New Brunswick Board of Commissioners of Public Utilities

Hearing

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

Delta Hotel, Saint John, N.B.
February 20th 2003, 1:00 p.m.

CHAIRMAN: David C. Nicholson, Q.C.

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

BOARD COUNSEL: Peter MacNutt, Q.C.

BOARD SECRETARY: Lorraine Légère

.... CHAIRMAN:

Good afternoon, ladies and gentlemen. Anything preliminary? Yes, Mr. Zed?

MR. ZED: Mr. Chairman, I have three matters. The first is -- the first two really deal with questions that the Board put to me yesterday afternoon at the conclusion of my summation.

And I just wanted to -- one question the Chair put was with respect to whether or not Nova Scotia had decided on adopting an OASIS system or developing an OASIS system. And I just want to confirm that what I advised the Board

yesterday appears to be correct.

On page 19 of the December interim report of the Electricity Marketplace Governance Committee, the second paragraph they talk about an option to keep costs low while providing essential service would be to discuss the possible sharing of the New Brunswick OASIS with its system operator for scheduling transmission in Nova Scotia. And it goes on to explain the cost benefits of that.

But I think I did advise the Board that I thought that was part of the -- that was still under discussion. And it appears to be from a review of the report.

CHAIRMAN: Okay. Thank you.

MR. ZED: The next item is I believe you asked if there was anything in the Public Utilities Act or any similar legislation to require -- I understood the question to be an independent power producer from constructing a generator, whether or not they needed Board approval.

And there is nothing in any of the relevant statutes requiring private generation, a private party from constructing generation facilities, I mean, subject to the normal I guess environmental permits and municipal permits.

But there is no provision to go to the UARB nor is

there any provision to go to the Lieutenant-Governor-in-Council.

CHAIRMAN: Okay.

MR. ZED: And the third and final matter, I was contacted by Mr. Allen Crandlemire of the Nova Scotia Department of Energy this morning. And as some people may be aware, they circulated a submission that they asked be read as part of the record. And he asked me to bring hard copies, to make them available at this Hearing.

And I understand the Board has discussed the matter. And I just really want to put it on the record that the matter has been raised by Mr. Crandlemire and the Department of Energy.

CHAIRMAN: Thank you, Mr. Zed. Now the Board was aware that there was a letter circulated. We have not read it. The record has closed.

There were plenty of opportunities for that department or representatives to appear before the Board. And I'm sorry, we have to cut it off at some point. And that is the point.

But thank you for bringing it to our attention, Mr. Zed.

MR. ZED: Thank you.

CHAIRMAN: Anything else, sir?

MR. ZED: No. That is the end of the preliminary.

CHAIRMAN: Okay. What we intend to do, as I think I outlined yesterday when we broke is we have some questions that we would like the parties to address as we go around the room for the last time.

Hopefully they are not too complex. But you can comment on them if you wish to comment on them. And if you don't want to you don't need to. But we thought we would bring them to your attention.

I have got two or three here. I will start off. And what we would like the Intervenors and the Applicant to do is to address the issue of contracts for transmission capacity on each interconnection.

In other words what contracts are there now? What is the duration of those contracts presently? And that is on all of the interconnections. We would like each of you to define equity. And we are not talking about what was administered by the courts of pie powder.

The representative, and I forget the gentleman's name, from Nova Scotia, talking about wind power generation, I believe Mr. Hashey indicated that it probably should be looked at. And it was not an issue for this particular hearing.

I would like you to confirm that to me. And also if

any parties have any thoughts on wind power and what we might do in the future in order to facilitate its being accepted on the grid and at no penalty.

And I believe those are all the questions that I wish to have addressed. And now I will go to Commissioner Richardson.

MR. RICHARDSON: Thank you, Mr. Chairman. I have three points that I will lay on the table. And anyone can give some comments, if they so feel.

We heard a lot yesterday or some yesterday about upstairs and downstairs. I'm not sure there was an elevator in that or not. But in any event, I would like to take you down to the basement in the first one.

We had a fairly extensive review of risk in Mr. Smellie's presentation yesterday on pages 134, 135 and 136, in that area. But nowhere in that presentation or in what I have listened to from the other intervenors has anybody addressed management risk.

And one of the very foundations in the running of any company is its management. And through its management in effect you will then come to your debt equity and to your rates that will be charged, either through the change or how you look at data and so on. And I would like some comments from you in that regard.

In addition, when you look at again Mr. Smellie's comments on page 128, his comments regarding debt equity, and particularly I would refer you to paragraph 2 where the inference to this Commission is that you really don't have to worry very much about the structure of the new transmission company. Because really who is going to pull the trigger on it? In other words, don't set too high a debt equity because, Commissioners, there is no need to worry about it.

I have some concerns when anytime you create a company with that type of a mindset, and particularly where we are looking at a stand-alone company that is going to be operated in a commercial manner. And I would like some comments there.

Secondly, in Mr. Nettleton's remarks, and I refer you to the aid to argument, page 4. And he has discussed the legacy debt. And in his view -- he went to great lengths that the 233 million avoided borrowings should not form part of the structure.

And I have some concerns in that where the transmission company shared in the spoils when they didn't have to go borrow that money, why should the transmission company not have to pay the piper when they have to pay it back?

I also would like some comments from you in relation to the amortization of foreign exchange losses. It was evident yesterday that Mr. Nettleton felt that we shouldn't face that till the end of the line. That is a real loss.

Anybody that has been to the U.S., and you put your dollar on the table, you will find out that it doesn't buy a dollar in U.S. funds. And do you want to face, at the end of the road, a huge bump, whether it is 10 years out or just exactly whenever it is, why doesn't it make better sense to amortize it over the remaining period? So your comments in these three points would be very much appreciated.

And I thank you, Mr. Chairman.

CHAIRMAN: Thank you.

MR. BREMNER: Mr. Chairman, just to follow up what Commissioner Bob has said, I would like to know on which side of the room we are supposed to go here. If you will go to aid to argument on page -- table 5, it says here, a credit spread with government guarantee on one side is 20.1, on the other side is 12.8. I would like for someone to explain that to me, please? Thank you, Mr. Chairman.

CHAIRMAN: Mr. Sollows.

MR. SOLLOWS: Thank you, Mr. Chairman. I have a number of

questions and I will try to make the lead up to them as short as possible.

I guess the first question that I have relates to Mr. Hashey's argument that the Board's hands are essentially tied by a section of the Act that requires us to consider future years and future costs in determination of costs, and I think, if I understood the argument correctly, he is suggesting that we must use a future test year by reference to that section of the Act.

The difficulty I'm having is that it is also argued that the Board should rely on proxy costs for generation based auxiliary services, and as I understand the evidence the proxy units that are the basis of the cost don't exist now on the system and will not exist during the test year and in fact will not -- very likely will not exist for the foreseeable future.

I have also got the understanding from the evidence that the actual cost of providing the services, at least in NB Power's estimation, is higher than the proxy cost, proxy unit cost.

So in view of all this it would be very helpful if all of the participants could indicate what statutory basis we should rely on to fix the cost based on the proxies. It seems to me that if we have to rely on future costs it's

hard to rely on proxies.

My second question relates to Mr. MacDougall's argument that we should rely on the most recent filing or estimates of NB Power's embedded costs for generation based auxiliaries. And he asserted that the methodology that was used to calculate those embedded costs is consistent with that used by FERC in allowing recovery of auxiliary services for the utilities that were providing those services prior to the development of markets.

I guess my problem with this is it seems to me that FERC, in applying such a methodology, might have been implicitly relying on the fact that most of the utilities that would be providing such services had been subject to regulation by state Boards. And in that case FERC might reasonably be confident that the assets were used and useful for the purpose and therefore could simply rely on the embedded cost analysis.

It seems to me that in this case NB Power seems to lack the kind of record of continuous regulatory oversight that would justify similar confidence on our part. And the evidence also seems to show that the applicant has a capability to provide auxiliary services that greatly exceeds or substantially exceeds the auxiliary services requirements.

Now I think I understand that that excess capability could naturally arise from energy planning decisions that are reasonably based, but those decisions weren't subject to regulatory oversight either.

The final thing that is causing me a little bit of problem here is that NB Power's witnesses I think indicated a willingness to discount the price that they will actually charge transmission customers for these ancillary services even below the proxy cost which is below -- which is in itself below their embedded cost.

So with all of this in the record, I am just wondering if any of the participants can provide any arguments or insights that would give us some comfort that the embedded costs are a reasonable basis for rates.

The next area that I'm finding a little -- I have a little bit of concern with would be Mr. Smellie I think has asked the Board, if I understand it in his argument, to direct NB Power Transmission to develop and file a new tariff for self-generation customers. I think the rationale for that request is that the proposed tariff will result in rate shock for the group.

I'm unclear on this point, but I would like to know if there is anything in the evidence before the Board, an indication that that kind of rate shock would apply to

self-generators in a discriminatory fashion or would it apply to all customers under the tariff? If there is such evidence, is it clear that the old tariff, which again was not subject to regulatory approval, was nonetheless just, reasonable and fairly allocated the costs?

The second part on this point is I -- based on my understanding of energy policy, I can understand an argument that combined heat and power plants, or so-called co-generators, may provide social or environmental benefits that could justify the use of a tariff that spreads the cost associated with serving such plants over a broader group. I think that's what might be called in some circumstances a socialized costing approach to the rate setting procedure.

The general question I have for all participants is, should self-generators, as they are understood to be here in New Brunswick, benefit from such a rate making approach?

And finally Mr. Belcher in his comments yesterday indicated that the issue of reservations on the MEPCO tie line might be resolved with reference to proceedings in other jurisdictions that related to hoarding -- what he termed hoarding of transmission capacity reservations, I think. I'm wondering if any of the participants can

provide any further insight as to the nature of the proceedings that would relate to such issues and maybe the considerations that were relevant in those cases.

That's all I have, Mr. Chairman.

CHAIRMAN: Having heard all those brief questions read, I think it's only fair that we give the parties the opportunity to think about some responses before we head into it. So I'm going to suggest that we come back in 25 minutes. If you want more time than that let us know, okay, and we will stay out of here until then.

(Recess)

CHAIRMAN: I came into the room during the break and indicated with apologies that I had forgotten a question. And off the record I think I gave it to most of the parties. And for the sake of the record, I will put it in the record.

And the question is does the Board have the authority to require that the system operator conduct a request for proposals process with respect to the provision of its ancillary services requirements?

In other words, the system operator would be required to solicit bids for the provision of the necessary ancillary services on an annual basis. And the Board would have oversight to ensure that these services were

obtained at the lowest possible cost.

I would propose that we go around the room now. If an intervenor wishes to rebut that which another intervenor has said or didn't have an opportunity for whatever reason to rebut something the applicant had said initially, you can touch upon it.

But please don't recover ground. And then at the end of that the applicant will have the opportunity to rebut as well as attempting to answer the Board's questions.

And I will tell you that since we have sprung all these on you at this late time that if someone wishes to -- some of the intervenors wish to comment on the questions in writing then they can do so, but by close of business tomorrow.

And Mr. Hashey will have the opportunity to receive those by close of business tomorrow and will be able to comment on them in writing by close of business on Monday, okay. But if we possibly can, let's do it today.

And we are pleased to see that Ms. MacFarlane has returned to take her name plate and put in the proper place.

Bayside Power is not here. Canadian Manufacturers and Exporters. I guess Mr. Smellie, you can choose if you want to go in that slot or if you want to go in J.D.

Irving.

MR. SMELLIE: I'm quite happy to proceed now, Mr. Chairman.

CHAIRMAN: Okay. Go ahead, sir.

MR. SMELLIE: Mr. Nettleton and I will follow our usual tag-team approach, if that is all right, sir. And I will just start with the questions as they came from the panel.

We can't help you, Mr. Chairman, with respect to your first question about the state of the contracts relative to the system interconnections. That information is simply not available to us as we sit here today.

And your second question asked for a definition of equity. And let me come at it this way. We have an evidentiary record which is clear, at least in the use of that term, that there is no equity in New Brunswick Power today. And there will be no equity in New Brunswick Power Transmission on April 1. And there is no contemplated equity infusion into that company.

Let me come at it in a way that at least I can understand, Mr. Chairman. If I buy a house tomorrow for $100,000 and I go to the bank and borrow that $100,000 to buy that house, I think everybody in the room would understand that I have no equity in that house.

If the house was sold the next day for the same price, I wouldn't get any of the purchase price because it would

all be owed to the bank.

However I have a job. And from time to time I earn money. And let's assume for the moment that I have the privilege quarterly of paying down that mortgage without penalty.

And so at the end of the first quarter I take $5,000 to the bank and I give it to them. And if I sell the house for what I paid for it the next day, the bank gets $95,000 and I get $5,000. I have a 5 percent equity interest in that asset.

Why? Because from my earnings I have infused cash into the asset, into the -- I have invested the money in the asset. And therefore I have what, in response to your question, is a 5 percent equity interest in the asset.

What happens if on the next quarter not only do my earnings suffer to the point that I can't make the quarterly payment, but they suffer such that I can't make the monthly payment on the mortgage.

But I have a Visa card. And I go to my banker. And I say here, chalk the monthly payment up to my Visa. And there is a component of principal paid on that monthly payment.

Have I increased my equity in the house? Well, arguably, but not really. Because if I sold the house the

next day, yes, I would have my $5,000 equity. And yes, I would have a touch more because of the monthly payment. But I would still have to get rid of the Visa debt that I had racked up to make the payment. So that is not really equity.

And now the next quarter rolls around. And in between time a great aunt has passed away and has left me $10,000. And I take that $10,000 to the bank. It is not earnings, but it is cash. And it is infused by way of an investment into my asset. And therefore I have increased my equity in the house, in the asset.

And so you should know that we actually endeavored to talk to Dr. Yatchew on the break. But unfortunately he is not available. So you are stuck with my response.

But the concept, Mr. Chairman, is that over time, either via my earnings or separate sources of non-borrowed funds, I'm able to make an investment in the asset that I own and accordingly develop and build my equity interest in that asset.

The third question, sir, you asked had to do with wind power and how the Board might facilitate that source of energy without penalty.

The response, sir, is really given to you in the context of Bill 30 as it sits before us. There is a

requirement in the Act, in the statute I believe under Section 142 and which applies to standard service supplier, any municipal utility or industrial customer in respect of electricity that it obtains from other than the standard service supplier.

And the requirement is that such a person must ensure that a portion of the electricity that it uses is obtained from renewable resources. That would include wind power. But this is one of those statutes where we are going to have to wait and see. Because while that obligation is there in general, we know that the Lieutenant-Governor-in-Council is going to have to give us and give you some regulations respecting the requirements to obtain electricity from renewable resources, setting a base level, setting a percentage, specifying renewable resources, setting targets to be met, and this is the important part, and how they are to be achieved.

Well, clearly the question of penalties that arise for example in the context of the provision of power using wind is something that would have to be addressed. We certainly think that it is a key source of future generation which is to be encouraged in this province.

If there is some possible way, Mr. Chairman, that the Board or the Province or New Brunswick Power can

investigate how the penalty issues have been addressed in other jurisdictions which are maybe a step or two ahead in the exercise or the putting in place of wind power as a component of overall supply, that may well be helpful in providing an answer as to how in this province under your jurisdiction one can get around those penalties -- or those penalty issues.

Mr. Richardson, I want to respond to your first question about the basement and the notion that nowhere has anybody addressed management risk. Our view of that is simply this.

We have expressed to you indirectly concerns about the implementation of a price cap framework going forward. And we have recommended benchmarking. We say that that sort of objective information would assist management in embarking with this new company on April 1.

And for us, sir, management risk is a subset of business risk. And if we were creating a new company, in fact if we were creating a company that was going to embark on a greenfield venture with new management, then perhaps that sub element of business risk would perhaps be more striking than it is here.

Yes, for titular purposes New Brunswick Power Transmission will be incorporated under the Business

Corporations Act. But it is not a greenfield venture, sir. It is not likely to be one that is going to be steered by new management.

It is not one that management is going to have to sit around and determine, all right, we have this new venture and we need to go get some capital. Because the actual capital for New Brunswick Power Transmission is in place, as I said in my submissions to you.

As I said in response to the Chairman's question, there is not an actual equity component of New Brunswick Power today. And there will not be an actual equity component of New Brunswick Power Transmission tomorrow. And it is on those actual facts that existing management, as part of the overall business risk of the company, moves it forward.

The notion of upstairs and downstairs, sir, was simply intended to convey that the task before this hearing is to determine, for ratemaking purposes, what the rates, what the tolls, what the revenue requirement of the company are to be.

And that, sir, in our submission is as much about the determination of just and reasonable rates which yes, have to have regard for business risk, of which management risk is a component. But it is management risk in the context

of an existing company moving forward.

Your second question, sir, was -- had to do with the remarks that I made to you yesterday about who would pull the trigger on New Brunswick Power Transmission. And I understood your question to be at least to some degree saying, well listen, Mr. Smellie, you are not thinking about this from the perspective or with the mind-set of a stand-alone corporation. Even on a stand-alone basis though, one has to ask who are the creditors of this company. The evidence says that the fixed obligations of the company are well supported by cash flows. The evidence says that this application to you for rates going forward is not prompted by any revenue shortfall.

We certainly didn't mean to imply, Mr. Richardson, that one simply ignores the financial integrity of the company going forward. That's not our case at all.

It's an issue but it's an issue that has to be addressed in light of the evidence that I have just mentioned. We very much thought about New Brunswick Power Transmission as a restructured component of the former New Brunswick Power going forward. But simply put, with respect to the overall balance that you have to strike, we have come down in favour of submitting to you that in the assessment, the overall assessment of the risk of the

company going forward, that default risk is not an issue that is front and centre that needs to be considered, because the evidence doesn't suggest that there is a default risk.

I'm going to turn the microphone over to Mr. Nettleton to deal with your next question, Mr. Richardson.

MR. NETTLETON: Mr. Richardson, that other -- that next question, as I understand it, related to some concerns over the exclusion of avoided borrowings from page 4 of the aid to argument, which is the table 5 from Ms. MacFarlane's Panel C evidence.

I think the best way to explain again the reason for the exclusion relates to what are we trying to do with table 5? What we are trying to do, you will recall from the evidence, and I note that it's not in the heading on this aid to argument page, but it is intended to provide a forecast interest rate for 2004 -- for year ending 2004.

The reality is is that for the year ending 2004, New Brunswick Power Corporation will no longer be in the form that it is today. There will be separate corporations for transmission and for nuclear.

We understand also that for nuclear the capital structure for nuclear will be 100 percent debt and it will be a Crown agent. So there will be a government guarantee

continuation of that debt as well.

The concern that we have with respect to including a cost item that is completely and entirely related to the nuclear generation operations, is that if you include any portion of it in respect of the transmission rates, then you offend what the White Paper wants and that is to ensure that price signals reflect actual embedded costs for the purposes of determining rates.

So because the avoided borrowing cost item is and will remain a requirement of the Canadian Nuclear Safety Commission's licence requirement, we find it inappropriate to be including this amount in the calculation of the interest cost that will be paid by transmission ratepayers.

Now you suggested, sir, that if there was a benefit from the avoided borrowings in years past, aren't you being unfair by having the burden be foisted upon those that took the benefit? Well again for rate making purposes, sir, there is a problem with that logic, and the problem is that the benefit that was obtained, that was consumed, the benefit that was provided, has been provided to the ratepayers in the past. There is an inter-generational inequity here if you include the avoided borrowing costs for future ratepayers, especially when

those ratepayers have no opportunity to control or have any relationship to the service, namely transmission, the service that they are going to be providing.

With respect to your third question, Mr. Richardson, I believe it related to the amortization of foreign exchange losses. I discussed that in my portion of the argument at pages 97 through 102. You made a very important comment in your question and that is, isn't it better for customers, for ratepayers, to have a smooth road ahead if you know that there is going to be a cost down the road? And, Mr. Richardson, I think if that were the case, then there would be logic to what is being suggested here.

The problem is this. We don't know what the cost is going to be down the road and so we can't apply that actual cost to today, to the rates that are going to be charged today, so that we are ensured that the cost is in fact certain and applied fairly.

Remember that these charges relate to a foreign exchange loss that won't actually be known until some ten or 20 years from now. That's when the debt matures and that is only when we will know whether in fact there is any loss. If we start applying amounts today and the foreign exchange loss isn't realized, the problem becomes again inter-generational inequities. That is, today's

ratepayers will have paid transmission -- the transmission service provider through its rates for an amount, for a cost, that it actually didn't have to pay. And you then have the problem of saying down the road, well who should get that benefit back?

Well 20 years from now we can't be assured that the same ratepayers that are on the system then were in fact the ratepayers that were actually the ones that paid the amount.

So in traditional rate making and rate of return and cost of service legal principles, the issue of inter-generational inequities has been a very strong and cautious point and ones which regulators very carefully ensure that ratepayers don't face.

The other point on this, Mr. Richardson, was one that I did not bring up in the argument, and that relates to the fact that -- and I hate to use this term because it's in here already twice -- is sinking funds. Remember the evidence in this proceeding is that the actual sinking fund amounts -- and I can't recall the evidence but it's certainly in the annual report -- the actual sinking fund amounts have in fact been used by New Brunswick Power as a natural hedge as against that expected foreign exchange risk or loss.

And so there is a natural hedge already built in to that financing that again is good reason to exclude the line item for amortization of foreign exchange losses.

MR. SMELLIE: Mr. Bremner, you asked a question, sir, about the difference between the line 5 on page 4 of the aid to argument, credit spread government guarantee, 20.1 million dollars sought by the applicant and 12.8 million dollars in our recommendation, and just what are those numbers. Very briefly we are talking of course about existing debt, sometimes called legacy debt. That legacy debt attracts a guarantee fee because it is guaranteed by the Province and the level of that guarantee fee is prescribed, as I recall it, under something called the fees regulation under the current Electric Power Act. And the rate for that guarantee fee is I believe 64 basis points or thereabouts.

And so if you look at column JDI CME recommendation, if you apply 64 -- or .64 to the amount of outstanding legacy debt, you come up with 12.8 million dollars.

But that's not what New Brunswick Power wants you to do. New Brunswick Power wants you to apply to the amount of outstanding legacy debt a credit spread of I believe it's something in the order of 94 basis points.

And I will just give you the reference and not take the time. If you look at page 94 to 96 of our argument

notes, there is a fairly healthy discussion about this that Mr. Nettleton undertook yesterday, but bluntly put, 20.1 million dollars arises from applying the credit spread figure to the debt as opposed to the actual in fact to be incurred guarantee fee.

And as Mr. Nettleton discussed with Ms. MacFarlane, he put this question to her, 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.

So that's why it became a feature of our argument. It is one of those fictional costs, in our respectful submission, that New Brunswick Power is seeking to recover from ratepayers as distinct from the actual cost of the guarantee fee.

Hopefully that will help you, sir.

Mr. Sollows, you asked a question about whether you and your colleagues are tied to determining rates on the basis of a future test year, and that arose given what Mr. Hashey told you in his argument in chief.

And ultimately your question was, well, what is the statutory basis for proxies if we can only rely on future

costs? And our position on that question, sir, you may recall, is that we don't agree with Mr. Hashey. We don't think that you are limited in the determination of just and reasonable rates to simply considering an estimate of future costs. We think that your obligation under the Act, your overriding obligation, and by Act I mean Bill 30, of determining just and reasonable rates cannot, as a matter of law, constrain you to but one view of the cost base that an applicant brings before you.

It's true that Section 111 of the Act indicates that you need to base your decision on projected revenue requirement. Or base your order on the sale of ancillary services and of the projected cost to be incurred.

But that doesn't mean, as I think I alluded to in my argument, that if you have a different view of what would be just and reasonable at the end of the day, that you are bound to accept an applicant's estimation of what its future costs are going to be.

MR. NETTLETON: Mr. Sollows, I would like to turn to, I believe, your third question. We have no comments on the second question either.

But with respect to the third question, I understood that to be essentially what comfort do we have in using the embedded costs for the purposes of determining the

ancillary service rates?

Our simple position is, sir, we are not sure that you actually have the embedded costs of providing ancillary services. What we believe, and I say that with all due respect, because it wouldn't be reasonable for a utility to not offer rates to recover their actual embedded costs. And I think that's the point you were making.

The point that we addressed in argument and through cross examination was that the ancillary services rates based on a proxy method take into account a credit. They take into account a credit for energy production. And the only way we see of correcting the embedded cost study is to apply the same pricing formula. Take into account the energy production in the same manner.

Now what we have suggested in doing so is to take into account a credit based on the export energy production and sales. That is, in our submission, one which ensures that there is recognition of at least a part of the energy production amount. Is that helpful, sir?

The fourth question dealt with self-generation. And the record and in respect to, as I understand it, whether there has in fact been a benefit provided to self-generators in the past, and whether this is now really showing its colours, so to speak, through an unbundled

rate process.

The problem is this. This record, unfortunately, has not tested the proposition that self-generators have in fact been the beneficiaries of a benefit under the bundled rate design. Certainly Mr. Mosher was here. Certainly we expected the applicant to ask questions about this issue. The applicant chose not to do that.

What we understand the position of the applicant to be through Mr. Marshall, is that he is prepared to look at ways to resolve the rate shock that is associated with the applied for rates. And he has suggested that, we submit, through offering ideas up like using point to point service and self-providing ancillary services. And those are both much different ways and types of service that is currently provided today and that's the point.

So, unfortunately, we don't have a record. And there isn't evidence on this record that relates to the benefit that self-generators have provided or been the recipients of, and it just simply wasn't tested.

Part of the problem, as I mentioned to the Chairman, that drives this issue is the fact that ratepayers, self-generators as a class have not had the opportunity to do a comparison of the actual transmission charges and the ancillary charges that they are paying under a bundled

rate. And for that reason it makes it very difficult for the proposition to be tested.

While we are on the topic of ancillary services, it might be appropriate now to provide some reply to what we heard from Mr. Belcher from Northern Maine Independent System Administrator.
As we understand Mr. Belcher's views, it is that Northern Maine ISA supports the applicant's proposal for the method by which it suggests to determine ancillary service rates.

Now if I understand Mr. Belcher's position, it is that a cap has been applied in Northern Maine that prices that actually are charged to ratepayers are below this cap. And that the cap was based upon prices provided by New Brunswick Power, but that Northern Maine ISA did not in approving those prices see or have the information behind those prices, namely, the embedded cost study. Which is understandably why we saw Mr. Belcher question the reasonableness of an 18 percent ROE.

Now Mr. Belcher seems to imply that it would be appropriate because of the experience in Northern Maine where there is a bidding process, where there is an opportunity for market players to participate in that market. But those are not the facts and circumstances in

this market where this applicant wants to apply the same price cap. Ask yourself who it is that's going to be offering ancillary services. The evidence says there is only one party, the affiliate of New Brunswick Power Transmission.

It's for these reasons, Mr. Chairman and Commissioners, that while Mr. Belcher seems to support what the applicant wishes to do because of the price being consistent with the cap, the fact is that there are settlements of ancillary services based on a bidding process that will not be equivalent in the marketplace that will operate in this province following April 1, 2003.

Those are our submissions.

MR. SMELLIE: One more, Mr. Chairman, which was your last question. Which as I have it is does the Board have authority to require the system operator, contemplated by Bill 30, I take it, to conduct a request for proposal in the matter of ancillary services. That is to say, to solicit bids on an annual basis for the provision of those services subject to your oversight in order to ensure lowest possible prices.

The short answer is yes. Clearly an RFP process, Mr. Chairman, tends to impose a certain discipline on those

who are invited to participate. Obviously an RFP process works better, I suppose is the right word, when there is more than one participant and that may take some time in this jurisdiction. But with respect to your authority, the system operator is a regulated entity. It comes to this Board for the relief that it needs to do the tasks that are going to be assigned to it under the statute.

Section 136 I note of Bill 30 allows you to request information from the system operator. And if you request it, the system operator has to provide it.

Section 125 of the statute says this as well, "In approving or affixing just and reasonable charges, rates, tolls or tariffs the Board may adopt any method or technique that it considers appropriate."

And very briefly, Mr. Chairman, we would submit that requiring the SO to conduct an RFP process in order to arrive at just and reasonable ancillary service rates would be just such a method or technique that is within your purview.

Thank you, Chairman and Members, those are our submissions in response to your questions. We hope we have been of some assistance.

CHAIRMAN: Thank you very much. I'm trying to remember the order of intervenors. If you came last or if there was

someone after you that you had something you wanted to comment on?

MR. SMELLIE: No. I think Mr. Zed for NSPI came after us as did Mr. Belcher as well. So beyond that, sir, we have nothing.

CHAIRMAN: Great. Thank you very much. Mr. Zed?

MR. ZED: Thank you, Mr. Chair. Mr. Belcher did follow me and I don't know how Northern came after Nova but I guess that's the way it transpired. And I do have some comments about Mr. Belcher's testimony, if I might, by way of rebuttal and/or clarification.

Mr. Belcher indicated that he supported reciprocity. And I just want to be sure that no adverse inference was drawn as he followed closely on my summation. We as well support reciprocity. And the reciprocity provision contains a provision allowing for waiver and that's what we are seeking. It's not reciprocity with which we take issue. It's merely waiver. And I didn't understand Mr. Belcher to say we would not be entitled to such a waiver.

The other issue that he raised, and just I want to clarify this, he indicated, and I just briefly had an opportunity to review the transcript. But he seemed to indicate that we could overcome this -- the issue of reciprocity could be overcome if a waiver were not granted

by employing a third party to take power at the border. And that is certainly true. But I would just ask the Board to be mindful of the fact that that third party must be a third party, not a related party.

And, of course, there are obviously adverse economic implications for doing that. We have certain contracts in place, one of which the Board asked about and detail was provided. And those contracts will have to be continued to be serviced. And without reciprocity the economic liability of those contracts is going to be obviously modified.

CHAIRMAN: I have often wondered about this, Mr. Zed. If, for instance, Maritime Electric were to become a marketer or a broker, and I don't know the terminology under Bill 30, could it then buy at the Nova Scotia border?

MR. ZED: I don't know the answer to that because they are also a transmission provider in their own province and they are not a reciprocating jurisdiction. So it may be a situation where that's -- you know, I mean that's something obviously if this Board rules that a waiver is not granted, which we hope is not the case, the situation will have to be looked at. But it certainly will create adverse economic implications for my client.

CHAIRMAN: Maybe when we get to NB Power they can indicate

to us who bought at the border from them, without disclosing any commercially protected information. Just to know who it is that actually buys from them.

MR. ZED: My understanding is, subject to clarification, is that Emera Energy buys the transmission rights in this province. And Emera Energy buys from Nova Scotia Power and transports to NBCL.

CHAIRMAN: No. I'm sorry. Just to clarify that if NB Power, as Mr. Belcher as I remember his presentation indicated, NB Power perhaps did not have to go the route it did because it could sell at the border to somebody who was purchasing at the end of the MEPCO tie line at the boarder.

MR. ZED: I think to be fair, and maybe Mr. Belcher will want to clarify, but I think the third party issue really is there is always ways to get around the actual delivery of electricity. The question becomes how many parties are involved and how economic is it if you have to intercede a third party in between. I think that's really the issue is that there are obviously financial consequences of delivering to different points and having third parties pick up some of the chore, so to speak.

CHAIRMAN: Okay.

MR. ZED: So that presents us with the, as I say, the

reciprocity we support, waiver we support. And the intercession of a third party is not a simple solution and it may not be a practical solution.

The other issue I would like to clarify, and it arises out of a question that you asked, Mr. Chair, regarding Mr. Connors' characterization of the problem with developing NOATT. And I guess I read it. And to be fair, Mr. Connors did characterize it as more of a practical than a legal problem. But I think in fairness his testimony indicates that it is not an easy practical problem to solve. It's still a considerable problem.

Finally, I would like to deal with your first question posed as to the contracts, and specifically with respect to the MEPCO tie, but I'm not sure exactly what the question relates to.

CHAIRMAN: To refresh my memory without my having to go back to the transcript, Mr. Zed, I was asking about all of the interconnections in NB Power. And I believe you came back to us about the nature of the contracts that your client has with PEI with Maritime Electric.

MR. ZED: Yes.

CHAIRMAN: Could you reiterate that for clarity sake to me? How long is that contract for?

MR. ZED: Well, the only contract that I am prepared to

respond to right now is the Maritime Electric contract.

CHAIRMAN: Yes.

MR. ZED: And that expires December 31st 2004. There is no right of renewal in the contract. Of course it is subject to any renewals that the parties themselves may negotiate. And that contract is between Emera Energy and Maritime Electric.

I really am not in a position on 25 minutes notice, if that's what the question is, to respond to what other contracts we might have elsewhere. And even if I knew what they were, of course there are issues of confidentiality that would have to be dealt with. And even tomorrow may not present an appropriate time frame.

As you may recall, the last time when we dealt with the Maritime Electric contract we had to receive permission from Maritime Electric before we could divulge the information. And the gentleman with whom we had to make contact was away for two weeks over Christmas. And so it's really not a simple matter of -- and, again, most of these contracts are private in nature and bipartite.

So if what you are asking is the contracts for reservation capacity on the tie lines, I can speak to that.

CHAIRMAN: We would like to know that too. All we are

looking for in reference to the contracts, both kinds, is what is their duration, how long do they last, not who the parties are, et cetera. I'm sure that NB Power will probably, when we get to them, be able to indicate to us as well what they might be.

MR. ZED: Let me refer the Board to a number of references --

CHAIRMAN: Yes. Great.

MR. ZED: -- and perhaps that will -- first of all in Emera Energy's evidence at appendix 1, which is at the end of the evidence, there is attachment A, and that is a list of existing agreements that NB Power is seeking to preserve. If we look at NB Power NSPI IR-28, which is at page 245 of exhibit A-4, there is a table which provides details on the individual reservations that make up the 720 megawatts of firm reserve capacity on all of the New Brunswick ties. You will note from that that approximately 670 megawatts relate to the MEPCO tie.

If I could refer the Chairman and the Board to the transcript at page 232, Mr. Marshall testifies, and if I may paraphrase, that 90 percent -- that's his number -- of the MEPCO tie is fully subscribed by NB Power Generation. 90 percent of it is subscribed. Of that 90 percent I believe he said, and I will read it here, about 33 percent

of that is under long-term firm contract.

Now I will refer the Board generally to my cross examination of Mr. Marshall back pages roughly 180 to 188, and there was a discussion of how those figures came to be. But our simple point is, let's get away from whether there is a reservation with respect to transmission or a reservation with respect to power. Our simple point is if NB Power Generation has either a power contract or just a transmission reservation that is backed up by a third party contract, we take no issue with that. In other words, the 33 percent, assuming Mr. Marshall is accurate, we take no issue.

CHAIRMAN: I understand that, and you were quite clear in your presentation on that, Mr. Zed.

MR. ZED: Okay. All right. Now why I am getting to that is you further asked the question about -- what was the word we used -- Mr. Belcher's word --

CHAIRMAN: Hoarding.

MR. ZED: Hoarding. And hoarding, as nearly as I can tell, is exactly what it sounds like. What remains a bit of a problem for us is it was dealt with -- several of us have caucused and it has been dealt with in I believe FERC 888, but none of us have that excerpt here present. And apparently I am led to believe that it has been dealt with

and defined by a number of FERC rulings. But on short notice, Mr. Chair, I'm going to have to undertake to provide that information tomorrow. But regardless of whether the definition is helpful or hurtful, the real issue becomes you have an opportunity to avoid the situation at the outset and so I think to that extent we would say whatever we provide you on hoarding is for the benefit of the Board, but get it right, as everybody has been saying from day one. And this presents an opportunity to do just that by not grandfathering the 67 percent of contracts that are not supported by third party contracts.

Beyond that, Mr. Chairman, I have nothing further.

CHAIRMAN: You are not going to tackle equity? I just wondered if you wanted to buy and sell a house, that's all. Thank you, Mr. Zed. Energie Edmundston?

MR. YOUNG: Mr. Chairman, when it comes to the Saint John Energy slot I will speak for the MEU's.

CHAIRMAN: All right. And Mr. Gillis is not here. Mr. Smellie and Mr. Nettleton have already done their thing. Maine Public Service Company isn't here. Mr. Belcher?

MR. BELCHER: Good afternoon. My response is basically to Mr. Sollows -- Commissioner Sollows.

Regarding statutory basis to rely ancillary services

on proxy costs, we are establishing a market here and there are FERC where they do establish caps. Some of the caps may be arbitrary. In my particular market, Northern Maine ISA, that is approved by FERC. They realize that the caps for ancillary services are based on a contract with New Brunswick Power. In that particular contract the cap is based on an embedded cost. However, our analysis saw that it was consistent with costs for a new unit. So as far as anything statutory I cannot quote any, but just with FERC relying on caps, whether they are arbitrary or based on cost, there is precedent there.

Regarding whether NB Power's embedded cost study is consistent with FERC, there is one check with that. FERC on their website provides a quick and dirty calculation for fixed charge rates for generators. It's a spreadsheet that you can download and do a fairly quick test, and it was provided or established initially for power marketing rates, caps on power marketing rates. If one was to do that spreadsheet based on NB Power's costs, they would probably have a fairly good idea if they line up and if they are consistent.

As far as discounting ancillary services below proxy or embedded cost, are you going to under-collect I believe is the question, or similar to. The answer to that is I

feel that the units that supply ancillary services not only supply ancillary services, they are there for other reasons. And if they don't discount down below then they will have lost opportunity costs which occurs in our market, although New Brunswick Power is the default provider and the total amount of ancillary services that we are responsible for is 22.4 megawatts, they don't serve -- I think they only serve approximately eight megawatts of that. That's on their website posted daily which can be seen with what amount is available for bid and what amount is self-supplied.

So by having caps as your ancillary services, cap rate, other people can bid in or self-generators can self-supply. It's no different than being an interruptible service if you can get off the line -- if you can get off line within ten minutes you essentially can self-supply your ancillary services. There is provisions in the market rules for that.

Regarding hoarding, I tried to contact our FERC attorney and couldn't get ahold of him, couldn't get a line through to DC, I don't know if there is still snow down there or not, but there are cases that have been brought in front of FERC since Order 888 have come out regarding hoarding and there have been rulings on them.

And I agree as far as the SL having the authority to do an RFP -- do an RFP for ancillary services, I would agree with Mr. Smellie that you can, and that it is actually their obligation, to continuously try to lower ancillary services. It's a market. That's the whole idea of it is, to try to get those ancillary services down as much as possible. And I believe that they will go down in the region. Although New Brunswick Power appears to be the only supplier of it in our market. They are the only connection we have and we do have, as I stated earlier, other people -- other contractors supplying ancillary services.

And then just to quickly comment regarding reciprocity and selling at the border, the comments yesterday. New Brunswick does that now for Northern Maine. They do not -- they are not a marketer inside our market. They sell to our market at the border. And we also have for ancillary services other entities outside of Northern Maine that are serving -- supplying some of our ancillary services and we have contracts with them. So you can sell at the border and across. It's just a matter of who is buying.

Thank you.

CHAIRMAN: Thank you, Mr. Belcher. Mr. Knight? No comments. So Mr. Young and then Mr. MacDougall.

MR. YOUNG: Mr. Chairman, I would like to comment on the following questions. Number 1, current contracts for transmission capacity. Currently, from our understanding, these are legal existing contracts that should not be breached but renewed through a bidding process at a future clear and reasonable time frame, a sunset time frame, of preferably five to 10 years.

Question number 3, addressing the issue of wind energy. The MEU's, especially Saint John Energy, is very interested in green power in its many forms including wind energy. Saint John Energy is currently involved in a feasibility study with its partner City of Saint John and UNBSJ.

Our concern currently is the wind energy policy needs to be clearly defined before we can offer this product, the green power program to our customers. And as yet we haven't seen that clarified.

Question I believe 17, system operator supply of ancillaries. I believe the draft market rules appropriately handle this issue by indicating that the system operator has the authority to issue an RFP to add additional ancillary supply beyond existing heritage ancillaries as the system requires, not based solely on a yearly time frame or calendar.

And yes, this RFP and acceptance of it, the award should be subject to the Public Utilities Board. And we believe it is, as written in the current draft market rules.

CHAIRMAN: Have you gone far enough, Mr. Young, in reference to wind energy to have any suggestions on how we proceed other than what NB Power has suggested is that there is no one able to put power into the network today from wind power, therefore it would be something that would be dealt with in the future?

MR. YOUNG: I believe so. I believe NB Power is heading down the right road in that direction. And it is a matter of us waiting for legislation to fall in place first. Our concern is heading way out in front and finding out legislation veered off to the left.

CHAIRMAN: Thank you, Mr. Young. I'm not turning any corners here this afternoon.

MR. YOUNG: No, sir. I just made the comment.

CHAIRMAN: Mr. MacDougall?

MR. MACDOUGALL: Mr. Chair, I will move up to the front here.

CHAIRMAN: And then it would be our intention, after Mr. MacDougall, to take a 15-minute break. And then we will come back for NB Power.

MR. MACDOUGALL: Mr. Chair, Commissioners, thank you for the chance to do the rebuttal argument on behalf of WPS. What I would like to do is start with some reply argument and after the reply argument answer some of the questions posed this morning, principally if not solely those from Commissioner Sollows.

And I think in doing part of our reply it may answer some of the questions or help lead in to the follow-up answers that we will have for the questions. So I will do it in that order.

Mr. Chair, the issue of ancillary services is complex. There is no doubt about some level of complexity. But I think all of the issues before you are complex.

However, with due respect to Mr. Nettleton and his comments on this complexity, we don't believe the record is complicated. And if it is complicated we feel it is complicated because of some of the items JDI has put onto the record and how they have approached those items.

So what I'm going to try to do briefly, if I can, is try to uncomplicate this record. I'm going to start with the issue of the energy production credit. Now I'm hopeful that after I'm finished, it will be an issue that you will not have to spend much time on.

Mr. Nettleton said that Mr. Porter did not address why

a credit for energy production was not appropriate. With the greatest of respect again, Mr. Chair, Mr. Nettleton failed to indicate that Mr. Bishop fully addressed this matter in this record. Two short quotes will illustrate the position on the record on this point.

First off, Mr. Bishop at page 2348. "In the embedded cost study there is already provision for the fact that generation is used to provide both energy and ancillary services. So in the calculations, as you go through the schedules, it is a determination of how much of the capacity is not online. You can look at the availability factors and the capacity factors or as not producing energy including export energy. And it is that portion of the capital cost that gets allocated to the ancillary services. In other words, in this calculation, in the calculation of each of these schedules, only the portion of that generation that is used for supplying ancillaries is costed to need a derivation of revenue to cover those ancillaries."

In my view, Mr. Chair, that could not possibly be any clearer. However, to make it clearer sometimes people use examples. That is what Mr. Bishop subsequently did. He did that at transcript page 2350.

Mr. Nettleton: "Well, it has been based on

capability, correct, not actual energy production?" Mr. Bishop: "It is one is the inverse of the other or one is one minus the other. When a 300-megawatt unit is producing energy to the extent of 150 megawatt-hours per hour, then in fact we note 150 megawatts, the remaining portion, as available for the provision of the ancillary service."

Now Mr. Chair, Commissioners, that is exactly the point. If for example -- and I will go away from

Mr. Bishop's example and just pick a unit in New Brunswick -- Coleson Cove was producing 200 megawatts of energy and was capable of producing 300 megawatts, then only the 100 megawatts left available for spinning reserve for example is to be costed. There is no energy cost for this 100 megawatts and thus there is no credit for it.

In the proxy approach it is a new unit that can provide both energy and ancillaries. Since you have both you need to give some credit for the energy. But in the embedded cost study that NB Power did, that has already been taken account of.

Now if we back to JDI-31, that is the document where JDI purported to take an embedded cost study that was only based on the amount of capability for ancillaries and then have an energy production credit. Well, that is just an

absolute double count. It has been taken account of. It is clear on the record that it has been taken account of. There is absolutely no basis whatsoever to give an energy production credit when it has already been accounted for. It is a mixing of apples and oranges to come up with, and as Commissioner Sollows noted at the time, extremely low rates.

If 38 million of the proxy is only a portion of 48 million -- look at the numbers from this document, 20 million and 25 million in revenue.

Now likewise, with the greatest of respect to Mr. Nettleton, he says that they did not bring a witness on this document because he could not attend in the shortness of time.

I do not recall JDI or CME making a motion for an extension, asking to bring a witness, doing anything. I have my views on why you wouldn't bring a witness on this document. And I have just put them before this Board.

Plus Mr. Smellie yesterday in his argument, talking in relation to NB Power's lack of a witness from the investment banking community, says documents not supported by witnesses should have no probative value. I believe those were his words. We concur.

Now Mr. Chair, to go to the second option put forward

by JDI, CME, the use of the three-year NEPOOL average price. Mr. Chair, Commissioners, as I think it was clear or we thought it was clear, NB Power noted this in their argument.

NEPOOL is a much bigger pool with a much smaller ratio for required contingency reserves. So New Brunswick, where we have a ratio based in part on Point Lepreau, the single contingency compared to the size of the market is much more significant in New Brunswick than in NEPOOL. This is just a fact.

So the ratio in New Brunswick is much higher. And this is used as the basis for the determination of items such as 10 and 30-minute spinning reserves. But that is completely appropriate. Those are the numbers that are meant to be used.

What is important to note is that both NB Power referenced this, but JDI also referenced Dr. Earle, who was JDI's own witness, saying that it is counterintuitive that NB Power has low energy costs but high ancillary costs compared to NEPOOL. However the explanation was it wasn't counterintuitive in the context of the size of the ratio share based on the largest contingencies.

However, I didn't see JDI saying oh, because NB Power has lower energy costs and higher ancillaries, the

ancillaries should go down. That is what they said. What they didn't say was oh, maybe the ancillaries are -- maybe the energy prices of NEPOOL should be put into this market.

So when you look at these comparisons of where the ancillary price is compared to NEPOOL, you also have to look at energy prices. And I commend the Board to look at energy prices in NEPOOL compared to those in New Brunswick. And you will also see phenomenally big differences.

So you can't just pick and choose. That is absolutely inappropriate. It is a totally different market with totally different market structures. You can use methodologies that are approved. That is why that is appropriate to do using FERC methodologies that are often put before the parties, because they have been looked at a lot. But you can't just pick and choose numbers to put in them based on another market that isn't this market and isn't based on these market structures.

So again we just see no validity in using NEPOOL three-year averages for the opening of the New Brunswick market. Their irrelevance is extreme.

Mr. Nettleton, Mr. Chair, said that NB Power may have used the embedded study, that is the new embedded study,

the current one, to prop up the proxy. This makes no sense to us at all, since it is the old 2000 study that if anything was supposedly consistent with the proxies. The new study shows that the actual revenue requirement is some $10 million more.

I can't impute any bad faith notice to NB Power. They are putting forward a proxy approach which we have fully argued why we think that's inappropriate. However, when this Board asked them to put forward an embedded cost study, they did so. And we believe they did so correctly, subject to my next point which is another point of clarification.

Mr. Nettleton said that I tacitly agreed with a 55, 45 equity debt ratio with respect to Generation. Well, at page 2611 of the transcript I quote what I said in my argument, after speaking about that number being on the record. "We have no specific position on this point,

Mr. Chair, except to note what is on the record in this regard."

Then at page 2613 we commended the embedded cost methodology to you. And then again I quote "Subject however to the Board's final findings on the appropriate capital structure and cost of capital to be subscribed to NB Power's generating business." That is our position.

It was our position. And it is still our position.

The reason I particularly raised that latter point is that Mr. Nettleton then followed up with a statement that -- and this was his words -- that this is the epitome of self-interest, and that this wasn't being put forward because of the creation of just and reasonable rates.

Well, first we did not make the statement of tacit acceptance of 55, 45 percent. More importantly we believe this is a completely unfair characterization of WPS' position.

From the outset, WPS saw the proxy approach creating unfairly low costs and prices that would stop the development of the market. Our position couldn't be much clearer on our cross examination and our subsequent evidence in that regard. We are here today, as we have been from the outset, to argue for just and reasonable rates.

Mr. Nettleton also said WPS may well want to compete in the market using the NB Power cost as a benchmark. Exactly, Mr. Chair. That is exactly what we want to do. We want to be able to compete in the market using the proper prices and costs as a benchmark. And I will come to the cap and the issue that Mr. Belcher quite adequately and appropriately just discussed.

But that is the entire point. This process is part of a New Brunswick market opening. That is the intent of the new legislation, the intent of the energy policy, the intent of this proceeding.

You put a transmission tariff in place to help open a market. That is the goal of all parties here, from what I can understand. The Province wants competition. WPS wants an opportunity to compete, but to compete fairly against true costs. To impute any other motive to my client is unfair.

Mr. Smellie said yesterday it is important to have correct and accurate going in rates. He said that is crucial. Again on that point we completely concur.

To come now to Mr. Belcher's points and this was a point I was going to raise in any event. As NB Power noted at various times during this process, Mr. Chairman, NB Power noted this, Mr. Bishop particularly noted this, these ancillary service rates will be a cap in the market. And that is appropriate. Competition can then reduce the price if it can materialize. Setting an artificially low cap, however, based on proxy prices that do not reflect the embedded costs of NB Power just ensures that the market may never develop. And no new parties will be able to enter this market.

Let's get it right in New Brunswick, Mr. Chair, Commissioners. Let's let the market open and if we get it right and everybody is encouraged to participate, everyone will be treated fairly and hopefully we will have the right prices in this market.

The market is going to start with NB Power, Mr. Chair, but we have to note -- this is Mr. Marshall, not WPS but Mr. Marshall noting at transcript pages 1877 through 1879. "Now in the free market WPS Energy Services could choose to sell those services to Saint John Energy". He is there talking about ancillary services that it supplies from its tinker plant to northern Maine.

They don't have to continue to sell them into northern Maine so there are sources that may be available in the market that free parties would negotiate an agreement. That's the whole purpose, Mr. Chair, to open a market so that those parties who are potential participants can do so.

CHAIRMAN: Just so I understand you, Mr. MacDougall. Your client can sell into the northern Maine ISO?

MR. MACDOUGALL: That's correct. And does so.

CHAIRMAN: Thank you.

MR. MACDOUGALL: Mr. Chair, just a few comments on the applicant's statement. Mr. Morrison in here -- I don't

have the transcript reference, Mr. Chair, I'm using -- it's document reference page 13 of the handout that they gave out as part of -- as a copy of their submission.

On page 13 in talking about the proxy unit approach, item -- bullet 1 under item 1, NB Power says that proxy pricing provides appropriate pricing signals to suppliers because 1) it provides adequate compensation to the supplier. But, Mr. Chair, that is not necessarily what the record says about proxy pricing. What it says is that because this is still a bundled utility, generation is being kind of told or someone is telling someone that these are what the prices will be. And this will be the proxy unit and new generation will accept that proxy unit. That's what we see on the record. We are not imputing any motives, we are just saying that's the situation. That's what the situation is on the record.

We do not have generation as a separate entity saying that this is providing adequate compensation. What we do have is an embedded cost study that shows it is not providing adequate compensation.

The next point, Mr. Chair, is that proxy pricing does not set the price so high as to motivate self supply that would not make good overall economic sense. Well as Mr. Belcher just said, there is nothing wrong with promoting

self supply. This is a market opening. This is what it is for, to give a whole bunch of people the ability to try and get self supply if they want it. That's the purpose of this.

And then the next point, does not set the price so low that there is inadequate incentive to promote the introduction of new supply. Well clearly you know our views on that. That is what the proxy pricing is doing, it is potentially setting the prices too artificially low. So rather than setting a cap at the true prices, it is setting a low cap. Well if it is a cap that people can bid into and under, then that is fine. But you can't set it so low to begin with that no other market participants will come in.

That is the whole point that we have been trying to make here at this proceeding.

And finally item number 3 on page 14. Mr. Morrison talked about proxy pricing will facilitate investment decisions by providing more predictable pricing.

Well again in our submission, proxy prices that are unduly low will not facilitate investment decisions to encourage anyone to compete in the marketplace.

Mr. Chair, a couple of comments on Mr. Belcher's initial submission and then I will respond to some of the

questions.

Yesterday Mr. Belcher in talking about proxy pricing said that he thought that it was a surrogate of some sort for long run marginal cost. But then he went on to state this, which is quite enlightening in my view. There is some concerns with proxy pricing in regards to its sort of surrogate for long run marginal costs. So typically this will not be equal to the actual costs. So some sort of reconciliation occurs so that you can put the costs back to the proper revenue requirement.

So he acknowledged that where the proxy pricing doesn't equal the proper revenue requirement, adjustments are usually made. But then he went on to say, In this case, however, since NB Power seems willing to take the risk why do we care? That's the problem here. Does NB Power Generation really wish to take that risk? What the record says is NB Power as it is now situate says this is -- we are going to use the proxy method and this part of the business will supply at that proxy. That's the difficulty we have there.

So we think in order to overcome that let's put it back to the proper revenue requirement.

Mr. Chair, before I get to the questions, we have one item in reply that we really didn't anticipate Mr. Belcher

dealing with. But since he did, we have to make a few comments on it which really require a reference back to the record, because Mr. Belcher dealt with it very generically but I think for us to show the point we have to refer back to the record a little bit. So I would ask that people could pull out exhibit A-2, NSPI's evidence.

And the two places I'm going to look, Mr. Chair, are page 45 of appendix B, NB Power Transmission tariff design, and page 69 which is schedule 1.2. Those are the two pages I will reference, page 45 and page 69, schedule 1.2.

Tab appendix B, NB Power Transmission tariff at 4 -- I guess it's appendix B to tab 4, Mr. Chair. Actually it's the last document in the binder.

Thank you, Mr. Chair. I apologize. I could have forewarned you that I needed a few pages.

This issue is one that we hadn't dealt with but we didn't expect any parties to raise this, so we do have to make some comments on it, and maybe -- I haven't talked to my colleagues across the isle here, but NB Power may be making their own responses to this.

But this has to do with the concept yesterday raised by Mr. Belcher of load ratio share for ancillary services.

And you will recall what he said is that the current

process to come up with the load ratio share, and if you look at schedule 1.2, he says, the current item has Nova Scotia in, and he thinks that Nova Scotia should stay in. And you will see what NB Power has done here is in the third line under Maritimes Control Area load share ratio, it then says, without Nova Scotia, and then it comes up with the various load share ratios.

Mr. Chair, what we would like to point out to you is a couple of items. First off, this current method, if you look at it at line one, says peak load using 12 CP. Okay. Now the current method uses one CP. The new method proposed by NB Power uses a 12 CP method.

Secondly, if we go to page 45, line 11, it reads, the portion of the first contingency in excess of ten percent of annual the peak load, i.e., 5,000 megawatts for the control area, shall be the direct responsibility of the owner of the first contingency.

That again is new. That isn't the case as it currently exists in the relationship for load ratio share now. So we are moving to something that reflects that ten percent of that contingency will go to the owner of the contingency where it's greater than ten percent of the overall load.

And what is more important is if we go to line 20,

operating reserve sharing agreements have been made with Nova Scotia Power, Maritime Electric and Northern Maine. Then more particularly the specific items dealing with Nova Scotia are referenced in NB Power's testimony. Nova Scotia Power provides 125 megawatts of contingency reserve for the first contingency, of which 25 percent is spinning and 75 percent is supplemental.

So that's a relationship that has been put in place and that NB Power is using in coming up with their reserve requirements on schedule 1.2. Okay.

All we want to point out is there has been numerous changes made to this and the changes are reflected and build on each other to create what we believe is the right load sharing ratio. You can't again tinker with one point and say, let's put Nova Scotia back. And the point that I will show you why is if you look at without Nova Scotia, what they have essentially done is there is no percentage along the line here, whereas Nova Scotia has 1,598 megawatts in the first line, which is approximately 40 percent of the Maritimes' control area of 3,926. So the ratio of the 1,598 to the 3.926 would be approximately 25 percent -- would be approximately 40 percent.

If you go down below under Nova Scotia and you see spinning reserve 10, that's 25, supplemental 100, for a

total of 125, then the ratio would be much higher if you put -- if you put Nova Scotia back in you would have to re-jig all of these columns. You couldn't then just rely on the agreement with Nova Scotia because then it would be out of whack.

And that's why Nova Scotia is out. Our understanding is Nova Scotia is out because this arrangement is in place with NB Power to deal with that issue, and if you just then put Nova Scotia back in, the numbers don't work appropriately at all. And you would have to significantly revisit this issue.

So I believe the concept of -- for Mr. Belcher just saying we should put Nova Scotia back in because they already have been in, doesn't take account of any of the other factors that occurred in this calculation.

Mr. Chair, now to deal just with some of the questions that were put forward by Commissioner Sollows. I am hopeful that some of the comments we made in the reply might have addressed some of those issues, but to go to them a little more specifically.

The first issue had to do with whether the Board's hands were tied by any sections of the Act in using a future test year where I think he indicated that proxy costs don't exist on the system during the test year or in

the future.

I would like just to leave the Board with a few references, and I will make a couple of comments on them, but references that I think in your deliberations may be useful to you.

A little bit of the difficulty in your deliberations will come from the fact that you are in transition. So right now if you are looking at Bill 53 which changed the Public Utilities Act, or a consolidated version of the existing Public Utilities Act, then this application is under Section 62, 1 and 2. Section 1 deals with transmission services, Section 62.2 deals with ancillary services.

At the time this was put in place though there is no reference to an SO. The SO has become part of the larger electricity restructuring regime. When these sections were put in place presumably the intent was to allow NB Power to make an application to move this along because this was something that was going to take a lot of time to occur and we were looking for an April 1 opening. This was put in place in advance of making the holus bolus changes to the Act.

So when you do look at that you have to look at those sections because that's what the application is now under.

Then we flip over to Bill 130 which is the legislation that respectfully may be or may not finally be, depending on how much filibustering occurs in your legislation I guess before you when you make your final decision. I guess that's another decision you have to make as to when you are going to do that.

What I do note is that the new legislation provides that in section 155 essentially a continuance of an application that's -- this application that is before you, it's written in generic words, where the Board is conducting a hearing under part 2 or 3 of the Public Utilities Act in the transmission Section 62, part 2, immediately before the repeal of those parts which have not yet been repealed, it shall continue the hearing in accordance with the provisions of this Act. Whether -- you will have to make an interpretation whether continuing the hearing deals with your deliberations as well, and I presume it does, it's a continuation of the open hearing.

The reason I raise that is if we look at the similar provisions of the legislation at Section 111 to those of Section 62, they are not the same. They are not the same because they contemplate an SO. But further than that in the particular section in question, Section 62.2 now before you dealing with ancillary services, it deals with

a transmission provider, and all it says is that you may base your order respecting the tariff on all of the projected revenues from the sale of ancillary services and all the projected costs to be incurred by the public utility. So there is only one item referred to, that basis.

However, under Bill 30, Section 115.5, there is another piece added to that section. The Board shall, when considering an application by the SO, in respect of an approval of a tariff pertaining to ancillary services, allow in its order or decision for mechanisms to recover the reasonable costs incurred by the SO in the acquisition and provision of ancillary services, or base its order or decision in respect of the tariff on all the projected revenues in the sale of the ancillary service.

Mr. Chair, Commissioners, I can't tell you exactly what to do with these sections. I can point them out to you. I think the move here is to create a transmission tariff that will then be rolled into the SO. I would presume the most guiding principles are Bill 30. I will take the huge leap in faith that Bill 30 will be out and you will be continuing your deliberations, and I leave that to you, because the wording there seems to provide more flexibility than the wording under the initial

legislation.

I would rather not make a further determination. I think you may have to look at that in your deliberations.

However, I would also like to point out, and I believe Mr. Smellie did this as well, Section 125, sub 1, which is that in approving or fixing just and reasonable charges, rates, tolls or tariffs, the Board may adopt any method or technique that it considers appropriate, including an alternative form of regulation.

Again, however, unlike Mr. Smellie I don't think I will make a final response on it, but I do believe the Board has to read that and read Section 111, and see if there is any dispute between the two, any conflict between the two, or whether they work in concert. But they certainly seem to give some level of flexibility to the Board in dealing with that matter.

So I guess I wouldn't say your hands are tied but I do think you have to read those provisions and be -- those are the provisions that I feel you need to be aware of.

Your second question, Commissioner Sollows, was, should we rely on the most recent filing based on actual costs consistent with FERC -- I'm trying to paraphrase, I was writing quickly when I was taking it down -- prior to the development of the markets where FERC may have been

implicitly relying on the fact that most of the utilities before them had been regulated by state Boards and you could rely more or less on the embedded cost analysis.

Well I think there is a couple of points to be made there. I don't think that just because NB Power hasn't come before you in a period of time, that they weren't subject to or could be regulated. First off they were a part of the Crown and they were operating in a certain manner under the direction of the Crown, and they were certainly subject to certain regulation if they carried out certain activities.

I think what is more important is the legislature has given you guidance, be it right or be it wrong, it is in the legislation. And I guess I would refer you to Section 156. And I may as well read this into the record. I think it's useful.

For the purposes of the first hearing before this Board under division B of part 5 and for the first hearing before the Board under division C of part 5, one is distribution and one is transmission, so once we are into this legislation and if that's a continuation of the other hearing under this part, then the assets transfer by transfer order or otherwise attributable by virtue of a transfer order or assets otherwise acquired by the

distribution corporation, the transmission corporation or the SO, on or before April 1, 2003, shall be deemed to have been prudently acquired and useful for the operation of a distribution or transmission system or the provisions of the SO. And any expenditures arising from distribution service contracts, standard service contracts, power purchase contracts, transmission service contracts or ancillary services contracts, entered into or before the commencement of this section are deemed to be necessary for the provision of the service.

I'm not going to interpret that for you. I think the legislature made its views known. If you want an answer to this question I believe it's Section 156. So I believe we can presume that the embedded costs are appropriate because, not that a legislature is better than a Board, God forbid I would say that, but this legislature has told you what it thinks on the view and that's all I can say on that point.

Now your next issue I believe was the capability to -- where NB Power's capability substantially -- capability to provide ancillary services substantially exceeds its capabilities.

Commissioner Sollows, with the greatest of respect, I don't know that the record is actually clear on that. I

believe Mr. Bishop said in certain times we do exceed them by a lot, in certain times we don't. In certain times they have to buy from the market. This is the whole concept why it's appropriate in New Brunswick to use recallable energy supplies, because they have developed some stuff for energy, then they can sell it into the market, but then they can recall the ancillaries. Sometimes they have to do that. Sometimes they do have units out. Lepreau is a single biggest contingency in this market and we know the history -- the recent history of Lepreau on some of these issues.

So I don't believe that's appropriate. Ancillary services are there. Capability has to be there, particularly in this market where we talked about the difference between here and NEPOOL. This market has a large single contingency to the market and we have to be ready to deal with that. And that's why those capabilities are there and that's why they are costed for being there.

So I have to disagree with your question because I don't believe that the record actually supports that these capabilities aren't fully utilized. They may not be fully utilized all the time but they are a form of insurance. They are a form of fire hall. I have to totally agree

with Messrs. Porter and Bishop on that. That is what they are.

Your next point was this concept of NB Power's witnesses saying their willingness to discount even below the proxy costs, and how that ties into this.

Well I actually believe you had posed a question on JDI-31 to Mr. Bishop, and he said, well we wouldn't be discounting to those numbers. But I also think we have to understand the marketplace. What is supposed to happen here, or what should happen, is that a cap can be set and other parties can bid into it. So the cap causes the exact same protection in New Brunswick that Mr. Belcher said would happen in Northern Maine. And then parties can come into the market. Now NB Power can't then willy-nilly go and discount. And I think the discussion -- the record may not be clear, but let me give you my views on it.

What was said in the discounting was if the SO acquires some ancillary services and can get them at a lower cost, well that may only be a portion of the market. And Mr. Bishop said, well if that's only ten percent of the market we may not discount it all, you know, we might not have a problem with that. We will keep our market share at our other price. And also if that ten percent comes in well that will be shared out. The SO will then

have a lower overall cost. And my understanding is the discount will then go because it's an overall cost that the SO is charging.

I know the record was unclear because I think at times what people were doing was talking about two different aspects of the market. There is the bilateral contract market that may be outside some of this fear, where people can actually have bilateral contracts with parties. But then there is also the SO and what is the SO's obligation? I think Mr. Belcher very clearly said what it was and if someone comes in, that will lower the overall ancillary services cost. And we believe again that's the way the market is supposed to operate and our cross examination and our points to date have always been on that basis.

But if you have set an unusually low cap to begin with, then it isn't a cap.

Mr. Chair, on I think it was the last point -- I mean, on this part I guess I was writing while you were speaking again, and I think it was does the Board have the authority to order or to have the SO respond to an RFP to solicit bids to look for the lowest possible price.

And again on that point I think with the earlier point I will just lead you to where I think some guidance might be found in the legislation.

In this case in Bill 30, that's all we can talk about here because the SO concept isn't in the earlier legislation. I think we should start with Section 42(d), which says, what are the objects of the SO? So Mr. Belcher said them anyway but I think you were looking for some specific legislative references, so I will take his generic and make it more specific.

The objects of the SO are 42(d) to procure and provide ancillary services. Then I think you have to look again at Section 111(5) and 111(6), which I referred you to earlier. Particularly the provision of 111(5) that says the SO, in respect and with approval of the tariff pertaining to ancillary services allow in its order a decision for mechanisms to recover the reasonable costs incurred by the SO. There may be some guidance there.

Section 111(6), the Board at the conclusion of the hearing shall approve the tariff if it is satisfied the tariff applied for is just and reasonable or if not so satisfied, affix such other tariff as it finds to be just and reasonable. And set the time at which any change in the tariff is to take effect.

Then Section 128(1)(b) is your general powers of inquiry. And 128(1)(c) that deals with your ability to rule in relation to market power. And I think some of

your further general powers in that regard are set out in Sections 129 and 130.

I also would like to point out the market rules, again Mr. Belcher spoke about this generically, but they are part 4 of the legislation. And in particular Section 63(1) talks about appeals, you know, if people are dissatisfied with how things are working in the market place under some of the market rules. And in particular I refer you to Section 63(1)(b) and (c).

I think the intent here is to have a market develop. To have a cap, not an unreasonably low cap but an appropriate cap that shows the embedded costs the parties have to compete against from the NB Power system to allow a bilateral market to eventually develop and to allow parties through the rules or through the legislation to provide ancillary services tariffs, if that's what they want to do.

I highly doubt that if the SO had someone come to him who says we could provide some services at a lower value that the SO isn't either going to be before you to do that, or that if they don't come before you to do that, the party who can supply those services would come before you to do that.

So certainly bidding into the market, that's what this

all anticipates. You may not find a section there that says you can order the SO to do that. You may not have to do that. I believe once the SO is set up that's its obligation to provide and procure ancillary services. It's not to do it at the highest cost. I think that will be pretty clear to the SO.

I don't know if you have to do that but I think the bidding system will start to mature and to work. It will only do so though if we start off with the proper and appropriate prices.

Mr. Chair, that is my comments. I'm the last I think before the applicant, so --

MR. SOLLOWS: If I could just ask one -- it will clarify one remark that you had made. You commented that NEPOOL energy prices are much higher than they are here. I'm sure you have knowledge of them. And NB Power hasn't -- none of this has really dealt with energy prices. But I heard on the radio this morning on my way in that their typical energy price here is 5 cents per kilowatt hour Canadian. And when I look at the New England average energy clearing price since market inception, it comes out to about 5.8 or '6 cents Canadian a kilowatt hour.

Do you feel that that is a very significant difference?

MR. MACDOUGALL: My understanding -- and again Mr. Howard isn't here with me now and I don't know if it is appropriate for us to put anything on the record. But what you will have to look at though, Commissioner Sollows, is the wholesale prices in NEPOOL and not --

MR. SOLLOWS: Not the clearing price?

MR. MACDOUGALL: No. The wholesale market prices in NEPOOL, if you look at the ratios between them and -- and I think the record is clear because even Dr. Earle says that the reason he had an issue with this, is he says you in New Brunswick have lower energy prices, why do you have higher ancillaries? Well that means NEPOOL has higher energy prices and lower ancillaries.

I think if you look at the numbers -- and I don't want to be presumptuous to put numbers on the record but Mr. Howard told me what they were for January between the two and the wholesale market.

MR. SOLLOWS: They are very high right now, there is no question.

MR. MACDOUGALL: They are very high right now. But the point to make is they are very high not everywhere. They are very high compared to New Brunswick.

MR. SOLLOWS: Yes.

MR. MACDOUGALL: And you can't come in and say I want

NEPOOL's ancillary prices but not their energy prices. It's -- you know, it is mixing apples and oranges in our view and that's why we make the point.

MR. SOLLOWS: Thank you.

CHAIRMAN: Thank you. Mr. Smellie, Mr. Nettleton, are you still planning on vacating the premises shortly after 4:00?

MR. SMELLIE: We will have to talk, Mr. Chairman, during the break that you scheduled.

CHAIRMAN: Well I --

MR. SMELLIE: I suspect Mr. Nettleton may be back.

CHAIRMAN: Well then if you are not here when we come back and I have some nice things to say about you and your participation in the hearing, Mr. Smellie, why Mr. Nettleton will pass it along to you, I'm sure, sir.

MR. SMELLIE: I appreciate that, Chairman.

MR. HASHEY: Mr. Chairman, just for clarification I have had a note passed to me that the hotel needs to know whether we will keep on going into -- beyond 5:00, I guess they call that evening? It would be our preference that we do and finish.

CHAIRMAN: Well, Mr. Hashey, as you sit here now, how long do you think it will take you?

MR. HASHEY: An hour and 10 minutes, an hour and 15 minutes.

CHAIRMAN: That's good. I will speak to the shorthand reporters and see if that's okay and the translators.

MR. HASHEY: If we come back shortly after 4:00 we should be done by 5:30, I think is the safe way to look at it.

CHAIRMAN: That's more than an hour and 10 minutes, Mr. Hashey.

MR. HASHEY: I'm on MacNutt time.

(Recess)

CHAIRMAN: Nettleton got the nod too?

MR. GODDARD: He is rebooking a room, Mr. Chairman.

CHAIRMAN: Well do you mind if --

MR. GODDARD: Please go ahead.

CHAIRMAN: Okay. Mr. Hashey.

MR. HASHEY: Thank you, Mr. Chairman. I would deal with a couple of the questions that were posed and probably in the order that they were posed if we might. And hopefully we can save some time in the way we do this. But, Mr. Morrison, you might address the first one.

MR. MORRISON: I believe the first one that we want to address came from you, Mr. Chairman, dealing with the contracts, the reservations. Now -- and perhaps like Mr. Zed, we weren't entirely clear on what your question was, but we do have the information. As Mr. Zed pointed out, with respect to the reservations and all of the

interconnections is contained in exhibit A-4, and it's NBP NSPI IR 28. And that is all of the reservations for all of the interconnections.

CHAIRMAN: A-4, NSPI?

MR. MORRISON: IR 28. And that's all the long term firm reservations on all of the interconnections.

CHAIRMAN: That's sufficient. We are well covered on that.

MR. MORRISON: And just so that we are clear, and that I'm clear, these aren't energy contracts, these are reservation contracts and I understand that Mr. Zed was talking about -- I think you got into a discussion with the Maritime Electric contract which is due to expire at the end of next year. But I believe their reservation is on a non firm month to month basis. But these are the reservations and not energy contracts.

MR. HASHEY: The next area is the issue of how do you define equity, correct? I would define equity as the form of financing that is not debt and while it has an expectation of return there is no guarantee to the equity holder. The equity holder takes the risk.

Now if I could expand that a little bit. Mr. Smellie continually says that there is no real equity. We sincerely disagree with that. I think really here, and I will read what I have written down here, "The critical

determining factor is that 1.5 billion of debt contractually owed by NB Power to the Province of New Brunswick on March 31st will not be owed on April 1st. The source of financing that an investor uses to come up with its equity investment is not relevant. An investor can get its capital anywhere it wants to. That is a separate issue. Whether the investor borrows the money, earns it or gets it by a windfall is irrelevant to the investment he or she makes. As long as the investment is at risk and the investor has no guarantee of return or recovery, it is an equity investment. It's irrelevant how the Province finances its equity investment. What is relevant is that NB Power has been relieved of the legal obligation to repay."

I think really that gets into what the explanation of equity is. The best I could do. It's getting late.

CHAIRMAN: I hear you, Mr. Hashey.

MR. HASHEY: Okay. The next one I think is the wind power one which, I believe it was mine. In such a haste I'm not sure at times whether I'm answering or Mr. Morrison is. But I will take a crack at this one.

You know, we have dealt with wind power in the brief. I don't think there is a lot more to say about it. We do believe that the SO has the authority. And there will be

a market advisory committee. If there is any significant change, and as my friend Mr. MacDougall said I think quite eloquently and adequately, that the SO will have to come back. And there will be a full opportunity for input on that.

Now to try to ride my way through Mr. Richardson's points and they are good ones. I would say I would like to answer the first one, but truly the others are answered in my rebuttal in some detail. And I think we would be better to not try to duplicate it, if I might.

But the first one on management risk, a good point. And we do believe and we know that is a significant and a real risk. We know that credit rating facilities take this seriously. And here you have a situation that the transmission people in our view have done their job very, very well. We have even had lights the last little bit in New Brunswick when we ran out of generation capacity. You know, and things have gone quite well in New Brunswick notwithstanding terrible ice storms.

But there is a commercial risk and a financial risk. That's something that will be new to this organization. Something that will be considered. They will have to have expertise. There will have to be a centralization of financial management. They haven't had that before. And

that's going to be something that has to be looked at. There is going to be new players, new experience and there is a new Board. This is a real company. There is going to be a new Board of Directors and that Board of Directors will appoint their management and that is yet to be done. But we do know that this is something that is considered by the credit rating facilities. And that is something that will be coming up. And they will be asking for more information. And on that regard there may be new evidence, but there has been a bit of delay while that's in place, before they will deal with some of those things. So we think that's a real risk.

And the other arguments on legacy, amortization and the other issues we will come directly to those in our rebuttal. And maybe then Mr. Morrison could answer the -- sorry, one more for me.

Mr. Bremner, your one question, sir. Is the 20 million in this exhibit 5 and the difference. If I can try to explain this, the $20 million is a 91 point base point credit spread applied to the legacy debt. It's an estimate of the market credit spread that a corporation would pay on that debt, frankly. The 12.8 million is based on the 65 base point guarantee fee that will be paid by NB Power to the province on the legacy debt.

Now what we say is in our application we have included the 91 basis point spread in order to ensure third party users of NB Power's Transmission pay the full costs. NB Power's system was built on government guaranteed debt. Including in the tariff only the guarantee fee means that users outside the province do not pay for full commercial costs, rather their tariff would include an effective subsidy from the province on the finance portion of that tariff, and we don't think that should happen. It's attempting to level that aspect of it.

Is that fair? Am I getting through at all, sir, on that?

MR. BREMNER: It's a controversial thing. What you are saying then, Mr. Hashey, is that because the debt was guaranteed by the province that the future transmission should pay their portion of that. Is that what you are saying?

MR. HASHEY: Yes. Quite, basically, yes. A good part of it, yes.

MR. BREMNER: The other side of the coin says that because the debt is already there, they don't need to charge that. That's what I have trouble getting through my head.

MR. HASHEY: Well, the debt, of course -- when you say the debt is already there, the share of debt that is passed on

to the transmission company -- I will take a crack at this. I may seek some assistance. But that portion of the debt that's passed onto this transmission company will be a debt of that company. I mean, it's not going to be -- it's not going to be a province debt anymore. It will be the debt of that company. Notwithstanding that that legacy debt if there are defaults there will still be guarantees on that, yes. And the fees relating to that we believe should be passed on completely.

Now maybe Ms. MacFarlane can take a crack at it. Would you mind?

CHAIRMAN: Let me jump in here. If I might my understanding of the 20.1 million is what the charges would have been had NB Power gone out on its on and floated that debt. And the 12.8 takes into consideration only the cost of the provincial guarantee.

MR. HASHEY: That's correct. That's correct. Then the questions that have been posed by Commissioner Sollows I pass over to Mr. Morrison to respond.

MR. MORRISON: Thank you, Mr. Chairman. I believe the first question from Mr. Sollows dealt our reference in our brief to Section 42 of the Act dealing with prospective costs in a prospective test year.

The reference in our brief basically dealt with -- had

to deal with Dr. Earle's evidence and his going in OM&A costs and the fact that he relied on historical data and did not project it through to the test year that we used.

The only -- we are not trying to make the point that historical data isn't relevant. What we are saying is that the Act that you are currently under requires you to look at the projected costs.

So that gets us back to Dr. Sollows' question concerning well, it is a proxy unit that really doesn't exist at this point in time. Is that something that is a -- can you take a projection from that?

My answer to that is that our evidence is in our application is that the proxy unit projects the long-run marginal costs of the ancillary services. So in effect the proxy unit pricing that is contained in the application is a projection, although it is based on, as you say, Dr. Sollows and I agree, a unit that isn't in existence now. But quite frankly, with all due respect, I believe that is irrelevant to the consideration of projection.

With respect to the second question, and I believe that dealt with should we rely on the embedded costs where there hasn't been some Board oversight in some time? We really have nothing more to add than what Mr. MacDougall

said on behalf of WPS.

With respect to the discounting of ancillary service below proxy costs, again we have nothing further to add beyond what Mr. MacDougall had to say.

The rate shock issue I will be dealing with in the course of our rebuttal argument. I believe the last question from Dr. Sollows dealt with whether there should be a socialization of cogeneration rates.

We don't believe that that is really a subject for this hearing. We are dealing with an application for a nondiscriminatory tariff. I think that goes outside the nondiscriminatory aspect of it.

It may very well be dealt with in other avenues, perhaps during I believe the renewable portfolio or perhaps in market rules. But we don't believe that really we can get into hiving off cogeneration at this point. And that is our submission in that regard.

The last question dealt with -- I believe the last question dealt with the issue of hoarding. And it related to hoarding in connection with preserving the reservations.

If there is evidence that NB Power Generation was hoarding, in other words was taking these reservations that they had and not using it, and basically tying up

that capacity to exercise market power, then we would agree that that would be a justification for having those reservations set aside. However, there is no evidence of that.

And in fact under the current system any capacity that isn't used goes up on OASIS on an open bid. And in the tariff itself it is a requirement that any unused capacity be up for open bid.

And the current situation is all of unused capacity that isn't used by 11:00 a.m. in the morning goes up. So hoarding isn't an issue. And there is no -- it doesn't form a basis for overturning those reservations

The last question I think came from you, Mr. Chairman, with respect to the Board's authority to call for -- have the SO send out an RFP for ancillary services and then have that RFP come under the scrutiny of the Board.

Again we agree with the submissions on behalf of WPS and have nothing further to add in that regard. Thank you.

CHAIRMAN: Mr. Morrison, if I might -- and we may well have had this discussion previously. But there has been a lot that has come before this Board. Going back to hoarding.

What do you say if -- we know that the first out and through Transmission Tariff which would have been in place

at the time that you had the bids in reference to the MEPCO time line, et cetera, we have heard that you reduced that tariff subsequent to that auction, as I understand it. And you did so on the basis that you brought it down to the out tariff. That is my understanding.

MR. MORRISON: Well --

CHAIRMAN: I don't know the amounts of that. It is not on the record as to what the difference is. But if that through tariff were placed so high as to make it uneconomic for any generator who was looking at using the through tariff and then going into the bidding system on the MEPCO line, is that not inappropriate?

MR. MORRISON: All I can say to that, Mr. Chairman, is that at the time that the out and through tariff was introduced in 1998 I believe, there was a concern that was raised by one of the market participants which was Hydro Quebec.

And as a result of that concern, the out and through rate was -- the differential was changed. It was leveled as I understand it. That -- there was no concerns raised by any other market participant at that time.

And all I can say to that is had they been addressed or had there been concerns raised, they in all likelihood would have been addressed. But I don't know at this point what the difference was.

We take the view obviously in our argument that the out and through tariff that was introduced in 1998 was comported with all of the fundamental principles of an Open Access Transmission Tariff from FERC. And therefore those reservations ought not to be disturbed on the basis of trying to come into more comportment with FERC requirements.

I don't know if that answers your question. But it is the best I can do.

CHAIRMAN: Well, it is okay. The record is -- it's not -- the actual amounts are not there.

Mr. Hashey?

MR. HASHEY: At this point we would like to move into the rebuttal points. On a couple of preliminary points is -- I believe there are a couple of things I would like to say that I really hoped that I wouldn't be saying here.

But first of all -- and I don't like to make the allegation, but I do, that Mr. Smellie I think is a master at twisting statements to make a point. There are many examples. We are not going to enter into a meaningless I do, you said issue here.

For example, on benchmarking Mr. Smellie said that I said that Dr. Yatchew recommended benchmarking for delay purposes. I absolutely didn't say that. That is just one

example. And I would just say when you are going through it be careful, because there are others.

Second, this was raised at an early -- at a preliminary hearing. It is not a civil or a criminal trial. A process here was available to allow interrogatories, supplemental interrogatories and undertakings. Not one item of evidence requested was not supplied.

If something more was requested why weren't we asked? If a report's author was to be required, why weren't we told? Why were relevant questions not posed through interrogatories?

There was a prehearing conference. My friends attended that prehearing conference when we talked about this very procedural issue and how we would handle it. Dr. Yatchew has put in selected writings. We haven't objected. We put in some ourselves.

What about the book, the whole book of evidence that really was put in from Booth and Berkowitz? We didn't object. We thought and we still believe that in this proceeding and this type of proceeding it is important to have the best possible information before the Board that might be relevant and might give assistance to the Board. And that is still the position we take.

There has been some attack on our witnesses. I think that was a little bit unfair. To accuse our witnesses, Ms. MacFarlane of being misleading, I would suggest is far from fair. And I would just ask the Board to judge from the people they have heard and what has been said.

With that said I will move on to the issue of financial. And that would be the first direction. I think this was more the issues that Mr. Richardson has raised. But I hope that we can answer a lot. Unfortunately it is going to take a bit of time. But there was a lot said that we don't think is accurate.

We do have very serious problems, as I have said, with the presentation of Mr. Nettleton on the financial issues. We believe that we have to deal with these in some detail. Because there seems to be some lack of understanding of basic accounting and financial principles. And we are concerned about cherry-picking evidence. I think

Mr. MacDougall raised that. And that is a concern.

So continual confusion with what our friends think should happen and what the government has dictated exists. A debt equity structure has been decreed. This is a fact of life, something we have got to live with whether we like it or not. To borrow at all and/or decent rates requires an equity position. And we will carry it from

there.

The first issue that I would like to deal with is the issue of revenue requirements. My friends have questioned the revenue requirements. But before we deal with the key items we note some of the arguments. And we state that these are fundamentally flawed.

Now on amortization for instance we submit that the $18.4 million amortization expense included in the revenue requirement is appropriate. My friends contend that NB Power provided little information to prove that the amount is just and reasonable. We disagree. And we refer to the evidence, the interrogatories and the cross examination.

This Board is aware that a full depreciation study was filed and reviewed in 1991. That study formed the foundation for all amortization policies and processes since then. At the Board's suggestion, an amortization review committee reporting directly to NB Power audit committee performed rigorous reviews. And that has happened.

However again what I guess troubles us, that no party has requested additional evidence in the extensive Interrogatory process, nor in cross examination.

Mr. Nettleton then goes on to suggest that until a study of amortization costs can be filed and reviewed by

the PUB, amortization costs be included in a deferral account. We believe that the suggestion of accumulating costs under a deferral account is unreasonable and unwarranted.

Moreover it would be a financial impairment to the company's ability to credibly borrow in the short-term or in the long-term bond markets and debt markets.

On finance charges, with respect -- sorry, we respect that the points raised by Mr. Nettleton are in contradiction of generally accepted practices in rulings to the Board. However, we cannot leave unanswered the lengthy and flawed argument presented by Mr. Nettleton on this topic.

We are going to apologize, or I do, at the start of this for the length of this. But the enormity of the errors and the importance of our application must not be disregarded.

Firstly, NB Power maintains that the finance charges included in the revenue requirement are based on the correct regulatory principles. Secondly, the principles have been applied correctly without mistake. And the finance charges included in the revenue requirement are appropriate.

Now Mr. Nettleton makes several references to the use

of actual costs, not fictional costs. The record shows that all costs included in the finance charges are actual costs. What we believe Mr. Nettleton is confusing is cash costs and actual costs.

Now on the issue of the embedded cost of the legacy debt, which I think is in one response will deal partially with Commissioner Richardson's point.

Now regarding the weighted average coupon rate we make the following points: (a) Mr. Nettleton and Dr. Yatchew contend that the weighted average coupon rate stated in NB Power's annual report of 8.2 percent is the embedded cost of debt.

Then Mr. Nettleton quotes Dr. Morin's textbook extensively on the calculation of the embedded cost of debt. However Dr. Morin's textbook does not support

Mr. Nettleton and Dr. Yatchew's contention.

Moreover, NB Power's calculation of the embedded cost of debt is fully aligned with Dr. Morin's references.

Mr. Nettleton quotes Dr. Morin's text as saying "The embedded cost is clearly stated on the bond certificate."

Mr. Nettleton neglects to read further on where

Dr. Morin says that "In practice the embedded cost should also include issuant costs, premium or discounts at the time of issue and should recognize sinking fund and call

provisions."

So Dr. Morin's textbook really states that embedded cost in practice is not the simplistic rate stated on the bond certificate. NB Power's calculations of embedded costs are entirely consistent with Dr. Morin's textbook. NB Power's cost of debt is not, as suggested by Mr. Nettleton, the weighted average coupon rate, that is the 8.2 percent stated in NB Power's annual report.

In fact Mr. Nettleton even says as much as he later quotes Dr. Morin's textbook again at page 26 stating Embedded cost "includes actual interest obligation including amortization of discount, premium and expense related to the principal outstanding as of a particular date."

We suggest Mr. Nettleton is also and inappropriately using the Board's own decisions to suggest coupon rate is the embedded cost of debt. He quotes the June 2000 Board decision on Enbridge Gas as if it is in contravention of our calculations.

But he quotes that "The total cost of debt may also include other contributing factors such as costs of issuing the debt and foreign exchange variations." NB Power's calculation includes both these costs and is entirely consistent with this ruling.

On another note, Mr. Nettleton again demonstrates his lack of understanding of embedded costs. He again misuses Dr. Morin's expert testimony. Mr. Nettleton quotes Dr. Morin as saying that cost of debt is "strictly a function of the borrowing rates that prevail at the time of borrowing, whether seven years ago or 12 years ago or 15 years ago."

We say this isn't true. Yet Mr. Nettleton asked the Board at page 90 of his notes to "Think for a moment what banks are offering today as lending rates."

Dr. Morin's text and the evidence speaks extensively of the inappropriateness of such a suggestion as attributing windfall gains or losses to shareholders.

Finally Mr., Nettleton's suggestion that the weighted average coupon rate is the embedded cost of legacy debt or that current market rates are a benchmark for the cost of debt are simply not correct.

Now let's go on to the sinking fund issue which is the next one. Again, we believe this is straightforward and was misconstrued or possibly is an error of Mr. Nettleton. We again refer to Mr. Nettleton's quote of Dr. Morin's textbook where it states Embedded cost of debt "should recognize sinking fund provisions." NB Power's calculations of embedded costs appropriately recognize

sinking fund provisions.

In his aid to argument Mr. Nettleton has double-counted the effect of sinking funds, once in line 1, what he calls deemed, and again in line 3, what he calls actual.

NB Power recognizes that sinking fund earnings offset interest expense. NB Power's calculation of both the numerator, that is the finance charges, and the denominator, the average debt, are appropriately net of sinking fund provisions, as referenced in Dr. Morin's textbook and as referenced in the NEB decision and which Mr. Nettleton points.

Mr. Nettleton is suggesting that NB Power net sinking funds from the total debt so as to "deem redemption" of a certain portion of the debt, and therefore the costs of that redeemed debt should be excluded. We say not so and is never stated as such anywhere on the record. And we will make the three further points on that.

Firstly, sinking funds are netted against the outstanding debt issues in our application and in our financial statements in accordance with the CICA requirements, because they are contractually required by the bondholders for that reason and that reason only.

Second, even if sinking funds were presented, if they

were redeemed part of the debt, both the cost of the redeemed debt and the earnings on the now used sinking funds would have to be reduced.

Mr. Nettleton has reduced the cost of the "deemed redeemed" debt but has not accordingly reduced the sinking fund earnings. In fact there is no way around it. Mr. Nettleton is double-counting the use of sinking funds.

Now let's go on to the issue -- another issue that has been raised by Commissioner Richardson. And that is the amortization of foreign exchange. When you borrow in U.S. capital markets, just as when you buy goods and services in the U.S., there is a cost to the foreign exchange. It is an actual cost and is appropriately included by NB Power in the revenue requirement.

I make the following points on that. Mr. Nettleton claims that the foreign exchange adjustment is not an actual cost outlay, but rather an accounting adjustment. However, it is well recognized that current year cash outlay is not a requirement for defining an amount as a cost, not by CICA and not by the regulators -- I'm sorry -- not for cost to be included in the revenue requirement.

Thirdly, in the current year cash outlay where the definition of cost, all capital expenditures would hit taxpayers at the same time of cash outlay rather than over

the used and useful life of the asset purchased. I think that's a key point. Likewise, with foreign exchange cost associated with the debt, the lack of a current outlay does not imply it is not a real cost that will ultimately at maturity require a cash outlay.

Fourthly, principal related foreign exchange costs are appropriately included in the embedded cost because they will ultimately be a cash outlay. As noted in the evidence the utility got X-amount of cash at the time of borrowing to invest in assets and will have to pay Y-amount back. The difference between X and Y is part of the cost of U.S. dollar debt and is just and reasonable to include in finance costs.

Fifthly, Mr. Nettleton points out that the ultimate cost is not known with certainty and that it will only be determined some ten to 20 years in the future. That doesn't mean that it's not a cost. At this point absent a crystal ball the best that can be done is to estimate the ultimate foreign exchange variation and allocate it in some rational and reasonable manner.

Next point, six, Mr. Nettleton points out that the final cost may be different than the effective estimate provided by this approach, resulting in and windfall to the final year ratepayers and a penalty to current

ratepayers. The opposite is true as well. The amortization approach avoids this by smoothing the impact of foreign exchange variations over the generation of ratepayers.

Next point on page 12 in his aid to argument Mr. Nettleton points to the 2002 column and the low unrealized foreign exchange costs referenced there as $4 million. He neglects to draw your attention to the 2001 column where those same costs were $82 million. NB Power's evidence shows that this huge swing in annual costs resulted from an application of new CICA accounting guidelines and a six cent change in the U.S. dollar. NB Power believes that because of these potential huge annual swings that costs should be smoothed, deferred and amortized over the life of the debt issue.

Finally, we contend that NB Power's finance costs appropriately reflect this real cost and do so in a way that is fair to ratepayers inter-generationally.

The next issue that I would like to address on the finance side, Mr. Chairman, and I think we are getting down to the last two or three and these are shorter, is the issue of cost of avoided borrowings.

Mr. Nettleton claims that avoided borrowing is related only to the nuclear business unit. It has nothing to do

with transmission and should not be included in finance costs. We believe that there is some misunderstanding here of the evidence. This issue was subject to intensive interrogatories in cross examination. The Board has also reviewed it in the past. The Board in its May 1991 decision noted that NB Power properly in the view of the Board uses these funds as part of its financing of its current operation. NB Power has used the amounts collected from customers to avoid borrowing for corporate-wide capital expenditures rather than for the purposes collected.

Secondly, NB Power's treatment of the cost of this avoided borrowing is consistent with the May 1991 decision that the obligation not be included in NB Power's debt while no trust fund exists. A trust fund will exist as of the test year, being the previously avoided borrowing becomes the real debt. So the transmission portion of the costs thereof are appropriately included in the revenue requirement.

The final point on this one is the inclusion of avoided borrowing in transmission debt calculations in no way represents cost shifting from generation to transmission. A portion of the funds were used for capital expenditures in transmission and transmission

customers must bear the cost for that portion.

In summary, on embedded cost of debt included in finance charges we say the following and make the following points. NB Power is including actual costs of legacy debt in its finance charges. Secondly, actual costs are not in practice narrowly defined as coupon rate stated on the face of the debt instrument. Thirdly, sinking fund provisions are appropriately treated in the finance charge calculation. Fourthly, principal related foreign exchange is a real cost and is recognized as such by the Board in past decisions. Fifthly, the most equitable recognition of foreign exchange costs for all generations of ratepayers is to amortize the cost over the life of the debt. And finally, amounts collected from customers for UFM and decommissioning were used for capital expenditures across the corporation, including transmission. Borrowing to replace those amounts is appropriately included in legacy debt. Inclusion of those costs does not represent cost shifting from generation to transmission.

Now on the final issue on the finance side, on the matter of new debt we would like to go into some detail, but to respect the time of the Board here today we make two points.

Firstly, Mr. Nettleton incorrectly references a reasonable proxy for cost of new debt as being five percent. That is Ms. MacFarlane's statement in the testimony about a recent PNB issue. This amount, this five percent, is not a reasonable comparator for the following reasons. Firstly, it was a three year issue, not a long-term issue, not long-term being ten to 30 years. It was a very large issue, $500,000,000 U.S., and accordingly included significant size economies. NB Power Transmission could never undertake an issue of that size to get the associated economies. I think that's obvious from the size of this transmission company to be. That the debt was issued on the guarantee of the Province, NB Power Transmission would issue debt at higher costs on its own credit. It won't have that benefit. And finally, Mr. Nettleton incorrectly makes reference to a 6.41 percent as an appropriate rate because NB Power used the rate to avoid borrowings. The 6.41 percent is only put forward in the evidence as a cost applied to avoid a debt. NB Power makes no assertion that it is supportable at a cost of new debt and does not believe it to be so.

Now I would then like to make about five short additional points and then we will turn over to Mr. Morrison to finalize.

First of all I would comment on Dr. Morin. A lot of criticism has been heaped on him about his work and what he has done, particularly in relation to betas and the CPM methods and things of that nature, which we believe are -- there are issues and arguments in every direction on that.

But I raise these questions. If Dr. Morin is so inaccurate and so unreliable why is he called upon and continuously being called upon across North America? We will stand with his submission.

The point -- I think the main point is there is no science attached to proper returns. We are looking at a lot of different methods, we have got a lot of different authors, we have got a lot of different discussion. But we are dealing with professional judgments called by an expert in finance, and I don't think anyone fits the bill better than Dr. Morin does on that. And you can challenge little bits of everybody, but in this one I think he stands pretty well.

The next issue is the issue of capital requirements. Mr. Smellie in this instance has suggested that perhaps one option is to assume a transmission company with a hundred percent debt. This seemed to be an issue that ran throughout the argument that we heard yesterday.

Clearly, the Electricity Act requires that the revenue

for operating companies will include a return on equity and a payment in lieu of taxes. It is further suggested by my friends that a new company does not need to borrow money and therefore, need not be concerned about its credit rating. The fact is that the new company from day one will have to deal with banks for its day to day working capital and short-term borrowings.

How is the company to finance its ancillary services? What if an ice storm occurs and significant expenditures are necessary. Moreover, it's first year of commercial return will impact the go forward credit rating. The new company is required to take on the existing debt. It is required to generate sufficient revenues to meet its obligations on the existing and the new debt. This is what is being ordered.

The suggestion was made that what the government and its bankers are doing is irrelevant to what this Board decides on capital structure and return on equity. Mr. Chairman, the decision of this Board on debt and equity is important for the new entity to be able to generate the cash flows needed to cover its costs and attract capital. The deemed equity and the ROE allowed by the Board will result in a real return on equity. The resultant return will without question affect the company's future

sustainability. Clearly the legislation is aimed at allowing all operating companies, including the transmission company, to become self-reliant.

Mr. Smellie emphasizes the need for implementing the lowest possible tariff. What he seems to be suggesting is that external users of NB Power's transmission system be subsidized by New Brunswickers. If we open up our system to all users on a non-discriminatory basis, then surely the tariff should reflect a reasonable capital structure and a reasonable rate of return on equity.

Going to the next issue, benchmarking. Mr. Smellie suggests that we should have asked Dr. Yatchew for his views on benchmarking. He further suggests by not doing so we must accept Dr. Yatchew's recommendations on this issue.

The fact is and the evidence will show that we have experienced people like Ms. MacFarlane and Mr. Snowdon who know a great deal about benchmarking. These witnesses provide ample evidence on the issues related to benchmarking. The reason we didn't question Dr. Yatchew is simple. We did not think that an academic dissertation would add to the complex realities of benchmarking a unique system.

Now two short final items on price cap. We were a bit

amazed by the suggestion that Dr. Morin's case hinges upon the implementation of a price cap. Nothing can be further from the truth. This is evident from the exchange that you, Mr. Chairman, had with Dr. Morin, in the transcript, pages 1312 and 1313, when you asked, Doctor, I think I know the answer to this but if this Board were to accept your rate cap or your proposal of a rate cap, et cetera -- sorry, I will start again. But if this Board were not to accept your rate cap or your proposal on rate caps, et cetera, that you would recommend 10.5 percent. And Dr. Morin said, yes, he would.

Now the reality check, which is the final issue that I will address. Mr. Smellie has talked several times about reality checks. We don't have the time and you don't want to hear us on the number of times that that was discussed. However, we do wish to offer simple reality checks of our own.

In our search and through the questioning of Dr. Yatchew we could not find a single example where an 8.25 percent ROE was accepted. In fact if we look at recent decisions elsewhere and the evidence presented at this hearing, it seems clear that the return on equity for New Brunswick Power Transmission would be easily more than ten percent.

Now there was some reference made to the fact that Dr. Morin did not always get what he recommended in other jurisdictions. That's true. However, the record speaks for itself. The decisions are much closer to Dr. Morin's recommendation than to that of Doctors Booth & Berkowitz which was the evidence relied upon by Dr. Yatchew and which was put before you in great detail.

Mr. Smellie states that the Public Utilities Board is being asked to create an enormous fiction. This is no fiction. Also it is suggested that it is not the best interests of the citizens of the province. Much has been said and it is obvious that the enormous weight of NB Power borrowing is being passed on, so the ability to borrow effectively -- efficiently effective for hospitals, schools and other purposes will be available to this province. That has been openly stated, and unfortunately or fortunately, whatever you may see, the Province in its wisdom is passing the debt on to these companies. To make this work effective and efficient, entities must be created that will succeed.

And I think in my closing part it is worthy to note Ms. MacFarlane's testimony when questioned by Mr. Nettleton on this issue, where she says, it is a matter of public policy, it is a matter of legislation, that New

Brunswick's capital structure will be changed. The government has determined they no longer want to guarantee NB Power's debt on a going forward basis. That's not a matter for us to debate. Done. Since it's done we have to be competitive in the financial markets in order to be able to attract capital. And that requires a certain capital structure on a go forward basis.

Thank you, Mr. Chairman. At that point I will pass this over to my friend Mr. Morrison to complete our submission.

MR. MORRISON: Mr. Chairman, I will deal with a number of issues and they don't really arise in any particular order. But the first one that I'm going to deal with is the other day Mr. Smellie, and it's the level playing field issue, and when he was dealing with his policy framework or legislative overview.

Mr. Smellie submitted that the level playing field concept applies only to generation and that there was no premise for levelling the transmission playing field. The suggestion being that a capital structure, return on equity and payment in lieu of taxes wouldn't be necessary or required for transmission.

With respect, this is incorrect. It is true that Mr. Marshall acknowledged that the White Paper has no specific

other references to the level playing field. However, he clearly indicated that it is government policy, as stated in Mr. Volpe's statement to the Legislature in May that the level playing field concept applies to the entire energy industry. And that's found at pages 1768 and 1769 of the transcript.

I want to deal with Mr. Nettleton's discussion of the NOPR. On Tuesday Mr. Nettleton said that you should be sceptical in approving an order 888 compliant tariff because it may not longer meet FERC approval. He relies for this assertion on the FERC standard market design NOPR. And he refers to it as a finding by FERC.

First, let's be clear on what the NOPR really is. It is a notice of proposed rule making and not a rule. It was issued after this application was filed. FERC, I think the evidence is clear, has sent this NOPR out for a comment. It has received comments. To date there is no ruling. They are still in the discussion process. Maybe some day it will result in a finding or ruling by FERC. But right now it is very much a work in progress.

Mr. Nettleton makes much of the fact that he couldn't find a FERC decision approving a pro forma tariff since the issuance of the NOPR. Well let's remember that all FERC jurisdictions were required to file tariffs back in

1996. No wonder he couldn't find a case.

It should be remembered that JDI was a member of the Market Design Committee which recommended an order 888 pro forma tariff. It should also be noted, and I believe this is important, Mr. Chairman, that the NOPR itself provides that order 888 pro forma tariffs of nonjurisdictional utilities would be respected in any event. And that's in the reciprocity provisions of the NOPR. In other words, this tariff will be upheld by FERC even if and when the NOPR results in a ruling.

I would like to get into a discussion about ancillary services. And quite frankly, I don't know if I can do Mr. MacDougall justice. He has capsulized the arguments I have had here. But for the purposes of the record I will put arguments on the record. On Tuesday Mr. Nettleton submitted that in order to achieve just and reasonable ancillary service rates that it was necessary to use embedded costs and to apply the correct pricing formula to ensure that costs and revenues are correctly allocated to the actual plants that provide the ancillary services.

Now in order to get the actual costs and correct formula he reviewed three ancillary service cost studies that were made available. The first was the proxy method, which is included in our application. The next was

exhibit A-50, which was the embedded cost study, the 2003 embedded cost study. And finally A-52, which was the year 2000 embedded cost study which was used for purposes of the Northern Maine negotiation.

Now before I address the approach taken by Mr. Nettleton regarding this issue, I do want to clear the air on something. There has been an insinuation that NB Power withheld this study. And I think it's clear from the record, Mr. Chairman, that simply is not the case. The fact is that the study was immediately offered when it was requested, as a result of a question in cross examination. It was not included in the original filing or as part of exhibit A-50 because it's an outdated study done for different reasons and not consistent with procedures approved by FERC. This position has been explained by Mr. Porter in the transcript at pages 2285 and 2511, and also were stated by Mr. MacDougall in his argument on behalf of WPS.

Now Mr. Nettleton submits that exhibit A-50 NB Power did not provide actual provision of ancillary services, but instead substituted the capability of generating plant to provide ancillary services. In a sense said that we didn't provide what the Board asked us to provide.

On the NB Power system, any generator with the

capability to provide ancillary services does actually provide service. And this is Mr. Bishop's evidence at page 2458 and 2497. Unused capacity of any unit with a capability to load in 10 or 30 minutes is the capacity that actually provides reserve. This capability is we submit both used and useful.

Mr. Nettleton also states, "NB Power's embedded cost rates in exhibit A-50", and I'm quoting, "have been based on the fixed costs of the total plant, not simply a portion of the total plant costs attributed to ancillary services." And Mr. MacDougall raised this point earlier, that simply is not correct. NB Power ancillary service costs are based not on the costs of the total plant, but on the per unit dollar per kilowatt hour year cost of capacity for each plant. This is the basis of all the ancillary service studies. The portion of the plant producing energy has its costs recovered through energy sales. The important thing being and only that portion providing the ancillary services is allocated to the ancillary service costs.

Now regarding Point Lepreau, Mr. Nettleton states that it has never actually been used to provide reserves. And he refers to exhibit A-50 and it's Schedule 6, he notes column 11 as his rationale. What he doesn't do is he

doesn't explain that column 11 applies only to unused available capability. Columns 12 and 14 of that same schedule show that Point Lepreau provided recallable energy that contributed to reserve.

Now regarding recallable energy there seems to be some confusion. Mr. Nettleton in his argument regarding the use of recallable sales does not recognize the fact that there are differences between firm and nonfirm energy and how these recallable sales actually reduce the size of the contingency. He also implies that NB Power has excess capacity, and should not be using these sales to provide reserve and thus, to use his words, "by selecting nonfirm that choice is depriving New Brunswickers of lower rates." These sales are in fact firm sales. And by making them recallable under predetermined contingencies as explained by Mr. Bishop, and I believe that's at page 2336 of the transcript, by doing that they are reducing the amount of reserve required by all New Brunswick customers. So enough of the contingent.

How does Mr. Nettleton use the studies to get to his goal of actual costs and price correct pricing formula? Well he begins with the proxy study, and submits that it applies the correct pricing formula. But that it's fixed cost inputs are incorrect and not appropriate for costing.

So from this study he selects the formula and ignores the costs.

Then he moves on to the 2003 study and notes that its approach is flawed, but it could possibly be the basis for the embedded cost determination. But again not with the input assumptions for fixed costs.

So then he goes on to the 2000 ancillary service study. And Mr. Nettleton notes that the 60/40 capital structure would be reasonable, but not while NB Power is a hundred percent debt financed. He likes the 7.5 percent interest rate. But asserts that JDI could accept as a higher rate of 8.2 percent.

In the 2000 study, he also rejects the 18 percent after tax rate return on equity and submits that a rate only slightly higher than the 8.2 percent is appropriate even for generation. And then finally JDI and CME provide three options for the Board for ancillary service pricing.

Now the first option we would submit is based on selecting criteria from each of the studies using the pricing formula found in the proxy method. And I'm not going to get into too many analogies, especially when it comes to fruit. But this is akin to picking apples, oranges and cherries and mixing them together to try to make a strawberry pie.

The second option is simply a variation of option one using data selected by JDI and we submit should be rejected on the same basis.

And finally he sets out an option of using NEPOOL rates. And as Mr. MacDougall pointed out, and as we have pointed out in our submission, it so happens that NEPOOL prices for ancillary services are low relative to the application. And this is because of a variety of factors as mentioned by Mr. MacDougall. But as explained in our argument, the amount of capacity requirement proportional to load in New Brunswick is higher than that required in NEPOOL. For these reasons NEPOOL prices are not relevant for New Brunswick. This is clearly not an option that we think the Board should seriously consider.

In conclusion with respect to ancillary service rates, NB Power submits that the proxy method provides just and reasonable rates that properly price ancillary services for the competitive bilateral market that is to be implemented in New Brunswick.

Now I would like to move on to the issue of rate shock.

JDI and the CME submit that -- and I am quoting, "The proposed tariff ought not to apply to self-generation customers situated in the province, and that

the Board should direct the applicant to file a different rate or tariff specific to self-generation customers." And I know this is an issue that we addressed in part in response to some questions.

NB Power submits that such an approach would be inappropriate for the following reasons. First, the market design committee recommended in its final report, which is exhibit A-5 that -- and I am quoting, "The tariff design approved by the PUB provide that self-generators connected to the transmission system pay for ancillary services on the basis of monthly net noncoincident peak demand." And that's recommendation 667. And further in recommendation 668, it states, quote, "Self-generators choosing network service will be charged for transmission service on the basis of their monthly net nonconicident peak demand."

So the market design committee has set the framework. Now it remains NB Power's position that mitigation of rate shock for self-generators is not necessary as avoidance of rate shock is within the control of the self-generating customer. A self-generation customer with a low load factor, but an unreliable generator, can avoid rate shock by choosing point-to-point service and self-supplying ancillary service. And you will recall that discussion.

But more significantly, the market design committee in its final report acknowledged, and I'm quoting that, "The actual impact on specific self-generators will depend on the kind of service they now receive on their own operating characteristics and on the decisions they may take in response to tariff changes." We also note any need to avoid rate shock for a self-generation customer is only an issue should the customer choose to leave standard offer service. A customer that does not choose to go to a competitive supply can continue to receive the service it receives today.

Nonetheless, should the Board decide in spite of our submissions that rate shock for these customers is an issue, then the Board should order a phasing in of the proposed rate, as opposed to introducing a new service as submitted by JDI. Phasing in was noted as a potential means to address rate shock for self-generators in the White Paper energy policy. And that's at Section 3.1.4. Such a phase in could occur over a period of three years and avoid the need for any ongoing special conditions for current self-generators.

Now in connection with rate shock, Mr. Chairman, you asked us -- all of the participants to address the question regarding subsidization of self-generators, and I

am going to go on to answer that question. To address this question it is necessary to understand the past treatment of interruptible energy supply to self-generators in the bundled service world and compare it to the proposed treatment in the new unbundled world.

Interruptible energy has been and continues to be provided to self-generation customers as an alternative supply to their own generator. There is no demand component in the rate, rather it is billed as an energy product at marginal energy cost with a price adder to make a contribution to fixed costs. And it's really the price adder, which is the key to understanding this.

When the rate was developed many years ago, there was no differentiation of the allocation of these fixed costs to either transmission or generation. And as to generation, there was no differentiation or consideration of an ancillary service contribution. This is in the era of bundled service integrated utilities. Ancillary services existed, but were never unbundled and costed separately.

The evidence on the record is clear that capacity-based ancillary services are capacity that needs to be provided all the time and ready to be activated and to be producing energy only if required. Under the

interruptible energy rate today, self-generators are receiving the benefit of this continuous supply of ancillary services at all times that they are synchronized to the system. When they self-supply their own energy and take no energy from the system, they do not make any payment for the ancillary services provided. When they do take energy, they make a payment towards generation fixed costs and thus towards ancillary services.

Interruptible energy customers who take this product at a high load factor are making a reasonable contribution to the cost of services because they are paying the adder on the energy they consume. But interruptible cost customers who take this product at a low load factor are not. In short, the more energy consumed the higher the contribution to fixed costs and thus to ancillary services.

Now we are moving to an unbundled world with transmission and ancillary services treated separately from generation. It now becomes necessary to set up separate billing determinants for each service. The billing determinant for ancillary services in this application is monthly net noncoincident peak demand. And this is as was recommended by the market design committee and was recommended after much discussion by that

committee I might add.

Now it is apparent from JDI 7 that when this new unbundled billing determinant is applied to self-generators without any mitigation action on their part, then a subsidization is revealed in the interruptible energy rate class for low load factor customers. They are receiving the benefits of ancillary services today that are paid for by other customers. So yes, the answer to your question, although it's a long answer to a short question, is that yes, there is a cross-subsidization. The second part of that is who is providing that cross-subsidy?

The cost of service of the large industrial class is near unity, as you pointed out the other day, Mr. Chairman, and it includes the subclass of interruptible energy. On this basis the cross-subsidization would not come from other rate classes, but rather from within the large industrial class. More specifically, the cross-subsidization would come from large industrial firm load customers and possibly other interruptible energy customers who take supply at a high load factor.

Now I would like to move on to OM&A. And I am mindful of the time and I will be very brief. There has been a lot of discussion about OM&A costs, and we wish it was as

simple that you could just take out a pen and reduce the cost of operating and maintaining a reliable transmission system, but that's not the case. But we would suggest that's what our friends are suggesting. During cross-examination, Dr. Earle's suggestion that OM&A can be reduced was called into question.

First, NB Power believes that the OM&A of 37.6 million included in the rate base is reasonable and that the evidence and record support this.

Secondly, Mr. Nettleton stated that, quote, "A 1999 report prepared by Stone & Webster concludes that OM&A costs can be significantly reduced should NB Power take appropriate steps to invest in capital projects that improve overall reliability."

With respect the Stone & Webster report really doesn't say that. The Stone & Webster report does say in Section 4.5, and I am quoting, "That future OM&A expense budgets should be sufficient to ensure safe and continued reliable operation. There are opportunities for cost reduction without compromising equipment performance on reliability. Principle among these is the phase in of RCM." And you will recall my discussion and cross-examination of Dr. Earle with respect to the phase in of RCM.

Now Mr. Nettleton also says that the savings come from

the capital program and that the capital program is in his words, "almost over". Now again with respect there is nothing on the record to support this. The capital upgrades of the system will continue for a number of years. And the record demonstrates this through a higher level of capital spending throughout the three-year period. Such programs will and are intended to contain upward pressure on maintenance costs.

Before concluding, Mr. Chairman, there was one issue that was raised by Mr. Belcher and Northern Maine, and it dealt with load ratio share. And quite frankly, we have very little to add. We agree with what Mr. MacDougall had to say in this regard. We have very little to add, except that in his submission, he characterized the increase -- basically, what he said that there would be an increase of, quote, "almost double" I think was what Mr. Belcher said. Now this figure roughly reflects the change in the sharing percentages, and it does not take into account the reduction in the total quantity, nor does it take into account the reduction in rates. And the combined effect of these two additional items results in an increase of 13 percent and not the almost double that Mr. Belcher was referring to.

Now there is one last issue that I am going to

address. And it quite frankly deals with Mr. Bishop's evidence. Something arose on Tuesday that NB Power feels compelled to comment upon. In discussing the 2000 embedded cost study and Mr. Bishop's negotiations with Northern Maine Independent System Operator, Mr. Nettleton stated that Mr. Bishop -- and I am quoting Mr. Nettleton's comments -- "Led the other party into believing that NB Power was subject to taxes in 2000 when it wasn't." I can assure you that NB Power takes this allegation very seriously.

There is absolutely no evidence on the record to suggest that Mr. Bishop misled anyone. The statement is unfounded and unfair.

And that concludes my remarks, Mr. Chairman. I believe Mr. Hashey has something in conclusion.

MR. HASHEY: The good news is that that does conclude our summation. That's my conclusion. I think that's the best one you have heard. But I would match Mr. MacNutt any day.

But thank you again, Mr. Chairman. I think we are all very tired and probably it has been an exhausting hearing and I wish you well on your thinking and your thoughts on this matter and the deliberations that you are obviously going to have. I don't see this as an easy matter and I

don't envy you the task that you have ahead of you. But thank you again for hearing us out.

CHAIRMAN: All right. Thank you, Mr. Hashey and Mr. Morrison. It has been a long hearing and a very complex record in front of us and our task will not be easy in what it is that we have to do.

An individual who spoke to me recently who was exposed to this process for the first time and that individual said they were impressed with the respectful way in which the hearing was conducted. And I would -- I interpret it as being a gentlemanly conduct between the parties and counsel here. And that certainly has been the case. And I and I know my fellow Commissioners wish to thank all of you for that.

We have been cast in a very difficult role but I think that all of the witnesses and that includes those of the intervenors have done their level best to complete the best record that we could possibly have in the circumstances. And I thank you all for that.

It has made my job in this hearing room extremely easy. The only difficulty I have is in the break out room with these people. But no, seriously, I do appreciate that. I also want to thank the shorthand reporters and their service and I know they provided an excellent

service and as well the translators who really have been working as hard as the rest of us and probably the least appreciated because we haven't been listening. But it has been difficult.

I also want to thank Board counsel, Mr. MacNutt, who does his excellent job and takes being the brunt of many jokes in reference to timing right in this his stride. I appreciate that. And to Mr. Goss and to Ms. Dressler and to Mr. Lawton who is not here today as well as Mr. Easson who isn't here today. And the Commissioners appreciate your advice and your patience with us when we ask you the same question eight times in a row.

So I will make no promises but I can tell you that in our discussions we are attempting to deliver a decision by the Thursday -- what is it Pogo used to say, Friday the 13th falls on Thursday next month? On Thursday, the 13th of March. That is our object.

We will let you know if we can meet that kind of time table. It is certainly pushed, especially with March break in the middle of it and all that, but we will do our level best. And again thank you for your participation in making this what I hope is a complete record.

Thank you.

(Adjourned)

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

Reporter