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1 OCTOBER 19, 2015
 2 (9:00 a.m.)
 3 CHAIRMAN:
 4 Q. Good morning. Before we move to our witness,
 5 I believe there are some preliminary matters.
 6 MS. GLYNN:
 7 Q. Just an undertaking, Mr. Chair.
 8 MS. PENNELL:
 9 Q. Good morning, we have two undertakings this
 10 morning; Undertaking 40, which is the Minutes
 11 from the Joint Utilities meeting, and
 12 Undertaking 51, which is a breakdown of the
 13 positions of the additional FTEs included in
 14 our 2014 and 2015 test years.
 15 CHAIRMAN:
 16 Q. Okay. So we're now ready to go to Mr. Rolph.
 17 MR. BRAD ROLPH (SWORN) EXAMINATION-IN-CHIEF BY MAUREEN
 18 GREENE, Q.C.:
 19 GREENE, Q.C.:
 20 Q. Good morning, Mr. Rolph. For the record, what
 21 is your name and your current position?
 22 MR. ROLPH:
 23 A. My name is Brad Rolph. I'm a partner at Grant
 24 Thornton Consulting, a subsidiary of Grant
 25 Thornton LLP. I'm leader of Grand Thornton's

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1 transfer pricing practice in Canada. I'm also
 2 the tax service line leader for Southern
 3 Ontario.
 4 GREENE, Q.C.:
 5 Q. Could you please outline your academic
 6 background?
 7 MR. ROLPH:
 8 A. I obtained a BA in Economics from Wilfred
 9 Laurier University, an MA in Economics from
 10 Queens University, and I've completed the
 11 course work and the comprehensive theory exams
 12 in economics at York University.
 13 GREENE, Q.C.:
 14 Q. And that's at the Ph.D level?
 15 MR. ROLPH:
 16 A. Yes.
 17 GREENE, Q.C.:
 18 Q. Please outline your work experience?
 19 MR. ROLPH:
 20 A. I have over 20 years of transfer pricing
 21 experience, the last two of which with Grand
 22 Thornton. Prior to joining Grant Thornton, I
 23 held senior positions at two transfer pricing
 24 boutiques, and I was a partner at Deloitte's
 25 between 2000 and 2009. I've advised multi-

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1 national companies from a wide cross section
 2 of industries, including a Finnish utility
 3 company with regulated and unregulated
 4 subsidiaries. I've dealt with a variety of
 5 inter-company transactions, including the
 6 allocation of centralized management and
 7 administrative services and expenses.
 8 GREENE, Q.C.:
 9 Q. You stated that you're Grant Thornton's
 10 national leader of transfer pricing practices
 11 in Canada and the Americas. Could you please
 12 explain what transfer pricing involves?
 13 MR. ROLPH:
 14 A. Transfer pricing deals with the price charged
 15 for physical goods, intangible assets and
 16 services that are bought, licenced, or sold
 17 between related parties, also known as non-
 18 arms length parties.
 19 GREENE, Q.C.:
 20 Q. Could you please explain how the principles of
 21 transfer pricing are involved with respect to
 22 the guidelines to be used in determining the
 23 appropriate fees to be charged by Hydro in
 24 providing services to affiliated companies in
 25 the Nalcor Group, and for services rendered

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1 for Hydro by an affiliated company?
 2 MR. ROLPH:
 3 A. When related parties transact with each other,
 4 the potential exists for them to determine and
 5 use a price that can disadvantage one party
 6 over the other, but on the whole generates a
 7 benefit for the corporate group. This
 8 situation is a critical issue for tax
 9 administrators worldwide. Cross border
 10 transfer pricing lies at the core of concerns
 11 expressed by tax administrators regarding the
 12 ability of multi-national companies to reduce
 13 their effective corporate tax rate through the
 14 use of inappropriate transfer pricing.
 15 Although the affiliate transactions involving
 16 Hydro do not transpire across international
 17 borders, there exists the potential for the
 18 parties to determine and use a transfer price
 19 for the affiliate transactions I evaluated
 20 that might affect the price or the rate at
 21 which users pay for electricity in the
 22 province.
 23 GREENE, Q.C.:
 24 Q. Please outline your experience in providing
 25 assistance for litigation with respect to

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1 transfer pricing?
 2 MR. ROLPH:
 3 A. I assisted counsel representing a Canadian
 4 taxpayer in the discovery process for a matter
 5 that was before the Tax Court of Canada
 6 earlier this year. I have prepared expert
 7 reports in anticipation of litigation for
 8 counsel representing Canadian taxpayers that
 9 address transfer pricing adjustments
 10 reassessed by the Canada Revenue Agency. Two
 11 of these matters are currently before the Tax
 12 Court of Canada. The remaining matters were
 13 settled without me having to provide evidence
 14 at trial.
 15 GREENE, Q.C.:
 16 Q. So this is the first time that you have
 17 actually given evidence in a hearing in a
 18 matter?
 19 MR. ROLPH:
 20 A. Yes.
 21 GREENE, Q.C.:
 22 Q. You've been retained by the Board to provide
 23 expert testimony on Hydros inter-company
 24 transactions costing guidelines, and you've
 25 prepared two reports; the first dated April

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1 25th, 2014, on the original application, and
 2 the second dated June 1st, 2015, on Hydro's
 3 amended application. Do you adopt both
 4 reports as your evidence?
 5 MR. ROLPH:
 6 A. I do.
 7 GREENE, Q.C.:
 8 Q. You also prepared responses to requests for
 9 information on your reports. Do you adopt
 10 these responses as your evidence?
 11 MR. ROLPH:
 12 A. I do.
 13 GREENE, Q.C.:
 14 Q. You stated in your report that the evaluation
 15 framework you used to review Hydro's inter-
 16 company costing guidelines was based on your
 17 own experience and expertise, and on guidance
 18 from managerial and accounting literature,
 19 utility industry practice, and tax
 20 administration guidance. Would you please
 21 explain first what was the utility industry
 22 experience you considered?
 23 MR. ROLPH:
 24 A. The utility experience I considered is
 25 detailed in Appendix B of my report. I used

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1 information from Industry Canada and the
 2 Electricity Forum's database of utilities
 3 companies first to identify Canadian utility
 4 companies. I then relied on the allocation
 5 method used by the largest utility company,
 6 that's with the largest revenues in each
 7 province, with the exception of Newfoundland
 8 and Labrador, to represent the allocation
 9 methods used by utility companies in that
 10 province.
 11 GREENE, Q.C.:
 12 Q. Did you review Newfoundland Power's inter-
 13 affiliate code of conduct and what is its
 14 applicability or relevance to Hydro's
 15 guidelines for charges for inter-company
 16 transactions?
 17 MR. ROLPH:
 18 A. I have reviewed Newfoundland Power's inter-
 19 affiliate code of conduct. It establishes
 20 standards and conditions for interactions
 21 between Newfoundland Power and its utility and
 22 non-utility affiliates. These affiliate
 23 transactions are by definition "between
 24 related parties". To be useful as a reliable
 25 benchmark, the price charged in a transaction

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1 must involved two unrelated parties, also
 2 known as arms-length parties. I believe that
 3 Newfoundland Power's inter-affiliate code of
 4 conduct does provide some evidence of its
 5 practices that may be of assistance to the
 6 board in this matter.
 7 GREENE, Q.C.:
 8 Q. You've explained that you also looked at tax
 9 administration guidelines in preparing your
 10 report. Why is tax administration guidance
 11 useful here?
 12 MR. ROLPH:
 13 A. As I explained earlier, the tax administrators
 14 are very concerned about cross border transfer
 15 prices. They are concerned that multi-
 16 national companies can reduce their effective
 17 corporate tax rate through the use of
 18 inappropriate transfer prices. As a result,
 19 there's been significant work done by the
 20 Organization for Economic Cooperation and
 21 Development, the OECD, that provides guidance
 22 regarding the proper application of the arms-
 23 length principle. That's the international
 24 norm for establishing arms-length transfer
 25 prices. Again although the affiliate

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1 transactions involving Hydro do not transpire
 2 across international borders, there exists the
 3 potential for the parties to determine and use
 4 a transfer price for the affiliate
 5 transactions that might affect the rate at
 6 which users pay for electricity in the
 7 province. To mitigate this risk, regulated
 8 utilities generally require the use of the
 9 lower of the market price for shared service
 10 or the cost of that shared service to
 11 determine the amounts to be charged to
 12 affiliates. This is akin to an application of
 13 the arms-length principle.

14 GREENE, Q.C.:

15 Q. Please explain how you completed the work
 16 necessary to provide your opinion and what
 17 documentation did you review?

18 MR. ROLPH:

19 A. To prepare my report, I reviewed Hydro's 2013
 20 amended GRA, including Hydro's inter-company
 21 costing guidelines. I submitted and reviewed
 22 the responses to over 100 questions during the
 23 RFI process. I reviewed relevant accounting
 24 literature, industry practices, and tax
 25 administration guidance.

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1 GREENE, Q.C.:

2 Q. Turning now to the principles Hydro does use
 3 with respect to inter-company charges, first
 4 Hydro does provide certain common services in
 5 the areas of human resources, safety and
 6 health, and information services to other
 7 companies in the Nalcor Group. How does Hydro
 8 charge for these human resources, safety and
 9 health services, and is Hydro's approach
 10 reasonable?

11 MR. ROLPH:

12 A. So based on the evidence submitted by Hydro,
 13 it determines the amount charged for rendering
 14 human resource and safety and health services
 15 to Nalcor and its other lines of business
 16 based on an indirect cost recovery method
 17 without a markup. It calculates the human
 18 resource and safety and health related cost to
 19 be recovered by adding the relevant operating
 20 expenses, such as salary and fringe benefits,
 21 office supplies, and professional fees. It
 22 then subtracts from that amount any recharges
 23 for corporate services rendered to Nalcor or
 24 one of its other business lines. In the case
 25 of human resource related cost, it also

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1 subtracts payroll taxes and any advertising
 2 costs initially borne by Hydro that are
 3 charged back to Nalcor as another expense.
 4 Hydro then allocates costs to be recovered
 5 based on FTES. In my opinion, it's reasonable
 6 for Hydro to determine the amount to charge
 7 for rendering human resource and safety and
 8 health services to Nalcor and its other lines
 9 of business using this approach.

10 GREENE, Q.C.:

11 Q. Another common service Hydro provides is
 12 information system services, and could you
 13 please explain how Hydro does charge for these
 14 services and whether its approach is
 15 reasonable in your opinion?

16 MR. ROLPH:

17 A. So based on the evidence submitted by Hydro,
 18 it determines the amount charged for rendering
 19 information system services to Nalcor and its
 20 other lines of business based on the indirect
 21 cost recovery method without a markup. It
 22 calculates the information systems cost to be
 23 recovered by adding relevant operating
 24 expenses, depreciation, and a return on rate
 25 base for capitalized relevant common assets,

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1 such as servers and software. It then
 2 subtracts any recharges for corporate services
 3 rendered to Nalcor or one of its other
 4 business lines, and software maintenance costs
 5 initially borne by Hydro, they are charged
 6 back as another expense to Nalcor, or one of
 7 its other business lines. Hydro then
 8 allocates these costs to be recovered based on
 9 average number of users. In my opinion, it's
 10 reasonable for Hydro to determine the amount
 11 to charge for rendering information system
 12 services to Nalcor and its other lines of
 13 business using this approach.

14 GREENE, Q.C.:

15 Q. In your report, you said, "These common
 16 services related cost might not be full
 17 burdened, and as a result Hydro's charges for
 18 the common service it provides might be
 19 understated". Could you please explain why
 20 you think this may be the case?

21 MR. ROLPH:

22 A. I thought there was two potential issues that
 23 warranted further investigation. The first
 24 involves the inclusion of payroll taxes in the
 25 HR department's miscellaneous expense line

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1 item. Hydro’s HR department is responsible
 2 for administrating payroll related activities
 3 in all of Nalcor’s lines of business. There
 4 was no indication in the evidence what these
 5 payroll tax related expenses were and whether
 6 they related to Hydro employees or employees
 7 of its affiliates. If these payroll taxes are
 8 attributed to Hydro employees providing common
 9 services, then these payroll taxes should be
 10 included in the cost base to be recovered.
 11 The second issue involves the way in which
 12 Hydro allocates common expenses. There was no
 13 indication in the evidence that Hydro included
 14 in its cost to render common services an
 15 amount to account for the HR department’s
 16 share of common expenses, for example. The
 17 same is true of safety and health, and the
 18 information systems department. If it is the
 19 case that Hydro has not allocated share of
 20 common expenses internally, then the cost to
 21 be recovered for rendering common services are
 22 not fully burdened, and as a result the charge
 23 for common services to Nalcor and its other
 24 lines of business would be understated.
 25 GREENE, Q.C.:

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1 Q. You also expressed an opinion in your report
 2 that there should be no markup on the common
 3 services unless the recipient of the services
 4 included private interests and was not a
 5 wholly owned Crown entity. Why, in your
 6 opinion, is the ownership of the entity
 7 relevant and how did it influence your
 8 opinion?
 9 (9:15 a.m.)
 10 MR. ROLPH:
 11 A.
 12 GREENE, Q.C.:
 13 Q. Nalcor and Hydro are provincial Crown
 14 corporations, and as a result are not subject
 15 to tax. Consequently, relying on a tax
 16 implications for guidance in this matter, as I
 17 would in the transfer pricing matter, would be
 18 ineffective. So alternatively, I considered
 19 whether the absence of a markup would create
 20 an inappropriate subsidy. So first I
 21 considered the implications of Nalcor marking
 22 up the cost of rendering certain corporate
 23 services to Hydro. Such a markup would
 24 increase Hydro’s revenue requirements and the
 25 rates that it would charge its customers. For

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1 this reason, I believe that applying a markup
 2 to the cost of rendering corporate services to
 3 Hydro would be inappropriate. I believe that
 4 the same answer applies to situations in which
 5 Hydro is providing common or corporate
 6 services for the benefit of public energy
 7 projects to its affiliates. To do otherwise
 8 would create a situation in which Hydro’s
 9 revenue requirement would decline at the
 10 expense of Nalcor, one of the public energy
 11 projects of the other lines of business or the
 12 province. However, not all of Nalcor’s energy
 13 projects are entirely publicly owned. Some of
 14 its energy projects are partially owned by
 15 other provincial governments or private
 16 interests. In the context of energy projects
 17 involving private interests, in the absence of
 18 a markup on the cost of rendering common
 19 services or corporate services for the direct
 20 benefit of these private energy projects, it
 21 would lower the amount charged for such
 22 services and increase the profits generated by
 23 these projects for the benefit of the private
 24 interests. This outcome would create an
 25 inappropriate subsidy at the expense of Hydro

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1 and its customers. For this reason, I believe
 2 that should Hydro render services to Nalcor or
 3 one of its other lines of business for the
 4 benefit of an energy project involving private
 5 interests, the cost of rendering such services
 6 should be marked up by an arms-length amount.
 7 GREENE, Q.C.:
 8 Q. Has this principle of determining whether
 9 there should be a markup based on the
 10 ownership of the entities been applied by any
 11 other Canadian regulator?
 12 MR. ROLPH:
 13 A. No, not that I have found.
 14 GREENE, Q.C.:
 15 Q. For the Canadian utilities included in your
 16 survey in Appendix B of your report, the nine
 17 utilities, I believe, did you determine
 18 whether any of these companies apply a markup
 19 on common services or corporate services
 20 rendered to affiliated companies?
 21 MR. ROLPH:
 22 A. No, not that I have found.
 23 GREENE, Q.C.:
 24 Q. If a markup were to be applied, what would be
 25 reasonable for it?

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1 MR. ROLPH:
 2 A. In my report, and in response to RFIs
 3 regarding my report, I indicated that should
 4 Hydro render services to Nalcor or one of its
 5 line of businesses for the benefit of energy
 6 project involving private interests, the cost
 7 of rendering such services should be marked up
 8 by an arms-length amount between 2 and 5
 9 percent. This range was based on guidance for
 10 determining a markup for low value adding
 11 inter-group services provided by the OECD,
 12 which appeared in a draft of a document
 13 release prior to the submission of my report
 14 dated June 1st, 2015. The OECD has since
 15 finalized that document and in it amended the
 16 guidance to replace the range with a single
 17 markup of 5 percent. For this reason, if a
 18 markup were to be applied to the common
 19 services rendered by Hydro, it would be
 20 reasonable for Hydro to apply a 5 percent
 21 markup.
 22 GREENE, Q.C.:
 23 Q. In your report, you suggested that
 24 clarification should be provided by Hydro
 25 about common services charged to Nalcor and

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1 its affiliated companies. Did you seek
 2 clarification in preparing your report on this
 3 issue and what was Hydro's response?
 4 MR. ROLPH:
 5 A. I sought clarification from Hydro to determine
 6 which of Nalcor's other lines of businesses
 7 were allocated an amount for common services.
 8 In its response, Hydro indicated that listing
 9 the entities and the amounts that were
 10 allocated to each entity was not relevant for
 11 the understanding of the issue.
 12 GREENE, Q.C.:
 13 Q. In your opinion, why is it important to know
 14 what common services were charged to other
 15 entities in the Nalcor Group?
 16 MR. ROLPH:
 17 A. There's two reasons why I think it's important
 18 to identify which entities have been allocated
 19 cost for common services. The first is
 20 transparency. The information would be
 21 required to ensure that Hydro has implemented
 22 its affiliated pricing policy properly. The
 23 second is that not all of Nalcor's energy
 24 projects are entirely publicly owned, as I
 25 indicated. Some of them are partially owned

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1 by private interests. In the absence of that
 2 markup on costs rendering the common services
 3 or corporate services for the direct benefit
 4 of an energy project involving these private
 5 interests, it creates an inappropriate subsidy
 6 at the expense of Hydro and its customers.
 7 GREENE, Q.C.:
 8 Q. Turning now to common expenses, Hydro
 9 initially pays certain common expenses on
 10 behalf of itself and other companies in the
 11 Nalcor Group and then charges them back. Could
 12 you explain first how Hydro charges for rental
 13 costs and whether its practice in this regard
 14 is reasonable?
 15 MR. ROLPH:
 16 A. From the evidence submitted by Hydro, it
 17 determines the amount charged for renting the
 18 floor space occupied at Hydro Place by Nalcor
 19 and its other lines of business, based on an
 20 indirect cost recovery method without a
 21 markup, it calculates the building rental
 22 costs by recovering or to be recovered by
 23 adding relevant operating expenses,
 24 depreciation, and a return on rate base for
 25 capitalized relevant common assets such as

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1 furniture, printers, and fax machines. It
 2 then allocates its building rental costs based
 3 on the amount of office space occupied and a
 4 square footage rental charge. In my opinion,
 5 it's reasonable for Hydro to determine the
 6 amount to charge for renting office space to
 7 Nalcor and its other lines of business using
 8 this approach.
 9 GREENE, Q.C.:
 10 Q. How does Hydro charge back for another common
 11 expense, telephone infrastructure related
 12 cost, and is its approach reasonable?
 13 MR. ROLPH:
 14 A. Based on the evidence submitted by Hydro, it
 15 determines the amount charged for telephone
 16 infrastructure used by Hydro and its other
 17 lines of business based on an indirect cost
 18 recovery method without a markup. It
 19 calculates the telephone infrastructure cost
 20 to be recovered by dividing the LAN costs
 21 provided by the network service department by
 22 the total number of LAN ports to derive a cost
 23 per user, and then divides the telephone cost
 24 provided by the network services department
 25 and divides it by the number of telephones,

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1 fax, and modem lines to derive a cost per
 2 telephone per user. It then allocates its
 3 telephone infrastructure costs using the
 4 average number of users for each of the
 5 business lines. In my opinion, it's
 6 reasonable for Hydro to determine the amount
 7 to charge for providing telephone
 8 infrastructure to Nalcor and its other lines
 9 of business using this approach.

10 GREENE, Q.C.:
 11 Q. How does Hydro charge back the other common
 12 expenses that it initially incurs and is its
 13 approach reasonable?

14 MR. ROLPH:
 15 A. Based on evidence submitted by Hydro, it
 16 determines the amount charged for other
 17 expenses paid initially by Hydro, but
 18 attributable to Nalcor or one of its other
 19 lines of business based on a direct cost
 20 recovery without a markup. In my opinion, it
 21 is reasonable for Hydro to determine the
 22 amount to charge for these other expenses
 23 initially paid by Hydro, but attributable to
 24 Nalcor or one of its line of businesses using
 25 this approach. I have highlighted in my

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1 report certain transactions about which the
 2 Board may want further clarification to ensure
 3 that Hydro has implemented its transactions in
 4 accordance with this aspect of its affiliate
 5 pricing policy.

6 GREENE, Q.C.:
 7 Q. Like common services, you also suggested that
 8 Hydro should provide information on the common
 9 expenses that it charges Nalcor and other
 10 entities in the Nalcor Group. Did you also
 11 try to get this clarification in preparing
 12 your report and what was Hydro's response?

13 MR. ROLPH:
 14 A. I sought clarification from Hydro to determine
 15 the initial amounts it paid, and the amount
 16 charged back to Nalcor or one of its other
 17 lines of business for these other expenses
 18 that were attributable to them. In its
 19 response, Hydro did not provide the requested
 20 information because it submitted that to do so
 21 was unduly onerous and the time effort and
 22 expense involved in providing the requested
 23 information was not warranted for the
 24 understanding and assessment of the issues
 25 before the Board.

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1 GREENE, Q.C.:
 2 Q. Why, in your opinion, is this clarification
 3 necessary?

4 MR. ROLPH:
 5 A. Transparency. The information will be
 6 required to ensure that Hydro has implemented
 7 this aspect of its affiliate pricing policy
 8 properly.

9 GREENE, Q.C.:
 10 Q. Turning to the last area of corporate
 11 services, Hydro and the other entities in the
 12 Nalcor Group provide corporate services to
 13 each other. How are the charges for such
 14 services determined and is Hydro's approach
 15 reasonable?

16 MR. ROLPH:
 17 A. Nalcor and its affiliates determine the amount
 18 charged to each affiliate for which corporate
 19 related services are rendered based on a
 20 direct charge method, without including a
 21 profit margin. The amount charged by Nalcor
 22 or any of its lines of business, including
 23 Hydro, for corporate related services rendered
 24 is based on the amount of time spent by an
 25 employee performing the service and the

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1 employee's labour rate. An employee's labour
 2 rate is determined on a cost recovery basis
 3 designed to recover salary, benefits, and
 4 indirect costs overhead. It doesn't include a
 5 profit margin. The labour rate includes a
 6 billing rate and a fixed charge. The billing
 7 rate is determined based on an employee's
 8 hourly wage amount, plus a variable component
 9 that for the 2014 and 2015 test years was
 10 equal to 57 percent of the hourly wage amount.
 11 The billing rates are reviewed annually and
 12 updated accordingly. The fixed charges are
 13 intended to recover overhead costs directly
 14 associated with employees rendering the
 15 corporate related services.

16 GREENE, Q.C.:
 17 Q. You mentioned that the labour rates used are
 18 fully burdened and the proxy used to determine
 19 the fringe benefits portion should be
 20 reevaluated annually. You also indicated at
 21 the time of writing your report the rate for
 22 this was 57 percent. Hydro has now indicated
 23 that its increased to 68 percent. Have you
 24 reviewed this increase in that rate?

25 MR. ROLPH:

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1 A. No, I have not reviewed this increase, nor did
 2 I audit or verify the accuracy of the 57
 3 percent. The variable component of the billing
 4 rate is intended to cover such costs as Canada
 5 Pension Plan, Public Service Pension Plan,
 6 insurance, payroll taxes, bonuses, and leave,
 7 all of which are costs that should be
 8 recovered by the affiliate rendering the
 9 corporate service.
 10 GREENE, Q.C.:
 11 Q. In your report, you also recommended that for
 12 these corporate services, as for common
 13 services, there be no markup unless the
 14 ultimate recipient included some privately
 15 owned interest. Is your rationale for the
 16 position for corporate services the same as
 17 you've already expressed for common services?
 18 MR. ROLPH:
 19 A. Yes.
 20 GREENE, Q.C.:
 21 Q. In reviewing the charges for the time charged
 22 to Hydro for corporate services, did you audit
 23 or look at the amount of time to verify the
 24 accuracy of the hours recorded as services for
 25 Hydro or whether the corporate and common

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1 services provided or forecast for 2015 were
 2 appropriate?
 3 MR. ROLPH:
 4 A. No, I did not audit or verify the accuracy of
 5 the hours reported for rendering corporate
 6 services. To be clear, I also did not audit
 7 or verify whether the common or corporate
 8 services had been rendered or whether they had
 9 been rendered effectively or efficiently. I
 10 relied entirely on evidence submitted by
 11 Hydro.
 12 (9:30 a.m.)
 13 GREENE, Q.C.:
 14 Q. Are you familiar with Hydro's policies for
 15 recording time spent on non-Hydro matters and
 16 Nalcor's policy for recording time spent on
 17 Hydro matters, and are these policies
 18 reasonable in your opinion?
 19 MR. ROLPH:
 20 A. So based on the evidence submitted by Hydro,
 21 Nalcor employees that perform corporate
 22 related services, including those at Hydro,
 23 are required to complete weekly time sheets
 24 which allocate their time to specific work
 25 orders. Time is coded in 30 minute

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1 increments. In my opinion, time should be
 2 allocated to specific work orders on a daily
 3 basis and submitted weekly. There's no rule
 4 of thumb that I know of regarding best
 5 practices in terms of minute increments,
 6 however, I would recommend that time be coded
 7 in 30 minute increments - 15, sorry, minute
 8 increments.
 9 GREENE, Q.C.:
 10 Q. And finally, Mr. Rolph, in your opinion should
 11 Hydro be required to report to the Board on
 12 inter-company transactions, and if so, on what
 13 frequency?
 14 MR. ROLPH:
 15 A. Yes, I believe that Hydro should be required
 16 to report its inter-company transactions to
 17 the Board. I would recommend an annual review
 18 of inter-affiliate transactions that describes
 19 all the services rendered, the cost charged
 20 back to and from the affiliates, the amounts
 21 involved and the methods used for determining
 22 those amounts.
 23 GREENE, Q.C.:
 24 Q. Thank you, Mr. Rolph. That completes Mr.
 25 Rolph's direct examination, Mr. Chair.

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1 CHAIRMAN:
 2 Q. I believe we're over to Newfoundland Hydro
 3 now.
 4 MR. CASS:
 5 Q. We have no questions, Mr. Chair. Thank you.
 6 CHAIRMAN:
 7 Q. Okay. Newfoundland Power.
 8 MR. O'BRIEN:
 9 Q. I do have some questions, Mr. Chair.
 10 MR. BRAD ROLPH - CROSS-EXAMINATION BY MR. LIAM O'BRIEN:
 11 MR. O'BRIEN:
 12 Q. Good morning, Mr. Rolph.
 13 MR. ROLPH:
 14 A. Good morning.
 15 MR. O'BRIEN:
 16 Q. In terms of - I'm going to try to stick with
 17 your second report, I guess, the June, 2015
 18 report. I wonder if we could have a look at
 19 page one of that report, lines 12 to 15, just
 20 to get an idea of your assignment and I think
 21 you've covered that off in the end here of
 22 some of the questions I had with your
 23 questioning with Ms. Greene, but your
 24 assignment was really to focus on the
 25 reasonableness of the methods of Hydro, is

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1 that correct?
 2 MR. ROLPH:
 3 A. That is correct.
 4 MR. O'BRIEN:
 5 Q. And you didn't perform any auditing services,
 6 obviously, with respect to whether or not
 7 those methods had been performed appropriately
 8 or in accordance with policy?
 9 MR. ROLPH:
 10 A. I did not.
 11 MR. O'BRIEN:
 12 Q. Okay, and that goes for all of the common
 13 expenses, common services, and corporate
 14 services as well?
 15 MR. ROLPH:
 16 A. It does.
 17 MR. O'BRIEN:
 18 Q. And I presume that were you to be asked to do
 19 that, that would be quite a task, would it be?
 20 MR. ROLPH:
 21 A. As an economist, yes.
 22 MR. O'BRIEN:
 23 Q. Okay, it would involve a full audit of
 24 services and time sheets and that sort of
 25 thing?

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1 MR. ROLPH:
 2 A. It would.
 3 MR. O'BRIEN:
 4 Q. And it wouldn't be something that would fall
 5 within your purview, would it?
 6 MR. ROLPH:
 7 A. Not necessarily.
 8 MR. O'BRIEN:
 9 Q. Is it something you've ever been asked to do
 10 before?
 11 MR. ROLPH:
 12 A. In the context of income tax audits, I've
 13 helped taxpayers to prepare such information.
 14 MR. O'BRIEN:
 15 Q. Okay.
 16 MR. ROLPH:
 17 A. So it can be done.
 18 MR. O'BRIEN:
 19 Q. It can be, sure, okay.
 20 GREENE, Q.C.:
 21 Q. Excuse me for a moment. I think some of the
 22 parties are having difficulty hearing.
 23 MR. O'BRIEN:
 24 Q. I'm sorry, microphone is not in, okay.
 25 GREENE, Q.C.:

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1 Q. Yes, can you speak more closely to the
 2 microphone, Mr. Rolph.
 3 MR. ROLPH:
 4 A. Sorry.
 5 MR. O'BRIEN:
 6 Q. Can I ask that we turn to the CV of Mr. Rolph.
 7 I believe it's at page 61. I just had a few
 8 questions for you on that, and you've answered
 9 some of them. Just in terms of your
 10 experience with recent transfer pricing
 11 engagements, so page 61, and I just wanted to
 12 get a flavour sort of what types of
 13 engagements you were involved in. This A.2.1,
 14 TЕСSM, what does that stand for?
 15 MR. ROLPH:
 16 A. Tax Efficient Supply Chain Management.
 17 MR. O'BRIEN:
 18 Q. Okay, and the engagements under that heading,
 19 what types of things are we looking at there?
 20 Is anything involving utilities there that you
 21 would have engaged in?
 22 MR. ROLPH:
 23 A. Not in that particular space, no.
 24 MR. O'BRIEN:
 25 Q. And in what areas would you have been involved

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1 in engagements with utilities?
 2 MR. ROLPH:
 3 A. The engagements that I have done with
 4 utilities predominantly involving loans
 5 transactions.
 6 MR. O'BRIEN:
 7 Q. And that's under the financial transactions
 8 section?
 9 MR. ROLPH:
 10 A. Yes.
 11 MR. O'BRIEN:
 12 Q. I believe you mentioned a Finnish utility
 13 company and that's one of the ones under here
 14 I see mentioned, but that would be the extent
 15 of your involvement in transfer pricing type
 16 issues with utilities?
 17 MR. ROLPH:
 18 A. In that particular case, yes.
 19 MR. O'BRIEN:
 20 Q. Okay. In terms of - there's a number of areas
 21 if we scroll up, if we look, there's
 22 alternative dispute resolution, and advanced
 23 pricing arrangements, and expert witnesses.
 24 Apart from those financial transactions, you
 25 weren't involved in any utility engagements in

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1 those areas, were you?
 2 MR. ROLPH:
 3 A. Not at that time, no.
 4 MR. O'BRIEN:
 5 Q. And this is obviously the first time you're
 6 testifying in terms of a utility engagement,
 7 is that right?
 8 MR. ROLPH:
 9 A. It is.
 10 MR. O'BRIEN:
 11 Q. I had mentioned to Ms. Greene on Friday that I
 12 might run through just a few points with some
 13 recent - I shouldn't say "recent", some orders
 14 from the Board with respect to these types of
 15 issues involving Newfoundland Power. I wonder
 16 if I could ask that we pull up Order PU-19,
 17 2003, and if we could look at page 57.
 18 MS. GRAY:
 19 Q. Yes.
 20 MR. O'BRIEN:
 21 Q. Okay, scroll down just a little bit here,
 22 okay, and we see, "Newfoundland Power will be
 23 required to observe the following principles
 24 in all inter-corporate transactions". So
 25 there's a number of principles that the Board

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1 had required Newfoundland Power to follow with
 2 respect to their inter-corporate transactions.
 3 I just want to run through those just a little
 4 bit with you just to see if those are the
 5 types of principles that you would see
 6 applicable to these types of transactions.
 7 The first one being, "All inter-corporate
 8 transactions between a utility and its
 9 affiliates shall be fully transparent and are
 10 subject to scrutiny by the Board", and I know
 11 that you had mentioned transparency a couple
 12 of times in your testimony. Would you agree
 13 with that principle as being appropriate?
 14 MR. ROLPH:
 15 A. I would agree with that principle as being
 16 appropriate. It's akin to a taxpayer being
 17 able to provide evidence that its charges or
 18 expenses are reasonable. I can see -
 19 MR. O'BRIEN:
 20 Q. So you would agree that that would be
 21 appropriate, okay, and the second one there,
 22 "A utility shall have a right to manage its
 23 affairs, but must demonstrate to the
 24 satisfaction of the Board that all affiliate
 25 transactions are prudent", would you agree

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1 with that principle as appropriate?
 2 MR. ROLPH:
 3 A. I would agree with that principle. In a tax
 4 context, the service recipient needs to
 5 benefit from the service. I think that's what
 6 that is trying to get to.
 7 MR. O'BRIEN:
 8 Q. And in terms of prudence, I guess, based on
 9 the fact that you haven't performed an audit
 10 in this case, you couldn't comment on that
 11 with respect to Hydro's application here and
 12 its services, is that right?
 13 MR. ROLPH:
 14 A. That's right.
 15 MR. O'BRIEN:
 16 Q. And the third one, "A utility shall ensure
 17 that inter-corporate transactions will not
 18 disadvantage the interest of rate payers, and
 19 furthermore that rate payers and the utility
 20 will derive some demonstrable benefit from
 21 such transactions". I wonder could you
 22 comment on that principle?
 23 MR. ROLPH:
 24 A. So the first part of that principle, I
 25 believe, would be akin to adherence to an

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1 arms-length principle, so that the
 2 transactions needs to be priced properly and
 3 that both the utility and the rate payers are
 4 getting a benefit, as I described earlier,
 5 from services that are being provided.
 6 MR. O'BRIEN:
 7 Q. So would the two be, not disadvantaging the
 8 interest of the rate payers and showing a
 9 demonstrable benefit, are they the same thing
 10 or are they two different things in your mind?
 11 MR. ROLPH:
 12 A. I suspect that - so they're two different
 13 things of a similar item.
 14 MR. O'BRIEN:
 15 Q. Okay.
 16 MR. ROLPH:
 17 A. Let me explain.
 18 MR. O'BRIEN:
 19 Q. Sure.
 20 MR. ROLPH:
 21 A. The service recipient needs to effectively
 22 require the service, so has a choice of
 23 whether it's going to do the service in-house
 24 using its own people or whether it's going to
 25 out source effectively that service, and it

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1 could be provided by a related party or could
 2 be provided by a third party, but in essence
 3 it needed the service to be rendered in order
 4 to operate its business. So that's the - I
 5 think, in number three. The prudent part
 6 might come with respect to how much one is
 7 paying for that service, and whether you are
 8 using a Rolls Royce version of service versus
 9 a Camry version of service. I mean, whether
 10 or not that's prudent is not up to me.

11 MR. O'BRIEN:
 12 Q. Is it possible that a rate payer, say, would
 13 not be disadvantaged by a transaction, but in
 14 the same vein doesn't benefit from the
 15 transaction either?

16 MR. ROLPH:
 17 A. Could you repeat that question?

18 MR. O'BRIEN:
 19 Q. Is it possible that, say, an entity would not
 20 be disadvantaged by a transaction, but also
 21 wouldn't necessarily benefit from the
 22 transaction either? I guess that was my point
 23 with number three, or does it need to be -
 24 does there need to be a benefit as long as
 25 you're not disadvantaged?

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1 MR. ROLPH:
 2 A. If I'm not receiving a benefit, why would I
 3 enter into the transaction.
 4 (9:45 a.m.)

5 MR. O'BRIEN:
 6 Q. I think that's a fair point. I'm wondering
 7 whether or not the two are mutually exclusive,
 8 not being disadvantaged, and while the Board
 9 would say, "And furthermore, the rate payers
 10 and the utility will derive some demonstrable
 11 benefit", it doesn't seem that particular
 12 sentence suggests that the two are mutually
 13 exclusive.

14 MR. ROLPH:
 15 A. I'm not sure that they can be.

16 MR. O'BRIEN:
 17 Q. Okay, the fourth one there, "The onus is on
 18 the utility to show that it is in compliance
 19 with the guidelines and principles with
 20 respect to the inter-corporate transactions",
 21 would you take issue with that?

22 MR. ROLPH:
 23 A. I would not.

24 MR. O'BRIEN:
 25 Q. And there's one other that I wanted to point

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1 to you, and I wonder if we could bring up an
 2 order of the Board, PU-32, 2007, page 30. I'm
 3 sorry, page 35. Under Board findings, if we
 4 can find the statement here - the second last
 5 paragraph of that page, I believe. Okay, the
 6 first sentence there, "The Board accepts that
 7 inter-corporate transactions may present
 8 unique opportunities for Newfoundland Power
 9 from time to time, but in accordance with
 10 similar findings in Order PU-19, 2003, such
 11 transactions should provide a net benefit to
 12 rate payers and should only be entered into
 13 insofar as they do not compromise the
 14 operational or managerial integrity of the
 15 utility", and it's the last part of that
 16 statement that I wonder if I could ask you to
 17 comment on. Is that something you would
 18 accept as being an appropriate principle?

19 MR. ROLPH:
 20 A. I think that speaks to the management of the
 21 organization itself, so in a shared service
 22 context somebody is going to have to determine
 23 where to apply those resources. That's not
 24 something that I would have actually looked
 25 at.

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1 MR. O'BRIEN:
 2 Q. Okay. When you went through - in your report,
 3 you go through the background of Hydro in
 4 terms of its corporate structure and the
 5 various entities, the related entities as
 6 well, but you also talk about the corporate
 7 structure of Hydro, and we've heard a lot of
 8 evidence to date about a matrix organization.
 9 Are you familiar with that phrase?

10 MR. ROLPH:
 11 A. I've heard the phrase, yes.

12 MR. O'BRIEN:
 13 Q. Can you tell us whether or not you evaluated
 14 the reasonableness of Hydro's inter-company
 15 transaction costing guidelines with a view to
 16 consider whether any of the transactions could
 17 compromise the operational or managerial
 18 integrity within this type of a matrix
 19 organization?

20 MR. ROLPH:
 21 A. I did not.

22 MR. O'BRIEN:
 23 Q. Okay. I'd like to ask you just a few points
 24 about the arms-length standard. You commented
 25 on that and I believe your sources for the

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1 arms-length standard was essentially the
 2 Organization for Economic Cooperation and
 3 Development, is that right, or is this a
 4 broader standard?
 5 MR. ROLPH:
 6 A. There's a number of sources of guidance. The
 7 OECD's guidance on transfer pricing is the
 8 most well known. The Canada Revenue Agency
 9 also provides its own interpretation of that
 10 guidance, and there's laws in the United
 11 States that are codified that also provide
 12 some guidance with respect to how one could
 13 apply the arms-length principle.
 14 MR. O'BRIEN:
 15 Q. So when you talk about applying the arms-
 16 length principle, I guess we're in agreement
 17 that Hydro and its related parties here are
 18 not specifically arms-length in this scenario,
 19 is that right?
 20 MR. ROLPH:
 21 A. That would be correct.
 22 MR. O'BRIEN:
 23 Q. And how would Hydro go about applying the
 24 arms-length principle?
 25 MR. ROLPH:

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1 A. Applying the arms-length principle effectively
 2 means choosing a transfer pricing method that
 3 derives an arms-length price. In the context
 4 of the utility industry, you often hear that
 5 phrased as the use of the market price or the
 6 lower of the cost of providing the service to
 7 the service recipient. That's akin in the
 8 transfer pricing methodology and guidance
 9 applying what is known as the comparable
 10 uncontrolled price method that would be akin
 11 to the market price, or a cost recovery method
 12 and that would be the lower of the cost to
 13 provide it.
 14 MR. O'BRIEN:
 15 Q. Of the two, okay.
 16 MR. ROLPH:
 17 A. So it's literally the same concepts are being
 18 used, different language are being used in the
 19 utility industry as opposed to a specific tax
 20 context.
 21 MR. O'BRIEN:
 22 Q. So in a utility situation, have you seen the
 23 use of the phrase "arms-length principle" or
 24 the use of that principle in evaluating these
 25 types of guidelines?

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1 MR. ROLPH:
 2 A. No, I've typically continued to use the
 3 market.
 4 MR. O'BRIEN:
 5 Q. Market versus cost type of analysis, okay. I
 6 take it from your opinion, would either be
 7 acceptable?
 8 MR. ROLPH:
 9 A. I believe either are the same.
 10 MR. O'BRIEN:
 11 Q. Are the same, yeah.
 12 MR. ROLPH:
 13 A. Potatoe potatoe.
 14 MR. O'BRIEN:
 15 Q. Potatoe potatoe. I tell my daughters potato
 16 tomato. So the Organization for Economic
 17 Cooperation and Development, this is an
 18 internationally accepted sort of way of
 19 evaluating these types of - transfer pricing,
 20 I guess, is it, they set down these guidelines
 21 and you've mentioned that it was a draft set
 22 of guidelines in your initial report, and
 23 those have been finalized now, is that right?
 24 MR. ROLPH:
 25 A. Yes, the OECD has embarked on an initiative

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1 two years ago to address what they refer to as
 2 base erosion and profit shifting. I describe
 3 that in my testimony as multi-national
 4 companies using transfer pricing and other tax
 5 loopholes to lower their corporate effective
 6 tax rates. So the OECD prepared 15 action
 7 items or launched a plan to initiate 15 action
 8 items. One of the things they were addressing
 9 was centralized managerial and administrative
 10 costs.
 11 MR. O'BRIEN:
 12 Q. Okay, and you mentioned that while Hydro and
 13 its transactions between its affiliates don't
 14 go across international borders, why would
 15 again - just explain to me why these
 16 principles set out by the Organization for
 17 Economic Cooperation and Development would
 18 apply to Hydro?
 19 MR. ROLPH:
 20 A. Transfer pricing at its core is really an
 21 accounting concept, so whether it's across
 22 international borders or whether it's across
 23 provincial borders, or whether it's actually
 24 within a company corporate structure itself,
 25 or within between divisions within a company,

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1 there are situations where goods and services
 2 are being bought and sold which have
 3 implications for not only taxpayers, but also
 4 for minority shareholders and employees in the
 5 determination of their bonuses. So because it
 6 has such a high profile, the cross border
 7 transfer pricing has created an environment
 8 where a lot of work has been done to create
 9 guidance on how to actually apply an arms-
 10 length price, and I think that we can just use
 11 that guidance and apply it as we believe it
 12 should in this particular context.
 13 MR. O'BRIEN:
 14 Q. And is there any difference between applying
 15 that price in a taxation scenario versus a
 16 utility scenario applying those principles?
 17 MR. ROLPH:
 18 A. I don't believe so.
 19 MR. O'BRIEN:
 20 Q. Okay. The common services which you spoke of
 21 earlier, I understand that - and this, I
 22 guess, flows from the arms-length principle,
 23 it was your opinion that whether or not an
 24 activity should be charged out in the first
 25 place would come down to whether or not the

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1 recipient would have been willing to pay for
 2 that service, or alternatively perform it in-
 3 house, is that right?
 4 MR. ROLPH:
 5 A. That's right.
 6 MR. O'BRIEN:
 7 Q. So here when we're talking about common
 8 services, as you indicated, we've got human
 9 resources, safety and health, and information
 10 services, those were the three areas that you
 11 dealt with in your report, is that right?
 12 MR. ROLPH:
 13 A. Those are the only known common services that
 14 Hydro identified, yes.
 15 MR. O'BRIEN:
 16 Q. And I believe - did you identify those as
 17 intra-group services, are they what those are
 18 considered?
 19 MR. ROLPH:
 20 A. Yeah, so inter-group or inter-company tend to
 21 get - are words that tend to get used back and
 22 forth.
 23 MR. O'BRIEN:
 24 Q. So what types of services could be, I guess,
 25 provided back and forth that wouldn't be

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1 considered inter-group services, in your mind,
 2 wouldn't appropriately be considered inter-
 3 group services?
 4 MR. ROLPH:
 5 A. One of them is the stewardship costs. So any
 6 cost that the corporate parent incurs in order
 7 for it to be a corporation for its
 8 shareholders. It would - that cost shouldn't
 9 be allocated out to subsidiaries.
 10 MR. O'BRIEN:
 11 Q. Let me ask if we can turn to page 28 of Mr.
 12 Rolph's report. There's a list here of some
 13 services, I think, starting at line 16. Okay,
 14 there's a comment here at line 16 - actually,
 15 if we go up to line 11, activities that
 16 ordinarily would be considered inter-group
 17 services can include administrative services,
 18 financial services, marketing services,
 19 services in staff matters. Now from line 16
 20 down to 21, you've got a number there that an
 21 activity would not be considered an inter-
 22 group service. Can you just take us briefly
 23 through those bullets and what services you're
 24 talking about there?
 25 MR. ROLPH:

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1 A. The first bullet is what I just got through
 2 describing.
 3 MR. O'BRIEN:
 4 Q. Okay.
 5 MR. ROLPH:
 6 A. The second bullet is the activity is actually
 7 a duplication sort of services.
 8 MR. O'BRIEN:
 9 Q. Sure.
 10 MR. ROLPH:
 11 A. So in this example, if Nalcor also performed
 12 its own HR services, it would be odd for it to
 13 be also allocated HR services from Hydro.
 14 MR. O'BRIEN:
 15 Q. All right, and if the benefit results from a
 16 recipient status as a member of a control
 17 group, what does that mean?
 18 MR. ROLPH:
 19 A. What that means is that in certain
 20 circumstances the price of, say, a commodity,
 21 you may get - a subsidiary might get the
 22 benefit of volume, and the guidance is that
 23 because you're an affiliate, you should be
 24 able to benefit from that larger volume
 25 discount just as much as the parent company

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1 should.

2 MR. O'BRIEN:

3 Q. So in that case, that wouldn't be considered

4 an inter-group service?

5 MR. ROLPH:

6 A. Right. So the difference between what you

7 would pay normally and what you get as a

8 benefit of being the multinational group, the

9 guidance is that that would not be something

10 that you would charge for.

11 MR. O'BRIEN:

12 Q. Okay. I guess lines 22 to 30 here, you talk

13 about shareholder activity. Is that --

14 related costs, that's applicable to line 17

15 there, the shareholder benefits? Is that

16 right?

17 MR. ROLPH:

18 A. Yes.

19 MR. O'BRIEN:

20 Q. Okay. And with respect to those shareholder

21 benefits then that you talk about here,

22 shareholder activity costs, I was wondering in

23 particular, costs related to the legal

24 structure of a parent company, what types of

25 costs are you talking about there?

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1 MR. ROLPH:

2 A. Actually, in particular, shareholder meeting

3 costs, I identified that as one of the items

4 that may require further investigation.

5 MR. O'BRIEN:

6 Q. Okay.

7 MR. ROLPH:

8 A. There was a -- it wasn't clear to me that --

9 Hydro it seemed was paying initially for some

10 of the costs with respect to the parent

11 shareholder meetings.

12 MR. O'BRIEN:

13 Q. Okay.

14 MR. ROLPH:

15 A. And then that was getting allocated out to a

16 variety of the subsidiaries in a manner that

17 was -- there was no evidence of how that was

18 being done. So I questioned whether that --

19 all those expenses just should be set back up

20 to Nalcor.

21 MR. O'BRIEN:

22 Q. The parent company. And in terms of say work

23 done on the legal structure of the parent

24 company that may in fact, I guess, time spent

25 in reorganizing the parent company or in

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1 reorganizing Hydro within the parent company,

2 would those types of costs be something you

3 would expect to be borne by Hydro?

4 MR. ROLPH:

5 A. I would expect those to be borne by Nalcor.

6 MR. O'BRIEN:

7 Q. So they wouldn't be considered intracompany

8 costs?

9 MR. ROLPH:

10 A. No.

11 (10:00 a.m.)

12 MR. O'BRIEN:

13 Q. Okay. Let's talk about just the HR costs

14 again, just for a little bit. So Hydro

15 provides those services to the affiliates? Is

16 that right?

17 MR. ROLPH:

18 A. It does.

19 MR. O'BRIEN:

20 Q. Okay. And you had indicated that you felt it

21 was reasonable to allocate those costs by way

22 of an indirect allocation? Is that right?

23 MR. ROLPH:

24 A. That's correct.

25 MR. O'BRIEN:

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1 Q. And I believe it's done by way of an FTE

2 allocator. Is that right?

3 MR. ROLPH:

4 A. That is correct.

5 MR. O'BRIEN:

6 Q. And that's something you've seen in other

7 jurisdictions?

8 MR. ROLPH:

9 A. Many times.

10 MR. O'BRIEN:

11 Q. Okay. And you're satisfied that that meets

12 the arms-length standard? Can you just

13 explain that to me?

14 MR. ROLPH:

15 A. Yes, I think the approach that they're using,

16 which is effectively identifying fully

17 burdened costs of providing the service and

18 then allocating it based on head count, would

19 be an application of a transfer price and

20 method known as the cost plus method.

21 MR. O'BRIEN:

22 Q. In the end, what does that result in? Does it

23 result in sort of a wash in terms of costs in

24 that Hydro recovers its cost, just on a cost

25 recovery basis and any overhead costs

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1 associated with that work as well?
 2 MR. ROLPH:
 3 A. Yes. So fully burdened means all direct and
 4 indirect expenses required to render the
 5 service.
 6 MR. O'BRIEN:
 7 Q. Okay. I want to ask if we can turn to page 37
 8 of Mr. Rolph's report, lines eight -- okay,
 9 lines eight to -- yeah, okay, this is the
 10 conclusion you've got for the HR. These are
 11 the bullets, I guess, that represent your
 12 conclusion for the allocation of the HR costs.
 13 Is that right?
 14 MR. ROLPH:
 15 A. That's correct.
 16 MR. O'BRIEN:
 17 Q. That first bullet there, you conclude that
 18 "allocating the costs of HR-related services
 19 rendered by Hydro to its affiliates using an
 20 indirect cost recovery method is reasonable.
 21 It would not be practical for Hydro to conduct
 22 the research required to determine a direct
 23 charge for such services based on market
 24 data." Can you explain that last sentence to
 25 me?

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1 MR. ROLPH:
 2 A. So in the context of providing intergroup
 3 services, there's typically two methodologies
 4 that are used to derive the arms-length price.
 5 One of them is the comparable uncontrolled
 6 price method or the CUP method, and the other
 7 is this cost plus method. Many times people
 8 want to go and find a market price.
 9 MR. O'BRIEN:
 10 Q. Something to compare it to.
 11 MR. ROLPH:
 12 A. Something to compare it to. Oftentimes,
 13 that's just impractical to do. You would
 14 spend a lot of time and effort and money for
 15 not a whole lot of benefit. So I believe in
 16 this particular case that allocating the
 17 expenses that are incurred based on FTEs is a
 18 reasonable approach.
 19 MR. O'BRIEN:
 20 Q. Okay. So in terms of human resources type
 21 services, would you believe that it would be
 22 difficult to find a market price for those
 23 types of services?
 24 MR. ROLPH:
 25 A. It's difficult to find a comparable price for

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1 that service. That service, you could find a
 2 price for that service but comparing apples to
 3 apples would be very difficult and it's very
 4 rarely done.
 5 MR. O'BRIEN:
 6 Q. Okay. The second bullet, "further disclosure
 7 is warranted" -- you mentioned this in your
 8 direct. "Further disclosure is warranted
 9 regarding Hydro's treatment of the payroll
 10 taxes reported in the HR department's
 11 operating costs." Can you just elaborate a
 12 bit on that for me?
 13 MR. ROLPH:
 14 A. It was just a line item that was in the list
 15 of operating expenses that they used in order
 16 to determine the cost recovery amount and they
 17 subtracted it out at the bottom and there
 18 wasn't a clear indication of where it went.
 19 MR. O'BRIEN:
 20 Q. And is that something you -- I guess from your
 21 direct, it's something you figured should have
 22 been included in the cost base, is it?
 23 MR. ROLPH:
 24 A. Yes. Well, it might -- depending on what it
 25 is, it could or could not be something that

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1 would be included in the cost base.
 2 MR. O'BRIEN:
 3 Q. Did you seek any further clarification from
 4 Hydro on that point?
 5 MR. ROLPH:
 6 A. Yes.
 7 MR. O'BRIEN:
 8 Q. And do you recall what the response was?
 9 MR. ROLPH:
 10 A. I believe it was an onerous task.
 11 MR. O'BRIEN:
 12 Q. Okay. And just tell me sort of why that might
 13 be a concern for you if you don't get that
 14 clarification?
 15 MR. ROLPH:
 16 A. Just from a transparency issue predominantly.
 17 It's a very -- there's a transfer pricing
 18 policy and there's implementing the policy.
 19 So you can have a really great policy but if
 20 you're not implementing it in accordance with
 21 the policy, you're not going to derive the
 22 result that you want to get at the end of the
 23 day, which is a fair share of services
 24 relative to usage.
 25 MR. O'BRIEN:

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1 Q. And would that be -- would that have any
 2 ramifications to the rate payer if the policy
 3 wasn't being applied appropriately?
 4 MR. ROLPH:
 5 A. It would increase the costs. I believe it
 6 would increase the costs that are being held
 7 in Hydro and then as a result the cost base
 8 would be higher and the rate would be higher.
 9 MR. O'BRIEN:
 10 Q. Your third bullet here, "note the HR-related
 11 costs to be recovered from the administrative
 12 fee might not be fully burdened. As a result
 13 the amount charged by Hydro to its affiliates
 14 for this common service might be understated."
 15 Is that relating to the second bullet or is
 16 there another issue with respect to -
 17 MR. ROLPH:
 18 A. That's related to the second issue that I
 19 brought up earlier today.
 20 MR. O'BRIEN:
 21 Q. And what was that?
 22 MR. ROLPH:
 23 A. With respect to the way in which Hydro does or
 24 doesn't allocate internally the common
 25 expenses.

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1 MR. O'BRIEN:
 2 Q. Oh right, okay. You're concerned there might
 3 be a possibility of a cross subsidy there?
 4 You're just going to have to say yes or no for
 5 the record, sorry.
 6 MR. ROLPH:
 7 A. Yes.
 8 MR. O'BRIEN:
 9 Q. And you asked for clarification on that point?
 10 Is that correct?
 11 MR. ROLPH:
 12 A. I'm not sure that I actually asked for
 13 clarification on that particular point.
 14 MR. O'BRIEN:
 15 Q. What sort of information would you look for in
 16 order to clarify that?
 17 MR. ROLPH:
 18 A. It would be presumably in their books and
 19 records. It should have been a journal entry,
 20 one would have thought, that indicated how
 21 much of that common expense was allocated to
 22 the HR department.
 23 MR. O'BRIEN:
 24 Q. With respect to safety and health, from what I
 25 heard in your direct, you had similar

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1 conclusions with respect to the allocation, it
 2 was reasonable on an indirect charge. Is that
 3 right?
 4 MR. ROLPH:
 5 A. That's correct.
 6 MR. O'BRIEN:
 7 Q. And in terms of your comments about any
 8 particular information that you -- or further
 9 clarification you might require, was it
 10 similar comments for those services?
 11 MR. ROLPH:
 12 A. Yes. I had similar comments with respect to
 13 the allocation of common expenses and whether
 14 or not that was built into the cost base or
 15 not.
 16 MR. O'BRIEN:
 17 Q. Okay. And with respect to that, if you don't
 18 have that additional information, does that
 19 cause any transparency issues in your mind?
 20 MR. ROLPH:
 21 A. Yes.
 22 MR. O'BRIEN:
 23 Q. I wonder if we could turn to page 30, lines 33
 24 to 35, and we're still under the safety and
 25 health services. Line 33, I believe. Okay.

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1 Or maybe we'll start at 32. "Whether the
 2 common services rendered by Hydro or the
 3 corporate services rendered by affiliates for
 4 Hydro and by Hydro for its affiliates might be
 5 marked up depends on the specific service
 6 rendered. For example, the safety and health
 7 and IS services rendered by Hydro are services
 8 that, in my experience, would normally be
 9 marked up because they require engineering and
 10 IT skills to perform these functions." I
 11 wonder why -- whether you can elaborate why it
 12 was reasonable or you feel it's reasonable to
 13 use an indirect charge in this particular
 14 situation?
 15 MR. ROLPH:
 16 A. It would still be an indirect charge. It
 17 would just be with a markup.
 18 MR. O'BRIEN:
 19 Q. And the markup, have you recommended a markup
 20 in your report?
 21 MR. ROLPH:
 22 A. I have not.
 23 MR. O'BRIEN:
 24 Q. Why is that?
 25 MR. ROLPH:

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1 A. Because the two entities are non-tax paying
 2 entities.
 3 MR. O'BRIEN:
 4 Q. Okay. And that goes to, I guess, the point in
 5 your report where you talk about the
 6 ownership, I guess?
 7 MR. ROLPH:
 8 A. It does.
 9 MR. O'BRIEN:
 10 Q. Okay. I'll take you to that now in a bit.
 11 The corporate services, let's just talk about
 12 corporate services for a minute, and you've
 13 indicated a direct charge was an appropriate
 14 method and that met with the arms-length
 15 standard. Is that right?
 16 MR. ROLPH:
 17 A. That is correct.
 18 MR. O'BRIEN:
 19 Q. Okay. So rather than allocate by indirect
 20 charge, this method would require allocation,
 21 I believe you said, based on time spent by an
 22 employee as well as the employee's labour rate
 23 and a fixed charge on top of that? Is that
 24 right?
 25 MR. ROLPH:

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1 A. That's correct.
 2 MR. O'BRIEN:
 3 Q. Okay. What are the practicalities that in
 4 this particular case would weigh in favour of
 5 a direct charge versus an indirect charge,
 6 what we saw in common services situation?
 7 MR. ROLPH:
 8 A. It's really around time spent by the
 9 individuals. I've seen it actually done both
 10 ways.
 11 MR. O'BRIEN:
 12 Q. Have you?
 13 MR. ROLPH:
 14 A. So you can base it on time spent or you could
 15 base it on -- I have seen it based on FTEs,
 16 but because it's so -- tends to be so specific
 17 to a particular task or a group of tasks, the
 18 predominant one is time.
 19 MR. O'BRIEN:
 20 Q. Okay. So in terms of, I guess, from a
 21 practical standpoint, would it be easier to
 22 allocate a direct charge for corporate
 23 services than it would be for common services?
 24 It would be, would it?
 25 MR. ROLPH:

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1 A. It would.
 2 MR. O'BRIEN:
 3 Q. Okay. And that would -- would that depend on
 4 the amount of time generally spent or
 5 allocated in a corporate situation versus a
 6 common services situation?
 7 MR. ROLPH:
 8 A. Yeah. So you can imagine if you're doing an
 9 HR function, trying to figure out which person
 10 that you've actually dealt with and what
 11 entity they're from on a day -- on a 15-minute
 12 interval basis. It would be very onerous, I
 13 think.
 14 MR. O'BRIEN:
 15 Q. Okay.
 16 MR. ROLPH:
 17 A. In your corporate service perspective, you're
 18 typically dealing on a project, so you're, I
 19 think, able to identify your time a little bit
 20 more precisely.
 21 MR. O'BRIEN:
 22 Q. You talked with Ms. Greene just about
 23 recording time, that sort of thing, and you've
 24 made some recommendations I think yourself in
 25 terms of how increments of time and that sort

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1 of thing. Have you reviewed Hydro's -- any of
 2 Hydro's policies for recording time, apart
 3 from what's in the exhibit that we have?
 4 MR. ROLPH:
 5 A. All I've reviewed was their policy with
 6 respect to recording time.
 7 MR. O'BRIEN:
 8 Q. And would that be -- if we could turn to
 9 Exhibit 8, is that the exhibit that was filed
 10 or there was a subsequent policy or a
 11 subsequent information filed, but would that
 12 be Exhibit 8 that you're talking about what
 13 you looked at, intercompany transaction
 14 costing guidelines? Maybe I can refer you to
 15 -
 16 (10:15 a.m.)
 17 MR. ROLPH:
 18 A. Yes, please refer me.
 19 MR. O'BRIEN:
 20 Q. There's another document that we have.
 21 Undertaking 25, pull that up. Just wondering
 22 if you've reviewed this particular document
 23 and go to page two of that document.
 24 MR. ROLPH:
 25 A. Yeah.

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1 MR. O'BRIEN:
 2 Q. Yes, have you seen this document? You have?
 3 Is that a yes, for the record?
 4 MR. ROLPH:
 5 A. That would be a yes. Sorry.
 6 MR. O'BRIEN:
 7 Q. Okay. I just wanted to ask you a couple of
 8 things about that document. If we go to page
 9 two of -- and I believe it's -- yes, on the
 10 bottom left-hand corner there, the page is.
 11 Yeah, there we go. I wanted to ask you about
 12 a comment there at the bottom, the last
 13 bullet, "note: in some locations electronic
 14 timesheets are completed on behalf of
 15 employees by designated administrative staff.
 16 Please ask your supervisor or administrative
 17 staff what the process is in your area."
 18 Would you have any comment on the
 19 reasonableness of that approach to recording
 20 time?
 21 MR. ROLPH:
 22 A. I believe that it's a personal preference. At
 23 times, I've had my administrative assistant do
 24 my time and at other times, I haven't.
 25 MR. O'BRIEN:

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1 Q. Would you have any concern in terms of
 2 accuracy of time if someone else is recording
 3 your time?
 4 MR. ROLPH:
 5 A. I think it would depend on the information
 6 that that person was provided. So if that
 7 person was provided accurate information to
 8 input the hours, it wouldn't be a problem. If
 9 they're trying to figure out the time on their
 10 self without any guidance or direction, that
 11 would be a bit of a concern.
 12 MR. O'BRIEN:
 13 Q. In his evidence, Mr. Martin indicated that his
 14 executive assistant records his time from
 15 reviewing his schedule. Is that something
 16 that you would consider of a concern in terms
 17 of timekeeping?
 18 MR. ROLPH:
 19 A. I haven't reviewed his schedule, so I don't
 20 know how detailed it is.
 21 MR. O'BRIEN:
 22 Q. It would depend on how detailed the
 23 information is in that schedule?
 24 MR. ROLPH:
 25 A. Depending on how accurate the schedule is.

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1 MR. O'BRIEN:
 2 Q. There's been some mention as well that -- by
 3 Mr. Martin and a couple of other individuals
 4 that from an executive standpoint, I guess,
 5 there's a policy or rule at Hydro to only
 6 charge hours into Hydro for activities which
 7 were solely related to Hydro. Are you aware
 8 of that?
 9 MR. ROLPH:
 10 A. I've heard that, yes.
 11 MR. O'BRIEN:
 12 Q. Is that something that you saw in any of the
 13 documents that you reviewed?
 14 MR. ROLPH:
 15 A. That's not something that I saw in any of the
 16 documents, no.
 17 MR. O'BRIEN:
 18 Q. Is it something that you've come across in any
 19 other situation of your own review?
 20 MR. ROLPH:
 21 A. Based on my experience, no.
 22 MR. O'BRIEN:
 23 Q. Would it cause you any concern from a
 24 transparency perspective?
 25 MR. ROLPH:

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1 A. It would.
 2 MR. O'BRIEN:
 3 Q. And why is that?
 4 MR. ROLPH:
 5 A. Because it means that the allocation of an
 6 individual's time is not being accurately
 7 allocated.
 8 MR. O'BRIEN:
 9 Q. In terms of common expenses now, Mr. Rolph,
 10 you mentioned the office space was one,
 11 telephone infrastructure was another and there
 12 was another group just entitled other
 13 expenses, I guess, not covered by
 14 administrative fee. Is that right?
 15 MR. ROLPH:
 16 A. That's correct.
 17 MR. O'BRIEN:
 18 Q. Those are the three. I wonder if we can have
 19 a quick look at page 48, lines two to four, of
 20 Mr. Rolph's June report? And this is the
 21 conclusion section with respect to network
 22 services, I believe. Yes, the first bullet
 23 there at line two, "further inquiry is
 24 warranted to confirm the telephone
 25 infrastructure costs to be recovered by Hydro

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1 from Nalcor and its other lines of business
 2 are fully burdened and do not include any non-
 3 operating expenses." What do you mean by that
 4 when you say that?
 5 MR. ROLPH:
 6 A. So, in applying this particular methodology,
 7 you only want to include operating expenses
 8 and not what I would refer to as financial
 9 expenses, like interest. It wasn't clear to
 10 me that items such as interest weren't being
 11 included in that base.
 12 MR. O'BRIEN:
 13 Q. And did you seek -
 14 MR. ROLPH:
 15 A. So it's really a clarification of what was in
 16 the base.
 17 MR. O'BRIEN:
 18 Q. Did you seek clarification on that?
 19 MR. ROLPH:
 20 A. I did not.
 21 MR. O'BRIEN:
 22 Q. Okay. If we can turn to the other expenses,
 23 page 53, lines two to four? Okay, and this is
 24 the conclusion for under the other expenses
 25 grouping. I wanted to ask you just about the

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1 first bullet there, "further clarification is
 2 warranted regarding which of the other
 3 expenses are initially paid for by Hydro and
 4 subsequently charged back to Nalcor -- to one
 5 of Nalcor's other lines of business." Now you
 6 -- I believe you indicated in your direct, you
 7 did ask for this information?
 8 MR. ROLPH:
 9 A. I did.
 10 MR. O'BRIEN:
 11 Q. You did, and it wasn't forthcoming?
 12 MR. ROLPH:
 13 A. It wasn't forthcoming.
 14 MR. O'BRIEN:
 15 Q. No? And why is it important for you to have
 16 that information?
 17 MR. ROLPH:
 18 A. From a transparency perspective. In order to
 19 be able to demonstrate that they're applying
 20 the affiliate pricing policy, there should be
 21 a paper trail effectively that indicates this
 22 is the charge that they paid initially on
 23 behalf of one of their affiliates and this is
 24 how much they charged back to the affiliate.
 25 MR. O'BRIEN:

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1 Q. And is there a concern from rate payers'
 2 perspective of any implication there?
 3 MR. ROLPH:
 4 A. I think that it's more of a implementation
 5 issue than anything else. The magnitude of
 6 these transactions were not very high.
 7 MR. O'BRIEN:
 8 Q. Okay. So in terms of materiality, it wouldn't
 9 be something that you'd have a concern about?
 10 MR. ROLPH:
 11 A. Correct.
 12 MR. O'BRIEN:
 13 Q. Let's just briefly talk about your testimony
 14 concerning the difference, I guess, between an
 15 investor-owned, say, utility and a Crown-owned
 16 utility. I guess that seemed to be one of the
 17 focuses you had as to how you looked at
 18 whether or not corporate services should be --
 19 have a markup, that kind of thing. Can you
 20 give me a little bit more information on that
 21 and how you see that, how there's a difference
 22 here between say Hydro and an investor-owned
 23 utility?
 24 MR. ROLPH:
 25 A. In a investor-owned utility scenario, the

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1 corporate group is effectively trying to
 2 generate profit and in a situation where
 3 Newfoundland Power were providing a service to
 4 Fortis, for example, the -- and didn't charge
 5 a markup, then Newfoundland Power wouldn't
 6 effectively be sharing in the profits of the
 7 fruit of their efforts for providing that
 8 service. The same would be in the reverse
 9 order. And that's really where -- in that
 10 scenario, why a markup would be applied.
 11 MR. O'BRIEN:
 12 Q. And in terms of this scenario we have here,
 13 you've mentioned there'd be a concern of a
 14 cross subsidy, say if Nalcor provided a
 15 service with a markup to Hydro? Is that
 16 correct?
 17 MR. ROLPH:
 18 A. That's correct.
 19 MR. O'BRIEN:
 20 Q. And also going back, if Hydro provided a
 21 service to Nalcor, in your report you indicate
 22 there'd be a concern of an inappropriate
 23 markup. Is that right?
 24 MR. ROLPH:
 25 A. That's correct.

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1 MR. O'BRIEN:
 2 Q. And just explain to me why it would be a
 3 concern to you there, from Hydro providing a
 4 service to say Nalcor or one of the other
 5 entities, why it would be inappropriate for
 6 Hydro to provide that service with a markup?
 7 MR. ROLPH:
 8 A. Because each of the entities are not profit
 9 entities and both of them are, in particular
 10 Hydro, its business is generated on a cost
 11 basis. So, in terms of applying a markup on
 12 services provided by Nalcor, all that's going
 13 to do is increase the costs that Hydro is
 14 bearing and that would get put on as an
 15 additional burden to the rate payers.
 16 MR. O'BRIEN:
 17 Q. And why is it an additional burden to the rate
 18 payers? Are you equating a rate payer with a
 19 taxpayer in that scenario?
 20 MR. ROLPH:
 21 A. No. I'm saying that because the rate at which
 22 the electricity is paid is based on a cost
 23 based approach and if you increase the costs,
 24 then the rate is going to have to increase in
 25 order to pay for the additional costs.

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1 MR. O'BRIEN:
 2 Q. Okay. I wonder if we could have a look at NP-
 3 PUB-26? So this was an RFI and there was a
 4 question asked of you to "explain in full Mr.
 5 Rolph's view as to the degree, if any, that
 6 the Board should make distinctions between
 7 rate payers and taxpayers in its regulatory
 8 decision making concerning Hydro. In the
 9 response, please explicitly address the
 10 distinction that Mr. Rolph perceives between
 11 rate payers and taxpayers."
 12 And if we go down to line 13 here, your
 13 response indicates "a taxpayer" -- maybe I'll
 14 start at line 10 there. "From my perspective
 15 concerning Newfoundland and Labrador Hydro, a
 16 rate payer could be a residential or a
 17 commercial customer in Rural Newfoundland and
 18 Labrador, a major industrial customer or
 19 Newfoundland Power Inc. A taxpayer, on the
 20 other hand, could be a person or any form of
 21 business enterprise not limited to those that
 22 reside in the province that pays any form of
 23 tax including, but not limited to, personal
 24 income tax, corporate income tax and sales
 25 tax. Not all rate payers are taxpayers and

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1 vice versa." So I guess, I mean, we're in
 2 agreement here that a rate payer doesn't
 3 necessarily mean a taxpayer?
 4 MR. ROLPH:
 5 A. Correct.
 6 MR. O'BRIEN:
 7 Q. Okay. "They have different interests. For
 8 example, rate payers have not guaranteed
 9 Hydro's debt." Why is that important?
 10 MR. ROLPH:
 11 A. I just used it as an example.
 12 MR. O'BRIEN:
 13 Q. Okay. Is it of any consequence to you in the
 14 analysis of whether or not Hydro should charge
 15 a markup to any services provided to Nalcor or
 16 to one of its other affiliates?
 17 MR. ROLPH:
 18 A. Given the magnitude of the transactions, no.
 19 MR. O'BRIEN:
 20 Q. Okay. Later on you say "the Government of
 21 Newfoundland" -- and this is at line 17, "the
 22 Government of Newfoundland and Labrador has
 23 guaranteed Hydro's debt. Consequently, should
 24 Hydro default on its debt obligations, the
 25 Government is obligated to step in and pay

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1 Hydro's debt obligations using revenue
 2 generated or Provincial debt supported by
 3 taxpayers. As a result, taxpayers have a
 4 vested interest in ensuring that rate payers
 5 pay a rate that enables Hydro to meet its debt
 6 obligations." Is that something that the
 7 Board should be considering here, is the
 8 vested interest of a rate -- of a taxpayer in
 9 determining whether or not a markup should be
 10 applied for services provided by Hydro to an
 11 affiliate?
 12 MR. ROLPH:
 13 A. No, I don't believe so.
 14 MR. O'BRIEN:
 15 Q. Okay. So you're in agreement with me that the
 16 focus for the Board here should be the rate
 17 payer and balancing the rate payer's interest
 18 with that of -- and I guess there's no concern
 19 about balancing the rate payer's interest with
 20 the taxpayer's interest?
 21 MR. ROLPH:
 22 A. Could you ask that question -
 23 MR. O'BRIEN:
 24 Q. Sure. And I'm just sort of trying to get a
 25 flavour for your reasoning here as to whether

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1 or not there's a concern here that the Board
 2 should have in the forefront of its mind when
 3 considering whether a markup should be
 4 applied, say in Hydro's situation, whether or
 5 not the Board has to balance the interests of
 6 a rate payer versus the interest of a
 7 taxpayer.
 8 MR. ROLPH:
 9 A. Oh, the Board should be concerned with the
 10 rate payer.
 11 MR. O'BRIEN:
 12 Q. Okay. So apart from that, why then does it
 13 matter if Hydro is owned -- is publicly owned,
 14 say owned by Nalcor which is a public
 15 corporation? What does that matter versus say
 16 an investor-owned situation?
 17 MR. ROLPH:
 18 A. Because the rate payers would end up paying a
 19 higher rate if there was a markup
 20 theoretically at the margin.
 21 MR. O'BRIEN:
 22 Q. But if the rate payer -- if Hydro provided a
 23 service with a markup, then the rate payer
 24 wouldn't pay higher.
 25 MR. ROLPH:

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1 A. That is true.
 2 (10:32 a.m.)
 3 MR. O'BRIEN:
 4 Q. Okay. In terms of materiality, there's a
 5 number of points throughout your report you
 6 talk about materiality and I want to have just
 7 a quick discussion on that. If we can turn to
 8 page 57, Table 22? So in your report, there's
 9 a number of instances where you talk about
 10 whether or not there might be a difference in
 11 cost and it's not a material difference, that
 12 sort of thing. I just wanted to ask you about
 13 your -- this particular table, if we can
 14 scroll up just a little bit, and this is under
 15 the -- might have to go to the previous page.
 16 Yeah, you talk about a sensitivity analysis
 17 that you did to determine whether or not there
 18 were material impacts. Can you just walk me
 19 through how you did that analysis?
 20 MR. ROLPH:
 21 A. Effectively what I did was look at the current
 22 revenue requirement based on the costs and
 23 then increased the cost by an incremental
 24 amount to determine how much more costs or how
 25 much less costs would have to be incurred in

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1 order to move the -- change the 8.9 cent per
 2 kilowatt hour number.
 3 MR. O'BRIEN:
 4 Q. And the 8.9 cent per kilowatt hour, that's --
 5 what does that reflect?
 6 MR. ROLPH:
 7 A. That reflects the revenue requirement in the
 8 2015 test year and the estimated usage and
 9 dividing the two.
 10 MR. O'BRIEN:
 11 Q. Is this of Newfoundland Power?
 12 MR. ROLPH:
 13 A. Hydro.
 14 MR. O'BRIEN:
 15 Q. Hydro. In line 11 and 12 there -- or sorry, 9
 16 to 12, "to demonstrate the rate increase
 17 sought by Hydro is not very sensitive to the
 18 potential refinements to Nalcor's intercompany
 19 policy -- pricing policy identified in Section
 20 4, I undertook the following sensitivity
 21 analysis. In Table 21, I present my estimate
 22 of the effective rate per kilowatt hour
 23 required by Hydro to achieve its estimated
 24 revenue requirement for NPI." What's NPI?
 25 MR. ROLPH:

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1 A. Correct.
 2 MR. O'BRIEN:
 3 Q. What's that? What is NPI?
 4 MR. ROLPH:
 5 A. Newfoundland Power.
 6 MR. O'BRIEN:
 7 Q. Okay. "During the 2015 test year to be 8.9
 8 cents."
 9 MR. ROLPH:
 10 A. So the revenue requirement was the amount for
 11 Newfoundland Power.
 12 MR. O'BRIEN:
 13 Q. Right, and this -
 14 MR. ROLPH:
 15 A. And the estimated usage.
 16 MR. O'BRIEN:
 17 Q. And why did you do an analysis like this?
 18 Have you seen that type of analysis before?
 19 MR. ROLPH:
 20 A. There's a balancing act between planning and
 21 implementing a transfer pricing policy and
 22 what you want to be able to accomplish from a
 23 transparency perspective and then in terms of
 24 is it always prudent to put in a whole bunch
 25 of time and effort to accomplish that. What I

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1 really was trying to demonstrate in this thing
 2 that despite the fact that there might be some
 3 implementation issues with respect to the way
 4 that the policy that has been planned and
 5 written has transpired that those changes
 6 weren't very material, were not going to be
 7 material.
 8 MR. O'BRIEN:
 9 Q. Okay. And that was the understanding I got,
 10 you were looking for an analysis to say how
 11 can I look at the materiality here to say
 12 well, there may be implementation problems
 13 here, but ultimately the outcome is probably
 14 not going to be material if we do get into a
 15 full audit type of an analysis. Is that
 16 right?
 17 MR. ROLPH:
 18 A. That's correct.
 19 MR. O'BRIEN:
 20 Q. Okay. And I just wanted to know, just in
 21 terms of the sensitivity though, you come to a
 22 conclusion that it would take a three million
 23 dollar adjustment in cost to get to a
 24 materiality situation? Is that what your
 25 conclusion is?

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1 MR. ROLPH:
 2 A. That's what my calculation determined, yes.
 3 MR. O'BRIEN:
 4 Q. So ultimately, there could be three million
 5 dollars going either way before you would say
 6 there was a materiality issue with how
 7 implementation of these pricing methods would
 8 raise concern?
 9 MR. ROLPH:
 10 A. That's what my calculation indicated.
 11 MR. O'BRIEN:
 12 Q. And you're satisfied that three million
 13 dollars is something -- do you think that's a
 14 low number, a high number? Is it something
 15 the Board should -
 16 MR. ROLPH:
 17 A. In the context of the shared services, that's
 18 a -- that would be a very high number,
 19 considering that it's higher than most of the
 20 actual shared services itself.
 21 MR. O'BRIEN:
 22 Q. And that's what I was going to get to, I
 23 guess. The shared services that we see that
 24 are being claimed are -- that would be almost
 25 one-third in some years. Is that right?

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1 MR. ROLPH:
 2 A. Correct, yes.
 3 MR. O'BRIEN:
 4 Q. Okay. And how would you square that circle
 5 then in terms of whether or not there's a
 6 materiality here, if we've got a one-third
 7 swing?
 8 MR. ROLPH:
 9 A. I think I would square that by saying we need
 10 to balance transparency with just prudence.
 11 So, we need to -- the Board needs to think
 12 about how much time and effort will they
 13 require of Hydro in order to ensure that
 14 they're accurately implementing the transfer
 15 pricing or their affiliate pricing policies.
 16 There's a bit of a cost benefit to that.
 17 MR. O'BRIEN:
 18 Q. Okay. So if you look at it from the
 19 perspective of your sensitivity analysis, the
 20 materiality would require three million
 21 dollars, but if you look at it from the
 22 perspective if you compare it to what's
 23 actually being charged and what's actually
 24 being recovered, it might be a much more
 25 significant figure, if you look at it in that

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1 -- with that approach. You're looking at a
 2 three million dollar figure either way of a
 3 nine million dollar claim.
 4 MR. ROLPH:
 5 A. If there was three million that was missing in
 6 the system.
 7 MR. O'BRIEN:
 8 Q. Exactly, yeah.
 9 MR. ROLPH:
 10 A. Yes. Based on the evidence that I saw, it
 11 would be difficult, I think, to get to three
 12 million dollars.
 13 MR. O'BRIEN:
 14 Q. To get to that figure, okay. One of the other
 15 things I wanted to ask you about is your
 16 comments about reviewing and reporting
 17 protocol, I guess. Your recommendation would
 18 be to have a reporting protocol to the Board
 19 annually. Is that right?
 20 MR. ROLPH:
 21 A. That's correct.
 22 MR. O'BRIEN:
 23 Q. And is it something that you think from a
 24 practical perspective would be difficult for
 25 Hydro to do quarterly or semi-annually?

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1 MR. ROLPH:
 2 A. It's again relative to the size of the
 3 transactions, I think that doing it from a
 4 quarterly perspective would be a little
 5 onerous.
 6 MR. O'BRIEN:
 7 Q. Okay.
 8 MR. ROLPH:
 9 A. If the transactions were much larger and had
 10 the potential to have a material impact, then
 11 I might think about doing it on a quarterly
 12 basis.
 13 MR. O'BRIEN:
 14 Q. And are you focused on materiality again here
 15 or would you be focused more on a figure, if
 16 you were going to say if the transaction was a
 17 larger figure, that might be something you'd
 18 report?
 19 MR. ROLPH:
 20 A. It's a question of a couple of things. So is
 21 there evidence that the transfer pricing
 22 policy has been implemented properly before.
 23 MR. O'BRIEN:
 24 Q. Right.
 25 MR. ROLPH:

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1 A. And then that would -- so almost from a risk
 2 sensitivity scenario. If you've had issues in
 3 the past with a particular area, you may want
 4 to pay more attention to that particular area
 5 and otherwise, you would audit them on a less
 6 frequent basis.
 7 MR. O'BRIEN:
 8 Q. Okay. And would your comments concerning
 9 transparency and the availability of all the
 10 information here, you've indicated there's a
 11 few areas where you thought further
 12 information was required, would that enter
 13 into your mind set as to how often reporting
 14 should be required?
 15 MR. ROLPH:
 16 A. It would.
 17 MR. O'BRIEN:
 18 Q. And just elaborate on that.
 19 MR. ROLPH:
 20 A. I think from an implementation perspective,
 21 until some of these things are clarified and
 22 also considering the size of the transactions,
 23 I would look at things from an annual basis
 24 and then once there's some protocols put in
 25 place that have been audited and people are

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1 comfortable that they're being followed, then
 2 you could -- because again, of the size of the
 3 transactions, instead of looking at it on an
 4 annual basis, you may want to consider at some
 5 future time a different reporting timeframe.
 6 MR. O'BRIEN:
 7 Q. So it may depend on the outcome of the annual
 8 reviews as to whether or not you have a longer
 9 period before you'd review or a shorter period
 10 in the future?
 11 MR. ROLPH:
 12 A. Right. So I can draw on my income tax audit
 13 experience.
 14 MR. O'BRIEN:
 15 Q. Sure.
 16 MR. ROLPH:
 17 A. If an audit has gone poorly because of
 18 information concerns, the Canada Revenue
 19 Agency typically comes back more frequently
 20 and the larger your transactions are, the more
 21 frequently they will audit them.
 22 MR. O'BRIEN:
 23 Q. And if you had a situation where you've gone
 24 say annually and there's been no concerns
 25 there, is it something you would stretch out

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1 any further?
 2 MR. ROLPH:
 3 A. Some taxpayers have to be audited every year.
 4 There's a program called large tax file
 5 program, so regardless of the size of their
 6 transactions, they get the pleasure of the
 7 company of a Canada Revenue Agency on an
 8 annual basis. There's others that once
 9 they've demonstrated that they have their
 10 transfer pricing in place, they will wait for
 11 three years and then audit three years in a
 12 row and make appropriate adjustments.
 13 MR. O'BRIEN:
 14 Q. Okay. I don't have any further questions for
 15 Mr. Rolph.
 16 CHAIRMAN:
 17 Q. I think Mr. Johnson we're over to you.
 18 MR. BRAD ROLPH, CROSS-EXAMINATION BY THOMAS JOHNSON, Q.C.
 19 JOHNSON, Q.C.:
 20 Q. Yes, thank you, Mr. Chairman. Mr. Rolph, my
 21 name is Tom Johnson, Consumer Advocate in
 22 these proceedings.
 23 MR. ROLPH:
 24 A. Hello.
 25 JOHNSON, Q.C.:

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1 Q. I have questions for you arising out of your
 2 report and your evidence. Just to start off,
 3 Mr. Rolph, I understand both from your report
 4 and from what you've confirmed in direct
 5 evidence this morning that when you were
 6 preparing your report and considering and
 7 evaluating Hydro's methods and their
 8 reasonableness that you looked at your own
 9 experience and expertise and you also looked
 10 at managerial and cost accounting literature,
 11 industry practice, tax administration guidance
 12 to develop your framework, right?
 13 MR. ROLPH:
 14 A. That's correct.
 15 JOHNSON, Q.C.:
 16 Q. And just, I guess, the question that I would
 17 have is why did you not consider the Board's
 18 previous orders, because there's been a fair
 19 bit of juris prudence on Board awards, et
 20 cetera, Board orders in this jurisdiction
 21 regarding Newfoundland Power's affiliate
 22 costing and I guess the question I would have
 23 is why you wouldn't have considered the
 24 Board's previous orders regarding Newfoundland
 25 Power as a source of guidance when you were

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1 developing a framework upon which to evaluate
 2 the reasonableness of the methods used by
 3 Hydro. Can you comment on that?
 4 MR. ROLPH:
 5 A. In the context of related party transactions
 6 reliable benchmarks, I would not ordinarily
 7 look at related party transactions and the
 8 guidance that the Board has provided with
 9 respect to those particular transactions
 10 between those related parties. It provides me
 11 with guidance but I wanted to take a more pure
 12 transfer pricing arms-length approach to it to
 13 the framework.
 14 (10:45 a.m.)
 15 JOHNSON, Q.C.:
 16 Q. But aren't some of the same issues at play as
 17 between Newfoundland Power and its parent? I
 18 mean they're not in an arms-length
 19 relationship either, nor is Hydro and Nalcor
 20 in an arms-length relationship. So, I'm still
 21 left wondering why the regulatory landscape
 22 here wouldn't have been more prominent in your
 23 evaluation of the reasonableness of Hydro's
 24 approach.
 25 MR. ROLPH:

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1 A. I think it just was a little too close to
 2 home. So, if you're trying to determine what
 3 the -- in my mind, what the right answer
 4 should be, the actions of the Board in the
 5 past shouldn't really cloud my -- or help to
 6 form my determination or the approach that I
 7 took.
 8 JOHNSON, Q.C.:
 9 Q. So, what role would you suggest that the Board
 10 give to its prior orders and the guidelines
 11 that, for instance, Newfoundland Power has
 12 been using for pricing services? What role
 13 should that be given in evaluation, in your
 14 view, by the -- when the Board is taking all
 15 this onboard, as it were, and assessing the
 16 reasonableness of Hydro's situation?
 17 MR. ROLPH:
 18 A. It's an indication of what -- how they've
 19 dealt with the issue in the past.
 20 JOHNSON, Q.C.:
 21 Q. So it's no more than that in your judgment?
 22 MR. ROLPH:
 23 A. I think it's one piece of a number of evidence
 24 that they can consider.
 25 JOHNSON, Q.C.:

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1 Q. Okay. So in your reply -- if we could bring
 2 up the reply to NP-PUB-030 for a second?
 3 Here's where Newfoundland Power asked you if
 4 you believed that the Board should consider
 5 the inter-affiliate code of conduct between
 6 Newfoundland Power and its affiliates, and I
 7 think this response would indicate that this
 8 would be anecdotal type of evidence. Was that
 9 -- I think what -- I'm looking for the word.
 10 Yes, line 14.
 11 MR. ROLPH:
 12 A. Right, so it's an indication of what industry
 13 practices are.
 14 JOHNSON, Q.C.:
 15 Q. Yeah. So -
 16 MR. ROLPH:
 17 A. Or of what one industry practice is.
 18 JOHNSON, Q.C.:
 19 Q. Right. So, the information from utilities
 20 besides Newfoundland Power, would that be
 21 anecdotal as well?
 22 MR. ROLPH:
 23 A. That would also be transactions between
 24 related parties that provide evidence of what
 25 they're doing and whether the Board considers

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1 that to be an appropriate way of doing things
 2 is up to the Board.
 3 JOHNSON, Q.C.:
 4 Q. Mr. O'Brien brought you through some of the
 5 principles this morning that have been applied
 6 in the Newfoundland Power context and I take
 7 it you're aware, Mr. Rolph, that -- from your
 8 review of the Newfoundland Power policy that
 9 in fact not only should benefits be
 10 transparent and demonstrable but that they
 11 should be maximized to the advantage of rate
 12 payers? Do you recall that?
 13 MR. ROLPH:
 14 A. I don't recall the word "maximum" but that
 15 notion, yes.
 16 JOHNSON, Q.C.:
 17 Q. Yeah. Just take that subject to check that
 18 that's one of the underlying principles of
 19 Newfoundland Power's policy. And now, Mr.
 20 Rolph, I recognize that you've not done much
 21 work in the regulated environment, but would
 22 you -- can I get you to comment on the -- that
 23 there should be some level of consistency when
 24 we're talking about utilities in the same
 25 regulatory environment when it comes to these

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1 matters?
 2 MR. ROLPH:
 3 A. I believe that there is a level of
 4 consistency. I think all of the codes of
 5 conduct have at their core what I will
 6 describe as the arms-length principle. You
 7 describe or the industry describes it in
 8 different language perhaps, but in the
 9 essence, we want to make sure that the costs
 10 that are being paid or charged by a regulated
 11 industry is an appropriate amount for the
 12 goods or services that they're buying or
 13 selling.
 14 JOHNSON, Q.C.:
 15 Q. And of course, you'd be aware, I take it, that
 16 Newfoundland Power charges a markup on
 17 services for affiliates?
 18 MR. ROLPH:
 19 A. Yes, I'm aware of that.
 20 JOHNSON, Q.C.:
 21 Q. Yeah, okay. And should that -- but that
 22 doesn't -- does that influence your view at
 23 all as to whether Newfoundland Hydro should
 24 charge a markup?
 25 MR. ROLPH:

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1 A. No, it does not actually.
 2 JOHNSON, Q.C.:
 3 Q. It doesn't at all? Okay. And why doesn't
 4 that influence your judgment as to whether a
 5 markup should be applied?
 6 MR. ROLPH:
 7 A. Because every transaction is actually
 8 different and the appropriate transfer price
 9 for one related party transaction is not
 10 necessarily akin to another related party
 11 transaction. So, in looking at intercompany
 12 transactions, it's very important to look at
 13 the terms and conditions of that particular
 14 intercompany transaction and the functions
 15 that are being performed by each of the
 16 parties that are involved, the level of assets
 17 that each are using and the risks that each of
 18 them are bearing and it's only in putting the
 19 transaction in that context that you'll be
 20 able to determine whether the transfer price
 21 in that circumstance is good, bad or
 22 indifferent.
 23 JOHNSON, Q.C.:
 24 Q. Okay. Now, just bring you to your view that
 25 unless the recipient of the common service

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1 rendered is an energy project involving
 2 private interest, not marking up the common
 3 service related costs is reasonable in your
 4 view, and you say the same thing about
 5 corporate services, but then you go on to
 6 suggest that if there is going to be a markup,
 7 it should -- in your report, you said it
 8 should be between two and five percent, but
 9 you indicate now it should be five percent,
 10 basically on the OECD. Now, just want to
 11 understand this concept that you've outlined
 12 in terms of drawing a distinction as you have
 13 between, you know, government and private
 14 interests on the markup.
 15 And if you just go to page 31 of your
 16 report for a moment, and in particular, at
 17 line 11. You say "in the context of energy
 18 projects involving private interest, the
 19 absence of a markup on the cost of rendering
 20 common services or corporate services for the
 21 direct benefit of these private energy
 22 projects would lower the amounts charged for
 23 such services and increase the profits
 24 generated by these projects to the benefit of
 25 private interest. This outcome would create"

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1 what you call "an inappropriate subsidy at the
 2 expense of Hydro and its customers."
 3 Now, can you explain, just so I can
 4 understand this a bit better, why not charging
 5 a markup on services to an energy project with
 6 private interests would create an
 7 inappropriate subsidy, but not charging a
 8 markup to projects that are taxpayer owned
 9 would not create an inappropriate subsidy?
 10 MR. ROLPH:
 11 A. It has everything to do with the fact that the
 12 -- in the one case, the project is trying to
 13 generate profits and in the other case,
 14 they're actually not. So, if it's trying to
 15 generate a profit and by providing a --
 16 performing a function that is helping to
 17 generate that profit, I should share in the
 18 profit, and the only way that I can share in
 19 that piece of the profit is to add a markup.
 20 JOHNSON, Q.C.:
 21 Q. So are you making the assumption that because
 22 the Crown is involved that they're not
 23 interested in the bottom line that comes back
 24 to their shareholders, the taxpayer?
 25 MR. ROLPH:

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1 A. I'm making the assumption that because it's a
 2 cost based approach, they're not looking to
 3 make profit, but achieve costs -- make sure
 4 that they're paying for their cost over the
 5 long term.
 6 JOHNSON, Q.C.:
 7 Q. Maybe if we could stop here, Mr. Chairman.
 8 We're close to 11.
 9 CHAIRMAN:
 10 Q. Certainly.
 11 JOHNSON, Q.C.:
 12 Q. Thank you.
 13 MR. ROLPH:
 14 A. Thank you.
 15 (BREAK - 10:58 a.m.)
 16 (RESUME - 11:34 a.m.)
 17 CHAIRMAN:
 18 Q. I guess, Mr. Johnson, you may continue, sir.
 19 JOHNSON, Q.C.:
 20 Q. Thank you. I understand I was talking a
 21 little bit quiet there, so I'll try to speak
 22 up. Mr. Rolph, we were having discussion
 23 pertaining to the subsidies in the context of
 24 government and non-government involvement in
 25 projects and, but would you -- I take it that

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1 you would agree with me however that from the
 2 standpoint of the rate payer, the subsidy
 3 itself doesn't go away depending upon whether
 4 the project we're speaking about is public or
 5 part public, part private? Would that be a
 6 fair statement?
 7 MR. ROLPH:
 8 A. Well, it depends on the context that you take
 9 the shared services concept. Is it -- it's
 10 not something that Hydro does as its business,
 11 so is it a situation where Hydro is actually
 12 sharing in the costs of those services with a
 13 group of corporate affiliates or are they
 14 providing a service for a profit to those
 15 guys. I think in this case it's probably
 16 better described that they're providing a
 17 shared service and that's the language that is
 18 certainly used. So in that context, I think
 19 it's not one in which I would think that
 20 there'd be a markup put on top of it, also
 21 particularly because there's no tax
 22 implications for doing so.
 23 JOHNSON, Q.C.:
 24 Q. Let us say that the -- just take an example
 25 where -- because what you're suggesting is

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1 that in the event of there being a private
 2 interest involved with a project, they would -
 3 - Hydro would charge them a different cost?
 4 MR. ROLPH:
 5 A. Right.
 6 JOHNSON, Q.C.:
 7 Q. A higher cost, right, and I guess from the
 8 standpoint of the rate payer, wouldn't the
 9 rate payer always want the higher cost? Isn't
 10 that what would be beneficial from the rate
 11 payer's point of view, if they're in -- if
 12 Hydro is charging for these services?
 13 MR. ROLPH:
 14 A. Correct, the higher price would be more
 15 beneficial to the rate payer in this scenario.
 16 JOHNSON, Q.C.:
 17 Q. And would the rate payer have a reason to be
 18 more tolerable of receiving less in the
 19 instance of a service being provided to a
 20 fully Crown owned corporation as opposed to a
 21 project that involves a mixture of Crown and
 22 private?
 23 MR. ROLPH:
 24 A. From a pure rate payer perspective, perhaps
 25 not, unless of course the company that it is

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1 transacting with is also providing services to
 2 it and puts a markup on top of it and it's a
 3 higher cost net.
 4 JOHNSON, Q.C.:
 5 Q. Yes, okay. Now you've indicated in your
 6 report that the tax guidance that you would --
 7 that your report speaks about is not
 8 particularly applicable or in fact is not
 9 applicable to the Hydro and Nalcor situation
 10 on account of the fact that neither pay any
 11 taxes, right?
 12 MR. ROLPH:
 13 A. It's guidance, yes.
 14 JOHNSON, Q.C.:
 15 Q. Yes, that's right. Now this guidance of the
 16 OECD and the CRA and the IRS, just elaborate
 17 on what are the concerns particularly of the -
 18 - because I understand the OECD developed
 19 guidance and that was basically--principle to
 20 deal with tax administrators around the world.
 21 Is that right?
 22 MR. ROLPH:
 23 A. Yes, the group that is involved with -- or at
 24 the OECD, they call it Working Party Six and
 25 it's a group of tax administrators from the

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1 member countries of the OECD and they get
 2 together in an effort to try to do or create
 3 transfer pricing policies that will be
 4 applicable to all the tax administrators or
 5 that they will all use.
 6 JOHNSON, Q.C.:
 7 Q. So Canada is obviously a member of OECD.
 8 MR. ROLPH:
 9 A. It is. In fact, the leader of Working Party
 10 Six is Canadian.
 11 JOHNSON, Q.C.:
 12 Q. Is that right? Okay. And would this be an
 13 individual from CRA itself?
 14 MR. ROLPH:
 15 A. Yes, it would be.
 16 JOHNSON, Q.C.:
 17 Q. Okay. So on this Working Group Six, what
 18 position would this person, for instance, hold
 19 in CRA? Do you know that?
 20 MR. ROLPH:
 21 A. Currently that individual holds the corporate
 22 rulings.
 23 JOHNSON, Q.C.:
 24 Q. Corporate rulings, okay. So let me just
 25 understand, get you to elaborate a bit further

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1 on why tax administrators like the CRA and the
 2 IRS, et cetera, what gets them excited about
 3 this prices -- the prices that are charged
 4 across borders, et cetera, and as between
 5 taxpaying entities. Just if you could
 6 elaborate on their concern?
 7 MR. ROLPH:
 8 A. Certainly. What gets the Canada Revenue
 9 Agency excited is Canadian corporations who
 10 move transactions through tax havens, such as
 11 the Barbados, where they transfer a number of
 12 profits related to those transactions and
 13 leave them in the Barbados, which is probably
 14 about a two percent, two and a half percent
 15 tax rate, versus the current Canadian tax rate
 16 of roughly 26 percent.
 17 JOHNSON, Q.C.:
 18 Q. Okay. And is it only -- is their concern
 19 strictly a tax haven concern or is it more
 20 than that?
 21 MR. ROLPH:
 22 A. No, it's more than that. So, all the tax
 23 administrators are interested in their revenue
 24 base, protecting the revenue base. So even
 25 with transactions with the United States, for

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1 example, Revenue Canada will try to create a
 2 position that would put more taxable income in
 3 Canada than it would -- than what would be
 4 otherwise in the United States.
 5 JOHNSON, Q.C.:
 6 Q. And so how -- so given that general tendency
 7 of people at CRA to protect the tax base, how
 8 does that translate into their concerns over
 9 transfer pricing?
 10 MR. ROLPH:
 11 A. They would be looking at whether Canadian
 12 companies are charging too little for goods
 13 that are exported to foreign subsidiaries or
 14 whether they're being -- Canadian companies
 15 are being charged too much for goods that they
 16 are acquiring from foreign jurisdictions. The
 17 same examples would be true for goods and
 18 services -- or services, sorry.
 19 JOHNSON, Q.C.:
 20 Q. Yeah, and I think in your evidence as well,
 21 you indicated that there would be a concern
 22 for minority shareholders. Did you mention
 23 that as well?
 24 MR. ROLPH:
 25 A. There would be, yes.

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1 JOHNSON, Q.C.:

2 Q. And could you elaborate on what that concern

3 was?

4 MR. ROLPH:

5 A. Minority shareholders, when they get bought

6 out, the valuation of the company is based on

7 the financial performance of the entity that

8 they happen to own and if that entity happens

9 to be a member of a multi-national corporation

10 as opposed to owning the top company, the

11 transfer pricing could be set such that that

12 entity is under performing and therefore

13 undervalued at the time that the shareholders

14 get bought out.

15 JOHNSON, Q.C.:

16 Q. And is that a concern of the working group as

17 well?

18 MR. ROLPH:

19 A. That's not a concern of the working group.

20 That's a concern of the minority shareholders.

21 JOHNSON, Q.C.:

22 Q. Right, okay. Yes, all right. Now you

23 recommended that when Hydro renders services

24 to Nalcor or one of its other lines of

25 business for the benefit of an energy project

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1 involving private interests that the cost of

2 rendering the services should be marked up by

3 an arms-length amount which you now would put

4 at five percent as proposed by the OECD,

5 right. Now, and the -- as I understand it,

6 that recommendation of OECD for that

7 percentage markup, that's for what they term

8 as a markup being applicable to low value

9 added services. Is that -

10 MR. ROLPH:

11 A. That's correct.

12 JOHNSON, Q.C.:

13 Q. That's correct, okay, and do they have another

14 figure for higher value added services?

15 MR. ROLPH:

16 A. They do not.

17 JOHNSON, Q.C.:

18 Q. They don't, okay. And so are you -- is it

19 your view that all of the services that are

20 being priced as between Nalcor and Hydro, that

21 these are all low value?

22 MR. ROLPH:

23 A. The human resource, safety and health and the

24 information system services that are being

25 provided all fall within the definition that

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1 the OECD has prepared to define low value

2 adding services.

3 JOHNSON, Q.C.:

4 Q. I see, okay. But I take it your

5 recommendation for five percent being

6 applicable to any entity involving a private

7 interest that we've discussed, that would be

8 an across the board recommendation for any

9 services? Is that right?

10 MR. ROLPH:

11 A. Not for any services, no. If it's a higher

12 value service, then there would be a higher

13 markup put on that service.

14 (11:45 a.m.)

15 JOHNSON, Q.C.:

16 Q. Okay. So what sort of markup would you be

17 talking about in that instance?

18 MR. ROLPH:

19 A. A markup higher than five percent. It depends

20 particularly on the service that's being

21 provided.

22 JOHNSON, Q.C.:

23 Q. I see. And is that all the guidance you can

24 provide, that it would be some -- that it

25 would be higher than five percent?

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1 MR. ROLPH:

2 A. Without analysing the particular or knowing

3 the particular service that you're referring

4 to or actually analysing the comparables that

5 I would use to derive a proxy or benchmark,

6 it's difficult to just simply give you a

7 markup.

8 JOHNSON, Q.C.:

9 Q. Okay. And so if we look at your

10 recommendation of a five percent markup on

11 services and work, et cetera, that's being

12 provided to an entity that has some private

13 interest, do you believe that the five percent

14 would be sufficient to prevent an

15 inappropriate subsidy at the expense of

16 Hydro's customers?

17 MR. ROLPH:

18 A. I do.

19 JOHNSON, Q.C.:

20 Q. You do? And what's the basis for your belief?

21 Is it strictly what OECD says in the tax

22 guidance area?

23 MR. ROLPH:

24 A. What OECD has proposed is their basis. My

25 experience in looking at a variety of general

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1 service providers and the markups that they
 2 would make, there is a range of markups that
 3 companies make. Not everybody makes five
 4 percent, but I think that five percent would
 5 be a reasonable amount.
 6 JOHNSON, Q.C.:
 7 Q. So are you saying that you would expect
 8 something in the order -- because previously
 9 your report had said that something in the
 10 order of two to five percent markup would be
 11 recommended and so are you saying that that's
 12 the level of markup that you would see, for
 13 instance, if two non arms-length parties were
 14 dealing with each other? Like five percent
 15 above cost?
 16 MR. ROLPH:
 17 A. Fully burdened costs, yes.
 18 JOHNSON, Q.C.:
 19 Q. Okay.
 20 MR. ROLPH:
 21 A. Remember, it's low value costs or low value
 22 services, so you're not going to have a high
 23 return for a low value service.
 24 JOHNSON, Q.C.:
 25 Q. Okay.

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1 MR. ROLPH:
 2 A. There are a number of other services that
 3 aren't defined in that list that are higher
 4 value services.
 5 JOHNSON, Q.C.:
 6 Q. But even low -- even what you're terming as
 7 low value services, a five percent markup,
 8 while might pass muster with the OECD in terms
 9 of dealing with the tax authorities, but it
 10 would strike me as being a fairly low markup
 11 as between non arms-length parties, even for
 12 these services.
 13 MR. ROLPH:
 14 A. Arguably there's some of the services that
 15 they've defined that you could say are higher
 16 value and could get a markup. As I indicated
 17 earlier, it's guidance and it is guidance that
 18 tax authorities are relying on in order to
 19 make sure that they're getting their fair
 20 share of tax dollars and I think that's
 21 something that in this context we should
 22 consider.
 23 JOHNSON, Q.C.:
 24 Q. And when you say -- and I guess sort of it
 25 begs the question as to what degree of concern

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1 should there be about adopting an approach
 2 that was borne out of, you know, international
 3 tax concerns and, you know, these concerns
 4 that, you know, IRS and CRA has about getting
 5 their share, et cetera, about transposing that
 6 into a regulated environment, particularly one
 7 where, you know, rate payers are supposed to
 8 be getting demonstrable benefit and, for
 9 instance, in the case of Newfoundland Power,
 10 you know, their code, a maximization of rate
 11 payer benefit by transactions. Can you
 12 comment on that?
 13 MR. ROLPH:
 14 A. Having worked in the area of transfer pricing
 15 for 20 years, I can tell you there's been a
 16 considerable amount of work done by
 17 organizations to try to get to guidance that
 18 is actually quite reasonable. So, as a
 19 practitioner, if the codes were based on those
 20 principles and that guidance, I would take
 21 great comfort with it.
 22 JOHNSON, Q.C.:
 23 Q. I wonder -- you've indicated that you had a
 24 copy of Newfoundland Power's inter-affiliate
 25 code of conduct at your disposal. I wonder if

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1 you would file that for the record in this
 2 proceeding? Undertake to file that?
 3 MS. GLYNN:
 4 Q. It's not an issue, but I'm wondering if it's
 5 already on the record.
 6 JOHNSON, Q.C.:
 7 Q. Is it already on?
 8 GREENE, Q.C.:
 9 Q. It's not on the record in this proceeding, I
 10 don't think, but in terms of -- it's certainly
 11 available. I mean, it's been approved by the
 12 Board, so yes, we can certainly file it.
 13 JOHNSON, Q.C.:
 14 Q. Yeah. I'm not sure if it -- if it was
 15 attached to a Board Order, I wouldn't have
 16 been asking for it, but I wonder if -
 17 GREENE, Q.C.:
 18 Q. No, it wasn't attached. It was done -- the
 19 Board had directed that it be compiled and
 20 codified back in Newfoundland Power's 2008
 21 hearing and consequently, in communication
 22 between the Consumer Advocate and Newfoundland
 23 Power, they agreed upon the code of conduct
 24 which was submitted to the Board in 2011.
 25 MS. GLYNN:

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1 Q. So there's no issue with filing that.
 2 GREENE, Q.C.:
 3 Q. No.
 4 JOHNSON, Q.C.:
 5 Q. No, because it's just -- just to confirm it
 6 wasn't on this record, so we might as well put
 7 it on the record.
 8 GREENE, Q.C.:
 9 Q. And it wasn't attached to a Board order
 10 either.
 11 JOHNSON, Q.C.:
 12 Q. Right, yeah, okay, if we could.
 13 MS. GLYNN:
 14 Q. Undertaking noted.
 15 JOHNSON, Q.C.:
 16 Q. Good. Okay. Those are my questions. Thank
 17 you.
 18 CHAIRMAN:
 19 Q. So I guess, Mr. Coxworthy, we're over to you.
 20 MR. BRAD ROLPH, CROSS-EXAMINATION BY MR. PAUL COXWORTHY
 21 MR. COXWORTHY:
 22 Q. Yes, thank you, Mr. Chair. Good morning, Mr.
 23 Rolph. My name is Paul Coxworthy and my
 24 colleague, Dean Porter. We represent a group
 25 of Industrial Customers served by Hydro.

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1 MR. ROLPH:
 2 A. Good morning, Mr. Coxworthy.
 3 MR. COXWORTHY:
 4 Q. I wanted to start with page 27 of your report,
 5 the section that deals with an area which Mr.
 6 Johnson was just exploring with you, the OECD
 7 principles. And earlier in your report, you
 8 outlined a part of your review and arriving at
 9 an opinion as to the reasonableness of Hydro's
 10 methodology, in terms of transfer pricing.
 11 One of the areas that you reviewed was
 12 industry practice, and in that section, you
 13 list a number of Canadian public -- or
 14 Canadian utilities. I don't know that they're
 15 all public but it would be characterized as
 16 Canadian utilities. Can you tell us from that
 17 review to what extent any of those utilities
 18 used these OECD principles that you discuss
 19 starting at page 27, in terms of establishing
 20 transfer pricing between their affiliates?
 21 MR. ROLPH:
 22 A. They don't explicitly state that they're using
 23 the OECD guidelines. When I looked at the
 24 guidelines that they had created, the essence
 25 of what the OECD has done is embedded in those

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1 codes.
 2 MR. COXWORTHY:
 3 Q. Including with respect to, again what Mr.
 4 Johnson was just asking you about, the concept
 5 of when a price markup is appropriate or not?
 6 MR. ROLPH:
 7 A. Yes.
 8 MR. COXWORTHY:
 9 Q. Turning to page 28 then of your report, and
 10 throughout this section, you make several
 11 references to Chapter 7 of the OECD transfer
 12 pricing guidelines. I've been able to find
 13 online a July 22nd, 2010 draft. I wasn't able
 14 to find a date associated with your footnotes.
 15 Maybe it's there somewhere and I've missed it.
 16 Is that the draft that we're discussing or
 17 that your footnoting referring to?
 18 MR. ROLPH:
 19 A. It wouldn't have been a draft that I was
 20 referencing, but it was the 2010 OECD transfer
 21 pricing guidelines.
 22 MR. COXWORTHY:
 23 Q. I guess that's just my misunderstanding. I
 24 saw at the end of the footnote, the public
 25 discussion draft. Of course, that's referring

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1 to another document?
 2 MR. ROLPH:
 3 A. Yes, that's referring to another document.
 4 So, as I described earlier, the OECD has been
 5 reviewing transfer pricing and international
 6 tax laws as part of its base erosion and
 7 profit shifting initiative and has published
 8 15 documents, I believe, and that's what I'm
 9 referring to in that footnote as one of the
 10 documents.
 11 MR. COXWORTHY:
 12 Q. Thank you. Mr. O'Brien asked you some
 13 questions from page 28 of your report in
 14 relation to shareholder activity related costs
 15 provided by OECD and in your report, you refer
 16 to those as examples. Are there other
 17 examples found in Chapter 7 of the OECD
 18 transfer pricing guidelines of shareholder
 19 activity related costs? Would we find other
 20 examples or other illustrations beyond the
 21 five that are there?
 22 MR. ROLPH:
 23 A. No, I don't believe that you will.
 24 MR. COXWORTHY:
 25 Q. Mr. O'Brien did ask you a question with

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1 respect to corporate reorganization and
 2 whether in the context of a corporate group
 3 with parents, subsidiaries and affiliates
 4 whether corporate reorganization costs is
 5 something that should be considered to be a
 6 shareholder activity related cost or otherwise
 7 a cost that is properly chargeable down to the
 8 affiliates, subsidiaries, if I can make that
 9 distinction.
 10 MR. ROLPH:
 11 A. Yes, so the latter. No, hold on, the -- hold
 12 on. Can I get you to -
 13 MR. COXWORTHY:
 14 Q. Sure, repeat the question.
 15 MR. ROLPH:
 16 A. - repeat the question.
 17 MR. COXWORTHY:
 18 Q. Absolutely.
 19 MR. ROLPH:
 20 A. Thank you.
 21 MR. COXWORTHY:
 22 Q. So with respect to in a corporate group,
 23 parents with subsidiaries or affiliates,
 24 corporate reorganization costs with respect to
 25 reorganizing that group, are those costs

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1 properly considered under the OECD principles,
 2 shareholder activity related costs or are they
 3 properly considered as costs that could be
 4 charged down to the affiliate or subsidiary by
 5 the parent?
 6 MR. ROLPH:
 7 A. They're considered shareholder costs.
 8 MR. COXWORTHY:
 9 Q. Mr. O'Brien also elicited some response from
 10 you with respect to steward-- I'm sorry,
 11 stewardship costs.
 12 MR. ROLPH:
 13 A. Yeah, stewardship.
 14 MR. COXWORTHY:
 15 Q. I'm going to have trouble with that word, I
 16 can tell.
 17 MR. ROLPH:
 18 A. Me too.
 19 MR. COXWORTHY:
 20 Q. How are those distinct or are they, from
 21 shareholder activity related costs?
 22 MR. ROLPH:
 23 A. I believe that one is a subset of the other.
 24 So, the stewardship costs, there'll be other
 25 stewardship costs. One of them would be these

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1 shareholder activities.
 2 MR. COXWORTHY:
 3 Q. Okay. So stewardship is the top line sort of
 4 category and shareholder related -- so what
 5 other -- are the other ones not shareholder
 6 related costs, the other cost group under
 7 stewardship?
 8 MR. ROLPH:
 9 A. So another example would be a consolidated
 10 audit of the corporate group as something that
 11 you would not -
 12 MR. COXWORTHY:
 13 Q. Would you charge that down to an affiliate or
 14 subsidiary?
 15 MR. ROLPH:
 16 A. You would not charge that down.
 17 MR. COXWORTHY:
 18 Q. No. So are any stewardship costs properly
 19 charged down to an affiliate or subsidiary?
 20 MR. ROLPH:
 21 A. No.
 22 MR. COXWORTHY:
 23 Q. I would like to ask for an undertaking through
 24 this witness at this point, if it's possible
 25 to produce Chapter 7 of the OECD transfer

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1 pricing guidelines, which are extensively
 2 referred to in your footnotes in this section
 3 of your report, and any updates. You referred
 4 that there may have been some papers or
 5 further documents produced that would update
 6 some of the information in relation to Chapter
 7 7. Would it be possible for you to produce
 8 those as well?
 9 MR. ROLPH:
 10 A. Yes, it would.
 11 GREENE, Q.C.:
 12 Q. Noted as an undertaking on the record.
 13 MR. COXWORTHY:
 14 Q. Thank you. Mr. Johnson asked you some
 15 questions about transfer pricing and the
 16 principles behind it. I wanted to explore
 17 that a little bit better, maybe just for my
 18 own understanding. And this may be a
 19 simplistic view and it may be only one of the
 20 issues that arise with transfer pricing, but I
 21 guess as I conceptualize it in the multi-
 22 national context, if you have a parent company
 23 in a country with a high tax regime, I put it
 24 high corporate tax regime, but a subsidiary in
 25 a low cost regime, there could be some

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1 advantages to that corporate entity as a group
 2 to shifting costs from one to the other.
 3 MR. ROLPH:
 4 A. Correct.
 5 MR. COXWORTHY:
 6 Q. And transfer pricing, correct me if I'm wrong,
 7 is establish some principles as to when it is
 8 reasonable to transfer costs from one to the
 9 other? Is that a fair way of summarizing the
 10 intent of transfer pricing principles?
 11 MR. ROLPH:
 12 A. The intent is to ensure that the prices paid
 13 for the physical goods, the intangible assets
 14 or the services that are bought and sold
 15 between the related parties in your context
 16 are a price that two parties who would
 17 otherwise be arms-length parties have a --
 18 would have agreed to in the circumstances.
 19 (12:00 p.m.)
 20 MR. COXWORTHY:
 21 Q. And so reasonableness is not necessarily the
 22 measure. It's more a market driven analysis?
 23 MR. ROLPH:
 24 A. It's more a market -- it is more of a market
 25 driven analysis. Although there is a

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1 reasonableness aspect to that, what is
 2 reasonable in one circumstance may not
 3 necessarily be reasonable in another.
 4 MR. COXWORTHY:
 5 Q. Well, you know, I guess I'll use perhaps a
 6 prosaic example. Auditing services, I mean,
 7 you could have a subsidiary that has a choice.
 8 It could either -- perhaps the parent company
 9 has an auditing department and it could use
 10 its services or it could go to a Grant
 11 Thornton, an external source, and you can
 12 arrive at a market price, at a reasonableness,
 13 but comparing what would you have had to have
 14 paid Grant Thornton for that audit price, as
 15 opposed to what the subsidiary is paying to
 16 the parent for that same auditing service. Is
 17 that one way of establishing the
 18 reasonableness of transfer pricing?
 19 MR. ROLPH:
 20 A. That would be one way, although the question
 21 would arise as to whether the internal
 22 auditing folks are comparable to the Grant
 23 Thornton folks, and perhaps a premium might be
 24 paid for the Grant Thornton folks.
 25 MR. COXWORTHY:

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1 Q. And the question might be what the audit is
 2 for. Perhaps you don't need the Grant
 3 Thornton, the Rolls Royce. Maybe the Camry is
 4 good enough, depending on the purpose of the
 5 audit. Is that a fair -
 6 MR. ROLPH:
 7 A. That's a fair distinction.
 8 CHAIRMAN:
 9 Q. Sounds like an ad to me.
 10 MR. COXWORTHY:
 11 Q. For Grant Thornton or for automobiles?
 12 MR. ROLPH:
 13 A. I was going to thank him, if I could.
 14 MR. COXWORTHY:
 15 Q. Thank you. And I guess I wanted to compare
 16 that to what this Board has to do in terms of
 17 looking at transfer pricing between an
 18 unregulated parent, non-regulated parent, and
 19 its regulated subsidiary in terms of -- you
 20 know, and this was spoken about a bit by -- or
 21 asked about by Mr. Johnson about the concerns,
 22 you know, what should get the Board excited as
 23 opposed to CRA about what, you know, what
 24 might occur in those types of scenarios. And
 25 in -

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1 CHAIRMAN:
 2 Q. Excited?
 3 MR. COXWORTHY:
 4 Q. I'm trying to get there, Mr. Chair. Maybe I
 5 won't get there. Maybe I won't get there.
 6 Interested. Interested.
 7 MR. ROLPH:
 8 A. I'm waiting for the exciting and transfer
 9 pricing to get together.
 10 CHAIRMAN:
 11 Q. Be a dandy.
 12 MR. COXWORTHY:
 13 Q. And it seems to be that when you're advising a
 14 multi-national about transfer pricing and
 15 you're looking at what the tax authority in
 16 that jurisdiction is going to look at, that
 17 what you're concerned about is that they can
 18 justify that that is a reasonable expense,
 19 what's been charged out the subsidiary, that
 20 they can justify that to the tax authority
 21 because if that wouldn't maximize their tax
 22 return, might have reason to question the
 23 transfer of that cost?
 24 MR. ROLPH:
 25 A. Right, that's a fair assessment.

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1 MR. COXWORTHY:
 2 Q. And is it fair to say that there's a band
 3 within which a reasonableness that is sought
 4 to be achieved, and when you give that type of
 5 advise, that it's not a number, that it's a
 6 band of reasonableness?
 7 MR. ROLPH:
 8 A. Yes, in transfer pricing terminology we call
 9 it a range of arms-length prices. So there
 10 would be a range of potential prices at which
 11 to - or to arms-length parties might transact.
 12 MR. COXWORTHY:
 13 Q. So when challenged by a tax authority about
 14 that, and you present them with a range, I
 15 mean, is it reasonable for the tax authority
 16 to say, well, look, we're only going to accept
 17 something at the bottom of that range as being
 18 something that was appropriate to charge now,
 19 not something within that band? What is the
 20 experience within the transfer pricing world
 21 in terms of how tax authorities look at that?
 22 MR. ROLPH:
 23 A. It is really dependent on the auditor. There
 24 are times in which they will try to justify a
 25 lower markup within the range if it's to their

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1 advantage, and other times if it's to their
 2 advantage, they'll try to support a higher
 3 number in the range.
 4 MR. COXWORTHY:
 5 Q. Sure.
 6 MR. ROLPH:
 7 A. There's a - so when one tax authority assesses
 8 a taxpayer in that context it's created a
 9 double tax scenario. So the taxpayer is, in
 10 essence, going to pay tax in two different
 11 jurisdictions. One of the things the OECD
 12 works towards is so that there's no double
 13 taxation. So the two countries get together
 14 and individuals who are responsible for each
 15 country, they'll agree to what the right
 16 amount will be. So if, for example, Revenue
 17 Canada reassessed the Canadian taxpayer with
 18 an unsupportable position, the US, if that was
 19 the country they were transacting with, could
 20 enter in negotiations with them and fight back
 21 and get either the right answer or a
 22 reasonable answer in the range that everybody
 23 could live with.
 24 MR. COXWORTHY:
 25 Q. I want to contrast that to the extent there is

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1 a contrast with here we're not talking about a
 2 tax authority scrutinizing the subsidiaries
 3 bottom line, you have a Board that's reviewing
 4 a regulated utilities bottom line, and in that
 5 context, and you may be aware of it, one of
 6 the tests that the Board has to apply is
 7 whether this is consistent with least cost
 8 service, least cost consistent with reliable
 9 service, least cost consistent with reliable
 10 service, and is there really any analog to
 11 that in the tax world, does a tax authority
 12 apply a least cost test to what costs are
 13 properly charged into a subsidiary from a
 14 parent?
 15 MR. ROLPH:
 16 A. There are occasions where the tax authority
 17 will object to the reasonableness of an
 18 expenditure or a business expenditure, and
 19 will try to demonstrate that that business
 20 expense was not reasonable.
 21 MR. COXWORTHY:
 22 Q. Was not reasonable, but will they be
 23 successful on the basis that it wasn't the
 24 least cost?
 25 MR. ROLPH:

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1 A. I don't have enough experience with that
 2 particular concept to comment on that.
 3 MR. COXWORTHY:
 4 Q. I'd like to move on then, thank you, Mr.
 5 Rolph, again to an area that was explored by
 6 Mr. Johnson, and I think by Mr. O'Brien as
 7 well, and that's when is it appropriate for
 8 Hydro to charge a markup in terms of cost that
 9 it's charging to another company within the
 10 Nalcor Group, and you've drawn the distinction
 11 between where that charge in is to a line of
 12 business of Nalcor where there are also
 13 private interests involved, private
 14 shareholders or private partners. As I
 15 understood the explanation for that, and I may
 16 not be paraphrasing it correctly, I don't have
 17 the benefit of a transcript, so I'll ask you
 18 to help me if I'm not, but the rationale
 19 behind that is that Hydro ought to have an
 20 opportunity to share in the profit that
 21 presumably or hopefully is going to be earned
 22 by the line of business that has this private
 23 interests, and the only opportunity it has to
 24 share in that profit is to charge a markup?
 25 MR. ROLPH:

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1 A. As a service provider to that group, yes.
 2 MR. COXWORTHY:
 3 Q. As a service provider, thank you, for that
 4 company. So I understand that, but I don't
 5 understand why you wouldn't charge a markup in
 6 all instances. If you're providing services
 7 to another entity that has objectives that are
 8 different from your own, let's leave aside
 9 whether it's profit motive, what is it about
 10 profit motive that justifies the markup when
 11 its other situations it doesn't?
 12 MR. ROLPH:
 13 A. It relates to the common asset in a sense of
 14 the taxpayers, so in essence they're trying to
 15 - my assumption is that they are trying to
 16 provide electricity at a cost that is the
 17 lowest for the group, so in that corporate
 18 structure the way that it is established,
 19 their focus isn't driving that profit element,
 20 it's making sure that the two entities in this
 21 case are getting the human resource services
 22 that they need. They could choose to do that
 23 in a couple of ways. Do they all themselves
 24 for internal purposes, or they could choose to
 25 share the group and share the cost. Since

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1 neither one of them are particularly
 2 interested in the profit element of it,
 3 charging back and forth for the profit element
 4 of it doesn't seem to make -
 5 MR. COXWORTHY:
 6 Q. Doesn't that rationale, though, at least risk
 7 conflating, perhaps improperly, the interest
 8 of taxpayers, which is the term you just used,
 9 and rate payers of Hydro, because you've
 10 already acknowledged their interests aren't
 11 necessarily the same?
 12 MR. ROLPH:
 13 A. They're not necessarily the same.
 14 MR. COXWORTHY:
 15 Q. And so given that, given that the interest of
 16 Nalcor, its shareholder, the Provincial
 17 Government, quite rightfully they may be
 18 interested in the interest of the taxpayer,
 19 but would you agree there won't always
 20 necessarily be alignment between the interest
 21 of the taxpayer and that of the rate payer?
 22 MR. ROLPH:
 23 A. There won't always be alignment.
 24 MR. COXWORTHY:
 25 Q. In a situation where there isn't that

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1 alignment, is that not another situation that
 2 at least is analogous to the private interest
 3 reason for a markup in that context?
 4 MR. ROLPH:
 5 A. I think that the interest in the two parties
 6 would have to be extremely divergent for that
 7 to happen, and although rate payers aren't tax
 8 payers, they're not very divergent.
 9 MR. COXWORTHY:
 10 Q. They are not, but if we talked about Nalcor,
 11 its interests are non-regulated, would you
 12 agree, to the extent they're not related to
 13 Hydro?
 14 MR. ROLPH:
 15 A. I would agree.
 16 MR. COXWORTHY:
 17 Q. So that's a divergence there, would you agree?
 18 MR. ROLPH:
 19 A. Agreed.
 20 MR. COXWORTHY:
 21 Q. And the taxpayers may or may not have an
 22 interest in least cost power as a group as
 23 compared to the rate payers, would you agree?
 24 MR. ROLPH:
 25 A. I don't know if I have enough experience to

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1 answer that question.
 2 MR. COXWORTHY:
 3 Q. Okay, that's fair.
 4 MR. ROLPH:
 5 A. I'd have to do some polling.
 6 MR. COXWORTHY:
 7 Q. I'm prepared to move on.
 8 MR. ROLPH:
 9 A. Okay.
 10 MR. COXWORTHY:
 11 Q. Thank you, Mr. Rolph. Sir, I'd like to turn
 12 to page 3 of your report, and this is, I
 13 guess, a summary or a setting out of your
 14 opinions starting on the previous page, page
 15 two, but I want to focus in starting on page
 16 3, line 17, with respect to the corporate
 17 services that Hydro renders for its
 18 affiliates, or its affiliates render for
 19 Hydro. So in particular, the second, and in
 20 particular, I'm thinking about services
 21 provided by Nalcor to Hydro.
 22 MR. ROLPH:
 23 A. Okay.
 24 MR. COXWORTHY:
 25 Q. And one of the areas of service that you refer

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1 to, and it's referred to at various places,
 2 but I'll just turn to here, page 21, table 2
 3 of your report, one of the areas of corporate
 4 services charged by affiliates to Hydro that
 5 you identify is the executive leadership
 6 services for the 2015 test year, approximately
 7 a quarter of it, more of a quarter of the
 8 overall services that are being charged in to
 9 Hydro, or expected to be, forecasted to be,
 10 and again in terms of your review of other
 11 public utilities that you did to prepare this
 12 report, other Canadian public utilities, are
 13 you able to comment on whether there is that
 14 extent of charge in of executive leadership
 15 services by any of those other utilities to
 16 their subsidiary or affiliate?
 17 MR. ROLPH:
 18 A. Yeah, I did not focus on that level of detail.
 19 (12:15 p.m.)
 20 MR. COXWORTHY:
 21 Q. So again turning back to page 3, line 17, line
 22 19, "Hydro and its affiliates render corporate
 23 services that would ordinarily be considered
 24 inter-group services". Based on what - on
 25 what is your opinion based that those

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1 executive leadership services are services
 2 that would be ordinarily considered to be
 3 inter-group services? If it's not based on
 4 your review of the public utilities experience
 5 or the information you were able to glean,
 6 what is it based on?
 7 MR. ROLPH:
 8 A. In my experience in a corporate setting, the
 9 senior executives of the parent company often
 10 are responsible for other subsidiaries and
 11 share their time between the two entities, so
 12 those services time are allocated.
 13 MR. COXWORTHY:
 14 Q. So these would be private companies. The
 15 second bullet under this section where you
 16 express the opinion, "Hydro and its affiliates
 17 derive value from the corporate services
 18 rendered by its affiliates", and I presume you
 19 include in that the executive leadership
 20 services, is that part of your opinion?
 21 MR. ROLPH:
 22 A. That would be part of my opinion.
 23 MR. COXWORTHY:
 24 Q. When you say derives value, I was trying to
 25 square that with answers to questions that

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1 were posed to you by Mr. O'Brien when he was
 2 putting to you the principles that apply to
 3 Newfoundland Power when they do these inter-
 4 company charges, and one of them - perhaps we
 5 could turn rather than relying on my memory to
 6 PU-19, 2003. I think it was page 57. So the
 7 second (ii), "A utility should have the right
 8 to manage its affairs, but it must demonstrate
 9 to the satisfaction of the Board that all
 10 affiliate transactions are prudent", and I
 11 understood, correct me if I'm wrong, that at
 12 least part of the prudence test that they
 13 didn't pay too much for that service.
 14 MR. ROLPH:
 15 A. Fair enough, yes.
 16 MR. COXWORTHY:
 17 Q. More than was reasonable.
 18 MR. ROLPH:
 19 A. Yes.
 20 MR. COXWORTHY:
 21 Q. So when you express the view that Hydro and
 22 its affiliates derive value for corporate
 23 services, are you expressing any opinion as to
 24 the prudence of that expense?
 25 MR. ROLPH:

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1 A. No, I think the value is more in terms of
 2 benefit, so they derived the benefit from the
 3 services that were being provided, and as a
 4 result of that benefit there should be a
 5 charge.
 6 MR. COXWORTHY:
 7 Q. So whether there was good value obtained for
 8 that service, are you expressing any opinion
 9 on that?
 10 MR. ROLPH:
 11 A. No, I'm not expressing any particular opinion
 12 on that.
 13 MR. COXWORTHY:
 14 Q. Are you expressing any opinion as to whether
 15 that was a cost effective means of obtaining
 16 that value?
 17 MR. ROLPH:
 18 A. No, sir.
 19 MR. COXWORTHY:
 20 Q. And then going on then again in the same
 21 bullet, "Hydro would have been willing to pay
 22 for these services had they been rendered by
 23 an independent enterprise or would have
 24 performed the activity on its own behalf in-
 25 house", again when you're expressing that

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1 opinion, are you expressing any opinion as to
 2 whether what Hydro has actually paid for those
 3 services in the past, or what it is forecast
 4 to pay for those services in the future,
 5 whether that's reasonable, the actual amount
 6 paid?
 7 MR. ROLPH:
 8 A. It was more specifically the service itself
 9 and not the amount of the service.
 10 MR. COXWORTHY:
 11 Q. In other words, the type of service you would
 12 expect to pay something for?
 13 MR. ROLPH:
 14 A. Correct.
 15 MR. COXWORTHY:
 16 Q. It's not something you wouldn't expect to get
 17 for free, either you would pay for it by
 18 incurring an internal cost or by paying
 19 someone external for it?
 20 MR. ROLPH:
 21 A. Precisely.
 22 MR. COXWORTHY:
 23 Q. But you're not expressing any opinion there as
 24 to what has been actually paid by Hydro being
 25 reasonable or cost effective to obtain that

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1 service?
 2 MR. ROLPH:
 3 A. No, I am not.
 4 MR. COXWORTHY:
 5 Q. If we could turn to Section 5.1 of your
 6 report, Mr. Rolph, and this was your
 7 sensitivity analysis with respect to transfer
 8 pricing. Am I right in thinking that in that
 9 section you are focusing on what Hydro charges
 10 its affiliates for services that it provides
 11 to its affiliates? That's the focus of that
 12 section?
 13 MR. ROLPH:
 14 A. Actually, I believe I was looking at both the
 15 transactions that Hydro charged and paid.
 16 MR. COXWORTHY:
 17 Q. So both ways?
 18 MR. ROLPH:
 19 A. Both ways.
 20 MR. COXWORTHY:
 21 Q. Okay, and on page 57, line 9, you state,
 22 "Accordingly, the potential understatements of
 23 the amounts charged by Hydro for rendering
 24 cost of services to its affiliates as
 25 described in Section 4.2.12 of this report

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1 would not be material". Although I don't
 2 believe it's stated explicitly, are you saying
 3 that similarly if Hydro was overpaying for
 4 services that it was receiving from its
 5 affiliates, are you expressing any opinion
 6 with respect to whether those would be
 7 material or not?
 8 MR. ROLPH:
 9 A. I didn't - in my evaluation, I didn't see any
 10 indication that charges coming down was
 11 inappropriate, so I didn't comment on those.
 12 MR. COXWORTHY:
 13 Q. When you say you didn't comment, you didn't
 14 assess that?
 15 MR. ROLPH:
 16 A. Yes.
 17 MR. COXWORTHY:
 18 Q. That's what I thought, you had not gone there,
 19 and thank you for clarifying that. You did, I
 20 think in the context of this section, and
 21 again in response, I think, to some questions
 22 from Mr. O'Brien, you talked about, and I
 23 think you felt that this could be applicable
 24 to this Board, that in applying or ordering
 25 additional measures on Hydro to achieve great

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1 transparency with respect to these inter-
 2 company charges, that at some level you have
 3 to do a bit of a cost benefit analysis. One
 4 of the things you would take into account is
 5 the materiality of, you know, if there
 6 actually was a difference, and that that might
 7 stay the Board's hands in terms of there's all
 8 sorts of nice things you might put in place
 9 for transparency, but at some point you got to
 10 stand back, look at how much that would cost
 11 and say, look, in terms of the potential
 12 benefit of achieving all that transparency,
 13 it's not worth it, is that fair?
 14 MR. ROLPH:
 15 A. Those are considerations that the Board will
 16 need to take into consideration.
 17 MR. COXWORTHY:
 18 Q. My question would be, though, given your
 19 experience at least with private sector
 20 companies, and if you have any information
 21 with respect to public utilities from your
 22 review, I'd ask you to add that there, when
 23 what we're talking about is charges from
 24 Nalcor into Hydro, and if what's sought to be
 25 achieved is greater transparency there as to

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1 whether those are appropriate and reasonable,
 2 wouldn't it be reasonable that those charges,
 3 that additional expense be borne by Nalcor,
 4 not by Hydro?
 5 MR. ROLPH:
 6 A. Maybe yes, maybe no.
 7 MR. COXWORTHY:
 8 Q. You don't have enough information to answer
 9 that question? Do you have an opinion, do you
 10 have an opinion on it?
 11 MR. ROLPH:
 12 A. Actually, from a commercial perspective, if
 13 I'm paying an invoice, I'm going to want to
 14 know what I'm paying for. So if an invoice
 15 was supplied presumably from Nalcor to Hydro,
 16 that's one piece of evidence. How that number
 17 gets - how the amount gets determined based on
 18 the billing rate times, hours that the person
 19 actually worked on, adds enough - or adds more
 20 support to the credibility, and so I don't
 21 know that it's an unreasonable request on the
 22 part of Hydro that they receive from Nalcor
 23 this type of documentation to just
 24 substantiate the expense in the first
 25 instance.

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1 MR. COXWORTHY:
 2 Q. And it would be Nalcor in the first instance
 3 that would bear the cost of providing that
 4 information, not Hydro?
 5 MR. ROLPH:
 6 A. Yeah, I don't charge my clients to -
 7 MR. COXWORTHY:
 8 Q. That's a prosaic example I was getting around
 9 to. When I render a bill to my client and
 10 they come back and they say, look, there's not
 11 enough detail there, this is the detail we
 12 require, typically that's not something I get
 13 to charge back to my client, whatever
 14 additional time and effort and cost involved
 15 in providing that.
 16 MR. ROLPH:
 17 A. Agree.
 18 MR. COXWORTHY:
 19 Q. Is that typical experience?
 20 MR. ROLPH:
 21 A. That's my experience.
 22 MR. COXWORTHY:
 23 Q. Thank you, Mr. Rolph. I have no further
 24 questions.
 25 CHAIRMAN:

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1 Q. Mr. O'Reilly, sir.
 2 O'REILLY, Q.C.:
 3 Q. Thank you, Mr. Chair.
 4 MR. BRAD ROLPH - CROSS-EXAMINATION BY O'REILLY, Q.C.:
 5 O'REILLY, Q.C.:
 6 Q. Good afternoon, Mr. Rolph. My name is Tom
 7 O'Reilly, and with me, Mr. Denis Fleming, and
 8 we represent the interest of Vale Newfoundland
 9 Limited in this GRA hearing. I don't have
 10 many questions, but being the last on a
 11 pecking order, the low fruit is already gone
 12 and I'm in a sitting position, so I do have
 13 just a couple of brief - I guess, to get your
 14 views on something, and let us deal with the
 15 issue of materiality, and you deal with that
 16 at Section 5 of your report. You talk about
 17 materiality of affiliate transactions. I'm
 18 familiar with that terminology as it applies
 19 to audited financial statements. What is
 20 material when an auditor performs an audit on
 21 a commercial business and it reviews the
 22 financial statements, they express an opinion
 23 on reasonableness, and, therefore, materiality
 24 comes in. Is there a definition for
 25 materiality in the context of what we're doing

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1 here, and that is the Board's job is to set a
 2 rate, and something as being material in a
 3 rate setting scenario? Is there a definition
 4 or would you see a difference?
 5 MR. ROLPH:
 6 A. I actually don't think I would see a
 7 difference.
 8 O'REILLY, Q.C.:
 9 Q. Okay.
 10 MR. ROLPH:
 11 A. It's not something that I have direct
 12 experience with, but -
 13 O'REILLY, Q.C.:
 14 Q. You mean, in the rate setting situation
 15 scenario?
 16 MR. ROLPH:
 17 A. Right.
 18 O'REILLY, Q.C.:
 19 Q. You don't have a breadth of experience in
 20 that?
 21 MR. ROLPH:
 22 A. Right.
 23 O'REILLY, Q.C.:
 24 Q. Now as I understand, as a result of your
 25 review, and I'm paraphrasing here,

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1 transactions are going both ways, you're
 2 looking at it - you're looking at what the
 3 regulated company, Hydro, charges to its
 4 unregulated affiliates, and then there are
 5 charges coming the other way. There's the
 6 unregulated institution's affiliates, they
 7 charge into the regulated, into Hydro, and I
 8 understood that in the case of the former,
 9 that is where there are charges - as a result
 10 of your analysis, the charges that are coming
 11 out of Hydro to the affiliates for the
 12 services that Hydro performs for those, may
 13 not be fully burdened? In other words, there
 14 may be some costs that haven't been recognized
 15 in those charges, but in your opinion they are
 16 not material, the differences are not
 17 material, is that correct?
 18 MR. ROLPH:
 19 A. The differences are not material to cause the
 20 rate that would be determined through this
 21 process.
 22 O'REILLY, Q.C.:
 23 Q. To be affected, okay.
 24 MR. ROLPH:
 25 A. The level of materiality from a transactional

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1 perspective is something that the Board is
 2 going to have to come to an amount.
 3 O'REILLY, Q.C.:
 4 Q. I'm sorry?
 5 MR. ROLPH:
 6 A. I said the level of materiality that the Board
 7 has in terms of how far off an inter-company
 8 transaction can be before they're not going to
 9 be concerned about it from a transparency
 10 perspective, is going to be something that
 11 they're going to have to address.
 12 O'REILLY, Q.C.:
 13 Q. Okay, the other set of transactions are coming
 14 from the unregulated, from Nalcor, into Hydro,
 15 and Mr. Coxworthy recently asked you about
 16 those charges. You said that you were
 17 satisfied that the services that were
 18 performed had value for Hydro, but you did not
 19 express, nor did you investigate as to whether
 20 or not those services were reasonably priced?
 21 MR. ROLPH:
 22 A. Based on the -
 23 O'REILLY, Q.C.:
 24 Q. Or reasonably costed, whatever - however you
 25 want to use that, is that fair?

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1 MR. ROLPH:
 2 A. I didn't determine whether it was good value
 3 or bad value.
 4 O'REILLY, Q.C.:
 5 Q. Right, okay, and again referring to what is
 6 material, if the cost from Hydro to Nalcor not
 7 fully burdened, there may be some costs there
 8 that as cross-subsidization to the unregulated
 9 business, not material, but if we added those
 10 to the potential of what the over cost, if
 11 there is an over charge to the extent that the
 12 services being provided by Nalcor to Hydro are
 13 in excess of - less than value, might that
 14 have at least the potential of being material,
 15 those two combined? Would you allow that? In
 16 other words, they may affect the rates, your
 17 definition?
 18 MR. ROLPH:
 19 A. They would have to be wildly out of -
 20 O'REILLY, Q.C.:
 21 Q. Pardon me?
 22 MR. ROLPH:
 23 A. They would have to be wildly wrong.
 24 O'REILLY, Q.C.:
 25 Q. Wildly wrong?

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1 MR. ROLPH:
 2 A. I believe.
 3 O'REILLY, Q.C.:
 4 Q. Beyond the capacity of the numbers that we're
 5 talking about here?
 6 MR. ROLPH:
 7 A. Yes.
 8 O'REILLY, Q.C.:
 9 Q. What?
 10 MR. ROLPH:
 11 A. Yes.
 12 O'REILLY, Q.C.:
 13 Q. It would have to be? That is looking at
 14 figures, for example, in Table 2 of -
 15 paragraph 2.5.11, those numbers, with the
 16 unburdened charges together wouldn't have the
 17 potential to affect the rates? This is your
 18 opinion?
 19 MR. ROLPH:
 20 A. Unless the evidence that Hydro has provided is
 21 not accurate, it would be difficult to get to
 22 that level.
 23 O'REILLY, Q.C.:
 24 Q. But, I mean, we know that these are the
 25 numbers that are here, okay, and I'm asking

1 you to assume that those numbers are correct.
 2 What I'm saying is that even if all of those
 3 numbers were off by 100 percent in terms of
 4 their value to Hydro, that it wouldn't still
 5 have the effect of being potentially material
 6 to affect rates?
 7 MR. ROLPH:
 8 A. I didn't make any efforts to audit or verify
 9 these numbers, so I wouldn't be in a position
 10 to indicate whether they are wildly wrong or
 11 not.
 12 (12:30 p.m.)
 13 O'REILLY, Q.C.:
 14 Q. Okay, I think that's all I have, Mr. Chairman.
 15 Thank you very much, Mr. Rolph.
 16 CHAIRMAN:
 17 Q. Okay.
 18 VICE CHAIR WHALEN:
 19 Q. No questions. Thank you, Mr. Rolph.
 20 CHAIRMAN:
 21 Q. Do you have any?
 22 GREENE, Q.C.:
 23 Q. No, thank you, Mr. Chair, I have no rebuttal.
 24 CHAIRMAN:
 25 Q. Sir, thank you very much.

1 MS. GLYNN:
 2 Q. We are going to break for today, and we will
 3 start with -
 4 CHAIRMAN:
 5 Q. Okay, thank you, we're adjourned until
 6 tomorrow morning.
 7 (UPON CONCLUDING AT 12:33 P.M.)

1 CERTIFICATE
 2 I, Judy Moss, hereby certify that the foregoing is a true
 3 and correct transcript of a hearing in the matter of
 4 Newfoundland and Labrador Hydro's General Rate
 5 Application heard on the 19th of October, A.D., 2015
 6 before the Commissioners of the Public Utilities Board,
 7 St. John's, Newfoundland and Labrador and was transcribed
 8 by me to the best of my ability by means of a sound
 9 apparatus.
 10 Dated at St. John's, Newfoundland and Labrador
 11 this 19th day of October, A.D., 2015
 12 Judy Moss

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