New Brunswick Board of Commissioners of Public Utilities

In the Matter of an application by the NBP Distribution & Customer Service Corporation (DISCO) for changes to its Charges, Rates and Tolls - Revenue Requirement

Delta Hotel, Saint John, N.B.
February 13th 2006

Henneberry Reporting Service

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BOARD STAFF:	Doug Goss
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CHAIRMAN: Good morning, ladies and gentlemen. Could I have appearances please for the Applicant.

MR. MORRISON: Terry Morrison and David Hashey for the Applicant, Mr. Chairman.

CHAIRMAN: Thank you, Mr. Morrison. Canadian Manufacturers and Exporters?

MR. LAWSON: Gary Lawson for CME. And David Plante has just arrived.

CHAIRMAN: Thank you, Mr. Lawson. Conservation Council? Enbridge Gas New Brunswick?

MR. MACDOUGALL: Yes, Mr. Chair. David MacDougall for Enbridge Gas New Brunswick. And I may be joined later by Ms. Ruth York.

CHAIRMAN: Thanks, Mr. MacDougall. Irving Group?

MR. BOOKER: Good morning, Mr. Chair and Commissionaires. Andrew Booker for the J.D. Irving companies. Also with me today is Mr. Wayne Wolfe, Mr. Mark Mosher and Mr. Bruce Nicholson.

CHAIRMAN: Thanks, Mr. Booker. Mr. Gillis isn't present. Rogers Cable? Self-represented individuals? Municipal Utilities?

MR. GORMAN: Good morning, Mr. Chairman and Commissioners. Ray Gorman appearing on behalf of the Municipal Utilities. This morning I have Eric Marr and Dana Young with me.

CHAIRMAN: Thanks, Mr. Gorman. Vibrant Communities? Public Intervenor?

MR. HYSLOP: Good morning, Mr. Chair. Peter Hyslop with Robert O'Rourke and Carol Ann Power.

CHAIRMAN: Thanks, Mr. Hyslop. And again I will go through the Informal Intervenors. If there are any present make your presence known.

Agricultural Producers Association of New Brunswick.

Atlantic Centre for Energy. Canadian Council of Grocery Distributors. City of Miramichi. Charles Collin. Energy Probe. Falconbridge. Flakeboard. Genco. The NBSO. Potash Corporation. Terrence Thompson Consulting and UPM-Kymmene.

Any preliminary matters? Oh, you see, I didn't think you were here, Mr. MacNutt. You are at your normal place. Mr. Plante just arrived. And Mr. MacNutt, who do you have with you this morning?

MR. MACNUTT: I have with me this morning, Mr. Chairman, Doug Goss, Senior Adviser, John Lawton, Adviser, John Murphy, Jim Easson and Andrew Logan, Consultants.

CHAIRMAN: Thank you, sir. Any preliminary matters?

MR. MORRISON: Yes, Mr. Chairman. Some undertakings coming out of last week. Two that I will just read on the record. And I believe there is two that are more detailed that we have given copies to the Secretary.

The first was an undertaking requested by Mr. Hyslop which was "Please provide the authors to the Balanced Scorecard methodology used by Disco." And the authors of the methodology are Kaplin and Norton.

The second was also a question, an undertaking from Mr. Hyslop. And I believe the panel referred him to an IR response. But the question was "Please explain the process that Disco goes through to identify capital investment needs in each of the categories in table 3(a)."

And I believe the witness said that was included in an IR response. And the IR response is appendix A-56, PUB IR-134. That is answer (a) dated August 5th 2005. And A-54, PUB IR-182. And that is dated November 14th 2005.

And I believe the Secretary has two other written responses to undertakings, Mr. Chairman. The first is -- again it is an undertaking requested by Mr. Hyslop.

And the question was "Provide the analysis of credit spread between a stand-alone distribution utility and the provincial borrowing rate." And we have a written response to that undertaking.

CHAIRMAN: That will be A-78.

MR. MORRISON: And the second written undertaking response is undertaking requested by Mr. MacNutt. And the question was "Provide a similar calculation for 2005/06 in the manner shown in table 4(f) for the 2005/2006 budget."

CHAIRMAN: That will be exhibit A-79.

MR. MORRISON: And finally, Mr. Chairman, you will recall that there were responses to interrogatories which were filed on February 9th with respect to the 06/07 CCAS and rate proposal.

And that is a binder 1 of 1 dated February 9th 2006.

And that should probably be marked.

MR. MACNUTT: The document being put up for marking at this time represents what? I'm sorry, I missed it.

CHAIRMAN: It represents the responses to interrogatories 2006/07 Cost Allocation Study at Proposed Rates and Rate Proposal dated February 9, volume 1 of 1. And that will be A-80.

MR. MORRISON: That is all at this time, Mr. Chairman, for preliminary matters.

CHAIRMAN: Thanks, Mr. Morrison. Anyone else? Mr. Hyslop?

MR. HYSLOP: Just if I could ask, because I haven't spoken in the halls about it, Mr. Morrison might advise as to the status of the document relating to the payments by all the different companies to the government.

MR. MORRISON: I understand that they will probably be ready later this morning.

CHAIRMAN: Anything else? Before I ask Mr. MacNutt on behalf of Board staff to do his cross of this panel,

Ms. MacFarlane, do you know what portion of income taxes paid in New Brunswick are paid by corporations?

I don't mean the rate. I mean of every dollar the Province collects in income tax or from income tax, what portion comes from corporations and what portion comes from individuals?

MS. MACFARLANE: I'm sorry. I don't know that.

CHAIRMAN: Could you find that out?

MS. MACFARLANE: Yes.

CHAIRMAN: I think Department of Finance would have those figures. Thank you. Mr. MacNutt?

CROSS EXAMINATION BY MR. MACNUTT:

MR. MACNUTT: Thank you, Mr. Chairman. Good morning, Commissioners and witnesses. I'm going to pick up in sequence of questions where I left off last week.
And I'm going to ask you to turn up exhibit A-62 in response to PUB IR-224. And you should keep exhibit A-62 out because there was a series of questions relating to IR's asked in that volume. A-62, response to PUB IR-224.

CHAIRMAN: Could you pull the mic in a little bit, Mr. MacNutt, and give us the number of PUB IR?

MR. MACNUTT: A-62, response to PUB IR-224.

CHAIRMAN: Are we ready?

MS. MACFARLANE: Yes.

Q.1014 - PUB IR-224 asked why salaries and benefits incurred for engineering and construction personnel that were not directly chargeable to project costs are capitalized?
In the response it is stated "There are employees working in Disco that perform tasks that relate to and support both OM&A and capital work. This work is not

directly attributable to one particular project but instead is related to numerous projects and assignments of both an OM&A and capital nature. The most practical approach is to charge a percentage of those employees' time through the overhead."

Then in the response to part (b) it is stated that "Employees that have their time charged to both capital and OM&A where the overhead is charged to capital, that OM&A is credited."

Now would you please describe the type of work carried out by such employees?

MS. CLARK: So there are basically two ways that time can get charged to capital. If a lineman, for instance, is working on maintenance activities, then he would charge his time directly to maintenance during that time, which is an OM&A charge. If he's working on capital, a construction of a line, then he would be charging his time to capital.

The other way charges get to capital are through the overhead chargeout rate. And that specifically related to supervisory, engineering and safety personnel who wouldn't directly charge their time to a capital project but would charge a portion of their time through the overhead rate to capital work.

Q.1015 - Well, I guess the follow-up question would be can you explain why those employees do not report their work in such a manner that the time spent in each activity, that is OM&A and capital, could be calculated and accurately allocated between OM&A and capital?

MS. CLARK: It simply wouldn't be practical for some of those employees to track their time during the day that way. And it's a well-known method for charging overhead to capital work.

So it would be a portion of my time that would be used to supervise or review capital expenditures, a portion of a director's time who may not be directly working on a capital project but would be overseeing it in some kind of a supervisory fashion.

MR. MACNUTT: Thank you.

DR. SOLLOWS: If I may, do I take it from your answer that these personnel are not required to complete time sheets?

MS. CLARK: We have a default reporting system for timekeeping. So they are reporting their time. And it's being charged to OM&A. And then through the OM&A charge there is an overhead chargeout rate that goes to capital. So they are filling out -- it's a default time reporting system. So if they weren't to record their time it would all go to OM&A.

DR. SOLLOWS: Thank you.

Q.1016 - Still with exhibit A-62, I would like you to turn to the response to PUB IR-228. And this is really an undertaking. I will just give you the background.

The response to PUB IR-41 stated that the methodology used to allocate overhead to capital projects and corporate OM&A costs to business units was based on a study dated August 2001. That study states "Estimate costs by activity through an interview process using statistical information and management's best estimates."

PUB IR-228 was a follow-up and asked why that study is still considered a sufficiently accurate basis for allocating overhead costs. The response to PUB IR-228 stated that the 2001 study should be updated in fiscal 2006/07 when the full impact of the restructuring of NB Power is better known and understood.

And really what I would like you to do is undertake to file this update with the Board as soon as it is completed.

MS. CLARK: Yes. We can do that.

MR. MACNUTT: Thank you.

Q.1017 - Now still with exhibit A-62 I would like you to go to PUB IR -- response to PUB IR-230. This has to do with load research meters.

Now the response to PUB IR-230 advised that $75,000 has been included in the 2006/07 capital budget for load research materials. And the funds are kept in reserve for necessary purchase of supplies to supplement the load research program.

As well, Disco advised that it does not have any specific plans to purchase load research meters in 2006/07.

Finally an explanation was provided as to the additional cost that would have to be incurred to expand the program.

Now is it considered a discretionary capital budget item?

MR. MAROIS: I guess it's discretionary in the sense that it depends if we need to invest the money or not as part of our ongoing load research program.

Q.1018 - Okay. Could you explain the process used to authorize spending from this capital budget item?

MR. MAROIS: Yes. Any such investment would be initiated by the load research group depending on the projects they want to initiate in the coming year. So they would make a proposal which would follow the normal path of project approval depending on the importance of the dollars to be spent on capital.

Q.1019 - Now the response to PUB IR-230 provided an overview of the costs of expanding the load research program, as I just mentioned. Please explain in greater detail why Disco has not provided for a meaningful program of load research that would include the purchase of additional load research meters?

MR. MAROIS: I guess the first thing is I believe this topic was canvassed as part of the CARD proceedings. So I would like to dig out the exact reference. And we did address this.

Second is I'm not certain if I would qualify what we done as not meaningful. I believe what we had explained as part of the CARD proceeding is we had worked using an approach of statistically valid information. And so we do believe that what we have done is statistically valid. And the comment made in this response is really due to the fact that this issue had been raised as part of the CARD proceeding and we just wanted to inform the Board in particular that if it wanted to expand the program, then these would be the costs that would be involved.

DR. SOLLOWS: If I may. So the -- I guess what I would like to know is Disco's view of the value of a $200,000 capital investment to improve the quality of their load research, improve the knowledge of their customer's load profiles, I mean, is this something that you think would be valuable, and, if so, why would it not be included in your test year budget?

MR. MAROIS: I'm not able to comment as to the value of spending additional money. Like I said, the only thing I can say is what we have done we believe is statistically valid, but we always do more but I'm not able to comment on the benefits we would gain from spending this additional money.

DR. SOLLOWS: Thank you.

Q.1020 - Thank you. Now I would like you to turn to -- still with exhibit A-62 and go to the response to PUB IR-232. And this deals with the second tie-line to New England. Now the response to PUB IR-232, a detailed explanation was given as to how the second tie-line will reduce in-province flow losses. First of all, what is the capacity of the second tie-line?

MR. MAROIS: Subject to check, it's a thousand megawatts for export and 40 megawatts for imports.

Q.1021 - Thank you. Now please describe the number of contracts, if any, that have been entered into whereby commitments to purchase capacity on the second tie-line have been made and the total capacity covered by such contracts?

MR. MAROIS: I don't have the exact information here because these contracts are not with Disco. These contracts would be with Transco. So there are several what we call commitment agreements or back stopping agreements where parties committed to take -- to commit to a certain amount of capacity should the new tie-line not be fully contracted for as part of what is called the open season. Once capacity comes available if the second tie-line is not fully contracted for the parties that have committed to back stop it would have to take on some of that excess capacity.

Q.1022 - I guess my question was really going to -- that's the back stop. Do you know how much of the capacity for export and how much of the capacity for import has actually been committed to as opposed to being back stopped?

MR. MAROIS: Well the open season has not been held yet. So there hasn't been any offer for capacity yet.

Q.1023 - Thank you. Now what commitments or contracts has Disco made in respect of this second tie-line? I guess the part of the same question, if there are such contracts or commitments to Disco, do any of them involve the infusion of capital by Disco? Make it all one question.

MR. MAROIS: Could you repeat the second part of your question, please?

Q.1024 - I will repeat the whole question. What commitments or contracts has Disco made in respect of the second tie-line, and if there are any, do they involve the provision of capital by Disco, and, if so, what capital sum?

MR. MAROIS: Disco has made a commitment of back stopping -- a commitment for 87 megawatts on the new tie-line. And so this does not represent an expense unless it is called to take on that capacity, and that capacity is expected to be worth approximately 2.5 million.

And Disco anticipates that the annual minimum savings that it would get from the new tie-line just in the form of losses would be 3.1 million. So there is going to be a benefit of 3.1 million no matter what, and the worst case scenario if Disco would have to commit or to take the 87 megawatts it would mean an expense of 2.5 million. So there would still be a positive impact on Disco of about $600,000.

DR. SOLLOWS: If I may. So it's clear in my mind, the dollar amounts you just quoted as loss reductions, those don't include export related losses, do they? Those are purely losses related to servicing internal New Brunswick loads?

MR. MAROIS: That's my understanding. Those are the losses that would be attributed to Disco, the benefits that would be attributed to Disco for serving in-province load.

DR. SOLLOWS: Yes. Thank you.

CHAIRMAN: Mr. Marois, explain for the laymen up here how a transmission line can be good for a thousand megawatts for export, but only 400 for import? You can defer it to a later panel, if you want to, sir.

MR. MAROIS: It would probably be wiser.

CHAIRMAN: I don't know. I might enjoy this more. Okay. Thank you. That's fair.

MR. MAROIS: Some would say that's cruel.

Q.1025 - I am now going to go over -- I am going to deal with vehicle purchase analysis, and that's in exhibit A-62 at PUB IR-229.

CHAIRMAN: We will take a recess.

(Recess)

CHAIRMAN: Mr. MacNutt, it's difficult to have a piercing cross examination with interruptions like that, but carry on, sir.

Q.1026 - Thank you, Mr. Chairman. I would like you to turn up exhibit A-62 and go to the response to PUB IR-229. Now the questions I am going to ask -- if you could -- there are seven columns in the table that was provided as an example in the response. And just for ease of reference, if we could just number those 1, 2, 3, 4, 5, 6, 7 across, it will just simplify referencing when we get into this line of questioning.

Now the IR requested an example of a type of financial analysis that is performed to support decisions on vehicle replacements. The response indicates that the analysis includes the cash flows as well as the income statement impact. An example is provided. In the following I am going to refer to that example.

First of all, what is capital CSM as used in the headings of the table provided in the response?

MS. CLARK: That would be a vehicle relating to work completed by a customer service man.

Q.1027 - Thank you. Now the following questions relate to the approach used by Disco to exactly estimate the expenses to retain an old vehicle for an additional year. First of all, do you take into account the most recent repairs to the vehicles?

MS. CLARK: Yes, we do.

Q.1028 - Do you have a data base from which you estimate the normal repair costs for the next year's forecasted mileage band of use?

MS. CLARK: We certainly have a data base that looks at future requirements of the vehicle as well as the kilometres on the vehicle, the age of the vehicle and where it will be used in the operation. But I don't know the specifics as to whether or not we would have that in the data base.

Q.1029 - The estimated annual cost for each of the last three vehicles on the list, those would be vehicle numbers 4677, 4735 and 4736, equals exactly $11,000 as may be seen in column 2. Would you please explain how the figure for each vehicle was arrived at and why they are all the same?

MS. CLARK: I don't have that information here with me, but my understanding would be that those vehicles were purchased at relatively the same time, and so therefore the future operating expenses on those vehicles are expected to be primarily the same without any major repair to the vehicle.

Q.1030 - So in effect the $11,000 used for each is a bit of a rounding, is it, or an estimate?

MS. CLARK: It would be an estimate.

Q.1031 - Now please explain how the estimate was arrived at?

MS. CLARK: I don't have that with me but I can find that information out from our fleet group.

Q.1032 - Yes. Would you undertake to do that, please. Now assume for a moment -- we will go into a hypothetical here. Assume for a moment that the estimate was $10,000 each for vehicles 4677 and 4735. Would you agree with me that those vehicles would be uneconomic to replace if the estimated repairs were $1,000 less than that shown?

MS. CLARK: This is one type of analysis we do when vehicles are replaced. As I said before, we look at where the vehicles is being used in the operation, we look at the number of kilometres on the vehicle, we look at the age of the vehicle, and we also look at the productivity impacts if the vehicle were to be in the shop for repairs if it was being used for a two or three or one man crew. So this is just one of the types of analysis that we would use to determine whether or not a vehicle needed to be replaced for operations.

Q.1033 - But coming back to my question, would you agree with me that those vehicles, namely 4677 and 4735, would be uneconomic to replace if the estimated repairs to those vehicles were a thousand dollars less than shown in the table?

MS. CLARK: I don't think -- I think there would be more that would go into the analysis than just looking purely at the numbers.

Q.1034 - What cost of capital does Disco use to finance its vehicle purchase?

MS. CLARK: We aren't using any right now when we are calculating the purchase of a new vehicle, and primarily because if we were using a discounted cash flow method, because the vehicles are being replaced fairly often, it wouldn't show significant differences in our results.

Q.1035 - Okay. Now we are going to go through sort of a hypothetical here which touches on what you just said. Now in respect of the capital cost of new vehicles, can we assume that the new vehicles are written off over a five year period so that the depreciation on the new vehicles would be in the order of $39,582.57 as shown in column 4? Then one would have to accept that the depreciation on the new vehicles of $39,582.67 would be multiplied by five to approximately the capital costs of new vehicles to be $200,000 as a group in total. And that is simply what I have done there is using round numbers for vehicles at $10,000 the depreciation for each vehicle each year, thus resulting in $40,000 for the four vehicles for each year times five years equals $200,000, is that -- that's the hypothetical I would like to use as an example. Do you accept that?

MS. CLARK: Yes.

Q.1036 - Thank you. Now if we assume that cost of capital is ten percent -- this is hypothetical, remember -- based on $200,000 of purchases, this would result in the cost of capital in the first year of $20,000, is that correct?

MS. CLARK: That's correct.

Q.1037 - Thank you. What would Disco use as the cost to finance the $200,000 for one year?

MS. CLARK: In your hypothetical example it would be the ten percent.

Q.1038 - Thank you. Now going back to the table again in response PUB IR-29. First the expense for the four new vehicles is shown in column 7 to be $62,183.34, correct?

MS. CLARK: That's correct.

Q.1039 - Now if we add interest expense of $20,000 to that amount, we get a total of $82,183.34.

MS. CLARK: So you are no longer talking the hypothetical example.

Q.1040 - Well it's still hypothetical, yes. We are doing a hypothetical but we are working some of the actual numbers for the example, so that when you add the $20,000 to the $62,183.34 you come up with, 82,183.34, do you not?

MS. CLARK: You would, but Disco's cost of capital isn't ten percent. So it wouldn't be $20,000 in this case.

Q.1041 - What would it be?

MS. CLARK: In this case it would be the weighted average cost of capital which would be somewhere between the cost of equity and the cost of debt. When we are looking at capital investment decisions and doing business cases we have been using the weighted average cost of capital for future capital additions with the understanding that that would be the cost of a going forward basis.

Q.1042 - And what would that number be?

MS. CLARK: We can find that information for you.

Q.1043 - You are undertaking to get that number for me?

MS. CLARK: Yes.

Q.1044 - Thank you. Now you have undertaken to get me that number. But I'm going to continue with my example using the 10 percent. And we had arrived at the point where we had taken $62,183.34 and we added a hypothetical interest expense of $20,000 to arrive at 82,183.34.

Now I would like you to subtract from that total expense for the old CSM in column 6 in the amount of $65,007.29 from that amount, which should result in a sum of $17,176.05.

Would you agree with that --

MS. CLARK: Yes. That's correct.

Q.1045 - Now the result of my hypothetical exercise shows that there would be a loss of $17,000 rounded in the first year to replace the vehicles. Would that not be correct?

MS. CLARK: In that scenario, yes, that's correct.

Q.1046 - Now in the transcript for Wednesday, February 8th -- and you can turn it -- I'm going to go to page 3666. But

I'm going to quote. But if you want to look it up you may. February 8th, page 3666.

MS. CLARK: I'm sorry. What was that page number?

Q.1047 - 3666. Three thousand six hundred and sixty-six. You were asked the question 773, the following question by Mr. Hyslop. "So with respect to vehicles, does NB Power use discounted cash flow techniques such as optimal replacement interval for replacement of vehicles?"

And you replied "I'm not familiar with those terms." Which terms were you not familiar with?

MS. CLARK: The optimal replacement interval.

Q.1048 - Okay. That is what I thought. Now it is my understanding that it is generally a common practice for business to use a discounted cash flow technique to support capital expenditure justification because that technique takes into account the cost of financing. Would you please explain why you were not familiar with this technique in this context and why Disco has not used it in respect of its vehicles?

MS. CLARK: I'm certainly familiar with the discounted cash flow technique. It was the optimal interval replacement that I wasn't familiar with. And as I said before, typically the vehicles that we are replacing have a five to eight-year life. And so using a discounted cash flow method wouldn't have shown significantly different results in the outcome. So we hadn't used it.

DR. SOLLOWS: May I? And just so that I'm clear, how did you determine the typical life if you didn't use a discounted cash flow technique? That is usually what it yields is the life.

MS. CLARK: The typical life is looked at through our Amortization Review Committee. And it's part of the depreciation life of the asset.

DR. SOLLOWS: Thank you.

Q.1049 - Now if we were to insert the real cost of capital in the hypothetical we just went through, would you not agree that it would have a different outcome in terms of the analysis that you would do?

MS. CLARK: Yes, it would.

MR. MACNUTT: Thank you.

MR. MAROIS: Mr. MacNutt, if I may?

MR. MACNUTT: Yes.

MR. MAROIS: I guess you have got me sufficiently intrigued about this that I will personally make a commitment to look into it. Because to be honest, I'm not certain myself why we didn't include the capital cost in the analysis. So that's one thing. -

3803 - Cross by Mr. MacNutt -

And I guess two things is -- the second thing is we are currently in the process of outsourcing the fleet management to a specialized third party. And one of the reasons for doing so is we believe we will have more or better information as part of this process.

And down the road this will certainly help us in determining the optimal time for replacing a vehicle, by having more information, more and better information.

MR. MACNUTT: Thank you.

Q.1050 - Now going on to another question. And this one involved exhibit A-56. It is perhaps not necessary to look it up. Because I'm going to quote from it. And it is a very simple question and involves the document that was just handed around. It deals with engineering analysis software.

And in exhibit A-56 at tab -- August 25, 2005 there is a response to PUB IR-134(a). And the document that was just handed around, which I'm going to ask the witnesses to have a brief look at, just note the title for the moment.

CHAIRMAN: Mr. MacNutt, you have got us confused and the Secretary confused too, I think. What are you referring to?

MR. MACNUTT: Yes. You could provide -- the Secretary could provide those to the Commissioners. And the participants in the room have a copy of it. And the witnesses do as well. But I don't -- it may not be necessary to mark it as an exhibit, Mr. Chairman.

Q.1051 - And the document that I'm referring to is from a publication. And I quote "IEE Transactions on Power Systems", Volume 9, Number 1, February 1994, entitled "A Canadian Customer Survey to Assess Power System Reliability Worth" by Tollefson, Billington, Whacker, Chan and Allay.

And in the response to PUB IR-134 (a) Disco advised that it employs engineering analysis software that enables the assessment of the current and future performance of the system from a loading and power quality perspective.

And my request is that would you please undertake to advise the Board whether the engineering analysis software used by Disco includes the methodology described in the study, which I have just handed around and I just referenced you to, referred you to, which supports the use of detailed cost benefit analysis in system upgrade and customer satisfaction planning.

MR. MAROIS: We will undertake to do that.

CHAIRMAN: Mr. MacNutt, I think for the sake of retaining this until you refer to it again, et cetera we should mark it as an exhibit.

MR. MACNUTT: Thank you, Mr. Chairman.

CHAIRMAN: My records indicate that that article will be PUB-13.

Go ahead, Mr. MacNutt.

MR. MACNUTT: Thank you, Mr. Chairman.

Q.1052 - I'm going to come back to something we were addressing last Thursday on August -- February the 9th.

And I'm going to ask you to go -- and it relates to payment in lieu of income taxes.

And I'm going to -- if you have a copy of the Electricity Act there, I'm going to ask you to look at subsection 37(1). But I'm going to read it anyway. But you could turn it up to follow.

What I'm going to do is -- subsection 37(1) states "During the period that the corporation or a subsidiary of the corporation incorporated pursuant to subsection 4(1) is exempt under subsection 149(1) of the Income Tax Act (Canada) from the payment of tax under that Act, it shall pay to the finance corporation in respect of each taxation year an amount equal to the amount of the tax that it would have been liable to pay under that Act if it were not exempt."

Now would you not agree that the words "under that

Act" refer to the Income Tax Act of Canada?

MS. MACFARLANE: That's correct.

MR. MACNUTT: Thank you.

Q.1053 - Now in your testimony on February 9th at page 3759, Ms. MacFarlane --

MS. MACFARLANE: Could you repeat the page number please?

Q.1054 - 3759. And I will just quote a couple of statements from that. Ms. MacFarlane, you stated beginning at line 9, and you said "Lines 7 through 12 speak to the calculations showing the underlying rates which are specified by the Income Tax Act and the calculations. The calculation is done on the basis of accounting income. And there is no allowance for any temporary differences in asset base between what might be capital cost allowance or undepreciated capital cost in the Income Tax Act and the accounting value of the assets."

Then you go on to say at line 22 "So the tax is done on the basis of accounting income, and that is the amount that is remitted to EFC", which you said was Electric Finance Corporation.

Do you agree with that statement there?

MS. MACFARLANE: That's correct.

MR. MACNUTT: Thank you.

Q.1055 - Now you would agree that your calculation of the estimated "special payment in lieu of income taxes" is not in compliance with the Electricity Act?

MS. MACFARLANE: To the extent that it is based on accounting income as opposed to taxable income, I would agree, yes.

Q.1056 - And on what basis do you feel that Disco can deviate from the express words of the Electricity Act?

MS. MACFARLANE: This is part of the transition, shall we say, for getting to the point where we are fully capable of managing compliance with this section.

I believe I had gone on in the transcript to speak about advice that we had sought from Deloitte & Touche as to what would be required in order to comply specifically with that.

And it would incur -- we would have to incur significant systems cost. We would have to add additional staff, both tax accountants and tax lawyers. EFC would have to do the same. We would have had to seek costly external advice from tax accountants and tax lawyers in order to establish the opening asset base.

And it was a decision between EFC and ourselves that in the first instance that was not the highest priority. So we came to an agreement that as part of the transition we would make the payment on the basis of accounting income.

Q.1057 - Did you get anything in writing from Deloitte?

MS. MACFARLANE: From Deloitte? Yes, we did.

Q.1058 - And did it simply say you can not comply with a provision of the Electricity Act -- or they report it, as you have suggested, and then it was an executive decision that Disco did not want to incur the cost of setting up the systems Deloitte recommended?

MS. MACFARLANE: Deloitte simply commented on the effort and cost it would take for us to comply. And it was a decision between the executive of NB Power and the staff at Electric Finance that in the near term we would use the more simplified method until such time as we were capable of making the investment necessary to move to the system.

Q.1059 - So it wasn't Deloitte who said it was an appropriate way to avoid compliance with the Act?

MS. MACFARLANE: Oh, no. Not at all.

Q.1060 - Now I would like you to turn up exhibit A-80 which is the response to IRs that were filed on February 9th and marked as an exhibit this morning.

And go to response to PUB IR-261. And I would like you to look at comparison of --

CHAIRMAN: Just a minute, Mr. MacNutt. We haven't all got it up here.

MR. MACNUTT: Sorry.

CHAIRMAN: And it was what IR?

MR. MACNUTT: Exhibit A-80 which was filed -- marked this morning.

CHAIRMAN: No, no. We know that. But what IR?

MR. MACNUTT: PUB IR-261.

CHAIRMAN: Thank you.

Q.1061 - And what we are going to do is look at a comparison of tables 1 and 2.

Now the variance explanations for purchased power indicate that the gross margin variance credit from Genco is forecast to decrease by 7.5 million in Disco's last quarter, that is from 50.1 million to 42.6 million.

Can you please explain why?

MS. CLARK: So the gross margin credit is actually increasing. But it's the variance that's decreasing between the two tables.

And the reason for that is between the period October and December we had extremely high export margins. And then in the period January to March they are expected to be lower than budget because prices are falling off during that period.

Q.1062 - Now still looking at the two pages in question, when we compare the forecast transmission expense line 2 on tables 1 and 2, December's actual to Disco's year-end forecast increases by 25.9 million, that is from 33.9 million to 59.8 million, whereas the budgeted third quarter to fourth quarter increase is 24.3 million which is 38.1 million to 62.4 million.

Could you explain why the forecast transmission expense is 1.6 million greater than the budget amount when the energy requirements to service the in-province load is less?

MS. CLARK: I don't have that information with me here.

Q.1063 - Would you undertake to provide that for us?

MS. CLARK: Yes, we could.

Q.1064 - Now on page 4 of the response, the first bullet which is the fifth line down, you note the higher bad debt expense of 2.6 million.

Would you please explain what is the miscellaneous receivable, i.e. the third party pole attachment? Or is it related to a specific rate class? And the period covered by the amount.

MS. CLARK: The amount is for third party pole attachments. And it's for previous years that were in dispute. It's unclear how we may handle that given that this is in front of the PUB at this point in time.

MR. MACNUTT: Thank you.

CHAIRMAN: Mr. MacNutt, is this a good time to take our official mid-morning break?

MR. MACNUTT: Yes, Mr. Chairman. I have got three more questions which will take 15, 20 minutes.

(Recess)

CHAIRMAN: If there is nothing preliminary go ahead, Mr. MacNutt.

MR. MORRISON: There is one preliminary matter, Mr. Chairman. We do have another further undertaking. It was an undertaking that was given on Wednesday, February 8th, a request by Mr. Hyslop.

The question was to provide a breakdown of specified amounts budgeted to be paid by each company to the Province of New Brunswick, specifically Electric Finance Corporation, for fiscal 2006/07. In addition, please provide a breakdown of specified actual amounts paid by the NB Power Corporation TO the Province of New Brunswick for fiscal 2003/04. That's a written response. And copies have been given to the Board secretary, Mr. Chairman.

CHAIRMAN: Thank you. My records indicate that will be <u>exhibit A-81</u>. Go ahead, Mr. --

MR. MAROIS: Mr. Chairman, I am able to provide a little bit of information regarding the capacity of the export -- the second filing. In my response when I said the capacity of the second tie-line was a thousand megawatts for exports and 40 megawatts for imports, I guess this included the existing facilities. So the incremental capacity related to the second tie-line is 200 megawatts, both for exports and imports. So it is the same amount.

DR. SOLLOWS: So that we are clear, then in the thousand and 400 there is 200 megawatts of import capacity in the MEPCO tie-line and about 750 export capacity?

MR. MAROIS: Well the total capacity for exports will be a thousand megawatts --

DR. SOLLOWS: Okay.

MR. MAROIS: -- and the second tie is for 300. So really the existing facilities are able to do 700 megawatts --

DR. SOLLOWS: I see.

MR. MAROIS: -- and for imports the current facilities allow for imports of only 100 megawatts and the second tie will add 300 megawatts, for a total of 400.

DR. SOLLOWS: So in total we will have the ability to import 400 megawatts into the province, both lines?

MR. MAROIS: From the US, yes.

DR. SOLLOWS: I guess we will maybe come back to that later. Thank you.

MR. MAROIS: You are welcome.

CHAIRMAN: Okay. I will give you a chance to carry on further, if you would like to. The layman doesn't understand how if you couldn't put the same amount of electricity going to exporting it or importing it. Why has it a larger capacity for export than it does for import.

MR. MAROIS: I am only able to provide a very succinct answer. And my understanding is because of down stream congestion in southern Maine, but if you wish we can provide a more detailed response.

CHAIRMAN: Well please do, because if there is down stream congestion in Maine, then logic would say that the export capacity would be less than the import capacity.

MR. MAROIS: Like I said, we will have to provide something in writing.

CHAIRMAN: Okay. Thank you. Either that or if you know of a witness who can explain it for me why then please tell me and we will wait for him. Thank you. Mr. MacNutt, go ahead.

Q.1065 - Thank you, Mr. Chairman. What I am going to do is -- I'm not sure if we addressed it this morning but we are going to deal with it now. Go to exhibit A-80. That's the response to PUB IR-261. That was filed last Thursday, February 9th. And we have just handed around both to the witnesses, the Commissioners and the participants, a document entitled -- I'm not sure the Secretary has circulated -- yes, if you would give that to the Board members. It's a document entitled "NB Power Disco unit analysis of revised forecast for the year ended March 31, 2006". And I would like to mark that as an exhibit and then I will go through the details of where the numbers are found. It's a one-page document.

CHAIRMAN: That will be PUB-14.

Q.1066 - Now if you would turn to exhibit A-80 and go to the table on page 2 and the response to PUB IR-61. Column A in exhibit PUB-14 is taken from that table. I'm sorry. Go to table 2 on page 3. And if you go to table 2 on page 3 and you go to column 2 which is Quarter Three forecast, you will see where the revenue surplus is shown as a negative 22.6 million at the bottom, as is column A in exhibit PUB-14.

Now column A in PUB-14 is a slight restatement or reclassification of some of the items, but there is no -- should be no change in the essential numbers. Now the source of column B in exhibit PUB-14 is table 1, and the response to -- exhibit A-80, response to PUB IR-61, and comes from column 2 of that table. And again the classifications are slightly different but the numbers are the same, resulting in a negative revenue shortfall of minus 27.4 million. And what we have done on -- coming solely to -- excuse me. Would you confirm that that is the source of columns A and B in exhibit PUB-14?

MS. CLARK: Yes, it is.

Q.1067 - Thank you. Now what we have done on PUB-14 is subtracted A and B, and then in the fourth column we have taken in effect the fourth column shows the fourth quarter as a percentage of a total for the year. And I should explain further that column A shows for a year the actual figures for nine months and estimated for three months, and column B is the actual for nine months.

And what we have done is subtract Column A from Column B to get the column entitled "percentage quarter to total. Now subject to check, would you -- accepting for the moment, subject to check, the percentages shown in the fourth column, would you explain to us why for transmission there is a transmission cost for the fourth quarter or so high relative to the total cost for the year at 43.31 percent?

MS. CLARK: Before the break I undertook to provide the response to the transmission question. And this is a related question. So can I undertake to provide you with that response as well?

MR. MACNUTT: Yes. Thank you.

DR. SOLLOWS: If I --

MR. MACNUTT: Oh, yes, absolutely.

DR. SOLLOWS: You have undertaken to provide an explanation for transmission -- your projection that the fourth quarter costs for transmission will be 43 percent of your annual costs.

Could you extend that undertaking to explain how we get 32 percent of your purchase power cost in the last quarter and about 30 percent of your forecast revenue, just so that we have a complete, fairly complete record?

MS. CLARK: Yes, we can.

DR. SOLLOWS: Thank you.

Q.1068 - Now when I was questioning you on last Thursday, February 9th, we dealt with exhibit A-52 which was the 2004/2005 Annual Report. And we were looking at the pages 54 and 55 of that. That is exhibit A-52.

And page 55 had a chart entitled "Financial Overview" of the Holdco and its four subsidiary companies. And the question asked you for an explanation of the column headed "Eliminations" which was showing a net income of minus $8 million.

And you gave us an explanation of why that figure did not net to zero. And your explanation was given at transcript for February 9th 2006 at pages 3741 to 3743 and then again at -- you volunteered a further explanation at pages 3767 to 3769. And I would like to ask a couple of follow-up questions.

On page 3743, the February 9th transcript, you told us that the financial statements in exhibit A-52 were for a full year. And the business units were "emulating transactions" in preparation for the second half of the year ending March 31, 2005.

You said that they were paying dividends which you explained were proxy dividends payable to Holdco. And then on page 3768 of the February 9th transcript, you explained that the full financials were being emulated to give the business units practice as to what the situation would be following October 1, 2004 when the Electricity Act came into force and the business units were converted to corporations as shown on pages 54 and 55 of exhibit A-52.

Now I'm having trouble with your explanation. First of all, did Disco actually pay dividends to Holdco in the fiscal year ending March 31, 2005? And if so what was the amount?

MS. MACFARLANE: In the period ended September 30, 2004 the business unit Disco paid emulated dividends to corporate in the amount of $5 million.

Q.1069 - And "corporate" being what?

MS. MACFARLANE: Corporate being -- at the time, NB Power was an integrated utility with four operating business units. And the rest of the corporation was referred to as corporate. It was not a specific business unit. It was a division.

Q.1070 - I'm a little confused. Corporate doesn't equate to New Brunswick Electric Power Commission before restructuring?

MS. MACFARLANE: It was a division of, as was the Disco business unit. They were both divisions of New Brunswick Power Corporation.

Q.1071 - So you are saying when you refer, use the term "corporate" you are referring to what is now known as Holdco before the restruct' -- which is now known as Holdco?

MS. MACFARLANE: That's correct.

Q.1072 - So corporate refers to Holdco as a business unit prior, immediately prior to the restructuring?

MS. MACFARLANE: In essence that's correct. It wasn't referred to as a business unit. It was a division. But the concept is the same.

Q.1073 - Now would you please explain how that amount was calculated, that is the amount that was paid to corporate as we have just defined it?

MS. MACFARLANE: I don't have that with me. I certainly can get the information. But as I say it was -- these transactions were largely undertaken to test our systems. And related accounting processes would -- and the cash processes would manage these transactions when they became real after October 1st.

Q.1074 - Would you undertake to tell us how that was calculated?

MS. MACFARLANE: Yes, I will.

MR. MACNUTT: Thank you.

Q.1075 - Now coming back to page 55, exhibit A-52, since the eliminations on page 55 do not net out to zero and in fact they represent a net reduction of income of $8 million, how was this difference accounted for in the combined financial statements as of March 31, 2005?

MS. MACFARLANE: On page 55, which is only the income statement, there are two lines that eliminate each other for the amount of $8 million which was the dividends. The two lines are under total revenues, the last line up at the top of the page just before total revenues, other intercompany revenues.

If you go over to Holdco, $139 million. 8,000,000 of that was dividends from corporations. And the offset to that in the income statement is to eliminate it from net income. Because it would have been included in Disco's net income or net loss of 17,000,000. So it was eliminated both from the revenue line and from their net income line.

In the articulated financial statements the offset to the 8,000,000 in net income is in the retained earnings statement which is not shown here. Because those dividends would have been shown as a reduction of retained earnings, we would have then added back the dividends, because they were not real, to eliminate the transaction altogether.

DR. SOLLOWS: If I may, I just -- you used a phrase that I had never heard before in -- three words in that context, "articulated financial statements."

MS. MACFARLANE: Yes.

DR. SOLLOWS: I know what an articulated vehicle is. What is an articulated financial statement?

MS. MACFARLANE: Perhaps I could ask Mr. Easson to help. But financial statements by their nature, the balance sheet, the income statement, the statement of retained earnings and the statement of cash flow must, quote, unquote, articulate.

They must balance among themselves and tie in one to the other. So you -- if you have an elimination in one part of the global financial statements it must be offset somewhere else.

DR. SOLLOWS: Thank you.

Q.1076 - Now if you turn to page 37 of exhibit A-52, there is a combined statement of income for the year ending March 31. And if you go down to about just below the halfway point on the page, there is a line states, net income (loss for the year). And it shows $9 million.

Then we come back to page 55, and if we go to the net income (loss for the year) in the total column, the very right-hand side, we have $9 million, is that correct?

MS. MACFARLANE: That's correct.

Q.1077 - Then we go to combined -- to page 37, again the combined financial statements, and then we go down at the bottom and we have combined statement of deficit. There -- four lines there. We don't see that $8 million?

MS. MACFARLANE: The statement presented on page 37 is simply the combined total. There is not a breakout of segmented information disclosed here. The income statement, the segmented information is disclosed on page 55. But we did not provide a segmented retained earnings statement. So on page 55, it is the total column that is represented on page 37 for the income statement. And similarly the statement of deficit is a combined. It's simply the total and in getting to the total, you would have done the elimination.

Q.1078 - So we still have a difference of $8 million on the elimination. Where did you adjust it in the balance sheet?

MS. MACFARLANE: If we had shown on the combined statement of deficit each of the individual companies, you would have shown that -- we would have shown that dividends would have totalled 13 million. You will see that it is 5 million combined. But if we added up all the company amounts for the full year, it would have been 13 million. We took off the 8 million that was not real and it eliminates against the income statement amount to leave the real amount of dividends paid of $5 million. And those dividends would have been for the period October 1st 2004 to March 31st 2005 for Transco. Transco was the only operating company that paid dividends in the fiscal year.

Q.1079 - Thank you. Now coming back again to my questioning on February 9th and I would like you to -- ask two follow-up questions. We were dealing with projected purchase power cost of 907.9 million for 2005/2006. And we were at exhibit A-50, tab 3, evidence of Lori Clark, page 2, table

1.

CHAIRMAN: Repeat that, Mr. MacNutt?

MR. MACNUTT: Exhibit A-50, yellow tab 3, evidence of Lori Clark, page 2, table 1.

Q.1080 - And table 1 shows Disco's forecasted revenue requirement and revenue shortfall for several year endings March 31, is that correct?

MS. CLARK: That's correct.

Q.1081 - Now, I asked you the question with respect to the $907.9 million in column 1, line 2. And you provided a response. And I advised you at page 3748 of the transcript of February 9th 2006 that we would come back to this if appropriate after reviewing the response to PUB IR-261.

I do have two follow-up questions. Please advise if the $61.6 million figure for estimated transmission shortfall in column 1 at line 2 of table 1 accords with the load forecast information for that year?

CHAIRMAN: I am sorry. Can I get you to repeat that question?

Q.1082 - Yes. We should be on table 1 of your evidence, page 2, in exhibit A-50. And if you go to column 1 at line 2, there is a figure of $61.6 million. And I would like you to advise us if that $61.6 million figure for estimated transmission shortfall accords with the load forecast information for that year?

I may have misled -- I think at some point in my question I called it a shortfall. It shouldn't be. It should be an expense.

MS. CLARK: So the expense was stated in 2006/2007 for transmission and purchase power does not include any adjustment for the second tie line or the transmission losses.

Q.1083 - I don't -- I am not sure if you are entirely responsive to the question. We were -- the question was asked in terms of whether or not that shortfall -- or expense, I should say -- of 61.6 million accords with the load forecast information for that year?

MS. CLARK: Yes, it does. And it is in table 1(e), page 11 under the direct evidence of Lori Clark, tab 1.

Q.1084 - Now that's based on billing determinants as in column 1, of that table 1(e) of 29,498 megawatts?

MS. CLARK: That is consistent with the load forecast as it was presented at a previous hearing.

Q.1085 - Thank you. Now coming back to table 1 of your evidence in exhibit A-50 -- table 1 on page 2, in column 2 at line 9, the 2005/2006 estimated total revenue requirement of one billion, 173.7 million dollars, which is one billion, 173.7 million -- shown at line 10, the forecasted revenue at current rates is shown as 1.127.9 million, correct?

MS. CLARK: That's correct.

Q.1086 - Now, please advise what rates were used to arrive at the forecasted revenues, that is the rates put forth in the original application or the rates put forth in the revised 2006/2007 application?

MS. CLARK: The amount on line 10, column 2 would be the amount with rates effective March 31st 2005, but would exclude any rates that came into effect on July 7th 2005.

Q.1087 - Now in that table 1 you were showing a revenue shortfall of $45.8 million, is that not correct?

MS. CLARK: That's correct.

Q.1088 - Now in exhibit A-80, which is that page we had marked a few minutes ago, in column A, you are showing a net income available for dividends of 22.6 million?

MS. CLARK: That's correct.

Q.1089 - You would agree with those two numbers?

MR. MACNUTT: No further questions, Mr. Chairman.

CHAIRMAN: Believe me, I think it will save some time if we break for lunch now. Come back at 1:00 p.m.

(Recess - 11:45 a.m. - 1:00 p.m.)

CHAIRMAN: Good afternoon, ladies and gentlemen. Any preliminary matters?

MR. MORRISON: Yes, Mr. Chairman. Some more undertaking responses to deal with. I believe these have all been provided to the Secretary.

The first is an undertaking that was given on Tuesday, February 7th, undertaking requested by Mr. Peacock. And it was to provide the amount of revenue resulting from reconnection to the grid from residential accounts whose arrears had been removed. And the amount of revenue resulting from new connections to grid.

CHAIRMAN: Okay. That will be A-82.

MR. MORRISON: The next one, Mr. Chairman, is an undertaking given also on February 7th 2006, again a request from Mr. Peacock.

And the question dealt with provide the average security deposit amount paid by residential customers in the past five fiscal years.

CHAIRMAN: That will be A-83. A-84 will be in answer to undertaking number 3 on the 7th of February.

MR. MORRISON: I'm sorry, Mr. Chairman. Yes, you are correct.

CHAIRMAN: Sorry. That is A-84.

MR. MORRISON: And the next undertaking, Mr. Chairman, is an undertaking --

MR. MACNUTT: Has A-84 been handed around?
CHAIRMAN: A-84 is undertaking number 3 of 7th of February, Mr. MacNutt.
MR. MORRISON: The next one, Mr. Chairman, is an undertaking on February 7th 2006, a request from Mr. Hyslop. The question was to provide the amount that NB Power had lost cumulatively from 1993 through 2004.
CHAIRMAN: That will be <u>A-85</u>.
MR. MORRISON: The next one, Mr. Chairman, is an undertaking given on Wednesday, February 8th, a request by Mr. Hyslop. And it dealt with the pole replacement policy.
CHAIRMAN: We don't know how many pages are in that, do we, Mr. Morrison? Well, it is okay. If you don't know then that is fine.
MR. MORRISON: I don't know.
CHAIRMAN: All right. That is fine. That is <u>A-86</u>.
MR. MORRISON: And finally, Mr. Chairman, it is an undertaking of February 9th.
MR. MACNUTT: Perhaps, Mr. Morrison, just slow down for a moment please.
MR. MORRISON: The last one, Mr. Chairman, is an undertaking on Thursday, February 9th requested by Mr. Hyslop. Provide the report from Transco detailing the calculations and estimates that were used both for the losses -- before

the prior loss estimates based on the in-service date of the fall of '06.

And they report that they used -- that they are using to base the higher losses on for in-service in the fall of '07.

CHAIRMAN: So that is undertaking number 9 on February 9?

MR. MORRISON: That's correct.

CHAIRMAN: Okay. And that will be A-87. Any other preliminary matters?

MR. MORRISON: That is all, Mr. Chairman.

CHAIRMAN: Thank you. Mr. MacNutt, Mr. Sollows has raised something in reference to A-87. You asked for a report. Have you had an opportunity to read that response?

MR. MACNUTT: I will read it right now, Mr. Chairman.

CHAIRMAN: All right. Give you a second. Okay. We cleared it up. The last line in the answer is that there was no report.

MR. MACNUTT: Thank you, Mr. Chairman.

CHAIRMAN: All right. The Commissioners have some questions. Commissioner Bell?

MR. BELL: Thank you. Good afternoon, panel.

BY THE BOARD:

MR. BELL: My question is just a question on theory with respect to the corporate tax rate that is being used.

And my understanding from reading the material is that rate was used to put you to a level playing field should another company come into the marketplace such that there is no unfair advantage or disadvantage by having Disco not paying its fair share of tax. Am I correct on that?

MS. MACFARLANE: That's correct. Yes.

MR. BELL: Now let's assume that a new player came into the marketplace and used just standard tax planning which would be available to that company and possibly -- for certain the tax paid would not necessarily be the maximum amount that you are using here, and could be substantially less if in fact any tax at all, given that it may be a new company or startup losses, et cetera.

Do you accept that as a possibility that the rates used by a competitor may well be less paid?

MS. MACFARLANE: You had two elements to your examples. One was with respect to any losses they might be incurring as a startup company.

And if NB Power Disco has losses, it takes advantage of the tax benefit from that and has a tax loss carried forward --

MR. BELL: Right.

MS. MACFARLANE: -- just as a private sector company would be. The only difference is really with respect to the tax depreciation of assets versus the accounting depreciation of assets, were they to be different. And as you know that's just a timing issue.

And because we have not had CCRA do an estimate of the tax value of the assets, we don't know what that difference would be. It could be more. It could be less.

MR. BELL: But it is possible that a competitor could come in and pay less and perhaps substantially less?

MS. MACFARLANE: That's correct.

MR. BELL: And if that were to be the case would you then consider yourself still to be on a level playing field?

MS. MACFARLANE: Over time yes. Because those amounts are simply timing differences. In the end the asset gets fully depreciated whether for accounting purposes or tax purposes. It's just a timing difference.

MR. BELL: But the timing could be substantial and could be substantial cash flow wise?

MS. MACFARLANE: It could be. When we were making that decision as to how to implement this aspect of the Act, given the effort there and the effort in many other areas and decided that we would take this approach in the early stages for this section of the Act, it was felt that it was very likely that CCRA may assess for -- because they would have no other basis, they well assess the tax value of the assets as the accounting value on October 1st 2004. And from that perspective we may well -- if that were the case we may well be able to determine what the difference would be. But we really have no idea whether it would be above or below.

MR. BELL: Okay. Thank you.

MR. MAROIS: Mr. Bell, maybe if I just could add, the payment in lieu of taxes serves two purposes. One as you mentioned is to establish a level playing field. The second purpose is to help pay down the debt.

MR. BELL: Right. I understand that. Thank you.

MR. NELSON: In your testimony this morning in regards to Section 31, subsection (1) of the Electricity Act you stated that as the chief financial officer you knowingly disregarded the legislature of the Province of New Brunswick.

MS. MACFARLANE: As a transition measure we did after significant consultation with not only consultants in the field but also with the shareholder, yes.

MR. NELSON: So the shareholder gave you authority?

MS. MACFARLANE: The shareholder doesn't theoretically have authority to give us permission not to comply with the Act, but we did jointly determine that when you looked at the cost of compliance versus the cost of complying with the spirit given the intent of the legislation, that in these early days we would comply with the spirit so as to avoid those start-up costs at a time when the corporation was struggling with many other start-up issues.

As I said, it was the advice of our auditors that we would need to employ three or four tax accountants and a tax lawyer which would be very difficult to recruit in this environment, that we would have to incur significant system costs in order to be able to track our asset values differently for tax purposes and for accounting purposes, and that we would incur significant consultant costs, both on start-up and annually. And given that this was our first year and our highest priority was obviously to ensure that we had the company operating as a company, that we had the PPAs in place and operating with appropriate due diligence, that we proceeded with preparation of budgets and business plans and evidence required for the revenue requirement, we delayed implementation of that part of the transition.

MR. NELSON: But you really didn't have the authority to do it?

MS. MACFARLANE: That's correct.

MR. NELSON: So it was taken upon yourselves to do it --

MS. MACFARLANE: That's correct.

MR. NELSON: -- without going back to the legislature or anything to have that section of the Act modified or altered or anything?

MS. MACFARLANE: That's correct.

MR. NELSON: So why didn't you go back to the legislature to do it?

MS. MACFARLANE: In discussions with Electric Finance, that was something that at the time they did not want to do. And so we took this transitional measure in the corporation's first couple of fiscal years with the intent that we would either have the Act changed in the longer term or in fact we would move toward compliance.

MR. NELSON: So there has been really notification anywhere along -- to anybody publicly that this has been done?

MS. MACFARLANE: The form of our compliance is in a note to the financial statements. Our auditors' management report to the audit committee and to the Board noted that we were not in compliance and the Auditor General obviously reviews the management letter prepared to -- by Deloitte & Touche to the NB Power Board. So the shareholder is also aware of it.

MR. NELSON: Are you aware of any other sections in the Act which you have disregarded or changed?

MS. MACFARLANE: With respect, we did not disregard it. We are complying with the spirit of it. And as I say, it's a transitional move. But there are no other sections of the Act that we are not in compliance with.

MR. NELSON: Thank you.

DR. SOLLOWS: Following up on that point, Ms. MacFarlane, or really anyone, you took advice from your auditors. Did you benchmark that advice against any other? Did you consult counsel? Did you -- I mean, I'm aware that other fairly large organizations can do this without having such a large cost of doing it. And so I'm wondering why it's particularly costly for you to do it when other companies routinely do it?

MS. MACFARLANE: We are aware that Nova Scotia Power, as an example, has a tax department of that size. Utilities would be particularly heavy in their investment in compliance with the timing issues related to your assets because we are so asset intensive. Obviously if you were a retail operation or a different type of business it's different, but utilities being very asset intensive have to make significant investments in compliance which the Income Tax Act.

DR. SOLLOWS: Thank you. That's somewhat inconsistent with what we heard this morning that we aren't even considering the cost of capital in assets like vehicles, short-lived assets. But I will leave it at that and carry on with my prepared questions.

MS. MACFARLANE: If I could just make a comment on that. We have a business case format that is prescribed across the corporation and it does take into account cost of capital. Disco is not using that methodology for vehicles alone but for other capital purchases they are using the designated template and methodology which does include cost of capital.

BR. SOLLOWS: All other asset purchases?

MS. MACFARLANE: There are other asset purchases that qualify for requiring a business case.

DR. SOLLOWS: What assets do you purchase that do not include cost of capital in their life calculations or in their decisions?

MS. MACFARLANE: The planning for the non-discretionary work and for customer demand work does not include an analysis of the return on capital. The discretionary projects like IT projects or building projects or what have you do include it.

DR. SOLLOWS: Is there a breakdown somewhere in the evidence of the relative amounts of these?

MS. MACFARLANE: No, there isn't.

DR. SOLLOWS: Can that be provided?

MS. CLARK: Are you asking for a specific breakdown of our capital projects or where business cases have been used to justify the capital projects?

DR. SOLLOWS: I guess what I would like to know on the record is how -- what fraction of your assets are managed taking into account a reasonable cost of capital and what fraction of your assets are not so managed?

MS. CLARK: Okay. We can do that.

DR. SOLLOWS: Thank you. So if I may then proceed on with my prepared questions, such as they are. I'm wondering if you -- and this is to the whole panel -- could you just give us as a background describe the overall organization of Disco regarding its service delivery personnel? I assume they aren't all stationed and dispatched in Fredericton and that you have got some sort of an organization and districts around the province. Could you give us a brief description of that?

MR. MAROIS: Maybe I could refer you to my direct evidence in A-50. That's under orange tab 2. And then you have got my direct evidence. And it's part 2 of my evidence.

DR. SOLLOWS: And you are referring particularly to page 2, the second paragraph?

MR. MAROIS: Yes. Page 2, paragraph -- the paragraph starting from line 4 to 7.

DR. SOLLOWS: Right.

MR. MAROIS: So the way we are structured is we now have three regional areas, central region which really covers basically from Fredericton to the west side of the province all the way up north, all the way to the Quebec border, and down south includes the islands like Grand Manan. So that's the central region.

We have got the eastern region which starts really from Rothesay all the way up to north of Buctouche. So that's really all the southeastern part of the province.

And then from the Miramichi north we have got the northern region. So we cover the northeast of the province. Prior to restructuring on April 1st, 2005, we had five regions.

So that was one way of coping with the people leaving the companies. By reducing the amount of regions we were able to streamline the process, so we reduced some of the supervisory staff, et cetera. So now we have three regional areas. Within those three regional areas we got fourteen operation centres. And these are really smaller offices, regional offices or district offices, where you have got more -- mostly operating stats. So like the line workers basically. We do have some administrative people who look after dispatching work, for example, and you have got some engineering staff in those offices as well.

I guess in the larger regional offices we have got three offices that are a bit larger. We have got in the northern region we have the Bathurst office. In the eastern region we have got the Moncton office and the central office is located in Marysville just north of Fredericton.

So these three regional offices have operational related staff but of a more administrative nature. So each region has quite a bit of autonomy in terms of responding to work load, responding to outages and things of that nature.

We also have centralized as mentioned here a distribution control centre. That also is in the Fredericton area, in Marysville. So that's where we really imagine the system centrally.

And we have also three contact centres, one in -- the head office on King Street in Fredericton, one in Shediac and one in Tracadie-Sheila. So we have got -- those are three contact centres. So the three contact centres over and above taking inbound calls they also deal with collection matters. So they do outbound calls as well. And naturally we have centralized staff at the head office.

So we have got a financial group, we have got the engineering group, the people that are looking after our contracts, for example, in terms of wholesale contracts, large customer contracts and the power purchase agreements. Those people are in the head office. We have billing energy advisors and account managers are managed centrally, but the account managers energy advisors are spread out across the province.

DR. SOLLOWS: That's helpful. So when you consolidated from five down to three regions, I guess we called them, each of those are roughly equal in size or volume of energy delivered?

MR. MAROIS: They are somewhat similar. But they are also quite a bit different. I mean, each --

DR. SOLLOWS: Depending on industry and the --

MR. MAROIS: Each area has its own realities. Like the eastern region covering the greater Moncton area is really a fast-growing area. And the northern region being -- is a smaller area in terms of customers. But being more remote they have their own challenges. So they have some distinct differences.

DR. SOLLOWS: Okay. So I guess what I'm wondering here is the people that manage these regional areas, you said they have some autonomy. I'm wondering if they have sufficient autonomy for example to source goods and service locally, if they can find them locally more cheaply than they can buy them from central stores and that sort of thing?

MR. MAROIS: Well, in terms of that example we have just gone the opposite way. I guess that's part of looking at best practices.

We have centralized our supply chain function for all the group of companies, the shared services. So we have now one centralized function that are really looking at standardizing all our purchasing processes, trying to achieve more economies of scale.

And one good example is -- for example we went with one preferred carrier throughout the group of companies which has allowed us to save some significant dollars and improve the service we are getting.

So -- and it's the same group that looks after fleet management as part of the initiative I mentioned this morning. They are going to be outsourcing the fleet management maintenance program.

So again by doing that centrally you can achieve some economies of scale that you couldn't do in each company. And this is consistent with what other utilities are doing.

DR. SOLLOWS: Do you have any report or background or business case or any documentation to support those kinds of decisions? I tell you where I'm coming from. In preparation for these things I tend to read the literature in different areas.

And I have found more than one reference to situations where the optimal size, the point of diminishing economies of scale to be quite a bit smaller than Disco as a stand-alone utility, and even probably quite a bit smaller than what the size of each of your regions is.

So I would be very interested in seeing documentation to support the decision to centralize and make it larger as opposed to running them with smaller, more independent, more closely tied to the area served. Do you have any business case or documentation like that?

MR. MAROIS: Well, I'm certain we have documentation. And I can look into it. But really what we are trying to do is strike a balance between the best of two worlds.

I mean, by having regional operations, we do have people in the field that know what's going on, that have contacts in the areas and can make decisions on a daily basis. But also at the same time we are trying to leverage any central resources we have. And for example we have just done this with safety.

I mean, because of some of the challenges, ongoing challenges we face with safety which is not unique to us, we have decided to put additional focus on it.

And corporately there was a decision made that we would have a central function to ensure that we have a consistent approach to safety, that the message is consistent, that the approach is consistent.

So that's an area where people in the field are responsible for delivering those programs. But sometimes there is a benefit of central coordination.

DR. SOLLOWS: And you will file the report that demonstrates this?

MR. MAROIS: Yes. I will file what's available, yes.

DR. SOLLOWS: Thank you. Ms. MacFarlane, you indicated last week -- and sorry, I can't recall the day -- but my paraphrasing of your words are that the original plan called for fairly slow steady rate increases of about 3 percent per year for about 10 years, is that right?

MS. MACFARLANE: I believe I said about seven years.

DR. SOLLOWS: Oh seven years?

MS. MACFARLANE: Yes.

DR. SOLLOWS: Okay. Thank you. That would certainly be consistent with what had been done prior to the reorganization, would it not, since 1993?

MS. MACFARLANE: I don't believe that they had been quite as prescriptive. The rate increase -- I'm sorry I only have five years in front of me. But 2004, 2005, 2 1/2. Prior to that, 2.6. The year before that, 2.1. 2001, 2002 there was no rate increase. The year before that was 3 percent.

DR. SOLLOWS: So fairly low and low, steady. Not a 12 or a 13 percent anywhere to be seen?

MS. MACFARLANE: That's right. And as I mentioned, the modelers, the financial advisers and energy advisers that the Province was working with were among many in the world that did not forecast what was going to happen to fuel prices.

So they had looked at a very steady state model going forward, and with that had determined that they could, through a slow steady state process get the companies to commercial operating merchants.

DR. SOLLOWS: Yes. I will come to that a little later. Right now I just want to follow up on this to make sure I have got it clearly in my mind.

If things had gone according to the plan, your customers would have been cumulatively been exposed to a period something close to 20 years, where the basic assumptions about their cost allocations would have been untested, is that correct?

MS. MACFARLANE: Certainly in that restructuring plan that the Province put together there was -- as I had indicated there was no time when the advisers were recommending a rate increase that would have caused the utility to come before the Public Utilities Board.

DR. SOLLOWS: And do you anticipate that you would have advised Disco to come before the Board even if they did not have to? Am I right in assuming that we would have seen 20 years between tests of the basic assumptions in cost allocation and rate design?

MS. MACFARLANE: All I can tell you is that the restructuring model as designed by the Province's financial and energy advisers did not call for rate increases that would cause the utility to go before the regulator.

Other things may cause -- may have caused that. In fact that's why we are here today is because fuel prices have caused a rate increase greater than the threshold in the Electricity Act.

But the plan as put together by the financial advisers did not call for that.

DR. SOLLOWS: Okay. Thank you. So to take another example from something that has been dealt with earlier today, what assurance should we have and the public have that issues like the cost of money allocated to things like vehicles be appropriately handled in the company?

How would -- except through this process how would we have ever known that you weren't properly accounting for the costs of replacing your assets, those particular assets?

MS. MACFARLANE: I think the essence of your statement is perhaps one of the drivers behind the government undertaking to change NB Power.

We last week talked about some of the statements in the Minister's announcement of the future of NB Power back in 2002. And he referred specifically to -- and I will read to you -- NB Power has performed well for New Brunswickers over the year in many respects. It has acquired a solid reputation as a safe, reliable service-oriented utility, based in large part on dedication and excellence of its employees. But times have changed. And NB Power must change with it.

And that was specific to the business practices and the rigor and discipline in those business practices. As you know, the Act has changed requiring the corporation to act like a business with no public policy intervention. Requirement to earn a return, requirement to pay dividends, requirement to pay taxes, new board of directors appointed all of whom come from the private sector with very strong business backgrounds, new CEO appointed who has come from the private sector out of the financial community, a very strong business background. The government believes -- I shouldn't say that. The corporation believes that together with government there has been a governance process put in place to ensure the very processes and practices you are talking about are rigorous.

And as the companies move into the capital debt markets there will be another whole layer of discipline and rigor imposed by virtue of reviews by credit rating agencies and reviews and compliance with covenants of debtholders.

So I believe that as the financial advisers and energy advisers were working with government to determine the new structure for NB Power, they had many avenues in their mind as to how they could assure the owner of appropriate governance and appropriate rigor in business practices.

DR. SOLLOWS: Okay. Well, I will leave that there for now. And carrying on with this, this slow steady rate increase, I think you indicated at that point, and I think you have reaffirmed, that it really was the shareholders' preference for slow steady rate increases, is that right?

MS. MACFARLANE: That's very much the case, yes.

DR. SOLLOWS: And you know that how exactly?

MS. MACFARLANE: I -- you are correct that I don't know that definitively. I only know that as the financial advisers were putting together the model for restructuring and outlining the time frame in which each of the companies would earn their commercial returns, the shaping of the PPA's to allow that to happen over time, one of the guidelines they were using was slow steady rate increases over a period of years. And I assume they got that guideline from the shareholder.

DR. SOLLOWS: Okay. Thank you. I guess you anticipated where I'm going in that certainly I would, based on what I read in the newspaper, assume that you are correct. And the shareholder would prefer slower, more steady rate increases rather than a sudden change that we seem to be facing in this application.

I guess the question in my mind is if it is pretty clear that the shareholder doesn't like this proposal, you are here not representing the shareholder but the company, feeling the company requires it, I'm just wondering where that leaves us?

MS. MACFARLANE: As I say, it would be the shareholders' preference and NB Power's preference to have slow steady increases over a period of time. But the realities of the commodity markets in the world are not allowing this in this instance.

The Premier spoke through The Telegraph Journal on Saturday very definitively about the fact that one of the overriding objectives of restructuring was to balance risk between taxpayers and ratepayers, and that subsidizing energy costs by leaving a burden on taxpayers is not getting the province anywhere.

It's not allowing us or keeping us competitive. And that unfortunately these high fuel prices are a new reality. And we have to get used to it.

We can certainly provide a copy of those statements in The Telegraph Journal if that would be helpful.

DR. SOLLOWS: No, not to me. Thank you.

MR. MAROIS: Just maybe if I can add, I'm just afraid we might be mixing apples with oranges. My belief is when we talk about the gradual rate increase of 3 percent, that was to make NB Power group of companies commercial. What we are seeing here is nothing to do with that. The reason why we are here is increased fuel costs which are dictated by world markets.

So I just want to make sure we are not -- when we say -- nobody likes sharp increases. But these increases are real costs. I mean, we are going to be paying 90 million more this year in fuel costs. These costs don't go away. We may try to make believe they will go away. But they are there. So I just want to make sure we are not comparing apples with oranges.

DR. SOLLOWS: Thank you.

MS. MACFARLANE: I just wanted to add as well that in line with the restructuring plan this year, Disco is asking to achieve the equivalent of a return on equity. But Genco is not -- pardon me, Nuclearco is not.

Because in the restructuring plan those were to happen in year 5. And as I said the other day, post restructuring it was a gradual. And that part of the plan is continuing forward.

DR. SOLLOWS: I understand. Thank you.

MR. MAROIS: And the other thing that's related to this is the fact the government has absorbed $377 million in debt. If those debts were still in our books we would be paying more interest. So that's part of the gradualism.

DR. SOLLOWS: Thank you. In your answer to that last question, you did bring up the fact that you have faced a very apparently unexpected rise in fossil fuel prices. That certainly is the case and I know anybody buying fossil fuels knows that's the case. My understanding of fossil fuel prices based just on my own experience is they are notoriously volatile. That's one of the reasons they are normally excluded from the Bank of Canada's cost of living or CPI calculation. They go up and down very quickly. Is that consistent with your understanding of fossil fuel prices?

MS. MACFARLANE: Yes, it is. And the forecasters, let me say two years ago when they were looking at rising fuel prices in this period, that would be without the knowledge of the effects of world events like Katrina. They did predict it was a temporary rise and our long-term forecasts were that in fact prices would decline and come back to something more reasonable. They have not. And in fact the forecasters that we use are indicating that they are now beginning to see this as a long-term trend. They may continue to be volatile but they may never return to the levels that we might have once believed were more normal.

DR. SOLLOWS: Is that evidence on the record, the reports from those advisors?

MS. MACFARLANE: No, it is not.

DR. SOLLOWS: Could you put it on record, please?

MS. MACFARLANE: I will, yes. We can I think.

DR. SOLLOWS: Thank you.

MS. MACFARLANE: I will try.

DR. SOLLOWS: I guess one of the reasons why this is a particular issue for me at least is I recall in the late '80s, early '90s, NB Power applied for a rate increase under the emergency provisions then available to them in the Act because of the run up in fossil fuel prices during the Gulf War, the first Gulf War, that is.

If I recall correctly it was granted with the provision that if the prices fell there would have to be an adjustment, and the prices did subsequently fall quite markedly, and then NB Power had to deal with a very messy business of providing rebates back to the customers. So I guess that I want to be sure that the situation we are in now is distinctly different from the situation we were in then to ensure that we don't set your base of revenue requirements too high, frankly. So I guess that's why I would be very much interested in having on the record fuel price projections.

MR. MAROIS: That's a fair comment, Mr. Sollows, but I think one thing we must not forget -- two things. First of all, Disco's prices are set for the year. So the price will not go down in fiscal 06/07. And again we are setting the rates -- we are here today to set rates for 06/07. So we have got a high degree of certitude that the prices are what they are for fiscal 06/07.

DR. SOLLOWS: That brings me just to the next point that I wanted to deal with. Again my memory then is -- I'm inferring to your comment that you fully hedged your fuel costs and therefore it's fixed, is that correct?

MS. MACFARLANE: We have fully hedged our fuel costs, but even if Disco had not fully hedged its fuel costs the PPA calls for its price from Genco to be fixed on October 1 of the year preceding the year in question.

DR. SOLLOWS: Why would that be, if we are really trying to share risks appropriately between generators and Disco? That would seem to shift the normal risk that generators face in a market to Disco. But maybe we should defer this until we discuss the PPAs.

MS. MACFARLANE: Okay. And we should pursue it because I don't think we have a full understanding of it yet.

DR. SOLLOWS: Perhaps. Thank you. So I guess the question without getting into the PPAs, since we know that -- you are telling me that since we pre-bought all our fuel through a hedging process, this is very different than the early '90s where we didn't do that, we didn't hedge all our fuel costs, and the customers eventually benefited from the fall of fuel prices, you say you have structured things so that the customer cannot benefit from the fall of fuel prices if it occurs.

MS. MACFARLANE: No. The cost that is passed through in the vesting agreement is reset every year and it's calculated based on forward prices that incorporate hedges to the extent that they are done. So for the year 06/07 the energy price under the vesting agreement was set on October 1st.

Disco had asked Genco to hedge throughout the year to provide for -- to provide against the risk that there would be a temporary spike in prices on October 1 -- on or about October 1. So they got an averaged price over the course of the year. But once that is set any unhedged requirements in the year go to the account of Genco. And then in the following year the price would be reset. So if prices do fall in the following year the price is reset the following October.

DR. SOLLOWS: Okay. So when -- what you are saying then is the fuel was hedged in a series of periodic transactions throughout the year. Did you follow forward prices and ensure that you were taking advantage of any short-term trends?

MS. MACFARLANE: The hedging policy for both Disco and Genco is a corporate policy, and it is one that does not -- that is based on volumetric amounts. Every month there is a forecast of the fuel requirements 18 months out and that is the amount that is hedged in the commodity markets. So it is not one that looks at taking any price view because we are not experts in the market. It's a very systematic approach every month. The requirement for 18 months out is hedged and averaged into. And as markets go up and as markets come down, there is simply a tracking of that over time.

DR. SOLLOWS: Okay. I guess again that is something that I'm finding a little bit confusing in the sense -- again from my review of literature, I see lots of references to sort of the optimal purchasing arrangement to include not 100 percent hedging but to, you know, get your firm supply settled at an appropriate time being somewhat more careful than when you buy, and leaving some of your volume to be purchased at spot prices as market opportunities occur. And what you are telling me is that is not done currently.

MS. MACFARLANE: Well perhaps as we get into fuel and the PPAs next week and the witnesses who are involved in that are here we can discuss it more fully.

DR. SOLLOWS: Okay. That would be fine. At the same time we might discuss how gas is purchased.

MS. MACFARLANE: Yes.

DR. SOLLOWS: All right. Now I want to come to -- I had a piece of paper here for Mr. Marois. This one I do have a reference to the transcript but I will give you the reference. I don't think you need to look it up but unless you think I have misstated you -- and I'm going to try to read it verbatim. On page 3678 lines 9 through 16 of the transcript, Mr. Marois, you said, if I get it correct here, so the purpose of the exit fee -- this was in relation to some questions posed to you by Mr. Hyslop on exit fees -- the purpose of the exit fee is to recover any of those remaining costs from the customers who leave, and that's related to the stranded cost concept. Any utility in the world that has looked at opening its market has had to deal with the issue of stranded costs. And what I mean by stranded costs is really the cost of the generators that have been built over the years prior to the market opening. So these costs are legitimate costs. They need to be recovered. And then you go on. Is that a fair -- do you recall that?

MR. MAROIS: Yes, I do.

DR. SOLLOWS: Okay. Thank you. Now I certainly understand that other regulators have found that ratepayers and not shareholders should bear the cost of stranded generation assets, that's without question. The basis of those decisions, as near as I can tell from my reading of those decisions, has been what has been called the regulatory compact. And as I understand the notion, it's that the regulator acts as a representative of the customer and had either given prior approval for construction of the asset or its inclusion in the rate base, and in either case I can see why the ratepayers would have to pay for the stranded asset costs, because they have received prior approval to acquire them.

I also understand that in other jurisdictions regulators have the right and the duty to oversee the activities of a utility. I understand that to be the case in other jurisdictions but I understand that's specifically not to be the case here in New Brunswick. We have no right of general regulatory oversight is my understanding.

In the case where these regulators do have general regulatory oversight the utility would normally argue that it acquired the assets in good faith even if they had never been in the rate base or subject to prior approval. And again in that case I can see why the ratepayer might be responsible for stranded costs. But I don't see in any of my reading of the case history in this or the papers, the economic papers, the regulatory papers, I don't see any explanation that I can find as to why these considerations would apply to Disco's and Genco's and NB

Power's specific case.

So can you please illuminate me and the rest of the panel?

MR. MAROIS: Well I hope I understood your question, but I think in New Brunswick the government through its legislation decided to deal with the stranded cost issues in two ways. First of all, the way the model had been structured is that Disco has really contracted for the existing generation facilities. So that basically deals with it in the sense that the cost of the existing generation facilities that were there prior to restructuring are now paid for through Disco and ultimately through the customer. So that's your kind of base case scenario where they cover the recovery of the stranded costs that way.

Then in the Act, the Act provides for a scenario where some customers can leave the system. So those are the wholesale customers and large industry. And really what the Act has done is it has attributed the responsibility for any potential stranded costs to the customers leaving the system, because my understanding of how the Act is written in terms of exit fees, if somebody leaves it should not cause any burden to the remaining customers. So at the end of the day they are the ones that have to cover any non-mitigated costs for leaving the system.

So I mean again I don't know how that ties into other models or compacts in other parts of the world. My comment on the transcript for that, as soon as you look at opening a market you have to deal with the issue of stranded assets, stranded costs, because I mean if you create competition, if you don't -- you have to ensure that the costs of the existing assets get recovered. In my mind the way the Province did it New Brunswick is the way I just described it. The normal case is it's recovered through Disco to the customers and if somebody leaves the system, they have to ensure -- they are responsible for paying any non-mitigated costs for leaving the system.

DR. SOLLOWS: I guess the question it raises in my own mind is here you seem to be telling me that the shareholder decided that on balance the ratepayers should pay for the stranded costs without any process that would have given an opportunity to represent the ratepayers' interests. To me it seems a little one-sided.

MR. MAROIS: Well I can't comment on the process other than really this recommendation came from the market design committee. As soon as the market design committee decided to have a bilateral market and that Disco should play the role of standard service provider and that for playing the role of standard service provider Disco should contract the existing assets, they unmade that decision. So really the recommendation come from the market design committee which had a pretty broad representation, maybe not by the public but by several parties.

DR. SOLLOWS: Thank you. Now again I want to go on to a different topic, and I know -- I think more than once -- and I have your initials beside this question, Ms. MacFarlane, but I'm just going from memory -- but I have heard several references to competitive rates and an interest in being able to ensure that your rates are competitive while at the same time ensuring the financial stability of the company. Is that -- am I getting it right?

MS. MACFARLANE: You are getting it right. I believe the cross that brought that out was with Mr. Marois.

DR. SOLLOWS: Could be. Okay. I'm sorry then. I will open this to anyone who is your competition.

MR. MAROIS: It is not our competition.

DR. SOLLOWS: So you don't care about having competitive rates?

MR. MAROIS: We know our customers care.

DR. SOLLOWS: Who -- okay.

MR. MAROIS: If our customers -- I mean, they remind us all the time that they compete with businesses in Nova Scotia, in Maine, in Quebec. And if our rates are not competitive, then it doesn't make them competitive.

DR. SOLLOWS: So competitive as distinct from cost based? I mean, when I think of a competitive market, I mean, basically market sets the price and the cost is somewhat irrelevant. You go out of business if you can't meet the market price.

So I guess I am just having a hard time with the notion of competitive pricing for distribution rates. I can understand it from the point of view of electricity and generation's end, where there may be some market. But I am having a hard time with the concept at the distribution level.

MR. MAROIS: Well I guess I -- when I responded to a question I can't -- from whom the other day, I mentioned there were several factors to try and achieve competitive rates. One of them is exactly what you said, is costs, because utilities typically have costs rates that are cost based.

So if we have a good control on our costs, it is going to help make our rates more competitive. But it is also broader than that and includes a rate design itself, issues regarding cross-subsidization, for example. So if you have a lot of cross-subsidization, it can compound the issue of not having competitive rates. Because if you are over-recovering from one class, then from their perspective it might be imputing a bigger burden on them. So there is our overall costs, how the rates are designed themselves, the issue of cross-subsidization and so on. So those are the key elements.

DR. SOLLOWS: So on the issue of cross subsidization, are you -- do you think the cost allocation and rate design that is currently before the Board increases or decreases cross-subsidization relative to the rate design that you originally filed?

MR. MAROIS: Was your question the rate proposal or the cost allocation?

DR. SOLLOWS: The cost allocation. You were talking about making sure we get the cost allocations right. And I know the one that is currently before the Board based on the Board's decision is significantly different from the one that you originally filed. And do you feel that the one that you originally filed was a better allocation? I am just trying -- I am a little bit confused here because we are -- I am wondering how we got to where we are if your intent was to improve cost allocations. And we have just heard that it is unlikely that you would have been here at all except for this somewhat fortuitous, I guess, from the interests of the public's -- this fortuitous rise in fossil fuel prices so that we do get the opportunity to review your operations.

MR. MAROIS: Well with all due respect, Mr. Sollows, we did spend six months on the cost allocation but we are back to square one, we have basically the same cost allocation study we had in '94.

DR. SOLLOWS: Right. Which was the one approved by the Board at that time.

MR. MAROIS: Yes. So I guess if we would not have come in, we would not have had any different cost allocation than what the Board has just decided.

DR. SOLLOWS: But I guess then my question is how we got the rates that we had but we will deal with that a little later.

MR. MAROIS: Well from my perspective, when I talk about cross-subsidization, it really has nothing to do with the cost allocation study. It has something to do with it, but not how you design it. You should design your cost allocation study to allocate costs in the proper manner without caring about cross-subsidization.

DR. SOLLOWS: Yes, certainly.

MR. MAROIS: Then once you have got your cost allocation study, when it kicks in is when you start designing your rates and you try to have rates that balance the recover of costs with other objectives such as gradualism.

So to answer your question, based on the cost allocation methodology approved by the Board in December, the rate proposal that we did file this time around does definitely address the issue of cross-subsidization. Because every rate moves toward reducing --

DR. SOLLOWS: Right. And I support that. I guess what is causing me some confusion is the notion that you, prior to that, were using it every year in your adjustment of rates, were using the approved cost allocation by the Board in 1993 or 1994. Because I saw in evidence I think a number of cost allocation studies and it is not entirely clear to me that they do follow that.

MR. MAROIS: The only significant change we made to our cost allocation study was as a result of restructuring. And that was what we filed to this Board. We believed at the time and we still believe now that what is driving the costs for Disco are the power purchase agreements and that is why we allocated costs accordingly.

Prior to restructuring the cost allocation studies we had done subject to minor refinements, were based on the previously approved Board methodology.

DR. SOLLOWS: Okay. We will get into when we talk about rate design how the outcomes occurred. Finally -- I think this is finally it, maybe one or two more. The issue of nomination -- the issue of the option of reducing your nomination for the test year.

I think I heard that you had not studied that, the opportunity to reduce your costs by reducing your nomination.

MR. MAROIS: I would like to bring you to we answered a question on this last Thursday.

DR. SOLLOWS: Yes.

MR. MAROIS: It is in binder -- schedule A-80. PUB IR-266.

DR. SOLLOWS: 266.

MR. MAROIS: Yes. So we did consider it. But we did not do a cost benefit analysis, mainly for the four reasons that are outlined there.

And those four reasons is, first of all, during the Lepreau refurbishment outage we will need all the capacity and energy we can get otherwise we will have to go on the market and incur that risk.

Second is leading up to Lepreau refurbishment there are risks regarding Lepreau. It's an aging plant. And it has already been derated. And there are risks that it may be -- its capacity factor may be lower than anticipated. So if we reduce our capacity on Genco then we are more at risk of not getting the replacement power, at least not in current terms and conditions.

The third component is until a second tie line gets built we are more at risk of being able to import the power we would need if we were to reduce our nominations on the Disco -- on Genco, in the Genco PPA.

And really the fourth one, which is once the refurbishment is over, within a couple of years we know we need new capacity.

So for all these reasons we felt it was not prudent to seriously consider reducing the nominations. Naturally if somebody were to leave the system, like a wholesale customer or large industry, we would take another look at it, because that would be part of the mitigating measures we would look at in determining an exit fee.

DR. SOLLOWS: I guess the difficulty I'm having is you said you would take another look at it. But you started out by saying that you haven't looked at it at all. Because you have not done a cost benefit analysis.

And each of these bullets, as I understand them, would be something that would be considered in a normal cost benefit analysis.

MR. MAROIS: We could have done a cost benefit analysis. But like I say, why go through the motions? We looked at it intuitively. And because of these reasons we felt it was not a prudent -- we would not reduce our capacity because it would expose us at too much risk because of those elements.

So we could run many scenarios and look at different potential benefits. But we still -- because of the risk involved we believe it's not a prudent thing to do.

DR. SOLLOWS: You don't then attach a financial value to the risk?

MR. MAROIS: Oh, we could. But at this day -- like I say, the risk for me is high enough that it doesn't -- it would not be prudent to reduce our nominations.

DR. SOLLOWS: I guess I will leave that point then. I think there was only one, maybe two things that came out of this morning's questioning that I have to look at. If you will just give me one moment.

CHAIRMAN: We will take our afternoon break and let Commissioner Sollows look.

(Recess - 2:15 p.m. - 2:30 p.m.)

CHAIRMAN: Did any more undertaking answers materialize in the break?

MR. MORRISON: No, Mr. Chairman.

CHAIRMAN: Okay. Thanks. Commissioner Sollows?

DR. SOLLOWS: Thank you, Mr. Chair. I determined just two more questions. The first one, I would like to refer you -- I think, Mr. Marois, you indicated this morning the quantity or the size of the tie line that is being proposed to connect southern New Brunswick into Maine. And it was going to add how many more megawatts for import capacity into New Brunswick?

MR. MAROIS: 300.

DR. SOLLOWS: 300 plus the 100 existing in the MEPCO tie line for 400 in total?

MR. MAROIS: Exactly.

DR. SOLLOWS: Okay. So I'm referring now to page 16 of the White Paper. It is marked as PUB 12. And page 16. It is section 3.1.3.2. And I'm again not sure you need to dig it out.

I just want to read one sentence that appears in it. It starts about two-thirds of the way down the paragraph and says "Strictly speaking to achieve a workably competitive market within New Brunswick, either the Crown utility's Generation portfolio must be broken up or the Province's transmission interconnections with the adjacent markets must be significantly increased to allow for greater access to New Brunswick."

Now the decision was made not to break up the Generation assets. And that is fine.

My question is can you provide or cause to be provided the reports or studies or underlying or unpinning work for the proposal to establish that the 400 megawatts is significant enough to form the foundation of a competitive market in this province?

MR. MAROIS: I don't know if such a study exists. But I can see what's available.

DR. SOLLOWS: Thank you. And if you could provide us with any documentation for it that would be helpful.

Finally in the discussions this morning we were referred to table 1 (e) under big tab 3, the Direct Evidence of Lori Clark, Part 1, tab 1, page 11, table 1(e).

Do you have that?

MS. CLARK: Yes.

DR. SOLLOWS: Thank you. Just for clarification, when I looked at the numbers, the tables didn't really make sense to me. We had column number 1, the billing determined in megawatts was 29,498 megawatts.

Can you confirm to me that that should be megawatt months?

MS. CLARK: I will confirm that. I don't have that here. I will check that.

DR. SOLLOWS: Okay. If you would. Then if I divide the 29,498 by 12 I get something close to the amount of capacities you have received under the PPA's, is the reason I say that. But if you could confirm that.

And then my question would be if that is the case, I was under the understanding that the amount of power that you needed to transmit varied throughout the year.

And this would appear to be based on your peak. And I'm wondering if you could confirm that this could be reduced by using the actual monthly megawatt months rather than the peak over 12 months.

Or have I got this wrong? I mean, if we could just clarify that.

MS. CLARK: Certainly.

DR. SOLLOWS: Thank you. And the other item on this table, I see there is a footnote with an asterisk under line 3, ancillary services, schedule 2. The footnote says "Credited back from Genco and Nuclearco."

What exactly does that mean?

MS. CLARK: Those ancillary services are referenced in table 1(b) and 1(c). And there is a provision in the Genco and Nuclearco PPA for Disco to recover ancillary service credits provided to the SO for supplying ancillary services to the system operator.

DR. SOLLOWS: So if Disco is recovering them why is it listed as an expense to transmission?

MS. CLARK: It's shown as a transmission expense and a credit for ancillary services under the Genco PPA and the Nuclearco PPA. So they net out.

DR. SOLLOWS: Okay. I think -- I'm not entirely clear but perhaps staff will be able to explain that to me.

MS. MACFARLANE: Mr. Sollows, if I could assist. You know that Disco is paying for all of the capacity in the Genco assets. It's paying for all the capacity and the transmission tariff allows for provision of self-supply of ancillary services. Through it's payment of -- or it's basic right to all of the capacity Disco is providing the ancillary services out of that. So to the extent that the SO is giving Genco any money for it, Disco has already paid Genco for it through the capacity payment. So the vesting agreement calls for Genco to basically give it back.

DR. SOLLOWS: So how does that translate into a 3.5 million dollar expense for transmission?

MS. MACFARLANE: As Ms. Clark indicated, there is an expense and then it's offset by revenue. So it's a neutral -- it's a zero cost to Disco because they have already in effect paid for it.

DR. SOLLOWS: Okay. Thank you. One final question. I see the rate under column 2 is above the rate in column 5. How is that rate set, the dollars per megawatt month?

MS. CLARK: Are you talking about table 1(c)?

DR. SOLLOWS: 1(e). I'm still back there.

MS. CLARK: Those rates come directly from the OATT and there were some changes effective May 1st, 2005, that made the change in the rates year-over-year.

DR. SOLLOWS: So the OATT change would have been reflected in the '05/'06, is that correct?

MS. CLARK: In fact they were, because when we followed their evidence we weren't aware of the changes at that time.

DR. SOLLOWS: So under column 5 that number should be 1771?

MS. CLARK: I believe that's correct.

DR. SOLLOWS: And so that 54.5 million is incorrect as well?

MS. CLARK: That's my understanding.

DR. SOLLOWS: Could you update that for us, please?

MS. CLARK: Yes.

DR. SOLLOWS: Thank you. That's all, Mr. Chairman. Thank you very much. I appreciate it.

MR. MACNUTT: Commissioner Sollows, you want her to update the whole table, do you?

DR. SOLLOWS: Well yes. I would like to see the updates carried through the rest of the evidence too, so that we know how -- what this changes.

MR. MACNUTT: Thank you. That's where I was coming from.

CHAIRMAN: That's a perfect example of a leading question, Mr. MacNutt. Commissioner Dumont has a question.

MR. DUMONT: I do, Mr. Chairman. I'm looking at -- what I am concerned about is the OM&A costs. When I look at your evidence, Ms. Clark, on page 6 of -- tab 2, page 6 -- what is meant by partly offset by non-union and merit increases, 2.6 million?

MS. CLARK: I think as Mr. Marois said earlier last week, 90 percent of employees are unionized and we have a union agreement with those employees. And we are intending to pay those employees at market rates. And as a result our union increases -- the non-union increases which relate to the other 10 percent of our employees and merit, which are step increases in their rate of pay, reflect the $2.6 million increase.

MR. DUMONT: So from what I see here, you lowered your labour expenses -- well you are supposed to in 2006/07 by 2.8 million because of business excellence initiatives, but you are planning to -- 2.6 million for non-union and merit increases in union, is that correct? So it offsets the 2.8. So that's 2. million -- 2 million in increase, is that correct?

MS. CLARK: That's correct. The other thing I should add is in 05/06 we reduced our cost and increased our miscellaneous revenue by $13.4 million. So that has been reduced in 05/06 and sustained through 06/07.

MR. DUMONT: Now if I look at table 2(c), we see on wages, the line 1, that is 90 percent of your employees. The variance there is -- it goes down by 1.4, is that correct?

MS. CLARK: That's correct.

MR. DUMONT: So look at 10 percent of your employees non-union, it would be the same amount, 5.9, 5.9, is that correct?

MS. CLARK: That's correct.

MR. DUMONT: Now if I look at the benefits on line 3 and 4, the benefits for union, it goes down by .1. But the benefits the non-union goes up by .1, which is only 10 percent of your employees. Why is that?

MS. CLARK: I don't have that information here with me, but I can provide that.

MR. DUMONT: Could you please? Because when I look at -- I know you have to respect union contracts, but non-union, you know, when you are in financial difficulty, I don't see why they would get increases.

You know, something that I would like to add is that we have seen in the last two years, every industry and manufacturer is having to restructure and rationalize, and I know, because I have lost my job because of it, because they have to cut their costs. And they have to deal with the world markets. They can't really increase their products because of competition. There is no competition here in this province for electricity. What are you going to do in the future to cut your OM&A costs? Because you are not planning to really from what I see on table 1. You are going from 05/06 from 99.2 million and you are going to 98.9 in 06/07?

MR. MAROIS: I guess I can answer that. A couple of elements. I guess first of all it's difficult to compare us with industry, for example, because we do provide an essential service. So at one point in time naturally we are looking at everything we do. As we mentioned I think from the beginning of this hearing, we are in a new era at NB Power. We are more commercially focused. So I know in my group we are turning every stone to make certain that we can be as efficient as we can. But that's only part of the element. We also have to provide -- what's driving our cost is naturally efficiency, but also service level and standards in terms of reliability, for example. And our challenge is to strike the right balance. And we can see it, because I mean last year when we reduced our cost some people applauded us. But at the same time we were criticized because some people perceived we were not as quick to turn back power following an outage. So that's following an outage, if there is storm, for example. So that's the reality we are in. In my mind, we will be successful if we strike the right balance between cost, service level and standards such as reliability.

We could do things, for example, some utilities have to cut their costs, for example, in terms of tree trimming for many years. But then it shows up in terms of catch up. At one point in time, you have to catch up and cut those trees. It shows up in terms of reliability. So I think we have to be smart at what we do and how we manage the utility.

So I can tell you for a fact that the changes we made last year reducing the number of employees by 150 was not an easy thing to do. And we are still recovering from it, because as you can imagine when 150 people leave, you have got people in new roles. They need to be trained. They need to develop. We have -- the way we survive is by implementing new systems. So you have training going on. You have implementation. So it's going to take us a little while to digest these changes, but I can tell you that the intention is to be as efficient as we can. And if you look at our vision, it's to be known as one of the best run utilities.

MR. DUMONT: Thank you. So could you be specific -- is there anything specific that you plan to do in the coming year -- 06/07 -- or '07 and the years after that, do you have any specific plans to cut more OM&A costs?

MR. MAROIS: Well the plans that we have for 06/07 are already reflected in our budget. So like we said in our evidence, we did do some cuts in 05/06, additional cuts in 06/07. And the cuts we have built in our budget in 06/07 unfortunately are not fait accompli.

One of the big cuts that we have reflected in our budget is a reduction in overtime of $800,000, for example. That's not implemented yet. Last year we were able -- we were successful in negotiating an agreement with the union to reduce overtime by implementing shiftwork basically. The union agreed to it, but it was turned down by the employees. So this year, we are coming back with a new approach. But that is a good example where something that has already been budgeted is not yet achieved.

So for 06/07 in my mind, we can't do more. And really we are at risk for what's budgeted for. But what we are doing right now and what we are going to be doing in 06/07 is laying the groundwork for the future. And I am working with my direct report right now to really put together the plan I talked about.

First of all, look at everything we can in terms of efficiency. But also we started to do some market research, for example, with our customers to better understand the tradeoff between rates and customer service level. What's their perception? Are they willing to maybe have a little reduction in customer service level in exchange of lower rates. We don't have good information on that right now and we started that research. So that's an example of something we want to do.

We also want to look at all our standards. In my mind, a little bit to Mr. Sollows' question is, we should factor in more risk assessment when we do the design of our plant. And maybe we can potentially design plant that is somewhat less expensive. But again you have to be very careful when you do that because if your plant is not robust enough customers will end up paying the price.

So those are kind of things that we are doing with the expectation of again becoming a well-run utility. The other thing we do quite a bit and I think we are too modest about it, is we have a lot of interaction with a lot other utility and we try to identify the best practices. And when we look -- and when we identify best practices, we try to incorporate them in how we do things. So there is an ongoing I guess continuous improvement mentality. But at the same time in my mind, we are at a stage where we have to look at more deeper, more transformational change.

MR. DUMONT: Thank you. Under the PPAs, something that bothers me a little bit is what incentives does Genco have to cut their costs? I don't see it in the PPAs where there is an incentive there to cut their costs of generating?

MR. MAROIS: Well it depends which costs you are talking about. I mean two things come to mind. Is the way Genco recovers their -- for example, their operating costs on a go forward basis. The price they will get for that is cast in stone in the PPAs. So the revenue they will get is fixed. So if they want to make more money, they have to become more efficient and they have to reduce their costs. And otherwise -- and if they are not -- if the costs go higher then what they can bring into the PPA, they will lose money. So they have a built-in incentive there to manage their shop efficiently.

Another incentive they have and that's more on the fuel side and operating the system side is because they share in the export margin, they lowered their fuel costs, the best margin they can share in at the end of the day. So there are some built-in financial incentives in the PPA, both in the terms of operation and both in terms of -- and in terms of fuel.

MR. DUMONT: See what I am worried about is the perception out there from people that talk to me, they say well what incentives does Genco have to cut their costs because they know how much they are going to get for their power for the next years to come? And even though they make more profit, they would cut their costs and make more money, it goes to Holdco or Financeco. So the people who run Genco, you know, if they cut their costs or not, they are not making more money. The money just goes to Financeco. Where is -- you know, where is the real -- how would they really want to cut their costs, because they are not benefiting more? The money doesn't stay there. It goes to pay down the debt.

MR. MAROIS: Well, I think that's a very noble cause.

MR. DUMONT: I know. It is.

MR. MAROIS: Because I can tell you internally, we all are very worried with the level of debt that we are carrying, that the Province is carrying on our behalf and we have made it a group objective of reducing that debt. So for me it's even more noble than trying to generate profit for -- but we are generating profit for the next generation. Because each set of profit that we make, it helps pay down the debt, which helps reduce the interest, reduce the debt for our children to pay. So for me, I can tell you it's extremely motivating. A lot more than just making profit for somebody I don't know. So -- and I believe it's shared amongst the companies.

MR. DUMONT: You know what I am saying, the perception out there -- you know, the layman out there, you know, that's how he thinks. You know, why would they reduce costs? Anyway --

MR. MAROIS: Unfortunately, I believe NB Power is a victim to a lot of perceptions. And one thing that we have learned from our surveys is that is we need to communicate more and educate our customers and the general public. So I believe that's something we will be addressing in the future.

MR. DUMONT: Thank you. That's all for me.

CHAIRMAN: I am going to reserve my questions for tomorrow morning. My fellow Commissioners have taken up the afternoon.

But we do have five minutes before we break. And Mr. Hyslop, do you have something you want to discuss with the Board at this time?

MR. HYSLOP: I have two matters. One is an issue relating to scheduling. The other is I was asking the Board if I might have permission to ask a few questions of this Panel in response to one of the undertakings they filled this morning. I would think the questioning would last all of two minutes if that, Mr. Chair.

CHAIRMAN: Yes. Well, you can do that tomorrow.

MR. HYSLOP: The issue of scheduling. All counsel met at noon. We went through a revision to the schedule and one of the issues that I had related to Dr. Makholm, who was scheduled to fly into Saint John or Fredericton last night. With the storm, he did not get out. And he has indicated to me, and I have indicated this to the counsel for the applicant, but I did not indicate it to Mr. MacDougall earlier on and then I caught Mr. MacDougall a little bit by surprise.

In any event, Dr. Makholm could fly in tonight to testify. I don't know if he can now or not, but at noon hour he could of. And we anticipated a cross examination for him that would go considerably passed the time where he has to fly back to Boston in order to fly on to Panama.

For that reason we had discussed at noon hour that Dr. Makholm's cross examination be pushed out to March 13, subject to instructions from counsel. I think all counsel have agreed to that. But I do understand that Mr. Morrison has a problem with it.

In any event, I would move that the cross examination of the Public Intervenor's expert witness, Dr. Makholm be scheduled for March 14th -- 13th.

CHAIRMAN: Anybody any comments on that?

MR. MORRISON: Yes, Mr. Chairman. I do have a comment on it. And I am not trying to be unreasonable here, but I think everyone including the Board and the Board Staff, Commisson, all of the Intervenors, have worked very, very diligently to try to maintain the schedule that we agreed upon. And I understand that contingencies arise. But certainly the fact that Mr. Makholm only made himself available essentially for one day, when we knew that we were going to be having a panel on today causes me some concern.

CHAIRMAN: Mr. Morrison, I am going to stop you right there. If somebody is cut off because of a storm, this Board will certianly bend over backwards to give them an other opportunity to testify.

Now if you want to carry on with your argument, go ahead. But there was a storm.

MR. MORRISON: Well, I just would like to -- fine, Mr. Chairman. I would like to make the point though that we are very, very concerned. I appreciate that it's an inconvenience to all of us, to the other Intervenors, it's an inconvenience, not an insiginficant one, but I would like to make the point that -- to the applicant it's more than just an inconvenience, because every delay in schedule has a cost associated with it.

CHAIRMAN: Well, that's true. But then that witness might throw a lot of light on the things that the Board has to consider and our deliberations be shortened by his testimony. You never know about these things.

All right. We will rise and reconvene tomorrow moring at 9:15.

(Adjourned)

Certified to be a true transcript of this hearing, as recorded by me, to the best of my ability.

Reporter