New Brunswick Board of Commissioners of Public Utilities

Hearing

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

Delta Hotel, Saint John, N.B.
December 16th 2002, 9:30 a.m.

CHAIRMAN: David C. Nicholson, Q.C.

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

BOARD COUNSEL: Peter MacNutt, Q.C.

BOARD SECRETARY: Lorraine Légère

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CHAIRMAN: Good morning, ladies and gentlemen. Since we are starting a new week I will take appearances.

Mr. Hashey?

MR. HASHEY: Yes. David Hashey, Terry Morrison, numerous others all identified earlier.

CHAIRMAN: Bayside Power? Canadian Manufacturers and Exporters?

MR. NETTLETON: Good morning, Mr. Chairman. Gordon Nettleton and Jim Smellie on behalf of CME. And also I will register the appearance of J.D. Irving at this time.

CHAIRMAN: Do I understand that you flew through Toronto? That's always a mistake.

MR. NETTLETON: A funny thing happened on the way to Saint John, Mr. Chairman. And maybe we can talk about that after appearances.

CHAIRMAN: The City of Summerside? Emera?

MR. ZED: Peter Zed.

CHAIRMAN: Energie Edmundston? Mr. Gillis? Mr. Nettleton has already appeared. Maine Public Service Company? Northern Maine Independent System Administrator. Nova Scotia Power Inc.? Mr. Zed. Perth-Andover Electric Light Commission. Province of New Brunswick?

MR. BARTLETT: Don Bartlett, Jim Knight, Mr. Chairman.

CHAIRMAN: Province of Nova Scotia, Department of Energy? Saint John Energy?

MR. YOUNG: Yes, Mr. Chairman. Dana Young, Jan Carr, Ray Gorman.

CHAIRMAN: WPS Energy Services Inc.? Okay. Back to your unpleasant experience of yesterday, Mr. Nettleton?

MR. NETTLETON: Well, it is I think a first for me, Mr. Chairman, to be here appearing before a Commission somewhat naked and without a tie. My bags were lost, sir. And unfortunately part of the lost assets were materials for my preparation in this cross examination.

I have however found and can proceed with respect to matters respecting the revenue requirement which is in particular the evidence of Ms. MacFarlane and Mr. Lavigne. And I think that is consistent with the directions that we discussed last week in terms of having that area of cross examination conducted today.

I would though seek your indulgence of postponing if you will my cross examination on ancillary services, in particular until I have had an opportunity to locate my lost materials.

CHAIRMAN: Subject only to a reasonable locate.

MR. NETTLETON: I understand, sir.

CHAIRMAN: Do they know where they are?

MR. NETTLETON: Well, at 1:00 o'clock this morning when our flight arrived at Saint John, the answer was no. I have not had --

CHAIRMAN: My experience normally is they will say oh, dear, it went to St. John's.

MR. NETTLETON: You must know the attendant very well, sir.

CHAIRMAN: You always look when your bags are being checked to see that YSJ is on the tag. All of us in this room know to do that, that is for sure. Anyway that is not a fun thing, having been there.

You can just simply go ahead and do what you can do.

And hopefully they will locate it.

MR. NETTLETON: Thank you, sir.

CHAIRMAN: Any preliminary matters?

MR. HASHEY: Yes. Thank you, Mr. Chairman. We do have a couple of undertaking answers.

I should say that Ms. MacFarlane who is here today has -- I'm fearful that the flu may run through all of us. She is just barely getting over it here. So stand back. But she is here. And we are prepared to -- she tells me she is fully able to proceed.

But I would ask that anytime that she needs a break she just indicate it to us quickly and we will --

CHAIRMAN: I think that the flu has been running around some of the Board members too. So just what is it, the terminology? I forget what witness it was that said, I need a biology break or something.

MR. HASHEY: A bio break.

CHAIRMAN: Anyway, by all means, just --

MR. HASHEY: No problems.

CHAIRMAN: -- just go.

MR. HASHEY: Anyway we would start off with an answer -- there was question posed by Mr. Richardson to Ms. MacFarlane in the transcript at 1288, 1289 dealing with the sales into New England.

And I think Ms. MacFarlane indicated she would appreciate being able to come back to the beginning of Panel C and speak more fully to that. I would ask that she address that further if she would please.

MS. MACFARLANE: Thank you, Mr. Hashey. The budget for the current fiscal year for export margins was 103 million. And that was down significantly from last year's actual for a 102 of 169 million. And that was largely because of a collapse of prices.

And as it turns out our forecast for the year is just under 90 million in margins. Prices have held from last year. They dropped precipitously but then recovered.

Our problem has been volume. And that is because the cost of heavy fuel oil is up and we are not competitive in that market as it currently stands, not competitive for good portions of the time.

So our volume is down by -- or will be down for the year by 24.2 percent against what we had anticipated for budget, though the average price we are anticipating will be about 7 1/4 cents compared to a budget of 5.8 cents.

MR. HASHEY: If there are no further questions on that. I don't know if Mr. Richardson may want to ask any further. If not I can answer one further undertaking.

MR. RICHARDSON: Thank you, Mr. Hashey. My concern at raising the question was how firm can we look forward to these sales as we move down the road the next several years? Do you have any great crystal ball in that regard?

MS. MACFARLANE: We continue to believe that as Coleson is converted to Orimulsion our price will be much more competitive and therefore export margins will go up once again.

That is one of the problems with that plant being on heavy fuel oil. The price is so volatile that our ability to predict what it is going to be and our ability to compete when it is high is much reduced.

But with Orimulsion we will have a stable price and a lower price.

MR. RICHARDSON: Is there any concern from your part as to the amount of capacity coming on stream in New England, that it may force prices down and again give us some heartburn up here regarding our competitive position?

MR. MARSHALL: The effect of the capacity in New England is all gas, combined cycle gas capacity which is on the margin. So the issue is not the amount of that capacity.

Most of the cost of a combined cycle gas unit is fuel-related. So it is really what is the cost of natural gas fuel in that market which will drive more the market price.

And the margins that our generation group would make depend on the difference between the marginal cost here of fuel and the costs in the New England market.

And as Ms. MacFarlane said, after the Orimulsion conversion at Coleson, marginal costs in New Brunswick will be lower and there will be a margin -- a margin contribution to fixed costs.

So we see the forecast of prices in New England -- the forecast in actual gas prices is to stay in the 3.50, $4 range. And that is -- so the market prices should stay reasonably firm.

MR. RICHARDSON: One of the keys then, Mr. Marshall, is Orimulsion. And how do you feel about that aspect this morning in light of what has been taking place?

MR. MARSHALL: The project is still two years away. There is time to resolve short-term issues in Venezuela we hope.

MR. RICHARDSON: No further questions.

CHAIRMAN: Go ahead, Mr. Hashey.

MR. HASHEY: There was a question asked I believe to Ms. MacFarlane by Mr. MacNutt concerning the ability -- and maybe it even was directed to the panel -- it might have been Dr. Morin as well -- dealing with the alternative ratemaking, the authority for this Board to deal with that.

And I would say in answer to that, that it is very clear under section 8.3 (4) of the Public Utilities Act which has been adopted by section 53 (1), part 3 that the Board has very wide authority in its decisions here concerning the tariff.

That would be the response to two of the undertakings. We hope to have a couple more for you by afternoon. And we will try to clear up the ones that are behind us. I think we have got most of them answered.

But I think there are four or five yet that are still outstanding. And we still don't have an answer in the business plan issue that was raised, and a request made as to whether that is available and whether it can be released. We are trying to determine that today or tomorrow.

CHAIRMAN: Good. Thank you, Mr. Hashey. Mr. Zed, do you have a couple of matters you want to address the Board on?

MR. ZED: I have one in particular, Mr. Chair.

CHAIRMAN: That is number 3 mike.

MR. ZED: On page 763 of the transcript, after questioning Mr. Connors at length about the issue of grandfathering and Emera's position with respect to same, Mr. Morrison asked the question "So when you say a third party contract you are not tied to any specific type or duration of contract?" And the response from Mr. Connors was "I'm advancing that as a general proposition, that's correct."

And I guess what I would like to clarify, with the Chair's permission, is simply that what NB Power has asked for is that existing firm service customers, that is with a contract term of one year or more, be grandfathered. And Emera's position is that that should only be done if there are bona fide third party contracts in support of those. And we just want to make it clear that from Mr. Connors' answer, he was not suggesting that contracts of less than a year duration should be grandfathered if they are supported by third party contracts. And I don't think there is any issue with the applicant on that. They weren't seeking to grandfather those short-term contracts.

But we just wanted to make sure that from Mr. Connors' response, nobody was misled.

MR. MORRISON: We have no problem. We discussed this on Friday.

CHAIRMAN: It is rather unorthodox but --

MR. MORRISON: Rather than having Mr. Connors come back to clarify, I agreed that --

MR. ZED: Thank you.

CHAIRMAN: Any other preliminary matters? Now, Mr. Nettleton, are you going in the Canadian Manufacturers' slot or are you going to wait for JDI?

MR. NETTLETON: I really don't think it matters which but I will throw the dice and say that we will cross examine in the JDI slot and see what happens.

CHAIRMAN: Okay.

MR. HASHEY: Mr. Chairman, well before cross examination begins I would ask the panel if possible there will be a couple of corrections to evidence.

CHAIRMAN: Sure.

MR. HASHEY: Maybe this would be the better time before we start cross examination obviously. I was going to ask the panel -- we have four members of this panel. Mr. Lavigne, Ms. MacFarlane, Mr. Marshall and Mr. Porter sitting in the order from closest to Mr. Bremner down the line. And I think these witnesses were sworn, were they not --

CHAIRMAN: Yes, they were.

MR. HASHEY: -- at the beginning when we gave the presentation, yes.

CHAIRMAN: Yes.

MR. HASHEY: And starting with Mr. Lavigne I would ask Mr. Lavigne if he adopts his evidence and if there are any corrections he wishes to make in any of the evidence that he has presented?

MR. LAVIGNE: Yes.

MR. HASHEY: I am referring to exhibit A-2 where the evidence can be located. And there may be a short -- a couple of interrogatory references by Mr. Lavigne as well. Mr. Lavigne?

MR. LAVIGNE: Thank you, Mr. Hashey. Yes, I have a couple of corrections to make. The first is in binder A-4, which is the responses to interrogatories number 1. In particular it is the Province of New Brunswick IR number 28.

CHAIRMAN: Try and give us some time, Mr. Lavigne.

MR. LAVIGNE: Sorry.

CHAIRMAN: It is in A-4. At what page?

MR. LAVIGNE: It would be page 317.

CHAIRMAN: 370?

MR. LAVIGNE: 317.

CHAIRMAN: 317.

MR. LAVIGNE: Which is the Province of New Brunswick IR number 28. In particular it is number 9-6. It reads amortization.

CHAIRMAN: Yes.

MR. LAVIGNE: The correction is if you look at line number 3 under amortization, it says distribution system 10 to 35 years. It should read the transmission system. And it should be 35 to 55 years.

CHAIRMAN: So it should read 35 to?

MR. LAVIGNE: 35 to 55 years.

CHAIRMAN: Thank you.

MR. LAVIGNE: The second correction is in binder A-5, under tab number 6. These pages aren't numbered but it would be page number 7. The top reads installed costs, telecommunications. The correction resides in line 52 and 53. Line 52 should read 1.1 rather than 1.6. And line 53 should read 2.5 versus 2. It has no impact on the bottom line of that particular spreadsheet.

And the final change is in binder A-2. And that would be under tab 4. The direct evidence of David Lavigne. And in particular it's page 8, table 4. I'm putting forth a revision to that particular table based on the discussions which took place last week in Panel B between Dr. Morin and Mr. MacNutt pertaining to the textbook of Dr. Morin. In particular the handling of work in progress in the rate base.

Subsequent to the discussion which took place, we had some consultation with Dr. Morin in terms of how that should be handled in terms of the rate base. Based on that discussion we deem that the work in progress should come out of that -- of the rate base.

So we are putting forth a revision to that table removing the work in progress as well as the deferred liability, which again based on discussions with Dr. Morin was deemed that this is zero rated and we have elected to remove it from the rate base.

We had not had any previous consultation with Dr. Morin on that -- on this particular matter, so based on the discussions which came out of last week, we thought it prudent to do so.

CHAIRMAN: Does that mean -- which of the two methods, CWHIP or AFUDC are you using?

MR. LAVIGNE: That would be AFUDC.

MR. MACNUTT: Mr. Chairman, I would inquire of Mr. Hashey if it is possible that they can file --

CHAIRMAN: Can't hear you very well, Mr. MacNutt.

MR. MACNUTT: I would ask of Mr. Hashey if it was possible for NB Power to file a new table 4?

CHAIRMAN: Well that --

MR. HASHEY: I was just about to do that. We have it.

MR. MACNUTT: Thank you.

MR. HASHEY: And maybe this would be the appropriate time to offer that.

CHAIRMAN: Yes. That will be A-28.

MR. LAVIGNE: That can be seen from the table --

MR. HASHEY: Just wait a second, Mr. Lavigne, till the Board has a chance to mark it. Raise your hand.

MR. LAVIGNE: As can be seen from the table the allowable return on equity drops to 12.6 million from the 13.1 million which was put forth in the original evidence. So we are looking at a decrease of $500,000 to the revenue requirement, resulting in a revenue requirement of 97.9 million versus the 98.4 million which we put forth for the test year.

That completes my corrections.

MR. MACNUTT: Would you just repeat the revenue requirement, please?

MR. LAVIGNE: Yes, I'm sorry. It drops to 97.9 million from 98.4, which was in the original evidence.

CHAIRMAN: We don't know. We are waiting. Mr. MacNutt is shuffling paper back there. Did you have anything more, Mr. MacNutt?

MR. MACNUTT: No. We are just wondering where that revenue -- that revised revenue figure, what other tables it would appear in?

CHAIRMAN: Sorry?

MR. MACNUTT: Where that revised revenue figure -- what other table would it appear in. We have now found that it appears at table 5. Are there any other tables?

MR. LAVIGNE: It would impact a number of tables throughout the evidence.

CHAIRMAN: Okay. Mr. Lavigne, perhaps after the next break you could indicate to everyone what tables will be affected, or after lunch is fine.

MR. LAVIGNE: Okay. Yes.

CHAIRMAN: Any other corrections, Mr. Hashey?

MR. HASHEY: No. I believe what I should though then direct -- it's not for Mr. Lavigne. Ms. MacFarlane, you adopt your evidence that has been given here subject to these amendments and how it might affect it?

MS. MACFARLANE: Yes, I do.

MR. HASHEY: And Mr. Marshall and Mr. Porter, your evidence, do you adopt that as filed and are there any corrections? Maybe you could comment on first of all what effect that change would have that Mr. Lavigne is referencing here?

MR. MARSHALL: The reduction from 98.4 to 97.9 of .5 million is a .5 percent reduction. So all of the rate schedules that are in appendix B, the rate design document -- I believe it is appendix B. All of the numbers in appendix B where 98.4 is there reduces to 97.9. And all of the rates calculated there related to transmission assets would be reduced by .5 percent.

MR. HASHEY: Thank you. I think that is a fairly easy calculation.

MR. MARSHALL: And Mr. Porter has one little change to make as well.

MR. HASHEY: No, I appreciate that. I was just going to say I think the calculations are fairly simple and there may be other changes coming from cross examination. One doesn't know. So we haven't tried to do a whole pile of revisions at this point in time. Anything the Board wishes one, we will obviously do it and be pleased to. Mr. Porter?

MR. PORTER: In addition to that .5 percent impact on rates which do appear in my evidence, I have one relatively minor issue to point out. It is in exhibit A-2 as well on page 57. And I really just want to -- as I say it's minor.

CHAIRMAN: Is that in your evidence, Mr. Porter?

MR. PORTER: It's -- no, it's in the appendix B, so it's a joint document of Mr. Marshall and myself.

CHAIRMAN: Okay. And it is what page?

MR. PORTER: Page 57.

CHAIRMAN: Yes.

MR. PORTER: And this is -- just to avoid any confusion, if you look at the list of schedules, the titles of the first two schedules 1.1 and 1.2, the titles should be reversed.

MR. MARSHALL: Only on that page.

MR. PORTER: And only on that page. That's to make it consistent with the other appearances of those schedule numbers and titles. Thank you.

MR. HASHEY: Okay. Thank you, Mr. Porter. I believe that amounts to the corrections. Thank you, Mr. Chairman.

CHAIRMAN: Good. Thanks, Mr. Hashey. Any other preliminary matters? Then refresh my memory but, Mr. Nettleton, I think you went with the JDI position, which would mean that I would invite Mr. Zed to cross the panel.

MR. ZED: Mr. Zed is going in the Nova Scotia Power slot.

CHAIRMAN: Well I guess that sort of shows you, Mr. Nettleton. You haven't got -- yours aren't gapped enough, I guess.

MR. NETTLETON: What is the saying, bad things happen in threes?

CHAIRMAN: Oh dear. Okay. Well go ahead, sir.

<u>CROSS EXAMINATION BY MR. NETTLETON</u>:

Q. - Thank you, Mr. Chairman. Ms. MacFarlane, you provided this morning some further clarification to questions asked by Commissioner Richardson. Could I just follow up with you on the current evidence you gave this morning.

Is it my understanding that the change in the forecast relates to both a change in the price of energy as well as a change in the volume of, for lack of a better term, throughput on your wires?

MS. MACFARLANE: You are referring to the fact that we budgeted at one level and we are now forecasting at a lower level?

Q. - That's correct.

MS. MACFARLANE: And, yes, it is a change both in price and in volume.

Q. - And your expectation though with the Coleson Cove project -- let's first start with that. The Coleson Cove project is a generation project, right?

MS. MACFARLANE: That's correct.

Q. - Okay. So it has nothing to do with New Brunswick Power Transmission, correct?

MS. MACFARLANE: Could you repeat the question, Mr. Nettleton?

Q. - The Coleson Cove refurbishment project that I believe you were referring to relates to New Brunswick Power Generation, correct?

MS. MACFARLANE: Yes, it does.

Q. - And so we are not talking about assets of New Brunswick Power Transmission, are we?

MS. MACFARLANE: That's correct.

Q. - Okay. And do I understand, Ms. MacFarlane, that you are now forecasting that once the Coleson Cove project has been completed, there will be volume increases?

MS. MACFARLANE: That's correct.

Q. - And those volume increases will be back to the current level that you are today experiencing on your system?

MS. MACFARLANE: I don't have that information with me. I certainly can look at what our forecast is, but I know that we are expecting that we will be more competitive. The generation business unit will be more competitive on exports once Orimulsion comes on line.

Q. - All right. Well maybe I could ask you to make that undertaking and find out what the volume levels will be once the Coleson Cove project is completed. Would you do that?

MS. MACFARLANE: Yes.

Q. - Thank you. Ms. MacFarlane, I would like to take us back to the discussion of butterflies. I am hoping that you can provide some further clarification about the new evidence that we have heard concerning Debtco and its role and function and how it will relate to New Brunswick Power Transmission.

Just so that the record is clear, Debtco has not been referred to anywhere in your prepared written evidence or your responses to interrogatories, has it?

MS. MACFARLANE: That's correct.

Q. - And can you confirm that New Brunswick Power Transmission will in fact be a separate legal entity, a corporation separate and apart from New Brunswick Power, when the market opens.

MS. MACFARLANE: That is my understanding. Obviously none of us will know until the legislation is actually passed in the House, but it is my understanding that that is the intent.

Now when you say separate and apart from New Brunswick Power, New Brunswick Power as it currently exists, as I understand, will be continued as New Brunswick Power, some sort of holding company. And the transmission company will be a subsidiary thereof. So there is a connection.

Q. - Right. But the two, as you understand it, will be separate and distinct corporations?

MS. MACFARLANE: That's correct.

Q. - I guess what I would like to do now, Ms. MacFarlane, is have you help me understand how New Brunswick Power Transmission Corporation is going to be capitalized in fact in the brave new world.

Who will New Brunswick Power Transmission obtain the Transco assets from?

MS. MACFARLANE: Again, this is not -- this is only based on my understanding of what will happen. Until the legislation and accompanying documents are finalized, we are not sure. But as I understand it, the intent is that NB Power will be continued under the Business Corporations Act as a -- as a holding sort of company.

It will -- the assets of NB Power therefore will be in this holding company. One of its first undertakings will be to transfer those assets from the holding company into the individual subsidiaries, including the transmission company.

Q. - So will monies flow from New Brunswick Power Transmission Corporation to New Brunswick Power, for lack of a better term, Holdco in consideration for the assets?

MS. MACFARLANE: The shares of the transmission company will be held by, for lack of a better term, the holding company. So to that extent there will be a transfer of value, shall we say, from the transmission company in the form of shares.

Now coincident with the assets being transferred, the debt equity swap will occur between the holding company, for lack of a better term, and the debt company, for lack of a better term. And at the same time as the assets are sent down to Transco, debt and share capital will be sent to Transco in order to capitalize those assets. It will flow from Debtco to Holdco to the transmission company, is my understanding of how it will work.

Q. - Well let's take that in pieces, if we could. The assets will go to Transco. Shares will be taken by Holdco in exchange. Have I got it right so far?

MS. MACFARLANE: Mmmm.

Q. - Okay. And as it relates to Debtco, there will be a debt equity swap between Holdco and Debtco?

MS. MACFARLANE: That's correct.

Q. - And so the amount of debt taken by Holdco is what?

MS. MACFARLANE: Each of the subsidiary companies will have a different capital structure depending upon the risk -- the assessment of risk that they face. So as the assets are transferred down into the subsidiary companies, an appropriate amount of equity and debt will flow down as well to be matched by that.

It is the composite of those different capital structures that will be the amount that will be swapped between Debtco and Holdco.

Q. - And so is it your understanding at the end of the day the current debt held by Holdco will in effect be held or be placed in the Debtco corporation?

MS. MACFARLANE: Some portion of it will in the following sense. All of the debt as it currently exists, as I understand it, will move to this separate Crown corporation we are referring to here as Debtco.

What will come back is a combination of some of that debt and equity in a proportion that will allow proper capitalization of the subsidiaries.

Q. - So if I understand this, Ms. MacFarlane, there will be some form of financial instrument provided from Debtco to Transco?

MS. MACFARLANE: The instruments as they exist today will be reissued in a sense. Today the debt of NB Power is issued in the name of the Province of New Brunswick. And there is simply a note between the Minister of Finance and NB Power indicating that NB Power is accepting responsibility for a portion of that.

That will -- when we do the debt equity swap, we will be, to the extent possible, simply moving it all over to Debtco and moving back issues that will allow a distribution of debt in the subsidiary companies with the same terms and conditions, shall we say, of the pool, so that no subsidiary is adversely affected by the redistribution of debt. And they will be instruments just as they are today, that are covered by a note between the Province of New Brunswick and the Minister.

Q. - So the terms of the financial instrument between Debtco and Transco will be the same terms as exist today on that outstanding debt?

MS. MACFARLANE: That's correct.

Q. - I think you have indicated this, Ms. MacFarlane, but just to be clear, Debtco, to your understanding, will be a Crown corporation?

MS. MACFARLANE: That is my understanding.

Q. - And as between Debtco and Holdco and Debtco and Transco, who are Transco's lenders? Isn't Debtco and the Province through Debtco, the lender?

MS. MACFARLANE: In effect, the lenders are the ultimate issuers of the -- the ultimate investors. And we are speaking here about legacy debt. I should make that distinction. As it goes to the legacy debt, i.e. the debt that exists today and will be brought back in the debt equity swap, the ultimate lenders are the investors that the Province deals with.

Q. - All right. But as between two corporations and the Province, both corporations being Crown corporations, the ultimate lender in this case remains the Province, fair?

MS. MACFARLANE: That's correct.

Q. - There was some discussion of Thursday last dealing with lifelines. Again, a point raised by Commissioner Richardson. Transco is remaining as a Crown corporation. Is that your understanding?

MS. MACFARLANE: That's correct.

Q. - So the risk borne by Debtco as it relates to Transco, is the risk of default. Is that fair?

MS. MACFARLANE: It is the risk of default on the existing legacy debt. It will assume no responsibility for new debt that is issued as that existing debt matures.

Q. - All right. I think that is a very important distinction and thank you for that, that this discussion is in respect of legacy debt. So that's fair.

And as it relates to legacy debt, that default risk is as between two Crown corporations, correct?

MS. MACFARLANE: I don't believe so, Mr. Nettleton. I think you would look right through to the ultimate transaction. That at the end of the day, the risk for default is to the holders of these bonds. And although it starts with the transmission entity, at the end of the day on the legacy debt, the Province is responsible.

Q. - Is that any different than the current risk of default?

MS. MACFARLANE: No.

Q. - Ms. MacFarlane, in your professional experience as a chartered accountant, can you recall any instance where a Crown corporation has gone bankrupt?

MS. MACFARLANE: I think there is another distinction. The answer to that is no, but there is another important distinction to make here. Most Crown corporations also carry the status of agent of the Crown, which means on all of their transactions, be they debt or operations, any contractual obligation is in effect done in the name of the Crown.

And again, subject to the legislation actually being passed, it is my understanding that Transco will not carry the status of agent to the Crown. So the fact that it is owned by the Province does not mean that the Province has a financial responsibility for it beyond the legacy debt. And therefore there is every possibility that there is a risk of default if things go wrong.

Q. - Well I understand that things may be different for non-legacy debt.

But as it relates to legacy debt, would you agree that if there was a change in the risk of the outstanding legacy debt as it concerns default, the terms and conditions of those debt instruments, the covenants, would have to be modified as between the Province and the outstanding and ultimate lenders. Fair?

MS. MACFARLANE: The ultimate responsibility for that debt is with the Province of New Brunswick if the transmission company defaults.

Q. - And that is no different than how it is today, correct?

MS. MACFARLANE: That's correct.

Q. - Thank you. All right. Let's move on to non-legacy debt. In the new world, could you help me understand how new debt will be raised by Transco?

MS. MACFARLANE: The first issue will be obtaining a credit rating. And as Dr. Morin indicated last week, it is the intent to capitalize the company so that it can receive an investment grade credit rating. And then with investment bankers the utility will approach the debt markets, looking for capital.

Because of the size of the issues that in all likelihood will happen in Transmission they will probably be private placements or something akin to that, which comes with a basis point penalty, shall we say. But that's what is intended.

Q. - And I believe, Ms. MacFarlane, you indicated last week that you are currently in discussions with investment bankers concerning credit ratings?

MS. MACFARLANE: The Province is currently in discussions and NB Power is part of those discussions, yes.

Q. - Have you obtained any opinion, as of today's date, respecting the credit rating of Transco?

MS. MACFARLANE: I have been subject to discussions where the investment bankers have made their opinions known.

But I do not have an opinion having been given to me.

Q. - All right. I think we have talked about investment bankers. Let's now talk about credit agencies, credit rating agencies. Have you had discussions with any credit rating agencies respecting this topic?

MS. MACFARLANE: We have not discussed the reorganization with the credit rating agencies, no.

Q. - Ms. MacFarlane, could you turn to page 11 of your direct evidence please? I believe that is A-2.

MS. MACFARLANE: I have it, yes.

Q. - It's my understanding in your testimony with Dr. Morin that your intentions are to finance Transco so as to obtain an A rating on a bond, is that fair?

MS. MACFARLANE: That's correct.

Q. - Do you see any A ratings with respect to the utilities listed in table 4?

MS. MACFARLANE: The different bond rating agencies use different terminology. And what you are seeing here is the terminology used by Standard & Poors.

The A rating that we would have been referring to would have been DBRS terminology. So the Province of New Brunswick has an A rating in DBRS terminology.

Q. - Could you undertake, Ms. MacFarlane, to provide a list of the Canadian electric utilities -- actually, sorry, the

Canadian utilities which you have used for your credit spread analysis that shows the DBRS ratings?

And by that I mean not only table 4, but I believe there was also -- and if I had my bag here I would be able to tell you -- but I believe there was a response to an Information Request where you provided CIBC world markets, and the analysis of that showed the various credit spreads and bond ratings.

And I'm wondering if you could provide that in DBRS terms please?

MS. MACFARLANE: Yes.

Q. - Thank you, Ms. MacFarlane, that is very helpful with respect to Debtco. I'm going to move on a bit.

I would like to start, Ms. MacFarlane, with a general proposition before we get into the detail of your evidence. And the detail that I'm about to get into is the calculation of the finance charge.

Would you agree that under your proposed PBR scheme, New Brunswick Power Transmission's challenge, shall we say, to maximize its profits very much depends on what the starting point revenue requirement is established at?

MS. MACFARLANE: That's correct.

Q. - And so if this amount is set too high, or shall we say is overinflated, the company has a much better time or likelihood of achieving cost savings, fair?

MS. MACFARLANE: That's true. But that is why Dr. Morin put the safety barriers into the design of the PBR, such that although it is important to get the going-in rates correct, at the same time if they are too high or too low, the mechanism becomes self-correcting outside of the band of 10 to 12 percent ROE.

Q. - Outside of the band?

MS. MACFARLANE: Yes.

Q. - Thank you. And alternatively if the starting point revenue requirement is too low, the company has a much more difficult time achieving its cost of capital objectives, is that fair?

MS. MACFARLANE: Yes.

Q. - So getting the starting point revenue requirement right matters, fair?

MS. MACFARLANE: Yes.

Q. - And its importance is amplified, is it not, because the proposed term of your application is for three years?

That is the earliest time a ratepayer would under your proposal be able to review this would be at the conclusion of three years?

MS. MACFARLANE: Except for the safety mechanism that would say that any earnings below 9 percent would allow the company or the PUB to open the tariff up for reexamination.

Q. - But if it went the other way, if earnings were consistently above the higher end of the band, there would be no opportunity to review that?

MS. MACFARLANE: Under the proposal we have put forward, there is no opportunity to review it. But it does call for 100 percent refund of any earnings over the 14 percent, which in effect is the same as if the -- except for it being retroactive, it is the same as if the rate were lower.

Q. - Ms. MacFarlane, do you know of any Canadian regulated utility that is earning 14 percent return on equity?

MS. MACFARLANE: No. And that is why Dr. Morin felt that the lack of symmetry, as pointed out by the Chair, in that the tariff doesn't open again at earnings over 14 percent was pretty low risk, because it is very doubtful, especially in the ensuing three years, that we will get there.

Q. - Assuming the revenue requirement is right?

MS. MACFARLANE: That's correct.

Q. - Let's turn to your evidence, Ms. MacFarlane. Let's start with the finance charge found at table 1-A. I'm looking at line 7.

MS. MACFARLANE: Yes.

Q. - And from table 1-A, if I follow the bouncing ball if you will, we got a first look at table 7, is that right?

MS. MACFARLANE: That's correct.

Q. - And the item of table 7 that I would like to focus on is the long-term debt interest of 14.8 million.

Now I ask this because I don't think the answer is yes. But that number hasn't changed as a result of the corrections given today, has it?

MS. MACFARLANE: No, it has not.

Q. - Thank you. So from table 7 we have to then go to table 6, correct?

MS. MACFARLANE: That's correct.

Q. - And line item 4 of table 6 shows a cost of debt for fiscal year 2003 and '4 of 10.7 percent. Do you see that?

MS. MACFARLANE: Yes.

Q. - And so we then go to table 5, right?

MS. MACFARLANE: Yes.

Q. - And I think we have landed. We have drilled down. And we are ready to talk about table 5.

Is it fair, Ms. MacFarlane, that table 5 really is showing a numerator and a denominator, the numerator comprised of lines, items 1 through 5 and the denominator comprising of lines 7 and 9?

MS. MACFARLANE: No. I believe the numerator would be line 6 -- yes, 1 through 5. And the denominator would be line 15. 15 is an average of lines 7 through 9 and lines 11 through 13.

Q. - All right. And that is a simple average of the outstanding long-term debt forecast to exist at the end of the test year, fair?

MS. MACFARLANE: Yes.

Q. - So there is a numerator comprising of long-term existing debt interest and a denominator of long-term existing debt and sinking funds?

MS. MACFARLANE: Yes.

Q. - I would like to concentrate first on the numerator if I could. Line 1 is entitled "Interest on long-term debt." And this amount is stated at 202 million -- 202.6 million, right?

MS. MACFARLANE: Yes.

Q. - Now to understand what makes up this amount we need to look at Province of New Brunswick Information Request 28 at sub (15). And I believe that is A-4.

MS. MACFARLANE: I'm sorry. Could you repeat the reference please?

Q. - Yes. It is the New Brunswick Power response to PNB, Province of New Brunswick IR 28, sub part (15).

MS. MACFARLANE: Yes, I have it.

Q. - Right. And I believe at page 319, the first category shown is "interest expense". And that amount is 174.4 million, is that fair?

MS. MACFARLANE: Yes.

Q. - All right. And the next category is "foreign exchange on interest." And that is found at page 320. And that amount is 13.2 million, right?

MS. MACFARLANE: That's correct.

Q. - And the third category you have shown is UFM and decommissioning of 15 million?

MS. MACFARLANE: That's correct.

Q. - Now back to table 5. And Ms. MacFarlane, we are calculating the cost of debt for the purposes of New Brunswick Power Corporation as opposed to New Brunswick Power Transmission, right?

MS. MACFARLANE: That's correct. And then an allocation is made.

Q. - Right. But for the purposes of table 5 we are only considering the cost of debt for New Brunswick Power Corporation?

MS. MACFARLANE: That's correct.

Q. - Can you confirm, Ms. MacFarlane, that the UFM and decommissioning interest relates to New Brunswick Power's

Point Lepreau nuclear generation facilities?

MS. MACFARLANE: The liabilities may have arisen from that. But they do not relate to the nuclear operation in the following sense. Our rates include an amount collected from customers each year for an allowance for used fuel management and decommissioning of the nuclear facility over time. So our rates include that amount.

That amount could have been, should have been, will be set aside in a trust fund and invested in order to allow for those activities to take place when they happen.

They over history have not been set aside though. They have been used in order to finance other parts of the operation including the transmission entity and including transmission assets. And to that end they are considered part of NB Power's overall debt.

When I say that they ultimately will be set aside in a trust fund which will require borrowing, that in fact will be happening in the current fiscal year because of a licencing requirement of the CNSC to provide financial guarantees by March 31st 2003.

Q. - I don't think you have to turn this up, Ms. MacFarlane. But your response to Information Request 39 to Mr. Gillis indicated that the decommissioning liabilities refers to post facility closure site cleanup costs for Point Lepreau and for costs for the disposal of irradiated nuclear fuel?

MS. MACFARLANE: That is what the amounts were collected from customers for. And therefore there is an ultimate liability for that.

When one looks though at where is that liability coming from, it is not coming from customers anymore, because the amounts have already been collected from customers.

But they were used, those funds, instead of being set aside for UFM and decommissioning, they were used to avoid borrowing on other asset purchases across the corporation.

At the time that we have to reestablish those trust funds, which will be in the current fiscal year, we have to go to the market and borrow amounts in order to put those trust funds in place, the amounts having already been expended on other assets of the entity. And that will happen in the current fiscal year.

Q. - The $15 million that you have referred to comprising the 202.6, do you pay that to anyone today?

MS. MACFARLANE: In the test year we will be paying it to whoever issues the -- whoever accepts the bonds that we issue to replace that money.

Q. - But it has nothing to do with legacy debt, does it?

MS. MACFARLANE: It certainly does, in the following sense.

Money was collected from customers, should have been set aside in a trust fund and wasn't -- let's say $10 was collected from customers. Instead of putting it in a savings account, that $10 was used to finance transmission assets, generation assets, distribution assets and in some cases nuclear assets, that amount was used to avoid having to go out and borrow money to finance those assets. It has avoided borrowing that those funds have been put to use.

At the time that they have to be reinstated, which is in the current fiscal year, as a result of a licencing condition, we will have to go to the markets to borrow those amounts. Therefore it very directly relates to the financing of transmission assets.

Q. - But that money, Ms. MacFarlane, relates to the issuance of new debt?

MS. MACFARLANE: That's correct.

Q. - Thank you. Mr. Lavigne, your turn. Could I take you to page 3 of your evidence please?

MR. LAVIGNE: Yes.

Q. - This is a simple question, sir. And it is just confirmation that the assets that you show here that comprise the rate base do not include assets for New Brunswick Power Generation. Fair?

MR. LAVIGNE: Yes, that is correct.

Q. - And that includes Point Lepreau. Right?

MR. LAVIGNE: Yes, that is correct.

Q. - Ms. MacFarlane, you said that these were an avoided cost in your answer.

MS. MACFARLANE: They were avoided borrowings. They were not avoided costs in the sense that we attributed interest income to the -- shall we say the deemed borrowings, we attributed interest income or interest expense to the operations and attributed interest income to the liability as if we had borrowed on the open market to achieve the funds that would have been used to fund assets in other business units. So there was no avoided cost.

Q. - You will just have to bear with me for one second, Ms. MacFarlane.

CHAIRMAN: Actually I think it is a good time for us to take our 15 minute break.

(Recess)

CHAIRMAN: Go ahead, Mr. Nettleton.

MR. NETTLETON: Thank you, Mr. Chairman. Unfortunately I have to report that there are no bags yet. But we will keep checking.

CHAIRMAN: No flights either.

MR. NETTLETON: I am told noon is the first opportunity.

CHAIRMAN: That is about right.

Q. - Ms. MacFarlane, earlier this morning you were indicating that the PBR scheme that you are proposing has a self-correcting feature to it. I would like to understand how this self-correcting feature applies to the cost of legacy debt.

If you -- if this Board were to approve your PBR mechanism, are you suggesting that if you have some way of improving upon the cost of debt, that that reduction somehow flows back to ratepayers?

MS. MACFARLANE: Let me start by saying that if I used the term self-correcting, I should have used the term safety net.

Secondly, you will recall that the formula is such that if NB Power is able to beat indices in respect of its cost, then it presumably can improve its return on equity within the 10 to 12 percent band without sharing, and above the 12 percent band or below the 10 percent band with sharing.

I believe your question was if we are able to improve on the interest costs of legacy debt.

Q. - That's correct.

MS. MACFARLANE: The cost of legacy debt is embedded with the exception of the assumption made for UFM and decom' avoided borrowings in which case the assumption there should be the cost of new debt.

It isn't -- it is less than the cost of new debt in the testimony. We chose not to correct that. But with that one exception, the cost of imbedded debt isn't something that we can change for the very reason that it is embedded.

Q. - All right. So I think we are in agreement that the cost of debt that we are discussing here is not forecast to change over the proposed test year period?

MS. MACFARLANE: It is as the debt attrits. As the debt matures the proportion of old debt to new debt changes and the interest rate amount changes slightly and there is a table in the evidence that points to that. Would you like me to point it out?

Q. - Certainly.

MS. MACFARLANE: It is table 10 in the evidence which is --

Q. - Sorry, this is your evidence?

MS. MACFARLANE: It is my evidence, yes, in exhibit A-2, table 10 in my direct evidence which is page 18.

Q. - I am there.

MS. MACFARLANE: The very bottom line, line number 16 is the annual cost of debt for the fiscal year indicated at the top. And the test year is 10.7 percent and the year after is 10.98 percent.

Q. - All right. So we can't expect a reduction then in the cost of debt. We are expecting an increase?

MS. MACFARLANE: In the cost of legacy debt. There is a decrease in the cost of overall debt because as this legacy debt matures, it is replaced by new debt at lower rates.

Q. - Can you turn to table 9 please? Which -- I am assuming that this is a table of the legacy debt. Correct?

MS. MACFARLANE: That's correct.

Q. - Can you show me which of these issues you are intending or expecting to mature during the three year period?

MS. MACFARLANE: We would have taken this table which shows the way the debt attrits over time, we would have taken it back to the fiscal year for which we -- the last fiscal year for which we have audited financial statements which is 2001, 2002. And that is the column that is indicated at the left entitled "2002".

So the amount -- you will notice that every single issue has a principal amount in it at that point in time. And as we move forward, the maturity dates, which are in the fourth column over, any maturity date that would be in the fiscal year '02, '03 or beyond would expire in the table as it comes due. And you can see that represented in dashes in the table.

So as an example, line number 5, issue number 70, which was a Canadian dollar issue expired April 1st, '02, you can see that it is not shown in the translated amount at April 30th 2003, because it would have expired in that fiscal year.

Q. - But as between 2004 and 2005, there are no incremental maturities, right?

MS. MACFARLANE: That is correct, yes. The amounts differ on the U.S. issues because of the translation rate and there is a small principal payment on the NCPC issue at the top. That is a federal government issue. There is a small principal change there.

Q. - But there are no maturities, correct?

MS. MACFARLANE: There are no maturities, that's right.

Q. - And we are seeing yet an increase in debt from your table 10 from 10.7 to 10.98?

MS. MACFARLANE: Remember that there are various components of that in table 10.

Q. - Right.

MS. MACFARLANE: The interest on the long-term debt, you will see on line number 1 on table 10 does reduce slightly. But the sinking fund earnings have increased, the amortization of principal related debt -- or pardon me, amortization of foreign exchange cost has not changed, but the credit spread has changed slightly.

Q. - And we will get to each of those line items, rest assured. But overall from that table we can conclude that the cost of debt is increasing, right?

MS. MACFARLANE: The percentage has increased, the magnitude has decreased.

Q. - Well line 16 shows an increase, right?

MS. MACFARLANE: Line 16 shows an increase in the percentage. Line 6, which is long-term debt interest for NB Power, shows a decrease. In pure dollar amounts, it is a decrease.

Q. - All right. Fair enough. You were helping me understand, I believe, the nature of the UFM and decommissioning liability.

MS. MACFARLANE: Yes.

Q. - Is it fair to say, Ms. MacFarlane, in your lingo as a chartered accountant, that this is a deferred liability?

MS. MACFARLANE: The debt itself is not a deferred liability, no. The fact that there will ultimately be a cost to undertaking this is a deferred liability, undertaking the used fuel management and the decommissioning.

When the trust funds are established -- and as I say, that will be in the current fiscal year -- you will see a new asset arise which will be trust funds. And you will see a new liability arise, which will be the replacement of what we are referring to here as avoided borrowing, through issuance of actual debt certificates.

Q. - Do you have or could you put before you exhibit A-5, tab 4, the annual report of New Brunswick Power?

CHAIRMAN: What exhibit is that?

MR. NETTLETON: That is A-5, Mr. Chairman.

CHAIRMAN: A-5. Thank you.

MS. MACFARLANE: I have it.

Q. - I would like you to turn to page 35, if you would, please.

MS. MACFARLANE: Yes.

Q. - You will see under the heading "deferred liabilities" in your balance sheet there is a line item called plant decommissioning and used nuclear fuel management?

MS. MACFARLANE: That's correct.

Q. - Is that what we are speaking of here?

MS. MACFARLANE: We are speaking of the amounts that will be required to undertake the activities behind that liability.

Q. - All right.

MS. MACFARLANE: So as I say, we would have collected amounts from customers and rather than setting them aside in a trust account, we have used them to avoid other borrowing, so therefore the asset is lower. There is no trust account, and the borrowing is lower.

When we create that trust account the assets will be higher and the borrowing will be higher.

And a point -- I would just like to -- I know it's confusing. I would just like to point out once again the amount we are borrowing is not an amount to fund those liabilities. It's an amount to replace the dollars that we already collected from customers and used on other asset and operational items across the corporation instead of creating a trust fund to fund those liabilities.

Q. - Has -- does your accounting system allow you to delineate what assets you have funded with these monies as they relate to transmission?

MS. MACFARLANE: No, it does not. It would be just part of the general borrowing of the corporation. We don't assign borrowing to specific assets.

Q. - But that is going to change in the new -- brand new world, right?

MS. MACFARLANE: It will change in the sense that company by company we will understand what borrowings are funding which company. But within that company we will not understand what borrowings are funding which assets. Some of the assets are funded out of cash flow. Some will be funded out of borrowings.

Q. - If you turn to page 43 of your annual report, there is the note 12. And will you confirm with me, Ms. MacFarlane, that this obligation is indeed -- that is the decommissioning of -- and used nuclear fuel management is a unfunded obligation?

MS. MACFARLANE: At the year end that we are speaking of it is an unfunded obligation. We have, as I say, collected those amounts from customers and used them in other parts of the operation as opposed to setting them aside in a trust fund to manage this liability. That's why it says the obligation is not funded.

Q. - Are you saying then that as part of this application and of the change to decoupling Transco that there will be a change in this -- in the nature of this liability to being one where it is a funded obligation?

MS. MACFARLANE: The reason for funding this obligation is not related to the restructuring of NB Power. It's related to a CNSC licence condition that was embedded in our licence issued October of this year.

So the ability to collect funds from customers and use it other than for setting it aside for future obligations for decommissioning and used fuel management is no longer there for us, either historically or prospectively, so we must borrow to put these funds in place.

And again I stress that the only reason we are borrowing is because we used these funds on assets and operations across the organization including transmission.

I should just clarify, Mr. Nettleton, CNSC is Canadian Nuclear Safety Commission.

Q. - That was going to be my next question, so thank you for that. That condition though, Ms. MacFarlane, relates to again Point Lepreau?

MS. MACFARLANE: The condition relates to Point Lepreau, that's correct.

Q. - Thank you. Could you turn to page 38 of your annual report, which again provides a more descript discussion of the deferred liability we are speaking of?

MS. MACFARLANE: Yes.

Q. - As I read this note, that is note 1H, the corporation has the discretion to make provision for this future liability by taking an accounting deduction from the calculated net income, right?

MS. MACFARLANE: Could I ask you to say that again, please?

Q. - Yes. Does the corporation -- it is the corporation who has the discretion to make provision for the future liability, right?

MS. MACFARLANE: No, I -- well it depends on your interpretation. Canadian Institute of Chartered Accountants Guidelines would indicate under their matching principle that we would have to set aside a current cost for the -- a current portion of the estimated future costs for these liabilities so as to match the usage of the asset and the accumulation of the liability with the current time period.

Q. - All right. Can I take you back, Ms. MacFarlane, to page 35 of your annual report. I see under the heading "deferred liabilities" that there is an entry for other. And I believe that relates to -- as I read notes 9 and 13, pension benefits and retiring -- retirements?

MS. MACFARLANE: The corporation has a retirement allowance program that's tied to its collective agreements. And part of it relates to that liability. And the other is an early retirement program payout. This is for the early retirement program that have been undertaken and recognized in previous years as a cost and the liability is being extinguished over time.

Q. - And that isn't included in your interest calculation found on page 1 -- or line 1 of table 5, right?

MS. MACFARLANE: Did you say it is or it isn't?

Q. - Is not. I think we went through the categories and that wasn't included in one of your entries, right?

MS. MACFARLANE: Mr. Nettleton, may I take an undertaking on that so that I can examine the supplementary schedules just to ensure?

Q. - Certainly. Thanks. I would like to move on to the next category that we did identify and that was foreign exchange on interest.

Ms. MacFarlane, are you aware of any -- or does New Brunswick Power Transmission hold cash flow streams or are you proposing to hold cash flows streams which have a U.S. dollar denomination? You are not charging rates in U.S. dollars, are you?

MS. MACFARLANE: No, we won't be charging rates in U.S. dollars. Some of the costs may be in U.S. dollars.

Q. - Other than debt costs what costs would those be?

MS. MACFARLANE: There may be some supplies purchased out of the U.S.

Q. - But all of your assets reside in the Province of New Brunswick?

MS. MACFARLANE: That's correct.

Q. - And you have referred in your evidence, Ms. MacFarlane, to the Ontario Hydro experience. Do you recall that? Ontario Hydro as being a electric utility that has gone through a similar unbundling?

MS. MACFARLANE: I referred to it in respect of setting up a separate Crown corporation to hold the debt in the debt equity swap.

Q. - Are you aware, Ms. MacFarlane, whether Ontario Hydro -- well it is now Hydro One has been allocated any U.S. debt, any foreign debt as part of its restructuring?

MS. MACFARLANE: I'm not aware, no.

Q. - Would you be surprised if they had been allocated U.S. debt?

MS. MACFARLANE: No, I would not be surprised.

Q. - Why?

MS. MACFARLANE: Because generally speaking, at least the understanding that we have approached this with, is that we want to avoid any cost shifting between the regulated parts and the unregulated parts of the business when the debt allocation is done through the debt equity swap.

Therefore, the intent is to ensure that the pool of debt, its characteristics as a pool, emulate to the extent possible the characteristics of the pool of debt in the new subsidiaries. And since there is debt in the corporate entity now, NB Power, that will be part of the debt sent over to this separate Crown corporation I would -- it's not unreasonable to assume that either some

U.S. debt issues will come back or an equivalent cost will come back to the transmission entity and the other subsidiaries.

Q. - Ms. MacFarlane, who are you paying the foreign exchange on interest that is embedded in your $202.6 million number to in respect of that amount? Who gets paid that amount?

MS. MACFARLANE: We pay it to the Province of New Brunswick. And the Province of New Brunswick would pay it to the holders of the bonds.

Q. - So it's an actual cash cost?

MS. MACFARLANE: It is an actual cash cost.

Q. - Now when this U.S. debt was subscribed were there specific assets that were used or were they -- was that debt used for the purposes of financing specific assets?

MS. MACFARLANE: NB Power has, as far as I know, always managed its debt as a collective pool. The assets are financed partly through cash flow and partly through borrowings and there is no attribution of specific borrowings to specific assets.

Q. - Ms. MacFarlane, you are an officer of New Brunswick Power?

MS. MACFARLANE: I am.

Q. - Are you aware whether New Brunswick Power has revenue or cash flow streams in U.S. dollars?

MS. MACFARLANE: Yes, it does.

Q. - What are those? Can you describe them?

MS. MACFARLANE: There are two -- three primarily. One as you have pointed out is the interest and where required principal payments on U.S. debt.

There are revenues from export sales that are received in U.S. dollars. And there are foreign currency translation requirements for our fuel. We pay that in U.S. dollars.

Most of our fuel is paid in U.S. dollars. And in addition to that there is the odd supply, which are minor items.

Q. - And the export revenues that you receive in U.S. dollars, they are related to the sale of energy?

MS. MACFARLANE: That's correct.

Q. - And those are from generation facilities?

MS. MACFARLANE: That's correct.

Q. - Why would you not allocate those revenue -- U.S. revenue-generating assets to the U.S. debt?

MS. MACFARLANE: I suppose one might look at something like that from a hedging point of view to ensure that there is a natural hedge in place.

But one would only do that if we still achieved the objective of ensuring that the cost of debt of the pool as it exists today is the same as the cost of debt of the pools that are broken up and distributed to the subsidiary entities.

One would not want to see higher cost or lower cost debt go to the regulated parts of the business versus the unregulated parts of the business, because it would be unfair.

If I could expand I could give you an example.

Q. - Sure.

MS. MACFARLANE: The Province just did a U.S. global issue, and NB Power participated in it. The all-in cost of that issue was just over 5 percent.

Were we to attribute that particular issue to Generation it would be to the detriment of Transmission, because the cost of that debt is so low.

What we are trying to achieve in the debt/equity swap was to ensure that there is a fair attribution of debt both in terms of its duration, its term, its coupon rate, et cetera to each of the subsidiaries.

Q. - All right. Can you turn to page 46 of the annual report please?

Now earlier you indicated that if there was a natural hedge, that is U.S. dollar revenues could be matched against U.S. dollar debt costs, do I take it from note 18

(b) that in fact the corporation has identified that type of hedge and is intending to apply over $200 million of sinking funds to create that hedge?

MS. MACFARLANE: That's correct. There are very prescriptive CICA guidelines in respect of what represents an effective hedge. And short-term revenues and revenues that are not tied to a contract do not represent an effective hedge against a long-term liability.

In this case you see where we are using assets. And we have taken those assets and invested them in U.S. dollars so as to provide an effective hedge against the U.S. debt.

And I will point out that what gets allocated to the subsidiaries and what is allocated in our evidence to the transmission entity is the net of debt minus sinking funds.

Q. - We will get there. But the point that I would like you to confirm with me is that this hedge -- let me put it this way.

Has this hedge, this natural hedge been factored into line 1 of table 5?

MS. MACFARLANE: Yes. And I can show you that. If you turn to table 9 on page 17.

Q. - Yes.

MS. MACFARLANE: In the column 2004, the last four entries are for U.S. dollar debt. And you can see that year over year the last two items which have a purchase hedged against them, you can see that the translation rates for those do not change.

And you can see that year over year the two items above that, which are U.S. debt that go out to 2020 and 2022, are very similar in their translated amount but not exactly the same.

And that is because you will see that there is $250 million worth of debt outstanding. And we have applied 200 million of sinking funds against those as a natural hedge, leaving 50 million unhedged.

So the change in currency in those two years in our forecast has led to only a slight difference in the statement date liability of those obligations.

Q. - Well, let me go back to the note then, Ms. MacFarlane, because I'm obviously missing something.

As I read it it says "Subsequent to year end the corporation entered into cross currency interest rate swaps to hedge foreign exchange risk associated with 200 million of its outstanding U.S. debentures."

MS. MACFARLANE: Mmmm.

Q. - So there was some hedging activity on that 200 million of outstanding U.S. debt, right?

MS. MACFARLANE: That's right. And that is -- on table 9 that is lines 27 and 28. And you will see that in the columns "2004 statement date rate" and "2005 statement date rate" compared to "2003 statement date rate", you will see that the numbers don't change. And that is because we have a hedge, a purchased hedge against those amounts.

Q. - All right. But the note then goes on to say "Also, subsequent to year-end, certain U.S. denominated sinking fund assets were assigned to provide a hedge against an additional U.S. 200 million in outstanding debentures."

MS. MACFARLANE: That's right. So that would be lines 24 and 25. And in column number 7 or so it says "Principal amount U.S. dollar debt." And you will see it is 150' and 100'. That is $250 million in U.S. debt.

You will see that the translated amounts only change slightly. If they were unhedged they would be changing by more. But because we have applied a hedge of 200 million against the 250 million most of that amount is hedged. And the translated dollar amounts only move slightly.

Q. - All right. Thank you for that explanation, Ms. MacFarlane. That is very helpful.

I would like to go back though to line 1 of your calculation of table 5. And I understand that what we just discussed was the value of the outstanding debt.

But what I'm interested in is how that factors into -- that natural hedge, how does that factor into the numerator, namely the interest on that debt?

MS. MACFARLANE: There are detailed schedules by issue of what the debt amount is. I believe you referred to it in Interrogatory PNB IR 28 that shows the detailed interest by debenture. And then it also translates the interest on that at the foreign exchange rate.

Q. - So are you saying that those stated foreign exchange rates are inclusive of all hedging effects?

MS. MACFARLANE: They should be, yes. The ones that have a purchased hedge, the translation rate should be at the stated amount.

And the ones that are hedged against sinking funds, the interest on the debt would be translated at the statement date rate, the interest on the sinking fund would be stated at the interest rate -- pardon me, statement date rate, and the two would net out.

Q. - Can you just, subject to check, if there is some concern, could you do that check for me?

MS. MACFARLANE: Certainly.

Q. - Thank you. Ms. MacFarlane, Transco as you have pointed out does not have that U.S. income cash flow stream in the brave new world, right?

MS. MACFARLANE: That's correct.

Q. - So how do they take the advantage or how do they take advantage of the hedge associated with the U.S. $200 million natural hedge?

MS. MACFARLANE: They take advantage of it in the sense that when the debt equity swap is done, to the extent that U.S. dollar debt is issued to the subsidiary, offsetting sinking funds in U.S. dollars would be issued as well. The net amount would be issued.

Q. - But the allocation is of the liability, right? It is not the cash flow associated with that liability, is it?

MS. MACFARLANE: The liability comes with the cash flow in the sense that the interest -- there is interest expense on the U.S. dollar debt.

But to the extent that sinking funds would also be allocated in U.S. dollars, they earn interest in U.S. dollars. And the two should offset each other.

There may be some differential between the interest earned and the interest expensed. But by and large they should represent an effective hedge both on the interest side and on the principal side.

Q. - When you considered the allocation of debt to Transco, did you consider the allocation based on how that capital has been deployed throughout the company?

MS. MACFARLANE: If I understand your question correctly, I believe I have already answered it, which is no. The corporation funds its assets through a combination of working capital and debt -- pardon me, cash flow and debt, and pools its debt and cash flows against its asset acquisitions. We do not track asset by asset how they are financed.

Q. - All right. Let's move to the next line item if we could, and that's of interest to me, and that's sinking funds which is line 3?

MS. MACFARLANE: Yes.

Q. - Are the sinking funds -- is the sinking fund earnings an amount that NBP, New Brunswick Power actually earns?

MS. MACFARLANE: Yes, it is.

Q. - This is a cash amount received by the corporation, correct?

MS. MACFARLANE: That's correct.

Q. - All right. Let's move to line 4. And that is the "amortization of principal-related foreign exchange costs."

Before getting to line 9 -- sorry, line 4 specifically -- you were providing me with some understanding of CICA principles associated with the foreign exchange issues and the hedges.

This table though, this table 5, this is not an accounting statement, is it? It is a forecast?

MS. MACFARLANE: That's correct.

Q. - Now with line 4, I would like you to first go to pages 9 and 10 of your testimony?

MS. MACFARLANE: Yes. I have it.

Q. - I took it from that evidence starting at the answer to Question 10 that the amortization that you are proposing is not a generally accepted accounting principle, is that fair?

MS. MACFARLANE: The CICA guidelines for accounting for foreign exchange have changed. The corporation for years was following CICA guidelines that required that at each statement date you translated the debt at the current statement date rate. And the difference in debt attributable to the translation at the previous statement date rate and the current statement date rate would be amortized over the life of the debt issue. And that is the practice NB Power was following for some period of time.

The CICA guidelines changed last year and required that that differential year over year that arises from translation of the foreign denominated debt be written off in the current year.

In order to put that new practice into place NB Power was required to make a retroactive adjustment to its retained earnings to write off the amount of accumulated foreign exchange differential between the time that the debt was borrowed and the time of the change in CICA guidelines.

It was required to write that off. That does not mean it is not a cost to the corporation. And we believe it is a cost to the corporation.

I can illustrate that on table 9. And it is a cash cost to the corporation. If you would just turn to table 9, perhaps that could help in our discussion.

Q. - Thank you. Yes.

MS. MACFARLANE: On page 17. We were referring earlier to the U.S. dollar issues which are at the bottom of the table, lines 23 down through 28.

And you can see that in the column just before the years begin, there is a column entitled "foreign exchange rate at issue date." And you will see it is $1.25, $1.18, $1.19, $1.04 et cetera.

Those are the amounts of money for each $1 U.S. debt that the corporation would have issued, it would have received at the time, let's say on the first one, $1.25. In actual dollars we would have issued 90 million in U.S. debt. And in that first year we would have received 112 million Canadian.

But you can see in the next column on that same line -- I'm on line 23 now -- that when we actually paid that back we had to pay back 142 million Canadian because of changes in interest rates between -- changes in foreign exchange rates between the time we actually got the cash and we had to pay it back.

That is a real cost to the corporation. We only received 112.8 million to invest in assets. We have to pay 142.5 million back. That is a cash cost. And we believe it should be part of rates collected from customers.

Q. - But it is a cash cost that arises at maturity date, right?

MS. MACFARLANE: It arises at maturity date. And so we are -- for purposes of rate setting, continuing to follow the practice of amortizing that amount over the period between issue date and maturity date.

Q. - Right.

MS. MACFARLANE: The CICA guidelines have changed so that those foreign exchange changes hit in the fiscal year that they occur, which we don't believe is fair to ratepayers.

We end up with intergenerational inequity in years in which there is a large swing in the Canadian dollar, as there has been in the not-too-distant past.

I can use just as an example the restated figures in our most recently issued annual report. We would have reported last year -- on page 33 as an example, in the annual report --

Q. - I'm there.

MS. MACFARLANE: -- you can see the -- on page 33 under "2001 restated" you will see net income loss for the year is a loss of 78 million.

When we filed that annual report the previous year we were following the defer and amortize approach for foreign exchange guidelines. And that loss was 12 million.

When we were forced to take the loss in one year, you can see it went from a loss of 12 million to a loss of 78 million. Because the dollar moved from 68 cents to 63 cents. We do not believe that is equitable to ratepayers, to have that degree of variation occurring in one fiscal year.

So for ratemaking purposes we are proposing that we continue to defer and amortize it over the life of the debt issue which is also coincidentally generally the life of the asset that it supports.

Q. - But the value of the current period amount that is shown in table 5, that is the value of the principal expressed in current dollars and amortized out over the remaining portion of the term, right?

MS. MACFARLANE: It is the portion of the principal arising from the change in U.S. dollars. And then it is spread out over the life of the issue, yes.

Q. - And so if the Canadian dollar were so very kind to increase in value, that would then change the amount stated in that line item, right?

MS. MACFARLANE: That's correct.

Q. - And so this all depends upon what the value of the U.S. dollar is as against the Canadian dollar at the time of maturity?

MS. MACFARLANE: It does. And because it is spread out over the life of the issue, and most of the issues are quite long in their term, there is a smoothing effect that takes place on account of that.

Q. - Was the amortization treatment specifically an accounting policy approved by this Board?

MS. MACFARLANE: I would have to check on that, but I would assume it would have been, yes. Would you like me to find the reference to that?

Q. - Yes, please. Thank you.

And Ms. MacFarlane, can we agree then that the current period of that amortization, which is again stated on line 4 of table 5, that is not a cash cost to the company, is it? It is an accounting entry?

MS. MACFARLANE: It is ultimately going to be a cash cost to the corporation.

Q. - But it is not a cash cost in the current period?

MS. MACFARLANE: Some portion of it would be a cash cost in the current period to the extent that U.S. dollar issues come due. If U.S. dollar issues are not coming due it will be a cash cost in another period.

But the asset which is being financed by this debt, this U.S. dollar debt, would be being expired in the current period. And the matching principle would say that you should ensure that the costs related to the debt are spread over the life of the asset.

Q. - But from table 9 would you confirm that there are no U.S. debt expiries proposed in years 2004 and 2005?

MS. MACFARLANE: There are no expiries. So there is no cash requirement in the test year. However, as I said, there is ultimately a cash cost.

And the matching principle would say that cash cost should be spread over the life of the asset which is financed by that debt.

Q. - But again, Ms. MacFarlane, from table 5 we are not calculating an accounting statement. We are calculating a forecast, correct?

MS. MACFARLANE: We are calculating a forecast but a forecast of net income.

Q. - Net income?

MS. MACFARLANE: Net income as an accounting concept.

Q. - Aren't we trying to calculate the interest cost on your debt?

MS. MACFARLANE: We are. But we aren't necessarily calculating the cash interest costs on the debt. Cash flow and expense are two different concepts.

Q. - Now you have lost me. Are we not trying to figure out the cost of debt by taking the interest expense on that debt and dividing it by the outstanding debt?

MS. MACFARLANE: Yes, we are. But as an example, line 2 -- line 2 again is not a cash cost in the test year. Item number 2 again is an item where there would have been a cash layout at another period of time related to the debt.

And the cost of that cash payout is expensed over the life of the debt, so that it is matched against the life of the asset which the debt financed.

Q. - All right. So line 2 is another non-cash item?

MS. MACFARLANE: Yes. But cash is not the issue here. Cost is the issue. And some costs, like amortization of fixed assets, are appropriately recognized over time, in this case it's over the time of the debt issue.

And it is over the time of the debt issue because by and large the time of the debt issue matches the life of the asset which it is financing.

Q. - Now Ms. MacFarlane, again from the annual report and back to the natural hedge, how has that been factored into this calculation?

Has there been any consideration given to how the U.S. sinking fund amounts have been applied to effectively hedge against that interest, that amortization risk?

MS. MACFARLANE: I think that was -- I believe it has been. And as I say, I think that was part of the undertaking, that I agreed to look at the detail schedules in order to assure you that that is the case.

Q. - So it equally applies to the amortization as much as it does apply to the foreign exchange interest expense on the legacy debt?

If you have got $200 million of U.S. debt, doesn't that help you with respect to the potential risk of there being at maturity date a change in the outstanding principal of U.S. issued debt based on the currency fluctuation?

MS. MACFARLANE: I believe you meant if we had 200 million in U.S. asset. And yes, it does. That is specifically why that natural hedge has been put in place, so that the translation of the two of them offset each other.

Q. - And you are going to check to make sure that that is reflected in line 4?

MS. MACFARLANE: Yes, I'm quite sure it is. But I will check to make that is the case.

Q. - Thank you. Let's turn now to line 5, Ms. MacFarlane, and that is credit spread. You will agree with me that that item is reported as being $20.1 million? That is line 5 of table 5?

MS. MACFARLANE: That's correct.

Q. - Ms. MacFarlane, I am having a difficult time understanding who you will be paying this $20.1 million to as it concerns legacy debt. Can you help me out with that?

MS. MACFARLANE: Yes. In terms of actual payments out of the corporation, some portion of that amount will be paid to the Province of New Brunswick as a guarantee fee. The reason why we included an attributed or deemed credit spread over the Province of New Brunswick borrowing rate was again back to this full cost concept that we spoke of the other day in respect of a deemed capital structure.

At one time it was the case that all of the benefits of owning NB Power would naturally accrue to the Province of New Brunswick and to the ratepayers and the taxpayers of the Province of new Brunswick.

But with open access that is no longer the case. And there is the opportunity for third party users to use NB Power's transmission assets. Transmission assets which have been funded through provincial rates and therefore the benefits of that low cost borrowing would accrue to parties outside of the Province of New Brunswick.

In order to avoid that, we have deemed not only a debt equity ratio, but we have also deemed a credit spread equivalent to what we would be borrowing at were we a privately held corporation.

Q. - Well right now can we agree the Provincial guarantee has a legislated formula, correct?

MS. MACFARLANE: Right now it does, yes.

Q. - Right. And that is charged on the legacy debt, right?

MS. MACFARLANE: That's correct.

Q. - So the credit spread that you have that you are intending to include in the interest expense for the purposes of calculating the cost of debt of the corporation, that doesn't relate to the legacy debt as it exists today, right?

MS. MACFARLANE: This application was filed irrespective of reorganization. It was filed with the intent to ensure full costs were recovered through the tariff so that -- so as to ensure that out of province users of the transmission system did not benefit unduly at the expense of New Brunswick ratepayers and taxpayers who are effectively behind the Provincial borrowing rate included in our embedded cost of debt.

The credit spread is there to ensure that third party users pay full cost.

Q. - What about the non-third party users, Ms. MacFarlane?

MS. MACFARLANE: The non-third party users effectively receive their -- would pay full cost and that ends up accruing back to the Province of New Brunswick and they receive their benefit through taxes.

Q. - So this is social policy at work?

MS. MACFARLANE: This is unbundling of social policy at work in the sense that the fact that borrowing today happens with a provincial government guarantee and therefore NB Power's rates are accordingly lower is social policy. The fact that here we are deeming a capital structure such that that is not the case is removing any social policy.

The reorganization is intended to remove social policy to the extent that -- that as legacy debt is replaced with new debt.

Q. - Can we agree though, Ms. MacFarlane, that as of today, without knowledge of what the legislation says, there is no obligation upon New Brunswick Power Corporation to pay a credit spread as shown here to its lender?

MS. MACFARLANE: The obligation would be to pay a portion of that as a guarantee fee to the lender, being the Province of New Brunswick. But as I say, we didn't feel that was a fair attribution of costs because third party users benefit from the Province of New Brunswick borrowing rate.

Q. - I understand your social policy desire. But as a commercial enterprise and as an accountant intending to calculate the cost of debt of this corporation, does credit spread have anything to do with the interest expense that you, your corporation actually pays under the legacy debt?

MS. MACFARLANE: For the legacy debt, no, it does not.

Q. - Thank you. Now, Ms. MacFarlane, based on our earlier discussion concerning butterflies and Debtco, you are not expecting Debtco to reissue the outstanding legacy debt in the form of some lower cost borrowing to New Brunswick Power Transmission, are you?

MS. MACFARLANE: No, I am not expecting that.

Q. - Ms. MacFarlane, as it relates to new debt in the future, is that where this credit spread item is intending to apply?

MS. MACFARLANE: Yes, there will be a -- depending upon the credit rating that is attributed to Transco or the transmission company, it will attract a credit spread over and above Government of Canada bonds or over and above Province of New Brunswick bonds.

Q. - Can I have you turn to information request Nova Scotia Power number 6. That is found at page 221, Mr. Chairman.

MR. SOLLOWS: Which IR?

Q. - Sorry, it is number 6, page 221. Do you have that, Ms. MacFarlane?

MS. MACFARLANE: I do.

Q. - I am just interested in the last sentence of your response to number -- part B, which says "Any differences between proposed and actual costs will be part of the proposed performance based mechanism."

And that sentence is in respect of finance charges. Correct?

MS. MACFARLANE: Yes.

Q. - Can you help me understand the incentive that you are speaking of here with respect to minimizing debt cost?

MS. MACFARLANE: I think the answer was written in response to the question how will the over recovery through transmission tariff be reconciled to the benefit of all customers.

And to the extent that the credit spread on legacy debt, though we believe it is appropriate to recover full cost, is higher than the guarantee fee, that amount would form part of the general return of the corporation. And to the extent that it is above 12 percent, that is shared with customers in a 50/50 split.

MR. NETTLETON: Mr. Chairman, I see that it is noon. I don't know what your plans are, but I am about to move on to a different area.

CHAIRMAN: Well I think probably we will take a break and we will break until 1:30 and hopefully your baggage will materialize.

MR. NETTLETON: You might see me in a different suit.

(Recess - 12:00 p.m. - 1:30 p.m.)

CHAIRMAN: Good afternoon. Any preliminary matters?

MR. HASHEY: Yes. Thank you, Mr. Chairman. I would -- Ms. MacFarlane has indicated that she has one small correction that she would like to make to the evidence given this morning and then we -- she will have two answers to undertakings.

First of all the correction, please?

CHAIRMAN: Go ahead, Ms. MacFarlane.

MS. MACFARLANE: The correction I would like to make is I believe I was asked -- on table 9, page 17 of my evidence I believe I was asked if any of the debt issues mature in the test year. And I said no. In fact upon reexamining the schedule one of them does.

So we are on page 17 in my direct evidence. It's line 11, issue number 81. And if you follow across you will see that in the year '04, you can see two dashes that were not there in the year before, so that issue does come due in that year.

Now while I'm on the table, at the bottom I had indicated that 24 and 25 were translated using an effective hedge. They are translated using an effective hedge I believe but not on this schedule. Because these are the gross amounts translated at the foreign exchange rates at the end of the year and the sinking funds would be on a separate schedule and the two net off, so that those are translated at the gross amount on this schedule not the net amount.

MR. HASHEY: Mr. Chairman. Then, Ms. MacFarlane, would you please deal with the undertakings. First of all I think there was -- the discussion this morning concerning the Standard and Poors as against a DBRS.

MS. MACFARLANE: Yes. Yes. On table 4, page 11, we were asked to insert in this table the DBRS ratings. And if I may just read them out perhaps you could put them in the table and then I can show you the reference which is in the interrogatories.

The Province of New Brunswick where it says AA minus, the DBRS rating is A. Nova Scotia Power it's A low. Epcor is A low. TransAlta is A low. BCS Utility is A. And Hydro One is A. And TransCanada Pipelines is A. And my reference for those is in the interrogatories which is binder A-4. It is PNB IR-6, page 273. This is from CIBC. And on this sheet it shows both the S&P ratings and the DBRS ratings.

I might mention that was a spread summary from May 17th. We have the updated one from December 2nd. And I believe Epcor has been upgraded and the DBRS -- in S&P it has been upgraded, and in -- the BC Gas Utility has been downgraded by a small amount on the DBRS ratings. But by and large the items are not inconsistent with what they are in this table.

MR. HASHEY: The second and last one you were asked to do a review of the accounting of long-term debt, can you comment on that?

MS. MACFARLANE: Yes. This is to Mr. Nettleton's question about whether or not the Board had reviewed the accounting for foreign exchange on long-term debt. And they reviewed that in the May 1991 hearing at it is on page 41 of the decision.

MR. HASHEY: Thank you, Mr. Chairman, that ends the --

CHAIRMAN: Thank you, Mr. Hashey. Mr. Nettleton?

Q. - Ms. MacFarlane, with respect to the bond rating differentials between DBRS and S&P, you have referred to PNB IR-6.

MS. MACFARLANE: Yes.

Q. - The evidence in this proceedings by Dr. Morin has been that a triple B rated bond or a utility having a triple B rating would be an unacceptable rating for ratemaking purposes.

MS. MACFARLANE: I would have to check the testimony, but I believe he indicated that it is technically considered to be investment grade but it is not at the most cost efficient point on the curve, as he explained to us in his presentation. He believes the most cost efficient point is to have an A rating.

Q. - Are we talking about Standard & Poors ratings or are we talking about DBRS ratings having that inefficient or unacceptable triple B status?

MS. MACFARLANE: I understood that we were talking about

DBRS ratings because that is the Canadian rating agency and we are operating in Canada intending to borrow in Canada.

Q. - All right. So the fact that there have been triple B ratings for Canadian utilities rated by Standard & Poors, that's okay?

MS. MACFARLANE: There is a translation that will give you what the comparative ratings are between the two entities. But they both do their own risk assessment. And in the instance of table 4 as an example, you see Nova Scotia Power has triple B plus, the equivalent rating, if the risk assessment was the same, for DBRS would be triple B high.

In fact you will see that they have received a rating of A low by DBRS. And I would presume that they would be hoping for -- I think they have since been downgraded, by the way, to triple B, I am not sure. But they would be looking for a A rating if they were to get the best cost of debt relative to the cost of equity, according to Dr. Morin's testimony.

Q. - All right. And that is according to Dr. Morin's evidence, as you understand it. Is that fair?

MS. MACFARLANE: Yes, yes.

Q. - You indicated that you had an update to this CIBC document. Is that right?

MS. MACFARLANE: Yes.

Q. - Could you undertake to produce that for the parties to this proceeding?

MS. MACFARLANE: Yes. The update that we have is one that we obtained just before we came into the hearings and it is dated December 2nd.

Q. - Thank you. All right. We are back at table 5 of your evidence, Ms. MacFarlane. And I would like to move on to the denominator, if we could. And I think we agreed that the denominator was an average of lines in effect 10 and 14. Agreed?

MS. MACFARLANE: Yes.

Q. - The line item that I would like you to focus on is line 9 and line 13, which is entitled "Less sinking funds". Do you see that?

MS. MACFARLANE: Yes.

Q. - Would you agree that because line 9 is being subtracted from line 7 -- and the same applies to line 13, but I will just deal with line 7 and 9 right now -- the denominator effect, if you will, causes the cost of debt in line 16 to increase? That is just simply an algebraic result, right?

MS. MACFARLANE: Okay.

Q. - Do you agree with that?

MS. MACFARLANE: I have the flu. I can't do that in my head.

Q. - Do you need to take a break?

MS. MACFARLANE: Yes, I will agree with you. I will agree with you, yes.

Q. - Okay, thank you. Ms MacFarlane, does the line 9 sinking fund amount actually reduce the real debt obligation shown in line 7 as of March 31st 2004?

MS. MACFARLANE: Yes, it does. Those sinking fund obligations are in a -- in contractual form and are there in order to provide assurance to the bond holders that at least to some degree the amount will be available for redemption upon maturity.

Q. - All right. I understand there is a contractual obligation to fund the sinking fund.

MS. MACFARLANE: Yes.

Q. - But what I am asking is do those amounts actually retire the debt shown in line 10 in the current year?

MS. MACFARLANE: I don't know how to answer that because I don't really understand the question.

We have a certain number of bond issues outstanding. Each year the corporation sets aside 1 percent of the outstanding amount as sinking funds and it must be held in those sinking funds until the individual issues come due at which time it is withdrawn and applied against the repayment of that debt.

So in my view, yes, it does directly offset the debt. It cannot be used for any other purpose and that is outlined in the agreement -- in the contractual agreement.

Q. - Let's focus specifically on the retirement of debt.

MS. MACFARLANE: Okay.

Q. - Would you agree that the sinking funds only retire the debt, the debt obligation at the time of maturity?

MS. MACFARLANE: I would agree with that.

Q. - All right. So for the purposes of the current year, which is the forecast of March 31, 2004, are you telling me that there will be $450 million worth of debt maturing in that current year?

MS. MACFARLANE: No. I am suggesting that the balance at the end of the year of 2.1 billion, there is 450 million set aside to be used only for purposes of extinguishing that 2.1 billion when it comes due.

And just as on line 1 we have the interest on the 2.1 billion and we have deducted the sinking fund earnings in line 3, we also take the total amount of the debt in line 7 and deduct the sinking funds in line 9.

Q. - I understand the numerator effect. And I think we agreed that that is actual cash that you earn on those sinking funds, right?

MS. MACFARLANE: Yes.

Q. - But with respect to the denominator, you don't owe less money on the debt shown in line 7 in terms of interest cost, do you? You are not retiring the debt?

MS. MACFARLANE: We are not retiring the debt, but we do have funds set aside in a trust -- this is an actual trust, this is actual investment certificates that can be used for no other purpose than for retiring that debt. That trust account is required to be there by the debt holders.

Q. - But the fact that you are subtracting in the numerator -- or in the denominator, rather, the fact that you are subtracting the outstanding debt by the sinking fund amount, isn't that tantamount to a retirement of the debt?

MS. MACFARLANE: It is, I suppose, an economic defeasance.

Q. - All right. That's pretty good for the flu. But you haven't reduced the interest on the presumed retirement or debt retirement in the numerator, have you?

MS. MACFARLANE: Yes, we have.

Q. - How?

MS. MACFARLANE: On line 3 we have taken the earnings on those sinking funds that are set -- the sinking funds are set aside specifically to pay off the debt -- we have taken the earnings and we have deducted them from the interest on the debt. So if we presumably were in a position contractually to apply the 450 million directly against the 2.1 billion, we would have no more sinking fund, so there would be no more sinking fund earnings.

Q. - Well let's go back to line 1.

MS. MACFARLANE: Yes.

Q. - The first category of line 1 was the interest -- the actual interest cost on your outstanding debt, right?

MS. MACFARLANE: Yes.

Q. - And that was based on the obligation found at line 7, namely the $2,154,000,000, right?

MS. MACFARLANE: Yes.

Q. - So line 1 does not or is not reduced by the presumed retirement of that $2,154,000,000 arising from the sinking fund, right?

MS. MACFARLANE: Line 1 is not, but line 1 is not long-term debt interest in toto. It is one line indicating what the interest amount on the debentures themselves is. As you can see line 6, which is the total long-term debt interest is made up of a number of parts, one of which is sinking fund earnings. So just as the sinking fund is deducted from the debt, because the obligations are contractually tied, the sinking fund earnings is deducted from the interest expense.

Q. - So are you saying then we would be kept whole if all sinking fund amounts were removed from this calculation?

MS. MACFARLANE: Because there may be a differential in the amount that is earned versus the amount that is paid, it may not be completely whole. But conceptually, yes, it would be. We can do that calculation for you if you would like.

Q. - Well, I don't need you to do that calculation quite yet. We will get there.

MS. MACFARLANE: Okay.

Q. - Ms. MacFarlane, the sinking funds themselves are funded how?

MS. MACFARLANE: There is a trust fund that is -- for whom the trustee is the Province of New Brunswick. And they invest in various bonds and debentures that attract an interest rate.

Q. - But those sinking fund obligations are financed through internally generated funds, right, such as depreciation?

MS. MACFARLANE: The sinking funds -- I'm sorry, I'm misunderstanding you. There is a trust. There are two trusts, in fact, trust number 7 and trust number 19 by the Province of New Brunswick. They have -- they hold certificates in them. Those certificates earn interest.

Q. - Where does the dough come from that goes into those trust funds? Where do you get the money?

MS. MACFARLANE: The sinking funds require contractually a payment to be made into them. And so we would be showing in our financial statements sinking fund instalments that are made contractually each year. And that would come out of our operating cash flow.

Q. - And is one element of that operating cash flow depreciation?

MS. MACFARLANE: Our operating cash flow is an accumulation of all of our cash revenues minus all of our cash expenses. So depreciation is a non-cash expense. It would not represent a cash flow item. It's the exact opposite. It's something that you calculate from your accounting income in order to determine your cash flows.

Q. - Well don't you collect through this revenue requirement a provision for depreciation?

MS. MACFARLANE: That's included in the cash revenues, yes.

Q. - So that is a cash inflow that you receive from ratepayers?

MS. MACFARLANE: That's correct.

Q. - And are those funds then available for your use to satisfy your sinking fund obligations?

MS. MACFARLANE: They are available for anything on the cash flow statement that represents a cash outflow, whether that's a capital expenditure, a maturity -- pardon me, a repayment of a maturity, a sinking fund instalment, anything that requires a cash outflow.

Q. - And is the idea of a sinking fund, Ms. MacFarlane, that at the time of maturity the debt obligation ceases, it's paid out?

MS. MACFARLANE: If you are asking me if it's fully paid out by the sinking fund, that is not the intent. But some portion of it would be paid out by the sinking fund, yes.

Q. - And is the concept of depreciation to depreciate the usefulness of the asset over a period of time?

MS. MACFARLANE: It's not to depreciate the usefulness. It's to spread the cost over the use of the asset over its life, yes.

Q. - Fair. Thank you. So don't the two sort of jibe? That you are taking depreciation for that portion of the asset's cost and use and you are matching it against the debt obligation to finance that asset and putting it into a sinking fund?

MS. MACFARLANE: But a 1 percent sinking fund is not going to mature an issue.

Q. - Fair enough.

MS. MACFARLANE: Retire an issue.

Q. - Ms. MacFarlane, could you turn up NBP response to the Province of New Brunswick IR 2814?

CHAIRMAN: What page is that, Mr. Nettleton?

MR. NETTLETON: I'm scrambling here. I will find it.

MR. SOLLOWS: 318.

CHAIRMAN: 318, I'm told.

Q. - Yes.

MS. MACFARLANE: I have it.

Q. - Now the response indicates that table 5 does not include a provincial guarantee. And is that because the provincial guarantee is going to be removed by the Province?

MS. MACFARLANE: No. If you recall, the evidence was submitted before any contemplation of restructuring. And it was submitted with the understanding that we would be entering an open access market. And other users of the transmission system -- when I say other, I mean third party non New Brunswick users of the transmission system, without an adjustment like a credit spread would get the benefit of low interest government guaranteed debt that really is the burden of the taxpayer and New Brunswickers in general.

So we included in finance costs a credit spread as opposed to the guarantee fee so as to ensure that full costs were being paid.

If we are to take out the credit spread of 20.1 million and put back in the guarantee fee, subject to check, it would be something in the order 18 million or something. But we put in the higher number specifically to avoid a subsidy from New Brunswickers to non New Brunswickers.

Q. - Let's go back then to the legacy debt and let's talk about whether or not the legacy debt today has an obligation, a legislative obligation for you to pay a government guarantee. Does that exist?

MS. MACFARLANE: It does.

Q. - All right. And is it your understanding that that government guarantee is going to be removed by the Province?

MS. MACFARLANE: After April 3rd you mean?

Q. - Yes.

MS. MACFARLANE: Or after April 1st? No, it will not be removed. That's my understanding, it will not be removed on the legacy debt. And on new debt we will be required to borrow without a government guarantee. So we will be paying real credit spreads.

Q. - Who will the government guarantee be with on April 1, 2003? Will it be as between Debto and NB Holdco?

MS. MACFARLANE: It will flow through a series of entities. The -- it will be reflected on the balance sheet of the Province as debt from what we are referring to as Debtco. Debtco will then issue a note to Holdco and Holdco will issue a note to the subsidiary.

Q. - In the amount of the provincial guarantee?

A. In the amount of the debt that is -- in the amounts of the debt that is provincially guaranteed. I referred to one note. There will probably be several, because it will be a reissuance of the issues that are there today.

Q. - What I'm very interested in, Ms. MacFarlane, is your choice of words after your reference to the 91 basis point. You refer to something called the imbedded cost of the existing debt issued by the Province of New Brunswick on behalf of NB Power.

What is the -- what do you mean by the embedded cost of debt?

MS. MACFARLANE: What I'm referring to is the existing debt, the existing debt that NB Power holds, the all-in costs of that debt, which include its coupon rate, any amortization of premiums or discounts or issue costs, any foreign exchange costs on it and the guarantee fee.

Q. - Is that what table 5 reflects?

MS. MACFARLANE: That's correct. With the exception that line item number 5 we have made an intentional adjustment to replace the guarantee fee with a more normal credit spread that would be paid were we a private borrower.

And as I say, subject to check, if we were to take out the credit spread and insert the guarantee fee, I think the difference would be in the order of $2 million. And we are checking that.

But we had a long discussion, Mr. Nettleton, with Mr. Smellie about the issue of the benefit of the ownership of NB Power accruing to the citizens of New Brunswick.

And now that we have open access that cannot be done necessarily through power rates without providing some linkage or some subsidy to third party users.

Q. - Ms. MacFarlane, is it fair to say that the calculation found in table 5 is not found in your annual report?

MS. MACFARLANE: It wouldn't be found in the annual report in the sense that it is prospective and the annual report is historical. But it --

Q. - Well, I guess what I'm concerned about, Ms. MacFarlane, is wouldn't your investors be concerned that your financials are reporting your cost of debt?

Wouldn't that be something to be of interest to your investors?

MS. MACFARLANE: Yes, it would be. But it is not unusual to

have a set of assumptions or underlying principles, shall we say, for reporting that are different than the principles which you used for ratemaking. That is not unusual.

Q. - And that you think is true for the cost of debt?

MS. MACFARLANE: As it goes to two areas, our accounting cost will be different than the costs we believe are justifiable for ratemaking.

One of them is a continued treatment of principal-related foreign exchange costs as being amortized over the life of the debt in order to ensure equity across generations of ratepayers.

And the second item is that we have included a credit spread equivalent to a market-based amount where in fact the payment will be the provincial government guarantee fee.

Q. - Can I have you turn to page 42 of your annual report, Ms. MacFarlane?

MS. MACFARLANE: I have it.

Q. - The thing that caught my eye when I was reviewing your annual report was the bottom and last sentence on the right-hand column under note 10 that indicates that your weighted average coupon interest rate for all debentures and notes outstanding as of March 31, 2002 is 8.06

percent?

MS. MACFARLANE: Yes.

Q. - Why is that not your embedded cost of debt?

MS. MACFARLANE: It is a very careful wording in the annual report. The reference is to coupon rate. The coupon rate is 8.06.

But that does not reflect the items in table 5 for amortization of issue premiums, discounts and deferred interest costs, amortization of principal-related foreign exchange costs. And it does not reflect the guarantee fee paid to the Province of New Brunswick. This is simply the coupon rate on the debt as issued.

Q. - All right. Well, let's if we can't understand that further by first taking a look at some history.

If I could -- and I believe through counsel, Mr. Smellie indicated that I would be referring to these decisions, Mr. Chairman.

I would first like to have you pull up the accounting policies decision dated May 1991. Do you have that?

MS. MACFARLANE: I'm sorry. I believe I left them in the other room at noon hour. Would it be possible for me to get them?

MS. TRACY: We are getting those, Mr. Chairman.

MS. MACFARLANE: Yes. I have it. Could you give me the reference again?

Q. - Sure. I would like you to turn to appendix 2, page 1. And I believe this is one of the very few times that New Brunswick Power, I guess its predecessor, has provided the Board with a consolidated balance sheet in a reported decision.

MS. MACFARLANE: I'm not sure I have the right reference. It is May 1991?

Q. - Yes. And it is appendix 2. Do you have that?

MS. MACFARLANE: I have a consolidated balance sheet. I'm sorry. I don't see a reference to appendix 2 on it.

Q. - Mine is at the top right-hand corner.

MS. MACFARLANE: Yes. It appears it is a photocopy issue. Okay. Fine. Thank you.

Q. - And if you go over -- the first page deals with the asset side of the balance sheet?

MS. MACFARLANE: Yes.

Q. - And on page 2 we deal with the liabilities and equities, right?

MS. MACFARLANE: Yes.

Q. - Can you confirm with me that in the 1991 decision long-term debt was not reduced by sinking funds?

MS. MACFARLANE: May I take an undertaking on that?

Q. - Well, you can confirm it. And if you need to check on the numbers you can do that.

But I think it is clear from the appendix, is it not, that there is no reduction for sinking funds?

MS. MACFARLANE: It is not entirely clear in the sense that it may well be netted from the debentures and notes issued by the Commission.

The accounting treatment for sinking funds has changed in the last few years so that they now have to be disclosed separately on the balance sheet.

At one time they could be netted against the debt. And I suspect that is what has happened here. But I will take an undertaking to find out.

Q. - All right. And then over to appendix 1 --

MS. MACFARLANE: Is that the income statement?

Q. - That's correct.

MS. MACFARLANE: Yes. I have it.

Q. - You can see that there is a provision for interest and exchange. Do you see that?

MS. MACFARLANE: Interest -- is this 233,560?

Q. - Correct.

MS. MACFARLANE: Yes.

Q. - And then there is "less income from sinking funds and other investments"?

MS. MACFARLANE: Yes.

Q. - If I could now take you to the December 6th 1991 decision?

MS. MACFARLANE: I have it.

Q. - If I could have you turn to appendix 5?

MS. MACFARLANE: Yes.

Q. - And as I understand it, Ms. MacFarlane, this decision was issued some approximately six months after the May decision?

MS. MACFARLANE: That's correct.

Q. - Would you have any reason to believe that the cost of debt would have increased or changed dramatically in that time period?

MS. MACFARLANE: I'm sorry. You are kind of before my time, so I can't speak to what would have happened --

Q. - That's fine.

MS. MACFARLANE: -- in a six-month period.

Q. - But you can confirm with me that the embedded cost of debt in that decision is reported as 9.5 percent?

MS. MACFARLANE: That is what is here, yes.

Q. - Thank you. Would you agree, Ms. MacFarlane, that debt costs have for corporate borrowers declined significantly since 1991?

MS. MACFARLANE: I would agree that coupon rates and yield rates have declined since 1991.

Q. - Right.

MS. MACFARLANE: But the 9.5 percent that is indicated on appendix 5, it is not clear to me what that number is.

I know that in that decision there were some decisions made about inclusion of certain items and disallowance of other items such that the calculation may be different from what we are looking at today.

Q. - Ms. MacFarlane, if you could turn to table 2 of your direct evidence?

MS. MACFARLANE: Yes.

Q. - I think it's simply one part of table 9 that we have been referring to earlier, correct?

MS. MACFARLANE: Yes, it is.

Q. - Now subject to check would you agree, Ms. MacFarlane, that out of the 28 issues, 22 listed are issued after 1991 and have coupon rates less than 9.5 percent?

MS. MACFARLANE: I haven't checked that but I will take your word for it.

Q. - Do I take it, Ms. MacFarlane, that by including table 5 in your evidence you are seeking some form of change in the methodology by which the embedded cost of debt has been calculated by this Board?

MS. MACFARLANE: As far as I know only in two respects. In previous decisions I don't believe that amounts collected from customers for future used fuel management and decommissioning which were then expended on assets and thereby avoided debt, I do not believe that was considered in the allocation of debt and therefore in the cost of debt. And I think the Board's reasoning at the time was because there was no future expectation of having to put these trust funds in place in the near term. And I don't disagree with that decision in the early 90s.

However, there is that expectation now and within a matter of months before the fiscal year end we will indeed have to borrow those funds, replace what we have avoided borrowing and put those trust funds into place, so we believe that the avoided borrowing should be considered in the calculation. Because if we were here six months from now, the debt would be higher by that amount, the actual issued debt. That is one difference.

I think the other difference is the credit spread versus the guarantee fee. And I think there is indication in previous Board decisions that if some -- that there is -- there was further room for consideration if a stronger justification were put forward than simply an amount paid to the Province of New Brunswick.

Q. - And that justification that you are providing this Board with today is what?

MS. MACFARLANE: Is the fact that going into the future we will be converting our U.S. -- pardon me, our provincially guaranteed debt into market based debt with a credit spread on it in order to be on a level playing field and in order to ensure third party users pay full costs. We believe a credit spread should be attributed to the existing debt.

Q. - Can I have you turn to your annual report now, Ms. MacFarlane?

MS. MACFARLANE: Yes.

Q. - If you would turn to page 33, which is the consolidated statement of income and retained earnings?

MS. MACFARLANE: Yes.

Q. - The finance charge that is noted in the expenses is in an amount of 266 million, do you see that?

MS. MACFARLANE: That's correct.

Q. - I'm going to have you do a calculation for me using these numbers, so if you would just -- if you have a pen and paper handy it would probably be useful.

Now the finance charges have a reference to a note 5. And if I go over to note 5 I see amounts that are strikingly similar to those found in the numerator of table 5, fair?

MS. MACFARLANE: Yes.

Q. - Then if I take you to your consolidated balance sheet, which is on page 35, where it shows long-term debt of 2,530 less sinking funds of 3,559 for a total of 2,171. Do you see that?

MS. MACFARLANE: Yes.

Q. - And if we go to note 10, we see the amount of 2,530 explained as being an amount comprising of debentures guaranteed by the Province of New Brunswick, debentures held by the Province of New Brunswick and other loans totalling 3,249. Right?

MS. MACFARLANE: Yes.

Q. - And with respect to the payments due within one year, is it fair to say, Ms. MacFarlane, that you would be paying interest on those payments until there was an expiration?

MS. MACFARLANE: That's correct.

Q. - All right. So for the purposes of the calculation I would like you to do, could you calculate the finance charge amount of 266 million divided by the 3,249,000,000?

MS. MACFARLANE: Just to be clear, I don't believe that is a finance cost calculation. But the number 266 divided by 3249 is 8.187.

Q. - 8.1 percent?

MS. MACFARLANE: 8.187 percent.

Q. - And you take issue with that as being an appropriate embedded cost of debt figure why?

MS. MACFARLANE: A number of reasons. Number one, you have not used the average debt. You have used the ending year amount. Number two, you have not included the impact of these other items like amortization of issue premiums, discounts, et cetera, et cetera.

I think the biggest difference between that and the denominator used in table 5 is the fact that we have translated the debt at issue date rate as opposed to at statement date rate which is what you would see in note 10.

We have translated it at issue date rate because at the end of the day that is the amount of money that you received to invest in assets, the issue date translated amount.

And we believe that the interest cost should be measured on the amount that you actually received in cash and were able to invest in your plant. That is the difference in the two calculations by and large.

Q. - And that is a 260 basis point differential?

MS. MACFARLANE: If you would like me to determine the exact difference between those two calculations, I would like to do it as an undertaking instead of here.

Q. - I'm just asking that notionally that difference that you have explained happens to be 260 basis points?

MS. MACFARLANE: I don't know if that is the entire difference but I certainly will look into it for you if you would like me to do that.

Q. - And the difference between the issue date and the monies that you receive, are we talking about the fact that issues may be issued at a discount or a premium?

MS. MACFARLANE: We are talking primarily about the U.S. denominated issues. And they are detailed on table 9. We were looking at them earlier.

The example I think I showed you earlier on page 17 was issue number 57, which is line 23. A $90 million U.S. issue, that when we would have issued it we would have received $112.8 million that we would have then invested in assets. But when we were required to repay that amount we had to pay $142.5 million. So both the numerator the denominator have been adjusted to reflect the fact that that foreign exchange is a real cash cost to the utility.

Q. - Let's try a different table, Ms. MacFarlane. Now I would like you to turn back to table 6?

MS. MACFARLANE: Yes. I have it.

Q. - I guess the thing that struck me as odd was your description of average long-term debt and sinking funds.

Isn't it net sinking funds? It is not additional, is it?

MS. MACFARLANE: No. It is net of sinking funds, yes.

Q. - And your 6.89 percent figure refers to table 3?

MS. MACFARLANE: Yes.

Q. - Can we go there then?

MS. MACFARLANE: Yes. I have it.

Q. - Now can you help me understand how or where the $300.1 million of net fixed assets is found in your evidence?

MS. MACFARLANE: If you were to turn to table 14 (b) on page 22, where on the multi-year balance sheet, if you look in the column 2001, which would be the year ended April 30th -- or pardon me, March 31st 2001 -- or the opening balance sheet for April 1st 2001, you will see lines 1 and 2, land, buildings and equipment less accumulated depreciation, the net of those two amounts is 300.1 million.

Q. - Right.

MS. MACFARLANE: And those are actual amounts from the audited financial statements.

Q. - From the audited financial statements?

MS. MACFARLANE: That's correct.

Q. - Can you show me where that is in your annual report?

MS. MACFARLANE: I misspoke. Those are actual amounts from our general ledger which provide support to the audited financial statements.

Q. - But table 14 hasn't been the subject matter of an audit, has it?

MS. MACFARLANE: Table 14 itself has not, no. We have detailed fixed asset records and they are subject to audit as part of the balance sheet audit of NB Power.

Q. - Has this Board audited those statements or those accounts?

MS. MACFARLANE: This Board hasn't audited any of our statements or accounts. I was referring to Deloitte & Touche.

Q. - So we have no background knowledge, for the purposes of this proceeding, of what comprises the 300.1 million, is that fair?

MS. MACFARLANE: Other than what is here. And as I say, if you would like I can certainly provide detailed asset listings behind it.

Q. - I'm just wanting to confirm that we have not -- there is no other evidence on this record relating to how that number has been derived, fair?

MS. MACFARLANE: That's correct. I would like to correct that. Mr. Lavigne was able to find a reference in the Interrogatories for me. Mr. Lavigne?

MR. LAVIGNE: If you look at Province of New Brunswick IR

24, responses to the Interrogatories, part 1 there is a breakdown of the fixed assets for the years ending 2000, 2001, 2002, 2003 and 2005. If you look at --

CHAIRMAN: You have to wait for us.

MR. LAVIGNE: Oh, sorry. A little ahead of myself.

CHAIRMAN: The Province of New Brunswick. And what page would that be? And the Interrogatories -- mention the fact that it is exhibit A-4.

MR. LAVIGNE: I'm sorry, Mr. Chairman.

CHAIRMAN: Okay. No problem.

MR. LAVIGNE: I believe it is page 301.

CHAIRMAN: 301? Thank you. They all have it now. So go ahead with your answer again.

MR. LAVIGNE: There is a series of tables there, one of which is the data for the year ending March 31st 2001. It is the second table on that page.

Q. - All right.

MR. LAVIGNE: If you look at that table it does provide the breakdown of the assets which make up the 300.1 or 2,000 -- or million, sorry, net book value.

Q. - So that provides a further breakdown in terms of the categories that comprised that total of net fixed assets. Is that your point, Mr. Lavigne?

MR. LAVIGNE: Yes, that is correct.

Q. - Thanks. And Ms. MacFarlane, the allocation that you have used here to get at the 6.89 percent, that has been done on the decision to allocate long-term debt and short-term debt to the net asset base as of 2001?

MS. MACFARLANE: Yes. We wanted to be sure that we started with a set of numbers that was from the last audited year. So we began with fiscal '01, '02 and the opening balances at April '01 and worked forward from there.

Q. - Why was such a small amount of short-term debt applied to this calculation?

MS. MACFARLANE: That is very typical for NB Power. Most of our assets are long term, and therefore most of our financing is long term.

You may have noticed somewhere in the evidence that in fact in the year that was used to allocate the debt, NB Power did not have any short-term debt. We had all long-term debt.

But we felt for purposes of ensuring that there is an appropriate cost of debt attributed to the test year, we should adjust the figures to ensure that we had a 5 percent allocation to short-term debt. That is typically the level we leave it at.

Q. - All right. And just to confirm this morning's testimony, the 195.6 million of long-term debt has been allocated without any consideration given to the assets that have been used for the purposes of financing that debt. There has been no asset allocation based on the debt?

MS. MACFARLANE: That's correct.

Q. - And has that methodology been considered at all?

MS. MACFARLANE: No, it has not. NB Power has always pooled its debt and used its pooled debt and its pooled cash from operations as its sources of financing. And each asset bears the weighted average.

Q. - All right. Now back to table 6, Ms. MacFarlane, you derive at the value of 14.8 million from that calculation, and that is then used on table 7?

MS. MACFARLANE: That's correct.

Q. - And line 2 of table 7 reflects the long-term debt interest new?

MS. MACFARLANE: That's correct.

Q. - And the long-term debt interest new, does that include -- and I think we have already agreed that that would include the credit spread for new issue debt?

MS. MACFARLANE: Yes, it does.

Q. - And your credit spread testimony is summarized in table 4?

MS. MACFARLANE: Yes.

Q. - Is it fair to say that table 4 is simply an extrapolation of the CIBC world market spread?

MS. MACFARLANE: Yes.

Q. - And have you had any professional expertise on the issuance or rating of debt instruments?

MS. MACFARLANE: Have I personally?

Q. - Yes.

MS. MACFARLANE: No.

Q. - Have you obtained any professional advice with respect to the appropriate credit rating or issuance costs for debt raised by or to be raised by Nuco?

MS. MACFARLANE: By the nuclear company?

Q. - Sorry. By Transco?

MS. MACFARLANE: By Transco?

Q. - We have got too many butterflies here.

MS. MACFARLANE: To the extent that I have been a participant in discussions that the Province has held with investment bankers on appropriate credit rating in order to get an appropriate credit spread, yes.

But I have not personally endeavored to get that advice or -- and it hasn't been given to me personally. I just heard it.

Q. - And that is specific to Transco?

MS. MACFARLANE: Yes.

Q. - But that has not been evidenced in this proceeding?

MS. MACFARLANE: No.

Q. - Now Ms. MacFarlane, are you aware of whether there has been a common practice with other Canadian regulated electric transmission entities, a practice in terms of obtaining appropriate debt rates and spreads for new borrowings? Do you know of any practice that they have followed?

MS. MACFARLANE: I'm not quite sure I understand your question.

Q. - I guess I'm wondering if you have any experience or knowledge of a practice that is commonly followed by other Canadian electric transmission utilities with respect to how the cost of new debt is determined?

MS. MACFARLANE: Well, generally speaking you work with your investment bankers to put forward a presentation, shall we say, to credit rating agencies. You may choose to use one credit agency, credit rating agency. You may choose to use more than one.

And having done that and having your credit rating in hand, the practice is followed whereby the investment bankers seek interest in the case of private placements from potential debtholders.

\Q. - And opinions are obtained?

MS. MACFARLANE: Opinions are obtained, yes.

Q. - All right. I'm going to be moving on to another area, payment in lieu of taxes.

I'm quite happy to move on, Mr. Chairman, at your leisure.

CHAIRMAN: Why don't we take our 15-minute break now then, Mr. Nettleton. Maybe the bags will materialize.

(Recess)

CHAIRMAN: It is pretty obvious that the suitcase was found.

MR. NETTLETON: I am happy to report not only was the suitcase found, but so was the briefing bag, so we are there.

MR. MORRISON: We tried.

CHAIRMAN: Okay, go ahead, Mr. Nettleton.

Q. - Thank you. Ms. MacFarlane, I would like to turn to the other topic of your evidence. And that is the payment in lieu of taxes.

Do I understand that payment in lieu of taxes is now intended to be paid to Debtco, Ms. MacFarlane?

MS. MACFARLANE: That's correct.

Q. - And this was stated at 1292 of the transcript, that conclusion. But I am wondering where before then was that stated in your evidence, that Debtco would be the recipient of the payment in lieu of taxes?

MS. MACFARLANE: It is not stated in my evidence because you will recall that we submitted the evidence in the absence of restructuring.

We included payment in lieu of taxes on this full cost argument, the same argument that we have used for a deemed equity, debt equity ratio and the same argument we have used for including a credit spread as opposed to the guarantee fee. That argument is to ensure that out of province users of the transmission system do not benefit unduly at the expense of New Brunswick ratepayers and taxpayers.

Q. - Is this payment to Debtco for the purposes of reducing Transco's allocated portion of debt?

MS. MACFARLANE: If it transpires as I understand it will, because of course the legislation isn't in place yet, the portion of the debt in the debt equity swap that this company that we are calling Debtco keeps, will be financed through payment in lieu of taxes and dividend payments from the subsidiary companies, including Transco.

Q. - I mean, it is all very difficult, isn't it, to be speaking about this whole issue in a vacuum where the cart is before the horse and not knowing what the legislation says and what the expectations are of the parties. Is that fair?

MS. MACFARLANE: It is, but as we have said a number of times, we believe that full cost should be paid even in the absence of restructuring. We believe that is an important element of the tariff, to ensure that there is no subsidy from New Brunswick citizens through the Provincial government borrowing rate through to third party users.

Q. - If you were to pay or make payments towards your debt, would you be able to reduce the outstanding debt accordingly? If you increased you payments by an amount equal to how you are calculating payment in lieu of taxes, would you be legally able to reduce the outstanding balance of your debt?

Is that permitted under the covenants?

MS. MACFARLANE: I'm sorry. Could you say it one more time?

Q. - Sure. You have got existing debt outstanding, right?

MS. MACFARLANE: When you are making reference to you, are you talking about Transco or me personally?

Q. - I'm sorry, New Brunswick Power Transmission.

MS. MACFARLANE: Okay, thank you.

Q. - New Brunswick Power Corporation has debt issued, right?

MS. MACFARLANE: Yes.

Q. - And attached to the debt there are covenants, I am assuming?

MS. MACFARLANE: Yes.

Q. - Do those covenants allow you to redeem that debt before maturity?

MS. MACFARLANE: The covenants have not been fully drafted yet. But I would suggest -- and frankly, the whole issue of defeasance has not been -- legal defeasance has not been issued -- not been fully discussed yet. But I would presume in all likelihood the answer to that is no, you cannot redeem the debt before maturity.

Q. - So what is now proposed is that a -- an additional payment is going to be made to Debtco for what purpose?

MS. MACFARLANE: Let me start by saying that when one makes tax payments, the government can do with it whatever they want to do. However in this case -- and the government is proposing under restructuring that the NB Power family of companies will pay debt -- pardon me -- pay taxes so as to be on a level playing field. That is the purpose of ensuring that we pay an equivalent to taxes.

However, what they intend to do with the money is to service the portion of debt that is not being serviced by the subsidiary companies but rather represents equity in those subsidiary companies, and is held as debt by what we are calling Debtco.

Q. - You will agree, Ms. MacFarlane, that when tax payments are made if you don't make them Revenue Canada chases you, right?

MS. MACFARLANE: That's correct.

Q. - And that's because there is a legal obligation to pay taxes, right?

MS. MACFARLANE: That's correct.

Q. - Is there going to be a legal obligation to pay an amount to Debtco?

MS. MACFARLANE: That is my understanding. And you see similar examples of that in Ontario and in Quebec where the utility is required to pay payments in lieu of taxes.

Q. - And, Ms. MacFarlane, if there is no such legal obligation, positive obligation to pay taxes, not discretionary but a mandatory obligation to make payment, if there is no such obligation included in the legislation, why would you expect this Board to allow you to collect from ratepayers an amount for that?

MS. MACFARLANE: I believe I have been through this and at the risk of repeating myself again, we believe very strongly that the benefits of ownership by the Province of New Brunswick of NB Power should be returned to New Brunswickers, and that was part of an early 1990s decision by this Board. That used to be able to happen through rates.

It will not be able to happen through rates as it goes to transmission in the future because third party users now have access to our system under open access.

To ensure that they are not subsidized, those third party users, we believe all users of the transmission system should pay full cost, and those full costs will turn into revenues which turn into return on equity, which ultimately goes to the Province of New Brunswick, which ultimately forms part of their revenue base and it gets returned to New Brunswickers in that way.

You cannot use the toll itself anymore as a sole vehicle for ensuring that the benefits of ownership occur to New Brunswickers.

Q. - Could the government of New Brunswick not simply implement that policy if it deemed to be in the public interest?

MS. MACFARLANE: The government of New Brunswick does not set rates or tolls under -- for NB Power, whether they are regular rates or whether they are transmission tariff. It's this Board that sets those rates.

Q. - Surely we are not taking -- you are not taking issue with me that if the government of the Province of New Brunswick wanted to impose a tax or a surcharge for additional debt recovery it could by way of legislation do just that, could it not?

MS. MACFARLANE: It could but it doesn't need to because it has its "taxing authority" already through -- by virtue of having a Crown corporation that has the ability to collect cost through a tariff. It doesn't need to do it through taxes. It has a body that does it through tariffs, being NB Power.

Q. - So as the agent for the government you are imposing this social policy, is that fair?

MS. MACFARLANE: We are imposing the exact opposite of a social policy. Social policy would say that you could use rates to provide benefit to taxpayers. In this case because non-taxpayers will be accessing this system we don't believe that that principle can be continued. So we believe all users should pay full costs so that those users who are not New Brunswickers will not be subsidized by New Brunswick taxpayers and government guaranteed debt.

Q. - So let me get this straight. Your concern is the equities between parties using your system located outside of the province and parties who own the system within your province, right?

MS. MACFARLANE: Concerned with parties who ultimately are part of the New Brunswick tax base, shall we say, and parties that are not.

Q. - I think that was a yes.

MS. MACFARLANE: Okay.

Q. - And your solution to fix the equities between those two groups is to tax everyone?

CHAIRMAN: Microphone 13.

MR. MARSHALL: What we are trying to do is provide a tariff that provides open non discriminatory access to all users inside the province and outside the province on rates that are based on an equivalent private corporation, so that they all pay the same rates. That's what the objective is in the tariff.

Q. - Mr. Marshall, if you excluded the provision for payment in lieu of taxes, would the toll or rate that you assess to a ratepayer located in New Brunswick or outside of New Brunswick change? Would it be different?

MR. MARSHALL: If you excluded the payment in lieu of taxes from the rate base, the rate would be slightly lower and you could charge the same rate to everyone. Is that your question?

Q. - It's simply a mathematical result, I think. If you take out payment in lieu of taxes from the revenue requirement and did your allocation for network integration service and point to point service, that wouldn't cause a toll that would be different for parties outside of the province and parties inside the province?

MR. MARSHALL: No, it would not. But it -- but it would not be a toll on a level playing field with private corporations who are in the energy business so that electricity is treated in the same manner as the gas business and pipeline businesses and others because that's the businesses that we are involved in.

So it's a social policy issue of the Province of New Brunswick in the White Paper to provide for a level playing field of the electric utilities.

Q. - Mr. Marshall, you will agree with me that New Brunswick Power Transmission has no competition? There is no one is this province that's offering the same type of service, electric transmission service than NB Transmission, is there?

MR. MARSHALL: Not in the electricity business. But the NB Power Transmission under this tariff will be providing service to part of the entire northeast electricity market. That entire northeast market is not just electricity. It's an energy market. It's serviced by pipelines from United States, pipelines from Western Canada, pipelines from Eastern Canada, Maritimes and Northeast. So that it's part of that overall energy market. And on that basis the government policy is that we should compete on a level playing field in that marketplace.

Q. - The level playing field that you are speaking of, Mr. Marshall, did it not refer to the competitive marketplace for generation?

MR. MARSHALL: My understanding it refers to the overall competitive marketplace operate on the level playing field.

Enbridge Gas New Brunswick deals with customers, supplying energy services to customers make -- are private corporations and pay taxes.

Irving Oil deal in selling energy to customers as a private corporation and pays taxes.

So, you know, the delivery systems that deliver the energy to customers to get proper pricing of the value of the services to customers, payments in lieu of taxes should be made so that everyone is operating on a level playing field. That's my understanding of the direction of the Province of New Brunswick.

Q. - Ms. MacFarlane, have you considered what return on equity or return on capital rather, would result if New Brunswick Power Transmission collected the 9.8 million in addition to its return on equity but did not remit the 9.8 million. Have you considered what that result would be?

MS. MACFARLANE: No, I have not.

Q. - Would you undertake to do that, please?

MS. MACFARLANE: Could you outline that one more time to be sure we have it correct?

Q. - Yes. If New Brunswick Power Transmission collected the amount allocated to payment in lieu of taxes in addition to what you are contemplating to recover from ratepayers on return on equity, and you did not have a legal obligation to remit the $9.8 million, could you please calculate what the actual return on capital would be to New Brunswick Power Transmission?

MS. MACFARLANE: Thank you.

Q. - Now, Ms. MacFarlane, alone the same lines here, let's assume again that there is no mandatory obligation on the part of New Brunswick Power Transmission to at law remit the 9.8 million, and yet you have collected this amount. Does this amount then become available for sharing under the PBR scheme that you are proposing?

MS. MACFARLANE: If you are suggesting that the amount would be included in rates and therefore be a revenue, but it would not be recognized as a cost. Is that what you are suggesting?

Q. - Yes.

MS. MACFARLANE: Yes. Then it would be included through PBR in the return. And depending upon where that return fell, if it's between 10 and 12 percent there is no sharing. Above 12 percent there is sharing.

Q. - So by simply not having any legal obligation to pay the 9.8 million this rewards what type of cost minimizing behaviour on the part of New Brunswick Power Transmission?

MS. MACFARLANE: I would like to make a distinction here between an obligation to pay and recognition of an expense.

There -- we have not discussed whether or not NB Power -- we have not discussed what NB Power would do with this amount in the absence of an obligation to pay, or whether there would be a recognition of an expense for that item. But let's assume for a minute that there would not be a recognition and it would flow through to operating cash flow. The intent would be that the corporation would use it to reduce debt. Which is exactly why there will be a legal obligation, so that in effect it will flow through to reducing debt.

Q. - Well, if it actually is used for the purpose of reducing debt, why wouldn't we just call it that, that it's a super added debt reduction payment?

MS. MACFARLANE: Because it's achieving a number of things. It's achieving, as I indicated earlier, ensuring that benefits of ownership of NB Power only accrue to New

Brunswickers. It's achieving a level playing field, which is one of the objectives of the White Paper as Mr. Marshall indicated. It allows organizations like credit rating agencies and investors to do their various pieces of analyses with an understanding that the income statement of NB Power is not unlike the income statement of any other corporation in its accounting and in its ongoing charges. It achieves a number of benefits.

Q. - Ms. MacFarlane, you are not suggesting that investment bankers or bond rating agencies or credit rating agencies have not rated or considered Crown corporations that don't have that obligation, are you?

MS. MACFARLANE: No. They take financial statements of organizations, particularly Crown corporations, and make a number of adjustments before they do their analysis.

I'm just suggesting that if our -- the objective here is to ensure that NB Power Transmission and NB Power Transmission's financial statements look as much like a private entity as possible. And payment in lieu of taxes is one of the mechanisms to do that so as to ensure a level playing field.

I do want to go back as well to saying what NB Power would use that amount for and what Debtco would use that amount for.

It is irrelevant what the end use of it would be in the sense the objective is to ensure that -- at least through this evidence submission, the objective is to ensure that third party users pay full costs.

Q. - Mr. Marshall, are you familiar with the concept of different rates being charged over different distances or to different geographic regions. Are you familiar with that concept?

MR. MARSHALL: Yes.

Q. - If the concern, Ms. MacFarlane, is that users of your system existing outside of the province are not charged their fair share, that their rates are not just and reasonable without the inclusion of payment in lieu of taxes, Mr. Marshall, could the rate that those out of province users be charged include a payment for the very thing that you are concerned with?

MR. MARSHALL: We would see that as discriminatory. You would be charging a different rate to different customers for the same service.

Q. - Do all of your customers reside outside of the province?

MR. MARSHALL: No.

Q. - Are you familiar with tariffs on other energy transmission systems such as pipelines that charge different tolls for export versus domestic service?

MR. MARSHALL: I'm not familiar in detail with any of that, no.

Q. - Would you consider that to be an unjustly discriminatory toll?

MR. MARSHALL: I'm not familiar with it. Couldn't comment on it.

Q. - Would you consider a toll that provides export service on the NB transmission system that is different from service provided inside the province to by unjustly discriminatory if it was delineated on that fashion?

MR. MARSHALL: It may or may not be. This application is for an Order 888 compatible tariff meeting all the principles of Order 888. It's based on a postage stamp tariff where you charge the same service for point-to-point whether it's an in-system user or an external user.

Q. - Mr. Marshall, will rates be higher if payment in lieu of taxes is included in the revenue requirement than if it was not?

MR. MARSHALL: You are speaking of the transmission rates?

Q. - Yes.

MR. MARSHALL: If payment in lieu of taxes was not included the total revenue requirement would be lower. The usage is the same on the system. The revenue requirement divided by the determinants determines the rate. So if the revenue requirement goes down in the numerator the rate would go down proportionally. So it would be lower, yes.

Q. - Have you consulted with the citizens of the province of New Brunswick on their views of whether they want higher electric rates than would otherwise arise if payment in lieu of taxes was not included in your rate structure and design?

MR. MARSHALL: We have not run hearings or opening to consult the public specifically, but the Province ran a number of open processes through the legislative committee, the standing committee on the legislature, select committee on energy. Had open public hearings reviewing the structure of electricity and where it may go. Had the market design committee. And so there has been some collection of information and process. And it's the decision of the government to go forward with a level playing field.

Q. - I understand that, Mr. Marshall. But through all of that consultation and effort undertaken, are you familiar with any proceeding where specifically it was made known to the public that NB Transmission is intending to recover from ratepayers a payment in lieu of taxes, but without the obligation to remit those amounts to the government?

MR. MARSHALL: Well this information was filed before this Board in July 25th, so it's open to the public for anyone to intervene and to get access to that information. Other than that, I'm not aware of any process.

Q. - And until this hearing, this public hearing, are you aware of any evidence or answer to any information response where that point has been made clear?

MR. MARSHALL: We think it's pretty clear in the evidence as filed on July 25th.

Q. - Just one moment please, Mr. Chairman. Mr. Marshall, could you please turn up NB Power's response to Saint John Energy IR-59 found at page 536?

CHAIRMAN: What page?

MR. NETTLETON: 536, sir.

CHAIRMAN: Thank you.

Q. - Mr. Marshall, you say at -- or the company says at the second last sentence of that response, "An open access transmission tariff removes this competitive advantage of the generation assets that are opened by the people of New Brunswick. Such a change puts downward pressure on New Brunswicker's recovery of the financial benefits of their investment in the transmission system."

Are you saying there that the open access transmission tariff removes the competitive advantage for generation assets that now must compete?

MR. MARSHALL: I think the -- without an open access transmission tariff in the past, the integrated utility NB Power owning generation and transmission, had monopoly rights over the transmission system and then could -- had access to whatever markets were connected external to the system through that transmission.

With an open access tariff, the system is open for anyone to use it, so there is some reduction. But you need to include in the tariff the proper full cost allocation of the system, so that when external parties use the system, they pay their full share of the transmission cost.

Q. - Even at the expense of those users found within the system?

MR. MARSHALL: I don't understand what you mean by the question.

Q. - Even though it comes at an extra cost to those ratepayers who are situated within the province?

MR. MARSHALL: Ultimately in the end the -- I guess there may be a slight increase in the transmission cost to parties inside the system.

Q. - But that doesn't lead to unjust or undue discrimination in rates?

MR. MARSHALL: No. It is treatment of everybody on a -- using the same rates on a level playing field at full cost recovery of the assets.

Q. - Ms. MacFarlane, are you aware of any plan or intention as part of this soon to be proclaimed legislation that noone has seen, of whether there will be rebates offered to ratepayers wholly situated within the province of New Brunswick?

MS. MACFARLANE: I am not aware that that would be included.

Q. - Mr. Marshall, this response to your information request led me to the view that PILT really needs to be charged so that there is a level playing field at the Genco level on that playing field. Isn't that the case?

MR. MARSHALL: Would you just -- reference to PILT? I don't quite understand.

Q. - Sorry. Payment in lieu of taxes.

MR. MARSHALL: Oh okay. Again as I said before, the NB Power Transmission is part of a much larger energy infostructure where all of the other companies in that infostructure make payments in lieu of taxes or are private corporations that make tax payments. In order to fit on a level playing field within the whole infostructure of the energy industry, it is the government's policy that we level the playing field.

Q. - Isn't one of the benefits of having a crown corporation act as a transmission service provider the fact that taxes aren't required to be paid? Isn't that one of the benefits to ratepayers?

MR. MARSHALL: It has been.

Q. - And this benefit is now being taken away?

MR. MARSHALL: Yes. But I might say it may not totally be taken away. There may be a slight additional cost in transmission. In terms of making generation to a level playing field, the monies, as Ms. MacFarlane said, will flow back through to the government. The government will then use those monies to reinvest or to pay off existing debt or to reinvest in other infostructure for the benefit of the people of New Brunswick who own the assets.

Q. - So you are telling the ratepayers in the province that higher rates are justified, but don't worry because the government will pay you back in some other way?

MR. MARSHALL: I can't speak for the government exactly what they will do with the money.

Q. - Well isn't that what you are suggesting should happen through your application?

MR. MARSHALL: I said I can't speak for them. I don't know what they will do with the money. I know what the mandate is to -- under the restructuring to set up the corporations.

Q. - Well until this Board knows what the obligation is in terms of remitting the payment that is collected from ratepayers, how would you expect this Board to approve of such a collection if it is not for the purposes of providing service?

MR. MARSHALL: Again as Ms. MacFarlane said, this application has originally been filed as an integrated utility with what we believe to be the proper full cost of service on the transmission system so that we will charge external users full cost and internal users on the same basis.

Q. - Can you turn up please New Brunswick Power, Saint John Energy 48? That is at page 525. Now, Ms. MacFarlane, the response is dealing with deferred taxes. And as I understand it, deferred taxes arise directly as a result of this amount called payment in lieu of taxes being collected, is that right?

MS. MACFARLANE: Yes.

Q. - So have we come to the conclusion here that the amount that you are intending to collect is an amount equal to how or what would be charged to a non crown corporation, a tax-paying corporation?

MS. MACFARLANE: Yes, in the sense that generally speaking tax amounts -- on an income statement your income tax expense is calculated on your accounting income. That is the amount that would be included in your revenue requirement.

The actual cash payment is either more or less than that depending upon how your accounting deductions match amounts allowed for tax deductions.

And specifically in our case we would be referring to the deductions we make on our income statement for amortization of fixed assets compared to capital cost allowance allowed under the income tax system.

Q. - Does your provision for deferred taxes have the effect of increasing or decreasing the revenue requirement?

MS. MACFARLANE: It doesn't affect the revenue requirement through the tax item itself. It effectively increases the revenue requirement through return on equity in the following sense, our calculations would indicate that the CCA amount, the amount deducted for tax purposes, would actually be less than the amount deducted for depreciation. And that is because we are starting this calculation with the assets midway through their lives.

Depreciation is straight line. CCA is a declining balance. So once we get halfway through the lines, CCA is actually less than depreciation. And that means that the cash remittance under those guidelines would actually be less -- or pardon me, more than the accounting income.

And therefore there is a deferred tax asset on the balance sheet. Since that is representative of a cash outflow it is included in rate base because that cash outflow should earn a return.

Q. - All right. But the point here is that deferred taxes arises because of the yet to be proclaimed obligation maybe to collect payment in lieu of taxes, is that right?

MS. MACFARLANE: In our application they arise because we are trying to put this submission forward on the basis of a level playing field. And a utility in our circumstances with our asset base would end up with a deferred asset on their balance sheet.

In fact if legislation is proclaimed that requires the utility to submit the equivalent of income taxes under that same calculation, we would have an actual deferred asset.

Q. - And one last question on this area, Mr. Marshall. If my client or clients, in the case of the CME, wanted to go out tomorrow and acquire transmission service from and to locations wholly situated within New Brunswick, would they be able to do that without contracting with you, with New Brunswick Power Transmission?

MR. MARSHALL: As the -- other than the piece of transmission owned by Wisconsin Public Service serving Perth-Andover, it is my understanding all of the transmission in the province is owned by NB Power Corporation, is included in this tariff. In order to take service across that system would require service under this tariff.

Q. - Thank you. Mr. Lavigne, you have been awfully quiet. And I know, Mr. Porter, you have been even quieter. So I'm about to move on to you two gentlemen.

Mr. Lavigne, starting with you, sir, I understand from your evidence that you are a Certified Management Accountant, is that right?

MR. LAVIGNE: Yes. That is correct.

Q. - And you have been with the company for two years, correct?

MR. LAVIGNE: I would be about closer to two and a half at this point.

Q. - And can you tell me what your experience has been prior to joining New Brunswick Power Corporation?

MR. LAVIGNE: I have worked for a number of different companies prior to joining NB Power.

Q. - And have any of those been utilities or companies in the utility industry?

MR. LAVIGNE: No.

Q. - Have any of those companies been in the energy industry?

MR. LAVIGNE: No.

Q. - So when you were asked to calculate the revenue requirement for the company, what steps did you take to ensure that the revenue requirement calculations followed Canadian utility regulatory practice?

MR. LAVIGNE: It was a team effort. I worked with the people from the regulatory affairs office to develop the revenue requirement. So they provided some guidance and assistance in that particular area.

Q. - Okay. So you had assistance in the preparation of your evidence?

MR. LAVIGNE: Yes. That is correct.

Q. - Mr. Lavigne, I would like you to turn to table 2 of your evidence?

MR. LAVIGNE: Yes, I have it.

Q. - And I think you have already indicated this, but just to be clear, that information has not been the subject matter of a separate independent audit or third party verification process, has it?

MR. LAVIGNE: No. That is correct. This is a forecast.

Q. - And to your knowledge this Board has not conducted any type of prudency review of the assets that have been included in the line items comprising this table, is that fair?

MR. LAVIGNE: Yes, that is fair. Not to my knowledge.

Q. - And, Ms. MacFarlane, would you agree with me that the effect of your application in essence freezes the rate-based numbers found in table 2 for a period of three years?

It is the starting point revenue requirement. It factors into the starting point revenue requirement.

MS. MACFARLANE: Could we just return to an earlier question for a moment, that being the basis for table 2 in Mr. Lavigne's evidence?

Q. - Yes.

MR. LAVIGNE: If I could add, the starting point for this particular table was the actuals for the year ending 2002 which were a part of the overall NB Power audited financial statements. So indirectly these numbers are subject to audit by our external auditors.

Q. - But that relates to the 2001 numbers, right?

MR. LAVIGNE: That would be the year ending 2002, yes, which was the foundation for these particular numbers going forward.

Q. - But from 2002 until what is stated here, which is 2004, those numbers have not been the subject matter of any type of audit or third party verification?

MR. LAVIGNE: No. That is correct.

Q. - Back to the freezing, Ms. MacFarlane, do you agree with that concept, that these numbers will be frozen in effect for the purposes of your PBR methodology?

MS. MACFARLANE: In the sense that the dollars in table 2 form part of the rate base in the test year, and on the rate base in the test year we calculate a return on equity, return on capital, and that is an amount included in the revenue requirement that forms the transmission tariff that we are suggesting be frozen for three years, yes.

Q. - You are forgetting amortization?

MS. MACFARLANE: Oh, I forgot amortization. Yes.

Q. - All right. Ms. MacFarlane, I mean no disrespect when I ask this, but on what basis would you expect my clients to have some form of reasonable or objective assurance that the numbers you have provided are firstly accurate, and secondly only reflect prudently incurred costs for transmission facilities?

MS. MACFARLANE: As Mr. Lavigne indicated, these numbers are by virtue of the requirements under the Public Utilities Act forecasts. The revenues and expenses are forecast.

But they are derived from the most recent audited financial statements and have not materially changed over those recently audited financial statements.

There was an interrogatory process that would have allowed any Intervenor or any interested party to ask for specific verification of any particular number, specific verification both of the number and of the usefulness of the asset which stands behind it. And to the extent that those questions have been asked, we have answered them. I believe -- in one of the JDI interrogatories we provided a detailed listing. And again the detailed listing would be from fixed asset records which are subject to audit, both compliance audit and substantive audit, by Deloitte & Touche. This is a hearing that requires us to tell the truth under all circumstances, as do our audited records require us to do that. I don't see that we can do much more.

Q. - Well let me give you an example of our concern then. The allocated net fixed asset number for 2004 found in table 2 is reported as 308.6 million, right?

MS. MACFARLANE: Yes.

Q. - And if you could turn up your response to the Province of New Brunswick IR number 5 at page 266 --

MS. MACFARLANE: Yes, I have it.

Q. - In that response you say there has been an operating history for transmission since 1996, correct?

MS. MACFARLANE: Could you tell me which response refers to that? It's number 3. Yes.

Q. - Yes, number 3.

MS. MACFARLANE: Yes.

Q. - Let's turn over now to PNB IR-72 at 446.

MR. MACNUTT: Could we have that again?

MR. NETTLETON: Province of New Brunswick information request 72 found at page 446.

MR. MACNUTT: Perhaps PUB?

MR. NETTLETON: Sorry. PUB.

Q. - Your response there indicates that you are not prepared to provide comparable actuals for 2001 and 2002 of an income statement and balance sheet as are outlined in table 14, right?

MS. MACFARLANE: That's correct.

Q. - All right. Now let's go over to Province of New Brunswick IR-24, found at page 303. And it's in particular 4(iii) found at page 303. Have you got that, Ms. MacFarlane?

MS. MACFARLANE: Just a moment, please. Yes.

Q. - And the response there is this is the first filing with the PUB under the new legislation other than for information purposes, and it indicates that there therefore would not be any continuity schedule or table that shows accumulated depreciation, et cetera, since the last PUB rate case, right?

MS. MACFARLANE: There is not one prepared. I believe part of the difficulty here was the extent of preparation that would be required in order to do that and the assumptions that would have to be made. It's a very onerous undertaking and we weren't -- we weren't of the sense that that degree of effort, and it's a significant degree of effort, would have been illuminating.

Q. - Well how are my clients expected to accept the 308.6 million dollar number as being an accurate reflection of net plant attributable solely to transmission without that type of information?

MR. LAVIGNE: If I could add, I think you can probably get a sense of what the IR is looking for by looking at the response to number 1 of that same interrogatory. It does provide a breakdown of the gross book value, accumulated amortization for a number of years starting with the year ending March 31st, 2000.

Q. - I understand that, Mr. Lavigne, but understand also that this company has not been before this regulator for over ten years. And the query that we have, or the concern that we have, is that we have a full understanding of what the 308.6 million dollar number reflects. We understand the rate categorizations or the classes of assets. It's the numbers behind those assets. How would we gain that understanding?

MS. MACFARLANE: Although the corporation has not submitted numbers to this Board for that period of time, we have been subject to annual audit over that period of time, both compliance audits that look at the system of controls around the recording of transactions in our books and records, the classification of those as capital versus operating, the classification of those as within a particular category of assets to which a particular depreciation rate applies, and not -- those are the compliance controls. And the substantive controls would include audit of the -- both the determination of the amortization amount, the vetting back to invoices for the calculation of the capitalized amounts or for the recording of the capitalized amounts. Those audits have taken place each and every year over that period of time.

Q. - Where is that evidence in this proceeding?

MS. MACFARLANE: It's in evidence by virtue of the fact that we are relying on the opening audited balance sheet of NB Power for April 1st 2001, that is the 2001/2002 year, which is audited, and those figures are continuous through history.

Q. - Right. And the audits that you have undertaken have been accounting audits, is that correct, that have been conducted by Deloitte Touche?

MS. MACFARLANE: They have been conducted by Deloitte Touche, that's correct.

Q. - And are they for the purposes of your annual report?

MS. MACFARLANE: That's correct.

Q. - So there have not been prudency audits in respect of those numbers, have there?

MS. MACFARLANE: Could you repeat that question?

Q. - Yes. There have not been prudency audits conducted in respect of the numbers, have there?

MS. MACFARLANE: To the extent that they are operating on behalf of the Board of NB Power and certainly have an obligation to report to the Board of NB Power, any egregious situations that they come across as a course of their audit it does, but by and large their audit is aimed at ensuring the integrity of the numbers recorded.

Mr. Marshall also points out that Stone & Webster would have, in conducting their review, would have performed a sort of an audit on our fixed assets and on the usefulness thereof.

Q. - Mr. Marshall, since you are relying on the Stone &

Webster study, can you confirm that that was done in 1999?

MR. MARSHALL: I'm not certain. Subject to check, I think that's about right.

Q. - And that's the last third party type of prudency audit that has been conducted in respect of the asset base?

MR. MARSHALL: As far as I know, that's correct.

Q. - And let's get that document out, would you. It's exhibit A-5, tab 3. Do you have it, Mr. Marshall?

MR. MARSHALL: Yes.

Q. - Could you please read the title of this document into the record?

MR. MARSHALL: "Transmission and distribution OM&A Assessment, NB Power Corporation - Stone Webster Management Consultants Inc.".

Q. - All right.

MR. MARSHALL: And the date, November 18th 1999.

Q. - Could you turn to the executive summary of that document, which is an untitled page, but it is the first text following the table of contents.

MR. MARSHALL: Yes.

Q. - Under the heading "Project objectives", can you show me where there is any discussion of the objective of conducting a prudency review of the rate base of the transmission assets associated with New Brunswick Power

Corporation?

MR. MARSHALL: I don't know that they concluded a specific prudency review of the rate base as -- they did a review of the transmission business unit, all of the assets, the O&M, the reliability, adequacy assessment, planning, budgeting and all related information systems. But when reviewing all of that they would have looked at what were transmission assets and what were not and then how they were operated and maintained.

Q. - Why do you think they would have called it then OMA assessment? Isn't that to imply operating, maintenance and administration? Isn't that the intent of this document, is to assess that specific expense and not the asset?

MR. LAVIGNE: Although the focus was on OM&A, they certainly did get into the capital side of things, looking at the various programs that were underway. So it was a bit broader than specifically looking at OM&A.

MR. PORTER: I might add to that that in looking at issues such as reliability and doing comparisons with other systems, I think inherently you get a feel for whether or not the expenditures were prudent.

We are not talking about an item by item prudency review, but on an overall evaluation of the system, I think there is some indication contained within that Stone & Webster report.

Q. - Could you turn to page Roman Numeral VII, which outlines the findings and conclusions. And Mr. Porter, I believe you are referring to -- I believe you are referring to -- correct me if I am wrong, reliability based maintenance, RCM methods. Is that what you are referring to in your last answer?

MR. PORTER: I would have to turn it up but there are various evaluations on reliability of the system, looking at SAIDI and SAIFI statistics.

Q. - But these all are in respect of -- and in particular, the fourth bullet point down the page on item 7 relates to opportunities exist to better utilize available OM&A dollars, including reliability based maintenance, RCM methods, schedule adjustments, and equipment replacement.

It is a technique, isn't it, to ensure your OM&A dollars are spent more prudently?

MR. PORTER: Yes, that is the case, but Ms. MacFarlane just pointed out, that in section 6, is where the evaluation of the physical assets is documented.

Q. - All right. Let's turn there. Can you show me where in this chapter there is any type of prudency conclusion about the capital dollars that have been expended by New

Brunswick Power on its system?

MR. PORTER: Could you be a bit more specific in terms of how you would define prudency so I could help you out and make a response?

Q. - I want to make sure that -- as a ratepayer my clients want to make sure that the capital dollars which have been spent by New Brunswick Power Corporation have been prudently incurred. Has there been any type of finding or conclusion respecting that issue?

MR. PORTER: As I noted there is not an explicit evaluation or statement concerning prudency. I believe it's implied within the assessment of the reliability of the system and where our system stacks up versus other systems.

Q. - From a reability perspective?

MR. LAVIGNE: I believe the report actually speaks more to the prudency of the future expenditures. And I think Stone & Webster in their recommendation speaks maybe, as Mr. Porter says, indirectly to the prudency by putting forth recommendations which support these various capital expenditure programs.

Q. - Future capital expenditure programs. Is that your point, Mr. Lavigne?

MR. LAVIGNE: Yes, that is correct.

Q. - Now, Ms. MacFarlane, could you please turn up Bayside --

your response to Bayside information request 41, please? That's at page 43. Have you got response to 41?

MS. MACFARLANE: Yes, I do.

Q. - All right. Now the question asked about the types of records you would be keeping for reintroduction of rate-based regulation at the end of the test year period. Is that your understanding of the question?

MS. MACFARLANE: Yes.

Q. - And what records are you specifically thinking about there in that response?

MS. MACFARLANE: Most specifically about the fixed asset records that would form part of rate base. But I suspect it would also apply to any records of patterns of costs and revenues that have been incurred historically and therefore form the basis of forecasts and projections.

Q. - So projecting or looking into the crystal ball in the future three years from now, Ms. MacFarlane, do you anticipate the inability of New Brunswick Power Transmission to provide comparative financial statements or continuity tables for accumulated depreciation at that point in time in three years when this performance-based revenue application, if approved, is up for renewal?

MS. MACFARLANE: No, I don't anticipate that as a problem.

Q. - Have you thought about uniform accounts for and applicable to New Brunswick Power Transmission, and I am thinking of accounting accounts, general ledger accounts?

MS. MACFARLANE: Are you asking under restructuring have we designed a general ledger?

Q. - Yes. Thank you.

MS. MACFARLANE: Yes. Yes, we have.

Q. - And is that information that you would be willing to share with the Board?

MS. MACFARLANE: What I can suggest to you that it is not significantly different from the general ledger information we collect today, except as it goes to the fact that the general ledger will now contain a shareholders' equity section that looks different than the current one.

There will also be accounts for things like collection and payment of taxes, et cetera.

Q. - What about intercompany transactions?

MS. MACFARLANE: There will be intercompany transactions as well, yes.

Q. - And again would that be information you are prepared to share with the Board?

MS. MACFARLANE: We are still exploring that -- we were asked yesterday by Mr. Richardson whether we could share the modelling going into the future, and the modelling would include information about the things that you are asking. And when we determine the answer to that question, I will be able to answer the question about whether we can give you GL account numbers.

Q. - In formulating or modelling that are you taking into account other regulatory jurisdictions that require regulated utilities to have standard or uniform accounting procedures and accounts, such as the National Energy Board?

MS. MACFARLANE: We have taken into consideration accounting requirements of the FERC organization and determined that we will be able to meet those requirements if necessary.

Q. - And when you say if necessary, if necessary meaning if the FERC requires you to?

MS. MACFARLANE: That's correct.

Q. - What about if this Board were to require you to do that, would that be something you would be prepared to accept?

MS. MACFARLANE: Yes.

Q. - And are you intending to periodically report on those general ledger accounts to ratepayers or to this Board?

MR. LAVIGNE: I believe Ms. MacFarlane had stated in her Panel B discussion that we would be providing monthly reporting to the Board.

Q. - On these accounts?

MR. LAVIGNE: Yes, that is correct.

MS. MACFARLANE: If they request it. We will be preparing quarterly financial information for external issue. I believe the Chairman asked if we were able to provide monthly information to the Board on the basis of what we issue to management and we reviewed that matter and we are able to provide that, yes.

Q. - But only if they request it. Only if the Board requests it. What if ratepayers request it?

MS. MACFARLANE: As a Crown corporation, I believe, though I am not certain, the corporation will continue to be subject to the Right to Information Act, and so from that perspective they could receive monthly information.

I think any quarterly information, because it will be available to debt holders will be available publicly. And certainly the annual report is filed with many bodies publicly.

Q. - All right. Could you now turn to Bayside supplementary information request number 34, please.

CHAIRMAN: Is that in A-6?

MR. NETTLETON: Yes, it is, sir. Page 34.

Q. - Have you got that, Ms. MacFarlane?

MS. MACFARLANE: Yes, I do.

Q. - Your response indicates that New Brunswick Transmission is in the midst of a higher than normal capital cycle due to the need to reinforce the transmission system. Do you see that?

MR. LAVIGNE: Yes, I do.

Q. - And it goes on to say, you are right now in year three of that asset renewal plan. Do you see that?

MR. LAVIGNE: Yes, that is correct. The current fiscal year that we are in is year 3 of that program.

Q. - Now what has been the capital cost outlay since you began this three year program?

MR. LAVIGNE: For the past two years I believe it's in the vicinity of about $25 million per year, subject to check.

Q. - Per year?

MR. LAVIGNE: Per year.

Q. - Would you expect those capital programs to be reflected in your projected rate base calculations?

MR. LAVIGNE: Yes, they are.

Q. - Can you show me those, please? Would they be reflected as work in progress?

MR. LAVIGNE: Yes, that is correct. That would be part of the work in progress. I don't think I can provide it directly out of the evidence, but I would be willing to provide the breakdown of the capital program going forward.

Q. - Why is it, Mr. Lavigne, that it wouldn't be reported in your evidence in this proceeding in the work in progress line items in, for example, table 4 of your evidence?

MR. LAVIGNE: I believe I took that out earlier this morning.

Q. - Oh, okay.

MR. LAVIGNE: But you are correct. Based on the previous evidence it would have given a perspective -- the prospectus -- a perspective of the capital program.

Q. - So are you saying then that for 2003 the work in progress is not actually 9.5 but 25 million?

MR. LAVIGNE: The work in progress number represents what is left at the end of that fiscal year. It is not representative of all of the work that has taken place, i.e., the settlements which would have transpired to fixed assets.

Q. - Okay. So are you then saying that we would see $25 million per year increase in the fixed asset total?

MR. LAVIGNE: If you refer to Province of New Brunswick IR 24 --

Q. - I have that.

A. -- which is in Vol A-4, I think you can determine that the --

CHAIRMAN: Mr. Lavigne, what page is that?

MR. LAVIGNE: Sorry, 301, Mr. Chairman.

CHAIRMAN: Just a second.

MR. LAVIGNE: Certainly. As you can see the increase in the gross book value is in the vicinity of about 20 million per year. Except for the last year where we see a fairly significant increase due to the -- certain aspects of the program.

Q. - So it would be reflected in the gross and not the net. Maybe that's where I was getting confused.

MR. LAVIGNE: It's also representative in net. The net is obviously net of accumulated depreciation.

Q. - Right. But the difference between your 2000 and 2001 is only 7 million in net, right?

MR. LAVIGNE: Yes, that is correct.

Q. - So back to this capital expense.

MR. LAVIGNE: If I could just add?

Q. - Yes.

MR. LAVIGNE: There are retirements -- retirals that would be factored into these equations. So those would have to be factored in also, which would offset some of the additions to the fixed assets.

Q. - And is there some sort of policy that you implement with respect to retirals that would reflect that by calculation? We are just trying to figure out the numbers here.

MR. LAVIGNE: Well, when the assets has run its useful life, obviously it would be retired.

Q. - Right. So the three year program has -- you have spent over 50, did I hear, or is it 75 million?

MR. LAVIGNE: Well, in the first two years it would be approximately 50 million again, subject to check.

Q. - And, Ms. MacFarlane, would you agree that those programs have been financed through or by New Brunswick Power Transmission's ratepayers as they are today? I guess as they are in the prior years that the investments were made.

MS. MACFARLANE: Are you speaking specifically of the $50 million investment?

Q. - Yes.

MS. MACFARLANE: They will be over time paid for by the ratepayers that benefit from the service those investments provide.

Q. - Is it not the case though, under your performance-based rate making proposal that ratepayers will not take the full benefit of the system cost improvements? There is a sharing mechanism, right?

MS. MACFARLANE: There is a sharing mechanism, yes.

Q. - And that sharing mechanism relates to prior period capital additions, right?

MS. MACFARLANE: I'm sorry, I don't -- I don't really understand your question.

Q. - Well, these capital assets were built prior to the implementation of PBR, right?

MS. MACFARLANE: Right.

Q. - And is it not the case that you expect operating cost reductions with these capital asset improvements?

MR. LAVIGNE: Where it is a multi-year program you are not necessarily going to see those type of, I guess, decreases in the OM&A side initially. I suspect once the multi-year program has run its course then, yes, you will see some -- some benefit on the OM&A side.

Q. - But those capital cost programs were invested three years ago, right?

MR. LAVIGNE: Yes, that is correct. We are in the -- I guess the middle of the year 3. But yes, we have I guess two years under out belt.

But again it would take some time before we are going to see the gains from those capital investments.

Q. - But those capital assets have been paid for by the ratepayers when the investments were first made, right?

MS. MACFARLANE: The assets are paid -- if you are referring to a cash outlay there is a cash outlay and a borrowing that occurs when the assets are installed. But that is not when the expense for incurring that debt accrues through to ratepayers. The cost of the debt and the cost of the assets through depreciation are spread out over the life of the asset, so all ratepayers who benefit from the service from that asset also bear the cost.

Q. - But if the asset was employed and there was no PBR mechanism, Ms. MacFarlane, isn't it the case that ratepayers would be receiving the full benefit of those asset improvements?

MS. MACFARLANE: I think one of the beauties that Mr. -- Dr. Morin referred to in the PBR mechanism is that there is a greater incentive in the mechanism to ensure that those savings are actually achieved and when they are achieved they are then shared.

Q. - What is the incentive when the asset has been constructed in prior -- in periods prior to the initiation of the PBR mechanism?

MS. MACFARLANE: The inventive is ongoing reduction of maintenance costs and ongoing benefits from ensuring that the assets reach their useful life, so in fact they do provide the benefits intended if not more.

Q. - But isn't that going to happen simply by the installation of the asset?

MS. MACFARLANE: The -- yes, it is. I don't believe that the PBR mechanism gets in the way of achieving those benefits. And I don't -- I believe if anything the PBR mechanism could help ensure that they do accrue.

Q. - That is the part that I don't understand, is how could this PBR mechanism improve upon the efficiencies of the asset that has been placed in service in prior periods?

MS. MACFARLANE: The asset attributes a number of costs. It has fixed costs with it which come from its installation and the financing thereof. But there are also considerable costs associated with its ongoing use and maintenance. And a PBR mechanism is designed to incent management to look for the most effective processes for ensuring the benefit either out of the fixed costs or in ensuring that there are reduced maintenance costs.

Q. - Mr. Marshall, you will probably be able to help me with this. I'm interested in learning about how new rate base additions will be treated under the policy, under your tariff and under the PBR methodology.

Will -- and in particular I think we will be referring to the transmission expansion policy that is found at attachment K to the tariff. And that is exhibit A-1.

CHAIRMAN: Volume A-3?

MR. NETTLETON: I believe it is A-1. It is part of the application. Just one minute.

MR. MARSHALL: Page 324.

MR. NETTLETON: Yes.

MR. MARSHALL: A-3, page 324.

CHAIRMAN: 324.

MR. NETTLETON: Thank you.

Q. - My question, Mr. Marshall, is will all new rate base additions beyond that which is forecast be made subject to the transmission expansion policy found in the tariff?

MR. MARSHALL: No. There would be ongoing need for capital upgrades to the existing system to continue the reliable supply to the existing system. And there may be additional needs as load grows to upgrade certain lines in the system to maintain reliability and meet reliability targets and standards.

Q. - All right. So the transmission expansion policy only is in respect of requests for new service?

MR. MARSHALL: That's my understanding.

Q. - If I can take you to lines 22 to 25?

MR. MARSHALL: Yes.

Q. - Who makes the determination about whether increased transmission use is more than or equal to transmission system revenue requirements?

MR. MARSHALL: The transmission company would do the evaluation based on the reservation request.

Q. - The transmission company, or the transmission administrator or the independent system operator?

MR. MARSHALL: Well in this tariff as filed right now it's the transmission company. The implementation of the tariff though as proposed under restructuring would be done through the independent system operator. So there -- the independent system operator I think would have a role in determining whether this transmission was going to be used and useful and whether there would be an additional charge or not.

Q. - And so we are clear, there will be an independent system operator when the market opens, right?

MR. MARSHALL: That is the intent of the government as stated in the -- in their press release of August and I believe in the -- I don't think it is -- I don't know if it is necessarily specifically mentioned in the speech from the Throne but in the legislation it is my understanding there will be provision for an independent system operator.

Q. - At the time that the market opens?

MR. MARSHALL: That's my understanding, yes.

Q. - Thank you. If I can take you to page 325 at line 6. There is reference made to system benefits and a net present value of system benefits. And again my question really is a simple one of who performs this study and this analysis?

MR. MARSHALL: And I think in the implementation of this tariff as -- taking into account restructuring and where the government policy is going, it would be done jointly with the transmission owner and the system operator would be involved in what that system benefits would be. But under the application as it is before this Board at this time, it would be -- the transmission provider would undertake the study.

Q. - When you make that qualification I get concerned that the current application may not be the right application once the market opens. Are you thinking that there may be another application?

MR. MARSHALL: No.

Q. - Okay.

MR. MARSHALL: So our understanding is this tariff is to provide an open and nondiscriminatory access tariff, provide provision for expansion of the system. And the administration of this tariff would be done by the independent system operator.

Then depending upon the powers that that operator has, if there were going to be any changes to the tariff, they would need to come back with an additional application to this Board to change the tariff. That is my understanding.

Q. - So, Mr. Marshall, the transmission company will be involved in this analysis, is that right, in the system benefit net present value analysis?

MR. MARSHALL: I think they would be involved to assist with the transmission -- with the system operator in assessing what the benefits are and analysis of the system in order to determine exactly what those benefits are and their value, yes.

Q. - Ms. MacFarlane, what discount rate will the transmission company use in making the net present value calculation? Will it be the cost of capital for the transmission company?

MS. MACFARLANE: I would assume it would be the weighted average cost of capital on a prospective basis.

MR. MARSHALL: I would concur. I believe that would be the correct discount rate to use.

Q. - Whose weighted average cost of capital? The Transco's?

MR. MARSHALL: The Transco's weighted average cost of capital, yes.

Q. - Now, Mr. Marshall, we have all heard about this new intertie facility that has been applied for to the

National Energy Board. How is that facility going to be considered under your tariff?

MR. MARSHALL: Under the expansion policy it would be an opportunity for increased point-to-point reservations out of the system. Those reservations would fund a good portion of that line.

There are opportunities for loss savings across the existing interface. There are reliability improvements to the whole Maritime area.

So it is -- a combination of those factors would be included to assess the impact of that line within the existing tariff structure.

Q. - And is your net present value analysis of the system benefits one that you will share with other ratepayers?

MR. MARSHALL: I would think from the transmission point of view that that would be available to be looked at. It is an open tariff, nondiscriminatory tariff. If there were any effects on costs that affect the tariff, there is. There would be a prudency requirement on that line. How are those costs assessed? Where does the value come from? I would expect that it would be made available.

Q. - Ms. MacFarlane or Mr. Marshall, what happens if the transmission provider incurs cost overruns with a project?

Who is at risk for those cost overruns? Is it the requesting party or is it all ratepayers on the system?

MR. MARSHALL: My understanding is that if a transmission request requires additional transmission to be built, if that transmission is built within the tariff and can be rolled into the tariff without increasing the tariff charges, it would be handled within the PBR mechanism and wouldn't affect the tariff at all and the risk would be with the transmission company.

If the transmission line, the revenue stream from the transmission reservation will not cover the tariff, there is an aid to construction required, then the risk would associate with the contract then between who is building the line and the request to do it.

So if the requesting party contracts totally and say, we will pay this much, and it's a fixed contract that we will pay this aid to construction, and then the constructing parties, there are cost overruns, the cost overruns would have to be handled through the contract relationship between the transmission provider and the constructor, and one party would be liable depending upon the contract terms.

Q. - So what you are telling me, I believe, Mr. Marshall, is that the aid to construct payment is based on actual costs incurred and not forecast costs?

MR. MARSHALL: No. I think I said the aid to construct payment again between the contract between the transmission customer and the transmission provider, there would be a negotiated price, I will pay this aid to construction.

Q. - Based on a forecast?

MR. MARSHALL: Based on the forecast of what it is there would be a contract, yes, I want the line built, I will pay this aid to construction and I will take service on the line under transmission contract for so long.

The question then is after it's built if it runs over that has to be -- any cost overrun has to be dealt with contractually between the contracting parties to having the line built.

Q. - Okay. So the risk is borne by the party making the aid to construct payment, is that right?

MR. MARSHALL: No. I think the risk then, if the arrangement was -- if the aid to construct payment or party was willing to say, well we think it may be built for lower cost than that, we will take the risk on a cost overrun or underrun, then they would take the risk if that's their negotiated position up front. If they say, no, we will only fund your projected cost overrun that you forecast, you are the transmission experts, you forecast this cost overrun, then we fix that payment, sign a contract, the transmission provider goes out and contracts with a constructor to build the line, if there is a cost overrun, it's then between the constructor and the transmission provider to settle any differences in their contract.

Q. - Maybe I can summarize what you have just indicated. And that is ultimately the risk borne for cost overuns is a matter of negotiation between the Transco and the party requesting service?

MR. MARSHALL: I think that that would be as all contracts ultimately are negotiation between the parties. Anybody taking service under the tariff will pay the tariff. An aid to construction is an additional cost outside the tariff that requires a signed contract, so it's a negotiated price.

Q. - I think that's a yes.

MR. MARSHALL: Subject to some lawyers involved in the contract probably.

Q. - Now if there isn't an aid to construct payment and there is a cost overrun, who bears the risk then?

MR. MARSHALL: If the service and the expectation is that it could be built within the revenue stream from the tariff without an aid to construction, and the transmission provider goes forward and agrees and goes forward and has a cost overrun, and the transmission -- the PBR would be -- would suffer and it would be be borne through the PBR mechanism. So the transmission provider would -- the Transco would carry the responsibility. That would be my understanding.

Q. - There would -- to be clear, there would be a reduction in cost savings that could be passed on to ratepayers?

MR. MARSHALL: Or there would be a reduction in the net income and rate of return to the Transco.

Q. - Do you find that result symmetric? That is, that ratepayers may be at risk if there is no aid to construct, but where there is an aid to construct and there are cost overruns, the ratepayer doesn't pay or doesn't take any risk of that overrun? Do you think that's a symmetrical result?

MR. MARSHALL: Would you repeat that, please?

Q. - Yes. I'm wondering your view on whether you think it's a symmetrical result that in the event that there is no aid to construct, that the ratepayer on your system may take or does take the risk of cost overruns. But in the event that there is a cost overrun -- or sorry -- an aid to construct, and there is a cost overrun there, that the ratepayer on your system not requesting the service is fully protected.

MR. MARSHALL: Under our application as it is here, the rates as set in the test year would then escalate at half CPI. Any construction in here would be -- if there isn't an aid to construction and an expansion fits within the tariff without the need for an aid to construction, it would be undertaken and the risks, as I said, essentially are born by the Transco in its performance base rate. They are not borne by the customer contracting or other customers. The tariff doesn't change. It can escalate at half CPI.

Q. - Let's use an example. Let's assume you have cost savings in a year of $100, but because of a project that you have undertaken as a result of a requested service, there have been cost overruns. And that has otherwise reduced the amount of cost savings that could be passed on to customers, to ratepayers, in the form of lower rates. Would you agree that in those circumstances that the ratepayer isn't getting the full amount of the cost savings that would otherwise be attributed to him?

MS. MACFARLANE: You are suggesting that if there is a cost overrun on a capital project, there will he higher depreciation and higher finance costs on that asset --

Q. - Yes.

MS. MACFARLANE: -- that will be included in the net income --

Q. - Yes.

MS. MACFARLANE: -- offsetting other cost savings?

Q. - Yes.

MS. MACFARLANE: The answer to that is yes, that will happen. And so if it falls between -- if it is such that the return falls between ten and 12 percent, there will be no sharing, below ten percent there will be 50/50 sharing and above 12 percent there will be 50/50 sharing.

MR. NETTLETON: Thank you. Mr. Chairman, I'm at a point of having a rather lengthy discussion with Mr. Lavigne about amortization.

CHAIRMAN: And we are at the point of adjourning.

MR. NETTLETON: I thought that was going to be the answer.

CHAIRMAN: So we will adjourn until tomorrow morning at 9:30.

(Adjourned)

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

Reporter