS:
A. It didn't result in any rate change to the company.

Page 123

Q. Well, is there any real difference--I mean, let's get down to brass tacks. The unbilled revenue has--the use of the unbilled revenue, as Newfoundland Power has proposed it, is in essence a request for increased revenue, correct?
MR. MEYERS:
A. An accrual of revenue, yes, unbilled revenue.
Q. Yes. Because you need the revenue in order to get to your rate base. I haven't missed that, I hope.
MR. MEYERS:
A. No.
Q. Now the other way of getting revenue is applying for rates. But at the end of the day, it's the same thing, you're applying for revenue, correct?
MR. MEYERS:
A. Yes, but how I record my revenue and how I recognize my revenue, depending on whether I'm within that range or above my allowed range is different. If I'm within my range, then I don't recognize that as revenue. I recognize it as excess earnings, the benefit of which

Page 124

goes back to customers somehow. And that would have been the situation with Newfoundland Telephone in those years. Because they were in an excess earnings position, they wouldn't have accounted for that money as revenue.
Q. And with respect to P.U. 3 (1995-1996), am I also correct in putting to you that the Board's Order in that case also did not result in a revenue increase to the Company, at least until there could be a GRA? Would that be correct?
MR. MEYERS:
A. It allowed Newfoundland Power to use pension funding and tax deductions resulting from pension funding to offset other cost increases.
Q. An accounting change that did not affect the amount of revenue the Company would be receiving?
MR. MEYERS:
A. The accounting change at the time was a change in the way the Company records or allocates general expenses to capital. And that was changed to reduce the amount that was being

Page 125

MR. MEYERS
allocated over a five-year period. So in effect, what the Board's Order did was it allowed Newfoundland Power to recognize increased operating expenses and to offset those increases by increased tax deductions which reduced its tax expense.
Q. And just finally, to close out the point, I asked the question of Newfoundland Power in my request for information as to whether there were any precedents that dealt with just this type of situation, and do you know whether, you know, a specific research task was undertaken to find out if there was anything similar to what you're proposing here?
MR. MEYERS:
A. I think the two cases that we've quoted are very similar. In both cases, there were changes in accounting policy and it involved decisions and orders by the Board that allowed the Company to do certain things to offset the impact of those changes in accounting policy. So they are very similar to what we're proposing.
Q. I understand that, but I think my question in

Page 126

CA-12 -
MR. MEYERS:
A. I guess, we did -
Q. My question -
MR. MEYERS:
A. - we did state here that we weren't aware of any decision that dealt specifically with using unbilled revenue to address a revenue shortfall.
Q. And that would be--that would include any precedent regulatory decisions in either Canada or the United States?
MR. MEYERS:
A. Subject to check, I would say.
Q. And did anybody at the Company or on behalf of the Company actually, you know, do a database check to see whether there was anything like this?
MR. MEYERS:
A. I can't say how extensive our search would have been, given the time restraint and so on we were under in answering and responding to the questions, but we certainly weren't aware of any specific ones that dealt with using unbilled revenue to offset shortfall.

Page 127

Q. And you would have brought this request to the attention of your consultant, John Browne?
MR. MEYERS:
A. We did, yes.
Q. And he was unable to provide you with anything obviously?
MR. MEYERS:
A. Yes.
Q. Those are my questions. Thank you very much, gentlemen.
MR. SMITH:
A. Thank you.
CHAIRMAN:
Q. Thank you, Mr. Johnson. Good afternoon, Mr. Kennedy. When you're ready please.
MR. KENNEDY:
Q. Good afternoon, Chair, Vice-Chair, thank you. Mr. Smith, Mr. Meyers, I won't be long. I just have two sort of key areas that I wanted to just discuss with you. One is just following up on some questions of the Consumer Advocate and I wanted to see if I understood correctly the assumptions that the Company is basically asking the Board to make when granting or deciding, I guess, to grant the

Page 128

order that's requested by the Company in its application. And am I correct in that one of the assumptions is that the operating expenses of the Company will come in, in material sense, as forecast in 2006?
MR. MEYERS:
A. Yes, that's correct.
Q. And another assumption would be that the finance charges of the Company in 2006 will come in as forecast?
MR. MEYERS:
A. Generally speaking, yes.
Q. Similarly for sales, that the sales for 2006 will be as forecast?
MR. MEYERS:
A. Yes.
Q. And I guess correspondingly then that your purchased power expense will be as forecast?
MR. MEYERS:
A. Yes.
Q. And that thus if all those things come in as forecast, then, other things remaining the same, the revenue shortfall in 2006 will be as forecast, due to the loss of the true up extensively and the tax -

Page 129

MR. MEYERS:
A. And the tax.
Q. - consequences of the tax settlement.
MR. MEYERS:
A. Yes.
Q. Okay. I just wanted to ask you then to comment principally on the very first of those assumptions dealing with the operating expenses and we've looked at the two exhibits, but we never actually compared the two numbers sort of side by side, and the first RFI was PUB-5, I want to look at, and it was Attachment A. This is an exhibit the consumer advocate had up just a moment ago, and the number, as I understand it, that the Company is using in its forecast figures for 2006 on its operating expenses is that very last number, the net operating expenses for 2006, 54,153,000, is that correct?
MR. MEYERS:
A. That's right.
Q. Okay. And if we go up to line 25, we have a subtotal, 49,499,000.
MR. MEYERS:
A. Yes.

Page 130

Q. That is, as I understand from this appendix or this attachment, the core operating expenses, if you will, and the other expenses relate to deferred regulatory costs and then your extraordinary pension costs?
MR. MEYERS:
A. Generally speaking, yes.
Q. Now just on that point, line 29, your 2005 early retirement program costs, they would have been as a result of a early retirement program approved by this Board in 2004?
MR. MEYERS:
A. Late 2004, early 2005, I believe, yes.
Q. Right. And as I understand it, that would have been as a result of a specific application by the Company seeking approval of the early retirement program?
MR. MEYERS:
A. Yes.
Q. So when the Company applied for that and in turn, knew that there would be an increase in the early retirement costs of 1.666 million dollars as reflected here, it would also have been aware of the projected shortfall in 2006 due to the loss of the true up?

Page 131

MR. MEYERS:
A. I wasn't here at the time, but I'm assuming, yes.
MR. SMITH:
A. Yes, that's correct.
Q. You would have been aware of that?
MR. MEYERS:
A. Yes.
Q. Line 28, the pension cost increase from 3.855 million to 5.088 million, is that a result of the Company's exercising a discretion or is this an expense that, if I could borrow from the vernacular, is being thrust upon the Company as a result of factors beyond its control?
MR. MEYERS:
A. It's due to factors beyond our control, yes.
Q. Okay. So line 29 or sorry, line 28, those pension costs increasing from the test year of 3.855 million to 5.088 million, the Company has no direct control over?
MR. MEYERS:
A. That's correct.
Q. The extra retirement costs for 2005 attributable to the early retirement program,

Page 132

is it fair to say that those were within the control of the Company?
MR. MEYERS:
A. Those costs would be based on the approved Board Orders with respect to the early retirement program itself.
Q. Right, and since the Company decided or had it within its power whether to proceed with an early retirement program or not, is it fair assumption then to say--or fair conclusion then to reach that well then the actual booking of the early retirement costs was within the control of the Company?
MR. MEYERS:
A. Yeah, I guess I would qualify that by saying that the early retirement program, you know, is justified based on the longer term -
Q. Sure. There's -
MR. MEYERS:
A. - benefits associated with it.
Q. - there's usually a positive net present value attributable to any particular early retirement program -
MR. MEYERS:
A. Yes.

Page 133

MR. JOHNSON:
Q. - that's applied for and then subsequently presumably approved by the Board?
MR. MEYERS:
A. Yes.
Q. Right. So while we have an increase of 1.666 million dollars in early retirement costs, that is, over the long term, actually because of the set up of the early retirement, it's supposed to lower the overall cost to the Company?
MR. MEYERS:
A. Yes.
Q. That increase would be offset by a corresponding decrease somewhere?
MR. MEYERS:
A. In later years, yes.
Q. Right, in later years, correct. Now the core number then, the 49,499,000, if we could just keep that in mind and then just look at PUB-15, Attachment A. Do you have that before you there now?
MR. MEYERS:
A. Yes.
Q. There's a line there, line--I'm looking at the

Page 134

same columns as the Consumer Advocate and specifically the ones to the far right, the annuals forecast 2005 and plan 2005. And I guess we could deal with the plan as much as the forecast. There's little difference between the two. I just happen to use the plan figure. I'm looking at the operating expenses, line 5.
MR. MEYERS:
A. Yes.
Q. And so if we take the operating expenses, line 5, from this attachment for plan for 2005 is 47,643,000.
MR. MEYERS:
A. That's correct.
Q. Now would that number, if I may, on an apples-to-apple basis, is that number comparable to the operating expense figure we looked at on line 25 on Attachment A on PUB-5, the 49,499,000?
MR. MEYERS:
A. I think about the only thing that would be different would be the deferred regulatory cost line.
Q. Right. That's the $400,000 that was in your

Page 135

2000--but that's in your 2000--it's below that line in your PUB-5, Attachment A?
MR. MEYERS:
A. Yes, but I believe that $400,000 expense for 2005 would be included in that operating expenses line.
Q. Okay. So the amortization also continued in 2005?
MR. MEYERS:
A. Yes.
Q. The regulatory expense from the 2003 hearing?
MR. MEYERS:
A. Yes.
Q. Okay. So there's 400,000 in that, so let's go back to the one that we have on the screen there, line 5, operating expenses, the last one over, plan 2005. You're saying that the 47,643,000 includes $400,000 relating to the deferred regulatory costs?
MR. MEYERS:
A. Yes. I'm not sure if it's exactly 400,000 but it's in that vicinity.
Q. Okay. So just with that in mind then, basically if we netted that out then of roughly 400,000, what we're dealing with is

Page 136

$47,243,000?
MR. MEYERS:
A. Yes.
Q. As an operating expense for 2005?
MR. MEYERS:
A. Yes, that's right.
Q. Now your forecast for 2006 is then 49,499,000?
MR. MEYERS:
A. That's correct, yes.
Q. So roughly 2.2 million difference between the two?
MR. MEYERS:
A. Yes.
Q. Is there something driving that, Mr. Meyers? Is there a reason why your forecast operating expenses for 2006 are, according to Attachment A of PUB-5, going to come in at 2.2 million dollars higher than your expenses, similar expenses for 2005?
MR. MEYERS:
A. I don't see any one particular item here, based on what I'm looking at.
Q. It would be sort of a--would it be fair to say then, kind of an across the Board increase in a lot of operating expense categories?

MR. MEYERS:
A. I'm going to pop back to--I'm sorry, I don't have the 2005 plan numbers broken down so I can't really tell you if there's something specific that's in there or if it's a combination of several things.
Q. If there's one cost driver or several. Right, okay. Of the assumptions I just covered over then, the other one I wanted to ask you about was--or two of them actually, was sales forecast. For the 2006 sales, as forecasted for this application, did Newfoundland Power refactor your sales forecast? In other words, is that based on a updated forecast of sales delivered by Mr. Crane?
MR. MEYERS:
A. It's based on the same sales forecast that would have been used to prepare our Capital Budget earlier this year.
Q. Okay.
MR. MEYERS:
A. And I think it would have been prepared in March sometime, the actual sales forecast.
Q. Okay. And your purchased power expense, the utilities now, Newfoundland Power, is subject

to a new demand wholesale rate as between itself and Hydro. Could you give us some indication of your level of confidence about the purchase power expense that Newfoundland Power will see in 2006? And it being in the, if you will, early days of the implementation of that new wholesale demand rate.
MR. MEYERS:
A. I guess I would say that the forecast that we've presented would be--certainly be our best estimate at this time, based on the fact that the demand component of that rate will change or is proposed to change on January 1st. So we have that factored that in to our 2006 forecast.
Q. Okay. So the purchase power expense in your 2006 forecast, for the purposes of this application, is being refactored to take into account changes in the wholesale demand energy rate that are expected in January?
MR. MEYERS:
A. Yes.
Q. Okay. So the sales forecast is slightly refactored in the sense that it's been updated as of March roughly of this year?

MR. MEYERS:
A. Yes, and that same forecast would be used to generate the forecast for purchase power expense as well, based on the updated rate.
Q. Right. Yes, one would be plugged into the other virtually?
MR. MEYERS:
A. Yes, yeah.
Q. Okay. Okay. I'd just like to switch now to the discussion, if I may, with either of you on the alternatives that have been partially explored through RFIs and I just wanted to see if we could get them nice and clear on the record. And at the same time, feel free to comment about how you feel about the alternative proposal.
(1:30 P.M.)
And the first one I wanted to look at was--these are all very conveniently laid out in PUB RFIs 7, 8, 9 and 11. So if we can line them up. And just as a preamble, I had initially identified four different alternatives, as discussed throughout the documentation. But as I understand it, you've--in your direct testimony, you've

raised a fifth alternative.
The four I had previously was a settlement--or a proposal to deal with the unbilled revenue purely on the basis of the tax settlement itself, which would be basically a three-year term. The second one was an all-at-once, so in other words, taking all the 2005 unbilled revenue into a particular year. One was spreading the unbilled revenue over two years, that would be the transition period. The fourth option was the deferral of the depreciation expense. And as I understand it, and which is PUB-11, I understand now you're putting forward a possible further alternative or I guess these aren't alternatives that the Board--or sorry, just to be clear, that the Company didn't put forward, so but that the Company has put forward an alternative where it would be deferral of the recovery of the costs, as opposed to a deferral of the depreciation expense.
MR. MEYERS:
A. Yes.
Q. Right. And that being two distinctly

Page 141

MR. JOHNSON
different things.
MR. MEYERS:
A. Yes.
Q. All right. Now first of all, on that fifth one, on the one that you raised in your direct testimony, the deferral of the recovery of the actual cost to take into account the depreciation expense and tax consequences, is there anything by way of RFI on the record that would show how that would work?
MR. MEYERS:
A. No, not to my knowledge, no.
Q. Okay. Let's just follow up on that then and make sure I understand it. As I understand it, that proposal would involve the Board recognizing the tax consequences and increase depreciation expenses of loss of the true up in 2006, but defer the Utility's ability to recover that expense until 2007 as part of the GRA?
MR. MEYERS:
A. Yes.
Q. And the unbilled--presumably then that it would still be--the unbilled revenue, let's say, was used to recover the cost when it was finally recovered, is that the scenario that the Company would see?

Page 142

MR. MEYERS:
A. I guess for purposes of 2006, there wouldn't be an accrual of unbilled revenue in 2006. Whether or not it would be required in 2007 then would be tied up into the GRA for 2007, which would look at all the costs.
Q. I'm just trying to think, so--go ahead, Mr. Smith.
MR. SMITH:
A. I was just going to say, that would be one possible outcome absolutely.
MR. MEYERS:
A. Yes.
MR. SMITH:
A. That the--if it was ascertained that there was additional revenue required for 2007, it could come from one of two sources, rates or unbilled revenue. I think that's--is that the gist of your question?
Q. Yes, absolutely.
MR. SMITH:
A. Okay.

Page 143

Q. If it was recovered through rates, I guess a complicating factor would be that if 2007 was the test year and then the rates approved included costs related to 2006, those same rates then would be applied in 2008, so we'd have that awkwardness, wouldn't we, where you would be recovering costs in 2008 related to 2006 in your rates?
MR. MEYERS:
A. It would involve some complications, yes.
Q. Right. So the use of the unbilled revenues, the likely--if I may, the likely source of making adjustments at the end of the day, if there's going to be a deferral of the recovery of the costs, it would still be unbilled revenue be used to fill that hole if you will?
MR. MEYERS:
A. That would be the preferred option, yes, for customers.
Q. And so what would be the advantage of doing a recovery of costs as you've described then? Is it just so that it can be dealt with in the context of a GRA?
MR. MEYERS:
A. Generally speaking, yes.

Page 144

Q. And so would the Board need to--under that scenario, would the Board need to now, if you will, crystallize what the amount for 2006 needs to be covered off? In other words, can it all be dealt with then in the GRA under that scenario? The Board would, at the same time as it sets out the recovery costs for 2007 using unbilled revenue, also says "well, how much of the recovery costs is to be deferred?" That it would assess that amount also as part of the GRA in 2006.
MR. MEYERS:
A. The Board could determine the amount of cost recovery to be looked at for 2007, yes.
Q. Right.
MR. MEYERS:
A. And that amount could vary. Let's say it could include the 5.8 million dollar true up, the 1.2 million dollar increase in depreciation expense, and the 3.1 million increase in tax effects.
Q. Right. And if it dealt with it all as part of the GRA, just say, in 2006, it would, at that point, have some actuals for 2006, I guess, before the Board, if the GRA took place in say

MR. JOHNSON
the latter half of 2006, you'd at least have a quarter or two of actual results from 2006?
MR. MEYERS:
A. You would have some actual results and you'd still be dealing with a forecast for the year.
Q. Sure, yes, okay. So let's just go through the other scenarios, if I could, the other alternatives, and the first one was PUB-7, yes, which is up there now on the screens, and this is the alternative per the tax settlement and this is, as I understand it, just a straightforward taking 8,087,000 in as unbilled revenues, from the unbilled revenue, in each year, 2006, 2007, 2008? Is that correct?
MR. MEYERS:
A. Of the 2005 unbilled revenue, yes.
Q. Right. Of the 2005 unbilled revenue.
MR. MEYERS:
A. Yes.
Q. And could you comment on what--does the Company see a down side to that scenario, and if so, what would be the down side?
MR. MEYERS:

A. The down side, I guess, is that it would only provide us a rate of return on rate base of 8.37 percent, which would still be below the range of 8.5 to 8.86 currently in place.
Q. Right. And that's accepting the assumptions that we talked about a minute ago, about the operating expenses coming in, in 2006 as forecast, the sales coming in in 2006 as forecast and so on?
MR. MEYERS:
A. Yes.
Q. Did the Company fashion this out for, under that scenario, what impact there would be on the Company's finances in 2007 and 2008?
MR. MEYERS:
A. I guess what happens in 2007 and 2008 would depend on a lot of different things. How you would account for other costs, let's say, and that sort of thing.
Q. So -
MR. MEYERS:
A. How would you deal with the revenue shortfalls that might occur in those years?
Q. So is it the visibility gets somewhat clouded when we start looking in 2007/2008, so it's

difficult to fashion a number to what impacts there would be if you had the three-year taken?
MR. MEYERS:
A. Based on what we know right now, given that these increases in depreciation expense and so on will carry on because the true up ends as of this year, even as we--even if we recognize, in accordance with this scenario for 2007 and 2008, there will likely be revenue shortfalls in those years as well, and if we assume that those revenue shortfalls are offset somehow by reductions in other costs or increases in customer rates or whatever, it would appear that our return on rate base for 2000 would come in at around 8.4 percent and our return on rate base for 2008 would come in at around 8.25-26 percent, somewhere in that range.
Q. And just to be clear, that's under what scenario, sorry?
MR. MEYERS:
A. That's the tax settlement scenario in PUB-7.
Q. Right, okay. And as I guess, if in comparison to your present range that's below your--what

would consider to be your low point, correct, your current range is eight and a half to 8.86?
MR. MEYERS:
A. Yes.
Q. And as I understand it from the proposal by the Company before the Board now under its annual filing, in accordance with the Automatic Adjustment Formula, you're not proposing a change to your range?
MR. MEYERS:
A. The operation of the formula for 2006 would not result in a change in that range, no.
Q. Change in your approved range. As I understand it though, from looking at that application and just in loose terms though, that if fashioned new today, it would cause a shift. In other words, notwithstanding the Automatic Adjustment Formula, all else being the same, risk premiums being the same and so on, the slide in the long bond yield would correspondingly cause a--potentially cause a drop in the approved rate of return of the Company?

MR. MEYERS:
A. I don't know if I'd necessarily agree with you on that.
Q. Okay. Well, we're kind of delving into areas of expertise which I know I don't have, so we'll just leave that as it is. Let me refashion it this way. The assumption that the Company's making is that the rate of return that it would be entitled to achieve in 2007, for instance, and 2008 will be in keeping with the rate of return that they're currently entitled to achieve?
MR. MEYERS:
A. If we assume the same range and so on, yes.
Q. Right. And so--right, okay. And that's why under the three-year tax settlement scenario, the Company is indicating that not only would it under earn in 2006, it would also under earn in 2007 and under earn in 2008? That's what that statement is based upon?
MR. MEYERS:
A. Yes.
Q. Okay. Let's just switch to the all-at-once scenario, Mr. Meyers, which is PUB-8. And this is the scenario that what if the Company

were to recognize the entire amount of 2005 unbilled revenue in one year, and I think it's a given that that would result in over earnings by the Company, and as per PUB-8 the Company calculates that for 2006, it would result in a over earnings of 11,815,000?
MR. MEYERS:
A. That's right, yes.
Q. Okay. Now as I think you pointed out, that doesn't ipso facto mean that that money goes back to consumers, that the Board then has to determine what's the fair and reasonable disposition of those excess earnings, correct?
MR. MEYERS:
A. That's right.
Q. Let's just go with the hypothetical that the Board decides to give it all back in one form or another to consumers, the 11,815,000. How would--and as you commented previously, these are not cash amounts. These are notional adjustments, if you will, to your financial statements borne from the changes in accounting policy. How would the Company actually come up with the 11,815,000, if you will, to pay back to customers if it was--if

it had to?
MR. MEYERS:
A. It would have to either borrow that money somehow or--likely would have to borrow that money.
Q. And are you in a position to be able to comment on whether the financial integrity of Newfoundland Power would be materially impacted if it was to have to borrow money on its short lines or what have you to pay back excess earnings in that range?
MR. MEYERS:
A. It would certainly put some pressure on our credit matrix that the rating agencies use to determine our credit rating.
Q. Did you do any--fashion any debt to equity ratio calculations of what that would come out to? Or interest coverage ratio, either one?
(1:45 P.M.)
MR. MEYERS:
A. Yes, I believe our interest coverage ratio in 2007 would drop to about 2.0 times.
Q. On the nose? 2.0 on the nose?
A. Yeah, and the Board has always considered something in the 2.4 to 2.7 range to be

appropriate.
Q. Okay, the third scenario was the unbilled revenue over two years, which is addressed in PUB 9. I guess is it--let's start with this, under the current proposal that's before the Board, the Company is asking for roughly ten million dollars of the unbilled revenue to be used in 2006, so less than this scenario in 2006 and as a result, no excess earnings under your proposal, excess earnings under this scenario that will equal application of the 24 million in unbilled revenue to the two years. What--can the Company indicate now what it expects the likely scenario to be for the remaining 14 million dollars of the unbilled revenue? Does it expect that all of that would be used to adjust rates for 2007? Have you got any visibility on that now? I know in your responses you've indicated that the 14 million is something to be left with in the GRA, but do you expect that after that 2006 GRA related to a 2007 test year, that there will still be money left over in the unbilled revenue account, or would all the 14 million be used up?

Page 153

MR. MEYERS:
A. I don't think we've gotten to that stage yet, to be honest with you. There's a lot of things that would have to come into play in 2007.
Q. So, similarly then, under the scenario here that we have before us in PUB 9.0, that one discussed there, which is the application, the unbilled revenue equally over the 2006/2007 years, and it ends up in an over earning in 2006, but am I fair to say that the amount of over earning certainly wouldn't place any pressure on the Company's financial integrity?
MR. MEYERS:
A. That's correct, yes. One of the things though about this scenario and the previous scenario that we talked about, by pushing the company to the top of its allowed range, you reduce the benefit to customers.
Q. Right.
MR. MEYERS:
A. Of the total 24 million dollars that's available, so I want to make sure that that's clear.
Q. Yes, right, and for instance, under this

Page 154

scenario the Company has earned, right to the top of its range in 2006?
MR. MEYERS:
A. Yes.
Q. Right, and thus the excess earnings. But I guess for the reasons that you just discussed, there's no way to know what would shake out in 2007 under this scenario though?
MR. MEYERS:
A. No, not really.
Q. Right, don't know that there would still be an over earning in 2007 or whether there would be an under earning in 2007?
MR. MEYERS:
A. Based on what we know right now, there would certainly be a revenue shortfall in 2007.
Q. Even with 12 million of unbilled revenue applied to it?
MR. MEYERS:
A. A small revenue shortfall, yes, I believe.
Q. Okay. So based on that, you would expect to need somewhere between 12 and 14 million dollars worth of the unbilled revenue in 2007?
MR. MEYERS:
A. If we were going to use up all the unbilled at

Page 155

the one time?
Q. Right.
MR. MEYERS:
A. Then you have a major -
Q. But then you'll have probably 2008, right.
MR. MEYERS:
A. You'll have a major impact in 2008, so, you know, in deciding how to -
Q. You might blend it.
MR. MEYERS:
A. - avail of the 14 million dollars, it might be more balanced to do it over a couple of years or -
Q. So, Mr. Meyers or Mr. Smith, just on the hypothetical that the Board isn't prepared to award the Company its proposal as filed, what would be the lesser of the evils presented in the form of these alternatives? In other words, is there an option here that the Company could live with?
MR. SMITH:
A. You haven't canvassed the deferral option yet.
Q. Deferral and depreciation expense.
MR. SMITH:
A. Yes.

Page 156

Q. Right, sorry, yes.
MR. MEYERS:
A. Deferral of cost recovery.
Q. Deferral of depreciation expense, right, sorry.
MR. SMITH:
A. Yes.
MR. MEYERS:
A. Deferral of cost recovery.
Q. Yes, the deferral of the recovery of the cost, I discussed that one at the very start.
MR. SMITH:
A. Okay then.
Q. So let's say--and that's the proposal the Company has put forward as an alternative, so presumably that's one that you prefer over the other alternatives.
MR. SMITH:
A. Absolutely, absolutely.
Q. Okay, that's what I was getting at. Sometimes the question is just so obvious, just appeared to be a question. So just one clarification, Mr. Meyers. You indicated there and it might have been just the fact of giving direct testimony and you don't get to read your

Page 157

MR. SMITH
words, you indicated that the Company has a right to earn a just and reasonable rate of return, and I just want--we're going to do some semantics here today, but would you agree that it's not a right to earn a just and reasonable return, it is the right for an opportunity to earn a just and reasonable rate of return?

MR. MEYERS:
A. Yes.
Q. So it is indicated by Mr. Brushett in his report that one of the decisions that this Board has to make prior to the Company closing out its 2005 financials is what regulatory--or sorry, what accounting treatment to provide the 2.1 million dollars worth of interest income that the Company has received from the tax settlement, that that decision has--a decision has to be made by the Board so that the Company knows whether to book that amount in 2005 or no?

MR. MEYERS:
A. Mr. Brushett has indicated that in his report, yes.

Page 158

Q. Is there another decision besides that one which the Board has to make a decision on now?

MR. MEYERS:
A. When you says "now" -
Q. Well, assuming that the other issues could be deferred by the Board for a subsequent GRA? In other words, under the scenario that we'll deal with all this, come what may, in 2006 and as I understand it, Grant Thornton was pointing out that while the Board has that as an option, there is at least one thing that has to be decided now and that's whether the interest income is going to stay in 2005 or not. And I just want to make sure that is there another decision that the Company needs decided now because it's going to affect your 2005 financial year?

MR. SMITH:
A. In terms of this specific application, I can't think of another one.
Q. Okay, looking ahead at your GRA, a filing in that respect, I guess that per the mediation agreement, we've indicated that the Company--it makes sense that from the parties' consent, that it makes sense for the Company to use the

Page 159

Asset Rate Base Model and also that it makes sense for the Company to--just a second now, sorry, the obvious, that you would use the accrual method of revenue recognition in fashioning your application as well?

MR. SMITH:
A. Uh-hm.

MR. MEYERS:
A. I think just to pick up on what Mr. Smith said, there's nothing else in this application that would impact 2005.
Q. Right.

MR. MEYERS:
A. But there are some decisions, I guess, that have to be made by the Board going into 2006, in terms of, like you say, moving to the accrual method, the ARDM and using the forecast values for rate base and invested capital for operation of the formula for next year, that sort of thing.
Q. Right, right, now the last piece is your unbilled revenue increase reserve, the 295, is that something that has to be decided now, or is that something that can get also pushed ahead to 2006?

Page 160

MR. MEYERS:
A. It doesn't absolutely have to be addressed right now.
Q. That's all the questions I have Chair, Vice-Chair, thank you gentlemen.

CHAIRMAN:
Q. Thank you, Mr. Kennedy. Just a comment, I guess Mr. Kelly, this may affect you more than anybody else, I'll speak for myself, I've been used to, I guess, GRA's having rules and procedures laid down. There are none in this proceeding, other than the Board Regulations. I'm used to having re-direct before Board questions and I prefer it that way.

KELLY, Q.C.:
Q. I'm certainly -

CHAIRMAN:
Q. Does anybody--and have Board questions and then the opportunity for questions on matters arising and re-direct after that. Is there anybody who would have an objection to that order?

KELLY, Q.C.:
Q. No problem at this stage. One point, Mr. Chairman, I'd like Mr. Meyers to have the

Page 161

KELLY, Q.C.

opportunity to just review some material with respect to Mr. Kennedy's question about the operating expense. And I could either deal with a couple of other re-direct questions first or it might be more appropriate to just take the five minutes now, let Mr. Meyers do that and then resume for the re-direct and then the Board questions.

CHAIRMAN:

Q. I'm fine, whatever you prefer.

KELLY, Q.C.:

Q. That would be preferable, I think.

CHAIRMAN:

Q. Sure.

(RECESS - 1:57 P.M.)

(RETURN - 2:06 P.M.)

CHAIRMAN:

Q. Mr. Kelly, when ready please.

KELLY, Q.C.:

Q. Thank you, Chair. Just a couple of short areas on re-direct. Mr. Smith, Mr. Johnson asked you about the Company's position with respect to the 2.1 million dollar interest issue and you indicated and acknowledged the

Page 162

Board's power to consider that 2.1 million dollar issue. There may be implicit in Mr. Johnson's question some suggestion that the Board might have the power to deal with that or defer that interest, notwithstanding the fact that the Company will be at or near the lower end of its range of rate of return and that there will be no excess revenue or no excess earnings. I just want to be clear with you, I take it that your comment was not intended to, in any sense, address any legal issues arising with respect to the excess earnings issue?

MR. SMITH:

A. That is correct.

Q. Now, the second--another area that Mr. Johnson addressed with you was with respect to the costs in 1995 and 1996 and he pointed out to you that the Company did not under earn its range at that point in time, and you acknowledge that. And you also responded that the interest revenue should be treated similarly. Now, in 2005, if the interest revenue is removed or deferred from 2005, will the Company under earn its range of rate of

Page 163

return on rate base?

MR. SMITH:

A. Yes, it will, based on our current forecast.

Q. Okay, the third point I want to take you to is there might have been some suggestion in one of Mr. Johnson's last questions, towards the end of his examination, that Grant Thornton may have questioned the appropriateness of this type of proceeding to deal with specific cost items. I want you to go to CA-39 PUB with me for a moment. Perhaps we can put that up on the screen. The last paragraph of that answer from Grant Thornton. Perhaps you can just read that, Mr. Smith.

MR. SMITH:

A. "While a full review of revenue requirement is appropriate for a GRA, regulatory practice would permit the Board to hear evidence on specific issues, including individual cost items outside of a full review and render a decision based on its assessment of that evidence, where it determines it is appropriate in the circumstances."

Q. Thank you. Now the final area that I just want to touch on, Mr. Meyers, is a question

Page 164

for you. Mr. Kennedy asked you some questions about operating expenses and looked at the various schedules. Could we come back to that and I wonder if you're now able to address Mr. Kennedy's question about those numbers.

MR. MEYERS:

A. Yes, one of those things that it's so obvious you overlook it, I guess. In PUB 15, the operating expense number that Mr. Kennedy was referring to, which was the -

Q. Mr. Meyers, if we could just get that up on the screen here. There you go.

MR. MEYERS:

A. The number for operating expenses, the 47.6 million dollars, that number is actually net of transfers to GEC and those transfers would be about 2.1 million dollars. So if you were to compare like to like, in terms of the number here for 2005 and the number forecast for 2006 in attachment A to PUB 5, on a like-to-like basis, they would both be very similar. There'd be about $200,000.00 in the two numbers. If you look at attachment A to PUB 5, we have 49.5 million dollars, which is before the transfers to GEC, which is shown on

Page 165

MR. MEYERS
line 31, so the 49.5 million less the 2.1, would give you a number of 47.4 million, which would be comparable to the 47.6 million in PUB 15 for 2005.
Q. Thank you, Mr. Meyers. Those are my questions, Mr. Chair.
CHAIRMAN:
Q. Thank you, Mr. Kelly. Commissioner Whalen, do you have -
VICE-CHAIR:
Q. Suffering from empty head and empty stomach at this stage. I thought I had it, I'm not sure. Just to follow up on a question that Mr. Kelly just put to you in terms of your earning situation for 2005 and forecast 2006. And it's my understanding that absent the tax settlement, Newfoundland Power would actually be in an under earning situation for 2005 in respect of the range of rate of return on rate base?
MR. MEYERS:
A. Yes, our return on rate base would be below the range in 2005.
Q. And absent the tax settlement, Newfoundland

Page 166

Power would be in a potential--I'm not sure perhaps known at this stage, based on what's before us, that in an under earning situation for 2006 as well? That 7.02 percent that was put to us this morning is the forecast range rate of return on rate base?
MR. MEYERS:
A. Yes.
Q. And I guess, the only thing that comes to mind for me is absent the tax settlement, what--and absent this application before the Board, that seems to me something that Newfoundland Power would have had to be anticipating or planning for? I mean, was either this application or a general rate application, is that really what we're looking at here?
MR. SMITH:
A. I think that's really the two choices that were available to us. The magnitude and the numbers are such that--as I mentioned earlier, the magnitude of--but cost savings to address it would be in the order of ten million dollars more, which it's just out of the question, considering that our absolute level of operating cost is 50 million. So I think

Page 167

those are the two choices and we've been looking at that for a couple of years, I guess, quite frankly, given the depreciation true up, but as Bob mentioned earlier, the possibility of the tax case being settled was out there at the same time, so thankfully they both came together in a time that we could put together this application and address the issues.
Q. And had the tax settlement not manifested itself in the way that it did in a positive outcome for the Company and consumers ultimately, perhaps, if you had had a negative decision, the liability to consumers at this stage would have been somewhere in the order of 15 to 16 million dollars I think you would have had to request, is that what you'd be looking at, absent the benefits that you've outlined in NPV and the NPV announcement, that is the risk that was on the books?
MR. SMITH:
A. That's correct. The number was approximately 16 million dollars that was at risk there.
Q. And you would have come to the Company (sic) for rate relief, presumably to--or come to the

Page 168

Board for rate relief for that?
MR. SMITH:
A. I think that an application in front of the Board would have incorporated some element of relief associated with that, that tax liability.
Q. And you're looking--one of the proposals is this recognition of 10 million dollars for 2006 to address a revenue shortfall, essentially that's what it is, for 2006?
MR. SMITH:
A. Yes.
(2:15 p.m.)
Q. So the Board would have to, in looking at that proposal, would it be your position that the Board would have to--or would you agree, I guess, that the Board will actually have to make a finding of fact that there will indeed be a revenue deficiency for 2006? Is that sort of where we got to go with this?
MR. SMITH:
A. Well I think that's a conclusion that you have to arrive at, yes, as part of the overall application. And I think there's enough information in front of the Board to be able

Page 169

MR. SMITH
to make a conclusion one way or the other and that's where the forecast information comes into play, and some judgment is involved, obviously, but I think the magnitude of the shortfall and the amounts in question and everything else, provides the proper context to make that decision, yes.

Q. What's happened since 2003 and it only seems like, I won't even say years ago, it was weeks ago that you were here even, what's happened since you were here last for Newfoundland Power to be in an under earning situation for 2005? I mean, are there any extraordinary circumstances that have presented themselves?

MR. SMITH:
A. There's no one particular extraordinary circumstance. As we've discussed a little bit, on the surface anyway, the bigger picture of things, that there have been continued efforts to reduce and minimize cost and that has taken place. One of the things that happened is the Early Retirement Program and again, I mean, clearly on a longer term it's the right thing to do, in the early going, in

Page 170

the early years of those, it takes a little bit of time for the results to be seen and felt. The pension, the pension expense has increased, I think due to factors beyond our control, quite frankly, because of the direction of interest rates. So it's a combination of all those things.

Q. I think that's all I have, Mr. Chairman.

CHAIRMAN:
Q. Thank you.

VICE-CHAIR:
Q. Thank you, gentlemen.

CHAIRMAN:
Q. Thank you, Commissioner Whalen. I really don't have--just a couple of--don't have very much, just a couple of short questions, I guess, more than anything. You spent time going through, I guess it was CA-23, outlining the net customer financial benefits. Would you not agree that some of these things came about as a result of good management and certain amount of good luck and that in essence, with a view to the tax rates decreasing, for example, and that these--the Company benefited from this as well, I mean,

Page 171

that these are not only customer financial benefits, but benefits to the Company as well?

MR. SMITH:
A. I'm a firm believer in the expression that you have to be good to be lucky. So I think I agree with your statement, but often times it's about positioning yourself to take the maximum advantage of the luck that does come your way.

Q. Yes, I wasn't so much placing emphasis on the luck, but placing an emphasis on the fact that the Company benefited from these as well. The way they're presented here is that, you know, these were net benefits to the customer, but, you know, the Company, I would think, shared in that as a result of the decisions you made.

MR. SMITH:
A. Absolutely, absolutely, there's some benefit to the Company, as well as to customers, no question about that.

Q. You made the comment, Mr. Smith, I guess that if it not were for the lower rate of return that you may indeed, I think Newfoundland Power would not be requesting this adjustment if they were earning an appropriate just and

Page 172

reasonable return. What do you view that as, is it the entire range? Is it at some point in the range if indeed you had a return that was in the midpoint of the range now, would you be promoting the application here that you are? Is there a number, a finite number, an approximate number that you would see as perhaps not precipitating this, in that range? I mean, -

MR. SMITH:
A. Our view is that if we earn within the range, then that's a fair, just and reasonable return.

Q. I have one more, but I think I'm going to leave it alone. Are there any other questions or queries? Okay, thank you very much both of you, Mr. Smith and Mr. Meyers, I appreciated your testimony, thank you. It is twenty after two, I think it's my opinion, anyway, it's a bit late to begin with another witness, so if we could conclude today's proceedings and we begin again tomorrow at 9:00 with Mr. Browne, fair enough?

KELLY, Q.C.:
Q. Thank you, Chair.

CHAIRMAN:
Q. Thank you very much, thanks again.
MR. JOHNSON:
Q. Mr. Chairman, I'm sorry, on that point, I think this morning you indicated that the normal time would be 9:30 to 1:30. I'm not -
CHAIRMAN:
Q. Did I say that?
VICE-CHAIR:
Q. The normal time is 9 to 1:30.
CHAIRMAN:
Q. I said 9:30? Okay, it is 9 to 1:30, sorry about that.
Upon concluding at 2:21 p.m.

CERTIFICATE

I, Judy Moss, hereby certify that the foregoing is a true and correct transcript in the matter of the accounting policy of Newfoundland Power Inc. concerning revenue recognition and matters related thereto, heard on the 7th day of December, A.D., 2005 before the Board of Commissioners of Public Utilities, Prince Charles Building, St. John's, Newfoundland and Labrador and was transcribed by me to the best of my ability by means of a sound apparatus.

Dated at St. John's, Newfoundland and Labrador this 7th day of December, A.D., 2005

Judy Moss