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 14th 2006

Henneberry Reporting Service

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CHAIRMAN:	David C. Nicholson, Q.C.
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	David S. Nelson
BOARD COUNSEL:	Peter MacNutt, Q.C.
BOARD STAFF:	Doug Goss
	John Lawton
BOARD SECRETARY:	Lorraine Légère

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CHAIRMAN: Good morning, ladies and gentlemen. Could I have appearances please for the Applicant?

MR. MORRISON: Good morning, Mr. Chairman, Commissioners. Please don't take this the wrong way, but Happy Valentine's Day.

Terry Morrison and David Hashey appearing for the applicant, Mr. Chairman.

CHAIRMAN: You forgot a lot of people. It is Valentine's Day. You should name them. I put you on the spot. All right. Okay.

We will go to Canadian Manufacturers and Exporters, New Brunswick Division.

MR. LAWSON: Gary Lawson appearing on behalf of CME along with David Plante.

CHAIRMAN: Thanks, Mr. Lawson. Happy Valentine's Day. Conservation Council of New Brunswick? Eastern Wind is not here. Enbridge Gas New Brunswick Inc.?

MR. MACDOUGALL: Yes, Mr. Chair. David MacDougall. And I'm joined today by Ruth York of EGNB.

CHAIRMAN: Thanks, Mr. MacDougall. The Irving Group of companies?

MR. BOOKER: Good morning, Mr. Chair. Andrew Booker for the Irving Group.

CHAIRMAN: Good morning, Mr. Booker. Jolly Farmer is not here. Happy Valentine's Day, Mr. Gillis. Rogers Cable. Self-represented individuals? Municipal Utilities?

MR. GORMAN: Good morning, Mr. Chairman. Raymond Gorman on behalf of the Municipal Utilities. This morning I'm joined by Dana Young. And later this morning we will be joined by Eric Marr.

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

MR. HYSLOP: Good morning, Mr. Chair. Peter Hyslop, Robert O'Rourke, Carolann Power. And joining us this morning is Mr. Kurt Strunk.

CHAIRMAN: Thanks, Mr. Hyslop. And I will do my normal again with the Informal Intervenors. And Mr. MacNutt, I won't forget you.

Agricultural Producers Associations 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 Corp. Terrence Thompson Consulting. UPM-Kymmene.

Those are our Informal Intervenors. And there are none present today.

Mr. MacNutt, who is accompanying you today, sir?

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

CHAIRMAN: Great. Thanks, Mr. MacNutt. Any preliminary matters?

MR. MORRISON: Yes, Mr. Chairman. One, introduction of undertaking responses in exhibit. It is undertaking number 2 from February 8th, inquiry by Mr. Hyslop. And it deals with the software programs in excess of $250,000.

And a copy has been given to the Board Secretary.

CHAIRMAN: The records indicated this will be A-88.

Anything else?

MR. MORRISON: No, Mr. Chairman.

MR. HYSLOP: Yes, Mr. Chair.

CHAIRMAN: Mr. Hyslop?

MR. HYSLOP: Right. Mr. Chair, last week you might recall a line of questioning where after comment by my colleague Mr. Morrison you ruled that I wasn't to proceed with that line of questioning.

In the effort to build a record for final argument I have two documents which I would like to introduce on the record. I will explain what they are momentarily. It is not my intention in any way to question any panel with regard to those documents unless and except they are directed to them by my colleague Mr. Morrison in the course of the direct.

The two documents are both documents of public record. The first is an extract from the Crown Corporations Committee, I believe it was February 2nd of this year, where there is about 20 pages in there which contain some evidence which will be pertinent to my final arguments. It is the evidence of Mr. Hay and Ms. MacFarlane before the Crown Corporations Committee of the Legislature.

The second document consists of a copy of the pre-filed evidence of Mr. Stewart MacPherson and Mr. William Marshall with respect to the application of the then NB Power before this Board in relation to the refurbishment of Coleson Cove.

I would move that in view of your ruling the other day and in the attempt to establish some record that those documents be admitted to the record.

CHAIRMAN: Frankly, Mr. Hyslop, I don't remember what ruling I made. But Mr. Morrison, do you know what Mr. Hyslop is referring to? And what do you have to say about it?

MR. MORRISON: I do know what he is referring to. And I do have quite a bit to say about it, Mr. Chairman.

Firstly, Mr. Hyslop has not indicated to me the nature of -- the use to which he intends to put those documents.

But I can only surmise that he is going to be making some type of what I would consider a prudent investment type argument.

But in any event I would say that this is most irregular and I would submit improper to attempt to have evidence that was given in another proceeding, and in fact one that was given not in a proceeding, a legal proceeding at least, for an entirely different purpose introduced as evidence in this proceeding.

And there are several reasons for that. First we do have a process here. The Applicant files evidence. There is an IR process. The Intervenors file evidence. There is an IR process. And the purpose of that is so that all the parties know which case they have to meet. To have this type of thing brought up at this point is just unfair.

CHAIRMAN: Mr. Morrison, can I ask you -- as I understand it, one would have been evidence filed at a previous hearing before this Board.

MR. MORRISON: That is correct.

CHAIRMAN: And the other is before the Crown Corporations, which is not sworn testimony.

MR. MORRISON: That is correct.

CHAIRMAN: Or at least they don't swear me when I go.

MR. MORRISON: That is correct.

CHAIRMAN: So they are a little different.

MR. MORRISON: They are different. But they are also extraneous. It is extraneous evidence to this proceeding in my submission, Mr. Chairman.

The other -- and the authorities are quite clear. And I don't have the cases in front of me. But I think it is pretty well established in administrative law that a party can't attempt to salvage or supplement or bolster its case when they get to the hearing stage of the proceeding, unless the information wasn't available at the time the party was supposed to file the evidence, their evidence.

Clearly this information was available to Mr. Hyslop long before he was to file his evidence. He chose not to do so. And he should have raised this months ago. And to take this step at this point is quite -- frankly, it is like -- it used to be called trial by ambush. But that essentially is what it is.

Probably most importantly of all is that the issue isn't really material to this rate application. If the issue is the capital improvement cost to Coleson, and you will recall that Mr. Hyslop spent a great deal of time reminding this Board a few days ago about the importance of the transfer orders and how much time is devoted to them in Act. Well, those capital costs were transferred with the transfer order.

As far as the fuel aspect, if any, that was set in the PPA for 06/07 last year. It is not an issue for an 06/07 rate application.

And if the argument that Mr. Hyslop is going to raise is one about prudency of investment, that is a very serious and complex issue.

And I will quote from the Leonard Saul Goodman text on the process of ratemaking. And at page 861 it says "An allegation of imprudence must be supported by evidence that creates a serious doubt regarding the prudence of the investment."

It goes on to say "The prudence test is not based on hindsight but rather on whether the decisions at the time they were made were reasonable in the circumstances."

The reason I raise that, Mr. Chairman, is if that is where Mr. Hyslop intends to go on final argument, it is a very serious matter in terms of the evidentiary requirements to prove it and to rebut it.

If he is going to go there he may as well tell us now. Because as much as I would hate to, if that is going to be an issue before this Board, it is one that is going to require a great deal more evidence than is before us now.

So those are my submissions, Mr. Chairman.

CHAIRMAN: Thanks, Mr. Morrison. Mr. Hyslop, do you have anything to say in response?

MR. HYSLOP: First the excerpt from the Crown Corporations was November 24th 2005, Mr. Chair. In answer to Mr. Morrison's comments, he takes the position that if I'm going to -- and he is correct -- the point in argument would be that this Board take into consideration a blunder of NB Power's management and whether that should reflect on the determined rate or revenue requirement.

So that is where I'm going. I think I indicated that to Mr. Morrison at the time I advised him of these documents.

I made an attempt last week to, without going very deep, to elicit through cross examination of the panel, an answer to a pretty straightforward question. I was cut off. Now Mr. Morrison is here today saying if I'm going to go down that road, I better develop all kinds of evidence.

So if that is the case I would ask if perhaps he would want to open up his panel so we can go into how that blunder was made. If that is what he wants me to do, I haven't got a problem with that. I am looking at the most innocuous and careful way of establishing some bit of record that I can refer to in final argument to make my point.

At the end of the day the Board may reject my point. It may approve my point. Mr. Morrison is free to make the argument that the evidence I have put on the record isn't satisfactory against the test that he wants. I say leave it to final argument.

But I do think that it is a point that is a fair point that can be raised in final argument. And I don't see any real reason why matters and statements of NB Power officials on the public record can't be made part of the evidence at this hearing.

Now those would be my comments, Mr. Chair.

CHAIRMAN: Thanks, Mr. Hyslop. Anybody else any comments? We will -- the entire Board will talk this over during our mid-morning break.

Mr. Hyslop, could you for me give me a transcript reference please to that exchange between you and I and where the ruling was made. I don't need it now. Give it to me shortly after the break starts.

MR. HYSLOP: We will do that, Mr. Chair.

CHAIRMAN: Okay. Thank you. Any other matters? All right. We broke off yesterday and I have a few questions to ask of this panel. I will try and get organized.

Commissioner Dumont was just asking if you had a response yet to the question he put to you concerning merit increases?

MS. CLARK: We should have something on that after lunch.

CHAIRMAN: Okay. Thank you.

BY THE CHAIRMAN:

CHAIRMAN: I am going back now to Mr. Lawson's cross examination and at some point I think, Mr. Marois, you indicated that large customers might have a contract, your large customers. Do all Disco's large customers have contracts?

MR. MAROIS: My understanding is all transmission customers have a contract.

CHAIRMAN: Now is that with Disco?

MR. MAROIS: Yes.

CHAIRMAN: And that is for the purchase of electricity, I presume?

MR. MAROIS: Yes.

CHAIRMAN: And what is the duration of those contracts? Anybody on the panel can answer, if they wish to.

MR. MAROIS: It's a minimum of one year and I believe maybe up to 10 years in the case of the wholesale customers. They have a longer --

CHAIRMAN: In the case of what customers?

MR. MAROIS: Wholesale customers.

CHAIRMAN: Wholesale, I see. So large industrials are just one year. Is there a general rule that you can tell us about or do they differ depending upon the nature of the time and place it was signed?

MS. CLARK: I believe they do differ, sir, among when they were signed and the types of service that is being provided. I think they do vary but we can check on that.

CHAIRMAN: All right. Well you give us the duration, et cetera. Now I believe when Mr. Lawson was cross examining you or the panel, that came up. We were talking about the stranded cost issue. And what happens if you have a customer that has, let's say a contract for five years, Mr. Marois, and gives you an indication that they wish to look at leaving the system. Would you have to breach that contract? Would it be a mutual breach? What would happen to the contract?

MR. MAROIS: Typically these contracts contain notice provision and so they would have to give us the notice provided for in the contract.

CHAIRMAN: So how long is that notice?

MR. MAROIS: I believe it is 12 months.

CHAIRMAN: Okay. So even if the interpretation that you were putting on the section in the Act, which I believe is 37, but I might be wrong on that, they under the contract would have to give you notice of 12 months?

MR. MAROIS: That is my understanding, yes.

CHAIRMAN: Yes. Do you still adhere to the opinion as to what section -- I believe it is 37 which deals with exit fees -- that subparagraph number 1 says?

MR. MAROIS: In what sense?

CHAIRMAN: Well Mr. Gorman and his interpretation of it was they would have to give you notice pursuant to that section that they were leaving the system, i.e., commit themselves before the provisions of that section would come into play.

And I took you to say that no, you could sit down and would sit down and deal with any customer who indicated a desire to do it.

MR. MAROIS: I guess we are talking about Section 79 here and I guess my understanding is that it is subject to interpretation and what I recall is you had even asked that the lawyers make representation to that effect.

But I guess notwithstanding the legal jargon of the section, my view is that if a customer wishes to obtain an exit fee, we will work with them. I mean, we will sit down and we will do the analysis. Exactly how it would fit in within the legislation, I guess that remains to be clarified.

But ultimately the PUB will have to approve this charge.

CHAIRMAN: Mr. Gorman, what was that section?

MR. MACNUTT: The section --

MR. GORMAN: Mr. Gorman?

MR. GORMAN: I believe it was 37(1).

CHAIRMAN: That's what I thought.

MR. MAROIS: It's 79(1).

MR. MACNUTT: 37(1) deals with the payment in lieu of taxes, Mr. Chairman.

MR. GORMAN: Sorry.

MR. MACNUTT: The section of the Act dealing with fee payable upon leaving standard service is Section 79.

CHAIRMAN: 79, Mr. MacNutt?

MR. MACNUTT: Yes, Mr. Chairman.

MR. MORRISON: To be helpful, Mr. Chairman, I believe when we had some off the record discussions with Mr. MacNutt and Mr. Gorman and some of the other counsel, it was a question of the interpretation of Section -- the process in Section 79 and reconciling that with the notice provision in Section 78, I believe was the issue. And I think Mr. MacNutt was canvassing counsel as to whether we would provide him with our interpretation of the reconciliation of those two sections and we haven't done that yet.

MR. MACNUTT: I believe it was the Chairman asked me to canvass counsel and to ask counsel for the various participants to be ready to speak to that interpretation that is Sections 78 and 79, which, Mr. Chairman, I don't believe you have called on counsel to speak to.

CHAIRMAN: I was hopeful that you would all come forward, frankly.

MR. GORMAN: Mr. Chairman, at your request I did speak with all counsel with respect to this issue as to whether or not any of them would take a contrary view to the view that I put forward in my cross examination.
And quite frankly, I just didn't ever get a consensus that that wasn't the case. I'm not sure if anybody would speak against it or not or speak to the contrary.
CHAIRMAN: Well all right. What I will do is I will postpone this. But if by 2:00 on Thursday of this week, counsel have not come back with a unanimous decision or an indication that there were parties that didn't agree with Mr. Gorman's interpretation, that we would set a time next week to hear argument as to that interpretation of those sections. I would like to have that cleared up. Mr. Lawson?
MR. LAWSON: Mr. Chairman, I was just wondering, are we only looking for the purposes of whether an argument different from Mr. Gorman's position will be made at this hearing or are you looking to make a ruling on this issue for the purposes of any future application in relation to it?
CHAIRMAN: Well if we interpret the legislation, Mr. Lawson, presumably even though we are not bound by precedent it would be certainly the platform from which one would launch an application for exit fees in the future.

MR. LAWSON: My concern, obviously, Mr. Chairman, is that not all the people who might have some interest with respect to this issue are here before the Board to make representation on the issues so I guess I was concerned if it was only for the limited purposes of will anybody make an argument different from Mr. Gorman's for the purposes of this hearing, I have no problem. But with respect to making a representation on what it is for the purposes of any future application, I certainly can't speak one way or another on the issue.

CHAIRMAN: Well I don't think that we should be in a position of having to issue a public notice calling for anybody in the province who wants to come in and argue this. This is the general rate application in which we are dealing with a whole spectrum of matters and most of the active participants in reference to this industry are here or are represented.

And again, if the Board hears good argument in the future and things are brought to its attention which were not during argument of counsel here, why we are always open as an administrative tribunal to change our mind as to the interpretation. So we will go ahead with the interpretation and until it changes, it will stand.

You have a -- Disco has a new Board of Directors since the last time we saw you, and certainly their CVs are that they are extremely well qualified individuals to make up that Board. Could you tell me, do they receive an annual stipend from your companies?

MS. MACFARLANE: They do.

CHAIRMAN: And could you tell us the amount of that?

MS. MACFARLANE: I don't have that with me but I can provide it.

CHAIRMAN: That's not emblazoned in your mind, Ms. MacFarlane?

MS. MACFARLANE: No.

CHAIRMAN: All right. You will file that?

MS. MACFARLANE: Yes.

CHAIRMAN: Do they get a per diem?

MS. MACFARLANE: I believe the Chairman is -- I was confusing your word stipend.

CHAIRMAN: The Commissioners on this Board --

MS. MACFARLANE: Yes, that's right.

CHAIRMAN: -- with the exception of myself get an annual per diem which in the case of the vice chair is 10,000, in the case of the other Commissioners it's five, and they get a per diem of $275 a day. So that's why I gave you a two part question, is just trying to find out --

MS. MACFARLANE: And I appreciate that.

CHAIRMAN: -- what your Board of Directors gets --
MS. MACFARLANE: And we will file that.
CHAIRMAN: -- and just to carry up on that, that I presume since there are separate boards of directors, do they get the one stipend or do they get multiple stipends?
MS. MACFARLANE: I believe they get the one stipend.
CHAIRMAN: The one stipend. Okay. So if you would file that with us I would appreciate it.
Now, Ms. MacFarlane, in my notes -- and they are kind of fuzzy, but when you were talking about the retirement package you -- I thought you said that you booked it during the year that it was accepted, and not the year that it was taken?
MS. MACFARLANE: We booked it in the 04/05 fiscal year and the employees left March 31st, '05. The one exception to that would be there were a small number of employees that because their positions were critical and their -- they were required to stay and train employees who were remaining with the company, they were extended, but because the commitment had been made and the contracts with them had been signed at March 31st we booked it in that year.
CHAIRMAN: What does the accounting handbook have to say about that?

MS. MACFARLANE: We followed the CICA guidelines, and that was subject to a good deal of review by our auditors.

CHAIRMAN: Okay. Now that I'm cleared up on that point, I will go back to the books, because I believe there was a Board order in the '90s which said that you book it when it's incurred, not when it is -- when it is nominated, but rather if you pay it in a fiscal period that's when you book it. So that if your retirement extends over a two or three year period, you will have two or three different bookings of those amounts. But I will go back to the books on that.

Okay. Mr. Marois, refresh my memory, but I think in the White Paper it indicated that in the new regime time of use rates would be established?

MR. MAROIS: I don't remember the exact wording, but the White Paper definitely addressed time of use rates. I don't remember if it said would consider or look at or --

CHAIRMAN: Okay. Certainly my recollection is that that was the tool that would be used. Now with the existing PPAs you really can't set time of use rates, can you?

MR. MAROIS: Well you can always set time of use rates but you don't see the benefits in reduced generation costs.

CHAIRMAN: No. In other words, the costs that flow from Genco to Disco are at one price for electricity?

MR. MAROIS: That is correct.

CHAIRMAN: And you and I know that at different times of the day and different seasons of the year the electricity costs differing amounts to produce.

MR. MAROIS: Yes. There could still be benefits because for example in terms of the peaking requirements are priced separately from the resting price. So we do pay separately for the use of combustion turbines or for purchases. So if we could get the peak down it will reduce those costs. So there is some benefits to reduce the peak. And there is also benefit to reduce the load period. And that's why we welcome the initiative by the Energy Efficiency Agency.

CHAIRMAN: I would be correct, would I not, in most jurisdictions in North America where they attempted to shave the peak, which is what you are referring to, et cetera, time of use rates were a very, very useful tool?

MR. MAROIS: I'm by no means an expert in time of use rates, but my understanding is the results have been mixed. I would agree that some utilities have had success. I believe that not every utility has had success. And you will recall in the CARD part of this proceeding, we did file some evidence to that effect and that was prior to the PPAs or prior to restructuring.

And the market research we did was that the benefits that the customers perceive would gain from time of use rates was not enough to really at the end of the day change their habits. And that's -- I always come back to my same point is I think what we can do more ways to help customers change their habit is send the right pricing out. People --

CHAIRMAN: That was exactly the quote I had in front of this question.

MR. MAROIS: No, but I guess my point is time of use rates for me is almost like fine-tuning. If we could get the base rate right, if we could get high enough so that the customers appreciate the true cost of electricity, including servicing the debt and repaying the debt, that will go a long way. Then we can look at fine tuning like seasonal rates or introducing some of these rates. But until we get the base right, we are just illusioning ourselves. We are kind of tweaking something that is not working. So for me the best price signal is sending the signal of the true cost of electricity, which we have not done in this province.

CHAIRMAN: You don't think that that signal is getting out to the people of this province?

MR. MAROIS: Well hopefully it is, but I guess it all --

it's in your hands. At the end of the day it's going to depend on the decision.

CHAIRMAN: Not totally in my hands.

MR. MAROIS: At least partly.

CHAIRMAN: No. But that signal is getting out and I don't know about you but I can -- I'm not as good as my wife, but I can multi-task. In other words, I can send out the signal and at the same time start to tweak or bring in changes which will allow the consumer out there to do something in their own home that will mitigate that price signal to them, which is time of use rates. You can do both at the same time.

MR. MAROIS: Yes. Well we haven't ruled it out. Like I said, we have looked at it, we have done some market research. For now it doesn't seem to be a high priority for the customers. But I guess one thing we are doing behind the scenes, like probably many other utilities, is we are working on a longer term metering policy. And that metering policy will include at one point in time smart metering and it's going to be a cost benefit analysis we will have to do, and as the prices go down definitely it's going to become more attractive. So the more sophisticated meters we have, the more ability we will have to introduce different pricing regimes.

CHAIRMAN: Just talking about something like that, you were
talking about metering, and this is really Commissioner
Sollows' question, but it's my turn, so I will ask it now.
And that is that you were talking about -- and there was a
discussion here concerning the difficulties that you were
having with your experimentation with estimating
consumer's energy consumption every third month in a test
case. In the algorithm that you have, is there not
something to deal with weather and that's not historical,
but rather plugging in forecasts of future weather
patterns for a month out or two months out?
MR. MAROIS: I haven't had a chance to review the algorithms
since the question was asked, but my understanding is our
algorithm is static in that sense, in the sense that we
have put in their normal weather. And so I would assume
that because our system doesn't have the sophistication to
be able to put in a weather forecast, because we do bill
daily. So I'm not able to comment what it could do but my
understanding is right now it does have a static value for
weather which is based on the normal weather.
CHAIRMAN: Would you find out if your mathematicians
indicate that you in fact could have something that would
input into that algorithm -- how do you pronounce that?
MR. MAROIS: Algorithm. For Francophone it's a

tongue-twister too.

CHAIRMAN: See if there could be, because you are dealing with month-to-month.

MR. MAROIS: Yes. My concern --

CHAIRMAN: And there are long-term forecasts.

MR. MAROIS: We will definitely look at it. And my concern I guess is not as much the mathematicians but that the billing capacity of our billing engine.

CHAIRMAN: Okay. Ms. MacFarlane, you indicated on the 7th of February that Genco's cost to Disco will, as you termed it, ramp-up is your terminology, over the next three or four years. That's so that they could then be getting a net income and make payment in lieu of taxes and possibly dividends. That's what my notes indicate.

MS. MACFARLANE: That's correct.

CHAIRMAN: How much -- if everything else were to remain static and stay the same, as it is in the test year in this hearing, how much over the four to five year period will the costs of fuel increase because of that ramping up? Now you can't answer that, I'm sure.

MS. MACFARLANE: Can I just clarify? Do you mean -- when you say the cost of fuel, you mean the cost of purchase power to Disco?

CHAIRMAN: I beg your pardon. Yes, that's exactly what I meant.

MS. MACFARLANE: In the vesting agreement with Genco there is a schedule 1.1.17 that sets out the best -- the capacity payment. And the capacity payment increases over a period of years until such time as it is collecting the full fixed cost for Genco.

It increased in 04/05. It started in 04/05. It increased in 05/06 by 12,000,000. It increases again in 06/07 by 12,000,000. And that's part of the purchase power variance in Disco this year that was explained in the evidence.

It is scheduled to increase next year, if you do the calculations, by approximately 37,000,000. And that should bring the capacity payment up to a level that is basically collecting Genco's fixed costs.

There is one other element that changes. And that is that the contribution to fixed costs, and that's fixed OM&A, in the vesting contract started at $7 a megawatt-hour. And that's an amount that, since it's tied to supply costs, increases I believe by CPI every year.

So those two amounts together should cover the fixed OM&A, the variable OM&A and the capital costs, both amortization and cost of capital for Genco and also cover the flow-through from Coleson in that back-to-back agreement.

CHAIRMAN: Okay. My recollection is roughly speaking 80 percent of what you need to recover. And your revenue requirement flows through that PPA. In other words, the cost of purchasing the power to Disco is approximately 80 percent.

MS. MACFARLANE: That's correct.

CHAIRMAN: Would you have an undertaking to just take and work that through and put it on a piece of paper for us? This is all in keeping with Mr. Marois' crusade to send out the right price signals. So we will know that next year you will have to get an additional, I forget what it was, $14 million in your revenue requirement, everything else remaining equal. And that will grow.

If you could do that from your knowledge of the PPAs we would appreciate it.

MS. MACFARLANE: Yes. If I could just clarify, what you are looking for is an estimate of how the capacity payment increases from the time the contract was signed through until Genco is earning its full returns?

CHAIRMAN: Yes. And if there are other factors in there that over time they are increasing as well, work those in --

MS. MACFARLANE: Yes.

CHAIRMAN: -- so we have -- so if everything else remained equal we would know that the PPA will cause you to have to look for X dollars of revenue each year over the next two to three years.

MS. MACFARLANE: Yes. I will be happy to do that. I did just want to clarify that once we get to the price, capacity price change on April 1st 2007, the capacity price is then fixed until April 2016. And then it begins to decrease.

CHAIRMAN: Yes.

MS. MACFARLANE: And that's in line with how the fixed costs are changing over that period of time as well.

CHAIRMAN: Okay. Thank you. Mr. Marois, you talked about your energy advisers. And then you went on with Mr. Peacock to describe the function.

It sounds an awful lot like they turn out to be service reps more than anything else. Is that a fair assessment?

MR. MAROIS: Well, they are not the service rep in the sense that they don't actually fix the problem. They are more I would say troubleshooters maybe.

CHAIRMAN: Yes.

MR. MAROIS: They help customers understand -- they help the customer understand if they have any technical issues.

And then they always take advantage of the opportunity to give advice in terms of energy efficiency measures. But they are really there to help answer technical questions of the customer.

CHAIRMAN: Yes. They are not -- I mean, in the context of Ms. Weir's organization that opened yesterday, when you hear energy adviser you think of somebody coming and inspecting your home and arranging to have the test taken to show how much electricity you are wasting, et cetera. That might be a small part of their function. But the other is simply to speak to your customers about the various problems dealing with electricity.

MR. MAROIS: Yes. I would agree with your characterization.

CHAIRMAN: Okay. Now I notice in your tariff you have -- and you indicated to Mr. Peacock again that you have a two months deposit required for new connections. And we will cover this more thoroughly in the customer service policies hearing to be convened after this is completed. But do you have any idea how you came up with the two months? Is that standard across Canada?

MR. MAROIS: I don't know how standard it is. But my recollection is we were using the same two months in the gas industry. And my understanding is it is for practical reasons is by the time you would detect that an account is overdue, you are really in the second month.

So by the time you can do anything you are within 60 days. And so if you don't have a 60-day guarantee you are going to be out of pocket. So it's really practical realities.

CHAIRMAN: You better get some advice from American Express. They can tell inside of two days. And it becomes very embarrassing.

I'm going to ask some questions about an undertaking that was put in yesterday. And that is at the request of Mr. Hyslop. And it is A-85. And the question was "Provide the amount that NB Power had lost cumulatively from 1993 through 2004."

And the response basically is there was a net loss of 595,000,000, including the $450 million write-off of the Point Lepreau Generating Station?

MS. MACFARLANE: That's correct.

CHAIRMAN: Now let's turn to A-50 which is right there. And Ms. MacFarlane, in your last bit of evidence in this binder, which is under tab -- well, Direct Evidence of Ms. Sharon MacFarlane, tab green 4 -- you talk about changes in accounting policy.

And at page 2 you describe the changes to the use of deferral accounts?

MS. MACFARLANE: That's correct.

CHAIRMAN: Now let me just set the scene. Back in the early '90's when this Board reviewed your accounting and financial policies, you had in force what I will call two rainy day accounts or income-smoothing accounts, one of them being the generation equalization -- no, it was the generation stabilization account which had two parts. One was nuclear and the other was hydro.

MS. MACFARLANE: Yes.

CHAIRMAN: The nuclear, as I recollect it, what would happen is in the early life of Point Lepreau it was running at a capacity factor of in the low 90s, whereas its capacity over its life was estimated to be in the low 80s. And therefore you were -- your predecessor corporation was making deposits to that account. So that when in fact it operated at less than the average lifetime capacity, i.e., let's say 78 percent, then you would draw down from that to supplement your net income in that particular year. So it was intergenerational equity. And as well it was an income-smoothing device. And this Board approved of it wholeheartedly in our review of your accounting and financial policies.

MS. MACFARLANE: That's correct.

CHAIRMAN: Then the water or the hydro one worked in a similar fashion, was based upon the average water flow, as I recollect it, over 31 years. All right.
The export sales stabilization account was more complex.
I won't attempt to do it. Except that what you did again is that you chose a profit figure that would occur from export sales. And if in one year you had greater sales you paid into that account unless you drew down.
And I forget but the surrogate was for -- I believe you were using oil or something like that. It doesn't matter.
Anyhow, those accounts were in existence when this Board last saw you, which was 93/94.
Now in the period of time that is covered in A-85 both -- all three of those accounts, or both of them, were collapsed. And I believe -- and I would like you to tell me -- but the amount in the export sales stabilization account in the end of fiscal '93 was $20,184,000 and in the generation equalization account in your report of 94/95 was $82,162,000. Now that is subject to check.
MS. MACFARLANE: There is a -- there was an interrogatory on that. It is PI IR-108 of November 14th 2005 which I believe was in A-56.
CHAIRMAN: Okay. Well, maybe I'm stealing the PI's thunder

here, but --
MS. MACFARLANE: No. It says nuclear equalization at March 31st 1994 was 136.2. Water equalization was 28.2. These are millions. And the export stabilization account at that time was 5.1 million.
CHAIRMAN: Okay. In total how many -- what would that equal?
MS. MACFARLANE: 169,000,000.
CHAIRMAN: Okay. So the question, the simple question is A-85 says in addition -- or sorry, that in that period you had a net loss of 595,000,000.
MS. MACFARLANE: Yes.
CHAIRMAN: Does that take into consideration the collapsing of these rainy day accounts?
MS. MACFARLANE: Yes, it does.
CHAIRMAN: And how does it do it?
MS. MACFARLANE: The rainy day accounts, so to speak, were amortized over three years following --
CHAIRMAN: Let me rephrase the question --
MS. MACFARLANE: Yes.
CHAIRMAN: -- Ms. MacFarlane. If those accounts had not been there, the 165,000,000, was it?
MS. MACFARLANE: 169,000,000. Yes. The loss would have been higher.

CHAIRMAN: Okay. 169'. If they had not been there to collapse, would that figure of a net loss of 595,000,000 be greater?

MS. MACFARLANE: It would be greater, yes.

CHAIRMAN: And that would therefore come to how much?

MS. MACFARLANE: 764,000,000.

CHAIRMAN: 764'. So my math, which is notoriously terrible, tells me that in your normal annual operations, that is excluding the $450 million one-time write-off for the Point Lepreau plant, you lost $314 million in that period of time. That is a net loss in your ordinary operations?

MS. MACFARLANE: That's correct.

CHAIRMAN: Okay. Now as we all know, the government of the day brought in the change to the Public Utilities Act in I believe it was the sitting of the fall of '94, it may have been in '95, which put this 3 percent cap on your -- you could raise your rates by 3 percent and not appear before this Board?

MS. MACFARLANE: I believe that was the Electric Power Act, yes.

CHAIRMAN: Yes. Now none of you were with your predecessor corporations at that time. And I'm not attempting to blame or place any blame or anything else. We have to look to the future. However we should learn from the past.

The Board then had no jurisdiction to call you in. We did not have general supervisory powers over you either. Therefore, we could not send in our auditors or our inspectors into the Power Corporation to see what was happening.

But I guess what I have to ask is, Mr. Marois, you are I think more experienced in the regulatory industry game than the other members of that panel.

Are you aware of anywhere else in North America that a monopoly utility is allowed to increase its rates by a set amount, in your case by 3 percent per annum, without scrutiny from its third party regulator?

MR. MAROIS: I am not aware of any other precedents of the same nature, no. You have some mechanism that are performance based regulation, for example, that are approved by regulators where a utility is able to increase rates by a certain amount without explicit approval from the Board. But a regime like we have here is somewhat unique.

CHAIRMAN: Mmmm. In the one that you describe which is really price cap regulation, as I would term it, there is the X-factor which effectively means that the utility has to increase its efficiency and deliver its product for less price in order that it enjoy increased profits which it then must share with the consumer in reduced price for that product. That's the true definition in the regulatory sense, I believe.

MR. MAROIS: Yes. I guess the new Act is different than the old Act in the sense that there is kind of a built-in safeguard that any profits that the utility will make really has to flow back to its banker, which is EFC, to pay down the debt. I mean,that's very clear in the Act is we have to pay dividends and then the dividends have to be used to pay down the debt. So there is a very specific use of the profits to be made under the Act.

CHAIRMAN: And that goes to Mr. -- Commissioner Dumont's questioning of you yesterday really dealing with what is there for Genco's management as an impetus for it to become more efficient in its operations.

And you -- and I admire your public stance that to pay down the public's debt is impetus enough for management to want to do it, and I sincerely hope that that's the case.

And yet I have to say I look back at the management of your predecessor corporation that stood by and allowed a loss of $314,000,000 that presumably was because of increased costs or lack of efficiency, but refused to come before the third party regulator for a period of 13 years.

So are you aware of any jurisdictions in the United States, for instance, where during the time of vertically integrated monopoly utilities there wasn't a third party regulator that didn't have -- that's a double negative, I had better reword that. Are you aware of any American jurisdiction where, a), there wasn't a third party regulator, and, b), where that regulator did not have general supervisory powers?

To the best of my knowledge, Mr. Marois, every one of them do. Some of them may be like this Board and others may be a line department in government itself.

MS. MACFARLANE: Mr. Chair, if I could just add, one of the other safeguards that I had mentioned yesterday that I believe was in the minds of the crafters, shall we say, of restructuring, is that when the companies are at a position that their revenues will support commercial level operating margins, the Province will undertake a debt for equity swap and send those companies to the debt capital markets.

And there was a belief by the financial advisors that the covenants and demands that the debt capital markets and the credit rating agencies would put on the companies in and of itself would be very, very rigorous. And that would not allow the types of practices that you have referred to in the past. It simply wouldn't allow the company to sustain continued losses because it would be in contravention of its debt covenants in the public markets.

CHAIRMAN: Well I don't disagree with you, Ms. MacFarlane, but certainly the men and women of the financial markets are not going to sit through and read all those volumes of evidence and they are not going to scrutinize your accounts in the same fashion that a third party regulator does.

MS. MACFARLANE: But what they will do is ensure that the companies are making adequate returns.

CHAIRMAN: Yes.

MS. MACFARLANE: And if that means appropriate and rigorous cost control and capital investment management, if it means ensuring that the companies that are supposed to be in front of the regulator are there for just and reasonable cost increases leading to rates, those things will have to happen, or otherwise those companies will not be able to get in the capital markets to sustain their debt.

CHAIRMAN: And I certainly don't disagree with that and I hope I am alive to see the day, frankly. I won't be sitting here, I'm sure, but -- or a miracle could happen I suppose. But you describe, and I won't bore you with

reading it back in the transcript, the transcript of February -- let me see -- no, that's the wrong one.
February 7th, beginning at page 3518 you talk about the new -- you are responding to Mr. Hyslop's question where he was trying to put you in a conflict of interest, which was an interesting exchange, I must say, ending approximately at page 3521. And you set up the new governance structure. You testify as to that, that it has been set up under the new regime, which basically has that new Board of Directors of yours giving scrutiny with a greater knowledge base of the electric industry than any previous one in my knowledge.
Also that government being actively involved in the form of Electric Finance Corporation which I believe has two ministers and two deputy ministers and a couple of other governmental officials involved in its management. And that certainly is an improvement.
And when we get to the point -- when we get to the point of going to the market for money you are absolutely right, those things will occur as well.
Do you expect that the new Board of Directors will look at the detail that a third party regulator does? And I give you an example in this hearing. Look at how you replace your vehicles, which I'm not saying isn't a good

way, but certainly for me having spent 17 years in the private sector the cost of money is certainly something that should be factored in there, will go out and hire an expert in the field of depreciation and file a report -- or ask that a report be filed to look at your present policies on depreciation and to show that really there is nothing terribly wrong with your present way of doing it, but you are certainly out of step with everybody else in North America. And probably the way that Mr. Kennedy recommended is probably a better way, a more equitable way of doing it, would your Board of Directors or Electric Finance Corporation analyze 2,000,000 pieces of data information concerning customer payments for electricity in a first-step effort to look at the way in which you have set up your customer classes. Would they look at that kind of detail?

MS. MACFARLANE: I can say that we have a very -- particularly since October 1st 2004 -- we have a very demanding audit committee. The Chair of our audit committee is the CFO for Hydro Ottawa. And she is very familiar with regulatory regimes and with distribution companies in particular. And she is very astute and very demanding.

As it goes to many of your other points, it is the case that the Board operates under broad targets and broad policy frameworks, and they expect that management will do those things. And they through setting the targets and measures that they have set on their ENDS policies they expect to see results that would indicate that those things are being done.

As an example they have a broad customer policy statement and the monitoring of that customer policy is reflected in customer surveys, reflected in complaints, reflected in a number of measures that they look at to determine whether or not they believe the policy is being followed.

And some times they use external -- certainly they have the right to use external assistance in making that assessment, whether or not they would get beneath that to the level of detail that this Board would, I would agree with you that they wouldn't.

CHAIRMAN: Thank you.

MR. MAROIS: Mr. Chair, can I --

CHAIRMAN: Yes. I was going to turn to you, Mr. Marois.

MR. MAROIS: I feel the need to add something here. I am a strong believer in striking a balance and you have alluded to some of the benefits of regulation which I agree with you they are. There are also costs of regulation and there are direct costs and indirect costs. And the estimated direct cost of this proceeding is well over $4,000,000, but what I believe is more important are the indirect costs, an indirect cost of having a team devoted to this process for a year-and-a-half.

So in my mind on a go forward basis you have to strike a balance between those costs and those benefits. And I believe there is -- there should be an objective of trying to make the regulatory regime as streamline and as efficient as possible to reduce both the direct and indirect costs to really leverage the benefits of it.

CHAIRMAN: Mr. Marois, I couldn't agree with you more. I can tell you however when the then minister responsible for NB Power introduced the legislation in the house back in 94/95, somewhere in that vicinity, he said as well that it has cost us $4,000,000 to appear before the Board. Therefore we are putting in this three percent cap so we don't incur that very great expense. Now I ask you, would it have been better every couple of years to spend $4,000,000 to appear before the Board or to lose $314,000,000 as occurred in that 13 year period?

There is -- the second thing I will say, and I know this is self-serving but it's not. I believe strongly that it's in favour of the people of New Brunswick and the consumers in this province of electric, is that over the three rate increase hearings we had in the early '90s, the time that it took to have those halved each time. So that the last general rate increase in 93/94 actually took I believe it was something like 12 days in hearings. I could be wrong but it's something like that.

We all go through a learning curve. I'm saying it right now to you is that I sincerely hope when we conclude this hearing within two or three years you come back again so at lest we can build upon what we have done here, and to your benefit and to the benefit of the customers of the Province of New Brunswick.

Ms. MacFarlane, I will give you the last opportunity to say something, but I did read through the pages in that transcript of February 7th, from pages 3518 through 3521, and the very last quote which I want to quote to you is that you are talking about the governance of the group of companies. And on the bottom of page 3520 at line 24, you say, in taking into consideration all of the issues and reaching a balanced decision that is in the best long-term interest of the utility, its owner, its ratepayers, I would be part of the Holdco management team making a recommendation to Holdco's Board of Directors, and then a recommendation will be made to the shareholder. And you are talking about the decision making process that you have set up with the new group of Companies.

I will give you a chance to comment. My comment is it sounds very much like a vertically integrated utility to me.

MS. MACFARLANE: Well it doesn't to me. It sounds like a group of companies to me. And it's quite often the case that when there are subsidiary corporations reporting to a holding corporation and that holding corporation has a separate shareholder, that there is a hierarchy where interests are balanced. And that's very often the case. That's true in Generation, that's true in Bell Canada and it's true in the NB Power group of companies.

CHAIRMAN: Very good answer. We will take our mid morning break.

(Recess)

CHAIRMAN: The Board has had an opportunity to talk about Mr. Hyslop's request that certain evidence that was before the Crown Corporations Committee and before this Board in another matter be introduced on the record in this hearing.

Gentlemen, with frankness, Mr. Morrison has referred to the fact that there is a lot of law on that and I and Board counsel believe that that's probably the case, and we would like to hear some of the law before we give our ruling on it. And I know that we are all working flat-out, but, Mr. Morrison, how long would you like to have to deal with that?

MR. MORRISON: Well it certainly won't be able to be done in the next couple of days, Mr. Chairman, with our schedule. And I would have to see whether I have some resources back in the office to pull some of the case law together. So likely next week. I guess it's not a burning issue in terms of if Mr. Hyslop's only purpose is to use it in argument, then we still have a little bit of time. So --

CHAIRMAN: Well you did mention and I can see that, is that it might well mean that you would want to have it addressed by some of your witnesses, Mr. Morrison, that's all. So I mean, certainly the Board has said in the past, if we were to allow either or both of those on the record and you felt obliged to recall some of this panel or whatever else, why we would certainly be receptive to that request.

MR. MORRISON: I don't think it's a question of recalling the panel, Mr. Chairman. It's an issue that -- I mean from my brief time in looking at the law with respect to the question of prudency, it's a fairly complex area which would require, I would submit, probably filing a lot of additional evidence and probably having expert witnesses to address the issue. So it's not a question of just recalling the panel and having them address something that might be in this.

CHAIRMAN: Okay. I hope it's not as complex as an agent of the Crown.

MR. MORRISON: I don't think so.

CHAIRMAN: Okay.

MR. MORRISON: So perhaps if we can say we can deal with it some time next week.

CHAIRMAN: All right. Mr. Hyslop?

MR. HYSLOP: My articling student is back from bar admission course on the weekend and I will put her to work on it. Hopefully -- I will speak to Mr. Morrison. It's not pressing, but we will try to file perhaps a written argument a week from Monday, Mr. Chair.

CHAIRMAN: Well you don't have to have a written argument. I just want you gentlemen to research the law and see what you can find. And then we can set aside ten or 15 minutes during a hearing day to hear from both of you, that's all.

MR. HYSLOP: Well it isn't pressing, I would concur with my friend. If I don't get it on the record today and it's dealt with -- as long as it's dealt with before argument. So we have got a window. I would say the end of next week or the first of the week after we would be in a position to argue, Mr. Chair.

CHAIRMAN: Okay. That's fine then. You gentlemen communicate with one another when you are each ready to go and then let the Board know and we will deal with it then.

MR. MORRISON: Thank you.

CHAIRMAN: Thank you. Any preliminary matters. Okay. Before redirect I think, Mr. Hyslop, you had some remnant questions, if I could call them that, of this panel dealing with some of the undertakings that have been filed, is that correct?

MR. HYSLOP: That's correct, Mr. Chair. I had a few questions relating to exhibit A-81 which was filed in response to an undertaking yesterday.

CHAIRMAN: Okay. Well by all means, do so.

<u>RECROSS EXAMINATION BY MR. HYSLOP</u>:

Q.1090 - Good morning, panel. Yesterday, panel, you filed response to an undertaking given to me with respect to a request that you fill out a chart for a number of companies, and that was marked for exhibit A-81. We took the liberty of trying to transpose your answers onto the sheet that we had given you and I understand that you have had a chance to review it, is that correct?

MS. MACFARLANE: That's correct.

Q.1091 - Right.

MR. MACNUTT: Mr. Chairman, I wonder if I could ask Mr. Hyslop if he has copies for the rest of the participants?

CHAIRMAN: I'm sorry, Mr. MacNutt. I couldn't hear all of what you said, sir?

MR. MACNUTT: I'm just asking if Mr. Hyslop had copies for the rest of the participants and he has answered that by handing them round now. Thank you.

CHAIRMAN: My records indicate that this exhibit will be PI-17.

MS. MACFARLANE: Mr. Chair, the document that Mr. Hyslop has given you he verbally changed the request after -- and it's the change in the request for the undertaking is not reflected on this document.

As an example you will noticed in the first statement it says, for each company please calculate the amounts that will be paid to the Province of New Brunswick or an agent of the Province of brunswick, and you pursued whether that would include bodies other than EFC. So he narrowed his request to EFC.

Secondly, in the second part he has asked for 2006/2007, assuming no reorganization has been done. And in our previous response to his first undertaking on this matter we said that that was not possible to do.

So he changed his request and simply asked as is indicated in A-81 for a breakdown of the specified amounts budgeted to be paid by each company to Electric Finance Company for 06/07 in the budget. So although the numbers he has transposed from A-81 are correct, the introduction to the table is not consistent with what the undertaking ultimately ended up being.

CHAIRMAN: That's correct, Mr. Hyslop, is it not?

MR. HYSLOP: I'm not quite sure. Would you run that past me again. You are saying that this doesn't include all the payments to the Province of New Brunswick. I know we excluded things like property taxes. Is that your point, Ms. MacFarlane?

MS. MACFARLANE: Agents to the Province of New Brunswick include Workers' Compensation, this Board, et cetera. And as I understand it, when we ultimately agreed on undertaking number 1 of February 8th you narrowed it to amounts paid to Electric Finance Corporation, and that's how A-81 was answered.

Q.1092 - Okay. And A-81 goes to payments through to the Province of New Brunswick via Electric Finance Corporation, is that correct?

MS. MACFARLANE: A-81 specifically has payments budgeted to be paid to Electric Finance Corporation. So that's the first part of the issue.

The second part, Mr. Hyslop, the second paragraph just before your table --

Q.1093 - Yes.

MS. MACFARLANE: -- if you recall you withdrew that request, as I understood it, because our response was that we were not able to do that. And we provided a lengthy verbal response to that read into the record on February 8th 2006.

Q.1094 - Yes. But you provided table 2 to your answer on exhibit A-81 which reflected the general intent of what we were looking for for the vertically integrated utility, correct?

MS. MACFARLANE: That's correct. It's just the document that you are trying to enter as an exhibit, the verbiage on it is not consistent with what your undertaking ultimately was, which is documented on A-81.

Q.1095 - Well just to ask a few questions then about this. First of all, in terms of the numbers on PI-17, have we correctly applied those numbers from exhibit A-81?

MS. MACFARLANE: The numbers on PI-17 are the same as the numbers on PI-81 -- pardon me -- A-81, with the exception that there is no recognition here of the tax loss carried forward for Disco that would reduce its payments in lieu of taxes.

Q.1096 - Correct. That would be $6,000,000?

MS. MACFARLANE: That's correct.

Q.1097 - Right. So other than that exception, these numbers are effectively transposed off of exhibit A-81 to exhibit PI-17.

MS. MACFARLANE: That's correct. But you understand that these numbers do not answer the questions outlined on the top of PI-17?

Q.1098 - Yes. If we change the word Agent to EFC on the second line, would I be correct?

MS. MACFARLANE: No, because we do make payments to the Province of New Brunswick for things like property taxes, utility taxes, et cetera. So what A-81 answers is payments to Electric Finance Corporation.

Q.1099 - So all the monies on PI-17 then are just the payments you make through to Electric Finance Corporation?

MS. MACFARLANE: That's correct.

Q.1100 - Okay. So I would exclude the words "to the Province of New Brunswick" and make it read "paid to the Electric Finance Corporation"?

MS. MACFARLANE: That's correct.

MR. HYSLOP: Okay. Could I ask that that amendment -- would it be the Board's preference we re-write it so it properly reflects the change?

CHAIRMAN: I think the record would be a lot clearer if you were to re-write the entire exhibit.

MR. HYSLOP: Yes.

CHAIRMAN: And put it in tomorrow or whenever you want to. We will have it as an additional but it will replace P-17 effectively.

MR. HYSLOP: Yes.

MS. MACFARLANE: Yes.

Q.1101 - Okay. Just a couple of questions coming out of the exhibit, if I might then, panel. This would reflect that a total of -- excluding dividends of $253,000,000 would be paid by the corporations to EFC.

MS. MACFARLANE: That's correct.

Q.1102 - Right. And you also have a $10,000,000 dividend that was declared for Transco or expected to be declared for Transco, so that the overall total would be 263,000,000, correct?

MS. MACFARLANE: That's correct.

Q.1103 - And the total interest that is paid by the group of companies by my calculation would be 201,000,000.

MS. MACFARLANE: On A-81 --

Q.1104 - I'm not asking about A-81. I'm asking about PI-17, Ms. MacFarlane.

MS. MACFARLANE: The total amount of interest paid by the companies --
Q.1105 - By these four companies is 201,000,000?
MS. MACFARLANE: -- is 221,000,000.
Q.1106 - I see 201.
MS. MACFARLANE: The debt portfolio management fee, the interest on short-term debt and the interest on long-term debt, and as I say, that's in a table on A-81.
Q.1107 - Okay. So you are adding in the $20,000,000 debt portfolio management fee and including that as an interest payment?
MS. MACFARLANE: That's correct.
Q.1108 - Isn't the debt portfolio management fee a fee that's charged and paid pursuant to Section 37 of the Electricity Act?
MS. MACFARLANE: It is.
Q.1109 - Right. So it's a statutory charge under the Electricity Act, it's not interest, is it, Ms. MacFarlane? It can't be both.
MS. MACFARLANE: EFC charges that amount to NB Power as part of its cost of debt. On each debt instrument there is a fee of 65 basis points charged by Electric Finance Company and that forms part of our cost of debt.
Q.1110 - So it's a fee that is charged pursuant to statute?

MS. MACFARLANE: To determine what it actually is, I'm sorry, I would have to pull out the Order in Council, but it is -- it is administered under Section 37(4) of the Act, yes.

Q.1111 - Okay. And I don't -- my question isn't how you treat it necessarily for accounting purposes. I'm asking whether or not it is actually interest in the purest sense of the word. It can't be a fee and it can't be interest at the same time. So I'm just trying to figure out what it is.

MS. MACFARLANE: NB Power is not able to borrow in the capital markets on its own, none of the NB Power companies are. They must borrow through the Province of New Brunswick and the Province of New Brunswick tops up the interest charge that they get by 65 basis points. And as I understand it, their reasoning for doing that is to represent a credit spread that as a minimum a corporation would get over and above the interest charge that the provincial government would get. In the Province's eyes it's interest and in NB Power's eyes it's interest. And we include it in our interest expense.

Q.1112 - Okay. How much interest does the Province pay for the long and short-term debt?

MS. MACFARLANE: I'm going to answer that generically

because embedded in interest would be amortization of some of the fees that are incurred in going to the capital markets, the underwriting fees and the discounts in premiums and so on. So I'm going to answer generically that it would be the 197 and the 4, the interest on long-term debt and interest on short-term debt.
Q.1113 - Thank you. Now if we use the interest the Province pays of $201 million and we used a concept of an interest ratio coverage and went 1.25 percent, would that approximate $250 million, Ms. MacFarlane?
MS. MACFARLANE: I'm not sure I understand your question. Would what represent $250 million?
Q.1114 - 1.25 times 200,000,000?
MS. MACFARLANE: 1.25 times 200' --
Q.1115 - 201,000,000. Yes.
MS. MACFARLANE: Yes. Your calculation is correct. But interest coverage is a measure --
Q.1116 - Thank you.
MS. MACFARLANE: -- of net income.
Q.1117 - Thank you.
MR. MORRISON: I think the witness should be allowed to answer the question, Mr. Chairman.
CHAIRMAN: Yes. Finish it, Ms. MacFarlane.
MS. MACFARLANE: Interest coverage is calculation based on

net income. And it is not based on interest expense. It's a financial calculation looking at the flexibility in your net earnings.

So I would agree that 1.25 time 200,000,000 is 250,000,000. But as I say, that number is not consistent with what our net income would be with a 1.25 times interest coverage.

One number that I couldn't figure out how it got into this table. And I refer you to exhibit A-50 under tab -- or section 3, Direct Evidence of Lori Clark, page 2, table 1.

MS. MACFARLANE: I have it.

Q.1118 - Okay. And I'm looking at line 8. And I'm looking at the number, the item "Net income 14.4 million."

Can you tell me or can any of the panel tell me how the net income for Disco in 2006/2007 was established? What calculations do we go through to get there?

MS. MACFARLANE: That is in my evidence. It is -- if you are carrying on behind the Direct Evidence of Lori Clark, you are in the introductory section. If you turn to tab 4 --

Q.1119 - The green tab 4 or --

MS. MACFARLANE: No.

Q.1120 - -- the beige tab 4?

MS. MACFARLANE: The beige tab 4.

Q.1121 - Thank you.

MS. MACFARLANE: And that evidence is on interest expense, special payments and net income. And the evidence on net income begins on page 10. I believe this is the subject of the next panel.

But nonetheless what was undertaken was to look at what would represent a reasonable net income for Disco. And there were two guidelines used in making that determination.

One was what the net income would be if Disco had capital structure, commercial capital structure. And the other was looking at interest coverage of stand-alone distribution utilities.

Q.1122 - Okay. Look, and I read the narrative on pages 10, 11 of your evidence, Ms. MacFarlane. And can you show me, working back or working forward, how you arrived at the 14.4 million using the asset base of about 585,000,000, the 42.5 percent equity and the 10 percent return, how you got there? Or was it just a number that kind of magically appeared after analysis?

What was the process to determine that you were going to have $14.4 million of profit for Disco in 2006/2007? Do you want to take it under an undertaking, Ms.

MacFarlane?

MS. MACFARLANE: If you could just give me a moment. There was an interrogatory on that.

Q.1123 - Yes.

MS. MACFARLANE: And I will find it in just a moment. Mr. Hyslop, if I could refer you to Disco PI IR-58 November 14th.

CHAIRMAN: What exhibit is that in, Ms. MacFarlane?

MS. MACFARLANE: A-54.

CHAIRMAN: Thank you.

MS. MACFARLANE: PI IR-58. It's on page 2. Again this is the subject of a discussion in the next panel. But as I say, there were two factors looked at and explained in the evidence to determine a reasonable net income for Disco. One of them was looking at what would the net income be if Distribution had a deemed capital structure?

The capital structure used was that provided by the financial advisers to the Province of New Brunswick in the restructuring exercise. It was their belief that a capital structure that included 57.5 percent debt and 42.5 percent equity would result in an A credit rating for the Distribution utility. They also determined that there should be an approximate 10 percent return on equity.

So this calculation shows how we took the earnings before special payments in lieu of income taxes on line 1 from the evidence. We deducted the interest cost that is shown in the evidence that wouldn't be there if in fact we had equity in our capital structure.

And that's the embedded cost of debt, 6.9 percent on the equity portion, which is down on line 22. That's simply taking the total with capital on line 19, 605,000,000, multiplying by the percentage equity to come up with 255,000,000.

So back on line 2 we deducted the interest to come up with a revised earnings before special payments in lieu of taxes, recalculated the taxes and special payments in lieu of both income and federal large corporate tax to derive what the net earnings would be with that capital structure and that rate of return of 10 percent.

We then reconciled it back to the evidence by taking that net income from line 6 down to line 8. We added back the calculated taxes because in fact we will not be remitting those taxes.

We again took the actual interest expense off. Because it is that interest expenses that's in the evidence. We deducted the taxes that we actually will be paying to arrive at an actual net earnings that would be accruing to Disco if it had a capital structure of that form.

In the evidence we also showed, and it was supported by Ms. McShane's evidence or Ms. McShane's report, we also showed another reasonableness test which is interest coverage. And that is both in the evidence and in Ms. McShane's report.

Q.1124 - Thank you. Referring to exhibit A-81 very briefly and the second page of the answer?

MS. MACFARLANE: Yes, I have it.

Q.1125 - And there is an item on the table "Less sinking fund earnings." And I appreciate --

CHAIRMAN: Just a second. Let us catch up with you, Mr. Hyslop. Okay. Go ahead, sir.

MR. HASHEY: Thank you, Mr. Chair.

Q.1126 - I'm looking at the item "Less sinking fund earnings" of 25,000,000 in 2003/2004.

Can you briefly outline to me what sinking fund earnings were? And can you indicate whether or not sinking fund earnings are any part of the financial projections for Disco in the test year?

MS. MACFARLANE: NB Power, prior to October 1st, the debt portfolio included notes that had a sinking fund requirement in them. And the Province of New Brunswick managed that sinking fund on behalf of NB Power.

When the restructuring took place on October 1st, there was a debt for equity swap to the Province. And all of NB Power's legacy debt less the sinking funds moved over to Electric Finance Corporation. And they transferred back new notes of a lesser amount.

But they did not put sinking funds in the new portfolio, nor are there sinking fund covenants in the new portfolio. Because that's not a common practice in commercial operations.

MR. HYSLOP: Thank you very much. That is all the questioning, Mr. Chair.

CHAIRMAN: Thank you, Mr. Hyslop. Mr. Morrison, any redirect?

MR. MORRISON: No redirect, Mr. Chairman.

CHAIRMAN: This is a case of musical chairs, I guess. This panel is excused. And the Board wishes to thank you for your cooperation and testimony before us. We look forward to your return trip.

So do you want to put on your next panel, Mr. Morrison? Or do you want to wait until after the lunch break?

MR. MORRISON: We may as well move right ahead, Mr. Chairman.

CHAIRMAN: All right. We will sit back for a minute while they play musical chairs.

MR. MORRISON: Ms. Kathleen McShane to join the other two witnesses, Mr. Marois and Ms. MacFarlane. Mr. Marois and Ms. MacFarlane are still under oath. So I don't see any reason for them to be resworn. But the new witness should be.

CHAIRMAN: Yes.

ROCK MAROIS, LORI CLARK, KATHLEEN MCSHANE:

DIRECT EXAMINATION BY MR. MORRISON:

MR. MORRISON: Mr. Chairman, I will be referring to exhibit A-55, appendix 1 which is the report by Ms. McShane which is dated October of 2005.

CHAIRMAN: Would you give us that citation again?

MR. MORRISON: Yes, Mr. Chairman. It is exhibit A-55, appendix 1.

Q.1 - Ms. McShane, do you have that document in front of you?

MS. MCSHANE: I do.

Q.2 - And was that document, that evidence prepared by you or under your direction?

MS. MCSHANE: Yes, it was.

Q.3 - And do you adopt that evidence as your own?

MS. MCSHANE: I do.

Q.4 - And I believe attached to that document, Ms. McShane, is a curriculum vitae of your experience and qualifications?

MS. MCSHANE: Yes, there is.

MR. MORRISON: Mr. Chairman, unless there is some objection or others wish to question Ms. McShane with respect to her qualifications, I would ask that she be qualified as an expert witness with respect to the question of net income and rate of return.

CHAIRMAN: In reference to what, Mr. Morrison? Say it again.

MR. MORRISON: An expert witness in connection with net income and return on equity or rate of return.

CHAIRMAN: Yes. Okay. Any problem with that? Well, Ms. McShane is familiar to the Board. So we will accept her testimony as an expert.

MR. MORRISON: Thank you, Mr. Chairman. As is the practice before the Board and the Board's rulings, if we wish to rebut any of the Intervenor evidence, then this is the appropriate time to do so.

And I do have a series of questions to Ms. McShane with respect to Mr. Makholm's evidence. It would probably take 15 or 20 minutes. And I would like to proceed with that now, Mr. Chairman.

CHAIRMAN: I see no reason why not. Go ahead, sir.

MR. MORRISON: Thank you.

Q.5 - Ms. McShane, Dr. Makholm in his report is recommending that the Board set the allowed return for Disco using Disco's actual capital structure which contains 100 percent debt and its embedded cost of debt.

He is also recommending that the utility be allowed to recover the debt portfolio management fee as an operating expense.

Do you agree with his recommendations?

MS. MCSHANE: No, I do not. Dr. Makholm's recommendations take as a point of departure his conclusion that Disco's capital structure is reasonable for ratemaking purposes. The only way a utility could even exist with 100 percent debt is if the debt is guaranteed by a third party. However, even in cases where a Crown utility does not have a mandate to operate on a stand-alone basis, as Disco explicitly does, no Canadian regulator has taken the position that a capital structure with 100 percent equity is reasonable.

Q.6 - Excuse me, Ms. McShane. Did you say 100 percent equity?

MS. MCSHANE: Sorry. No. I'm sure they have not said that as well, with 100 percent --

CHAIRMAN: Well, I certainly would like to see it.

MS. MCSHANE: When a utility has a capital structure with 100 percent debt, all of the risk that is associated with the utility has been shifted to the guarantor.

While the Province and the taxpayers of New Brunswick continue at present to back the debt of Disco, the Province has clearly stated that it is no longer willing to bear that risk.

As Mr. Marois indicated in his opening statement, the driving force behind restructuring, which includes the Electricity Act, was the objective of appropriately balancing the financial risk between taxpayers and ratepayers.

Moreover the guarantor, that being the Province, is not being appropriately compensated to bear the risk of a utility with 100 percent debt.

Now Ms. McShane, how do you know that the Province is not being compensated for bearing that risk?

MS. MCSHANE: Disco is currently being charged a debt portfolio management fee of 65 basis points, an amount, as Ms. MacFarlane indicated, is intended to reflect the difference between the rate at which the Province can raise debt and the rate at which the utility could raise debt on its own.

The choice of 65 basis points was based on the cost of debt to the typical stand-alone utility, that is one with no third party guarantees.

The typical stand-alone utility has a capital structure with a balance of debt and equity which reflects the level of business risk that it faces. No utility with 100 percent debt in its capital structure could raise debt at a cost equal to that of the Province plus 65 basis points. In fact, as Dr. Makholm himself indicates, Disco could not raise debt at all under current circumstances of the current capital structure.

If Dr. Makholm's recommendations are accepted, Disco's ratepayers would be receiving the benefit of a debt cost, inclusive of a debt portfolio management fee that is representative of a highly creditworthy utility, but only paying for a capital structure that could not even allow that utility to access debt capital on its own.

The acceptance of Dr. Makholm's recommendations which would provide Disco with no net income, that is no buffer, no cushion above its interest expense obligations, is not a sustainable situation. It would at best only perpetuate the status quo, which places all of the financial risk on the taxpayers' shoulders. Government has clearly stated that this is not a viable option.

In contrast Disco's proposal, which assumes a capital structure appropriate to its stand-alone business risk as a means of determining a reasonable level of net income, is compatible with the achievement of the objectives stated by the Province.

Those objectives include the mitigation of financial risk to taxpayers operating on the same basis as other commercially-driven utilities being able to borrow without a government guarantee, and competing on a level playing field with other energy providers.

Q.7 - Now Ms. McShane, Dr. Makholm states that if the Board were to use a deemed capital structure for the purposes of setting a return, it should set the return on the equity component of that capital structure equal to the Province's cost of debt, which he believes is equal to the opportunity cost of capital.

What do you say in response to that recommendation?

MS. MCSHANE: Dr. Makholm in my view misinterprets the concept of opportunity cost. In his testimony he does correctly state that opportunity cost is the price at which investors are willing to have their capital used for the provision of utility services.

A more general way of stating the same thing is it is the price at which investors are willing to have their capital used for any particular investment.

A further way of defining opportunity cost is the expected return foregone by investing in a specific venture rather than the alternative comparable risk or an alternative comparable risk in venture.

The opportunity cost concept focuses on the asset side of the balance sheet. That is on the use of funds rather than on the liability and net worth side of the balance sheet or the source of funds. Thus the opportunity cost is a function of the risk of the assets or the business. In Dr. Makholm's approach, it in contrast focuses on the fact that the utility to date has been able to raise debt at the Province's cost of debt plus the fee that it pays to the Province for guaranteeing the debt. In other words, Dr. Makholm has focused on the source of the capital.

This approach ignores the fact that the capital invested has alternative uses and thus has a cost which should be estimated by reference to the returns that are available on those if it invested elsewhere.

Q.8 - Ms. McShane, what is the danger of assuming that the opportunity cost of shareholders' equity in the utility is the Province's cost of debt rather than a return that reflects the risks of the assets in which the Province, and by extension the taxpayers of New Brunswick, are investing?

MS. MCSHANE: The danger is that capital will be misallocated. Capital is a scarce resource.

Dr. Makholm's approach operates under the assumption that the required return on provincially-owned shareholders' equity would be the same irrespective of what the investment is.

For example, Dr. Makholm's approach presumes that the Province would require the same return whether it invested in GIC's or whether it invested in offshore natural gas exploration and development.

By using the Province's cost of debt as the required return rather than a return that reflects the risk of the investment or the assets, a risky offshore oil and gas development project could appear to look highly profitable when in fact it would only lead to a return that's slightly higher than the Province's cost of debt.

The inappropriate use of the Province's cost of debt as the opportunity cost could lead to an allocation of capital to save that risky offshore oil and gas project while excluding investments to projects that might be at lower risk but provide higher benefits.

Q.9 - To your knowledge, Ms. McShane, has this Board with reference to any other utility under its jurisdiction allowed a return that reflects the risk of the project rather than the cost of capital to the shareholder?

MS. MCSHANE: Yes. The key example is Enbridge Gas New Brunswick. For Enbridge Gas New Brunswick, consistent with a stand-alone principle, this Board allowed a capital structure and return on equity that reflect the risk of that utility.

Quite correctly, it did not set the allowed return on capital structure based on the cost of capital that the parent company Enbridge Inc. would have incurred to raise capital.

It also allowed Enbridge Gas New Brunswick to recover a cost of debt reflecting loans from the parent company that was one percentage point higher than the rate at which Enbridge Inc., the parent company, could have raised debt on its own in the capital markets.

The same stand-alone principle that this Board applied to Enbridge Gas New Brunswick should equally apply to Disco.

Q.10 - Dr. Makholm argues in his report it is inappropriate to discuss business risks for a Crown corporation in the same manner as an investor-owned utility. And he explains that the only risk faced by Crown corporations with debt guarantees is the Province as guarantor will not honour its commitment to the bondholders. And what do you say to that statement?

MS. MCSHANE: I disagree with that statement. I agree that the risks have been shifted to the guarantor from the bondholders, but the risks have not disappeared. The financial risks instead are being born by taxpayers, who will bear the ultimate responsibility if the guarantor has to bail out the utility. That debt guarantee however does not cover shareholders' equity in a provincially-owned utility.

The risk of not recovering a reasonable return on the equity invested or retained in the utility, a provincially-owned utility as well as an investor-owned utility, arise from the same types of circumstances. And a number of those circumstances or risks are described at page 21 of Dr. Makholm's evidence.

Q.11 - Now we asked Dr. Makholm a series of interrogatories and in one of his responses, which is Disco IR-5, he states that the province-owned utilities do not face the risk that regulation will create volatility in common stock equity returns and/or prevent common stockholders from earning a fair return.

He also states in response to that IR that common stockholders in investor-owned utilities have greater risk to which their capital is exposed than provincial shareholders in provincial utilities where -- and he quotes, "the recovery of costs to serve the public lies in the hands of the Province to structure rates to cover." Do you agree with him?

MS. MCSHANE: No, I do not agree with him. Well, it's true that the shares of provincially-owned utilities are not traded, and thus do not -- their shares do not experience day-to-day volatility as shares in investor-owned utility might, the fact is that the majority of investor-owned utilities in Canada are publicly traded.

So, for example, EGNB, its allowed return on equity, similar to that for virtually every other utility in Canada has been set on the basis of the fundamental market supply operating in regulatory risk that it faces.

With respect to regulation, generally speaking, regulation has the power to expose the utility to enormous risks. It can create considerable volatility in returns or alternatively the regulatory environment can provide the basis for a utility to have the opportunity to consistently earn a compensatory return and to recover its invested capital.

There is no reason to believe in my mind that this Board would create a regulatory framework for Disco that was more or less favourable than it would create for an investor-owned utility. And in light of all of these circumstances, it seems to me, as well as the clearly defined objectives of the Province's restructuring, the opportunity cost of shareholders' equity in a provincially-owned utility is appropriately -- in this province is appropriately estimated by reference to investor-owned utilities, as has been the case in the preponderance of provinces and territories in this country.

Q.12 - Ms. McShane, you referred to EGNB. Now is that a publicly traded company?

MS. MCSHANE: No, it's not.

MR. MORRISON: Those are all the questions I have, Mr. Chairman. And the panel is open for cross examination.

CHAIRMAN: I think we will take our noon time break now. Let me just go around the room. With questions, how many parties do have questions for this panel? Just hold -- Mr. Hyslop, Mr. Lawson, Mr Gorman. Well, we will -- and, of course, Board counsel may have some, too. So on that basis we will come back at 1:00 o'clock.

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

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

MR. MORRISON: Yes, Mr. Chairman. In response to a question by the Chairman this morning about the New Brunswick Power Board of Directors, the Chairman receives $30,000 a year, Board members receive $12,000 a year and daily per diems are $500 a person a day.

CHAIRMAN: Thank you.

MR. MORRISON: We also have two undertaking responses. The first one is undertaking 1 from February 13th, requested by the Chairman, and it deals with the taxes that are paid by corporations. It speaks for itself.

CHAIRMAN: That will be A-89.

MR. MORRISON: And the second undertaking response is undertaking number 15 from February 13th, requested by Commissioner Dumont. And it deals with the benefits for the union and some other benefits.

CHAIRMAN: That will be A-90.

MR. MORRISON: That's it for me, Mr. Chairman.

CHAIRMAN: Thank you. Anybody else? Go ahead, Mr. Lawson.

CROSS EXAMINATION BY MR. LAWSON:

Q.13 - Thank you, Mr. Chairman. Good afternoon, panel. As will become evident during the course of my questions, I am treading on a subject on which I know very little. So I am going to try to make it basic and if we can try to keep it basic, then I will be able to follow. So I apologize in advance for that. But this is only one of a

long list of subjects of which I know very little.
First of all, am I correct in my understanding that the actual debt of Disco is in the neighbourhood of $606,000,000?
MS. MACFARLANE: That's correct, yes.
Q.14 - And am I correct in understanding that there is no amount additional to that $606,000,000 that is in fact equity in Disco?
MS. MACFARLANE: There is projected to be a million dollars worth of retained earnings, but effectively there is no shareholders' equity.
Q.15 - Is there any starting balance sheet, if you will, retained earnings?
MS. MACFARLANE: The company began October 1st, '04, with zero retained earnings.
Q.16 - So my understanding, if I am correct, is that what is happening is of the $606,000,000, approximately -- well maybe exactly -- 42.5 percent of that is being deemed -- instead of being debt is being deemed to be equity, is that a correct understanding?
MS. MACFARLANE: I don't think that's technically correct.
Q.17 - It is being dealt with as if it were equity?
MS. MACFARLANE: One of the reasonableness tests that we did on net income was to test on the basis that some of the

debt might be equity and what would our earnings be.
Q.18 - So it's dealt with for the purposes of calculations of your revenue requirements as if it were equity?
MS. MACFARLANE: That's correct.
Q.19 - For the purposes of this, I'm going to call it deeming because -- it may not be perhaps the technically correct term, but the reality is that there is actually as a starting point for this first fiscal year, there was zero dollars in actual equity.
MS. MACFARLANE: That's correct.
Q.20 - Okay. And to your knowledge is there any legal requirement to use 42 1/2 percent as the deemed equity?
MS. MACFARLANE: There is no legal requirement, no. That was on the advice of the Province's financial advisors.
Q.21 - Is there any legal requirement to actually have any amount deemed as equity?
MS. MACFARLANE: Not under the Business Corporations Act, no.
Q.22 - Or under the Electricity Act or any other legislation at least that you are aware of?
MS. MACFARLANE: Under the Electricity Act there is an implied requirement to have equity in the sense that there is a requirement to pay dividends, and obviously you can't pay dividends unless you have some equity ownership which

allows you to call for those dividends.
Q.23 - Now could you identify -- well let me before that, there was some discussion of this this morning. The ten percent figure that has been used for the purposes of the return on the equity as opposed to the debt component, how was that number -- let me rephrase it. Was that number dictated anywhere by any legislation or anything else?
MS. MACFARLANE: No. That number was determined by the financial advisors of the Province under restructuring, and their basis was in looking at stand-alone distribution utilities what capital structure and what return on equity would allow a distribution utility to get an A credit rating.
Q.24 - Okay. And is ten percent viewed then by Disco as being a reasonable rate of return on that amount?
MS. MACFARLANE: Yes.
Q.25 - Okay. Now could you identify for me what the extra cost -- I will call it cost, it's probably not an accounting term -- but what the extra cost is or extra revenue required by Disco in order to achieve this ten percent return on equity, bearing in mind of course the tax impact as well?
MR. MAROIS: I know we answered an IR on that but I believe it was in the CARD segment.

Q.26 - I don't even have those binders let alone not able to carry them up here. So I apologize.

CHAIRMAN: Would you care for some?

MR. LAWSON: Yes. I found some around here, spare copies.

MS. MACFARLANE: The $14,000,000 that is in our revenue requirement for net income is the differential between a cost of debt and what the top-up would be, shall we say, for the cost of equity. And if one were to look at that on the before tax basis it's 21.6 million dollars. But that would leave the company with zero net income and therefore zero cushion against any of the risks that the corporation faces.

Q.27 - Sure. But because -- and the reason you need to make a tax adjustment, if my understanding is correct, is that you by virtue of deeming it as an equity and a return on equity for the purposes of deemed taxes, if you will, that you don't have any deductibility for what is otherwise calculated as interest on that part of the debt, is that right?

MS. MACFARLANE: I don't think we are talking the same language. We do have interest expense deductibility in our revenue requirement for a hundred percent of the debt. All we have put in net income is that top-up for the portion -- the difference between an equity return and a

debt return on that portion of the debt that would be equity if we had a shareholder's input.
Q.28 - Okay.
MS. MACFARLANE: And the reason you have to have -- you have to back out the taxes is because obviously if you have earnings you are going to pay taxes on them.
Q.29 - Okay. So 21.6 million dollars then, considering the tax impact as well as the difference in income required for Disco because of this deemed equity?
MS. MACFARLANE: That's correct.
Q.30 - Okay.
MS. MACFARLANE: If I could just add to that, the -- just to clarify, that the 21.6 million which is the before tax number, is what we have requested in our revenue requirement as the pre-tax earnings. We could have requested a different amount. So in saying that the 21,000,000 is what comes from having a deemed equity you are assuming that we would have asked for zero otherwise, and that is probably not a safe assumption.
Q.31 - No, no. I'm trying to figure out what it would be if there was a zero assumption.
MS. MACFARLANE: Okay.
Q.32 - I'm not necessarily saying that that's what you would want. I understand I believe what you want is 42.5

percent deemed equity, is my understanding correct?

MS. MACFARLANE: Assumed equity. A net income that would assume.

Q.33 - Okay.

MS. MACFARLANE: It's an important distinction because there is a regulatory process to ask for a deemed capital structure and we haven't done that.

Q.34 - Okay. Now this -- these equity payments, if you will, are being paid to the Province -- sorry -- to the agent of the Province, is that right, the Electric Finance Corporation?

MS. MACFARLANE: Could you repeat the question?

Q.35 - This amount, this money, is being paid to Electric Finance Corporation?

MS. MACFARLANE: The 06/07 revenue requirement does not suggest that that amount would be paid to the shareholder. The only way it could be is if there were dividends called by the shareholder, and for 06/07 there have not been dividends. So it would stay in the company as retained earnings. And the first call on it would be -- you notice in the 04/05 year that there was a loss of 10.5 million. So we actually have a deficit starting out that year. The first call on the 14,000,000 obviously would be any deficit and the rest of it would stay as retained

earnings.
Q.36 - Okay. So it is not intended at the moment to be paid out to Electric Finance Company?
MS. MACFARLANE: That's correct.
Q.37 - Okay. Now I would like you to -- I would like to refer you to exhibit A-57 I believe it is, and what I'm looking for specifically is the governance manual, and it's November 10th's response to IRs appendices. And specifically appendix 7.
MS. MACFARLANE: Yes, I have it.
CHAIRMAN: We don't.
MR. LAWSON: No. I'm waiting. Specifically page 49 of appendix 7.
Q.38 - Now am I correct that this is a policy of the overall corporate structure, if you will, these policies?
MS. MACFARLANE: Yes.
Q.39 - And I'm assuming these were developed at a time that were either immediately preceding an anticipation of this current structure or some time subsequent to this current structure?
MS. MACFARLANE: Yes. There was an initial draft of Board policies prepared prior to restructuring by the previous Board to allow the new Board to have a working document, and the new Board subsequently amended and accepted these

Board policies as their own.

Q.40 - Now the first part of that policy -- I don't know if it's got a policy number or not, but it reads, "continue to provide rates that are just and reasonable for customers and that support the global competitiveness of New Brunswick business and industry".

And then the second part of it, it continues, "and that by 2015 produce commercial operating margins and a return on capital employed that is in line with comparable utilities in Canada." So that specifically addresses by 2015.

Now you have indicated that the requested rate of return of ten percent as you have applied is reasonable. Am I correct in stating that rather than working for 2015 -- by having it by 2015 gradually that you are looking for that rate of return for Disco right away?

MS. MACFARLANE: The Province's restructuring plan called for Transco to -- of course Transco went into October 1st, 2004, with commercial level rates that included a commercial return by virtue of having an approved transmission tariff. So it called for a commercial return for Transco for year one, Disco to be able to go to the markets in year three, Genco in year five and Nuclearco post-refurbishment which would be out in 2011.

So that was the timeframe of the restructuring. And that is why Disco is now seeking a net income that would allow its rates to get to a point that it would attract a credit rating. There are a number of steps that obviously have to take place before that can happen, but certainly it can't happen before we get the rates to that level.

Q.41 - Well are you seeking then to have what -- again this may be evidence of my ignorance on the subject, but by looking for the ten percent rate of return, are you looking to produce commercial operating margins as using just the terminology from here?

MS. MACFARLANE: By producing commercial operating margins, and that would give you a level of operating margin that is irrespective of your capital structure, the Province would then be in a position to undertake a debt equity swap to put into the company an adequate amount of equity so that the company could then go to the credit rating agencies and the debt capital markets.

So yes, the objective is to get a commercial level operating margin and then the province can make their decisions thereafter.

Q.42 - Okay. Am I correct though in my understanding of what is being sought in the rate increase that you are looking for today, that we are dealing with today, for next year, that by 2006/2007, if granted, that Disco would then have commercial operating margins?

MS. MACFARLANE: We are seeking that for 2006/2007 we would have a level of net income that would allow for commercial level operating margins. It's important though that that be sustainable. And we talked about the fact that the other companies' costs and therefore the capacity costs coming through to Disco are increasing over a period of time. So the other companies too later on get commercial level operating margins. So it's not just getting there in 2006/2007, it's also being able to sustain it as these additional costs come through.

Q.43 - But this policy says it's to be achieved by 2015 and Disco is seeking to have it achieved by 2006/2007, correct?

MS. MACFARLANE: That's correct.

Q.44 - And is it somewhere else in the policy that I may have missed where it spells out that notwithstanding that it says by 2015 here, somewhere else it says Disco is to achieve that much sooner than 2015?

MS. MACFARLANE: It is in two other places, one of which is in the restructuring plan of the Province of New Brunswick, and the second place is it is in the -- embedded in the budget for 2006/2007, which was approved

by Disco's Board of Directors.
Q.45 - Okay. This policy -- it's not in the policy anywhere?
MS. MACFARLANE: The policy is global and it's very broad. I would point out that perhaps part of the issue is that the Carver Model under which these policies were designed suggests that those ENDS policies, i.e., what in the long-term is the Board looking for, be done in ten year time horizon. And I would suggest to you that that's where the 2014/2015 came from is in ten years what did the Board want the corporations to look like? It did not suggest that they shouldn't look like that before then. It's just in ten years this is what we want to look like.
Q.46 - Now I have only -- I didn't bring the binder up, but I guess it's page 6 of that appendix which is the one that section 1, Board Policy, it may not be correct but it identifies on that page that the date of September 2005. Would all of these policies have been -- and I guess the same on the bottom of page 49. Were all of these policies developed in September -- or approved in September of '05?
MS. MACFARLANE: I think September 2005 was the date of the last set of revisions to it, but that's subject to check.
Q.47 - So in September of '05 the governance policy of Disco and the other companies was to achieve this by 2015?
MS. MACFARLANE: Yes. As I say I'm not clear that that's

when that policy was developed but that is the latest printing of this document.
Q.48 - Now my understanding is that Genco on the other hand has not in fact built into its rates any rate of return for it for 2006/2007 at least as it's charged to you folks?
MS. MACFARLANE: That's correct.
Q.49 - Do you know why Genco was willing to accept no rate of return, but Disco was expected to?
MS. MACFARLANE: I am speaking based on discussions that I would have been a party to, not involved in but heard in the working committee of the government on restructuring with their financial advisers. Genco is a higher risk business as determined by the capital markets than is transmission or distribution. And it was their view that the companies that were most likely to be ready and capable of getting a credible credit rating because they are regulated, and generally a regulatory environment will provide, as Ms. McShane referred to earlier this morning, a reasonable rate of return, that those companies would be best suited to be early in the stages of going to these debt capital markets. And the generating companies would best be pushed up and done later as their incomes became more stable and as their -- as we had an opportunity to

establish the processes in the other companies. So really it's leaving the risk with those companies with the shareholder until such time as restructuring over a period of five or six years takes place.

Q.50 - Now you mentioned just in your answer there that Genco is a higher risk company, is that the correct term?

MS. MACFARLANE: Generally speaking, generation companies are viewed by the capital markets as higher risk. It's generally the case as an example that the generating companies would have credit ratings of triple B whereas the transmission and distribution companies generally can attract an A credit rating.

Q.51 - Do you know reflective of that whether or not the management fee that is paid by Genco with respect to its debt to EFC is therefore higher than what is paid by Disco?

MS. MACFARLANE: It is not.

Q.52 - It is in fact lower or the same?

MS. MACFARLANE: It's the same.

Q.53 - It's the same even though it's a higher risk?

MS. MACFARLANE: That's correct.

Q.54 - With the exception then of the reference to some day there may be dividends issue under the legislation, there is no legislative provision that you are aware of that requires there be any net income generated by Disco, legally?

MS. MACFARLANE: Well, as I say, it's implied in the Act that taxes and dividends are to be paid. And you can't pay taxes and dividends unless you have positive earnings. Certainly as well it was very much part of the Minister's statement on announcing restructuring that the companies would all be expected to earn a positive rate of return. And it's also part of that statement that the Province wants to move away from the Provincial guarantee on debt, which again cannot be done unless the companies have commercial level earnings and can get their own credit ratings.

Q.55 - And I'm not wanting to engage in debate with you on the subject. But isn't it true that the Business Corporations Act generally contemplates the prospects of dividends? But unfortunately many of us know, from having been in the public market, that not always are they able to do that. So it is contemplated by the legislation. But not necessarily are we successful in seeing it as an investor.

MS. MACFARLANE: That's correct. But if I could just clarify. I wasn't referring to the Business Corporations Act.

Q.56 - Why not?

MS. MACFARLANE: I was referring to the Electricity Act.

Q.57 - Yes.

MS. MACFARLANE: But you are right that the Business Corporations Act does not require a company to make a profit.

Q.58 - I would like to refer you to A-80, if I could please, which are the answers to the interrogatories, most recent answers to the interrogatories, dated February 9th 2006. And more specifically under PUB IR-261.

CHAIRMAN: What was the reference again?

MR. LAWSON: PUB IR-261, Mr. Chairman.

Q.59 - And more specifically table 2 on page 3, which as I understand it is the forecast, the most recent forecast for years 2005/2006, the fiscal year 2005/2006, is that correct?

MS. MACFARLANE: That's correct.

Q.60 - Now you have explained both in here and through previous evidence the reason why you expect the changes that are indicated in here.

But my note is that, from my quick calculations, that there is I believe a $9.7 million increase in the payment in lieu of taxes as a result of this increased income, is that correct?

MS. MACFARLANE: That's correct.

Q.61 - And in addition to that there is an increase of -- is it $22.6 million increase, is that correct, in the surplus?

Or would that -- I guess it would be $17 million or something like that change, is that right, increase I think?

MS. MACFARLANE: That's correct.

Q.62 - So a better part of $30 million, is that right, in terms of the amount that, as an investor if you will or a shareholder of the company would say that we have done well by?

Because in this case they are going to get the increased taxes as well as -- reflected at least in the value of the company, the increased revenue of about $30 million, the two of them totaling about $30 million?

MS. MACFARLANE: That's correct.

Q.63 - Now will that extra $30 million in fact because of a better than expected year 2005/2006 be reflected in what rates you are going to require now in 2006/2007 for Disco?

MS. MACFARLANE: No, it will not, just as the previous year's losses because of worse than expected circumstances are not reflected in the revenue requirement for 06/07.

The variance analysis accompanying this table makes it very clear that controllable expenses are controlled. And they are managed according to budget.

But at the present time, in this forecast you are seeing a reflection of two operating factors over which we don't have control that are affecting the results, one being above-average hydro was 26' -- it's projected to be 26, above the long-term average, 26 percent above the long-term average for the fiscal year 05/06.

And the other piece of it is the export markets where prices have been inordinantly high because of the difficulties in the Gulf arising from Katrina. Those prices have since dropped.

But during the period October to December they were very, very high. And that benefit came through Genco to Disco. That is -- those are both anomalous situations and not something that can be expected in sustained earnings.

And in fact in 2001/2002 the corporation had 28 percent below long-term average in its hydro. In 2002/2003 we had 22 percent blow long-term average. And again the shareholder took those losses in this case because there is an above-average that too accrues to the corporation and does not go through to rates. What's embedded in rates is the long-term average.

Q.64 - And the loss year, what was the loss that year roughly?

MS. MACFARLANE: The loss in 2002/2003, and this again would be for NB Power Corporation, was $77 million. The loss in 2003/2004 was $18 million. 2000/2001 the loss was $80 million. Each of those years were below-average hydro. And in some years there has also been above-average hydro.

In 1999/00 as an example, hydro was 113 percent of long-term average. And in that year there was 17,000,000 net income which was subsequently adjusted for a foreign exchange gain of 46,000,000 leading to a net income of 63,000,000.

Our earnings are very volatile right now because of these items that are beyond the corporation's control, whether it's foreign exchange movement, whether it's -- we weren't hedging in those days -- foreign exchange movement, hydro flows or export markets in which we were a price-taker.

Q.65 - Okay. Now in that regard, the extraordinary -- the significant part of the extraordinariness of 2005/2006 there is reference in that same IR answer, "Higher gross margin variance credit from Genco $42.6 million." Now is that what I understand to be Disco's share of the profit as a result of a sale in the export market?

MS. MACFARLANE: The vesting agreement dictates what the projected sale -- profits in the export markets will be.

And those were forecast when the PPAs were developed for a five-year period. And I believe in 06/07 that amount is -- it's in the vicinity of $70 million.

So that profit is already included in the development of the vesting price from Genco to Disco. Beyond that any excess earnings or any under-earnings, the first 20 percent stays with Genco. And there is a 50 percent sharing beyond that.

So in the year 2005/2006, export margins have been extraordinarily high. And Disco has -- is projected to earn for the full fiscal year, in addition to the 70,000,000 that was baked into the PPA, an additional 43,000,000.

Q.66 - Okay. And because of the 20 percent variance component I presume Genco then must be getting more than $40 million than expected?

MS. MACFARLANE: If -- subject to check, let's say 69,000,000 is the amount in the PPA, the 20 percent plus or minus band would suggest that if gross margins were as high as 82,000,000 or as low as 56,000,000, those gains or losses would stay with Genco.

So Genco would have -- in this year would have started by earning that $13 million band above. And then beyond that they would be sharing on a 50/50 basis with Genco.

So they too would have gotten 42,000,000 as well as the 13,000,000 from the 20 percent.

Q.67 - So $55 million more than expected in Genco?

MS. MACFARLANE: That's correct.

Q.68 - And with the exception of your share of the $42.6 million, you don't see any other benefit of Genco's incremental gain as a result of that?

They don't drop your rates next year because of having a particularly good year in the export market in this year?

MS. MACFARLANE: No. The revenue requirement is based on forecasted numbers. And I will say that -- and it's also for export markets. It's determined based on the forecast that's built into the PPA for 06/07.

But I will say that the prices that we were experiencing in the October to mid-January time frame have dropped off.

Q.69 - Yes. I'm familiar with that. But this number, this 42.6 million, you have reflected that presumably in your forward calculations of what you are expecting from Genco by way of your credit for exports?

MS. MACFARLANE: That's correct. Almost all of that was earned in the period October to mid-January.

Q.70 - Sounds like an accountant's income in a year.

I'm just -- I'm jumping back here to the A-81 which was filed this morning identifying the amounts paid to the Province. I think it was this morning. Or yesterday I guess it might have been. Outlining the amount paid to Electric Finance Corporation based on budget. And also to PI-17 which is the summary sheet that was prepared.
MS. MACFARLANE: Yes, I have it.
Q.71 - Have you any idea whether or not the amounts paid in 2005/06 by Genco or Disco will be significantly different than the amounts that are identified on here for '6 and '7?
Leave aside the interest and long-term debt component.
MS. MACFARLANE: Are you speaking about the actuals for 05/06? Or are you speaking about the budget for 05/06?
Q.72 - The forecast, the most current anticipated amount for 05/06?
MS. MACFARLANE: The payments in lieu of income tax for Disco and Genco would be higher than the amounts in the revenue requirement for 06/07 which is what is indicated here.
And they are higher because of these anomalous net income amounts arising from high hydro and export markets.
Q.73 - Have you any sense of the order of magnitude of the difference?

MS. MACFARLANE: The amount of payments in lieu of income tax that's forecasted to be paid for Disco in 05/06 is 15.9 million.

And as compared to 8,000,000 that's in the revenue requirement for 06/07. And I don't have the Genco information for 05/06.

Q.74 - Presumably it would be, given the fortuitous events of export prices, it would be significantly more than zero?

MS. MACFARLANE: That's correct.

Q.75 - So just looking in I guess -- well, let me start with your A-81 numbers. Just out of curiosity, at the bottom of the first page of A-81 it has the average percentage of 8.5 percent for 2006/07. And when I look at 03/04 the average was 7.2 percent.

Is there -- what is the explanation for that fairly significant spread?

MS. MACFARLANE: You will notice that on the top part of page 2 which is the debt held by NB Power, that the number is yet again lower than the 7.2 --

Q.76 - Yes.

MS. MACFARLANE: -- percent.

When the restructuring occurred, because the Province wants the companies in due course, when they get their commercial level operating margins to go to market, they put the shorter-term debt into NB Power. And they kept the longer-term debt in their own portfolio.

And although at the time we ensured that the interest rate on the overall portfolio at October 1st 2004 was the same in all companies and in EFC, to ensure that the right cost got moved, because the terms were shorter, some of the debt has turned over in the companies and been refinanced at a lower rate. Nothing has turned over in EFC.

Q.77 - Maybe you are beginning to see my ignorance here fairly quickly and publicly I might add.

At the bottom of page 1 then, the small box, "Estimated EFC debt" and "Estimated requirements to service debt", the $32 million, is that EFC's own service costs as opposed to unrelated to Disco?

MS. MACFARLANE: This is their cost of servicing the debt that they took from NB Power on restructuring.

Q.78 - That is the $377 million of Disco's debt, is that --

MS. MACFARLANE: Of old NB Power's debt. Some portion of it would have been attributed to the Distribution operation. But it arose from the integrated utility.

Q.79 - So then this is where I come back to an average of 8.5 percent. I would have -- the lower cost of financing has not -- EFC has not reaped the benefit of that lower cost of financing, is that correct?

MS. MACFARLANE: The debt that they took over was longer term in nature. And none of it has come due. But that is subject to check. Would you just let me follow up on that?

Q.80 - Sure.

MS. MACFARLANE: Thank you.

Q.81 - In 05/06 we have talked about sort of the extraordinary -- the results of the extraordinary export market and the benefits Disco received as a result in its higher net income.

Now in 05/06 Disco also increased rates, spread by a few months in terms of the timing of it, but by 6 percent for its customers, is that right?

MS. MACFARLANE: There was a 3 percent increase March 31st '05 and a 3 percent increase July 7th 2005.

Q.82 - How much extra revenue was generated by Disco as a result of those increases in 2005/2006?

MS. MACFARLANE: Could I just clarify. When you say extra, in fact there was less revenue collected than had been anticipated when we made our application for a rate increase and a fuel surcharge. It was less than that. But we withdrew that application.

Q.83 - Right.

MS. MACFARLANE: So when you say extra you mean extra over what?

Q.84 - The previous year. How much would you have -- well, without the 6 percent increase, the two 3 percent increases, what would your -- how much revenue did you generate as a result of those?

MS. MACFARLANE: I don't have that number per se. However, on table 1 in Lori Clark's evidence in A-50 which we have looked at a number of times -- so this is behind gold tab 3, direct evidence of Lori Clark, page 2. So I'm on page 2. It's an up and down page. It's table 1.

Q.85 - Table 1. My colours are different than yours. Part 3, tab 3 of 5?

MS. MACFARLANE: Part 3, the very first tab says direct evidence of Lori Clark.

Q.86 - Okay.

MS. MACFARLANE: It's page 2, table 1. Column 2 is 05/06 and line 10 is forecasted revenue at current rates. That is the forecasted revenue without the July 7th increase. It would have been the forecasted revenue as at April 1, shall we say, '05, for the coming fiscal year. So it would have included the March 31st rate increase but it would not have included the in year rate increase at July 7.

Q.87 - Are you able to undertake to provide what the number would have been for the three percent effective March 1st and the July 7th figure?

MS. MACFARLANE: Yes.

Q.88 - Thank you. Now I had the benefit, or perhaps it's not the benefit, of not having been involved in the first part of these hearings. So I don't know the answer to this question. But what was the rate increase that was requested that was subsequently withdrawn with respect to 05/06?

MR. MAROIS: I guess if you look back at the previous table it was showing a revenue shortfall of 45.8 million. That was after the March 31st increase of three percent. So we were looking for roughly a 4.5 percent increase in rates.

Q.89 - Okay. About $45,000,000 in extra revenue? I apologize.

MR. MAROIS: Yes. From that -- that's what we were looking at, over and above the three percent that was implemented.

Q.90 - So coincidentally, the misfortune of others having caused it, your revenue -- extra revenue from the extraordinariness of export market appears to have generated about as much revenue in extraordinary revenue in 2004 -- 2005/2006 as you were requesting and have withdrawn, is that right? 42 versus $45,000,000?

MS. MACFARLANE: I'm not sure. We are forecasting 22,000,000 after tax and before tax that number is 33,000,000.

Q.91 - Sorry. Just in terms of the extraordinary income that you generated, you had anticipated an extraordinary -- you got 42-and-a-half million dollars extra that you hadn't -- probably wouldn't have been able to dream of last year when you withdrew the application, is that right?

MS. MACFARLANE: But there were a number of other offsets to that. As an example, it has been an exceptionally warm year and therefore our load is down and our revenue from that load is down. There are a number of offsets. You are just looking at one of the variances.

Q.92 - Okay. Fair enough. That's fair enough. But between taxes and everything else, that's I think the $30,000,000 extra that you are generating relative to -- say $30,000,000 extra that you are generating beyond what you had originally forecast -- sorry -- not what you are generating -- what you are generating plus the 9.7 million dollars in extra taxes, payment in lieu of taxes?

MS. MACFARLANE: At the -- for the year in 05/06 we had been forecasting in our budget a 4.4 million dollar net income which before taxes would be 6.8 million dollars. And in fact we because of these abnormal circumstances believe

that we will have 22,000,000 which is 33,000,000 before taxes.
So 33 minus seven is $26,000,000.
Q.93 - So $26,000,000. And you were looking, am I correct, in the application that was withdrawn for an extra $45,000,000 in revenue, is that correct?
MS. MACFARLANE: I was actually looking at that table that we were looking at earlier, table 1 in Lori Clark's evidence, where we see that the net income requirement in our 05/06 budget was 4.4 million and in the 06/07 was 14,000,000.
Q.94 - Right. I understood that. I'm speaking -- Mr. Marois earlier referred to $45,000,000.
MR. MAROIS: Yes. If you look at table 1 in Lori Clark's evidence under tab 3, the table you were looking at --
Q.95 - Okay.
MR. MAROIS: -- previously.
Q.96 - It's on page 2?
MR. MAROIS: Yes.
Q.97 - Okay.
MR. MAROIS: The column 2 of that table is really taken from the initial evidence we had filed last spring, and really what that showed was a revenue shortfall on line 11, column 2, of 45.8 million. So that's what we would have required at that time based on our forecast to recover our

revenue requirement, including a net income of 4.3 million. And that column or the revenue under that column, line 10, already reflected the March 31st three percent increase.
CHAIRMAN: Excuse me. Mr. Lawson, is this a good place for us to take our break?
MR. LAWSON: If you give me two minutes, I suspect you will be able to get rid of me entirely.
CHAIRMAN: Oh good. Let's go ahead.
MR. LAWSON: I knew you would find that an offer you couldn't refuse. At least for the day you will get rid of me.
Q.98 - And just for final clarification, the amount that we talked about in these charts -- I'm going to use more specifically PI-17 this morning just because I find it easier to refer to in terms of the numbers, recognizing that -- just using that chart under Disco specifically, the payment in lieu of income taxes in fact is likely to be 15.9 million dollars rather than 8.2 million dollars, is that correct, what I understood you --
MS. MACFARLANE: I'm sorry. I'm not quite able to follow you. Could you run me through that again?
Q.99 - I wrote this down, that 06/07 you were expecting as a result of -- these are based on budget -- your now

recalculated numbers, sort of for 06/07, am I correct -- I'm sorry. That was for 05/06, 15.9.

MS. MACFARLANE: That's right.

Q.100 - I have got to make better notes. So it's still expected to be 8.2 million dollars, I presume. There is an eight and an 8.2, I'm not sure which it is.

MS. MACFARLANE: Yes. It's 8.2 million in our revenue requirement, yes.

Q.101 - And then in addition to that amount, in terms of what will be paid to the Province, that's a payment in lieu of income tax and then you have payment in lieu of the provincial LCT and then payment in lieu of federal LCT which are all identified on there, and then in addition to that are the utility tax payments of 9.7 million dollars, property tax of 1.4 and right-of-way of .6 million dollars, does that sound correct?

MS. MACFARLANE: Those -- subject to check they sound right. Those amounts are not paid to Electric Finance, they are paid to the Province of New Brunswick.

Q.102 - Yes. And just lastly, the loss carry forward that you indicated is in A-81 but has not been referred to or identified to in P-17, that loss carried forward carries forward forever, so if it is not in fact used this year in 06/07, it can be used in any subsequent year, is that right.

MS. MACFARLANE: That's correct.

MR. LAWSON: Okay. Those are all the questions I have, Mr. Chairman.

CHAIRMAN: Thank you, Mr. Lawson.

MR. LAWSON: Thank you, panel.

CHAIRMAN: We will take our break.

(Recess)

CHAIRMAN: The press present in the room informed me that we have a new Minister of Energy, Ms. Fowlie. I thought I would share that with you.

Okay. Who is next? Mr. Gorman?

MR. MORRISON: Perhaps, Mr. Chairman, before Mr. Gorman takes his seat --

CHAIRMAN: Oh, preliminaries, sorry.

MR. MORRISON: We are trying to crank out these undertakings as quickly as possible, Mr. Chairman. I believe they have been given to the Board Secretary.

The first one I would like to have marked is marked as undertaking number 3 from February 13th from Mr. MacNutt. And it deals with the $11,000 estimate for vehicles.

CHAIRMAN: That is <u>A-91</u>.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 4 from February 13th.

MR. MACNUTT: Could we just slow down a little bit so we can get a copy of it and mark it.

CHAIRMAN: Tell us when, Mr. MacNutt.

MR. MACNUTT: Go.

MR. MORRISON: And we are off.

CHAIRMAN: This is undertaking number 4, February the 13th. And it is A-92.

MR. MORRISON: And finally, Mr. Chairman, is undertaking number 10 from February 13th.

CHAIRMAN: And that is A-93. Any other preliminary matters? Mr. Gorman, are you going to move up?

MR. GORMAN: Yes, Mr. Chairman. I'm just marking the exhibits.

CHAIRMAN: I see. None of your helpers could do that, eh. Go ahead when you are ready, sir.

MR. GORMAN: Thank you, Mr. Chairman. I hope the new Minister knows that one of the Intervenors has a propensity to want to summons them to attend before this Board. I wonder if she was informed of that in advance.

CHAIRMAN: I hope they both hold off.

MR. GORMAN: Thank you.

CROSS EXAMINATION BY MR. GORMAN:

Q.103 - Good afternoon, Mr. Marois, Ms. McShane and Ms. MacFarlane.

I would like to I guess start off with the report prepared by Kathleen McShane, which I understand is in exhibit A-55 as appendix 1.

Ms. McShane didn't seem to be getting any questions from Mr. Lawson. So I told her it would be a shame to come this far and not have a few questions to answer.

Ms. McShane, I'm going to refer you to page 2 of your report. And the very first paragraph says that "To evaluate the reasonableness of Disco's approach I started with a review of energy policy in New Brunswick including the Electricity Act which restructured the electricity industry in New Brunswick."

What policy did you consider?

MS. MCSHANE: The documents that I reviewed included the White Paper, the introduction of the Electricity Act which was a speech by the then Minister of Energy, Mr. Volpe. And the Minister's statement on the future of New Brunswick Power which was also by Mr. Volpe dated 2002. I also reviewed reports that came out prior to the White Paper, the discussion paper that was done in 1998 as well as reading the Electricity Act.

Q.104 - Okay. And you refer to -- and that was my next question actually, was that you say including the Electricity Act. And I guess that is not really policy, that is legislation.

MS. MCSHANE: That's true.

Q.105 - Okay. But with respect to the Electricity Act, specifically what sections of the Electricity Act did you I guess deal with with respect to return on equity?

MS. MCSHANE: Nothing specific, terribly specific with respect to the Act itself. My understanding of the objectives of the Province were taken primarily from the two documents that I referred to entitled The Minister's statement on the future of NB Power, which was the decision -- or the announcement of the decision to restructure New Brunswick Power as well as, as I indicated, the introduction of the Electricity Act, which was again a speech by the Minister, which indicated what the framework was for the electricity industry in the province.

Q.106 - Would you agree with me that provision for return on equity must be founded somewhere in the legislation? And I'm not suggesting there isn't any right to a return on equity by the way. But would you agree that effectively it must be found in the legislation, not just in policy?

MS. MCSHANE: Well, I think that Ms. MacFarlane made clear earlier today that what is in the Act is specifically the

requirement to pay income taxes and the requirement to pay dividends. And you can do neither without a return on equity or net income.
Q.107 - The requirement to pay dividends -- and Ms. MacFarlane, where specifically is that?
MS. MACFARLANE: It's in Section 37(4) of the Electricity Act.
Q.108 - And 37(4) indicates, without reading the entire section, that the Lieutenant Governor in Council may from time to time order the corporation to pay an amount specified. Is that what you are referring to?
MS. MACFARLANE: That's correct. And it's also in 37(3), this similar wording. But an exemption under a different Act.
Q.109 - And has that in fact happened?
MS. MACFARLANE: It has happened in the case of Transco, yes.
Q.110 - Has it happened with respect to Disco?
MS. MACFARLANE: No, it has not.
Q.111 - And when would you anticipate that that would happen?
MS. MACFARLANE: I anticipate it would happen at the time that Disco has demonstrated that it has earnings, sustainable earnings such that it can afford to pay dividends without putting itself in a deleterious

position.

The dividend policy is stated in the shareholders' agreement which is one of the documents that was filed with this Board. And it speaks to a balance.

In calling for dividends it speaks to EFC consulting with the Board of Directors of Disco and taking a balanced approach so that the needs for capital on behalf of the company are balanced with the need for cash by EFC.

And in the near term, while rates are where they are, the two groups have determined that the collective need is for capital in Disco.

Q.112 - Okay. But suffice it to say for the present time then there has been no requirement to pay from the Lieutenant Governor in Council?

MS. MCSHANE: I was just going to basically repeat what Ms. MacFarlane said. It's very difficult to pay dividends if you don't have any earnings. You have to establish a sustainable level of earnings in the first instance. You can't --

CHAIRMAN: Excuse me. Where does it say "dividend"?

MS. MACFARLANE: In the Act it doesn't specifically say dividends.

CHAIRMAN: No.

MS. MACFARLANE: It says amounts ordered from time to time by the Lieutenant Governor in Council. And that section is the section under which they would call for dividends.

Q.113 - Thank you. And then I guess that was where this series of questions began, was asking you where I would find dividends. And I think in your earlier evidence on this topic you talked about a lot that was implied in the legislation.

I guess is that what you are relying on are certain things that you imply to that legislation as opposed to being specifically there?

MS. MCSHANE: If you are asking me the question, I was relying in part at least on the speech that was given by the Minister of Energy entitled Introduction of the Electricity Act in which his words were, NB Power Holding Corporation will provide general management services to the four subsidiaries I mentioned a moment ago. The Province will be the sole shareholder of NB Power Holding Corporation which in turn will hold all the shares of its subsidiary corporations. In time each of the corporations will be required to pay dividends to the shareholder and they will be required to make special payments equivalent to the income and capital tax as other corporations that are not exempt from the tax would normally pay. They will operate on a level playing field with other energy providers.

Q.114 - Thank you for that. But my question was what would you find in the legislation itself? This is a speech that you are referring to?

MS. MCSHANE: This is a speech that was made in the Legislative Assembly, is what I understand, introducing the Act.

Q.115 - Certainly. And I don't have a copy of that. But I accept that as being accurate.

But I guess back to my question. Is there anything in the legislation mandating dividends?

MS. MACFARLANE: There isn't anything mandating dividends. There is a provision to allow for a call of dividends.

Q.116 - And that is 37(3) and 37(4) which you have referred to?

MS. MACFARLANE: That's correct. Those are the sections under which, through order in council, in fact under the shareholders' agreement through letter from EFC, that the shareholder has called for dividends from the Transmission Corporation. They have used their authority under that section of the Act to do it.

Q.117 - And in I guess justifying the dividend based on policy -- and this may well be a legal opinion. And I will just alert your counsel with respect to this.

But I would refer you to Section 101(4) of the Electricity Act which is the section which says what the Board may consider -- or sorry, take into consideration when considering an application.

And quite frankly, I just don't see policy -- I have heard a lot of evidence over the number of days I guess that we have sat, from I guess almost a year ago, with respect to policy.

But that doesn't explicitly talk about policy being one of the main considerations.

MS. MACFARLANE: You are referring to Section 101(4)?

Q.118 - Yes.

MS. MACFARLANE: It does refer to accounting and financial policies. And one of the financial policies of the Board is the dividend policy as dictated by the shareholders' agreement.

Q.119 - So you would say that fits within 101(4)(a) as an accounting or financial policy of Disco?

MS. MACFARLANE: That would be one interpretation I would put on it, yes.

MR. MORRISON: In addition to that, Mr. Chairman, if you refer to 101(3), what the Board must consider is all of the projected revenue requirements for the provision of the services referred to in Section 97.

And under our evidence obviously the return is part of the revenue requirement projected.

Q.120 - If I can go back then to 101(4)(a) dealing with your financial policies -- accounting and financial policies. The justification strikes me though that it's not your accounting and financial policy that we keep hearing about, but the White Paper and speeches introducing legislation and things of that nature, is that included in what would be considered under 101(4)?

MS. MACFARLANE: Mr. Gorman, I'm not a lawyer, so I'm not very good at interpreting the Act.

MR. GORMAN: No.

MS. MACFARLANE: I just refer back to the Chairman's statement earlier in the hearing that we have to follow the law, and it is clear from the Electricity Act that the companies have been restructured, that there is provision for the Electric Finance Corporation to -- not just provision, but in fact their purpose is stated as ensuring appropriate levels of equity in the companies over time and ensuring that they pay down the remainder of the debt, which they will do by exercising their rights under section 37 of the Act for payment of taxes and calling of dividends.

Q.121 - Well, I guess this whole line of questioning I must say is premised basically on my inability to see within the legislation precisely what you are relying on, but let me help you and I know that maybe you will find that hard to believe, but the only place I see this really covered is in the definition section, but it doesn't seem to be followed up in the Act, and I am going to refer you to the definition of revenue requirements. And if you would read through the definition of revenue requirements it talks about a reasonable return on equity, and I really don't see any other reference in the Act other than there, but -- and that really was the intent of my questions, whether or not you could point me to anything else.

MR. MORRISON: Mr. Chairman, my -- in dealing with the Act, I did point out section 101(3) which deals with the revenue requirement, and if you link that into the definition which is in the first part of the section it clearly indicates that it includes a reasonable return on equity. So there is specific provision in the Act under section 101(3) dealing with return on equity.

CHAIRMAN: Gentlemen, my knowledge of regulatory law is that we have a dual function or role, the first of which is to set just and equitable rates for the customers of the utility, and the second one is to allow the utility to make a return on investment sufficient so that it can borrow money to provide the services that it has the monopoly to deliver. So, you know, I think it's there, but that's -- that's all I will say now. I think that's rather clear that the regulatory law supports that, as well as I think what you have just done, Mr. Morrison, there. You know, the problem is the particular sections. The purpose may have been what the witness has been saying, but it's certainly not specifically spelled out. Go ahead, Mr. Gorman.

Q.122 - Thank you.

MS. MACFARLANE: Mr. Gorman, just if I may, I just wanted to complete the record. I just wanted to put into the record the section number that does define the purposes of the finance corporation as I indicated them was section 33(2) and it refers to the purpose being to facilitate the conversion of NB POwer's debt to appropriate levels of debt in the operating companies, and to assume and reduce the remaining portion of that debt.

Q.123 - Thank you. I am going to refer you -- excuse me for a moment here. The debt equity ratio that is being used in this portion of the hearing, that's not prescribed by legislation, that's something that has been developed by Disco?

MR. MCSHANE: My understanding is that in the first instance it was a recommendation to Disco by the province's financial advisors, and in the second instance I reviewed that capital structure as part of the review that I was asked to undertake to evaluate the reasonableness of Disco's approach to developing net income for the test year.

Q.124 - So, Ms. McShane, you did not develop that debt equity ratio, you simply reviewed it for test of reasonableness?

MS. MCSHANE: That's correct. I was not the person who was asked to advise the province on what the appropriate capital structure should be for Disco and Transco.

Q.125 - The amount of equity I guess that goes into the formula is 42.5 percent?

MS. MCSHANE: For purposes of developing the net income for the test year, the amount of equity that was used or was assumed was 42 1/2 percent.

Q.126 - Now I'm going to refer you to page 11 of your evidence, and that's entitled Capital Structures and Debt Ratings of Disco's Peers, and you list five utilities that I guess were the closest that you could find to Disco, would that be a fair way of putting it?

MS. MCSHANE: That's correct.

Q.127 - And would you agree with me when we look at the allowed common equity that Atco Electric is less at 37

percent?
MS. MCSHANE: Yes. I mean we can go through each and every one of these, but perhaps just to make it clear, I said at the outset that these were for the closest peers. And then I went on to explain why or what differences there were as between the utilities in this table and Disco, and with particular reference to Atco Electric and Fortis Alberta, which are strictly wires utilities. They have no obligation to purchase electricity. All of the purchase obligations and the retail obligations have been passed to another party. So the business risks of the Alberta distribution utilities are considerably lower than the business risks of Disco.
Q.128 - Well then without going through each of the five peers individually, let's go down to TransAlta Disco which was at 56 percent, but I believe you have a note with respect to that and on the next page do I understand that that was actually -- at the present time that's at 37 percent?
MS. MCSHANE: Let's understand the quick answer is yes, but that's not the complete answer. The complete answer is that the 56 percent common equity ratio for TransAlta's distribution function was determined early in the restructuring process when the wires business still included all of the retail operations and it included the

obligation of the distribution utility to purchase power. In fact they had an obligation to make reservation payments to the generation operations in Alberta, and as a result of that that the relatively small asset base of the distributors took on the large operating leverage of the generation, and as a result when the Alberta Board looked at the relative business risks of the three functions, generation, transmission and distribution, it determined that there was a capital structure that would apply to the integrated utility because the utilities were still -- even though they were functionalized all of the functions were still in the same company. But they were unbundled and they wanted to determine what the capital structure should be for each of those three functions based on the relative risks.

So their approach was that they said, okay, what we need to do is look at what the capital structure should be for the corporation, because it is after all the corporation in that case that went to the market. It wasn't the functions, which is somewhat different than here where we will have individual companies going to the market.

So they said, we believe that the business risks of the corporation require a common equity ratio of 40 percent. Now let's look at the risks of the individual three functions. And they said that given their restructuring model that transmission was the least risky, generation was the next risky because it had transferred the risk of basically these reservation payments to distribution, and distribution was the most risky. So distribution got the highest common equity ratio, generation got the second highest, transmission got the lowest. And in total they came out to what the appropriate overall capital structure was according to the Board for the entire three functions.

Q.129 - The 56 percent then that's in there for TransAlta Disco, just so that -- and I guess it's in your chart anyway. So that's for 1999/2000.

MS. MCSHANE: That's right. Because that was -- that was what was appropriate under that restructuring model, which -- at that point in time which as I explained in this report is most similar to what we have here where Disco is -- has the obligation of the PPAs. The capital structure that applies to distribution in Alberta now is quite different because it's a different model.

Q.130 - So if I take the 56 out -- let's just take that out for the time being because currently it's at 37, the numbers I would have going down would be 37, 37 up to 45, 40 and 37?

MS. MCSHANE: They would be lower than the average including 56. I don't have that number. But I mean I don't think that averaging those numbers is particularly relevant because they all as I explained are quite different, with the closest being Newfoundland Power, which purchases power. And even that is somewhat different because it has rate stabilization mechanism that allows flow through of its actual purchase power cost to customers.

Q.131 - If I did average them, and I am not sure exactly how I go about that particularly since in Ontario, we are talking about perhaps a number of distributors and how you would work the average out, but it would out to something less that 42 1/2, wouldn't it?

MS. MCSHANE: I mean that's obvious that it would, but again not particular relevant I don't think.

Q.132 - Well in choosing what's the appropriate level for equity and it seems to me from reading your report and from reading anything on this topic, it seems to me that there is a certain amount of judgment that has to be applied that perhaps there is a range of reasonableness, there isn't an absolute number that you can determine mathematically necessarily?

MS. MCSHANE: No, I agree with you that there is judgment involved. I would add perhaps to the comments however that I made with respect to the model being different in Alberta to the comments that you see later in the report with respect to what the debt rating agencies have said about the level of some of these allowed common equity ratios, in particular if you look at page 17 of my report in the very last paragraph, where the Dominion Bond Rating Service is writing a report on Atco. Subsequent to the generic cost of capital decision of the Alberta Board determined that the returns and the common equity components that were approved in that proceeding, which that table that we were just discussing reflect are relatively low.

Q.133 - Given that their -- and I guess I believe your evidence is that you have conceded that there would be a range that you wouldn't have one absolute number being the only one that you could pick for equity, for example, if we were to look at the Ontario Municipal Electricity Distributors at 40 percent, would that still be within the range of reasonableness?

MS. MCSHANE: I would make two points with respect to whether it's within the range of reasonableness. One is it depends on what the common equity return is. You cannot divorce one from the other. So perhaps 40 percent

is not unreasonable as long as the return reflects the level of financial risk that is in the capital structure.
Second, I still believe that it's on the low side given the relative level of business risk in relation to these utilities that are in this table.
Q.134 - And I appreciate your comment about low side, but there is a range and this would fit within that range wouldn't it?
MS. MCSHANE: My own view is that capital structures do fall within a range. You cannot pinpoint the absolute optimal common equity ratio.
Having said that I think 40 percent is too low to allow Disco on a stand alone basis to achieve it, A credit rating. So if Disco is attempting to get itself in a position where it can go to the market on its own and achieve an A credit rating, this equity ratio is not adequate.
Q.135 - Well just to follow up on that, your evidence is then that at 42 1/2 percent, it can get an A credit rating, is that correct?
MS. MCSHANE: Again, I think at that level, it's going to depend on the level of allowed return. I think you know once you get to the 42 percent level, if you have a return on equity that's in the 10 percent range and the return is

sustainable then, yes, they should be able to obtain an A rating.

Q.136 - Well, I understand that the return on equity is going to be an integral part of this. And if you had a return on equity of 10 percent, let's just stay with your example, and you were something below 42 1/2 is it sustainable, if your return on equity was 10 percent, because you are linking the two for obvious reasons. But, for example, if you did have a return on equity at 10 percent and you were 40 percent equity, isn't it possible you still get your A rating?

MS. MCSHANE: At 42 percent and 10 percent is that what you said?

Q.137 - Well, no, I think that's what you are proposing -- or sorry, that's what Disco is proposing and you are commenting on is 42 1/2 and 10. I am saying 40 and 10?

MS. MCSHANE: Since I am not a debt rater, I cannot guarantee what the debt rating agencies are going to do. Based on my experience and looking at what these other utilities have been able to achieve in looking at Disco's business risk, I believe something above 40 would be required.

Q.138 - This is all based on the concept of Disco being a -- as you call it, a stand alone utility?

MS. MCSHANE: Yes.

Q.139 - And by a stand alone utility, I take it from the evidence, essentially it's trying to be compared to an investor-owned utility, private -- something not connected to government?

MS. MCSHANE: Well, the term, stand alone, means -- and I will take you to the definition that I have set forth here. It's on page 4 and point one, the idea behind the stand alone principle is that it -- I will just read it -- it encompasses the notion that the cost of capital incurred by the ratepayers should be equivalent to that, which would be faced by the utility racing capital in the public markets on the strength of its own business and financial parameters. The cost of capital should reflect neither subsidies given to nor taken from other activities of the utility's parent. Application of the stand alone principle to Disco means that it should be treated as if it were operating independently from a financing perspective, which is what it will be in the future.

Q.140 - And I note in your definition that you say that it would be treated -- and I am intrigued by the words, as if it were operating independently from a financing perspective, because we can't ignore the fact that the sole shareholder ultimately here is the Province of New

Brunswick?

MS. MCSHANE: This principle applies to whoever the shareholder is. For example, if you were -- we would use the example in my comments this morning, I used the example of Enbridge Gas New Brunswick. Its shareholder is Enbridge Inc. But its shareholder is the cost of raising capital should not impact on what the return on capital is to Enbridge Gas New Brunswick. That should reflect it's own financial parameters and business risks.

Q.141 - Just so I understand what you are saying, the fact that the sole shareholder is the Government of New Brunswick, you are saying should not or would not impact of their interest rating?

MS. MCSHANE: Oh, I am sorry. I guess I wasn't quite clear what you were asking. If you are asking if -- if Disco goes to the market by itself without a parent guarantee then the fact that its shareholder is the Province of New Brunswick should not have an impact on its credit rating.

Q.142 - You believe that would be zero impact, the fact that the shareholder is the Province of New Brunswick?

MS. MCSHANE: On its credit rating, I guess if you look at the credit ratings that have been given say to Hydro One, I mean there is -- there is some halo effect. So that perhaps the spread that the Hydro One gets versus let's say Enbridge Gas -- sorry, Enbridge Gas Distribution in Ontario, which has approximately the same credit ratings, has approximately the same capital structure, has approximately the same allowed ROE, the spreads on the Hydro One debt are maybe 10 basis points lower than for a similar credit, Enbridge Gas Distribution.

Q.143 - But they are lower?

MS. MCSHANE: A little bit lower. There is a little bit of a halo effect. And there is a benefit to that obviously, he customers pay a lower cost of debt.

MR. GORMAN: It's five after 3:00, Mr. Chairman. Will I cease asking questions for today?

CHAIRMAN: Yes, I do, Mr. Gorman. I want to follow up on what you just asked though, a couple questions here of the witness.

A little differently than the way Mr. Gorman put it, what if government plays a role in the rate setting process, or said another way, government can interfere in the rate setting process, does that have an impact?

I am asking you, Madam, as an expert. You don't need coaching for New Brunswick?

MS. MCSHANE: She just told me what I was going to say anyway.

CHAIRMAN: Yes. You are well prepared for this hearing I can tell.

MS. MCSHANE: Well, government can interfere and government has interfered and it has not been a good thing. Government has interfered in Ontario and it has had a very negative impact on the credit ratings of government-owned -- I shouldn't say very negative impact, it had a negative impact on the credit ratings of Hydro One. It had a negative impact on the credit ratings of the municipally-owned electric utilities. Government interfered in Alberta. The impact was negative, but not as -- it didn't persist as long.

CHAIRMAN: Would I be correct in saying the market place likes to have a predictable regulatory scheme?

MS. MCSHANE: Yes, I would agree with that 100 percent.

CHAIRMAN: We will break until tomorrow morning at 9:15.

(Adjourned)

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