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Hearing April 13th, 2000

IN THE MATTER OF AN APPLICATION BY ENBRIDGE GAS NEW BRUNSWICK
INC. DATED DECEMBER 31, 1999, FOR APPROVAL OF ITS RATES AND
TARIFFS.

Henneberry Reporting Service

New Brunswick Board of Commissioners of Public Utilities

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IN THE MATTER OF AN APPLICATION BY ENBRIDGE GAS NEW BRUNSWICK
INC. DATED DECEMBER 31, 1999, FOR APPROVAL OF ITS RATES AND
TARIFFS.

Chairman: David C. Nicholson, Q.C.

Commissioner: Monika Zauhar

Commissioner: Robert Richardson

Commissioner: R. J. Lutes

Commissioner: Leonard Larocque

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

MR. O'CONNELL: Yes, Mr. Chairman. Two actually. Mr. MacDougall yesterday went through the list of undertakings from the day before and there was one that he did not mention. And I just wanted to remind both the Board and Mr. MacDougall of that one outstanding item. And it comes from page 278 of the transcript of the day before yesterday.

And that deals with the rate of interest that's being paid on borrowings from Enbridge Gas New Brunswick to Enbridge Inc.

And I'm sure just perhaps it was forgotten yesterday. But the item of giving us that information is still

outstanding.

Secondly --

CHAIRMAN: Mr. O'Connell, you are standing.

MR. O'CONNELL: I forgot. Force of habit, Mr. Chairman. I'm sorry. I don't feel nearly as articulate sitting down, if you must know.

The second item, Mr. Chairman, is the question of my learned friend's redirect. And I want to raise this now.

And I didn't raise this while he was delivering his redirect yesterday. Because to be fair to him, I didn't raise it when he had the opportunity to do direct examination of his witness.

And I want to do it now, so that if he wants to change his approach to the witness that is about to testify, he has time to do that.

I felt yesterday that my learned friend's redirect was inappropriate. To me redirect is examination that permits the applicant's counsel to raise items that were raised for the first time on cross-examination.

It is not an opportunity for counsel to split his case. It is not an opportunity for counsel to firm up items that were raised during direct examination.

As a matter of fact, it is not an opportunity for counsel to deal with items that he should have known were going to be raised during cross-examination.

On top of that I felt that the redirect yesterday was leading in the extreme. It solicited answers like yes, sir, no, sir, yes, sir, no, sir, which in my view are leading and inappropriate.

So to be fair to Mr. MacDougall what I want to do now is to say that if redirect of that nature takes place of this witness, I will be objecting. If redirect takes place that is merely to firm up this witness' testimony, I will object. If redirect takes place that solicits answers like yes, sir, no, sir, I will object.

I think that the redirect has to be limited. And I want my learned friend to know that now, so that if he wants to change his approach to this witness he has the opportunity to do so now.

CHAIRMAN: Thank you, Mr. O'Connell. If that eventuality arises, the Board will rule. I will say that in this quasi judicial or administrative tribunal setting with prefiled evidence, why the Board is loath to be terribly strict about ruling on redirect.

But certainly there are some rules that have to be applicable. I agree with that.

Any other preliminary matters?

MR. STEWART: Mr. Chairman?

CHAIRMAN: Mr. Stewart?

MR. STEWART: I just have one point. And I did discuss it

briefly with Enbridge counsel yesterday after we concluded. And it is -- and I thought it might be best to raise it now. And that is just some scheduling issues.

And I know it is a little premature because we don't know necessarily where we are going to be. But my thumbnail sketch is that there is a real possibility that we will conclude evidence today and tomorrow.

And I'm wondering whether it is appropriate or the Board would like to turn their mind to when we might do argument or just -- I just solicit the Board's views on how we would like to proceed in that fashion.

I guess my submission is that we may need some -- obviously some time between evidence and argument to prepare, don't need a great deal of time.

And it is -- I guess maybe I'm asking the Board to walk and run at the same time a little bit, because I want some time to prepare.

But I also would like to not come back, you know, two or three weeks down the road solely for the purpose of argument. I think it will begin to fade for us all on that point.

I would also, I guess -- part of this reason why this question is near and dear to my heart is that I have a hard conflict on next Monday and Tuesday.

CHAIRMAN: Well, the Board does as well. Some of the

Commissioners do.

MR. STEWART: Sure.

CHAIRMAN: So if we are going to conclude in sequence we have to do it on Saturday morning. I'm glad you are optimistic and believe that we will be done either today or tomorrow.

I think we are going to have to play it by ear. It is as simple as that.

The other thing is that if any of the informal Intervenors wish to make a presentation to the Board, the Board has ruled that they will have the opportunity as soon as the evidence closes.

Now to the best of my knowledge nobody has phoned the Board to find out when we felt evidence was going to close. So we may not have any informal Intervenors who do that.

However, I know that counsel for the applicant indicated to me at some break not too long ago that rather than adjourn as you say to say the 26th of April, which would be the next available date that the Board would have, that we go ahead without a break of the day or half a day that we had initially thought we would use to allow counsel to get ready, so that we are able to complete it all this week.

Any other comments from counsel?

MR. MACDOUGALL: Mr. Chairman, I think it is our position we would like to finish this this week if at all possible. And we will do all we can to do that.

Back to your first point, if I can very quickly, or the first point of the day, discretion being the better part of valour, I'm not going to follow up on Mr. O'Connell's comments.

I highly doubt that I will change my approach, which I think was perfectly fair. I certainly did not comment on his approach. I believe I had a lot of opportunity to do that.

If he has objections at anytime, he should raise them.

And when he raises them I will be more than willing to deal with them at that time.

CHAIRMAN: Well, as I indicated, if there is an objection the Board will rule on it at that time.

MR. STEWART: Mr. Chairman --

CHAIRMAN: Back to you, Mr. Stewart.

MR. STEWART: Yes. I just -- I guess what I'm -- if I could narrow it down as to what concern I think we may face -- and if Mr. MacDougall wants to go ahead he can do that.

But if we are in a situation where for example we finish at, you know, the end of Friday or 5:00 o'clock on Friday, I would be loath to come back with an argument beginning Saturday morning. I don't believe that is going

to give us enough time.

CHAIRMAN: Okay. Well, Mr. Stewart, I guess the best we can do is find out when it is in fact we complete the evidence and deal with it at that time.

MR. STEWART: Fair enough. Thank you.

CHAIRMAN: Okay. Mr. MacDougall? The witness hasn't been sworn, I guess.

MR. MACDOUGALL: No. That is correct.

CHAIRMAN: I cut the secretary off.

KATHY MCSHANE

DIRECT EXAMINATION BY MR. MACDOUGALL:

Q.1 - Now Ms. McShane, was the evidence that is at exhibit C of the applicant's rates binder, was that prepared under your direction and control?

A. Yes, it was.

Q.2 - And you adopt that as your evidence in this proceeding?

A. I do.

Q.3 - Are there any corrections to that evidence or answers to information requests that you have provided in this proceeding?

A. There is one correction that I would like to make.

That would be on exhibit E, schedule 64, page 4 of 10.

CHAIRMAN: That was exhibit E?

A. Yes, sir. Schedule 64.

CHAIRMAN: 64? Just a second.

A. And that would be page 4 of 10. If you are having trouble finding the specific schedule, it's behind all of these wonderful articles that were provided.

CHAIRMAN: I have it probably.

MR. MACDOUGALL: It is quite close to the back, Mr. Chair.

CHAIRMAN: 64. There is it. I did tab it. But I didn't write the right number on it. 64, page what of --

A. 4 of 10.

CHAIRMAN: 4 of 10. Thank you.

A. And if you come down to the next to the last company on the page Natural Resource Gas. I suppose it might be obvious that it's not an electric company, it is a gas company. And that's my only correction.

Q.4 - Ms. McShane, do you have a summary of your evidence today?

A. Yes, I do.

Q.5 - If you could proceed then, that would be terrific.

A. Thank you. The purpose of my testimony in this proceeding is to provide my expert opinion on the reasonableness of Enbridge Gas New Brunswick's proposed capital structure, cost of debt and return on equity.

The proposed return elements were evaluated within the context of the business risk environment and the proposed regulatory framework delineated by EGNB in its proposal and accepted by the Province in granting the franchise.

The return elements include a 50 percent debt, 50 percent common equity, capital structure, a cost of long-term debt equal to the yield on 10-year Canada's plus 250 basis points and a return on equity of 13 percent.

Specifically the proposed capital structure cost of debt and common equity return were assessed in light of the market development and competitive risk associated with a greenfield LDC, the key elements of EGNB's plan including market-based rates and pricing flexibility, a development period during which the company's returns will fall short of the proposed 13 percent and during which the company will have the ability to defer revenue shortfalls, the opportunity to recover the development period shortfall subsequent to the development period.

And in this context it is critical to recognize that the company's ability to actually have the opportunity to earn the proposed weighted average cost of capital requires that the shortfall be capitalized at the proposed weighted average cost of capital.

My evaluation also took into account the fact that the company intends to transition to a form of performance-based rates which would be more closely tied to costs subsequent to the development period and the fact that the company proposes no changes to the return on equity during the development period.

I also evaluated the proposed return elements in light of the somewhat higher risk operating environment relative to the typical Canadian LDC which results from the fact that this will be a smaller company, it will be operating in an environment with a less diverse economic base and it will face somewhat higher gas supply risks.

A critical premise of my analysis was the virtually universally accepted premise that the cost of capital is a function of the risks of the enterprise in which the investment is being made, not that of the entities making the investment. That premise, often referred to as the stand-alone principle, has been applied in virtually every regulatory jurisdiction in this country.

The cost of debt proposed by EGNB is a reasonable estimate of the stand-alone cost that EGNB would incur if it raised debt on the basis of its own business and financial risk.

The spread over 10-year Canada's is within the range that would be incurred by a firm with a debt rating in the B+ to B++ range.

By borrowing funds from an affiliate rather than from a bank, EGNB will have assurance that the funds will be available as needed and will be available on less onerous terms than would be available if it went out and raised the debt itself.

The proposed 50 percent debt, 50 percent common equity ratio is reasonable relative to those maintained by mature LDCs, recognizing the longer term business risk associated with the company's small size and inherently higher risk operating environment relative to the typical Canadian LDC.

The reasonableness of the 13 percent ROE was evaluated relative to the 10 to 11 percent returns currently allowed mature LDCs in North America.

In my opinion while these returns, particularly those for Canadian LDCs do not provide adequate compensation to the investor, I have accepted them as a relevant benchmark rather than examine in length the broader issue of a fair return from mature LDC.

A 13 percent ROE represents a premium of 2 to 3 percent over the ROE that have been allowed to mature LDCs.

Quantitative support for this premium, which provides investors compensation for the greenfield risk, was developed from several comparisons to alternative investment opportunities, including a comparison of equity cost for average risk versus higher risk mature LDCs.

Those analyses provide independent support for the differential between the 13 percent proposed ROE and the typical LDC allowed ROE.

- Ms. McShane - direct by Mr. MacDougall - 590 -My overall analysis appropriate and reasonable for EGNB taken together with its proposed 50/50 debt common equity capital structure.

Thank you.

MR. MACDOUGALL: Mr. Chairman, the witness is available for cross-examination.

CHAIRMAN: Mr. Stewart?

CROSS-EXAMINATION BY MR. STEWART:

Q.6 - Good morning, Ms. McShane.

A. Good morning.

Q.7 - I just have a question or two for you, quite frankly.

Do you have up there with you a copy of the other evidence that was filed, the exhibit A and B?

A. Yes.

Q.8 - Yes. All right. Can I refer you, please, to the now somewhat infamous schedule 7 of exhibit A, which I think is Enbridge's forecast year.

And my question, I guess, is this. If I could refer you to line 9, for example, of column 1, that's the 2001 test year.

A. Yes, I have that.

Q.9 - And don't get too wound up in these particular numbers,

I just want to make sure I understand how the process works. As I understand it -- because I just want to know where your piece of this puzzle fits in. As I understand

it Enbridge Gas New Brunswick is projecting a cost of service of about \$3.77 million in its first year. Is that correct?

A. Without taking into account the cost of capital.

Q.10 - Right. Okay. And that's where we are going to get to.

But I just want to make sure I have this terminology straight as much as anything. Again, as I say, just to see how you fit into this piece of the puzzle. We have \$3.77 million is their projected cost of service which is operations and maintenance, depreciation, taxes, et cetera?

A. Taxes other than income taxes, yes.

Q.11 - Right. Okay. And the numbers that you were talking about in terms of rate of return or whatever, they are reflected up in the cost of capital section?

A. Yes.

Q.12 - All right. So based on the recommendations or the opinion that you have given this -- and as I understand the application is that when you actually put hard numbers on your approach or your recommendation or your opinion for this test year, it comes to the -- it's a little different in a couple of places. But it's the 10.38 percent or the 10.375 percent. That's how your opinion reflects in this table?

A. Yes, generally speaking that's correct.

Q.13 - Okay.

A. The 10.38 percent reflects a specific estimate of the cost of debt which will have to be revisited when the debt is actually issued.

Q.14 - Right. I understand that. But as best we can, the forecast of how your opinion is reflected in this chart is reflected in this percentage. So we then take the rate base, which is 41,253 or 41 253,000, and then take a percentage of that to come up with the cost of capital of 4.28.

A. 38.

Q.15 - 38?

A. Yes.

Q.16 - Okay. I have 28.

A. 10 point -- sorry, maybe I -- I'm sorry, 428. You are talking about the dollar numbers. I'm sorry, I was focusing on the percent. I misheard you.

Q.17 - Yes. Okay. No, that's all right.

A. Yes, you are correct.

Q.18 - All right. Just so I understand then, whether or not -
- because as I understand it in test year the forecast deficiency never mind any lowering of the target distribution rate, is \$2.4 million after you get some tax benefits. That's the very bottom line, line 25?

A. That's my understanding.

Q.19 - That's your understanding, right. And part of this equation, or in this case part of the deficiency is that Enbridge will earn this rate of return even though for the year its revenues -- there is a significant revenue shortfall?

A. It will record the deficiency. And it will seek the opportunity to recover the deficiency, the cost of capital deficiency, if you will.

Q.20 - Right. But if we look at line 11, the revenue requirement, that's made up of in broad strokes three items. The so called cost of service which is the actual operations, maintenance, taxes other than income taxes, income taxes and then this cost of capital number which is, for lack of a better way to put it, your part?

A. Those are the items that make up the revenue requirement.

Q.21 - Right. So the revenue requirement of \$10.471 million includes your 10.38 percent?

A. Yes.

Q.22 - So Enbridge will then account for, as you said, its 10.38 percent whether or not it has enough revenue to meet its revenue requirement?

A. Yes. Because that's the very nature of this business. The fact that it has to at the outset invest large sums of money to undertake investments that will provide

benefits

far into the future.

Q.23 - Right. And to the extent it does not, as I believe you told me and as this chart demonstrates, meet its revenue requirement which includes its actual expenses and its cost of capital --

A. Correct.

Q.24 - -- those amounts will go into the deferral account?

A. That's correct.

Q.25 - Right. But those deferral accounts in and of themselves will also bear a carrying cost. Is that correct?

A. The deferral account will be capitalized at the weighted average cost of capital.

Q.26 - Right. This same 10.38 percent?

A. Correct.

Q.27 - So the 10.38 percent is applied in assessing the deficiency or arriving at the deficiency in any year, is that correct?

A. In the sense that it forms part of each and every year's revenue requirement, the cost of capital is taken into account in that year's revenue requirement.

Q.28 - Right. And to the extent that that revenue requirement is not met, those amounts go into the deferral account and also attract the projected rate or forecast rate of 10.38 percent per annum?

A. That's correct.

Q.29 - Right.

A. And if that does not happen, if those amounts are simply put into an account and do not attract the weighted average cost of capital, the company will not be able to actually earn in the longer term a return equal to the weighted average cost of capital.

Q.30 - And every year that balance or that annual deferral is in the deferral account throughout the development period it will continue to attract the 10.38 percent or whatever the weighted average cost of capital is?

A. That's right.

Q.31 - So it will grow throughout the development period?

A. That's correct. But there will be no cash flows from that. And as I said, until such time as the company starts to actually recover it, unless those amounts are capitalized at the weighted average cost of capital, the company will have been deprived of the opportunity to actually earn a compensatory return.

Q.32 - Okay. So that to the extent that rates are set in this hearing at whatever level they are set at, and Enbridge Gas New Brunswick doesn't meet its revenue requirement, the amounts will be put into a deferral account which will bear carrying costs or interest charges to the credit of Enbridge Gas New Brunswick of the weighted average cost of

capital which today you have set at 10.38 percent?

A. Correct.

MR. STEWART: All right. Thank you. Those are my questions for this witness, Mr. Chair.

CHAIRMAN: Thank you, Mr. Stewart. Mr Zed?

MR. ZED: No questions, Mr. Chairman.

CHAIRMAN: Mr. Holbrook?

MR. HOLBROOK: No questions, Mr. Chairman.

CHAIRMAN: Mr. Blue?

MR. BLUE: Yes, thank you, sir.

MR. O'CONNELL: Mr. Chairman, before Mr. Blue begins his cross-examination. In my view, it is not appropriate for Mr. Blue to cross-examine Mrs. McShane. As far as I know, there is no adverse interest between the Province and this applicant. I would categorize any cross-examination by Mr. Blue of this witness as a friendly cross-examination.

The witness said not five minutes ago that Enbridge proposed certain rates of return and other data to the Province and the Province accepted it. Allowing Mr. Blue to cross-examine this witness really only amounts to another direct examination of the witness, in my view, and it is not appropriate in this process to permit him to do that. Therefore, my suggestion would be that Mr. Blue not be permitted to cross-examine Mrs. McShane.

CHAIRMAN: Just so I understand, Mr. O'Connell, are you

suggesting that Mr. Blue not be able to ask any questions of this witness?

MR. O'CONNELL: Yes, that is precisely what I am suggesting.

CHAIRMAN: Mr. Blue?

MR. BLUE: Mr. Chairman, this is a public hearing. Under the Statute the Minister of Natural Resources and Energy of New Brunswick is by law a party to this hearing.

Under accepted and well known principles of Canadian administrative law, each party to a hearing has a right to be heard, to submit evidence, to cross-examine evidence of parties that have a different interest and to submit final argument.

The Province and Enbridge Gas New Brunswick have different interests. They are on the opposite side of the general franchise agreement. There is a tension between the Province's interest and Enbridge Gas New Brunswick's interest which must always be protected, and that is the reason the Province is represented in this hearing by counsel. If it was not a different interest there would be no need to be here.

If Enbridge does not meet the terms of the general franchise agreement, the Province has remedies which gets us into a zone which the Province does not even want to contemplate.

The Board in this hearing is entitled to have the

evidence of all witnesses on all relevant issues and the evidence that I want to adduce from Mrs. McShane is evidence that I need in order to make the argument that the Province wants to make to this Board.

There is no rule that says that a party that has a similar interest may not cross-examine. Mr. O'Connell has cited no authority for that. There is no rule that says that I cannot cross-examine a witness when the statute that you are under says that you must extend procedural fairness.

I submit the Board requires all the evidence that is coming before it in this hearing to make the decision and I want to help the Board do that, but mainly I want to get evidence that I need to make the argument the Province wishes to make to this Board in this case.

It is a most unusual submission from a Board counsel to try to muzzle a party to the hearing. I have never heard it before and I submit it is inappropriate.

CHAIRMAN: Mr. MacDougall, do you have any comments?

MR. MACDOUGALL: Mr. Chair, I guess I would have to agree with Mr. Blue. His interest -- he is representing the party who was an Intervenor from a long time ago. We have no problem with Mr. Blue cross-examining these witnesses. He is representing the Province of New Brunswick.

Also on a procedural issue though, I believe Mr.

O'Connell comes after Mr. Blue. If he feels there is any issues that were raised he is not prejudiced by them. He can continue to cross Mrs. McShane on evidence. If she adduces it a second time he has a right to cross-examine her on that.

I have no idea what Mr. Blue is going to ask this witness but Mr. O'Connell follows after and his cross-examination can be based on that basis

CHAIRMAN: Other counsel have any comments?

MR. STEWART: No, Mr. Chairman.

CHAIRMAN: Mr. Blue, when I -- I guess I anticipated that this might arise, and that occurred when I first read the general franchise agreement and the schedule attached thereto and some correspondence that accompanied it.

Now you have indicated, and I am just trying to canvass the various things that are in my mind about this before the Board retires and rules, but the infamous -- not the infamous, I shouldn't use that terminology -- but schedule E, part 2, can you assist me in finding that in the evidence right now? The essential elements.

MR. MACDOUGALL: Excuse me, Mr. Chair. In the evidence I believe the essential elements are just recorded in the applicant's exhibit A and then the general franchise agreement is attached to exhibit A. However, it doesn't have the exhibits because the exhibits were the proposal.

So I am sure I have a copy of the one with the exhibits here which I can --

CHAIRMAN: If you can find it, would you read into the record the first paragraph of that schedule of the essential elements?

MR. MACDOUGALL: Yes.

CHAIRMAN: Thank you.

MR. MACDOUGALL: I have it here, Mr. Chair.

CHAIRMAN: And this is in the context, Mr. Blue, of you saying you have a different interest and that is where I am coming from.

MR. MACDOUGALL: Mr. Chair, would it be more appropriate for you to read this into the record? Would it be more appropriate for you to read this into the record than myself?

CHAIRMAN: Thank you. The parties acknowledge that those specific items set out below were relied upon by the gas distributor as being integral to the proposal and

constitute
fundamental
terms of the
agreement.
The gas
distributor
and the
Province
confirm their
intention that
there shall
not be any
amendment by
the Board in
any way to
such items
unless the
Province and
the gas
distributor
have first
agreed to such
amendment.
These items
will apply to
and during the

development
period. And
then we are
all familiar
with what
those items
are.

I guess when I read that I said that -- to myself that there is no adverse relationship between the Province and the applicant concerning those essential elements, and I guess that's where I have been -- from the position from which I have been thinking anyway.

And you have said there is a different interest and the Province wishes to make argument as to the Province's position and presumably different from those particular elements. Perhaps you could enlighten us as to what the nature of that argument might be.

MR. BLUE: Well, Mr. Chairman, I said that the Province has a different interest from Enbridge. In this case in certain issues we support Enbridge. But I have a duty and I have a duty to my client and I have a duty to you to get the evidence I need to make that argument. It may be different from Mr. MacDougall's argument, but it's an argument that my client's interest has to make.

Now, sir, there are court decisions on this. There are court decisions that say that an administrative tribunal, if it lets one party cross-examine, must let all parties cross-examine.

The National Energy Board has ruled that eliciting information and clarification from witnesses is not friendly or sweetheart cross-examination. What I am doing I assure is entirely proper, and I assure you that if you

deny me that right you are denying the Province procedural fairness, which I submit is beyond your jurisdiction.

This is a most unusual request.

CHAIRMAN: All right. But I am sure, Mr. Blue, you will agree that in certain aspects of civil litigation where -- for instance, if you have an automobile accident case and there are co-defendants, one is the driver of the vehicle and the other is a passenger, and the solicitor for the driver hires an accident reconstruction engineer, et cetera, and calls him to the stand, the court is not going to allow the passengers' solicitor to cross-examine that expert.

MR. BLUE: The court will allow the passenger's solicitor to examine, it may not allow certain leading questions of the type Mr. O'Connell was talking about this morning. I do not propose to ask certain type of leading questions that elicit a yes, no answer.

But more importantly we are not talking about a motor vehicle accident here, we are talking about making wise decisions for this Province for 20 years to come, and I submit this Board needs all the evidence it can get on these issues to make a wise decision.

We are not relying on the essential elements agreement as a legal basis for saying award 13 percent, we are

relying on the evidence before you. And I am entitled to

bring out the evidence that I need to make my argument to try to persuade you on the merits that that is required, and that is what I am trying to do, sir.

CHAIRMAN: Before we retire, Mr. O'Connell, anything further you want to add?

MR. O'CONNELL: The only other comment I would make, Mr. Chairman, is that focus not on what Mr. Blue has said in the last couple of minutes, but focus on what he hasn't said. What he has said is that the interest of the Province is different than the interest of Enbridge. What he has not said is that the interest of the Province is adverse to the interest of Enbridge. And that is the key element of the decision the Board is about to make.

No adverse interest as between the Province and Enbridge, I suggest to you no cross-examination.

MR. BLUE: That is legal nonsense. This is a polycentric administrative law hearing. Every party has a different interest. They are not black and white. They shade in like colours of a Guido Molonari painting, everybody knows that, yet different parties with different interests cross-examine in these hearings. If you want law on that I am happy to get it for you.

CHAIRMAN: All right. The Board will retire. Thank you for that.

(Recess)

CHAIRMAN: The Board has taken some time to consider Board counsel's remarks. And we note that Mr. Blue has indicated that he is not going to lead this witness. And therefore you may examine the witness, Mr. Blue.

MR. BLUE: Thank you, Mr. Chairman.

CROSS-EXAMINATION BY MR. BLUE:

Q.33 - Ms. McShane, could you turn to your evidence.

MR. BLUE: Oh, before I start, sir, let me just do this.

What I have done -- what I have done, sir, is -- no, that is quite all right, sir. I am going to sit. It is just a reflex reaction.

Sir, because we have all had trouble finding the documents, I have taken all the documents I want to refer Ms. McShane to. And I have had them put together in a compendium.

And these are nothing but IR responses, pages from her evidence that are all neatly tabbed and indexed. And I'm going to refer to them by the tab.

I would like to hand those out to the Board and file that compendium as an exhibit. And then that will save us all a lot of time and effort as we go through this.

CHAIRMAN: Any counsel have any problem with that?

MR. MACDOUGALL: So long as it is the same document.

CHAIRMAN: I understand. They are the same documents. They are already --

MR. BLUE: There is one National Energy Board decision which I have given to Ms. McShane through Mr. MacDougall that she is aware of, but which I have not spoke to her about, that I have asked her to read in preparation for my examination, included in that brief.

CHAIRMAN: Counsel have any problems? If not go ahead, Mr. Blue.

MR. BLUE: I will ask Mr. Johnson and Mr. Parcell to hand those out.

CHAIRMAN: That will be C-15, Mr. Blue.

MR. BLUE: Sorry. E-15?

CHAIRMAN: C as in Charlie.

MR. BLUE: Thank you.

Q.34 - Okay. Ms. McShane, I note from your resume that you have a B.A., an M.A. and an M.B.A.?

A. That's correct.

Q.35 - Now Ms. McShane, you are testifying here about the topics of capital structure and cost of capital.

And what I wanted to know is whether those topics, capital structure and cost of capital, are they a specialized area in financial analysis that is probably not known to everyone that holds the same degrees that you hold?

A. I would agree with that, yes.

Q.36 - Okay. Now how many times have you been accepted as an

expert witness in the field of capital structure and cost of capital in Canada?

A. In excess of 75 times.

Q.37 - And can you just describe before what boards and commissions you have been accepted as an expert in capital structure and cost of capital in?

A. In Canada?

Q.38 - Yes.

A. Let's see. I go from left to right. British Columbia, Yukon Territory, Ontario, Quebec, Newfoundland.

Q.39 - What about Alberta?

A. Oh, sorry. I forgot Alberta. Yes, Alberta, Northwest Territories, the National Energy Board which is federal, the CRTC which is federal. Prince Edward Island, I have presented testimony there. And Nova Scotia.

Q.40 - Now how does the area of capital structure and cost of capital differ from other regulatory issues, just in terms of analytical approach?

A. How does it differ? That's a difficult question. I think it differs in that it does require a significant amount of research with respect to methodologies.

It requires a significant amount of research with respect to financial data, which cover a very broad range.

You must understand not only your own -- the specific company with which you are dealing, but you must have an

in-depth knowledge of the alternative investment opportunities available.

And you must have a relatively in-depth knowledge of the risk profiles of companies with which you are comparing the specific company with which you are dealing.

Q.41 - And your testimony -- could you describe -- in Canada, could you describe what types of companies that you have analyzed the risk, the capital structure and the required cost of capital for, just the nature of the businesses?

A. Yes. I have analyzed the cost of capital and capital structure for electric utilities, gas transmission pipelines, oil transmission pipelines, that would be in the U.S., telecommunications companies, water utilities, stand-alone generation companies and local gas distribution companies.

Q.42 - All right. Could we now turn to tab 1 in exhibit C-15, the brief of documents. And this is your response to New Brunswick IR number 23. Do you see that --

A. Yes.

Q.43 - -- document?

A. I have that, yes.

Q.44 - All right. Now there were some things that were not clear. And I just want to ask you the clear questions.

What exactly was your assignment from Enbridge Gas New Brunswick Inc. in this case?

A. My assignment was what I indicated in my opening statement, that I was asked to provide an expert opinion on the reasonableness of the company's proposed cost of capital elements, the capital structure, the proposed ROE, the cost of debt in the context of the regulatory and operating environment that the company would conduct business within.

Q.45 - Your report is short. So I would like you just to describe briefly the process and analyses that you followed and conducted to -- in order to prepare the report that is your evidence?

A. Basically I started with the proposition that understanding and having what I consider to be relatively in-depth knowledge of the risk profiles of LDCs in Canada as well as in North America, that I would start by accepting the returns that have been allowed for those companies as my point of departure.

And in doing that -- that's not to say that if I had done this study de novo, starting with a total independent assessment of the fair return on equity or capital structure from mature LDC, that I would have come up with the exact same number.

But I felt that those returns reflected various regulatory jurisdiction's decisions on what appropriate returns were for a broad number of LDCs in both the U.S.

and Canada.

And using those returns as a point of departure, I then assessed the business risks of EGNB basically from two perspectives, the first being trying to put myself ahead in time and saying to myself, how would this company compare as a mature LDC to the typical LDC?

And I concluded that on balance it would be viewed as a somewhat higher business risk company for the reasons that I have outlined in my testimony, being that it's a relatively small company.

It will be operating in a relatively less economically diverse environment than say Enbridge Consumers Gas or to reference the United States to perhaps an Atlanta Gas Lite.

Then I added onto that if you will, the additional risks that will be -- that this company will face as a result of being in a greenfield operation. And I determined essentially what I thought, by doing a number of comparative quantitative analyses, what a reasonable differential in common equity ratio would be for this company versus the industry, and a reasonable differential in return on equity for this company as a greenfield operation versus a mature LDC in light of the regulatory environment, or the regulatory framework, I guess is a better way to put it, that this company is proposing.

Q.46 - Okay. Than you. I am going to come back to those quantitative analyses you referred to and ask some questions about them, but before I do let me ask you this.

The capital structure of 50/50 and the request return on equity of 13 percent was something the company had in mind before it retained you --

A. Yes.

Q.47 - -- and I would like to know what your professional opinion -- your independent professional opinion is on that request by the company?

A. When you say my professional opinion on the request of the company, you don't mean the process but you mean the specific numbers?

Q.48 - Yes.

A. My conclusion, having gone through the entire analysis, was that the company's proposal, including the three elements that I was asked to review, the cost of debt, the capital structure and the return on equity, in light of the entire business risk environment that would be faced, those elements were eminently reasonable.

Q.49 - Okay. Let me ask you this question. If the decision was yours, the choice was yours, what capital structure and return on equity would you think appropriate for Enbridge?

A. If I had done this from sort of a de novo position --

Q.50 - Yes.

A. -- rather than being asked after the fact to review it, what I would have done would have been to go through essentially the same type of analysis that I conducted.

I think the only major difference would have been -- and I could have done this here as well, I chose not to -- but I think I probably would have gone through a complete independent analyses of what I thought the fair return on equity would be for a mature LDC.

And in that context, as I said in one of my information responses, that I would have determined that in this capital market environment that the fair return would have been closer to 11 percent for a mature LDC.

I believe that the proposed capital structure is appropriate. I don't think that I would have -- I might have come up with a range rather than a specific number and suggested to the company that an appropriate range might have been within the range of let's say 47 and a half to 52 and a half with a 50 percent equity ratio as the mid point of the range. Because there are judgments that have to be made and I don't think that when you do this kind of analysis that there is necessarily a single number that is the right answer. But at the end of the day you do have to come up with a number to settle on.

So had I been asked to recommend to them the capital

structure I probably would have, as I suggested, given them a range with 50 percent in the middle.

Q.51 - Yes,

A. I do believe that the -- as I said, the 11 percent would have been an appropriate point of departure for assessing the premium to which -- for which the investors require compensation to accept a greenfield risk.

And therefore based on the analyses that I have done, which I would have also done in the context of being approached to make recommendations in advance, that premium would have been the same premium, the analyses would have been similar, and therefore I believe that the answer that I would have arrived at would have been something in the range of 13 to 14 percent.

Q.52 - Ms. McShane, you said your departure point was looking at the return for mature Canadian LDCs, and do --

A. And US LDCs.

Q.53 - And US LDCs. Do all mature LDCs have the same risk?

A. Absolutely not.

Q.54 - And what are some of the factors that distinguish LDCs on the basis of risk?

A. Customer concentration, the extent to which the company has a very diverse economic base, the extent to which the company is protected by mechanisms such as whether normalization mechanisms which tend to shield the

earnings variability over time, the general regulatory environment which may either seek to expose the company to greater risk or work with the company to mitigate the inherent risks, the extent to which companies have contractual arrangements with customers, the extent to which companies recover their fixed costs and demand charges versus variable charges.

As an example of that, you take a pipeline like TransCanada Pipeline or Maritimes and Northeast Pipeline where virtually a hundred percent of their cost, because virtually all their costs are fixed, are going to be recovered in demand charges. That would create a lesser risk environment relative to a company that has to recover a significant proportion of their costs in a variable or commodity based charge.

Q.55 - Okay. Are you personally aware of any LDCs in Canada or the US that have the same risk as a greenfield LDC like Energy Gas New Brunswick -- Enbridge Gas New Brunswick rather?

A. Well every utility is a bit different in terms of the market that they face and the regulatory environment. There are a number of greenfield LDCs in the US and in Canada. There are to my knowledge three -- three greenfield LDCs in Canada and three that I'm aware of in the U.S. and a fourth in Canada which was a greenfield LDC

in 1980 but is no longer a greenfield LDC.

Q.56 - Was that the one in Eastern Quebec?

A. Yes. It's Gaz Inter Cité Quebec which has since been purchased by Gazifere Metro.

Q.57 - Now of the greenfield ROEs in Canada that you are talking about, can you just tell us what the return in equities of those are? Who they are and what --

A. Inuvik Gas ROE is 14 percent.

Q.58 - 14 percent.

A. Sempra Atlantic, their ROE is -- let me see how to put this. They do not have an allowed ROE per se. Because their proposal as accepted was based on market based rates throughout the life of the utility. In their proposal -- originally in their proposal they estimated a return of over 18 percent. And in the course of the proceeding they updated their estimates. And the final note of it that the Nova Scotia Board had was a return of around 15 percent.

The Board decision has allowed them to earn a cumulative return of 20 percent. I don't recall the GICQ numbers. But they were back in the early 80s and wouldn't really be terribly comparable today anyway.

The other one to which I was referring was the Vancouver Island Centra B.C. They are very different than -- than this situation because they had significant amount

of government subsidy. There was over a hundred million dollars that was actually contributed by the government. And a significant amount in addition to that that was provided interest free. So their return is -- and capital structure are quite similar to -- to those of mature LDCs.

But I view that as being sort of in light of the amount of subsidy that was provided by the government.

Q.59 - Would the subsidy reduce their risk?

A. Absolutely.

Q.60 - All right. Ms. McShane, I think it's common ground among all of the parties that Maritimes and Northeast Pipeline, the transmission line here in Eastern Canada has an allowed return in equity of 13 percent?

A. Correct.

Q.61 - Are you able to contrast the risk profile of Maritimes and Northeast with that of Enbridge Gas New Brunswick Inc.?

A. As I indicated in the data request that I responded to, I have not done an in-depth analysis of Maritimes and Northeast. But generally speaking, Maritimes and Northeast is quite similar to its mature peers in the sense that it has long-term contracts for the capacity.

And to the extent that the long-term contracts are not in place, there is a backstop agreement which creates a significantly lower risk relative to a company like

Enbridge Gas New Brunswick which is starting out with no customers. And certainly doesn't have the contractual commitments from its customers that Maritimes and Northeast does.

Maritimes and Northeast, when it starts out, it will - it will be collecting, to my understanding, a full cost of service type toll. And there will be no difference at the outset between the revenues that it takes in and the cost that it incurs.

Q.62 - Is the response that you referred to the document we have as tab 3?

A. That's correct.

Q.63 - All right. Thank you. Could we turn to tab 5, and that's page 2 of your testimony.

A. I have that.

Q.64 - And look at tab 6 as well, which is your response to IR 24.

A. I have that as well.

Q.65 - Now in your answer and you say that New Brunswick is a greenfield local distribution company. Its market must be built from the ground up, et cetera. Can you just draw a distinction, a general distinction in terms of risk briefly for us between a greenfield utility like Enbridge Gas New Brunswick Inc. and a mature utility LDC? What makes them different for purposes of determining cost of

capital?

A. A mature LDC has a market. It has customers. If I were to take a particular company, and I'm going to take Enbridge Consumers Gas, not because it's affiliated necessarily with this company, but because in my experience Enbridge Consumers Gas has always been used as sort of the bench mark utility in Canada.

It has a market that -- in which let's say in the residential market it's attaching 90 percent plus of customers. It can readily forecast its customer additions. It can readily forecast its costs.

Yes, it has risks. It has weather related risks. It has -- it has economic risks. But it has an established market. It has been operating in this market since, I think, the 1800s. I'm sure somebody in the company can correct it if I'm wrong.

It has established customer loyalty. It is -- it has established with its customers the knowledge that natural gas is a cost efficient form of energy. It has over the years, because it has been a bundle utility, been able to establish full customer relationships. Now it may well lose those as it moves into an unbundled environment. But it has had that advantage in developing its market since the company began.

As an unbundled utility in this province EGNB won't

have that ability. It will have to set its rates at the outset on the basis not of its cost but of market conditions. And it will have to coordinate carefully with all of the other parties to the industry in order to make this market work. That in itself is a risk that bundled utilities, mature utilities do not face.

Q.66 - Let's turn next to tab 7. And this is your page 6.

And I want to refer to your question 7. And this is where you make the point that Gas New Brunswick does not expect to participate in the merchant function.

And what I would ask you is that Consumers Gas Company, Enbridge Consumers Gas Company in Ontario does contract carriage. What makes the fact that Enbridge Gas New Brunswick does not participate in the merchant function something unique to it compared to an LDC that provides transportation service?

A. I'm sorry, could you repeat that last part of it?

Q.67 - Yes. My point is one of the risks you were citing in question 7 behind tab 7 you say that, okay, Enbridge Gas New Brunswick does not participate in the merchant function. I can show you other LDCs that also provide services where they do not participate in the merchant function. How does this fact make Enbridge Gas New Brunswick Inc. more risky than those companies?

A. Oh, I see what your question is. Okay. It's not --

it's not so much that they don't participate in the supply function. The point that I was trying to make here was that without supply you don't have a business. And the fact is that we are dealing in an environment where the gas supply is relatively untested.

And the security of supply is to my mind significantly less than for a company like Enbridge Consumers Gas which is getting gas supplies into its system from the Western Sedimentary Basin which has been operated since TransCanada was built. And it's coming through a pipeline which is triple or quadruple looped. It also has the ability to bring gas in through the US. So the security of supply which is required to make the business operate is significantly higher in Ontario than it is here.

Q.68 - Could we refer back to tab 5? And this is page 2 of your testimony. But down at the bottom of the page in answer 4 you say that the director's success in building the market will be a function of several factors, including competitive pricing at the burner tip, the ability to assure customers of the existence of a reliable source of energy and the ability to instill among potential customers a belief that natural gas is a superior source of energy from an economic efficiency and environmental safety perspective. I think I was reading page 3 of tab 8, so you will find the end of that sentence

behind tab 8.

A. I have that.

Q.69 - Okay. Tell me how these risks differentiate Enbridge Gas New Brunswick from a mature LDC, the point being that you could make the same points about some mature LDCs?

A. Virtually if I start with building the market to a critical mass requires conversion of customers currently using alternative forms of energy, each and every LDC in Canada other than the greenfield LDCs have a market that has reached a critical mass. They have already established with customers that there are reliable sources of supply and that's through experience. To my knowledge there have been no situations, at least in my experience, which I admit is somewhat limited in the grand scheme of the history of the natural gas industry, where supply has been disrupted for a significant period of time.

Customers are aware and are convinced of the economic efficiency, safety and environmental preference for natural gas. That still has to be established in a market where customers are used to propane, fuel oil and electricity.

With respect to the pricing, mature LDCs who have basically gotten past the early periods of front end load costs, are able to charge rates that fully recover their cost of service and earn a compensatory return and are

competitive, particularly in Ontario where natural gas is very competitive with alternative forms of energy.

Q.70 - Just keep your thumb on tab 8, because I want to go down the page a bit. And the first sentence in the second full paragraph you say, in contrast to mature LDCs, a startup utility requires an innovative pricing mechanism to assist in the development of the natural gas market. And I take it you are talking about the market based rates that we heard evidence of yesterday?

A. That's correct.

Q.71 - Okay. So my question is, how does that -- how does that distinguish Enbridge Gas New Brunswick Inc. as a startup company from a mature utility that wants to keep customers?

A. Because I think, as I suggested in my prior answer, mature LDCs' cost structure is such that they can charge full cost of service rates, full recovery of their costs, and be competitive, whereas a greenfield LDC, because it has to incur significant startup costs and invest in significant infrastructure at the outset without the customer base to -- from which to recover those costs, and because it is starting from a position where it has to draw customers away from alternative forms of energy, it needs to be able to set rates at specifically a level that will be competitive with those alternative forms of

energy. And those rates will have to be lower than full cost of service rates because of the large capital investments that have to be made by an LDC in the beginning years of operation.

Q.72 - Do conversion cost of customers have anything to do with the requirement for the pricing mechanism?

A. Do what?

Q.73 - Customer conversion costs say from electricity to gas, does that have any -- does that distinguish the Enbridge Gas New Brunswick market from a mature --

A. Oh, I understand what you are asking me. Yes. The majority of new customers that Consumers Gas -- Enbridge Consumers Gas would take on would be new customer additions and all of the customers that -- new customer additions in the sense that they are not converted customers. They do convert some customers but the majority of their customer additions are from new houses, new facilities, where the costs of conversion don't need to be directly taken into account.

In this market, on the other hand, you have potential customers with other forms of energy whose prices will not only have to reflect the current delivered cost of the alternative fuel, but will also have to take into account the fact that they will have to -- these customers will have to incur up front conversion costs.

So that the amount of the discount, if you will, from the delivered market price will have to take into account sufficient savings so that the cost of -- cost of -- capital cost of conversion will be offset.

Q.74 - Okay.

CHAIRMAN: The Board will take a ten minute recess now. And frankly, the last question and probably a few prior to that were leading. Anyway, we will take a ten minute recess.

(Recess)

CHAIRMAN: Go ahead, Mr. Blue.

MR. BLUE: Mr. Chairman, at the break Mr. Parcell and Mr. Johnson took me in the woodshed and said, the Chairman was right, you were asking leading questions. Settle up. It's just that my previous experience with Ms. McShane has always been that I have tried to spin those out of her as many as I could and just seeing her makes me do that, so I will try and do better.

Q.75 - Ms. McShane, let's go to tab 9 of your brief. And here you make the point that having the deferral accounts tends to lower the required return on equity of the company.

And why is that so?

A. Because essentially being able to defer these amounts and having them in a deferral account with the opportunity to recover them once the development period is over, when

the company moves to rates that are more closely aligned with costs, that there is a greater opportunity, because there is essentially a commitment from the regulator to provide that opportunity to recover the costs than for a company -- another greenfield utility that might simply be intending to operate on the basis of market based rates throughout the life of its franchise.

Q.76 - Okay. I guess what I would like -- you said something that if you didn't have the deferral accounts you would require a return of 20 to 40 percent, you say that in your written answer, and --

A. I am not sure that that's what I said. What I think I said was that the company would have to be allowed to earn returns in that -- in that kind of area in order for it to be able, over the entire lifetime of the assets, to on average have earned a compensatory return. But in every year it is not going to have to earn a return in the 20 to 40 percent range. It will have to during some part of the life of the assets.

Q.77 - If it doesn't have a deferral account?

A. Yes.

Q.78 - Can we go to -- back to tab 7. And one of the risk factors that you are mentioning for Enbridge Gas New Brunswick is the fact that during the development period, if its proposal is accepted the return on equity will be

fixed at 13 percent. And why would a fixed return on equity of 13 percent increase its risk?

A. Because there is a risk that the cost of equity will rise over the period during which that return is fixed and the 13 percent would undercompensate for the cost of equity in the marketplace.

Q.79 - But isn't there as equally a likelihood that the cost of equity will fall over that period?

A. Even if that were true, risk from the perspective of a shareholder is related to the potential for undercompensation.

Having said that, given the level of interest rates over the past five years in relation to the key factors that impinge upon interest rates, those being growth in the economy and inflation, the average level of inflation has only been 1.6 percent. Inflation is expected to average close to 2 percent over the next ten years, over the next five years as well, and interest rates averaged close to 6.75 percent.

The return on equity in this testimony is premised on an interest rate of six and a quarter percent and therefore, in my view, there is a larger probability that the required return on equity will be higher than what underpins the 13 percent.

Q.80 - Let's turn -- still in tab 7 and down to your question

8, and there you talk about the performance bond in the gas franchise agreement, and why do you say that increases the company's risk? And that goes over onto your page 7, but that page 7 for some reason is behind tab 12.

A. The performance bond is an additional amount of money that the company has had to put up, an amount of \$10 million. This is not something that a mature LDC typically has to provide. That \$10 million can be utilized by the Board if it determines that the company is not meeting its obligations and the company would then have to put additional funds to come back up to the \$10 million.

Unlike other elements of risk where there is an upside and a downside, there are no upsides to this. If the company is found to underperform and is required to -- and if the Province draws down on the line of credit, that's a risk to the company for which there is no opposite upside if the company is found to perform better than expectations.

Q.81 - Could we now just stay on tab 12, and you mentioned the small size -- and this is in your answer to question 9, you refer to the small size of the company as a risk factor.

A. Yes.

Q.82 - And why does the fact that it is small make it a higher

risk company than a small mature LDC?

A. Than a small mature LDC?

Q.83 - Yes.

A. Oh, I don't think that it's necessarily that in and of itself makes it riskier. Small companies generally speaking are riskier. I look at the greenfield risk sort of in isolation, but the size factor itself would be something that would affect mature LDCs as well as -- as well as greenfield LDCs.

Q.84 - All right. But as I -- and this is not leading, I am just trying to establish the witness' knowledge for the purpose of my question. But is it your understanding that Enbridge Gas New Brunswick is not going to sell debt publicly, all its financing is going to come from its parent company?

A. My understanding is that right now Enbridge Gas New Brunswick plans to borrow funds from an affiliate, that it does not plan to access the public markets. And in that context size certainly would be a factor if it tried to access funds from a bank through a private placement, the cost would be higher to the company than if it were to -- it would be higher to the company than the arrangements that are outlined in the company's proposal.

Q.85 - Okay. What do you say to the point that size/schmize, since the parent is going to finance the company this

should not be an additional risk factor?

A. Well there are two aspects to the size. One is simply a business risk. The small company simply has less ability to diversify risks across its market. Because if you take a large market like Enbridge Consumers Gas, if something goes wrong in one area of Ontario, another area of Ontario might be undergoing a significant economic boom. So there are greater abilities for these economic risks to be diversified across a larger market place.

The other aspect of the size is the ability of a company to access the public markets, and those abilities are to do with the lack of liquidity of the securities that would have to be issued. It would have to do as well with these underlying business risks.

So to avoid some of the costs that would be associated with having to issue -- issue debt itself, those would be costs of issuance, and perhaps even the inability to access debt when it wants to and in the amounts that make sense at the time. I mean if you go to a bank to access funds and you need a million dollars, chances are the bank is just not going to be interested. They will tell you, come back when you need 25 and we will talk. So --

Q.86 - Or go see your father.

A. Pardon me.

Q.87 - Or go see your father.

A. So for a company like Enbridge Gas New Brunswick, if its -- if one of its affiliates is willing to fund the debt and fund the debt in the amounts that are required, when it's required, and not to assess it the cost of issuance that the bank might assess it, and not to assess it the types of covenants that typically underlie the debt for smaller companies, say you can't issue any more debt if your interest coverage is less than two and a half times. Or you can't issue any more debt unless you maintain a capital structure with 50/50 in it. Or you can't issue any more debt -- or you can't -- I am thinking of an example.

In Ontario, where a small gas distributor went out and raised debt on its own because the Ontario Energy Board said, we want you to go out and raise money on a stand alone basis. So it did. And the cost that it had to incur was significantly higher than the cost that it had incurred by raising money from the parent, as well as the fact that there were these onerous conditions that were put on that debt, including the fact that it couldn't pay out any dividends. For an extended period of time it had to maintain a certain coverage ratio, it had to maintain a certain capital structure. So --

Q.88 - What company are you referring to?

A. Natural Resource Gas. And so the ability of Enbridge

Gas New Brunswick to have its debt funded by an affiliate gives it the benefits of not being subject to the potential lack of access and these additional costs and stringent covenants that it might face if it had to do it on its own.

Q.89 - I want to talk about your equity risk premium. And let's go to tab 15. And firstly could you just tell us briefly what the equity risk premium is for context?

A. I would except I'm not quite sure what tab 15 has to do with equity risk premium.

Q.90 - Well, let me check. I hope I haven't got the wrong reference here.

A. At least the first page I have --

Q.91 - You are quite correct.

A. -- under 15 is a table -- has a table that compares some different parameters.

Q.92 - You are quite correct. That is page 8. And you talk about it on page 9?

A. Oh, sorry. Okay. So the equity risk premium just generally speaking?

Q.93 - Just describe what it is, what you are doing here --

A. The equity --

Q.94 - -- before --

A. -- risk premium is the premium over a predefined fixed security yield to compensate for differential business and

financial risk.

Q.95 - Okay.

A. And when I say predefined, in that context it could be the cost of corporate debt. Or it could be in the context of what has often been referred to as the equity risk premium test, a risk-free rate which is typically defined to be a long-term government bond yield.

Q.96 - Yes. But on page -- at the top of page 9 you say the difference in the equity risk premium for a company the size of Enbridge Gas New Brunswick and the typical Canadian LDC would be close to 1 percent.

So what you are telling the Board is that 1 percent -- that the risk premium over Canadian LDCs for Enbridge Gas New Brunswick is 1 percent?

A. Just for size.

Q.97 - For size?

A. Right.

Q.98 - Okay. And all I want to know is how you arrived at the 1 percent?

A. Oh, well, you didn't ask me that. The 1 percent is the result of exhaustive studies that were performed by Ibbotson Associates where they took, in the first instance, all of the stocks in the S & P 500.

And they looked at different groups of those stocks based on size. And they determined that over the longer

term that small companies had higher returns than larger companies.

And there were a number of analyses that were done. One was using the S & P 500. One was using a broader index, the New York Stock Exchange companies.

And then they did a couple of other analyses where they tried to make adjustments to risk measures for these individual stocks to try to see if they could reflect the small size in different ways.

And on average, over these various analyses for these several stock indices, the difference between the return requirement for a stock the size of Enbridge Gas New Brunswick and stocks that would be of the size of the typical Canadian utility was on balance 1 percent.

Q.99 - Okay. Now you go on to say that the small size premium, this 1 percent, can be offset by the adoption of a more conservative capital structure. You say that on page 9.

And then down below you say that studies of the impact of the capital structure and cost of equity have indicated that on average for every 1 percent increase in debt ratio, the cost of equity increases by about 10 basis points or one-tenth of a percent. And you call that rule of thumb. Do you see that?

A. Yes.

Q.100 - Where does that rule of thumb come from? Is that

Kathy McShane's rule? Or is that a rule that comes from somewhere else?

A. The rule of thumb has been applied I guess in Ontario.

But what it really -- what it reflects is the various studies that have been performed.

Some of them have been what I would call theoretical studies. Some of them are empirical studies in the sense they actually have gone out in the marketplace and tested, using real data.

And the article that is referred to in the footnote summarizes all the various theoretical empirical studies that have been performed over the years.

And the rule of thumb is effectively the average of the changes that have been found in the various theoretical empirical studies.

Q.101 - I want to talk about cost of debt. And let's refer to tab 18. And I have also included in tab 20 and 21 and 22 some of your IR responses relative to that.

Now on page 10 you say that Enbridge Gas New Brunswick's proposal entails a cost of debt set at 250 basis points or about 2 1/2 percent above the 10-year Government of Canada bond yield prevailing at the time the debt is incurred.

And then if you go to tab 19 you opine that that is a

reasonable addition. And I want you -- why do you say that? Why is it reasonable?

A. Because as a greenfield LDC this company would not be able to achieve an investment grade debt rating on a stand-alone basis. The lowest investment grade category is B++.

This company is riskier today than -- given the capital structure that it proposes, it is riskier today than a company such as B. C. Gas which has a triple B rating. It's riskier than a company such as Pacific Northern Gas which has a triple B rating. These are mature LDCs.

Q.102 - Now is Pacific Northern Gas a Canadian company?

A. Yes, it is.

Q.103 - Where is it?

A. It's in Prince Rupert, British Columbia.

Q.104 - Very well. Okay.

A. I lost my train of thought.

Q.105 - No.

A. So triple B+ sort of forms the upper end of the range for -- it could not achieve a triple B rating. So the cost has got to be higher than what a triple B rated company could raise debt at. The next rating is B+.

So the company is likely to, if it had to go out and raise debt on its own, have to pay a rate that would be

somewhere between B++ or triple B and B+.

And that range, as I have said on page 12 of my testimony, would put the spread in the range of 1.6 which has been the spread for B++ corporates and the spread for 10-year B+ corporates which has been close to 3 percent, 2.95 to be exact.

So the spread of 250 that the company has indicated that it will be able to borrow funds from an affiliate at is well within the range that it would incur if it went out and raised that debt on its own.

But at the same time, as I indicated before, without the owner's covenants that would also accompany a debt issue that it might make to a bank or a private placement to an insurance company.

Q.106 - I want you to refer to now to tab 23. And this was on the stand-alone principle. And this is an extract from Mr. Kumar, the Board staff's -- or I'm sorry, the Board's witness' evidence.

And what Mr. Kumar says, and I quote, "My major problem with Ms. McShane's analysis is that most of her analysis is premised upon a fiction of operating on a stand-alone basis, i.e. looking solely at Enbridge Gas New Brunswick while ignoring the reality that Enbridge Gas New Brunswick is a part of a bigger entity." And he goes down -- he says this is patently wrong. And how do you respond

to that?

A. Well, my initial reaction to say if this is patently wrong then every regulator in this country has been patently wrong for a long time.

Because that is the way that companies in this country have been regulated, because it reflects the appropriate way of looking at investments.

If I'm any kind of a company -- I don't have to be a regulated company -- and I'm going to look at an investment, I'm not going to look at it at my overall cost of capital. I'm going to look at it from the point of view of the risk that that investment has.

If I were to evaluate and require a return from every project that I invested in at my overall cost of capital, I would be making some very bad investments.

Q.107 - Do you give the Board some precedents for stand-alone treatment by regulators in Canada?

A. For purposes of?

Q.108 - Cost of capital and return on equity?

A. Okay. Let's start with -- let's look at Westcoast Energy for example. Westcoast Energy is a large holding company and it has a number of regulated subsidiaries. Union Gas is one of them.

When the Ontario Energy Board looks at the return requirement on the equity for Union Gas, it doesn't look

at Westcoast, it looks at the risk profile of Union Gas.

Q.109 - Right.

A. When the BCUC looks at the risk profile of Pacific Northern Gas which is --

MR. O'CONNELL: Mr. Chairman, during the course of his remarks, Mr. Blue said there was some sort of authority or a decision or something somewhere in these materials.

I'm wondering if the witness is going to refer to -- well, I guess our decisions or refer to positions taken by the Board, I'm not in a position to assess those comments or to cross-examine on those comments unless I can have something in writing, a decision, a direction, a policy or something. And I'm wondering if there is anything like that available?

MR. BLUE: Mr. Chairman, at page 11 of 17 of Ms. McShane's testimony, she lists several precedents and gives the Board file numbers.

This document has been in the hands of the Board staff and Mr. O'Connell since it was filed. I assume that if Mr. O'Connell and the staff have intended to ask questions about her testimony, they would have done their research the way that anyone preparing a cross-examination has done so. I do not recall any requests for copies of these decisions.

But I'm sure -- I just make those observations in

passing. But I would appreciate Mr. O'Connell, if he could restrain himself until I finish.

CHAIRMAN: Well, Mr. Blue, it would be helpful to the Board if in fact the decisions that the witness is referring to are in the evidence. That we take a moment and refer to them so we can follow along.

My memory of the evidence is such that I believe there are charts, et cetera in there that go to the root of the question.

MR. MACDOUGALL: Mr. Chair, if I may, with respect to any decisions that may be being referred to, Mr. Blue just asked Ms. McShane if she could recall some. And she is doing that.

This is not me going through Ms. McShane with her evidence. We haven't put in decisions that people didn't ask for. As Mr. Blue said, we filed our information.

And if there are information requests to fill out the record, that would be fine. If the Board wants that now, I don't believe Ms. McShane has decisions that Mr. Blue may be referring her to. He asked her if she could recall. That is all she did.

So I'm now here on behalf of my witness to say it isn't Mr. Blue asking these questions, then Mr. O'Connell asking Mr. Blue for the decisions. Ms. McShane does not have those decisions. She was just asked off the top of

her head on how to do this.

So if Mr. Blue wants to get decisions to put to Ms. McShane, ask her if she is aware of those decisions, that is fine. If Mr. O'Connell wishes to do so, that is fine.

Ms. McShane's evidence is complete. These are other gentlemen now asking her about other decisions.

And it is very inappropriate to tell Ms. McShane, do you know of any jurisdictions? Yes, I do. Well, where is the decision? You will have to put the decision to her. That is the way the process works.

So unless Ms. McShane says she is sitting up there with all of the decisions on all of the questions that she may hypothetically be asked, that is not the applicant's ability to do that.

We will adjourn for such -- and if people want to get decisions, if they want to get them -- we want to move this process along.

If people want to ask Ms. McShane questions on her evidence, she will answer them. If they want to ask hypothetical questions as to other decisions that may occur, she can answer them if she wants.

But if someone else wants those decisions in this room, they will have to get those decisions. Or else she can say, I don't have those decisions handy. That can be her response. I don't see how that is our obligation.

MR. BLUE: Mr. Chairman, I'm just asking Ms. McShane to identify for the Board from her expert knowledge from having testified elsewhere of other places where the stand-alone principle is applied. She can give that evidence.

If somebody contests that evidence, then by all means get the document and put it to her. Anyway, I have got one here that I want to talk about.

CHAIRMAN: Mr. Blue, I let counsel go on. What I said was if those decisions that you are referring to form part of Ms. McShane's evidence, then it might be helpful if you could refer to them and the Board can follow along.

MR. BLUE: Well, as I say, she has given some reference to them on page 11 of her evidence. I don't need to go into those with her, because they are there in writing. I do have another one though.

CHAIRMAN: Ms. McShane, when you do refer to something in response to the question, if you remember that that forms part of your testimony, examination in chief, would you attempt --

A. I will, sir.

CHAIRMAN: Thank you very much.

A. The specific comment I was making was more broad than the specific reference on page 11 which is to the cost of debt specifically.

I was speaking just simply in terms of applying the stand-alone concept as a general proposition in other jurisdictions in Canada.

CHAIRMAN: Okay. Thank you. Go ahead, Mr. Blue.

MR. BLUE: Thank you, sir.

Q.110 - Ms. McShane, turn to tab 31. And this is the National Energy Board's reasons for decision in the matter of TransCanada Pipelines, August 1980 in decision RH-2-80.

A. I have that.

Q.111 - And did you at my request through your counsel read that decision?

A. I did.

Q.112 - And can you please assist us with whether or not that decision supports the stand-alone principle?

A. It does.

Q.113 - Can you explain to the Board why it does and what it is about?

CHAIRMAN: That is not the complete decision, Mr. Blue.

MR. BLUE: No, sir. It is not. It is the relevant extracts. The complete decision --

CHAIRMAN: I was looking to see who was counsel for the Board at that time.

MR. BLUE: Oh. It wasn't me.

CHAIRMAN: Go ahead, Mr. Blue.

A. At the time of this decision, when I was still in

college, my understanding is that TransCanada Pipelines had recently undertaken some diversification, which meant that within TransCanada Pipelines Corporation there were other than the utility operations.

Q.114 - Right.

A. The company applied to the National Energy Board for - - this doesn't actually form part of what you gave me. But they applied for a capital structure which reflected the risk of the pipeline operations, not the overall risk of the company.

Q.115 - Right.

A. The National Energy Board used a deemed common equity ratio that was determined to be reflective of the pipeline risk, not of the overall risk.

And in that context the company also applied to have its income taxes determined on a stand-alone basis, that the only interest expense that would be included for purposes of determining the income tax allowance was that income tax -- I'm sorry, that interest expense that would be compatible with a deemed common equity ratio of TransCanada Pipelines, the regulated operations.

And the National Energy Board agreed that the income tax allowance should be determined on a stand-alone basis inasmuch as the capital structure was determined on a stand-alone basis.

Q.116 - Just so I'm clear, within the corporate -- within the corporation TransCanada Pipelines, no subsidiaries, no business units, but within the corporation, the Board looked at the pipeline operation as a stand-alone operation?

A. Correct.

Q.117 - Thank you. Could we turn now to tab 25?

A. I have that.

Q.118 - I think we have covered -- I think we have covered this point. So let's move on to tab 26.

A. I have that.

Q.119 - Now here you say -- and we are getting into numbers again -- you say, I estimate the expected market risk premium in Canada at a long Canada yield of 6.25 percent but no less than 6.0 to 6.5 percent.

Now this is a market risk premium we are talking about, is it?

A. It is.

Q.120 - And how does that differ from the risk premium we were talking about related to size of 1 percent a few minutes ago?

A. I am trying to decide how to answer this question.

The risk premium related to size is -- let's say I had a company that was equal in risk to an average risk stock in every way except size. So an average risk stock would

require a risk premium over long Canadas of 6 to 6 and a half percent.

Q.121 - Right.

A. A small company would require an additional premium of 1 percent.

Q.122 - All right. So the 6.0 to 6.5 percent does not include the 1 percent we were talking about earlier?

A. No, but as my evidence indicates, that 1 percent has effectively been already reflected in the capital structure by imputing a somewhat higher common equity ratio than for your average size LDC.

Q.123 - Now the risk premium of 6.0 to 6.5 percent represents a lot of money and it's a number. Is that risk premium range -- is that a Kathy McShane creation or does that come from somewhere else?

A. Well it's a Kathy McShane creation actually.

Q.124 - Okay.

A. That is my view of the market risk premium. On the other hand, there are underpinning numerous decisions in this country, a risk premium of at least 6 percent, and to give you a couple of examples, the most recent Stentor decision for all of the regional telephone companies determined that the risk premium in Canada was 5.9 percent.

The most recent Quebec decision for Gaz Metro

determined that the market risk premium was 6.5 percent. The various decisions in -- let's see -- the National Energy Board decision for the pipelines, because of the -- they have an automatic adjustment formula, and the automatic adjustment formula for ROE changes the return every year based on a formula which says that the return will change by 75 percent of the change in interest rates.

And when the formula was put in place in 1995 the underlying risk premium at the time given the level of interest rates, which was then 9 and a quarter percent, was effectively 5 percent.

With the -- with the formula, once we get to interest rates of where we are today in the 6 to 6 1/4 percent range, the implied market equity risk premium underpinning that is about 6.2 percent.

So the 10 percent returns generally speaking that form the benchmark are compatible with a market risk premium of at least 6 percent.

Q.125 - Was your estimate of 6.0 to 6.5 percent based on some methodology and analytical

--

A. Yes, it was. The 6 to 6 and a half percent market risk premium that I have used here is the same 6 to 6 and a half percent that I have developed and used in every mature LDC cost of capital presentation that I have made,

and it was presented in detail in response --

Q.126 - I am going to help you --

A. -- to a data request.

Q.127 - Yes. And you will find those data requests, Mr.

Chairman, behind tab 29 and tab 30, 29 being from the Canadian Western Natural Gas case and tab 30 from the Gazifere de Hull case.

A. And actually I believe in response to a Board staff interrogatory they asked something quite similar, and I put the entire market risk premium analysis in response to that as well.

MR. BLUE: Thank you. Thank you, Ms. McShane. Thank you, Mr. Chairman. Those are my questions.

CHAIRMAN: We will take five minutes and Board counsel will have an opportunity to have a break.

(Recess)

CHAIRMAN: Go ahead, Mr. O'Connell.

CROSS-EXAMINATION BY MR. O'CONNELL:

MR. O'CONNELL: Thank you, Mr. Chairman, Commissioners.

Good morning, Mrs. McShane.

MRS. MCSHANE: Good morning.

MR. O'CONNELL: Mr. Chairman, just as a -- if I could -- a preliminary matter. I obviously haven't had much time to look at this case from the National Energy Board, but if you look at the table of contents for this case it shows you that there are basically six chapters. What we have

in the material that Mr. Blue has provided to us is chapter 4, dealing with allowable cost of service, and chapter 6 which is a dissenting opinion.

Now this case is about determining rates. This case is about cost of capital, cost of debt, return on equity.

So the chapters that aren't here, for example, chapter 2, the chapter about the rate base, chapter 3, the chapter about rate of return, and chapter 5, the chapter about rate design and other tariff matters. It seems to me that they are all things that are central to the deliberations that have been going on here this week and will go on in the future.

And I just want to say as a preliminary matter, I think very little weight, if any, should be given to this case and Mrs. McShane's comments on this case, when they don't bother to provide the chapters that seem to be directly relevant to our deliberations.

MR. BLUE: Mr. Chairman, I will have to undertake to provide the full decision to the Board this afternoon. That is not a problem. I just didn't want to clutter up the Board's record with irrelevant paper. I am surprised frankly that my friend hasn't read it before, doesn't have his own copy.

CHAIRMAN: The Board would appreciate it, Mr. Blue, if you did put in the portions of the decision that haven't been

filed.

Q.128 - Mrs. McShane, let's deal with this case just for a minute, if you don't mind, and then I will get on to the other issues that you and I have to discuss.

And I know you have heard me say this before earlier this week, but the concepts are difficult for me to understand sometimes, so please be patient with me if I use the wrong terminology or try to repeat something you said and screw it up. It is not intentional.

A. I will try to be as helpful as I can.

Q.129 - Thank you. You have read this case, this decision, that's what you said a few minutes ago, under tab 31 of the book?

A. Yes.

Q.130 - Can you show me where in the decision that's in this book it talks about the stand alone principle? I guess the reason I ask you that is you -- the case was referred to you and you talked about it, but you never said, this is what it says here.

A. The summary that I gave was with respect to the material which starts on 4-17, and it's part B and C. Now if you are asking whether the term stand alone principle specifically appears on these pages, it does not, to my recollection.

However, the conclusion which is found on page 4-19,

the paragraph that immediately precedes part D, where it says, having regard to all of the evidence presented and particularly to the deemed capitalization which includes a 30 percent common equity ratio, the Board has decided that the computation of income taxes for rate making purposes should not include interest expense that is not recovered in the approved return on rate base. That is the application of the stand alone principle.

What that is saying is that the Board looked at the common equity ratio and the rest of the capital structure ratios that would be applicable to a stand alone pipeline, and then it determined the interest expense on the very same basis, and the tax allowance.

Q.131 - Too complicated for me. Do you know -- and Mr. Blue is quite correct, I have never read this case, probably wouldn't understand most of the principles that it stands for if I did read it -- but can you tell me briefly just what this case was about? What was the application for? Is it something to do with splitting a regulated part of a company off from an unregulated part of a company?

A. No. This was a normal annual revenue requirement application and decision.

Q.132 - Okay.

A. So as you see in the table of contents to which you referred, the National Energy Board went through step by

step and determined the pipelines rate base, determined the rate of return, determined the allowable cost of service and determined from the allowable cost of service the various rates that would apply to the various services that TransCanada Pipelines was offering.

Q.133 - Now in August of 1980 when this decision is dated -- and look, I know nothing about TransCanada Pipeline but my guess would be that TransCanada Pipeline was a large, mature company --

A. Yes.

Q.134 - -- operating heaven only knows how many hundreds of miles of pipe carrying different commodities --

A. Yes.

Q.135 - -- and employing heaven knows how many people and having an operating record that went back years and years.

A. Yes.

Q.136 - And the gist -- what you are saying in terms of the stand alone principle -- the gist of what you are telling the Board is that this decision said that TransCanada Pipeline should be viewed as a stand alone corporation?

A. For purposes of the capital structure, rate of return and income taxes, that the regulated operations for which -- over which the National Energy Board has jurisdiction should be treated as a stand alone entity.

Now we keep focusing on this particular decision

because Mr. Blue did introduce it, but that is not to say that somehow this decision is special.

This decision is consistent with virtually every decision that has come out of all regulatory jurisdictions since 1980, maybe before, I will use that as the point of departure because that's when this decision was dated.

But if you look at, for example, Enbridge Consumers Gas, they have had other operations in Enbridge Consumers Gas Inc., and for purposes of determining the capital structure and return, the capital structure and return have been determined on the basis of the risks of the utility operations, and so has the income tax allowance.

So this decision is not unique in any way. It is simply one example of how regulators in Canada treat the operations over which they have jurisdiction.

Q.137 - Look, I can't argue with you. All that I can say is that this is the decision -- the decision that got put before the Board this morning and to me it's a decision involving a very large, very successful, very mature Canadian corporation, and isn't particularly helpful to the Board. But I will move on. I just needed to find out something about the case and the situation.

Q.138 - Mrs. McShane, when were you retained to examine the Enbridge Gas New Brunswick proposal?

A. I believe it was about a month and a half before this

application was filed.

Q.139 - So if the application was filed on December 31st, you were retained in the middle of November?

A. I don't think that's right but -- I mean, I thought it was filed in -- I actually don't recall. But it was about a month and a half before it was filed.

Because I know I had a relatively short period of time in which to review the application and to do the analysis.

MR. MACDOUGALL: Mr. Chair, Ms. McShane may be referring to the filing of her evidence as opposed to the filing of our application. Our application occurred on December 31.

So maybe that is --

CHAIRMAN: The Board is aware of that.

Q.140 - Ms. McShane, at the time you were retained, what material was supplied to you to assist you in this project?

A. I believe that the material that was provided to me were parts of the company's proposal to the government.

Q.141 - And which parts were those?

A. I don't recall specifically. They were the parts that dealt with the forecast of volumes, the forecast of customers, the forecast cash flows. Those are the key parts that I recall.

Q.142 - Your evidence is dated -- I guess that is probably the 7th of February --

A. Yes.

Q.143 - -- 2000? And I want to talk about the time frame prior to that, the material you had as you were preparing your opinion and your evidence?

A. Yes.

Q.144 - Okay. So you had some materials from the proposal. And what I think you said it is forecast of volumes, forecast of customers, forecast of cash flows. Did you have any of the prefiled evidence of the applicant, other than your own obviously?

A. Did I have any of the prefiled evidence?

Q.145 - Yes.

A. No. To my knowledge the prefiled evidence was being prepared simultaneously.

Q.146 - Okay. And look, just so you understand where I'm going with this, one of the things I want to do in the next few minutes is to examine the material you had before you as you prepared your opinion. And then I'm going to look to see what material you didn't have while you prepared your opinion --

A. Okay.

Q.147 - -- and see if it changes your mind at all?

A. Okay.

Q.148 - Okay. So the first step in this process is to get a handle on what you had. Now other than those forecasts is

there anything else you can recall using to prepare your proposal or your opinion?

A. If you mean documentation per se, no. I mean, I had discussions with the company --

Q.149 - Okay.

A. -- where I would ask them questions with respect to how they expected the market to work, exactly how the rates would be set, how it compared for example to proposals that have been made in Nova Scotia.

So I had material that is not documented but was the result of discussions with --

Q.150 - Okay.

A. -- members of the company.

Q.151 - I want to be fair with you, you know. So I'm quite happy to have you tell us who you talked to at Enbridge and what you talked about and what information you collected to help you with your opinion?

A. Well, I certainly talked to Mr. Marois. I certainly talked to Mr. Maclure. I had some discussions with Mr. Luison. What did we talk about?

We talked about how -- as I said, how the target rates would be set, what the implications were as far as if relative alternative energy source prices changed, how the deferral mechanisms were to work. I mean, I don't recall specifically beyond that type of discussion.

Q.152 - Well, for example were you told that Enbridge Gas New Brunswick had made a proposal to the Province of New Brunswick that included the suggestion of a 50 percent debt, 50 percent equity capital structure?

A. Oh, yes. I knew that.

Q.153 - So you knew that that --

A. Because -- yes.

Q.154 - -- was one of the bases of the Enbridge proposal?

A. Absolutely. The point that I tried to make at the outset was that I was asked to review the reasonableness of their proposal. I was not asked to provide recommendations to them with respect to capital structure and return.

Q.155 - And the point I'm trying to make, Ms. McShane, is that you were asked to assess the reasonableness of that proposal after it was made to the Province of New Brunswick?

A. Yes.

Q.156 - Okay. And you were asked to assess the 13 percent return on equity after that suggestion was made to the Province of New Brunswick and accepted by the Province of New Brunswick?

A. Correct.

Q.157 - Ms. McShane, we are going to refer to an interrogatory from the Province. It is number F-23.

A. Sorry. F?

Q.158 - 23?

A. 23.

Q.159 - I just want to confirm that you also at the time you were doing your analysis had been given the -- what do they call those things, essential elements?

A. Yes.

Q.160 - You knew that those had been agreed to between the Province and Enbridge?

A. Yes.

Q.161 - Now, Ms. McShane, I'm looking at the Province's interrogatory number 37.

A. Is it before or after these testimonies that were filed?

Q.162 - It's exhibit F, schedule 37.

A. Okay. I have that.

Q.163 - And I just want to refer you to this because of the response B, Ms. McShane's approach was intended to limit the scope of the issue to risk differential --

A. Yes.

Q.164 - -- between EGNB and mature local distribution companies?

A. Yes.

Q.165 - So that limitation was placed on at the time you were doing your analysis?

A. Was it placed on me?

Q.166 - Yes.

A. No.

Q.167 - So that was just the intention of Enbridge but not what in fact happened?

A. Excuse me? I don't understand your question. I indicated to Enbridge that I thought that this was an appropriate way to go about making this assessment by avoiding the controversies associated with -- typically associated with this first step, which is if one accepts the typical allowed rate of return for mature LDCs, then we can avoid getting into all of the issues that -- that have generally surrounded that determination. And we would just limit the discussion to the risk differential as between a mature LDC and EGNB.

Q.168 - Ms. McShane, can we now turn to your evidence. And we will start with -- which is tab D and schedule 1.

A. Tab C, schedule 1?

Q.169 - D.

A. D?

Q.170 - Oh, C, sorry, you are right, C. My mistake. And I will tell you what I am going to ask you to do, Ms. McShane, as we go through your evidence.

I want to try to focus on, one, Canadian utilities as opposed to American or other utilities. And I also want

to focus on gas utilities as opposed to electrical and other types of utilities.

A. Well there are only two in this schedule gas and electric. And there is no significant difference in risk as between them as mature companies.

But, I mean, if you would like to focus on just gas, that's fine. If you want to focus on Canadian only, I mean that's fine as well.

I would simply say in that regard that alternative investment opportunities in this market certainly are not limited to Canadian gas utilities. That any company has the ability to invest in a broad range of utilities, including both Canadian and U.S. utilities, as well as utilities outside those two countries.

Q.171 - When you look at schedule 1 in your evidence, I guess, to me keeping in mind your 50/50 debt equity proposal, I looked over to those Canadian gas distributors that are listed and the highest equity number that I could find there was 40.6 percent.

A. That's right.

Q.172 - Okay. And I was interested because I heard you say this morning -- and again I don't want to misquote you -- but something like, in Canada we tend to use Enbridge Gas or Enbridge Consumers Gas perhaps as a benchmark.

A. Oftentimes, that's correct.

Q.173 - As a model. And then I looked at the equity number here for Enbridge Consumers Gas and it's 29 percent.

A. It is at the end of 1998. At the end of 1999 it's 39 percent.

Q.174 - Okay.

A. I also would point out that you have to be somewhat careful when you look at these ratios.

At one point in time -- let's take Enbridge Consumers Gas for example. If you will notice the 1998 numbers that are here, you will notice that there is a significant component of short-term debt, 11.4 percent.

The typical gas distribution company, which collects a lot of its revenues in variable commodity based volumetric rates, makes its money in the winter, loses money in the summer. So if you have a September 30th year end you are going to have to raise a significant amount of short-term debt as interim financing to reflect the fact that your money is not going to really start coming in until the winter.

So for these companies the year end common stock ratio will generally understate the average, if you took the 12 month average for the whole year.

Q.175 - I can't argue with you. I don't know. All I am saying -- look at the average equity ratio for gas distributors that is, you know, down close to the bottom,

34.5 percent.

A. Correct, including that significant component of short-term debt.

Q.176 - I guess what -- when I looked at that I was struck by the difference between what appears to be the average equity ratio for gas utilities in Canada at 34.5 percent, and your suggestion that a 50/50 debt equity ratio is appropriate.

A. I think my analysis went through and explained why the difference.

Q.177 - Okay.

A. Number 1, we do have -- as I suggested, on average here if you look at this 12 percent short-term debt, some of that needs to be factored out to determine what the typical over the entire year average would be.

Number 2, I don't think personally that one can look simply at the gas distributors. I mean I think one has to look at -- because there are a relatively small number of regulated companies in Canada, that one needs to look at both electric and gas utilities.

Q.178 - But even when you look at the electrical utilities, none of those come even close to a 50 percent --

A. No, and none of those are a greenfield operation, and on average they are significantly larger companies.

Q.179 - Okay. And look, I will get to size eventually. The

other thing that struck me when I looked at schedule 1 was again -- and I will go back to electric for these purposes if you wish -- the fact that the equity in gas distributors was 34 percent, the average, down at the bottom, and the equity in electric utilities was almost 41 percent.

A. Yes.

Q.180 - Now does that mean that investors consider -- or that anybody considers gas distributors less risky than electric distributors?

A. I don't believe there is any evidence of that at all.

Q.181 - Okay. Look, I just wondered if the amount of equity versus debt in a corporation translated at all to a perception of risk. That was the reason for that question.

A. Well the fact of the matter is that electric utilities have typically been looked at as of lesser risk, and that may well be in part because they have been allowed on average to maintain somewhat higher common equity ratios.

For purposes of assessing the relative business risk, generally speaking electric utilities have been viewed as facing less business risk than gas distribution utilities.

Give you an example. Standard & Poors, which rates both electric and gas utilities in Canada and in the U.S.,

has guidelines for capital structures, and if you look at the guidelines for a gas distributor versus an electric utility, the required debt ratio for an electric utility of average business risk to achieve the same debt rating as a gas distributor of average business risk, the electric utility needs to have less -- can have more debt and still have that same debt rating.

So Standard & Poors considers electric utilities generally speaking to be less risky than gas utilities.

Q.182 - Okay. When you were conducting your analysis did you look at any of the statistics or financial results for Enbridge Inc., the parent?

A. I did not.

Q.183 - Did you look at any of the statistics or financial results with respect to Enbridge Consumers Gas?

A. Yes.

Q.184 - And did you look at any of the results for any of the other affiliates, financial statements --

A. No. And the only reason I looked at the financial results or statistics for Enbridge Consumers Gas was because Enbridge Consumers Gas is a large mature utility, just as I looked at statistics for BC Gas, Centra Gas Manitoba and the various electric utilities, Union Gas.

Q.185 - Ms. McShane, could you get out your response to Board interrogatory 64, so that will be E-64.

A. I have that.

Q.186 - There is a -- page 2 of that is a capital structure matrix?

A. Yes.

Q.187 - And in that matrix there are three local distribution companies, Centra Gas, Pacific Northern -- and Pacific Northern in 1999?

A. There are 1, 2 -- you told me just in British Columbia?

Q.188 - No, no, no, no. I just said that there are three -- on page 2 of 10 --

A. Yes.

Q.189 - -- there are three local distribution companies mentioned, Centra Gas, Pacific Northern Gas in 1997 --

A. Oh, sorry, okay. You are double-counting Pacific Northern Gas. Yes. That's correct.

Q.190 - And Pacific Northern Gas in 1999?

A. Yes.

Q.191 - And I looked at those and none of them had a debt equity ratio anywhere close to what you are proposing. Centra Gas, no more than 65 percent debt, no less than 35 percent equity?

A. Correct.

Q.192 - Pacific Northern in 1997, 59.09 percent debt, 3.38 percent preferred and 37.54 percent equity. And then

Pacific Northern in 1999, 36 percent equity ratio?

A. Yes. And these are all mature companies.

Q.193 - Okay.

A. Don't forget what also is not on this table is whether or not there is some kind of offsetting return on equity to reflect the fact that -- for example take Pacific Northern Gas which is a relatively small company. The Commission has determined that the equity ratio will be 36 percent.

But in its -- in addition it allows the company to earn a return on equity which reflects a significant premium over the return that allows a company like B.C. Gas, which is also under its jurisdiction, to earn.

So in that particular instance there is some component of risk compensated for in the return and some component of the risk compensated for in the capital structure.

Q.194 - Okay. In your opinion is there some point in time when Enbridge Gas New Brunswick will become mature, so that its debt equity ratio should change to be consistent with the other Canadian gas utilities?

A. I would suggest that at some point in time that would be reevaluated and the capital components would be more likely to reflect those of mature utilities, yes.

Q.195 - Okay. Now you have the forecasts in terms of volume forecasts and customer hookup statistics and materials of

that nature. In your view, if Enbridge Gas performs up to its forecasts, when would that be?

A. That it would actually --

Q.196 - Become a mature utility.

A. Well, the forecast at the moment is that the development period will end in eight years. At that point in time, it is anticipated that the company will be able to have the opportunity to earn a return commensurate with its risk and have the cash flows to support that.

I would think that at that point one would come back and reevaluate the return in the capital structure. I'm not sure that I would say it would be a mature utility at that point. But it would be at a point between a greenfield and mature utility. But I think, you know, at that time we need to reevaluate it in terms of the market circumstances that face it.

Q.197 - Okay. Can you look please at schedule 2 under tab C of your evidence?

A. I have that.

Q.198 - Now bear with me. Bond rating and bond rating services are a mystery to me. Among the Canadian utilities that are listed here, Pacific Northern Gas has the lowest rating?

A. Yes.

Q.199 - Okay. CBRS I'm told is something like a Canadian Bond

Rating Service?

A. Yes.

Q.200 - I must admit I did never ask what DBRS is?

A. The Dominion Bond Rating Service.

Q.201 - Also a Canadian?

A. Yes.

Q.202 - Do you know -- Pacific Northern Gas, is that a small utility --

A. Yes.

Q.203 - -- relatively speaking?

A. Yes, it is.

Q.204 - Okay. And then I went to look for -- by the way, just so we can get this on the record, it goes B and then B+. I'm just trying to get the ratings fixed in my mind from the worst to the best?

A. From the worst to the best. Well, the worst is like D.

Q.205 - Okay.

A. But --

Q.206 - For our purposes here, I guess.

A. For our purposes here we would be looking at B+ which would be the rating that I suggested that EGNB might be able to achieve if it -- somewhere between B+ and triple B.

So we go from B+, triple B which is also the same as

-- is it B++? B++, that's right. And then A and then double A.

Q.207 - Okay. So am I correct it would go A, A+ then double A, from low --

A. Well, let's --

Q.208 - -- to the top?

A. Can we focus on one of the rating agencies, since their categorizations are a bit different?

Q.209 - Oh, okay. Sure.

A. So if we looked at -- well let's look at DBRS since it's in the first column. So triple B. And within the triple B there will be a -- there are three gradations. There is triple B low, triple B, triple B high.

Q.210 - Okay.

A. And then there is the A which would be A low, A, A high. And then there is double A low, double A, double A high. And there used to be triple A. But there are no longer any regulated companies in Canada rated triple A.

Q.211 - Okay. So in terms of size -- and this whole line goes to -- I will get to size in the end. CU, Inc. which is related by -- is rated by CBRS as A+ is a small --

A. CU, Inc. --

Q.212 - Yes.

A. -- is a large company.

Q.213 - Large. Trans-Alberta Utilities?

A. Large.

Q.214 - Okay.

A. Trans-Alta Utilities, is that what you said?

Q.215 - Trans-Alta? Yes.

A. Yes. Is a big company.

Q.216 - Okay. Maritime Electric?

A. Small.

Q.217 - Consumers Gas --

A. Big.

Q.218 - -- is large. So I guess I can't draw any bond rating conclusion based on size of the utility?

A. Sorry?

Q.219 - A small utility can have a high bond rating?

A. Oh sure.

Q.220 - A small utility can have a low bond rating, size doesn't matter?

A. Of course it does. I don't think that this discussion we have had says anything about whether size matters. I know that Mr. Kumar had some problems with my little example in my testimony, where I compared companies. And I took two telephone companies and two electric utilities and showed that even though the smaller companies had better financial parameters, that they had lower bond ratings than the larger companies.

Now you can't just willy-nilly compare all these

companies and assume that everything else is equal, because it's not.

What I tried to do in this analysis was to choose companies that operated in similar industries and therefore -- and in similar operating environments to make this comparison.

So let's compare CU and Maritime Electric. They are both electrics. CU is a big company. It has got a higher rating than Maritime Electric. That's a comparison I would be willing to make.

Q.221 - Okay.

A. B.C. Gas is a bigger company than PNG. It has a better rating. I mean, having said that -- I mean, PNG faces a lot of different risks than B.C. Gas faces.

So I mean, I would be hard-pressed to say that the reason that PNG has a lower rating than B.C. Gas is because it's a smaller company.

I mean, it probably would. But the fact of the matter is that PNG has its own set of business risks, that if it had those same business risks as a large company, it would be lower rated.

So when I did this analysis to try to figure out if size had an impact, I was trying to filter out all of those other factors that would also come into play, so that I was left with a comparison that would permit me to

conclude that size was the determining difference.

And that results from the fact that I'm familiar with all of these companies.

Q.222 - Okay. Let me try it this way. Do you know what Enbridge's bond rating was prior to August 31st of last year?

A. No. I suspect it was A minus. But I don't know.

Q.223 - Okay. Do you know if the execution of the general franchise agreement by the Province of New Brunswick and Enbridge Gas New Brunswick had any impact on the bond rating of Enbridge Consumers Gas or Enbridge Inc.?

A. I doubt it. It's not big enough. Let's try it this way. Enbridge Inc. is a company of about -- that has probably \$7 billion of debt.

And in the long run it's going to raise on behalf of or lend to EGNB let's say \$150 million. That's 2 percent of its total debt.

The impact on the overall cost of debt. If the implicit cost of debt for EGNB is 2 1/2 percent higher than the cost of debt for an A rated company, is about 3 basis points.

The relative spreads change by more than that on, you know, a month-to-month basis. So the fact that you could not perceive a change in the debt rating because of this debt does not mean that there is not an effect.

And that the true cost of debt to EGNB is still 2.5 percent above the yield on 10-year Canada's, if it were a huge increase in the debt of Enbridge Inc., yes, then you would see that.

Q.224 - Okay. Can I ask you to get out your response to the Province of New Brunswick's interrogatory number 35, so that is F-35?

A. I have that.

Q.225 - Now as I understand what this is telling us is that in March of this year Enbridge Inc. incurred some debt at 6.815 percent or 67 basis points over the 10-year Canada long, whatever the proper term is?

A. 10-year Canada, yes.

Q.226 - Okay. How do you -- again basis points is -- how did you arrive at the 67 basis point number? How do you do that?

A. When a company goes out and issues debt, the underwriters will price that issue in relation to a benchmark. And the benchmark has a yield.

And so the differences in the yield at which Enbridge raised its issue and the yield on the benchmark Canada issue at the same point in time.

Q.227 - Okay. Now I want to talk about this concept of risk premium in terms of --

CHAIRMAN: I think I should risk an interruption here.

Perhaps it is a good time to take our luncheon break. And just before we do that, Mr. Blue?

MR. BLUE: Mr. Chairman, on the record, I'm now providing Mr. O'Connell with a full copy of the National Energy Board's August 1980 decision in RH-2-80.

MR. O'CONNELL: I suppose I will be forced to read it now. Thank you very much.

CHAIRMAN: We will break for lunch and try and be back at 1:30.

(12:30 p.m. - 1:30 p.m. - Recess)

CHAIRMAN: Before we begin, the Board almost lost the head table before lunch. And they have repaired that. They have propped up with pieces of bark.

And we have had our chairs oiled. But the WD-40 smell up here is unbelievable. So if we all pass out in unison you will know what to tell the ambulance attendant.

Go ahead, Mr. O'Connell.

MR. O'CONNELL: Thank you.

Q.228 - Ms. McShane, in your response to the Province's interrogatory number 35 you indicated that in March of this year Enbridge borrowed at a rate of 6.815 percent?

A. Yes.

Q.229 - And that that was 67 basis points over the 10-year Canadian long?

A. Yes.

Q.230 - And I hope I'm using the right terminology. If you would turn to schedule 8 under tab C. And I'm going back to this rating business?

A. Yes. I have that.

Q.231 - Okay. Page 2 of that is entitled "trend and interest rates and outstanding bond yields."

And I think what you said before lunch is that the best that Enbridge Gas New Brunswick could achieve is B++?

A. Well, that would have been the upper end of the range.

And then I said that it would be between that and a B+.

Q.232 - Okay. The most recent number we have there is for November 1999 or about five months ago. An A rated utility, which would be Enbridge, could borrow -- or shows 7.24. And a B++ shows 7.26.

And can I take that to say that the spread between Enbridge borrowing and Enbridge Gas New Brunswick borrowing might be in the vicinity of 2 basis points?

A. No. Because of a couple of things. (1) that's a spot difference. (2) if you are going to look at the typical spread you need to look at it over a period of time. (3) these are specific issues of specific companies which may have a split rating, which means that one of the bond rating agencies may rate that issue A and one of them may rate it triple B. And it may appear under the triple B issue.

One doesn't know specifically what issues are in those two categories, so that they may be a noncomparable mix of maturities.

For example the triple B's might be predominantly 10-year bonds. And the A's may be predominantly longer term bonds. And as well these are outstanding issues which the yields may not be comparable because -- let's see if I can explain this simply.

If you issue a bond let's say when interest rates are at 8 percent, the yield on that bond when interest rates go down to 6 percent will be higher than the yield on a bond that is issued at the time interest rates are 6 percent. So it will be a -- the 8 percent bond will be a premium bond and tend to trade at a higher yield.

So you cannot directly compare those in addition to the fact that the likely rating, if EGNB could even get a rating, would be -- you know, as I said, the B++ is the very max'. And it would be between B++ and B+, not at B++.

So for all of those reasons, no, I don't agree that you can say that the difference is 2 basis points.

Q.233 - Okay. All right. The McShane factor -- I forget what you called it now in response to Mr. Blue's question this morning?

A. Oh, about the equity risk premium --

Q.234 - Yes, the risk premium?

A. -- was that a Kathy McShane risk premium?

Q.235 - Okay.

A. Well, yes. Because -- you haven't asked the question, but the fact of the matter is that the equity risk premium is an estimate.

I mean, it is not an observable number. So every analyst has to come up with an independent estimate of the equity risk premium.

It's not like you can just go out and see it the way you can observe yields on long-term government bonds for example.

Q.236 - Okay. And there are a number, I think, of factors in the Enbridge Gas New Brunswick situation that mitigate the risk premium?

A. There are some mitigating factors --

Q.237 - Yes.

A. -- to what would otherwise be the required premium without those factors.

Q.238 - And one of those is the deferral accounts?

A. That's correct.

Q.239 - Another one of those is the proposed 50/50 debt equity ratio?

A. That would be a partial mitigant to the business risk, yes. It would -- the required return would be lower with

a 50/50 capital structure than if it had a 65/35 or a 60/40 debt equity capital structure.

Q.240 - Okay. Another one would be the rate flexibility that this particular applicant seeks?

A. Well, that is a risk mitigant in the sense that without that ability to flex rates, the risk would be higher because the company wouldn't have any ability to move its rates with changes in the market, yes.

Q.241 - Okay.

A. So in that respect it mitigates what would otherwise be the risk if it had to set a rate and live with that rate without being able to adapt to market conditions.

Q.242 - And another one would be the financial support that Enbridge Gas New Brunswick is receiving from its parent?

A. The financial support that it's receiving? And you mean by that the fact that it is --

Q.243 - One of the sources of funds for Enbridge Gas New Brunswick is its parent?

A. Oh, in that sense the cost of debt that is being accessed from the parent is less than it would be and more accessible than it would be, and with less onerous covenants than it would have to agree to, than if it raised it on its own.

Q.244 - I guess to me it would be very different if Enbridge Gas New Brunswick was standing out there all by itself.

But it has this parent that it can turn to and has turned to for support of different types, financial, expertise?

A. Yes. And those benefits have passed on, will pass on to the customers through the availability --

Q.245 - Yes.

A. -- of services.

Q.246 - And that mitigates the risk?

A. There is some risk mitigation in that regard, yes.

Q.247 - As a matter of fact the affiliation, if I can use that term, between Enbridge Gas New Brunswick and the other Enbridge companies, also would mitigate the risk. It lowers the risk because Enbridge Gas New Brunswick isn't out there all by itself?

A. Well, it lowers the risk to the customers, that the services would not be available on a competitive basis, yes.

MR. O'CONNELL: Ms. McShane, those are all the questions I have for you. Thanks very much.

MS. MCSHANE: We could have finished that before lunch.

MR. O'CONNELL: Well, you are exactly right.

MS. MCSHANE: Thank you.

BY THE BOARD:

MS. ZAUHAR: If I may just, Ms. McShane, go -- following from what Mr. O'Connell just said. If it is true that the benefits derived from the fact that there is a parent

company out there, it does I think you admit lower the risk?

A. Yes.

MS. ZAUHAR: Why then do you say that the return on equity of 13 percent is reasonable?

A. Because the 13 percent with all of these factors taken into account reflects the business risk and the financial risk within the context of the entire operating environment that this company faces.

It faces a different risk profile than the parent company. And the 13 percent reflects that overall business and financial risk profile.

MS. ZAUHAR: Okay. If you don't mind, explain to me what you mean by a different risk profile. I mean, I understand the words and the phrasing, but how does that actually -- how is that reflected in the return on equity?

A. Okay. Let's perhaps back up and look at -- try to look at this from the perspective of an investor. And in this case the investor would be Enbridge Inc.

Enbridge Inc. would likely look at this project and say to itself, how does this project compare in risk to other projects that I might invest funds in?

Now it has some of its own projects or companies with which it can compare Enbridge Gas New Brunswick. It can compare it with the business risk that it faces or that

its investment in Enbridge Consumers Gas faces.

So maybe if we take that as an example. Enbridge Consumers Gas is, as I discussed earlier today, a mature company with a diverse market, a market that has been developed over time, a market that is able to and knows that it's going to be able to access about 95 percent of additional customers coming into the marketplace.

It knows that its cost of service rates will be competitive with alternate -- it doesn't know that, but it has a better idea that its cost of service rates can stay competitive with those of alternative fuels, and in contrast to a brand-new market where everything is going to have to be built from the ground up.

So it's going to say to itself well, if I can achieve a return of let's say 10 percent in a company like Enbridge Consumers Gas, what kind of a return do I need in addition to that for me to take some of my investment funds and put them in a greenfield utility?

Or if I have funds available to do that, what kind of return could I get if I decided instead -- or do I require if I decided instead that there was a new pipeline project or a mature pipeline project?

So Enbridge Inc. as an investor will look at that greenfield risk, as I did independently, to assess what is the additional return that would induce me to put that

money in that project versus any number let's say of various mature utilities for which the fortunes have already been tested?

MS. ZAUHAR: Okay. So that is assuming that -- that is working with the scenario that you have got a parent company investing, as we are now into an affiliate, and providing all those benefits talked about earlier. What would you expect would be a reasonable rate of return, using the exact same scenario, greenfield situation but not a parent company?

A. In principle the return expectation should be approximately the same, in my personal view.

MS. ZAUHAR: Okay. I'm sorry. I don't mean to interrupt you. No. Please go ahead.

A. But that is not to be said that there are not synergies that can be brought to bear by having access to various skill sets, various expertise --

MS. ZAUHAR: Expertise?

A. -- in other parts of the company. And what happens in that regard is that those benefits essentially get shared as between the company and the customers.

MS. ZAUHAR: Okay. And that is how I view it as well. And so I understand what you are saying. But I have trouble making the leap to the fact that those benefits -- in terms of benefits being the expertise, the knowledge, you

know, the years and years of experience in that field elsewhere.

But I can't make the leap from there to that translating into benefits to customers at 13 percent. If that rate of return is, as you say, somewhat equivalent to what you would find in another situation where it weren't the parent company investing in an affiliate, how does that 13 percent then translate into customer benefits?

A. Well, the 13 percent itself -- I mean, I wouldn't say that that element translates into a customer benefit. The customer benefits arise from all of the other relationships, the availability of the skill sets, and indirectly in the cost of debt that we have talked about, the fact that there are lesser costs that will be imposed upon Enbridge Gas New Brunswick in terms of issue cost, legal cost, prospectus cost, all of those costs that as a totally stand-alone company, that company would incur. And as an investor in that company indirectly you would incur those as well.

MS. ZAUHAR: Okay. And I don't mean to belabor the point at all. I'm just -- I must admit I'm having a lot of difficulty still making that leap. Because I agree with everything that you stated in terms of the benefits derived from a parent investing in the affiliate.

However, I would think -- and you have said that if

this were some other financial institution in the same greenfield situation making the same kind of investment, a rate of return of 13 percent would nonetheless be reasonable?

A. Correct.

MS. ZAUHAR: And that means that that 13 percent, regardless of the fact that a parent exists, is reasonable?

A. Correct.

MS. ZAUHAR: Okay. Well, perhaps we could use that as a starting point and then work backwards.

If 13 percent is a reasonable rate of return for someone else than a parent, then why can't we say by virtue -- by virtue of the fact that we are using a parent, then the rate of return should be less, because the benefits that you have described should somehow be reflected to customers?

If you are telling me that as a customer -- as a customer of Enbridge N.B. Gas, I will benefit from the expertise, the know-how, the skills that the parent company will be investing in the affiliate, then why am I not looking at less than a 13 percent rate of return? How can that possibly not affect the rate of return?

A. Because each investment that any company makes has to be looked at on the basis of its stand-alone business and financial risk, not as a result of the relationship as

among the companies.

I mean, I would not say that, if I were going to invest in some shares let's say of a utility, where I am not going to take over a majority position that I would view the return requirement from those shares any differently than I would look at the return requirement if I were going to acquire the entire company. I would look at those on a similar basis, recognizing that inherently the risks of that operation are no different.

MS. ZAUHUR: Okay. Now I think that you have -- I think you have explained to us that it is important to look at the risk profile of the affiliate --

A. The affiliate being?

MS. ZAUHUR: I'm sorry. NB Gas.

A. Yes.

MS. ZAUHUR: -- as opposed to looking at -- as you put it earlier, looking at the risk profile from the investors' point of view as to where will I invest or what is worth my while. We need to look at the risk profile of NB Gas as a --

A. Yes, but it is from -- it is from the investors' perspective, but it is not from any particular investors' perspective. It is from -- it proceeds on the assumption that investors in the utility industry, let's just take that as an example, will have homogeneous expectations,

that the cost of equity for a utility is the cost of equity for a utility. It is not a different cost of equity because of who owns the company.

So just to give you an example for -- just to follow the logic through a little bit, if you are going to allow a return for this company that reflects appropriate compensation for the business and financial risk, it doesn't make any sense to my mind to say, well if the ultimate parent of this company is Enbridge Inc. I will let the company earn 13 percent, but let's suppose the company went public a year from now, and it was in the hands of multiple investors, are you all of a sudden going to say that the return to this company should be 14 percent? No. It is -- the return should be set irrespective of the happenstance of ownership. It should be based on the basic intrinsic business and financial risks of that company.

Just as with the cost of debt. If you have an affiliate today who is willing to make an arrangement with Enbridge New Brunswick to -- let's say to 250 basis points, and the -- for whatever reason the Board said, no, we don't think that's right, we think you should charge your overall cost of debt which, you know, is an A rating.

Well suppose tomorrow Enbridge was -- became an affiliate of a company that was a C rated company -- now I

am not suggesting that that would ever happen, but it's always a possibility -- are you now going to say the cost of debt to Enbridge Gas New Brunswick should be that of the C rated company? No. The cost of debt to Enbridge Gas New Brunswick should be reflective of the business and financial risks of Enbridge Gas New Brunswick.

MS. ZAUHUR: But on the flip side you agree that -- or you support the position that its investment from its parent company brings good things that positively impact on its cost of debt --

A. Yes.

MS. ZAUHUR: -- and in turn positively impact on its rate of return?

A. I agree that they positively impact on the cost of debt. I agree that they positively impact on the various costs that Enbridge Gas New Brunswick will likely incur. But I believe that the rate of return on common equity is -- would -- should be the same irrespective of the ownership.

And when I say that there are benefits from the cost of debt, that's -- that essentially is because Enbridge Inc. will have made an arrangement with Enbridge Gas New Brunswick to confer those benefits.

I mean Enbridge Inc. is certainly in a position to ask Enbridge Gas New Brunswick to pay the same costs that it

would fully pay and to try to I suppose impute the same type of accessibility to the debt market that the company would have if it had to go out and raise the money itself with the banks or insurance companies, but it has made the decision that it makes a lot more sense to make sure that this company gets up and running to confer those benefits on Enbridge Gas New Brunswick.

MS. ZAUHUR: Okay. And cost of debt is a component of return on equity?

A. No. Cost of debt is a component of the return on capital, where the return on capital is made up of the return on debt, the return on equity, and the return on debt applies only to the 50 percent debt component, and the return on equity applies to the 50 percent common equity component.

MS. ZAUHUR: To the 50 percent. Okay. Sorry. I misspoke on that. Great. I do have, Mr. Chair, another question.

You mentioned that in looking at -- in preparing your evidence you looked at the -- or part of the proposal that had been presented by Enbridge to the Province, and you mentioned that perhaps if you had done a full review -- and I don't mean -- you know, I use the word full loosely, I don't mean to insinuate at all that what you prepared or reviewed was incomplete, so I apologize for that -- but if you had started -- I think de novo is the manner in which

you described it -- you probably would have provided a range as opposed to a fixed target of 13 percent?

A. I think we were talking in that context about capital structure ratios --

MS. ZAUHUR: Yes.

A. -- and the fact that a reasonable capital structure tends to fall within a range, and yes, one has to choose at the end of the day a specific number for purposes of in this case setting the cost of service, but there is no single one magic number, if you will, that every company, you know, has to have that specific capital structure.

MS. ZAUHUR: Sure. And that is likely the reason why you usually provide a range, I would think.

A. If someone is asking me specifically to recommend a capital structure for their business, then I would likely recommend a range, and that's also true on the rate of return on equity. And typically on the rate of return on equity I would make a recommendation within say 50 basis points. So in this context if we -- if 13 percent had been the mid point of --

MS. ZAUHUR: The range.

A. -- my de novo range, then I would have reflected it in a range of 12.75 to 13 and a quarter.

MS. ZAUHUR: Sure. And I guess in -- I think you confirmed earlier that had you actually undertaken a complete or

full analysis independently on your own without being presented with this particular proposal, your testimony was that you would have come up with the same numbers.

A. Approximately the same capital structure but a somewhat higher return on equity. Because on the return on equity what I did was start as I indicated with the allowed returns for other utilities as a point of departure, rather than saying, well this is my -- this is my own personal analysis of the fair return for a mature company, that number being somewhat higher than what Boards have typically allowed, and therefore bringing into the whole discussion that -- I will call it a controversy if you will, I mean there are differences of views on what constitutes fair and reasonable return for a mature utility, and avoiding that by starting with the allowed returns and then from that point developing just the risk premium above and beyond that would compensate for the fact that this is a greenfield situation.

MS. ZAUHUR: Okay. So is it fair to say that you sort of skipped or assumed let's say a first stage of that analysis?

A. Well assumed is really not what I would characterize it as, because I have been involved in developing recommendations for returns for gas distribution companies regularly.

So I mean I know that I would and have recommended a return on common equity for a mature average risk LDC within the last six months when interest rates have been in the range that they are of about 11 percent.

So if I had given the Board the full blown presentation developing that number, that's what you would have seen, as opposed to saying, well we don't really need to go that far here. We know that regulators have been allowing 10 percent, 11 percent, in the U.S. and Canada, and that gives us a benchmark upon which to build.

MS. ZAUHUR: Okay. So is it then fair to say that the fact that you did not undertake a complete review and analysis is not significant in this instance?

A. I would say it is not significant in this instance, because I did undertake a complete review and analysis of the business and financial risks of this company, I have done, if not presented in this forum, a complete review and analysis of the cost of equity for a mature utility, and have knowledge of the basis for the benchmarks being the allowed returns that have already been vetted, if you will, by regulators.

So the shorter answer would have been, no, it isn't significant.

MS. ZAUHUR: Okay. That leads me to -- and I guess it just raises two other questions in my mind.

One would be, when is it significant to ensure that you undertake that first stage? And secondly, if you didn't undertake, as you say you didn't, then on what basis do you say that, but even if I had my numbers would be the same or close to being the same as what was presented in the proposal?

A. I think it becomes significant in the event that there are an inadequate number of returns that have been allowed in recent years, or in the recent past, within the last year, let's say, to permit one to make the assumption that those returns are indicative of what a mature company would be allowed in any number of jurisdictions if it had had a rate case in similar economic and capital market conditions.

I think it also would be significant in the case where there were major concerns on my part that the average rates of allowed returns simply were totally out of touch with capital market reality.

MS. ZAUHUR: Okay. Well is the fact that this is a greenfield situation -- perhaps I am wrong, but in my mind it would be sufficient to justify -- or it would actually reflect a significant economic factor that would justify actually undertaking that first stage?

A. Well maybe we are miscommunicating. I think that the first stage could have taken one of two approaches.

The approach that I took, which was to say that the returns that have been allowed for mature utilities are a relevant point of departure, a relevant benchmark against which to assess the premium that would be required for a greenfield operation, and then assess the risk of a greenfield operation relative to those values.

The second approach would be to have presented to you -- maybe I could direct you to an exhibit. I am trying to think where it is.

This is the Province of New Brunswick interrogatory number 38, and there are three complete testimonies that are filed in there.

MS. ZAUHUR: Thank you. 38?8?

A. Yes.

MS. ZAUHUR: Yes.

A. And I direct you perhaps to the first one which is entitled, "Fair Return on Common Equity for a Benchmark Utility". It was prepared on behalf of three utilities in British Columbia. And essentially what this did was establish in my view, and with my analysis, what a fair return would be for a benchmark low risk electric or gas distribution utility.

If I had done that first step, this is what you would have gotten, okay. You would have gotten a recommendation that the return for a mature LDC would have been 11

percent, because that is what this analysis would have shown, and then you would have gotten the 17 pages that you did get --

MS. ZAUHUR: From you.

A. -- which goes through the difference between the mature LDC and the greenfield.

So --

MS. ZAUHUR: Okay.

A. -- what I decided and -- was that rather than go through all of this to get to 11 percent, when various regulators around the US and Canada have already determined that generally speaking returns are in the range of 10 to 11, let's start there and go only through the business and financial risk analysis attributable to the greenfield.

MS. ZAUHUR: Okay. And you say that you would have come up with these so-called pages from interrogatory number 38 because -- for what reason? You had that in your possession at the time you prepared your review, or from your experience?

A. I had this -- this, you are talking about this particular document?

MS. ZAUHUR: Yes.

A. I would have had this in my possession when I did the review because I had prepared this on behalf of these

companies in May of 1999.

MS. ZAUHUR: Okay.

A. And at the same time, you know, I have been doing further analysis for mature LDCs in the interim to know that these conclusions would not have been altered.

MS. ZAUHUR: Okay. So if we can go back to my second part of that original question which may have been like two or three comments ago, you say that if you had prepared a de novo review, although not unreasonable to find a 13 percent return on equity, you would likely have provided a range, and your range would likely have been around the same as what has been presented. Now --

A. Somewhat higher, I believe, because --

MS. ZAUHUR: Okay.

A. -- we would have started with the 11 and added the 200 or 300 basis points to it --

MS. ZAUHUR: Right.

A. -- which would have given us something a bit higher than the 13.

MS. ZAUHUR: Right. Okay. Did you actually go through that exercise?

A. Which exercise?

MS. ZAUHUR: The exercise of starting at 11 percent, because -- and I say that, ma'am, only with -- because you present this -- these ranges with some certainty that they would

have been likely in that range. And so I am wondering if you actually went through the exercise or you are just basing that on what, I guess is my question? On what are you basing that?

If you didn't actually conduct or perform or undertake a full and complete analysis, then how can you state that those ranges would likely have fallen within what is presented?

A. Well I think there are two issues. One is the rate of return on equity and one is the capital structure. And I want to differentiate those because the capital structure itself requires a full analysis of the business risks of Enbridge Gas New Brunswick. I did that. I performed that.

My conclusion would have been, had I been asked to provide a recommendation for the capital structure, would have been to set the common equity ratio in the approximate range of 47 to 52 percent. 50 percent is in that range. That is the number that the company proposed and therefore it's in the middle of the range. It is a reasonable capital structure, from my perspective.

With respect to the return on equity, I have undertaken the full analysis of fair return on equity for a mature utility. That return, to my mind, is 11 percent.

I did not present it in this case, rather I went through

only the indepth analysis that was presented with respect to the business and financial risk and the premium for Enbridge Gas New Brunswick.

So no, I didn't present the full analysis of the fair return for a mature utility, but it was performed. It may not have been performed specifically after I received a phone call asking me to review this, but this is something that I do and on a regular basis.

So that information and those analyses were available to me. The only conclusion that I needed to draw from them is that those analyses were indeed the starting point insofar as they reflect a fair and reasonable return for a mature utility, in this case a mature gas utility.

MS. ZAUHUR: Right. Although you say that had you done that from scratch, let's say here in this instance, your range would have started at 11 percent?

A. My range for a mature utility would have started at 11 percent, that's right.

MS. ZAUHUR: True. Okay. Have you ever been involved either for the purpose of this particular hearing or in your several years of experience prior to that or prior to today, in the analysis of a utility in a greenfield situation?

A. Yes.

MS. ZAUHUR: And would that be one of the three -- I know

you mentioned three in the States and three in Canada earlier, would that -- that or those -- would you have been involved in any of those?

A. In the -- in Nova Scotia.

MS. ZAUHUR: In Nova Scotia. And what year was that one?

A. Last summer.

MS. ZAUHUR: Okay. And do you -- I don't -- perhaps -- is any of that evidence before the Board?

A. It is not.

MS. ZAUHUR: No. Would you mind providing us with some information as to how -- what we have compares to what you did in Nova Scotia?

A. The analysis -- the approach taken was similar, the project was different a bit, and the -- it was not for the company that won the franchise.

MS. ZAUHUR: And what was the anticipated or expected or reasonable rate of return on that particular project in which you were involved?

A. I determined for them that the return should be 13 percent.

MS. ZAUHUR: And would you just enlighten me a little bit as to whether that -- how different that was? Was it -- did it involve a parent company investing in an affiliate, or was it something completely different? I am not at all familiar with that particular proposal of which you speak.

A. It did involve a parent company. It was a proposal by Westcoast Energy and Irving Oil, and it was -- in contrast to the approach here, both parties who bid for the franchise in Nova Scotia presented their proposals to the Nova Scotia Public Utilities Board and went through extensive interrogatories and cross-examination.

MS. ZAUHUR: Typical, yes.

A. You want me to sort of describe the difference in the -- I mean the project as proposed was similar in the sense that the company was proposing to have target rates that would be tied to alternative fuels -- you are taxing my memory at the moment on this because I don't specifically recall all of the details.

The company was proposing a deferral account for under achieved returns in the early years.

MS. ZAUHUR: In terms of size how would it compare to what is before us today?

A. Well as the -- my understanding of the proposal that won, which was the Sempra Atlantic proposal, they are talking about a utility that will be about 600 million dollars in size, and this one is as proposed 300 million dollars.

MS. ZAUHUR: And do you recall the extent of the developmental period proposed?

A. The proposal was -- did not envision a developmental

period in the same sense that this proposal does. My recollection is that the proposal would have utilized market base rates throughout the life of the project, but that there would have been a sharing mechanism on the returns above a return of 11 percent, and there was a scale of returns. But the way the proposal and the market was structured my recollection was that there probably wouldn't have been any sharing within at least the first 30 years of the project.

MS. ZAUHUR: In your opinion would it have been or be useful to compare that particular situation with this one?

A. Would it have been useful?

MS. ZAUHUR: Would this --

A. It's not a situation that the return was ever accepted in. So I mean I think that what is -- what is most useful is to compare the project that the Nova Scotia Board actually accepted. And that was a return of -- as I said earlier, a return of 15 percent was what the company projected and the Nova Scotia Board in its decision when it accepted that proposal allowed -- will allow Sempra Atlantic to earn I believe a cumulative return up to 20 percent.

MS. ZAUHUR: Okay. So strictly from a comparative analysis point of view, it is your position that it would not be useful to compare even assumptions or premises on which

you would have been involved in that particular project.

So you don't see any usefulness in --

A. Well I am not saying that it wouldn't be particularly useful, but I think what's more useful is for the Board to look at returns and capital structures for projects that were actually approved, and returns available on actual projects rather than hypothetical numbers that will never be used anywhere.

MS. ZAUHUR: Okay. Thank you very much, Ms. McShane.

MS. MCSHANE: You are welcome.

MR. LUTES: My question will be brief. If the essential elements were all to remain unchanged save and except one, and that is the debt financing from the parent or affiliated company, and replace that with third party financing, independent third party financing with the accompanying covenants and restrictions and issues default and all of that sort of thing, if you were to do that would your view of the required return on equity be different, do you think?

A. No. I don't believe it would be different.

MR. LUTES: Thank you.

CHAIRMAN: Mr. MacDougall?

MR. MACDOUGALL: Just a couple of questions, Mr. Chair.

REDIRECT EXAMINATION BY MR. MACDOUGALL:

Q.248 - Ms. McShane, if Enbridge Gas New Brunswick was to have

a return of 13 percent and it was to be widely held in the general stock market, could you tell me what specific benefits that might give to the customers of Enbridge Gas New Brunswick?

A. None specific --

Q.249 - And if it had --

A. -- on benefits.

Q.250 - And if it had a rate of return of 13 percent yet it was owned entirely or partially by Enbridge Inc., what specific benefits would that give to the customers of Enbridge Gas New Brunswick?

A. Well, I have indicated what I thought the benefits were in terms of the access to financing, the less onerous covenants on the debt financing than would be required as a company that was accessing its own debts, lesser costs associated with the actual issue of the debt in terms of legal costs, preparation costs.

There would be less onerous covenants in terms of capital structure requirements, coverage requirements, dividend distribution requirements that often underpin those kinds of debt issues.

The company would be able to issue smaller amounts of debt when it needs rather than waiting until a significant enough tranche of debt needs had built up so that it could go to an insurance company or a bank.

There will obviously be the benefits associated with being able to draw upon the expertise of people in the treasury area, people in the insurance area, people in the area of gas operations, engineering, all of those skill sets that can either be found in the parent company or among some of the affiliates.

Q.251 - So in your view, at a given level of return, which would be better for the customers, for the company to be widely held or for the company to have some ownership and involvement by Enbridge Inc.?

A. I believe the customers will be better off by having the ability to look to Enbridge Gas New Brunswick's ability to get services and skills from its parent company and from its affiliates.

MR. MACDOUGALL: Thank you. That is all my questions, Mr. Chair.

CHAIRMAN: Thank you, Ms. McShane, for your testimony. We will take a 10-minute recess and Mr. Stewart can prepare.

(Recess - 2:40 p.m. - 3:14 p.m.)

CHAIRMAN: Yes, Mr. Blue?

MR. BLUE: Mr. Chairman, a couple of points. Firstly in a moment I'm going to hand out the same sections of the National Energy Board decision in RH-2-80 that I gave to Mr. O'Connell just before lunch.

The Board indicated that it would like to see copies

as well. I will do that in a minute.

But secondly and perhaps a little bit more importantly, sir, I would just like to speak about process matters.

This morning without notice Mr. O'Connell made the comments we heard about Mr. MacDougall's reexamination yesterday.

This morning without notice Mr. O'Connell objected to my right to cross-examine a witness before this Board. And this afternoon without notice, after leading everyone to believe that the next witness would be Mr. Kumar, we were told that the next witness wouldn't be Mr. Kumar.

All I'm saying is with respect to blindsiding me in other places, Mr. O'Connell would owe me a beer for that.

And maybe he would here.

But perhaps we could all work out a little bit of process. If we are going to raise things or do things, to please let each other know what we are going to do and what we are going to raise, so that people can prepare.

I think the process would go a lot more smoothly if we did that. I might have had the opportunity to persuade Mr. O'Connell that the request might not be founded. I just make that point and stop there.

CHAIRMAN: Mr. Stewart?

MR. NEWTON, MR. KIRSTIUK:

MR. STEWART: Mr. Chairman, Board members, I'm just going to introduce you to the Irving Oil Limited panel. Sitting closest to you, and having now been sworn by the secretary, is Murray Newton, Manager of Natural Gas Planning with Irving Oil. And sitting beside Mr. Newton is Mr. Kirstiuk, General Manager of Business Development with Irving Oil.

My understanding is that Mr. Kirstiuk has a brief opening statement. And then we will deal with the issue of their prefiled evidence.

MR. KIRSTIUK: Thank you. Mr. Chairman, Board members, my name is Steve Kirstiuk. And as General Manager of Business Development for Irving Oil Limited, I wish to make a brief opening statement with respect to Irving Oil Limited's approach to this proceeding.

Irving Oil Limited is taking an active role in this proceeding because of our interest in promoting a regulatory model and rate methodology that meets the following four objectives.

Number (1) the establishment of a regulatory model and rate methodology which is fair and equitable for all New Brunswick stakeholders. Particularly the Board should ask the following questions. Will the rate methodology be fair and equitable to EGNB's investors? Will it be fair to EGNB's future toll payers? Will it ensure the lowest

possible distribution rates for New Brunswickers? Will it help minimize the delivered cost of natural gas to New Brunswickers both now and the future? Will it encourage marketers to enter the market and remain for the long term?

Secondly the establishment of a gas distribution service structure and rate methodology which will encourage marketers and other customer service providers to enter New Brunswick's emerging natural gas industry.

We believe the Board should consider the following aspects of EGNB's proposal and reflect on how they may impact on marketers' decisions to enter the New Brunswick market.

(a) the EGNB suggestion, without detailed clarification, that if a competitive market for the supply of natural gas does not develop, revenues generated for the provision of gas supply services may need to be regulated or EGNB may seek to be allowed to cooperate with an affiliate in an unencumbered fashion.

And (b) the proposed EGNB rate methodology may reduce the remaining room available for marketer margin, thereby discouraging new market entrants.

Thirdly a regulatory model and associated distribution rate and service structure which maximizes the likelihood that the initial competitive advantages that natural gas

is expected to bring to New Brunswick remains sustainable over the long term.

The proposed rate methodology and deferral account mechanisms may not allow the initial pricing benefits to be sustained over the longer term.

The rate methodology should generate the lowest possible distribution tolls while providing investors with an opportunity to achieve reasonable and fair returns both during the development stage and over the longer term, after natural gas consumers have invested in natural gas-burning equipment.

And lastly a regulatory model which protects interested parties' ongoing ability to examine the prudence of EGNB's system development and which promotes issue resolution outside the formal hearing process while providing for full public review of unresolved issues if necessary.

EGNB's application is unclear in regard to the role it sees for interested parties in regard to reviewing the prudence of its ongoing investment decisions and rate and service offerings.

Irving Oil will be asking this Board to establish clear procedures allowing interested parties to comment on the prudence of EGNB's ongoing rates as well as dealing with any unresolved operational or other business issues

that may materialize.

Thank you.

MR. STEWART: Mr. Chairman, the format of our prefiled evidence was that certain portions were allocated to Mr. Kirstiuk's testimony and Mr. Newton. So I'm going to just go through with both gentlemen and confirm and have them adopt their evidence.

DIRECT EXAMINATION BY MR. STEWART:

Q.1 - Mr. Kirstiuk, you have reviewed the prefiled evidence that was filed with the Board with respect to this matter?

MR. KIRSTIUK: Yes, I have.

Q.2 - And that evidence was prepared by you and/or at your direction?

MR. KIRSTIUK: Yes.

Q.3 - And do you adopt that evidence for the purposes of this proceeding?

MR. KIRSTIUK: Yes, I do.

Q.4 - And similarly, Mr. Newton, you have had the opportunity to review the evidence that was prefiled in this matter?

MR. NEWTON: I have.

Q.5 - Particularly that portion that relates to your comments in there?

MR. NEWTON: Yes.

Q.6 - And that evidence was prepared by you and/or at your direction?

MR. NEWTON: It was.

Q.7 - And do you adopt that evidence as yours for the purposes of this proceeding?

MR. NEWTON: I do.

MR. STEWART: Thank you. Mr. Chairman, the witnesses are available for cross-examination if any.

CROSS-EXAMINATION BY MR. MACDOUGALL:

MR. MACDOUGALL: Mr. Chair, I don't have the benefit of a nice little binder like Mr. Blue. And I'm going to be referring to some of the interrogatories.

But at times I might just make statements from them. Unless I ask the witness to go to them, I might just make a comment from them.

And I think the questions will be clear. If they wish to then go and look at the interrogatory, they should. But that may move things along.

I believe most of my questions will be directed to Mr. Newton. They do come out of all that portion of the evidence.

Mr. Kirstiuk can jump in. But I have no specific questions for Mr. Kirstiuk today. So he can relax if he feels that is appropriate. It is up to him, Mr. Chair.

Q.8 - Mr. Newton, in response to Enbridge Gas New Brunswick's IR number 4B, you indicated that you felt Enbridge Gas New Brunswick should not be allowed to earn its weighted

average cost of capital on costs incurred that, in your words, may or may not be required by New Brunswick customers.

However in response to our IR number 4A you agreed that Enbridge Gas New Brunswick must incur costs in the early years to build the backbone infrastructure required for development of the initial natural gas market.

Would you agree that this Board, in reviewing Enbridge Gas New Brunswick's construction permit application, will be reviewing the facilities planned to be constructed in the first year of the development period and the general development period proposed?

MR. NEWTON: My understanding is this Board will be doing that, yes.

Q.9 - Are you aware that as part of Enbridge Gas New Brunswick's rate proposal, as indicated by the panels before you, that the company has indicated at the end of a fiscal period they would report to the Board on actual financial results and the actual resulting deferrals in their deferral account?

MR. NEWTON: I'm just hesitating. I'm not absolutely clear on precisely what it is that Enbridge Gas New Brunswick is going to report to the Board.

I guess I would accept your question subject to check.

I know there was a fair amount of cross-examination on

this Monday, I think, and perhaps into Tuesday as well.

But I'm not sure at the end of the day that I'm still crystal-clear precisely what it is that Enbridge will be reporting to the Board on an ongoing basis.

And I guess more importantly, from our perspective, I'm very unclear what role if any Enbridge sees for other stakeholders such as gas marketers, toll payers, anyone else who is using the system.

So I think I will agree with your question. But it really is subject to check. I would need to go back and check the transcript.

Q.10 - Okay. That is fine. And I believe you could check in the actual application document.

So considering that the Board will have the right to review both the construction application and the actual year-end costs including deferrals as put forward by EGNB, why does this not provide sufficient regulatory oversight to ensure that costs are being prudently incurred? Or does it?

MR. NEWTON: I'm not sure if it does. Because what I take from the Enbridge proposal is you are putting the Board and the Board staff in the position of having to review the prudence of your costs.

And it's not for me to argue whether that's an appropriate thing or an inappropriate thing. But the

people who are actually bearing your costs are New Brunswickers, marketers, toll payers.

And so I think, you know, to be fair, especially when you are dealing with all of the uncertainties that we are all dealing with here in a greenfield market, I think it's important that the other stakeholders on the system have the ability to assess that.

And we can't do that if we don't have access to any information. If information is filed to the Board then I guess it's left for the Board to in all cases determine whether or not your rates and services are just and reasonable. And it's being left to the Board to rule I guess on our behalf, on all stakeholders behalf, whether that's the case.

And quite frankly I'm not sure if today the Board is fully equipped to do that. And I think it's quite legitimate for other stakeholders in New Brunswick, especially during the initial stages of development of the gas industry, to want to satisfy themselves that that is the case.

We don't -- you know, one of the concerns we have here -- and I hope I'm not jumping into another area here. But when I look at the question and the response that we gave in particular to your IR number 4B, our concern about Enbridge earning its average weighted cost of capital, we

are not quarreling with the interest -- with the rate of return on equity that you have sought.

We are not taking issue with the capital structure, the proposed capital structure or the proposed debt cost that you have proposed.

And we don't quarrel with deferral accounts. I think, you know, there may have been some misunderstanding both ways in terms of what our position is on that.

Deferral accounts are an acceptable way for a regulated utility to record variances in revenues and costs, you know, items that are either -- you can't forecast reasonably or you can't control.

But you know, we do have a bit of an issue with what the precise carrying cost is that you apply to that.

So I just want to be clear that we are not quarreling with -- you know, I think it's fair to say that most of the financial parameters surrounding your application, we are not taking a position on them.

But we are concerned about the deferral account mechanism and the way it works, and --

Q.11 - Mr. Newton, I think we are jumping ahead. And I will have --

MR. NEWTON: I'm just about there. I just want to complete this one answer. To be fair, we really didn't fully understand your application and what it was you were

asking this Board to approve.

And that is why we have put as many questions as we have to your witnesses to try to understand how your deferral accounts work. And I think we have a better understanding of that today.

Q.12 - So come back maybe to the process we were going through about talking about, you know, protecting the consumer review process where we were after your comments before we moved to the deferral accounts.

If this Board adopted a written review process similar to that actually posed by you in response to the Board's IR number one, would this provide you sufficient comfort as apparently you state in that IR?

MR. NEWTON: I think -- I think, Mr. MacDougall, it depends on the circumstances. And the way we look at this, when you look at regulation we all throw a lot of terms around, like light handed regulation and -- those are very broad ended terms that mean very different things to different people.

And I guess from our perspective you have a wide -- there is a wide spectrum here of regulation that is available. Irving Oil is not proposing some kind of historic full blown type of regulation where, you know, hopefully we wouldn't be in these kinds of oral hearings for days. That is not what we want to see.

So on the one extreme I think it is fair to say there is a model that exists where you have full blown oral hearings whenever people take issue over issues. On the other extreme you might have an approach where the regulated utility simply makes periodic filings to the regulator and it's left to the regulator to decide whether or not all stakeholders' interests are being properly accommodated.

So what we are proposing, we think, is a position somewhere in the middle of that spectrum and we would like to think it's -- it approaches a little more closely the light handed model than the full blown model.

So we would just like to have an ongoing ability as we move forward to assess things and satisfy ourselves that the rates are appropriate and the other terms and conditions associated with the services that your client will be providing are just and reasonable, and a written proceeding may be appropriate.

I would like to think that in most circumstances it would be and hopefully in the majority of circumstances we wouldn't even need that.

Q.13 - So is there anything to your mind, Mr. Newton, in the record today though that why this Board should assume that Enbridge Gas New Brunswick will do anything but incur prudent costs for a used and useful system?

MR. NEWTON: I guess the way I would try to answer that, it's -- prudent sometimes can be in the eye of the beholder. And I certainly would never accuse Enbridge, or anyone else for that matter, of intentionally, you know, taking a business decision that it felt was not prudent.

But I think it's fair to suggest that others may have different perspectives on the prudence of different decisions and different issues. And I don't want to wander into issues here that we both agreed to take off the record, but, you know, I think there are examples that people can think of where different business interests may have very different perspectives on the prudence of a cost to revenue item.

I don't think there is anything inappropriate about that, especially in an environment where there is so much uncertainty and there are so many balls up in the air that, you know, to be fair, I mean Enbridge and anyone else in this room, prospective marketers who are exploring the business opportunity of entering this market -- there are a whole host of uncertainties here that neither one of us have control over. And I think it is fair to say we are all going to be learning as we go ahead here and hopefully we are going to be rowing in the same direction the majority of times. But that may not always be the case.

MR. KIRSTIUK: I would just like to build a little bit on what Mr. Newton has said. I think it is absolutely critical in this particular market that the distributor and the other stakeholders, including the marketers, are working in a way that is toward the best interests of New Brunswickers.

There are going to be many things that's going to be unfolding here over the next years to come that are going to be dependent upon all parties working together. That means information has to be shared and there has to be a way in which parties have the ability to work with each other and build the trust that they need in order to provide that value to customers.

Q.14 - Do you agree, Mr. Newton, that the infrastructure being developed, if EGNB's capital structure is approved, would be on the basis of 50 percent equity and 50 percent debt, that that's the proposal Enbridge Gas New Brunswick is putting forward?

MR. NEWTON: I am not sure I understand the question. I understand that that's what you proposed.

Q.15 - Yes. That's what I am asking, that you understand that our proposal is that the company be funded 50 percent equity and 50 percent debt?

MR. NEWTON: Yes.

Q.16 - So if the capital required to fund the system, and

particularly some of the backbone infrastructure that you referred to earlier, necessary to supply additional customers in later years includes a 50 percent equity component, would it not be fundamentally unfair to allow Enbridge Gas New Brunswick the opportunity to earn a return on the deferred amount of that equity component of its capital structure?

MR. NEWTON: I think one of the fundamental tenets, as I understand it, of the regulatory compact is that facilities have to be used and useful. That when facilities are built and management make business decisions that they think are prudent to put facilities in the ground -- I mean it's contemplated that at some point in time those facilities will be used.

And so I guess, you know, I would accept the premise in your question on the caveat that those facilities will be used and useful at some point in time.

Q.17 - Okay. And then to go back to some of my earlier questions, the facilities that Enbridge Gas New Brunswick is proposing to build will be the subject of approval by this Board in the construction application, is that correct?

MR. NEWTON: I am generally aware that at least insofar as the facilities that have been proposed for the 2000 construction program, that that's the case, and I am not

crystal clear in terms of how the approval process with respect to future construction programs will work.

Q.18 - That's fair, but for the --

MR. NEWTON: I am not clear on that.

Q.19 - Okay. But for the year 2000, the upcoming year, and the construction application, the system we are proposing to build that would require pipelines into Moncton, Saint John, Fredericton, Saint George, is going to be the subject of approval by this Board?

MR. NEWTON: Yes.

Q.20 - Thank you. Is it correct in your mind -- I am just going to sort of read right from the proposal -- if it's your view that in EGNB's proposal the deferral account is no specific to any certain item, rather it will at the end of the day merely be the difference between the actual revenues and the actual costs?

MR. NEWTON: Now are you referring me to the forecast discrepancies deferral account or the deferral account?

Q.21 - No. Let's think back to Mr. Marois' comments yesterday that the deferral accounts themselves could be netted out and his view I believe was that the deferral accounts at the end of the year would be the difference between actual costs and actual revenues. Would you agree that that is the proposal the company is putting forward?

MR. NEWTON: As I understand your proposal, I understand it

to mean that any variance between forecast and actual, whether it is a cost item or revenue item, would be recorded in one or both of those deferral accounts.

Q.22 - Okay. Whether these costs or the costs that Enbridge has approved and the construction has approved are covered by early year revenues or through the deferral mechanism, which is the vehicle which allows EGNB to put the appropriate sized pipe in the ground during the development period, should it not be entitled to the same return?

MR. NEWTON: Our issue on that, Mr. MacDougall, has to do with the effect that, as we understand it, dollars recorded in your forecast discrepancies deferral account would begin to carry a carrying cost beginning in year 1.

And what troubles us about that -- there are several things, but I guess to answer your question, what troubles us about that is your toll payers, your customers, are going to begin to -- at least costs are going to be recorded in that deferral account beginning in year 1. And we are not sure in all cases those facilities are going to be used and useful in year 1.

So we don't -- we are not opposed to the concept of a deferral account, I tried to make that clear in some of my earlier comments. We also can understand, to be fair, that a deferral account should attract a carrying cost

going forward. The issue we have is what the precise carrying cost ought to be.

And we are concerned when you are amortizing your deferral account over 40 years and I mean you take a look at this -- the graph that was filed by your witness panel a couple of days ago, and you just take a look at the massive dollars going forward that are sitting in that deferral account, we are concerned that the ultimate cost over the long term to New Brunswickers is higher than it needs to be.

And while I agree with you that you need to come up with some sort of a mechanism to kick-start the development of natural gas in New Brunswick, I think it's equally important that those benefits are sustainable over the long term. And we do have a concern that the costs that you are incurring in that deferral account may be higher than they need to be.

Q.23 - Okay. Let's go back to the beginning of that answer because your concerns seem to stem from the fact that the pipe that's put in the ground in the first year may not be used and useful. I would think we would probably stipulate that the pipe that is put in the first year will not be fully utilized. The idea, is it not, Mr. Newton, is to size pipe appropriate for a go forward basis to serve the customers during the franchise period? You

wouldn't size pipe to serve those customers just in the first year, would you?

MR. NEWTON: No. I don't think prudent engineering would do that, but it's a question of degree. I think to be fair you have to step back and you have to look at the total package that's been proposed by Enbridge. Your client is proposing a 13 percent rate of return on equity with a 50/50 capital structure and as I understand it you are proposing that the cost of debt be the 10 year long term Canada bond rate plus 250 basis points.

Q.24 - Right.

MR. NEWTON: Based on today's ten year bond rate -- I took a look at it this morning, I guess it was yesterday's bond rate, it was 5. -- I don't have the exact numbers in front of me here -- I believe it was 5.88 percent -- 88 percent -- you add 2 and a half percentage points to that and you are in between 8 and 9 percent for an average debt cost.

If you employ your weighted average cost of capital as the appropriate carrying cost, you are more in the 10 and a half percent. So --

Q.25 - But isn't it fair --

MR. NEWTON: I would like to finish my answer. So there is a 200 basis point difference between what I think you are

proposing the carrying cost should be and what we

proposed. And when you start applying that kind of a difference over 40 years I am not sure that's in the best interests of New Brunswickers.

Q.26 - But, Mr. Newton, didn't you agree that the capital structure that we are using to raise the money to build these facilities is 50 percent equity and 50 percent debt?

And then my second question is, on that basis the return on the facilities and the revenues generated from them, and subsequently the deferral account, should be the weighted average cost of capital? You can't just presume that the debt component is what is going into the deferral account.

MR. NEWTON: I misunderstood an earlier question then, because my earlier answer was intended to say that I understand your proposal is that you are looking for approval of a 50/50 capital structure debt -- debt equity capital structure. I don't know what your actual capital structure is going to be. I don't know whether that's a deemed capital structure or whether you see that as being an actual debt equity capital structure going forward. I don't know the answer to that.

Q.27 - If you assume that it was an actual capital structure going forward, you know, within a percentage or two, that the intent of the utility was to capitalize itself at 50 percent, 50 percent?

MR. NEWTON: I don't know that that is the case.

Q.28 - Okay. On the hypothetical that that is the case, should we be entitled to -- should the company be entitled to earn the weighted average cost of capital on used and useful facilities built with that capital, be it through revenues from the customers or the deferral mechanism, because it's the same thing?

MR. NEWTON: I think it depends on the deferral. I think it depends on the deferral and the nature of the cost or revenue item that is being deferred, what's causing the revenue shortfall. I really think you need to take a look at the specific circumstances. I know my former employer had somewhere around 35 separate deferral accounts and they were all very different in nature. And as I recall some attract -- they didn't all attract the same carrying cost. It depended on the nature of the cost or the nature of the revenue that was being deferred.

MR. KIRSTIUK: I think just again to add a point here. I think the principle, okay, that we have to ensure that we follow is that we don't want to incent Enbridge Gas New Brunswick to put more than necessary in the deferral account. That's the principle.

Q.29 - Mr. Newton, maybe we can turn it around the other way a little bit. If Enbridge Gas New Brunswick Inc. is disentitled, not allowed to recover its weighted average

cost of capital on the deferral account, do you believe that this could create an incentive to be overly conservative in the early years leading to the potential necessity for duplication in costs in later years as new customers may have to be added?

MR. NEWTON: I think we would like to see -- and I think Mr. Kirstiuk put this in his opening statement. That one of the fundamental principles we want to see going forward here is the rates and the rates of return, cost of capital realized by Enbridge need to be just and reasonable to all players.

They need to be just and reasonable to your client's shareholders. And they need to be just and reasonable to your customers and New Brunswickers.

And I guess, to be frank, the concern we have, we don't want to see deferral accounts used as a profit centre.

Q.30 - Well I guess that partially answers my question. But I guess my concern is that if Enbridge Gas New Brunswick has to put the money in the ground for the system that it thinks it's used and useful, but is not able to necessarily recover its weighted average cost of capital on that for the forecast deferral account let's say, wouldn't it be extremely cautious to ensure that it didn't get monies put into that forecast deferral account if its

capital structure is 50/50 and it's looking for a weighted average cost of capital?

MR. NEWTON: I guess I would turn it around the other way and say that, you know, we would like Enbridge to be incented in all cases to always be making prudent business decisions which are in the best interests of New Brunswickers.

So we would like you to be incented to develop the system in an economic fashion. And construct facilities that you believe are going to be used and useful. And maybe there is a linkage between this whole issue of carrying costs on deferral account and the method of regulation going forward. We don't want to manage your client's distribution system. I mean, that's for Enbridge to do.

But we do think it's appropriate for stakeholders to have -- at least have some data made available to them going forward, where they can examine, at least from their perspective, the prudence of the business decisions going forward.

Q.31 - Well let's talk maybe about some of those stakeholders, the customers generally. In response to the Board's IR number 2(a) you indicated that amounts recorded in the proposed Enbridge Gas New Brunswick deferral account will be recovered in future years from existing natural gas

customers, many of whom may be captive as they will have already made the necessary investments required to utilize natural gas.

So you refer to them as captive in the sense of having maybe having made an investment. Do you agree though, that following the development period rates charged to those customers will be the subject of this Board's approval?

A. Yes.

Q.32 - Thank you. In your evidence at page 9, line 11, and again I will just read into the record while you are looking at it. You indicate that you wonder with respect to the forecast discrepancies deferral account about the merit of providing EGNB any level of return. And then at line 19 you suggest that you do not believe EGNB should be able to profit from its error by earning a return on a deferral amount that resulted from that error.

Would you agree that in the greenfield nature of gas distribution in New Brunswick forecasts are fairly difficult?

MR. NEWTON: Yes, I would. And I would like add on to the response to this answer that when we put our evidence together, it was not clear to us in reading your application what -- how the mechanics of this particular deferral account were going to work.

And I have been here for the four days. I have listened to the Enbridge witnesses describe the proposed deferral accounts and the mechanics how they would work.

I have heard Mr. Marois indicate that he views these two separate deferral accounts, they could have been one.

You could have recorded the variances in one. We didn't understand that to be the case, quite frankly, when we put together our evidence.

And now that we have had an opportunity to hear your witnesses clarifying, not only what the nature of this particular deferral account is, but the way that it works going forward. That there can be both credits and debits working both ways, we would agree that it ought to attract, it should attract a carrying cost.

So we would make the same recommendation with respect to the forecast discrepancies deferral account as we have with the other, the pricing deferral account. So in other words, we are proposing that the carrying costs that be applied to both deferral accounts be the same.

Q.33 - And you agree yesterday, I believe, Mr. Marois in response to Mr. Stewart said if there was a payment back to a customer because of an over recovery, that payment would carry with it a return equal to the carrying cost?

MR. NEWTON: Yes. And I just want to be clear, Mr. MacDougall, that our review of the initial application

that was filed that wasn't clear to us.

Q.34 - No. But Mr. Marois did make that clear yesterday?

MR. NEWTON: Yes.

Q.35 - Would you agree with me that in the early years

Enbridge Gas New Brunswick will not be recovering its full cost of service and in part because it is trying to attract customers through market based rates?

MR. NEWTON: I would agree that if the rate design proposal that you have advanced in this hearing is adopted, accepted by this Board, that would likely be the case in the early years. So that's a yes.

Q.36 - I understand. You answered some of my questions earlier so I'm trying to -- if I'm given a second we can tick off questions as I go.

Would you agree that if these -- if the deferral accounts are approved by the Board, that there is some regulatory certainty that Enbridge Gas New Brunswick will be able to recover those deferral accounts but that there is no commercial certainty that they will be able to recover those amounts?

MR. NEWTON: Yes, I agree with that.

Q.37 - At this time do you believe that Enbridge Gas New Brunswick can forecast with any certainty the competitive pricing reaction that may occur by fuel oil providers?

I actually should tell Mr. Kirstiuk I have now thought

of a question for him.

MR. KIRSTIUK: Well, that's a very interesting question and

--

Q.38 - Yes, these are better questions for Mr. Kirstiuk.

MR. KIRSTIUK: Yes. Based on the numbers that I think were submitted in one of the IR's, I would say that Enbridge is going to have difficulty, you know, trying to predict. Even trying to get the numbers right in terms of history is a challenge. And I know even for ourselves --

Q.39 - That was my next question.

A. But if we go back to, I think, one of the original responses to Board staff IR18. And I think there was quite a lot of time spent comparing prices between Massachusetts and New Brunswick.

We did a little bit of work to look at what our tank wagon prices were relative to the prices that were attributed to the New Brunswick market. And there is a significant difference between what we were offering our customers, and what is being shown as the numbers by the WEFA study for New Brunswick.

So that competitive response may have started five years ago based on the numbers that are actually here right now. So I think it's going to be difficult for anybody to predict.

One thing that I think is important to point out here

too is that only 30 percent of the home heat market is actually supplied by oil in New Brunswick. And of that 30 percent we might have 40 percent of it. That means we have got 12 percent of the home heat market in New Brunswick. So in terms of what the competitive response is going to be, I have no idea.

Q.40 - And you would probably have a good idea if anyone. Is that correct, Mr. Kirstiuk?

A. I don't think anybody has got a good idea. And I think even looking at what -- what we are looking at in terms of these numbers here, I would put very little weight on them based on what is actually the case in New Brunswick over the last few years. So --

Q.41 - So you are not putting weight on them because the forecasting -- it's just difficult to forecast the numbers?

A. I think it has proven to be difficult even to get the numbers right in terms of the history.

Q.42 - Should Enbridge Gas New Brunswick be penalized with respect to revenue forecasts if it has to react to unregulated competitive forces in the marketplace such as fuel oil providers who may vigorously fight to keep their market share?

MR. KIRSTIUK: I think not any more than any marketer that is out there as well.

Q.43 - That's fine. Mr. Newton, this question is probably for you. Again whoever wants to answer them.

With respect still to the issue of forecasting, in response to Enbridge Gas New Brunswick's IR number 5 where you were asked to provide your views on what the marketers' margin would be in the years 2000 through 2002. You indicated that marketer margins will not be the same for all marketers and that margins will depend on a number of independent variables including the market price of natural gas, individual marketer cost structures and the specific nature of the marketers' service offerings.

Would you agree that your response is indicative of the fact that it is difficult to accurately forecast with certainty at this time specifics of how the natural gas market in New Brunswick will develop?

MR. NEWTON: I think it is a fair statement to say that no one, at least no one that I know, has the ability to accurately forecast how things are going to turn out.

The market price, the delivered burner tip market price for natural gas will be whatever the market determines it will be. We won't set that.

Q.44 - And there is no market today.

MR. NEWTON: And Enbridge won't set that either. And I'm not suggesting that you said you would. But the market will set that price.

I think it's fair to say that's the way commodity pricing works in North America. But there will be costs.

And without running through all of the costs, there will be costs.

And I think it's fair to say that to the extent costs are greater, then margins will be less.

Q.45 - And I'm just really on the forecasting question. I would just like to maybe reiterate then once again, it will be difficult for Enbridge Gas New Brunswick to completely forecast the competitive fuel reaction. And it is difficult to forecast the marketers' margin. This is a difficult task?

MR. NEWTON: Yes. I think that there is no doubt that trying to come up with a forecast will be difficult. But I think one thing that's important here is that some of the numbers that have been filed haven't been necessarily based on a forecast.

They have been computed based on what is actually seen in the marketplace over a period of time that we have seen already.

So when we go ahead and we look at, you know, commodity costs that have been put forward or transportation costs and we see that there are things like -- areas like penalties with respect to transportation or the fact that producers might be requiring very high load

factors or marketing costs that aren't being taken into account or things like even trying to run an office, secretarial help, telephones, all of that, and we see all of that trying to be jammed into say a \$7 a year margin per customer, that causes us concern as a potential marketer, as I'm sure it would cause other marketers considerable concern if they were contemplating coming into this market.

This is the time that we ought to be doing everything we can to try to convince marketers to come in here. By sending signals to the marketplace that there is \$7 per year per customer margin is sending the marketers the wrong signal at a critical time.

CHAIRMAN: Take a five-minute break.

(Short recess)

CHAIRMAN: What do you mean, you have never asked the same question twice?

MR. MACDOUGALL: I have never had someone ask me to ask the same question twice.

Q.46 - Mr. Newton, would you agree that Enbridge Gas New Brunswick has acknowledged that it only controls a portion of the delivered price of natural gas?

MR. NEWTON: Yes. A very large portion.

MR. MACDOUGALL: I was hoping to catch him, but --

Q.47 - And do you agree that Enbridge Gas New Brunswick's

proposal in setting its rates is that it wants the flexibility to be able to reduce its rates to help ensure customer attachment?

MR. NEWTON: Yes. I have heard -- I want to expand on my yes answer here. I have heard various Enbridge witnesses this week indicate a willingness going forward to work with prospective marketers and sit down, hopefully outside of a hearing room, and talk about if there are problems in convincing customers to convert to gas, a willingness to sit down with prospective marketers and talk about how we might make that work.

So, you know, in the spirit of cooperation we are delighted to hear that. And we are equally interested in doing that going forward.

And I guess none of us -- again picking up on your earlier questions, have the ability to forecast with any certainty how this is going to play out or, you know, whether -- we just don't know how that's going to work out.

I mean, I don't think any of us want to get into a situation where we are changing rates to the point where customers are confused. We think rate stability is important. And rate certainty is important to at least some customers, some end users, consumers of gas.

But I take Enbridge at its word, that you are prepared

to discount, at least consider discounting your rate, if there is a problem. Your distribution charge, to be clear.

Q.48 - So if the reason there wasn't customer attachment, if Mr. Thompson or Mr. Harrington decided that we don't have customer attachment because we don't have marketers, it is not the customers but the marketers aren't here, do you understand that Enbridge's proposal is that it has the ability to use its rate rider to reduce its price to rectify that situation? That is what it is asking to do, whether it be for a marketer reason or other reason?

MR. KIRSTIUK: I think there is an important point that has to be made here. Marketers are not going to necessarily be attracted into this market solely because, you know, EGNB decides to change their rate for a short time period, okay, you know, sometime in the middle of the year or whatever.

And for a marketer to come into this market, they have to assess what the dynamics are going to be for a longer time period, you know. They have got a contract for gas supply. They have got to contract for transportation.

They have got to figure out how they are going to deal with peaking supplies. They are going to have an operation that they are going to run. They are going to have to make certain investments.

They have to have the confidence that the distributor is going to allow them to compete. If they don't have that confidence they are not going to come here. And that's our concern.

So changing a rider halfway through the year I don't think is going to be sufficient. There has to be the confidence by marketers that this environment is going to allow them to be competitive and for them to make a fair rate of return. Marketers don't have a deferral account.

Q.49 - Okay. Well, let's get to that then, Mr. Kirstiuk.

Because that is sort of where I'm leading.

If Enbridge Gas New Brunswick sets its target rates at a rate that it thinks it is appropriate for marketers to come in, or it decides to lower those rates for the purposes of assisting marketers -- because it has a concern with marketers, so it lowers its distribution rates to allow a certain margin for the market to develop, okay.

If it does that then is it going to recover less of its cost of service because it does that, in its overall revenues?

MR. KIRSTIUK: It may, yes.

Q.50 - And if it goes to the effort to reduce its rates, okay, for the purposes of assisting all of the customers and the marketers to start up, that underrecovery will go into its

deferral account, is that right?

MR. KIRSTIUK: That's correct.

Q.51 - So you are suggesting overall then that if Enbridge Gas New Brunswick should help out the marketers by reducing their rates if they do that, they shouldn't be allowed to earn their weighted average cost of capital on the deferral account that is caused because they are lowering the rates to assist the market, including the marketers?

MR. KIRSTIUK: What we have said, Mr. MacDougall, is that what ought to be the rate of return on the deferral account, it ought to be fair to the investors of EGNB.

But it also ought to be fair to customers and other stakeholders. There has to be that balance.

Q.52 - But it is Enbridge Gas New Brunswick who is taking the risk of that deferral account, be it to help the customers or the marketers in the early years, is that not correct?

MR. KIRSTIUK: Mr. MacDougall?

Q.53 - Yes.

MR. KIRSTIUK: Could you repeat the question? That's the second time you have been asked.

Q.54 - No. I guess I'm just looking at the two different aspects. You are concerned with their deferral account, but you are concerned that our rate may be too high.

You know, Enbridge Gas New Brunswick Inc. is looking for it's weighted average cost of capital on the deferral

account to compensate it for the fact that it may not earn revenues at its weighted average cost of capital in the early years. So if it reduces it's rates to help the marketers, to help the market, to help the customers and to not earn the revenues on which it is looking for its weighted average cost of capital, should it not be entitled to its weighted average costs of capital in the deferral account so that it will work out the same for the administrators?

MR. KIRSTIUK: All right. And then I guess I repeat my answer. Is that what ought to be the rate is what is fair to the investors. I might add here that for the marketers -- say the marketers have gone out and actually committed to long term gas supply already, wouldn't it be fair that if they lose money that they end up with some sort of rate of return on what they are losing money? I don't think anybody here is saying that they should.

But, I mean, with the distributor, what we want to ensure is that the decisions that are being made here, okay, with respect to what goes into the deferral account are fair. And that they have -- they attract a rate of return that are fair.

Q.55 - That's fair, Mr. Kirstiuk.

MR. NEWTON: I think, you know, as well it depends -- and we tried to talk about a little bit of this a few minutes

ago, it really depends on the nature of the deferral. And I think, Mr. MacDougall, maybe you are making the point for us better than we can that we really need the opportunity on a case specific basis going forward. Your stakeholders need the opportunity. And it may be in your best interest that they have that opportunity to examine the prudence of decisions that are made.

And there may well be cases where it's in both of our interests -- both marketers interests and distribution company's interest to take an action that may have an impact on your deferral. And our position on how those dollars ought to be treated may well depend on the nature of the expense incurred and the reason for it.

But we can't sit here today and then make those decisions in advance. And we certainly can't assess them going forward if we don't -- if we don't have the ability to examine the amounts that you record in your deferral accounts. And have an ability to understand why the variances were incurred and hear your explanation as to why they were prudently incurred, and why they ought to carry a carrying cost. That's our real concern here. That you not go away.

And it's all well and good for us to be able to have, you know, informal business meetings going forward on these issues but, you know, we don't want to get ourselves

into a situation with all the uncertainty that we all have in this new marketplace where you go away and we don't hear from you again on this issue for seven or eight years.

Q.56 - So, Mr. Newton, then your concern isn't really the issue of Enbridge Gas New Brunswick Inc.'s right to earn the weighted average cost of capital on those deferral accounts. Your concern is more just to make sure that those deferral accounts are for capital items for use in useful plant. Is that a good way to put it?

MR. NEWTON: No, it's both. Based on what we have seen today, based on the information that we have before us today, we don't feel that -- we are not comfortable with the deferral accounts carrying a carrying cost equal to the weighted average cost of capital. We think it's too high based on what we know today.

Q.57 - Mr. Kirstiuk, can I come back to you. You were talking about the rate rider. You know, and that if we used the rate rider as a mechanism to reduce rates the marketers may be concerned that we would just up those rates later on.

Do you understand that it's Enbridge Gas New Brunswick's proposal that the rate rider can only be used to reduce rates during a given year, and that target rates would only be reset annually?

MR. KIRSTIUK: Right. I think what I said, Mr. MacDougall, is that a marketer will not be attracted into the market through the action of just using the rate rider to lower the rate. What I didn't say was that the rate rider would be used to actually increase rates later because I don't think the rate rider works that way. Okay.

I think that the target price that could be set could actually increase, and that may be set annually. But the rate rider itself will not be increasing. Once it's set at a level, it doesn't increase over that level for that -
- the duration of that year.

Q.58 - And would you agree with me that it wouldn't be a sound business policy for Enbridge Gas New Brunswick to set a rate for the purpose of having marketers enter the market just to then increase that rate to potentially drive those marketers out if its goal is to attach customers?

MR. KIRSTIUK: Well, I think, what is really important here is that we all gain the confidence, all of us, that there really is a desire to attract marketers into this market. What we don't want to have happen is we don't want there to be a single entity ultimately that is providing the commodity to all New Brunswickers. We all know that that's not the intent of the Gas Distribution Act. Nor is it the intent of what we are trying to achieve here.

Q.59 - Do you see that being the intent from any of the

evidence put forward by Enbridge Gas New Brunswick, particularly discussing yesterday with Mr. Maclure and others?

MR. KIRSTIUK: I'm very concerned, Mr. MacDougall, with respect to the types of numbers that have been put forward. They would do nothing to attract a marketer into this market.

I mean, if a marketer like Direct Energy or Engage or whatever were looking at the numbers that were being placed with respect to the commodity, the transportation rate, the load factor issues, the fact that a whole host of numbers are missing they probably wouldn't show up even probably for the rest of the -- these hearings. Okay. So that's a concern.

If we are sending the wrong signals to those marketers, that there is no money to be made in this market, they won't show up. And then what will happen. What we don't want to see, is we don't want to see us migrating into a situation where we only have one marketer and that -- that basically being the distributor.

MR. NEWTON: This is a very important point. Yesterday near the end of the day -- and I don't recall who made the comment. But the comment was made that the marketer controls its own destiny. I wish that were the case.

Our concern is -- we have tried to say before that the

market price, the delivered price for natural gas that the end user pays, whether it's residential, consumer or a commercial or industrial consumer, the market will set that price just like it does for any other commodity. The market will set that price.

And there are costs that marketers will have to bear in order to enter the market. Most of these costs we have little or not control over. We have no control over the Maritimes and Northeast Pipeline toll. That's regulated by the National Energy Board. We will be very active and very vigilant there trying to do everything we can to minimize the toll. But at the end of the day that's something we don't control.

Nor do we control the price -- the gas supply cost for natural gas, the commodity cost of the gas itself. We can enter into commercial arrangements with people and do what we can to negotiate the best deal we can negotiate. But we don't control that price.

We don't control the distribution company's charges. And to a residential customer that's likely to be 40 to 50 percent of the delivered cost of the commodity.

We don't control the billing charge. If we want to offer our customers a one shop -- one stop shopping service and we elect to use Enbridge's ABC service, we will have to pay a fee for that, and we don't control

that.

What is left over Mr. Kirstiuk said, and I'm not going to go through the list again, that there are a whole host of overhead costs in addition to that. What is left over is left over for the marketer margin.

In using Enbridge's own numbers, you know, without taking issue to the data that you have put on the record in this hearing, just using your own numbers, your own analysis shows marketers losing money.

And the solution that we have heard offered to solve that problem is that marketers will sell gas, the commodity, as a loss leader. Because you can make money in other parts of the business. And we don't know that to be true today. And we don't think that's the appropriate signal to be sending to marketers who are trying to make a business decision today, a responsible business decision, whether or not they should enter this market. And to send a signal to prospective markets that they are going to have to lose money on the gas commodity in the hope of making it up somewhere else, recognizing all these other costs they have little or not control over, we are concerned that that's not going to send the appropriate signal to perspective marketers that they ought to be coming to New Brunswick.

incented to bring marketers into the marketplace?

MR. KIRSTIUK: We would hope that Enbridge Gas New Brunswick wants marketers to come into the marketplace. We are concerned because we have seen things. In the hearings we have heard about what will happen if they don't come. If they don't come, Enbridge Gas New Brunswick wants to have the ability to be essentially the sole marketer of natural gas. That ought to be a concern to everyone here.

So do we know what the intent is? I mean, really, the only one who knows the intent of Enbridge Gas New Brunswick is Enbridge Gas New Brunswick. We hope that we are all working together. And that we are all going to try to provide the best solution possible to New Brunswickers.

Q.61 - And do you not believe that that's the intent of Enbridge Gas New Brunswick?

A. I hope it is the intent. And I think the more we get to work with Enbridge Gas New Brunswick, the more we try to find the solutions that I'm sure we can -- we can all find together, the more we are going to know that that in fact is the case. And I think we need to have the working arrangement to know that we are both looking to try to achieve a very positive marketplace for natural gas within the province.

Q.62 - Let's talk about the marketers rates. Is the marketers

rate regulated by this Board?

MR. KIRSTIUK: Is the marketers rate regulated?

Q.63 - Yes.

MR. KIRSTIUK: No.

Q.64 - Okay. As a marketer, as a potential marketer are you willing to work with Enbridge Gas New Brunswick to ensure that there is a fair rate to customers, a fair rate to the marketer and a fair rate to Enbridge Gas New Brunswick?

MR. KIRSTIUK: Absolutely.

Q.65 - Mr. Newton, in response to Board IR number 6, you indicated that with respect to ancillary services, these services, some of which you stated were in the development stage, would be competitive services that are proprietary in nature.

With respect to your comment on those services that are in the development stage, do you agree that it is difficult at this time to determine all the services that the market may want, the specific terms and the rates for those services for the market?

MR. NEWTON: Yes.

Q.66 - On page 9 of your testimony -- sorry, page 5 of your testimony, Mr. Newton, but I also believe you just repeated this point recently -- you indicated that Irving Oil Limited can not only market to residential, commercial and industrial customers but can provide a number of

ancillary services, such as load balancing and peaking supplies, and that Irving Oil Limited intends to offer those ancillary services.

So Irving Oil Limited's intent with respect to the natural gas market is not just to earn margins from the sale of the commodity, is that correct?

MR. KIRSTIUK: I think that is probably under my testimony.

Q.67 - Okay. That's fine.

MR. KIRSTIUK: Yes, I would -- I think it would be fair to say that if there are opportunities to earn the business and make a profit by providing other services, we would be interested in doing so.

But I might add that there are going to be parties that will probably be coming into the market that want to provide those services that may not necessarily be providing the commodity.

Q.68 - Okay. Mr. Thompson yesterday indicated that there was value in a customer. Is it Irving Oil Limited's position that there is value in a customer?

MR. KIRSTIUK: Absolutely there is value in a customer.

Q.69 - So as a gas marketer would there be value in having the customer?

MR. KIRSTIUK: There is definitely value as a gas marketer to have a customer. But I think you have to ask yourself if you have that customer and you are losing money year

after year after year by going ahead and having that customer, I think any reasonable business person would then begin to ask themselves whether or not there really is value in having that particular customer.

Q.70 - And whether you make money off of that customer would depend on the services you provide that customer?

MR. KIRSTIUK: That's correct.

Q.71 - You speak to the issue of marketers' margin at the bottom of page 10, top of page 11 of your testimony, and you spoke about it earlier today. I guess I could try to get back to comments made by some of the Enbridge witnesses yesterday.

In this proceeding is it not Enbridge Gas New Brunswick that is the residual component of the overall rate, not the marketer?

MR. KIRSTIUK: Okay. Could you maybe rephrase the question?

I am not sure I understood the question.

Q.72 - Sure. If we go through the rate as shown by Mr. Harrington or Ms. Duguay yesterday, it is made up of various components. There is the gas commodity component --

MR. NEWTON: When you say rate, do you mean delivered price?

Q.73 - Delivered price. I'm sorry, Mr. Newton. So if we go through the delivered price, at the end of the day Enbridge Gas New Brunswick's proposal is that they will

move their portion of that price to set a rate that they believe will attract customers, is that not correct?

MR. KIRSTIUK: Okay. Enbridge Gas New Brunswick will change their rate based on what they believe will be necessary to attract customers, that's correct.

I think the term that you used when you phrased the question to begin with was, are they going to be the residual part of the full delivered cost --

Q.74 - That's correct.

MR. KIRSTIUK: -- and I would take issue with that, from the point of view that the distributor is the entity that is actually determining what that rate -- that delivered cost ought to be.

So in other words, the marketer is basically sitting there, very dependent upon whatever that distributor toll is and the fact that he knows that if he isn't in the neighbourhood of say something in the order of 30 percent less than the competing fuel, because of the cost to try to induce the customer to convert in the first place, he is going to be very unlikely to convince the customer that they ought to be changing to natural gas.

So the marketer is squeezed between whatever the distributor determines his rate might be and whatever the number is that is going to cause a customer to convert to that alternate fuel.

Q.75 - But isn't it true, Mr. Kirstiuk, that in this proceeding the proposal put forward, Enbridge Gas New Brunswick Inc. is proposing to incur losses, significant losses, revenues that do not recover cost of service, to encourage that attachment, and are the marketers going to do that?

MR. KIRSTIUK: Revenues that do not --

Q.76 - Cover cost of service.

MR. KIRSTIUK: Okay. I understood that any of those losses in terms of deficiencies that did not meet the requirements went into a deferral account. That --

Q.77 - But Mr. Newton said earlier that he agrees that Enbridge Gas New Brunswick is bearing the commercial risk of that deferral account.

MR. NEWTON: No, I didn't agree to that. I think what I said was that I would accept the premise that there was no guarantee that the market would allow you in all cases to recover that.

Q.78 - I'm sorry, that's correct.

MR. NEWTON: You know, and what we are talking about here is deferred income, essentially that's what we are talking about.

Q.79 - Non-guaranteed deferred income.

MR. NEWTON: We are talking about deferred income, and marketers don't have the ability to record deferred income

in deferral accounts today and --

Q.80 - Well that's why the proposal I would put to you is that we are the residual component, we are the party who is willing to take the risk to reduce our rates to allow the market to develop, to allow marketers to achieve their margin, we will take that risk if this Board is willing to accept a deferral account so that we can get a regulatory opportunity to earn a fair return on that deferral account, and Enbridge Gas New Brunswick is willing to take the commercial risk and the lack of a guarantee that goes with that to develop this market.

MR. NEWTON: We don't know, Mr. MacDougall, what Enbridge is going to do. We know what Enbridge --

Q.81 - Well that is the proposal, is what I am putting to you.

MR. NEWTON: We know that you have asked for the ability to discount your rate if in -- sorry -- Enbridge has asked for the ability to discount its rate if in its opinion that's required to kick-start the market or help develop natural gas. We don't know that that's going to happen --

Q.82 - No, but --

MR. NEWTON: -- and there may be differences of opinion going forward, heaven forbid, between marketers and the distribution company whether or not that needs to happen.

Q.83 - But, Mr. Newton, our initial target rates are

discounted by 30 percent already, but we are not proposing to -- our target rates are 30 percent discount, we are proposing a second step to maybe even discount them farther. You can't say we are not proposing to discount them. The entire proposal is to discount them --

MR. NEWTON: With respect -- with respect, I think I have heard Enbridge indicate that you were going to make a one time filing several months down the road. We don't know what you are going to propose. I don't know whether it's going to be a 20 percent discount or a 30 percent discount. I don't know.

MR. KIRSTIUK: I think the other point that I would make here is that Enbridge has deemed that they believe that it will take a 30 percent discount from what they will also deem to be the competitive oil price to require customers to convert to natural gas. Okay. So that's one element of this.

The other element is what they are deeming their distribution toll will be. Okay.

What is in between, okay, which is determined by Enbridge Gas New Brunswick, is what is left over for a marketer. Okay.

Now we heard Mr. Thompson speak yesterday and he basically made the point that while there is maybe a little bit more, the marketer might be able to do better

than the 30 percent discount, maybe he can convert the customer at maybe a 20 percent discount. Well, if that were the case, why are they coming up with a 30 percent discount to begin with?

The likelihood is that customer will not convert at a 20 percent discount, because the price -- or the cost that it would take to put the equipment in, based on the savings that that customer is going to save for a year, is not going to be great enough. So the marketer find themselves in the situation where they are stuck between these two points.

Q.84 - But I guess to come back to Mr. Thompson's comments yesterday and Mr. Newton's I think earlier today, the price in the market will be what is set by the market, is that correct?

MR. KIRSTIUK: That's correct.

Q.85 - And if Enbridge Gas New Brunswick's intent is to attach customers, as I believe all their witnesses said, the overall price in the market will have to be such to allow them to attach customers, is that correct?

MR. KIRSTIUK: That's correct, and we hope that that will be with a robust group of marketers that are all competing to try to get that customer.

Q.86 - And I suggest to you that Enbridge -- there is nothing in the evidence today that would suggest that isn't the

intent of Enbridge Gas New Brunswick. Silence is as good as any answer, Mr. Kirstiuk.

MR. NEWTON: I want to make a comment again going back to this -- the need for certainty in the market --

Q.87 - He is ahead of the question this time, but that's fine.

MR. NEWTON: -- and one of the worst things that can happen in any market, but I think it's fair to say in particular in a market that's developing, where we are all trying to introduce a new energy form to consumers who are not totally familiar with it, price certainly is going to be important we think, you know, from a marketer perspective we think that's important.

And I think someone made the comment earlier this week and I agree with it, that if the price is going down no one is going to complain about that.

But sustained benefits are important. People, industries are going to be making considerable capital investments in order to use natural gas. From a marketer's perspective customer is important and we don't want to have to be delivering bad message -- bad messages to customers that their prices are going up because distribution rates, you know, were lowered at one point in time in order to encourage people to attach to the system, and a year or two later they need to go -- to be increased in order to in part help recover what we think is perhaps

too high of a carrying cost.

So I know we are all focusing on the initial stage here, the need to attract customers and the need to develop the natural gas industry in New Brunswick, and we all agree with that, but it's important that those benefits be sustained.

Q.88 - I was going to try to think of the question for his answer, but I don't think I can quite do that.

Mr. Newton, just a few more questions. Would you agree that the provincial regime as set up now in New Brunswick for natural gas is an unbundled model?

MR. NEWTON: I think if by unbundled you mean that it's contemplated that the regulated distribution company cannot buy or sell gas with the exception of last resort supply, yes.

Q.89 - That's exactly what I mean.

MR. NEWTON: Yes.

Q.90 - And is it your understanding that Enbridge Gas New Brunswick entered into the general franchise agreement with the Province of New Brunswick within the parameters of the existing legislative regime?

MR. NEWTON: I would hope so. I would say yes.

MR. MACDOUGALL: Thank you. That's all my questions, Mr. Chair.

CHAIRMAN: Mr. Zed?

MR. ZED: I don't have any questions, Mr. Chairman.

CHAIRMAN: Mr. Holbrook?

MR. HOLBROOK: No questions, Mr. Chairman.

CHAIRMAN: Board counsel? I'm sorry. Mr. Blue?

MR. BLUE: The Province has no questions of this panel, sir.

CHAIRMAN: Okay. And Board counsel?

MR. O'CONNELL: Board counsel has no questions for this panel.

BY THE BOARD:

MS. ZAUHAR: Understanding that concept of fairness and prudence that has been discussed, and I think everyone does, would you be able to perhaps put a little bit more clarify into how the proposal from Enbridge could or should reflect this confidence criteria that you have discussed?

MR. KIRSTIUK: I think one of the points that Mr. Newton made, and I think it's an important one, is that there are a number of uncertainties with respect to the nature of what's going to go into certain deferral accounts and even the way in which the market is going to unfold.

And I think it ties back into one of the things that we feel is very, very important, is that all stakeholders have an opportunity to actually comment, based on the specifics and the facts at that particular moment in time, on truly what is fair.

And to -- and I think this is probably why we have some difficulty maybe providing the clarity that I think the Board might like us to have with respect to what the number ought to be, is because there are different situations that will occur under different circumstances that may require, you know, a different treatment.

And I think we all need to be contributing our own perspectives, our own knowledge to try to come up with whatever the right answer is, so that it's fair to all stakeholders.

MS. ZAUHAR: Thank you.

CHAIRMAN: Mr. Newton, I want you to know I didn't take umbrage with the statement that you made that you felt that the Board would be ill-equipped to rule on what was a prudent expenditure. Because I understand that is only in reference to a paper hearing where the marketers would have no opportunity to have their input. And I just have a comment to make though, which is certainly highlighted by your testimony here today.

I'm a lawyer by training. I have always believed in the open public hearing as the best method that we have discovered so far in ferreting out the facts.

And your statement, Mr. Newton, that you did not appreciate or understand how the deferral accounts would work until you had sat through three or four days

testimony certainly goes to prove that.

I hope that -- and I think this Board has proven in our marketers hearing that we are certainly open to trying new methods in cutting back what can be a very cumbersome process.

But anyway my point is that that is one of the fears that I have in a purely paper kind of hearing.

MR. NEWTON: Could I make a comment to your comment?

CHAIRMAN: I'm sure you will. Go ahead.

MR. NEWTON: I think if all parties go into a written hearing with good faith and make a genuine opportunity to provide helpful responsive answers to written information quests, most times that may do it.

Unfortunately when you get into these kinds of full-blown oral hearings, sometimes information requests are not responded to to the degree that the person asking the question would hold. And so you are forced to cross examine witnesses.

And I just -- my only point here is I wouldn't totally kick out the idea of using some kind of paper hearing or written process to try to determine parties' views.

Because in most cases I would like to think working forward that might be sufficient. There may be times where a full oral hearing is required.

CHAIRMAN: To the best of my knowledge, in jurisdictions

where paper hearings are used, why you go through that paper process.

And normally with the regulator there is the opportunity to say, we don't need an oral hearing, or the paper look has not done the work and we had better have it. So that may be the best of both worlds.

MR. NEWTON: That's fair. And I think it's also true that, you know, that there is a type of regulation out there that some call complaint-based regulation.

And the way that can work is the regulated utility is free to go about its business the way it sees fit. But it does on a regular basis report information on the public record to the regulated utility. And in most cases the -- sorry, to the regulatory tribunal.

And in most cases that Board or PUB will make that kind of information available to other stakeholders and may even seek their input in terms of whether or not they are content with what they see.

And in the absence of a complaint from an Intervenor, you don't have hearings, written or oral.

CHAIRMAN: That is the case with Inuvik Gas, as I understand it.

Mr. Stewart, any redirect?

MR. STEWART: No, Mr. Chairman.

CHAIRMAN: What is Board counsel's preference?

MR. O'CONNELL: Mr. Chairman, my preference would be that we put Dr. Kumar on in the morning.

CHAIRMAN: Well, we will adjourn until 8:30 then?

MR. MACDOUGALL: If we may just talk about how quickly we can get through if that happens maybe. I don't know if any of the other informal Intervenors were going to make any presentations. I don't know if the Board knows of any of that.

CHAIRMAN: I have heard absolutely nothing. As far as I'm concerned, if they don't keep in touch and aren't here, then they don't make -- and I will go back and look at my correspondence with them. But certainly in my phone calls with them -- that is their responsibility. As we are a small Board -- and we can't be phoning people up and saying our estimate is we are going to be through by such-and-such time.

But I will -- just before I turn it back to you, Mr. MacDougall, the room is available tomorrow -- or excuse me, Saturday until 5:00 o'clock.

MR. MACDOUGALL: Okay.

CHAIRMAN: Okay. Which we just learned a short time ago.

MR. MACDOUGALL: Because what I was going to say, if the parties now could just be polled on how long they think they may be with Mr. Kumar, if we come in within the time frame, maybe you could -- we could decide that we would do

our oral arguments on Saturday. That is certainly the applicant's position. And if we are able to finish tomorrow at noon, I would hope everyone would have time to do that.

CHAIRMAN: Well, if you want us to poll the parties we will do that. I guess I look at and say we will be done when we are done.

MR. MACDOUGALL: I just wondered how much time you felt you would have to leave for the oral examination, and if we thought we would be able to do it on the Saturday.

CHAIRMAN: All right. Let's start with the applicant then. How long do you think it will take you for oral summation?

MR. MACDOUGALL: I believe Mr. Blue is willing to go ahead of us. So depending on how long he is, we will probably be no more than an hour and a half.

CHAIRMAN: That is interesting. Is this equal time or -- no, I'm kidding. All right. Mr. Blue, an hour and a half? Is that what --

MR. MACDOUGALL: I said we would be an hour and a half.

CHAIRMAN: You would be an hour and a half. Mr. Stewart?

MR. STEWART: Well, it appears that Mr. Blue and Mr. MacDougall are going before me. It would be very difficult for me to assess what might be left. But I expect -- I can't be any more precise than not very much.

CHAIRMAN: Okay. Mr. Zed, are you -- no, you are not.

Mr. Holbrook?

MR. MACDOUGALL: Mr. Chair, that question was with respect to cross examination for Mr. Kumar tomorrow.

CHAIRMAN: I misunderstood you.

MR. MACDOUGALL: Yes. I thought one of my colleagues said it might have been for argument. This is for cross examination to Mr. Kumar tomorrow.

CHAIRMAN: Okay. Well, let's go back around again.

Examination in chief of Mr. Kumar?

MR. MACDOUGALL: Very brief.

CHAIRMAN: And then to Mr. Blue?

MR. BLUE: Mr. Chairman, do I understand that I'm to go first? I don't mind, if that is the --

CHAIRMAN: No. I was just following Mr. MacDougall's directions as to who --

MR. MACDOUGALL: Mr. Blue had asked me if he could go first.

So I thought that he wanted to go first, Mr. Chair.

CHAIRMAN: I wish people would communicate around here.

MR. BLUE: Yes. What I had said to Mr. MacDougall was that I assumed that since he had most interest at stake, he would want the final cross examination.

MR. MACDOUGALL: And I am agreeable to that.

MR. BLUE: And I had not had any conversation with Mr. Stewart. I'm quite prepared to go whenever the Board wants. It is just that if Mr. Stewart or someone else

precedes me, then my estimate of time will be affected by what they ask.

CHAIRMAN: All right. I will make a ruling right now. We will go in accordance with our normal order of counsel. And Mr. MacDougall, your cross examination will take an hour and a half?

MR. MACDOUGALL: Two hours at a max'.

CHAIRMAN: Two hours at a max'. Mr. Stewart, you are next.

MR. STEWART: Short.

CHAIRMAN: Short. That is not an MN, that is a short.

Okay. And then Mr. Zed, do you still hold the same position?

MR. ZED: We don't anticipate any questions.

CHAIRMAN: Right. Mr. Holbrook?

MR. HOLBROOK: Marico doesn't anticipate any questions either.

CHAIRMAN: Okay. Mr. Blue?

MR. BLUE: So I have agreed with Mr. MacDougall that I'm going ahead of him. He is going last.

CHAIRMAN: I think we better have this conversation tomorrow morning. Okay. We will adjourn till 8:30 in the morning.

(Adjourned)

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

Reporter