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 18th, 2003, 9:30 a.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 morning, ladies and gentlemen. Before we call on the municipal utilities for their presentation are there any preliminary matters?

All right. Good. Mr. Young, do you want to come up to the number five.

MR. YOUNG: Yes, Mr. Chairman.

CHAIRMAN: Okay. Go ahead, sir.

MR. YOUNG: Good morning, Mr. Chairman, Commissioners. My name is Dana Young and I have been an employee of Saint John Energy who has, as you know, been closely been

involved throughout the entire hearing on behalf of three New Brunswick municipal utilities, Perth-Andover Light Commission, Edmundston Energy and Saint John Energy. The municipal utilities were all originally established to provide cost-effective service to our customers and it is the long-term interests of our customers that have governed our participation here.

I would like to begin by thanking the Board for its patience and guidance throughout this lengthy hearing and for the opportunity to voice our position on the Open Access Transmission Tariff application as applied for by NB Power on June 21st 2002.

The municipal utilities all became formal Intervenors in this process primarily for the purpose of addressing the implications of this application to our customers. The municipal utilities are supportive of the concept of an Open Access Transmission Tariff. And in addition, the municipal utilities accept the basic FERC model proposed by NB Power.

The governing principles for the Board in this proceeding are set out at Section 58 of the Public Utilities Act, which states, "All tariffs shall be just and reasonable." The municipal utilities support that goal and are greatly concerned about the impact the tariff

may have on their customers.

To make the best use of your time, the municipal utilities will present our summations together. This is possible because we have many issues in common.

The closing summation that we have prepared will be presented in the following manner. I will begin by addressing some of the issues we share in common. Then each utility will address some of their issues which are a particular focus for them or relate to their individual and unique situations. The last of these three presentations to be made by Saint John Energy, we will also present a brief summary of all the key issues we have covered.

The three MEU leaders that will speak on behalf of their utilities and customers will be, Mr. Dan Dionne of Perth-Andover Electric Light Commission, Mr. Michel Morin of Edmundston Energy and Mr. Eric Marr of Saint John Energy. Mr. Michel Morin will give his portion of this presentation in French, if that's acceptable to the Chairman.

CHAIRMAN: Of course it is.

MR. YOUNG: I had no doubt, sir. Let me begin with the common issues. From the beginning of this tariff application and approval process we have expressed concern

on the difficult position that electricity customers have been put in by the sequence of events. The fact that NB Power proceeded with an open-access transmission tariff implementation process prior to the availability of the government's policy with respect to the new structure of the electricity industry has been a source of constant confusion and frustration, which was compounded by the release just before the Christmas holidays of the first draft of the Market Rules. The logical sequence of events would have been the exact reverse, legislation then rules then tariff application.

Throughout most of these hearings the new structure of NB Power was known only in general terms and was gleaned only from statements made by the Minister and the expectations that NB Power offered. While today we have the benefit of Bill 30, which provides more reliable information on this matter, we are still left with considerable uncertainty. For example, we still do not know whether profits from export sales will continue to be used to reduce electricity costs for New Brunswick consumers, and this is an issue of considerable interest to the consumers who pay all the bills that support the electricity industry in this province.

Another example relates to the new tax payments that

have been mandated for NB Power. It appears these taxes have been implemented without regard for the existing taxes paid by the municipal utilities. At present the municipal utilities pay both the New Brunswick Utility Tax and the New Brunswick Property Tax and our expectation would be that all taxes be considered when changes are made to one part of the tax regime. Depending on how the proceeds from the next taxes on NB Power are used, our concerns about double taxation may be proved to be unfounded. Again, however, information on this has not been forthcoming to date.

The evidence presented at this hearing establishes rate of return and capital structure requirements on the basis of theoretical arguments made from the perspective of investors. We understand that the dividends, interest and pseudo tax payments proposed for inclusion in NB Power's revenue requirements are intended to ensure that external users of the grid pay their full commercial costs and do not get a free ride. What we do not understand is how New Brunswick consumers are to be protected from these extra costs and how they will benefit from the extra revenues collected. Again these are critical issues that might have been more appropriately addressed prior to proceeding with the formalities of putting an open access

transmission tariff in place.

We are even less comfortable with the proposal for performance based rates or PBR. This issue seems to be an easily avoidable complexity in the overall restructuring program which will have more than enough unavoidable complexities. The evidence at the hearing was that other jurisdictions have not been quick to embrace PBR and we do not think that this Board should accept the applicant's proposal on this issue at this time. What might be more appropriate would be to consider PBR after two to three years of experience under open access operation and in the context of a public benchmarking program.

We also note that the first draft of the market rules would have required that the transmission tariff be heavily amended. While Bill 30 has made it clear that the transmission tariff prevails over the market rules so that there is no immediate concern, it is reasonable to assume that since the market rules should logically have been developed and finalized prior to filing the tariff, it will in fact be necessary to revise both the rules and refile for a new tariff, in that sequence in the near future.

In addition to this, Bill 30 raises further questions about the advisability of putting PBR in place

immediately. It indicates that the corporate status of the transmission company will be changed twice between today and a year or so from now. It also indicates that the revenue requirements of both the present NB Power Transmission Company and WPS Generation Canada will be combined in the not too distant future which would seem to create some complexities in establishing appropriate PBR arrangements.

So in getting the logical sequence between the rules and tariff correct and changing the corporate structure of the transmission company, it appears there will need to be a new transmission tariff some time in the months ahead. This clearly requires a reconsideration of some sort for the Board, which defeats one of the main purposes of having PBR arrangements, that is reducing the frequency of regulatory hearings. As I said earlier, we therefore believe that it is inappropriate to include PBR in the approved tariff. This could be effectively achieved by limiting the term of the tariff to 12 to 18 months, which Bill 30 appears to indicate is all that is advisable in any case.

It has become evident that something is amiss in the pricing of ancillary services in the application as filed. The prices appear to be very high compared to those in

the open markets of Maine and confidence in the pricing is undermined by the fact that it involves transfer pricing between companies that as-yet have not been unbundled from the applicant. The hearing has revealed that determining the appropriate pricing is a very complex process at the best of times, and is particularly complex for this application which has been submitted by a vertically integrated utility, but is to be applied to a collection of entities that result from the unbundling and segregating that utility.

This high level of complexity will inevitably undermine the confidence that stakeholders have in whatever pricing the Board approves. We therefore suggest, regardless of what pricing is approved for ancillary services, the system operator "butterfly" that is spun off from the applicant should be required to publish weekly or monthly the actual cost they have experienced in providing ancillary services which will serve to focus continual attention on the pricing and its cost effectiveness.

I would like now to turn the microphone over to Mr. Dan Dionne who will address the Board on behalf of Perth-Andover Electric Light Commission.

MR. DIONNE: Good morning, Mr. Chairman and Board members.

My name is Dan Dionne. I am the Chief Administrative Officer for the Village of Perth-Andover. On behalf of Mayor and Council and the residents of Perth-Andover, I would like to thank you for this opportunity to speak to you regarding this important issue.

Our municipally owned electric utility was originally incorporated in 1903 as the Andover Perth Light Commission. As I am sure you might expect with this year being the utility's 100th anniversary, our community is very proud of its Light Commission and the century of service it has provided to our residents and our businesses

The Perth-Andover Light Commission has several unique features, a lot that you may not be aware of.

It is the only electric utility in New Brunswick that is owned by a village, the other two of course being owned by cities. We are clearly the smallest utility in the province serving 1,000 residential and small business customers with a population of 1,908 residents.

We take pride in offering the lowest power rates in the province. As a result of having the most favourable electric rates over many years, we have had the highest proportion of electric heating load of any utility in the province. We are the only community in New Brunswick that

is not supplied by NB Power. Our supplier presently is Wisconsin Public Service Company which is based in the state of Maine.

Our utility is served by a transmission line directly from the Tinker dam facility located in Four Falls located along the Maine border. This line is controlled by the Northern Maine System operator and is currently independent from the NB Power grid.

Another feature we are proud of that we are a debt free utility which is a direct result of the strong dedication of financial planning and a commitment to pay as you go policy.

Our utility has always maintained a capital reserve fund for future capital improvements. In addition to this, during 2002 we have established an operation reserve fund to ensure we could provide short-term protection to our customers from changes in the utility cost that result from electricity restructuring activities. For example, our current supply contract will see our costs for wholesale power supply increase by 72 percent between 2002 and April 2007.

Our community has been very concerned with the Open Access Transmission Tariff and the entire electricity restructuring process. New Brunswick has been very

fortunate to have had some of the lowest power costs in the region over a sustained period of time. However, it appears from these hearings that the provincial electricity restructuring program will introduce many new costs into New Brunswick's electrical supply.

Some of the more obvious of these additional costs are the future payment of a dividend to the Province, increased borrowing costs for NB Power and increased administration costs resulting from the operation of five independent corporations. We are very concerned of how these new costs items will be reflected in the future electricity rates.

We understand that this cost structure has been put in place to recover the true cost of using the transmission system. But this consideration relates to users from outside the province. In-province users including the residents of Perth-Andover have implicitly carried the business risk of building, owning and operating the provincial transmission grid by underwriting it as New Brunswick tax payers. It is unfair, and we believe unwarranted, to simply increase the cost of transmission services to New Brunswick residents and businesses without also providing some offsetting advantage. Maybe that advantage exists in the form of reduced provincial taxes

or reduced price for electricity itself but we have not been told of this and therefore remain concerned with the impact of this tariff and the overall cost of electricity service.

During the transmission tariff hearing, our community has been concerned with the possible pancaking of transmission charges. As you are aware pancaking is a term applied when payments must be made to two separate transmission systems for a power transfer that involves both systems. Bill 30 has greatly improved the clarity in this area. As you are probably aware, it provides that effective January 1st 2005 there will be a single transmission tariff which applies to the new system operator or SO organization that will be -- incorporate the revenue requirements of all transmission owners in the province. Because we are currently taking supply through a contract that will take us to January 1st 2005, and because the contract includes delivery to our substation, therefore includes all the transmission related services. Bill 30 effectively eliminates pancaking. Our concerns on this issue therefore have been resolved during the course of these hearings.

This entire electricity restructuring process has been a learning experience for all potential market

participants. We appreciate, Mr. Chairman and Board members, that you may have been frustrated at times during these hearings when intervenors, including ourselves asked questions while cross examining to find out how things worked. This has been a genuine requirement on our part to better understand what is going on so that we can keep our customers informed of how the transmission tariff may impact them. For restructuring to succeed and this tariff to work much has to be done on improving customer education and communication. On behalf of the municipal utilities, we would like to recommend that your approval of this application require that one or more of the NB Power "butterflies" take initiatives to provide educational sessions to distributors, system users and customers.

In summary, our residential and small business customers are very concerned about the new cost items associated with the proposed new electricity market and would like to hear what offsetting advantages are and how they will directly benefit individual customers. I'm sure that you can recognize that this concern is heightened by the difficulties that other regions have faced in transforming their electricity industries. And we trust the Board will make the decision on this tariff

application that is the best one for all New Brunswickers.

I would now like to introduce Mr. Michel Morin representing Edmundston Energy.

MR. MORIN: Bonjour, Monsieur le président et membres de la Commission. Je m'appelle Michel Morin et je représente Energie Edmundston. Je veux vous remercier pour m'avoir accordé l'occasion de vous parler.

Bien qu'Energie Edmundston n'ait pas pu assister à ces audiences, nous tenons tiens à vous rassurer que nous avons tout de même suivi les délibérations de très près. Comme vous le savez, nous avons travaillé en étroite collaboration avec les deux autres entreprises de service public municipal de la province sur la gamme complète des questions et des activités qui se rapportent à la restructuration de notre réseau d'approvisionnement en énergie électrique. Une telle collaboration comprend nos efforts conjoints lors des présentes audiences, et nous tenons à reconnaître les efforts de l'équipe de Saint John Energy pour avoir agi en notre nom aux audiences, nous pouvons vous confirmer à vous, Monsieur le président et aux membres de la commission, que nous sommes en complet accord avec les dépositions, avec les questions et avec les déclarations que Saint John Energy a déposées auprès de la commission au nom des enterprises de service public

municipales.

Nous pensons qu'il serait utile et informatif pour vous dans la considération de nos commentaires si nous commencions en vous donnant un bref historique de notre départment. C'est en 1911 que la ville d'Edmundston satisfaisait à un besoin d'approvioionnement en énergie pour exploiter son approvisionnement en eau en établissant le Département électrique d'Edmundston. Aujourd'hui, il est connu comme Energie Edmundston.

A l'époque en question, Fraser Paper construisit un barrage sur la Rivière-Verte afin de faire descendre les billes à l'usine de papier. Notre approvisionnement en énergie électrique venait de deux génératrices de 125 kW qui ont été installées sur le barrage et fournissaient de l'énergie électrique aux stations de pompage d'eau de la ville ainsi qu'à 112 clients. Au cours des années, nous avons modernisé en ayant de plus grosses génératrices et en installant aussi trois unités au mazout qui ont été retirées du service en 1969. A titre de grossiste, nous nous sommes aussi branchés au réseau d'interconnexion de Energie N.-B. en 1961. En 1984, dans un important programme de modernisation, deux génératrices de 1 MW one été rajoutées à l'unité de 1 MW déjà installée, et, aujourd'hui, la centrale fournit 5 % de notre

consommation.

Appartenant à la municipalité, nous sommes fiers de notre fonctionnement et nous desservons 5800 clients. L'usine Fraser Nexfor Paper est située dans la municipalité et possède une grande centrale de cogénération; toutefois, l'usine est approvisionnée directement du réseau de transport d'Energie N.-B. A l'heure actuelle, nous ne desservons qu'une partie de la municipalité, mais nous avons toujours eu l'objectif de desservir l'ensemble du territoire municipal. En 1998, nous avons acheté une certaine partie de réseau de distribution d'Energie N.-B., ce qui nous permettait de desservir l'ensemble de la municipalité tel qu'elle existait alors. Depuis, la municipalité s'est encore agrandie, et nous faisons des efforts pour atteindre l'objectif d'étendre notre droit de propriété afin que Energie Edmundston puisse encore une fois desservir l'ensemble de la municipalité. Le fait de desservir les résidents et les entreprises à l'intérieur de nos limites municipales pourrait avantager la collectivité entière sur le plan économique et social.

Comme vous pouvez le constster, nous sommes fiers de ce que nous avons accompli pour notre localité et nous voulons nous assurer que nous pourrons continuer à offrir

le meilleur service possible aux tarifs les moins élevés. Comme nous le disions auparavant, nous avons toujours appuyé activement la restructuration du réseau d'energie électrique de la province parce que nour croyons que de nouvelles pratiques peuvent être avantageuses pour la clientèle actuelle tout en stimulant le développement économique général. Nous croyons que les changements peuvent être apportés au réseau et que l'ensemble de la clientèle néo-brunswickoise en bénéficiera, mais nous croyons très fermement que les changements doivent être effectués dans le cadre d'un processus délibéré et contrôlé - tout comme le gouvernement l'a dit. D'après les transcriptions, nous savons que vous avez déjà entendu de tels termes - délibéré et contrôlé. Il s'agit d'une citation tirée du Livre blanc du gouvernement, qui est très importante pour nous.

Etant donné la situation, nous sommes déçus du moment qu'a choisi Energie N.-B. pour faire la demande d'un tarif de transport à accès libre. Le tarif constitue une partie très importante du processus de restructuration de l'énergie électrique, on peut dire même la partie la plus importante pour l'exploitation quotidienne actuelle. Cependant, une telle demande isolée portant sur le tarif de transport est comparable à une seule pièce d'un gros

casse-tête. Nous aurions préféré avoir une idée plus claire de ce à quoi ressemblera le portrait une fois le casse-tête achevé avant d'avoir à faire face à une seule pièce faisant partie de l'inconnu.

A titre d'exemple, nous devons connaître plus de détails sur le fonctionnement de l'offre de service normalisé, ainsi que sur le coût et sur les conséquences, par rapport au tarif de transport. Nous devons savoir quels autres services Energie N.-B. pourrait offrir. Pour connaître de tels détails, il nous faut comprendre en détail de quelle façon Energie N.-B. sera réorganisée. Nour devons savoir quelle sera le responsabilité de chacune des nouvelles sociétés d'Energie N.-B et qui sera chargé de leur exploitation. Il nous faut comprendre si les bénéfices d' Energie N.-B,, y compris les gains accrus qui proviendront apparemment du nouveau tarif, continueront à être utilisés pour subventionner les tarifs d'électricité, ainsi que les arrangements qui seront pris à ce chapitre.

D'après les transcriptions, nous savons que la question de l'offre de service normalisé a été soulevée auparavant et nous savons que la résolution des questions entourant l'offre de service normalisé ne fait pas formellement partie du présent processus. Cependant, nous

reconnaissons aussi que la Commission a un rôle important à jouer dans la protection des intérêts des consummatuers. En fait, au plus haut niveau et dans sa forme la plus simple, c'est ce que nous comprenons être le rôle de la Commission - voir à ce que les intérêts supérieurs des consommateurs d'énergie électrique dans la province du Nouveau-Brunswick soient satisfaits. C'est en suivant cette philosophie que nous notons que la Loi sur les services publics requièrent tous les tarifs soient justes et raisonnables. C'est là résultat que souhaite atteindre Energie Edmundston.

Par conséquent, nous sommes certains que vous pouvez reconnaître la grande difficulté que nous éprouvons en étant confronté avec la demande portant sur le tarif de transport sans le contexte à savoir comment la nouvelle structure va fonctionner et, surtout, comment les arrangements visant l'offre de service normalisé seront exécutés. Nous osons croire que vous pouvez être d'accord avec nous en ce que certaines questions qui, au sens le plus strict, ne devraient pas faire partie des présentes audiences sur les tarifs, mais, de fait, doivent être prises en considération parce qu'elles sont d'une importance capitale pour les intérêts des consommateurs, et le processus par ou passe la restructuration de

l'énergie électrique n'offre pas assez de clarté ni d'autres forums équitables pouvant permettre les discutions nécessaires sur un certain nombre de questions très importantes. En fait, alors qu'il ne reste que quelques semaines d'ici la date d'instauration de 1 er avril, la présente audience semble être la seule occasion qu'aurons les consommateurs, et pour ceux d'entre nous qui ont la tâche de les desservir. d'avoir accès à une procédure établie.

Jusqu'à ce qu'il soit clair à savoir comment la clientèle constituée des plus petits utilisateurs finaux seront touchés et quels choix les enterprises de service public de distribution auront dans la gestion des conséquences, il est difficile de déterminer de quelle façon réagir au tarif de transport proposé. Nous croyons que respecter la politique du gouvernement visant à faire des changements de façon délibérée et contrôlée signifie qu'Energie N.-B. aurait dû attendre jusqu'à ce que des réponses puissent être obtenues aux questions plus larges et générales avant de faire la demande pour un nouveau tarif de transport. Si cela n'était pas pratique, Energie N.-B. ou le gouvernement aurait dû au moins donner aux consommateurs d'Energie Edmundston des réponses aux questions les plus importantes, mais, plus

essentiellement, les clients ont besoin de réponses expéditives sur la façon dont les arrangements non-interventionnistes attenants à l'offre de service normalisé fonctionneront.

Nous tenons aussi à faire des commentaires sur l'avenir de notre centrale. La centrale en question a été avantageuse pour notre clientèle et pour le réseau d'Energie N.-B. depuis que nous l'utilisons pour réduire la demande de pointe. Energie N.-B. reçoit l'avantage d'une demande réduite, et nos clients reçoivent le bénéfice de coûts réduit lors de la demande de pointe. Energie N.-B. a aussi profité du réglage additionnel du niveau de l'eau que notre centrale fournit à leurs centrales en aval, et nous recevons une certaine somme pour fournir un tel service. Notre centrale est une source renouvelable d'énergie électrique et, bien que cela ait toujours été vrai, nous prévoyons que cette source renouvelable d'énergie électrique deviendra de plus en plus importante dans l'avenir. Par conséquent, nous voulons metter l'accent sur le fait qu'il est important, selon nous, que le tarif de transport et la restructuration généerale de l'industrie continuent de permettre à Energie Edmundston, ainsi qu'à autres, d'être le propriétaire de leurs propres installations locales de

production, et de les exploiter. Comme nous l'avons déjà mentionné, étant donné que nous n'avons pas l'information sur la situation dans son ensemble, il est difficile de voir comment on y arrivera. Comme nous le comprenons, le tarif de transport en question n'aura pas de conséquences sur notre centrale, mais, encore une fois, il s'agit d'une seule pièce du casse-tête. L'inconnu comprend des factuers à savoir comment se fera le partage dans l'avenir des bénéfices de la réduction de la demande de pointe et du réglage du niveau de l'eau.

En résumé, Monsiuer le président et membres de la Commission, nous avons deux préoccupations et une proposition. Notre première préoccupation porte sur le fait que, avoir un tarif de transport sans avoir une idée claire de l'ensemble de la restructuration de l'industrie de l'énergie électrique, c'est de mettre la charrue avant les boeufs, en ce que les conséquences d'un tel tarif sur les petits clients résidentiels et commerciaux au Nouveau-Brunswick ne peuvent être déterminées avant que la situation dans son ensemble ne soit clarifiée. Surtout, nous croyons qu'une demande portant sur le tarif de transport à accès libre avant d'avoir clarifié l'offre de service normalisé va à l'encontre des intérêts primordiaux des consommateurs d'énergie électrique. Notre deuxième

préoccupation porte sur le fait que le tarif ne devrait toucher ni le fonctionnement ni les aspects financiers des petites centrales comme la nôtre. Comme nous l'avons dit, nous ne pensons pas que ce sera le cas mias nous ne pouvons pas en être certains.

En conclusion, nous aimerions vous prèsenter notre proposition. Comme l'a fait dans le passé cette Commission en rendant décision, nous vous suggérons de prendre le plus grande soin pour être satisfait, d'autant plus que les conséquences sur la clientèle résidentielle et sur celle des petites enterprises au Nouveau-Brunswick aient été considérées pleinement. Nous savons que vous avez l'habitude d'établir l'équilibre nécessaire entre la réalité financière et les préférences de la clientèle dans l'établissement des tarifs, mais nous nous voyons dans l'obligation de signaler que vous n'vez pas entendu beaucoup sur la point de vue des milliers de petits clients au Nouveau-Brunswick qui, jusqu'ici, du moins, n'ont été représentés que par les trois entreprises de service public municipales. Vous pourriez peut-être accorder une approbation conditionnelle au tarif et ne pas approuver son entrée en vigeur jusqu'à ce qu'il soit clair que les intérêts des clients soient protégés par d'autres mesures de restructuration comme la finalisation des

détails portant sur la politique en la matière et sur l'établissement des prix pour l'offre de service normalisé. Nous croyons que c'est ce que le gouvernement voulait dire lorsqu'il a pris l'engagement envers une procédure délibérée et contrôlée de restructuration de l'énergie électrique.

Encore une fois, Monsieure le président et membres de la Commission, nous vous remercions pour cette occasion nous permettant de vous parler au nom d'Energie Edmundston. Nous vous répétons que vous avez notre entière coopération dans la décision historique qui constituera une très importante partie de la fondation servant à la restructuration du réseau d'énergie électrique du Nouveau-Brunswick.

MR. MARR: Good morning, Mr. Chairman and Board members, and thank you for the opportunity of speaking to you. My name is Eric Marr and I am the Vice President of Saint John Energy. I think you may find it useful and informative in considering my comments if I also begin by giving you a brief history of our utility. As you are probably seeing, that while New Brunswick's municipal utilities have a lot in common we each also have unique histories which influence our specific views on restructuring the electricity industry and this transmission tariff

application.

The Power Commission of the City of Saint John, formerly known as Civic Hydro and now identified under the trade name Saint John Energy, began as a result of efforts by a group of local citizens interested in having power at cost available to City consumers. Saint John Common Council established the Power Commission some 80 years ago, on December 5, 1922 to carry out this mandate.

The first substation transformer was energized a few months later at our Cranston Avenue Substation. To be precise, that occurred on July 28, 1923 at 12:30 p.m. That substation was manned by three power operators with 24 hour supervision. The Commission initially contracted for the purchase of 10,000,000 kilowatt hours of energy a year from the New Brunswick Electric Power Commission's Musquash plant.

In 1948, the New Brunswick Electric Power Commission expropriated the assets of the New Brunswick Power Company, a privately-owned power utility operating in Saint John at the time, and then sold the distribution system to Civic Hydro for $1,500,000. Merging the two systems, Civic Hydro saw its energy sales jump to 70,000,000 kilowatt hours in 1949. On August 1, 1997, the Commission changed its trade name from "Civic Hydro" to

"Saint John Energy", a name better identifying the utility with the community.

Today, Saint John Energy serves a geographic area of 323 square kilometers and maintains 13 substations with an installed capacity of 336 megawatts. We have more than 36,000 residential, commercial and industrial customers with energy sales of over 900 gigawatt-hours annually. The utility also has numerous customer service orientated programs ranging from low-interest loans for electrical upgrades to a premium water heater program.

Our mission statement is, and I quote, "To provide value to the citizens of Saint John by maintaining a modern, efficient distribution system which provides safe, reliable energy services at the lowest rates possible, while contributing to our community's environmental and social well-being."

As Dana Young has mentioned, we have been actively involved in these hearings because of their importance to our continuing ability to meeting the goals embodied in that mission statement. I might also add that we have been equally active in several other initiatives related to implementing the government's electricity restructuring program. This is a program that, properly planned and carefully executed, will be beneficial to all electricity

customers in New Brunswick. This includes not only our customers but those of the other municipal electric utilities and the new NB Power distribution company. Our interest today is therefore to ensure that customers' interests are served and our suggestions and recommendations to you are from that perspective.

Saint John Energy sees the need for having all distribution utilities in the province on a level playing field. This is a basic requirement to ensure that there are no inadvertent cross subsidies between their respective customers. Unfortunately, a level playing field between all distribution utilities is not assured on the basis of the evidence that has been presented at this hearing. And, furthermore, while this may not be a direct concern of the Board in these hearings, we would like you to be aware of the fact that the Market Rules which were published in late December and are presently in the final phases of a very hasty and cursory stakeholder review process confirm our concerns that there will not be a level playing field. The pattern that is emerging is that the New Brunswick Power Distribution and Customer Service Corporation could receive favoured treatment in comparison to the municipal utilities. This could result in a greater disparity in the treatment of customers across the

province, which we feel would be a retrograde change.

While we understand that the details behind these issues may be outside of the scope of the application we hope you will agree with us that the principle of even-handed treatment is fundamental to any regulatory process and we therefore request that your decision consider this fact. Specifically Saint John Energy requests that the Board's decision include a requirement that the applicant treat the New Brunswick Power Distribution and Customer Service Corporation as an arm's length entity with multiple points of delivery, each of which is a separate transmission customer. This is exactly the way the municipal utilities will be treated under the tariff.

Another area deserving your consideration relates to metering and billing arrangements for transmission customers that have multiple delivery points, which is the case for Saint John Energy. We recommend that your approval require that any future application should include provisions for aggregating billing for delivery points that are close to each other. In effect, this will treat a distributor in a region as a single transmission customer and not as multiple customers. We feel this will be beneficial in encouraging rational development of the system since, without this change, distributors will avoid

establishing new substations when general economics say they should. This is a variation on the coincident versus non-coincident billing issue. We are effectively suggesting that it be mandatory for the next transmission tariff application to include allowances for coincident peak billing by regional distribution companies.

You will of course notice that these two recommendations appear contradictory. On the one hand we are asking that each substation supplying a distribution utility be considered as a single transmission customer while on the other we are requesting that there would be multiple delivery points per customer. The apparent contradiction is only a matter of timing and natural progression. The reason for one customer per delivery point relates to the provisions of the existing tariff and is aimed at providing equal treatment to all distribution utilities regardless of their ownership. We believe that rational arrangements for the distribution sector will see New Brunswick Power Distribution and Customer Service Corporation organized into a number of regional utilities. Initially, this reorganization of the NB Power distribution system would be for accounting and billing purposes, but ultimately they could be each be essentially free-standing operations. Under this regionalized

arrangement it wouldbe appropriate to move to the multiple delivery points per transmission customer arrangement.

And now, Mr. Chairman and Board members, I would like to briefly summarize for you the points that the municipal utilities have collectively addressed here today.

Firstly, we have restated our concern about the lack of information on the implementation plan for the whole electricity restructuring program. This has been evident in these hearings in several ways including confusion about how the tariff relates to the various new NB Power spin-off companies. You could assist all electricity customers in the province by including in your decision a requirement that the applicant or its various spin-off companies initiate educational sessions for all users of the transmission system.

What is even more distressing is the lack of information on how this tariff will affect residential and small business customers. We are not opposed to the proposed arrangements for a reasonable return on equity and payment in lieu of taxes to ensure that external users of the transmission system are not free riders, but we can not make a clear statement of support until it is clear how New Brunswick electricity customers will be affected by the new costs involved and how they will benefit from

the new revenues collected. We also pointed out that the municipal utilities are already subject to taxes and changes in taxation policy should recognize this fact.

We have heard much about the government's desire to introduce electricity restructuring through a deliberate and controlled approach and we are very supportive of this. Such an approach should allow us to make changes in a fashion that do not unnecessarily increase costs to consumers and therefore preserve one of New Brunswick's advantages of having some of the lowest electricity prices in the region.

To mitigate potential negative impacts on customers we have asked this Board to consider making approval of the open access transmission tariff conditional on bringing greater clarity to the issues and finalizing satisfactory arrangements for standard offer service.

We have suggested that performance based regulation appears to be an unnecessary complication in an already complex process. We have also pointed out that the recently promulgated draft of the market rules will require changes to the transmission tariff in the near future, presumably through a new hearing. This requirement to hold a new hearing nullifies one of the most significant advantages of performance based

regulation from the perspective of customers. We have suggested that all these factors could be addressed by having the tariff approval limited to a term of between 12 and 18 months.

We have also suggested that the arrangements for ancillary services could benefit from reappraisal, perhaps as part of the new tariff hearings we just mentioned. In the interim, it may be appropriate to keep some focus on the actual costs involved by requiring that they be disclosed on a periodic basis.

We have indicated that our initial concerns about the pancaking of transmission charges have been addressed by Bill 30 which was introduced during the course of these hearings.

There is a growing interest and bright future for small generating facilities and the government's restructuring policy is clearly supportive in this regard. However, success will be largely dependent on the details of implementing that policy which will require everybody's continued support and commitment.

Finally, we have addressed the need for putting all distribution utilities, and hence the customers they serve, on a level playing field with respect to each other. We also suggest that the long-range

rationalization of system development requires viewing distribution utilities as single transmission customers, each covering a region within which there could be multiple points of delivery. To achieve these objectives we have suggested that the Board's decision should require that the new NB Power distribution company be put on the same footing under the tariff as the municipal utilities and that the next tariff application should include proposals to serve regional distribution companies as single transmission customers.

In conclusion, Mr. Chairman and Board members, I would like to underline the fact that New Brunswick's electricity customers look to their Public Utilities Board to protect their interests. The municipal electric utilities believe that changes to the way electricity service is provided in New Brunswick can be a benefit to customers. But that benefit is not automatic. There is ample evidence that restructuring the electricity industry does not always work in customers' best interests and we believe you have an important role to play in making sure it does so here. That means respecting in your decision the government's wise provision that changes be made in a deliberate and controlled manner and making your approval of this tariff conditional on a much greater level of

clarity on customer impacts than has so far been evident.

The mandate of this Board is to ensure that the tariff be "just and reasonable." The White Paper on New Brunswick Energy Policy, which preceded this application, listed as its number one policy goal to "ensure a secure, reliable and cost effective energy supply for residential, commercial and industrial customers" which includes wholesale customers such as the three municipal utilities in New Brunswick. We would also refer the Board to the R. J. Rudden report which, amongst other things, outlines a number of considerations for a FERC compliant tariff which includes the requirement that transmission pricing should promote fairness. The municipal utilities strongly believe that by adopting the recommendations we have made, the Board in its decision can go a long way towards achieving the aforementioned objectives.

The municipal utilities are at this hearing in support of our customers. They have enjoyed reliable electricity service while benefiting financially from low rates for most of the last century. And we hope for many more years to come. Since our inception our mandate has been to make all decisions in the best interest of our customers and through this keep rates as low as possible. We look forward to being supportive of a decision in regard to

this application that reflects a commitment to continuing the tradition of an affordable and reliable electricity supply for our customers.

This concludes the summation on behalf of the New Brunswick municipal utilities. Again, Mr. Chairman and Board members, thank you for the opportunity to address these issues with you on behalf of our customers.

Thank you.

CHAIRMAN: Thank you, Mr. Marr. I feel obliged to point out to all of you that we are the creature of the legislature. And it is what is in this legislation that -- from whence we derive our power. And whether it was in the White Paper -- like in the White Paper we were supposed to regulate your rates and yet we don't have that power, so we can't do that.

I can understand your motivation in a lot of the things you are asking us to do but we have to be guided by the legislation. But I thank you for your presentation today.

I wonder if my Commissioners have any -- well we will take a 15 minute recess then. Thank you.

(Recess)

CHAIRMAN: Things have changed since I practiced law. Aides to argument sounds like a lawyer's crutch or something,

you know. Mr. Smellie, go ahead.

MR. SMELLIE: That's precisely what it is, Mr. Chairman, particularly in a case as complex as this.

Good morning, Chairman, Members of the Board. Firstly some preliminary and housekeeping matters, if I may.

I have passed to the secretary and she has apparently passed to you and your colleagues an aid to argument, which we have prepared in order to assist a) ourselves and b) hopefully you with some of the financial and more technical issues as we come to them in our argument. My friend, Mr. Hashey and Mr. Morrison, have a copy. I have left copies at the back of the room and I have provided a copy to the reporter.

Unlike Mr. MacDougall's aid to argument, this aid to argument is not simply an incorporation of exhibits, however, it is reflective of and contains only the evidence that has been led in this hearing.

Secondly, sir, I have provided again to those that I have mentioned copies of three cases. The first of which is the subject of a short quote that my colleague, Mr. Nettleton, will speak to. The other two are simply footnoted in our argument. And we thought you should have them. The message is that we won't be spending a great deal of time on them.

Thirdly, Mr. Chairman, I have given a copy of our speaking notes to the reporter and I would request that she insert the headings, footnotes, exhibits and transcript references that are in those notes in the record in order that I don't have to take and Mr. Nettleton doesn't have to take time to make those specific references.

It is of course a pleasure for Mr. Nettleton and I to be able to address you in argument. As we thought about this opportunity we considered long and hard whether a short broad brush summary would do. And we came to the conclusion that the answer simply was that that was not possible.

My friend, Mr. Hashey, spent a short amount of time on a number of issues yesterday and my friend, Mr. MacDougall, spent some greater amount of time on a narrow number of issues yesterday.

The evidence, sir, in this case is complex and it deserves in our submission a careful review. It deserves a careful review because it is the evidence that of course will be the basis of your decision. Given the importance of this case, we think it would do a disservice to our clients, to Mr. Hashey and Mr. Morrison's client, and most importantly to you and your colleagues if we did anything

less. So we are going to be a while.

The structure of our argument today, Mr. Chairman, is this, there are six substantive parts and Mr. Nettleton and I have allocated them generally along the lines that we undertook cross examination on. Following a short introduction, I will deal with the policy legislative and regulatory context which bears on this application.

Mr. Nettleton will then address tariff and ancillary services issues, as well as the revenue requirement with the exception of return. When he is done I will return to deal with capital structure, risk and return.

And with that let me turn to the introductory portion of this argument.

On June the 21st of last year, New Brunswick Power filed with the Board of Public Utilities Commissioners a one page application pursuant to Section 56 of the Public Utilities Act.

The application supported by evidence subsequently filed on July the 25th seeks your approval of an open access transmission tariff including terms, conditions and rates for both transmission and ancillary services, service and interconnection agreements, the transmission expansion policy and the standards of conduct under which the proposed services will be provided.

We wish to begin following the adage that it is important often to know where you have been in order to understand where it is that you are going by putting this application in context.

It is the first regulatory filing that New Brunswick Power has made since 1993. As a vertically integrated utility providing bundled service, New brunswick Power has since that time not been required to seek regulatory approval of rate changes, provided in the overall that such changes don't exceed the greater of 3 percent or the change in average CPI. Since that time its rates have most assuredly increased, but on an annual average basis New Brunswick Power has stayed underneath your radar screen.

Now culminating with amendments to the Public Utilities Act which came into effect last June 7, a number of factors no longer permitted New Brunswick Power to avoid regulatory scrutiny insofar as the provision of transmission and ancillary services is concerned.

In May of 1999 the province's select committee on energy issued its report entitled "Electricity Restructuring in New Brunswick", which recommended amongst other things that the province pursue a managed transition of its electricity market in order to gradually introduce

wholesale competition.

In January of 2001 the published -- the province published its White Paper on energy policy. In respect of electricity matters the province accepted the recommendation of the select committee and announced that it would proceed on a deliberate and controlled basis with the restructuring of its electricity market. In particular the province targeted the implementation of wholesale competition by April 1st of this year and announced that it would empower you to approve the use of NBP's transmission system under an open access tariff.

Later that year the market design committee contemplated by the White Paper undertook its mandate of developing the appropriate design, rules and structure for a competitive electricity market. The final report of that committee was delivered in April of last year. Amongst other things the committee recommended the institution of a bilateral contract market for electricity in the province in which industrial and wholesale customers might contract with alternate providers of electrical energy, whether inside or outside the province. Fundamentally, the market design committee recognized that such a market would function effectively only if there was an open and non-discriminatory access to New Brunswick

Power's transmission system.

The majority of the committee's recommendations were subsequently accepted by the Province in August of last year. The notion of open

access and the role of New Brunswick Power as a common carrier, providing that access on its transmission system, however, had already been accepted by the Province when it announced its restructuring plans for the company on May 30th of last year.

So it was no surprise to find, Mr. Chairman, when Bill 53 was introduced in the Legislature last May, the statutory framework which accommodated the application now before you.

Specifically, as of June 7th, part 3 of the Public Utilities Act prohibited New Brunswick Power from charging a rate or tariff for discreet transmission or ancillary services without your approval, required that any such tariff as it relates to transmission services must provide for open access to those services, and contemplated that a public utility would apply to the Board for approval of a tariff concerning those services.

There have been further legislative developments since the application was filed. And we will have more to say about Bill 30, the proposed Electricity Act, shortly.

Only when New Brunswick Power filed its evidence in July of last year did the full scope of its application become clear, particularly as it concerns rates for transmission services contemplated by its proposed tariff and the underlying revenue requirement for those rates, the application and the relief it seeks represents a material change for the company and its ratepayers.

How is that? Well, up to and including March 31st of this year,

New Brunswick Power continues to provide transmission and ancillary services as part of bundled rates. Those rates don't include a component for federal or provincial income taxes, because as a Crown Corporation the company isn't liable to pay them.

Up to and including March 31 those rates reflect New Brunswick Power's actual capital structure, both historically and currently, composed entirely of debt. Those rates aren't levied pursuant to any order or decision of the Board simply because, as it has turned out, no such approval has in fact been required. On April 1st however, all of this will change. Assuming that the Board were disposed to grant the relief which New Brunswick Power has asked you to provide.

First, New Brunswick Power's rates for transmission and ancillary services will be unbundled and severed from

any commodity or distribution charges as part of the tariff which it wishes you to approve.

On April 1st, insofar as transmission services are concerned, those rates would be at minimum 15 percent higher than the actual cost of the transmission component of the bundled rate which would have been in effect 24 hours earlier.

For self-generation in the province, the evidence of our clients is that the extent of the rate shock is considerably greater should they opt to use the different services offered under the applied-for tariff and not remain on standard offered service.

On April 1 New Brunswick Power wants you to approve rates for

transmission services that reflect a deemed capital structure of 65 percent debt and 35 percent equity.

As to the existing or legacy debt component, transmission rates will continue to reflect the cost of financing that debt. But for ratemaking purposes the company wants you to approve an all-in finance charge rate on that debt of 10.7 percent, some 470 to 500 basis points higher than current long-term Canada bond yields.

As to the equity component, and although there will be no actual infusion of equity into New Brunswick Power, it

wants you to approve transmission rates which reflect the new cost in the form of a return on this deemed equity of 11 percent equal to $12.6 million in the fiscal year ending March 31, 2004.

Whereas on March 31 of this year, New Brunswick Power would not recover income or capital taxes in its bundled rates consistent with its tax-exempt status, the next day New Brunswick Power asks you for the authority to recover from transmission ratepayers $9.8 million next year on account of a payment in lieu of taxes.

In other words, for every dollar of return on that equity which New Brunswick Power wants, you are also asked to approve the recovery of 78 cents of payment in lieu of taxes from ratepayers.

And finally all of this, as we now understand it, will occur in the context of a massive restructuring whereby transmission services in New Brunswick will be provided by New Brunswick Power Transmission, a wholly-owned subsidiary of New Brunswick Power, which will by then

have become a holding company for transmission and several other butterflies.

And finally on the recommendation of Dr. Morin and notwithstanding the historical uncertainty associated with restructured electricity markets, New Brunswick Power

wants you to approve a price cap regime for a period of three years for New Brunswick Power Transmission.

To be clear, Mr. Chairman and members, New Brunswick Power wants the following relief effective April 1: (a) the open access transmission tariff; (b) a revenue requirement for transmission services of $97.8 million for fiscal year 2004 consisting of amortization of $18.4 million, operating maintenance and administration expense of $37.6 million, finance charges of $19.4 million, the payment in lieu of taxes of $9.8 million and a return on deemed equity of $12.6 million; (c) underlying this revenue requirement, or at least the last three components of it, New Brunswick Power wants an all-in debt cost of 10.7 percent, a deemed capital structure of 65/35 and a return of 11 percent on the 35 percent equity wedge; (d) New Brunswick Power wants a revenue requirement for ancillary services of $38.4 million for fiscal year 2004; (e) New Brunswick Power wants a price cap system of regulation for New Brunswick Power Transmission effective for a three-year period ending March 31, 2006.

J.D. Irving Limited along with seven other members of the New

Brunswick division of the Canadian Manufacturers and Exporters, has intervened and actively participated in this important proceeding for a number of reasons.

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JDI and its CME colleagues are energy-dependent, resource-based companies having significant commercial interests in New Brunswick. This is uncontroverted. And so too is the fact that for our clients electricity is a significant operating cost. For Irving Paper as an example, electricity represents fully one-fifth of its input costs.

Further, as members of New Brunswick Power's largest single customer class representing more than 40 percent of its energy sales, JDI and its CME colleagues are legitimately concerned about increases to their operating costs related to the implementation of a competitive wholesale electricity market in the province.

In 2001, for example, the evidence shows that Irving Paper's electricity cost per megawatt hour was amongst the highest of 28 members of the PPPC, the Pulp and Paper Products Council, across Canada.

In some respects, Mr. Chairman, this is not surprising, given that New Brunswick Power's costs to industrial users, with the exception of one year, consistently increased throughout the 1990's, quite unlike the majority of Canadian electrical utilities.

And so while our clients are entirely supportive of the Province's decision to open the wholesale generation

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market in New Brunswick to competition on a level playing field, to promote self-generation and in support of these initiatives for you to approve an open access tariff for New Brunswick Power Transmission, our clients are vitally concerned about the apparent cost consequences of these developments, particularly as regards monopoly transmission services.

Our client's intervention and activity in this hearing has been undertaken at a very significant cost. JDI and its CME colleagues value their relationships with New Brunswick Power, who for each of them is an important if not vital supplier.

That said, the participation and interest of our clients in this application in no way arises simply for the purpose of leveling criticism at either the applicant or those who testified in support of the application.

Rather that intervention is prompted of necessity given the lack of evidence from New Brunswick Power as to the comparable costs of transmission service before and after April 1.

In response to interrogatories, New Brunswick Power did say that on a cost of service basis transmission rates for New Brunswick Power Transmission will increase at minimum by 15 percent over the transmission component of

the company's current bundled rates.

Ms. MacFarlane tried in vain, in my submission, to flush some portion of this unexpected increase in the price of transmission

services by telling us that this interrogatory response was wrong.

Apparently New Brunswick Power only included actual interest costs in the current figure and forgot to include an amount for interest times coverage. The increment she wanted to add, thereby hoping to reduce this 15 percent impact to about 6 percent however, is not an actual cost.

Our intervention was necessary given the lack of prior consultation by New Brunswick Power Transmission with its stakeholders in order that they might understand the full impact of the relief sought and potentially that you and your colleagues, Mr. Chairman, might be presented with a consensus view on aspects of the application, perhaps eliminating elements of what has been a lengthy and expensive process.

Dr. Morin said that the adversarial process is not conducive to enlightenment. Perhaps, but in this case it will not be for lack of effort on the part of the intervenor.

And, finally, it was necessary, Mr. Chairman, in order to cross examine the company's witnesses, and for our

clients to proffer evidence to you such that you and your colleagues would have a complete evidentiary record on which to base your decision, one which included the views of material stakeholders in the market. We hasten to add that that record has largely been developed in light of not only the application, but also the legislative and regulatory context applicable during the hearing.

And on the basis of that record, Mr. Chairman and Members, and for the reasons which we hope to make clear in this argument it is the respectful submission of JDI and its CME colleagues that you should not grant the relief sought by New Brunswick Power in this application as filed.

In summary, and with further explanation to follow, the position of our clients is this. (a) The Board should approve the open access tariff proposed for NB Power Transmission effective April 1 subject to certain conditions.

(b) The Board should not approve the implementation of the proposed price cap methodology at this time. Rather, the Board should require New Brunswick Power to undertake and deliver to it and to interested parties, the results of appropriate benchmarking studies of its transmission system by not later than July 31, 2004.

(c) The Board should direct New Brunswick Power to undertake, or cause to be undertaken, a cost of service study inclusive of a depreciation study, concerning the cost of its transmission system and assets for delivery to the Board and interested parties not later than July 31, 2004.

(d) The Board should approve final rates for network integration and point to point transmission services and rates for ancillary services for a period of not more than two years effective April 1, 2003.

(e) Given the level of rate shock, the Board should not approve

the applied for rates for self-generation customers. Instead, the Board should direct New Brunswick Power Transmission to develop and file for approval a new tariff that mitigates the level of applied for rates and puts in place rates which are demonstrated to be in line with the terms and conditions of the standard offer service.

(f) Final rates for ancillary services should be approved by the Board on the basis of actual or embedded generation costs, net of a credit for energy production. Or in the alternative, on the basis of the three year NEPOOL average price for such services.

(g) Final rates for transmission services should be

approved by the Board on the basis of a revenue requirement based on an historic test year and traditional cost of service principles based on an actual capital structure 100 percent debt.

On this basis the total amount of the revenue requirement for transmission services should be fixed at $72.4 million.

This is shown, Mr. Chairman and Members, including the various components which make up that total on page 1 of the Aid to Argument under the column JDI CME case 1.

In the alternative, and should you be persuaded that a deemed capital structure and return on equity are appropriate for New Brunswick Power Transmission as of April 1, 2003, final rates for transmission services should be approved on the basis of a revenue requirement which reflects a 70/30 debt equity structure, and a return on equity of 8.25 percent. That rate, 8.25 percent is shown in the

resulting dollar amount on page 9 of the Aid to Argument under the column JDI, CME case 2.

On this basis as shown on page 1 of the Aid to Argument under the column JDI, CME case 2, the total amount of the revenue requirement should be $81.9 million.

(h) The finance charge component of New Brunswick Power Transmission's revenue requirement should in any

event be based not on an effective cost of 10.7 percent, but on a debt cost of 8.2 percent.

Mr. Nettleton will address this in the context of pages 3 through 8 of the Aid to Argument.

(i) The Board should direct New Brunswick Power Transmission to file a further application for transmission rates by not later than September 30, 2004 for effect on April 1, 2005.

(j) The Board should establish a deferral account for New Brunswick Power Transmission's amortization expense. And Mr. Nettleton will deal with that.

Now before turning to the evidence in detail, Mr. Chairman, it is appropriate to deal with two other issues at this early stage of our argument.

Who bears the burden of proof in this proceeding? In our respectful submission, New Brunswick Power must bear the burden of proof or onus, of demonstrating on a balance of probabilities that each element of the relief which it seeks meets the requisite criteria

that such relief be just and reasonable.

This is what the cases say, Mr. Chairman. And, indeed, this is precisely what Bill 30 says in Section 125. In this case where it is New Brunswick Power who is proposing an entirely new transmission tariff and rates

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for unbundled transmission and ancillary services there can be no serious doubt on this point. We, of course, recognize that in light of your statutory mandate the Board must focus its attention not only on the specific interests of New Brunswick Power or any other commercial party, but equally on the broader public interest. Nevertheless the principle that the ultimate burden of proof rests with the applicant applies in this record.

And with respect to this record, Mr. Chairman, it is unfortunate, in our submission, and particularly given the importance of the task which you face, that the evidentiary record is not as complete or as wholesome as it might have been as regards third party opinions and assertions relied upon by New Brunswick Power.

While it is one thing, sir, for an expert such as Dr. Yatchew to rely on top ranked peer reviewed literature as sources for empirical data gathered for the purpose of expressing his opinion in evidence in cross examination, we submit it is quite another thing for an applicant to provide reports upon which it relies in support of the relief it claims without providing an opportunity for the contents of those reports to be tested adequately or at all.

For example, the application material includes the

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1999 Stone & Webster report, reports from CIBC world markets concerning utility credit spreads, the corporate cost allocation report from Deloitte Touche as well as the RJ Rudden report, all of which New Brunswick Power relies upon and, indeed, urges you to rely upon.

New Brunswick Power also relies on internal depreciation studies for about 20 percent of its applied for revenue requirement, but those studies weren't produced for your benefit. Indeed, last Friday in response to your request, New Brunswick Power provided a response to undertaking 56, which is now in the record in revised fashion as exhibit A-58. But no witness has appeared to testify and be cross examined on the apparent suggestion of the province's bankers on a debt equity ratio or return for New Brunswick Power Transmission for restructuring purposes and the relationship this has to the task at your hand, namely, establishing just and reasonable rates.

In our view, the Board must proceed cautiously with this material because neither you nor interested parties were given a fair opportunity to test the contents of these reports and documents with their authors as to the assertions or suggestions which are contained in them.

We are confident that you will, in assessing a weight

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to give to this evidence, carefully consider the extent to which,

absent production of the source document and/or the availability of its author or authors for cross examination, whether it should be considered reliable and persuasive.

Let me turn to my second topic, Mr. Chairman. The policy, legislative and regulatory context. As I mentioned, the evidence and record have been developed almost exclusively on the basis of policies and the legislation being the Public Utilities Act and a regulatory framework with which the Board and all parties were familiar.

However on January 31 the government introduced Bill 30, the Electricity Act. This is important because that legislation, which concerns amongst other things the restructuring of the applicant effective April 1, will also repeal part 3 of the Public Utilities Act which was in fact the statutory basis for this application, as well as the entire Electric Power Act.

When it is proclaimed in force the Electricity Act is going to be the principal statute which governs the affairs and regulation of New Brunswick Power Transmission.

You will recall that in November Mr. Marshall appeared

as a policy witness. And you will also recall how intent he was to convince us all that the restructuring of New Brunswick Power was not at all relevant to the decisions which the company was asking you to make at the end of this hearing. He told us that. He told Mr. Young that and he told Mr. MacNutt that twice.

It will be obvious to all who have read Bill 30, Mr. Chairman,

that Mr. Marshall was very mistaken indeed. In light of the introduction of this important piece of legislation, we wish to address at the outset what we believe to be the relevant policy environment in which you are asked to decide the application as well the legislation itself and the associated ramifications for New Brunswick Power Transmission's regulatory setting going forward.

First, what about the policies of the government of New Brunswick which are relevant to the application and which need your attention?

For example, the clear policy genesis of this application is the White Paper in which the Province enunciated a new energy policy to enable New Brunswick Power to compete in North American markets, which established a broad future direction for energy in New Brunswick including electricity and which is

well-signaled, the deliberate and controlled approach which it wants to follow in restructuring the electricity market.

New Brunswick Power has told you that its application relied upon the policy directions contained in the White Paper and the market design committee's final report and that there are no other such directions upon which it is relying.

That being the case, Mr. Chairman, the Board can with some confidence decide this application, having regard to four of the five key goals set out in the White Paper. We exclude for the moment the important matter of the protection and enhancement of the environment.

First, your decision concerning the application should be

consistent with the goal of ensuring that New Brunswick consumers are provided with secure and reliable electrical energy at "the lowest possible cost."

Insofar as transmission is concerned, this accords with an important principle expressed in the Bluefield and Hope case, cited by the applicant's expert Dr. Morin, that ratepayers are entitled to service at the lowest reasonable cost.

Second, you will wish to ensure that the relief given to the applicant will achieve the kind of "economic

efficiency" that will allow New Brunswick companies and utilities to compete effectively in both domestic and export markets, in the particular context of the Province's historic, geographic and strategic advantage against neighboring utilities, refiners and energy distribution companies.

Third, and this is happily consistent with the evidence of JDI and CME, your decision should ensure that the relief given to New Brunswick Power advances or is consistent with the promotion of the Province's energy-intensive and resource-based industries for whom the cost of energy is a substantial operating expense and for whom competitive energy rates are critical.

And finally your decision should be informed by the goal of fostering an appropriate form of transparent regulation for the restructured market and one in which the transmission system of New Brunswick Power is not rendered less competitive.

In the respectful submission of our clients these key policy goals are important elements of the overall public interest which ultimately governs the exercise of your discretion.

As the applicant New Brunswick Power bears the onus of demonstrating that the relief it seeks by this application

is broadly consistent with these goals. And if not, and in our submission, it must demonstrate to you that any inconsistency is not fatal to one or more of its elements.

Behind the Province's expression of these key policy goals which underpin the framework of the imminent competitive generation market in New Brunswick, we also submit that certain of the key substantive findings made in the White Paper are also relevant to your deliberations.

The government concluded, as I have alluded to and as is well known by our clients, that energy costs are of fundamental importance in maintaining competitiveness.

Another important finding in the White Paper arose from the fact that relative to neighboring jurisdictions, particularly the U.S. northeast or New England, New Brunswick Power's electricity prices are quite low.

The White Paper observes that not only is New England a major export market for New Brunswick Power, representing 18 percent of its power sales revenue, but in fact its transmission network was built to capitalize on those opportunities.

The White Paper went on to note that until the transmission system was subject to open access, New Brunswick Power's ability to make sales in New England

markets would be limited in view of the fact that FERC's reciprocity requirements would not be satisfied.

As well the White Paper noted that New Brunswick Power's participation in New England markets is in any event physically constrained, concluding that a critical aspect of establishing a competitive market for New Brunswick would be the construction of additional transmission capacity to and from New England.

While Mr. Marshall would not agree that ensuring maximum direct access to New England markets for New Brunswick Power is an important policy purpose or driver underlying this application, but merely an incidental consequence of having an open access tariff in place, we submit that this simply doesn't square with the White Paper, nor with common sense. There are at least 170 million reasons, at least in 2002 terms, to the contrary.

Moreover, Mr. Chairman, we think you can take notice of the fact, at least according to Minister Volpe, that

U.S. access is the first issue which warrants restructuring the New Brunswick market.

On January 31 the Minister said this to the Legislature. "First New Brunswick Power is unable to meet some of the U.S. federal regulators' standards for selling

electricity in the United States. As NB Power's exports of electricity help to keep our local rates lower, we must restructure the utility to allow NB Power to make sales directly into the U.S. Export opportunities and their benefits are thereby increased."

And Mr. Marshall, you will recall, doesn't argue with the Minister.

Whatever the semantic differences, on March 24 the National Energy Board will hear New Brunswick Power's application for approval to spend some $45 million to increase its transmission capacity to New England by about 50 percent more than the current 700 megawatts which it currently controls.

So U.S. access is an underlying reason for the open access tariff which New Brunswick Power wants you to approve.

As we are all aware, the White Paper is the origin of the oft used phrase "deliberate and controlled" in respect of the restructuring of New Brunswick's electricity market and also speaks in terms of a managed transition.

What this finding means to our clients, to the Minister and to the market design committee is quite simple. It is far more important, indeed critical, to correctly implement a competitive market in New Brunswick

than to rush into restructuring only to have to confront the need to correct material mistakes made in the process.

Happily, New Brunswick Power agrees that this should be the case.

In this regard then, Mr. Chairman, at each step of the way in exercising your discretion concerning this application, you will accordingly wish to ask yourselves whether the relief which New Brunswick Power wants is in fact necessary and right.

We would be remiss, sir, in the context of relevant policy concerns if we didn't touch on the concept of the level playing field. Indeed, given the evidence on the point, we need to do so lest the Board be left with a less than correct impression.

We begin with the White Paper, where in the context of a discussion on wholesale competition the following observation was made "An issue that could represent a barrier to entry in the wholesale power market is whether the Crown utility is perceived to have an inherent competitive advantage relative to new entrants."

The simple and evident notion here is that given its tax exempt status and provincially guaranteed debt, New Brunswick Power might have a 10 to 20 percent cost advantage over new competitive generation, which led to

the following further observation.

"If the Crown utility is free to develop new generation projects in New Brunswick, it may be able to do so at a lower cost than its competitors. This is likely to make competitors reluctant to invest in New Brunswick unless changes are made to put the Crown utility on a level playing field with other market participants."

Now initially we thought there was no issue on this point. Mr. Marshall confirmed that the White Paper clearly means what it says. The level playing field concern is about, and I quote, "an advantage to the Crown utility in competition to other generation suppliers."

But nothing is ever simple, Mr. Chairman. And you will recall Mr. Marshall's various subsequent attempts to persuade us that the level playing field also concerns transmission activities.

In fact in his appearance on Panel C, he went so far as to suggest that the concept refers to the overall marketplace, the overall competitive marketplace, which includes such entities as Enbridge Gas New Brunswick or an energy company such as Irving Oil.

Of course, neither of those companies, nor in fact any party, including the province has suggested that this is the case in this hearing.

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In response to your request for some evidence to back up this notion, Mr. Marshall ultimately concluded that his theory was implicit in the White Paper.

The best evidence on this point, in my submission, is that of Mr. Mosher and Dr. Yatchew, who say there is a clear and evident need to place New Brunswick Power's generation activity on a level playing field to encourage new competitive generation for this market, otherwise new competitors will be disadvantaged. And that's precisely the point made in the White Paper.

Transmission is going to remain a monopoly in New Brunswick, and accordingly, there is no legitimate premise for levelling the transmission playing field.

On that field what is necessary is to ensure that only costs fairly attributable to the provision of transmission services are recovered from New Brunswick Power Transmission ratepayers. Otherwise, cross subsidies can or will arise.

A word, Mr. Chairman, on the effect of any policy relevant to this case. We will be dealing with the question of whether the Board should implement New Brunswick Power's or Dr. Morin's proposed price cap methodology in due course.

Before leaving the topic of policy, however, a comment

on one further aspect of the White Paper is appropriate in this regard.

As currently reflected in the Public Utilities Act, the Board has been directed to regulate New Brunswick Power's open access transmission tariff.

Mr. Hashey told you, and we agree, that the Public Utilities Act affords the Board very wide authority or discretion to, "adopt any technique that it considers appropriate including an alternative form of regulation," in fixing just and reasonable rates for New Brunswick Power Transmission.

However, immediately after the recommendation in the White Paper for the Board to regulate the tariff, there was a comment on

performance-based regulation as follows:

"The regulatory focus will be one of increasing the administrative efficiencies of regulation, such as making greater use of paper hearings and other administrative processes that reduce the cost of regulation to all parties. The Province will direct the Board to adopt a light-handed performance-based method of regulation."

Now you will recall, Mr. Chairman, that we tried to clarify with the applicant's policy witnesses whether this direction was in fact contained in this comment, or whether some more concrete form of direction would be

forthcoming.

Mr. Marshall's evidence on the point is simply that performance-based regulation is the policy of the Province of New Brunswick. He said that as a policy witness for an applicant that wants you to adopt a performance-based regulation methodology.

Well, if last June's amendments to the Public Utilities Act were intended to direct the Board to adopt performance-based regulation for New Brunswick Power Transmission, then clearly, as Mr. Hashey says, that is not what the current legislation does.

Both the Public Utilities Act, and as we read it, Bill 30 permit the adoption of an alternative form of regulation, but clearly do not oblige you to go there. Nor in our submission is that what legislation should properly do. This Board, as with all other utility regulators, has and should continue to have the appropriate discretion

to fix just and reasonable rates.

We have no doubt, Mr. Chairman, that the Board will not fetter its own discretion by treating the White Paper's expression of policy in this regard as a binding rule to the exclusion of other evidence or alternatives concerning methods of regulation.

Mr. Chairman and Members, we submit that it would be

less than realistic to think that Bill 30 or something very similar to it will not be proclaimed in force by April 1. In the time available since January 31 we have carefully considered the proposed legislation and its effect on the application.

In the end we believe that in the current circumstances the relief which New Brunswick Power seeks must be addressed in the context of the requirements which we think it reasonable to assume will be in place when Bill 30 becomes law. That being the case, a short review of the significant components of the legislation is in order.

The first purpose of the legislation is to restructure New Brunswick Power and establish the applicable regulatory framework for each of the reorganized entities formerly part of New Brunswick Power.

More bluntly, as Ms. MacFarlane told you, the purpose is to get the government out of the business of guaranteeing New Brunswick Power's debt or at least certain parts of New Brunswick Power or at least certain parts of its debt.

New Brunswick Power as we know will be continued into a holding

corporation which will in turn own four new operating subsidiaries for each of its generation, nuclear

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generation, distribution and of course transmission functions.

Through the use of something called transfer orders, expected to be issued by the Lieutenant-Governor-in-Council by April 1, the separation of New Brunswick Power's appropriate assets and liabilities into each of the new operating subsidiaries will occur.

Importantly, the transfer orders will also specify the consideration flowing between each of the subsidiaries, New Brunswick Power Holding Corporation and a new Crown corporation, New Brunswick Electric Finance Corporation. I will call that EFC. I know we don't like acronyms. But it is such a long name.

The primary purpose of the EFC, Mr. Chairman, is to facilitate the conversion of New Brunswick Power's current debt to appropriate levels of debt in the four operating subsidiaries and to assume and reduce the remaining portion of New Brunswick Power's current debt.

The statutory means provided to the EFC to reduce the legacy debt is derived from four sources. The EFC is to receive payments from New Brunswick Power Holding Corporation and its subsidiaries on the existing legacy debt that will have been converted and dispersed.

The Holding Corporation and each of its subsidiaries

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will be obligated to pay the EFC an amount equal to the federal and provincial income taxes they would have been liable to pay if they

were not exempt under the appropriate legislation.

The EFC will also receive payments, dividends or otherwise, in respect of the security which it will hold in the Holding Corporation or its operating subsidiaries for any security taken in the swap for debt established by the transfer orders. And, finally, should the Cabinet deem it appropriate, the Holding Corporation or any of its subsidiaries can be ordered to remit further "special" payments directly to the EFC.

Which the EFC may be provided with security in the Holding Corporation or any of its subsidiaries in exchange for existing debt, this security will be used for the specific purpose of servicing outstanding debt and will not concern the voting shares of the operating subsidiaries which will be held by the Holding Corporation, that is to say the Crown.

Now Ms. MacFarlane's evidence on the mechanics of all of this was indeed helpful in order to provide some substance to this important framework and is deserving of brief comment.

She firstly said that the EFC, which will also be a

Crown agent, will not be part of the New Brunswick Power family. But this surely isn't the case. The EFC will be owned by the Crown, as will New Brunswick Power Transmission, either indirectly via the Holding Corporation or perhaps in a year or so directly. Affiliates, as defined in the Business Corporations Act of New Brunswick, Mr. Chairman, are most certainly family members.

We also know that the debt equity swap is being driven by the various capital structures which are being designed for the four operating subsidiaries. For nuclear 100 percent debt. For generation perhaps 45 debt/55 equity. For New Brunswick Power Transmission perhaps 65/35 or 60/40. And we don't know at this point what the deal is going to be for distribution.

We now know something about these structures, thanks to Ms. MacFarlane. And in respect of the restructuring she confirmed that there will be no actual infusion of equity into New Brunswick Power Transmission.

In our submission, Mr. Chairman and Members, whatever these structures end up being they are not determinative of the decisions you must make on New Brunswick Power Transmission's capital structure or revenue requirement for rate-making purposes. If they were, then one is bound

to conclude that in large measure this hearing will have been an academic exercise. And we are quite confident that Bill 30 is not intended to have this effect.

While the restructuring deliberations may not be complete and clear, what is clear is the debt situation for New Brunswick Power Transmission. Ms. MacFarlane tells us that all of New Brunswick Power Transmission's debt obligations on and as of April 1 will remain guaranteed by or life-lined to the province. And that none of the company's assets which are free and clear today, will be encumbered by

the transfer orders. We will have more to say on this when we discuss the return component of New Brunswick Power Transmission's proposed revenue requirement. Conversely, any debt issued by the Transmission company after April 1 won't be guaranteed by the Province.

Bill 30 also implements the concept of a system operator whose purpose it will be to operate the transmission system in the province and to manage all interconnections with systems outside the province and distribution systems in New Brunswick as a not for profit organization. One of the system operator's main functions is the creation and oversight of the market. And to this end it will be vested with significant powers and

authority so as to maintain reliability of the transmission system, and where necessary, impose financial penalties.

The initial market rules under the proposed legislation, however, will not be determined by the system operator, but by the Minister. The system operator will be neither a separate corporation, nor a subsidiary of New Brunswick Power Holding Corporation. Rather, it will simply be created by the Minister under the Electricity Act. And it will be the Minister who will have the authority to appoint the System Operator's Board.

There is no provision in the legislation which requires independence, financial or otherwise, by those who will operate and conduct the affairs of the system operator and other market participants. In fact in our submission, in looking at Bill 30, it

seems quite possible that New Brunswick Power Holding Corporation or its subsidiaries may be delegated system operator responsibilities. And while the system operator's general by-laws are to be made by its Board, those concerning the appointment of its CEO, removal of its directors, conflicts of interest, the delegation of its powers in the Market Advisory Committee must firstly be approved by the Minister.

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Mr. Nettleton will discuss this a little bit further when we deal with the applicant's Panel D evidence.

So I have touched on policy and I have touched on legislation. What about regulatory framework and jurisdiction under Bill 30. Well, we find it in part 5. The current method of regulation for NB Power, namely the ability to raise rates by as much as 3 percent without regulatory approval, will continue to be utilized for distribution. This means that the largest customer in New Brunswick won't be obligated to obtain your approval of its rates provided that any average increase doesn't exceed the greater of 3 percent or the percentage change in the average CPI. Accordingly, much as has been the case for New Brunswick Power in the past decade, regulatory oversight of distribution rates in New Brunswick may well be limited. In any event, decisions which the Board may make in respect of distribution rates will be subject to review and reversal by the Lieutenant-Governor-In-Council.

What about transmission? Well under Bill 30 the method of rate-making is going to be significantly different. First, the system

operator as opposed to New Brunswick Power Transmission will be filing for your approval of tariffs for the provision of both transmission

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and ancillary services. New Brunswick Power Transmission, however, will be the party obligated to come before you and defend its proposed revenue requirement. In respect of that revenue requirement, the Bill tells us that you will be obligated to base your decisions respecting transmission tariffs on all of the projected revenue requirements of the SO and transmitters and the allocation of such revenue requirements as between them.

Mr. Hashey said yesterday that the Public Utilities Act speaks in terms of projected revenues and expenses. And if I heard him correctly, you therefore have no authority to consider an historical test year as the basis for setting rates. Given the similarity of the language in Bill 30, I conclude that he would take the same position with respect to that legislation. Whether he does or he doesn't, in my respectful submission, sir, it's a remarkable position.

Does it mean that if the utility, or a utility's OM&A expense this year is, for example, $40 million, and it makes an application to you on which it projects $50 million of OM&A for next year, that you are bound by that projection?

What if the Board disagrees with the projection or, heaven forbid, the utility is not able to defend, as Bill

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30 requires it to do, its projection. What happens if it can't meet

the onus of demonstrating that its revenue requirement leads to just and reasonable rates. You get my point.

We simply submit that if the Board concludes that a projection doesn't lead to just and reasonable rates, and that the better view that just and reasonable rates should be based on some increase looking at an historical test year, or from an historical test year, to meet that goal, in our submission, that is fully within your authority.

Interestingly, the phrase revenue requirements is a significant term in the legislation in Bill 30. It's significant because it's precisely defined to mean this. "The annual amount of revenue required to cover projected operation, maintenance and administrative expenses, amortization expenses, taxes and payment in lieu of taxes, interest and other financing expenses and a reasonable return on equity."

We would note, as undoubtedly have others, that the government has seen fit to require the recovery in transmission rates by New Brunswick Power Transmission of payments in lieu of taxes. That is in our submission you have no discretion as to whether this item should be recovered from ratepayers. But in our submission you may

still clearly determine the amount of that recovery.

Similarly, the Board now will have the obligation under Bill 30 to allow recovery from transmission ratepayers by New Brunswick Power Transmission of a reasonable return on any equity portion of New

Brunswick Power Transmission's capital. Similarly you will be the arbiter of what is reasonable.

Nowhere in the statute, however, or in the definition of revenue requirements is there a provision which requires you to provide New Brunswick Power Transmission with a deemed capital structure.

Your jurisdiction over electric utility matters, Mr. Chairman, is dealt with extensively in the bill. But many provisions are similar to the current situation. One new one is your market monitoring responsibility.

You will be obliged to "monitor the electric sector including the efficiency, fairness, transparency and competitiveness of markets in the electricity sector and of the market rules, the conduct of the SO in relation to its activities and responsibilities and the conduct of the SO transmitters and market participants under the market rules."

What isn't exactly clear is what it is that you are supposed to do with this market monitoring information.

For example, you are not obligated to report on this monitoring function. But if you choose to do so, the only person that gets your report is the Minister.

Fortunately the Board and the utilities which it will regulate under the new legislation will continue to be subject to the just and reasonable standard of ratemaking that is presently found in the Public Utilities Act.

Complaints to the Board under the new legislation may be made

based on public interest concerns or the failure to do any act, matter or thing required to be done under it or where there are allegations of market abuse or potential abuse by a market participant.

Our clients, Mr. Chairman, were not particularly happy to see that the Board may require security for costs from a complainant which security may be forfeited if the complaint is not substantiated.

Conversely there is no provision in the legislation which allows the Board to award costs if such a complaint is upheld or for that matter in any circumstance.

Under the bill's transitional provisions, New Brunswick Power's application filed last June, as we understand it, will continue to be heard or dealt with under the proposed legislation if it is proclaimed before your decision is rendered.

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If not, and your decision is rendered before the proclamation, then the tariff and rates which you approve are deemed by the legislation to apply to the system operator and to New Brunswick Power Transmission from the date of proclamation, without further inquiry, unless and until a further application is made by the system operator.

Our clients are also concerned about what we perceive as an intrusive and peremptory Section 156 of the legislation.

The plain meaning of this provision, Mr. Chairman, suggests that assets acquired by New Brunswick Power Transmission cannot be the subject matter of any sort of prudency challenge. And equally, expenditures arising from contracts entered into by New Brunswick

Power Transmission for the provision of transmission or ancillary services prior to the proclamation of the Electricity Act may not be challenged.

However, this is proposed legislation. And as I think you pointed out earlier, our issue is with other people and another place.

As noted, Mr. Chairman, on the coming into force of the bill, both parts 2 and 3 of the Public Utilities Act will be repealed as well as the Electric Power Act in its

entirety.

So in conclusion, on this section of our argument, Mr. Chairman, clearly some hearing time would perhaps have been saved had we had the Electricity Act in place from the outset.

That said, in conjunction with relevant policy considerations, the legislation is or will shortly be a reality. And we believe it must be kept squarely in front of you as you deliberate on the relief which New Brunswick Power has sought, which is why we are all here.

And before I turn the microphone over to Mr. Nettleton, a brief comment if I may on why we aren't here. We are not here to debate the so-called actual debt equity structure for New Brunswick Power Holding Corporation or any operating subsidiary. We are not here to debate the details of the New Brunswick Power Holding Corporation, EFC debt equity swap. Neither are we here to discuss the asset composition of New Brunswick Power Holding Corporation.

We are here to determine the appropriate terms and conditions of an open access tariff for New Brunswick Power Transmission. We are here to discuss the ratemaking implications arising from the allocation of 6.89 percent of New Brunswick Power's total assets to New Brunswick

Power Transmission. We are here to provide you with the best record that we can concerning an appropriate revenue requirement for the transmission services to be provided commencing April 1.

We are most certainly here to ensure that the rates charged for those services are just and reasonable. We are here to discuss the evidence concerning each of the five components of that revenue requirement as well as the further component of ancillary services which will be acquired by New Brunswick Power Transmission from its affiliate and paid for by its ratepayers.

And finally we are here to discuss whether the time and the underlying conditions are right for you to exercise your discretion to implement an alternative method of ratemaking, the price cap regime for New Brunswick Power Transmission for the first three years of its existence.

And it is to these matters, Mr. Chairman, either now or after lunch if you wish, and beginning with open access tariff issues, that Mr. Nettleton will now turn.

CHAIRMAN: Thank you, Mr. Smellie. I think after lunch is appropriate. And would it be sufficient time if we came back at 1:15? Okay.

Adjourned till 1:15.

(Recess - 12:00 p.m. - 1:15 p.m.)

CHAIRMAN: Mr. Smellie.

MR. SMELLIE: A preliminary matter, Mr. Chairman. I'm advised by our stalwart court reporters that our plan of providing them with a copy of our notes with all of the transcript references, et cetera in it is going to be quite burdensome in order to accomplish. One alternative is for us to read in those myriad of references and add considerably simply by the fact to the time it's going to take us to go through this.

Another alternative, Mr. Chairman, would be that when we finish and we had planned to give Mr. Hashey and Mr. Morrison a copy of our notes in any event, so they will have the transcript references. If we can just deliver to the Board a copy of our notes with those transcript and exhibit references that would solve the reporter's problem.

CHAIRMAN: Quite nicely for the reporter.

MR. SMELLIE: And then the Board would have access to the document that has the actual references in it. Would that be satisfactory?

CHAIRMAN: Well, yes, it would. And I think Mr. MacNutt may have spoken with you but at lunchtime I said we would like to have a copy of your remarks since they are in existence, so that would be fine with us. You could also

make it available, presumably, for any other intervenor in addition to the applicant. And that would be fine with the Board.

MR. SMELLIE: My understanding, Mr. Chairman, as to Mr. MacNutt's request is that at the end of the day today we would provide you with a copy of what we have said today and should it perhaps be the case that we have some more to say tomorrow, we would hold onto that until tomorrow.

CHAIRMAN: Yes. Don't ever hand out what you are going to say in advance.

MR. SMELLIE: Absolutely. Thank you, Chairman.

MR. NETTLETON: Good afternoon, Mr. Chairman and Commissioners. The next part of our argument is with respect to the open access tariff issues and ancillary services.

Now as an introduction to the tariff issues, we really need to look at what the primary objective of this proceeding is. A primary objective is to establish the foundation for a competitive wholesale market in New Brunswick. Clearly, the rules applicable to transmission service will play a key role in this regard and indeed be the rule book. Namely the open access transmission tariff will be the rule book.

JDI and its CME colleagues support the objective of

approving an open access transmission tariff, but not at any price. The tariff must not allow unjust discrimination, must adequately protect against market power abuse and must promote competition in the

market. Regrettably our clients have been and remain concerned with New Brunswick Power's reliance on the use of a FERC 888, 889 pro forma tariff and its supposed compliance with FERC requirements.

This concern relates to the scant evidence tendered to support this conclusion, and as well, to the findings made by the FERC in its notice of proposed rule making last July.

New Brunswick Power has said many times that the proposed tariff is FERC compliant based largely on the Rudden report.

This report simply asserts that the tariff would be found to be FERC compliant but we don't know the basis of that assertion, nor were we given any chance to test it. Accordingly, we say very little weight should be given to the assertion. No one from Rudden appeared and thus no opportunity was provided to take issue with the assertion.

The applicant has the onus and on this point they have not made out their case.

There was good reason to take issue with the Rudden

assertion because events in the United States have put in issue the validity of tariffs based on compliance with FERC 888, 889. Specifically the FERC notice of proposed rule making provides compelling reasons why any regulator reviewing a tariff said to comply with 888, 889 should be very sceptical.

The simple fact is that the FERC has found such a tariff to allow unjust discrimination. Perhaps it really isn't surprising that Rudden wasn't present. Why would you expect an objective third party to

testify to the outdated assertion that FERC 888, 889 pro forma tariffs are compliant when the FERC has in fact since said otherwise.

We simply don't know whether the FERC would approve this tariff document today in light of its findings in the NOPR. The idea of running this tariff by FERC staff was one raised in cross examination but this step has not been taken. All that we do know is that when we tried to find a FERC decision approving an 888, 889 tariff after the issuance of the NOPR, none could be found.

Of particular concern are FERC's findings which say that the 888, 889 pro forma tariff does not adequately address issues of market power and the potential for market abuse as it concerns integrated utilities and that

vertically integrated transmission owners and operators have when operating under an 888, 889 tariff, found ways to use their own transmission facilities in discriminatory ways which inhibit competition in wholesale markets.

These discriminatory preferences have been found by FERC to create barriers to new sellers that could provide lower cost power in turn causing higher prices to the native load served by the transmission owner.

While competitive generation has yet to arrive in New Brunswick, nevertheless the objective is to foster and promote an environment to attract it and we therefore submit a concern that arises and is evident in this proceeding is shifting costs away from New Brunswick

Power's generation activities onto its transmission activities. That is one way in which New Brunswick Power can provide itself with an undue advantage to compete against new generation. And that is precisely what the FERC is concerned about.

A second issue relates to the perception of market power abuse and its impact on the development of a competitive wholesale market. FERC is concerned and has found that efficient and competitive markets will develop only if market participants have confidence that the system is administered fairly. In turn, lack of

confidence may lead to a reluctance on the part of market participants to share operational real time and planning data with transmission providers because of the suspicion that they could be providing a competitive advantage to their affiliated power marketers.

Unlike the Rudden report, these concerns have resulted in actual findings by the FERC that undue discrimination in transmission service results from integrated utilities using and offering service under a FERC 888, 889 pro forma tariff.

Now turning to the issue of the independent system operator. We know that the answer to these serious concerns have not yet been settled. But it would be folly not to consider them simply because the solutions remain to be determined. There is nothing that remains outstanding about FERC's findings. They are compelling and highly relevant to this case. We do know that FERC is advocating the implementation of significant regulatory backstops to protect

customers against the exercise of market power.

Market monitoring at all times and market power mitigation when needed in FERC's view are essential. The primary backstop which FERC says is now essential in ensuring all transmission owners and operators contract --

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is through contract with an independent entity to operate their transmission services. An entity that has no financial interest, either directly or indirectly, or through an affiliate in any market participant in the region in which it provides transmission services.

Is this what NBP -- is this what New Brunswick Power proposes in its application? Is that type of approach necessary in New Brunswick? Let's discuss these issues now.

First it is important to reiterate that our clients are wholly supportive of the creation of a competitive wholesale generation market and the implementation of an open access transmission tariff. They are supportive because they want the economic opportunity to participate in the marketplace.

But what JDI and CME are saying is let's get it right. Let's not wilfully blind ourselves to the findings that the FERC has made, particularly at the outset. Instead let's be proactive. Let's learn from the U.S. experience and avoid the mistakes that have been made there.

In our submission there is little doubt that FERC's concerns apply to New Brunswick. New Brunswick Power will remain directly or

indirectly a vertically integrated utility operating in all sectors of the wholesale

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marketplace and will have significant market power. New Brunswick Power will be the principal provider of generation in the province and the sole provider of ancillary services. We have seen New Brunswick Power's reluctance to provide information that would otherwise send accurate cost based price signals to the market and allow competitive generation to be fostered.

New Brunswick Power's evidence -- New Brunswick Power's evident market power and the potential for its abuse require close examination of how New Brunswick Power Transmission's operations will in fact be conducted under the proposed tariff.

The New Brunswick Power application suggested that transmission operations will be conducted by a unit of the transmission division of New Brunswick Power headed by Mr. Snowdon. Neither Mr. Snowdon or his group would be separated from the transmission business unit, but instead would be subject only to the FERC 889, pro forma standard of conduct.

Through cross examination it seemed that agreement was reached on some greater division or separation of Mr. Snowdon's department. He said that upon market opening there would in fact be an independent system operator. And Ms. MacFarlane said that the cost of taking this step

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would not be significant.

JDI and CME were glad to hear that the I in ISO would be entrenched in that acronym in New Brunswick even though you were given little detail as to the level of independence to be created. And that the new approach addressed the concerns outlined in the FERC notice of proposed rule making.

Well what about Bill 30, how far does it go to address these issues? Well, we are all now familiar with the provisions which will establish the statutory system operator. We know that the title Independent System Operator did not pass legislative muster. We know a little more about this skeletal framework for the system operator, including the important market monitoring function which will be vested in the Board, and this is a good thing.

But while the government's release accompanying Bill 30 called the system operator an independent body, the Bill tells us that the system operator will consist of a Board of Directors to be appointed and potentially removed by Cabinet. Which Board can delegate any of the system operator's duties or power to any other body.

The bill also says that the Minister has a veto right concerning the appointment of the chief executive officer

of the system operator and by-laws concerning other important functions.

Should JDI and its CME colleagues now withdraw their concerns or erase their doubts in view of this framework? In our submission that

would be neither prudent nor warranted in light of the substance of their concerns. So where do we go from here? We recognize the need to balance our clients' legitimate ongoing concerns against the need to put in place the foundation of the bilateral wholesale power market.

JDI and CME therefore believe that New Brunswick Power's proposed open access transmission tariff, having regard to the amendments made to its original proposal, should be approved. They look forward to seeing how this proposal fits in the framework mandated by Bill 30. But we believe additional steps must be implemented both to deter actual market power abuse, as well as to prevent the perception of such abuse from interfering with the establishment of that market.

To that end we submit that the Board should, at minimum, require the same sorts of provisions which the Regie has implemented in Quebec concerning TransEnergie and Hydro Quebec Transmission. In particular these are as follows, (a) New Brunswick Power Transmission and the

system operator should be required to disclose details of all transactions directly or indirectly with related companies. This includes New Brunswick Power Generation and New Brunswick Power Nuclear for the provision of ancillary services.

(b) New Brunswick Power Transmission should be required to prepare and produce for public disclosure a transfer pricing policy for related party transactions. This is required given that, again, New Brunswick Power Generation will essentially be sole sourcing

ancillary services to the New Brunswick Power Transmission.

The Board should also impose regular compliance audits for both the books and records of transmission. And in respect to generation, be providing ancillary services in addition to the audit required of the system operator under Bill 30.

CHAIRMAN: Is there something in Bill 30 that you think we could hang our hat on if we did that?

MR. NETTLETON: Mr. Chairman, it's a fair question. The fact is, sir, is that you are approving a rate charged by Transmission for ancillary services. You can attach, we submit, terms and conditions to that ancillary service rate. We do not believe Bill 30 in any way limits your discretion as to your terms and conditions that you may

impose upon that ancillary service rate.

CHAIRMAN: Thank you, Mr. Nettleton.

MR. NETTLETON: The fourth suggestion, Mr. Chairman, is this. The system operator should be required to prepare a report to you for public disclosure on the steps it intends to take to ensure information and data, electronic or otherwise, will not be disclosed to any related party.

And, finally, the system operator should be required to prepare a report to you for public disclosure on the steps and processes it will implement to acquire ancillary services.

All of these reasonable and necessary requirements should be imposed, again, as a minimum condition of your approval to the

proposed open access transmission tariff.

We would now like to turn to the topic of ancillary services in more detail. The topic is complex and significant. Significant because New Brunswick Power seeks your approval to recover from transmission ratepayers some $38.4 million for capacity based ancillary services which will not be provided by New Brunswick Power Transmission, but by its affiliate, New Brunswick Power Generation. The incremental amount is approximately 40 percent of the applied for transmission revenue requirement. So the issue of whether the applied for

ancillary service rates are just and reasonable is of significant importance, particularly to industrial ratepayers who likely stand near the front of the line in having to obtain and pay for these services.

We submit that special care and attention need to be given to the issue of whether the ancillary service amounts applied for are indeed just and reasonable, because of the unique circumstances that will exist during the time in which the applied for rates will be in effect and who will be providing these services.

We submit the guiding principle or the golden rule which you should employ, as is the case with all other rates, is that ancillary service charges must be based on the actual cost of the service that is provided to Transmission by Generation. We submit you must be vigilant in applying this principle in these areas in order to

overcome any actual or perceived market power abuse as between affiliates. Particularly since generation will be in effect the sole provider of these services.

Ancillary service rates which are based upon actual costs of the facilities used to provide the actual service is consistent with the White Paper and particularly ensures accurate pricing which informs customers about the

true embedded cost of service.

And the way to meet this objective, we submit, is by firstly using the actual embedded costs of generation as inputs. And secondly, applying the correct pricing formula to ensure costs and revenues are correctly allocated to the actual plants that provide the actual ancillary services.

Let's turn now to the proxy methodology applied for. New Brunswick Power's position is that a proxy method should be used to determine ancillary service rates. The position of JDI and CME in response is this. First, it is not necessary to use the proxy method because we have or should have been provided the actual cost information. Second, in any event, the proxy method includes capital costs and capital structure assumptions that are hypothetical and not justified. Third, the proxy method has not been justified as a reasonable or appropriate long run marginal cost method to ascertain New Brunswick Power's costs of providing ancillary service. Fourth, the proxy method does provide the correct formula to determine the

price of ancillary services, namely, actual fixed cost of actual plant less a credit for energy production from that plant. We will review these four points in detail.

It is, we submit, inappropriate to design ancillary

service rates based on hypothetical cost assumptions when actual cost information has been made available. Why would this be considered just and reasonable? Clearly, we presume transmission rates have not been developed using hypothetical rate base, or OM&A expenses, or amortization costs, so why should rates for ancillary services be treated any differently. There is simply no legitimate reason to use a proxy for actual costs when actual costs are readily available. In the face of actual cost information using hypothetical generation capital costs and untested capital structure assumptions runs counter to the development of the proper pricing signal in order for consumers to make economically rational decisions.

Our second concern with proxy pricing methodologies is the use of untested cost of capital and capital structure assumptions. With respect, there is not one ounce of evidence on the record to support a 55 percent equity and 45 percent debt capital structure ratio embedded in the proxy cost method. The best we have is Mr. Porter's comment that Dr. Morin mentioned this might be reasonable in passing discussion. But Dr. Morin was not retained to provide any advice on this issue. So while an unprecedented structure using rates of 11 percent on equity and 10.3 percent on debt is assumed, the

reasonableness of these assumptions has not been justified in any way, shape or form and should therefore be rejected outright.

Turning to the issue of long run marginal cost. Notwithstanding the availability of actual costs, Mr. Porter says the proxy methodology is not intended to provide a reasonable approximation of the embedded costs of the actual facilities that will in fact provide the services. Instead he says the method approximates to New Brunswick Power Generation's long run marginal cost. But where is the evidence that justifies the assertion? The term long run marginal cost is not used anywhere in the transmission tariff design document. While these words are mentioned in one interrogatory response in the Panel C presentation materials, a justifiable explanation of how the proxy costs demonstrates or approximates to New Brunswick Power's long run marginal cost of providing ancillary service has not been provided.

The pitfalls of using a long run marginal cost methodology to approximate ancillary services was discussed at great length by Dr. Earle. During his presentation he told you why pricing ancillary services under an assumed long run marginal cost methodology was, for lack of a better word, wrong.

Unlike New Brunswick Power's suggestion at page 42 of the tariff design document that this is an easy methodology, long run marginal cost methods are very complicated. Dr. Earle says you must first

develop a long run marginal cost for a plant. This is not an easy task. It requires predictions and justifications for such predictions of short run marginal costs, of capital structure, return on equity, interest rates, cost of debt as it relates to the plant. It also means one must develop demand forecasts, capacity utilizations for the plant that are built and the recovery of costs in the market by these plants when they are not providing ancillary services.

Dr. Earle says a long run marginal cost approach while a complicated undertaking is also speculative in many ways. Recall the litany of problems he provided specific to the proxy method proposed by applicant. There has been no optimization study as between the services provided by the assumed proxy units or actual plant facilities.

For rate making purposes the proxy method is very problematic because the method proposes to recover costs not actually incurred or anticipated to be incurred for the provision of service. The method is not based on actual costs or circumstances which actually exist in New

Brunswick. It is not generally true that if you need one more megawatt for ancillary services that this results in the need to construct a brand new generation facility to obtain that supply. But that is the assumption that has been made.

And finally, the prices generated by the method put forward by the applicant were counterintuitive to common and practical sense.

Proxy unit prices, not including redispatch costs, are three times as high as those found in the NEPOOL market and under a three year NEPOOl average. Yet it is the NEPOOL market that is the vibrant export market to which New Brunswick Power is attracted. If one has low energy prices, says Dr. Earle, one should also expect low ancillary prices. So there is something very counterintuitive about the proposal.

Given his views, it was reasonable to expect those views to be challenged during cross examination. But they weren't. And his evidence is largely uncontroverted.

We submit that New Brunswick Power has not come close to demonstrating why the proxy methodology is in any way a reasonable approximation of its long run marginal cost. There is simply no evidence on the record why the use of long run marginal cost is a better predictor, especially now that embedded costs are now known.

We have no evidence which supports or justifies the hypothetical costs assigned to construct combined cycle and combustion turbine generation units cited in New Brunswick, let alone the assumed capital structure and capital cost components.

What we do agree with though is the formula used by New Brunswick Power to calculate the price of ancillary services, that is fixed costs of the generation plant actually used to provide ancillary service less a credit for energy production from those facilities.

This formula is correct since it recognizes that ancillary

services are not the only service provided by generation plant.

If you calculate the fixed costs of providing ancillary services based on entire plant costs, it is only just and reasonable, in our submission, to credit ancillary service ratepayers for revenues earned by the energy production from the plant.

And we see this calculation in schedule 1.1 of the tariff design document, exhibit A-2, appendix B at page 68. The fixed charge found in column 7 is reduced by columns 8 through 10 resulting in the applied for rate of column 11.

Now Mr. Porter in rebuttal tried to suggest that you

can't use this formula for purposes other than a long run marginal cost study. He suggested that cherry-picking this type of formula and applying it to embedded costs was not reasonable.

The question he either forgot to answer or chose to ignore is why. Why, if a hypothetical plant is allocated an energy production credit, would a similar credit not be applicable to actual plant and actual energy production?

We submit that the logic should hold true in both cases. The formula used in the proxy method is correct. But the inputs, namely hypothetical costs, are wrong.

Now Mr. Morrison recounted their justification for proxy pricing. He indicated one of the justifications was adequate compensation to the supplier. Now that is a funny justification. It has nothing to do with just and reasonable rates charged to ratepayers. I suppose it

is a driver when the supplier is an affiliate. But that is not what should be a determinative factor here.

The next item he suggested justifying proxy was that proxies would facilitate investment decisions. But on what price signal? A complete fictitious one is not going to help investors. That is not how sophisticated investment decisions regarding multimillion dollar generation facilities are or should be made, not when or

if there is market power to reduce this price by the incumbent to its actual costs.

Now the third item he suggested was that proxy pricing provides certainty. But what kind of price certainty are we talking about here? If I say the price is a thousand dollars a megawatt, we have price certainty by definition. But that is not going to help matters in respect of creating investment decisions in the province. And ratepayers who are expecting to pay for this service are not exactly going to be happy.

Turning to the embedded cost study that was prepared as of 2003, that was exhibit A-50, JDI and the CME submit that the actual embedded costs of producing ancillary services should be used in determining ancillary service rates. And if they had been, one would have expected these to be based on that study, on exhibit A-50.

Regrettably there are significant issues we submit with the study. First it didn't do what Mr. Marshall claimed it would do, that is show a consistency with the proxy price of ancillary services.

Second and more importantly, the study didn't do what the Board asked. Based on Mr. Marshall's evidence, there was a reasonable expectation that the embedded costs, cost results, would be consistent with what was submitted under

the proxy method.

Mr. Marshall said, and I quote, "The proxy cost pricing that we have put forward before this Board in this application comes up with rates that are consistent and similar to an embedded cost of study."

But from page 10 of exhibit A-50 we clearly see significant differences in the ancillary service rates determined using embedded costs and particularly so with respect to reserve services.

What astonished us the most was the fact that the embedded cost study indicated that a $9.8 million shortfall in revenue requirement would be created if proxy pricing was adopted.

Now this seemed quite serious. Think about it. Why would a prudent utility design going-in rates that are to be locked in for a period of three years intentionally design such rates so that they would not recover actual costs?

But our review of exhibit A-50 quickly showed what the problems were. These may be summarized as follows. First, an untested and unjustified capital structure and cost of capital were applied to actual generation plant.

Second, erroneous assumptions were made that all plants having the capability to provide ancillary service

should have a portion of their cost allocated to the ancillary service rate, even though not all of these facilities actually are used to provide ancillary service.

Third, a different and erroneous price formula was used to determine the embedded cost of the ancillary service compared to what was used with proxy pricing. The error made was that no credit was given to the rate for the energy produced from the generation plant.

Let's recall what the study you asked for was supposed to do. It was supposed to provide the estimated embedded costs of the existing and actual plant actually used to provide the actual ancillary service.

But that is not what you got. What exhibit A-50 does is tell a story. New Brunswick Power is asking you, if you will, to join Alice down the rabbit hole on the way to Wonderland. And yes, it does, says Alice, get curiouser and curiouser.

The first chapter to the story is the assumed capital structure. Exhibit A-50 asks you to believe that all existing generation plant is financed using a capital structure of 55 percent equity and 45 percent debt. And the reason?

Well, says Mr. Bishop, we just wanted to be consistent with the proxy cost assumptions. But wait a minute here.

Proxy costs are based on a brand spanking new plant, plant that is, as Mr. Porter says, based upon the risks and assumptions of a stand-alone

independent power project.

How are those assumptions relevant to existing plant? Existing plant has been financed with the most efficient capital structure of 100 percent debt. That is what Ms. MacFarlane said. And she is right.

As long as the government guarantee applies to existing outstanding debt there is certainly no reason to adjust the capital structure assumption, as Mr. Bishop has done in his study. It is simply unjustified.

To get at least some evidence of what a reasonable capital structure would be for generation, we asked Mr. Porter and Mr. Bishop about other integrated utilities and their capital structures.

What we know is that where private sector facilities have acquired plant and financed it with real equity, a 70 percent debt, 30 percent equity component has been used. That was the case with Bangor Hydro in 1995. This information was readily available to Mr. Porter before exhibit A-50 was delivered, but obviously not taken into account.

We also discussed Nova Scotia Power Inc.'s 65 percent debt and 35 percent equity and the fact that it is an

actual private sector enterprise that has financed its assets with actual equity.

But unlike these cases, New Brunswick Power Generation is in a

much better and different position, even with the introduction of Bill 30. Ms. MacFarlane indicated actual outstanding debt will remain guaranteed by the Province.

So using a deemed capital structure for New Brunswick Power Generation that approaches what Nova Scotia Power Inc. was granted would be extremely generous, since there is no intention to attract new capital equal to 35 percent of the net book value of New Brunswick Power Generation's rate base.

But even if a deemed capital structure was considered appropriate for existing generation plant, what would this be? Would it be 55 percent equity? Well, surely there is need for some credible evidence to support this amount.

At best you were told that the Province's investment bankers haven't sorted this one out. The Province's investment bankers, not New Brunswick Power Generation's investment bankers, the Province.

So why would New Brunswick Power want to make this sort of assumption? To put it another way, why would New Brunswick Power, acting reasonably, choose for ratemaking purposes to finance its existing Generation assets with

such a high level of deemed, not actual but deemed equity, let alone any equity component at all?

We must remember that deemed equity is an incredibly tax-inefficient method to finance rate base for the purposes of ratemaking. Every one dollar of return on equity generates a tax

liability of 56.25 cents that must be recovered from ratepayers.

It is ratepayers who suffer the burden of this assumption and not the utility, since taxes are a passed-through cost, or shall we say a quasi pass-through cost.

We say quasi pass-through because we must also remember who the real beneficiary is here. It is the utility's ultimate owner. It is money that is kept in the family, just like how the government guarantee fee has been treated in years past.

New Brunswick Power Generation is and will remain a Crown Corporation. And the payments in lieu of taxes under Bill 30 are to be made to the EFC, another Crown Corporation and indeed an agent of the Crown.

By allowing a higher equity component in the ancillary service rate design, by definition you cause an increase in the tax payment made to the EFC.

Is that something to consider? Absolutely. Why exacerbate the payment in lieu of tax costs when any

right-thinking commercial enterprise would do everything within its power to minimize tax expense.

Now Ms. MacFarlane told us the tax efficiency of the capital structure wasn't the governing factor. The governing factor for what purpose? Why isn't it a governing factor for ratemaking purposes?

For ratepayers, given the significant implications on the level of the revenue requirement, the tax implications of the selected

capital structure is a very significant governing factor.

This impact should most certainly be taken into consideration when determining what the lowest costs are for providing the regulated service and the just and reasonable rates associated with this service charged to ratepayers.

Use of tax-efficient capital structures happen in the real world. Use in the regulated ratemaking role ensures New Brunswick Power is treated on a commercial basis, on a level playing field, shall we say, with tax-paying utilities.

This isn't novel thinking. Other regulators, when faced with the question of what reasonable allowance for taxes should be included in the rates of Crown-owned utilities, consider the commercial reality of tax

minimization.

This is why for example the British Columbia Utilities Commission calculates the provision for taxes for regulated Crown utilities by using an effective tax rate based on actual tax amounts that private utilities in the province have actually paid.

Now of course this Board does not have control over the relevant tax rates given Bill 30. But you do have control over, for ratemaking purposes, the capital structure.

We submit that the allowable capital structure for ancillary service embedded costs should reflect actual costs or at least an approximation of actual costs.

Using a 55 percent equity component is not a reasonable approximation because it does not reflect the reality of New Brunswick Power Generations' actual capital structure.

It does not even come remotely close to reflecting the capital structure used by other regulated utilities that have real equity invested in plant. This inflated equity component creates an enormous and unreasonable tax charge that ultimately must be recovered in rates and should be rejected.

Now Mr. Chairman, Mr. MacDougall's client, also a

transmission and generation provider, agrees tacitly with the 55 percent equity and 45 percent debt position, as I understand it.

Why is that? You have to ask yourself that question. Why would WPS Energy suggest as much? Why would any generation company want this type of capital structure, especially when it's on the verge of becoming rate regulated?

In our submission this is the epitome of self-interest and we submit drives why WPMS has agreed to this type of structure. It's not the creation of just and reasonable rates. These are not going to be rates charged and collected by WPS Energy. WPS Energy may well want to compete using that as the benchmark, but it's not about just and reasonable rates for WPS Energy. It certainly is just and reasonable rates that are going to be paid by our clients.

Let's turn to the topic of cost of capital for ancillary service rates. The first issue here is what return on equity should be used

for generation plant. What we know is the generation is not the same business as transmission. The recommendations provided by Doctors Yatchew and Warren concerned rates of return on deemed equity for transmission utilities, not generation

utilities. What we also know is that an 11 percent rate of return on deemed equity, which is what New Brunswick Power assumed in Exhibit A-50, is high as compared to the decisions made by other regulatory authorities. In the case of Nova Scotia Power a 10.13 percent rate of return is provided by its regulator.

And this applied both to generation and transmission of Nova Scotia Power, but because generation comprises such a large part of Nova Scotia Power and its operation and rate base it clearly is reasonable to expect a return on deemed equity not to exceed this level.

And so this takes us to the question of how big a deal are capital structure and cost of capital in the overall ancillary service grand scheme of things.

Well we showed that just by applying the Nova Scotia Power Inc. assumptions to the present case, the 2003 embedded cost study revenue requirement for ancillary services dropped by more than ten percent from 48.2 million to 43.2 million. That is a significant decline. And if the hundred percent debt capital structure is used the ancillary service revenue requirement would clearly decline further. But by exactly how much we don't know because this scenario was not

run by the applicant. But we are confident that it could be and in prompt order.

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JDI and CME submit that the capital structure and cost of capital assumed in the 2003 study must be revised in order for the study to have any useful value.

Turning to the issue of allocation of plant capability.

Our second concern with Exhibit A-50 is the assumption that embedded cost for ancillary service should be based on the capability of the facilities to provide ancillary service regardless of whether the plant actually provides the service.

Exhibit A-50 simply did not report on the information that was requested. The Chairman's directive did not say, provide information based on the capability of all plants having the potential to provide ancillary service. It said, state each of the generating units that will actually provide ancillary service and the estimated cost of providing the actual ancillary service based on -- and this is important and which Mr. Morrison failed to mention yesterday -- using -- and I quote -- "using the generating facilities that will actually be used to provide the ancillary service." Instead of providing actual use data New Brunswick Power substituted the capability of generating plant to provide ancillary service and that has significant implications.

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The first implication is that plant capability does not consider

actual plant use. Capability of a plant by definition has nothing to do with the actual services provided by the plant and the cost of providing the service in question.

Let's look at Point Lepreau, for example. From schedules 6 through 8 to Exhibit A-50 the costs of Point Lepreau have been included in the rates for spinning reserve service and the other reserve services. Yet Point Lepreau has never actually been used to provide this type of service. That is what column 11 tells us from these schedules. In other words, it might be useful for this purpose but it has never in fact been used for this purpose, and according to basic rate making principles a facility must be both used and useful in order to be included in rates.

Now Mr. Bishop says Lepreau is included in the ancillary service -- ancillary reserve services because of the ability to recall export sales if a contingency, that is a loss of generation occurs. The ability to recall sales means the energy is sold on a non-firm basis. If there is a loss of generation that is a contingency and a recall happens, then the plant capacity being recalled that provides the export sale is now being used to meet

that contingency. But if that capacity was really needed for ancillary service, namely reserve, that also means that where there is no contingency the profits of those non-firm sales should be credited to the ancillary service rate. You can't have it both ways. But that's what New Brunswick Power is suggesting.

Further, given the amount of excess capacity on the New Brunswick Power system even without Lepreau, why is there any reason to assume an interruption would be necessary to the non-firm export sales supplied by Lepreau? That is why one would expect Lepreau to never have been interrupted and that is why column 11 in schedules 6 through 8 read zero.

Finally, if it is true that New Brunswick Power has made non-firm as opposed to higher yielding, firm export sales out of its plants, while at the same time having excess capacity, surely that would be akin to acting imprudently.

The reason is simple. New Brunswick Power has excess firm capacity to sell at a higher price than non-firm. By selecting non-firm sales that choice is depriving New Brunswickers of lower rates.

So there are significant logical difficulties in accepting the recallable or non-firm attributes of export

sales as a reasonable justification for using the capability of all plants in the calculation of ancillary service rates.

The second reason why allocating costs based on capability is wrong also relates to overall excess capability of New Brunswick Power's existing plant generation. The excess is some four times the actual required amount in the case of load following and the other ancillary services have similarly excess levels of capability.

So the question is why would you have all this excess capability? There are really only two reasons. Either you have acted imprudently

in building excess plant that exceeds your requirements or you have built that plant for another reason, like providing energy. That is of course what Mr. Bishop says is the primary reason for generation plants to be built. It is not the provisions of ancillary service. So when a plant is built for the purpose of providing energy, a by-product of that decision is the additional capability to provide ancillary service, even though that was neither the purpose, nor will the plant in fact be used for that purpose. Yet by allocating ancillary service costs based on the plant capability you must assume wrongly that all capability was intended to be

used for the purpose of providing ancillary service. And that is the very heart of the problem. It is a problem because it violates a fundamental tenet of ratemaking, namely that only used and useful plant costs for the provided service should be included in the rates charged to ratepayers.

Our third area of concern with the 2003 study concerns the formula used to calculate the embedded cost of ancillary service.

Recall our views on the correct formula being found in the proxy methodology. We say that is the correct formula because it recognizes the true or actual nature of generation plant, that is, the contemporaneous purposes of energy production and ancillary service.

Now Mr. Morrison told you his client rejects the embedded cost methodology because the numbers result in higher rates. But that comparison is like comparing apples to oranges. That result is

entirely because the embedded cost price isn't calculating or isn't being calculated using the same formula found in the proxy methodology.

The proxy method takes the actual fixed cost of the plant necessary to provide the ancillary service and subtracts from this a credit for energy production arising

from the plant. But why has this formula been ignored in the 2003 study? We simply do not have a cogent answer from the applicant.

Mr. Porter says that the formula only applies to proxy and that it would be a mistake to take it out of context of a long-run marginal cost study. But again how can that be so? The formula has nothing to do with marginality, it has everything to do with ensuring ancillary service rates are designed based on the costs which are actually incurred for the service provider.

Embedded cost ancillary service rates have been based on the fixed cost of the total plant, not simply a portion of the total plant cost attributed to ancillary service. There is a big difference. And if the plant has another purpose and revenues are earned for that other purpose a proportionate share of that other revenue must be properly attributed to the ancillary service rate. That is what is done in the proxy method and what should have been done in the embedded cost analysis. If the credit concept is applicable to one, there is no reason why it is not applicable to the other. There is simply a breakdown in logic and regrettably for Mr. Porter, with all

due respect, the ancillary service wonderland story is now at the point where the Red Queen exclaims, Off with his head.

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A reasonable credit which we submit could properly be applied was outlined in Exhibit JDI-31. Recall this was based on the same sort of formula used in the proxy method. Amounts for the energy production credit were based upon the export energy sales margins and in the circumstances this is a reasonable and conservative assumption. It is reasonable firstly because the credits are based only on export sales alone. No credit was assumed for in-province energy production and sales, unlike the proxy method. And the only reason is because we had no basis to calculate this amount.

Now, Mr. Chairman, I understand Mr. MacDougall's concern about the veracity of this exhibit, that is, Exhibit JDI-31, that it did not come in by way of a witness provided by our client.

In our respectful submission, sir, we would have loved to have that opportunity. We would definitely have had and brought a witness forward for that purpose. But the circumstances were such that we could not have that witness attend in light of the shortness of time that the study was provided.

The second reason why we say it is reasonable, that is the formula was reasonable and the credit is reasonable is because we know the total fixed costs of the plant shown

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in column 2 are based on overstated capital costs and payment in lieu

of tax amounts.

Perhaps the best way to explain why we submit the energy production credit should be applied to ancillary service rates is by way of analogy.

Let's take Mr. Bishop's fire hall analogy and assume we are all taxpayers in one municipality which decides that based on history our fire department will likely face three fires a year. And so our municipality builds two fire halls to meet both that need and the potential for any others.

Now our municipal leaders learn of an opportunity to provide fire protection services in the neighboring municipality. While additional revenue can be earned, additional plant is needed. And so a decision is taken to build three more fire halls.

Now as taxpayers we are sceptical because we know that we do not need this additional capacity. But in any event, and because there is the ability to earn revenues that may offset the cost of our existing fire halls, the additional fire halls are built.

And now the world changes. Now the municipality decides to unbundle the fire hall services so that better price signals are provided to taxpayers. So now taxpayers

have to pay for each of the services, one rate for the standby service, that is fire engines standing by, and a separate charge for the firefighting services when fires actually arise.

But the municipality, in calculating the standby service, decides

to calculate this rate based on all five of the fire halls in the municipality, not just those that the municipality actually needs. And also the municipality decides not to credit any of the revenue that it earns in the neighboring municipality to the standby service rate. That credit only goes to the firefighting service rate.

Well, that credit and that treatment of that credit is fine if you continue to obtain your firefighting services from the municipality, because you really don't care where the credit comes from.

But in an unbundled world it does matter. It matters because if customers can self-supply the firefighting services, yet are forced to continue to take standby or ancillary services from the municipality, they do not take the benefit of any of the revenue credit. And that is again wrong because they are paying ancillary services based on the cost of the entire plant.

The credit should be applied proportionately of

course. And that is what we submit happens with the proposal under JDI-31.

Now the other credit shown found in our exhibit is identical to what was used in the proxy method. It is the installed capacity credit. There is no reason not to take this value into account in the embedded cost calculation, or for that matter use any different number than what has been used in the proxy methodology.

Installed capacity requirements mandate that load servicing

entities, that is those supplying power to end users, demonstrate the ability to meet their projected annual peak load plus some reserve margin.

NEPOOL, the New York ISO, the PGM all have installed capacity requirements and markets for this. Under regulation, planners thought of reserve requirements in terms of short-term and long-term.

Operating reserves were the short-term buffer needed for the next day. Planning reserves were the long-term reserves needed in order to ensure annual peak load could be met reliably.

Capacity-based ancillary services are analogous to the operating reserves, the short-term requirements. Indeed this terminology is carried over from their description. But installed capacity requirements are analogous to

planning reserves.

The installed capacity value is derived from the market by the applicant. The value the applicant uses gives the value of the megawatt of generation capacity in its role of producing planning reserves.

Recall this credit is based upon a 12-month average value of installed capacity, not the value of capacity in the long run or on the margin and not based upon assumed units behind proxy cost pricing methodology.

Rather the value refers to installed capacity determined by quotations in the years 2002 and 2003 using that source information,

and applies to every installed megawatt of generation.

The credit has nothing to do with marginality and everything to do with the use of the megawatts. And so it should be applied consistently and taken into account in determining the actual embedded costs of the ancillary services.

This takes us to the next topic which is the Year 2000 Embedded Costs study, exhibit A-52. Now this is the study which New Brunswick Power tells you shows embedded costs to be consistent with the applied-for proxy cost method.

We were not told about this in the 2003 study nor as part of the original evidence, but rather some 24 hours

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before the evidentiary record closed. This is important for credibility reasons.

It was Mr. Marshall's statement, recall, that proxy cost pricing would be consistent with embedded costs that resulted in your directing New Brunswick Power to file the embedded costs data.

So why did the applicant withhold this information? Why did they not include this information as part of the initial filing, let alone included in exhibit A-50?

Mr. Porter, Bishop and Ms. MacFarlane say the reasons are twofold. First the study is outdated. And second the study was used for the purposes of deriving a negotiated rate.

But let's consider these reasons. Recall what was done in putting together the 2003 study. Fixed charges of existing plant are

accumulated and compared to the net book value of the assets. That is the ratio, the fixed charge rate for ratio.

Now this ratio should not, we submit, vary significantly from year to year, since the exercise itself is limited to just fixed charges and is relative to net book value of the plant. But that is not what we see when we compare the 2003 and the 2000 fixed cost charges.

What we see are significant changes in the amounts

calculated for depreciation, for example. This can only be due to fundamental changes in assumptions behind the calculation. Yet we have no information about what those changes are.

Of course, the other significant changes that we see are the capital cost assumptions. Now why are these outdated? We anticipate these relate to the negotiation reason. And so we will deal with those in a minute.

The other apparent outdated assumption appears to relate to the method by which actual plant has been studied and allocated to provide ancillary services. We see dramatic differences between the 2003 and the year 2000 embedded cost studies in this regard. And the question is are they reasonable?

Mr. Bishop says there have not been dramatic changes in generation plant usage. So if the 2000 study shows, as it does, that Belledune and Point Lepreau are not allocated to provide ancillary services, among other generation facilities, then why is it reasonable

to have these plants included in any of the ancillary service charges in the 2003 study?

Mr. Bishop tells you the reason is that assumptions have changed. Again the question is why? As best we can tell it is for one reason only, to demonstrate that the

proxy method yields reasonable ancillary service prices.

But is that a legitimate purpose of the study? Propping up the proxy method we submit is not what the 2003 study was intended for.

If the purpose of the 2000 study was to ascertain the actual embedded costs of the actual plant used to provide ancillary services, then why shouldn't the same assumptions hold true today and be reflected in the 2003 study?

The new assumption Mr. Bishop says is appropriate is that a portion of all plants having the capability to provide ancillary services, whether they do this in fact or not, is now the better method.

Better for whom? It is certainly not better for today's ratepayers or for the Board to obtain an understanding of what the real embedded costs are of using the generation facilities actually used to provide the ancillary services.

One must seriously question, we submit, whether it is reasonable to change the assumptions. Clearly the new assumptions were not used when New Brunswick Power negotiated a rate for this service with a sophisticated third party, and likely for good reason.

would certainly be smart enough to call New Brunswick Power on the suggestion that Belledune or Point Lepreau facilities should be included in the ancillary service rates when in fact they are not.

And we don't now see the Northern Maine Independent System Administrator standing up here saying, we agree, we agree with these changes in assumptions and we will amend our rates accordingly. And that is for good reason. Just consider what the rates would be now.

Now the next outdated assumption or inconsistent assumption, says Mr. Porter, is the suggestion of crediting export energy revenue to the ancillary service rates.

Mr. Porter says that because this type of credit was not included in the 2000 study, it should not be taken into account in the 2003 study. But was it really not taken into account in the year 2000?

At page 8 of exhibit A-52 we see export contributions being credited to the energy portion of the revenue requirement for generation. As Mr. Bishop has told us, that means that you receive the benefit of the export contribution only if you take energy production.

Do you think Northern Maine has not taken energy production along with the ancillary service? Because if

they have taken energy production then it matters not where the credit was allocated as between energy and ancillary service. We are back to

the fire hall example I submit.

So while export energy production was not specifically treated as a credit to ancillary service, we submit that the credit was provided in any event given that it was applied to energy production.

But the converse should hold true. If in the unbundled world, a world where all ancillary service is only provided by New Brunswick Power, if all customers take -- if all a customer takes is ancillary service and this service is priced on the entire plant, then it is reasonable to expect a relative portion of the energy production credit should be applied to the unbundled rate.

Why would any reasonable commercial party not expect this? The sum of the parts should equal the whole. And if you are taking only one part and paying based on the whole, fairness suggests that you receive a portion of the credit otherwise applied to the whole.

In summary and as it relates to the assertion of the study being outdated, we submit that while this may be so for individual fixed cost values, it is not clear why the study does not continue to bear significant relevance to

the questions of are the estimated costs of the actual facilities used to provide the actual service?

The 2000 study remains valid for this purpose. It remains valid and relevant to at least benchmark and to test the reasonableness of the new assumptions that are embedded in both the 2003 study and the proxy unit methodology. This is yet another example of how important

benchmarking and historical information can be.

Now the second reason, you will recall, concerning why the 2000 study was suggested as not being relevant was for negotiation purposes.

Let's go back a minute. Recall it is this study which Mr. Marshall says is consistent with the prices generated by the proxy methodology. And so if you approve the proxy method you approve the assumptions contained in the 2000 study. That includes capital structure and capital cost assumptions and of course the credit for energy production.

But there are significant differences between the proxy method and the 2000 study, particularly as it concerns capital cost and capital structure assumptions.

The 2000 study clearly uses a more traditional and reasonable capital structure of 60 percent debt, 40 percent equity. This is for again ratemaking purposes as

compared to what New Brunswick Power is proposing in the 2003 study, namely 55 percent equity and 45 percent debt.

The latter is not reasonable at all. The former is reasonable provided that there is actual capital in the utility giving rise to this type of capital structure.

But in the real world both in 2000 and in 2003 that isn't so. There is simply no real equity in the actual capital structure. There is only debt.

The Northern Maine Independent System Administrator negotiation obviously derived a reasonable cost of debt as well, being 7.5 percent. This is clearly more reasonable than what New Brunswick Power is now telling you is their cost in respect of the very same debt at a rate of 10.7 percent.

Why the difference? What story are we to believe? Mr. Bishop says it is because New Brunswick Power was not using its actual existing cost of debt, but rather a forecast cost of new debt. Well that is reasonable for new debt finances, but the 7.5 percent rate is applied to 60 percent of the existing and entire generation rate base. It's not new plant. It's existing plant. Assets which we know that have been financed entirely with existing legacy debt.

So is using a forecast cost of debt reasonable if the

actual cost of debt is more than 300 basis points higher? We say no. No reasonable commercial party would use a cost of debt if it did not allow for the recovery of its actual interest costs.

So this leads us to the only reasonable conclusion one could make. That New Brunswick Power's actual cost of debt was in the year 2000 7.5 percent. Again this study was about the embedded cost of their plant and not about proxies. It's about the recovery of the embedded cost and the rate charged to ratepayers. And 7.5 percent is acceptable to New Brunswick Power for ratemaking purposes for ratepayers outside of New Brunswick. Why should any higher rate be charged to those in the province? Again which story are we to

believe.

For the purposes of this proceeding JDI and CME can accept a more conservative rate than 7.5 percent based upon the actual cost of debt. We will talk about this in a minute, but that rate is 8.2 percent. The reason is that there is hard evidence to support this number. It is a rate that is disclosed in New Brunswick Power's annual report for the benefit of all in the public domain, including the investment community and ratepapers.

Now the real piece de la resistance that was highlighted in the 2000 study is the so-called negotiated

return on equity. Mr. Bishop is obviously a very skilled negotiator. He was able to convince a sophisticated party that an unprecedented 18 percent return on equity is just and reasonable. But he also told us his secret. He led the other party into believing New Brunswick Power was subject to taxes in 2000. It wasn't.

But this proceeding is not a negotiation. If you approve the ancillary service prices consistent with this study you will approve an 18 percent before tax return on equity. This is clearly inappropriate. When taking into account the tax implications, however, we see a relatively less offensive but in absolute terms still unreasonably high return on equity of 11.52 percent. That was provided by way of undertaking 54. And it showed that a weighted average cost of capital was 9.108 percent, and this was found to be acceptable by New Brunswick Power using a debt equity ratio of 60

percent debt and 40 percent equity.

Now again this weighted average cost of capital is much lower than what the applicant has applied for in this proceeding. And so adjustments and consistency must govern. At the very least we submit you must adjust -- you must adjust the applied for capital structure and cost components of debt inequity so that they reflect today's realities. And those realities are that generation like

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transmission will remain effectively 100 percent debt and that only a small portion of their requirement to attract capital should require any proportionate form of return on deemed equity. The cost of debt should be 8.2 percent and the cost of equity should not be higher, even for generation.

Let me talk a little bit about what we are recommending in the circumstances now as it relates to ancillary service.

Where does that leave us with respect to ancillary services and more particularly where does it leave the Board? We all like happy endings but unfortunately the plot here is very complex and easy solutions are not necessarily just and reasonable, which is what matters here.

The record is complicated by the initial unwillingness of New Brunswick Power to provide the embedded cost information. The record is unnecessarily complex through New Brunswick Power's use of unreasonable and hypothetical methods to estimate ancillary service rates. And finally the record is complicated by the fact that not one

but two embedded cost studies have been produced at the eleventh hour. These truly are unusual circumstances.

Our recommendation in these circumstances is for you

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to select one of the following three options.

The first option is to establish ancillary service rates based on select criteria from each of the studies using the pricing formula found in the proxy cost method. The problem we see with this option is that it is complex and requires careful judgment, but we certainly believe you are up to the task. It is not simple but it will ensure that ancillary services, like all other rates you approve, reflect the actual embedded costs of only the used and useful facilities that provide the service.

The second option recognizes the deficiencies contained in the embedded cost information that has been provided, but in any event and for a limited time, apply the rates that result from the calculation contained in Exhibit JDI-31. We must emphasize that JDI-31 is conservative given that the total fixed costs are based upon unreasonable assumptions of capital cost structure and capability as contained in the 2003 study. Having said that, Exhibit JDI-31 does use the correct pricing formula and results in a much more reasonable and just ancillary service rate than those applied for. It is for this reason that JDI and CME cases contained in the AT argument found at page 2 reflect the revenue requirements for ancillary services derived in that exhibit.

The third option is in our submission the cleanest and ensures the objective that correct pricing signals are given. It is simply to follow the recommendations of Dr. Earle. Dr. Earle's recommendation is to use a NEPOOL average as a basis for the ancillary service rates as set out in JDI's response to New Brunswick Power IR-3.

Dr. Earle justified the use of NEPOOL prices as follows, and I quote, "NEPOOL is the nearest market to New Brunswick. Moreover since it is the only market interconnected with New Brunswick it is especially relevant. Part of the assumption of the opening of the market in New Brunswick is that NEPOOL is an attractive market for power from New Brunswick. That is, it is thought that power prices in New Brunswick are low relative to those in NEPOOL. Since higher power prices usually mean higher ancillary service prices in a competitive market the level of ancillary service costs in NEPOOL are a good indicator of the proposed level of ancillary service costs in New Brunswick. The fact that they are lower on a long-term basis in a workably competitive market is striking."

Now Mr. Morrison in his argument suggested that NEPOOL would not be an appropriate methodology and he said so based on his cross examination of Dr. Earle. But just

remember here, Mr. Chairman and Commissioners, what we were talking about. We were talking about the applicant applying for ancillary service rates that are not five percent higher, not ten percent higher

than NEPOOL, but 300 percent higher than NEPOOL. If there needs to be some adjustment to NEPOOL to reflect some of the unique circumstances, fine, but 300 percent higher than NEPOOL? That clearly isn't evidence that is on this record that would allow you to support and justify the applied for rates.

Until actual embedded cost information can be provided to you and the true story is known about what the actual cost of the actual plant that is used to produce actual ancillary service, use of the NEPOOL average we submit is just and reasonable.

Certainly it is clear that what New Brunswick Power wants, namely the proxy pricing methodology, is not just and reasonable, because that method is not based on any form of embedded actual cost.

We say take the high road, take the road that is principled and apply the golden rule that rates must at all time be based upon the actual costs of the facilities that are used and useful for the purposes of the service provider. Until the applicant has properly demonstrated

and is willing to share with its ratepayers this derivation then a market based proxy for ancillary service rates, namely NEPOOL, is perhaps the best road to choose.

Mr. Chairman, I'm wanting to turn to another area. I am in your hands in terms of a break.

CHAIRMAN: We will take our break now. Thank you.

(Recess)

CHAIRMAN: Go ahead, Mr. Nettleton.

MR. NETTLETON: Thank you, Mr. Chairman. Moving from the topic of ancillary services, I would now like to touch upon a topic that is of great significance and import to our client. And that's the impact that this tariff and this application has upon self-generators and the apparent rate shock that is included in the tariff application.

You will recall that a portion of the extensive discussions about ancillary service again concern self-generators, particularly as it related to JDI's supplementary response to New Brunswick Power's information request number 9. That was the supplementary response that was filed.

Given that the evidence indicates from this response that approval of this application will result in rate shock particularly in the case for self-generators it would, we submit, be convenient and important to discuss

that now.

The White Paper and the market design committee singled out self-generators as an essential component of the transition to a competitive world and concluded that they should not be subjected to rate shock in the transition. Self-generators provide the best and surest way for there to be the needed increase in generation in New Brunswick. The question then is whether New Brunswick Power's application accords with this goal.

The evidence is that the tariff and rates which New Brunswick

Power wants to put in place will result in cost increases exceeding 160 percent for self-generators. This is clearly rate shock by anyone's definition, we submit. And New Brunswick Power does not seem to disagree. Rather, their response it two fold.

First, self-generators can decrease their rates under the proposed tariff if they take a different type of service than they currently have. Second, self-generators can reduce their costs if they self-supply ancillary services.

Let's take each of these in turn. New Brunswick Power proposes that a self-generator take point to point rather than network service to reduce its costs. The obvious problem is that point to point service is not comparable

with network service. The service received today is equivalent to network service. Therefore to get an apples to apples comparison of rates, we must compare rates today versus those under network service, as both Mr. Mosher and Dr. Earle did in their evidence.

What are the differences between network and point to point that make them not comparable? Under network service a self-generator does not have to nominate delivery and receipt points. Nor does a self-generator have to monitor the OASIS system for transmission availability in case one of its units goes down and needs extra transmission.

Under network service the self-generator does not bear the risk of having service curtailed resulting in shutdown of production that

could result in millions of dollars of losses.

Conversely, under point to point service a self-generator has to incur all these costs and risks. Even so if self-generators move to the clearly very inferior point to point service, there would still be a 59 percent increase over current rates. By any reasonable definition paying 59 percent more and receive vastly lesser service, is rate shock, we submit.

So New Brunswick Power has a second suggestion for

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self-generators. They should self-supply their ancillary services. The strange thing about their calculations in this regard, as New Brunswick Power has admitted, is that the company expects that self-generators could self-supply their ancillary services for free. JDI and CME find this a curious notion indeed. New Brunswick Power wants again in the neighbourhood of $38 million for ancillary services which it says represents the cost of providing these services. At the same time it suggests that self-generators can provide these services for free. Intuitively only two possibilities exist. Either New Brunswick Power should provide ancillary services for free as they suggest self-generators can. Or more likely New Brunswick Power's notion that self-generators can save money by self-providing ancillary services is not a realistic possibility.

As a result in our submission it is clear that at best under the proposed tariff self-generators will suffer rate shock in one of two ways. Either they will pay at least 163 percent more than they do now

unless they elect to take a vastly inferior type of service, and in which case they will only pay 59 percent more than they do it. We simply say that neither of these is a palatable option because of the rate shock implications and that New

Brunswick Power's application in this regard is seriously off side with the policy goals of the province. We said at the out --

CHAIRMAN: Just sitting here, what is the explanation on the basis of what you are saying for today's situation? Are self-generators being cross subsidized from within their own rate category? Or are they being cross subsidized by all of the other users of the system? In other words, these costs are not new costs. That, you know, they are being charged differently, et cetera, but presumably those costs are all being covered in the bundled service today.

MR. NETTLETON: Mr. Chairman, I understand your question. One of the problems, as you will recall, in making these comparisons was understanding what exactly the proportion of the bundled service rate is applicable to self-generation transmission service. We could not provide that. But the applicant can provide that information. It was part of the comparability issue that you will recall Mr. Mosher and Dr. Earle spoke to in evidence.

CHAIRMAN: Well I am going to -- that will be a question I will ask everybody to address when we go around the room again, et cetera. I mean, if we did a cost of service -- we reviewed a cost of service study back in the early 90s. We haven't had the opportunity to do so

since then. But

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at that time, why large industrial was pretty close to unity. And if that's the case, then presumably they were bearing the cost, that whole class of consumer was. But now, as you say, 163 percent increase, yes, that's rate shock. Go ahead. Sorry to interrupt.

MR. NETTLETON: No, that's fine. Please, if there are other questions, please feel free to interrupt.

Again, just to emphasis the point. We just simply do not consider either of these to be palatable options, again, because of the rate shock. And because that there is a significant contravention of what the policy goals were of the Province.

We said at the outset that if this were the case, then the burden fell to New Brunswick Power to demonstrate why exceptions to legitimate policy goals should be tolerated by the Board. And this has not been done.

Given this evidence, JDI and CME submit that the proposed tariff ought not to apply to self-generation customers situated in the province. The level of rate shock is simply too great. We submit the Board should direct the applicant to file a different rate or tariff specific to self-generation customers to take into account these special circumstances, so as to protect the policy objectives of facilitating further development of

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self-generation in the province.

Mr. Chairman, there is one last matter that I would like to touch upon in respect of the tariff design and the terms and conditions of the tariff, before moving back to the transmission revenue requirement items. And that concerns issues respecting the standard of conduct and how disputes arising under the tariff are proposed to be resolved.

Now Mr. Hashey you will recall provided revised documentation pages to the tariff. And one of those pages related to the method by which disputes were now being proposed to be resolved. The methodology that is proposed now is binding arbitration. The concern that JDI and CME have remains cost oriented. That is, is it reasonable to expect a party who has a complaint with Transmission to have to bear the costs of having to first take that complaint to the Transmission management for resolution first, and then have to go through a binding arbitration process. And then, and only then, having to take the matter before this Board, and be subject to potentially costs being awarded against the party. It strikes us as being somewhat -- in fact indeed very unfair. The matter of costs and the implications of taking complaints through that process is very arduous and expensive. The matter of

costs should be dealt with in the tariff and ensure that customers who have legitimate complaints do not have to have those costs charged to them for alternative dispute resolution processes. This is an alternative dispute resolution process. This Board is a alternative dispute resolution process.

CHAIRMAN: The provisions that are in there in reference to cost, are they all alternative dispute resolution?

MR. NETTLETON: The problem is this. I am not being clear, sir. The problem is that while the methodology by which disputes are to be resolved are set forth, the issue of who pays for that dispute resolution process is not. We assume that it's going to be a burden shared by both NBPT and the customer.

CHAIRMAN: Let me just a quick follow up on that, Mr. Nettleton.

z MR. NETTLETON: Yes.

CHAIRMAN: What do you think? If I were a solicitor acting on behalf of a client who had a situation that they simply looked at it and been there and done that before and said, you know, we are going to have to go before the Board because, you know, this is black and it's white and that's all there is to it. And there has to be a decision made.

Should there not be the option let's say with the

complainant that they go directly to the Board and not have to go through the ADR process?

MR. NETTLETON: Mr. Chairman, you raise an extremely important point. That in my experience as a litigator and very familiar with this alternate dispute processes, it only works when the parties consent to the method by which the dispute can be resolved. If there is no consent, then the process is doomed to fail.

CHAIRMAN: Yes.

MR. NETTLETON: So in my submission, I agree. I agree that the parties

should have the freedom to say that is one option. That is binding arbitration. But we believe, we submit, that the most fundamental option should always be available. The option of taking matters to this Board.

CHAIRMAN: Thank you.

MR. NETTLETON: Now, Mr. Chairman, let's turn now to the revenue requirement for the transmission service provider and the components of that revenue requirement. New Brunswick Power Transmission's proposed revenue requirement is made up of five components. And we will address each of these in turn. Coincidentally again they are the same as those found in the definition of revenue requirement found in Bill 30. That definition as we have noted is particular and specific. In other words, unless

New Brunswick Power Transmission can shoehorn a cost or expense item into one of those five components, it cannot recover that item in rates.

This lack of flexibility at the early stage of market restructuring is both a curious and intrusive step for the legislature to take given its potential impact on the Board's discretion. Now that said the legislature has not gone so far as to limit your discretion as to the quantum of any one of these components.

If for no other reason than the rates derived from revenue requirements must in any event be just and reasonable as well as non-discriminatory. That fundamental determination is reserved for you

having regard to the public interest.

Let's first talk about amortization. This is the first component of the proposed transmission revenue requirement. At 18.4 million, amortization represents 19 percent of the overall revenue requirement to be recovered from transmission's ratepayers. As much as we would have liked the Board to have a more complete record about this topic, the problem is that New Brunswick Power has provided little information to determine whether the $18.4 million is in fact just and reasonable.

Mr. Lavigne told you the task of determining our

amortization was left to New Brunswick Power's amortization review committee and that he was not familiar with the methods used. He essentially asked us to trust the committee because, quote, "they look at various components".

But Mr. Lavigne himself does not know exactly how these have been applied and that this would be something undertaken by an internal process which he could not address. JDI and the CME want to ensure that the rates they will be paying to New Brunswick Power Transmission reflect the actual cost of the service they receive. They are most concerned when New Brunswick Power tells you that they are not prepared to consult and answer their questions outside of a regulatory forum only to be told that the questions asked in that forum cannot be answered because the information was not available to any New Brunswick Power witness.

We hope you can understand our client's frustration. And the frustration is not undue. Ratepayers remember are being asked to pay $18.4 million for amortization. What we were told was that the committee carries out depreciation studies of all classes of transmission assets over a five year cycle. While this suggests that depreciation studies have in fact been conducted, the

results have not been provided as part of New Brunswick Power's evidence.

And then came the most curious admission of all. We asked Mr. Lavigne whether New Brunswick Power considers its level of applied for amortization to be consistent with that of other utilities. The answer was that it does.

Let me take you to the transcript at pages 1602 and '03. My question to Mr. Lavigne was this, "Have you compared the historic depreciation rates that you are proposing this Board implicitly to approve as compared to those used by other Canadian electric transmission utilities? Answer: As part of the amortization review process, that is one of the other components which takes place in this study, is a comparison to other utilities in terms of the service lives of the assets. Question: Sorry. Which study are you speaking of, sir? Is it in this evidence? Answer: No, it would not be in this evidence."

That is remarkable. New Brunswick Power admits that evidence in fact exists relevant to the reasonableness of the amount of applied

for depreciation, yet it chooses not to make it available for the kind of scrutiny that Dr. Morin, you will recall, suggests is one way of ensuring

that going in rates for the price cap regime are correct. Don't you have to ask yourself the question why? One cannot help but make an adverse inference towards the position taken by New Brunswick Power in this respect.

The second area of concern is the fact that New Brunswick Power took this position in the face of the Board's July 16, 1991 decision concerning depreciation. Commencing at page 22 in clear and unambiguous terms the Board concluded that New Brunswick Power should utilize statistical analysis of historical data to the greatest extent reasonably possible when calculating service life values used in the determination of amortization.

The Board clearly stated that full written explanations and the reasons for and the extent of adjustments or limitations of service lives will be necessary in future depreciation studies.

Well here we are. The first time New Brunswick Power has been before this Board since then where depreciation is an issue and there is no evidence of statistical analysis concerning service lives and there are no full written explanations concerning the reasons for and extent of adjustments or limitations of service lives.

Mr. Lavigne suggested during cross examination that these requirements have in fact been met and referred you

to their response to the Province of New Brunswick information request number 24 (4).

But we submit that this response provides no statistical analysis and no detailed written explanations concerning service lives at all. All this response says is as follows, and I quote, "On an ongoing basis the amortization review committee reviews select components within each major asset category and/or selected categories to provide reasonable coverage over a five year cycle period".

Now to his credit, Mr. Lavigne ultimately did the right thing. He admitted that New Brunswick Power has not complied with the 1991 decision. Full explanations of the service lives changes or service lives estimates have not been provided and made part of this application.

Why is this information so important? Why are statistical analysis and a full understanding of the method used to calculate the amortization amount necessary in this proceeding? The answer is that service lives are used in the method by which amortization is calculated. What we know is that since 1996 when the transmission -- when transmission became a business unit, a straight line method of depreciation has been employed. But what Mr. Lavigne also told us is that the depreciation rates have

changed since 1996 because service lives have changed for the various asset classes. The problem, however, is that we have no understanding

or knowledge of these changes.

Our recommendations in respect to this concern, Mr. Chairman, is this, this lack of evidence effectively stymied any meaningful discussion about how the proposed amortization amount can be determined to be just and reasonable. So what should we do?

We submit firstly that this lack of information and ability to test approximately 20 percent of New Brunswick Power Transmission's revenue requirement is in and of itself sufficient reason for the Board not to approve the proposed price cap. We will discuss this later but recall that the price cap proposal will freeze Transmission's revenue requirement for a period of three years and provides the firm with the opportunity to earn as much as 14 percent return on equity in the event the starting point revenue requirement is over inflated.

Without having a full grasp and understanding and sufficient opportunity to test the reasonableness of the amortization component, we submit the Board has no option but to disallow the price cap. As Mr. Mosher put it, the proposal is simply premature.

Clearly New Brunswick Power incurs an amortization

cost and should be allowed to recover that cost in its rates. We conclude that while the 18.4 million should not be adjusted, we submit that it should not be recovered without at minium some conditions.

The first is that New Brunswick Power should be required to refile for this Board's approval of the amortization on the basis of

an in depth depreciation study in respect of all asset classes that comprise the transmission rate base of the sort called for by the Board in 1991.

Also, we submit that the Board should require New Brunswick Power to provide all comparative studies of amortization rates which it has to demonstrate that the transmission rates which they now are implementing are just and reasonable. And which also demonstrate that the overall amortization amount satisfies this standard.

Until such time as the applicant has complied and a proper review has been completed by the Board, we see no other way around this problem, Mr. Chairman, than use of a deferral account for the amortization amount.

The next item of the applied for revenue requirement concerns operation, maintenance and administrative costs. The proposed OM & A expense is $37.6 million, the most significant component of the revenue requirement equaling

38 percent of the total.

Our concern about the adequacy of the evidence is once again upon us. New Brunswick Power suggests that it is appropriate for the Board to approve the operation, maintenance and administration expense simply because it says so.

Does that establish a prima facie case? Is that sufficient for interveners to test the OM&A amounts? More to the point, is that a sufficient ground for you to determine the OM&A amount is just and

reasonable? We submit the answer is no.

Remember that New Brunswick Power wants you to make this assessment not just for one year but for tolls over a three-year test period which will be adjusted so as to provide up to a 12 percent return on equity without any benefit being shared with ratepayers should the OM&A costs be overinflated.

This is another example of why it is so important to get the starting point revenue requirement right, which means that there must be a full and complete record on each individual line item of the revenue requirement.

What New Brunswick Power tells you is that the transmission business unit has operated again on a stand-alone basis since 1996. Now I heard Mr. Hashey yesterday

say that it was 1998. And so I may stand corrected on that point.

But you would expect in any event that it would be able to demonstrate what its track record has been in respect of OM&A costs at least since then. Has such information been provided? The answer is no.

What we know is that New Brunswick Power relies on a 1999 report prepared by Stone & Webster which concludes that OM&A costs can be significantly reduced should New Brunswick Power take appropriate steps to invest in capital projects that improve overall reliability.

Have those capital investments been made? The answer is yes. We

are in the final stages of that recommendation being fulfilled, as we understand it.

What then is the legitimate expectation of New Brunswick Power ratepayers who have made the investment in those capital projects? It is that OM&A costs should have declined. But that is not what we see in this application. What we see are OM&A costs increasing.

The problem of not actually seeing the benefit of the capital investments that have been made is exacerbated even further like amortization through the proposed price cap.

If OM&A costs are less than forecast, the benefit of

those cost reductions first flows to New Brunswick Power to the exclusion of ratepayers. Yet it is ratepayers who have made the investment in the capital projects giving rise to these cost savings.

Did New Brunswick Power put at risk its own investment dollars to obtain cost savings on its system? The answer is no. New Brunswick Power has obtained all of its financing from internally-generated funds of ratepayers in the province.

Is it just and reasonable for ratepayers who have invested in capital projects to have the benefit of those projects, namely OM&A cost savings reduced in total or by 50 percent as per the price cap? We submit that it is not. Yet that is the effect of the application.

To be clear, this occurs because we have no track record or evidence regarding the prudency of the applied-for OM&A costs. And secondly, investments have been made with the expectation of reducing

those costs of which the benefit will now be taken away or at least diluted through the introduction of the price cap.

We submit that does not give rise to a just and reasonable toll. We submit that it is another good reason for this Board to conclude that the price cap is premature.

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Now turning to the topic of pension costs. During our cross examination concerning individual OM&A elements, it became clear that significant evidence was missing on two key components.

With respect to pension costs we learned that OM&A includes an 88 percent increase in pension costs attributed to transmission employees. We know only that New Brunswick Power Transmission's employees will increase in number from 297 to 302.

Are individual employee pension costs tracked? The answer is yes. Is the amount included in OM&A based on the individual transmission employee pension cost amount? The answer is no.

And what Ms. MacFarlane tells us is that a new pension cost allocation methodology is under development. So here we go again. New Brunswick Power wants the revenue requirement frozen for three years unless the return level is 9 percent or less.

On the cost side, we know that the amount New Brunswick Power seeks to recover in and through transmission rates includes a pension cost amount that has increased by 88 percent. And that method used to calculate this amount is in the process of being changed.

Who do you think will take the benefit of this change

in the allocation methodology? Under the price cap, New Brunswick Power Transmission goes first and reaps all of the benefit up to an earnings threshold of 12 percent. And only then do ratepayers take any savings.

If New Brunswick Power knows that its current allocation methodology is wrong or at least is subject to review and has the ability to calculate pension costs on an individual transmission employee basis, surely cost-based ratemaking principles require that those calculations be used for determining the cost of providing the service offered.

Without knowing those calculations, without seeing the proposed change in the allocation methodology that is under development, introduction of the price cap is again premature.

The last component of the OM&A expense which we wish to highlight is labour. What evidence has New Brunswick Power given you that its applied-for labour costs are reasonable? The answer is very little.

What New Brunswick Power tells you is that no prudency tests in respect of the level of labour costs have been conducted. What you are told is that a recent collective agreement settlement has caused labour costs to increase by 2 percent.

What you are told is that the number of transmission employees is expected to rise from 279 to 302. Yet the overall increase in labour costs is 10 percent. What justification has there been for this

amount?

Clearly there has to be some discretion afforded to the management of New Brunswick Power to conduct its affairs in a businesslike manner and minimize costs where possible. That is what happens in the real world, in a competitive world. Competition is the governor to ensure costs in a business are minimized.

That is not necessarily true with regulated utilities who have the opportunity of having all of their applied-for costs recovered from ratepayers. There has been no prudency evidence respecting labour costs in this proceeding.

There is evidence that New Brunswick Power compares its labour costs with other members of the Canadian Electrical Association and that key performance indicators are taken into account.

Do we know where New Brunswick Power's labour costs stand relative to others? The answer is no. That information has not been provided. And the question is why not?

It seems that information is saved only for

management's consideration, because its interpretation may be difficult for ratepayers and this Board to understand. With all due respect, sir, we submit at least give us a chance.

That is the response though which we received from Ms. MacFarlane after the admission was made that key performance indicators are considered and that New Brunswick Power does participate in such benchmarking exercises.

But if they participate in those exercises they must do so for a purpose. What has been demonstrated in this proceeding however is that the results of those exercises are not to be shared with you or with our clients.

The evidence is out there, Mr. Chairman. But New Brunswick Power isn't prepared to provide it to you. And so we are back to the question of adverse inference.

What JDI and the CME recommend in these circumstances is the production of better information to justify the OM&A costs which have been applied for.

Our clients recognize that rates and tolls need to allow for the recovery of just and reasonable OM&A costs. That is not the point. They recognize that this should be the lion's share of the revenue requirement.

But they are not prepared to simply provide a blank

allow for the recovery of just and reasonable OM&A costs. That is not the point. They recognize that this should be the lion's share of the revenue requirement. But they are not prepared to simply provide a blank cheque. And they certainly aren't prepared to provide a blank cheque if the money which they provide is not reflective of the actual costs that will be incurred. That is the point.

What JDI and the CME have told you through the evidence of Dr. Earle is that OM&A costs in these circumstances should be based upon levels which New Brunswick Power says in its evidence existed for the years 2000 and 2002. That amount was $34.7 million.

We submit that not only has the approximate 10 percent applied-for increase in OM&A costs not been justified in this proceeding, there is in fact compelling evidence provided by the applicant and relied upon by Dr. Earle in suggesting the 2000 to 2002 amount is an appropriate and conservative estimate of what projected OM&A costs should be for the upcoming test year.

Dr. Earle referred in his evidence to numerous examples of cost-saving measures identified by Stone & Webster. Reliability-based evaluation methods alone was estimated to reduce maintenance expenses by 10 to 15 percent.

As Dr. Earle said, this suggests that lowering OM&A expense to $33.6 million is very reasonable and an achievable target for New Brunswick Power Transmission.

As a result, Mr. Chairman, we urge you to implement these three changes. The first change is that the price cap not be approved because it is premature given the lack of historical and verified OM&A information.

As Stone & Webster say, there has been minimal PUB oversight and approval of New Brunswick Power's initiatives and rates over the past several years. Information provided in the present proceeding does not overcome this verification deficit.

The second is that the OM&A component of the revenue requirement should be reduced to at least the 2000 to 2002 level, namely $34.7 million. Indeed based on the evidence, we submit that the level of $33.6 million recommended by Dr. Earle could be justified. And we leave it to you to determine whether this should in fact be the case.

Our third recommendation is that you should require New Brunswick Power to provide sufficient information necessary to justify the proposed OM&A expense, and that they do so for the purposes of the next rate proceeding.

We now turn to the next item of the revenue requirement, namely finance charges. Now this amount is $19.4 million. And it is the second largest line item.

The finance charge has four components, amounts due to

existing long-term or legacy debt, amounts forecast to be incurred due to new long-term debt to be issued by New Brunswick Power Transmission

after April 1, 2003. Three, a very small component attributable to short-term debt. And four, a small amount due to funds used during construction or AFUDC.

Our attention has been and will remain focused on the first two items. And we discussed three issues in respect of these.

First we want to discuss the correct legal and regulatory principles which should apply to determine a just and reasonable level of finance charges.

Second, whether these principles have been applied by New Brunswick Power and whether mistakes if any have been made.

And finally, JDI and the CME's recommendation on the appropriate finance charges for inclusion in New Brunswick Power Transmission's revenue requirement.

Let's start with the principles.

The first question which both the Public Utilities Act and Bill 30 require you to consider and answer is whether the proposed finance charge is just and reasonable? The principal here is that a balance must be struck which prevents New Brunswick Power from exercising market power

by charging excessive prices for the services offered, while ensuring it is provided with the opportunity to recover the costs it incurs for the provision of the services it offers. Those costs are ones actually incurred by the service provider and do not include theoretical or otherwise fictional costs.

And example of how this principal has been applied is found in the Alberta Gas Trunk Line, the Amoco Canada Petroleum case. This is where the Alberta Court of Appeal upheld the decision of the Alberta Public Utilities Board to restrict the recovery of income taxes to only those income taxes which were actually payable. The utility wanted to calculate income taxes using a method that recovered amounts in addition to actual taxes owing in the current period, namely deferred income taxes.

But the Alberta PUB rejected this proposal and its decision was upheld by both the Court of Appeal and the Supreme Court of Canada. This is what the PUB said, and I quote, "The Board considers that, in the absence of specific legislation authorizing the inclusion of deferred income taxes in its rates, tolls or charges the only income taxes that AGTL, that is Alberta Gas Trunk Line, should charge and collect are income taxes that are payable and are actually to be paid in respect to the

current year by AGTL. The Board has consistently taken this position in respect to all utilities within its jurisdiction. The Board considers that as a regulatory authority performing its regulatory function it ensures that costs and revenues are appropriately matched both in the short-term and the long-term when a company is permitted to collect through its rates tolls or other charges the income taxes actually paid each year."

Now this case is analogous to ours because New Brunswick Power

wants to include finance charges that are not actually incurred, but rather fictional or theoretical in nature. The inclusion of these sorts of financing charges would in our submission abrogate the just and reasonable legal standard and be wrong in law.

Let's now focus on the specific principles associated with finance charges. What rate making principles should be adopted in determining their justness and reasonableness? In our submission the Board should use well established cost based rate making principles. And you don't have to look far to find out where those are.

While we disagree with much of Dr. Morin's evidence and conclusions on capital structure and return on equity, the issue of cost of debt is one area where we do agree with him.

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In this proceeding Dr. Morin has often cited his 1994 text book. One of the -- on the topic of finance charges attributable to debt this is what Dr. Morin states at page 16. And I quote, "The return on debt is the least controversial element. Payment on bonds and on preferred stock are embedded costs, clearly stated on the bond and preferred stock certificate. The embedded cost of debt and preferred stock is simply the total interest payments divided by the book value of the outstanding debt and preferred dividend by the book value of the outstanding debt and preferred dividends, divided by the amount of preferred outstanding respectively."

At page 26 Dr. Morin also emphasises that the cost of debt for rate making purposes relates to actual, not avoided, not implied, not

full costs, but actual cost of debt outstanding. This is what he says at page 26, and I quote, "Under standard regulatory practices, which use book value rate bases, the embedded cost of debt is the actual interest obligation, including amortization of discount, premium and expense of the utility's embedded debt outstanding related to the principal amount outstanding as of a particular date expressed as a percent. While the inclusion of the embedded cost of debt and preferred cost in the overall cost of capital assures

that the actual costs associated with the current amounts outstanding are taken into account in the computation of revenue requirements, the company's current borrowing rate can be much higher or lower than its embedded rate."

And finally at page 411 of the text Dr. Morin says this, "The dollar cost of debt capital is viewed narrowly as the explicitly stated contractual obligation to pay interest during the life of the bond and to pay the principal amount at maturity. The accounting approach to debt costs stands in contrast to the economic approach which views the cost of debt as the yield to maturity required by bondholders related to the net proceeds of the issue. The rationale for using embedded cost of debt is that the award of a rate of return on rate base to cover market yield on debt would only result in windfall gains or losses to shareholders. That is, if market yields exceed embedded costs, rate coverage of the difference would not accrue to the bondholders but rather to the shareholders because of

the contractual fixity of bondholders' claims."

Thus Dr. Morin is very clear that just and reasonable finance charges are actual costs which a utility incurs for the issuance and payment of debt.

All right. That's Dr. Morin's text. What about his

evidence in this proceeding? Does it confirm as one would hope his text book views? Well his written evidence was focused on the price count and the return on equity, and although debt costs were not addressed in detail he did say this, "The cost of debt funds and preferred stock funds can usually be ascertained from an examination of the securities contracts."

During his presentation one of the topics Dr. Morin addressed was how debt financing charges should be calculated. And he said this, and I quote, "The cost of debt is strictly a function of the borrowing rates that prevail at the time of borrowing money, whether it was seven years ago or 12 years ago or 15 years ago. And for the purposes of this calculation, particularly for costs attributable to new debt, he told you that, and I quote, "It is important to look at what bond holders require", and I close quote.

So Dr. Morin is consistent on this point. The principle is that finance charges are limited to the actual costs incurred and are strictly a function of the borrowing rates that prevail at the time when money is borrowed. It is strictly the actual interest obligation including amortization of discount, premium and expense of the

utility's embedded cost of debt outstanding that

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relate to that principal and it's expressed as a percentage.

Now another important source of guidance relevant to finance charges are previous decisions of this Board and other regulators. Most recently in your June 23, 2000, decision concerning the rates and tariff of Enbridge Gas New Brunswick, the Board expressed cost of debt calculation principles this way, and I quote, "The cost of debt of a utility is the rate of interest charged by debtholders on the funds borrowed by the utility. The total cost of debt may also include other contributing factors such as costs incurred in the issuing of the debt and foreign exchange variations."

So again total cost of debt is the rate of interest charged by debtholders which implies the actual interest charged on the debt. While other contributing factors are included, these relate to costs actually incurred in relation to the issuance of the outstanding debt, namely amortization of premiums and discounts and foreign exchange variations.

Now under these principles what costs would you not -- would not be appropriate for inclusion in the finance charge amount attributed to existing debt? In our submission, these would be the amounts that are not

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actually incurred or borne by the utility for the existing debt.

Now we also looked to see if we could find a case before the

National Energy Board where an application has been made for the recovery of debt costs on any other basis than actual costs. We could not. And we submit this is equally supportive of the principled approach which we urge you to adopt in this case.

The only NEB decision somewhat on point related to the methodology used to calculate the rate applicable to existing debt. That was their RH-2-88 decision involving TransQuebec and Maritimes. The issue was whether it was appropriate for the calculation to have interest expressed as a gross amount and the denominator, namely the outstanding debt, expressed as a net amount. The Board found that you either use one or the other, net or gross, but you don't mix the two up.

And said this, "The Board finds there to be an inconsistency in determining debt cost rates on a net proceeds basis and the dollar amounts of debt outstanding on a gross proceeds basis. In its view, both the cost rates and dollar amounts should be determined on the same basis, i.e., net or gross proceeds. The Board agrees that if a net proceeds determined cost rate were applied to a

gross proceeds amount of debt outstanding a company over-recovers its financial charges." As we will see later on this problem and this principle is applicable to the case at hand.

We would also refer you to the National Energy Board's RH-4-2001 decision of last June. You will recall this is the case dealing with TransCanada Pipeline's attempt to change the Board's multi pipeline

cost of capital formula. A very contentious proceeding, I might add. It is important in this context because the decision makes clear that when it came to the topic of finance charges and debt costs, not one party objected to the method by which TransCanada calculated its debt cost.

The reason is simple. TransCanada, like every other utility regulated by the National Energy Board, calculates finance charged to be included in the revenue requirement using actual interest charged on actual outstanding debt. Nothing more, nothing less. Not avoided borrowings. Not all in or full costs but actual incurred costs. And for good reason. This approach represents the application of sound regulatory principles associated with cost based rate making, and to do otherwise would breach the just and reasonable standard.

So to summarize, there are two key parameters. First

there is interest expense charged by debtholders plus issuance type costs. Second, there is the actual amount of outstanding debt. Take the first as the numerator and the second as the denominator, and the result is the cost of debt expressed as a rate.

Now applying this rate to the actual outstanding debt amount attributed to the utility's operations provides you with a just and reasonable finance charge that accordingly should be recoverable as part of the utility's revenue requirement.

Does Transmission's proposed finance charge of $19.4 million -- does the proposal -- that is the finance charge of 19.4 million

comport with these well endorsed rate making principals? The answer is no. Problems arise with both the legacy or existing debt finance charges and the new debt finance charges.

We will first turn to the legacy debt. Our concerns are summarized as follows. First, there is inconsistent treatment of sinking funds in the rate calculation. Second, there is inclusion of a credit spread on legacy debt in the rate calculation. Third, there is inclusion of principal-related foreign exchange losses in the rate calculation. And, fourth, there is inclusion of UFM decommissioning costs as part of the legacy debt in the

rate and outstanding debt calculation.

Our concerns relate both to how the rate of interest is calculated for existing debt, as well as, how the outstanding debt amount is calculated. It's both the rate and the outstanding debt.

Now to assist in understanding our concerns let us turn to page 4 of the aid to argument, which is entitled NBPT cost of legacy debt. Now this includes under the column application on table 5 of Ms. MacFarlane's Panel C evidence.

That table provided the rate calculation NBP relies upon, and which it applies to the calculated portion of the existing outstanding debt. This page also includes the position of JDI and CME on each of the relevant line items.

Line 1 of table 5 has also been broken down into its component parts. Interest expense, foreign exchange losses and UFM

decommissioning charges.

As discussed with Ms. MacFarlane the calculation New Brunswick Power uses is a quotient. The numerator is comprised of lines 1 through 5, and the denominator is an average of lines 10 and 14. Line 16 shows the applied for rate of 10.7 percent. This is the result of dividing lines 6 by line 15.

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Now let's stop there for a minute and think pragmatically about what New Brunswick Power wants. It wants you to approve a rate of interest on the legacy debt of almost 11 percent. Think just for a moment what banks are offering today as lending rates. The 10.7 percent rate is incredibly high and accordingly warrants close examination.

What is NBP's justification? At best, it is that NBP's existing outstanding debt was issued in a different economic time and therefore has an interest rate that is in this neighbourhood. That is what one would pragmatically think.

But when we look at New Brunswick Power's evidence, in fact there is only one debt issue with a rate this high. The vast majority of the existing debt issues have coupon interest rates in the 7 to 9 percent range.

So how do we get to almost 11 percent? We submit that New Brunswick Power gets there by ignoring the principles which have been discussed, and which in the result inflates the interest rate used to calculate the finance charges on existing outstanding debt.

You can see from page 4 of the aid to argument how this takes place. It relates to our four areas of concern. Sinking fund treatment, amortization of

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principle-related foreign exchange, credit spread and UFM decommissioning avoided borrowings. And so we will discuss these now in order.

With respect to the sinking fund treatment, first remember the purpose of table 5 was to calculate the interest rate on the existing outstanding debt for the fiscal year ending March 31st 2004.

Now sinking funds are shown at line 9 and 13 as a reduction in the outstanding debt. But that actual reduction does not occur in the 2004 fiscal year.

What Ms. MacFarlane told us is that sinking funds only retire outstanding debt at maturity. That is what you would expect. Debt is due at maturity and only at that time is it retired by applying the sinking fund amounts.

And from Ms. MacFarlane's evidence we know there is only one New Brunswick Power debt issue which comes due in 2004. So what you have is a fictional retirement of debt. It is a fiction that $450 million -- $450.7 million of sinking funds will in fact be applied to reduce outstanding debt in the 2004 year.

Perhaps more importantly, what is the impact of this fiction? Simple math tells us that because we are reducing the amount of the denominator the resulting rate will be higher.

Let's take an example. If I had $10 of interest expense and $100 of outstanding debt, an effective rate on that debt would be 10 percent. If I now assume there is only $50 of debt outstanding, that is a reduction in outstanding debt due to sinking funds, but I keep the numerator the same, i.e. the $10, my effective rate is 20 percent.

And that is precisely the problem here. New Brunswick Power has reduced the outstanding debt in the denominator, but they have not included any offset in the numerator. We submit that an offset in the numerator is appropriate because of New Brunswick Power's assumption that the sinking funds are applied to retire outstanding debt next year. This will not happen in fact.

However, if debt is assumed to be retired, then it follows that there will be no interest to be paid on that retired debt next year. So that is why line 1 has been adjusted as shown on page 4 of the aid to argument by a reduction in interest expense of $34.2 million. And the calculation of that amount is explained in number 2.

Of course another way to solve this problem would simply be to avoid the fiction in the first place. If sinking funds are not in fact used to retire debt next year, then why subtract them from the denominator as shown

in lines 9 and 13?

The obvious problem here is the inconsistency of taking the gross interest expense, if you will, and dividing it by the net outstanding

debt, namely, debt less sinking funds.

As noted earlier, the problem of mismatching a net number with a gross number was one which the National Energy Board considered in its RH-2-88 decision. And as in that case, the same results should apply here.

Let's be consistent in the treatment and match net debt with net interest. To do this you must reduce the amount of interest expense by an amount that would no longer be collected as interest on an assumed retired debt portion attributed to the sinking fund retirement.

Alternatively, we can use gross outstanding debt by not including the reductions made in lines 9 and 13 and match this with the gross interest expense of 174.4 million. But let's not get these net apples and gross oranges confused, because if you do, the obvious result will be to overstate the rate of interest applicable to legacy debt which is critica, because it is that rate ultimately which determines the lion share of the finance charges.

Now you may ask what about line 3, which is entitled

sinking fund earnings. Is that the interest expense offset that keeps the quotient in check? Ms. MacFarlane would have you believe that is so.

We submit that is not the case. Sinking fund earnings are actual dollars earned on sinking funds due to the fact that the company has collected sinking funds from ratepayers and they must be placed to one

side. Typically in a secure investment so that the amounts can be used for debt retirement at the issue maturity dates.

Ms. MacFarlane has explained that in the case of New Brunswick Power the sinking fund amounts are held in different trust vehicles.

Given that the funds are actually held in trust and cannot be accessed until retirement actually occurs, income earned on the sinking fund amounts will accrue to New Brunswick Power whether or not the deemed retirement calculation is made.

Income actually earned on sinking funds therefore is not an offset to a deemed retirement. The amount earned on sinking funds will occur in any event of the deemed retirement calculation. It has nothing to do with it.

The concepts are and should remain mutually distinct even though each involves the application of the term sinking funds. This is explained further in note 2 on

page 4 of the aid to argument.

Now as a result, we submit that what is also missing from New Brunswick Power's table 5 is the interest expense offset to the proposed deemed retirement caused by lines 9 and 13.

If you change the assumption and have table 5 reflect no deemed retirement, that is remove lines 9 and 13, sinking fund earnings would still remain a component of this calculation because actual dollars are earned on the sinking funds.

Surely it is proper to apply these earnings to reduce the overall

interest expense incurred by the company. And that is precisely what you determined in your May 22nd 1991 decision concerning New Brunswick Power's accounting and financial policies. That is at page 72 of that decision.

Does the fact that actual sinking funds earn actual interest income, regardless of whether this deemed retirement happens or not, leads to the conclusion that sinking fund earnings are wholly unrelated to and should not be treated as a deemed interest expense offset, when one assumes retirement of debt from the application of lines 9 and 13?

Now our next concern relates to credit spread. The

concern relates to applying a fictional credit spread to the legacy debt. We know from our discussion with Ms. MacFarlane that the $20.1 million credit spread is not an actual charge or amount to be incurred by New Brunswick Power Transmission on on its legacy debt.

It is included in the cost of debt calculation to supposedly right the wrongs that allegedly arise if the shippers situated outside the province are allowed to use the transmission system at a rate which does not include so-called full costs.

In this context this means a more costly credit spread is applied instead of the actual guarantee fee. However since Transmission can't discriminate in the rates, the fictional full costs must be paid by domestic ratepayers as well.

Ask the question Mr. Hashey posed. Ask who is the victim in having to pay higher costs based on fiction?

Does this apparent social policy objective justify ignoring cost-based ratemaking principles so as to include a fictional amount in the calculation of the cost of debt? In our submission the answer is no. In fact it completely abrogates the objection of having Transmission act in a responsible, commercial and businesslike manner.

To include overstated amounts in the revenue

requirement also means that the starting point is overinflated. Ms. MacFarlane indicated that the credit spread included in table 5 is 91 basis points when the actual cost incurred for the government guarantee fee is 64.89 basis points. And the difference between the reality and the fiction would be kept by the utility.

Now New Brunswick Power suggests that the difference will either be passed on through the price cap or ultimately returned to domestic ratepayers, since they are also taxpayers. This is because the overcollected amount will ultimately be available to the provincial government.

But there are no guarantees and no promises of this happening. As Ms. MacFarlane stated, there are no rebates contemplated in the legislation. And as for the price cap, New Brunswick Power Transmission will take the full benefit of the overrecovery unless the sharing mechanism kicks in. And only then will ratepayers gets 50 cents back on their dollars.

Now Ms. MacFarlane agreed that getting the starting point revenue requirement right is important. And we submit that including fictional amounts in the revenue requirement means that the starting point will not be right.

We submit that the Board should deal with finance

charges for New Brunswick Power Transmission on the basis of first principles, on the basis that the amounts to be included in the interest rate calculation on legacy debt must actually be incurred.

That is not the case with the credit spread. New Brunswick Power is not actually paying the full amount of $20.1 million to anyone, but only the guarantee fee.

And Ms. MacFarlane admits the credit spread has nothing to do with the legacy debt. She says as much at transcript page 1425.

Question: "I understand your social policy desire. But as a commercial enterprise and as an accountant intending to calculate the cost of debt of this corporation, does credit spread have anything to do with the interest expense that you, your corporation actually pays under the legacy debt?" Answer: "For the legacy debt no, it does not."

We submit there is no justification to include the proposed credit spread amount in the interest calculation for legacy debt, particularly when the guarantee fee will remain in place until that debt is discharged. The difference is significant we submit. As we learned from Ms.MacFarlane, the actual guarantee cost is $12.8

million. A difference of $7.3 million. So that's what we have

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shown on page 4, line 5 of the aid to argument.

Now in terms of the effect that this change has on the interest rate calculation, itself, it doesn't seem like much. Ms. MacFarlane tell us that a $7.3 million reduction in line 5 of table 5 reduces the calculated interest rate from 10.7 percent to 10.35 percent. But this small change has a significant impact on the ultimate finance charge amount resulting in a reduction of approximately $483,000.

What's the saying, Mr. Chairman, if you watch the pennies, the dollars will look after themselves? A mere 35 basis point reduction causes almost a half million dollar reduction in the revenue requirement, which is significant. It's a lot of pennies, let alone a lot of dollars.

Our third area of concern relates to the principle -- relates to amortization of principle-related foreign exchange losses. And that's line 4 of table 5. Ms. MacFarlane has explained that this amount relates to a change in accounting rules, which require audited financial statements to report the current value of outstanding debt principle issued in foreign currency and for adjustments to be made to retained earnings on a year-to-year basis.

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This requirement caused New Brunswick Power to reduce its reported retained earnings for its 2001 fiscal year by $106 million. However, the reduction was not an actual cash outlay. Rather, the

reduction was made to New Brunswick Power's 2001 statements because of a new reporting requirement. However, Ms. MacFarlane tell us that the company now wants this money back on its books, and the way it is going to do this is to treat the retroactive $106 million adjustment as a loan and amortize the amount such that for the fiscal year 2004, we have a $15 million line item. We submit that that's not good enough.

There is little if any justification for treating New Brunswick Power Transmission's ratepayers this way. First the amount giving rise to the line item, the reduction in retained earnings, is not an actual cost incurred by the company in the test year, but relates simply to a change in reporting requirements. It does not relate to an increase in actual interest charged on outstanding debt. Yet that is the effect, which we submit again breaches the ratemaking principles which we have discussed. If you are going to calculate the actual cost of debt expressed as a rate, then table 5 must use only actual interest, plus actual incurred adjustments and the actual outstanding

debt balances.

Second, Ms. MacFarlane admits, if it were not apparent, that the inclusion of this amount in table 5 emanates from a retroactive adjustment to the company's retained earnings.

As you know it is a well-established principle that a regulator cannot retroactively or retrospectively make or approve rates unless

the enabling legislation clearly and expressly grants the specific authority.

This rule has been expressed as follows by the Supreme Court of Canada. And I am quoting from the Gustavson decision. The general rule is that statutes are not to be construed as having retrospective operations unless such a construction is expressly or by necessary implication required by the language of the Act. This principle has been applied to utility regulators who have attempted to implement rates on a retroactive basis as well.

And that's the Western Decalta Petroleum case. Neither the Public Utility Act, nor Bill 30, in our submission, give you retroactive or retrospective ratemaking authority.

Now besides these concerns there are several others. First, Ms. MacFarlane agreed that any difference in the debt principle amount that is in fact owed by the company

does not become due until maturity. That is very important for the purposes of calculating the interest expense on the existing outstanding debt. What this means is that if more dollars are owed on the principal at the time of maturity due to foreign exchange differences, any additional obligation does not arise until the maturity date. There is no obligation, no cash outlay, no -- nor any actual cost borne by the company now in fiscal year 2004. It is the current time horizon that counts for the purposes of this application, because we are here to establish just and reasonable rates for New

Brunswick Power Transmission fiscal year 2004, and perhaps two others.

The second point was Ms. MacFarlane's suggestion that intergenerational inequities would arise if amortization of principle-related foreign exchange losses were not implemented. If anything, it is New Brunswick Power's proposal which creates the inequity. And here is why.

Let's first remember we were talking about debt that has been issued in US dollars. Specifically and from table 9 of Ms. MacFarlane's evidence, we know that there are four debt tranches issued in US currency. We know that the maturity dates for these issues are at minimum 10 years from now, 10 years. Though most of them, most, do

not mature before the year 2020.

New Brunswick Power wants you to include in the interest rate calculation today a yearly charge equal to what it thinks will be necessary to make up the losses arising due to foreign exchange on the principal that will become due at these maturity dates.

Well what happens if they are wrong in their estimates? Ms. MacFarlane confirmed that if the Canadian dollar rebounds 10 years from now when the first layer of the US debt matures, or 20 years from now when the balance matures, there may not be any foreign exchange losses. But by then it will be too late. Today's ratepayers will have been saddled with the costs that have nothing to do with the transmission service they were provided with.

Moreover, who is to say that the amounts collected by Transmission will in fact be used to reduce the outstanding debt when it matures. Even then, however, the benefit of any reduced debt at maturity does now accrue to today's ratepayers. The benefit is taken by whoever the ratepayer is at that time, which is the epitome of intergenerational inequity.

A third concern was Ms. MacFarlane's evident confusion on the purpose and intent of table 5. Table 5 is not an audited financial statement, nor a report on net income.

It is intended to be a forecast of the actual interest rate borne by Transmission on legacy debt.

Now Ms. MacFarlane also admitted that at line -- that line 4 of table 5 was not an actual cash cost. No matter she says, because neither is line 2 of table 5. Namely, amortization of issue premiums. Which she seems to have meant by this reference is that both are cut from the same cloth and comparable adjustments, therefore, should be included in the calculation of the interest rate. We submit she is incorrect.

Amortization of issue premiums relates to the actual cost of issuing the debt. Due to the fact that not as much principal could have been issued due to the pricing of the bond and its coupon rate as compared to actual market conditions and the then prevailing interest rates. This actual difference is known and quantified with certainty at the time debt is in fact issued.

The reason why issue premiums are amortized over the life of the bond again relates to intergenerational inequities. In other words, all ratepayers should pay a proportionate share of premiums costs while the bond is outstanding. This is in the alternative to expensing the premium amount in the current period when the bond is issued. Amortization is preferred since expensing the

full amount in the current period would expose ratepayers in the current period to higher costs.

Thus there are legitimate reasons why amortization of actual issue premiums have been allowed. The amount of the premium is known with certainty. In the amortization the cost -- and amortizing the costs smoothes the rates and provides intergenerational equity.

In contrast none of these characteristics apply to New Brunswick Power's proposed amortization of principal-related foreign exchange losses. Whether these amounts will ever be incurred by New Brunswick Power Transmission is uncertain. The amount of the costs if it materializes at all will not be known until some future date. A date that is in this case 10 and 20 years away. Amortization today of an unknown and completely uncertain future cost has no relationship to the transmission service that is provided today and will expose the current ratepayers to intergenerational inequities. And so it is for these reasons why the attempt to place line 4 in the same camp as line 2 fails completely in our submission.

As a result, Mr. Chairman, and for all of these reasons, JDI and

CME submit that amortization of principal-related foreign exchange losses should not be included in the interest rate calculation for the existing

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legacy debt. And this is reflected on line 4 of the aid to argument.

The last area of concern respecting New Brunswick Power's table 5 relates to the treatment of used fuel management costs and the avoided borrowings associated with nuclear generation decommissioning costs. These items are found in line items 1, 8 and 12. We have learned that these amounts relate to borrowings that have not yet been made by New Brunswick Power. Akin to the problems of credit spread and amortization of principal-related foreign exchange losses, used fuel management and decommissioning charges, and the associated avoided borrowings -- borrowing amounts are not amounts associated with actual existing debt or cost incurred on actual debt, because these amounts have not in actual fact been borrowed and are not likely to be borrowed until sometime starting in fiscal year 2004, next year.

We have also learned that the new borrowings are intended to satisfy a condition to a licence issued in October 2002 by the Canadian Nuclear Safety Commission concerning the operation of Point Lepreau. When the borrowings are actually undertaken, they will not be used for any transmission-related purpose, but rather to fulfil a regulatory obligation associated with New Brunswick

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Power's nuclear generation activity.

Nevertheless, Ms. MacFarlane wants you to include some $234 million on this score in the calculation of the interest rate for existing outstanding debt for transmission ratemaking purposes.

Ms. MacFarlane's explanation as to why these amounts should be included in the calculation of the actual debt cost on legacy debt is remarkable, if not bizarre. They simply have nothing to do with the -- they simply have nothing to do with that debt and no amount has been paid to anyone. But Ms. MacFarlane says that we should treat them, shall we say, as deemed borrowings.

We have come to learn that we need to pay special attention when Ms. MacFarlane prefaces a phrase, with "shall we say", because what follows is of inevitable concern. The amounts have nothing to do with the transmission services and because of that their inclusion in our submission abrogates ratemaking principles. They are not actual costs, and they are not amounts that have anything to do with transmission service offered under this tariff.

Now what about lines 8 and 12? We say that the inclusion of these amounts is also an error. The avoided borrowings are not part of the existing debt. By her own

admission, Ms. MacFarlane tells us these amounts will be financed starting next year and treated as new debt. But new debt again will be for the purposes of New Brunswick Power's nuclear generation operations, fulfilling a requirement that has nothing to do with New Brunswick Power Transmission.

Ms. MacFarlane, who told us that the amounts comprising UFM decommissioning were collected in prior periods under New Brunswick Power's bundled rate, and that New Brunswick Power as a whole had the benefit of those funds to avoid borrowings.

Accordingly, she says that as part of the corporation some value must be attributed to New Brunswick Power Transmission, whose ratepayers should then pay back what was avoided in the first place.

I don't want to repeat myself with respect to retroactive and retrospective ratemaking so let me pick another area. At best we submit this logic is suspect. To begin with Ms. MacFarlane notes that New Brunswick Power's customers have already paid for the benefit enjoyed by having to avoid borrowings in the prior periods. So there is no inequity there.

Second, if New Brunswick Power wants to assert the transmission operations have benefited by these avoided

borrowings in a measurable and quantified way related to the transmission services to be provided beginning April 1, they have an obligation to show us how. The onus is on New Brunswick Power, but there is no evidence that shows how transmission operations next year will benefit from the avoided borrowing cost. This is not at all surprising because these amounts all relate to nuclear generation liabilities that will arise in the future.

Finally, Ms. MacFarlane reminded us that use of the funds for the purpose of avoided borrowings was a sound management practice. That

is what this Board -- that is what this Board said in its May 1991 decision at page 63. We certainly agree with that position. However, that does not mean that a future liability arising specifically and directly related to nuclear generation should be recovered from transmission ratepayers. By asking to include these amounts in the interest rate that is to be applied to the finance charge calculation ultimately to be recovered from transmission ratepayers, New Brunswick Power wants you to shift the cost associated with the services provided. These future costs are properly attributed to nuclear generation and moving them, or at least a portion of them into New Brunswick Power Transmission would create a cross-subsidy. This is a new concern for the Board, that

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the Board -- that you need to be aware of and guard against. The reason is abundantly apparent in the policy intent of the province to establish a competitive generation market in which price signals reflect actual embedded cost of providing the generation services. Recall what is said in the White Paper on this point, and I quote, "Accurate pricing that informs customers about the true embedded costs and time use costs for consumption is critical for consumers in making economically rational decisions about energy efficiency."

Clearly if you allow nuclear generation costs to be recovered by New Brunswick Power Transmission's revenue requirement from transmission ratepayers, it will enhance the ability of New Brunswick Power Nuclear to compete. Such cross-subsidization is not just and

reasonable for transmission rates and ratepayers. It is not consistent with the policy objectives contained in the White Paper because it will not inform Generation customers or indeed Transmission customers of the true embedded costs for different services. Actual costs of providing generation services cannot be paid for by Transmission customers.

The final area of concern on this topic is the impact of including avoided borrowings -- avoided borrowing costs on both the calculated interest rate and the average

outstanding long-term debt.

Let's go back to the aid to argument. It might be a bit surprising that JDI and CME believe that the UFM decommissioning costs should come out table 5 because New Brunswick Power told us that future borrowings on nuclear decommissioning liabilities are deemed to attract a lower rate of interest, namely 6.41 percent, as compared to the applied for 10.7 percent.

So inclusion of these amounts would therefore have the effect of reducing the overall interest rate calculation.

But surely the point is not simply to find the absolute lowest possible cost of debt. The point is one of integrity and principle, which tells us that since the nuclear decommissioning costs are not actual costs and have nothing to do with the actual existing cost of borrowing they must properly be excluded.

In conclusion on this topic, the finance charge amount is in part

calculated by multiplying the interest rate computed from line 15 of table 5 by the average amount of outstanding long-term debt, namely line 16.

So it is of equal importance to ensure not only that we get the interest rate correct on the existing outstanding debt, but also the correct amount of the actual outstanding debt.

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And therein lies the problem with including the 233.9 million dollars. Again this is shown on lines 8 and 12, the average long-term debt amount, and again on line 15. Including their avoided borrowings overstates the average long-term debt outstanding and in turn overstates the finance charge to be recovered from New Brunswick Power Transmission's ratepayers. This is another reason why we submit that the avoided borrowings must be excluded from table 5.

At the end of the day what do JDI and CME recommend as the appropriate interest rate on legacy debt and the level of that debt for the purposes of calculating New Brunswick Power Transmission's finance charges. Well based on the evidence in this proceeding we submit that the rate you should adopt is either 8.1 or 8.2 percent, not 10.7 percent, and we say the level of legacy debt you should use is 1.7728 billion as opposed to the 2.0067 billion.

To understand how we derive these numbers we need to turn back to page 4 of the aid to argument. Focusing first on the column entitled JDI Recommendation, this reflects only the effect on the interest rate of adopting our suggested changes and the sinking fund treatment and

the credit spread. Note the change in the cost of debt stated in line 16 from 10.7 percent to 8.1 percent. The

JDI recommendation column reflects what we submit is supported by the evidence. This case takes into account all of the suggested changes attributed to sinking fund treatment, UFM decommissioning, unavoided borrowing, amortization of principalrelated foreign exchange losses and the elimination of the credit spread in lieu of the actual government guaranteed fee, which Transmission we understand will pay on the legacy debt.

From line 15 you will see that the average long-term debt showing is the 1.7728 billion. The latter calculation is simply the reduction of New Brunswick Power's average long-term debt amount by the average avoiding -- avoided borrowing amounts in lines 9 and 13.

Now how can this proposal, this submission, be tested? Well we suggest that there are two ways of doing this. The first, as suggested by Dr. Morin, is to look at the interest rate on the stated bond or security certificates. From New Brunswick Power's 2001-2002 annual report we know that New Brunswick Power has reported to its stakeholders, including the investment community and taxpayers, that its weighted average coupon rate on existing outstanding debt is 8.06 percent. Now Ms. MacFarlane has agreed that it was this methodology, namely taking the weighted average coupon rate of interest on the existing outstanding debt

that is reported in the annual report, which was previously used and approved by this Board.

Recall, Mr. Chairman, that in the 1991 rate decision the Board approved a rate of 9.5 percent based on what was reported in New Brunswick Power's 1990 annual report. Now think about that for a moment. It's over ten years ago. The rate that they are applying for today is 10.7 percent. The rate that was applied for then was 9.5 percent. Interest rates haven't gone up.

What can't be defended, Mr. Chairman, is the reason that Ms. MacFarlane provided as to why this methodology is no longer applicable. What she said was the calculation was appropriate in 1991 because the regulatory framework was cost of service. But now this is not the case since the framework has changed to something she refers to as rate based concept.

Now we don't understand her description. The Public Utility Act and Bill 30 require you to approve just and reasonable rates for New Brunswick Power Transmission having regard to projected revenues and costs, or projected revenue requirements, or expenses of providing transmission services. That is what the law says and will say. The regulatory framework has not essentially changed. Recovery of the expenses or costs incurred for

the provision of the services provided remains the principal, the golden rule. The only change frankly is the new methodology which New Brunswick Power wants this Board to approve and we submit this would

be in breach of the provisions of the Public Utilities Act or Bill 30.

Now the second way to test the validity of the proposed rate is to look at audited financial statements, which report on the actual cost of debt and actual amounts of the debt that are outstanding.

Let's go back to the principal stated by the Board in the recent Enbridge Gas New Brunswick decision, page 21. Again I quote, "The cost of debt of a utility is the rate of interest charged by debt holders on the funds borrowed by the utility. The total cost of debt may also include other contributing factors such as costs incurred in the issuing of the debt and foreign exchange variations."

Let's turn to page 12 of the aid to argument for a minute.

Now what you will see there is taken from New Brunswick Power's 2001 and 2002 annual report. It's an excerpt. And you will see finance charges are reported to be $266 million. Now what about the so called other contributing factors? Well you can see that the $266 million includes income from sinking funds, the provincial

guarantee, amortizations of deferred debt costs and realized and unrealized foreign exchange losses. The contributing factors therefore are accounted for.

The issues which Ms. MacFarlane highlighted as reasons why it would be inappropriate for this Board to adopt this calculation are addressed.

What about the level of outstanding debt? Looking again at page 12 of the aid to argument we see that the outstanding long-term debt

in the current period is $3.249 billion. Now taking the interest expense of 266 million and dividing it by the existing outstanding long-term debt of 3.249 billion, the resulting rate is 8.178 percent. Call it 8.2 percent.

Now maybe New Brunswick Power says it is no longer appropriate to use actual audited financial statements for the purposes of calculating the actually incurred cost of debt. That seems to be what Ms. MacFarlane admitted when she suggests that it is appropriate to have one set of books and assumptions about the cost of debt for ratemaking purposes, and another set of books and assumptions for reporting purposes to the investment community. She prefaced this of course with shall we say.

In our submission this is clearly wrong and shows how New Brunswick Power wants you to deviate from well

established ratemaking principles used to establish the cost of debt.

Now we turn to new debt. The total finance charge on new debt is $5.6 million. Happily we have fewer concerns on this calculation but there significance from a principled perspective nevertheless deserves careful attention.

The concerns may be summarized as follows. First, the reasonableness of the 5.6 million. Second, the method by which this amount has been calculated. And third, the reasonableness of the applied for new debt finance charge.

It is common practice that an applicant provides sufficient justification and background information to support forecast estimates of new debt finance charges. Here there is simply no information about the $5.6 million or the debt that is required to be issued in respect of that amount. All that we know is that the amount has been calculated using an average annual long-term cost of debt of 7.48 percent.

Now what would be reasonable -- what would a reasonable ratepayer expect a reasonable applicant to provide? Well for starters, we submit it would be reasonable to expect the applicant to address the standard principle annunciated by Dr. Morin. What do bond holders

require? In most rate proceedings this is addressed through professional opinions provided by investment bankers or financial institutions such as Scotia MacLeod or Merrill Lynch or even CIBC World Markets about what the cost of financing new debt is likely to be in a test period.

We don't have that evidence here which makes it awfully difficult to know whether the estimated cost of new borrowings is reasonable.

So what has New Brunswick Power provided as a proxy for this standard information? Well, Ms. MacFarlane provided some summary information obtained from CIBC World Markets which outlines credit spreads of various utilities operating in Canada between long Canada bond rates and the rates at which they have been able to raise debt.

But did anyone from CIBC World Markets appear in this hearing and

to testify as to the relevance of this information? The answer is no. We have no idea if or how or why the CIBC analysis has any bearing on the actual cost of new debt for New Brunswick Power Transmission.

New Brunswick Power also relies on long-term interest rate forecasts described as the implied Government of Canada yield calculations as of May 17th 2002 as a proxy to determine new debt financing charges.

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This shows the implied yield on 10 and 30 year long Canada was for 2003 and 2004, 6.14 percent based on an estimate provided by the NBIMC, New Brunswick Investment Management Corporation.

Is this forecast reasonable? Yes, particularly in light of Ms. MacFarlane's evidence where she told us that in 2002 the company, through the province was able to raise debt on a, quote, "all in " basis at a rate of 5 percent.

This certainly is lower than the forecast rate provided as of May 17th 2002 of 6.14 percent. And in our submission is the best evidence available on the topic of new debt rates for and specifically applicable to New Brunswick Power. Use of the most recently issued debt rate of a parent company as a proxy for the forecast new debt finance charges is indeed consistent with what this Board did in the Enbridge Gas New Brunswick decision.

There the Board considered that Enbridge Gas New Brunswick could borrow funds from its parent, Enbridge Inc., at a rate of interest consistent with the latter's bond rating. And concluded, and I quote,

"The Board understands that Enbridge Gas New Brunswick is entering a greenfield situation which inherently carries a risk that the market will not develop satisfactorily, therefore,

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there must be a premium to compensate Enbridge Inc. for this risk. Accordingly, the Board orders that the cost of debt of Enbridge Gas New Brunswick be limited to the actual borrowing rate of the parent company plus one percent".

For Enbridge Gas New Brunswick this resulted in a capped debt rate of 7.815 percent based on the actual borrowing cost of Enbridge Inc. of 6.815 percent. Of course at that time, the 10 year Canada bond forecast was 6.2 percent. But rates have certainly and dramatically changed since then. For example last Friday the Bank of Canada's website reported Canada benchmarked 10 year bond yields at 4.97 percent and the 30 year bond rate at 5.48 percent.

How is the Enbridge Gas New Brunswick case relevant in these circumstances? First, it demonstrates that it is quite appropriate to use the actual and most recent borrowings incurred by a parent company, in this case the Province and New Brunswick Power to calculate the new debt forecast finance charges for New Brunswick Power Transmission and for ratemaking purposes.

The best evidence again in this regard is from Ms. MacFarlane where she says it's "all in at 5 percent". But what about the suggestion that New Brunswick Power

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Transmission will in the future be borrowing funds without a government guarantee?

Clearly if that was the case then there is reason to reconsider the applicability of the current guarantee fee of 64 basis points. But that's not the case, not as it relates to the new debt forecast to be issued in the test year. What Ms. MacFarlane told us is that this debt, at least for next year, is likely to be kept by the province.

If that is in fact the case then how relevant at all is the proposed cost of debt and credit spread amounts found in the new debt finance charge calculations set out in New Brunswick Power's response to the province, information request 2816?

It strikes us that the minium rate which this Board should approve as a reasonable cost of debt for next year is the 5 percent rate plus 64 basis points for and in respect of the government guarantee. That would be the minium but is clearly based on the actual and recent experience of the province and the utility.

As a maximum we return for a brief moment to the evidence on avoided nuclear decommissioning borrowings. The evidence of Ms. MacFarlane is that these have an expected borrowing cost of 6.41 percent. That is some 77 basis points above the actual and most recent financings

conducted by the province on behalf of New Brunswick Power, inclusive of the government guarantee amount.

So that level we say should considered a, quote, "all in" maximum

rate established by the Board.

Mr. Chairman, I see that is five minutes -- I have got two more pages left on debt and I would suggest that we continue on that?

CHAIRMAN: Mmmm. Go ahead.

MR. NETTLETON: Our second concern relates simply to how the $5.6 million amount has been calculated. And for ease of reference, Mr. Chairman, the relevant portion of this response has been included as page 7 to the aid to argument. Perhaps we could turn that up.

Here is the problem. This year New Brunswick Power says it will have raised 66.5 million of debt in the market using a cost of debt of 7.32 percent. The annual average of the new long-term debt this year is simply the $33.2 million figure.

Multiplying the 7.32 percent number by the 33.2 million gives us the 2.4 million in finance charges. So far so good, assuming the debt issued prior to April 1, 2003 is new debt and not attracting the government guarantee.

But the problem arises next year, namely fiscal year

2004. There, New Brunswick Power takes again the average amount of the debt outstanding in that year and multiplies it by the new forecast cost of debt, namely 7.48 percent.

Now that is incorrect. The problem is that the full value of the debt issued in 2003 has now been assessed a higher cost of debt, namely 7.48 percent. Assuming this is long-term debt, the interest rate on the principal will not change. The same problem is repeated

in 2005 where there is an even higher rate of interest applied.

The solution to the problem is a relatively simple one. It is again shown on this page of the aid to argument under the heading "JDI CME Restated Forecast."

The change proposed is that interest calculated on debt issued in a particular year is attributed the rate throughout the test year periods. Although 2003 is not a test year there would be no change. But in 2004 the debt issued in 2003 retains the 7.32 percent interest rate. And only the debt issued in 2004 is attributed the 7.48 percent and so on.

The overall change in calculating finance charges on new debt is relatively speaking minor. As is shown, roughly $100,000 reduction occurs in 2004. And again roughly $190,000 reduction occurs in 2005.

So we submit the Board should amend the forecast cost

of debt for new issues based on the best evidence in this proceeding, which at a maximum rate the cost of debt for 2003 should be based on an estimated 6.41 percent rate.

Again this takes into account both the actual borrowing rate that New Brunswick Power was able to obtain in 2002, namely the 5 percent, and provides a 141 basis point cushion over this amount. And we can see these calculations on page 8 of 12.

We do not suggest that such a credit spread is factually supported, that is the 141 basis point cushion. There is simply no better evidence on the principle of what bondholders require in these

circumstances.

We also encourage the Board to calculate the interest charges on new debt using the method we propose, namely applying each separate interest rate for each separate debt issue.

Now on page 8 the impact of this position is shown. Finance charges on new debt is reduced in fiscal year 2003 by 300,000. In year 2004 the reduction is 780,000. In fiscal year 2005 the reduction is 1.02 million -- 1.01 million.

Now, Mr. Chairman, I have one small area that I would like to try and get through, as it is my final area. Well, it is payment in lieu of taxes. And it is only two

pages. It will take four minutes. There is no reference to --

CHAIRMAN: Is that a MacNutt four or --

MR. NETTLETON: No, no, no. It is a Nettleton four.

CHAIRMAN: Yes. Go ahead, Mr. Nettleton. My only concern is we don't want to run over too far because of the shorthand reporters and their having to type, and et cetera.

MR. NETTLETON: I will hurry long.

CHAIRMAN: Thanks.

MR. NETTLETON: Payment in lieu of taxes. Let's first talk about payment in lieu of taxes in the context of Bill 30.

Assuming that no changes are made to Section 37 of Bill 30 before it is proclaimed in force, the principle of whether New Brunswick Power Transmission, notwithstanding its status as a Crown-owned tax-

exempt entity, should nevertheless recover payments in lieu of taxes from its ratepayers, appears to have been answered.

Indeed for such time as New Brunswick Power Transmission and its affiliates are exempt from federal or provincial taxes, each of them must pay to New Brunswick Electric Finance Corporation an amount equal to the amount of tax that they would be liable to pay if they were not so exempt.

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For transmission in fiscal year 2004, New Brunswick Power says this is $9.8 million. Of course this is all based on certain capital and capital structure assumptions, which for New Brunswick Power Transmission is in your hands.

Let's fully understand the purpose of imposing upon New Brunswick Power Generation, Transmission and Distribution customers these taxes and the possible special charge burdens.

The answer is found in Section 36 of the bill. Section 36 provides that all payments received by EFC under Section 37 may be used for two purposes. The payments may be used in support of EFC's management and disposition of New Brunswick Power's assets, liabilities, rights and obligations which it receives as part of restructuring. So that is a temporary purpose.

Second, these payments may be used to facilitate the conversion of New Brunswick Power's and New Brunswick Power Holdings' debt into debt of the butterflies, also a temporary purpose.

And finally the reduction of any debt that is left over.

As the Minister said to the Legislature on January 31, New Brunswick Power, Electric Finance Corporation will

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receive dividend and special payments from New Brunswick Power Holding Corporation and its subsidiaries in order to retire the debt incurred. This structure will ensure that these payments are applied directly to debt.

So Transmission ratepayers will, in their respective contributions to the utility's revenue requirement, not only pay finance charges to service the company's ongoing debt necessary to the provision of transmission services, but will as well make a payment in lieu of taxes and perhaps special payments to the Electric Finance Corporation to reduce the portion of the New Brunswick Power debt not allocated to Transmission or the other butterflies.

The position of our clients has always been that if the Legislature in its wisdom saw fit to require payment in lieu of taxes to be recovered by Transmission in its revenue requirement, then the debate about the merits of such a scheme would be resolved. So be it, almost.

New Brunswick Power Transmission is required to remit tax-equivalent payments to the Electric Finance Corporation. But the calculation of the amount of those payments is for you to determine.

Why? Because the cost of debt is deductible for the purposes of calculating tax. Or shall we say a smaller

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equity component in a deemed capital structure results in a lower amount to be recovered in the requirement for payment in lieu of taxes.

The determination for ratemaking purposes of New Brunswick Power Transmission's capital structure, its components and hence the amount of the payment in lieu of taxes are not prescribed by Bill 30 and remain matters for your discretion.

It is accordingly only if you agree that New Brunswick Power Transmission should have a deemed capital structure of 65 percent debt, 35 percent equity at rates proposed by New Brunswick Power, that the payment in lieu of taxes would in fact be the $9.8 million.

Given the relationship between payment in lieu of taxes and capital structure, Mr. Smellie will tomorrow discuss this concept further as it relates to the positions of JDI and CME.

Thank you, sir.

CHAIRMAN: Thank you, Mr. Nettleton.

MR. SMELLIE: Mr. Chairman, just before we rise, I do have copies for you and your colleagues of our speaking notes up to 10 seconds ago, that you can happily take away with you. And we would be happy to lodge the balance tomorrow morning when we complete it.

CHAIRMAN: That would be fine. Is there a possibility we could have an electronic version as well after you have completed tomorrow?

MR. NETTLETON: Yes.

CHAIRMAN: Mr. Hashey?

MR. HASHEY: Since we have the obligation to rebut or to speak to this, would it be possible for us to have a copy of this?

CHAIRMAN: I see no reason why not.

MR. SMELLIE: Of course not, Mr. Chairman. I mean, of course he can have one.

CHAIRMAN: 9:30 in the morning.

(Adjourned)

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

Reporter