New Brunswick Board of Commissioners of Public Utilities

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

Delta Hotel, Saint John, N.B.
February 16th 2006

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<u>Undertakings</u>

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CHAIRMAN: David C. Nicholson, Q.C.

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BOARD COUNSEL: Peter MacNutt, Q.C.

BOARD STAFF: Doug Goss
John Lawton

BOARD SECRETARY: Lorraine Légère

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CHAIRMAN: Good morning, ladies and gentlemen. Appearances please for the Applicant Disco?

MR. MORRISON: Good morning, Mr. Chairman, Commissioners. Terry Morrison and David Hashey for the Applicant. And with us at counsel table is Lori Clark.

CHAIRMAN: Thanks, Mr. Morrison. Canadian Manufacturers and Exporters?

MR. LAWSON: Good morning, Mr. Chairman, Commissioners. Gary Lawson appearing with David Plante and Mark Grayson.

CHAIRMAN: Thanks, Mr. Lawson. Mr. Coon is not here. Eastern Wind is not here. Enbridge Gas New Brunswick, not here today. The Irving Group of companies, Mr. Booker?

MR. BOOKER: Good morning. Andrew Booker for JDI.

CHAIRMAN: And Mr. Gillis is not here, nor the Jolly Farmer. Rogers is not here. Self-represented individuals? Municipal Utilities, Mr. Gorman?

MR. GORMAN: Good morning, Mr. Chairman. Raymond Gorman appearing for the Municipal Utilities. And this morning I have Eric Marr and Dana Young with me.

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

MR. HYSLOP: Peter Hyslop with Mr. O'Rourke and Ms. Power, Mr. Chair.

CHAIRMAN: Thanks, Mr. Hyslop. Mr. MacNutt, who is accompanying you today?

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

CHAIRMAN: Thanks, Mr. MacNutt. Before I ask any of the parties if they have preliminary motions, either

Mr. Hyslop and Mr. Morrison need a vacation or I do. Because I asked I thought for the paragraphs that were contentious in putting to the witnesses in cross examination.

So I was given a sheet of paper. And it has got three paragraphs X'd out and one isn't. I took it for granted that the contentious paragraphs was the one that had not been X'd out. But guess what, I was wrong. I don't know where you guys have been.

MR. MORRISON: I thought we explained that to Mr. MacNutt yesterday afternoon, Mr. Chairman.

MR. MACNUTT: It is Mr. MacNutt's fault, is that what you are saying?

MR. MORRISON: No. I'm not saying that, Mr. Chairman. What I'm saying is that Mr. Hyslop and I and Mr. MacNutt sat down yesterday afternoon.

And I thought it was quite clear that the paragraphs that were in contention were the ones that were cross-hatched like that. But they were cross-hatched in such a way that they could still be read.

Happy to do it in another format, Mr. Chairman.

CHAIRMAN: Well, let me tell you. The majority of Commissioners read it the same way. I was in the minority. But there were a few of us. So all of that work I did last night is for naught. So you gentlemen are going to have to be very articulate in your arguments when we get to that motion.

Anyhow, any other preliminary matters?

MR. MORRISON: Yes, Mr. Chairman. There are several. First there is a IR response which is PUB IR-263. And that deals -- it was a request for daily and cumulative totals for hydro generation and total of daily in-province load and also a breakdown of hydro generation totals between in-province sales and exports in both megawatt-hours and earned revenue.

We have that document available. The answer is here. We are going to be requesting the protection of Section 133. It is very confidential information, Mr. Chairman.

It is in the same nature as the information that was -- I think there was a letter from Mr. Bishop and Mr. Thomas that was put before this Board explaining why that information is confidential.

Basically it is for competitive reasons. And if it is the Board's wish, we would ask that that IR be submitted in confidence to the Board.

CHAIRMAN: All of that information? Or parts of it?

Frankly, Mr. Morrison -- and you have every right to ask for confidentiality.

But I find some difficulty in how much electricity was produced in this province let's say in the months of September of 2005 by hydroelectric generation as being a matter that should be dealt with in confidence.

MR. MORRISON: I can set out to you what Mr. Thomas indicated. Basically generation, daily generation information, if you have that, you know the fuel costs, you know production costs.

He feels at least that it would give competitors knowledge of specific production cost information. And therefore we are going to be requesting that the information be held in confidence.

CHAIRMAN: Okay. You are entitled to do that. Even I know what the cost of the fuel for hydro generation is. It is nothing. It is one of the assets we derive from being in this great province. So anyway, we will give it a confidential exhibit number. And it may well be the subject matter of a confidentiality hearing in a later date. So if you want to -- is that on pink paper, Mr. Morrison?

MR. MORRISON: Yes, sir.

CHAIRMAN: Good. Okay. And I will mark this as I have the confidential exhibits previously which is -- it will be A-97(c) for confidential.

MR. MORRISON: Mr. Chairman, I believe the Board Secretary has indicated we should also have the public version of that document marked as an exhibit.

CHAIRMAN: Okay. Well that would be -- I forget how I did that before, but let's call that A-97.

MR. MORRISON: Fine, sir.

CHAIRMAN: A-97(c) and A-97. Mr. Morrison?

MR. MORRISON: Thank you, Mr. Chairman. We have 12 undertaking responses that should be marked. The first one is undertaking number 4 from February 9th, bad debt expense of Newfoundland Power.

CHAIRMAN: Undertaking number 4 from February 9th is A-98.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 5 from February 9th, dealing with certain survey information.

MR. MACNUTT: What is it again?

MR. MORRISON: Undertaking number 5, February 9th.

CHAIRMAN: That is A-99.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 8 from February 9th, dealing with certain electricity statistics, Stats Canada information.

CHAIRMAN: This will be A-100.

DR. SOLLOWS: Mr. Morrison, I see the response to this is that Section 3 relates to gross receipts of electricity from the United States and that you don't import electricity.

I do note that when I reviewed the Statistics Canada filings that there are some numbers there for imports. Now they are small numbers but they are numbers nonetheless.

So I guess the question in my mind is how Statistics Canada gets their information if NB Power does not report it? And then I know there is also another section in the same statistics that lists the exports from New Brunswick to the United States and they didn't seem to be in the filing as well. So is it possible just to get the complete set of information that's filed with Statistics Canada?

MR. MORRISON: I will make the inquiry, Mr. Sollows.

DR. SOLLOWS: Thank you.

MR. DUMONT: Excuse me, Mr. Marois. On the A-99 undertaking, could you explain to me the results on page number 2 there? What is 5.9? Is that a percentage or --

MR. MAROIS: I believe that -- it's a scale of 1 to 10. So it's 5.9 on 10.

MR. DUMONT: Okay. Thank you.

MR. MORRISON: The next undertaking, Mr. Chairman, is undertaking number 10 on February 9th, software costs.

CHAIRMAN: <u>A-101</u>.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 5 from February 13th, dealing with the cost benefit analysis of system upgrade.

CHAIRMAN: That will be A-102.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 7 from February 13th, dealing with the second tie.

CHAIRMAN: That will be A-103.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 9 from February 13th, dealing with the percentage of power costs in the last quarter.

CHAIRMAN: And that will be A-104.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 11 from February 13th, dealing with what assets are dealt with taking into account reasonable costs of capital.

CHAIRMAN: And that's A-105.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 12 from the 13th of February, reports on fossil fuel prices.

CHAIRMAN: And that will be A-106.

MR. MORRISON: Next, Mr. Chairman, is undertaking number 13 from February 13, dealing with studies with respect to the 400 megawatts on the second tie.

CHAIRMAN: That's A-107.

MR. MORRISON: Next, Mr. Chairman, is undertaking number 14 on February 13. It deals with the billing determinants referenced in table 1(e) of Ms. Clark's evidence.

CHAIRMAN: That's A-108.

MR. MORRISON: And finally, Mr. Chairman, it's undertaking number 1 from February 14th, duration of large industrial and wholesale customer contracts.

CHAIRMAN: And that's A-109. We certainly broke the hundred barrier, didn't we?

MR. MORRISON: Mr. Chairman, there is one other matter. It doesn't show up on the transcript as an undertaking. I think it was a clarification that Mr. MacNutt sought on certain information. And I believe Ms. MacFarlane can address that.

MS. MACFARLANE: Yes. It was Question 207 on page 4038 of the February 15th transcript. And Mr. MacNutt noted in PI IR-58 that the opening retained earnings for April 1st 2006 was stated as negative 13,000,000. And he asked for a reconciliation in light of PUB IR-261 which was the most recent 05/06 forecast, the Q3 forecast.

With the most recent forecast, which is now projecting a net income for 05/06 of 22.6 million, we believe the opening retained earnings will be a positive 12,000,000 going into the 06/07 year.

MR. MORRISON: And one other clarification, Mr. Chairman. You will recall yesterday that Mr. Peaco -- well, we filed an exhibit A-95 which was the Power Point presentation. I'm advised that there is a typographical error on page 20, on slide 20.

On the far left-hand column, the imported coal, foremost and other figure in the block says 114.6. It should be 144.6. I believe the text is correct. The number in the graph is incorrect.

CHAIRMAN: Thanks, Mr. Morrison. Any other matters? Any other Intervenors?

MR. LAWSON: Mr. Chairman, I just didn't catch that page reference and line reference in that. I'm sorry.

MR. MORRISON: Page 20. And it is the FY 05/06 graph on the far left of -- it is the first bar I guess in that graph.

MR. MACNUTT: And the exhibit number?

MR. MORRISON: A-95.

MR. MACNUTT: Thank you.

CHAIRMAN: All right. Mr. Morrison, is this an appropriate time to discuss the four sheets of paper from I believe it is Messrs. Meehan and Strunk's report and whether or not the Public Intervenor will be allowed to question this panel in reference to the matters in those paragraphs? Is this a good time to talk about it?

MR. MORRISON: Yes, sir.

CHAIRMAN: Okay. I have in front of me -- and if that is okay with you, just so that we can organize this a little bit. There is -- the first one I have, and I will call it page number 1, is from the introduction. And it is page number 4. The next one is page number 5.

And across the top it says "The record contains evidence that the vesting agreement provides for payments that differ from Genco's cost." That is page 2.

Page 3, the heading across the top is "Record Lacks Evidence Regarding Genco's Cost." That is page 8.

And last but not least is page 9, again stated across the top "Record Lacks Evidence Regarding Genco's Cost." That is page number 4.

So in addition to the Applicant and the Public Intervenor, any of the other Intervenors wish to have an input into this discussion?

MR. GORMAN: No, Mr. Chairman.

CHAIRMAN: Okay. All right. Mr. Morrison?

MR. MORRISON: Well, first, Mr. Chair, and I think it is outlined in my letter of February 2nd to Mr. Hyslop, which had been copied to the Board and all other parties, that you don't have a copy of that letter. I do have copies available for the Board.

CHAIRMAN: Some don't. Some do. Maybe you can pass them around. I have got one here. I will find it in a minute. We all have a copy of that now, Mr. Morrison.

MR. MORRISON: Thank you, Mr. Chairman. If you read -- and I'm assuming that you haven't read, but -- the entire thrust of Mr. Strunk's report -- and I'm referring to it as the Strunk report, although Mr. Meehan is the co-author I believe Mr. Strunk is the witness who will be speaking to it. The entire thrust of his report in essence is that the provisions of the Genco PPA are more suited to a pre structuring environment, they are not arm's length, and therefore the underlying costs of Genco should be reviewed by this Board.

I will bring you back to the Board's ruling on January 11th, and I'm not going to quote from it at length. But the Board ruled at that time that the reasonableness of the underlying generating costs were not to be questioned or dealt with in the course of this hearing. Specifically the Board ruled that reasonableness relating to the return on equity in either Genco or Nuclearco was not a matter which was of any interest or was helpful -- I shouldn't say not of any interest -- but would not be helpful in this case.

The passages that I have noted as being objectionable relate directly to those two issues.

If you look at the first page in your document, which is page 4, paragraph number 1 -- what this passage questions is the vesting agreement between Genco and Disco, and it says it is not reflective of Genco's costs. Well we never said that the vesting agreement was a cost of service agreement. What Disco's evidence is, and I think it has been repeated numerous times over the last week or so, is that over time the Genco PPA is designed to recover the costs of that generator over the entire term of the contract.

This particular paragraph would involve an examination of the reasonableness of individual costs that are included in the amounts that Disco must pay pursuant to -- and using the Board's words -- those agreements referred to in Section 156 of the Electricity Act. And this Board has ruled that that information will not be accepted as evidence in this proceeding.

Similarly, if you look at paragraph 2 on page 4, this passage deals with an analysis or an examination of Genco's detailed costs to support the -- again to support the charges being passed through under the vesting agreement. And for the same reasons I just mentioned, it is our submission that that paragraph as well should not be accepted into evidence.

The third paragraph basically is an assertion. As I said at the outset, Mr. Strunk's view is that because these PPAs were not arm's length -- or in his view they were not arms length -- that the contract should be opened up to review. Clearly that is not in accord with Section 156 of the Board's ruling in connection with 156.

If you turn to the next page, which is page 5 of Mr. Strunk's report, and it's paragraph (a), and that paragraph is titled "Capital Structure and Financing Costs". This passage goes directly to the reasonableness of the capital structure and return on equity assumed for Genco under the vesting agreement.

Now the Board was quite clear that that was not something that this Board would examine in this hearing, quite clear in your January 11th ruling. Now to be fair, the Board said it would be of interest to know what those assumptions were, and of course you know what those are, you have been told what they were, but the reasonableness of them is something that this Board has ruled would not be the subject of examination in this hearing.

If you turn to the next page, which is page 8 of Mr. Strunk's report, Economy Energy Purchases. Now what he is getting at here is the third party purchases benefit adjustment, and that's set out in Article 6.5 of the Vesting Agreement, and that's fixed at 50 percent of the difference between the import price and the vesting energy price. The 50 percent threshold, as I said, is fixed. It's not variable. To question whether that 50 percent should be 51 percent or 49 percent I would suggest goes beyond what this Board rule on January 11th.

Similarly if you look at paragraph (d) on page 8, this deals with the adjustments for environmental costs. And if you look at Article 7.2 of the Vesting Agreement, it sets out -- basically what it says is Genco is responsible for 50 percent of any cost overruns and environmental costs and Disco is entitled to 50 percent of any cost savings.

Again this is fixed in the PPA. So whether it should be 48 percent or 52 percent or 40 percent and 60 percent, again that goes to the reasonableness. It's something that's fixed into the PPA and it's my submission that this Board has ruled that that is not an inquiry that it is going to pursue.

The bottom of page 8 and top of page 9 of Mr. Strunk's report starts with Capital Balances. And what this does -- at least paragraph (a) -- it questions the capacity price in the vesting agreement between Genco and Disco.

And what Mr. Strunk is doing is seeking verification that the capacity price reflects Genco's net plant value and amortization and return with respect thereto.

Again the capacity price is a fixed component of the PPAs. And again what he is attempting to do or what he is commenting on, in my view and in my submission flies completely in the face of Section 156 and what the Board ruled in connection with Section 156 on January 11th.

Finally, Mr. Chairman, if you turn to page 9, subparagraph (b), Capital Structure and Financing Costs. There is no question that what this passage is getting to is the capital structure and rate of return assumed for Genco in the vesting agreement. I don't think the Board could have been any clearer in its January 11th decision with respect to that issue. The Board ruled that an examination of the ROEs of the generators is not something that this Board is going to inquire into.

So those are my submissions with respect to Mr. Strunk's report.

As I said at the outset some time ago, about a week or week-and-a-half perhaps, when this issue first came up, to allow these passages to go into evidence creates difficulty for Disco in the sense that if you are going to conduct an examination of the ROE of Genco, for example, we are not in a position to provide evidence that can meet that case. So there are some practical considerations as well as what I consider legal issues.

Those are my submissions, Mr. Chairman. Thank you.

CHAIRMAN: Thank you, Mr. Morrison.

MR. HYSLOP: May I come up front, Mr. Chair?

CHAIRMAN: By all means.

MR. HYSLOP: Thank you. Mr. Chair, when I review the transcript relating to the ruling which was given on January 9th, and in particular at pages 2941 through to 2943 -- my colleague of course has pointed out the portion of the decision where it -- where you stated: The Board does not intend to review this cost information for the purpose of adjusting the amount that Disco must pay for purchase power 2006/2007. We consider that the Electricity Act requires the Board to accept the properly verified amounts that Disco must pay pursuant to various agreements described in Section 156 as being prudent for establishing Disco's revenue requirement in this proceeding. That amount I understand is $1,028,000,000. And we accept, as long as those are properly verified, which is certainly an issue in the La Capra report, that those amounts must be paid and there is nothing more or less that I can do from them. And that's fine. We accept that ruling.

But Mr. Morrison, with the greatest respect, did not read the comments of the Board at page 2943 where the Board stated -- and I think this is important and probably for the rest of my argument you will hear me refer to them many times -- the Board is of the view that information on the structure of the Electricity Act -- and this is a really important fact --

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

MR. HYSLOP: Pardon me?

CHAIRMAN: That's electricity market --

MR. HYSLOP: Market. Yes.

CHAIRMAN: -- not Act?

MR. HYSLOP: Yes. Electricity market in New Brunswick and on the manner in which the PPAs are designed and administered would be of assistance to it and to the public.

So dealing with this issue on a broad based approach, we asked Mr. Meehan and Mr. Strunk to take a look at these contracts and tell us, you know, where do these contracts fit in within a general scheme of an electricity environment? What are the weaknesses in them? What should Disco's responsibility be in the future in terms of administration of them? What should a regulator know with respect to the administration of these contracts, if not at this hearing at least, but at future hearings? That's what we took from the direction that the Board gave in the latter part of the judgment -- or the ruling.

And in that regard, you know, we asked some pretty basic questions. At page 20 of Ms. MacFarlane's evidence she answers the question, how were the PPA prices established? And here answer was is that "Financial models were developed to determine prices that reflect capital structures and returns, investments in the assets at book value, forecasted fuel and purchase power, forecast operating and maintenance expenses, decommissioning used management costs and ongoing capital expenditures."

In other words, the prices that are charged to Disco in the PPAs according to this evidence are at least supposed to reflect Genco's costs. And that's the evidence. And we asked a basic question. Is that really how these purchase power agreements work? I asked these people to comment on that. Are these cost based contracts?

Now there has been a lot of water under the bridge which made me think they were more than that, but these people said no, they are not cost based contracts. So that's the first thing, is how are they going to work.

You know, what type of risks were flowing through to Disco in the general administration of the PPAs and what did this mean for the proper regulation of the contract?

Now they did say -- they made an interesting comment my friend says that I can't say that prestructuring contracts that existed between affiliate corporations that were normally subject to extensive regulation. In his argument he equates that to being a challenge of the $1,028,000,000.

I equate that to a statement saying that this is the type of contract that used to exist in the United States between affiliated parties who would always have to have it subject to the regulation of the Board. And at this hearing here I agree, we can't go and challenge the $1,028,000,000, but I think this Board should be in a position at the end of this hearing to make comment as to whether or not it's the type of contract that will bear regulation at the end of the day.

And further, if it's going to bear regulation at the end of the day, what type of responsibility does Disco have when it comes before this Board next time and says, I want a rate increase of 11.6 percent to prove that it got a good deal under this contract? You know, the real issue in this whole case, if you want to cut through 30 -- and I know we are at day 40 -- is whether we are still one big happy family at NB Power or whether Disco is going to function as an independent company, an independent organization.

And the second part of that quite, frankly, is if it's going to function as an independent company and independent organization, then how does it approach these purchase power agreements?

Now a couple of things on the purchase power agreements. First of all, just because the Minister approved them, which I'm sure he did, there is nothing in the Act that said he approved them pursuant to legislation. So as far as I'm concerned, one of the fair questions I want to ask throughout this hearing is whether or not Disco's got any problems with the contracts, and is Disco going to be in a position to negotiate some of these terms so that they are more favourable to it and to the ratepayers it should be protecting in these negotiations with Genco?

CHAIRMAN: Mr. Hyslop, sorry to interrupt. I really didn't follow you on your comments in reference to the Minister. Would you mind backing up and developing that a little bit?

MR. HYSLOP: Yes. Well I tried to develop it last week in cross examination. Apparently maybe it's going to require more argument.

But yes, I go back. The cross examination last week you might recall we went through the purchase power agreements -- or we went through that section on the transfer orders and I tried to point out that the transfer orders were legislated under Section 12 of the Act. And then and it said that there are transfer orders that are set out and approved by the Lieutenant Governor in Council.

And then I tried to search through the Electricity Act for where we might have similar language with respect to the purchase power agreements. And as we recall and as Ms. MacFarlane indicated, we only found the words purchase power agreements once in the Act and the words purchase power twice in the Act. Section 80 was purchase power agreements with Genco and Nuclearco and then we talked about purchase power contracts in Section 156.

So my point is is that these aren't legislated contracts at all. Very simply what they amount to are contracts between independent parties which I assume would have the right to renegotiate some of the terms of them, which are approved ultimately by the shareholder. And it wouldn't matter one way or the other whether that shareholder is the Minister of Energy or Mr. Irving or Mr. Hyslop. There are lots of shareholder's agreements that go on in the business world. There is no magic to the fact that the shareholder happens to be the Minister except that the Minister can introduce legislation which can be approved, and I assume if he wants -- feels that strong about these contracts, you know, he can introduce legislation to do it. But whether he does or doesn't that's not my concern. But what I'm getting at here is because these contracts are made in this arm's length -- or supposedly arms length environment, which isn't an arm's length environment -- where do we stand? And I went to these people and I asked them very nicely, I said, what -- tell me -- I have never seen a purchase power agreement before this hearing. I doubt with the exception of Mr. Peaco many of the people on this Board have examined -- in this room have examined purchase power agreements.

And I said, do you have somebody that has looked at these and knows something about how they are administered and how they are dealt with in the United States, and what happens when the Discos of the world come in looking for rate increases, what type of steps do the Boards have to take down there to make sure -- and I don't think it was in the revised report, but that Disco drove a hard-nosed business deal.

And there is two parts to that. One is the terms themselves which I have spoken to, and the other is, and to use the Board's words again, the ongoing administration and structure of these contracts. And some of the questioning that's going to come out from my cross examination without showing more than I want to, is I want to know what happens -- you know -- there is three or 400 inputs that go into the PROMOD, maybe more, Mr. Peaco probably can enlighten me a little on that. You know, what does Disco do to review these, you know.

We are talking about a range of reasonableness and, look, I will accept Mr. Peaco that all the inputs that he looked at, and I don't think he looked at them all, are reasonable, but there is a range of reasonableness. How hard is Disco going to negotiate so that the range of reasonableness is the best opportunity for them?

I asked these people to provide me a report that indicates some of the issues that arise with regard to the responsibility that comes to an independent or an affiliate company to ensure that it has taken these type of steps. So that's what this report is about.

Mr. Morrison, just to make a couple of quick comments on some of the things he said. You know, he challenges on page 1 of his report, paragraph 2 -- and in that regard, you know, what I'm saying in paragraph 2 and the comments that I have in there, well, you know, I recall the 32 page slide presentation that Mr. Peaco gave us yesterday. You know, what he -- that's exactly what he did is went through some of the nature of how these costs are being passed on. And I'm saying it's not all these costs that are being passed on. And we will get into that in cross examination.

You know, it's not actual costs that are being passed on here. What are the actual costs that are being passed on, which ones aren't actual costs and how significant is that difference? And if the difference is significant, Mr. Chair, then how are we going to deal with it in the future? I mean, I think those are fair questions for the Board in that regard.

You know, yes, I can't challenge the 11 percent and the 50 percent for purposes of Genco's thing on this hearing, and in fact quite accurately I didn't challenge the 42 1/2 and 10 percent that Ms. McShane set out. I didn't quibble it should have been 9 1/2 and 45 or 40 or 35. You know, there wasn't sufficient evidence I didn't think in her report and that's what she wasn't engaged to do.

Again that was a number that was given. I'm not challenging those percentages.

But what I am getting at is a very basic point is whether you base it on cost -- on the actual costs or you base it on something deemed at all. You will be doing that with regard to Disco.

And that raises an interesting question, and you can write it down how you want to handle it because I'm going to ask it. And that question is pretty simple. If this Board was to rule at the end of the day that Disco's rate of return should be based on the cost of its embedded debt and not on this hypothetical structure that has been in discussion the last couple of days, you know, what is Disco going to do the next round of negotiations?

You know, if I was Disco I would be saying to Mr. Bishop, Mr. Bishop, you are overbilling me. You can only bill me for the cost of your embedded debt. That's what the Board told me and you got to do the same to me. And I'm going to want to know from Mr. Kennedy some time in this hearing if that's the position he is prepared to take at a renegotiation.

These reports -- it's a fine line that was drawn in your decision, with respect, Mr. Chair. And I think how I use this information is important. If I go in and say you shouldn't be able to bill me on the basis of a 50/50 capital structure, then I'm out of line. But if I go in and say, how are you going to handle it in the future and how are you going to present your case to this Board in the future, I think I'm totally and completely in accord with the ruling that you made on January 9th.

And Mr. Morrison referred to his letter which was elaborate and listed the issues. Mine was a pretty simple letter. I said one of us is clearly mistaken as to what this Board intended on January 9th. I will apologize if it's me. But I do think the second part of that report laid it out pretty good.

I had the real impression this Board wanted to know what these reports were about, how they should be administered, how they should be regulated if they are to be regulated.

And I went and asked somebody that has looked at 250 of these in his career, he has negotiated them in California, he has negotiated them in an arm's length environment, he has negotiated them in an environment where he has had to go in and present cases on behalf of utilities to regulators and support them. I have asked a knowledgeable person to help us out here. And I can't think for a minute it would not be useful information to this Board.

Those are my submissions, Mr. Chairman. Thank you.

CHAIRMAN: Thank you, Mr. Hyslop. Anything, Mr. Morrison?

MR. MORRISON: Indeed, Mr. Chairman.

MS. MACFARLANE: Before we go on, Mr. Chair, could I just note a correction? I did have in my evidence part 1 on page 15, line 24, the power purchase agreements were approved by the Minister of Energy.

But last week I was asked to and did correct that on the record that in fact the power purchase agreements were approved by Cabinet. So I just wanted to make sure that that correction was understood. Thank you.

MR. HYSLOP: And in that regard I think I pointed out there was nothing for Lieutenant Governor in Council to approve PPAs under the Act either, Mr. Chair, that I could find.

MR. MORRISON: Thank you, Mr. Chairman. I do have some comments. First I should have mentioned at the outset that Mr. MacDougall, who was here yesterday and thought this argument was going to be made yesterday had wanted to make representations. And he left yesterday afternoon. He did want me to indicate to him, and I'm sure you have read in his letter, that he supports Disco in our argument. And in fact Mr. MacDougall was of the view the entire Strunk report should not be included in evidence.

And I didn't go quite that far. And that's the point I want to make here, Mr. Chairman. I was very, very careful when I went through the Strunk report. The vast majority of the Strunk report offered in evidence, while I questioned whether it fell within the Board's ruling, I certainly gave it the benefit of the doubt.

And if it went to -- and I know the Board said in its January 11th ruling that there is an educational function here. You want to know how the PPAs are administered. You want to know how the Operating Committee works. You want to know how the PPAs work. I agree wholeheartedly with that. And all of the balance of Mr. Strunk's report that deals with that I have no challenge with.

What I do have a challenge with is those specific references in his report that fly directly in the face of your January 11th ruling and directly in the face of Section 156.

I will say a couple of things. Mr. Hyslop has said that you have to know -- how are these going to be administered in the future, in the future, in the future? Well, we are dealing with an 06/07 revenue requirement case.

Others want to turn this case into something it is not. They want to turn it into an examination of a lot of different things that have no bearing on determining this company's revenue requirement for the 06/07 year.

CHAIRMAN: Mr. Morrison, let me suggest to you -- and I think the Board, as we have said it before in this proceeding, is that this is our only opportunity to comment on the legislation and the setup of the market. And if I were sitting in government, then I would want to hear, after the Board has reviewed it, what suggestions we might have in order that the marketplace function in -- what in our opinion could be changed or should be changed, either with the legislation or in the actual marketplace, that will make it function in a fashion that the government policy indicates to us it should be. So in that regard we I think have always said that if we see a flaw, then we want to bring it up and say we believe this to be a flaw. And the government can do with it as it sees fit.

MR. MORRISON: And I understand that, Mr. Chairman. But it does create obviously a great deal of complication. When a utility, any utility comes before a regulator to basically establish its revenue requirement and do all the things that you normally do on one of these hearings, which is OM&A, depreciation, all of the things that go to establishing a revenue requirement, and then have to meet or address a case that really has nothing to do with this corporation in running its business, there may be lots of issues -- I'm sure there are many issues that ought to be debated somewhere, but not here.

In any event, Mr. Chairman, I would like to urge you to look at the passages that I have objection to. Because they do relate to specific issues that this Board has ruled were not appropriate in this hearing.

The balance of the Strunk report, as I said, where it goes to reasonableness, administration of the PPAs -- we are going to get into that extensively in the next few days I'm sure -- I have no objection with.

Those are all my submissions, Mr. Chairman. Thank you.

CHAIRMAN: Thank you, Mr. Morrison. We will take our break. And also when we come back rule on this particular motion. So it will be longer than 15 minutes, I assure you.

(Recess - 10:30 a.m. - 11:00 a.m.)

CHAIRMAN: I don't know which one of counsel said just before we went to consider this motion, but they said it is a fine line. It certainly is a fine line that you are asking us to draw.

Just a point that the panel wants to make. There is absolutely nothing in 156 that says the PPAs are confidential.

And we all agree and have said before that we must take the revenue requirement that is produced as a result of the PPAs as being reasonably and prudently incurred for the purposes of this hearing. And we will do so.

And both counsel have made very good and substantive argument. And frankly we are now down again, as I say it, to splitting hairs.

We will allow Mr. Hyslop to use all of these quotes on the basis of questioning. But it will be on the basis of our previous ruling that both of you gentlemen have quoted from.

So Mr. Hyslop, if you want to know the stance a certain witness will take in negotiations in the future to protect the customers of Disco, that is going too far. And I will stop you in that line of questioning. So we are going to have to go from topic to topic. It is as simple as that. I can't be more definitive.

So now Mr. Morrison, does that put you in a quandary on timing or anything, sir?

MR. MORRISON: No, Mr. Chairman. We will just have to roll with the punches, as they say.

CHAIRMAN: Yes. Okay. Good. Thank you. Where are we?

MR. MORRISON: I think we are ready to continue with this panel, Mr. Chairman. At least I hope so.

CHAIRMAN: Yes. And that is right. The witness had just simply gone through a slide presentation, is that --

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

CHAIRMAN: Okay.

MR. MORRISON: And you will recall at the close of yesterday I had a document marked. And it is marked A-93. And I would like Mr. Kennedy to basically explain what that document is.

Q.16 - Mr. Kennedy, you have caused to be prepared a document called A-96. I'm sorry. You have caused a document to be prepared that is called Power Purchase Cost Variance 06/07 over 05/06. And that was marked yesterday afternoon as A-96.

Generally can you tell me what this document is intended to demonstrate? And would you sort of please take us through it?

MR. KENNEDY: Yes. This document outlines the power purchase cost variance as stated with respect to the 2006/07 versus the 05/06 budget.

What it is attempting to do is to identify the costs and link my evidence with the report, with the La Capra Report with respect to the assessment that they did with respect to the PROMOD.

And in it I have included references to the Genco PPA or the vesting PPA and the Coleson Cove tolling agreement and the Nuclearco, Point Lepreau PPA with respect to where certain articles support the calculations that are outlined on a line by line basis.

And again I have also identified the areas in my evidence where lines line up with the tables that are presented in exhibit A-50, section 3 at tab 1.

So if I may, lines 1 to 4 --

MR. LAWSON: Mr. Chairman, sorry. I wonder if we could have the witness speak up. I'm having a hard time hearing him. Or move closer to the mic.

MR. KENNEDY: Is that better?

MR. LAWSON: Yes.

CHAIRMAN: Or as someone said yesterday, I will just speak louder.

MR. KENNEDY: First of all, items 1 to 4 connect the -- take us from table 1 of the La Capra Report to get us to a subtotal in line 5 of the energy charge that basically is a charge from Genco to Disco for the supply of energy for the various years. And it basically shows up in my evidence in table 1(b), row 2, columns 3 and 6.

And further to that, taking in the total to the other items with respect to some of the other charges, it gives you the total power purchase. When you takes line 5 and go to line 12, you come with a total power purchase cost that would be incurred by Disco in payments to Genco for the various years. And that is the Genco total.

The other part is from the part that is associated with the Nuclearco or the Point Lepreau power purchase agreement. And that is where you go from line 14 to line 16 with a total on line 17.

And line 18 deals with Disco's purchases with respect to other purchases that Disco makes directly on its own accord.

With respect to line 1, that appears in the La Capra Report. And Mr. Peaco made reference to that yesterday. And it shows up in his evidence.

When he was -- when La Capra was employed, first they were looking at the fuel costs, the fuel components only. So there has to be some reconciliation with respect to getting the numbers that appear in line 1 to the numbers that appear in my evidence with respect to the energy charge in line 5.

When Mr. La Capra -- or Mr. Peaco -- when La Capra was doing the analysis the PROMOD included other power purchases mainly with respect to renewable and self-generation. And that is shown in line 2. And therefore that is being removed. Because that is an agreement that is directly between Disco and those parties. So the 8.4 and the 1.9 are being removed from the fuel costs that go with La Capra.

And to that we have to add the fixed cost component with respect to the vesting energy price. And that is depicted in line 3. And at the time that La Capra were doing the reports for the Phase I, Phase II and Phase III, the initial piece as I mentioned did not include fixed costs. So line 4 is a reconciliation to the fact that we have to add back in the fixed cost components of the Heritage PPA's with respect to the natural gas units as well as netted with respect to diesel fuel for the Point Lepreau standby generator as well as net off the CTs and emergency purchases which are the responsibility for Disco as per the contract.

When you take this all into consideration line 4 is a bundled account to protect certain information. But those items are fixed costs and net of those other costs that I mentioned to bring the total energy charge that is depicted in line 5 and also is shown in my evidence.

So basically what we are doing here is reconciling the La Capra information that appears in all their documentation to bring it to the charge that Disco pays with respect to energy. And then we add back in certain things that are required.

Disco is responsible for interruptible and surplus energy. And that has to be added back in with respect to meet our requirements and to serve this group of customers. That is the energy that basically is purchased from Genco by Disco and then passed through with a certain markup and adders to the industrial customers that have the rights to this interruptible and surplus energy as per their contracts.

Line 7 basically is the capacity charge that is in the agreements. It's the capacity charge that is described in the contracts. And as you know, there also is an export benefit credit that still applies to Disco and therefore the customers in the province of New Brunswick. This is the export credit that is identified in the contracts and the PPAs that has to be taken back in, taken off the sum to come to a total in line 13.

Line 9 is the cost, the annual cost, estimated annual cost to upgrade the precipitators at our Point Lepreau -- at the Coleson Cove generating station. That is shown in our evidence. And there has been a number of IRs on that with respect to that precipitator upgrade.

And this year, what the next item is as identified in the contract is a Point Lepreau PPA shortfall in that Point Lepreau in 06/07 will not be operating at an 80 percent capacity factor. Therefore there will be -- a shortfall will occur.

And the difference is the difference between the Point Lepreau tier 1 price that we would pay Genco for as per the articles in the power purchase agreement and the difference between that tier 1 price and the Genco vesting energy price. That is an additional cost for that particular year.

With respect to line 11, line 11 is an ancillary service credit that Disco basically recoups from Coleson Cove operation and also the Genco other assets. The ancillary service credit is to compensate Disco, because it is obligated under the Open Access Transmission Tariff to pay schedule 1 and schedule 2 with respect to that tariff.

All other ancillary services are self-supplied by Disco utilizing the assets that it has under contract. It is an obligation for all market participants though to pay schedule 1 and schedule 2.

Schedule 2 is for voltage control or voltage regulation.

And since our assets that we have under

contract are providing those services, we under the contracts get a credit back from the appropriate parties to compensate that cost for schedule 2 only.

And with respect to the contracts, CTs and emergency purchases are the responsibility of Distribution and Customer Service. So that was taken out. But it has to be added back in here with respect to our requirements in the going years, the test year for 06/07. And we have indicated what it was for 05/06. This comes to a grand total for the Genco PPA of the line 13 where you will see our requirement with respect to power purchase from the Genco PPA.

So that is a piece of it. The next piece is our requirement to pay for the Point Lepreau output. And it indicates there the pieces that are required under that contract, which basically all those costs are identified in the various articles in the PPA. And they show in my evidence in the far column where they show up.

So that basically -- from line 14 to line -- from 14 to 16 equates to the total requirement that Disco has with respect to an obligation to pay Nuclearco.

And again as I mentioned, line 18 is the commitment, the estimate that Disco has with respect to paying for other power purchases that it makes on its own through its own contracts.

And that piece, if I refer you to line 2 and line 18, you will see that there is one item, as I mentioned, it was in the La Capra assessment, was taken out. And basically it was put back in down here including an additional million dollars on the 9.4.

That additional million dollars was an estimate with respect to Disco going out and acquiring environmental attributes to credits only from a point of view in the fiscal year 06/07. So that is the difference between the 8.4 and the 9.4.

And this basically, when you add it all up, comes to a total of the total power purchase cost requirements of one billion and 28.1 versus the 907.9 million for a difference.

And that basically is the amount of power purchase cost that Disco is putting before this Board, shows up in table 1(a), row 4, column 1 as our requirement with respect to power purchase cost for -- and analysis and cost comparison between year over year.

MR. MORRISON: Thank you, Mr. Kennedy. Mr. Chairman, we do have some rebuttal with respect to the Strunk report.

CHAIRMAN: All right. If I might though just before -- Mr. Kennedy, I presume that all of the figures on that exhibit come from PROMOD runs and not based on actuals and estimates?

MR. KENNEDY: Yes. May I clarify something? Yes. What I have done here is -- if you look -- I should have mentioned this. Under Notes, you will see that under Notes I have down A, prices, costs and benefits are computed by PROMOD based on PPA requirements, and, B -- any time you see a B in the notation it's prices, costs and benefits are set by the PPAs and they are what I would call hard wired in the PPAs with respect to looking at. And the -- so what I am trying to do is make the connections between the PROMOD analysis with respect to the fuel, and that has been identified by A, and any other items that are required to be computated and come out of the PROMOD run when you look at the notation A. C are other purchases with respect to Disco's purchases that we are making with respect to -- for example, to meet our requirement with respect to the renewable portfolio standard, and a certain amount of self-generation that is dumped back onto the system that we have from cogeneration customers that are in the system. So these numbers come out of the PROMOD and also are calculated with respect to the contracts.

CHAIRMAN: Thank you. Go ahead, Mr. Morrison.

MR. MORRISON: Thank you, Mr. Chairman.

MR. DUMONT: Excuse me. When you look at row 2, which is 05/06, are those numbers based on actual costs or are they --

MR. KENNEDY: No. Those are the budgeted costs for 05/06.

MR. DUMONT: Thank you.

Q.17 - Thank you, Mr. Chairman. Ms. MacFarlane, I'm going to ask -- well I will be asking various members of the panel to comment on portions of the report filed by the Public Intervenor which we have been calling the Strunk but it's really the Meehan-Strunk report.

Ms. MacFarlane, at page 2 of his report Mr. Strunk was asked to answer the following question. And it was quoted as, "Is the vesting agreement demonstrably consistent with Ms. MacFarlane's claim in evidence that it is cost based. What if anything do you have to say with respect to the assertion that the vesting agreement is cost based?"

MS. MACFARLANE: I would like to answer that in two parts. First, I made no claim in my evidence that the Genco PPA is a cost based contract. Part 1 of my evidence clearly outlines how each element of the Genco PPA is structured and how risk is apportioned over time between Disco and Genco. My evidence indicates that the PPA was designed to collect Genco's forecasted cost over the long-term with risk sharing incorporated in the design.

Second, Mr. Strunk is using the term cost based throughout his report as equivalent to cost of service, a regulatory term, or cost pass-through. The Genco PPA is not a cost of service contract, nor was it designed to be. Again, the evidence clearly lays out, number 1, areas where the costs are prescribed in the Genco PPA. An example is the capacity payments. And number 2, areas where the method of determining the costs are laid out in the PPA, like the fuel component of the energy price which is based on forward prices and hedges that are market based and are derived from externally verifiable and published indices.

Q.18 - Ms. MacFarlane, in light of what you just said, also I think it's at page 3 of Mr. Strunk's report he was asked to address another question, and the question was, is there evidence other than assertions by Ms. MacFarlane that the rates in the vesting agreement are cost based? In light of your other answer, what do you have to say about that?

MS. MACFARLANE: Disco does not need to provide evidence that the prices in the Genco PPA are cost based because I made no such assertion. The evidence filed supports the costs that are included in the revenue requirement as dictated by the Genco PPA.

Q.19 - Now at the bottom of page 10, and it starts at the bottom of page 10 and goes over to the top of page 11 of his report, Mr. Strunk says that the Operating Committee is given "considerable discretion over key Genco PPA features." What do you say with respect to that statement?

MS. MACFARLANE: I disagree with his statement. The Genco PPA which has been filed with the Board is clear and prescriptive. 60 percent of the costs in -- included in the revenue requirement are set in the Genco PPA. Other costs, areas that vary year by year, are set based on clear determinants that are prescribed in the PPA.

Let me give you an example supporting my disagreement with his statement that the Operating Committee is given considerable discretion over key variables.

On page 11 Mr. Strunk states that the committee has "considerable discretion" in ensuring that the third party gross margin credit in Section 6.3 has been properly determined. While the third party gross margin credit is prescribed in the PPA for 2006/2007, there is no discretion. It is set in the PPA.

Q.20 - Thank you, Ms. MacFarlane. Now have you identified any factual errors contained in Mr. Strunk's report that are important to his assertions?

MS. MACFARLANE: Yes, I have. There are at least three areas where Mr. Strunk has clearly misunderstood the terms of the Genco PPA and has consequently incorrectly reflected them in his report.

The first area is the setting of the energy price and applications of hedges. On pages 6 and 7 Mr. Strunk implies that forward prices can be picked by the Operating Committee at different times, so as to manipulate the energy price to Genco's advantage. Further he states that hedges are not counted as offsets to the vesting energy price. This is incorrect.

Disco requires Genco to hedge on Disco's behalf monthly over a rolling 18 month forward period so as to enhance predictability and to avoid the risk of a temporal price spike at any one point throughout the year. The hedges -- the hedge contracts effectively set the vesting energy price. And the La Capra report, Phase II, on page 11, confirms that the hedges are included in the vesting energy price.

So Mr. Strunk's report is in error.

Number 2, his comments with respect to the escalation of the capacity payment. He states on page 9 that the Genco PPA capacity payments escalate with the CPI Index.

This is incorrect. The capacity payments do not escalate with the CPI Index. Capacity payments are laid out in Schedule 1.1.17 and they increase by a set amount until 2007, they stay flat until 2016 and they decrease thereafter. They do not escalate with the CPI Index.

And finally he is incorrect with respect to his comments about delivered fuel costs. On page 9 Mr. Strunk states that the Genco PPA and the La Capra Phase III report do not incorporate delivered fuel costs. He specifically references Table 1 of the La Capra report. Well fuel costs on Table 1 are delivered fuel costs. Again he has incorrectly reflected this in his report.

Q.21 - Now turning to you, Mr. Peaco, on page 13 of Mr. Strunk's report, he does have some criticism of the La Capra review, and he asserts that your review lacked detailed analysis. Do you have any comments with respect to that statement?

MR. PEACO: Yes. I could comment a little bit. On page 14 Mr. Meehan -- I guess the comment is attributed to Mr. Meehan -- in the text compares this to the New York example, indicating that a more detailed review of model results including having commission staff review the inputs and outputs of the models would be representative and cites the New York example as an example of where that has gone.

I acknowledge that in New York and in some other instances that is a commission practice to do that. It's my experience that that's not the typical practice and it's not done in every case. And I think it's a very intensive exercise to do and is not typically -- it's not typical of every review of a utilities cost, based on my experience.

So it's a condition on case by case and the choice of the commission is to engage in that.

Q.22 - Thank you, Mr. Peacock -- sorry -- Peaco. At least I didn't call you Mr. La Capra. Finally, Mr. Marois, at page 4 of the Meehan-Strunk report, and it's under paragraph bullet number 4, they contend that Disco has no financial stake in the payments made to Genco, nor any incentive to minimize those payments. Do you have any comments with respect to that statement?

MR. MAROIS: Yes, I do. I guess I totally disagree with that statement. In order to achieve its objectives such as having competitive rates and paying down its debt, Disco has a strong financial incentive to minimize the payments it makes under the PPAs. Disco's operating committee members ensure compliance of the PPAs.

MR. MORRISON: Thank you, Panel. That's all I have with respect to rebuttal, Mr. Chairman, and the panel is now available for cross examination.

CHAIRMAN: Good. Thank you. I am sure Mr. Lawson will take us through to lunch and beyond. Whenever you are ready, sir?

CROSS EXAMINATION BY MR. LAWSON:

MR. LAWSON: Thank you, Mr. Chairman. Before I proceed with the panel, perhaps I could just point out to the Board pursuant to yesterday or the day before's comment with respect to the exit fee issue, I have looked at that question again. I wasn't exactly sure how we were supposed to proceed with this, but I just wanted to indicate to the Board that I have looked at the question and have a I guess what I describe as a view that's different from that which has been advanced as a possible interpretation.

I don't know if it's intended for the Board to hear my opinion on the matter at 2:00 o'clock or if you were just looking for people to identify if they had some issue with respect to it by 2:00?

CHAIRMAN: How did we leave that, Mr. Gorman?

MR. GORMAN: My recollection was that anybody who wished to put forward a theory that was different than the one I put to the panel was to I guess speak to the Board and I guess explain their interpretation of the section. I think you had asked that perhaps that might be done today.

CHAIRMAN: Did I not put the caveat on it if we were complete with this panel?

MR. MORRISON: I somehow -- and I can go and check, Mr. Chairman, but I thought it was next Thursday, but that's fine -- or sometime next week. But we can do it whenever it pleases the Board.

MR. GORMAN: Mr. Chairman, if you didn't put that caveat on it, it's not too late.

CHAIRMAN: Thank you, Mr. Gorman. You are being very clear today. And I think I will put that caveat on it, rather than interrupting this. We will find time and, Mr. Lawson, you will get the opportunity to address it.

MR. LAWSON: Thank you, Mr. Chairman. I just wanted to make sure that that --

CHAIRMAN: Well, thank you for bringing it up.

Q.23 - Perhaps I could start with the A-96 chart or sheet that was prepared by Mr. Kennedy. And just a few questions with respect to it.

Firstly, Mr. Kennedy, the column 1, 2006/2007 figure, I presume that that reflects, those pricing for the fuel costs in line 1, reflect the actual fuel costs for -- that were established in October 1st for the Genco supplied power, is that right?

MR. KENNEDY: Yes. Actually they were developed in -- actually on August 18th prior to October 1st.

Q.24 - The pricing was developed on August 18th for the April 2006/2007 period?

MR. KENNEDY: Yes.

Q.25 - And then with respect to the second column, the 2005/2006 figure, we have had revised -- and I haven't had a chance to compare the numbers -- have had revised figures given for the 2005/2006 period. You have indicated these are the budgeted amounts. Would any of these change in the second column as a result of the restated, I will call it, budgeted amounts?

MR. KENNEDY: Yes.

Q.26 - And could you identify for us what changes there would be? Would there be a significant number of changes?

MR. KENNEDY: Yes. The following would be subject to change and always with respect to actual costs. The line 1, when you were talking about budget versus an actual, actual could be different than that. And again --

Q.27 - Do you have the numbers -- have there been numbers developed for the purposes of the more updated forecast that has been supplied to the Board?

MR. MAROIS: I guess we have put on the record, being IR-261, table 2 we show the aggregate change in purchase

power. But we don't show the details. But the 907 million
900 that we see in column 2, last line of A-96 based on
our Q3 forecast is now estimated to be $824 million.
Q.28 - And I take it then the breakdown with respect to the
various components for that new total is not available, is
that correct?
MR. MAROIS: Well, we haven't provided it. But in IR-261
that I just referred to, we explain the key elements of
that change. But we have not provided the level of detail
you have got in A-96.
Q.29 - From what you do have available to you can you tell us
what the line 1 item variation would be as a result of the
revised budget, since it is a pretty significant piece of
this?
And I presume, given the explanation for the variation,
that that line has changed significantly. Would that be a
fair assessment?
MR. KENNEDY: We don't have that information here at this
time.
Q.30 - Is it something that you could undertake to supply at
least with respect to item 1?
MR. KENNEDY: Yes.
CHAIRMAN: I think, Mr. Lawson, some members of the panel

would like you -- as I understand it, you now have all of that information. If you are able to come up with the ultimate figure of 824' you know its component parts.

Why not just refile this on an undertaking basis reflecting the actuals and projected to the end of the year.

MR. KENNEDY: Yes. I will do that, Mr. Chairman.

MR. LAWSON: Thank you, Mr. Chairman.

Q.31 - Staying with the A-96 chart for a moment, looking specifically at the export benefits component which we do know has changed, at least in the second column rather significantly, but I notice that in the original budget for 2005/2006 there were -- you had anticipated a credit of $77 million.

And then in the end it grew by another I think $42 1/2 million, if my memory serves me correctly. I noticed in forecast for 2006/2007 that the $77 million figure of last year is anticipated to drop by $7.6 million.

Can you identify why that was forecast to take place, particularly given that I understood that the $77 million figure had been done based on historical information and what kinds of things have happened in the past to make the decision what 77,000,000 should be?

MR. KENNEDY: First of all, in 06/07 the export benefit is prescribed in the schedule 6.3 of the PPA. It's a number that is wired into the contract. And in 05/06 the contract had prescribed an amount that was -- I believe it was, subject to check, $7.2 million -- $72.9 million.

And there was an estimate with respect to the conditions that were occurring at the time that budget was set that there would be additional export benefits that would be shared with Disco. And they show up as a third party purchase benefit to make up the difference to bring you to the 77,000,000.

This is not the case with respect to the 06/07 budget. The export benefits are not going to be in excess of the amount that is prescribed in the contract.

Q.32 - I apologize then. Under the PPA then, the concept of the 50/50 sharing after a 20 percent variance which applied in 05/06 does not apply subsequent to the 05/06 period? Is that what you are saying?

MR. KENNEDY: No. It does apply. But the forecast, the revenue forecast from exports in 06/07 is not going to be such. It's going to be -- in fact at the time of budgeting at the level somewhat below what the prescribed amount was in the power purchase agreement.

Q.33 - Okay. So the $69.4 million could very well -- in fact I would suggest to you, may very well change?

MR. KENNEDY: That depends on the conditions of the market. But generally this is what was done with respect to looking at the forwards at the time as well as the opportunity it was in the export market at the time that the budget was set.

Q.34 - And did I understand you correctly that the figure under the PPAs or the base amount if you will for the export benefits in 05/06 was $72 million roughly?

MR. KENNEDY: 72.9.

Q.35 - Right. But yet it moved down to 69.4 in the subsequent year. Do you know why that was the case?

MR. KENNEDY: That is basically prescribed in the contract. When we set the contract back in October the 1st, 2004 --

Q.36 - Right.

MR. KENNEDY: -- there were five years that were set with respect to export credit guarantees by Genco.

Q.37 - I was just wondering if you know why the contract contemplated a decrease in the amount under that PPA for what I will call the base amount for the export benefits?

MR. KENNEDY: No. I'm not familiar with it at that time. These are prescribed items that are in the contract.

MS. MACFARLANE: I can add to that. The forecast that was done to support the numbers that, to quote Mr. Kennedy, were hard-wired into the contract, was done in -- prior to

October 1st obviously.

And at that time, based on market conditions and based on what was predicted to happen with our system over the five years that the numbers were derived, dictated a lower export amount.

And I believe it was because the capacity factor -- even back in '04 we anticipated the capacity factor for Lepreau would be lower than in 05/06 and consequently there would be less energy available for export.

Q.38 - But I would presume then the panel would agree that this 69.4 figure could indeed rise -- as a credit rise and could in fact, at least based on the 05/06 period, could rise significantly. Is that a fair statement?

MR. KENNEDY: Yes. But it also could go down. There is risk-sharing with respect to going on the opposite direction.

Q.39 - After 20 percent, is that correct?

MR. KENNEDY: Yes.

Q.40 - So it would have to go down by $14 million before there would be any consequence on Disco for that base amount?

MR. KENNEDY: Yes. If that's --

Q.41 - Roughly?

MR. KENNEDY: I would have to check the numbers.

Q.42 - 20 percent of 70,000,000?

MR. KENNEDY: Yes.

Q.43 - You have to check all of my numbers. I think that is right.

This number in the PPA, the $69.4 million figure, I take it that that was a number -- was that a number that was subject to negotiation between the parties, with Disco and Genco?

MR. MAROIS: The PPAs were not negotiated. I think the evidence shows that the PPAs were set by a working group and were as a result of restructuring.

Q.44 - Okay. So Disco wasn't at the table saying, that is not a number we want, we think it should be a different number. That wasn't the way the process worked?

MS. MACFARLANE: If I may, that wasn't the way the process worked. And I think we provided both in our evidence and in response to an IR that NB Power's role was to provide data and modeling support to the working committee. The bankers did the models. But NB Power provided the underlying numbers and also would have done due diligence to ensure that the numbers that they were using were consistent with our own modeling coming out of PROMOD.

Q.45 - Now knowing I guess what you know now, or given the fact that we are closer in time at least to the 06/07 period, at this point would Disco expect that the $69.4

million will in fact likely be a higher amount?

MR. KENNEDY: We have performed another assessment of that based on the forward prices of January 29th, is it -- just recently, and run the PROMOD run again, predicted with respect to the forwards at that time as well as the condition in the New England market. And again the benefits -- the export benefits have not -- are not going to exceed the 20 percent upper threshold with respect to the conditions that are occurring at that time.

One of the items that you have to look at too is with respect to the -- what has changed. One thing that has changed between '05 and '06 and '07 is the availability of certain units. And as Ms. MacFarlane mentioned with respect to the Point Lepreau, the capacity factor is falling off, and therefore that makes -- creates an opportunity where the generating units -- there is less generation available for the export market. More of it has to be used within province. So that affects the PROMOD run in the analysis. So that is what the latest is, we have done another check on that with respect to the third party purchase benefit.

Q.46 - I guess given the extraordinary spike, as I believe it was described, something of that nature, in this past fall, that things can change particularly when you are trying to predict the future.

MS. MACFARLANE: I think we indicated the other day that you certainly could not call the events of last fall anything except extraordinary on two fronts. It is not typical that we would have the level of rainfall in such an intense -- in such intense amounts and such a short period of time as we did in the fall. But more importantly the events in the markets triggered by Katrina are anything but ordinary and not something that we can base our future forecasts on.

Q.47 - I guess that was my point, is that that was an extraordinary event that happened that presumably you weren't able to predict last summer was going to occur, and you don't know what might occur as well on a go forward basis.

I would like to move to the La Capra report, specifically the presentation made yesterday, just a few questions with respect to it. It's A-95.

Just -- in a number of places there is reference to the word "reasonable" through the report and the presentation of yesterday. Am I correct in my understanding that this report was not designed to, nor does it in fact reflect on whether or not the price of power that Genco is supplying to Disco is in fact reasonable relative to a market place, is that right, Mr. Peaco?

MR. PEACO: Reasonable relative -- I'm sorry?

Q.48 - To a market based price. The third party supplier kind of pricing.

MR. PEACO: No. The reasonableness criteria that we were applying was were the calculations and assumptions used in a reasonable range relative to the interpretation of the PPA.

Q.49 - Right. So the PPA dictates to a certain extent what the inputs are to be, correct?

MR. PEACO: That's correct.

Q.50 - And then you have reviewed the inputs to insure their correctness, if you will, or --

MR. PEACO: Their reasonableness.

Q.51 - They are reasonably -- because there is some -- some of those are not in fact merely easily quantified numbers plugging into a formula under the PPA, correct?

MR. PEACO: Yes. We -- numbers like that we verified that they were in a reasonable range, but there is obviously some of those primers could be some slightly different number but still be a reasonable estimate.

Q.52 - So it would be fair to say that -- and this is as I understand it what you were engaged to do, but it would be fair to say that you could have reached the conclusion of reasonableness that you have here and yet the price of power itself relative to the market place, open market purchase of power, could be completely unreasonable, is that a fair statement?

MR. PEACO: Sure. The analysis here simply is what is a reasonable price outcome of this contract given the formula as specified. How that marks to the market is an entirely different question.

Q.53 - Right. And not an analysis you have done here obviously?

MR. PEACO: That's correct.

Q.54 - I will just move a little bit. I want to move specifically to sort of the fuel price component, and one of the things that I had heard the President of NB Power as I'm calling it indicate is that initially the statement was that all of the increase being sought here today was being driven by fuel prices. Then I think there was some qualifier that may have been put on that.

Looking at the numbers presented in this report, or this overhead or the summary if you will, La Capra report, I gather that that indeed is not the case and if I just look at the -- again A-96, the quick summary, it appears as though $89.6 million would be fuel related out of the I think $126,000,000 request, is that a correct assessment?

MR. PEACO: Is that a question to me or to Mr. Kennedy?

Q.55 - Anybody who would like to answer I guess.

MR. PEACO: The short answer is you are correct. As is shown in A-96 and as more -- in the more aggregate fashion as depicted on my charts from yesterday, there are a number of components. You know, the lion's share of the variance is fuel but there are many other moving parts.

MR. MAROIS: Maybe just to add to that, on line 6 interruptible, that line item is being driven primarily by fuel costs.

Q.56 - Okay. So that would total about $103,000,000 or something just on the variance component, assuming that all the variance at 13.4, which I believe was explained as being principally fuel given, that would be about $103,000,000?

MR. MAROIS: Yes.

Q.57 - And that's out of $126,000,000 of the request for increase, is that correct?

MR. MAROIS: Yes.

Q.58 - Now -- I'm sorry. Mr. Kennedy?

MR. KENNEDY: Yes. You were just referring to line 13 with respect to the difference being 125.9?

Q.59 - Yes.

MR. KENNEDY: Yes. You weren't including the nuclear portion of it.

Q.60 - Sorry. The 126 number you are referring to?

MR. KENNEDY: Yes.

Q.61 - The 126 number is merely what I got off the application in the additional revenue being sought.

MR. KENNEDY: Okay.

Q.62 - I'm sorry. As opposed to the 120,000,000 total, so --

MR. KENNEDY: Yes.

Q.63 - I understand -- am I correct in understanding that what is being sought here is $126,000,000 in additional revenue, Ms. MacFarlane?

MR. MAROIS: Yes.

Q.64 - Again looking at the La Capra report, I'm going to call it, there is in here somewhere -- where I should have had my fingers able to quickly put on it -- an indication of the percentage of the increase in the fuel as a percentage of the cost.

CHAIRMAN: Mr. Lawson, you are not referring to the La Capra report.

MR. LAWSON: No.

CHAIRMAN: It's the slide presentation.

MR. LAWSON: Yes. As I call it. Sorry.

CHAIRMAN: So that's A-95. Maybe you should --

MR. LAWSON: Yes. I'm sorry. I won't be referring to the report in any of the detailed reports. It will all be with respect to this one.

CHAIRMAN: All right. Well just refer to it as A-95.

MR. LAWSON: Okay. Sorry.

Q.65 - In A-95 somewhere, Mr. Peaco, I believe there is some indication that there was an increase in fuel prices of -- there it is -- on page 28, the fuel price increase in heavy oil of 56 percent and natural gas of 34 percent, where do those numbers come from?

MR. PEACO: Those percentages are a comparison of the market quotations for those prices that we used in computing the prices in the two respective power budget years the day that the prices were settled. And as you may recall, I described yesterday that there is two components to the fuel. There is the hedge adjustments and then there is the market quotation at the day they set the vesting price. This is a comparison of the market price quotations at the day they set the vesting prices between the two budget years.

Q.66 - Okay. Well my public display of ignorance shall commence now if I haven't already. It partly goes to this issue of the hedging component. Maybe I will -- well why don't we deal with this hedging issue at the moment and then it will help me understand perhaps a little better about the other component that is left for the determination of pricing. So --

CHAIRMAN: Mr. Lawson, I'm going to hedge my bets and say that this is probably a good time to break for lunch.

MR. LAWSON: And I'm going to -- more than five minutes.

CHAIRMAN: When you get into that you will need some time. Okay. We will come back quarter-after-one.

MR. LAWSON: I knew I would make you hungry for more.

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

CHAIRMAN: Any preliminary matters?

MR. MORRISON: Yes, Mr. Chairman. Three undertakings to have entered. First one is undertaking number 4 from February 14th, for an explanation of the increase in the capacity payments.

CHAIRMAN: My records indicate that is A-110.

MR. MORRISON: The next one, Mr. Chairman, is undertaking number 5 from February 14.

CHAIRMAN: That is A-111.

MR. MORRISON: And finally, Mr. Chairman, it is undertaking number 8 from February 13 regarding the Transmission costs in the fourth quarter.

CHAIRMAN: That is A-112.

MR. MORRISON: And that is all, Mr. Chairman. Thank you.

CHAIRMAN: Thanks, Mr. Morrison. Any other preliminary matters? If not continue with your examination, Mr. Lawson.

MR. LAWSON: Thank you, Mr. Chairman.

Q.67 - Out of concern that the -- dealing with an exciting subject like hedging right after lunch might cause a heart attack or something, I'm going to start a little more slowly. Perhaps -- and I again apologize for my basic questions. But I'm just trying to get a better understanding of how things work.

In terms of the arrangement with Genco for the supply of power to Disco, how is there a determination as to the source of power that is going to be supplied to Genco? Or does it matter to Genco -- or to Disco whether it comes from high fossil fuel cost or hydro power, its source of power that goes to Genco -- or sorry, to Disco?

MR. KENNEDY: Generally the -- yes, it does matter. And it's determined through the PROMOD. And the contract also outlines how the process is to evolve.

Basically it's done through an economic dispatch of the units, taking into consideration the cost to run the units, the generation cost and taking in -- to factor in any contractual arrangements or constraints there may be with respect to other generation facilities, for example the Heritage PPAs.

But generally it's done on an economic dispatch basis to come up with the cheapest cost source of generation to serve in-province load first. And then what is left over after the in-province load requirements are met is used to create opportunities in the export market.

So the PROMOD is a model that does the dispatch with respect to determining the generation to serve in-province load as well as export load, and is done on an economical dispatch basis with the exception of any items that are identified in the contract, the PPA, Genco PPA.

Q.68 - For a layman like me does that mean that as a rule the cheapest power that can be generated by Genco is the power that is supplied to Disco?

MR. KENNEDY: Yes, it is with the exceptions of must run units. For example hydro of course is a must run unit. And it's a zero cost energy source. And the nuclear unit is a must run, if it's available to run.

And any arrangements that we have made with respect to other -- or that Genco has made even with respect to other contracts must run. And then from there on it's a hierarchy of economical dispatch with the cheapest units being used first to serve in-province load.

Q.69 - Okay. Then how does it work -- an explanation was given that in 05/06 there is anticipated to be a much larger export credit than expected. And part of the explanation is hydro.

Now again, pardon my ignorance, but how is it that hydro ends up being the power that gets exported? Or I'm presuming it is hydro power that was getting exported, to have caused that extra profit if you will or extra credit. Is that correct? Or is that incorrect?

MR. KENNEDY: It is not as simple as that, you know. It depends on what units are available or what units are operating at the time that the actual sale occurs or that the loads are being served. What we are talking about now is the actual situation but what is occurring on a day by day basis.

So what we are referring to here now is not what was used to set the test year with respect to the 06/07 budget but what is actually happening with the hydro situation in the province at this time.

Q.70 - So at the end of the year or at some point in the year I presume a calculation is done for the export credits. And in doing that what is the determinant of the power -- in order to get a credit you have to figure out what your cost was to know what the surplus was if you will. Those terms may be the wrong ones. But I just don't know what goes in in terms of the cost of power for exporting to determine whether or not we got more than we expected by way of export credits.

MR. KENNEDY: We basically go back through and do an assessment. There is a PROMOD run done -- not a PROMOD run. We assess it through our scheduling system with respect to the actual gross margin that determines the cost of the generation to serve the export load versus the actual opportunity costs that are the actual costs that you basically are able to obtain through your sales on a day by day basis or on a week by week basis.

So it's after a fact assessment of what units were operating to service the export load with respect to the cost of those units, the operation, compared to what the revenue was obtained with respect to these sales or contracts.

Q.71 - So is it possible that some of the hydro -- sorry, some of the power that is being supplied in the export market is in fact hydro power, and shall I say perhaps some of the cheapest power? Is that a fair assessment?

MR. KENNEDY: Basically from a -- it basically is a calculation that way. But that's the way it's settled or determined, that you would have the in-province load that's required in that day or that hour. And then the units that are serving that are priced or where the generation comes to serve the in-province load.

And when the loads are down the hydro is up. Very significant generation is available. And Lepreau is running. And the loads have been lower than normal for this time of year.

The dispatch -- following the dispatch would show that some hydro and some hours goes out on the export market, therefore having in those hours having a lower cost of generation, and therefore creating a greater opportunity or spread with respect to the gross margin. So those export benefits come back to the in-province customer from a sharing point of view.

Q.72 - Okay. Again my ignorance has been well publicly displayed. You have got $42 million more in export credits this year than expected. How did that number get figured out?

I mean, I just don't understand -- I just don't understand. You know, the PROMOD is a concept that is I gather extremely complicated in how it works. I don't understand how it works. And I just need to have a sense. Are you saying that if right now in New Brunswick we are running certain facilities and then we decide to export, that those facilities that are supplying power into the New Brunswick marketplace, it's the incremental costs of whatever it is are source for the power that is being exported that is factored in as the cost?

MR. KENNEDY: Yes.

Q.73 - Okay. And is it the total cost of operating? Or is it just the marginal cost of the operation?

MR. KENNEDY: It would be the marginal cost of the operation.

Q.74 - Okay. And is that marginal cost going to be cheaper than the rest of the power, normally cheaper than the rest of the power that is being supplied into the New Brunswick marketplace?

MR. KENNEDY: In some hours, yes.

Q.75 - Generally speaking?

MR. KENNEDY: Not generally speaking, no. Just in a few hours.

Q.76 - So most of the time this is the most expensive power that NB Power is generating that is being exported?

MR. KENNEDY: Yes.

Q.77 - And that cost is then what is charged against the revenue to see what profit there is in the export market, is that right?

MR. KENNEDY: Yes.

Q.78 - Just back to the -- sort of the determination of the first part of the equation which is the assets that are being used for the purposes of supplying power into New Brunswick. Again the principle is that the cheapest source of power is the first source of power with the exception of the must run units, is that right?

MR. KENNEDY: Yes.

Q.79 - And is there any variation from that in terms of the minimum requirement purchase volume, if you will, or minimum power purchased during the course of the year from any particular source?

MR. KENNEDY: Basically -- maybe I wasn't clear, but there is -- we basically operate Point Lepreau on the basis of must run. If there is any of our -- Disco's NUGs that have to operate with respect to renewable, then we would run those, and then there are some Genco heritage PPAs that are -- the situation is where there is outlined in the Genco PPA that they will be treated as must run units, and they are used first. And then the cheapest sources that are available from Genco come into the dispatch to serve the remainder of the load up to the load for the in-province.

And generally after that those units that are -- the more expensive ones go out -- if it's oil for example or some hours there is other units that are on the export market, depending on what the load is.

Q.80 - Okay. Well if that's the case -- I'm moving back to the export market then -- if hydro capacity is sort of the place where the actual par because you are having to run certain of the facilities because of these other commitments, variety of other commitments, the NUGs or whatever, if hydro power is the place from which the export power is coming, do you say that we will take that hydro power cost, which is relatively cheap, and put it into the in-province costs and move some of that more expensive power that we have to run on a must run basis, or equivalent to a must run basis, and charge it as the export part?

MR. KENNEDY: No. No.

Q.81 - So you could in fact be exporting hydro -- cheap hydro power and supplying more expensive power here in New Brunswick to the market place in New Brunswick to Disco, is that right -- or Genco could?

MR. KENNEDY: Yes.

Q.82 - And the consequence of that is though that if there is any savings to be had, if you will, more money to be made in the export market, that you get at best 50 percent of it, isn't that right?

MR. KENNEDY: Yes. That's the next point I wanted to make, that the -- that energy that is out on the export market is used to determine the export benefit credit and the -- if there was additional benefit above the threshold, the 20 percent, then 50 percent of it comes back to distribution and customer service, or Disco.

Q.83 - With the exception of the 20 percent margin?

MR. KENNEDY: With the exception of the 20 percent margin.

Q.84 - So what you could have is the expensive power being supplied into New Brunswick and Genco basically keeping 50 percent of the profit on that other power, the hydro power that might be supplied in the export market?

MR. MAROIS: I guess one thing we must never lose track of is Disco is benefitting 100 percent from the projected export margins that are built into the PPAs. So what you are talking about is the variance.

Q.85 - That's right.

MR. MAROIS: I just don't want to lose track of that.

Q.86 - There is the variance and then the 50 percent on top of that. So that -- if as a result of selling this cheap hydro into the U.S. or export market, in doing that Genco makes $55,000,000 in profits, I think it was last year, it may have nothing to do with this source, but they can make -- they get to keep 20 percent, possibly all or conceivable at least half of all of that extra profit?

MR. MAROIS: That's what is built into the PPA.
Q.87 - That's right.
MR. MAROIS: I just want to make sure that the record is clear. Definitely Disco has benefitted from better export margins, or will benefit from better export margins, in 05/06 in part because of more -- of better hydro, but it does not mean that it's hydro that is being exported. Because I mean in layman's terms, everything else being equal, if you have got more hydro in any given year you got more generation, and by having more generation you get potentially more excess generation to export.
It doesn't mean necessarily it's the hydro that gets exported but that's part of the equation. You get more generation to export. And the fact you have got more hydro may change the hierarchy of the different generators, but again it doesn't necessarily mean that hydro is the one that gets exported. And so that's part of the equation. The other part is naturally the price you get for and the demand for it.
Q.88 - Sure.
MR. MAROIS: Because you have got excess generation there is demand. I just want to clarify that. Yes, hydro is a contributing factor but it does not equal the fact that it's hydro that's being exported.

Q.89 - I guess my only point is, and I think -- correct me if I understand it wrongly, but my only point is is that because of a commitment to buy power -- Disco's commitment to buy certain power from certain generation facilities, that regardless of cost they -- that cost is what is being supplied into the New Brunswick market. And it's the power beyond that that then is available for the export market, regardless of what its actual cost is to produce, high or low. Am I correct in that general statement?

MR. KENNEDY: Yes, that's as per the PPA, the existing structure that's outlined in the Genco PPA.

Q.90 - And then just to follow it to its conclusion, that if cheap energy is being -- cheaper produced energy is being exported, that the benefit of that export market is shared with Genco and Disco, not all credited to Disco, correct?

MR. KENNEDY: Yes.

Q.91 - Okay. Thank you.

MS. MACFARLANE: Could I just add, Mr. Lawson, that getting hydro into the exports is very unusual. As Mr. Marois pointed out, what happens is that if there is additional hydro, it just bumps up the economic dispatch so that Belledune and Dalhousie are more available for export as opposed to coal which increases the margin.

Because we had such extraordinary high hydro between

October and December there were -- and we had very low load because of the warm weather, there were actually instances where the load was such that after those must run units, the NUGs and Lepreau, hydro actually did serve all of in-province needs and there was some to export, and the other units were back down. But that's a very unusual situation.

Q.92 - I guess the principle that I was looking at is that the -- there is an obligation to run certain facilities and supply it into the New Brunswick market place. Whether it's hydro that becomes the surplus power or because of water or whatever, there are other sources of power that are exported, and that the cost of that power is what is used for the factoring of any profit, if you will, regardless of -- you don't say the cheapest power goes to the customers of Disco. You say the cost of these particular sources of power are costed into New Brunswick to Disco customers regardless of whether they are the cheapest power or not.

MS. MACFARLANE: That is true as it goes to the Genco NUGs, the renewable energy and Lepreau. That is not enough to serve the in-province load, but that -- those ones are a must run and in-province ratepayers do pay for those.

Q.93 - Now we will move to the fascinating subject of hedging, again something on which I know very little. But am I correct in my understanding that the purpose of hedging generally, would you agree, is to try to take out some of the volatility in pricing that might -- of whatever it might be in this case, fuel, the volatility that can occur in a market place?

MS. MACFARLANE: Yes.

Q.94 - Now does Disco actually purchase any fossil fuels?

MS. MACFARLANE: No, it does not.

Q.95 - Okay. So while the price of its power is very much dependent upon fossil fuels, it actually doesn't do any of the purchasing. That's done at Genco, I presume.

MS. MACFARLANE: Actually Disco is responsible for the fuel costs of the Coleson unit, but under the PPA it appoints Genco as its agent for purchasing that fuel. The rest of the fuel of the thermal units in fact is not Disco's responsibility. It's just purchased energy and so Genco is responsible for that.

Q.96 - Okay. And I guess -- I presume it goes without saying that fuel -- fossil fuel is a significant component of the operating costs of Disco? I don't know if operating cost is the right thing. The costs of Disco at least.

MS. MACFARLANE: Through purchase power, it's a significant portion of the purchase power expense, yes.

Q.97 - In fact am I correct in my understanding that -- would it be more than 50 percent of the fuel -- sorry -- of the purchase power costs are in fact fuel costs? Is that a correct number?

MR. MAROIS: I believe it's 44 percent.

Q.98 - 44 percent?

MR. MAROIS: For 06/07.

Q.99 - It's certainly I presume the single largest component -- single component in the cost factoring?

MR. MAROIS: Yes.

Q.100 - By some margin, would that -- by a significant margin, is that -- would that be correct?

MR. MAROIS: Well if you look for example at A-96. I mean in column 1, 06/07, line 1 the fuel cost is 449 million. And how I came up with the 44 percent was that number divided by the last number on that column, the billion 28'.

And then when you look at that column, the next single largest number I believe is 268 million on line 7 which is the capacity charge paid to Disco. So you are correct in your assertion.

Q.101 - So it is certainly a very significant cost to Disco, fuel. And I think it would be a safe statement to say that the price of fuel is volatile, has been over the last

-- at least the last number of years, the last couple of years anyway?

MR. MAROIS: That's probably an understatement.

Q.102 - Yes. That is why I figured it was a safe statement. Just out of curiosity, there was reference earlier in I believe Ms. MacFarlane's evidence that hedging fuel was not always the practice of the company. When did NB Power per se start hedging roughly?

MS. MACFARLANE: I believe it was 1999 or 2000.

Q.103 - Okay. So Disco has -- for the only fuel that Disco is responsible for is the Coleson Cove fuel. They have designated that or appointed Genco to be its supplier basically or purchaser of it, is that it?

MS. MACFARLANE: Yes. That's under the PPA.

Q.104 - Okay. And then the rest of the fuel cost, I will call it vulnerability, rests with -- in terms of the price vulnerability, rests with Genco itself which is a pass-through to you?

MR. MAROIS: Based on the PPA, the vesting -- the energy price is set on October 1st and is fixed for the following year. So the price is fixed.

Q.105 - The price is fixed. But the fuel price component, you are responsible for it. As to when it is determined is another issue. But you are responsible basically for absorbing the cost of the fuel price, is that correct?

MR. MAROIS: It's built into the power purchase cost, yes.

Q.106 - Right. Yes.

MS. MACFARLANE: But just to be clear it is not a pass-through. Because once that vesting energy price is set, whether fuel prices go up or down during the year, Disco is protected from that. They have a fixed price per megawatt-hour.

Q.107 - And consistent with that is -- Mr. Marois indicated on February 9th that there are procedures in place to control the fuel cost for Disco. I don't know if those are the precise words. But is that correct? Would that be generally a correct statement of what you had indicated, Mr. Marois? Do you remember?

MR. MAROIS: I do not remember that.

Q.108 - Would you say today that there are what you would describe as controls in place to sort of deal with the issue of Disco's vulnerability on fuel costs? Is that a fair statement?

MR. MAROIS: Are you referring to the issue of volatility?

Q.109 - Yes.

MR. MAROIS: Yes. Because there are two key ones. One like --

Q.110 - Yes. That was my next question.

MR. MAROIS: -- Ms. MacFarlane mentioned is the price is set as part of the PPA on October 1st. But in addition to that we have mandated Genco to hedge on a monthly basis so that really you -- smoothing is not a word.

But rather than rely on fixing the price at one day of the year where you don't know what that price may be, by locking in each month you really eliminate even more the exposure to fluctuations at any given date.

Q.111 - You say you have mandated Genco to do this. What is the basis upon which you have the ability to mandate that to Genco?

MS. MACFARLANE: There is a group of company policy calling for us to eliminate whatever financial risk we can. Given that by the very nature of the business that the operating companies are in, there is a significant amount of operating risk.

The policy calls for the entities to use whatever mechanisms are available on the market to reduce financial risk, specifically in commodities, interest expense and in foreign exchange. That corporate-wide policy applies to each one of the units. Both Genco and Distribution have exposure in those areas. And they both use the policy. Disco has asked Genco to do that on its behalf and manages that two ways, one through -- they are both sitting on an enterprise-wide hedging committee. And the other way is through the Operating Committee.

Q.112 - Okay. So when you say that it has been mandated, Disco hasn't mandated this except with respect to the Colesonco component, is that correct?

MS. MACFARLANE: No. I don't think that's quite the right characterization. The corporate-wide policy calls for each of the two companies to manage their financial risk in the commodities, foreign exchange and interest expense. Disco has chosen this -- instead of executing hedges on its own it has chosen to ask Genco to hedge on its behalf. But the method of hedging is done to Disco's advantage. Genco is exposed on and after October 1st only, okay. So theoretically Genco could, when it sets the vesting price on October 1st, it's based on forwards. That day it could go out and hedge all those forwards. And it would be protected.

Disco on the other hand does not want to take the risk of what might be happening in the market on any particular day. So Disco asks Genco or contracts with Genco to hedge on its behalf on a monthly basis so it averages into a price that takes out some of the volatility and risk of picking a particular day.

So both companies are under a corporate policy that requires them to hedge. Genco's needs are different than Disco's. So Disco asks Genco to do it in a particular manner so as to protect the setting of the vesting price to Disco's advantage.

Q.113 - But can Disco dictate to Genco to do that with respect to other than Colesonco's fuel? In other words can Disco say to Genco, you must -- under the contract we have the right to say you must hedge it in a certain way?

MS. MACFARLANE: I don't believe that it's covered in the contract. But they have a separate agreement, Disco does with Genco. And Genco has agreed to follow their instructions.

Disco has a requirement under the corporate policy to manage its financial exposures to natural gas, heavy fuel oil, foreign exchange. And it contracts with -- in the case of the commodities, Genco, and in the case of the foreign exchange, Holdco, to perform those hedges in a particular manner that meets Disco's needs.

As I say, if Genco is hedging on its own, its particular risks are different. And it would hedge in a different manner. But Genco has agreed to approach it from Disco's perspective. Because it is -- it doesn't matter to Genco one way or another, as long as post October 1st the price risk to them is eliminated.

Q.114 - But isn't it correct that Genco follows the corporate policy for hedging? And that is why they follow it, not because Disco has said, you are to do it this way?
MS. MACFARLANE: It is correct that Genco is required by corporate policy to hedge. But as I said before, their exposure only kicks in once the vesting price is set. As you are --
Q.115 - I recognize that.
MS. MACFARLANE: -- leading up to a particular year, they know that when the vesting price kicks in that that -- any movement in the forward markets up until that point in time, they are protected from.
Disco has that risk. But once they set that vesting price they have exposure. So if Genco is hedging on its own behalf it would hedge on the day they pick the vesting price.
Q.116 - Perhaps we can get into a little more detail of how the hedging program is in fact working. Just structurally then, there has been mention about a hedging committee which I understand you are the chairperson?
MS. MACFARLANE: That's correct.
Q.117 - Okay. Who is on that hedging committee?
MS. MACFARLANE: It's a two-tier committee. There is representation from any of the -- there is representation

from Corporate, I chair it, and our Treasury group which serves all the companies out of Holdco is on the committee as well.

There is representation from each of the companies that do have exposures under the policy, as I say, interest rate, foreign exchange rate risk or commodity risk.

At the current time the representation includes representatives from Genco and from Disco. When I say it's a two-tier committee, the policy group is at the Vice-president level. So the Vice-president of Genco and the Vice-president of Disco are on the committee.

And from an operational perspective the people who actually do the forecasting of the predicted requirements and who actually execute the hedges and do the documentation and so on are I believe at the director or manager level out of Disco and out of Genco.

Q.118 - Now as I presume the big decisions are made by tier 1?

MS. MACFARLANE: The policy decisions are made by tier 1. The decisions as to how much to hedge each month is made based on the analysis that the operating group makes.

Q.119 - Okay. And is that -- is the decision by each of those two-leveled committees done by consensus or by vote? Or how does it work?

MS. MACFARLANE: It's done by consensus.

Q.120 - So if Disco said, we don't think that is the right thing to do, and given that we have the greatest vulnerability here, would the others -- have you had experience where the others would agree that they will follow Disco's decision on that?

MS. MACFARLANE: In the situation that you mentioned, remember that this is a corporate-wide policy. So it would be the corporate representatives who would determine whether through that decision Genco is in compliance with the policy.

If they were in compliance with the policy and chose to make that decision, it wouldn't matter whether Genco agreed or not, Disco would be able to make its own decision.

The example you mentioned though, they would not be in compliance with the policy. And this is a Board-level policy.

Q.121 - My understanding is from previous evidence that the way that this is being done is the hedging is being done once a month?

MS. MACFARLANE: That's correct. It's on a rolling 18-month period.

Q.122 - Okay. So I don't believe the policy actually addresses the timing of the hedging, is that right?

MS. MACFARLANE: The policy addresses the time frame of the hedging. I don't believe it addresses the timing of the hedging. It does indicate that we are to ensure that we have managed our risk over the coming 18 months.
It does not suggest the methodology other than it limits us to certain types of instruments and it limits us to certain exposure levels. But it does not talk about the frequency.

Q.123 - Now would you perhaps explain to me -- and again I don't know anything about the hedging markets as well. So when you are saying it's being pushed out once a month for 18 months, is a determination being made -- let's say it's the first of the month and I don't know when it is but let's say it's the first of any given month -- how much is it determined will be hedged in terms of volume, if you will, volumetrics I think the policy speaks of?

MS. MACFARLANE: This is where to some degree the operating committee is involved, because each month the PROMOD, the production modelling is done to look out 18 months at what the load is likely to be and therefore what the fuel requirements are likely to be given the dispatch of the units for that eighteenth month.

Q.124 - Okay.

MS. MACFARLANE: And that then -- and there would be an opportunity for input from members of both Genco and Disco in that regard. Once that is determined that is brought to the hedging committee and the decision is affirmed that in fact that amount would be hedged. And too to the extent that that revised load forecast and economic dispatch forecast has led to any changes in amounts throughout that 18 month period that have already been hedged, there is a top-up or a draw-down shall we say of the existing hedges.

Q.125 - So the starting point is that whatever is estimated through PROMOD to be needed by way of volume in the eighteenth month from now will be 100 percent hedged, is that right?

MS. MACFARLANE: The policy actually calls for hedging of 80 percent of predicted exposures and 100 percent of what we call known exposures. So outside of the approved budget year the hedging is done at 80 percent. Once we are into an approved budget year or once we are into the risk being more certain, as in the case of the date that the vesting price is set, we are hedged at 100 percent. So throughout the year -- for example right now we have just hedged August of '07 which is not included in the budget year. That would have been hedged at 80 percent of predicted requirements.

And once we got closer to this fall where we are actually setting the budgets and setting the vesting price, then we would top up the remaining exposures by the other 20 percent to bring our hedging going into the budget year to 100 percent of predicted requirements.

Q.126 - So are you actually using the 80 percent figure or are you using between 80 and 100 and in some cases saying, let's take it to 100 of the -- 100 percent of it for 18 months from now rather than waiting for another closer to the vesting period?

MS. MACFARLANE: No. We are using the 80 percent period -- 80 percent number, I'm sorry, until we get to the time when the budget is set and then we do the top-up of the additional 20 percent.

Q.127 - And is there any trading of these hedging contracts of fuel?

MS. MACFARLANE: Our policy specifically does not allow that. It forbids any speculative activity.

Q.128 - Okay. Now again as a layman I look at that and I -- chatting with Mr. Grayson for example, his terminology for it was -- and I thought it particularly appropriate -- was pushing the wave. Essentially what you are doing today is saying, look, let's have established today what the price of substantially all of our fuel will be in 18 months from now.

So instead of buying the fuel today for today you are saying today I'm going to buy the fuel for 18 months. How does that hedge the way? Doesn't that just push the price increases that are taking place down further down the road?

MS. MACFARLANE: The primary objective of the policy -- the group-wide policy is to ensure predictability and to allow for appropriate budgeting and particularly in the case of Disco to determine the degree to which a revenue requirement hearing is in fact having to be held.

It's to -- remember when we were here in the fall, I remember a demonstrative statement by the Jolly Farmer saying that he knows his fuel prices far enough in advance to set his sales prices, why doesn't NB Power. Well we do, and that's why we do hedging is to ensure that predictability, particulary given that it is such a big portion of the costs of the total entity and has such an impact both on the bottom line of the entity and on rates for customers.

Q.129 - Wouldn't you agree that that -- while you achieve that predictability that it in fact doesn't really do much of anything in terms of giving you the prospects of lower fuel prices, it only pushes out the prospects of a delay on higher fuel prices?

MS. MACFARLANE: That's correct. The objective of the program is not to save money, though I will say that the forward markets tend to shave off the peaks and valleys from the spot market. It tends to never get as high as a spot market, it never gets as low as a spot market either. So there is some reduction in volatility that takes place by hedging. But the objective is not to save money. The objective is not to beat the market. The objective is predicability and to some degree to reduce volatility.

Q.130 - I'm just curious, when you have such a substantial portion of your costs dependent upon fuel, why has there not been a determination that you should at least review some or part of your hedging policy to try to save costs rather than depend upon reliability?

MS. MACFARLANE: We have had significant reviews done of our hedging policy. In fact the formation of the policy was done in consultation with external experts in the field. And done in light of the utility a) being a regulated entity and b) not being in the business of predicting fuel prices. In fact if any of us at the utility were experts in predicting market prices for fuel we probably wouldn't be working at the utility.

Q.131 - You would either be unemployed or rich, depending.

MS. MACFARLANE: That's exactly right. That's exactly right. That said though, most recently we had an audit done of our hedging program to ensure that it did meet the needs of the utility, that we were following it from a compliance perspective and that it would meet regulatory purposes, particularly in light of the no speculation and the fact that we are not equipped to take a price view. In fact even when the markets take a price view they often lose.

Q.132 - So just -- and I don't know sort of what the pattern has been, but I recall that the sort of most recent fierce spike in fossil fuels took place starting primarily I believe last summer, and then really took a nice spike shortly after that, and natural gas followed a similar kind of pattern, September being sort of the beginning of the real peak.

Is it safe to say then that you would expect that in about 18 months after that time frame we are going to start seeing -- you are going to start seeing or Genco is going to start seeing significant cost increases in their fuel for those particular months?

MS. MACFARLANE: We were hedging 18 months out during those months. So yes, there would be an impact down the road

for those.
Q.133 - So if and when prices drop in the market place, for example as we have seen in natural gas, you won't see the benefit of that -- I haven't asked you if you hedge natural gas yet -- but if you hedged natural gas in the same way you wouldn't see the benefit of that for another 18 months?
MS. MACFARLANE: As I mentioned a little bit earlier, the forwards tend not to spike to the degree that the spots do, neither up nor down. So there would be some buffeting of that effect. But yes, you are right, there is a price wave that will catch up in the 18 month cycle, yes.
Q.134 - Is there any actual hedging of natural gas?
MS MACFARLANE: There is -- through the Genco NUGs there was exposure to Disco of natural gas. They do not purchase natural gas but the price coming out of those NUGs is based on natural gas indices. So there is exposure for Disco there and Disco does have Genco hedge those exposures.
Q.135 - Okay. And using the same push the wave approach?
MS. MACFARLANE: That's correct.
Q.136 - 18 month out kind of approach as well?
MS. MACFARLANE: That's correct.
Q.137 - Now I noticed in the A-95 document that the profit

on -- I will refer you to the page specifically. Page 29. No, it's not 29. Page 30. It identifies the hedging variance estimates. Was that for example heavy fuel oil of 17.8 million dollars? Did I understand correctly that that was a profit on the hedging or something of -- I don't know -- is profit the right term?

MS. MACFARLANE: I will let Mr. La Capra --

Q.138 - Yes. He sort of looked like he was looking to you.

MS. MACFARLANE: I will let him answer the second part of the question, but -- or the first part of the question. But the second part of the question is profit is not the right term. We do not make or lose money on hedges. It is simply a measure of setting -- building predictability into our costs.

Q.139 - I just wanted to know what is this number then, or what are these numbers?

MR. PEACO: The numbers in here are actually -- they are variances in the hedge settlement positions year over year. So this is the differential between the 05/06 budget and the 06/07 budget. These are --

Q.140 - Budget for hedging itself? I don't understand yet. Sorry.

MR. PEACO: Okay. At the day that the vesting price is set --

Q.141 - October 1st.

MR. PEACO: October 1st. All of the hedges are laid in. So the fuels are fully hedged. And there is a settlement of the fuel and the hedges at that point. So there is a value put on the hedges at that point and that value is built into their budget. And it's a separate line item in the numbers we reviewed --

Q.142 - Right.

MR. PEACO: -- from the then current market price forward for that fuel. And so in each of the budget amounts that we looked at, there was a separate amount for the value of the hedge positions at that day, and that's included as a credit or a debit in the vesting price. But it's a separate line item from the then current market value of the fuel that was purchased. So those are separated. And this is just a variance year-over-year from that amount settled on the two days.

Q.143 - Well the Board looks like they understand but I don't. But I am going to go back to that in a second because this sort of movement to hedging arose as a result of your reference this morning to the question of whether or not the -- sort of these two components to the pricing on October 1st.

Now there is this issue that there has been 80 percent

hedged and as -- on the fossil fuels, and as you move closer to the time 100 percent is hedged by October 1st, correct?
MS. MACFARLANE: That's correct.
Q.144 - So when -- shouldn't it be a simple mathematical formula to figure out what the fuel cost component will be for Genco's supplied power for April 1st to March 31st of the following year where you now have hedged 100 percent of your fuel capacity -- of Genco's fuel requirements?
MS. MACFARLANE: It is -- I hesitate to use this term but it's probably simple to determine what those components of the fuel cost are, because in fact the price is set by virtue of the hedging contract.
Q.145 - Right.
MS. MACFARLANE: I don't know if you could call the whole exercise including the production modelling and the economic dispatch simple, but again I will let Mr. Peaco speak to that.
Q.146 - Let me deal with the first part then because it's what I am more interested in. There is the -- because a significant portion of the calculation is fuel costs, that part then on October 1st, that price has been determined, correct, for what the fuel component would be for -- on a go forward basis for that next fiscal period?

MS. MACFARLANE: For the fuels that are hedged.

Q.147 - Right.

MS. MACFARLANE: I will -- I just want to be careful with our use of terms here. The prices for the heavy fuel oil and the amount of heavy fuel oil to which we have hedge commitments is known. That is the same for the exposure to natural gas. The coal costs are known because it is tendered through -- under the Public Purchasing Act prior to the setting of the vesting price. So it too the price is known.

Q.148 - Right.

MS. MACFARLANE: The production modelling that is done as we get to the point of setting the vesting price is going to bring in some of the other variables in economic dispatch and some of those quantities might change slightly. But certainly the price part of the formula as it goes to the in-province load is going to be known.

Q.149 - Okay. So then back to Mr. Peaco's comment about the market price component on the October 1st day, how does that factor into the equation, or why does it factor into the equation?

MR. PEACO: Well let me try it again.

Q.150 - Okay. And I apologize but --

MR. PEACO: No, that's fine.

Q.151 - If I don't get it the second time we will leave it.

MR. PEACO: Let me back up.

CHAIRMAN: I will interrupt because looks can be deceiving, it's probably a good idea -- I think what was happening is I was thinking about when we should take a break and it looks right about now.

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

CHAIRMAN: Go ahead, Mr. Lawson. You better start that series again.

MR. LAWSON: Sorry. Start which? Being serious?

CHAIRMAN: Not the whole thing.

Q.152 - Okay. Where was I. Well, I am sure that everybody in the room probably remembers what the question was that was about to be answered. So I probably won't bother repeating it. But just in case somebody does forget, it was really around the question, Mr. Peaco, of the -- what relevance market price has considering the fuel price has been pre-determined basically by October 1st?

MR. PEACO: Yes. Let me try that again. See if I can -- in general concept, my understanding of you -- the premise of your question if we get to October 1, we have taken a position we are fully hedged. We know what the price is, why don't we just go from there. What is the market price have to do with it?

That analysis is correct, but for one thing. Is the setting of the vesting price in -- and the analysis in PROMOD includes the forecast of the gross export margin, which we discussed earlier with you. And to do that calculation requires some then current market information. So what happens in putting -- setting up the PROMOD run is that at the day that they settle the prices, instead of stopping at the logical point that you are wanting to stop at, they go a step further and say we have taken a set of fuel positions and we know exactly what our fuel expenses for the coming budget year. What's the market value of that position? And the market value of that position will be something different than whatever you have paid over the 18 months to get to that point.

Q.153 - Depending on what happened in reality to the market in that meantime?

MR. PEACO: That's right. That's right. So, you know, if you go and say, if I went out and I bought the same -- all of that commodity on that day --

Q.154 - Right.

MR. PEACO: -- it would be some different price --

Q.155 - Sure.

MR. PEACO: -- than the collected price of the hedged position you had taken to that point. So the differential is effectively is the value of the hedges that you took, either plus or minus. But in setting up the PROMOD runs that Genco does to set the vesting price, they use the market price forward for those fuels at that day in the model, because one of the things the model is doing is computing the exports. And it's using at the same time a forward electric market price from New England on the same day.

So in order to put PROMOD on a basis where it is looking for export opportunities with the true opportunity costs -- for example, once you have hedged that position on that day, you wouldn't turn around and sell. Let's say that the cumulative effect of buying hedges for oil meant that your embedded costs or your costs of that fuel was $50 a barrel. If the market price for oil that day was $75 a barrel, you would sell it for 75, not 50. And so -- and that's the concept where PROMOD takes the 75, puts it in and says if we are going to sell power for export, we are going to sell it at the then current market not at what we paid for it. And so that opportunity cost modelling goes into PROMOD.

And so what happens is for PROMOD modelling purposes, the actual cost of the fuel, you can know for certain on October 1 is broken apart into what is the market value for the fuel on that day. And the residual between the cost and the market is the -- is either the credit or debit due to the hedging that had been done. That credit or debit is carried through as a separate line item in the budget accounting. So you don't lose it. But the PROMOD model is set up to do the opportunity cost-based export analysis that is necessary to make that estimate. And so it's just breaking that apart into its two components and tracking them separately through the modelling.

Q.156 - And is this only with respect to that volume that is with respect or anticipated needing for the export market?

MR. PEACO: I am sorry?

Q.157 - Is it only with respect to the volume of fuel that will be required for -- or expected to be required for the export market that we are dealing with? Or is it for all the fuel that they have hedged we are talking about?

MR. PEACO: In terms -- the question again, please?

Q.158 - You have talked about looking at the export -- you have to factor in the export market, because of this issue of the export market and how much you would in fact sell that fuel -- how much that fuel is worth for the export market if you hadn't hedged, correct?

MR. PEACO: Yes.

Q.159 - And is that differential which you speak a factor with

respect to all of the fuel that is considered for the purposes of calculating the price for the subsequent fiscal period or is it only with respect to the calculation of how much credit there should be -- anticipated credit there should be for the coming year for export?
MR. PEACO: The hedged amount, it was hedged based upon the volume expected for in-province load.
Q.160 - Only?
MR. PEACO: That's my understanding.
MR. KENNEDY: Yes. Only for in-province hedged.
Q.161 - Okay. I recall that now.
MR. PEACO: But PROMOD is obviously dispatch -- actually dispatching the median province load, interruptible sales and the export opportunity. So it is set up to have that opportunity cost structure. And so in looking at the -- this is a complication that is important for that export analysis, but obviously confusing this discussion. The variance -- the variance that we talked about here is the difference in the hedged settlement positions that we were -- that were tracked separately through PROMOD from the mark to market fuel price that was used when they set the fuel price.
Q.162 - Leaving aside the export credit component is it fair

to say then that the fuel price in October 1st, based on the hedged volumes that have been put in place for 100 percent for in-province requirements, that there are no -- you don't need to consider the market price with respect to that part of it, aside from the export market -- export credit?

MR. PEACO: That's correct. I mean for the in-province load, it's basically fixed price at that point.

Q.163 - Right. Now again is the -- Ms. MacFarlane, you had indicated the PPAs actually have a predetermined price, or I believe it was you, and in A-96 it refers to the $69.4 million for 06/07. Is that a number that is actually in the PPA or calculated based upon the PPA?

MS. MACFARLANE: That number is in the PPA. It's in Schedule 6.3. When PROMOD is run in setting the vesting price, the export that is expected to be achieved -- the export margin expected to be achieved falls out and it is compared to the amount that's in the PPA. If it is greater by more than 20 percent, then there is a sharing of the amount by which it is greater. And that's how -- you will remember Mr. Kennedy said in column 2, that there had been a $5 million extra amount in setting the budget for 05/06, that's because the amount in the 05/06 PPA schedule was 72.9 million. PROMOD was run. Exports were going to be greater than 72.9 million. So the formula was applied to determine the sharing.

In the case of 06/07 when PROMOD was run, exports were actually expected to be less than 69.4, the amount in the vesting contract. But the sharing of the down side was not. The formula didn't bring any risk to Disco, because the down side was within that 20 percent band. So Genco took all of that down side.

Q.164 - But I presume that there is sort of an end of year reconciliation done on that account, is that correct?

MS. MACFARLANE: There is actually a monthly reconciliation done of the account, yes.

Q.165 - So when this is -- when this calculation is done on October 1st with respect to this market price for the actual oil -- or mostly oil -- for export market, it's only for the purposes of determining whether or not on a then look forward basis your projected amount of 69.4 or whatever it might be on exports is reasonable?

MS. MACFARLANE: It's to determine what amount goes into setting that Genco total and therefore the total purchase power cost for Disco. So it sets the number to go in line 8, whether it's directly out of the contract or whether it includes some adjustment for that sharing. And line 8 is part of the total purchase power cost that forms part of the budget and part of the revenue requirement. The top up or draw down during the year based on actual results is a variance against budget.

Q.166 - So it's the best guess on October 1st with respect to the export credits?

MS. MACFARLANE: That's correct.

Q.167 - And when doing this market price on October 1st for that purpose, is it the spot market price that is being used? Or what price is actually being used for the export market component?

MS. MACFARLANE: There are forward market prices off the New England market.

Q.168 - For the test year if you will?

MS. MACFARLANE: For the test year on each month. And I believe month by month. It might even be more specific than that.

MR. KENNEDY: Yes. Month by month.

Q.169 - Month by month. Just back to the hedging if I could for a moment. When you are doing the hedging are you actually buying the fuel or buying hedging contracts?

MS. MACFARLANE: We are buying the financial contract.

Q.170 - Okay. And there is a quote, unquote "premium attached" with respect to that? I don't know whether it is direct or hidden. But you would agree --

MS. MACFARLANE: It's hidden.

Q.171 - It is hidden? Okay. Any sense of how much you pay annually by way of premium for this hedging component?

MS. MACFARLANE: It depends on which expert you ask. The consultant that we used, who is independent of the markets -- this is Risk Advisory Services out of Calgary who helped us set up the program -- believes that there is no cost embedded in hedges. Because if you were to look at the implied or imputed transaction cost in the forward price and then also compare it to the shading off of the peaks and the valleys, at the end of the day there is no cost. There are other experts who believe it's a size, a quarter or half a percent.

Q.172 - Does he have any other free stuff we could get from him?

So I'm assuming that there is not a large amount of capital then tied up as a result of the hedging program?

MS. MACFARLANE: There is no capital tied up.

Q.173 - Just before I leave it, would it be fair to say that if this was a competitive marketplace for electricity in New Brunswick, and there are other suppliers, that as a rule would you expect that most of those, I'm going to call it free market suppliers, would hedge in a manner different than you folks are hedging and would in fact, quote, unquote "play the market" if you will on pricing as opposed to just pushing the wave?

MS. MACFARLANE: I think it depends upon the risk profile of the organization, their internal opportunities and risk hurdles. And two, the environment that they are in.
As say the consultant that we used in setting up the program advised us that regulated utilities have very prescriptive and very risk averse hedging programs. And that's the approach that we have taken.

Q.174 - This would be described as somewhere between very and extremely conservative approach?

MS. MACFARLANE: It would be at least very.

Q.175 - Yes.

MS. MACFARLANE: I might mention -- I would just go back to my comment about the degree of operating risk of NB Power companies face.
Being in the nuclear business and particularly with an aging unit, being exposed to New England markets where we are a price-taker and there is a great deal of volatility, and having a significant hydro operation, there is large operating risk over which we have no control. And that's why the financial risk policy is very conservative.

Q.176 - The good news is I'm taking time scanning, because I have covered most of these bases. Not that I'm dreaming up more.

I would like to look just quickly at the fuel cost increase from 2004/2005 and the projected 2005/2006. Now my understanding from again the A-95 Power Point Presentation, and I'm looking at page 19, that there was a $65.1 million increase in -- is it fuel costs? Am I correct in using fuel costs when describing the coal, Orimulsion, natural gas and fuel oil? Is that right?

MR. PEACO: That's correct.

Q.177 - The $65 million is the increase from 04/05 to 05/06 for fuel costs?

MR. PEACO: That's correct.

Q.178 - Okay. And that is as compared to the 89 -- $90 million expected from 05/06 to 06/07?

MR. PEACO: Yes.

Q.179 - So the additional increment is forecast at the moment to be $25 million, in that neighborhood, 04/05 to 05/06 -- 05/06 to 06/07?

MR. PEACO: These are year over year variances?

Q.180 - Right.

MR. PEACO: Just a second. When you say additional increment I'm not sure if I know what you mean.

Q.181 - Okay. 04/05 to 05/06 is $65 million?

MR. PEACO: Yes.

Q.182 - And 05/06 to 06/07 is going to be $90 million?

MR. PEACO: Yes, on top of that.

Q.183 - That is right. So there would be $25 million in additional -- in the variance -- not in the variance over the years but incremental?

MR. PEACO: Yes.

Q.184 - Okay. Now in -- I haven't received an answer to my undertaking, the undertaking with respect to the revenue, additional revenue generated as a result of the 3 percent increase of March 31st of '05 and July 7th, I believe it was, '05. Is that being worked on or forgotten about?

MR. MAROIS: It hasn't been forgotten.

MR. MORRISON: I believe that was filed this afternoon, Mr. Chairman.

MR. LAWSON: Oh, this afternoon?

MR. MORRISON: Yes. It is one of the three that we put in I believe.

MR. LAWSON: I guess I got -- it is hard to believe I got forgotten. But I'm up here.

MR. MACNUTT: It is A-112.

MR. MORRISON: It is A-111.

MR. MACNUTT: A-111. I'm sorry, Mr. Chairman.

Q.185 - So I am assuming in the answer to A-111 identifies that the July 7th 3 percent increase was to generate $23.7

million, I am assuming that's because that it would be higher if it was on an annualized basis?

MS. MACFARLANE: That's correct.

Q.186 - Closer to presumably $30 million or thereabouts?

MS. MACFARLANE: That's correct.

Q.187 - So the rate increases that were implemented I am going to call it two 3 percents, which equal 6 percent, which isn't right but let's say a 6 percent increase for guys like me who like to keep it simple. That that generated on an annualized basis would have been in the neighbourhood of $30 million -- $60 million?

MS. MACFARLANE: I think those two numbers would indicate 53, would they not, 30 and 23?

Q.188 - It's 23 but that was -- I am looking at in on a fully annualized basis.

MS. MACFARLANE: Oh, on a fully annualized basis, yes.

Q.189 - So in the $60 million neighbourhood. And you had a fuel price increase at that same timeframe of $65 million. Correct? Just looking at page 19.

MS. MACFARLANE: That's correct.

Q.190 - Okay. And of course that incremental revenue of 60 million on an annualized basis would still be there this year as well, correct, with or without an increase?

MS. MACFARLANE: That's correct.

Q.191 - So really for fuel price increases, don't you only need another -- only -- I don't want to be disrespectful to such large numbers -- but $25 million more in additional revenue which would be something less than one of these 3 percent increases?

MS. MACFARLANE: The 60 million, shall we say, that arose from those two rate increases was there to cover the $65.1 million increase in fuel that year, but that base has stayed. The revenue has stayed but that cost has stayed as well and there is an additional 89 million in costs beyond that. The 25 million you are referring to is really a variance of the variance.

Q.192 - Okay. Good point.

MS. MACFARLANE: The variance year over year though is 89 million.

MR. MAROIS: So it is really -- to use your example, it is 89 million plus 5 million so it would be 93, 94 million, using your example.

Q.193 - I don't know where the 5 million came from but -- I was okay up to that.

MR. MAROIS: You calculated that the additional revenues in 05/06 was 60 million --

Q.194 - Right.

MR. MAROIS: -- and the fuel had gone up by 65, so it's a 5 million shortfall. Using your example that you would have to add to the 90 million of the subsequent year.

Q.195 - So two 3 percents, a 6 percent increase, although it's not quite right, but a 6 percent increase roughly generates about $60 million in extra revenue. So would I be correct in doing some quick math and saying a 9 percent increase would generate about the $90 million that would be needed then?

MS. MACFARLANE: To cover the fuel increase, yes.

Q.196 - Yes. Okay. Now I would just like to ask what Disco plans on doing with respect to trying to Disco and Genco -- in cooperation with Genco and other companies, I guess, plans on doing in trying to control its fuel costs in the future. And I would like to specifically refer to something that was alluded to in the press about at least one initiative being the attempt to come up with a fuel option for Coleson Cove. Are there other sort of initiatives, if you will, that are underway by Disco or Disco and others to try to defray those costs or reduce those costs?

MR. MAROIS: Yes, there is one great success story is -- and it is coal blending at Belledune.

Q.197 - Coal blending?

MR. MAROIS: Coal blending. So really what Genco has done in Belledune is they were successful in blending different type of coals and actually try to inject as much cheaper coal, sulphur coal as they could, to bring down the price. And their experiments have been successful. It is estimated that over the current year the savings is about $18 million. So just from blending different type of coals.

And really what was alluded to in the papers is trying to do similar thing at Coleson but with oil.

Q.198 - Just on the initiative then in Belledune, is that $18 million savings built into the costing for 06/07 test year?

MR. MAROIS: Yes, it is.

Q.199 - Okay. For the full year?

MR. MAROIS: Yes, it is.

Q.200 - And is there any expectation that in the 06/07 period that you might reap any benefit from the Coleson Cove potential source of savings?

MR. MAROIS: No, not during that year.

Q.201 - Is it expected thereafter -- some time thereafter?

MR. MAROIS: It's still to preliminary to say.

Q.202 - Okay. Any sense of the order of magnitude of savings that could be achieved -- projected to be achieved?

MR. MAROIS: Too preliminary.

Q.203 - Okay. Now I just again would like to go back a little bit to this concept of the fuel prices having been sort of known on October 1st and through the fiscal year. Ms. MacFarlane, you referred to sort of the risk resting with Genco with respect to the volatility of fuel prices during the fiscal year of relevance, whatever it might be. And I'm at a bit of a loss as to figure out where that risk lies, given that 100 percent of the volume has in fact been hedged for that full period.

MS. MACFARLANE: Let me start by saying that without a hedge they would be completely exposed and obviously --

Q.204 - Sure.

MS. MACFARLANE: -- they would not be able to tolerate that situation.

Q.205 - That part I have already figured out on my own.

MS. MACFARLANE: Okay. But once they are hedged then the exposure that they have to fuel comes from shall we say operational issues with the units because they may have -- the PROMOD may have predicted certain units would be on at certain times and because of difficulties or forced outages or problems with heat rates or what have you, Genco ends up being exposed to fuel beyond what they would have predicted in order to supply the load, and they are exposed to that. There are also --

Q.206 - Sorry. If you don't mind, just before we leave that. So they just may have -- something -- the variables that went into the PROMOD may not have been perfect in spite of all the efforts of all the experts?

MS. MACFARLANE: That's correct.

Q.207 - Okay. And similarly I presume it could be the opposite, that there could be less fuel required than anticipated, is that another potential --

MS. MACFARLANE: That's correct. Yes.

Q.208 - Okay. Sorry.

MS. MACFARLANE: As an example the heat rates are pre-set as one of the determinants that goes into PROMOD.

Q.209 - Right.

MS. MACFARLANE: If through productivity improvements Genco is able to beat that heat rate they get the savings. If they can't maintain that historical heat rate they have to pay the cost.

Q.210 - Okay.

MS. MACFARLANE: So it's that exposure that they are facing. And they also have exposure to load variations. As an example if Genco ends up calling for more power than what was in the original load or less, Genco is still providing it at that price and they have the underlying exposure both the hedges they have put on and hedges that they haven't put on. So they have some fuel risk there as well.

Q.211 - Okay. So just again the risk and the benefit both rest with Genco?

MS. MACFARLANE: That's correct.

Q.212 - They don't -- if there is some productivity improvement during the course of the year over the PROMOD anticipated amounts, then Genco doesn't share that with Disco?

MS. MACFARLANE: That's correct.

Q.213 - Neither in that year nor does it get reflected in the subsequent year, or does the PROMOD then say, you guys are doing better now, so we are going to put in these new heat rates that are better, the new and improved version?

MS. MACFARLANE: No. The heat rates were set on historical performance and they are fixed forever. And as I say if Genco slips in its productivity, Genco will pay, and if Genco is able to improve its productivity Genco will benefit from it. The same is true forced outage rates. They are fixed in the -- as one of the inputs into PROMOD in the contract. So if Genco is able to improve on its forced outage rate, Genco gets the benefit. If it can't meet that forced outage rate, it isn't making the appropriate capital investments, it isn't doing the appropriate maintenance and its forced outage rate is higher, Genco pays for that.

Q.214 - So any productivity improvements then, is that correct, is not -- isn't passed on to Disco at all?

MS. MACFARLANE: On those two factors, being the heat rate and the forced outage schedule, they are not passed on.

Q.215 - I'm sorry. What is that last one?

MS. MACFARLANE: The forced outage rate.

Q.216 - Forced outage rate?

MS. MACFARLANE: Yes.

Q.217 - Okay. Now I know what the words are, I just don't know what it is. That's okay.

MS. MACFARLANE: There is an allowance made for units to go off line unexpectedly for unanticipated maintenance problems or lightening strikes that bring the plant down, et cetera. And that is a factor called the forced outage factor. And that is preset in the contract as one of the inputs into PROMOD.

Q.218 - Now is the -- the heat rate, and again I have heard of it at least anyway -- is it -- you mentioned the savings on the blended fuel, coal and Belledune, is that a heat rate factor that reaps benefit for them or is it in fact a savings in fuel that goes directly down to you folks?

MS. MACFARLANE: That's a savings in fuel that goes through to Disco.

Q.219 - But if they fine-tune the burners and get a better product, or get more BTUs, then that doesn't reap -- you don't see the benefit of that, right?

MR. KENNEDY: The -- if they as a result of this produce more energy then of course there is more opportunity for export, and that has a chance to come back to us.

I would also like to emphasize that if there is any improvements with respect to finding fuels for Coleson Cove or any other fuels, that will be reflected in the fuel price and when the PROMOD is run again that definitely will be passed through to Disco, and the contract provides for that.

Q.220 - No. I'm speaking about heat rates specifically.

MR. KENNEDY: Okay.

Q.221 - And the heat rate itself, other than the potential indirect benefit in export, and it's only potential, that forever is cast in stone and any improvement doesn't get passed on to Disco at all?

MR. KENNEDY: That's correct.

Q.222 - Is -- and perhaps it's been explained and lost on me, not surprising if so, what the rationale was for having it fixed and any productivity improvements would be only for Genco's benefit and not for the benefit of Disco?

MS. MACFARLANE: I think it was one of the underlying concepts that -- again I wasn't completely involved in this, but the -- that the financial advisers and the industry experts brought to the table that in order to incent these companies to operate like real businesses they needed to have an incentive to take productivity improvements and to benefit from them.

As Blair has pointed out there is some flow through of that benefit to Disco, but I think it was the emulate a commercial environment for Genco and provide it with an incentive to improve its performance, and likewise to penalize it if it becomes sloppy in its performance.

Q.223 - Would you agree in -- as a general principle that in most open markets -- and we are not talking specifically of the power market at the moment -- but in most open markets if there is an increase in productivity commonly that is as a result of the competitiveness of business in the world, commonly some element of that is passed down to the benefit of the consumer, not necessarily out of benevolence I might add but perhaps because of the need to compete with others who are doing the same, but would you agree that as a rule in the open marketplace there will be some benefit passed to the consumer?

MS. MACFARLANE: It depends how competitive the market is.

Q.224 - Precisely.
MS. MACFARLANE: But, yes, I would agree with that, and perhaps that is how the bankers believe that having some part of this benefit flow through in the additional export credits would provide a benefit to the customer, being Disco.
MR. MAROIS: That being said though in a competitive market the players do have a strong financial incentive to reap the benefits of increased productivity. So competition by itself should benefit customers but each player will try to maximize its own --
Q.225 - If for no other reason for survival?
MR. MAROIS: Those are market rules.
Q.226 - Okay. Now just on the Canadian dollar issue, I presume most of the oil fuel products that are purchased by Disco or -- sorry, by Genco or Genco on behalf of Disco, that those are purchased in U.S. dollars?
MS. MACFARLANE: That's correct.
Q.227 - And there is a hedging policy with respect to U.S. dollars?
MS. MACFARLANE: That's correct.
Q.228 - And is it pushed the way of hedging?
MS. MACFARLANE: The same methodology and the same policy applies.

Q.229 - Okay. Now again the advantage of not having any money is you don't trade anything. So I don't trade U.S. dollars either. But I am curious, I do know that the Canadian dollar has strengthened significantly over the last, I don't know, 24 months or whatever it has been. As significantly to the point where quick math tells me it's increased about one/third in value over the last three years, going from 65 cents to 85 cents. Would that be roughly good math?

MS. MACFARLANE: Yes. I think the period might have been a bit longer than that --

Q.230 - Okay.

MS. MACFARLANE: -- but there has been a significant strengthening, yes.

Q.231 - Given that the pushed wave approach to hedging I presume that the dollar is hedged that there would have been lag time when you would have seen the increase in the strength of the Canadian dollar, but that you are now presumably pretty well fully there, is that right?

MS. MACFARLANE: That's correct.

Q.232 - Okay. Now I guess I don't understand, and maybe there is a reason for it and maybe it is in there, but given the value of the dollar the currency itself has increased purchased power by conceivably as much as a third, I would

have expected there would be -- that would soften the blow of much of the U.S. priced -- fuel pricing, is that not a reasonable conclusion?
MS. MACFARLANE: Yes. And it has.
Q.233 - It has without question?
MS. MACFARLANE: Over the four or five years that the Canadian dollar has escalated it certainly has, yes.
Q.234 - Just back again in 95 to the reference to the substantial increase in heavy fuel, this is page 28, I am sorry, substantial increase in heavy fuel at 56 percent and gas price is 34 percent. I am sorry, Mr. Peaco, those were of the market prices as I recall? I was still confused what you were dealing with at the time, but I think that's what it was.
MR. PEACO: Yes, those were the market price quotes at the time of the setting of the vesting price.
Q.235 - And is that in -- just on October 1st of what would be 2005, is that right? That amount? I don't know what 56 percent of what over what?
MR. PEACO: It would be 56 percent of the price on -- was it August 18, relative to the -- what was the date the prior year budget was set?
MR. KENNEDY: October. October 1st.
MR. PEACO: October 1st in 2004.

MR. KENNEDY: Yes.
Q.236 - So October -- August 18th '05 relative to October 1st of '04?
MR. PEACO: That's correct.
Q.237 - And that I presume is the same with respect to natural gas?
MR. PEACO: Yes.
CHAIRMAN: Mr. Lawson, can you wrap this line of questioning up so that we can --
MR. LAWSON: Wrap it up. Certainly, Mr. Chairman.
Q.238 - Certainly strengthening of the Canadian dollar than during the -- I am going to call it any test year if you will, any particular fiscal year, is 100 percent of the currency hedged as well?
MS. MACFARLANE: Yes.
Q.239 - So Genco again would not normally expect to reap any windfall, if you will, on currency exchange during that -- during the test year?
MS. MACFARLANE: For variances between budget and actual.
Q.240 - Right. And to the extent there is any variation again, that is neither -- if it's a negative push down to Disco nor if there is a gain is it passed on to Disco?
MS. MACFARLANE: That's correct.
Q.241 - And unlike export, there is no indirect access to you

getting that benefit?

MS. MACFARLANE: Well when the hedges are put on for foreign exchange, we are looking at our U.S. dollar exposure and that includes exposure to commodities, but there is a netting off of the benefit that we get from selling in U.S. dollars. So the net amount is hedged and to that effect -- to that extent the third party gross margin credit is --

Q.242 - May be impacted?

MS. MACFARLANE: -- is impacted, yes.

MR. LAWSON: I will end it there for now, Mr. Chairman. I won't be long in finishing up.

CHAIRMAN: If I remember correctly, you told me an hour.

MR. LAWSON: Well, I said I would be at least an hour. And I was right.

CHAIRMAN: I don't remember that late. You are pushing Mr. MacNutt on the exactness of estimation of examination time.

MR. LAWSON: Just -- to redeem myself, the last time I said I would be an hour and I was an hour. So I am being more consistent now.

CHAIRMAN: We will break now and reconvene on Monday morning at 9:15.

(Adjourned)

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