OCTOBER 5, 2015
(9:07 a.m.)
CHAIRMAN:
Q. Good morning, everybody. I believe we're turning to Mr. Browne - there's some undertakings first, I'm sorry, thank you, sir.
MS. PENNELL:
Q. Thank you, Mr. Chair. This morning we have Undertakings 17 and 32, and also on Thursday the Consumer Advocate submitted an Undertaking for Hydro to consider. We've accepted that Undertaking and we have filed a response. I believe the number will be Undertaking 44. Thank you.
CHAIRMAN:
Q. Okay, so I think we have Mr. Feehan here. I'm looking for Mr. Browne.
BROWNE, Q.C.:
Q. I'm here, Chair.
CHAIRMAN:
Q. I beg your pardon. So you're ready to be sworn, are you, Mr. Feehan?
DR. FEEHAN:
Q. Yes.
DR. JAMES FEEHAN (SWORN) EXAMINATION-IN-CHIEF BY DENNIS

BROWNE, Q.C.:
BROWNE, Q.C.:
Q. Thank you, Mr. Chair, and Commissioners, colleagues. We're here as an intervenor for the interconnected Labrador system which are the towns of Labrador City, Wabush, Happy Valley Goose Bay, and Northwest River. Our intervention is limited, we are instructed to limit and focus on issues that were specific to the Labrador interconnected system. Therefore, our appearances have been few. What we have been doing is monitoring the case by way of the transcripts and we intend to make a final submission. Dr. Feehan, the interconnected Labrador towns have pre-filed your report, a report on the allocation of the rural deficit. Do you adopt this pre-filed report as your evidence?
DR. FEEHAN:
A. Yes, I do.
BROWNE, Q.C.:
Q. There were also requests for information to which you responded. Do you adopt these replies?
DR. FEEHAN:

A. Yes, I do.
BROWNE, Q.C.:
Q. Dr. Feehan, can you briefly provide some information in reference to yourself and your own experience?
DR. FEEHAN:
A. Well, I'm Professor of Economics, I'm a professional economist. I have been involved in issues related to electricity policy generally. I have published on them. There's a number in my CV which has been submitted to the hearings to indicate my work in electrical policy generally. I've also testified on two occasions before the Board with respect to, I believe, Newfoundland Power rate applications.
BROWNE, Q.C.:
Q. Dr. Feehan, can you provide a brief summary of your evidence?
DR. FEEHAN:
A. Yes. My main evidence, of course, is in the paper that's been submitted. Just a little bit on lead up to this, originally when Newfoundland Hydro made its general rate application, Mr. Edward Hearn, representing the towns in Labrador, asked me to assist him

in evaluating the general rate application and identifying issues of particular relevance to the towns in Labrador that are on the interconnected system.

At the time, the proposed rate increases were quite substantial in percentage terms. They ranged from, I think, 16 percent for residential customers probably around 26/27 percent. So in the process, I reviewed at a very early stage in the process of reviewing the application and identifying issues of particular interest to the towns in Labrador. The whole question of the allocation of the rural deficit appeared to me to be a substantial question. The amount that is allocated to the towns is quite substantial, and when I say the towns, I simply mean the customers in those towns who are classified as the rural Labrador interconnected customers. So the implications to them were quite substantial. It seemed like they were paying a disproportionate portion of the rural deficit.

At that point, Mr. Hearn really suggested or directed me to focus on the whole issue of

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the allocation of the rural deficit, and hence this is the paper that I prepared more than a year ago now, I suppose, and submitted. In the paper, it's main proposition is, as I've already suggested, that the rural deficit is disproportionately borne by customers on the Labrador interconnected system, and the paper essentially starts by looking at how that is, and I really focus on two things. If we look at it on a pre megawatt hour basis, the total dollars allocated to those customers versus Newfoundland Power's retail customers, we find that people in the Labrador system pay more per megawatt hour. Even more insightful, I think, is when you look at it on a per customer basis and we saw at least for the figures given in the original 2013 general rate application, the Labrador interconnected customers would be paying something like \$660.00 each on the average towards the rural deficit, whereas Newfoundland Power's customers would be paying something like \$220.00 each on the average. So that's a very substantial difference not only in dollar terms, but certainly in percentage terms.

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These aren't really small numbers any more as perhaps might have been the case when the rural deficit was smaller. There's no inherent fairness, it seemed to me, that one group of customers should be paying this much on the average and the other customers be paying so much less. The allocation of the rural deficit has been set by government, but the sharing of it - sorry, the rural deficit, of course, has to be allocated to those two groups of customers, but for one group to be paying so much more than another seemed to me to be quite unfair. The other thing as outlined in the paper, there's a time series there, and if you look back since the Labrador interconnected customers have been paying or contributing to this rural deficit, and again in both cases Newfoundland Power and Labrador interconnected, these contributions are not voluntary, they're a result of government policy and, of course, the contributions are hidden within rates, so no one quite knows what they're paying or perhaps most customers, practically all, I would suggest, probably don't even know that they're paying this or

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anything about the magnitudes.

Again if you look at the paper and the various other information that we've seen in questions and so forth, this anomaly is not something that varies by year, it's consistent since the Labrador interconnected customers have been paying a portion of the rural subsidy, their proportion of it per customer has been substantially higher than Newfoundland Power. So it's not as if it averages out or some years one group is paying more and the other group is paying less, it's consistent. The formula that's driving this means that Labrador interconnected customers are paying substantially more in absolute dollars and in percentage terms than Newfoundland Power customers. The formula that's driving this has been in place since 1993, although it's only been effective or implemented fully since about 2002, I believe. Even then there have been some adjustments because you have the process of the Labrador interconnected system moving to uniform rates, so there's other things going on in the process.

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(9:15 a.m.)

The formula itself is quite a complex formula. The nuts and bolts in terms of the arithmetic to be figured out with a bit of effort, but the underlying rationale for it seems to me to be quite questionable. It's based on a mini cost of service application, but in this case there is no cost or service for the people paying it. The rural deficit, of course, is for people who are not on either one of these two separate and quite different systems. The formula itself not only being complex and certainly far from transparent, also makes a number of assumptions and qualifications and imputations that really seem to defy an apparent logic.

So in light of that, and in particular in light of the outcome, the results of this formula, I developed four alternatives. The focus of these alternatives are all pretty similar, and that is to try to establish a simple transparent way by which given that these two groups of customers have to bear the burden of the rural deficit, we have to find a way in which they bear them roughly in proportion to their numbers, or maybe ideally in proportion to their numbers, and what I suggest essentially is making the rural deficit a burden to each customer on an equal per capita basis. That's one option. If you look at the amended GRA application, it looks like doing so would mean about $235.00 per customer or roughly $20.00 a month per customer, a lump sum fee.

We might try other methods such as making it an equal amount per megawatt hour consumed. That still doesn't - it reduces, but doesn't address the full amount of the discrepancy between the per capita burden, or customer burdens. The ultimate option, I suggest or recommend, is one where both systems are allocated an equal per capita burden, but then the collection within that system might be based upon again fixed monthly payments or could be a combination of a fixed payment with a per capita adjustment. Of course, it could be in one system or the other so that that allows for some flexibility, but the main focus and aim is to have customers in each system on the average contribute the same

amount. I don't think there's any real reason to discriminate between one system or the other.

When Newfoundland Hydro introduced its new application, or rather I should say amended application, we were quite pleased at the time to see that Newfoundland Hydro had pretty much - well, had come on side and introduced two options for funding the rural deficit; equal per capita payments, as one of my suggestions and overlapped, I guess, with other people's suggestions, it was certainly one of mine, and they also - I guess, this is the preferred option, although they don't rule out the other, they also went according to relative revenue requirements. As it turns out, because of the expenditure patterns, it seems to me that roughly expenditure on electricity per customer in Labrador and by Newfoundland Power customers seems to be roughly equal. That's when we look at the figures in the amended application, Table 4.3, we see that with the revenue requirement method, Newfoundland interconnected customers will pay about $207.00, Newfoundland Power

customers will pay about $236.00. So there's some discrepancy there, but they're approximately equal, and a one dollar shift from the Newfoundland Power customers would, of course, create complete equality, they would go down from 236 to 235, the 236 to 235 you see in Table 4.3, and, of course, Labrador interconnected would go up to 235.

So in either method the payments are approximately equal, and I suspect what's going on here, this reflects the fact that the revenue requirement method or revenue requirements in both systems would be increased by about 13 percent to fund the deficit. Since it raises roughly the same amount of revenue per customer, it must be that the customers on the average are spending roughly the same amount. There's different quantities and prices, but the price times quantity, the actual expenditure is not terribly different, so it works out to be almost per capita or equal per customer method.

So as I also understand, most of the other intervenors are practically, all except

maybe - well, are either on side, neutral, or I believe Newfoundland Power is not in entire agreement with this, but we were pleased to see, Mr. Hearn and I, that there was a growing consensus that this sort of approach would be fairer, more manageable, and clearly it's a lot more transparent and understandable.

So I think after that, of course, unfortunately, Mr. Hearn passed away and we were not actively involved for some time in this hearing process, but with the Newfoundland Hydro's application moving in this direction, and with the other intervenors as such, the last direction I had from Mr. Hearn was that we really did not need to do a lot more intervention other than he, I believe, wrote the Board in January of this year and indicated that some intervention would be there to ensure that the changes that were proposed by Newfoundland Hydro would be addressed, and hopefully adopted by the Board. Unfortunately, Mr. Hearn passed away after that and Mr. Browne now has taken over the file of late, and as a result, we appear here today.

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BROWNE, Q.C.:
Q. Dr. Feehan, I have a question for you. In reference to this hearing, transcripts reveal there's been some discussion as to whether the allocation of the rural deficit should be expressed on customer's power bills. Do you have an opinion on that?
DR. FEEHAN:
A. Yes, actually, I do mention in the paper that I think it's a good idea. The government policy of applying the rural deficit or having the rural deficit borne by customers of Newfoundland Power, and Newfoundland Hydro's customers on the rural Labrador interconnected system, is a public policy, it's a government policy. If the amounts that people are paid or have to pay through their bills is made explicit, I think this would contribute to good public policy because people are informed, they know in their power bills that this is how much they're paying for the rural subsidy. This would inform any future public debate about the continuation of the rural deficit policy.
BROWNE, Q.C.:

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Q. Thank you, Dr. Feehan. I'll tender Dr. Feehan for cross-examination.
CHAIRMAN:
Q. I think we start with you, Mr. O'Brien.
MS. GLYNN:
Q. Hydro first, actually.
CHAIRMAN:
Q. I'm sorry, I beg your pardon, Hydro first, yes.
MR. CASS:
Q. We have no questions, Mr. Chair.
CHAIRMAN:
Q. So I was right.
MR. O'BRIEN:
Q. You were right. I assumed you would have been, but just wanted to make sure.
DR. JAMES FEEHAN - CROSS-EXAMINATION BY MR. LIAM O'BRIEN:
MR. O'BRIEN:
Q. Good morning, Dr. Feehan. Liam O'Brien for Newfoundland Power.
DR. FEEHAN:
A. Good morning.
MR. O'BRIEN:
Q. I just had one question, Doctor, in terms of your CV that's attached to your report, and

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you'd also mentioned as well in your direct that you have some interest in electricity policy. What do you mean by that, I mean, what kind of papers have you written in that regard? I know I saw some there, but what's your area of expertise?
DR. FEEHAN:
A. With electrical pricing, electricity policy, my main focus is on investments, the actual assessment of investment in energy generation and transmission. I'm also interested in the workings of electricity markets, integrated markets, the move to competitive markets. I also have an interest in the development of electricity policy and actual electricity investments in Newfoundland. I can mention a few things to highlight this.
MR. O'BRIEN:
Q. Sure.
DR. FEEHAN:
A. Recently, I completed a chapter in a book on public policy in Newfoundland, and it was a book on the challenge of the Lower Churchill - sorry, the chapter was on the challenge of the Lower Churchill. It may not be - I'm going to

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check now. Yes, it's listed in my CV as forthcoming, but it's on page 2 of 9, that is actually published now and that deals with both the Lower Churchill and the whole issue of the development of the crown corporation approach as a method of developing and pricing electricity in Canada. So it gives quite a background on that. Another paper on this same page in terms of refereed articles was a paper on the power corridor through Quebec. That's the second refereed article on page 2 of 9. I've completed a paper on Newfoundland's electricity options, again listed on page 2 of 9, regarding efficient pricing when the system is connected to the grid through Quebec and through Nova Scotia. I have another paper published through the Atlantic Institute for Market Studies. That's on page 5 of 9, bottom of the page, "Electricity Market Integration, Newfoundland Chooses Monopoly and Protectionism". On the next page, you'll see a couple of more articles dealing with - this is page 6 of 9, dealing with Churchill Falls contract. So these are the sorts of things I'm looking at,

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it's sort of the overall economic policy
aspect of electricity development and pricing.
MR. O'BRIEN:
Q. So your focus is really tying into your main
area of expertise, which is economics, and
that's your focus with that policy?
DR. FEEHAN:
A. Yes.
MR. O'BRIEN:
Q. Have you had any experience in either
testifying or dealing with cost of service
allocation, that kind of thing?
DR. FEEHAN:
A. No, I haven't testified with respect to cost
of service allocation. I understand the
methodology and the basics of cost of service,
but I have never testified in that regard.
(9:30 a.m.)
MR. O'BRIEN:
Q. And is the first time you would have been
asked to testify or provide an opinion with
respect to an allocation of, say, the rural
deficit or a certain cost in an electrical
proceeding?
DR. FEEHAN:

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A. Yes, that would be true, although to some
extent this overlaps with my experience in
public economics because I look at things like
taxation, equity and taxation, and so forth.
In a sense, the allocation of the rural
deficit is like or has much in common with
imposing a tax. You're raising funds, it's not
for your own use, it's for payment to some
other party and it's a compulsory payment that
rate payers must pay, so there's a strong
equivalence here with subsidization policy,
taxation policy, which is my area as well
within economics.
MR. O'BRIEN:
Q. Okay, is this the first time you've been asked
to give an opinion with respect to the rural
deficit?
DR. FEEHAN:
A. Yes.
MR. O'BRIEN:
Q. Doctor, we've got on report here on file.
This was the only report, the April 20th, 2014
report that you prepared with the pre-filed
evidence?
DR. FEEHAN:

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A. Yes, that's correct.
MR. O'BRIEN:
Q. I want to ask you just briefly about - and
you've mentioned a lot of this, I guess, in
your direct in terms of your retainer in
preparing this report and that Mr. Hearn had
contacted you. You only deal with the
allocation of the rural deficit. Did you look
at other issues for cost of service as well
for Mr. Hearn?
DR. FEEHAN:
A. Yes, at the very early stage, we looked over
the entire application with an eye to what had
the most implications, direct implications for
the Labrador interconnected system, and there
were some questions, I believe, that we
prepared and submitted, some requests for
information related to things other than the
rural deficit, but very early on, at least I
focused on the rural deficit. It seemed to me
that this was a major issue because the
allocation of to the Labrador interconnected
system is quite large relative to the number
of customers and relative to the revenue
requirement in the system.

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MR. O'BRIEN:
Q. Okay.
DR. FEEHAN:
A. It's like unlike, I suppose, with Newfoundland
Power, which is much bigger in terms of number
of customers and revenue requirement, so the
proportionality of importance isn't quite the
same, but it was a big ticket item, I think,
with respect to the Labrador interconnected
customers. I think fairly early on in the
process, with that identified, Mr. Hearn
really had me just focus on that.
MR. O'BRIEN:
Q. And in terms of what Mr. Hearn had asked you
to focus on, was your focus to try to come up
with methods that would reduce that deficit or
was it to look at the fairness of the deficit?
The allocation, I should say.
DR. FEEHAN:
A. Well, of course, reducing the deficit has
significant implications, but, no, we
basically took the fact that this was
government policy, so we didn't evaluate or
attempt to evaluate, say, the fairness of the
policy itself, but given that there's going to

be a rural deficit and given government policy that it must be paid for by Newfoundland Power and the Labrador interconnected customers, we focused on, okay, is that burden shared fairly between the two parties that must bear the burden.

MR. O'BRIEN:

Q. And were you asked to look at whether there were any other options to reduce that amount allocated to Labrador interconnected customers, is that what Mr. Hearn had asked you, or is that something that you'd come up with in terms of your review?

DR. FEEHAN:

A. That's something that I came up with. I originally identified this as a substantial issue and basically Mr. Hearn said that I should pursue it and prepare a report on it, which I did, and it was to examine where it came from - at least in my mind, I'm trying to understand the formula, to look at the outcomes and to see or evaluate if this was a fair allocation or not, but fairly early on with the disproportionality and the numbers, it became pretty apparent to me that the

workings of the current formula gave results that were far from fair.

MR. O'BRIEN:

Q. Okay, I'll ask you a bit about that later. What I will ask you, and if you've reviewed the transcripts already, I've asked this of all the witnesses just in terms of whether or not you agree with me that no matter what we do here in terms of allocating cost to these two groups of customers, it's not going to be fair because they didn't cause those costs?

DR. FEEHAN:

A. Well, looking at it from a cost of service point of view, that is true, they didn't cause those costs, there's nothing they can do to change those costs, they have no control over them, but they're compelled to pay them through charges that are effectively hidden in their rates. In terms of your question, though -

MR. O'BRIEN:

Q. I guess, really what we're looking at is which is the least fair method - the least unfair method to allocate.

DR. FEEHAN:

A. I think that presumes that the government policy of allocating it to these two sets of customers is unfair, but it's a matter of public policy and many public policies involve redistribution, and so there's often, whether it's university education or school education, there's always - you know, people don't have children, but the pay their taxes, so in a sense they're subsidizing somebody else. So whether or not this is a fair public policy is beyond the realm of what I look at. I accept it as policy. Now, I think, and this is one side issue, but it has come up and it is in this report, is the suggestion that whatever is paid by the parties towards the rural deficit should be explicitly given on people's power bills, so at least if this policy is in place people are aware that it is in place and they're paying something towards it. I think this might help the public debate about the rural deficit policy, and maybe it might stem government to reassess it, to try and develop other ways to perhaps support communities in rural areas that have a high electricity cost. So that's a matter of public debate. I'm not

saying that the current policy is fair or unfair. What I'm saying is people should be informed more about the policy, and that might lead to an improved policy.

MR. O'BRIEN:

Q. So in the context that it's a public - this arises out of public policy, that's where your evidence ties that in terms of putting it on the bill?

DR. FEEHAN:

A. Yes. In fact, I mean, I've looked at for instance in Ontario when you get your electricity bill, among the charges that are on the bill is one line that says, I don't remember the exact terminology, but it's a line that says something akin to "Ontario Hydro debt" or "debt charges", and what it is, if you go further on the bill it explains it's a payment that people must make on their electricity bills to pay for the debt of Ontario Hydro. Ontario Hydro doesn't exist any more, of course, they made some bad investments, things went wrong, and they were wound up and there's a new system in Ontario, but, of course, Ontario Hydro left behind this

enormous debt. So what rate payers are now paying is the debt for Ontario Hydro and it's explicitly on their bills, so they know -
MR. O'BRIEN:
Q. So there's a line item for that?
DR. FEEHAN:
A. Pardon me?
MR. O'BRIEN:
Q. There's a line item on the bill for that?
DR. FEEHAN:
A. There's a line item on the bill, exactly, so people know that, hey, part of the reason our electricity is costing a bit more is because of this particular failure of Ontario Hydro in that case. So at least people are aware that part of what they're paying for is not their own consumption, but it's because of another matter ,but at least they're informed.
MR. O'BRIEN:
Q. Doctor, just in terms of the context of your report and there's a section here that you have in your report actually titled, "Context", but you've actually reviewed the 1992/1993 generic cost of service Board order, is that right?

DR. FEEHAN:
A. The Board order - I'm not sure -
MR. O'BRIEN:
Q. I guess, the recommendation.
DR. FEEHAN:
A. There was a report by the Board, yes.
MR. O'BRIEN:
Q. Yeah, the report, I should say.
DR. FEEHAN:
A. Yes, yes, the report, yes.
MR. O'BRIEN:
Q. So you've reviewed that?
DR. FEEHAN:
A. Yes.
MR. O'BRIEN:
Q. I want to take you just quickly to page 6 of your report, lines 22, if we could bring those up, lines 22 to 23, and I want to read a couple of sections here. The first one is 22 to 23, "Despite the previous Board's stated desire to have a fair outcome", and I'll take you through your tables later, "Tables 1 to 3 show that the intended outcome has not been realized", and if we then jump to your concluding remarks, page 11, lines 10 to 11,

there's a similar statement, "This report has demonstrated that the current formula for allocating the rural deficit does not meet the fairness criteria as was originally intended when the formula was first endorsed more than 20 years ago". I'm wondering what the basis for your statements about intended outcomes here, what the Board intended for an outcome?
DR. FEEHAN:
A. Well, the report, the 1993 report did mention or did state that the whole issue of the allocation of the rural deficit had to be assessed according to fairness, and I don't recall the exact line or page, but it also made the point that fairness has to be - I don't recall the exact words, but something along the lines that fairness has to be assessed according to the results.
MR. O'BRIEN:
Q. Yes, okay.
DR. FEEHAN:
A. And so if you look at the results, we see that since the Labrador interconnected customers have been paying a portion of the rural deficit, their payments have been

substantially more than the payments embodied in the rates for Newfoundland Power customers. I think most people looking at that and say, okay, it has to be fair, you have to look at the results, and if the results are one group is consistently paying two to three times what another group is paying, most disinterested observers would look at that and say, well, that seems to be quite unfair.
MR. O'BRIEN:
Q. Is there anywhere in the Board's report that indicates fairness is to be defined on a per customer basis, how much each customer will pay?
DR. FEEHAN:
A. No, I don't recall that, but there is the general assertion of fairness and looking at fairness in terms of results.
MR. O'BRIEN:
Q. Is there anywhere in the report that indicates fairness should be strictly assessed on the basis of a per megawatt hour purchased?
DR. FEEHAN:
A. No. Well, there is - I believe it's in Mr. Baker's testimony that was associated with

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that, he did allude to the fact that payments per megawatt hour would be quite different and to the advantage of one group over another, but, of course, what we have here is a situation where when you look at it on a per megawatt hour basis, even there the Labrador interconnected customers pay more than the Newfoundland Power customers.
MR. O'BRIEN:
Q. Okay, but in terms of the Board's intended criterion, intended result or the criterion for intended results, the Board hasn't indicated that that's the definition of fairness type of thing?
DR. FEEHAN:
A. No, it didn't give equal per customer payments as an indicator. I don't think it gave any specific number. It simply looked at the different options and then took Mr. Baker's advice.
MR. O'BRIEN:
Q. So the Board certainly didn't indicate that the definition of fairness is that each customer in each system pays the same amount?
DR. FEEHAN:

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A. Well, it didn't evaluate that either.
MR. O'BRIEN:
Q. In terms of what the Board ultimately did in relying on Mr. Baker's method, the unit cost method, the unit cost method, I guess, is sort of a - it's a commodities type approach, I take it, is that right?
DR. FEEHAN:
A. Well, you know, it's a funny approach in some ways. Sorry, maybe I shouldn't use the word "funny", but if you look at the table in which it's calculated, I don't recall, it's in the 1993 report in the appendix - perhaps I'll look at it.
MR. O'BRIEN:
Q. I'm not sure that table is actually on the record.
DR. FEEHAN:
A. It's in the report, I believe.
MR. O'BRIEN:
Q. It's in a PUB -
DR. FEEHAN:
A. A copy of the report was given under a request for information.
MR. O'BRIEN:

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Q. PUB-NLH-113. I'm not sure if the table -
DR. FEEHAN:
A. I think it's at the very end.
MR. O'BRIEN:
Q. Is it? Oh, here we go, okay.
DR. FEEHAN:
A. The previous page, one more page.
MR. O'BRIEN:
Q. All right.
DR. FEEHAN:
A. Yes, if you look at those unit costs, or if you look at the more recent tables, if you look at, for instance, the unit cost of energy, line 14 under energy, the $1.47 megawatt hour -
MR. O'BRIEN:
Q. Yeah.
(9:45 a.m.)
DR. FEEHAN:
A. Well, that's not the unit cost for the rural system. It's not the unit cost for Newfoundland Power, nor is it the unit cost for Labrador. As I recall, what you do is you take - this might take a little bit of time. You take the energy cost allocated to

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Newfoundland Power, and we'll forget about maybe the industrial customers since they're not in play, but you take the unit cost - you take the revenue requirement associated with energy for Newfoundland Power and for Labrador interconnected customers, you add them together, you express that as a percentage of the rural deficit, you get a number. You take that number and you essentially adjust it and allocate it to the two parties according to their relative consumptions, and then you get a number. Now they're calling that the unit cost. Now that has nothing to do with the actual energy consumed by the people in the rural deficit system. It's not the unit cost for Newfoundland Power customers and it's not the unit cost for Labrador customers. It's a number which really, in my mind, doesn't tell me very much because it's not actually anybody's unit cost. You could do something similar for either the demand side, or even more, oddly, the consumer side. If we look at the customer cost, for instance, it works out to be $27.00 per customer but where does that come from. Well, again you have this

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allocation of the rural deficit by looking at the proportion of customer cost that come from the Newfoundland Power and Labrador system, you take that as a percent of their total revenue requirement, you apply it to the rural deficit to get a number, and then you divide it or allocate it according to relative number of customers, which gives an odd - that's difficult to interpret as being a unit cost that belongs to anyone, and in the process of doing so, you imply or infer a number for Newfoundland Power customers at well, in this table at the time, 9,574 customers, where, in fact, Newfoundland Power has far more customers than that, and this number is imputed by getting costs that are on Newfoundland Hydro's integrated customer system on the island, dividing those customer costs by the number of customers there, so it's a Newfoundland Hydro number, getting the average cost to Newfoundland Hydro of their island interconnected customers, dividing that into the customer cost for Newfoundland Power to get customer cost for the rural deficit. That's not the customer cost for the rural

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deficit at all, it's just a number, and it's actual interpretation or meaning is very difficult to understand when you go through all that complex imputations and assumptions, and the way you get these numbers, you have a formula that's not all that transparent. So we end up with, yes, equal unit costs, you always get some number on line 14, but my contention is those numbers are not at all easily interpretable and they're not really anyone's particular unit costs.

MR. O'BRIEN:

Q. So in terms of unit cost for megawatt hour, the actual unit cost for, say, the Labrador interconnected system would be lower than that, the actual would be higher for Newfoundland Power if you were to look at their actual unit costs?

DR. FEEHAN:

A. Well, yeah, in this case, and if you went to demand, quite oddly, and I believe I checked this, if you look on the demand side, the coincident peak is the basis rather than AED, but that doesn't change things a lot, but if you look at that, you'll find that their

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coincident peak costs or demand costs, let's call it, per - well, let me try and think. Perhaps using the more recent numbers, if we go to Exhibit E, Schedule 1.3.1, I believe. I'm sorry, this would not be in the amended application. What I'm thinking of is the -

MR. O'BRIEN:

Q. Exhibit 13.

DR. FEEHAN:

A. Yes, but it would have been from the original 2013 application. I don't know if that's available.

MR. O'BRIEN:

Q. It should be available, Exhibit 13.

MS. GRAY:

Q. Is it 1.3.1?

MR. O'BRIEN:

Q. The cost of service study, that's what you're looking at?

DR. FEEHAN:

A. I'd have to have a quick look at it, a lot of numbers.

MR. O'BRIEN:

Q. 1.3.2 maybe.

DR. FEEHAN:

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A. Yes. Might be able to speed up the process here.

MR. O'BRIEN:

Q. This is the break out of the unit cost results at that time?

DR. FEEHAN:

A. Yes.

MR. O'BRIEN:

Q. Okay, 1.3.2, is it, or 1.3 - yeah, okay.

DR. FEEHAN:

A. Okay, those are billing demands.

MR. O'BRIEN:

Q. Scroll down there, Jennifer.

DR. FEEHAN:

A. What I'm looking for is the table where the rural deficit is allocated, so it's somewhere in this area.

MR. O'BRIEN:

Q. It's 1.2.1.

DR. FEEHAN:

A. Yes.

MR. O'BRIEN:

Q. Maybe if we scroll down to the next page.

DR. FEEHAN:

A. I believe that was it. Let me just have a

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look here.

MR. O'BRIEN:
Q. Okay.

DR. FEEHAN:
A. Is this the - this is the -

MS. GRAY:
Q. Amended application.

DR. FEEHAN:
A. The amended application, not the actual - the original application.

MR. O'BRIEN:
Q. No, the 2013 one, Jennifer.

DR. FEEHAN:
A. It's the same schedule exhibit, by looking at the earlier one, which has the old formula in place. I'm sorry, it's taking a while.

MR. O'BRIEN:
Q. That's okay.

DR. FEEHAN:
A. I was simply trying to make a point about the unit costs. Yeah, if you look at this table now that we see and look at line ten and you look at the unit cost per kilowatt, 15.27, well again, as I was saying in the other two cases, if you actually calculate the

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corresponding number, the unit cost let's say for Newfoundland Power and for the Rural Labrador Interconnected customers by dividing, for example, line one Newfoundland Power, the demand number is 127 million and the next line, the corresponding Labrador Interconnected is 9.8 million. If you divide those numbers by the actual quantities of kilowatts, you won't get your -- of course, you'll get two different numbers. You won't get 15 and you won't -- and so again, you get a very different -

MR. O'BRIEN:
Q. This was an attempt to try to look at these two groups on the same -- as if they were on the same system. Is that what that is? With respect to each one of these units, so that if there's an increase in units then you'd be treated as if you're on the same system across these three units, unit costs -

DR. FEEHAN:
A. Three units?

MR. O'BRIEN:
Q. Across these three, sorry, criteria, demand, energy and customer.

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DR. FEEHAN:
A. Well yeah, but what you're getting for that $15.27, you're using the relative kilowatts of Newfoundland Power compared to Labrador Interconnected to come up with a number. That number is the 15.27. That comes out of a division into the 20 million in line four. But that number in line four, the 20 million, isn't actually the demand -

MR. O'BRIEN:
Q. I understand.

DR. FEEHAN:
A. - amount in the rural system that you're -- where the actual subsidy is. This is an imputed number based upon the actual rural deficit of 60,724,000. So you're taking this number, which isn't the actual demand cost in the rural system, and you're applying these quantities of the peak demand, let's say, or coincident peak for the two entirely different systems and you're coming up with a number that doesn't represent either system.

MR. O'BRIEN:
Q. No, and I take it the idea was if you take the actual demand from the subsidized system,

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there's no connection to usage from Labrador Interconnected and Newfoundland Power's customers to that subsidized system.

DR. FEEHAN:
A. Right.

MR. O'BRIEN:
Q. So going forward, this was an attempt to try to treat these two subsidizing groups as if they were on the same system?

DR. FEEHAN:
A. Yeah. Well, that's part of it, and of course, these are two dramatically different systems.

MR. O'BRIEN:
Q. Sure.

DR. FEEHAN:
A. They're isolated from one another and isolated by themselves. One has entirely different costs of service cost structure and therefore there are different consumption patterns and the like. So you're really taking two entirely different systems that aren't connected and you're creating this system that doesn't exist and then you're calculating a unit deficit cost for demand that's based upon a 20 million dollar figure, we see in line

four, that isn't part of or the actual demand cost in the rural deficit area. So you're coming up with a lot of numbers here that aren't quite directly related to one another and you're adding two systems that are totally different, like adding apples and oranges together, to get a number.

MR. O'BRIEN:

Q. Right.

DR. FEEHAN:

A. So my point is these unit cost numbers, you could say okay, we'll use them equally in each system, but they really don't have any intuitive meaning to them.

MR. O'BRIEN:

Q. Is there any indication from Dr. Baker's -- from Mr. Baker's evidence or even from the Board's report that he understood that these particular figures were indicative of unit costs for each particular system or he was trying to put together a formula which would try to treat each as if they were on the same system?

DR. FEEHAN:

A. I have to admit that in Mr. Baker's testimony

and as well in the report, the PUB report that recommended this approach, it was never clear, at least in my reading, exactly what the logic was. I mean, it was, in a very general sense, described as a mini cost of service approach and so you see the methodology of cost of service there. But the actual imputation of these numbers and combination of different systems into sort of a system that doesn't exist and then coming up with unit costs that are not based upon the actual unit costs in the system you're subsidizing and is really not a reflective of the unit costs in either one of the two systems that are separate, then you've got that -- that sort of number really doesn't have any strong logical appeal as a basis for allocating the rural deficit.

It's an attempt I see to use the cost of service methodology and you know, you've got the basics in there in terms of the allocation, but the actual numbers used and the rationales for them, such as again if we go back to the number of customers, none of that is really well explained, I found, in either the report or in Mr. Baker's testimony.

I think it is an attempt to say okay, let's try cost of service. But, from what I can tell, these unit cost numbers are really extremely difficult to defend, because their underlying logic requires an awful lot of imputation, assumption and rearrangement and ratio'ing and combining two systems that are entirely unrelated, separate and isolated.

MR. O'BRIEN:

Q. Doctor, when you used the phrase "logic" there, where there's no cost causality here, is there any logical way to allocate these costs that would be a logical way to do it from an economics perspective?

DR. FEEHAN:

A. Well, in economics -- well, first of all, I would say a cost of service approach is not a good approach because I think we've agreed the Newfoundland Power customers and the Labrador Interconnected customers don't get any benefit and don't cause any of the costs.

MR. O'BRIEN:

Q. No.

DR. FEEHAN:

A. So it's a matter of public policy there. It's

not a cost of service issue, in my mind, because there's no cost that they cause and no service that they get, at least if you're in - - again, as a Labrador Interconnected customer or a Newfoundland Power customer. If we look to economics, then we could say okay, well, if someone has to pay, make a payment, a compulsory payment, it's somewhat equivalent or equivalent to a tax and what we look at in economics generally is two broad approaches and that is, you pay according to benefit and you pay according to ability to pay. Those are two widely used basis for allocating the burden of a tax or a compulsory payment, and this, of course, is a compulsory payment.

MR. O'BRIEN:

Q. Right.

(10:00 a.m.)

DR. FEEHAN:

A. And we really can't go by ability to pay because Newfoundland Hydro is not in a position, nor is Newfoundland Power, to impose rates based upon income, and that's -- or wealth or some other broad measure of ability to pay. We're also not in a position really

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to apply benefit taxation because there's no benefit. So this is an issue in which we have to say, okay, two groups of people, customers have to pay a certain amount to someone. You could think of a simple case, if two people had to pay for someone else's $100 meal, the two people might say, okay, well that's 50 bucks each. So if we boil it down to very simple situation like that, there's a certain appeal of equal payment.

What I address, and this is to say, okay, well, if we go to the equal payment, it's simple, it's understandable. Everybody knows how much they're paying. You could always vary it with sort of a combination of pay a fixed amount everybody, but then if your consumption is much higher, maybe you pay a bit more. If you consume more electricity and electricity consumption, if we assume it's correlated with income, which might be reasonable on the Labrador Interconnected system, I'm not so sure on the Island because there's so many more people on the island who use oil heat, so you could be quite wealthy, of course, and have an oil furnace in your

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house and so you're not really -- but you still wouldn't be paying much towards a rural deficit because your consumption is low. So I'm back to this idea of pretty much if you tell two groups to pay for it, if it was two individuals, you'd say, okay, we pay equal amounts. If it was two groups, the two groups pay equal amounts per capita, or in this case, per customer basis.

MR. O'BRIEN:

Q. Is that on a basis of logic though, Doctor? I can see the logical connection between on a cost of service basis, if you call -- if your cost of service was A, you pay for A. I can see that logic. But you're talking more sort of from a policy perspective, are you not, or what would look good for each? There's no necessarily -- it's not necessarily an economics logical perspective, is it?

DR. FEEHAN:

A. Well, there's a certain logic in it because again, you have two groups who have to pay. If you can't base it on benefit or ability to pay, then -

MR. O'BRIEN:

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Q. You have to base it on something.

DR. FEEHAN:

A. - you have to base it on something, so you could say you're a customer.

MR. O'BRIEN:

Q. Right.

DR. FEEHAN:

A. And as I understand the directive or the policy of government is these two groups must pay. It's not a subset of the groups or a disproportionate burden on one group or the other. It's just two groups. So these groups are pooled together, not -- even though they're in two entirely different systems. You can't, of course, pool costs and you're not charging uniform rates, but these are two groups of people who are being pooled together who have one thing in common and that is they must contribute towards rural deficit and in my opinion, if you have a system like this where everyone pays an equal amount, then of course that means each customer in the Labrador Interconnected system would pay as much as someone on the Newfoundland Power system. So if I, for instance, were to change

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my location and move to Lab City, should my contribution to the rural deficit go up? And if I move back to St. John's then it goes back down? It seems to me that that's not really an appropriate thing. You're in one province. There's a compulsory payment required by the Provincial Government that you must make. Does it make sense that by changing my location between the two regions I should pay more or less?

MR. O'BRIEN:

Q. Your rates would be different if you moved up to Labrador versus -

DR. FEEHAN:

A. Well, my cost of living would be different. I can accept if I move from one place to another that my cost of living would be different. I might pay less for electricity. I might pay more for gasoline. I might pay more for food. But, this is a compulsory payment.

MR. O'BRIEN:

Q. So you wouldn't consider that -

DR. FEEHAN:

A. Not associated with me buying food or electricity or anything else. This is just a payment I must make. It could have been -- you know, the Government could have said this is a policy of subsidizing incomes on the Labrador coast or in other areas and other people must pay. So in my view, in this case, you make it locationally independent, to make it independent of changes in the two systems or the eventual perhaps connection of the two systems. If it's an equal per capita payment, that would be robust with respect to changes in the system, and we don't have a better system. We can't go with ability to pay because again the taxation system isn't possible.

MR. O'BRIEN:

Q. Doctor, I'd like to turn you to Table 1. It's page three of your report. If we can bring that table up? And this is in your direct you talked about having a look at purchases per megawatt hour -- or sorry, cost per megawatt hour purchased from Newfoundland and Labrador Hydro and you've assessed that in terms of fairness. Is that right? That was your first look at the allocation to see if it was fair? You used this as a criteria?

DR. FEEHAN:

A. I wouldn't say I used it as a criterion. I'd say I looked at it and the way the paper is organized, it's presented first, not in order of say priority or anything. But, it was interesting to look at because it shows even on a per megawatt hour basis, the customers in the Labrador Integrated -- Interconnected system pay more than Newfoundland Power customers.

MR. O'BRIEN:

Q. And you later on actually one of your alternative methods is that you -- one of the -- Alternative B at page eight, every customer pays the same per megawatt hour. That's one of your alternative methods. Is that right?

DR. FEEHAN:

A. Yes.

MR. O'BRIEN:

Q. So if that table had everyone paying the same per megawatt hour, would you consider the allocation fair?

DR. FEEHAN:

A. No, I think in the paper it says that, you know, this is an option but the problem with it is if you did that -- well, I think as well -- could we go on to Table 2?

MR. O'BRIEN:

Q. Sure.

MS. GRAY:

Q. Sorry, what page?

MR. O'BRIEN:

Q. Sorry, that's page four. You want to go to Table 2?

DR. FEEHAN:

A. Well, we can stick with this for the moment. This is an alternative, but looking at it on page nine, what we find is while it does reduce the discrepancy between the burden per Labrador Interconnected customer and Newfoundland Power customer, you still find that the average customer in the Labrador Interconnected system would be paying about $385 a year hidden in their bills whereas Newfoundland Power customers would be paying 184 hidden in their bills.

MR. O'BRIEN:

Q. So it wouldn't be equal on a per customer basis?

DR. FEEHAN:

A. It wouldn't be equal on a per customer basis, no.

MR. O'BRIEN:

Q. So you'd still be paying the same per megawatt hour but you wouldn't be paying the same per customer, so that's not sufficient in terms of an alternative method for you?

DR. FEEHAN:

A. Well, I'm sorry, could you repeat that question?

MR. O'BRIEN:

Q. You'd still be paying -- you'd be paying now the same per megawatt hour, but that's not a sufficient alternative method in your mind?

DR. FEEHAN:

A. Well, it would result in too much of a discrepancy in my mind, and also, you know, again if we go to Table 2 now, we find that of course Newfoundland -- this is a smaller adjustment, but it shows the difference is a little bit bigger because of course Newfoundland Power customers, Newfoundland Power gets some of their electricity from their own self generation and so the burden, there's no let's say rural deficit component on that number because it's only on the amount that Newfoundland Power purchases from Newfoundland Hydro that we see the rural allocation being applied to. So if you did it on a per kilowatt hour consumed basis per customer, the difference would get a bit larger. So that's part of the reason why I think you get that discrepancy on the other page, but admittedly, it doesn't make a lot of difference because Newfoundland Power buys what, about 85 -

MR. O'BRIEN:
Q. Well, let's stay with that table, Doctor. This per megawatt hour consumed, you've worked into that table Newfoundland Power's own generation?

DR. FEEHAN:
A. Right, a quantity, yeah.

MR. O'BRIEN:
Q. Have you accounted for losses in that?

DR. FEEHAN:
A. Line losses?

MR. O'BRIEN:
Q. Yeah.

DR. FEEHAN:

A. No.

MR. O'BRIEN:
Q. No. So -

DR. FEEHAN:
A. Not that I recall. I just had the numbers for its own generation, so I don't know what the losses would be.

MR. O'BRIEN:
Q. Do you know if they would raise Newfoundland Power's customers rates up in your table if you accounted for that?

DR. FEEHAN:
A. To the extent that there's line losses, it would raise the numbers here. They'd still be -- there wouldn't be -- the percentage differences would still be larger than on Table 1 because I presume your line losses are not 100 percent. I presume that they're a modest percentage, but although I don't know the number.

MR. O'BRIEN:
Q. And you haven't calculated or accounted for that in your figure there?

DR. FEEHAN:
A. No, I just used the aggregate number.

MR. O'BRIEN:
Q. In your -- if you account for line losses and the generation here, would this bring your table -- sorry, your alternative B results on page nine, 385 and 184 in lines five and six, would it bring those results together so they were equal or would -

DR. FEEHAN:
A. No.

MR. O'BRIEN:
Q. - or would Labrador Interconnected customers still be paying more?

DR. FEEHAN:
A. I presume that both systems have line losses. I haven't looked at line losses, so I can't say. Because Newfoundland Power only self generates a fairly small portion of what it actually sells, my expectation is the numbers wouldn't change very much.

MR. O'BRIEN:
Q. Okay. Doctor, I want to ask you about a comment in your report, page six, lines 27 to 29, and maybe go back to 26. The formula itself, and you're talking here about in the context section about the Baker formula

"involves a somewhat complex set of calculations akin to what was described at the time as a mini cost of service. Broadly speaking, one can see the fairness in allocating a burden across two groups according to some proportionality, eg. the bigger group should pay more or the richer group should pay more." You're not espousing to that principle, are you, that because Newfoundland Power has a bigger group of customers, they should pay more of the deficit per capita?

DR. FEEHAN:
A. No, not per capita. I mean, if there's 20 people and there's one other person, then of course, what I'm saying is while the group of 20 would pay more than a group of one or two, I'm not suggesting that it should be equal per group.

MR. O'BRIEN:
Q. How about on a megawatt hour basis?

DR. FEEHAN:
A. Well, again, I think because you have two entirely different systems, two isolated and very different systems, that on a per megawatt

hour basis doesn't really have as much appeal as if they were on the one system. In addition, just by looking at the outcome, and I think ultimately people judge fairness by the outcome, if you look at the outcome, you see you'd still end up with this disproportionate amount falling on Labrador Interconnected customers versus Newfoundland Power customers and it seems to me that a big component in assessing fairness when people look at these issues is how much one person or one group pays relative to another.

MR. O'BRIEN:

Q. So in terms of per megawatt hour then, if you're not supporting your alternative B which shows a per megawatt -- a difference in cost between Labrador Interconnected system customers and Newfoundland Power customers, are you supporting Newfoundland Power's customers paying more on a megawatt hour basis?

DR. FEEHAN:

A. What I'm suggesting is that the groups pay equally towards the system. The systems are very different and therefore that requires

something akin to equal payment on the average per customer. That may result, of course, in one group paying on a price basis but it paying more or less than the other group. On a quantity basis, it might be more or less the other group. But these are two so different systems that it seems to me you can't go with a common charge per megawatt hour because you have two entirely different systems. I think, you know, this goes back to the cost of service approach that was in the old formula, that you really have two entirely different systems that take on very different characteristics because, of course, they have very different cost of service and as a result going equal amount per capita or something like that doesn't make as much sense as equal payments, because then you're saying, okay, we know the systems are entirely different, but the two groups have to pay. So have them pay an equal amount per customer or at least on the average.

(10:15 a.m.)

MR. O'BRIEN:

Q. But Doctor, I guess I thought my question was

quite simple.

DR. FEEHAN:

A. Okay.

MR. O'BRIEN:

Q. If you're not supporting an alternative where each group would pay the same on a per megawatt hour basis because that alternative results in the Labrador Island -- or Interconnected system customers paying more than Newfoundland Power customers, are you not then supporting that Newfoundland Power's customers pay more on a per megawatt hour basis?

DR. FEEHAN:

A. On the average, they would end up paying more.

MR. O'BRIEN:

Q. They would have to?

DR. FEEHAN:

A. Yeah.

MR. O'BRIEN:

Q. Okay.

DR. FEEHAN:

A. And per person, they would be paying the same or per customer.

MR. O'BRIEN:

Q. And why would you support that process, an alternative where Newfoundland Power's customers would pay more on a megawatt hour basis?

DR. FEEHAN:

A. Again, we have two different systems. One system, the Labrador Integrated system, has a cost of structure such that practically everybody is all electric, and people will consume more electricity per capita, again reflecting their cost of service, as well as maybe weather, but certainly their cost of service will induce people to consume more. So they take on different consumption patterns, reflective of the cost of service they're faced with. And because of that, you can't sort of assume that okay, it's one system, so let's just have a common rate per megawatt hour. So you have two entirely different systems, different costs of structure -- cost of service. That leads to different consumption patterns, very distinct consumption patterns from one another. So to go with a common charge per megawatt hour is going to result in a very different average

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payment per customer.

MR. O'BRIEN:

Q. Well, let me take up just one of the points you mentioned there in terms of the cost of service incenting to spend more or to use more energy, I guess, in terms of a cost. Is that what you're talking about, price signals and -

DR. FEEHAN:

A. Yeah. If we take that the cost of service is accurately reflected in prices, then of course people will react to that. So the people in Labrador Interconnected system would be paying their cost of service. People in Newfoundland Power's system would be paying their cost of service. Those are entirely different cost of service and therefore people will behave differently and their consumption patterns will be different, very different, but these two groups are still being called on to pay for or contribute to a pool over here that's not related to the fact that they're in two different systems, not related to their cost of service in terms of they don't cause those costs over there in the rural deficit systems.

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So again, you can't really combine the two because you have two different systems.

MR. O'BRIEN:

Q. And would you have a situation where you had a larger amount of the rural deficit being paid by Labrador Interconnected customers -- would they -- by putting a larger amount on that, would that induce them to be more efficient with their use of energy?

DR. FEEHAN:

A. Their efficient use of energy would be determined, I think, by the setting of the price of electricity through the regulatory process and through cost of service. The price that they should pay should reflect cost of service.

MR. O'BRIEN:

Q. Right.

DR. FEEHAN:

A. And that's the standard approach that's being used in our system. If you're going to say, well let's put a bigger burden on them because that'll make them more efficient, what you're telling me is that there's a problem with their cost of service pricing. That cost of

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service is flawed.

MR. O'BRIEN:

Q. Well, okay. In terms of efficient pricing then, what's that based on usually, marginal cost or embedded cost?

DR. FEEHAN:

A. In economics, it's marginal costs.

MR. O'BRIEN:

Q. Marginal costs. And if the RFIs responses are telling us that marginal costs for the two systems are going to be closer to one another, if not similar, on interconnection, would that result, do you think, in an increase in rates in the Labrador Interconnected system?

DR. FEEHAN:

A. I don't know what the Government policy will be three or four or five years out.

MR. O'BRIEN:

Q. So that would depend on policy, would it?

DR. FEEHAN:

A. If you went with an equal per customer payment, it would be robust with respect to that sort of change, and when you think about it, suppose there is a physical connection, there's still -- let's assume the deficit is

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the same. Why should that change anyone's contribution towards it? If my income hasn't changed, why should I pay more or less if the deficit is the same and the number of customers are the same? I don't know if a physical connection should make any difference, and that goes back to the idea of equal payments per customer. If it's equal throughout the two systems, then when you connect, it's still an equal payment because it should be independent of whether the systems are connected or not because it doesn't relate to the cost of providing service, connected or separate. This relates to a payment for something that will remain separate. So having equal payments per customer is robust with respect to the system being integrated or not.

MR. O'BRIEN:

Q. And it's your belief that that -- that we shouldn't take into account what the cost of service is for each of these customers? We should look at the allocation sort of separately and not take into account -

DR. FEEHAN:

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A. Yeah, I think it very much is a separate issue from cost of service.
MR. O'BRIEN:
Q. So we shouldn't take in -
DR. FEEHAN:
A. This is a compulsory payment, not related to cost of service.
MR. O'BRIEN:
Q. Okay. So we shouldn't take into account that the cost of serving Newfoundland Power's customers is higher because of where they're located and the use of thermal energy versus where Labrador Interconnected customers are close to hydro and basically relying on hydro, hydroelectricity I guess, in terms of energy?
DR. FEEHAN:
A. Yes, that's true.
MR. O'BRIEN:
Q. Okay. And the other proposals you've provided, Doctor, you've got alternative A, that's your every customer pays the same dollar amount. Is that right?
DR. FEEHAN:
A. Yes.
MR. O'BRIEN:

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Q. And is that -- you're not necessarily proposing that one? You're proposing the same dollar amount sort of shared costs between systems, but then break it down per megawatt hour inside the systems? Is that right?
DR. FEEHAN:
A. Alternative D encompasses A because as I think I say in there, you could have a system where this would give you the flexibility. You could say, okay, we're going to make it equal per capita or sorry, per customer in the two systems, but then you could say, okay, within each system, because now you have -- each system has its own characteristics, so within each system you could then go with how are you going to raise this average amount, equal amount, and you could decide, okay, it's a fixed charge plus some charge per megawatt hour, but it would still raise the same amount per customer on the average in each system. Now you don't have to do this because within this system, you could just say, no, it's just as well to go with a fixed charge in every customer. It might make more sense in the Labrador system to the extent that consumption

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within that system may be correlated with income. It's a little trickier I think with the Newfoundland Power system because I think I mentioned this earlier, Newfoundland Power system, of course, has a fair number of customers who don't use electric heat. Their primary source of heat may be wood or likely oil furnace heat and so it's a little trickier to use I think in a Newfoundland Power system, but this would create, I think, the flexibility of doing it.
MR. O'BRIEN:
Q. And I take it by using that alternative D, you wouldn't have any situation really where anybody is paying the exact same cost? It would all be based on -
DR. FEEHAN:
A. Well, if you're in one system and you're paying the same fixed charge, then you'd pay the same cost if you consumed the same amount.
MR. O'BRIEN:
Q. If you consumed the same amount, yeah.
DR. FEEHAN:
A. Yeah.
MR. O'BRIEN:

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Q. So likely there's going to be some differences.
DR. FEEHAN:
A. Yeah, and it would create, I think, problems particularly in the Newfoundland Power system because again, you've got the oil furnace people and the wood people.
MR. O'BRIEN:
Q. And in terms of understandability then, would customers still have -- they look at their neighbour's bill, they'd obviously see a difference in the bill, but it'd be understandable in terms of it's broken down per megawatt hour inside that system?
DR. FEEHAN:
A. Yeah. I mean, of course and it's most understandable if it's simply a fixed charge. I mean, I think if you go back to Newfoundland Hydro's numbers, it was roughly $235 per customer if you did it on an equal basis, and so that's pretty much -- you know, $20 a month on your bill would give you 240 a year. So if every customer had an explicit amount, if it was a fixed charge of $20 a month on their bill, it would be very understandable. People

may not like it, but it would be -- they'd be informed and it would be very understandable. I think any other formula that's, you know, not terribly different than that would again be relatively easy to understand.

MR. O'BRIEN:

Q. Doctor, we're expecting a cost of service methodology study by the end of the -- by end of next year, I guess, and marginal cost study by the end of this year. Any reason not to wait 'til those studies are completed to look at revising this methodology?

DR. FEEHAN:

A. I don't think so. I think again, I mean, the marginal costs would feed into the appropriate and efficient pricing of electricity. What we have in this case is a separate issue. This is an extra charge that people must pay that's not related to marginal cost or cost of service or anything like that. So, I think they should be handled as separately.

MR. O'BRIEN:

Q. Okay. I don't have any further questions for Dr. Feehan.

CHAIRMAN:

Q. I think Mr. Johnson, you're up next.

JOHNSON, Q.C.:

Q. Yes, Mr. Chairman. I have no questions for Dr. Feehan. Thank you.

CHAIRMAN:

Q. Mr. Coxworthy?

MR. COXWORTHY:

Q. No questions, thank you, Mr. Chair.

CHAIRMAN:

Q. Mr. O'Reilly?

O'REILLY, Q.C.:

Q. No questions, Mr. Chairman.

CHAIRMAN:

Q. Mr. Luk?

MR. LUK:

Q. No questions, Mr. Chair.

CHAIRMAN:

Q. Madam Dawson?

MS. DAWSON:

Q. No questions.

CHAIRMAN:

Q. So we're over to Madam Greene.

DR. JAMES FEEHAN, CROSS-EXAMINATION BY MAUREEN GREENE, Q.C.

GREENE, Q.C.:

Q. Good morning, Dr. Feehan.

DR. FEEHAN:

A. Good morning.

GREENE, Q.C.:

Q. I do have one question. It relates to your opinion with respect to stating on the bill the amount that a customer would pay towards the subsidy and I wanted to ask what your opinion would be about having a statement on the bill for those people who receive the benefit of the subsidy. Do you think it is appropriate that the people who benefit from the subsidy also have a statement on their bill indicating what percentage of their bill they would have had to pay but for the fact of the subsidy?

DR. FEEHAN:

A. I have no problem with that. You're informing people that they're receiving a subsidy and you're making it explicitly -- you're making it explicit. Actually, with the Northern Strategic Plan of the Provincial Government, I understand that people who get bills now, it's explicitly shown how much they're receiving. They get their full bill and then there's a

line or a couple of lines that indicate how much they're receiving through the subsidy under that NSP plan. So the precedent has already been set there. And even until recently, our rebates on the Provincial portion of the HST was shown on our electricity bills if we were with Newfoundland Power and I presume all the other customers of Newfoundland Hydro. So, I think that's perfectly fine. I see no reason not to inform people of the amount that they're receiving in a subsidy and just like people who are paying the subsidy should really see it on their bills as well.

GREENE, Q.C.:

Q. And taking it one step further, would that also, in your opinion, help to inform that public policy discussion you had mentioned would arise from putting it on the bills of the people who actually pay the subsidy?

DR. FEEHAN:

A. Yes, I think it's -- it informs the public, informs rate payers and they may give feedback of course to government or to the Consumer Advocate or various groups. I think it

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informs the debate about electricity policy. It's information. As long as it's accurate information, I think it should be given.

GREENE, Q.C.:

Q. Thank you, Dr. Feehan. Those are my questions.

DR. JAMES FEEHAN, CROSS-EXAMINATION BY COMMISSIONER DARLENE WHALEN

COMMISSIONER WHALEN:

Q. Good morning, Dr. Feehan.

DR. FEEHAN:

A. Good morning.

COMMISSIONER WHALEN:

Q. I understand -- do tell me if I understand what you're proposal is alternative D

DR. FEEHAN:

A. Um-hm.

COMMISSIONER WHALEN:

Q. And that's what you're recommending, which is it's a two-part piece?

DR. FEEHAN:

A. Yes.

COMMISSIONER WHALEN:

Q. So you see a distinction between the allocation of the deficit itself between the

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two systems and then within the systems, the collection is a different issue or a different piece of that?

DR. FEEHAN:

A. Yes.

COMMISSIONER WHALEN:

Q. Okay.

DR. FEEHAN:

A. What I have in mind there is once you know that, for example, the Labrador Interconnected customers would on the average be paying the same amount as Newfoundland Power customers, then you may want to take into account the characteristics of the Labrador Interconnected system. For example, almost everybody is electric heat.

COMMISSIONER WHALEN:

Q. Um-hm.

DR. FEEHAN:

A. And therefore you can treat people a little more -- perhaps a little differently than on the island where many people have furnace. So this option or alternative D gives a little bit more flexibility in how you get to that point of equal payment on each system. And of

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course, for simplicity, one might still say, no, let's just go with an equal customer charge, which is one of the options that Newfoundland Hydro has suggested that it's open to, although its preference is to go with the revenue requirements, which roughly equates to almost equal outcomes in the two systems anyway.

COMMISSIONER WHALEN:

Q. So it goes -- the allocation piece is the per customer concept?

DR. FEEHAN:

A. Yes.

COMMISSIONER WHALEN:

Q. And then within the system, you would be looking at it in terms of the rate structure and identifying some -- there could be some differences even within the rate structure, some cells within the systems to recognize these -

DR. FEEHAN:

A. Yeah, there might be some splitting according to, for example, customer class.

COMMISSIONER WHALEN:

Q. Right. On the collection itself?

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DR. FEEHAN:

A. Yeah.

COMMISSIONER WHALEN:

Q. And that gets me to my next question. When you actually go down the path of the first, the first piece, the allocation piece on a per customer basis, are you making any distinction between the customer classes at that step or is it all customers, residential, commercial? You know, does the supermarket pay the same as the -- in the allocation piece itself upfront or do you think -

(10:30 a.m.)

DR. FEEHAN:

A. If you went with equal customer payments, yeah, you could have all the general service customers, they all contribute, for example, their $20 a month.

COMMISSIONER WHALEN:

Q. Right.

DR. FEEHAN:

A. You could say well, you know, there's a distinction between commercial businesses buying electricity and households, but again, we're in a system where this is simply a

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payment, a compulsory payment, and you could,
I suppose, once you say that we'll make an
equal average for the two systems, you could
split it according to classes and so forth,
but then you're getting almost into a cost of
service type of arrangement and the
supermarket and the local corner store, as
well as the person who owns that corner store,
well, you know, they're all customers. None
of them are cost -- but none of them are
causing a cost of service. They just have to
pay. So really, I don't know that there
should be any distinction. Maybe it should be
based on just everybody pays an equal amount.
COMMISSIONER WHALEN:
Q. Okay.
DR. FEEHAN:
A. Maybe with some adjustment for consumption,
but even there, you know, if it's correlated
with income, it may make some sense.
COMMISSIONER WHALEN:
Q. Yeah. It seems easy on -
DR. FEEHAN:
A. Yeah, a very simple way of doing it, yes,
compared to the formula that exists now, which

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from what I can tell very few people
understand. The average customer, if you sent
them out a copy of that formula and say this
is how we're doing those rates -- so when I --
for example, when I suggest that you're told
on your bill what you're paying, I wouldn't
suggest that you append to it the old formula
if it stayed in place because no one would
understand it anyway. They'd just be at a
loss.
CHAIRMAN:
Q. It's impenetrable.
DR. FEEHAN:
A. Yes, I think that's a good word.
COMMISSIONER WHALEN:
Q. Thank you, Dr. Feehan. That's all I have.
DR. JAMES FEEHAN, CROSS-EXAMINATION BY CHAIRMAN WELLS
CHAIRMAN:
Q. No? So really what we're talking about here,
I think you said it's not an economic issue
really, is it?
DR. FEEHAN:
A. Well, it's not a cost of service issue.
Economics does entail issues that deals with
the burden of taxation and equity and those

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sorts of things, so there's an economic
element here.
CHAIRMAN:
Q. Okay. But really what we've got is a
situation where you've got a non-market
commodity and as a consequence, it's
controlled by the government. Would that be a
fair statement?
DR. FEEHAN:
A. What do you mean by non-market commodity?
CHAIRMAN:
Q. Well, it's -- electricity is a monopoly and
it's regulated, but basically it's controlled
through government power.
DR. FEEHAN:
A. It's a regulated monopoly market. It's still
a market, but it's a regulated monopoly
market.
CHAIRMAN:
Q. But the government is using its authority here
to decide that one -- a group of people have
to subsidize consumption of another group of
people?
DR. FEEHAN:
A. That's right, yes.

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CHAIRMAN:
Q. And that -
DR. FEEHAN:
A. It's the result of government policy. It's
not the result of market interaction.
CHAIRMAN:
Q. And that couldn't happen, for instance, in a
market commodity where there's -- you know,
where there's -
DR. FEEHAN:
A. It would only happen -
CHAIRMAN:
Q. - voluntary exchange.
DR. FEEHAN:
A. Yes, that's true. It would only happen on a
small scale, but for practical reasons, for
example, some firms may charge everybody the
same delivery fee even though they're going
further with one delivery than another because
in practical terms, it -
CHAIRMAN:
Q. But there's still some benefit there. I'm
getting a good delivered.
DR. FEEHAN:
A. Yes.

CHAIRMAN:
Q. So it's not -- the analogy doesn't hold.
DR. FEEHAN:
A. Yeah, you're still getting some benefit. It may not be exactly the same, but the practicality is firms would look at the profitability aspect of that and say, no, we're not really going to charge somebody extra because we're going half mile more delivery.
CHAIRMAN:
Q. Some economists think about it as a public choice issue. What you've got here is a situation where you've got concentrated benefit in the recipients of the subsidy and the costs are diffuse. Have you ever come across that in your -
DR. FEEHAN:
A. Yes.
CHAIRMAN:
Q. Like James Buchanan won a Nobel Prize for that, didn't he?
DR. FEEHAN:
A. Yes, yes, that's right. Yeah, public choice is a growing field.

CHAIRMAN:
Q. I have trouble, you know, arguing with him.
DR. FEEHAN:
A. I think in this case too that links up to the idea of informing people.
CHAIRMAN:
Q. Yes.
DR. FEEHAN:
A. Because if you inform the public on their bills that pay, this isn't hidden in your rates any more. We're telling you, this is how much you're paying per month towards supporting this policy. Then maybe there'll be a political consensus and political leaders, public opinion might say that's okay because we agree with this sort of support for these groups or public opinion might say no, this is too much. It should be less. But at least people are informed and a debate can happen in an informed way.
CHAIRMAN:
Q. And even if there's a majority in favour, the people who are not in favour still have to pay anyway. So there's always going to be compulsion.

DR. FEEHAN:
A. That's right. There's going to be compulsion. In the end, there's going to be, but at least -- the hope is with an informed debate, policies would be better than people uninformed.
CHAIRMAN:
Q. I think that might be a valid point. I'm not sure, but anyway. Do you have any redirect, sir?
BROWNE, Q.C.:
Q. No, thank you.
CHAIRMAN:
Q. So I think we're going to take a short break now to -
MS. GLYNN:
Q. I think we'll take our half hour break.
CHAIRMAN:
Q. Oh, we're going to take our half hour, are we? Okay. We'll take our half hour.
(BREAK - 10:37 A.M.)
(RESUME - 11:18 A.M.)
CHAIRMAN:
Q. So I believe we're ready to commence with Mr. Fagan. Is that Correct?

MR. CASS:
Q. Yes, sir. Mr. Fagan is ready to be sworn.
MR. KEVIN FAGAN, SWORN, EXAMINATION-IN-CHIEF BY MR. FRED CASS
MR. CASS:
Q. Mr. Fagan, can you please summarize your work and education experience?
MR. FAGAN:
A. In 1982, I graduated with a Bachelor of Science, Mathematics and Statistics from Memorial University and I started my career with the Finance and Rates Group with City of Calgary Electric System that same year. I moved back to Newfoundland and Labrador in 1986 to work with Newfoundland Power where I remained employed until March of 2014. While at Newfoundland Power, I worked in a number of roles, including finance, rates and regulatory matters, such as conducting load research studies, developing the weather normalization methodology, conducting reviews of rate designs and regulations and developing supply cost recovery mechanisms. I was also a customer service policy specialist for a few years. The position included administering

the contribution in aid of construction policy, we refer to it as CIC, from customers. I was the lead person on developing the current CIC policy approved by the Board in 2005. I'm assistant (phonetic) at Newfoundland Power at my time of leaving, I was director of rates. So, I'm currently the manager of rates and regulation. I've been actively involved in Hydro's amended application.

This is my first time testifying before the Board in a General Rate Application. However, I've previously made presentations before the Board in 1995 on the proposing new weather normalization methodology. I've also made presentations to Board staff on the CIC policy that was implemented in 2005, as well as the Newfoundland Power retail rate review in 2010.

MR. CASS:

Q. And what areas of evidence in the Amended Application are you responsible for, Mr. Fagan?

MR. FAGAN:

A. I'm responsible for Section 4 of the evidence

to the Amended Application. Section 4 provides evidence on Hydro's regulatory outlook and preparation for transition to the Labrador Island interconnection, cost of service proposals in the proceeding, recovery of the forecast revenue deficiency as a result of delayed rate implementation beyond January 1, 2014, the proposed rates for Newfoundland Power, Industrial Customers and Hydro Rural customers, the phase in of Industrial Customer rates, proposed changes to the rate stabilization plan, the proposed Labrador transmission rate and the proposed recovery of conservation and demand management costs.

Most of the cost of service and rate design issues presented in evidence have been settled. With these settlement agreements, issues that would have been debated before the Board can now be dealt with more efficiently in a separate cost of service proceeding planned for 2016. The scheduled cost of service methodology review was planned to deal with system changes that will result from the Labrador Island interconnection.

I was also involved in developing the

mechanics of the proposed supply cost recovery mechanisms in Hydro's Amended Application.

MR. CASS:

Q. Do you adopt the written evidence in these areas of the Amended Application that you're responsible for?

MR. FAGAN:

A. I do.

MR. CASS:

Q. Can you, Mr. Fagan, please provide some background on the rural deficit issue?

MR. FAGAN:

A. Sure. Hydro serves 23,700 customers at the retail level on the Island Interconnected system. On the 21 isolated systems, including the L'Anse au Loup system, Hydro serves 4600 rural customers. The rural deficit results from revenues from customers paying rates that do not recover the full cost of service. The average cost of serving customers on isolated systems is approximately 80 cents per kilowatt hour. Government policy on rural rates is based on providing affordable electricity to customers on Hydro's rural systems.

The rates proposed in the Amended

Application are based on the policies for rural rates as approved in Order No. P.U. 7 (2002-2003). The rates policies impacting the rural deficit directly are on the Island Interconnected system, Hydro's rural customers pay the same rates as the customers of Newfoundland Power. The impact of this rates policy is approximately 25.7 million dollars in the 2007 test year -- 2015 test year, so that's the impact on the rural deficit.

The rural deficit for the Island Interconnected system customers represents approximately 40 percent of the test year rural deficit. The cost of providing service to Hydro's retail customers on the Island Interconnected system is likely comparable to the cost of providing service to rural areas in Newfoundland Power's system. However, Newfoundland Power does not separately identify costs between rural and urban areas to isolate a rural deficit on their system.

On Hydro's Isolated systems, a lifeline block of energy is provided to domestic customers. The Isolated systems rural deficit is approximately 35.8 million in the 2015 test

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year. The Isolated system deficit also includes revenue deficiency resulting from fish plants in diesel areas being charged Island Interconnected rates, churches and community halls in diesel areas being charged diesel domestic rates, low cost recovery levels from general service customers in diesel areas, and the provision of preferential electricity rates to schools and health facilities.

Customers on the L'Anse au Loup system pay the same rates as customers of Newfoundland Power. The impact of this rates policy on the amount of the rural deficit is approximately 3.6 million dollars in the 2015 test year. This billing practice was approved by the Board in July 1996 following a hearing on L'Anse au Loup rates.

On a number of occasions prior to Order No. P.U. 7 (2002-2003) Hydro made a number of applications to reduce the rural deficit through the phase out of preferential rates. However these proposals have not been accepted for implementation.

Pricing for Hydro rural customers in

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Labrador is also impacted by the Northern Strategy Plan. Order No. 2007-134 requires Hydro to charge rural domestic customers in Labrador Isolated systems a price for the lifeline block equal to that charged to domestic customers on the Labrador Interconnected system. The savings to Labrador Isolated system customers is funded by the Provincial Government and is not reflected in the calculation of the rural deficit.

MR. CASS:

Q. Why has Hydro proposed to change the method of allocation of the rural deficit in the Amended Application?

MR. FAGAN:

A. In its original application, Hydro reflected rural deficit cost of service methodology approved in 1993. In RFI CA-NLH-166, the Consumer Advocate asked Hydro to comment on the fairness of the methodology. Hydro conducted a review of the methodology based on the allocation of the rural deficit reflected in the 2015 test year and concluded that the methodology did not result in a fair

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allocation of the deficit between customers of Newfoundland Power and the customers on the Labrador Interconnected system. The results of the fairness assessment is provided on pages 4.7 to page 4.10 of the evidence to the Amended Application. Jenny, can you bring up Table 1 on page 4.8, please?

So Table 1 summarizes customer impacts and shows the relative impact on a per customer basis. So $653.15 for Labrador Interconnected customers versus $216.64 for customers of Newfoundland Power. So under the existing method, Labrador Interconnected customers would pay approximately $440 per year more than the customers of Newfoundland Power or approximately three times the amount to be paid by the customers of Newfoundland Power.

Now let's look at Table 4.2, please. Table 4.2 provides the impact of the current rural deficit allocation on a revenue to cost ratio for the customers on the Labrador Interconnected versus the revenue to cost ratio for Newfoundland Power. Mr. Brockman seems to consider this table as, in his words,

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"a strange use of revenue to cost ratios". That's from page 202 on the September 29th transcript.

It appears Mr. Brockman was making the statement because both the revenue to cost ratio for NP and Labrador Interconnected are above one. To clarify the table for the Board, the revenue to cost ratios for both groups are above one because the revenue to cost ratio for Hydro rural customers is 0.51. Jenny, can you please bring up Exhibit 13, page three of 109? We need to see the columns on the right. There we go.

So, in column eight, line 15, we see the total revenue to cost ratio in unity, okay. In line 14, the revenue to cost ratio for the subtotal of the Hydro rural is .51. So in this table, there's a 1.13 revenue to cost ratio for Newfoundland Power and a 1.13 revenue to cost ratio for rural Labrador Interconnected. The Newfoundland Power would be in line three and the Rural Labrador Interconnected would be in line eight. So, the revenue to cost ratios do add up to one multiplicably, arrive at a result of one as would be the normal circumstance for revenue to cost ratios.

So, if we go back to Table 4.2, so the revenue to cost ratio there of the 1.42 versus the 1.13 in the previous table for Labrador Interconnected shows the effect of the different methodology of the rural deficit allocation. Whereas the Newfoundland Power one, under the existing method, would be 1.12 becoming 1.13 if you use the revenue requirement method proposed by Hydro.

Ever since the rural deficit was proposed for recovery from rate payers, the revenue to cost ratios have presented in the same manner to isolate the impact of the deficit on each customer group. So the manner in which it is presented here is not a new approach in presenting the impact of the rural deficit to the Board.

MR. CASS:

Q. Why has Hydro proposed to use the revenue requirement method for allocation of the rural deficit?

(11:30 a.m.)

MR. FAGAN:

A. Hydro's test year cost to serve the Labrador Interconnected system is approximately $1561 per customer, based on the 2015 test year. Can we go back to Exhibit 3, page three?

So, in column three, line eight, we see the cost of serving the rural deficit as 18. 1 million dollars. If we divide that by the number of customers in Labrador Interconnected, which is 11,600, we arrive at the average cost I just quoted of 1561 and this compares to the average cost of $1778 of serving each of Newfoundland Power's customers and that's from 463 million dollar cost in column three before the rural deficit. That's on line three, column three, 463.7 million dollars divided by the number of customers Newfoundland Power serves. Now in our evidence on the number of customers we use in response to CA-NLH-166 was 260,771 customers and that was based on the number when we filed in November of 2014.

So the average Hydro cost to serve each Newfoundland Power customer is approximately 14 percent higher than the average cost to serve a customer in the Labrador

Interconnected system. This difference in average cost to serve did not support customers on the Labrador Interconnected system being charged three times the rural deficit as the customers of Newfoundland Power.

Hydro has reviewed two alternatives to the existing methodology, the revenue requirement method and the average cost per customer method. Hydro prefers the revenue requirement method as the deficit allocation approach reflects the average cost of serving both customers on the Labrador Interconnected system and the customers from Newfoundland Power. Jenny, could you bring back Table 4.3 of the evidence, please?

So Table 4.3 shows that under the revenue requirement method, the allocated cost per customer is 236.46 for customers of Newfoundland Power and $207.60 for customers on the Labrador Interconnected system. This difference reflects 14 percent higher average cost to serve Newfoundland Power's customers by Hydro.

Hydro believes the current methodology

does not provide a fair result in cost allocation to the customers on the Labrador Interconnected system. Hydro's proposed approach would allocate on average an additional $19 per year to the customers of Newfoundland Power. This represents an additional 0.7 percent increase for these customers. Under our proposed methodology, the rural deficit will comprise approximately eight percent of the average bill to Newfoundland Power's customers.

Jenny, could you please bring up response to PUB-NLH-081? So we estimate eight percent, so there in line ten of the response, so the rural deficit comprise approximately 12 percent of the total revenue requirement for Newfoundland Power, but for Newfoundland Power's customers, the cost to purchase this from Hydro comprises approximately 68 percent of the total cost, so the percent impact of the rural deficit on the bills of Newfoundland Power under the proposed rates is about eight percent. So the total cost to Newfoundland Power under the Amended Application of the rural deficit would comprise eight percent of

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the cost to their customers.

Hydro considers -- oh, sorry, one other thing. The impact on the customers in Labrador under Hydro's proposed method would be 12 percent of the average bill because Hydro's customers, whereas their retail and directly served by Hydro versus Newfoundland Power, the charges from Hydro are making up 100 percent of their bill. So our proposal is that the rural deficit would comprise 12 percent of the rates for Labrador Interconnected customers and eight percent of the rates for Newfoundland Power's customers.

MR. CASS:

Q. Shifting gears a little bit, Mr. Fagan, can you update the Board on the most recent No. 6 fuel price forecast for 2016 please?

MR. FAGAN:

A. Hydro will be filing a No. 6 fuel price forecast for 2016 next week. The filing of the fuel price forecast is required for the operation of the RSP to determine the fuel rider to be used to update Industrial Customer rates for 2016. I checked with our forecast person on Friday and his new numbers that he's

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got indicate a fuel price, No. 6 fuel price for 2016 of approximately $70 a barrel. So in the Amended Application, it was based on $93 a barrel, 93.32 I believe. So, the $70 a barrel is closer to the price that was used to set retail customers rates in July, the RSP factor. It was $73 a barrel in July.

Jenny, I wonder if you could bring up response to PUB-NLH-485? So, if we go to Table 2 for a moment. So Table 2 was a request from the Board of what's the impact on customers of implementing test year rates if the fuel price that was used to set rates for customers in July, the RSP fuel rider, would have been used for the 2015 test year. So this table is based on the $73 a barrel. So, the most recent numbers would be around $70 a barrel. So, the numbers here are fairly comparable to what one would expect if the Board approved all the test year costs coming out of the GRA, assuming the Board changed the test year to reflect Hydro's No. 6 fuel price forecast that's to be presented next week.

MR. CASS:

Q. Now Mr. Doug Bowman, the expert for the

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Consumer Advocate, has brought up the concept of normalization of the 2015 test year to reflect future load requirements of Vale and Praxair. What are your comments on this?

MR. FAGAN:

A. The proposed firm demand rate, firm energy rate for the Industrial Customers, in combination with the operation of the RSP, are reasonable for recovering the cost of serving the Industrial Customer class for the period of 2015 to 2017. As the Industrial Customer load increases, the new customers will pay increased demand costs as a result of their increased demand requirements. The customers will also pay increased energy charges based on the firm energy rate approved by the Board coming out of the GRA, plus the additional RSP charges to recover additional fuel costs due to their load growth.

Normalization to reflect higher future loads in the allocation of the 2015 test year revenue requirement will result in reflecting future costs of serving Industrial Customers in the current rates. Allocation of a higher proportion of costs to Industrial Customers

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based on 2017 forecast will have the effect of materially increasing the rates to be charged to Industrial Customers and result in over recovering the cost of serving Industrial Customers in both the test year and in future years. The load forecast reflected in the 2015 test year includes Vale and Praxair as high load factor customers and therefore no normalization is required.

We should look at the new undertaking that was circulated this morning. So from a background perspective, what was done here was we kept the total demand requirements on the system the same with respect to the 2015 test year forecast. Then we looked at the 2017 forecast -- I don't know if I said 2015. I should have said 2015 test year forecast. So, we looked at the 2017 forecast then of Industrial Customers and said, okay, what proportion of the demand requirements in 2017 are Industrial Customers, and we took those percentages and applied it to the 2015 total demand requirements. So effectively, restating the 2015 split on demand, system demand, based on the 2017 forecast loads. So the total load in the test year wouldn't change. It would be just a re-sharing of it based on the forecast loads out two years, okay.

So the first portion of the table is the 2015 test year proposed. So, for the Island Industrial Customers, a demand charge of $8.38 was derived. Now with Industrial Customers, we use the unit cost approach for doing rate design. Effectively we run the cost of service study, come up with the average cost of demand and the average cost of energy and that effectively becomes the rate for Industrial Customers. It's not the same way for Newfoundland Power. We've got a demand price which in this particular hearing we've negotiated to be $4.75. The current one is $4. And we have the tail block rate for Newfoundland Power set to reflect the fuel cost for No. 6 fuel coming out of the hearing. So it's not quite the same, but for Industrial Customers there's a unit cost basis for rate design. So the 8.38 reflects the unit cost for the 2015 test year.

So we move over and -- well, I just drop

down there. The Newfoundland Power one would be 10.18 and the Rural one would be $26.51 per kilowatt.

So, let's move over to the middle and we've got the normalized 2015 test year based on 2017 loads. So, by modifying it and modifying the allocators on a percentage basis, we'd end up with a much higher demand revenue requirement to the Island Industrial customers, 11,660,000 versus 8,920,000, which would derive a unit cost for Industrial Customers of $10.95 per kilowatt and Newfoundland Power's would drop slightly and Hydro Rural customers would drop more materially. So it shows the differences in revenue requirement at the last portion of the table. So the Island Industrial Customers revenue requirement on a demand basis would increase 2.7 million dollars, a 30 percent increase in their unit cost.

Just move down a little bit below the table there. There's some text there. So from a -- historically, I believe in every test year I've ever seen that's before the Board on rate design for Island Industrial

Customers and Newfoundland Power's customers, the demand cost, unit demand cost for serving Industrial Customers is generally lower. They've got a higher load factor and their coincidence of their load at time of system peak is less than Newfoundland Power's customers. So generally you'd see the unit demand costs for Industrial Customers being lower than the unit demand cost for Newfoundland Power. So as you can see in this particular example, the unit demand cost is materially higher for the customers, the Island Industrial Customers versus Newfoundland Power. That usually will ring a bell that there's something going on with the test year when you see something like that.

So, the unit -- so, under the normalized approach, if you actually implemented this $10.95, you would be effectively recovering the 2017 costs of demand in 2015 and you'd end up with too high a charge for the test year. And then as the Industrial Customers load ramped up in '16 and '17, you'd have this higher unit cost charge applying to the load growth as well. So you end up effectively

double counting.

Now, if we looked at Undertaking 41 for a moment. I didn't pre-warn you of that one.

MS. GRAY:

Q. That's okay. I can find it.

MR. FAGAN:

A. If we can move down to Table 1 for a moment? So in this particular example, when we look out to the next couple of years, I don't think there's material capacity cost additions on the system. So, energy cost is a difficult table to use in moving out from '15 to '16 because fuel cost is a big cost driver. So you end up changing costs a lot. But on a capacity cost basis for the next couple of years should be fairly stable. So, if we look at the forecast demand billing units for Industrial Customers going out for '15, '16 and '17, and reallocated the revenue requirement based on their demand requirements, you'd end up with fairly stable unit costs for the Industrial Customers. So, that basically, to me, means that as their load increases, they're paying their share because there's stability in the demand charge

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that's coming out of that table.

So, as -- because the new customers coming on the system have similar load factor to the existing Industrial Customers, the demand charge coming out of the cost of service study should be fairly stable from year to year, and so this reallocation of bringing the load back into 2015 test year, that basically conflicts with what one would expect for a rate design perspective.

So, I understand Mr. Bowman's -- Doug Bowman's concern with regard to making sure that the Industrial Customers are paying their fair share, but a reallocation based on bringing loads back from a previous year creates complexities in rate design that doesn't really achieve what the goal is.

MR. CASS:

Q. Mr. Fagan, why would it have been appropriate to make a demand normalization adjustment for Island Industrial Customers for the 2013 test year?

MR. FAGAN:

A. The 2013 test year did not reflect Vale and Praxair as being higher load factor customers.

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Their load ramped up throughout the year. So in the early part of the year, there was effectively no load and late in the year, they had their full -- their highest demand requirement throughout the year. So they didn't have the energy to support a high load factor customer. I know when I looked at the 2013 test year, I actually saw that the average demand cost for the Industrial Customers I believe was higher than the average demand cost for Newfoundland Power, which as I mentioned would be very unusual with regard to rate design.

(11:45 a.m.)

So, what happened with regard to restating IC-140 or the original version of IC-140, the RFI, was that there was an adjustment made to the demand of the Industrial Customers to reflect a high load factor for Vale and Praxair and so reducing the demand from -- I forget the exact number, but reducing it downwards to come up with a reasonable load factor for Industrial Customer in the 2013 test year. So, but the adjustment that occurred at that time wasn't bringing

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back loads from a future year and distorting the allocations in the current test year.

MR. CASS:

Q. Thank you, Mr. Fagan. Now, switching gears again, can you please describe Hydro's proposed approach to recovery of the deficiencies resulting from delayed rate implementation since 2014?

MR. FAGAN:

A. Sure. Hydro's proposed recovery of the 2014 net income deficiency of 45.9 million using the 2014 year end credit balances in the rate stabilization plan. At the end of 2014, there's approximately 33 million dollar credit in the load variation component and approximately 43 million dollar credit in the RSP hydraulic variation component. So, about 73 -- 76 million dollars after the transfer for hydraulic at year end 2014.

Hydro believes using the RSP credit is consistent with intergenerational equity in that it applies funds already recovered from customers to recover costs that have already been incurred to provide service to those customers.

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Hydro has provided details on the allocation of the 2014 deficiency in its cost recovery application filed with the Board in December 2014. The cost of service study filed with the Board with the Application will be required to be updated to reflect the test costs subsequent to the GRA order. Hydro's 2015 cost deferral application filed in July of 2015 indicates a forecast revenue deficiency of approximately 42 million in 2015. The actual deficiency would be finalized at the conclusion of the GRA. However, a large portion of this deficiency can be recovered through the remaining portion of the RSP credit balance just referred to. However a portion may be required to be recovered through future rates.

One other aspect with respect to the rate stabilization plan, with the phase out of Holyrood within the next few years, you're sitting there looking at high credit balances in the rate stabilization plan and the normal disposition of the funds in the hydraulic balance is spread over a four-year period. So, the -- and we're at high water levels

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right now on the system right now, okay, so it's -- the way it works and it's currently operating is that the balances will not reduce. So you're maintaining a credit balance and I don't think that's the preferred approach with respect to trying to recover costs already incurred from customers when you've got these funds set up that have been collected from customers. So I do believe it provides a better match, especially given the short term implications on the rate stabilization right now.

MR. CASS:

Q. And finally, Mr. Fagan, are Hydro's proposed rates based on a 2015 test year appropriate to provide recovery of 2016 forecast costs?

MR. FAGAN:

A. The reasonableness of rates being derived for the 2015 test year to recover 2016 costs will depend on the magnitude of the test year adjustments approved by the Board. Jenny, could you please bring up response to PUB-NLH-487?

So in this response, Hydro provided a forecast return on rate base for 2015 and 2016

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reflecting reduced rate base for the 2015 test year as a result of assets which were scheduled to go into service in 2014 but were delayed into '15. So as a result of delayed implementation of putting these assets in service, the opening balance in rate base in the 2015 test year would be reduced. And the largest of these assets is the Holyrood combustion turbine.

So, response to PUB-487 demonstrates if the capital additions were carried over into 2015 are deducted from rate base for determining rates in 2016, then Hydro's forecast return for 2016 will below the lower end of the proposed return on rate base. We can see in the table the 6.18 percent would be the forecast return. It's my understanding that the 2016 forecast was transposed wrong from response to NP-20, so there's going to be a revision so that 2016 forecast number I believe is 6.46 and that will be filed with the Board today. But the focus of my number is more on the 6.18. So Hydro has proposed a range of return on rate base of plus or minus 20 basis points, so the 6.18 would below the

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bottom end of the range if the 2016 forecast with the assets included would have been 6.46.

It's appropriate that the Holyrood combustion turbine be removed from the opening balance for 2015 rate base. This should impact the Board's determination of revenue deficiency for 2015. However, the Holyrood combustion turbine went into service in 2015, so it appears reasonable to include the asset in rate base for the purpose of determining rate base and establishing customer rates for 2016.

The potential for differing treatments of the Holyrood combustion turbine for cost recovery in 2015 versus rate setting purposes in 2016 is an important distinction. Due to delayed rate implementation until 2016, the Board, when making test year adjustments, should consider separately whether such adjustments are required for determining the 2015 net income deficiency or for determining revenue requirement for rates to go into effect for 2016. In some cases, the same test year adjustment could be required for both years. However, as illustrated in the

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combustion turbine example, under certain circumstances different treatment for 2015 and 2016 may be appropriate.

MR. CASS:

Q. Those are the questions in examination-in-chief, Mr. Chair. Thank you.

CHAIRMAN:

Q. Okay. I understand in respect to cross-examination, we're going to proceed with you, Mr. Luk.

(11:52 a.m.)

MR. KEVIN FAGAN, CROSS-EXAMINATION BY MR. SENWUNG LUK

MR. LUK:

Q. Yes, thank you, Mr. Chair. Mr. Fagan, I'm Senwung Luk, counsel for Innu Nation. Good morning.

MR. FAGAN:

A. Good morning.

MR. LUK:

Q. I believe it's still the morning. So Innu Nation would like to begin by asking you a couple of questions in order to clarify the record on the issue of what the Board knew about where the rural deficit allocation was headed in 1993. So, Ms. Gray, if you could bring up the September 30th transcript, page seven? If you could scroll down so that -- thank you. So, Mr. Raphals on September 30th had opined that, and I quote, "so my understanding" -- and this is line 17, "so my understanding at this point is that what happened in between those numbers may be more or less solid, but any case, they are bookends from '93 to 2001 that do essentially show the same situation prior to the dramatic change in 2002. So unless we learn dramatically different things next week about those costs of your test studies -- sorry, the cost of service studies in the non test years, my understanding remains that the big picture shown by this figure is correct, which is that from 1993 looking forward, the differential was on the order of 50 percent and it's only starting in 2002-2003 that it became much greater."

And this is in -- I end that quote -- and that was in relation to the division of the rural deficit allocation per customer between Labrador Interconnected and NP customers. So, if I could ask you, did you inform Mr. Raphals

subsequent to his testimony that it was your knowledge that the Board maintain the revenue requirement approach to the rural deficit allocation from 1993 through to the next general rate application which in fact took place in 2002?

MR. FAGAN:
A. That's correct.

MR. LUK:
Q. And as far as you know, Mr. Raphals did not know at the time of his giving evidence that the Board had deferred the implementation of the Baker method to the rural deficit allocation until 2002?

MR. FAGAN:
A. No, Mr. Raphals wouldn't. Let me provide more background though.

MR. LUK:
Q. Sure. If I could just -- can I ask you for more background just after -

MR. FAGAN:
A. You go on. You go first.

MR. LUK:
Q. - just after concluding this line of questioning. So Innu Nation just would like

to ask the Board to understand Mr. Raphals comments about the Board's intentions in 1993 in light of the fact that Mr. Fagan has just shared with the hearing here.

So could I ask you now about the source of your knowledge of the Board's decision making process in 1993?

MR. FAGAN:
A. Well, going back to Hydro's GRA prior to the cost of service methodology hearing, okay, so Hydro filed a cost of service study with the Board and it was the first cost of service study filed with the Board reflecting the rural deficit. So, in that particular application, Hydro proposed the revenue requirement approach. The Board determined that the revenue requirement approach should proceed until a cost of service methodology hearing was complete. They specifically approved -- they were satisfied with the revenue requirement approach between Newfoundland Power and the Industrial Customers, but want further review of the approach for sharing with Labrador Interconnected.

So, then the cost of service methodology hearing occurred in 2002 and the Board -- sorry, 1992, and the Board ruled in 1993. Hydro didn't have another GRA until they filed in 2001, I believe. So the 2002 test year was the first time that the cost of service methodology approach proposed by Mr. Baker and implemented by the Board came into effect. So, in RFI -- the Lab West, Town of Labrador No. 55, just move down to the table.

So the numbers provided here between '93, '94, '95, '97 and '99, are based on -- they were cost of service studies that were run between GRAs. So they never impacted customer rates, but the numbers here reflect a methodology that was approved on an interim -- it wasn't actually on an interim basis -- approved by the Board until it had the full cost of service methodology hearing.

So the numbers used by Mr. Raphals reflect the revenue requirement approach. Now, so that was the basis for his numbers. Mr. Brockman was using a different source of numbers and I'm pretty sure it wasn't based on this particular approach, but I don't have the source of his numbers at the time.

MR. LUK:

Q. I believe that the RFI from which Mr. Brockman drew his numbers was NP-PUB-005.

MR. FAGAN:

A. Could we bring that up?

MR. LUK:

Q. If you could pull that up, Ms. Gray? Sorry, PUB-NP-005. If you could scroll down to the bottom of that page? Thank you.

So, Mr. Fagan, as between this table in PUB-NP-005, Table 1, and the numbers shown in Town's question 55, which one would you say is more reliable?

MR. FAGAN:

A. Well, it depends on the purpose, but the rural deficit allocated to and recovered from Labrador Interconnected customers for the years prior to 2002 was zero. It wasn't in customer rates. Mr. Brockman's numbers -- there's a footnote on that 1995. Could we just see what that is? So it's a report -- that's documenting a report to the Board, a report of the Board to the government. It must have been a forecast number, because the

total cost there of $34 million differs from the 1995 number used in the RFI for Towns of Labrador No. 55, which I think was 29 million. So the number, this must have been a forecast number and I anticipate it was probably using the generic methodology that wasn't in place at the time.

(12:00 p.m.)

MR. LUK:

Q. Okay, thank you.

MR. FAGAN:

A. But the number, in any event, the customers weren't paying it, so this was -- it was probably -- it was a forecast that must have been the basis for Mr. Brockman's number.

MR. LUK:

Q. Thank you. And do you have views on whether the Board in 1993 foresaw the ratio of revenue or rural deficit burden per customer as compared to between Labrador Interconnected and NP customers rising to three to four? Well, what's your view of what their intention was?

MR. FAGAN:

A. Just go to response to NP-NLH-407, please. So

this is a question Newfoundland Power asked about whether the Board understood the relative impact of the rural deficit allocation, the 1992 methodology. So, I won't go through it all, but if we could just go to the last part of the response, please. So, there's been a number of changes since the Board's hearings since 1992. So, there weren't uniform rates on Labrador at the time. Labrador Interconnected rates have increased materially since the time when the Board had its hearing. The secondary revenue credit, back in 1992, I don't even think there was a discussion of the secondary revenue credit at the time. The Industrial Customers were also sharing in the rural deficit.

So it's difficult to really assess what the Board was thinking at that time with regard to a view on where we are now, because there's a lot of new information before the Board to consider. So I really couldn't read their mind. I know they were struggling in reading all the documents about what's the best approach because it's not an easy decision for the Board on trying to determine

the methodology for sharing the rural deficit. So I think with a lot of the changes that occurred, I don't know if they could have anticipated that the methodology they approved would have resulted in the Labrador customers paying more than $400 more than the customers on Newfoundland Power's system.

MR. LUK:

Q. To your knowledge, was the revenue -- or excuse me, was the rural deficit burden per customer figure before the Board in 1992/93?

MR. FAGAN:

A. I can't say. I'd be surprised if it wasn't somewhat, but actually I don't recall seeing it.

MR. LUK:

Q. Okay, thank you.

MR. FAGAN:

A. I was at the hearing, but I don't recall seeing it.

MR. LUK:

Q. And you don't remember them discussing it at the hearing?

MR. FAGAN:

A. I don't recall that being discussed, no.

MR. LUK:
Q. Thank you. I'd like to move on to another aspect of the rural deficit allocation and that's the comparison of cost of service between Labrador Interconnected and NP customers. So Ms. Gray, could you bring up on the screen the exhibit that Innu Nation had circulated last Friday for cross-examination of the Rates panel?
MS. GLYNN:
Q. This has been circulated and we'll enter it on the record as Information No. 10.
MR. LUK:
Q. I believe there was a corrected version that was recirculated.
MS. GRAY:
Q. This is Revision 2, Mr. Luk.
MR. LUK:
Q. Should be Revision 3. Is that the one that's on the -- is that the one that's before the Commissioners? That is?
MS. GLYNN:
Q. No, that's not the -
UNKNOWN SPEAKER:
Q. No, that's not the right one.

MR. YOUNG:
Q. Circulated another one.
MR. LUK:
Q. I circulated -- errors in this one were identified to me and it was -
MS. GLYNN:
Q. I'll forward it to you now, Jenny.
MS. GRAY:
Q. Okay, thank you. Sorry, Mr. Luk, just be one moment.
MR. LUK:
Q. That's okay. Thank you. Great, thank you. So, Mr. Fagan, if I could ask you to identify these numbers. As far as you can tell, subject to check, these are figures drawn from the cost of service study that Hydro has put into evidence already, as well as from an answer to an RFI posed by the Towns, in columns one, two and three?
MR. FAGAN:
A. Yeah, the numbers that you've presented there, the $1767 for average cost per customer for Newfoundland Power and the 1561, the 1561 matches what I had mentioned in my opening statement. 1767 was slightly different

because I was using a different customer number with regard to when we prepared the amended application in November. But, yes, I don't have any issues with the table.
MR. LUK:
Q. Okay, thank you. So, and you've heard it suggested here at the hearing that one way of looking at the revenue requirement method for rural deficit allocation is that it's less fair than the Baker method because it imposes higher rural deficit burdens on NP customers who already pay more for their electricity. Are you aware of that argument?
MR. FAGAN:
A. I think that's a fair summary.
MR. LUK:
Q. And what's your -- your understanding of NP rates as paid by the customer, do they include generation, transmission and distribution?
MR. FAGAN:
A. NP rates, Newfoundland Power's customer rates would recover the cost of transmission, generation, distribution, as well as the rural deficit.
MR. LUK:

Q. Right. And for Labrador Interconnected rates as paid by the customer, it also includes generation, transmission, distribution and rural deficit paid by the customer?
MR. FAGAN:
A. That's correct. Now the only thing with respect to the 1767 in this table, it's reflecting Hydro's costs to serve Newfoundland Power's customers, not the overall cost to serve Newfoundland Power's customer, just for clarity.
MR. LUK:
Q. Right. So in the calculation of rural deficit allocation in fact, the cost of service for NP includes only generation and transmission, but not distribution? Is that correct?
MR. FAGAN:
A. With respect to the costs in the cost of service study for Newfoundland Power.
MR. LUK:
Q. Yes.
MR. FAGAN:
A. Yes.
MR. LUK:
Q. Under column one, what's labelled as NP, that

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400 and -
MR. FAGAN:
A. Yes, that's correct.
MR. LUK:
Q. So it excludes distribution costs?
MR. FAGAN:
A. Yes.
MR. LUK:
Q. But the LIS rural figure includes distribution costs?
MR. FAGAN:
A. That's correct.
MR. LUK:
Q. So when we speak of the ratio of NP cost versus Labrador rural cost, in fact, it's not exactly an apples to apples comparison, is it, with respect to the figures used for rural deficit allocation?
MR. FAGAN:
A. Not from a customer perspective, I would say.
MR. LUK:
Q. Right.
MR. FAGAN:
A. So from a customer bill perspective, it's not. Now the numbers here, what we got cost per customer being fairly comparable, there's been a lot - a lot has been said historically about the low rates for Labrador interconnected customers, but, obviously, because of the colder climate, they're using a lot more as well, so the distribution costs plus their higher usage would be contributing to their cost being closer to the average cost per Newfoundland Power customer within the cost of service.

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MR. LUK:
Q. So when you've heard it said that NP customers pay three to four times, or two to three times as much as Labrador interconnected customers in their customer rates, that is referring to the comparison of the rates as paid by the customer on their final bill, and not in the cost of service per customer as used to calculate rural deficit, is that right?
MR. FAGAN:
A. I'd accept that, yes.
MR. LUK:
Q. In fact, when you look at this Exhibit Information 10, when you divide the cost for NP customers cost of service before rural deficit allocation by the number of customers, you get $1,767.00, and when you divide the cost of service before rural deficit allocation for Labrador interconnected customers, you get $1,561.00, and that yields a ratio of 1.13 or so?

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MR. FAGAN:
A. That's right. In my numbers, I get 1.14.
MR. LUK:
Q. So, in fact, another way of looking at the cost of service ratio between NP and Labrador rural is not two to three times as much, but 13 and 14 percent higher?
MR. FAGAN:
A. Yes, and I think that's why in the table in the evidence where it shows the difference between the average cost per customer versus the revenue requirement method, they're fairly close.
MR. LUK:
Q. Is that table in Section 4 of the application?
MR. FAGAN:
A. Yes, Table - let me check for a number. I believe it's 4.3. Yes, Table 4.3 on page 4.10.

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MR. LUK:
Q. So, in fact, under Table 4.3, if you take - under the revenue requirement method of rural deficit allocation, if you take the amount that's allocated to NP customers of $236. 46 and divide that by the amount allocated to Labrador interconnected customers, you get about 13 to 14 percent?
MR. FAGAN:
A. Yes, and that particular number is a 14 percent difference. If the cost of service was the same, you'd end up with the same answer, I think, as the number of customers.
MR. LUK:
Q. Right. I think that concludes our cross-examination of Mr. Fagan.
CHAIRMAN:
Q. I understand now we're over to Mr. O'Brien.
MR. O'BRIEN:
Q. Thank you, Mr. Chair.
MR. KEVIN FAGAN - CROSS-EXAMINATION BY MR. LIAM O'BRIEN:
MR. O'BRIEN:
Q. Mr. Fagan, I just wanted to - you've given us some background of your educational background, I guess. I wanted to ask you if

we could pull up, Ms. Gray, PUB-NLH-138, Revision 2, so we get an idea of where you sit in the organizational structure. Page 5, I believe, that attachment. You're under the Finance Department, is that right?

MR. FAGAN:
A. That's correct.

MR. O'BRIEN:
Q. So you report directly to General Manager of Finance, is that right?

MR. FAGAN:
A. That's correct.

MR. O'BRIEN:
Q. Do you have any, I guess, dotted line reports to anyone in the Nalcor department?

MR. FAGAN:
A. No.

MR. O'BRIEN:
Q. Okay, and you've got a few, I see, individuals that would report directly to you, there's five there in total, is that right?

MR. FAGAN:
A. Let me just review it.

MR. O'BRIEN:
Q. Or has there been a change?

MR. FAGAN:
A. Well, I think the Manager of Regulatory Engineering - I think with regard to regulatory, it may be through me sometimes, but with regard to - there may be also a dotted line to the General Manager of Finance, but it's not presented here.

MR. O'BRIEN:
Q. That would go, I guess, around you to the General Manager of Finance, is that right?

MR. FAGAN:
A. Yeah.

MR. O'BRIEN:
Q. Okay, anyone else - the rest of those individuals, is that right?

MR. FAGAN:
A. There's one new position that we're just hiring, which will be called Interim Regulatory Coordinator, but that position may be reporting to the Manager of Regulatory Engineering.

MR. O'BRIEN:
Q. It's not decided yet?

MR. FAGAN:
A. It's one of those things we're saying maybe

we'll share the load.

MR. O'BRIEN:
Q. Okay, all right.

MR. FAGAN:
A. But it's still in the regulatory group.

MR. O'BRIEN:
Q. Okay, just give me an overview in terms of what your general job responsibilities are?

(12:15 a.m.)

MR. FAGAN:
A. Well, pretty well all applications that are required to go to the Board go through my group at some point. We may not be the originator of all the applications, but - even capital applications is somewhat between myself and the Manager of Regulatory Engineering. It's also the group that goes through the General Manager of Finance. Rate proposals before the Board would go, so the filing of the annual RSP adjustments, anything on rates matters, but also looking forward with respect to preparing for the Labrador-Island interconnection and looking at, okay, is the cost of service methodology that's currently approved by the Board still

reasonable, so planning for future hearings before the Board, and also we got a marginal cost study currently underway. It's somewhat of a team effort with regard to our group and system planning, but with regard to the final product, I think regulatory has a strong influence on it, not with regard to what the results are, but as providing information to the consultants in conducting the study. So that's part of regulatory. The rate stabilization plan, producing the monthly reports for rate stabilization plan, propose any changes for rate stabilization plan. With regard to the timing of general rate applications, I've only been at Newfoundland Hydro since last year, so I wasn't involved in the initial filing, but with regard to planning, we've got a senior regulatory planning - it's a financial planning specialist somewhere, that that person would be looking at what our financial outlook is and the timing of future applications type thing.

MR. O'BRIEN:
Q. Where is that individual?

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MR. FAGAN:
A. The second on the list there.
MR. O'BRIEN:
Q. I see it, okay. My eyes aren't as good as they used to be.
MR. FAGAN:
A. So we've got the - so we're getting more involved with regard to planning, with regard to regulatory proceedings, so that's where we are now. Since I've come over, that's our current outlook.
MR. O'BRIEN:
Q. So since you've been there, has this organization changed in terms of where - your position, was that a new position, Manager of Rates and Regulatory?
MR. FAGAN:
A. No.
MR. O'BRIEN:
Q. No?
MR. FAGAN:
A. No. I think the current General Manager of Finance - well, actually, it's not a change because there was a General Manager of Finance before Carla Russell took that position, and

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so I replaced her as Manager of Rates and Regulatory.
MR. O'BRIEN:
Q. Okay.
MR. FAGAN:
A. So the structure is still the same with regard to regulatory. It's just we added that new position with regard to the financial planning aspect.
MR. O'BRIEN:
Q. You mentioned as well in terms of general rate applications. Were you involved with preparing the amended general rate application after you moved over to Newfoundland and Labrador Hydro?
MR. FAGAN:
A. That's correct, yes, I was.
MR. O'BRIEN:
Q. And did you have any involvement in terms of the decision making around deciding not to proceed with the initial application and the public hearing in July of 2014, and re-filing or filing an amended application, were you part of that decision making process?
MR. FAGAN:

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A. I didn't make the final decision, but I was part of the decision making process, yes.
MR. O'BRIEN:
Q. What role did you play in that regard?
MR. FAGAN:
A. Well, I looked at what was on the table in regard to the proposals and the rates resulting from the proposals, and the time lag with respect to - it was a 2013 test year. We were now in, I believe, the spring of 2014, and so we started reviewing the anticipated results if the Board approved the application and determined that it wouldn't provide a reasonable opportunity to achieve a return going forward.
MR. O'BRIEN:
Q. And were you concerned about the 2014 return at that point, 2013 rates reflecting 2014, or were you looking further out to 2015 being the concern?
MR. FAGAN:
A. Well, we were in the spring of 2014. The hearing was planned for the summer. The earliest when we would have gotten an order, I would think, would have been in late 2014, so

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we would have been sitting looking at a revenue deficiency for 2014 whether we filed an amended application or not. So we looked at it from that perspective. I mean, looking at a go forward basis, we said, all right, so we're not going to have rates for 2014 - our proposal was to have rates for January, 2014, that's not occurring. The earliest we'll probably have rates is maybe January, 2015, so whether the hearing started at that point or not, that was the basis for our application. So when we filed in November, we were hoping that the hearing would be - we'd move along more quickly than the end result has been because we had updated, like, 400 or more requests for information, and put it out there, but there's a lot of other regulatory proceedings on the go at the same time with regard to the outage inquiry and stuff, and I think that's all contributed to a delay. So now it's where we are looking more at '16, but when we looked at the amended application filing in November of '14, we were hoping we would maybe have a hearing over by mid 2015, which we, obviously, were off -

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MR. O'BRIEN:
Q. When you talk about the revenue deficiency then for 2014, I also understand that there's been an application filed for 2015 along the same basis, is that right, that there'd be a revenue deficiency?
MR. FAGAN:
A. Well, the Board approved the interim rates in July of 2015, which actually recovered most of the costs of serving Newfoundland Power for the remainder of 2015. There's still - but for the first half of 2015 because of the delayed implementation because Hydro proposed interim rates in January of 2015 to avoid having a material revenue deficiency for 2015, but interim rates weren't approved until July. So had interim rates been approved in January, we wouldn't be sitting with this large deficiency for 2015.
MR. O'BRIEN:
Q. So you've got a combination there of two factors, I guess, the interim rates not implemented back to January 1, as well as a difference then between what's implemented in interim and what's in the forecast?

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MR. FAGAN:
A. Yes, so the application filed in July of 2015 reflects, I think, a revenue shortfall for '15, I mentioned, of around 42 million dollars. So Hydro filed an amended - not amended, an application, an interim application for deferral account a while back to try and achieve 70 percent of the deficiency recovery until the Board had an opportunity to fully test costs. So that's still outstanding. If that isn't addressed prior to, you know, as we get closer to the year end, we'll have to determine - we may need to amend that application to try and get a higher proportion of forecast revenue deficiency for 2015, but there's been no movement on that at this point.
MR. O'BRIEN:
Q. Will you be seeking an order, I guess, at that time before the end of the year for 2015 on that application?
MR. FAGAN:
A. Yes, we would hope so. It would obviously be interim.
MR. O'BRIEN:

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Q. Interim, sure, and I presume if we don't come into 2016 without an order, would there be a similar application for 2016 pending?
MR. FAGAN:
A. Well, fortunately the Board's approval of Newfoundland Power's rate in July provides, I think, a fairly reasonable recovery of the costs that were reflected in 2015 test year on a go forward basis, so I don't think there would be a large revenue deficiency for Newfoundland Power if rates are delayed being implemented for a month or two into 2016. However, for island industrial customers, it's more of a concern with regard to the rate increase approved for July of 2015 was 10 percent. Hydro is trying to phase in the industrial customer rates fully by September of 2016, and the most recent numbers I've seen is that we would require - what was implemented in July for industrial customers was a 10 percent base rate increase on demand and energy charges, with offsetting RSP surplus amounts to reduce the increase to around 2.7 percent. So the RSP surplus credits, what we're assuming and provided, we

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can probably bring it up, it's response to CA-363, I think, just so we can see where we're sitting. Maybe avoid the question from Mr. Coxworthy. So when we did our phase in for industrial customers, it started back in 2013. So the order 21-2015 is when the Board approved the 10 percent increase in base rates, and then energy charges for the island industrial customers, and the creation of the RSP surplus adjustment to limit the demand and energy base rate increases to 2.7 percent. If we can just move down a little bit there. So the actual ultimate impact on industrial customers with regard to fully phasing in the rates will depend on what fuel price is in the test year. Now I indicated this morning that the current fuel price forecast that we'll be filed next week is in the neighbourhood of $70.00 a barrel, so the response to PUB-485 that we provided will probably be a reasonable impact estimate for the industrial customers. I think we've got an RSP adjustment mentioned. If we could go further to the next page, please. So the Board approved RSP surplus adjustment factors of 49 cents per kilowatt

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and .296 per kilowatt hour for the industrial customers. Having those in play for the remainder of this year would leave about 3 million dollars in the RSP surplus for industrial customers for next year. So modifying those adjustments to dispose of them over the first eight months of next year gets those numbers that were presented here of 93 cents per kilowatt, and the .513 cents per kilowatt hour. So we're assuming that even if the Board didn't have final rates for January 1 of 2016, it would be helpful that we could have interim rates for industrial customer for January 1, 2016, at the same time as you implement these adjustments.

MR. O'BRIEN:
Q. Okay.
MR. FAGAN:
A. And I did some numbers there yesterday or the day before which I think that may be in the neighbourhood of about a 7 percent increase, and then when September comes, I think with the phase out of the RSP surplus adjustments, you'd be more in line with maybe around the 12 or 13 percent increase for industrial

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customers. So that's kind of where you're looking if the Board implemented final interim - final rate for January 1, but if they don't have a final order, I guess they can approve them on an interim basis subject to modification after.
MR. O'BRIEN:
Q. So you might -
MR. FAGAN:
A. And I probably went off track on what your question was.
MR. O'BRIEN:
Q. I think you did, but you back to it in terms of what would happen if there's no final order as of January 2016; you'd have your IC application as well, and you may have to have an interim application for 2016 to cover off any revenue deficiency for that year?
MR. FAGAN:
A. That's correct.
MR. O'BRIEN:
Q. Any other applications that you'd foresee arising out of this general rate application as we go forward? I'm thinking more regulatory outlook here now.

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MR. FAGAN:
A. Not so much as part of the general rate application. We'll be filing - in my evidence, the early section of my evidence talks about the studies, a regulatory outlook, page 4, 4.4.
MR. O'BRIEN:
Q. Yeah. So these are separate and apart from the general rate application?
MR. FAGAN:
A. They're separate from the general rate application, but the - for instance, the marginal cost study is anticipated to be filed this year.
MR. O'BRIEN:
Q. Sure.
MR. FAGAN:
A. That doesn't impact anything with respect to revenue requirements. Then we've also got the rate stabilization plan review and retail rate review plan, as well as the cost of service review, so we're currently in the process of working on those and they'll be filed by mid next year.
MR. O'BRIEN:

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Q. You mentioned the rate stabilization plan review. Any time line on that?
MR. FAGAN:
A. I believe in the settlement agreement, it's no later than mid next year, I think.
MR. O'BRIEN:
Q. And what do you contemplate with that particular one in terms of consultation process, is there a consultation process contemplated?
MR. FAGAN:
A. Yes, for instance, in the marginal cost study, prior to finalizing the approach, we circulated the planned approach to Newfoundland Power to review and it was basically similar methodology was employed back when Emera did it in 2007. So we're looking at a similar methodology for purposes of the marginal cost study that will be filed later this year.
(12:30 p.m.)
MR. O'BRIEN:
Q. And would you be looking at similar sort of consultation process for cost of service methodology as well, or is that something

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different?

MR. FAGAN:

A. Yes, I think - I know when I was involved in the retail rate review that we did over a two year period, it seemed longer, but it's not much longer before it was implemented because we were waiting for Newfoundland Power's checks the next year (phonetic), but we provided drafts - once we finished, we provided drafts for feedback and got feedback from the Consumer Advocate and Newfoundland Power - well, actually we got feedback from the Consumer Advocate, and we actually did focus groups with customers and got feedback from customers before we decided on our final approach on it, so I do certainly agree with all the studies that we're doing, we should involve the parties before we come to a final proposal before the Board. We may no agree on everything, and we'll have to have some issues, I expect, resolved before the Board, but I think it's good to have everybody's input in advance because some things we may be able to agree on, I expect most of them.

MR. O'BRIEN:

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Q. You mentioned the settlement agreement just in terms of timing, I guess, a marginal cost study you're looking at by the end of this calendar year?

MR. FAGAN:

A. Yes.

MR. O'BRIEN:

Q. And the cost of service study by the end of next year, is that right?

MR. FAGAN:

A. I think the cost of service study review - if I had the settlement agree there, but I think it may be the end of the first quarter of 2016 for our filing of a report.

MR. O'BRIEN:

Q. Okay, and we heard some mention last week in terms of the status of first power out of Muskrat Falls. That doesn't impact you in terms of those particular studies, does it, in terms of the timing?

MR. FAGAN:

A. No.

MR. O'BRIEN:

Q. There's no delay anticipated or anything like that as a result of that?

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MR. FAGAN:

A. No.

MR. O'BRIEN:

Q. Okay. We were talking earlier about the revenue deficiency. I wonder if you could take me through - this is the 2014. If we could turn to Table 3.1, page 3.7.

MR. FAGAN:

A. You may be looking for a punt (phonetic) there.

MR. O'BRIEN:

Q. You're asking for one already. Page 3.7, this is a breakdown of - some breakdown of the figures, I guess, in terms of the revenue deficiency. Did you have any involvement in the break out of the figures?

MR. FAGAN:

A. I participated in the application for the supply cost revenue. It's referred to the supply cost revenue deficiency, and there's a 9.7 million dollars associated of additional supply cost incurred in the spring of 2014 with respect to - this is part of the Prudence Review. I was involved with regard to development of the application for recovery of

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that, but I wasn't involved in deriving any of the other numbers.

MR. O'BRIEN:

Q. So that would fall in the power purchases, would it, under that?

MR. FAGAN:

A. No, no, right at the bottom.

MR. O'BRIEN:

Q. No, no, sorry, above that. You're talking about the 10 million supply?

MR. FAGAN:

A. That's correct.

MR. O'BRIEN:

Q. In terms of the break out of these, the revenue deficiency dollars then that we're talking about, you are really here to talk about the method of collecting them, is that right, as opposed to the calculation?

MR. FAGAN:

A. That's correct, yes.

MR. O'BRIEN:

Q. Well, the method - in terms of collecting them, would you agree with me that these figures here are still subject to review by the Board in terms of whether or not they're

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prudently - the costs are prudently incurred, whether or not there's proof of requirement for recovery, that sort of thing, no guarantee?

MR. FAGAN:

A. Well, the Prudence Review is on some specific aspects of the 45.9, is my understanding, but all the costs are obviously before the Board for review.

MR. O'BRIEN:

Q. Okay, so ultimately in terms of how much gets recovered, then you would take a look then, and your evidence deals with how we recover it?

MR. FAGAN:

A. Yes, and in the cost recovery application filed in December, 2014, we filed a cost of service study based on our forecast cost reflected in derivation, okay.

MR. O'BRIEN:

Q. Right.

MR. FAGAN:

A. And tried to determine the sharing of it, effectively. So once the Board ruled and determined what the revenue deficiency would

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be, we run that to determine the sharing of the deficiency identified by the Board because you've got the total amounts, determine how much is associated with rural, how much is associated with the industrial customers, and how much would be recovered from Newfoundland Power.

MR. O'BRIEN:

Q. Okay, and I'm going to ask you in terms of the method of collection then, I believe from reading the evidence and from listening to you, your proposal or Hydro's proposal is to collect the revenue deficiency through the RSP?

MR. FAGAN:

A. That's a high level description, but to do it fairly, we'd look at the balances in the RSP, the industrial customer portion versus Newfoundland Power customer portion, and only be using the portions that are attributable for Newfoundland Power versus industrials for recovering the costs due from each party. So you'd split it. For example, I mentioned the 33 million dollars that's in the load variation balance, credit balance currently.

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The Board hasn't ruled on the sharing approach for that yet. The load variation component accumulated the large amount that was dealt with by the government effective August 31st, 2013. So the government directive determined the split of those funds, but there's still - because industrial loads remain below the 2007 test year forecast up to the end of 2014, then there's been additional savings, and that's the additional savings we're talking about. So the Board needs to rule on a disposition of those savings. So what Hydro is proposing is that the disposition of the savings be on an energy basis consistent with what's been settled in the agreement on a go forward basis, assuming the load variation component remains in place. So that's what Hydro would be proposing, so Hydro would have taken that 33 million and we'd -

MR. O'BRIEN:

Q. Share it on the basis of energy ratio?

MR. FAGAN:

A. Share it between the parties on the basis of energy, and so we'd break out the RSP funds by party, and then look at the cost of service

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allocation by party, and see where we are with regard to matching our credits against our costs.

MR. O'BRIEN:

Q. Okay, and then there's another hydraulic portion of the RSP as well?

MR. FAGAN:

A. Yes, which is also allocated on an energy basis as well.

MR. O'BRIEN:

Q. So you'd be looking and using both of those to the extent necessary in 2014, and I take it whatever is remaining in 2015 as well?

MR. FAGAN:

A. Yes, and you may notice that I haven't mentioned balances in the RSP in 2015. Well, 2015, being a test year, when the Board determines rates from 2015, we effectively - we run the RSP reflecting those 2015 rates and costs, so if the Board approves us fuel costs, our fuel costs price, and our forecast of hydraulic for the year, we'd effectively have to rerun the 2015 RSP to make sure that the rates coming out for 2015 are reflective of the RSP because they work hand in hand. So

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when I'm looking at this position of balances, I'm only looking at the balances at the end of 2014.

MR. O'BRIEN:
Q. Okay, so there may be a difference depending on what the ultimate figures coming out of the Board in terms of the test year might be?
MR. FAGAN:
A. Yes, there will be balances in the RSP for 2015, but it's difficult to determine what they are at this point. For instance, the normal hydrology that's used in the RSP currently is based on the 2007 test year. So when we're running the RSP, the hydraulic normal is now higher than it was, say, in 2007, so the credits going to and fro won't be exactly the same -
MR. O'BRIEN:
Q. Will be different, yeah.
MR. FAGAN:
A. As the interim reports that are being produced each month for 2015.
MR. O'BRIEN:
Q. Okay, and in terms of the Labrador interconnected system and any other

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contribution with respect to the revenue deficiency, that would be recovered by a rate rider, is that what - anyone who doesn't contribute to the RSP?
MR. FAGAN:
A. I'd say, yes. The only complicating factor within the RSP is that there's certain - it's called a rural rate adjustment, okay, within the RSP, and the rural rate adjustment was implemented probably '91, but the purpose of the rural rate adjustment was because Newfoundland Power's customers were paying the rural deficit, Newfoundland Power would have rate increases between Hydro's test years, and so the additional funds from those rate increases could go to Hydro, and could have contributed to income, but because Newfoundland Power's customers were paying the rural deficit, it was viewed as fair to transfer those funds back to Newfoundland Power's customers, so the additional revenue as a result of Hydro rate increases for rural to offset somewhat the effects of the customers paying the rural deficit. So this rural rate adjustment, when we do it within

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the rate stabilization plan, a portion of the rural rate adjustment goes to Labrador customers too, and it's written off, so if there was a savings that was being credit back, a small portion of that, for example, I think in a revenue requirement approach, if the Board approved that for rural deficit, say, 3.6 percent, say, of whatever the funds that would have been allocated to Newfoundland Power through the rural rate alteration would go as a conceptual credit to Labrador interconnected. If that was fairly close to an outstanding amount for Labrador interconnected, it would probably be fair to apply it against it, but in general, I accept it will be a rate rider.
MR. O'BRIEN:
Q. So otherwise if it's not, then if they're the same, you'd have an offset?
MR. FAGAN:
A. Most people would get lost in that description, so I'm not concerned if anyone crossed -
MR. O'BRIEN:
Q. I think I followed you. Just in terms of -

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let's jump to the rural deficit, Mr. Fagan, you weren't involved with Hydro's filing in 2013, obviously, the initial application, is that correct?
MR. FAGAN:
A. That's correct, yes.
MR. O'BRIEN:
Q. I'm just wondering in terms of the initial application, the rural deficit was allocated on the basis of the method proposed by Mr. Baker in '92, is that right?
MR. FAGAN:
A. That's correct, method approved, yes.
MR. O'BRIEN:
Q. The unit cost method. I guess, the mini cost of service method, I guess, he phrased it, is that right?
MR. FAGAN:
A. That's how he referred to it.
MR. O'BRIEN:
Q. He referred to it, I believe, as a commodity approach, and Dr. Feehan had his own comments on that. I'm just wondering whether or not you're able to tell us in your position now at Hydro, whether Hydro had a concern in 2013 in

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filing the initial application, over whether or not this amount was being allocated fairly, because I don't see any indication in the 2013 application of a concern raised by Hydro about the fairness of the allocation approach?

MR. FAGAN:

A. Yes, it's my understanding that Hydro filed the original application based on the Board's original method, and never did a fairness assessment of the approach.

MR. O'BRIEN:

Q. What do you mean in terms of doing a fairness assessment?

MR. FAGAN:

A. Let's go to responses CA-NLH-166, please. So the Consumer Advocate asked the question, "To comment on the fairness of using the method today versus 20 years ago".

MR. O'BRIEN:

Q. Uh-hm.

MR. FAGAN:

A. So that request - when I reviewed that request, I thought it was appropriate to do a thorough review of the fairness of the approach.

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MR. O'BRIEN:

Q. And Hydro didn't consider in filing the application first off whether or not it was a fair approach?

MR. FAGAN:

A. Well, I think -

MR. O'BRIEN:

Q. I'm just trying to get a sense of -

MR. FAGAN:

A. Well, Hydro doesn't review every cost of service aspect usually in filing its general rate application in that cost of service methodology has been approved for years, and so Hydro filed its methodology in accordance with it. There were some new items that came into the cost of service, such as wind purchases, maybe purchases from Nalcor Energy, which were new, so they would have had to make a judgment call, and I assume they would speak to Mr. Greneman on the approach to doing the cost of service for new items, but with regard to existing costs that were already approved, there was - I'm pretty well sure there was no proposals for any changes, so there was not a review conducted on all aspects of the cost of

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service methodology prior to filing the original application.

MR. O'BRIEN:

Q. So Hydro didn't consider whether or not the Labrador interconnected system customers were paying too much towards this allocation when they first filed, didn't even take that into consideration?

(12:45 p.m.)

MR. FAGAN:

A. Hydro filed its application in accordance with the method approved by the Board.

MR. O'BRIEN:

Q. Okay, just take me through historically how the allocation ultimately found its way into rates for the Labrador interconnected system?

MR. FAGAN:

A. Okay, so Hydro had filed a response. I think you can probably bring it up - maybe the original response to CA-NLH-166.

MR. O'BRIEN:

Q. Okay, we're looking at Revision 3 here.

MR. FAGAN:

A. And I think the bottom of the response - one moment. So Hydro's position originally was,

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"Based on the Board's reasoning in arriving at a decision on the allocation of the rural deficit, there will be no basis to believe that there should be a concern on the fairness of using this method versus 20 years ago". So when I moved to Hydro, and I reviewed this RFI, I didn't think that was - really to answer the question, because the question was for a review of the fairness of it, so we undertook to review the fairness based on my direction -

MR. O'BRIEN:

Q. I understand that. I guess, I'm trying to get an idea -

MR. FAGAN:

A. That was the first step.

MR. O'BRIEN:

Q. Okay, all right.

MR. FAGAN:

A. So then we refiled responses to CA-NLH-166, which did the fairness assessment. This was still while we were using the 2013 test year, okay, and so then when we filed, we - in our response to CA-NLH-166, we effectively recommended changing the approach based on the

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fairness assessment. So when we refiled our application, then we incorporated that into the amended application.

MR. O'BRIEN:

Q. Okay, and I think that we were on different wavelengths here, I think, in terms of the question.

MR. FAGAN:

A. Oh, I thought that was what you wanted.

MR. O'BRIEN:

Q. That's okay. I think what I'm sort of looking at is the history before the 2013 test year, so how - and you spoke about this earlier a bit, how the allocation to Labrador interconnected systems wasn't imposed into the rates, I don't think, until GRA of 2001, is that right?

MR. FAGAN:

A. 2002, it was implemented.

MR. O'BRIEN:

Q. 2002, sorry, in that order, and at that point in time would their rates have reflected the full allocation of the Baker method, let's say?

MR. FAGAN:

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A. Well, I know in the 2002 hearing, there was 5 million dollars - the 2001 hearing for 2002 test year, I believe, there was 5 million dollars allocated to Labrador interconnected. There was 3.7 million dollar credit from CFB secondary to reduce the impact on Labrador interconnected customers at that time.

MR. O'BRIEN:

Q. So that was used at that time to reduce the impact for Labrador interconnected customers?

MR. FAGAN:

A. Yes.

MR. O'BRIEN:

Q. What happened after that then, just take us through sort of -

MR. FAGAN:

A. Just give me a second.

MR. O'BRIEN:

Q. Yeah.

MR. FAGAN:

A. So the Board implemented rates with a credit effectively. Then Hydro came in for the GRA again and applied the 2006/2007 test year. At the same time as trying to, I guess, phase in the rural deficit, the Board was also trying

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to merge - they had approved a merger over the rates between Lab East and Lab West, okay, so there was a five year plan put in play, and the rates changed each year then from 2007 to 2011, until the Labrador rates were merged into the single class. At the same time, the amount of funding from the CFB Goose Bay credit was reduced each year until the full 2007 test year portion - the full 2007 rural deficit amount would be reflected in the rates in 2011.

MR. O'BRIEN:

Q. Okay, so by 2011 then we've got a situation where the full amount of the rural rate is reflected in rates now for -

MR. FAGAN:

A. Just the cost up to 2007, though, because it wasn't reflecting the new costs from '07 to '11.

MR. O'BRIEN:

Q. No, okay, and there is a difference, obviously, from 2007 to 2011, but in terms of the impact as of 2007, then the Labrador interconnected system customers would be seeing that full effect by 2011?

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MR. FAGAN:

A. That's right, and this the first hearing before the Board that we've actually had the merger in rates. We've got the industrial customers no longer paying the rural deficit, and the CFB credit is materially reduced now. It used to be around 4 million dollars. I think in the current application, it might be $982,000.00 credit, something like that. So there's a much smaller offset now, and, of course, the Board approved that the CFB credit become a credit against the rural deficit itself, not a credit to Labrador customers as a reduction of their bill impacts, so now it's going into the pot and benefiting both customers in Labrador as well as the customers of Newfoundland Power.

MR. O'BRIEN:

Q. So as of 2011, that's all in place, the rural deficit is now benefiting Newfoundland Power - sorry, the subsidy is benefiting Newfoundland Power's customers as well as Labrador interconnected customers, and all are paying their share towards the rural deficit?

MR. FAGAN:

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A. Well, I don't know if I accept your last statement, dropping the approved rates that would have been approved for 2007, including the rural deficit.

MR. O'BRIEN:

Q. Right, with that caveat, because it might have changed from 2007 forward?

MR. FAGAN:

A. Yeah, but I was more concerned about what you called their share because that's one of the reasons we're in dispute -

MR. O'BRIEN:

Q. Oh, no, I'm not - I get your point, but in terms of the Board approved allocation share?

MR. FAGAN:

A. That's right.

MR. O'BRIEN:

Q. Okay, so by this point in 2011, everyone is paying their Board allocated - Board approved allocated share, is that right?

MR. FAGAN:

A. That's correct. So with the 2013 application then, the real change at that point in time is a change in the cost to serve the Labrador interconnected customers, is that right, from

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2007 there's a big change in the cost to serve those customers?

MR. FAGAN:

A. If you assumed that the rural deficit methodology remained the same as approved in '92, there was a large increase proposed for customers on the Labrador interconnected system, I believe it was 28 percent.

MR. O'BRIEN:

Q. Yeah, but that's - there's also an increase in cost of serving those customers as well, right?

MR. FAGAN:

A. All else staying the same, the increase in cost of the 28 percent would have been driven by other cost increases.

MR. O'BRIEN:

Q. Yes, so there are other cost increases?

MR. FAGAN:

A. Oh, yes.

MR. O'BRIEN:

Q. This is not just - we're not just talking about the rural deficit?

MR. FAGAN:

A. Well, for purposes of cost of service, we're

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just talking about the rural deficit. For purposes of the ultimate rate change to customers, it's rates to recover full costs.

MR. O'BRIEN:

Q. And was Hydro concerned at that point in time in filing the initial application - sorry, the amended application, in looking for a way to offset the increased cost to Labrador interconnected customers, and -

MR. FAGAN:

A. Well, I don't think so.

MR. O'BRIEN:

Q. And that this rural deficit methodology was a way to offset those increased costs?

MR. FAGAN:

A. Well, if that was the case, I think Hydro would have filed its original application in 2013. They could have filed that based on change in the rural deficit allocation methodology and got rid of the decrease. To me, that increase seemed to be fairly transparent and in the review presented in our evidence, it's quite clear that the impact was 27 or 28 percent, so it's not like Hydro has been trying to hide the percentage change

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relevant to the existing methodology versus the proposed methodology.

MR. O'BRIEN:

Q. No, I'm not suggesting that. I'm just suggesting that there is an offset now, there's a - so how much are we talking in terms of the change from one methodology to another? We're talking about 4.5 million dollars that goes from one group to the other if we change it, is that right, something in that range?

MR. FAGAN:

A. Sounds reasonable, subject to check.

MR. O'BRIEN:

Q. Yeah, so were the methodology to remain in place, Labrador interconnected customers would be paying 4.5 million dollars more towards the rural deficit?

MR. FAGAN:

A. That sounds about right because it's about 4.5 million dollars divided by 11,000 customers gets you around the $440.00 per customer.

MR. O'BRIEN:

Q. Yeah.

MR. FAGAN:

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A. Additional deficit of one method versus the other, so I think that sounds reasonable.

MR. O'BRIEN:

Q. And by changing the method now, we put 4. 5 million dollars back onto the Labrador interconnected systems ledger, and that offsets the cost of increasing their - the increase in cost of service from 2007 to 2013, doesn't it, or 2014?

MR. FAGAN:

A. Just one second now. I'm just checking because I don't want to misstate anything. Yes, the proposed increase would have been 27.8 percent for Labrador interconnected, and under the change in methodology, it's now 2. 1 percent.

MR. O'BRIEN:

Q. Right, so there's an offset there. By changing that methodology, you offset the cost?

MR. FAGAN:

A. Yes.

MR. O'BRIEN:

Q. Not completely -

MR. FAGAN:

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A. Certainly reduce the rate increase proposed.

MR. O'BRIEN:

Q. Yeah.

MR. FAGAN:

A. Because from our perspective, the rate increase proposed is materially impacted by the rural deficit methodology as well.

MR. O'BRIEN:

Q. Did Hydro consider any other options to offset those costs, like, a phase in for increased costs as opposed to changing the methodology in the rural deficit allocation?

MR. FAGAN:

A. When Hydro filed its application in 2013, it was proposing approximately 28 percent. Hydro's was requested to review the methodology from a fairness perspective, so Hydro completed the review and determined that the current approach wasn't reasonable. So when Hydro changed the approach to what we thought was reasonable, the rate increase changed from the 27.8 percent to 2.1 percent. I think the cost of service methodology needs to be reasonable, so I don't see it was a way to get rid of the 28 percent increase.

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MR. O'BRIEN:

Q. You don't see it that way?

MR. FAGAN:

A. That's certainly not the reason it was done.

MR. O'BRIEN:

Q. Okay, was there ever any options considered in terms of phasing in the 27.8 percent? Is that a possibility as opposed to looking at the allocation of the rural deficit?

MR. FAGAN:

A. From Hydro's perspective, the 27.8 percent increase was reasonable because after our fairness review, we determined that the rural method allocation methodology wasn't reasonable, so I didn't see any reason to propose a phase in of a rate increase that wasn't reasonable.

MR. O'BRIEN:

Q. Well, from the initial filing in 2013, there was going to be a 16 to 27 percent increase, something in that range, is that right?

MR. FAGAN:

A. Yes, and when Hydro filed that, Hydro didn't propose any phase in.

MR. O'BRIEN:

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Q. No, okay, and why is that?

MR. FAGAN:

A. I wasn't there.

MR. O'BRIEN:

Q. You weren't there?

MR. FAGAN:

A. No.

MR. O'BRIEN:

Q. But you're speaking about the application. You're here to testify about the application. Can you tell us that?

MR. FAGAN:

A. If Hydro had - so is the question, if I was there?

MR. O'BRIEN:

Q. I'm not asking if you where there. I'm asking Hydro's position on it. If you don't know the position -

MR. FAGAN:

A. I believe there's an RFI response which indicated that Hydro reviewed whether there were other methods of recovering the 28 percent increase, and determined that there were no other methods available unless you basically increase rates from other customers.

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So if you're going to phase in, unless Hydro decided to take a reduced rate of return to allow lower rates for the Labrador interconnected customers, Hydro viewed no alternatives to recovering the cost other than proposing recovery from the Labrador interconnected customers. I'm pretty sure that was Hydro's position when it filed its original application.

MR. O'BRIEN:

Q. And that was the only alternative was to look at the allocation of the rural subsidy?

MR. FAGAN:

A. I don't think I said that. That actually wasn't the basis for reviewing the rural subsidy. The consumer advocate requested that Hydro review the fairness of the rural subsidy, and based on the review of the fairness of the rural subsidy, we determined that the methodology didn't provide a fair result.

MR. O'BRIEN:

Q. Okay.

MR. FAGAN:

A. So Hydro proposed a change in methodology.

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(1:00 p.m.)

MR. O'BRIEN:

Q. Let's have a look at your proposals then. You've got two proposals. The first one was the revenue requirement method that you indicated. So, that method--and you indicated that you were at the Generic Cost of Service Hearing in '92, was it?

MR. FAGAN:

A. I wasn't on the stand, but I was there.

MR. O'BRIEN:

Q. You were there, okay. And I take it you've reviewed the Board's report following that hearing?

MR. FAGAN:

A. Yes.

MR. O'BRIEN:

Q. And that revenue requirement method was proposed at that time by Hydro.

MR. FAGAN:

A. The revenue requirement method was proposed at that time, yes, that's correct.

MR. O'BRIEN:

Q. And it wasn't accepted by the Board at that point as a reasonable method.

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MR. FAGAN:

A. In the 1991 hearing the revenue requirement method was initially proposed and the Board determined it was reasonable for sharing between Newfoundland Power and industrial customers, but wanted it further looked at, what's the appropriate approach for the sharing between Labrador interconnected and Newfoundland Power. So, that approach was approved, to remain in play until after the cost of service methodology hearing and the new method that was implemented which wasn't until 2002 which wouldn't have been anticipated at that point, wouldn't have been that far out, but yes, the revenue requirement method was proposed by Hydro in the 1992 cost of service methodology.

MR. O'BRIEN:

Q. And it wasn't accepted by the Board ultimately as being an appropriate approach. You indicated that it was accepted earlier on an interim basis, I believe, in terms of -

MR. FAGAN:

A. Yes, interim is probably not the technical/legal term. They approved it for Newfoundland Power--sharing to Newfoundland Power and industrial customers, but they wanted a further--and they approved it for Labrador interconnected customers until a further order of the Board, I expect, on a perspective basis.

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MR. O'BRIEN:

Q. Okay. So, they do so for all customers really until the full review could be done in the generic cost of study.

MR. FAGAN:

A. The concern was about the sharing between Labrador interconnected. Newfoundland Power had Mr. Brockman as a witness at that hearing and he was, in summary, presenting the position that because Labrador interconnected customers had lower rates, they would be receiving too much of a benefit or in the other way around he'd say because Newfoundland Power's customers had higher rates, it was unfair to allocate more costs to Newfoundland Power's customers.

MR. O'BRIEN:

Q. Okay.

MR. FAGAN:

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A. That was in the 1991 hearing.
MR. O'BRIEN:
Q. That was the '91 hearing?
MR. FAGAN:
A. Yes.
MR. O'BRIEN:
Q. Okay.
MR. FAGAN:
A. He didn't change his proposal between the '91 hearing and the '92 cost of service methodology. He followed the same proposal.
MR. O'BRIEN:
Q. Okay.
MR. FAGAN:
A. The 50 percent energy and -
MR. O'BRIEN:
Q. Yes, and ultimately the Board didn't accept any of those proposals; went with the method proposed by Mr. Baker.
MR. FAGAN:
A. That's correct.
MR. O'BRIEN:
Q. I want to ask you about your Table, 4.2. I guess it's at page 4.9. I just have a couple of questions on that. Did you prepare that table, Mr. Fagan?

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MR. FAGAN:
A. Well, it would have been under my direction.
MR. O'BRIEN:
Q. Okay. And it comes out the cost of service study, is that right, those figures?
MR. FAGAN:
A. It would have come out of the cost of service study, if the existing methodology had applied in the 2015 test year.
MR. O'BRIEN:
Q. You mentioned in your direct about a problem Mr. Brockman had with the table.
MR. FAGAN:
A. Yes, I quoted his transcript.
MR. O'BRIEN:
Q. Can you just refer me back to what the problem was that you had with what Mr. Brockman had said.
MR. FAGAN:
A. Yes, in the transcript, on September 29, Pg. 202, lines 21 to 22. So, on lines 21 to 22, "so I'm saying these are strange usage of revenue to cost ratios. It's sort of outside of the way we normally do things in a cost of service study."

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MR. O'BRIEN:
Q. And what did you understand him to mean by that?
MR. FAGAN:
A. I understand him to mean that because both of the numbers in the table were above 1, he was saying, normally if you look at a cost of service study, you'd see revenue to cost ratios above one and below one. So, you'd end up with a unity cost of service in total.
MR. O'BRIEN:
Q. That's if you see all the players that are on the system, you would see that?
MR. FAGAN:
A. That's right.
MR. O'BRIEN:
Q. Okay. Mr. Brockman also indicated that he had a concern with these figures that the cost was not put in the denominator and the numerator, in terms of calculating that figure. So, if you decide that here's what the subsidy allocation is, you would put that in the denominator and the numerator, so ultimately you would have one for each party, is that right?

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MR. FAGAN:
A. Well, for transparency, what Hydro has done for every cost of service study in a test year since 1992 or since 2002 when the rural deficit went in under current methodology, it's shown the revenue to cost ratio keeping the rural deficit as a separate item. So, if we go to page 3 of 109 of Exhibit 13. So, in Hydro's proposed cost of service study which would be based on the revenue requirement approach, you can see the revenue requirement for--the revenue to cost ratio in column 8 for Newfoundland Power which would be 1.13, that's line 3. Line 8, the revenue to cost ratio for rural Labrador interconnected 1.13 and the rural deficit area, the subtotal which would be 0.51 and then the total revenue to cost ration of 1.0. So, I mean, if you wanted to put--make--restate (phonetic) Table 4.2, you could put 0.51 below 1.42 and the 1.12 and you'd end up with a unity revenue to cost ratio. So, I don't think there's any misrepresentation -
MR. O'BRIEN:

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Q. No, I'm not suggesting that. I guess Mr. Brockman's main concern was, is that the reason you've got a 1.42 and a 1.12 has to do with the cost base for each one of those groups.

MR. FAGAN:

A. Yes, I understand, but if you look at the text introducing Table 4.2 and what the evidence is doing and this is consistent with the response to CA-NLH 166. This is a fairness review. So, we're assessing the impact of the rural deficit on customer rates for Newfoundland Power and customer rates for the Labrador interconnected system. So, you needed to isolate the effect of the rural deficit. So, Table 4.2 isolates the effect of the rural deficit on the customers of Labrador interconnected and the customers of Newfoundland Power. So, that's what the purpose--the purpose wasn't to try and confuse anyone with respect to revenue to cost ratio. I think it achieved the purpose with regard to isolating the effects on the customers.

MR. O'BRIEN:

Q. But it shows the effects based on the fact

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that they have different cost basis, is that right? That's why it's 1.4 for Labrador interconnected because their cost base is much lower than Newfoundland Power's customers, isn't that right?

MR. FAGAN:

A. I wouldn't agree. I think if we look at the exhibit presented by Mr. Raphals. I think it was presented to me by Mr. Luk with regard to the average cost per customer. Could we bring that back up please? So, in column 4 the average cost of serving Newfoundland Power and it's slightly the same number of customers as mine, but in general, fairly close, okay, the average cost per customer in Mr. Raphals' table would be 1767. For Newfoundland Power's customer, that's Hydro's costs, versus the Labrador interconnected system, it's 1561. So, the cost per customer, in this particular, is about 13 percent different, of Hydro's cost attributable to Labrador interconnected customers versus Newfoundland Power's customers, if you use the full population of Newfoundland Power's customers in driving the cost.

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MR. O'BRIEN:

Q. But in terms of the cost base, Newfoundland Power's customers have a higher cost base than Labrador interconnected customers. I believe you're testimony was a 14 percent difference.

MR. FAGAN:

A. Yes.

MR. O'BRIEN:

Q. So, there is a 14 percent difference.

MR. FAGAN:

A. Yes, 14 percent difference and that's similar to this table and that's a 13 percent.

MR. O'BRIEN:

Q. And one of the problems the Board had in '92 with using the revenue requirement method was it doesn't have the same cost base among each one of these groups.

MR. FAGAN:

A. At the time rates were a lot different as well, okay. The rates for Labrador interconnected customers, I believe, may have been close to 1/3 of where they are now. I thought they were slightly above a cent on domestic at the time. So, their rates have increased materially. Also the fact that they

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use a lot more because they are in a colder climate. So, there's been a fair shift with regard to the overall cost to serve Labrador interconnected customers now compared to what it would have been in 1992. And, of course, that's the truth as well for Newfoundland Power's customers, the cost to serve is much higher now than it was in 1992. In 1992, I believe the cost per barrel of number 6 (phonetic) fuel is about 12.50. So, overall costs have increased for both parties. I'd say the comparison of the average cost to serve per customer is a lot closer now than it was back in 1992.

MR. O'BRIEN:

Q. Than it was back then. But it's still a higher cost base for Newfoundland Power's customers.

MR. FAGAN:

A. Oh yes, it is.

MR. O'BRIEN:

Q. And that was a concern for the Board with using the revenue requirement method. You're not comparing apples to apples. If we were on the same system, it would be different.

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MR. FAGAN:
A. Well, in the Board order in--or Board referral to the government in 1991 the Board considering the revenue to costs ratios, I believe. And one of the arguments against Mr. Brockman's method at that time was that the revenue to cost ratio for industrials would have been slightly higher than the revenue to cost ratio for Newfoundland Power, if you use anything other than a revenue requirement method. And there's different costs, average costs of serving industrial customers as it is, as well as Newfoundland Power's customers, their average cost is lower. So, I don't view the fact that they got a different average cost necessarily a negative against using the revenue requirement method.
MR. O'BRIEN:
Q. One of the things the Board raised as a concern with the revenue requirement is that it would, as Mr. Luk had indicated, it would, by using that method, appear to saddle certain classes with higher allocation on the basis that they already pay a higher cost of service. Is that right?

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MR. FAGAN:
A. I'm not sure. You'd have to point me to what was said so I can make sure I get it in context.
MR. O'BRIEN:
Q. Well, would you agree with me that what you're proposing here is that you apply a 14 percent difference in cost base on a normal cost of service to the revenue requirement method so that they pay 14 percent higher, sorry, to the allocation, so they pay 14 higher on the allocation as well.
MR. FAGAN:
A. Well, what we're proposing is that we take--we got the total revenue requirement between Newfoundland Power and Labrador interconnected and we say, okay, what portion of the revenue requirement is Newfoundland Power and what proportion of the revenue requirement is Labrador interconnected. And we take that proportion and apply it to the rural deficit to determine the proportion that would be recovered from Newfoundland Power's customers versus the proportion that would be recovered from Labrador interconnected customers.

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MR. O'BRIEN:
Q. And you've already stated that there's a 14 percent difference on the normal cost of service between one system to the other, is that right?
MR. FAGAN:
A. The average cost per customer is about 14 percent difference, yes.
MR. O'BRIEN:
Q. So, you're going to apply that then to the allocation as well, so because -
MR. FAGAN:
A. That's the effect of allocating on a revenue requirement method, that's correct.
MR. O'BRIEN:
Q. Right. Okay. And that was a concern that the Board had in '92, that didn't appear fair to Newfoundland Power's customers.
MR. FAGAN:
A. I don't know, I'd have to see what they said with respect to accepting your conclusion.
MR. O'BRIEN:
Q. Well, maybe I can refer you to that. If we go to PUB NLH 113, attachment 1, page 64. If we scroll up, yes, okay, page 64 up top. No, sorry, page 64 of the attachment.
MS. GRAY:
Q. Oh, sorry, my apologies.
MR. O'BRIEN:
Q. Okay, just scroll down a bit there. The Board's expert witness pointed out that this method on allocation equates to a subsidy island interconnected customers of $4.71 per megawatt hour and about $1.94 per megawatt hour from Labrador classes. Mr. Baker feels that to saddle certain classes with higher subsidy costs simply because they have higher rates to start with seems unfair.
(1:15 p.m.)
MR. FAGAN:
A. That's Mr. Baker, yeah.
MR. O'BRIEN:
Q. And did the Board appear to accept Mr. Baker's position?
MR. FAGAN:
A. The Board approved Mr. Baker's methodology. I don't know if the Board had the same feelings as Mr. Baker. However, the Board did state also when the methodology for rural deficit allocation came up in Newfoundland Power's

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hearing back in 1997--let's see, yes. The Board said, "the Board confirms its previous opinion in the February 1993, notwithstanding recommendations made in October 10, 1995 report which was not accepted by the government that the rural subsidy is form of cross subsidization and must be dealt with as all other expenses". So, to me, the Board is viewing it as a cost and costs will--if we're looking at determining rates here, in our jurisdiction, if it's not approved by or directed by Order in Council, we generally accept the practices in determining rates. So, when looking at the rural deficit, I looked at--the Board is viewing it as it should be looked at as an expense. It's not just something out there. So, when we look at expenses and if we look at Newfoundland Power's methodology. Newfoundland Power's methodology does it on revenue requirement. Whether that's fair, that's debatable, I guess, depending on the customer. If ones a street lighting, someone has a street light and they've got an 8 percent on the street light as a revenue requirement versus a

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domestic customer with 8 percent, I suppose it could be done in energy. If it was done in energy, there'd be a lot less on the street light. So, the Board has approved Newfoundland Power's methodology, using revenue requirement. I think the current methodology that Mr. Baker has created is effectively, appear to be directed based on a policy interpretation that customers with lower rates should receive more of the costs. If we could go to his evidence in PUB NLH 483. It's an attachment, I believe, the back of that--I think there's an attachment with his evidence. He's mentioned a little later on about the policy. Yes, it's on that page there. "One might try the inference"--lines 9 to 12--" that public policy at this time requires those who are fortunate to enjoy cheap electric service to share the good fortune with those who are not so lucky". And then down further, I think it might be a little further down, okay, "however, such an approach would increase the rate differential between Labrador and Island interconnected systems and would seem in respect to

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circumvent rather than support public policy". Now, I'm not sure what public policy Mr. Baker is referring to because public policy for rate making is determined from, either by the Board or from government origin council and there's been no direction that the rural deficit should be recovered, giving consideration to lower rates for customers in Labrador. So, the approach that he followed with regard to his methodology effectively biases the recovery of the rural subsidy from Labrador interconnected customers because of their lower rates. That's the effect of the methodology. If you looked at the cost of serving the customers on Labrador interconnected versus the customers on Newfoundland Power, average, they are not that much different; we said 14 percent apart. But he methodology Mr. Baker came up with proposing it tripling the recovery from the customers of Labrador interconnected versus the customers of Newfoundland Power. So, a $440.00 difference to me which is based on a public policy interpretation which, to me, is not clear, that's based on any public policy

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direction.

MR. O'BRIEN:

Q. Is Mr. Baker giving some insight to the Board here because the Board, as you say, ultimately makes the public policy and the Board made the order at that time. So we have public policy now before us in that the Board has already made that order, haven't they?

MR. FAGAN:

A. Well, if you want to look close at Mr.--I know Mr. Baker has called it a mini cost of service approach. And I thought Mr. Feehan did a fair job of describing some concerns with the approach, but I mean, the approach effectively--well, example, the customer costs within Mr. Baker's approach, he effectively allocates more to Labrador interconnected that he does to Newfoundland Power because his methodology assumes there's more customers in Labrador interconnected than there are in Newfoundland Power. Now, that alone creates some concern with regard to this methodology. It's not the largest portion of it, but the per unit cost basis of energy, because the customers in Labrador interconnected have much

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higher energy, they're getting a lot more cost assigned to them, strictly because they live in a colder climate. So, the cost differences between Labrador interconnected now on an average basis and Newfoundland Power are not that far apart. They are 14 percent. So, I struggled how we'd get from a 14 percent difference on average cost to a, you know, triple the cost allocation to the Labrador interconnected customers and consider that reasonable.

MR. O'BRIEN:

Q. Well, at the time you're saying that it wasn't 14 percent difference at that time, was it?

MR. FAGAN:

A. I'm assuming it may not have been, but I don't know if there was a full review of the average cost per customer at that time. I know the rates were materially lower and I expect because the distribution system was effectively transferred to Hydro from the mining company. So, there wasn't much capital investment in the distribution system up there at that time by Hydro. So, that would have contributed to the rates being lower, at the

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time. So, all I'm saying is that when the looked at it back then, there was a lot less information before then, and the factors were a lot different than they are now. So, I think it's reasonable that they take a second look.

MR. O'BRIEN:

Q. You mentioned earlier in terms of what the Board said in 1997 in Newfoundland Power's hearing, are you suggesting that the Board had taken a new approach at the time and decided to look at this as a cost in terms of a cost of service?

MR. FAGAN:

A. Well, all I'm saying is in their statement, what they said was that they're confirming the previous opinion of February 1993 that the rural subsidy, a form of cross subsidization and must be dealt as all other expenses. I think that statement was in light of discussion of it being a tax.

MR. O'BRIEN:

Q. Okay.

MR. FAGAN:

A. And so when Dr. Feehan was referring to his--

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looking at it as a tax and Newfoundland Power actually proposed a methodology for recovering the rural deficit from its customers more as a fixed recovery on a block of energy. I believe it was the first 700 kilowatt hours. So, if people had electric heat, they wouldn't more of the rural deficit than customers who had oil heating. And there was a huge debate on that particular issue by the intervenors and as I said, there wasn't a lot of agreement on it. It was rejected by the Board. So that was more of a basis for this particular statement, but they are confirming that they view it as expenses to be recovered according to their words as a cost for recovery; not so much something that must be ignoring cost of service principles. That's my interpretation. That you still use cost of service principles to deal with recovery.

MR. O'BRIEN:

Q. So, Dr. Baker still uses cost of services principles in his mini cost of service?

MR. FAGAN:

A. Well, mixing the two costs of service and the average costs between Labrador and the

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Newfoundland Power system, creates some odd results. And one particular aspect of it is if fuel costs go up on the Island, okay, then because the Labrador customers got higher usage, they're getting a lot more of the rural deficit through the method of allocation because he's coming up with an average energy cost in this cost of service study by blending the two. So, as the costs go up on the Island with regard to fuel costs which has happened a lot since 1992, that in itself is driving the allocation of additional costs to the Labrador interconnected system. so, I don't think that was an intention, but I think it's a result.

MR. O'BRIEN:

Q. Did you understand back in 1992 that the Board saw that by implementing this, I guess, unit cost method or mini cost of service method, that Labrador interconnected customers would be paying twice as much as Newfoundland Power's customers at that time?

MR. FAGAN:

A. I think that was foreseeable. The dollar amounts, when someone is paying twice as much as someone else, it may be as big a deal

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depending on the amount as well. So, the rural subsidy is increase, I believe, in the early '90s, it was probably about 20 million dollars and now I believe it's 64 million dollars. So, paying twice as much can mean different things at different times. And currently they're paying three times as much, but the total pot is so much bigger that the dollar differential maybe creating more of a concern. I mean, the Board has made statements before that they're going to have--there'll be ongoing monitoring of the rural deficit to make sure that rates are reasonable and not discriminatory amongst customers. So, I just think that that's part of this process that we're taking a second look at it, given we finally got--there's been the migration of the Labrador rates; Lab East and Lab West; the phase out of the industrial customers paying it; the CFB credit now going to the rural deficit itself, and the - so I think given it's probably an appropriate time, and it's the first time we've had a hearing with all those things in place to look at the costs, so it's probably appropriate to revisit the

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methodology. There's been enough expert testimony more here before this Board dealing with this issue than there was in 1992. Mr. Baker's methodology was effectively a spreadsheet attached to his evidence. The Board was obviously struggling to come up with a methodology and they obviously weren't comfortable with the other ones presented at that time and they chose Mr. Baker's methodology, but I just don't think it works any more for purposes of coming up with a fair result.

MR. O'BRIEN:

Q. And is that because it doesn't result in everybody paying the same?

MR. FAGAN:

A. I wouldn't quite say that because the proposed method of Hydro doesn't come up with everybody paying the same.

MR. O'BRIEN:

Q. It's the revenue requirement method?

MR. FAGAN:

A. Yes, so it's based on the overall cost. I mean, the revenue requirement method gives consideration to both the lower rates and the

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higher usage, so while Labrador customers have lower rates, they've also got higher usage, and so both of those items are considered in the revenue requirement method. The methodology of Mr. Baker focuses more on the lower rates and that it creates more of a shift to Labrador interconnected. I think, as Mr. Greneman said, the more robustness to the method on revenue requirement type of thing.

MR. O'BRIEN:

Q. So Newfoundland Power's customers perspective then, the fact that they pay higher rates and have lower usages, they should pay more of the revenue - the subsidy, on a 14 percent basis?

MR. FAGAN:

A. Well, there's no perfect answer. The impact of Hydro's proposed method is that customers of Newfoundland Power would have 8 percent of their revenue requirement rates go towards, I call it, equalization policy of rates across the province, okay. The Labrador customers will pay 12 percent more. So the rate component of their revenue requirement of the rural deficit is 12 percent. So it's 12 percent for Labrador, it's 8 percent for

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Newfoundland Power, so it's still a higher percentage for Labrador interconnected customers. From a dollar perspective, it's slightly higher for Newfoundland Power's customers, so it's - but I think the end result is probably more reasonable than having the $660.00 for the Labrador interconnected customers versus the $217.00 or whatever for the Newfoundland Power's customers.

MR. O'BRIEN:

Q. I just have a couple of more questions, Mr. Chair. I should be able to finish them in time.

CHAIRMAN:

Q. It looks like you got about a minute.

MR. O'BRIEN:

Q. Yeah, I think I should finish the last one then. I'll hold it to one. Mr. Fagan, we heard last week from Mr. Martin that there was going to be an impact of cost overruns from the delay - sorry, cost overruns at Muskrat Falls of an additional $7.00 a month on the average customer's bill. Are you able to shed some light on how that number was calculated?

MR. FAGAN:

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A. No.
MR. O'BRIEN:
Q. So it's not something in your position as Manager of Rates you would have had any involvement in?
MR. FAGAN:
A. I will be involved in the transitioning from the current cost structure to the Muskrat Falls structure. We presented studies before the Board - we will be next year looking at how that's shared among customers, how rates should change to reflect that, how the rate stabilization plan will work in future, it won't maybe be called that, but whether there's some sort of a supply cost recovery mechanism to deal with the cost, but I haven't been directly involved with the cost, but I will be involved with transitioning to recover those costs, but I'm not the one to discuss the actual numbers.
MR. O'BRIEN:
Q. And who would be the one to discuss that?
MR. FAGAN:
A. Well, I actually don't know if it's relevant to the current proceeding with regard to the proposed costs, so I don't think we actually would have a witness that will be talking about what the actual costs are associated with Muskrat Falls right now.

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MR. O'BRIEN:
Q. Okay, perhaps I'll take it under advisement and speak to counsel.
CHAIRMAN:
Q. Okay, I think we're adjourned until tomorrow morning. Thank you.
(UPON CONCLUDING AT 1:32 p.m.)

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CERTIFICATE

I, Judy Moss, hereby certify that the foregoing is a true and correct transcript of a hearing in the matter of Newfoundland and Labrador Hydro's General Rate Application heard on the 5th of October, A.D., 2015 before the Commissioners of the Public Utilities Board, St. John's, Newfoundland and Labrador and was transcribed by me to the best of my ability by means of a sound apparatus.

Dated at St. John's, Newfoundland and Labrador
this 5th day of October, A.D., 2015
Judy Moss

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