

1 New Brunswick Energy and Utilities Board

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5 IN THE MATTER OF an application by New Brunswick Power
6 Distribution and Customer Service Corporation (DISCO) for
7 approval of changes in its Charges, Rates and Tolls (Includes
8 Interim Rate Proposal)

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10 Delta Hotel, Saint John, N.B., on December 18th 2007.

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Henneberry Reporting Service

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INDEX

1
2
3
4
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6
7
8
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10
11
12
13
14
15
16
17
18
19
20
21
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Dr. Booth

- Direct by Mr. Theriault - page 2211

- Cross by Mr. Keyes - page 2219

Mr. Strunk

- Direct by Mr. Theriault - page 2220

- Cross by Mr. Morrison - page 2232

- By the Vice Chairman - page 2269

- Redirect by Mr. Theriault - page 2270

A-54 - Undertaking response - page 2273

1
2
3
4
5
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New Brunswick Energy and Utilities Board

IN THE MATTER OF an application by New Brunswick Power
Distribution and Customer Service Corporation (DISCO) for
approval of changes in its Charges, Rates and Tolls (Includes
Interim Rate Proposal)

Delta Hotel, Saint John, N.B., on December 18th 2007.

BEFORE: Raymond Gorman, Esq., Q.C. - Chairman
Cyril Johnston, Esq. - Vice Chairman
Mr. Roger McKenzie - Member
Mr. Don Barnett - Member
Ms. Connie Morrison - Member
Mr. Yvon Normandeau - Member

N.B. Energy and Utilities
Board Counsel - Ms. Ellen Desmond

Board Staff - Mr. Doug Goss
- Mr. John Lawton
- Mr. David Keenan
- Mr. Dave Young
- Mr. Andrew Logan

Secretary to the Board - Ms. Lorraine Légère
Assistant Secretary - Ms. Juliette Savoie

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CHAIRMAN: Good morning, everyone. I will take the
appearances at this time, starting with the Applicant.

MR. KEYES: Thank you, Mr. Chairman, Members of the Board.
Edward Keyes and Terry Morrison for the Applicant. And
together at counsel table with us this morning is Sharon
MacFarlane, Mike Gorman and Darren Murphy.

CHAIRMAN: Thank you, Mr. Keyes. CME?

MR. LAWSON: Good morning, Mr. Chair. Gary Lawson for CME.

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CHAIRMAN: Good morning, Mr. Lawson. Conservation Council of New Brunswick? Enbridge Gas New Brunswick? Irving Oil Limited? JD Irving Pulp & Paper Group?

MR. WOLFE: Good morning, Mr. Chairman. Wayne Wolfe.

CHAIRMAN: Good morning. NB Forest Products Association? Dr. Sollows? Utilities Municipal?

MR. ZED: Good morning, Mr. Chair, Members of the Board. Peter Zed and I am joined by Dana Young, Michael Couturier, and Marta Kelly.

CHAIRMAN: Thank you, Mr. Zed. Vibrant Communities Saint John?

MR. PEACOCK: Good morning, Mr. Chair. Kurt Peacock here.

CHAIRMAN: Public Intervenor?

MR. THERIAULT: Good morning, Mr. Chair. Daniel Theriault. I am joined this morning by Robert O'Rourke, Jayme O'Donnell and Kurt Strunk will be joining us shortly.

CHAIRMAN: Thank you, Mr. Theriault. New Brunswick Energy and Utilities Board?

MS. DESMOND: Ellen Desmond, Mr. Chair. And from Board staff, Doug Goss, John Lawton, Dave Young, Dave Keenan and Board Consultant, Andrew Logan.

CHAIRMAN: Thank you, Ms. Desmond. I received a letter yesterday -- I think it was distributed to everybody, requesting that Dr. Booth testify by way of telephone

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conference call. Does anybody have any difficulty with that?

Well I don't see anybody objecting so we will allow him to testify in that fashion.

And if there are any preliminary matters, perhaps we can deal with them after Dr. Booth's testimony. I am told that he in fact is on the line and connected at this point in time.

So Mr. Theriault, perhaps then you can introduce Dr. Booth and I will ask our sound technician to make sure that Dr. Booth's voice will be heard by us. Thank you.

MR. THERIAULT: Thank you, Mr. Chairman. Dr. Booth, are you there?

DR. BOOTH: Yes, I'm here.

DR. LAWRENCE BOOTH:

DIRECT EXAMINATION BY MR. THERIAULT:

Q.1 - Perhaps for the record you could please state your name and occupation?

A. I am Lawrence David Booth. I am a Professor of Finance. I hold a CIT Chair in Structured Finance at the Rotman School of Management at the University of Toronto.

Q.2 - Okay. And Dr. Booth, perhaps by way of background, you could review briefly your academic qualifications with respect to proceedings such as these?

CHAIRMAN: Mr. Theriault, perhaps before -- and Dr. Booth,

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2 before we proceed any further, I am going to ask Board counsel
3 to swear you. I'm not sure exactly how we are going to do
4 this by telephone because I expect there is no bible.

5 MR. THERIAULT: Affirmation perhaps?

6 CHAIRMAN: How about an affirmation. We will do it by way
7 of affirmation so I will ask Board counsel to do that.

8 DR. BOOTH, affirmed.

9 CHAIRMAN: All right, Mr. Theriault, proceed.

10 MR. THERIAULT: Thank you.

11 Q.3 - Dr. Booth, just getting back, if you could give the
12 Board -- first of all, I guess, you have filed with your
13 evidence a copy of your cv?

14 A. That is correct.

15 Q.4 - And perhaps just by way of background, you could give an
16 overview of your academic and professional qualifications
17 to the Board?

18 A. Yes. I teach Business Finance, Corporate Financing,
19 Mergers and Acquisitions in Rotman School at the
20 University of Toronto, where I have been since 1978. I
21 graduated my undergraduate from the London School of
22 Economics and then did an MA in Economics and MBA in
23 Finance and Doctorate in Finance at Indiana University in
24 the States.

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2 My teaching, as I indicated, has primarily been in the
3 area of Corporate Finance, raising capital and spending
4 money on the part of corporations and the principles
5 attached to those areas.

6 As part of that teaching commitment, I have been involved
7 in executive programs and I have become extensively
8 involved in expert financial witness work as my research
9 and teaching has evolved.

10 I first testified before the CRTC in a Bell Canada hearing
11 in 1986 with my colleague Professor Michael Berkewitz and
12 since then I have testified before most of the public
13 utility boards across Canada. And I think I have
14 testified directly through written testimony or through
15 oral hearings at every province in Canada except
16 Saskatchewan.

17 Q.5 - Now, Mr. Chairman, based on that information, I would
18 ask that Dr. Booth be declared an expert to give opinion
19 evidence in utility cost of capital for this proceeding.

20 CHAIRMAN: Do any of the parties wish to question Dr. Booth
21 with respect to his qualifications or do they have any
22 comments on him being so qualified? All right. Then Dr.
23 Booth will be qualified as an expert witness in the field
24 of utility cost of capital.

25 MR. THERIAULT: Thank you, Mr. Chairman.

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2 Q.6 - Dr. Booth, perhaps we could turn to your evidence now.

3 And if you could perhaps describe what you were asked to
4 do.

5 A. Yes. I was asked to look at the opinion filed by Ms.
6 McShane and comment on the recommended capital structure
7 of 25 to 30 percent as the target that she recommends.
8 And the interim goal of the 1.25 interest coverage ratio
9 for DISCO.

10 Q.7 - Okay. And could you give an overview of your evidence
11 to the Board?

12 A. Yes. I would say at the moment there is no sign that de
13 facto DISCO is operating as a private regulated
14 distribution utility. Whereas that may be the low end
15 goal of the Province, at the moment it doesn't demonstrate
16 any of the characteristics that I would associate with a
17 privately regulated distribution utility.

18 If it were operated as a private distribution utility, I
19 would regard Ms. McShane's interim and low end targets as
20 being reasonable, if not marginally on the low side. But
21 from my review of documents in terms of the operation of
22 DISCO, I can't see it at the moment as being anything
23 other than a crown corporation, where ultimately the
24 authority for its rates is determined in cabinet. And as
25 such, and as long as it continues to operate as a crown

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corporation with a Provincial guarantee, any target such as an interest coverage ratio of 1.75 or 25 to 30 percent retained earnings are essentially totally irrelevant. Because as a Provincially guaranteed crown corporation, the interest coverage ratio is essentially meaningless. Because the debt raised by -- on behalf of DISCO is basically supported by the full faith in credit of the Province of New Brunswick. In that sense, any equity that is built up on the balance sheets for retained earnings is totally irrelevant to the financial parameters of DISCO. As I mention in my report, this is very similar to US corporations operating in Canada under a guarantee from their US parents in which case the cost of the funds that are raised in the financial parameters operating in Canada are totally irrelevant to their operations. So until I see evidence that the Province actually is treating DISCO as a privately run distribution utility, I would see no need to allow DISCO anything other than a fair return on its existing retained earnings and on the debt that has been raised on its behalf. To see any changes I would look to an absence of intervention by the Province in the operations of DISCO or the rulings of this Board. I would look to see Electric Finance specifically refinance DISCO's financial

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operations in the same way as it has done for Transmission,
and I would see that DISCO's actually operating as a stand
alone entity whereas at the correct point in time, as I
mentioned in my report, is joined at the hip with
generating facilities within this province. And it
appears that that's going to continue to be the case for
many, many, many, many years into the future.

So at this point I see no reason to depart from existing
Board rulings in terms of interest coverage ratios or
existing practice for the distribution utility.

Q.8 - Thank you, Dr. Booth. Dr. Booth, in the transcript of
Ms. McShane's evidence at page 1613, she speaks of a
misunderstanding which is central to her report. Have you
had an opportunity to review this section?

A. I have.

Q.9 - And do you have any comments on this?

A. I am not quite sure why she says this, I misunderstood or
misinterpreted her remarks. It's quite clear in her
report that the first thing she starts out with on page 2
and 3 of her report, and as she says -- she starts at the
bottom of page 2 -- she starts out, if DISCO was to
ultimately access the debt market (inaudible) and then it
proceeds to the next paragraph onto the next page --
discussing what would be reasonable parameters for a

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privately regulated stand-alone completely independent distribution utility. And then she draws on the information in schedules 1, 2 and 3 of her report.

All I said in my opening remarks is that those targets that she -- the targets that she is using at the moment would be very conservative compared to the information contained in her appendix, and that she is using privately regulated utilities as part of the information on which she draws her opinion. So I don't think there is any misinterpretation in my comments there.

Q.10 - Does anything that she says change your opinion of the appropriately retained earnings of DISCO and its interest coverage ratio?

A. No, nothing at all. I will just reiterate that equity is a risk bearing security. That's the whole point of equity. It bears the risk of prior fixed charges on the corporation. So for privately regulated companies we need an equity cushion to absorb all the risk of the business operations of the corporation. Within a crown corporation that equity (inaudible) is totally meaningless, because the equity in a crown corporation lies with the taxing power of the Provincial government that eventually supports the operations of NB Power Corporation. So the level of the interest coverage

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2 ratio and the level of the retained earnings is irrelevant
3 until something substantial happens in the distribution
4 utility.

5 Q.11 - Okay. Dr. Booth, just so we are clear, what do you
6 propose as retained earnings and interest costs -- or
7 interest coverage ratio for DISCO?

8 A. I would recommend that the Board continue with its
9 existing practice. I can see no reason for any changes.
10 An interest coverage ratio of 1 would essentially -- it
11 just covers the interest that is being charged on DISCO's
12 operation is sufficient. There is a question of the
13 build-up of retained earnings that has already occurred,
14 but that is relatively low. I would suggest that that
15 also be charged at the borrowing cost of the Province,
16 because that equity is not equity in any substantive
17 sense. It is simply payments made by the people of New
18 Brunswick for electricity in excess of the cost of
19 providing that service.

20 MR. THERIAULT: Thank you, Dr. Booth. Mr. Chairman, that's
21 all the questions I have. Dr. Booth is available for
22 cross examination.

23 CHAIRMAN: Thank you, Mr. Theriault. Mr. Lawson, any
24 questions?

25 MR. LAWSON: No, Mr. Chairman.

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CHAIRMAN: Mr. Wolfe, any questions?

MR. WOLFE: No, Mr. Chairman.

CHAIRMAN: Mr. Zed, any questions?

MR. ZED: None, sir.

CHAIRMAN: Mr. Peacock, any cross examination? We have lost Mr. Peacock. He must have left. Mr. Keyes?

CROSS EXAMINATION BY MR. KEYES:

MR. KEYES: Thank you, Mr. Chairman. Dr. Booth, can you answer this question for me. Are you aware of any regulator in Canada who has ruled that a crown owned electric utility does not need to have any retained earnings?

DR. BOOTH: I'm not aware of any rulings on the part of crown corporations. I am aware of --

Q.12 - That was my question, Doctor. If you are aware of any regulators in Canada that have ruled in a proceeding such as this that a crown owned electric utility does not need to have any retained earnings.

A. No. I'm aware that the rulings of the regulators have persistently been overruled by cabinet.

Q.13 - That's fine. The next question I have for you, are you aware of any regulator in Canada who has ruled that an appropriate interest coverage ratio for a crown owned electric utility is 1 times?

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2 A. That's the same question, Mr. Keyes, and the answer would
3 be the same.

4 MR. KEYES: Thank you very much. Those are my questions.

5 CHAIRMAN: Thank you, Mr. Keyes. Ms. Desmond?

6 MR. DESMOND: No questions, Mr. Chair.

7 CHAIRMAN: Any questions from the Board? Any redirect?

8 MR. THERIAULT: No redirect.

9 CHAIRMAN: Dr. Booth, I think that concludes your testimony.

10 I'm sorry that you had difficulty attempting to travel
11 here, but in any event, I guess we did end up getting your
12 evidence by telephone today. So thank you for your
13 participation in this proceeding.

14 DR. BOOTH: Thank you. And I appreciate the indulgence of
15 the Board in allowing me to testify through a conference
16 call.

17 CHAIRMAN: Thank you. Mr. Theriault, then are you ready to
18 call your next witness?

19 MR. THERIAULT: Yes, I am. I would like to call Kurt
20 Strunk.

21 CHAIRMAN: And I will ask Board counsel to come forward and
22 swear or affirm this witness.

23 KURT STRUNK, sworn:

24 DIRECT EXAMINATION BY MR. THERIAULT:

25 Q.1 - Good morning. Would you please state your name and

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2 occupation for the record?

3 A. My name is Kurt Strunk. I am a consulting economist with
4 National Economic Research Associates.

5 Q.2 - And Mr. Strunk, perhaps we could refresh the Board's
6 memory, if you could review your academic and professional
7 qualifications?

8 A. Sure. I have an undergraduate degree in economics from
9 Vassar College. And an MBA from INSEAD in France. I have
10 been working in the energy sector since the mid-1990s.
11 And I have worked on a number of projects that deal with
12 electric sector restructuring, power purchase contracts,
13 contracting in general by utilities, the prudence of
14 purchase power contracts and management of purchase power
15 contracts.

16 Q.3 - Mr. Strunk, perhaps I could just get you to back away
17 from the microphone just a bit and that way we don't get
18 the popping sound.

19 Now are you the same individual who testified here before
20 this Board with respect to generation costs?

21 A. In June?

22 Q.4 - Yes.

23 A. Yes.

24 Q.5 - And since that time what has your work been involved in?

25 A. Mostly I have been working on the development of a

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2 power purchase contract in Spain and the option of that power
3 purchase contract to competitive suppliers to serve the
4 distribution company's load -- the Spanish distribution
5 company's load. And we have been working on getting an
6 option that allows small generators and small -- and new
7 entrants to compete with the incumbents to serve the load
8 of the distribution companies.

9 Q.6 - And Mr. Strunk, attached to your November 5th 2007
10 report is a copy of your professional qualifications?

11 A. That's correct.

12 MR. THERIAULT: Mr. Chairman, at this time I would ask that
13 Mr. Strunk be declared an expert to give opinion evidence
14 on utility economics with specialization in the
15 examination, review and comment on power purchase
16 agreements?

17 CHAIRMAN: Any questions or comments from any of the
18 intervenors with respect to him being qualified as an
19 expert witness from the Applicant?

20 MR. MORRISON: No, Mr. Chairman.

21 CHAIRMAN: I am not sure I got all of that, but Mr. Strunk
22 will be qualified as an expert witness to give opinion
23 evidence in utility economics. What was the rest of it?

24 MR. THERIAULT: With the specialization in the examination,
25 review and comment on power purchase agreements, which is

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2 identical to what he was qualified at before before this
3 Board.

4 CHAIRMAN: He is so qualified.

5 MR. THERIAULT: Thank you.

6 Q.7 - Now, Mr. Strunk, you filed two reports in this matter,
7 one dated November 5th 2007 and one dated December 7th
8 2007?

9 A. That's correct.

10 Q.8 - And I would like to deal right now first with the
11 November 5th report?

12 A. Okay.

13 MR. THERIAULT: Yes. That does bring up a good point, the
14 December 7th report, Mr. Chairman, I spoke to Ms. Légère
15 yesterday. It has been put out, but I don't think the
16 exhibit list has been circulated yet for Mr. Strunk's
17 December 7th report. So I don't know if it's been marked
18 as an exhibit?

19 CHAIRMAN: Yes, that appears to have been marked as PI-5.

20 MR. THERIAULT: And if I may, because I don't have my
21 exhibit list, the first report would have been PI-3.

22 CHAIRMAN: PI-3.

23 MR. THERIAULT: So I guess those will be the two reports,
24 Mr. Chairman, that we are going to refer to this morning.

25 Q.9 - And Mr. Strunk, I would like to deal with the November

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2 5th report, which is an exhibit as PI-3. First of all, with
3 respect to this report, could you just overview to the
4 Board, the general thrust of this report?

5 A. Sure. I also do have one correction to that report and
6 one correction to the December 7th report.

7 Q.10 - Perhaps we could deal with the corrections then before
8 we get into that and you could identify those corrections?

9 A. On page 7 of the November 5th report under paragraph
10 number 6, it had read, "DISCO has not provided any
11 evidence to demonstrate that the underlying PPA prices are
12 reasonable." That should read, "DISCO has not provided
13 sufficient evidence to demonstrate that the underlying PPA
14 prices are reasonable."

15 And then in the second to last sentence instead of no
16 evidence has been put forth, it should be insufficient
17 evidence has been put forth.

18 Q.11 - And with respect to the second report, we might as well
19 deal with that, the December 7th report, is there any
20 corrections?

21 A. Yes, there is one correction.

22 Q.12 - And that would be exhibit number 5, PI-5?

23 A. Yes. On pages page 12 and 13 of that report, on the
24 bottom of page 12 on the last line, if in fact Belledune
25 could have been operated without the upgrade except using

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oil. Oil should be changed to a lower percentage of petcoke.

So strike oil, strike instead, and add a lower percentage.

Q.13 - Okay. Now do either one of those -- do any of those changes change the conclusions that you formulated in your report?

A. No, they do not.

Q.14 - Okay. So if we could go back to PI exhibit number 3, which is the November 5th report, I think I had asked you if you could explain to the Board the overall thrust of your evidence?

A. Yes. The Board has an obligation to approve rates that are just and reasonable. In order for DISCO's rates to be just and reasonable, the costs that make up DISCO's revenue requirement must be reasonable costs and they must be prudently incurred.

The largest cost making up DISCO's revenue requirement are the purchased power costs which come in the form of the PPA costs. Therefore it is very important for the Board to be assured that the PPA costs are reasonable and prudent before they are charged on to the consumers of New Brunswick.

In order for the PPA costs to be prudent we need to analyze DISCO's administration of the PPAs. Was DISCO's

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2 management efficient and reasonable in the administration of
3 the PPAs? And given that the PPAs are affiliate
4 contracts, we need to answer the question of whether DISCO
5 has favoured its affiliates through its management of the
6 PPAs and whether that preferential treatment has resulted
7 in excessive costs being charged on to the ratepayers.

8 Q.15 - Okay. Now in your November 5th report, exhibit PI-3,
9 you examined six areas. Could you briefly for the Board
10 give an overview of the fuel and foreign exchange hedging
11 by Genco and its impact on rates?

12 A. Yes. I examined six areas where I looked at the prudence
13 of DISCO's management of PPAs, and one of those areas is
14 fuel and foreign hedging -- foreign exchange hedging.
15 DISCO's proposed revenue requirement includes a charge of
16 48.9 million to compensate Genco for losses on derivatives
17 that Genco entered into. There is no basis for that
18 charge in the vesting agreement. And that appears to be
19 an excess cost over and above the charges that are
20 reasonably due under the vesting agreement.

21 Q.16 - Okay. And again, if you could briefly give an overview
22 of your conclusions with respect to the NUG contracts?

23 A. Yes. DISCO has an oversight responsibility to making sure
24 that all of its purchased power contracts -- all of

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2 its purchased power costs are reasonable and that there can be
3 no -- there are no additional savings that could be had
4 through renegotiation of those contracts.

5 In some cases DISCO has its own NUG contracts, in some
6 cases DISCO would be overseeing the NUG contracts that
7 Genco has, but in either case DISCO has a responsibility
8 to make sure that there are no renegotiation opportunities
9 that could be taken advantage of to reduce costs to its
10 customers.

11 And it's my experience that in this industry there have
12 been a number of contracts that -- with non-utility
13 generators that have been renegotiated and have been
14 changed from being must take to being dispatchable. And
15 that has created savings for both the buyer and seller
16 which has been split between the buyer and seller in the
17 renegotiation. And to the extent that there are
18 renegotiation opportunities, it's my opinion that DISCO
19 should pursue those.

20 Q.17 - And have you been able to do any analyzation with
21 respect to a monetary amount as it relates to the NUG
22 contracts?

23 A. I did make an estimate for -- based on a PPA, and I made
24 an order of magnitude estimate. And for the period of
25 2005/2006 I estimated that that -- the potential

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savings could be in the order of 11,000,000.

Q.18 - And again, Mr. Strunk, with respect to the PDVSA

settlement and its impact on rates, if you could give the Board an overview briefly of your conclusions?

A. Sure. With respect to the report that I filed in November, I addressed the PDVSA settlement based on the PPAs that were filed by DISCO in April. And in those PPAs DISCO has a contractual right to the cash proceeds from the settlement. DISCO's proposed treatment which gives those cash proceeds to its affiliates is inconsistent with the terms of the vesting agreement. No prudent manager would ignore its contractual rights and give up these significant proceeds.

Further, the documentation that DISCO has provided suggests that DISCO may have overvalued the in kind portion of the settlement.

Q.19 - Now your section with respect to alternatives of the vesting agreement, again if you could briefly describe that for the Board?

A. The vesting agreement includes an option for DISCO to reduce quantities. And to ensure that DISCO's customers are not harmed by the PPAs in DISCO's PPAs with its affiliates, DISCO must demonstrate that it cannot purchase from a non-affiliated seller at a lower cost than the cost

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2 of the PPAs. And based on the evidence that I have reviewed,
3 DISCO has not shown that the PPAs are in fact its least
4 cost option.

5 Q.20 - And with respect to DISCO's negotiations of the PPAs,
6 could you briefly give your conclusions to the Board?

7 A. Sure. With respect to the application of the prudent
8 standard, it's generally accepted that a utility should
9 not be excused from hard-nosed bargaining with its
10 suppliers with respect to purchased power costs. So we
11 would expect to see aggressive defence of customers'
12 rights under the PPAs. And the evidence that DISCO has
13 put forth does not demonstrate that DISCO was aggressive
14 in defending the rights -- the contractual rights of its
15 customers and assuring that its purchased power costs were
16 minimized.

17 Q.21 - Okay. And finally with respect to the reasonableness
18 of the PPA costs, could you give your -- briefly give your
19 conclusions?

20 A. The PPA prices must be -- the prices in the PPAs between
21 DISCO and its generation affiliates must be just and
22 reasonable in order for the end use tariff to customers to
23 be just and reasonable. And as I put forth the evidence
24 in June, that could be demonstrated through being a cost
25 based contract or being subject to a market

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2 test. And the evidence that DISCO has put forth in this
3 respect is not sufficient to make a determination that the
4 contract prices themselves are just and reasonable.

5 Q.22 - Mr. Strunk, I would like to turn now to your December
6 7th evidence, which is exhibit PI number 5. And what was
7 the purpose of this report?

8 A. The purpose of this report was to look at the specific
9 amendments made by DISCO to the PPAs. Those amendments
10 was the act -- was DISCO's management prudent in executing
11 those amendments and looking at the question of whether
12 the amendments favoured DISCO's affiliates at the expense
13 of DISCO's customers.

14 Q.23 - And, Mr. Strunk, could you give the Board an overview
15 of the effect of these amendments as it relates firstly to
16 affiliate preferences?

17 A. Sure. I identified two areas where the change in
18 treatment appears to favour DISCO's affiliates at the
19 expense of DISCO's customers. Those two areas are the
20 financial hedges and the PDVSA settlement. DISCO has
21 retroactively changed the vesting agreement to apply
22 financial hedge costs and DISCO has changed the terms of
23 the PDVSA settlement treatment in the vesting agreement.
24 These two changes appear to favour DISCO's affiliates and
25 are not changes that a prudent manager would accept.

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There is another change which is the change to Belledune, the treatment of the capital costs of the Belledune upgrade. And while that is not in itself imprudent, what I would expect to see from DISCO with respect to Belledune was resistance to paying the charges and some effort to get the charges covered under section 7 of the vesting agreement, but the evidence as put forth looks as if DISCO accepted those costs without resistance, without a fight on behalf of its customers.

Q.24 - So with respect to the amendments, is it your opinion that the prudent standards should apply?

A. Yes. Yes, they should apply.

Q.25 - Now, Mr. Strunk, in your experience are such amendments unusual in that they retroactively apply?

A. I would say it's not uncommon to retroactively apply an amendment, yes. It's not unheard of, but it's not common.

MR. THERIAULT: Mr. Chairman, that's all the questions I have and Mr. Strunk is available for cross examination.

CHAIRMAN: Thank you, Mr. Theriault. Mr. Lawson?

MR. LAWSON: No questions, Mr. Chairman. Thank you.

CHAIRMAN: Thank you. Mr. Wolfe?

MR. WOLFE: No questions, Mr. Chairman.

CHAIRMAN: Mr. Zed?

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2 MR. ZED: We do not have any questions.

3 CHAIRMAN: Is Mr. Peacock in the room? Guess not. Mr.

4 Morrison?

5 MR. MORRISON: Yes, I do have some questions. Mr. Chairman,

6 I am wondering if I could have a couple of minutes, five

7 minutes before I start?

8 CHAIRMAN: And perhaps maybe the crowd will settle down next

9 door, too. It might be easier to hear.

10 MR. MORRISON: I understand there is an announcement about a

11 new justice building, Mr. Chairman. So I can understand

12 why everybody is excited.

13 CHAIRMAN: Exactly. We will take a short break.

14 (Recess - 10:25 a.m. to 10:35 a.m.)

15 CHAIRMAN: All right. Mr. Morrison, are you ready?

16 MR. MORRISON: Yes, Mr. Chairman. Thank you.

17 CROSS EXAMINATION BY MR. MORRISON:

18 CHAIRMAN: Mr. Chairman, I was -- to keep everybody from

19 pulling out binder after binder, I have made copies of

20 extracts from the binders with the exhibit number. I just

21 think it would be easier and I will give a copy to Mr.

22 Theriault and the witness and of course the Board.

23 CHAIRMAN: That would probably make things go much smoother.

24 Thanks you.

25 MR. MORRISON: A little easier on the neck, I find, and the

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2 shoulders.

3 Q.26 - Good morning, Mr. Strunk.

4 A. Good morning.

5 Q.27 - I am glad you could make it.

6 A. Thank you.

7 Q.28 - I am just going to start my questioning with something
8 that you said in your direct examination in response to
9 questions from Mr. Theriault and it deals with the
10 dispatch of the NUGs I think you referred to in your
11 report?

12 A. Right.

13 Q.29 - And you did a calculation -- and you don't have to turn
14 it up, but I think you arrived at a number of potential
15 savings of approximately \$11 million if the NUGs could be
16 dispatched rather than modelled as must take, is that
17 correct?

18 A. Yes, that was with respect to the Bayside PPA --

19 Q.30 - Correct.

20 A. -- with respect to 2005/2006. If you were to take all the
21 NUGs and a different time period, you would probably get a
22 different number.

23 Q.31 - But I think I may have misspoke. Your \$11 million
24 related specifically to Bayside, I believe. Is that
25 correct?

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2 A. That's correct.

3 Q.32 - And I think you just mentioned that the calculations
4 that you did were based on data from 2005 and 2006, is
5 that right?

6 A. Right.

7 Q.33 - And is it fair to say that it is your position that
8 DISCO ought to be attempting to renegotiate the NUGs to
9 make them dispatchable, is that fair?

10 A. I think I would refine that position. In my own words, I
11 would say my position -- my opinion is that DISCO has an
12 oversight responsibility in its oversight of all purchased
13 power costs, which include NUGs, some of which belong to
14 Genco.

15 Q.34 - But I believe --

16 A. And so if there are renegotiation opportunities either for
17 DISCO or for Genco, DISCO in its oversight responsibility
18 in my opinion should encourage the pursuit of those
19 opportunities.

20 Q.35 - So that \$11 million savings on Bayside could only
21 result if DISCO were able to renegotiate that particular
22 NUG with the owners of that NUG, is that fair?

23 A. DISCO or Genco.

24 Q.36 - Okay. And in order to get a renegotiation you have to
25 have two willing parties, you would agree with that?

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2 A. Right.

3 Q.37 - The owners of Bayside would have to agree to any change
4 in the terms of that contract, wouldn't they?

5 A. That's correct.

6 Q.38 - And the \$11 million that you calculated and I
7 understand from your report and perhaps from response to
8 IRs and you don't have to turn them up, is it fair to say
9 that the model that you used was a fairly simplistic
10 calculation?

11 A. Yes, it was a simplistic calculation designed to get an
12 order of magnitude.

13 Q.39 - Correct. And you would agree that any redispach of
14 Bayside would have an impact on the export benefit margin,
15 wouldn't it? Either plus or minus, it would have an
16 impact on --

17 A. It could indirectly, yes.

18 Q.40 - And your estimate of \$11 million doesn't take into
19 account -- you did no analysis as to what that impact
20 might be, is that correct?

21 A. No, I didn't estimate any knock on effects of the on
22 export sales.

23 Q.41 - I would like to turn now, Mr. Strunk, if you could turn
24 to your November 5th report, which I believe is PI-3. Do
25 you have that in front of you now?

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2 A. Yes, I do.

3 Q.42 - I'm looking specifically at pages 8 and 9 dealing with
4 your comments with respect to hedging. Is it fair to say
5 that you conclude that schedule 6.2 of the original
6 vesting agreement prohibits the pass-through of hedging
7 costs from Genco to DISCO subject to one limited
8 exception, is that fair?

9 A. Yes, being the exception that all financial hedges
10 transacted prior to October 1st 2004 would be taken into
11 account.

12 Q.43 - So it's your view that schedule 6.2 is exclusionary but
13 for pre-restructuring hedges?

14 A. It has a specific provision which allows for the flow-
15 through of pre-restructuring hedges which suggests that
16 post-restructuring hedges would not be allowed.

17 Q.44 - I would ask you to -- unfortunately you are going to
18 have to grab one binder, which is exhibit A-3, and it
19 would be the original vesting agreement, Mr. Strunk. You
20 may have that separate.

21 A. Yes, I have it.

22 Q.45 - I know it's a little difficult to navigate, but it
23 starts after the second green page.

24 CHAIRMAN: Is it the vesting agreement that --

25 MR. MORRISON: The original vesting agreement, yes. And if

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2 you flip right to the back and then turn in approximately ten
3 pages, you will find schedule 6.2. It's exhibit A-3,
4 appendix A, after the second green page, you will find the
5 vesting agreement -- sorry -- third green page. There you
6 go. If you could turn right to the end of that agreement
7 and then back up ten pages, you will find schedule 6.2.
8 Unfortunately it does not have a page number.

9 Mr. Strunk, I believe it's fair to say that you are
10 relying on schedule 6.2, subparagraph 7, is that correct?

11 A. That's correct.

12 Q.46 - And is there any language in subparagraph 7 that
13 specifically excludes hedges that were entered into after
14 October 1st 2004?

15 A. No. But if the intent and the letter of agreement was to
16 include those hedges, I believe it would have said
17 something different. I think it would have said all
18 financial hedges entered into will be included in the
19 calculation of -- it didn't. It specifically said all
20 financial hedges entered into prior to the date of this
21 agreement. So I think I read that to exclude.

22 Q.47 - And that's the basis of your opinion on that particular
23 point?

24 A. That's correct.

25 Q.48 - And is it fair to say that that's your interpretation?

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2 It's based on your interpretation of that section, correct?

3 A. It's based on my read of the contract as an economist

4 having worked with many contracts that look like this.

5 Q.49 - And I don't mean to be flip, Mr. Strunk, but you are

6 not a lawyer, are you?

7 A. No, I'm not a lawyer.

8 Q.50 - I would like -- and I ask everyone to keep A-3 handy

9 because we are going to be going back to it again. If I

10 could refer again to page 8 of your November report, Mr.

11 Strunk, and particularly in the last paragraph of page 8,

12 you say, "It is logical that the vesting agreement would

13 prohibit the pass-through of hedges that are under Genco's

14 control, not DISCO's control", you see that?

15 A. That's correct.

16 Q.51 - And I want to explore with you a little bit about this

17 notion of Genco's control. First in the package I gave

18 you I would ask you to refer to --

19 A. I didn't get a package, sir.

20 Q.52 - Sorry. The first item in the package should be exhibit

21 A-2(1) section 1, page 7, do you see that marked at the

22 top?

23 A. Right.

24 Q.53 - Now referring to the first full paragraph in that -- in

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2 DISCO's direct evidence.

3 A. Right.

4 Q.54 - It says: DISCO engages in world commodity markets for
5 heavy fuel oil and natural gas through its financial risk
6 management program. In this program Genco, acting as
7 DISCO's agent for fuel purchasing, enters into forward
8 fuel purchase contracts, et cetera, et cetera.

9 So would you agree that as far as hedging is concerned
10 Genco is acting as the agent of DISCO?

11 A. That may be the case, but the contract still doesn't
12 provide for those costs to be flowed through to customers.

13 Q.55 - And if you can turn to the second item I referred you
14 to which is exhibit A-21, appendix 10. And you would
15 agree that that's a simple -- it's simply a copy of the
16 forward purchase policy, the hedging policy?

17 A. Yes.

18 Q.56 - And if you look down at the -- near the bottom of the
19 page it says reference, it says policy will be managed by
20 the financial risk oversight committee, you see that?

21 A. Yes.

22 Q.57 - Now I would refer you to the next item which is exhibit
23 A-27. It's response to PI IR-39. That was an
24 interrogatory where Mr. Theriault asked for the names and
25 positions and which company was represented on several

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2 committees including the financial risk oversight committee,
3 do you see that?

4 A. Yes. On the second page.

5 Q.58 - And if you turn the page you will see what the
6 membership is of the financial risk oversight committee?

7 A. Yes.

8 Q.59 - And you will see that Sharon MacFarlane, who is Vice
9 President Finance and Chief Financial Officer for DISCO
10 was on that committee, Darren Murphy who is the Vice
11 President of DISCO was on that committee, and Blair
12 Kennedy, the Director of energy supply and contract
13 management is on that committee as well. Do you see that?

14 A. Yes.

15 Q.60 - And if you look down under number E where it says the
16 composition of the financial risk operating committee, you
17 will see that Mr. Kennedy, who is from DISCO, is also a
18 member of that committee as well, you see that?

19 A. I see all those names, yes.

20 Q.61 - Yes. Would you agree based on the evidence I have just
21 directed you to, Mr. Strunk, that DISCO has significant
22 representation on the oversight committee and the
23 operating committee?

24 A. Yes.

25 Q.62 - And we have already determined of course the financial

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2 risk oversight committee is charged with managing the fuel
3 hedging program?

4 A. Yes.

5 Q.63 - Based on that -- oh I want to refer you to another IR
6 actually, which is the next one, which is exhibit A-23,
7 and it's CME IR-33. Do you have that?

8 A. It's in your packet, yes. I have it.

9 Q.64 - And that was a question from Mr. Lawson. And he asked
10 does DISCO have any input into Genco's fuel hedging
11 program. And the answer is, you will see in B, DISCO has
12 representation along with Genco and Holdco in the
13 financial risk oversight committee. DISCO participates in
14 the hedging program as this activity removes fuel price
15 uncertainty and as such ensures that prices to be paid for
16 fuel are known when establishing the revenue requirements
17 for the test year. Do you see that?

18 A. Yes.

19 Q.65 - In light of all of this evidence, is it still your
20 position that the fuel hedging program is under Genco's
21 control?

22 A. Genco is the entity that is legally entering into those
23 contracts. Those contracts do not specify that Genco is
24 entering into the contracts as an agent for DISCO. Genco
25 is the only counterparty entering into those

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2 contracts.

3 Q.66 - But the evidence is clear, I would suggest to you, Mr.

4 Strunk, that Genco doesn't do this in a vacuum and in fact

5 is acting as the agent of DISCO in this regard.

6 A. That may be the case but that is not stated in the

7 contract and legally Genco is the only counterparty to

8 those contracts, and I also don't think it's relevant with

9 respect to recovering under the vesting agreement.

10 Q.67 - Well there is an old saying, Mr. Chairman, you can lead

11 a horse to water but you can't make him drink. But can I

12 at least get you to admit, Mr. Strunk, that you would

13 agree that Genco -- that DISCO has at least a say in how

14 the hedging is done and must concur in the hedging?

15 A. The evidence certainly demonstrates that, yes.

16 Q.68 - I want to turn now to page 9 of your November report.

17 And at page 9 you say that the costs should only go to

18 customers if DISCO has been prudent in authorizing the

19 hedge strategy and has verified the execution of the

20 strategy. Do you see that?

21 A. What line are you on?

22 Q.69 - Well the lines aren't numbered in my version, but it

23 would be over the last five lines before subheading (B).

24 A. Right.

25 Q.70 - And if you back up a few lines, you outline what I

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2 believe is your opinion on what would demonstrate prudence, is
3 that fair?

4 A. Right. For a strategy that had been approved by the
5 Board.

6 Q.71 - And assuming that was the case, there are basically
7 three points, which you say must be demonstrated to
8 demonstrate prudence and I will paraphrase. And the first
9 is that support for the reasonableness of its forecast
10 fuel need, do you agree with that?

11 A. Yes.

12 Q.72 - Support for the quantities transacted, you agree with
13 that?

14 A. Right.

15 Q.73 - And finally the reasonableness of the price paid in
16 each hedging transaction?

17 A. Right.

18 Q.74 - Going back to the first one, Mr. Strunk, which deals
19 with support for the reasonableness of the forecast fuel
20 need, you are aware, of course, that the forecasted fuel
21 comes out of PROMOD?

22 A. Yes.

23 Q.75 - And similarly support for the quantities transacted
24 that also is a product of PROMOD?

25 A. Yes.

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2 Q.76 - And the third item, which is the reasonableness of the
3 price paid in each hedging transaction. I gave you in your
4 package that I gave you as exhibit A-30, and it is PI IR-
5 56, do you see that?

6 A. I do.

7 Q.77 - And if you look at question 3, Mr. Theriault asked, how
8 does NB Power assure that it is achieving a reasonable
9 execution price for its financial hedges? Do you see
10 that?

11 A. Right.

12 Q.78 - And if you turn the page, you will see the answer to
13 that question. It is, NB Power assures that it is
14 achieving a reasonable execution price for its financial
15 hedges by requesting quotes for multiple counterparties?

16 A. Right.

17 Q.79 - Is that a reasonable approach in your view for
18 determining reasonableness of the price of the hedging
19 transaction?

20 A. That's one component. I think what I have seen in a
21 typical prudence review of a financial hedging execution
22 you tend to see additional factors such as each
23 transaction lined up with a market quote on the same day
24 that the transaction was executed for a similar or the
25 same product.

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So what you would typically see goes a little bit further, but I think it is also worth clarifying that it is not my opinion that the execution of these financial hedging transactions has been imprudent or that the strategy in and of itself is imprudent. What my opinion is is that the pass through of the costs under the vesting agreement is imprudent, because there is a clause that specifically suggests that those costs should not be flowed through. So I -- I actually do not have any doubts about the prudence of the strategy itself or the execution. It's what -- the issue comes down to the specific terms of the PPAs and whether those PPAs, which were imposed on DISCO by government, and as indeed prudent at the last rate case pursuant to the Electricity Act allow for the pass through of these costs. And the way I read the PPA is -- and I have read a lot of power contracts, is that they don't.

Q.80 - I was going to take you to a number of places in your report in exploring this very notion of whether you believe that the hedging policy itself was imprudent, but given your response, I don't need to go there.

Let me try to encapsulate if I can what I believe your position is and you will correct me if I am wrong. It isn't the hedging program itself that you have any

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specific problem with is it?

A. That's correct. I address specifically in my IR responses that the hedging program that DISCO has approved is one of a variety of reasonable options. There is another reasonable option which is in the vesting agreement, which is to just rely on the terms of the vesting agreement.

Q.81 - So the program itself, isn't necessarily unreasonable. Where I think you are coming from is that because it was known this year in the test year when the amendment was made that the hedge settlements were in a negative position as opposed to a positive position. That it wasn't prudent for DISCO to agree to have those hedges included in the revenue requirement for the test year, is that a fair summary of your position?

A. Yes. If I could restate it, it's the fact that DISCO -- if DISCO were operating as a stand alone entity on an arm's length basis with an independent supplier, DISCO would not retroactively amend the agreement to allow for a pass through of those costs. DISCO has no contractual obligation to pay those contract costs prior to the amendment that was executed in November. And I don't -- I certainly don't believe that if DISCO were operating as a stand alone entity in a prudent fashion

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2 looking out for the cost of its consumers it would have agreed
3 to apply those financial hedged losses on a retrospective
4 basis.

5 Q.82 - Well, I am sure we will have some debate as to what the
6 contractual obligations were. But let me put this
7 question to you, Mr. Strunk. Assume that for this year at
8 the time the amendment was made, it was known that the
9 inclusion of the hedges would result in a \$48 million gain
10 to DISCO, as opposed to the settlement worked out, be a
11 \$48 million loss, you would agree that that would be a
12 benefit to DISCO in that case, correct?

13 A. In the hypothetical that you have just led?

14 Q.83 - Right.

15 A. Yes.

16 Q.84 - And in your view, and if I follow your logic correctly,
17 that it then would have been prudent for DISCO to agree to
18 the amendment, is that fair?

19 A. I think it is uncommon for amendments to be retroactive.
20 I certainly state in my testimony that on a going forward
21 basis, it's prudent. If it had been a gain instead of a
22 loss, and I don't think Genco would have laid that on the
23 table as a potential amendment, but sure if Genco had
24 offered to give DISCO 48.9 million as a gain as opposed to
25 a loss --

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2 Q.85 - It would have been prudent for DISCO to accept it?

3 A. -- DISCO would have accepted it. Sure. A reasonable man
4 sure would of.

5 Q.86 - Indeed you were involved in the 2005-2006 rate case?

6 A. To some degree, yes.

7 Q.87 - Yes. You weren't questioned extensively at that time
8 as I recall but --

9 A. Right.

10 Q.88 - -- but you were involved in that rate case? And in
11 that test year, the 2005-2006 test year, indeed the
12 hedging settlement for that year was positive to the tune
13 of about \$25 million, do you recall that?

14 A. I wasn't privy to that data at that time, no.

15 Q.89 - But if the situation in 2005-06 was repeated in this
16 test year, in other words, it was a gain as opposed to a
17 loss, again your answer would be the same that it would be
18 DISCO -- it would be prudent for DISCO to agree to the
19 amendment and take the cash, right?

20 A. If Genco was going to put that on the table, sure.

21 Q.90 - Okay. And at page 9 you say that the costs should only
22 go to customers if DISCO has been prudent in authorizing
23 the hedge strategy and has verified the execution of the
24 strategy. Do you see that?

25 A. What line are you on?

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2 Q.91 - Well the lines aren't numbered in my version, but it
3 would be over the last five lines before subheading (B).

4 A. Right.

5 Q.92 - And if you back up a few lines, you outline what I
6 believe is your opinion on what would demonstrate
7 prudence, is that fair?

8 A. Right. For a strategy that had been approved by the
9 Board.

10 Q.93 - And assuming that was the case, there are basically
11 three points, which you say must be demonstrated to
12 demonstrate prudence and I will paraphrase. And the first
13 is that support for the reasonableness of its forecast
14 fuel need, do you agree with that?

15 A. Yes.

16 Q.94 - Support for the quantities transacted, you agree with
17 that?

18 A. Right.

19 Q.95 - And finally the reasonableness of the price paid in
20 each hedging transaction?

21 A. Right.

22 Q.96 - Going back to the first one, Mr. Strunk, which deals
23 with support for the reasonableness of the forecast fuel
24 need, you are aware, of course, that the forecasted fuel
25 comes out of PROMOD?

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2 A. Yes.

3 Q.97 - And similarly support for the quantities transacted

4 that also is a product of PROMOD?

5 A. Yes.

6 Q.98 - And the third item, which is the reasonableness of the

7 price paid in each hedging transaction. I gave you in your

8 package that I gave you as exhibit A-30, and it is PI IR-

9 56, do you see that?

10 A. I do.

11 Q.99 - And if you look at question 3, Mr. Theriault asked, how

12 does NB Power assure that it is achieving a reasonable

13 execution price for its financial hedges? Do you see

14 that?

15 A. Right.

16 Q.100 - And if you turn the page, you will see the answer to

17 that question. It is, NB Power assures that it is

18 achieving a reasonable execution price for its financial

19 hedges by requesting quotes for multiple counterparties?

20 A. Right.

21 Q.101 - Is that a reasonable approach in your view for

22 determining reasonableness of the price of the hedging

23 transaction?

24 A. That's one component. I think what I have seen in a

25 typical prudence review of a financial hedging execution

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you tend to see additional factors such as each transaction lined up with a market quote on the same day that the transaction was executed for a similar or the same product.

So what you would typically see goes a little bit further, but I think it is also worth clarifying that it is not my opinion that the execution of these financial hedging transactions has been imprudent or that the strategy in and of itself is imprudent. What my opinion is is that the pass through of the costs under the vesting agreement is imprudent, because there is a clause that specifically suggests that those costs should not be flowed through.

So I -- I actually do not have any doubts about the prudence of the strategy itself or the execution. It's what -- the issue comes down to the specific terms of the PPAs and whether those PPAs, which were imposed on DISCO by government, and as indeed prudent at the last rate case pursuant to the Electricity Act allow for the pass through of these costs. And the way I read the PPA is -- and I have read a lot of power contracts, is that they don't.

Q.102 - I was going to take you to a number of places in your report in exploring this very notion of whether you believe that the hedging policy itself was imprudent, but

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given your response, I don't need to go there.

Let me try to encapsulate if I can what I believe your position is and you will correct me if I am wrong. It isn't the hedging program itself that you have any specific problem with is it?

A. That's correct. I address specifically in my IR responses that the hedging program that DISCO has approved is one of a variety of reasonable options. There is another reasonable option which is in the vesting agreement, which is to just rely on the terms of the vesting agreement.

Q.103 - So the program itself, isn't necessarily unreasonable.

Where I think you are coming from is that because it was known this year in the test year when the amendment was made that the hedge settlements were in a negative position as opposed to a positive position. That it wasn't prudent for DISCO to agree to have those hedges included in the revenue requirement for the test year, is that a fair summary of your position?

A. Yes. If I could restate it, it's the fact that DISCO -- if DISCO were operating as a stand alone entity on an arm's length basis with an independent supplier, DISCO would not retroactively amend the agreement to allow for a pass through of those costs. DISCO has no

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2 contractual obligation to pay those contract costs prior to
3 the amendment that was executed in November. And I don't
4 -- I certainly don't believe that if DISCO were operating
5 as a stand alone entity in a prudent fashion looking out
6 for the cost of its consumers it would have agreed to
7 apply those financial hedged losses on a retrospective
8 basis.

9 Q.104 - Well, I am sure we will have some debate as to what
10 the contractual obligations were. But let me put this
11 question to you, Mr. Strunk. Assume that for this year at
12 the time the amendment was made, it was known that the
13 inclusion of the hedges would result in a \$48 million gain
14 to DISCO, as opposed to the settlement worked out, be a
15 \$48 million loss, you would agree that that would be a
16 benefit to DISCO in that case, correct?

17 A. In the hypothetical that you have just led?

18 Q.105 - Right.

19 A. Yes.

20 Q.106 - And in your view, and if I follow your logic
21 correctly, that it then would have been prudent for DISCO
22 to agree to the amendment, is that fair?

23 A. I think it is uncommon for amendments to be retroactive.
24 I certainly state in my testimony that on a going forward
25 basis, it's prudent. If it had been a gain

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2 instead of a loss, and I don't think Genco would have laid

3 that on the table as a potential amendment, but sure if

4 Genco had offered to give DISCO 48.9 million as a gain as

5 opposed to a loss --

6 Q.107 - It would have been prudent for DISCO to accept it?

7 A. -- DISCO would have accepted it. Sure. A reasonable man

8 sure would of.

9 Q.108 - Indeed you were involved in the 2005-2006 rate case?

10 A. To some degree, yes.

11 Q.109 - Yes. You weren't questioned extensively at that time

12 as I recall but --

13 A. Right.

14 Q.110 - -- but you were involved in that rate case? And in

15 that test year, the 2005-2006 test year, indeed the

16 hedging settlement for that year was positive to the tune

17 of about \$25 million, do you recall that?

18 A. I wasn't privy to that data at that time, no.

19 Q.111 - But if the situation in 2005-06 was repeated in this

20 test year, in other words, it was a gain as opposed to a

21 loss, again your answer would be the same that it would be

22 DISCO -- it would be prudent for DISCO to agree to the

23 amendment and take the cash, right?

24 A. If Genco was going to put that on the table, sure.

25 Q.112 - Okay. I am going to turn now to the Belledune water

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2 well upgrade. It seems to have generated a fair amount of
3 discussion in the course of these proceedings. And I want
4 you to turn to exhibit A-3 again, which is the vesting
5 agreement. Just have that handy. Mr. Strunk, I know you
6 have had a fair amount of experience with power purchase
7 agreements and so on, so you would be familiar with the
8 term good utility practice, correct?

9 A. Yes.

10 Q.113 - And if you turn to -- I believe it's page 13 of the
11 vesting agreement. It's section 1.1.70. It's the
12 definition of good utility practices?

13 A. Okay.

14 Q.114 - You see that? I'm not going to read the whole thing,
15 but would you agree with me that good utility practice
16 means practices, methods and activities adopted by a
17 significant portion of the North American utility industry
18 which exercise skill, diligence, prudence, foresight and
19 reasonable judgment by a prudent operator in light of the
20 facts known at the time that the decision was made could
21 have been an expected -- sorry -- could have been expected
22 to accomplish the desired result at a reasonable cost
23 consistent with good business practices, reliability,
24 safety, expedition in applicable law -- I'm glad I don't
25 take responsibility for drafting these things -- but

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2 that's essentially what it says, correct?

3 A. That's right.

4 Q.115 - You would agree, would you, Mr. Strunk, that it would
5 not be good utility practice for a generator to knowingly
6 burn a fuel that would damage its generator, damage its
7 plant, and shorten that plant's expected life, would you
8 agree with that?

9 A. Yes.

10 Q.116 - And if I can get you to turn to page 66 of the vesting
11 agreement -- I think the Board may need a water wall, Mr.
12 Chairman -- and I'm looking specifically at section 8.2,
13 Mr. Strunk, and it says, and I will again paraphrase this,
14 Genco shall operate, repair, maintain, rehabilitate the
15 Genco facilities in accordance with good utility
16 practices, you see that?

17 A. Yes.

18 Q.117 - So you would agree that Genco has an obligation to
19 operate using good utility practice, correct?

20 A. Yes, that section makes that clear.

21 Q.118 - And I want to refer to page 12 of your December
22 report. This is where you made the correction this
23 morning?

24 A. Right.

25 Q.119 - And actually I was quite perplexed reading it, how we

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2 were -- you were going to explain how you burn oil at

3 Belledune -- I was going to have a little fun with that.

4 A. Okay.

5 Q.120 - You are kind of ruining my day.

6 A. Sorry about that.

7 Q.121 - If I understand your correction this morning, would it

8 be fair if I can just read back this section as I think it

9 should read now with your correction?

10 A. Yes.

11 Q.122 - If in fact Belledune could be operated with the

12 upgrade excepting using lower petcoke, and if Genco is

13 entitled under the vesting agreement to switch Belledune

14 to lower percentage of petcoke and to charge DISCO for the

15 -- and I change higher to different fuel costs through the

16 energy charge?

17 A. I didn't change it.

18 Q.123 - Well is that fair, that's how it should now read,

19 other than my installation of higher?

20 A. Yes. I think you said with and it's still -- my original

21 text says without and that didn't change.

22 Q.124 - Okay. Let me try this again.

23 A. Okay.

24 Q.125 - If in fact Belledune could be operated without the

25 upgrade excepting using a lower percentage of petcoke, and

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2 if Genco was entitled under the vesting agreement to switch
3 Belledune to a lower percentage of petcoke and to charge
4 DISCO for the higher fuel costs through the energy charge,
5 is that how it should read now?

6 A. Yes.

7 Q.126 - Okay. And at page 7 of -- again with your December
8 report, it's right up in the first paragraph on page 7,
9 Mr. Strunk. That's where you are referring to when it's
10 appropriate to amend the PPA.

11 A. Right.

12 Q.127 - And you say, in addition the buyer may seek to amend a
13 PPA if it can better its position as a result of the
14 amendment. Do you see that?

15 A. Yes.

16 Q.128 - And you agree with that statement, don't you?

17 A. Yes.

18 Q.129 - I would like to turn now, Mr. Strunk, to the PDVSA
19 settlement.

20 A. Okay.

21 Q.130 - And I'm going to be switching back and forth between
22 your two reports. So keep them at hand.

23 And if you look at page 14 of your report, the question in
24 the middle of the page under the vesting agreement -- do
25 you see that -- and your answer is "Net

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2 proceeds from the settlement received by Genco or Holdco are
3 supposed to be paid to DISCO under section 4.3.4 of the
4 vesting agreement."

5 Do you see that?

6 A. Yes.

7 Q.131 - And again at page 10 -- and you don't have to turn
8 this up -- of your December report you say "The proceeds
9 in their entirety are to flow to DISCO."

10 Do you see that, "proceeds in their entirety"? It is on
11 the bottom of page 10.

12 A. That is right. And that was referring to the 115.3
13 million.

14 Q.132 - And it is your view that under section 4.3.4, all of
15 the proceeds of the PDVSA settlement are to flow to DISCO,
16 correct?

17 A. That was taken from the vesting agreement itself which
18 states that Genco shall pay DISCO all damages it receives
19 in connection therewith.

20 Q.133 - And again that is your interpretation of section
21 4.3.4?

22 A. The language is pretty straightforward. But yes.

23 Q.134 - Well, that is what I want to get to, Mr. Strunk.

24 Because you say that all the proceeds of the settlement
25 are to flow to DISCO.

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2 And when I read section 4.3.4 I don't see the word

3 "proceeds". In fact what I see is Genco shall pay DISCO

4 all damages it receives. Is that correct?

5 A. Right.

6 Q.135 - It doesn't use the word "proceeds", does it?

7 A. No.

8 Q.136 - And I appreciate that you are not a lawyer, Mr.

9 Strunk. But are you aware of any difference in the terms

10 "proceeds" and "damages"?

11 MR. THERIAULT: Mr. Chairman, he is getting into legal

12 argument here, when you decide what the legal definition

13 of "damages" are. And that will be addressed I'm sure by

14 my friend in closing.

15 MR. MORRISON: Mr. Chairman, Mr. Strunk is offering

16 interpretations of legal contracts. I'm asking a simple

17 question, if we are going to rely on his interpretation of

18 the contract, whether he is aware of a distinction between

19 the terms "proceeds" and "damages".

20 CHAIRMAN: I think it is a fair question.

21 A. Right. And I'm answering it as an economist who has

22 worked with contracts. And certainly there could be a

23 judicial decision that leads to damages.

24 Or there could be a settlement that leads to a payment of

25 what would be consideration of compensation for what

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would have happened through the judicial proceeding.

So I did not make a distinction between those two words for the purposes of my evidence.

Q.137 - And that is fair enough.

You did mention this morning, and I believe it may have arisen as a result of an interrogatory request by us. You said this morning that you came to the view that the settlement benefits were overstated?

A. Yes.

Q.138 - And I just want to take you there for a moment, Mr.

Strunk. It is my understanding that your conclusion that they were overstated is because the in kind portion, the fuel supply portion of the contract did not have a collateral guarantee. Is that fair?

A. Can I clarify? I would also like to refer back to the specific language of the report.

Q.139 - Certainly. Can you just tell me where it is?

A. Yes. I will take a second to find it. My recollection this morning was that it may be overstated. And I have a number of reasons why I believe it may be overstated. And certainly there is some default with risk with PDVSA.

Q.140 - Before we go too deeply in that -- and that is why I'm cautioning you a little bit. Because there is some

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2 confidentiality issues around some aspects of this.

3 The point I'm trying to get to, Mr. Strunk, quite frankly,
4 is you haven't been able to quantify, at least from the
5 responses to our undertakings, what that possible
6 overstatement of the value is, have you?

7 A. With respect to PDVSA default risk now, I think there is
8 a pretty easy calculation with respect to some of the
9 other aspects.

10 Q.141 - That was the issue I was getting at.

11 A. Okay.

12 Q.142 - I'm going to turn now to page 17 of your November
13 report.

14 MR. MORRISON: And Mr. Chairman, just so everyone knows, I
15 only have two fairly brief lines of questions. So this
16 shouldn't endure too much longer.

17 CHAIRMAN: Well, take whatever time you need.

18 Q.143 - At page 17 you are basically discussing the notion
19 that DISCO should investigate alternative sources of
20 power, correct?

21 A. Yes.

22 Q.144 - And you say sort of near the bottom of the page that
23 section 2.4 allows DISCO to reduce quantities taken under
24 the agreement, correct?

25 A. That is the text of the report, yes.

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2 Q.145 - Now I'm going to ask you to turn to section 2.4.2 of
3 the vesting agreement. And that is at page 29. That is
4 in exhibit A-3 again.

5 Do you have that in front of you?

6 A. Yes.

7 Q.146 - And that section says, "Notwithstanding section 2.4.1,
8 DISCO may not reduce the nominated capacity solely because
9 it has entered into an alternative arrangement."

10 And I can take you to the definition of alternative
11 arrangement, if you wish. But it basically is a contract
12 with a party that is not Genco for the supply of energy.

13 Do you see that?

14 A. Yes.

15 Q.147 - So this right for DISCO to reduce its nomination is
16 not an absolute right, is it, Mr. Strunk?

17 A. 2.4.2 appears to put some limitations on that.

18 Q.148 - In fact, if you look further in 2.4.2 the only time
19 that DISCO can reduce its nomination is with respect to
20 section 1.4.2 of the Electricity Act.

21 Do you see that?

22 A. That is not the way I read the section as the whole in
23 the context of the White Paper and in the context of the
24 transition to competition in a New Brunswick market. But
25 the language here is pretty complicated. I think that

2 there is -- there would be some --

3 Q.149 - Interpretation of both?

4 A. -- interpretation as well.

5 Q.150 - Do you understand, Mr. Strunk, what happens when DISCO

6 reduces its nomination, that -- I'm paraphrasing here --

7 that if DISCO decides -- for example, if DISCO could

8 reduced its nomination, that it basically loses a vertical

9 slice of all the generation, it loses a piece of

10 everything of the heritage assets?

11 Is that your understanding? Or do you have any

12 understanding of how the reduction in nomination works?

13 A. Could you point me to a place in the vesting agreement

14 Q.151 - Well, I can refer you to section 2.4.1 again. And if

15 you look at the bottom of page 28, going onto the top of

16 page 29.

17 Upon any such reduction of the nominated capacity, the

18 available peaking capacity shall also be reduced by the

19 percentage that the amount of the reduction in the

20 nominated capacity represents of the aggregate of the

21 nominated capacity power reduction, peaking capacity and

22 so on.

23 Do you see that?

24 A. Right.

25 Q.152 - So it is proportional -- if there is a reduction in

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2 capacity, it isn't just for example the peaking capacity that
3 is gone, it is a piece of the base load?

4 A. It comes out as a percentage.

5 Q.153 - Yes. You understand that?

6 A. Yes.

7 Q.154 - So if DISCO could reduce its nomination and did in
8 fact reduce its nomination it would lose part of the
9 hydro, it would lose part of the low cost thermal
10 generation, part of its access to the peaking assets,
11 correct?

12 A. Yes.

13 Q.155 - And if you look at section 2.4.1, once DISCO makes a
14 reduction in its nominated capacity it really can't just
15 changes its mind and go back, correct? Is that your --

16 A. That is correct.

17 Q.156 - And Mr. Strunk, you are aware, or perhaps you are not,
18 that Point Lepreau nuclear plant begins an 18-month
19 refurbishment outage next year?

20 A. I'm generally aware of that, yes.

21 Q.157 - And do you believe it would be prudent for DISCO to
22 reduce its nominated capacity, even if it could, at a time
23 when it may not have sufficient resources during this
24 refurbishment outage?

25 A. At this point for that timeframe, I don't believe it

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2 would make sense. However, when we are looking at the test
3 year, we are looking at 2007/2008.

4 This agreement has been in place since 2004. There may
5 have been opportunities in 2004/2005 that could have
6 provided test year supply and supply throughout that
7 period of the refurbishment outage.

8 So not just limited to looking today would it make sense
9 for that time period to reduce, but --

10 Q.158 - If in fact DISCO could reduce its nomination --

11 A. Right.

12 Q.159 - -- correct?

13 A. If in fact, right.

14 Q.160 - I'm going to turn now, Mr. Strunk, to page 13 of your
15 December report.

16 And again back to the Belledune boiler water wall. And I
17 was intrigued by a statement that you make on page 13,
18 which is the last sentence before the summary of your
19 conclusions.

20 You say if the vesting agreement is so loose that Genco
21 can claim that any upgrade that saves DISCO fuel costs
22 should be paid by DISCO, it would seem to make section
23 7.1.2 meaningless. Do you see that?

24 A. Right.

25 Q.161 - I want you to turn to section 7.1.2. And that is at

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2 page 54?

3 A. Yes.

4 Q.162 - And have you had a chance to read that section? Take
5 your time.

6 A. Yes.

7 Q.163 - And would you agree that when a Refurbishment, and
8 that is a capitalized term, is required that is less than
9 a major Refurbishment threshold, Genco pays the costs,
10 correct?

11 A. Yes.

12 Q.164 - And I would concede to you, Mr. Strunk, for the
13 purpose of argument, that the Belledune boiler upgrade is
14 less than the major Refurbishment threshold.

15 I think you have come to that conclusion and so has
16 DISCO's Operating Committee.

17 A. Okay.

18 Q.165 - Do you agree with that?

19 A. Yes.

20 Q.166 - I now want to turn -- ask you to turn to section
21 1.1.136 which is at page 21 of the vesting agreement?

22 A. Yes.

23 Q.167 - And that is the definition of Refurbishment. And
24 Refurbishment means in respect of a unit generator, et
25 cetera any Refurbishment, construction or rehabilitation

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2 of or in respect of that unit generator that is required in
3 order to enable that unit generator to continue to operate
4 until its estimated shutdown date as of the date of the
5 agreement. Do you see that?

6 A. Yes.

7 Q.168 - So you would agree that a Refurbishment for purposes
8 of section 7.1.2 is only a rehabilitation of a plant that
9 is required to enable that plant to continue to operate
10 until its estimated shutdown life -- date?

11 A. Right.

12 Q.169 - And you would agree that if Belledune could continue
13 to operate until its estimated shutdown date without the
14 boiler water wall upgrade, that section 7.1.2 would not
15 apply, correct?

16 A. I think it's ambiguous. Because it doesn't specify
17 whether or not you are operating using the same fuel or
18 you are operating using a different fuel.

19 So that is where the ambiguity in the vesting agreement
20 is. And that is why the Belledune issue is a complicated
21 issue.

22 Q.170 - Well, you see it as an ambiguity, Mr. Strunk. But I
23 suggest to you that it is quite clear that the definition
24 of Refurbishment means a rehabilitation to meet the
25 estimated life of the plant, correct?

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2 A. That is correct. But it doesn't address the issue of fuel
3 switching.

4 Q.171 - Just to get back to your statement again on page 13 --
5 and I will just read it again. If the vesting agreement
6 is so loose that Genco can claim that any upgrade that
7 saves DISCO fuel costs should be paid by DISCO, it would
8 seem to make section 7.1.2 meaningless.

9 But DISCO didn't have to agree to the boiler water wall
10 upgrade did it? It could have refused?

11 A. That is correct.

12 MR. MORRISON: Those are all my questions, Mr. Chairman.

13 Thank you.

14 CHAIRMAN: Thank you, Mr. Morrison.

15 Ms. Desmond, do you have any cross examination?

16 MS. DESMOND: We have no questions, Mr. Chair.

17 CHAIRMAN: Any questions from the Board? Mr. Johnston?

18 BY VICE CHAIRMAN:

19 Q.172 - Mr. Strunk, I just have one question, something that
20 interested me. My note-taking skills have atrophied with
21 these daily transcripts.

22 But I believe you said that in your experience in other
23 jurisdictions, you had seen the change of contracts with
24 nonutility generators from must-run to dispatchable with
25 profit occurring for both sides subsequent to those

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2 changes in the contracts?

3 A. Yes.

4 Q.173 - And I'm just wondering if you could expand on that a
5 little bit to explain the economics of how changing that
6 can be profitable for both sides?

7 A. Sure. The purchasing utility would incur fuel savings.
8 And the fuel savings incurred by the purchasing utility
9 could be shared between the purchasing utility and the
10 nonutility generator.

11 So if we have an estimate of the fuel savings -- like in
12 this case for Bayside I estimated it would be 11 million -
13 - that could be shared. It wouldn't all have to -- that
14 could be shared with the nonutility generator through the
15 renegotiations. So there could be a payment for the
16 renegotiation.

17 We worked with Niagara Mohawk on some of its
18 renegotiations. And there was -- in those instances there
19 was a payment that was made to the nonutility generator to
20 compensate them for moving from must-run to dispatchable.

21 VICE CHAIRMAN: Thank you.

22 CHAIRMAN: Any redirect, Mr. Theriault?

23 MR. THERIAULT: Just a bit, Mr. Chairman.

24 REDIRECT EXAMINATION BY MR. THERIAULT:

25 Q.174 - Mr. Strunk, I'm going to refer you to document A-27

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2 which is a handout that my friend provided this morning.

3 And specifically IR-39. And on the second page, the

4 Financial Risk Oversight Committee.

5 A. Yes.

6 Q.175 - Now my friend referred to Ms. MacFarlane being there

7 as a DISCO representative. But according to this record

8 she is holding another hat there is she not?

9 A. It says Holdco.

10 Q.176 - So in fact that just leaves two DISCO members on

11 there?

12 A. Yes.

13 Q.177 - Now I just want to also be clear on your evidence of

14 exhibit number 5, PI 5 of December 7th.

15 Just so I'm clear, my friend asked you -- he read in what

16 he interpreted you to believe. Perhaps for the record

17 here, so we are absolutely clear, you could read the

18 change into the record in totality, so that I'm clear

19 anyway?

20 A. Changes on pages 12 and 13. On the last line of page 12

21 my change is, strike the two words "oil" and "instead" and

22 replace them with "a lower percentage."

23 Q.178 - And that is it?

24 A. And then on page 13, top line, strike the word "oil" and

25 replace with "a lower percentage of petcoke."

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2 Q.179 - Thank you. Now in the discussion -- I think it was in

3 exhibit number 3 at page 17 of your report. And Mr.

4 Morrison had a discussion about nominated capacity.

5 I'm just going to ask you to refer to page 17 of exhibit 3

6 of your report, PI 3?

7 A. Right.

8 Q.180 - Now it was your conclusion that DISCO should reduce

9 its nominated capacity or perform an analysis to see if

10 that was necessary?

11 A. It was really to perform an analysis whether that would be

12 economic as part of its overall management of the purchase

13 power costs to assure that those purchase power costs were

14 minimized.

15 Q.181 - And did they perform any such analysis?

16 A. I did not see any analysis. There were some -- there was

17 some data put in on current fuel prices in New England.

18 But I didn't see an analysis of the type that I would

19 expect to see in detail for all of the relevant periods.

20 MR. THERIAULT: Thank you. That is all the questions I

21 have.

22 CHAIRMAN: Thank you, Mr. Theriault. And thank you,

23 Mr. Strunk, for your attendance at the hearing today.

24 WITNESS: Thank you.

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CHAIRMAN: Mr. Theriault, I guess that would conclude all of the evidence that you will be bringing forward at these hearings?

MR. THERIAULT: It does.

CHAIRMAN: And in fact as I look at the schedule it appears that that concludes all of the evidence that any of the parties will be bringing forward.

So perhaps there just are a few housekeeping matters that have to be dealt with. And I have a list. I'm sure that perhaps others may as well.

But, first of all, I just want to ensure that all documents that should be marked as exhibits in fact have been marked.

Is anybody aware of any documents that should have been marked that have not been?

MR. KEYES: Mr. Chairman, just the answer to the last outstanding undertaking that was filed electronically last night should be marked as an exhibit I believe as well.

CHAIRMAN: I think the undertaking came from the in-camera session. But because it has been circulated electronically I'm assuming it is not a confidential exhibit.

MR. KEYES: No issues with confidentiality.

CHAIRMAN: So we will mark it as exhibit A-54.

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Any other exhibits from the applicants?

MR. KEYES: No other exhibits. The only other comment that I would make, Mr. Chairman, is this morning Mr. Theriault gave me -- we discussed the issue of what items were discussed in confidence. It could go into the public session. We are reviewing that. And we will have discussions with them this afternoon.

So that is -- if it needs to come back before the Board I would propose doing it first thing in the morning. But we are going to have some discussions this afternoon to see if we can work that out.

CHAIRMAN: Do any other parties want to become involved in that discussion? I guess that -- I see Mr. Zed shaking his head negatively. Mr. Lawson, are you interested in --

MR. LAWSON: Mr. Chairman, I have had some brief discussion with the Public Intervenor and believe he will represent the same position I will.

CHAIRMAN: Mr. Wolfe? No, I guess not. Mr. Peacock? And Ms. Desmond?

MS. DESMOND: Mr. Chair, I have another issue. With respect to the undertaking that was provided this morning, could Board Staff have a moment just to review the response to see if it in fact answers the question that was put to the panel yesterday?

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2 CHAIRMAN: Certainly. Is that the last undertaking
3 response? I guess that was one of the items on my list as
4 well.

5 MR. KEYES: That is my understanding.

6 CHAIRMAN: Nothing outstanding?

7 MR. KEYES: No.

8 CHAIRMAN: Ms. Desmond, are there any other matters, other
9 than reviewing that undertaking response, that you are
10 aware of that the Board should be addressing before
11 closing argument?

12 MS. DESMOND: I'm not aware of any other issue, Mr. Chair.

13 CHAIRMAN: All right. Any of the other parties have any
14 issues to bring at this time before we start final
15 argument tomorrow morning?

16 Ms. Desmond, how much time do you think it would take to
17 review that document?

18 MS. DESMOND: If we could just have 10 minutes, Mr. Chair.

19 CHAIRMAN: All right. We will adjourn until you have had an
20 opportunity to review that. So about 10, 15 minutes,
21 whatever it takes.

22 (Recess - 11:25 a.m. - 11:45 a.m.)

23 CHAIRMAN: Ms. Desmond, you have had an opportunity to
24 review the response to that undertaking. Are you
25 satisfied that all of the undertakings have been looked

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after?

MS. DESMOND: Yes, we are, Mr. Chair. Thank you for the opportunity to review those.

CHAIRMAN: All right. So I don't think there is any other business. Other than I do want to just take a moment and again review the process for final argument, in the event that there is any misunderstanding arising out of what I had said yesterday. With final argument we will start tomorrow at 9:30 with the applicant's final argument. We will then go with the Formal Intervenors in alphabetical order. So CME and Mr. Lawson get to go first again, as they have for the last three and a half weeks. Once we get to the Public Intervenor, he will be the last intervenor to make final argument.

And Mr. Theriault, if you want to break at that point in time that is fine. Because you are going to get a second opportunity, one to give your prepared closing argument, but then an opportunity to rebut anything that you have heard from other intervenors and from the applicant. So if you feel you need a little bit of a break there we will accommodate you. And then we will hear from the other intervenors moving back up through. Because once they have spoken there may be some

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intervenor that have raised arguments that of course they
couldn't address. They haven't heard their arguments yet.

So they will be able to do a rebuttal back through to the
applicant who will have the final opportunity for
rebuttal.

Any questions from anybody on that process?

All right. Well, then we will adjourn until tomorrow at
9:30. Thank you.

(Adjourned)

Certified to be a true transcript of

the proceedings of this hearing, as
recorded by me, to the best of my
ability.

Reporter