New Brunswick Board of Commissioners of Public Utilities

Hearing

In the Matter of an application by New Brunswick Power Corporation dated June 21, 2002 in connection with an Open Access Transmission Tariff

Delta Hotel, Saint John, N.B.
February 17th, 2003, 1:00 p.m.

CHAIRMAN: David C. Nicholson, Q.C.

COMMISSIONERS: J. Cowan-McGuigan
Ken F. Sollows
Robert Richardson
Leon C. Bremner

BOARD COUNSEL: Peter MacNutt, Q.C.

BOARD SECRETARY: Lorraine Légère

.... CHAIRMAN:

Good afternoon, ladies and gentlemen. I'm going to go around the room and find out who we do have here. Mr. Hashey, for the applicant?

MR. HASHEY: Yes, Mr. Chairman. Thank you.

CHAIRMAN: How about Bayside Power? Are they represented today? Canadian Manufacturers & Exporters New Brunswick Division?

MR. SMELLIE: Good afternoon, Mr. Chairman. James H. Smellie and Gordon M. Nettleton for CME and while I'm at it J.D. Irving Limited.

CHAIRMAN: Thank you, Mr. Smellie. City of Summerside? Emera and Nova Scotia Power?

MR. ZED: Peter Zed, Mr. Chairman.

CHAIRMAN: Energie Edmundston? Well, Mr. Young, you are coordinating the municipals, I understand, is that correct?

MR. YOUNG: That's correct, Mr. Chairman. They will be here bright and early tomorrow morning, sir.

CHAIRMAN: Okay. Mr. Gillis? Maine Public Service Company? Northern Maine Independent System Administrator? And the same stands for -- is Mr. Dionne here today? No, he is not here yet. Province of New Brunswick. Mr. Knight I see here? .

MR. KNIGHT: Yes, Mr. Chairman.

CHAIRMAN: Province of Novas Scotia? Mr. Young for Saint John Energy. And WPS Energy Services. Mr. MacDougall, yes, there he is.

MR. MACDOUGALL: Yes, Mr. Chair.

CHAIRMAN: And Mr. MacNutt is here as Board counsel. Any preliminary matters, Mr. Hashey?

MR. HASHEY: Thank you, Mr. Chairman. There is the one undertaking that was circulated last -- I guess on Friday and then corrected yesterday, which arose from the questions from the PUB concerning the outcome of the current meetings with CIBC World Market Investors.

CHAIRMAN: Mark that as an exhibit, Mr. Hashey?

MR. HASHEY: Yes. Could we circulate that?

CHAIRMAN: Thank you. My records indicate that will be exhibit A-58.

MR. SMELLIE: Mr. Chairman, just -- I see that what is being passed around is a revised version of what Mr. Hashey was kind enough to send out at the end of last week. Can I just have a minute to --

CHAIRMAN: Certainly.

MR. SMELLIE: -- find the revision?

MR. HASHEY: I can tell you what the revision is, Mr. Smellie. The -- in review of the transcript after the initial response was prepared it appeared that there was a request, and I believe it came from Commissioner Richardson, not only to deal with the debt equity but also to deal with the ROE, the rate of return. And there is -- I think the only change at the end of paragraph 1 there is a small -- or there is an additional sentence that deals with the ROE. In the second paragraph, last line.

CHAIRMAN: The second paragraph of the response?

MR. HASHEY: Yes.

MR. SMELLIE: That's fine, Mr. Chairman. Thank you.

CHAIRMAN: Okay. Fine, Mr. Smellie. Anything else, Mr.

Hashey?

MR. HASHEY: No, that's it.

CHAIRMAN: Any other parties any preliminary matters? All right. As I think I attempted to rule on the last time that we were together is that Mr. Hashey will sum up to begin with and then we will go through the intervenors. And we will probably take a short break to find out if there are any matters that the Board believes should be addressed in the summation that haven't been touched upon in the first go around. And we will bring those up and then we will ask everybody to comment on certain matters and Mr. Hashey will be able to have a rebuttal of what the intervenors have said.

Mr. Hashey, go ahead, sir.

MR. HASHEY: Thank you, Mr. Chairman, Members of the Board. We sat through a number of days of hearing. And hopefully we can give some type of a meaningful response or make our position known.

What I intend to do today with your concurrence is to give a brief introduction of what has gone on, which will be very brief. And then we would like to move into eight areas where we believe that significant challenges have been made. And we will try to deal with those. We are not here to go over the evidence.

I respect that this Board has been very attentive. The Board has understood the evidence. The Board has made a number of inquiries, has asked a lot of questions. And the evidence has been very, very long and very extensive. But I think we can cut it down to what we believe that the interveners and others are raising as issues.

CHAIRMAN: I'm just trying to refresh my memory as I sit here. What has happened in reference to the amendments that you filed to the tariff document itself? Where does that stand now?

MR. HASHEY: Well, I think they have been filed and were marked as an exhibit.

CHAIRMAN: Yes.

MR. HASHEY: And I don't believe there has been any challenge to those. They seem to have been accepted as being reasonable as far as the tariff document and its wording goes.

CHAIRMAN: Mr. Nettleton --

MR. HASHEY: I may be incorrect in that.

CHAIRMAN: Let's just find out. Mr. Nettleton, go ahead.

MR. NETTLETON: Thank you, Mr. Chairman. My recollection was that the revised tariff documents were filed. But we did not have -- and I believe that there was intention for a discussion about any changes or any comments parties would have to those revisions. And my recollection is that that did not happen last week.

We will be mentioning one change that we have noted in the revisions as it relates to the standard of conduct and the dispute resolution process. But because of what happened last week and the lack of comment, we assumed that that would be a matter for argument.

CHAIRMAN: Gracious sakes. You should have brought it up last week. I can't remember everything. Anyhow, I think it might serve us well if during our break this afternoon you would share with the applicant and the other interveners what it is that you have difficulty with. Because there might be a solution that you can come up with on the spot.

Mr. Zed?

MR. ZED: Along the same lines, Mr. Chairman, I did indicate last week that I hadn't had a chance to thoroughly review the changes. And I will just make this comment. One of the changes that was made dealt with the issue of reciprocity. And while we do not agree with the change that is made, the change was consistent with what the applicant put to our witnesses. So we can deal with it in argument. I mean, there is no need to call further evidence. But I don't want -- your initial comments were that we agree to the changes or if we had any issue. I do have issue. And I will take it up in argument.

CHAIRMAN: Okay. Thank you. Anybody else any comment?

All right. Go ahead, Mr. Hashey. Sorry for that interruption.

MR. HASHEY: No. Thank you, Mr. Chairman. I think that is good that we clarify that. And I have no problem. I recognize that those amendments went in. They were being worked on right up until almost the time that we resumed hearing.

And I do respect Mr. Nettleton's view that he may not have had adequate time to examine all of them. I have no problem with what he says.

Anyway, to lead off, first of all, Mr. Chairman, there were amendments to the Public Utilities Act and the Transmission Tariff as we all know. And I think it might be worth reviewing how we got here in such a hurry. And there was a bit of a time line.

In the spring session of the New Brunswick Legislature, these amendments were introduced which were assented to on June 7th 2002. And in the transitional and saving provisions which do not form part of the Consolidated Act as provided by the Queen's Printer, and that is Section 116 (2), there were transitional provisions provided.

And in Section (b) NB Power is required within 60 days of the commencement of this section to file a proposed tariff pertaining to the provision of transmission services or ancillary services or both with the Public Utilities Board -- and with your indulgence I will just refer to that as the PUB as I go through this -- and to apply at the same time for approval of the proposed tariff pertaining to the provision of transmission services or ancillary services or both.

And that Act we respect. And it does provide very wide authority to the PUB. The Act -- and I think there is a couple of sections worth mentioning. The Act makes provisions -- and that is Section 58 -- that the tariff is to be just and reasonable and to cause changes to be equal to all persons on the same route.

Another consideration that we have been noting includes the addition of Section 62, which I think is relevant here to some of the things we will be saying later, which requires PUB in its order or decision respecting the tariff to consider the projected revenues and projected costs for the provision of transmission services. And I think the word "projected" is the key word there.

This is applicable of course to both the transmission services and the ancillary services. And the wide authority of PUB is confirmed and continued in the new legislation which is only in the form of a bill presently, but something that we have referenced. And I will make a very short referral to it later.

Now just to review what has gone on in the past number of months, there has been a long and I guess somewhat tedious for many procedures that have taken place.

On June 21st 2002 NB Power applied to the Board for approval of the Open Access Transmission Tariff in accordance with the requirements of the Act.

Extensive evidence was filed on July 25, 2002. And as we look at the volumes of documents, the amount of work involved is quite obvious.

In the evidence filed was a tariff which included terms, conditions, rates for transmission services, ancillary services, service agreements, interconnection agreements, transmission expansion policy and the standards of conduct under which service would be provided.

The application was for a tariff that would be for a three-year period. And I might mention briefly on that is that there has been some discussion about an interim tariff. But when you think of a three-year period, it is not a very long period.

If you go from this point forward and you gain some experience, by the time you get to year 2 or towards the end of year 2, you probably or would almost have to be providing and being making a further application for another tariff.

So you really -- I think there is a good reason for that three-year, if you look at how quickly time passes and what you would need in an interim time.

In any event, as set out in the evidence, the tariff was designed to collect the total revenue requirements of the transmission system based on system usage.

Now just to review very, very quickly, the evidence was divided into four general areas. As you will remember we had overview and policy framework addressed by Mr. Snowdon and Mr. Marshall. Then we had the capital structure and rate of return addressed by Ms. MacFarlane and Dr. Morin, our expert consultant.

Then the revenue requirements were addressed by Ms. MacFarlane and Mr. Lavigne. And that dealt with various types of expenses, including operations, maintenance, administration, amortization, interest and taxes as well as an allowable return on the rate base.

Mr. Marshall and Mr. Porter then addressed the cost allocation and the tariff design. And this included consideration of the transmission and ancillary services offered, the allocation of the revenue requirement to those services and the development of the rates for those services based on accepted transmission pricing principles.

Following up to that of course was the service delivery and operation issues that Mr. Snowdon and Mr. Scott addressed. And the evidence covered the terms and conditions of the tariff, the Open Access Same Time Information System, the OASIS that you are familiar with, the reservation system and the standards of conduct and related administrative activities.

As you can see, the evidence was very extensive. There was a tremendous amount of work done in that. And with the assistance of many of the parties here there have been some very useful suggestions made. And they have been incorporated in the basic tariff document itself.

Then following the filing of evidence, numerous interrogatories were presented which required massive human hours to answer. But at all times deadlines were met. There have been questions on them.

But I think generally the interrogatories and the answers have held up very, very well. When you look at the number of it I know that, in speaking and throwing some of Dr. Morin's comment, that he had never seen such an extensive interrogatories in the hearings that he has ever attended. We know how many he has attended from his evidence.

The hearing took place. It has been 17 days of hearing time. The cross examination has been very extensive, very thorough and very professional. The tariff document itself came under extensive review. And suggestions were incorporated. That is our exhibits A-47 and A-57.

And hopefully, from what I hear today, we are down to very few points that are contentious on that at this point.

The time frames required for individual performance were indeed narrow. The efforts of the individuals involved in presenting the evidence and attending for cross examination in our view was commendable.

All witnesses answered questions directed to them in a forthright manner and required to fulfil answers to undertakings which were in themselves extensive and very complicated.

The fact that the evidence could be presented, interrogatories answered and the witness be able to attend and answer the numerous questions presented, I think is truly remarkable and speaks very, very highly of the professional people that this applicant has put forward. In addition PUB requested an embedded cost study of ancillary services.

That was prepared in a very limited period. It was submitted. It was carefully tested by -- Mr. Bishop and Mr. Porter of course testified. And they were questioned last week.

So it is submitted that with the mass of materials, the time line involved and the complexity of the issues, there will be matters that reasonably may be debated. And there may be some alternatives. Some changes are always possible.

In this instance it is submitted that notwithstanding all the challenges and the critique of the tariff, that this tariff should be approved. It is important to note there was very little questioning or dispute with the actual terms as we have just talked about. And we have put those forward.

Now from this point, Mr. Chairman, Members of the Board, I would like to move into eight isolated areas that we believe are areas that our friends have raised issues with and that we believe that we can and should answer.

These include -- and they will be addressed. The first four will be addressed by my friend Mr. Morrison, the last four by myself. They will be in the order of reciprocity, transmission reservations, energy imbalance, pricing, ancillary service rates.

Then we will move on to the return on equity, the debt equity ratio, the base OM&A costs and finally the performance-based regulation that we have referred to here as PBR.

If that suits the Chairman I would turn this over to Mr. Morrison at this point.

MR. MORRISON: Thank you, Mr. Chairman. The first issue I am going to deal with and I am trying to deal with them in generally the order in which they appeared in the hearing. It was an issue that was raised by Nova Scotia Power dealing with reciprocity. Now NB Power's application contains an industry standard reciprocity clause.

NSPI generally supports the proposed reciprocity provisions contained in the application, but generally is arguing that it should be granted a waiver of reciprocity until it catches up in terms of the regulatory requirements. In addition, it also argues that if there are any conditions attached to the waiver of reciprocity that these be administered or governed or regulated in some way by this Board.

The issue of reciprocity is really just an issue of fairness. Under this tariff New Brunswick is opening up its market to competition at the wholesale and industrial level. Reciprocity under FERC requires any market participant who chooses to access the New Brunswick market to offer comparable service on similar terms and conditions.

I think it's important or it's useful to recall a few pertinent facts at this point. First, while New Brunswick is opening up its market to both the wholesale and industrial customers, it is requiring Nova Scotia to open its market only to the wholesale level. And the wholesale level is the minimum level of reciprocity set out by FERC in Order 888. The wholesale market in Nova Scotia is significantly smaller than the wholesale industrial market in New Brunswick. New Brunswick is opening up a significant portion of its domestic market to competition, while Nova Scotia is proposing to open only 1.6 percent of its domestic market.

Secondly, and I think this is important. NB Power is required to grant reciprocity provided that NSPI implements the standards of conduct and commits to a FERC compatible open access transmission tariff by January 1st of next year.

Now these were the subject of some discussion among the parties or between the parties. And these amendments that were proposed were set out in exhibit A-12. Now in the course of examination of NSPI on exhibit A-12 and on the issue of reciprocity, NSPI has agreed to implement the standards of conduct as a condition precedent to its market access. What it does not agree with is the time frame. And that is really the only issue that I believe separates us and NSPI.

It seeks a waiver until some time, not particularly specified, but some unspecified time in 2005. Now the question is really whether the January 2004 time frame proposed by NB Power is reasonable. Now NSPI in its evidence, in its filed evidence, argues that in the United States FERC orders have always included an appropriate compliance time frame.

Now under cross examination NSPI did not disagree that the compliance time frame for FERC Order 888 from the issuance of the Notice of Proposed Rulemaking until full implementation that the compliance time frame was approximately 17 months. Now if you compare that to the time frame that we are operating under in New Brunswick, from the issuance of the New Brunswick White Paper to the proposed market opening on April 1st of this year is about two years. And NB Power is prepared to grant another eight months beyond that two years.

It is my submission, Mr. Chairman and Members of the Board, that this is more than reasonable on NB Power's part. Nova Scotia has had more than ample time to address this issue in time for the market opening. It has, for whatever reason, chosen not to do so. And there was a question from the Chairman directed to NSPI. And NSPI admitted that there is no legal impediment that would have prevented it from applying to its regulator for an open access transmission tariff.

Now NSPI is now asking that it have two additional years of access to the New Brunswick market while it continues to insulate its own market from competition. Under cross examination Mr. Whalen was asked whether he thought this was fair. And his response was, "whether I believe it's fair or not is not really the issue". Well, with respect, reciprocity as I said earlier is all about fairness. Fairness is the issue. And it's my submission that NSPI's position simply is not fair.

I would like to move on to another area, another issue that came up.

CHAIRMAN: Just before we leave that. You characterized I think it was the FERC's wholesale requirement that the market be opened up as being the minimum. And my understanding is that FERC only has the jurisdiction to order a wholesale market.

MR. MORRISON: I believe you are correct. That is the only requirement is the wholesale.

CHAIRMAN: What New Brunswick has done going beyond to large retail which you have characterized as industrial, that's not required for FERC reciprocity?

MR. MORRISON: That's correct.

CHAIRMAN: Okay. Fine. Carry on, sir.

MR. MORRISON: There is a very important issue that came up early on in the hearing. And it's an important issue to Nova Scotia Power. Emera Energy takes the position that all of the transmission reservations held by NB Power Generation unit deriving from the 1998 allocation process that went along with the out and through tariff should be put up on an open season unless they are supported by existing sales obligations.

Now I understand that -- and I appreciate this Board is not bound by stare decisis. You are not bound by decisions of other regulators, indeed, by your own decisions.

I have provided my friend Mr. Zed with copies of a few cases out of FERC. And I am going to be referring to those. I will provide copies to the Board as well. They may be of some assistance to the Board, although I realize they are not binding.

Now FERC's position with respect to honouring existing reservations is clearly set out in FERC Orders 888 and Order 2000. And they were entered as exhibits A-16 and A-15. FERC is crystal clear in its position. Existing transmission reservations are to be honoured.

Now Emera agrees with this principle, but says that there are two exceptions to this non-abrogation policy. It's says, first, only reservations supported by a power sales obligation, a third party contract, if you will, are to be preserved. And reservations held by an affiliated company, in this case between NB Power Transmission and NB Power Generation, are not to be preserved. And I would like to deal with both of those issues.

Now the first reason given by Emera for its position that the FERC pronouncements only apply to reservations supported by power sales contract. They say that, if I understood Mr. Connors' evidence correctly, that was his interpretation of the FERC pronouncement. And it's my submission that that interpretation is incorrect.

First, if you look at Orders 888 and 2000, FERC does not specifically indicate that this non-abrogation policy that it has should be restricted to reservations supported by power supply obligations. It's not stated in those orders. In Order 888 FERC really drew no distinction between grandfathering transmission agreements that solely involve transmission capacity and transmission agreements that included a power supply component.

Secondly, the cases which I'm going to refer to, I submit, indicate that Emera's interpretation of the policy is not correct. The first case I'm going to refer to is a case called -- it's a United States Court of Appeal decision. It was Idaho Power Company versus FERC. And this issue arose in that case. In that case Idaho Power's affiliate merchant group submitted a request for long-term firm transmission. Now an intervenor in that case, Arizona Public Service Company, argued that an agreement for firm point to point transmission service is valid only if it is accompanied by a power sale or supply agreement.

Now in fairness, if you read that case, neither FERC nor the Court of Appeal directly dealt with the case in a sense, in essence they ignored the argument. Ultimately the Circuit Court directed FERC to issue appropriate orders approving Idaho Power's proposal to provide electrical transmission to its affiliated merchant group even though in that case there was no specific power sales agreement associated with the transmission reservation.

Now the second reason relied upon by Emera is that reservation contracts between NB Power Transmission and NB Power Generation are not bona fide. Emera suggests that they are improper and ought not to be protected. And that was evidence which was on December 9th. And it's in the transcript at page 689.

NB Power Generation obtained its transmission capacity through a transparent non-discriminatory, publicly accessible bidding process which was posted on the OASIS system. Any eligible customer, including Emera or NSPI, could have submitted a bid during that 60 day open season. No such bid was made.

I would suggest that in the absence of any improper conduct between NB Power Transmission and NB Power Generation, that there is no basis for rendering these contracts or those reservations unenforceable.

In that regard I'm going to refer briefly to a case. It's called Enron Power Marketing Inc. versus United States Department of Energy and Bonneville Power Administrator. In that case Enron alleged that Bonneville had awarded transmission capacity preferentially to its affiliate Power Business Line. In support of its complaint Enron pointed to the fact that within five hours after Bonneville's OASIS posting, Power Business Line, the affiliate, tendered its request for service.

FERC concluded there was no basis for assuming that Power Business Line had received the transmission service improperly. FERC noted that the terms of the transmission service offer were posted on the Bonneville OASIS with customers given a two month long bidding opportunity. Power Business Line tendered an offer for service but Enron failed to do so.

After investigation FERC concluded that Power Business Line's advantage comes not from improper conduct, but from its practice of carefully monitoring and evaluating the transmission information on the OASIS.

In short, and I guess the nub of that case is you have the two affiliates but in short the fact that the parties were affiliated was not the relevant point. The only point was whether they acted improperly.

A similar conclusion was reached in another case called Morgan Stanley Capital Group versus Illinois Power Company. In that case FERC did not find it improper that the transmission entity had granted its bulk power marketing affiliate a favourable firm capacity transmission allocation. And in that case there were some allegations that actually it wasn't properly posted on the OASIS and Illinois Power basically said, well it wasn't our fault, it was the computer software people who designed it. That's why it wasn't properly posted. There was an allegation because the reservation wasn't posted properly that there was some improper conduct between the affiliates.

FERC concluded that the allegations of affiliate preference were not sufficient basis upon which to abrogate the contract. And again the only issue was whether there was improper conduct. The fact that these reservations were between two affiliates was not a relevant consideration.

Finally with respect to this particular issue, reference is made to the Regie decision in the Hydro Quebec case which was introduced as an exhibit A-17. And if you will recall, one of the issues in that case was the grandfathering of transmission rights granted by TransEnergie through its generation unit, Hydro Quebec Production Group. And Ontario Power Generation argued that reservations made between TransEnergie and its generation unit be set aside and the reservations put up for bid in open season. And the Regie rejected OPG's argument.

I make reference to these cases, Mr. Chairman, Members of the Board, as I believe it makes it clear that the mere fact that a reservation contract exists between the transmission and merchant functions of an integrated utility is not reason alone to render the contract unenforceable in the absence of some evidence of improper conduct.

In this case there is no evidence of improper conduct between NB Power Generation and NB Power Transmission when those reservations were made.

Furthermore, in Order 888 FERC draws no distinction between grandfathering transmission agreements that were executed between parties representing the pre-structured merchant and transmission functions of an integrated utility.

And I think it's important to revisit the reservation process that was utilized in 1998. When the out and through tariff was introduced in '98 Emera, NSPI and indeed anybody else, any potential customer, had the opportunity to bid for available transmission during the 60 day open season. It was public, it was open, it was posted on the OASIS.

Now Emera's predecessor, NSPI, chose not to submit a bid. Now in its evidence and if you read Emera's evidence carefully, and I have, Emera does not really state why it did not submit a bid in 1998. Emera now cites as reasons for its current position that the capacity should now be made available to support that argument. The fact that there was regulatory uncertainty in 1998 and that the position of the New Brunswick government on restructuring was not clear in 1998. And perhaps Mr. Zed will speak to this. But no where in its evidence does it state that those are the reasons it did not submit a bid in 1998. Under cross-examination by Mr. Barnett, Mr. Connors admitted that NSPI did not raise any objection to the out and through tariff when it was introduced.

Now some four years later it seeks to have the 1998 reservation process set aside.

So what has happened since 1998? What has changed since 1998?

What has changed since 1998 is that in 2001 Emera's affiliate, Emera Energy Services Inc., obtained a FERC marketing licence enabling it to sell energy directly to U.S. customers.

NB Power Generation assumed the risks and costs inherent in reserving the transmission capacity in 1998, and it is now obligated to pay for that reservation.

NSPI chose not to assume those long-term risks, and that's its choice. But one must ask, if NB Power's acquisition of the transmission capacity had turned out to be a bad deal, in other works, it was unprofitable or imprudent, would Emera now be demanding that the reservations be nullified and subject to a new open season?

A legitimately conducted and fairly administered open season bidding process would be meaningless if it were not binding on the winner.

As I said earlier, the 1998 reservation process was open and public, it was posted on OASIS and made unused capacity available to others. In short, it complied with all of the fundamental goals and principles of open access. I would suggest that it would be absurd to abrogate a contract that basically complies with open access principles on the strength of Emera's argument that by doing so would further the goals of open access.

Those are the comments that I have with respect to the issue of having the transmission reservation set aside. I can only say that this is an issue which is of great importance to NB Power.

Another issue that was raised early on in the hearing dealt with energy imbalance pricing. Schedule 4 of the tariff sets out the treatment to be given energy imbalance. And as you will recall, energy imbalance occurs when there is a difference between the scheduled energy and the actual delivery of energy. And as Mr. Porter stated in his evidence energy imbalance is an operation issue as well as a cost issue.

Under the tariff, particularly the point to point which is where I believe Emera has its issues, hourly energy imbalances within a plus or minus 1.5 percent bandwidth may be repaid in kind within 30 days. Similarly cumulative energy imbalances less than 20 percent may be repaid in kind, within 30 days.

Energy imbalance which exceeds these limits are compensated for in money. Of course avoidance of these charges is entirely within the control of the customer. If the customer does not create an imbalance outside the bandwidth then it does not include a charge.

Now one issue that came up late in the hearing dealing with energy imbalance was raised by Mr. Twohig. And we acknowledge the concerns raised by him and recognize that, and this is with respect to windpower, that energy output at such projects would vary with wind conditions that are not controllable.

However, we submit that this is not an issue that needs to be addressed at this time, as there are no such projects currently in existence or that are committed in New Brunswick. Treatment of wind energy in the New Brunswick electricity market is an unknown at this time and should be left for future consideration of the system operator following which any tariff revisions could then be brought to the PUB.

But we do realize that this energy imbalance as it relates to wind power is definitely an issue. It is our submission that it can be addressed at a later date when wind power is in fact a reality.

CHAIRMAN: Mr. Morrison, if however we don't set or do something in the tariff today, then -- and again I am very fuzzy on this, but I ask for your advice on it. Then the SO might in fact be able to say this is a new service and prescribe a rate that would not receive the Board's review.

MR. MORRISON: I hadn't considered that, Mr. Chairman.

CHAIRMAN: Okay. Well then why don't you consider it and then when we go around the room again perhaps you can address it at that time.

MR. MORRISON: Yes. Now the issue with respect to Emera and energy imbalance is really one of price. Emera has taken issue with the price which must be paid when NB Power must provide energy to compensate for a shortfall in delivery outside the 1.5 percent or 20 percent bandwidth. Their issue seems to be more with the point to point service.

Now the price stipulated in the tariff is 110 percent of the cost of the combustion turbine unit. Emera in its evidence suggests that the pricing is too high and does not reflect the market price of energy at the time that the energy imbalance is supplied. It suggests that the price not be linked to the price of the combustion turbine unit since it is not the most likely generator to be used to supply the imbalance.

Now there is no question the energy imbalance pricing contained in the tariff is a penalty and it's intended to be a penalty.

In its evidence Emera states that there must be proper pricing signals to incent adherence to schedule.

Now on cross examination I asked Mr. Sidebottom a question and he agreed that the pricing of energy imbalance must provide a disincentive for participants to lean on the system. Even so Emera suggests that the price is too high and should be lowered.

Now under cross examination by Mr. Nettleton, Mr. Porter stated that giving the cost -- I'm sorry -- given the cost profiles of the market players, lowering imbalanced pricing would provide an opportunity for parties to game the system.

In my review of the transcript that is the only evidence on that particular matter.

It is our submission that the energy imbalance for pricing proposed by NB Power sends the appropriate price signal to deter gaming of the system. The only evidence before this Board, as I said, is that of Mr. Porter where he suggests that lowering the price would encourage gaming.

Emera has put forward no evidence to demonstrate that its proposed alternative pricing would operate as a disincentive to gaming.

Finally, Mr. Chairman, the last issue I will be dealing with before turning the mike and floor over to Mr. Hashey is the issue of ancillary service rates. And essentially there are two aspects to this, but probably the most fundamental one is do you use the proxy unit pricing or do you use embedded costs.

Now NB Power's application for the pricing of ancillary services in this application is based on long run marginal costs using a proxy generating unit.

Now JDI and Wisconsin Public Service have indicated that the pricing for these services should be based on embedded costs. And as ordered by this Board NB Power has submitted an embedded cost analysis in which basically sets out the cost of supplying ancillary services based on the facilities that actually provide the service.

Now the results of this embedded cost study, the rates are higher than that of the pricing based on the proxy unit. The use of the embedded cost approach rather than the proxy approach would increase the cost of transmission customers for the purchase of ancillary services.

The proxy method, I would submit, has the following advantages over the embedded cost approach.

First, proxy pricing provides appropriate pricing signals to suppliers because it provides adequate compensation to the supplier, it doesn't set the price so high so as to motivate self-supply and it does not set the price so low that there is an inadequate incentive to promote the introduction of new supplies.

Secondly, proxy pricing is not specific to a particular supplier. Embedded cost pricing on the NB Power system produces higher numbers because the capacity in the NB Power system, as I believe Mr. Porter indicated, was built to supply energy and to keep the cost of energy low.

Thirdly, proxy pricing will facilitate investment decisions by providing more predictable pricing. Embedded cost pricing on the other hand is subject to changes due to new investments, retirement of assets, changes in amortization and changes in operating conditions.

Finally, proxy prices are predictable and transparent and readily confirmed by market participants.

For these reasons NB Power's position remains that the proxy unit pricing method is preferred to the embedded cost methodology and therefore should be accepted in this application.

You will recall that Dr. Earle on giving his evidence -- or actually when he submitted his evidence -- compared NB Power's ancillary service rates to the NEPOOL rates, and concluded that the differences in those rates are evidence that NB Power's rates are too high.

In his evidence, I believe it's at page 1977 of the transcript, he went on to say that it is "counter intuitive" that NB Power has low energy costs but high ancillary costs compared to NEPOOL. Now it is true that compared to NEPOOL NB Power's rates for ancillary services are higher. It is also true that compared to NEPOOL, NB Power's generation capacity requirement proportional to its load is also higher.

Now Dr. Earle agreed that the differences between the percentages, and you will recall we went through that exercise with Dr. Earle, he agreed that the differences between the percentages for NB Power and NEPOOL are attributable to the required generation capacity relative to the size of the load.

He further agreed that between two utilities the system that has the larger requirement proportional to its load is likely to have higher rates for ancillary services. Therefore, I would argue one must expect that NB Power's rates for ancillary services will be higher than those of NEPOOL.

In that regard I wold submit that Dr. Earle's comparison of the NEPOOL ancillary charges to NB Power rates is not evidence that NB Power's rates are too high, as he suggests. There is no other evidence to that effect. And in fact if you look at Exhibit A-23, that illustrates that the rates to be paid to generators under this proposal are actually lower than Manitoba Hydro and Saskatchewan Power.

Those are my submissions with respect to those four issues, Mr. Chairman, Members of the Board. And I will turn the microphone over to Mr. Hashey.

MR. HASHEY: Thank you, Mr. Chairman. The next issue that we wish to address on the issues that we felt that were the contentious ones is the issue of return on equity, which has been widely discussed, been an extensive amount of cross-examination.

The evidence of the applicant was presented through Dr. Roger Morin, whose expertise is widely recognized. Dr. Morin has testified in numerous hearings and has written texts on relevant financial issues. Reference obviously should be made to Dr. Morin's evidence and particularly his Panel B presentation which summarizes his evidence in a meaningful way. I haven't tried to repeat that and don't intend to repeat that, because I know that was something that was paid attention to by everyone here.

In the presentation, however, Dr. Morin does set out the principles that are relevant to the Public Utility Board, PUB's decision.

Firstly, the PUB must set just and reasonable rates by way of a fair and reasonable return. Much evidence has been delivered on this principle and will be commented upon in our submission.

Dr. Morin then points out the governing legal standard coming from the leading legal authorities of BC Electric Railway, Northwestern Utilities and the Bloomfield and Hope cases. They are well summarized in his evidence. From BC Electric the principle that emerges is that earnings must be sufficient to enable the utility to attract capital, either by the sale of shares or securities.

The Hope case stands for the principles outlined, one of which is that by that standard the return to the equity owner should be commensurate with return on investments and other enterprises having corresponding risk.

On this issue I think the best evidence that has been before this Board will probably be the decision of the Regie on the TransEnergie in Quebec issue, which we will again be referencing.

From the Bloomfield case the importance of the return is shown to assure confidence in the financial soundness of the utility and must be adequate under efficient and economical -- sorry, economical management to maintain and support its credit and to enable it to raise money for the purpose of discharging the public duties. We submit that these principles are worthy of reminder in making decisions that could have a significant effect on a company which is now being set up and is now required for the first time to perform on its own.

In reaching his conclusions on a reasonable rate of return, Dr. Morin related to two standards and that is the comparable earnings and the capital attraction. In his evidence he has overviewed the regulatory process and provided significant background information that has led to his conclusion that a reasonable rate of return for this small transmission company should be in the vicinity of 10.5 to 11 percent.

Dr. Morin has used a number of tests to reach the conclusion which are well outlined in his evidence and have withstood challenge, I would suggest.

My friends representing J.D. Irving have demonstrated that the use of the capital asset pricing model which has been known as CAPM method relies on betas that have had some uncertainty due to varying areas from other utilities in areas which would have their own interests.

Arguments have been raised concerning the length of the term for investment rates and various results can and have been achieved. I mean, you can twist those numbers and go just about in any direction. But I believe we will all come right back to where we are.

Dr. Morin on the other hand has gone beyond the CAPM method and has provided much more extensive evidence than has Dr. Yatchew, we would submit.

Dr. Morin, using many factors, has come up with a reasoned approach. It is particularly interesting to note that the CAPM approach is the one upon which Dr. Morin places the least reliance consistent with the comments contained in the article that was put to Dr. Yatchew in cross examination from the journal that he himself had submitted to and that's the Cragg article which is exhibit A-43. And I will be further referencing that.

This exhibit has an interesting table showing how the CAPM results in a very -- do result in a very low estimate which traditionally has not been followed by FERC. FERC have used a two stage discounted cash flow, the DCF model, in numerous hearings they have conducted in the United States.

Dr. Morin's evidence indicates that he used three methodologies which are as follows. The risk premium, the CAPM and the DCF. We will not go into the specifics of these methods other than to say that the result recommended by Mr. Morin is sound and should be accepted.

In the comparative arguments from experts there seems to be generally accepted is the long-term Canadian bond rate at six percent. There didn't seem to be any great issue with that. And issues around the rate of return and the reason for the significant difference between Dr. Morin and Dr. Yatchew relates to risk premium.

What Dr. Morin has emphasized is the importance of an adequate rate of return if the company's bonds are to meet the required level of rating so as to attract a reasonable cost of borrowing. To lower the rate of return to an unreasonable level, as suggested by Dr. Yatchew, can only result in a lower rating with the obvious cost implications.

Dr. Morin has indicated in his evidence and under questions from intervenors that PUB -- and the PUB that credit rating factors are very important to the success of the new transmission company. Dr. Yatchew has stayed with one test and has not expanded his horizon. It's also important to note, Dr. Yatchew has admitted in interrogatories and enforced on cross examination that his return on equity and capital debt equity structure at the levels he has stated depends on a PBR proposal which he has recommended. He has further indicated that his PBR submission will require benchmarking and a significant time, I would suggest, to implement would not be something that would be relevant today.

On the return on equity the most appropriate comparison must be the most recent decision that we have referred to of the Regie in Quebec. A very long, well reasoned decision is publicly available. In that instance experts for intervenors, namely Booth and Berkowitz we have heard so much about, whose testimony has been produced by Dr. Yatchew and by my friends for the intervenors, JDI were recommending an 8.25 percent return on equity. Admittedly Dr. Morin was suggesting a 10.5 percent return on that matter and the Regie has ultimately reached the conclusion of 9.72 percent. And I will come to some comparisons.

In cross examination Dr. Yatchew agreed that NB Power Transmission has higher risk in certain areas than would TransEnergie, which include the following. Firstly, TransEnergie has no revenue risk from the long-term in-province users of the transmission system. As a revenue requirement it is fully recovered. NB Power Transmission, on the other hand, is proposing a fixed tariff and will bear the risk of volume fluctuations on in-province load. Again that would be a topic, the first one, I would suggest, which would increase the ROE requirement.

Secondly, TransEnergie is a much smaller -- has a much smaller proportion of its revenue derived from short-term transactions. It's less than 1 percent as compared to NB Power's 10 percent.

Thirdly, TransEnergie will not need to raise capital in the open market on a standalone basis as will NB Power Transmission. I think that is a very significant issue.

Fourthly, TransEnergie is much larger than NB Power

Transmission and size is a factor that must be considered. Specific reference is made to the Booth and Berkowitz in their evidence relied upon by Dr. Yatchew which states that size is a relevant risk factor.

And we would suggest that these four reasons would give this Board some assistance in finding a conclusion on this ROE issue.

But taking all of these into consideration, it is clear that NB Power would be considered as a more risky entity than TransEnergie and logically should have a higher rate of return on equity.

Reference should be made -- and I will give a couple of quotes that would be of assistance I believe to the applicant -- to Dr. Morin concerning TransEnergie which -- where he had, as you remember, very considerable involvement and had a lot of knowledge that he had gained by being a witness and being very actively participating in a lengthy hearing that took place in Quebec. The closely one I would suggest and the only one that may have significant relevance here.

And Dr. Morin stated, "TransEnergie essentially passes the bill to the distribution component of Hydro Quebec and is virtually guaranteeing a recovery of its costs that way. So it incurs very little business risk by virtue of that toll making -- that rate making policy. And that is not the case for NB Power Transmission."

Then he further states, and I quote, "Everything else being costed, a smaller issue will have a riskier or less attractive bond rating than a very large entity because of the diversification, the size and the equity requirements of the bond issue and so forth." Continuing, "For these reasons when we look at Hydro Quebec, TransEnergie we have to position TransEnergie as a sort of less risky entity for all these reasons than NB Power Transmission".

Now a great deal of question -- excuse me.

A great deal of the questioning of Dr. Morin and the evidence of Dr. Yatchew related to pipelines. Dr. Morin has emphasized that the pipeline business 100 percent of the costs are recovered through demand charges by the pipeline. And that's not the case for NB Power Transmission. Dr. Morin emphasized that pipelines typically have less business risk than a company like NB Power Transmission would have, and therefore you will have a less equity rich company if you have less business risk. When this goes to equity ratio, it would also relate to return on equity which is closely linked to it.

Now I would like to make a couple of comments on the article of the Cragg article I have referenced that deals with assessment of cost of capital for a stand-alone transmission company. Some interesting points are there that can support Dr. Morin. And that's the article, of course, that was referenced to Dr. Yatchew.

The article makes the point in the early stages of restructuring the market, risks from inadequate transmission investment are the greatest. The social cost of setting return it states on equity for stand-alone companies too low is likely to be greater than the social costs of setting return on equity too high.

It is pointed out, and we submit, that the return on equity plays a critical role in assuring that adequate investment in transmission facilities will be forthcoming. Without adequate investment in transmission facilities, it is questionable whether the anticipated benefits of competitive wholesale power markets -- that is more efficient production and lower prices for consumers, can be achieved.

A great deal has been said concerning the effect of the new tariff on industry in New Brunswick. PUB must be cognizant of the impact of setting the rate too high. We acknowledge that. But we also must remember that the transmission amounts are about 10 percent of the total cost of power, and as stated, even a sizeable overstatement in the allowed ROE, will result in only a small increase in the delivered price of power.

The alternative risk is worthy of note in that if the ROE is set too low, the immediate effect may be a small reduction in the delivered price, but the ultimate result is more likely to be a substantial increase in the cost to consumers. This, of course, is something that should be avoided. The victims would be in-province customers. External users must pay a fair return for the use of the transmission system.

The allowable ROE is directly connected to the firm's capital structure. It was agreed by all experts that the more debt in a firm's capital structure increases the required ROE, which leads to the next area of our submission, being the debt equity ratio which I think one flows right to the other.

Now to commence this part of the submission, we must remember what the evidence is, and I'm certain that the Board does remember this. But I'm being a bit repetitious. Dr. Morin recommended 65/35. And on cross examination by the Board or the Commissioners, indicated that certainly that was the lowest he would go.

Dr. Yatchew recommended 70/30. And today, and as was stated earlier by Ms. MacFarlane, I suggest today's evidence or the answer was merely confirming what the bankers views have been in relation to this. Ms. MacFarlane indicated the current views of the investment bankers was 60/40 rather than the one at 65/35. That the evidence, of course, was presented before consultation with bankers, as you would understand by the timing of our application.

Dr. Morin has given detailed evidence as to how he arrives at his recommendation. Much of his evidence relates to the importance of the reasonable bond rating and how the debt equity ratio must be adequate so as to attract capital. In summary he shows the ratios that currently exist in various utilities will not average below 35 percent.

Dr. Yatchew provides very little support, we would suggest, for this recommended 70/30. But does reference the fact that in TransEnergie, a 70/30 ratio is provided. This goes right back, I would suggest, to the discussion we have just had on TransEnergie. And all of the points that we have pointed out concerning the riskiness of NB Power Transmission, the comparability with TransEnergie would establish that NB Power is not in as sound a position and would need higher capital.

The questioning of Dr. Morin by Mr. Richardson clearly indicates the importance of doing it right and making sure that the company is adequately capitalized. As Dr. Morin has stated, the ability to attract capital under reasonable costs and terms is crucial to an electric utility that is very capital intensive.

Further discussion was entered into concerning the electrical markets and the effects on the attraction of capital. As Dr. Morin has stated, and I quote, "Right now the investment community is very nervous about the electrical utility industry in light of some of the experiences in the US, and in light of uncertainties that have been brought about by restructuring. In the real world proof of that is when you look at the bond yield spreads between electric utility bonds and long-term Canadas. They have reached a very, very high level that I haven't seen in a very long, long time. So there is a lot of jitteriness. A lot of nervousness about electrical utilities. And my prescription for that would be that if you have to make a judgment about capital structure, about rate of return, you should make it on the conservative side of things. I would much rather see a stronger electric utility rather than a weaker utility."

Under cross examination by Mr. Gillis Ms. MacFarlane indicated the investment bankers consulted utilized a methodology consistent with that used by Dr. Morin. And they have come up with an even higher debt equity ratio of 60/40.

Dr. Morin further emphasized that he was tempted to say 35 to 40 percent, but emphasized the most important issue was achieving a single A bond rating. His evidence went into that very extensively as you will all remember.

Dr. Morin then further stated, "The Board has a crucial role to play here in changing all of that by approving a decent rate of return and a decent equity ratio, and a price cap plan that would stimulate a free market mentality or culture in the company."

In response to questions from the PUB, Dr. Morin suggested that if there is to be a change in the debt equity structure, that it be on the side of a stronger equity component.

This will lead to a discussion next of the performance based regulation which is promoted by both experts. But what we are saying on the debt equity is that Dr. Morin's evidence certainly may be on the conservative side and maybe even a little light side from what we are now being told by the bankers. I think that has come out quite clear, that the equity component is very important and it does link itself to the ROE as the evidence today has indicated as well. There is no doubt, the higher the equity, the lower the ROE can drop a little bit.

CHAIRMAN: NB Power, however has asked for 65/35. Does that remain its position?

MR. HASHEY: That is still our position. That's the evidence that we presented to this Board. But we have given you the other, the other evidence and the other information. And I think the Board is free to go, obviously you are not bound by whatever we may say. And they are bound by their own determination, their own logic and their own -- the effect of everything they have heard here.

I would go on to the items. The next two that I would comment upon, Mr. Chairman, they are a bit shorter than the last two that I have touched upon.

The base OM&A costs. This is something that probably will be a matter of some discussion by my friends. It may be something that we will respond to.

But I can tell you that what we believe is the OM&A cost included in the revenue requirements submitted in evidence here are reasonable. The transmission unit has been operating as a business unit since 1998 and has tracked its costs separately. Therefore, there are a number of years of history in terms of transmission unit's

OM&A costs.

The evidence of Mr. Snowdon is that these costs are relatively stable. Furthermore, the OM&A costs related to maintenance were subject to review in the Stone & Webster Study. NB Power is therefore confident that the going-in OM&A costs are reasonable.

Now I think that not to be overlooked here of course is the long discussion on assets, and whether the assets were correct and prudent. And we all know that there is a provision now in the new bill that deals with that. And I won't address that. I think that has probably been satisfied. And that was, I believe, a large segment of this OM&A discussion.

In cross examination Dr. Earle confirmed that his based OM&A figure of 34.7 million is based on his recommended use of historical data for a test year rather than a prospective test year. In short his evidence is predicated on the PUB accepting his recommended historical costs over prospective costs as the basis of the test year.

And we submit that Section 42.1 overrules this approach by Dr. Earle when it specifically states that the Board shall when considering an application by New Brunswick Power Corporation in respective of charges, rates and tolls to be charged or being charged by the New Brunswick Power Corporation, base its order or decision respecting the charges, rates and tolls to be charged, and I go on, on all of the projected revenues, and all of the projected costs of a future rate period, and in so doing shall provide for the full recovery of all the New Brunswick Power Corporation's costs as set out under Section 20 of the Electric Power Act. I think that's the binding section.

And we suggest that PUB is mandated by the Act to consider the projected costs. It really doesn't have authority to consider historical test years as that Act has formulated. And we believe that the OM&A that we have presented is reasonable.

The next issue, and I realize it is one that was quite contentious in the discussion, is the issue of PBR. There was a lot said about PBR. There was a lot of discussion about it. But it's interesting that both experts, Morin and Yatchew, do promote PBR schemes. However, there is a significant difference in the method promoted and the timing required and when this should be applied.

Mr. Chairman, with a traditional rate of return regulation there are very high costs that must be borne by the company and ultimately the customer equated to the judicial adversarial proceedings and the costly accounting controls required. The frequency and the breadth of the hearings, together with the nature of the hearings and the cost to company management, are I would suggest significant.

As Dr. Morin has pointed out, there are many indirect costs which are the potential for overcapitalization, the potential for inflated operating costs, regulatory lag dampens incentives to innovate, lack of pricing flexibility to remove or constrain cross-subsidization, the reward/penalty issues, prices are out of touch with marginal costs. All of those things can happen.

So it has been demonstrated that many businesses are moving towards such a system that should significantly improve the company's performance. And of course that is what PBR is all about.

Dr. Morin has recommended a price cap formula that uses the initially set tariff rates as his basis. He proposes future rate adjustments to be set according to a predetermined formula, namely a price cap linked to an aggressive measure of inflation with a productivity offset. It is suggested that this be put in place for a three-year period. This plan includes provisions for monitoring performance for safety, reliability and environment. We recognize the that PUB does have monitoring rights.

In Dr. Morin's price cap principle, he is recommending the price cap to compensate the company for the real costs of producing its services adjusted for inflation. There must be economic incentives to promote cost reduction innovation. And we would suggest that Dr. Morin's plan achieves these goals.

Dr. Yatchew, on the other hand, is suggesting a scheme that will involve extensive benchmarking.

Dr. Yatchew is also a strong supporter of performance-based regulation. Dr. Yatchew however is critical of Dr. Morin's approach and is suggesting that there is not sufficient historical information and data available. Dr. Yatchew also is critical of the linkage between productivity growth and inflation, and suggests that productivity growth should be linked to other factors.

He then suggests a detailed benchmarking framework is necessary to determine the appropriate initial price lever and the X factors. He is suggesting a redesign of the system to ensure efficiency improvements.

It was suggested by Dr. Yatchew that benchmarking is an important component to PBR. The evidence of Mr. Wayne

Snowdon and Ms. Sharon MacFarlane was clear that benchmarking OM & A costs for the transmission unit is an extremely difficult and unproductive task. The results of such a study would not be meaningful. The schemes proposed by Dr. Yatchew have apparently been used in other countries, and we would suggest in relation to industries that are far larger than NB Power Transmission. The schemes proposed by Dr. Yatchew will be terribly expensive to initiate and have not been evaluated by him in relation to cost, which should be a significant factor here.   What Dr. Yatchew is suggesting is the postponement of the introduction of PBR after some development of a benchmarking procedure, and then the three-year period would be appropriate.

What the applicant is suggesting is the putting in place of a system now which would be subject to the possibility of an overhaul in three years which is truly not a long period, as we have stated. The PUB has brought oversight responsibility so that if circumstances change significantly it can request a recall.

From the evidence heard, competitive forces are not an issue in transmission services with the exception of some ancillary services. Many of the factors listed by Dr. Yatchew would be far more significant to generation where competitive factors are more likely to come into play.

Dr. Yatchew in his evidence admits that in a regulated, natural monopoly industry, it is difficult to institute incentives that deliver efficiency and innovation, particularly if it is publicly-owned. However, he does suggest that incentive regulation can lead to improved performance, and one must question whether the cost of this implementation would warrant the results and the matter of transmission should be readily reviewable, as is suggested by Dr. Morin.

In summary, Dr. Morin's proposal is still supported by this applicant. We believe it is simple. We believe it is effective. And we believe that it is inexpensive. On the other hand Dr. Yatchew's proposal is complex and we believe is potentially very, very expensive and will probably not achieve any greater result.

That would complete comments. And I'm near conclusion, Mr. Chairman. The last item that I would like to reference is the Electricity Act if it would help. And I think there are sections in that legislation that has been tabled on January 31 that are relevant to this application and really relate to a lot of the issues that were discussed.

First of all, Section 37 provides for payment to the

Finance Corporation an amount equal to the amount of tax that would be payable. So this is the issue that we have been dealing with so extensively, of the appropriateness of whether there should be a payment in lieu of taxes.

Well, simply it is a matter that, as was indicated and has been always suggested through the papers, that it would be an item that would be placed upon us by the Legislature. And that clearly is what is happening.

There was a lot of discussion about the necessity of a system operator. That is in part 3, very, very extensively.

Then there is the market rules, part 5. Then the sections dealing with the continuation of PUB hearings, very extensive of course on that. I don't need to tell you gentlemen and lady on that topic.

And then Section 156, a lot of discussion was held in cross examination and on interrogatories on prudency. Section 156 covers off that.

In conclusion, Mr. Chairman, I believe that NB Power has put before the Board extensive evidence and has presented a very detailed, a very fair and very equitable transmission tariff. We respectfully request your endorsement.

I would in conclusion like to thank you for your attention. The level of questions showed to all of us that the Board was very knowledgeable on this topic. I don't think that we need to go into long reviews of evidence. I know that it has been considered.

I would like to thank the witnesses. I would like to thank my friends the intervenors for all -- for the attention that they have shown. They have done a good job.

But at all times they have been very respectful. And we have had a hearing I think with, through their efforts as well, to put things over to the Board in a most complete fashion as possible. They have been very efficient, very good.

I would also finally like to thank Margaret Tracy and her staff. And I think those are the people that have made this hearing go as smoothly as it has.

There has been a tremendous amount of paper. And I think maybe few people realize the efforts behind the scenes to try to create the mass of documentation and see that it has met time frames, as a civil trial lawyer I would have found completely impossible to meet.

Thank you again, Mr. Chairman and Members of the Board.

CHAIRMAN: Thank you, Mr. Hashey. We are going to take a recess.

Mr. Smellie, are you prepared to start this afternoon?

MR. SMELLIE: I prefer not to, Mr. Chairman. I had understood, although I stand to be corrected, that there might have been a couple of interveners that are perhaps going to be a little shorter than I and Mr. Nettleton will be.

But as I say, I may be mistaken in that. It would be my preference to start tomorrow. And if it met you and your colleagues' convenience, I would be quite happy to start a little bit earlier.

CHAIRMAN: How can you get earlier than tomorrow?

MR. SMELLIE: Earlier than the usual 9:30.

CHAIRMAN: I see. Oh, no, no. We can't do that, Mr. Smellie.

CHAIRMAN: Any of the other Interveners wish to sum up? Mr. MacDougall, I see you going towards your mike yet. The last time we met, your position was let's keep in accordance with the way we have done it in cross examination.

Go ahead, Mr. MacDougall.

MR. MACDOUGALL: That is --

MR. SMELLIE: Before Mr. MacDougall goes ahead, sorry, I had also been under the impression that we were -- and my friends have been very concise -- but I was banking on the half-day estimate that I heard about towards the end of the evidentiary proceeding. And my apologies in that regard.

CHAIRMAN: Mr. MacDougall?

MR. MACDOUGALL: Mr. Chair, I guess my earlier comments last week were also based on that, that we thought today would probably be taken up fully with the applicant. But to the extent that it hasn't been, we could probably do most -- take up most of the rest of the afternoon with WPS' argument.

I would have to seek instructions from my client to do that. But if that would move the hearing along, we would probably be willing to do that, since there is a time gap.

My comments last week were really not to move us out of order if it was just for the sake of moving out of order. But if it is to progress the matter I could certainly seek instructions at the break and we could maybe be able to be helpful to all the parties.

CHAIRMAN: All right. Mr. Zed, from your perspective how long are you going to need? And would you be able to proceed after the break?

MR. ZED: Mr. Chairman, I would be prepared to -- I was prepared to do Emera Energy's summation. Mr. Morrison provided me with copies of three cases just before we started.

And I think to be fair to the Board and to my client I should at least have an opportunity to read them. And so but for that --

CHAIRMAN: Well, all right. Mr. MacDougall, would you contact your client during the break and see what the approach is?

I will speak with my fellow Commissioners. And Mr. Zed, you can start to read.

MR. ZED: I will, Mr. Chair.

MR. MACDOUGALL: I will, Mr. Chair.

CHAIRMAN: All right. We will come back at 3:00 o'clock.

(Recess - 2:35 p.m. - 3:00 p.m.)

CHAIRMAN: Mr. MacDougall, we spoke during the break and you have contacted your clients and you are prepared to go ahead, I guess.

MR. MACDOUGALL: I am, Mr. Chair.

CHAIRMAN: Okay. Well the Board appreciates that. Go ahead, sir.

MR. MACDOUGALL: Thank you very much, Mr. Chair.

MR. HASHEY: Mr. Chairman, before you begin, Mr. MacDougall, we have put copies of our submission on the table by the secretary, if anybody wishes one, and there is further at the back of the room. I realize we spoke fairly quickly and probably there are points there that you might like to refer to. Thank you.

CHAIRMAN: Okay. Go ahead, Mr. MacDougall.

MR. MACDOUGALL: Thank you, Mr. Chair. Mr. Chair, just to start off, you will note in front of you the Secretary has placed a document that is entitled "WPS Canada Generation Inc. aids to final oral argument". That document merely has attached to it two documents that are already part of the record. So I don't propose to make this an exhibit in this proceeding. However, during my argument I thought it would be useful to have the documents in front of the Board when I refer to them. So these are the two I'm going to refer to and they are just for your ease of reference.

CHAIRMAN: Thank you.

MR. MACDOUGALL: And unlike Mr. Hashey, at the end of the day I will not be submitting a copy of my argument in part because we moved up and I'm still using mine with some of my own handwritten notes on it. So my pencil scratchings probably won't be of use to any parties.

But also unlike Mr. Hashey, I am going to make some quite extensive references to the record, Mr. Chair, and read in portions of the record on the issues which my client had an interest. We thought it was important to draw the Board's attention back to the record where these statements are made. So I will make certain transcript references and they flow through as part of the argument.

Before I start, Mr. Chair, I would like to commend counsel for NB Power on their ability to summarize the issues they saw in a case of this magnitude so quickly and in such a succinct form. That's a difficult chore. I'm sure if other parties think there are other issues they will raise them, but I commend my colleagues for being able to do that. I'm here today on a very narrow amount of issues but it may take almost as much time. Sometimes it's easier to spend a bit of time on a narrow issue than lots of time on many issues.

Good afternoon, Mr. Chair, Commissioners. Thank you for the opportunity to present the final argument on behalf of WPS Canada Generation Inc.

As Mr. Howard indicated in his pre-filed direct evidence, exhibit WPS-2, WPS Canada's primary reason for participating in this proceeding was due to concerns it had with how NB Power was proposing to cost ancillary services.

The primary, though not the only issue in this regard, was NB Power's filing of various ancillary service costs based on proxy units.

Under cross examination by myself and Mr. Nettleton on behalf of JD Irving and the CME, Mr. Marshall on numerous occasions reiterated NB Power's primary reason for using the proxy unit approach as opposed to an imbedded cost study.

For example only, at transcript page 1553 I had the following exchange with Mr. Porter and Mr. Marshall. "Question, Thank you. Now as we have already discussed your approach to pricing ancillary service number 1, scheduling system control and dispatch, which is also mandatory, was based on an embedded cost approach, correct? Mr. Porter responded, That's correct." My next question, "So you have no general bias against using imbedded costs. In fact your transmission tariff as a whole is based on imbedded costs. Mr. Marshall's response, That's correct. The transmission tariff is based on the embedded cost of transmission assets and the transmission system, which is 100 percent regulated cost of service business and the jurisdiction of this Board. The issue with generation related ancillary services is that it wold publicly make available to all competitors of NB Power Generation its detailed costs of all its assets and competitively disadvantage it in the market place, potentially causing commercial loss. That's why that information is not available."

And then in response to Mr. Nettleton, at transcript page 1647, "Question, I understand that, Mr. Marshall. But your reason, as I understand it, to reject embedded cost relates to having confidential data of commercial value disclosed. Is that not the reason why you rejected embedded costs? Mr. Marshall, That's correct."

Now following on that at page 1948 of the transcript, Mr. Hashey in providing oral responses to undertakings noted as follows. The next one was undertaking 51. Again, it was a question which you raised, Mr. Chairman. And you asked us to find out if at the time of FERC 888 in order for a utility to be compliant with the tariff filing requirements if they in fact had to file this information in a public way with the FERC. And obviously questions and queries were raised. And the answer to that is based on discussions with parties who were involved with the filings of the Bangor Hydro tariff and the Central Maine Power tariff FERC required generator cost of service information for ancillary services for all public utilities in the United States. The information was subsequently made public.

Now as the Board is aware, you requested in your preliminary ruling that NB Power identify which generating facilities will actually provide each of the necessary ancillary services and the estimated cost of providing the actual services based on using the generating facilities that will actually be used to provide such services. And NB Power responded by filing its embedded cost of ancillary services study dated February 3rd, 2003.

In WPS Canada's respectful submission, NB Power both transmission and generation, have now conceded or waived their concern with respect to the filing of the information, your preliminary ruling having given them the opportunity to oppose its disclosure. Which it is abundantly clear from the record, in our respectful submission, was the primary reason they had rejected the use of embedded cost to cost out their ancillary services.

Now to reiterate the practice elsewhere. At transcript page 1549 myself and Mr. Porter had the following exchange. "Can you advise the Board or are you aware of any FERC approved compliant tariffs to which reactive supply and voltage control is based on a proxy unit basis? Mr. Porter, No. And we responded to that fact in an IR from WPS."

In the same regard on redirect by Mr. Smellie, Dr. Earle, his witness, at transcript page 2177, responded as follows, "Question, Can you comment for us, sir, on the present practice of FERC in this regard? Mr. Earle, They do not use proxy units." Likewise Mr. Howard in his direct evidence filed with this Board indicated as follows, "Question, Why is the embedded cost of ancillary services approach now filed with the Board an appropriate approach to determine the cost of ancillary services under NB Power's proposed tariff? Mr. Howard's response, As indicated in the embedded cost of ancillary services document at page 4, that's NB Power's document, the approach is similar to the approach used by Central Maine Power Company." And Mr. Howard went on to say in his experience it's similar to the approach used by other organizations seeking a FERC compliant or compatible tariff.

As the Board is aware, NB Power has filed its tariff based on the FERC pro-forma. And has also filed as part of its evidence a report by Steve Garwood, vice president of R.J. Ruddon Associates, which in the words of Mr. Garwood's report at page 3 states, "This report provides Ruddon's views, opinions and recommendations regarding the compatibility of NB Power's proposed OATT, that's the open access transmission tariff, and other related documents with those developed in the US and approved by the FERC."

Then at page 2 of the Ruddon report the following statement is made. With the adoption of the New Brunswick Energy Policy the Province of New Brunswick is setting the stage for the introduction of competitive electricity markets not only at wholesale but also at the retail level for a segment of its retail customers directly connected to its transmission system. Taking direction from the New Brunswick Energy Policy its efforts are focused towards creating tariff and market structures that will be compatible with the competitive market structures and other development in neighbouring control areas in both Canada and the US. Compatibility with adjacent tariff and market structures is critical for the desired end result of efficient markets to be realized. One of the primary tasks required to be accomplished by NB Power in order to set the stage to accomplish these objectives is the development and implementation of a new open access transmission tariff defined as OATT that is in concert with those of adjacent markets.

That's the evidence submitted by Mr. Garwood on behalf of NB Power.

In footnote 2 of the Ruddon report, which footnote is directly applicable and found in the above noted paragraph, the report cites directly from the New

Brunswick Energy Policy White Paper at page 1 as follows. "In order to participate and to continue to capture the benefits of a competitive market New Brunswick must operate by rules and procedures compatible with those established by FERC."

In fact, Mr. Chair, Commissioners, the White Paper, New Brunswick Energy Policy, more completely states in paragraph 3 of its introduction at page 1, "During the mid 1980's the natural gas industry began moving in the direction of deregulation. In the 1990's the electricity sector emerged from a regulated industry toward one being driven in many jurisdictions by competitive market forces. These market forces are a global phenomena driven in North America primarily by the United States Federal Energy Regulatory commission. There is little option but to become part of what is developing into a fully integrated North American electricity supply and marketing grid. In order to participate and to continue to capture the benefits of the competitive market, New Brunswick must operate by rules and procedures compatible with those established by FERC."

That, Mr. Chair, Commissioners, is directly quoted from the New Brunswick Energy Policy which in our submission is a primary background to this hearing.

Mr. Chair and Commissioners, on the basis of the foregoing, it is WPS Canada's respectful submission that now that NB Power has undertaken a full embedded cost study with respect to ancillary services, and considering the majority practice in this regard, and that one of the Province's stated objectives is to have a FERC compatible New Brunswick tariff, that this Board should reject the use of proxy units for costing ancillary services and should accept the embedded cost methodology put forward at NB Power's embedded cost of ancillary services document filed with this Board on February 3rd.

Furthermore, although it is WPS Canada's respectful submission that the foregoing discussion is more than determinative, it is clear that the proxy unit approach has its own fundamental flaws.

This discrepancy is highlighted in great detail at page 10 of NB Power's embedded cost of ancillary services document where they compare the cost arising from the embedded cost study with the proxy method, showing a wide variation of approximately $10 million.

One of NB Power's supporting rationale for their use of proxy pricing was that the data was transparent. The following discussion between me and Mr. Porter found at transcript page 1553, is in our view telling. "Question:

So isn't transparency not supposed to reflect actual costs. What is transparent about providing the costs of a proxy unit? Mr. Porter: The point here on transparency is that that these are not units which are specific to a particular system, or a particular site, or a particular installation. So any market participant or someone familiar with the industry could go out and evaluate costs and come up with presumably, they will come with a very close to being the same figure. That's what was intended by the statement that there is transparency." My next question: "But they would get the transparent cost of the proxy unit as opposed to the transparent cost of the provision of the service or the cost of the service by the utility? Mr. Porter: What they would have would be a transparent evaluation of cost of the proxy unit."

It is WPS Canada's respectful submission that nothing could be less transparent than using proxy unit pricing. This gives the transparency of the wrong number.

Further, nothing could be more transparent than the embedded cost analysis that is now before the Board, an approach that is accepted and followed elsewhere.

Now, Mr. Chair, Commissioners, I would like to address two items specifically related to exhibit A-50, which is NB Power's embedded cost of ancillary services document.

The first relates to exhibit A-52, the January 6th 2000 cost of service study that was referred to late in this proceeding. And the second refers to JDI-31, which is entitled, "Recalculation of Rates Taking Into Account Credits From Other Generator Activities."

Mr. Chair, before I get to those points, I would like to note that again as we understood we may be coming later in the proceeding, these issues deal in large part with JDI, CME cross. I thought we might have the opportunity of hearing their argument on these points and that some of this may have become a moot point, because we are going before them, I want to put on the record all of our comments with respect to these issues that we believe may be raised by one of the other parties who are to follow.

With respect to A-52, this document became part of the record in that Mr. Marshall had indicated that proxy pricing that NB Power had put forward in its application came up with rates that were consistent and similar to an embedded cost study. And when Mr. Nettleton asked Mr. Porter what this referred to, Mr. Porter at page 2278 of the transcript indicated that Mr. Marshall made that statement in reference to a cost study which was done in the past. NB Power subsequently made that study available as exhibit A-52 at the request of Mr. Nettleton. That was the late filed cost study.

With respect to this study, the record is abundantly clear that it was presented in Northern Maine at the opening of the Northern Maine market, and that it was part of a negotiation on ancillary services to be charged to Northern Maine at that time. And I reference the transcript at pages 2278, 2392 and 2394.

Messrs. Porter and Bishop specifically noted in part at transcript pages 2282 to 2284 as follows: "Mr. Porter: This study was performed, as you can see, in the end of 1999, early 2000 and was used to produce the prices that would be charged by NB Power to Northern Maine and that was done at the request of Northern Maine." He then went on further, "It is not a study that has been submitted to FERC for their approval, nor was it based on a study that was submitted to FERC for their approval. It is a study that was done in in-house NB Power methodology." Mr. Bishop then discussed some of the salient differences in the two studies and then noted, "I might add that the interest rates and other things, the capital structures have been updated somewhat since that study was done in the embedded cost service that we have provided you here today as A-50." That is the updated and current embedded cost study.

Mr. Chair, Commissioners, it is extremely important to realize that this study is three years old, done in a context completely dissimilar to the one you are now adjudicating upon, and containing information that is outdated as respects the marketplace of New Brunswick.

In contrast, exhibit A-50 is an embedded cost study done by NB Power, the basis of your preliminary ruling, to reflect current market conditions and is in line with the FERC approved methodology.

With respect to this latter point, Mr. Porter, in response to a question from Mr. Nettleton, at transcript page 2285, particularly stated as follows: "My statement was that this study, which we have just handed out as A-52, has never been submitted to FERC, nor was its origin any FERC-based study. And I made that statement in contrast to the study which Mr. Bishop has submitted as A-51." And that in fact was the A-50 study which was attached to Mr. Bishop's evidence at A-51. Which was based on the Central Maine Power methodology, which as Dr. Earle has acknowledged under cross examination, was submitted and approved by FERC.

And again at page 2294, Mr. Bishop, on questioning from Mr. Nettleton. "And, Mr. Bishop, is it your evidence here today that the embedded cost study performed most recently in exhibit A-50 is the better of the two cost studies now conducted?" Mr. Bishop, "In my opinion, yes, it is."

Even more telling however is the following exchange between Mr. Snowdon, another witness on behalf of NB Power, and Mr. Nettleton. Mr. Nettleton's question, "Okay. Now, Mr. Snowdon, we have before this Board three documents with various calculations all purporting to show the cost of ancillary services provided by New Brunswick Power. We have the tariff design document that described the proxy unit pricing. The embedded cost document sponsored by Mr. Bishop. And the recently admitted embedded cost study of January 2000. In your opinion as currently, I take it, in the role of director of energy control centre, which of these studies that result in widely different costs represents the best methodology for determining New Brunswick Power's actual cost of providing ancillary services?"

And at this point Mr. Porter jumped in and said, "Before Mr. Snowdon answers, I just wanted to make a comment on your question. You indicated that those three documents, all three of them purported to represent the costs of the provision of the ancillary services. And I would like to submit that the latter, the one that is stale from the year 2000 is just that, a stale document. And I don't think anyone has put that forward. No one at NB Power has put that forward as reflecting the current scenario or the current cost of ancillaries as provided by NB Power."

Mr. Nettleton, "Well, I take it then, Mr. Porter answering for Mr. Snowdon, Mr. Snowdon, you wouldn't accept the January 2000 document?" Mr. Snowdon, "I have not seen the 2000 document." Mr. Nettleton, "I see. So which of the studies of the, I guess, the two studies that you are familiar with do you believe to be reflective of the actual costs of providing ancillaries?" And Mr. Snowdon's response on the record, "The first one you referred to, the proxy unit is a proxy unit pricing. And the second one is the embedded cost on a prospective basis for supplying those services. So I would have to say the second one reflects the costs."

Now, Mr. Chair, I would like to refer to these aids to final argument. It may be useful just to turn to the first page which is just a copy of JDI-31. This is the second specific point that I wanted to reference.

The document is entitled, "Recalculation of Rates taking into Account Credits from Other Generator Activities." Quite simply, WPS Canada's position on this document is that JDI has mixed apples with oranges for the sole purpose of attempting to take a credit from one method, the proxy method, and apply it to another method, the embedded cost method, so as to reduce the embedded costs which they had appeared to be supporting as the appropriate method in this hearing.

On redirect from Mr. Morrison when Mr. Porter was asked to explain why he disagreed with the methodology of JDI-31, he stated as follows, "Yes, thank you. It comes back to the point that was made in the Panel C presentation by Mr. Marshall that there are really four distinctly different approaches to pricing that were considered. And two of those approaches, the proxy based pricing and embedded cost pricing, are really based on distinct sets of economic principles. And therefore doing a direct comparison between the two or taking parts of one type of study and using them in another, would be inappropriate."

Mr. Porter then described the two separate methodologies and went on to state, "So on that basis I would say that what is done here" -- and, Mr. Chair, at this time you may just wish to look at the document JDI-31 which shows columns 5 and 6 the energy production credits. Again, back to Mr. Porter, "So on that basis I would say that what is done here on this JDI-31 is inappropriate in that these total fixed costs in column 2, which are derived from the embedded cost study, should not have these other components in columns 4, 5 and 6 subtracted off to create a net revenue requirement to be associated with ancillary services. This is a case of mixing and matching components from two different pricing approaches, and I would say that that is inappropriate."

And when Mr. Nettleton asked Mr. Porter at transcript page 2346, "Why would a credit calculation like we have just explained not be appropriate for the calculation of the embedded cost of ancillaries?" He and Mr. Bishop described that very clearly as follows. Mr. Porter, "I think the best way to answer that question is I can give you an explanation as to why it is appropriate for the proxy, which is what I'm familiar with, and either I could answer or perhaps Mr. Bishop will answer with regards to the embedded cost study, and what the approach is in the embedded cost study." Mr. Bishop then said, "In the embedded cost study there is already provision for the fact that generation is used to provide both energy and ancillary services. So in the calculations as you go through the schedules it is a determination of how much of the capacity is not on-line. You can look at the availability factors and the capacity factors or is not producing energy including export energy. And it is that portion of the capital cost that gets allocated to the ancillary services. In other words, in this calculation in the calculation in each of these schedules, and that's in the embedded cost study, only the portion of that generation that is used for supplying ancillaries is costed to meet a derivation of revenue to cover those ancillaries."

Mr. Chair, Commissioners, we accordingly submit that the record is clear that any energy production credit is absolutely inappropriate to be applied to an embedded cost methodology that already contemplates this issue fully.

It is also very important to note that there is no evidence on the record that supports JDI's position. In fact Mr. Nettleton quite candidly stated at transcript, page 2342 with respect to JDI-31, and I quote "I realize that this would probably be best put through a witness of JDI, CME. But in light of these unusual circumstances, I -- we have decided to see if we can just simply cross examine on this calculation that has been performed. That cross-examination derived no support for this position. And JDI, CME has no evidence to suggest any credence to this specific document."

This issue also leads to an area of what appeared to be some confusion on the part of JDI, CME during Mr. Nettleton's cross-examination. That is the issue of capability to provide ancillary services.

It appeared from WPS Canada's perspective that Mr. Nettleton was trying to state that pricing ancillaries based on capability rather than what he called "in my view actuals" was somehow incorrect.

Mr. Chair, Commissioners, as the record makes clear, reserves are, as Mr. Porter stated, something akin to insurance. That is transcript at page 2330. And Mr. Bishop I believe used an analogy to the fire hall.

Reserves are there to be available. They are not always actually utilized. That is the nature of reserve capability.

The transcript has many descriptions from Mr. Porter and Mr. Bishop on this issue. The few I would like to specifically note are Mr. Porter at various points on pages 2328 through 2330 as follows.

"I just want to add that those quantities are the quantities that were available, as Mr. Bishop had said. And the system operator could call on those resources in the case of a contingency. So those are services, quantities of services that I could say that they were provided. So the numbers on the tables do reflect what was available and in that respect were provided to the system operator."

Later on he goes on to say, "From the system operator's perspective, a system operator looks at it from the perspective of whether generation capability exists in the system based on the generation dispatch. They would take that into account. And as I say, many hours it would exceed the minimum requirement. But from the system operator sitting there in the control centre, the service that is provided is reflected in these numbers. And while you say it is not just the fact that they are capable, those resources are there, can be called upon by the system operator. So this is really just a reserve or an insurance. So to me that insurance service is being provided."

And at page 2330 on questioning from Mr. Nettleton to the intent that NB Power is asking ratepayers to pay a cost that may have nothing to do with the actual service that is provided, Mr. Bishop responded, "I think it has got to do with -- I believe it has to do with the service that is provided and in fact that is used to establish a rate. We have a service that is provided to the system operator by a number of generating facilities. The embedded cost study has calculated the embedded cost that New Brunswick Power incurs in having generation there ready to provide that service, any particular service and indeed to determine the amount that is charged in any one hour. That rate is applied against the actual quantity that the system operator chooses to use or is required to use by reliability criteria."

And then when specifically asked by Commissioner Sollows -- I'm sure we will remember this exchange at transcript page 2331 -- "If you don't mind, just so that it is clear in my mind, they must -- there must be some record of the total output of each unit. And that could be compared to the requirement in that hour that we could -- I mean the amount of available capacity must be known to the dispatcher?"

Mr. Porter: "That's what is reflected in the studies, the available capacity."

Mr. Sollows: "Right. That is the total that is available?" "Yes."

"And the amount of required capacity to meet your reliability criteria must be known to the dispatcher as well?" Mr. Porter: "Yes."

Mr. Sollows: "So the difference between these two would be known to the dispatcher, is that" -- Mr. Porter:

"Yes."

Mr. Bishop: "And that is the numbers that we have provided."

Mr. Chair, I would now like to make a few comments on exhibit A-56. And that is the next document. I think JDI-31 was two pages. So it is the last page of this document A-56.

Now this is the document where JDI requested NB Power to run scenarios of both the January 2000 and the present-day embedded cost study models using different capital structures, cost of equity and cost of debt.

As I argued on behalf of WPS Canada at the time, we were concerned with running scenarios using the January 2000 model for all of the reasons we noted above as in our view respectfully being inappropriate in today's market and inappropriate for the purposes of this proceeding.

We also reiterate at this point that there is no evidence on the record by any party that supports the use of that model.

However, what is particularly useful to note in exhibit A-56, is in each of the three scenarios asked to be run by JDI for the January 2003 model, that is scenarios (d) (e) and (f), they all produced a revenue requirement for ancillary services well in excess of the proxy method.

The proxy method yielded a revenue requirement of $38.4 million. The 2003 embedded cost study, as you can see from the first column prepared by NB Power, yielded a revenue requirement of $48.2 million.

It is this model -- and on that point, Mr. Chair, Commissioners, I would like to make clear -- it is the 2003 methodology which WPS Canada supports, and which WPS Canada believes is fully supported by the record in this proceeding.

That being said, there is of course some leeway to discuss inputs to the model and the methodology, particularly regarding items such as the appropriate capital structure and the cost of capital in the newly unbundled NB Power.

In that regard JDI proposed scenarios with a decreased equity component, a decreased cost of debt and a decreased cost of equity in its scenarios (d) (e) and (f). And at the bottom you can see those scenarios.

As the Board can see, even in the case where the January 2003 methodology has an equity component of only 35 percent, cost of debt of only 7.5 percent and cost of equity of only 8.5 percent, the revenue requirement that is yielded is still $41.5 million as compared to the proxy method of $38.4 million.

WPS Canada's position is that the embedded cost analysis is the analysis that is going to send the correct price signals to the market.

WPS Canada's position throughout this hearing was always to ensure that the rates for ancillaries that were going to be charged in this market were reflective of the costs to provide those services.

That is what is necessary if a competitive market is ever to develop in New Brunswick. The proxy method undervalues ancillaries and will pretty well eliminate the ability for any other parties to enter the market.

That being said, if this Board is convinced that the capital structure proposed by NB Power with respect to ancillaries, i.e. the capital structure for Generation as opposed to Transmission, or the proposed cost of debt or cost of equity require adjustment, it is still clear that even in much revised scenarios, the actual costs derived from an appropriate embedded cost study still far exceed the proxy method results. That has got to be very telling to this Board.

With respect now to the issue of the appropriate capital structure, we do note that in response to Commissioner Richardson, Ms. MacFarlane filed revised undertaking response number 56.

I apologize. It was just given an exhibit number this morning. But it is the revised undertaking, response number 56, which indicated that CIBC World Markets was still suggesting a debt/equity ratio of 60/40 for the Transmission entity.

Although she noted the CIBC had not yet finalized their recommendation for a capital structure in the generation entity, since the allocation of risk between that entity and the Distribution entity will be significantly affected by the terms of the vesting contract, Mr. Porter did indicate that the risk profile for Generation is different and that NB Power had some indication that 55 percent equity in Generation -- in a Generation-only entity is reasonable and common. That is at transcript page 2401.

We have no specific position on that point, Mr. Chair, except to note what is on the record in that regard.

Ms. MacFarlane at transcript pages 2403 through 2404 also noted that the bankers to the Province would recommend a higher return than what NB Power has applied for in the ancillary services application, i.e. a rate of return that would be in excess of 13 percent where NB Power included 11 percent.

That was at transcript pages 2403, 2404. Now that is with respect to Generation, but also has to be kept in mind in light of the revised filing this morning.

Finally on the issue of competition which -- and I ask the Board to refer -- think back to the comments that I quoted. And when you look back at the transcript directly from the energy policy of the Province of New Brunswick, look at their comments on competition.

This was an issue that was raised regularly by Mr. Bishop. He often mentioned competition. Because it is his side of the business that is going to start to face competition.

Mr. Chair, Commissioners, the incumbent NB Power should not be able to set artificially low prices for ancillary services so as to protect its market share moving into a competitive marketplace. This would be counterproductive to the opening of the market.

If over time competition or competitive providers bring the costs down, that is appropriate. For NB Power to start with an artificially low cost, that serves no one in the marketplace and is not appropriate.

Mr. Chair, Commissioners, as examples from other jurisdictions provide, it is very important to get the markets structurally correct from the outset. Creating anomalies that are inconsistent with the competitive market is a route fraught with difficulty.

In conclusion, Mr. Chair, Commissioners, WPS Canada Generation Inc. submits that the evidence in this proceeding is clear, that exhibit A-50 is the appropriate methodology to be used for determining the cost of ancillary services in the New Brunswick marketplace.

This methodology will send the correct price signals, not an overly high nor an overly low price signal. And WPS Canada commends this approach to the Board consistent with its acceptance by FERC, subject however to the Board's final findings on the appropriate capital structure and cost of capital to be subscribed to NB Power's generating business.

Mr. Chair, that is the end of my formal submission. And like Mr. Hashey, I would just like to thank the Board for its consideration throughout during this process for Board staff and for my other colleagues as well.

This is a very professional well-run hearing over a long period of time and some unusual circumstances. As I believe that was mentioned once or twice during the hearing. And we certainly appreciate all your considerations.

CHAIRMAN: Thank you, Mr. MacDougall. Mr. Zed, can you follow up for Emera?

MR. ZED: Yes, Mr. Chair.

CHAIRMAN: Do you want to do it from mike number 3?

MR. ZED: I prefer to if that's okay.

CHAIRMAN: Certainly. We will give Mr. MacDougall an opportunity to go back to his normal place.

MR. ZED: Thank you, Mr. Chairman, Commissioners. I now wish to take an opportunity to summarize the evidence and arguments on behalf of Emera Energy Inc.

To begin with I would perhaps attempt one more time to distinguish Emera Energy Inc. from Nova Scotia Power.

Emera Energy is an independent company focused on acquiring and growing energy investments in northeast North America. It is actively engaged in a multitude of businesses in the Maritimes and throughout the US northeast.

In principal, we see the proposed electricity market changes and NB Power's tariff application as positive steps toward creating a proper regulatory environment to encourage other market entrants to participate in the New Brunswick market.

Ultimately, the success of the market opening can only be judged by the extent of benefits to customers in the long run. The more transparent and competitive the market becomes the more benefits will ultimately be realized at the consumer/customer level. This type of market can only evolve if the regulatory environment adopted in New Brunswick is fair, non-discriminatory and does not include unreasonable barriers to entry for new participants.

We believe that three matters must be addressed in order to enhance this regulatory environment for the development of a transparent and competitive market. To ignore these matters and approve the tariff as requested will in our respectful opinion have the opposite effect to varying degrees.

The three matters with which we have concern are, firstly, the initial allocation of transmission capacity, secondly, the calculation of path losses on point-to-point service, and finally, third, the proxy suggested by NB Power to settle energy imbalance charges which in our view does not properly account for the true cost of service.

Firstly, dealing with the issue of initial allocation of transmission capacity, Emera Energy feels very strongly that NB Power's proposal to grandfather all long-term firm reservations is flawed and thus not defensible.

To understand why this is so one only has to look at the evidence on which all parties agree.

We all agree that access to the northeast US market is an absolute necessity to justify investment in generation capacity in this province. On that point the evidence is clear. Also all parties are in agreement that the only economically viable path to transport electricity to the northeast US runs through the MEPCO tie. NB Power has confirmed in its evidence that virtually none of that capacity is available primarily because of the process undertaken by NB Power in 1998.

Now we see no need to review that process in detail but my learned friend, Mr. Morrison, referred to it, I lost track, either three or four times, and repeated what was done. We all know what was done and we also all know what the objections that Emera has voiced in regard to that process. They are the same objections that were voiced by Hydro Quebec and they were the same issues or similar issues that were taken up by northern Maine. And all of this is contained in our evidence, in Emera's evidence. Mr. Marshall confirmed it in his own evidence. This evidence had not been refuted.

So to suggest that those reasons, i.e., no regulatory environment in place, to suggest that that is immaterial is just purely erroneous and not supported by the evidence.

This flawed process -- and again we are not importing any bad faith. NB Power did what they did and the results are evident. But whether there was bad faith or not it was a flawed process.

In any event, it resulted in NB Power tying up virtually all of the transmission capacity on the MEPCO tie. And this should not be given this Board's approval to continue beyond the opening of the market in April.

What we are suggesting is very simply that all transmission allocations should be open to an auction process in an open and non-discriminatory manner as provided in the standard FERC tariff. This of course should not only apply to the MEPCO tie but all other ties.

We do agree that any long-term transmission allocations supported by a contract with a bona fide third party should be exempted from this process. However, we do not include in this list of exemptions those contracts that are currently held by NB Power Generation or another of NB Power's divisions, unless of course these are in support of bringing forward third party long-term firm reservations.

So we don't want to be too technical about this. If there is a bona fide third party involved and a commitment has been made, we are not suggesting that that commitment should not be honored, but to the extent that there is not long-term firm reservation capacity either directly or indirectly assigned and spoken for by a third party, then it should be part of the open auction process.

I really -- our difficulty -- I listened to Mr Morrison make distinctions between affiliates and power contracts and I think really with respect that is missing the point. And perhaps we should go back to a little Contracts 101, if you will indulge me.

Emera Energy is asking that what NB Power is asking this Board to do should not be granted, because in effect they are asking the Board to grandfather -- and I use the term advisedly -- contracts, but there are no contracts. They are contracts with itself. I know of no tentative contract law nor any pronouncement by FERC or any other body that gives support to this novel argument. Our evidence in this regard has been clear and unequivocal. NB Power's evidence quite frankly has been non-existent.

Now what they did is said, we want to grandfather "contracts". There wasn't any direct testimony. There wasn't any rebuttal evidence. Instead they put excerpts of various FERC pronouncements to primarily Mr. Connors, and as the Chair reminded Mr. Connors after asking the same question so many times the answer was the same. Mr. Connors could not on a review of those excerpts find any indication that FERC was grandfathering other than third party contracts.

In NB Power's application they have asked that arrangements made between their transmission and generation divisions be grandfathered and given the force of contracts in perpetuity. With due respect, that is not proper.

Mr. Morrison today has raised three particular cases, and on a quick review of the cases he is really, with respect, getting at two issues. He suggests that Emera is saying -- and I will read from his summary. He says, Emera agrees with this position but subject to two exceptions, only reservations supported by a power sales obligation are to be preserved. Well we have already said that if there is a third party who has a power sales obligation or the right to take power, then that's fine.

But -- and reservations held by an affiliate party should not be preserved. Well I don't know what the definition of affiliate party is, but if affiliate party means reservations held by another division of the same company should not be preserved, then yes, we agree with his characterization.

Returning to the FERC Order 888 and 889 excerpts, there is nothing in those excerpts to indicate that those contracts were anything other than third party contracts. Common sense would tell us in the absence of an explanation to the contrary one must assume them to have been third party contracts.

Moveover, while it is our contention that the FERC excerpts put to our Panel by NB Power referenced third party contracts and are therefore of no assistance to NB Power's argument, FERC and Mr. Connors confirmed that his review indicated that the number of such contracts grandfathered was minimal and would have no negative effect on the market. That was certainly inferred from the excerpts put to Mr. Connors. How unlike the present situation where what NB Power is seeking to do is have this Board sanction the closing of the MEPCO tie.

How can NB Power, given the market design committee and the government's strong expressions of a desire to open the market, ask this Board to sanction activity that will eliminate the largest single incentive for potential market entrants to participate? Depriving potential investors from access to the northeast US market is short-sighted and counter productive.

In summary, we are asking this Board to adopt and approve the tariff insofar as it calls for an open auction for existing capacity as of the date of the market opening for any firm, long-term capacity, with the only exception to be capacity which is contracted for by bona fide third party arrangements.

I will now move on to the second issue and that is of path losses.

NB Power currently calculates path losses on point-to-point service on a path specific basis. Mr. Scott's written evidence indicates that post April 1st 2003, this will not be possible. Their oral evidence on cross-examination looking at transcript pages 381 and 382, directly contradicts this erroneous assertion. Upon cross-examination Mr. Scott willing admitted that there is no operational reason why post April 1st they cannot do the same calculation and assign the cost to specific paths.

The only economic rationale, and I'm left to infer this, is that it will be easier and more profitable for NB Power to assign a system average loss to all participants. Is this a good enough reason to change the current system?

Now it's probably instructive to look at this proposal from two different perspectives. From a rate-makers perspective one would have thought that the more appropriate method in costing a service is to assign actual costs where those costs are readily available.

Secondly, from a potential investors perspective, one would have thought that the ideal would be that costs should be borne where they are incurred as this assists in the analysis of the economic feasibility of any particular investment. Using this simplistic analysis, it would appear that the same method is advantageous to both the rate-maker and the rate-taker. Moreover, if one looks at the NOPR rules it appears that FERC is intent at looking at the issue of locational marginal pricing. At its most basic this is a method of assigning costs where they are incurred.

In other words, notwithstanding the rule in effect in other Canadian jurisdictions, we can infer from the NOPR rules that the trend would appear to be to path specific pricing.

If this is the case why is NB Power seeking to go in the opposite direction? We therefore ask this Board to rule that the current method of assessing line losses on point-to-point service be maintained. It just makes sense.

Thirdly and finally, I would like to deal briefly with the issue of energy imbalance charges. NB Power has proposed the use of a proxy for calculation of energy imbalance charges. In this regard, the only evidence they have offered is that it is necessary to penalize participants for being out of balance.

As far as that statement goes, Emera Energy is in complete agreement. We do recognize, however, and have adduced in evidence that there is a more appropriate pricing proxy for imbalance charges.

Now while we agree there must be a punitive component in assessing such charges, we would remind the Board that because of the very nature of the system it is virtually impossible for any participants to be in perfect balance.

Participants no matter how diligently they forecast loads, will almost always be in error. NB Power has recognized this by allowing for a reasonable level in their provision of deadbands. So while we recognize the need to send the proper signals to the market, the cost of obtaining imbalance services should be somewhat reflective of the cost of the utility providing such service.

In this regard we have provided our evidence for your consideration in a proxy which more appropriately reflects the cost of providing the service. We have also suggested that an appropriate amount be added to this cost of service to serve as a disincentive for parties to forecast incorrectly.

Now if I might Mr. Morrison I believe raised the issue of Mr. Sidebottom's testimony. And he read an answer from Mr. Sidebottom on page 744. And the answer he read really was taken out of context, because if you had gone back to 743 you would see that the question was put to Mr. Sidebottom thusly at line -- beginning at line 13 on page 743.

"And conversely then you would also agree with me that the pricing signal should be a disincentive for people or participants to lean on the system. And you know what I mean by leaning on the system, right? Answer: Mr. Sidebottom: Yes. I would say that the disincentive needs to be of the right size so that it puts appropriate signals to move the generator to the load schedule and at the same time balancing the fact that you don't want to over penalize the generator to the extent that it is going to cause them not to consider using potential paths or in a general case, you know, probably disincent using the open access system".

"So Mr. Sidebottom's answer in its entirety is really just an illustration or recognition of this balancing act? Yes, we don't want to encourage people to be out of balance, but we have to recognize that they are going to be as a normal operational rule out of balance to some degree. But also we do want to penalize people to the extent that they do not want to avail themselves of these services. So there is that balancing act to protect the integrity of the system on the one had and on the other hand do not disincent anybody from investing in the system".

Now we have of necessity made some very general suggestions in our evidence but those suggestions are very capable of being converted to appropriate proxy formulas if the Board should so decide. And we would be pleased to provide the Board with more specific information should they so rule, because it's very difficult to start throwing numbers around. But if the Board for example were to rule that the true cost of service of providing this energy imbalance must be incorporated into the proxy, then the matter could be addressed by way of paper exchange. We are more than confident that could be done. And that's what really we are suggesting.

And unless there are any questions, I would like to end the presentation on behalf of Emera Energy, and like the previous speakers, thank the Board and all other participants for co-operation and until I return tomorrow to speak on behalf of Nova Scotia Power, that is all I have for now. Thank you.

CHAIRMAN: Thank you, Mr. Zed. Just before we break, Mr.

Smellie, how long do you think it is going to take for your summation?

MR. SMELLIE: I'm thinking of my friend, Mr. MacNutt, Mr. Chairman.

CHAIRMAN: He doesn't have to sum up so he is out of the picture.

MR. SMELLIE: Assuming that we were to start at 9:30, I'm going to try and be reasonably conservative and say that we would be done by the afternoon break.

CHAIRMAN: Okay. The reason that I put the question to you, sir, is that unless Mr. Young and Saint John Energy and the Municipals get on tomorrow, you will cut off the power to the Board's premises. So I want to make certain that there will be time for him, that's all.

MR. SMELLIE: Yes. And quite frankly, Mr. Chairman, if my friend, Mr. Young -- I have no sense of how long he plans to be. If it would be his preference -- because I'm away from home, I'm focused entirely on this proceeding. If they would like to precede us that's --

CHAIRMAN: All right.

MR. SMELLIE: Perhaps I can talk to him and -- I take it it makes no never mind to Mr. Hashey whether Saint John Energy goes first or not. But maybe I can work that out with Mr. Young.

CHAIRMAN: All right. You work that out. Well Mr. Young has his hand up. Mr. Young?

MR. YOUNG: Yes. We would enjoy going first and in fact our presentation should be half an hour at the most. Mr. Smellie, would that be --

CHAIRMAN: That sounds like --

MR. SMELLIE: That's fine, Mr. Chairman. You will see that my colleague, Mr. Nettleton, is beavering away, as they say. We listened carefully to Mr. Morrison and Mr. Hashey's remarks. I think we will have some reply on the way by and that's the variable. But I'm going to do my best to endeavour to meet that time table, sir.

CHAIRMAN: That sounds great. All right. If there are no further matters then we will break now until 9:30 tomorrow morning. Thank you very much.

(Adjourned)

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

Reporter