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<p>1 (9:00 A.M.)</p> <p>2 CHAIRMAN:</p> <p>3 Q. Thank you and good morning. Before we get</p> <p>4 started, I guess, good morning, Ms. Newman,</p> <p>5 are there any preliminary matters, please?</p> <p>6 MS. NEWMAN:</p> <p>7 Q. Yes, good morning, Mr. Chairman. I believe</p> <p>8 that there is an information item that</p> <p>9 Newfoundland Power has filed yesterday in</p> <p>10 response to a matter that came up during the</p> <p>11 testimony of Karl Smith on cross-examination.</p> <p>12 And I think we're going to call that</p> <p>13 Information No. 1. And that's all.</p> <p>14 CHAIRMAN:</p> <p>15 Q. Mr. Kennedy's famous option, is it?</p> <p>16 MR. KENNEDY:</p> <p>17 Q. As long as I don't have to take the stand and</p> <p>18 defend it.</p> <p>19 CHAIRMAN:</p> <p>20 Q. Okay. Just before we get started, I</p> <p>21 understand that we may have a short period,</p> <p>22 Mr. Brushett, with yourself this morning. I'm</p> <p>23 sure you're not--that's not a problem for you.</p> <p>24 But, in any event, it looks like the direct</p> <p>25 and cross-examination of Mr. Brushett may be</p>	<p>1 short, I understand. And I understand as well</p> <p>2 there's been agreement that we'll take a half-</p> <p>3 hour break and then there will be final</p> <p>4 argument after that. Is that generally the</p> <p>5 consensus?</p> <p>6 KELLY, Q.C.:</p> <p>7 Q. That's correct, Chair.</p> <p>8 CHAIRMAN:</p> <p>9 Q. The Panel thanks you for that. My wife woke</p> <p>10 up this morning and said, "Who's true up?"</p> <p>11 Apparently I commented in my sleep last night,</p> <p>12 so it'll be good to get it over today. In any</p> <p>13 event, thank you.</p> <p>14 MR. JOHNSON:</p> <p>15 Q. I wonder is that a Newfoundland way of</p> <p>16 explaining stomach sickness.</p> <p>17 CHAIRMAN:</p> <p>18 Q. Anyway, good morning, Mr. Brushett.</p> <p>19 MR. BRUSHETT:</p> <p>20 Q. Good morning.</p> <p>21 MR. BILL BRUSHETT (SWORN)</p> <p>22 CHAIRMAN:</p> <p>23 Q. Mr. Kennedy.</p> <p>24 MR. KENNEDY:</p> <p>25 Q. Chair, there's no direct examination of Mr.</p>
<p>Page 3</p> <p>1 Brushett. But perhaps for the record just to</p> <p>2 formally introduce Mr. Brushett as an</p> <p>3 accountant with the firm Grant Thornton, who</p> <p>4 have filed a report in this matter, the Board</p> <p>5 of Commissioners of Public Utilities,</p> <p>6 Newfoundland Power, 2006, Accounting Policy</p> <p>7 Application. Mr. Brushett, this is your</p> <p>8 report and you had direct involvement in the</p> <p>9 authoring of it?</p> <p>10 A. Yes, that's correct.</p> <p>11 Q. That's fine. He's available for cross-</p> <p>12 examination. Thank you.</p> <p>13 CHAIRMAN:</p> <p>14 Q. Thank you, very much. Good morning, Mr.</p> <p>15 Kelly.</p> <p>16 KELLY, Q.C.:</p> <p>17 Q. Good morning, Chair.</p> <p>18 CHAIRMAN:</p> <p>19 Q. When you're ready, please.</p> <p>20 KELLY, Q.C.:</p> <p>21 Q. Mr. Brushett, I just have a couple of very</p> <p>22 short areas to touch on with you. First of</p> <p>23 all, with respect to the question of the 2005</p> <p>24 interest, refund interest, that, will you</p> <p>25 agree with me, has been credited or applied in</p>	<p>Page 4</p> <p>1 accordance with generally accepted accounting</p> <p>2 principles?</p> <p>3 A. That is correct. That would be required to be</p> <p>4 recorded in the year that it is certainly</p> <p>5 received or that it would be deemed to your</p> <p>6 receivable, yes.</p> <p>7 Q. That would be 2005?</p> <p>8 A. Yes.</p> <p>9 Q. And secondly, if we just have a quick look at</p> <p>10 PUB-10. And the second paragraph there refers</p> <p>11 to the board approved system of accounts, in</p> <p>12 particular Section 5.00(j), the interest has</p> <p>13 been applied as revenue in accordance with the</p> <p>14 system of accounts as approved by the Board?</p> <p>15 A. Yes. The system of accounts would require</p> <p>16 that item be recorded in the manner described</p> <p>17 there, yes, I agree with that.</p> <p>18 Q. And that approach is consistent with the</p> <p>19 treatment of past interest, refund interest?</p> <p>20 A. Yes. Based on my experience and knowledge of</p> <p>21 what occurred in 2000 and 2001, that would be</p> <p>22 correct, yes, it is consistently treated in</p> <p>23 2005.</p> <p>24 Q. And the Board, to your knowledge, has not</p> <p>25 created any kind of deferral account with</p>

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<p>1 KELLY, Q.C. 2 respect to interest, refund interest? 3 A. Certainly not explicitly created a deferral 4 account. And I would mention, I guess, the 5 comments from Mr. Todd yesterday about what 6 was really intended by P.U. 19, the words in 7 P.U. 19, but certainly no explicit, has not 8 explicitly established a deferral account for 9 interest. 10 Q. Exactly. I don't intend to take you into the 11 legal aspects of P.U. 19 but there's no 12 expressed deferral account that you're aware 13 of? 14 A. No. 15 Q. Okay. Second area I just want to touch on 16 with you, you've had an opportunity, have you, 17 to look at Information Response No. 1, the one 18 that was marked this morning? 19 A. Yes, I have. 20 Q. Okay. And that deals with the deferral of 21 cost recovery for any of the items in issue 22 here? 23 A. Yes. 24 Q. Okay. And as I understand it, you just 25 confirm this for us, essentially this approach</p>	<p>1 avoids any potential income tax consequences? 2 A. Yes, that is my understanding of the effect of 3 providing for recovery in this manner as 4 opposed to a deferral of the cost that the tax 5 impacts would be essentially avoided. 6 Q. And in terms of the financial results that it 7 would permit, they would be essentially the 8 same as the Company's proposal? I'll come to 9 a distinction in a second, but the financial 10 results would essentially be the same, 11 adopting this type of approach? 12 A. Depending on what was actually deferred and 13 what decision the Board made as to individual 14 items, yes, we would end up with the same 15 result. 16 Q. That's exactly what I mean. In other words, 17 if tax was dealt with with accrual versus tax 18 was deferred, you get the same result? 19 A. Yes. 20 Q. Okay. And the difference in the Company's 21 approach and this approach essentially means 22 that the recovery will be deferred to the 2007 23 test year and the 2006 GRA where the Board 24 will then consider the most appropriate 25 methodology for recovery of the amount?</p>
<p>Page 7</p> <p>1 A. Yes. As when it reviews all items, certainly 2 that will be brought forward in a GRA, it 3 would have additional evidence, so to be able 4 to assess the most appropriate means of 5 recovery of those amounts. 6 Q. Okay. And the Board would not then, as part 7 of that process, go back and retroactively 8 look at 2006 costs and expenses? 9 A. No, I would not expect that would be the 10 approach that would be used, no. 11 Q. Thank you, Mr. Brushett. Those are all my 12 questions. 13 CHAIRMAN: 14 Q. Thank you, Mr. Kelly. Good morning, Mr. 15 Johnson. When you're ready, please. 16 MR. JOHNSON: 17 Q. Good morning. Just a couple of follow-ups, 18 Mr. Brushett. Mr. Kelly asked you about the 19 treatment of the refund interest as being in 20 accordance with GAAP and of course you 21 confirmed that that was the case. But, would 22 you agree with the evidence of Newfoundland 23 Power's expert, Mr. Browne, that, of course, 24 GAAP treatment would not determine the 25 regulatory treatment of those monies?</p>	<p>Page 8</p> <p>1 A. I would agree with that, the Board would have 2 the, I guess, ability to order alternative 3 treatment. But, GAAP would be what you would 4 defer to in the absence of a regulatory order 5 to treat it in some other manner. 6 Q. Thank you. And you referred in response to 7 questions from my learned friend regarding the 8 system of accounts that you've, of course, 9 heard the evidence of my consultant, Mr. Todd. 10 And without asking you in any manner, because 11 I don't think it would be appropriate to wade 12 into the interpretation of what the words mean 13 in the 2003 GRA decision, but, would I be 14 correct in my assumption that if this Board 15 were to find that a defacto deferral account 16 was set up by virtue of that decision that the 17 issue of how Newfoundland Power booked it in 18 its system of accounts would not be 19 particularly relevant to the Board's 20 disposition of the 2.1 million in interest? 21 (9:15 A.M.) 22 A. I agree that we need to, the Board would need 23 to consider what is the appropriate 24 interpretation of what was said in P.U. 19, 25 and that is the real issue.</p>

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<p>1 MR. JOHNSON: 2 Q. Right. 3 A. And in answering your question I would agree 4 that the system of accounts and so on would 5 not preclude the Board from making some other 6 determination in this case. 7 Q. Okay. And with respect to the Mark Kennedy 8 option, I think that's probably getting a 9 little old, if I just try to understand, Mr. 10 Brushett, accepting for the moment that 11 there's probably little significant difference 12 between option No. 5 and what Newfoundland 13 Power had presented in its application with 14 respect to trying to get up to its allowed 15 rate of return, essentially - 16 A. The end result is essentially the same, yes, I 17 would agree with that. 18 Q. Accepting that, is there any--as you know, 19 you've sat through the proceeding and you've 20 known that the position where we're coming 21 from on this and that is this proceeding, in 22 our submission, is not really designed, does 23 not really have the trappings to give the 24 Board a degree of comfort, in our view, as to 25 what the overall revenue deficiency is.</p>	<p>1 You've sat through that evidence, you 2 understand where we're coming from. Is there 3 any material difference in terms of the 4 Board's ability to test the overall revenue 5 requirement by basically going with this 6 option No. 5? I mean, does that core concern 7 that the Consumer Advocate has get, in any 8 fashion, ameliorated by just putting together 9 a deferral of recovery as opposed to what the 10 application as framed originally sought? 11 A. As I understand your question, I would have to 12 answer that, no, it does not provide for any 13 more comfort in terms of the 2006 revenue 14 requirement than the Company's proposals, 15 under the understanding that the consideration 16 of the recovery and the means of recovery of 17 these costs in a 2006 GRA setting 2007 rates 18 will not be looking back at those costs in 19 terms of their prudence and so on. So, 20 therefore, on that basis, it would not. 21 Q. So, the only difference of any significance at 22 all between the option as proposed and option 23 No. 5 is timing, essentially, and the tax - 24 A. It's timing. And I guess what may come 25 forward in terms of additional information</p>
<p>Page 11</p> <p>1 relative to the financial condition and so on 2 of Newfoundland Power in a 2007 test year, 3 there may be information there that would 4 impact how and such costs could be recovered. 5 And I'm not sure, I can't think of any benefit 6 that you might derive from that today, but 7 with the benefit of additional information you 8 may have, you know, other benefits that would 9 arise from that. 10 Q. So, the Consumer Advocate would be sort of 11 taking a shot in the dark if he had any 12 expectation that that process would yield any 13 material advantage in terms of oversight and 14 determination of a deficiency in 2006? 15 A. I'm not sure about shot in the dark. 16 Q. It's certainly speculative? 17 A. There is no material difference in terms of 18 the ability to review the revenue deficiency 19 that is being put forward by the Company. One 20 thing that I would point out to you, Mr. 21 Johnson, is that while the Board doesn't have 22 the comfort of a full review of the 2006 GRA, 23 we do have in this jurisdiction still 24 mechanisms that would protect ratepayers to 25 the extent of the range of return, the upper</p>	<p>Page 12</p> <p>1 end of the range of return. That is something 2 that, you know, should be taken into 3 consideration in all of this, as well, so. 4 Q. Would your comments there refer to mechanisms 5 such as the Automatic Adjustment Formula? 6 A. No. 7 Q. No? 8 A. I'm referring to the upper limit of the range 9 - 10 Q. Excess earnings, I'm sorry - 11 A. - which would suggest that while there is a 12 range, I suppose, to a specific point at 13 which, you know, a just and reasonable return 14 is set. 15 Q. Yes. 16 A. The utility cannot earn above the upper limit 17 of the range. So, to the extent, you know, 18 and we wouldn't be exact in terms of 19 determining the revenue deficiency, excuse me, 20 on a perspective basis, we do have that 21 mechanism, at least, and it's not sort of just 22 thrown out as whatever it is it is. 23 Q. So, it's probably not as robust a protection 24 for consumers as a process whereby the 25 consumers would have a chance to test up front</p>

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<p>1 MR. JOHNSON: 2 the revenue requirement? 3 A. I agree with that 100 percent. A full review 4 would provide more comfort. And we mention 5 that in the report and it's come out in other 6 testimony in evidence here, as well. 7 Q. Yeah, I understand. Mr. Brushett, I 8 expressed--I don't know if you were here when 9 we first started the proceeding and I asked a 10 question what the hearing was all about. And 11 I wasn't really being factitious, to be honest 12 with you, because--and so what I would like to 13 ask you is that why couldn't this Board view 14 the Newfoundland Power account application 15 strictly as an accounting application and say, 16 look, we're not getting into revenue 17 deficiency and cost of service, we're getting 18 into--what's the best means in light of the 19 Tax Settlement scenario that Newfoundland 20 Power has arranged with Canada Customs Revenue 21 Agency, what's the best accounting policy, 22 what makes the most sense from the point of 23 view of matching expenses and revenues? Would 24 that be a viable approach, in your view, for 25 the Board to consider in its assessment of the</p>	<p>1 Newfoundland Power application? 2 A. I believe the Board certainly has the 3 jurisdiction to deal with it in that manner if 4 it chose to. But then, obviously the Board 5 still has to deal with any implications of 6 dealing with it in that manner versus the 7 manner proposed versus any other manner. 8 There would be other implications of doing 9 that. 10 Q. Yeah, I understand that. But, it would seem 11 to me that other implications, if the Board 12 were to adopt a policy of saying, look, CCRA 13 and Newfoundland Power have reached the Tax 14 Settlement, we should determine as a matter of 15 policy whether it makes sense for this Board 16 to approve the recognition of revenue in a 17 symmetrical fashion with the tax policy. 18 Okay? Follow me so far? 19 A. Yes. 20 Q. The implications--and then the Board would 21 consider such implications as, well, what 22 effect if we did that would there be on the 23 financial integrity of Newfoundland Power. 24 Would that be a consideration? 25 A. Yes.</p>
<p>1 Q. They would also consider what effect would 2 there be in terms of inter-generational equity 3 concerns. Would that be - 4 A. Sure, they would consider that, as well. 5 Q. They'd also look at what effects or 6 implications may there be in relation to rate 7 instability? 8 A. Yes. 9 Q. Okay. Those are the types of implications 10 that we're talking about. Really divorced 11 from, I would put to you, any notion of what 12 Newfoundland Power's rate of return is going 13 to be or not going to be in 2006? 14 A. I would agree with your concept or where 15 you're going with that, that it can be 16 divorced or treated as two completely two 17 separate issues, but it doesn't make the other 18 issue go away and still would have to be dealt 19 with. 20 Q. No, I understand, I understand. And if to the 21 extent that the other issue, being the would 22 be revenue deficiency issue is not addressed 23 through that policy adoption, well, then, 24 Newfoundland Power, well, it's put to its own 25 devices, what are you going to do about it,</p>	<p>1 right? The GRA or whatever they decide to do, 2 correct? 3 A. Yes. You know, certainly it would fall back 4 to the Company to come forward with proposals, 5 which probably wouldn't be a whole lot 6 different than what they have, to deal with 7 that particular issue in 2006. And, you know, 8 the considerations there, obviously, are the, 9 and we've heard it previously over the past 10 couple of days would be do we need a full GRA 11 to deal with this, is that--and the Board's 12 consideration would be around regulatory 13 efficiency of all that process and all of 14 those things they'd have to take into 15 consideration in seeing which approach is the 16 most efficient. 17 Q. Mr. Brushett, would it be fair for me to ask 18 you whether in your professional judgment the 19 issue of how much the Company should be 20 permitted to dip into, as I have called it, 21 the UUR to achieve its revenue requirement 22 objectives, would it be fair for me to ask you 23 whether that deserves less scrutiny than if 24 Newfoundland Power were coming in and asking 25 for rates to offset the very same items?</p>
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<p>1 MR. BRUSHETT:</p> <p>2 A. I would agree that it deserves no less</p> <p>3 scrutiny. It should be equal in terms of the</p> <p>4 degree of scrutiny that would be or should be</p> <p>5 put to bear on the issue.</p> <p>6 Q. Finally, I'd like to ask you, I would assume</p> <p>7 that with Grant Thornton that from time to</p> <p>8 time issues with the CCRA come up?</p> <p>9 A. Yes.</p> <p>10 Q. At a general level, would you agree with me</p> <p>11 that the CCRA are not usually indifferent to</p> <p>12 getting paid taxes earlier or later, if</p> <p>13 taxpayer, in the judgment of the CCRA, owes it</p> <p>14 money?</p> <p>15 A. They are certainly not indifferent and they</p> <p>16 much prefer and have many processes to collect</p> <p>17 as fast as they can.</p> <p>18 Q. They are, would you agree with me, a highly</p> <p>19 motivated creditor?</p> <p>20 A. That's a very general statement, but yes, I</p> <p>21 would suggest that by most measures they would</p> <p>22 be considered a motivated creditor, yes.</p> <p>23 Q. Even though the Queen's resources are</p> <p>24 limitless, in theory. Mr. Brushett, the</p> <p>25 Company evidence from its executives indicates</p>	<p>1 that it was informed in the mid to late '90s</p> <p>2 that a Canadian utility arrived at an</p> <p>3 arrangement with the CCRA whereby they could</p> <p>4 have the tax paid switched to the new method</p> <p>5 in three years starting in the year of the</p> <p>6 settlement. Were you here for that evidence?</p> <p>7 A. Yes, I heard that evidence.</p> <p>8 Q. Yeah. Would it be reasonable to assume that</p> <p>9 given that precedent of that other sister</p> <p>10 Canadian utility, given that that precedent</p> <p>11 existed, that Revenue Canada would have been</p> <p>12 receptive to treating Newfoundland Power the</p> <p>13 same way if Newfoundland Power had asked it to</p> <p>14 be treated in the same fashion?</p> <p>15 A. I believe that CRA employs, I guess, many</p> <p>16 approaches when they're negotiating with</p> <p>17 taxpayers. And that would be a reasonable</p> <p>18 assumption, but it wouldn't necessarily be the</p> <p>19 only course that they would take. I hesitate</p> <p>20 to say that that's--and again, maybe we're</p> <p>21 talking more--when we're talking precedent and</p> <p>22 the legalities of it, I don't know if I should</p> <p>23 be commenting on whether they'd be bound or</p> <p>24 anyone would be bound by that. But, it's not</p> <p>25 unusually for CRA to prolong or for issues</p>
<p>Page 19</p> <p>1 with CRA to be prolonged just even though the</p> <p>2 answer may seem obvious to someone.</p> <p>3 (9:30 A.M.)</p> <p>4 Q. I understand that. But, let me suggest to</p> <p>5 you, Mr. Brushett, that if Newfoundland Power</p> <p>6 had wanted to be treated in accordance with</p> <p>7 precedent set by the agreement that it found</p> <p>8 out about with this other Canadian utility and</p> <p>9 the CCRA would not have acceded to that</p> <p>10 request, which I think would have been odd,</p> <p>11 would you not agree with me that Newfoundland</p> <p>12 Power would have a pretty legitimate beef with</p> <p>13 CCRA that they were being treated in an</p> <p>14 unequal fashion to a case, supposing the case</p> <p>15 is similar?</p> <p>16 A. Certainly if there was a very similar case out</p> <p>17 there, you would have a very strong position,</p> <p>18 I would suggest, in your negotiation, yes.</p> <p>19 Q. You've heard the evidence of Newfoundland</p> <p>20 Power that it had basically a different goal</p> <p>21 which was to delay all payments from a little</p> <p>22 bit long so they would start, it would start</p> <p>23 in the next year so they wouldn't be three</p> <p>24 years, including the year of settlement? You</p> <p>25 recall that evidence?</p>	<p>Page 20</p> <p>1 A. Yes, I recall that.</p> <p>2 Q. Would you think it reasonable to deduce that</p> <p>3 that would have been a tougher sell with</p> <p>4 Revenue Canada than the adoption of the method</p> <p>5 that was arrived at with the other Canadian</p> <p>6 utility?</p> <p>7 A. On the face of those facts and not knowing all</p> <p>8 of the facts that were involved in that</p> <p>9 particular case and all of the issues that</p> <p>10 were brought in terms of the negotiation, just</p> <p>11 on that fact alone and knowing that there was,</p> <p>12 accepting that there was a settlement very</p> <p>13 similar, then I would agree with your comment</p> <p>14 that it would be, you would expect CRA to be</p> <p>15 looking for, in its negotiation, a similar</p> <p>16 type arrangement as the other utility.</p> <p>17 Q. Yeah. So, it would be tougher, take awhile to</p> <p>18 make that case with the CCRA if you're -</p> <p>19 A. Again, just isolating those facts, I would</p> <p>20 agree that that would be tougher, yes.</p> <p>21 Q. Thank you. I think that--thank you.</p> <p>22 CHAIRMAN:</p> <p>23 Q. Thank you, Mr. Johnson. Mr. Kennedy, do you</p> <p>24 have any?</p>

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1 MR. KENNEDY:
 2 Q. Nothing arising, Chair.
 3 CHAIRMAN:
 4 Q. Ms. Whalen?
 5 COMMISSIONER WHALEN:
 6 Q. No questions. Thank you, Mr. Brushett.
 7 CHAIRMAN:
 8 Q. No questions. Thank you, very much, Mr.
 9 Brushett. Ms. Newman, you may have commented
 10 on this before. With regard to Information
 11 Item 1, I just may not have heard it, are
 12 there any questions or anything in relation to
 13 this that anybody would have at this point in
 14 time, the need to call anybody from
 15 Newfoundland Power?
 16 MS. NEWMAN:
 17 Q. No, Mr. Chairman. I believe that everybody
 18 was in agreement that it was fine to file and
 19 -
 20 CHAIRMAN:
 21 Q. Just file, okay.
 22 MS. NEWMAN:
 23 Q. And nobody had any questions, I understood,
 24 about it.
 25 CHAIRMAN:

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1 handle the increased tax and depreciation
 2 expense in 2006? And the second is what is
 3 the proper treatment with respect to the 2.1
 4 million of refund interest in 2005? Those are
 5 the two issues that are remaining.
 6 Before I deal with those issues, let me
 7 first thank Board staff, including Grant
 8 Thornton, and the Consumer Advocate for their
 9 cooperation throughout this matter. If you
 10 look at the orders requested in Part E of the
 11 application, just have that on the screen in a
 12 second, here you go, you'll see that the
 13 matters dealt with in paragraphs 20A, C and D
 14 of the application have been agreed and are
 15 not in dispute. They are: the adoption of the
 16 Accrual Method of revenue recognition,
 17 commencing in 2006, that's in subparagraph A;
 18 the application of 295,000 of the Unbilled--
 19 2005 Unbilled Revenue in 2006 to dispose of
 20 the current balance in the reserve, that's
 21 paragraph D; and that the average value of the
 22 unrecognized 2005 unbilled revenue be deducted
 23 from rate base commencing in 2006. And the
 24 achievement of that resolution has been
 25 possible through the cooperation of the

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1 Q. Okay. Thank you, very much. I think that
 2 concludes the main portion of the hearing.
 3 And we'll, I understand from the agreement
 4 we'll break now for half an hour and we'll
 5 come back for final argument. That's it. I
 6 guess the order of final argument, just to get
 7 some--Mr. Kelly, Mr. Johnson, Mr. Kennedy and
 8 back to Mr. Kelly. Is that -
 9 KELLY, Q.C.:
 10 Q. That would be appropriate, Chair.
 11 CHAIRMAN:
 12 Q. Thank you, very much. And five after ten, I
 13 guess.
 14 (BREAK - 9:33 A.M.)
 15 (RESUME - 10:15 A.M.)
 16 CHAIRMAN:
 17 Q. Thank you. Mr. Kelly, when you're ready,
 18 please.
 19 KELLY, Q.C.:
 20 Q. Thank you, Chair. Chair and Vice-Chair, I'm
 21 sure that at first blush the issues in this
 22 application may have appeared rather complex.
 23 However, in reality, the outstanding issues
 24 resolve themselves into two rather simple
 25 points. The first is what is the best way to

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1 parties and has greatly simplified the issues.
 2 In paragraph 20B of the application,
 3 Newfoundland Power sought the Board's approval
 4 of the recognition for regulatory purposes of
 5 9,579,000 of the 2005 unbilled revenue in
 6 2006. That's the first outstanding issue.
 7 And finally, you'll note in paragraph 20.E,
 8 the Company has sought approval for forecast
 9 2006 values for rate base and invested capital
 10 for use in the Formula. Those values will be
 11 dependent on the Board's decision in paragraph
 12 20.B and that's because the rate base value
 13 will be affected by the amount of
 14 unrecognized, unbilled revenue, but there's no
 15 issue otherwise.
 16 Now let me turn next to the first
 17 outstanding issue. What is the best way to
 18 handle the increased tax and depreciation
 19 expense in 2006? One approach would have been
 20 to proceed with an expensive and difficult
 21 general rate application. That approach was
 22 rejected by the Company for several reasons.
 23 It is unnecessary. These are additional costs
 24 clearly known and determined. The tax amount
 25 is a defined amount. The depreciation true-up

Page 25

1 KELLY, Q.C.:

2 amount has been already tested in the 2003

3 hearing and the additional depreciation flows

4 directly from Board approved capital

5 expenditures and approved depreciation rates.

6 In fact, all of the parties agree on the

7 amounts in issue, including the Consumer

8 Advocate's expert, Mr. Todd. So there's no

9 issue there.

10 Mr. Browne and Grant Thornton have

11 recognized that it is appropriate to deal with

12 individual cost items outside of a GRA where

13 the Board determines that it is appropriate.

14 Grant Thornton has discussed that in the

15 response CA-39 PUB. The Board has adopted

16 this approach in the past. It is not new.

17 CA-12 NP contains a discussion of cases in

18 which the Board has adopted this approach in

19 the past. I won't review them for you again

20 in argument, but they are in CA-12. So in the

21 circumstances, the Company did not believe

22 that the GRA approach made practical

23 regulatory sense. The detailed reasons are

24 set out more fully in the response to PUB- 6

25 and have been canvassed fully throughout this

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1 proposal. The forecast rate of return on rate

2 base would be 8.56 percent in 2006. The

3 difference is that the recovery of the

4 depreciation would await the next GRA, the

5 2007 test year. So on this approach, you'd

6 accrue the amount for the tax and defer the

7 two depreciation items. The recovery of the

8 increased depreciation costs--and again, just

9 let me emphasize the point, those numbers are

10 not in dispute, nor are they disputed as

11 legitimate and prudent costs. You'll remember

12 Mr. Todd's evidence on that--would be dealt

13 with in the decision of the Board in the GRA

14 where the Board would consider not only the

15 option of applying some of the accrued 2005

16 unbilled revenue, but all of the revenue and

17 expense issues in the test year to determine

18 the most appropriate cost recovery strategy.

19 The Board, however, would not revisit 2000

20 costs and expenses.

21 The Board would also have the benefit of

22 the next depreciation study before making a

23 final decision, and Vice-Chair Whalen referred

24 to that point in one of her questions to the

25 Company witnesses, they would have--the Board

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1 hearing.

2 So now at this stage, there are

3 essentially three approaches for the Board to

4 consider on this issue. First is Newfoundland

5 Power's approach of applying 9.6 million of

6 accrued unbilled revenue to cover 3.1 million

7 of tax, 5.8 million of true-up depreciation

8 and 1.2 million of additional depreciation.

9 That approach would give Newfoundland Power an

10 opportunity to earn a forecast rate of return

11 on rate base in 2006 of 8.56 percent, towards

12 the lower end of the range. The application

13 of the accrual for the amount of the 2006 tax

14 of approximately 3.1 million has been accepted

15 as reasonable by all of the parties. So that

16 issue doesn't seem to be in dispute, that the

17 accrual should be applied to the 3.1 million

18 in tax. So that's approach number one.

19 The second approach is to defer recovery

20 of all or some of those three items in

21 accordance with the approach set out in

22 information response number one. If the

23 recovery of the depreciation cost items were

24 deferred in that manner, the net effect is

25 exactly the same as in Newfoundland Power's

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1 would have the benefit of the next

2 depreciation study to see whether there were

3 any depreciation adjustments required.

4 As I've said, if the increased

5 depreciation were deferred, Newfoundland Power

6 would have a forecast rate of return on rate

7 base of 8.56 percent in 2006, the same as

8 under the Company's proposal. The example in

9 information response number one shows, for

10 comparison purposes, a calculation on the same

11 basis as in PUB-14 which permits accrual for

12 recovery of the additional tax and deferral of

13 the depreciation true up, in other words the

14 additional depreciation is not covered. That

15 would give the Company a forecast rate of

16 return on rate base of 8.41 percent, nine

17 basis points below the bottom of the currently

18 approved range. And as I've already

19 indicated, the Board could apply accrued

20 revenue in 2006 to deal with one or more of

21 the items, for example, tax, and could defer

22 other items and the net result becomes the

23 same. So that's the second approach.

24 The first one is we have applied the

25 accrual. Second one is deferral and the third

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1 KELLY, Q.C.:

2 approach is Mr. Todd's approach. Mr. Todd

3 proposed essentially dividing the amount of

4 the unbilled accrued revenue equally among

5 2006, 2007 and 2008. The results are shown in

6 PUB-7 and perhaps if we just put that on the

7 screen. We go to the text and just scroll up

8 the table. That approach would produce a

9 forecast rate of return on rate base of 8. 37

10 percent, 13 basis points below the bottom of

11 the currently approved range. That approach

12 essentially does not require the Board to

13 determine which costs it will allow recovery

14 of. It simply adopts the recognition agreed

15 to in the tax settlement, but it leaves the

16 Company with a rate of return of only 8. 37

17 percent.

18 From Newfoundland Power's perspective,

19 either the Company's proposal or the deferral

20 proposal or some combination, in other words

21 accrue the tax, defer the depreciation, is the

22 preferred approach. It permits the Company an

23 opportunity to earn a return on rate base

24 within the approved range in 2006. Ultimately

25 the decision on the appropriate approach is a

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1 it has no jurisdiction under the Act to

2 require payment by Newfoundland Power into a

3 reserve account or otherwise deprive

4 Newfoundland Power of any amount which is

5 within the allowed return on rate base as

6 fixed and determined by the Board pursuant to

7 Section 80.1 of the Act." And note, the Board

8 specifically dealt with two points, either

9 payment into a reserve account or to otherwise

10 deprive Newfoundland Power of any amount, and

11 that decision is clearly in accordance with

12 the Stated Case.

13 (10:30 A.M.)

14 Now the next step in this is to note that

15 interest income on tax refunds is treated as

16 revenue to the Company by Section 5.J of the

17 System of Accounts, and that's dealt with in

18 PUB-10. The paragraph on the screen, the

19 Section 5.J of the System of Accounts requires

20 that interest revenue derived from income tax

21 refunds be recorded as miscellaneous non-

22 consumer revenue. So consequently, the Board

23 has already approved that refund interest is

24 revenue to the Company. And consequently, the

25 refund interest has been treated by

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1 matter of regulatory judgment for the Board.

2 Let me turn next to the second issue, and

3 that is, what is the proper treatment with

4 respect to the 2.1 million of refund interest

5 in 2005? Now the starting point surely must

6 be that this issue must properly be considered

7 within the context of the regulatory regime in

8 Newfoundland and Labrador. Let's just look at

9 some of the components. This Board has

10 established a permitted range of rate of

11 return on rate base. Our Court of Appeal in

12 the Stated Case has referred to it as the

13 range of reasonableness. Earnings within that

14 range are just and reasonable returns. The

15 Board has also created an excess earnings

16 account to deal with earnings in excess of the

17 upper end of the range. The Board has

18 correctly recognized, in accordance with the

19 Stated Case decision, that earnings within the

20 range belong to the utility. The Board

21 addressed that specifically in P.U. 19 at page

22 26, and just put that on the board, on the

23 screen. There you go.

24 The Board, having reviewed the Stated

25 Case decision, concluded "the Board finds that

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1 Newfoundland Power in that manner in its

2 accounts for 2005, and that, as Mr. Brushett

3 indicated to us this morning, is also in

4 accordance with Generally Accepted Accounting

5 Principles.

6 So in accordance with Order P.U. 19, the

7 Board cannot now deprive Newfoundland Power of

8 that revenue or require that that revenue be

9 paid into a reserve account where it is within

10 the approved range of rate of return. All the

11 more, the Board cannot now retroactively take

12 back that revenue from the Company where to do

13 so would be to push the rate of return below

14 the bottom of the approved range. And while

15 that might be the legal position, more

16 importantly, from a policy perspective, which

17 is what this Board obviously must be most

18 concerned about, such an approach would be

19 inappropriate. It would deprive Newfoundland

20 Power, late in 2005, of its opportunity to

21 earn a just and reasonable return, and it

22 would remove revenue from Newfoundland Power

23 when Newfoundland Power has not recovered in

24 electricity rates all of its costs associated

25 with the tax dispute, and you've heard the

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<p>1 KELLY, Q.C.:</p> <p>2 evidence from Mr. Meyers and Mr. Browne</p> <p>3 outlining that in considerable detail.</p> <p>4 Customers have received benefits and will</p> <p>5 receive further benefits as a result of the</p> <p>6 tax settlement. They will have no potential</p> <p>7 liabilities. As Mr. Smith indicated, all</p> <p>8 potential liabilities have been eliminated.</p> <p>9 Recognition of this interest by Newfoundland</p> <p>10 Power as revenue in 2005 provides balance</p> <p>11 between the interests of the utility on the</p> <p>12 one hand and its customers on the other. The</p> <p>13 Board should also consider regulatory</p> <p>14 consistency. The Board has to date adopted a</p> <p>15 consistent approach of treating refund</p> <p>16 interest as revenue since the beginning of the</p> <p>17 tax dispute. The Board should continue to</p> <p>18 follow the same approach.</p> <p>19 Mr. Todd has suggested that the Board has</p> <p>20 established some kind of defacto deferral</p> <p>21 account with respect to all of the</p> <p>22 consequences of the tax settlement. When I</p> <p>23 examined him on that, he seemed to suggest</p> <p>24 that such a deferral account would only apply</p> <p>25 to the consequences of the tax settlement in</p>	<p>1 2005, not to the full conduct of the</p> <p>2 management and settlement of the tax dispute</p> <p>3 from its inception.</p> <p>4 Let me make three comments in response.</p> <p>5 First, the Board, in fact, did not establish</p> <p>6 such a deferral account. It's as simple as</p> <p>7 that. All previous interest refunds have been</p> <p>8 dealt with the normal manner. Secondly,</p> <p>9 logically, Mr. Todd's approach would require</p> <p>10 the Board to reopen all of the years back to</p> <p>11 1995 and to look at all of the consequences of</p> <p>12 the management and settlement of the tax</p> <p>13 dispute. That would be one, retroactive, and</p> <p>14 number two, create significant regulatory</p> <p>15 uncertainty. And three, third of my three</p> <p>16 comments, the approach is not legally</p> <p>17 permissible because it is not in accordance</p> <p>18 with the Stated Case decision of our Court of</p> <p>19 Appeal and it is not in accordance with the</p> <p>20 Board's last order on excess earnings, P.U.</p> <p>21 19.</p> <p>22 Question six of the Stated Case, the</p> <p>23 answer to question six, specifically</p> <p>24 recognizes the Board's right to review</p> <p>25 expenditures for prudence. Imprudent</p>
<p>Page 35</p> <p>1 expenditures can be disallowed, potentially</p> <p>2 creating excess earnings. No suggestion of</p> <p>3 imprudence has been made or could be made with</p> <p>4 respect to the Company's handling of the tax</p> <p>5 dispute. The evidence is clear that this is a</p> <p>6 huge success for customers. Mr. Johnson</p> <p>7 suggests that the Board has, in P.U. 19,</p> <p>8 preserved its jurisdiction to deal with the</p> <p>9 question of benefits and liabilities, and that</p> <p>10 is so, but one must ask the jurisdiction to</p> <p>11 consider exactly what, and the answer to that</p> <p>12 is found in the Stated Case decision. It is</p> <p>13 to review the handling of the issue from a</p> <p>14 prudence test. To look at the benefits and</p> <p>15 liabilities from a prudence test, and in that</p> <p>16 perspective the company is entitled to the</p> <p>17 presumption of managerial good faith.</p> <p>18 So where does that take us? The effect</p> <p>19 of the Board's adoption of Mr. Todd's</p> <p>20 proposal, with respect to interest income, is</p> <p>21 not only to deprive the Company of earnings</p> <p>22 within its range in 2005, but would also be to</p> <p>23 effectively ensure that the Company does not</p> <p>24 even earn within the range in 2005. Mr.</p> <p>25 Chairman, that simply is not within the</p>	<p>Page 36</p> <p>1 Board's jurisdiction, nor is it good</p> <p>2 regulatory policy. As a result, the 2005</p> <p>3 interest income should be treated as revenue</p> <p>4 to the Company in 2005 in the normal course</p> <p>5 and in accordance with existing Board orders</p> <p>6 and procedures.</p> <p>7 Chair, Vice-Chair, unless you have</p> <p>8 questions, those are my submissions on this</p> <p>9 application.</p> <p>10 VICE-CHAIR WHALEN:</p> <p>11 Q. I have no questions. Thank you, Mr. Kelly.</p> <p>12 CHAIRMAN:</p> <p>13 Q. Thank you, Mr. Kelly.</p> <p>14 KELLY, Q.C.:</p> <p>15 Q. Thank you, Chair.</p> <p>16 CHAIRMAN:</p> <p>17 Q. Mr. Johnson.</p> <p>18 MR. JOHNSON:</p> <p>19 Q. Mr. Chairman, Madame Vice-Chair, as I've sat</p> <p>20 here over the last few days and in fact, prior</p> <p>21 to that, in terms of trying to read through</p> <p>22 and understand the application as presented to</p> <p>23 Newfoundland Power, I'm afraid I must say that</p> <p>24 I was probably a little late, although I don't</p> <p>25 think I could be faulted for it, to coming to</p>

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1 MR. JOHNSON:
 2 understand the true nature of the application
 3 that's before this Board. And the view that I
 4 take of this application as prepared and as
 5 presented to this Board, I'm afraid, is that
 6 it's ill conceived. So let me try to frame
 7 this debate up properly because the way the
 8 application was presented to you really sent
 9 us on a bit of a wild goose chase and
 10 distracted from how, in my view, the
 11 application should be viewed.
 12 What this application should have been
 13 framed as is truly an accounting application,
 14 which is what it says right on its cover,
 15 "2006 Policy Accounting Application." But
 16 it's a complete misnomer. The application, as
 17 framed, is one part accounting, one part
 18 revenue deficiency. This Board must dispose
 19 of the revenue deficiency part because this is
 20 not an appropriate forum to deal with revenue
 21 deficiency. It's just as simple as that.
 22 That leaves us with the question, how
 23 should we address--how should the Board
 24 address in a principled manner the accounting
 25 issues that fall out of the Tax Settlement?

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1 Newfoundland Power to bring forward, in light
 2 of its tax settlement, its Revenue Recognition
 3 Study. And it is also wholly appropriate for
 4 Newfoundland Power to request that the Board
 5 set down a policy for recognizing the 2005
 6 unbilled revenue that is created as a result
 7 of the switch to the accrual method. And
 8 essentially, they were suggesting some sort of
 9 transitional period. And I agree with that.
 10 I share that sentiment, but perhaps for
 11 different reasons. But it is not appropriate
 12 for Newfoundland Power to request, and in my
 13 respectfully submission, nor is it appropriate
 14 for this Board to even consider any revenue
 15 deficiency matter. If we narrow this hearing
 16 to the appropriate issue, they in my
 17 submission, we are driven to the three year
 18 tax settlement scenario envisioned in one of
 19 the Public Utility Board's information
 20 requests, which calls for the recognition of
 21 the unbilled revenue in equal amounts over the
 22 next three years. If that's the context,
 23 which I respectfully submit should be the
 24 context, then the only purpose for including
 25 and reviewing 2006 forecasts is to provide

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1 The Tax Settlement that but for the existence
 2 of the Tax Settlement, we would never be
 3 talking about an accounting policy change.
 4 Here we are talking about a Tax Settlement
 5 that calls for one-third of the un--of the UUR
 6 to be recognized for income tax purposes over
 7 each of the next three years, about three
 8 million bucks per year, 2006, '07 and '08.
 9 It is, in my submission, perfectly
 10 legitimate for this Board to deal with this as
 11 an accounting application. Dealing with
 12 accounting matters is a standard regulatory
 13 practice. I won't refer to them briefly, but
 14 for the record, and I would commend to your
 15 attention, for instance, in Mr. Browne's
 16 expert report, a decision called the Foothills
 17 case, and you may wish to read the Foothills
 18 case because essentially what the Board was
 19 faced with was an accounting policy issue and
 20 the Board made a decision as to how to go
 21 about an amortization. It was not driven by a
 22 revenue deficiency problem, much less an
 23 untested revenue deficiency, which is what we
 24 have here before you. Let me say as well,
 25 that it is perfectly appropriate for

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1 this Board with the comfort that it is not
 2 going to implement a policy that has
 3 unacceptable ramifications to issues like rate
 4 instability, financial integrity of
 5 Newfoundland Power, and inter-generational
 6 equity. And to consider the ramifications, if
 7 any, to principles such as those, you do not
 8 require a GRA. And the state of the record is
 9 sufficient. This approach really does not
 10 require pragmatism. This requires a principle
 11 decision on accounting issues. Now, I wish
 12 now to turn to looking for a moment at the way
 13 Newfoundland Power has this application frames
 14 and which it continues to wish to have it
 15 framed for this Board's consideration. And
 16 what are the implications of the way that it
 17 has it framed. Mr. Todd's evidence points out
 18 that on the UUR issue, if we're taking a
 19 purely principled approach, a cost based
 20 approach, the result of the application of
 21 this approach is that the Newfoundland Power
 22 application must fail because this proceeding
 23 does not afford the opportunity to fully test
 24 and verify the overall revenue requirement.
 25 And therefore, it is impossible to arrive at a

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1 MR. JOHNSON:
 2 finding of fact that a revenue deficiency
 3 exists in an amount equivalent to the nine
 4 point six million dollars sought. And the
 5 Board has had the benefit of the viva voce
 6 testimony of Mr. Brushett this morning, who I
 7 think it's fair to say, indicated that the
 8 dipping into UUR deserves no less scrutiny
 9 than would a normal request for rates. Let me
 10 say that the upshot of this principled
 11 approach--again, looking at the application as
 12 Newfoundland Power has framed it. And the
 13 only possible upshot that there would have to
 14 be a GRA in order for Newfoundland Power to
 15 make its case for the nine point six million
 16 dollars. I should also add that the option
 17 number five scenario similarly founders
 18 because all that is, is a variation in timing
 19 essentially, but not in substance. There
 20 would still be no opportunity to review the
 21 overall revenue requirement, and quite simply,
 22 in my submission, that is fatal to its
 23 acceptability. It's no coincidence that
 24 Newfoundland Power would be equally happy with
 25 option number five, because it gives them the

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1 you that to exceed to Newfoundland Power's
 2 initial proposal or its alternative proposal,
 3 is to create an odious precedent. Might I
 4 also add that references by Newfoundland Power
 5 to mechanisms such as the automatic adjustment
 6 formula are not helpful and are easily
 7 distinguishable. These preset, preexisting
 8 mechanisms are designed and are premised on
 9 the notion of symmetry, whereby consumers bear
 10 increases but also enjoy the benefits of
 11 decreases in the factors that make up the
 12 formula. What you have here is single issue
 13 rate making--at least single issue revenue
 14 seeking. For instance, if we did not have
 15 this pool of UUR, does anybody think that
 16 Newfoundland Power could come in and seek a
 17 rate increase on the basis of the record that
 18 they have put before this Board. Keep in mind
 19 that as the way Newfoundland Power sees this
 20 application, the real focus of this accounting
 21 application, so-called, is a revenue increase
 22 to get the Company up to its allowed range of
 23 return in 2006. That request is clearly not a
 24 transitional, or issue arising out of a policy
 25 change in accounting. It has nothing to do

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1 same thing practically. The Board must reject
 2 the evidence of the Company's witnesses,
 3 including Mr. Browne, to the extent that they
 4 suggest that this proceeding gives the Board
 5 the means to arrive at the conclusion that the
 6 overall revenue deficiency can be confirmed.
 7 This Board should also reject the evidence of
 8 the Company's president, where he indicated on
 9 December 7th, that in his view, a less
 10 exacting scrutiny was required because we were
 11 dealing with UUR. Obviously, this hearing
 12 does not have the trappings of scrutiny,
 13 commensurate with a revenue request of nine
 14 point six million dollars. The bottom line is
 15 that they are seeking revenue. And if you do
 16 not get the revenue deficiency right, as Mr.
 17 Todd pointed out in his evidence, it has a
 18 cascading effect down the line, which will
 19 manifest itself in higher rates in the future.
 20 Clearly, that's not in the consumer's
 21 interest. This is not a scenario which this
 22 Board can countenance in light of its quasi
 23 judicial role and its duty to consumers, and
 24 to the utilities under its enabling
 25 legislation. Respectfully, I must submit to

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1 with it. I should say as well, that it is
 2 totally in Newfoundland Power's lap that this
 3 unique application is being advanced. And
 4 they must take the consequences. They knew
 5 that the true up was coming off. They knew
 6 that there was increased depreciation expense
 7 expected in 2006. What did they do? Nothing,
 8 really, except use the happenstance of the
 9 settlement of the tax case to put together an
 10 application that would, hopefully, produce the
 11 result that if you accept their estimates,
 12 would have arisen if they had gone to a GRA.
 13 But if you don't go to a GRA, and be subjected
 14 to the normal standards that are well
 15 engrained in that process, you can hardly
 16 expect to skip the normal standards and reap
 17 the same result in this three day hearing.
 18 The tax settlement scenario is to be preferred
 19 because it can be made without reference to
 20 the need for covering off a revenue
 21 deficiency. It can be made in the context of
 22 being true to what the accounting change is
 23 all about. The tax settlement agreement and
 24 the legal obligation it places upon
 25 Newfoundland Power to recognize a third of the

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<p>1 MR. JOHNSON: 2 UUR over each of the next three years is the 3 factual background. It's the reality which 4 determines both the recognition of revenue for 5 tax purposes and the additional tax expense 6 that arises there from in 2006, 2007, 2008. 7 The Company's application adopts the accrual 8 method for regulatory purposes, mirroring the 9 obligation to switch to the accrual method for 10 tax purposes. The Company also recognizes tax 11 expense in a manner that matches the actual 12 tax consequences of the settlement. The 13 Company's--and therefore, the most appropriate 14 and principal method of recognizing the 15 unbilled revenue for regulatory purposes is to 16 adopt the reality of the tax agreement, which 17 is one third each year. And there's support 18 for this, really, within the Company's own 19 evidence. The Company's Revenue Recognition 20 Study, for the record, at M.P. 3, page 3, 21 states, " Adoption of the accrual method for 22 regulatory purposes on a prospective basis, 23 would enhance regulatory transparency by 24 ensuring a consisting matching of recognized 25 revenue and associated income tax expense. "</p>	<p>1 Newfoundland Power seeks to deviate from what 2 it terms in its evidence in M.P. 3, they 3 acknowledge Canadian Standard and Practice in 4 its own Revenue Recognition Study. But I pose 5 the question to the Board, what good reason 6 for deviating from that has been--from that 7 method has been provided in this hearing? The 8 Company's rationale for deviating from this 9 standard is that the deviation is necessary to 10 allow it to earn a fair return in 2006. But 11 that rationale founders because the 2006 12 revenue requirement has not been tested and 13 proven to a sufficient degree before this 14 Board in this proceeding. We are accordingly 15 left with no sound rationale for deviating 16 from the accepted Canadian standard of 17 recognizing revenue and costs for regulatory 18 purposes as they are being recognized for 19 management and tax purposes. In fact, there 20 are only sound basis for not deviating from 21 that practice. As Mr. Todd pointed out, it 22 will not create rate instability. It will not 23 offend principles of inter-generational 24 equity, nor does the tax agreement treatment 25 impair or threaten the Company's financial</p>
<p>Page 47</p> <p>1 integrity, which of course, is a key 2 consideration. Let me now turn to the two 3 point one million dollars in interest. But 4 before doing, I should note that I have 5 provided to my learned friend and to the 6 Board, a case from Rhode Island, which I 7 thought summed up pretty well the duty of the 8 Board in terms of the scrutiny required if you 9 view this application the way Newfoundland 10 Power does, in terms of a revenue deficiency 11 approach. And I don't know if the panel has 12 that.</p> <p>13 CHAIRMAN: 14 Q. Is that in the record in any other way? 15 MS. NEWMAN: 16 Q. Yes, Mr. Chairman, it has been circulated to 17 everybody I understand. And there was copies 18 left on the panel there. We have just 19 referred to it, I think, as information item 20 number 2--is what we normally do with - 21 CHAIRMAN: 22 Q. Thank you. 23 MS. NEWMAN: 24 Q. - the authorities that are filed. 25 CHAIRMAN:</p>	<p>Page 48</p> <p>1 Q. Thank you. 2 MR. JOHNSON: 3 Q. Thank you. I'm referring to page four of 4 seven. The quote is, " Among the essential 5 factual findings, which the PUC must make in 6 carrying out its duty of regulating the rates, 7 is a determination of the operating expenses 8 of the utility in this instance. " And they 9 refer to cases from the United States and this 10 quote from 1947. Expenses, using that term in 11 its broad sense, to include not only operating 12 expenses but depreciation and taxes, are 13 facts. They are to be ascertained, not 14 created by the regulatory authorities. If 15 properly incurred, they must be allowed as 16 part of the composition of the rates. 17 Otherwise, the so-called allowance of a return 18 upon the investing being an amount over and 19 above expenses would be a farce. And if I-- 20 and I think that is so indicative of why the 21 Board must be careful not to go down the road 22 of being invited to make findings of fact in 23 respect of an overall revenue deficiency. 24 Now, the two point one million dollars in 25 interest, the Company's application and</p>

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<p>1 MR. JOHNSON: 2 request for an order makes no specific 3 reference, or no reference at all in fact, to 4 the two point one million dollars of interest 5 arising from the tax settlement. And 6 likewise, the Company's summary of proposals 7 makes no reference to the issue The Board 8 has--the Company has noted however, in its 9 application at paragraph two, that the Board, 10 by order numbers 36 and 98, 99, PU 28 in '99, 11 2000 and PU 19 in 2003, ordered, in effect, 12 that the Company file a revenue recognition 13 study upon resolution of an outstanding 14 dispute with the Canadian Revenue Agency. 15 However, it must be noted that this Board, in 16 order number PU 19, 2003, also stated at page 17 87 as follows, the Board will deal with any 18 issues arising from the final decision of the 19 tax case, including any potential liabilities 20 or benefits to rate payers, once the case has 21 been resolved--any issues, any issues. The 22 Board's independent consultant, Grant 23 Thornton, stated in its report at page five, 24 the Board may way to consider whether the 25 interest income arising from the tax</p>	<p>1 settlement should be incorporated with the 2 transitional issues noted in the application. 3 If so, the Board would need to make a decision 4 on the issue before the Company is required to 5 finalize its December 31st, 2005, financial 6 statements. Otherwise, the Company would have 7 to record the interest income in 2005. This 8 Board not only reserved to itself the 9 jurisdiction to deal with any issues arising 10 from the final decision of the tax case, but 11 also, in effect set up a reserve. First of 12 all, let's look at some background here, which 13 is crucial to the analysis as to whether a 14 defacto deferral account was set up. There 15 was litigation ongoing for a number of years. 16 The issue of revenue recognition could not be 17 addressed for fear of prejudicing the tax 18 case. That would be common sense. The Board 19 agreed, quite properly, that it was not 20 appropriate to press forward with these 21 matters until the case was resolved. It's 22 also important consideration that it was also 23 not possible to thoroughly examine, during 24 previous GRAs, the potential liabilities and 25 benefits that awaited. That had to wait for</p>
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<p>1 the case to be resolved. So this is the first 2 real opportunity for that promised review. 3 The Consumer Advocate regards the Board's 4 now oft quoted sentence as creating a defacto 5 deferral account to capture the liabilities 6 and the benefits which would necessarily 7 include the recovery of interest revenue upon 8 the final resolution of the case. Now let me 9 say that that was set up at that time in that 10 decision. So it obviously would not--that's 11 when the deferral, defacto deferral account 12 was set up. So the idea that that would 13 invite you to go back to '95, '96, '97, and 14 restate earnings and that type of thing, I 15 think, misses the point. Because no, the 16 deferral account was set up in 2003. 17 If a defacto deferral account was created 18 which captured the liabilities and benefits, 19 then Newfoundland Power erred when in 2005 it 20 received the interest refund and entered it on 21 its approved books of account. It should have 22 been placed in the deferral account. If it 23 had been placed in a deferral account, it 24 would not have become the Company's revenue 25 until this Board had determined its</p>	<p>1 appropriate disposition. The accounting 2 treatment, in terms of approved books of 3 account, is not the tail that wags the dog. 4 The entitlement to the monies is the key. 5 Let's not lose sight of that. 6 If the Board's Order created a defacto 7 deferral account, the Stated Case clearly 8 poses no legal or jurisdictional impediment to 9 the Board's disposition of this money. The 10 Stated Case only prohibits the Board from 11 removing revenue retroactively from the 12 Company's just and reasonable return. This 13 prohibition would not apply to funds that are 14 properly placed in a deferral account, whose 15 deferral accounts the existence of which 16 predates the receipt of the funds. There's 17 nothing retroactive about that. Was--this is 18 the question. Was a defacto deferral account 19 created in 2003? 20 To determine this issue, my submission to 21 you is that we must give the words used a 22 plain and ordinary meaning, informed by all of 23 the circumstances. What do we think it means 24 in light of the circumstances? The words 25 could not be more plain. Newfoundland Power</p>

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1 MR. JOHNSON:
 2 admits that the words in the Order
 3 would include the interest revenue, the words
 4 in the Order would. It comes within the
 5 ambit. So there does not appear to be debate
 6 on that. The circumstances were that this
 7 Board had to defer the issue because it would
 8 have been inappropriate to address them while
 9 the case was ongoing.
 10 Clearly, one of the logical possibilities
 11 that these words contemplate was that
 12 Newfoundland Power could have lost its tax
 13 case and triggered a 16.2 million dollar tax
 14 hit. Newfoundland Power makes no bones about
 15 the fact, as they explained to investors in
 16 their 2004 annual report, as follows, under
 17 the topic contingent liability, "the Company
 18 has disclosed a contingent liability of 16.2
 19 million dollars as at December 31st, 2004
 20 related to a reassessment by the Canada
 21 Revenue Agency on its 1993 taxation year. At
 22 issue is the method the Company uses to
 23 recognize revenue. The Company believes that
 24 it has reported its tax position appropriately
 25 and has filed a notice of appeal with the Tax

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1 starting in 1993. Had the case gone to Court
 2 and final judgment been rendered against the
 3 Company, the taxes would have become
 4 immediately due and payable. They would have
 5 been uncollectible from rate payers unless
 6 they had been deferred and disposed of in a
 7 later proceeding. At the time the tax bill
 8 came, rates would have already been in place
 9 for that year, and unless the costs were
 10 captured in a deferral account so that they
 11 could be recovered in rates in a subsequent
 12 year, Newfoundland Power would have had no
 13 recourse against its rate payers. Now do you
 14 think that that's what Newfoundland Power
 15 contemplated? Newfoundland Power is hard
 16 pressed to deny the existence of a deferral
 17 account. You can't suck and blow.
 18 The next issue is who is entitled to the
 19 interest and on what basis is that
 20 determination to be made? As a matter of
 21 symmetry, if the 16.2 million dollars would
 22 have been picked up by rate payers, the two
 23 million dollars should go to rate payers. Let
 24 me point out that in every year in which the
 25 Company and customers are shown to have borne

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1 Court of Canada." And this is at page 32, by
 2 the way, of Mr. Todd's evidence, in his
 3 report. "Should the Company be unsuccessful
 4 in defending its position, a liability of
 5 approximately 16.2 million dollars, including
 6 accrued interest, would arise. In this event,
 7 the Company would apply to the PUB to include
 8 the amount in the rate making process. This
 9 application may include a request to change
 10 the current practice of recognizing revenue
 11 when billed to recognizing revenue on an
 12 accrual basis. The decision of the Court is
 13 not expected before 2006. The provisions of
 14 the Income Tax Act require the Company to
 15 deposit one half of the amount in the dispute
 16 with the CRA. The amount currently on deposit
 17 with the CRA is 16.2 million dollars." Thank
 18 you very much, investors. How do you feel
 19 about that? That's what they said.
 20 Now the Company's claim--and this is
 21 vital--the Company's claim to seek these tax
 22 expenses from the rate payer would only be
 23 possible if there had been a deferral account.
 24 The Tax Settlement agreement says that these
 25 taxes were payable in respect of tax years

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1 costs in the tax dispute, in the Company's
 2 analysis at CA-23, attachments B and C, the
 3 Company's rates were set at a level that
 4 allowed it to earn a just and reasonable
 5 return on rate base. The Company's executives
 6 acknowledged this on the stand. Through that
 7 period, the cost to consumers has a net
 8 present value, accepting the 8.5 percent
 9 discount, of ten million bucks, which
 10 represents real dollars out of the pockets of
 11 rate payers that was paid by customers through
 12 higher rates than otherwise would have been
 13 necessary but for the inclusion of the
 14 carrying costs embedded in their rates.
 15 Based on the Company's executives'
 16 evidence, it is a very reasonable inference
 17 that Newfoundland Power, I would point out,
 18 had it so chosen could have settled this case
 19 with Revenue Canada on the same terms as the
 20 other Canadian utility in the mid to late
 21 1990s. They held fast in order to get the
 22 delay that caused all these unnecessary
 23 carrying charges, rather than settling
 24 earlier. Let me explain.
 25 (11:15 A.M.)

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1 MR. JOHNSON:
 2 They've actually imposed unnecessary
 3 costs on the customer, and that's only evident
 4 through this proceeding. And the only gain
 5 was to have the settlement delayed to ensure
 6 that they could get the first year's tax
 7 expense from the customer. That's why they
 8 didn't want the deal that the other Canadian
 9 utility had been offered and accepted. The
 10 unwitting customer financed the delay,
 11 actually financed the delay which was used to
 12 extract a concession from Revenue Canada which
 13 disadvantaged the very customers who were
 14 financing the slow movement of the case. An
 15 early settlement would have avoided a
 16 significant portion of the ten million dollars
 17 in present value in carrying costs and legal
 18 fees. In my submission, those unnecessary
 19 financing and legal costs were imprudently
 20 incurred by the Company and should have been
 21 recovered--and should not have been recovered
 22 from customers.
 23 Now but for this veil of secrecy over the
 24 case while it was ongoing, these costs could
 25 have been avoided, and that's prudent

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1 Now I would now like to address, in a
 2 little further detail, some of the
 3 propositions put forward by my learned friend,
 4 to the extent that I've--I hope I have not
 5 covered them off and I won't be repetitive.
 6 Let me take you, let me commend to your
 7 attention the Stated Case obviously. Mr.
 8 Kelly put some emphasis on this Board's
 9 statement and conclusion in the last GRA
 10 decision. I don't know if you could--that's
 11 beyond your--okay. It's probably not
 12 necessary, Ms. Blundon. Wherein the Board
 13 concluded that it was without jurisdiction.
 14 The quote alludes me for the moment.
 15 MS. NEWMAN:
 16 Q. We have that, don't we?
 17 KELLY, Q.C.:
 18 Q. It's on.
 19 MR. JOHNSON:
 20 Q. It's on.
 21 KELLY, Q.C.:
 22 Q. 19, P.U.B -
 23 MS. NEWMAN:
 24 Q. Just clarify your request.
 25 MR. KENNEDY:

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1 management? Now I recognize that this is
 2 perhaps not the forum to have a determination
 3 as to imprudently incurred costs, but it would
 4 be appropriate to look at this in the next GRA
 5 now that the veil of secrecy has been removed.
 6 I might also point out that it does not take a
 7 lot of management effort, with due respect, to
 8 get a lawyer's opinion when you get a
 9 reassessment of 16 million bucks. Okay, let's
 10 be realistic. It would have been dereliction
 11 of duty not to get independent legal advice
 12 and to act appropriately on the legal advice.
 13 It appears, unfortunately, that too much
 14 effort went into delay in the case's
 15 resolution so, if I could put it colloquially,
 16 that "the Company could get the mine and the
 17 customers could get the shaft."
 18 In all of these circumstances, it is my
 19 submission that it is appropriate that the
 20 entire 2.1 million dollars should flow to the
 21 benefit of customers and the only way to
 22 accomplish that is to hold the 2.1 million
 23 dollars in a deferral account to be disposed
 24 of at the next GRA to reduce requirement that
 25 would otherwise be recovered in rates.

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1 Q. P.U. 19.
 2 MS. NEWMAN:
 3 Q. Yes, P.U. 19, we have that.
 4 KELLY, Q.C.:
 5 Q. Page 26.
 6 MR. JOHNSON:
 7 Q. Page 26 of that Order states "the Board finds
 8 that it has no jurisdiction under the Act to
 9 require payment by Newfoundland Power into a
 10 reserve account or otherwise deprive
 11 Newfoundland Power of any amount which is
 12 within the allowed return on rate base as
 13 fixed and determined by the Board pursuant to
 14 Section 80 of the Act."
 15 Now not to get into disagreement with the
 16 Board on my first utility hearing, but that
 17 statement arises out of a particular context
 18 which should not be used for the proposition
 19 that Mr. Kelly is advancing it. Be very
 20 careful with this statement. This statement
 21 arose out of a contention that you could
 22 somehow set up a deferral account, as I
 23 understand it, or somehow claw into earnings
 24 by reference to the rate of return on common
 25 equity. That would be offside with the Stated

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1 MR. JOHNSON:
 2 Case, because in paragraph 61 of the Stated
 3 Case, Mr. Justice Green, as he then was,
 4 stated "I therefore conclude that the power to
 5 determine a just and reasonable return on rate
 6 base, as contained in Section 80, does not
 7 include within a power to set and fix a rate
 8 of return on common equity, but it obviously
 9 does contemplate that the analysis of
 10 appropriate rates of return on common equity
 11 will be undertaken and factored into the
 12 conclusion as to what is a just and reasonable
 13 return on rate base."
 14 But that statement does not--that
 15 statement should not be taken as meaning that
 16 the Board could not set up, properly set up a
 17 deferral account in which revenue would go for
 18 a later Board disposition. You couldn't do it
 19 if you were basing it on the common equity.
 20 That would be inappropriate and offside with
 21 the Act. Let me explain. Page 70--paragraph
 22 75 of the Court of Appeal's decision.
 23 Justice Green, I just commend this to the
 24 Board's attention, notes question four, which
 25 asked "does the Board have jurisdiction to

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1 in subsequent periods below what would
 2 otherwise be indicated in the absence of a
 3 reserve account."
 4 Now what would be illegal and would put
 5 you ultra vires in a jurisdictional sense,
 6 would be to set up a deferral account by
 7 reference to the return on cost of common
 8 equity, but doesn't put you offside to set up
 9 a deferral account for other purposes. And
 10 please, do not think for a moment that you
 11 would be disturbing existing rights. That's
 12 the rule against retroactivity. Let me
 13 address that by reference to the Stated Case
 14 in paragraph 85. Keep in mind now that the
 15 Excess Earnings Account was something that
 16 was, you know, set up for a number of years
 17 and I commend to your attention Justice
 18 Green's remarks in paragraph 85 of that
 19 decision, which really goes to the
 20 retroactivity idea.
 21 About two-thirds of the way down on page
 22 87 of the report case from the Newfoundland
 23 and PEI reports, Judge Green states, "any
 24 decision by the Board with respect to
 25 disposition of excess revenue will therefore

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1 order that the rates, tolls and charges of a
 2 public utility shall be approved, taking into
 3 account earnings in excess of a just and
 4 reasonable return upon, one, the rate base as
 5 fixed and determined by the Board for each
 6 type of service applied by the public utility,
 7 or two, the investment which the Board has
 8 determined has been made in a public utility
 9 by the holders of the common shares in prior
 10 years?"
 11 And Justice Green remarks, at paragraph
 12 75, "question four is really a subset of the
 13 revenue reduction approach. In one sense, it
 14 really asks the same question as in question
 15 three, clause one, but does not limit the
 16 process to the application of excess earnings
 17 to only the year next exceeding the year in
 18 which the excess earnings have been achieved.
 19 It appears to ask the Court to address the
 20 question of whether, in the absence of the
 21 existence of a reserve account, the Board may,
 22 upon being made aware of excess earnings in
 23 prior years, reach back into those prior years
 24 and take account of those excess earnings by
 25 using them to reduce rates, tolls and charges

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1 not retroactively interfere with past revenues
 2 which the utility assumes belong to it and
 3 which may be disbursed to shareholders or
 4 otherwise spent. Given the concept of excess
 5 revenue as explained in this opinion, the
 6 utility knows in advance that it is not
 7 entitled to excess revenue so defined and may
 8 institute whatever accounting practices are
 9 necessary to segregate and deal with such
 10 revenues pending direction from the Board."
 11 So the key is knowing in advance. You're not
 12 offside by just setting up a deferral account.
 13 Now in our submission, they knew in
 14 advance. They knew in advance. They told the
 15 shareholders if they lost the case they were
 16 going to come in. That's a deferral account.
 17 That's a defacto recognition of a deferral
 18 account. It doesn't lie in Newfoundland
 19 Power's mouths to say to this proceeding, to
 20 this Board, that it didn't know. It's a very
 21 sophisticated company.
 22 Now, paragraph 88 of Judge Green's
 23 decision, crucial. Judge Green says, "in the
 24 situation presently under consideration,
 25 however, there is no subsequent order of the

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1 MR. JOHNSON:
 2 Board which retroactively changes previously
 3 approved rates, tolls or charges or revises
 4 the prescribed level of return to which the
 5 utility is entitled. All that occurs is the
 6 subsequent examination of actual results and a
 7 determination of whether excess revenue was in
 8 fact earned by applying a pre-existing
 9 standard derived from a previous Board order
 10 made under Section 80." That's why this is
 11 not retroactive, because we have the deferral
 12 account, now we're looking back and saying we
 13 knew this tax case was coming. The Board, in
 14 its wisdom, said we've got to recognize that
 15 there could be fall out one way or the other.
 16 Tax case settles, let's look at all the fall
 17 out, let's determine where the revenue from
 18 the interest goes. Let's determine where the
 19 tax hit goes.
 20 Now as I've pointed out to you, the
 21 accounting treatment and the approved
 22 accounting method followed by Newfoundland
 23 Power, that's the tail on the dog. The
 24 reserve is the dog. That accounting treatment
 25 does not wag the dog. It's convenient to

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1 a misapprehension as to how this deferral
 2 account was to operate, "as to how excess
 3 revenue should be calculated, the change in
 4 calculation method comes about not because of
 5 a retroactive change in the rule by the Board,
 6 but by a perhaps, in parentheses,
 7 unanticipated declaration and clarification by
 8 the Court of what the law is and how it is or
 9 should be applied."
 10 The law is and the law as it should be
 11 applied is, in my respectful submission, how
 12 I've just outlined it. And if Newfoundland
 13 Power misread it, which I can't see for the
 14 life of me that they misread, if they were
 15 seeking a 6.2 million--16.2 million from tax
 16 payers, but if they did, that's their problem,
 17 not the customers.
 18 I would like to conclude there and I too
 19 would like to thank the Board staff and my
 20 learned friend opposite for their cooperation
 21 throughout the proceeding. Thank you.
 22 CHAIRMAN:
 23 Q. Thank you, Mr. Johnson. Do you have any
 24 questions?
 25 VICE-CHAIR WHALEN:

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1 argue that, but it's just not so.
 2 (11:30 A.M.)
 3 Now can Newfoundland Power--I don't think
 4 they can realistically say, to be honest, that
 5 they didn't recognize a defacto deferral
 6 account. You know, on the facts, I just don't
 7 see how they could make that case. But nor
 8 does it help them to say "oh, we were
 9 confused. We didn't understand what they
 10 wording meant." Even if we accept that
 11 premise, that does not work. Stated Case says
 12 so. The Stated Case says, paragraph 91,
 13 because you'll recall that Newfoundland Power,
 14 in relation to the excess earnings, was under
 15 what it termed a misapprehension as to how it
 16 was supposed to operate. Judge Green says
 17 "the issue therefore is not whether the Board
 18 may revise the definition of excess revenue
 19 and then apply the revised definition to the
 20 results of previous years." That might well
 21 engage the principle of non-retroactivity. He
 22 says "here, assuming, without deciding, that
 23 there was a misapprehension in the past as to
 24 how excess revenue should be calculated" and I
 25 would substitute there assuming that there was

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1 Q. Mr. Johnson, are you--is it your position that
 2 the 2.1 million dollars of interest revenue
 3 that is to be recorded in 2005 is in fact
 4 excess revenue? Is that where you just -
 5 MR. JOHNSON:
 6 Q. It doesn't make it into revenue. It's in a
 7 deferral account.
 8 VICE-CHAIR WHALEN:
 9 Q. Take me back to the Stated Case and the
 10 Board's jurisdiction if--I mean, where we just
 11 went was the excess earnings and the excess
 12 earnings in terms of what the Board is dealing
 13 with in respect of the just and reasonable
 14 rate of return, and the Board sets the range
 15 and we define the excess earnings account with
 16 regards to the upper end of that range. How
 17 the 2.1 million dollars in interest, it is
 18 revenue.
 19 MR. JOHNSON:
 20 Q. Well -
 21 VICE-CHAIR WHALEN:
 22 Q. Where does the Board get the ability then to
 23 go--you're going to have to take me to, under
 24 the Public Utilities Act, where we get the
 25 ability to go back to that, accepting the

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<p>1 VICE-CHAIR WHALEN: 2 defacto deferral account. I mean, is it all 3 premised on that basis? 4 MR. JOHNSON: 5 Q. Yes. 6 VICE-CHAIR WHALEN: 7 Q. We have to go there first before we can go 8 anywhere else? Is that the - 9 MR. JOHNSON: 10 Q. You've got to go there first, and as I pointed 11 out in one of the paragraphs, it'll be better 12 reflected in the record I'm sure after, that 13 Judge Green talks about in the absence of a 14 reserve. 15 VICE-CHAIR WHALEN: 16 Q. Yes. 17 MR. JOHNSON: 18 Q. And so it's perfectly permissible for you to 19 have set up the reserve, and I think we--I'll 20 do my best to try to address it. This income 21 that shook out of the heavens, let's say, in 22 mid year 2005, we must be careful that 23 Newfoundland Power, keep in mind, would not 24 have been able--they had an opportunity in 25 2005, I think we all agree, to reach its</p>	<p>1 approved range of return on rate base, fair 2 and just return, etcetera, which they--even 3 without the 2.1 million dollars, they would 4 not have been able to accomplish. So we must 5 be careful that we don't fall into the trap of 6 converting the opportunity to earn a just and 7 reasonable rate of return on rate base into a 8 guarantee. That's the first comment. But I 9 think, as well, that the Board should not fall 10 into what I respectfully suggest to you is the 11 conceptual trap of reading the Stated Case 12 which principally dealt with the issue of the 13 idea of setting up a reserve on the basis of-- 14 well, one of the issues was going by the 15 return on common equity. And as reading 16 therefore that well, if we can't do that, well 17 then we can't do this. Because the reason 18 that you're offside if you did that is because 19 they have--they are to be regulated on the 20 basis of rate of return on rate base, not 21 common equity. I mean, I don't know if it's-- 22 it would be possible to fully understand--I 23 mean, I guess the question does not the Board-- 24 just one second now. Yeah, I guess just to 25 go back to my comment, in a sense the deferral</p>
<p>Page 71</p> <p>1 account, you know, the Company, in our 2 submission, ought to put that money in the 3 deferral account, in which case it would not 4 end up in the revenue. It would be subject-- 5 you see what I mean, the whole question is 6 what's in the bucket, right, what is allowed 7 to be in the bucket. And what we're saying 8 is that, hold on now, before you decide to 9 put--because there's problem by trying to take 10 stuff out of the bucket once it's in. 11 COMMISSIONER WHALEN: 12 Q. Yeah, I guess that's where I was. Because we 13 have to--it has to not be there. Once that 14 2.1 million is in revenue, for the Board to go 15 and pull it back - 16 MR. JOHNSON: 17 Q. Yes. But, if it's not in revenue. 18 COMMISSIONER WHALEN: 19 Q. Yes. But, that's the whole point is that the 20 argument that you put forward is based on that 21 initial premise that it's not in revenue, it 22 can't be there for us to be able to - 23 MR. JOHNSON: 24 Q. Right. 25 COMMISSIONER WHALEN:</p>	<p>Page 72</p> <p>1 Q. That's fine. Okay. 2 MR. JOHNSON: 3 Q. Okay. 4 COMMISSIONER WHALEN: 5 Q. You don't need to - 6 MR. JOHNSON: 7 Q. I thought there was more to it. Okay. 8 COMMISSIONER WHALEN: 9 Q. No, no, that's fine. I understand everything 10 then that flows, because we dealt with the 11 Stated Case extensively in all appearance, 12 that's fine. 13 MR. JOHNSON: 14 Q. Okay. All right. Thank you. 15 COMMISSIONER WHALEN: 16 Q. I just wanted to make sure I was clear that 17 the entire discussion of the Stated Case was 18 premised on that piece. That's okay. 19 MR. JOHNSON: 20 Q. Thank you. 21 COMMISSIONER WHALEN: 22 Q. That's fine. Thank you. 23 CHAIRMAN: 24 Q. Thank you, Mr. Johnson. Mr. Kennedy. 25 (11:39 A.M.)</p>

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1 MR. KENNEDY:
 2 Q. Chair, Vice-Chair, I won't be long at all. I
 3 thought I would start with just pointing out
 4 to the Panel the order that specifically is
 5 being sought by the Applicant. It's in page
 6 3, paragraph 20 of its actually application
 7 filed. And, yes, perhaps if we could just
 8 bring that up, just so we could canvas it.
 9 So, there's--it continues on to the next page,
 10 but (a) is the request for the approval of
 11 adoption of the accrual method of the revenue
 12 recognition. Point (b) was the recognition
 13 for regulatory purposes of the 9.579 million
 14 from the 2005 Unbilled Revenue in 2006. And
 15 the Company's put forward in its application
 16 and through its evidence the rationale for that
 17 number, the 9.579 million. The third thing
 18 that was specifically being requested of the
 19 Panel was to make an order seeking approval of
 20 the application of an amount of 295,000 of the
 21 2005 Unbilled Revenue in 2006 to dispose of
 22 the balance in the reserve, what's known as the
 23 Unbilled Revenue Increase Reserve. The fourth
 24 request was the approval of the average value
 25 of the Unrecognized 2005 Unbilled Revenue to

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1 Again, the second request was the accrual
 2 policy and whether that is expressly approved
 3 right now, moving to the accrual method for
 4 recognizing revenue. That would have
 5 implications for the Company's filing of its
 6 GRA, for instance, in 2006. It would need to
 7 know on what basis the revenue is to be
 8 recognized for the purposes of putting
 9 together that application.
 10 The other point that the Company actually
 11 sought in this application was for the
 12 purposes, again, of its next GRA, the approval
 13 of using the Asset Rate Base Model as opposed
 14 to invested capital in the determination of
 15 the revenue requirement. So, that would be
 16 something that this Board would, Panel would
 17 need to address in its order. And I won't
 18 repeat the other issues that were already
 19 stated in the order itself.
 20 Just to be clear, the burden is on the
 21 Applicant to make out its application,
 22 Newfoundland Power, not for the Consumer
 23 Advocate to defeat the application. That
 24 being said, there's also, this Board's applied
 25 in the past the presumption of management's

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1 be deducted from the rate base commencing in
 2 2006. That obviously is hinged into item (b)
 3 which would be the approval of an amount to be
 4 deducted from Unbilled Revenue. And item (e)
 5 is the approval of the rate base for 2006 as
 6 well as the invested capital. Those figures
 7 then would be used by the Company in the
 8 determination of its rate of return earned in
 9 2006, among other things. And again, that
 10 rate base figure would be hinged, as well, on
 11 the approval of point (b) the 9.579 billion
 12 (sic.) in Unbilled Revenue. And then the (f)
 13 is the catchall of anything else that is
 14 deemed appropriate and as requested in the
 15 Board's order--in the application.
 16 So, as a result of that there's, as I
 17 have indicated, there were six issues that
 18 arose during this hearing which the Board is
 19 being asked to address specifically. The
 20 perhaps most contentious one, the first on the
 21 list is the treatment of the interest income,
 22 the amount of \$2.1 million that the Company
 23 received from Revenue Canada on settlement of
 24 the Tax Case and what's the appropriate
 25 treatment of that money.

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1 prudence in normal conduct of affairs of its
 2 operations and the Board might want to keep
 3 that in mind when it's making its
 4 determinations in this instance on the burden
 5 that Newfoundland Power would need to show in
 6 specific issues.
 7 Being the most contentious issue, the 2.1
 8 million related to the interest income, I did
 9 want to provide some, hopefully some guidance
 10 to the Panel on how it might be able to
 11 grapple with that issue. And it does, in
 12 part, hinge on the language in P.U. 19 (2003),
 13 which has been quoted extensively already.
 14 It's at page 87. It arises, that language,
 15 it's the last sentence, actually, in the
 16 paragraph on page 87 of P.U. 19. Page 86, or
 17 page 87, sorry. And it's the last sentence
 18 just above the bold type there which says "The
 19 Board will deal with any issues arising from
 20 the final decision of the tax case, including
 21 any potential liabilities or benefits to
 22 ratepayers once the case has been resolved."
 23 I would suggest that that statement is
 24 predicated on an understanding that's stated
 25 just prior to that, it's the second sentence

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1 MR. KENNEDY:
 2 of that same paragraph, "The Board accepts
 3 Newfoundland Power's position in this
 4 proceeding that any further consideration of
 5 this issue", meaning the revenue recognition
 6 issue, "at this time may prejudice the outcome
 7 of its current dispute with CCRA with respect
 8 to the Income Tax Reassessment relating to
 9 revenue recognition." So, the idea was that
 10 an examination, full examination of the issue
 11 in 2003 and a discussion of the implications
 12 that it could have and potentially an order
 13 flowing from the Board may have prejudiced the
 14 Company's position with Revenue Canada and as
 15 a result the Board said, well, we'll deal
 16 with, as it said, any issues arising from the
 17 final decision of the tax case once they've
 18 been resolved.
 19 The question is at issue, I guess, did
 20 P.U. 19, that specific language create a,
 21 what's been referred to as a defacto deferral
 22 account. In other words, as also been put in
 23 the vernacular, was the money in the bucket or
 24 out of the bucket. In other words, when that
 25 interest income was received by the Company,

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1 that they're ipso facto placed into a deferral
 2 account and then subject to further Board
 3 determinations about what to do with them.
 4 They're also not ipso facto the customers,
 5 just by virtue of being put in an excess
 6 earnings account. The whole idea is it goes
 7 in that deferral account and then the Board
 8 decides what to do with the money. So, the
 9 question is does P.U. 19 do the same for the
 10 \$2.1 million interest income that the excess
 11 earnings account does.
 12 Now, in determining whether the language
 13 in P.U. 19, and specifically that paragraph
 14 does create this defacto deferral account, the
 15 Board is, in effect, interpreting its own
 16 decision. Now, there's a legal fiction that
 17 the Board, I would suggest, needs to follow in
 18 interpreting the language of P.U. 19. In
 19 interpreting the language in P.U. 19 the Board
 20 does not ask itself the question of what was
 21 its intention at the time of writing P.U. 19.
 22 In other words, you can't put to yourself,
 23 gee, what was I actually trying to say in P.U.
 24 19? That would be unfair to the Utility and
 25 for that matter all parties to be subject to

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1 were they able to follow GAAP and book it as
 2 other income for 2005 or was that interest
 3 income trapped by that language in P.U. 19
 4 such that it was in a defacto deferral account
 5 and the Company would have to seek further
 6 approval of the Board to know exactly what to
 7 do with that 2.1 million, apply it to its
 8 income for 2005 or some alternative.
 9 The Stated Case does provide a lot of
 10 helpful guidance, but like some decisions of
 11 the Court of Appeal, can also confuse and
 12 adjudicate what might be otherwise obvious.
 13 But, it does turn on the whole issue of
 14 perspective versus retroactive rate making,
 15 that's the essence of the issue and the fact
 16 that the Board does not have jurisdiction to
 17 determine Newfoundland Power's earnings after
 18 they've been eared, that's what's very clear
 19 in the Stated Case. And stated another way,
 20 the rules of the game need to be known before
 21 the game is played. As an example, the excess
 22 earnings account specifically puts
 23 Newfoundland Power on notice that earnings in
 24 excess of the maximum allowed rate of return
 25 in a given year are not the Utility's to keep,

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1 the subsequent interpretation of the Board by
 2 clarifying what its intention was.
 3 The question is, what do the words in
 4 P.U. 19 now mean using the normal rules of
 5 understanding a provision such as this and the
 6 construction, normal construction of the
 7 language. In other words, what does that say
 8 to people being apprised of the situation,
 9 being apprised of the regulatory scheme, what
 10 does this say now and what did it say to
 11 Newfoundland Power in 2003, what did it say to
 12 the Consumer Advocate in 2003, what did it say
 13 to anybody who read that sentence in 2003, not
 14 what your intention was in saying, in writing
 15 that sentence. And the Board is allowed to
 16 provide and should provide the normal or plain
 17 meaning of the words in interpreting that
 18 provision. It's not recommended that the
 19 Panel attempt to provide definitions to the
 20 words that appear in that, that are beyond
 21 their normal interpretation or normal meaning.
 22 So, what does the phrase mean or what did the
 23 phrase mean in 2003 when read by the parties
 24 in the cold light of the day in an objective
 25 sense.

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1 MR. KENNEDY:
 2 Now, ultimately I think it's solid ground
 3 to suggest that the Board needs to make its
 4 determination ultimately on this issue as well
 5 as all issues on the basis of what makes
 6 economic sense. The Board is, as has been
 7 pointed out repeatedly by the Board itself, an
 8 economic regulator. It's not an arbiter of
 9 issues based on what's fair to the parties.
 10 Not an issue here of what is fair to
 11 Newfoundland Power or what is fair to the
 12 Consumer Advocate or what's fair to
 13 ratepayers. It's ultimately what makes the
 14 best economic sense, what is from an economic
 15 perspective the smartest way to dispose of
 16 this issue, what benefits the Company, what
 17 benefits the ratepayers.
 18 So, in that conclusion the Board could
 19 ask itself when interpreting that passage in
 20 P.U. 19 of whether the Company knew or whether
 21 the Company ought to have known that funds
 22 received, such as interest income from the Tax
 23 Settlement, were to be subject to further
 24 Board orders. If the Board concludes that,
 25 yes, that's the case, then the 2.1, I would

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1 the submissions that I made to you on the
 2 first issue of how to deal with the
 3 depreciation tax issue. Because the Consumer
 4 Advocate's submissions confirm the three
 5 approaches are the ones that are really before
 6 the Board now for your consideration.
 7 The Consumer Advocate rejects the accrual
 8 and the deferral approaches simply by saying
 9 that they can only be dealt with in a GRA.
 10 And of course, in my respectful submission,
 11 that's not the correct approach and I'm not
 12 going to belabour the argument further. But,
 13 what the Consumer Advocate appears to miss in
 14 his analysis is an understanding of the
 15 ongoing regulatory role of the Board. He
 16 ignores the ongoing jurisdiction of the Board,
 17 fully recognized in the Stated Case, to
 18 provide for regulatory supervision of the
 19 Utility. Information is required to be filed
 20 by the Utility, additional information can be
 21 requested. And the Consumer Advocate appears
 22 to have some kind of belief that there's no
 23 review at all of the Company's or the
 24 Utility's financial position unless you do it
 25 in a GRA. And, of course, that's just not

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1 suggest, 2.1 million, I would suggest, is in a
 2 defacto deferral account and needs to be
 3 subsequently, the determination of what to do
 4 with that needs to be determined by this Board
 5 on subsequent reflection. If, however, the
 6 Board reads P.U. 19 now as not having put the
 7 Company on notice that funds received on
 8 settlement of the tax case were going to be
 9 subject to further Board order, then the funds
 10 are properly booked by Newfoundland Power in
 11 accordance with GAAP as interest income in
 12 2005.
 13 And that's all the comments I have.
 14 Thank you, Chair, Vice-Chair.
 15 CHAIRMAN:
 16 Q. Thank you, Mr. Kennedy. Mr. Kelly, do you
 17 require five or ten minutes or anything?
 18 KELLY, Q.C.:
 19 Q. No, Chair. I'm prepared, ready to go.
 20 CHAIRMAN:
 21 Q. Okay. Go ahead.
 22 (11:54 A.M.)
 23 KELLY, Q.C.:
 24 Q. Chair, Vice-Chair, the submissions by the
 25 Consumer Advocate confirm the correctness of

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1 right. It's not the way the regulatory system
 2 works. If, in fact, you take the Consumer
 3 Advocate's position logically, then we would
 4 have had to come in with a 2005 GRA followed
 5 by a 2006 GRA totally abrogating the concept
 6 of regulatory efficiency. And if we had done
 7 that, surely the answer in a 2005 GRA would
 8 have been use the 2005 accrued Unbilled
 9 Revenue and don't increase customers' rates.
 10 So, we're here in a very practical sense to
 11 achieve that objective.
 12 And the Board should address the issue of
 13 which of these three approaches is the
 14 preferable approach, the Board should decide
 15 that on the basis of the most appropriate
 16 approach in the circumstances. If I can adopt
 17 Mr. Kennedy's language from a different
 18 context, what's the smartest way to deal with
 19 that issue. That's the regulatory decision
 20 that this Board has to grapple with.
 21 The second point that I wanted to touch
 22 on is the question of the 2.1 interest refund.
 23 First of all, I am surprised by the Consumer
 24 Advocate's questioning of the prudence of the
 25 Tax Settlement. He first of all either

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1 KELLY, Q.C.:

2 forgets or ignores the full scope of the tax

3 dispute. Keep in mind, as you well know and

4 as you've heard in the evidence, that this

5 dispute goes back to '95 but did not simply

6 deal with the accrual issue, but dealt with a

7 whole series of issues around GEC which were

8 successfully dealt with and managed by the

9 Company and that that resolution did not occur

10 until 2000. So, the long-term effective

11 management of all of those issues has been

12 dealt with prudently.

13 I took pains in my examination of the

14 Consumer Advocate's witness to ensure that

15 that issue was not in dispute, and I put this

16 question to Mr. Todd, "Let's just see if we

17 agree on this. I take it you do not quarrel

18 with, at any stage, with the prudence of the

19 Tax Settlement, how the Company handled the

20 tax dispute?" Answer, "No." And that's at

21 page 149, line 8 of the December 8th

22 transcript. The suggestion that somehow the

23 Company manipulated the matter is speculative,

24 there is no evidence, and of course, as Mr.

25 Kennedy has rightly pointed out, the Company

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1 P.U. 19, there would be no question of the

2 Board now ordering the Company to establish a

3 deferral account. So, Mr. Todd, on the plain

4 reading of P.U. 19 did not understand that a

5 deferral account had been created. So, we

6 come back to the proposition what is the usual

7 Board set, set of parameters for the

8 recognition of this revenue. It is in

9 accordance with the Board orders approving,

10 specifically approving the system of accounts

11 which treats this as revenue. There is no

12 order in any sense departing from that in

13 relation to the 2.1 million of interest

14 revenue.

15 Chair, those are my submissions in reply.

16 I thank you for your attention and patience.

17 CHAIRMAN:

18 Q. Thank you, once again, Mr. Kelly. This brings

19 to a conclusion this particular hearing. I

20 would like to thank all the parties, actually,

21 for your cooperation, particularly as it

22 relates to the agreement that was made on

23 certain issues beforehand. I think that in

24 itself was quite helpful to the Board and

25 indeed reduced some of our time in this room.

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1 is entitled to the presumption of managerial

2 good faith.

3 Let me just deal briefly in reply again

4 with this question of the deferral account.

5 One of the key hallmarks of good regulation is

6 regulatory certainty. And this Board has

7 acted in the past with clarity and certainty.

8 If the Board had intended to set up this

9 deferral account, it would undoubtedly have

10 done so. It did not, it did not create such

11 language. And I'm puzzled, to some extent, by

12 the Consumer Advocate's submission that the

13 Board did so because it's interesting when you

14 look at Mr. Todd's written report, could we

15 put that on the screen, at page 30 of 35.

16 Because Mr. Todd, as we took him through his

17 evidence, had read order P.U. 19, etcetera.

18 And at page 30 of 35, line 15, 16, Mr. Todd

19 writes, "It is therefore incumbent on the

20 Board to determine whether it is more

21 appropriate to recognize this revenue in 2005

22 or to direct the Company to establish a

23 deferral account so that the revenue can be

24 disposed of at a later date." If the deferral

25 account had already been established back in

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1 And certainly I think reduce some of the costs

2 associated with this hearing. And for the

3 benefit of all those in the room who might be

4 here again, the Board would be very receptive

5 to this approach in future in respect of

6 general rate applications or any other

7 matters, to be frank with you, that are

8 brought before the Board. So, I want to thank

9 you for your cooperation, all of you, in

10 respect of that. I'd like to thank the

11 witnesses, the staff and, indeed, Ms. Moss,

12 the transcription, for the transcription

13 services. And in particular, Ms. Walsh, this

14 is your first time at this and I'd like to

15 commend you for a good job. Hope to see you--

16 well, I'll take that back. We look forward to

17 seeing you sometime in the future. Thanks,

18 everybody. And for those heading into the

19 Christmas season, if I don't get a chance to

20 see you again, I wish you and your families

21 all the very best for a joyous Christmas

22 season. And have a good weekend. And this

23 brings to an end the hearing. Thank you. The

24 decision itself, certainly we'll make every--

25 guide ourselves in an expeditious way as

1 CHAIRMAN:
2 possible to get the hearing out as quickly as
3 we can. Thank you.
4 (12:03 A.M.)

1 CERTIFICATE
2 I, Judy Moss, hereby certify that the foregoing is
3 a true and correct transcript in the matter of the
4 accounting policy of Newfoundland Power Inc.
5 concerning revenue recognition and matters related
6 thereto, heard on the 9th day of December, A.D.,
7 2005 before the Board of Commissioners of Public
8 Utilities, Prince Charles Building, St. John's,
9 Newfoundland and Labrador and was transcribed by me
10 to the best of my ability by means of a sound
11 apparatus.
12 Dated at St. John's, Newfoundland and Labrador
13 this 8th day of December, A.D., 2005
14 Judy Moss