

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 19th, 2003, 9:30 a.m.

CHAIRMAN: David C. Nicholson, Q.C.

COMMISSIONERS: J. Cowan-McGuigan
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BOARD COUNSEL: Peter MacNutt, Q.C.

BOARD SECRETARY: Lorraine Légère

..... CHAIRMAN:

Good morning, ladies and gentlemen. Any preliminary matters? I
understand that Mr. Belcher is here? Yes, he is. He is a long ways
away though. You do have a few remarks you want to make, I
understand?

MR. BELCHER: Yes.

CHAIRMAN: All right. We will put you after Mr. Zed.

Mr. Smellie?

MR. SMELLIE: Good morning, Mr. Chairman. Just one housekeeping matter,
if I may. Yesterday my colleague

Mr. Nettleton, in the context of his submissions to you on

ancillary services, you may recall, made reference to the British Columbia Utilities Commission.

At the end of the day we realized that the computer gremlins had crept in to our notes. And we had intended to give you a citation to that decision, but it didn't appear in the notes. It can be found at page 2735 of the transcript.

The decision that we intended to cite was a decision of December 7, 1993 in the matter of the revenue requirement of B.C. Hydro and the Power Authority. I believe that decision is available on the Commission's website. But I'm not certain of that, Mr. Chairman.

So that brings us, sir, to the topic of capital structure, risk and return. As noted yesterday, Bill 30 prescribes that in determining a transmission revenue requirement for NB Power Transmission, the company is entitled to a reasonable return on equity component of its capital.

We know from Bill 30 and Ms. MacFarlane's evidence that the intended result of the restructuring will be to provide the company with an asset base which will be financed based upon the advice of the Province's bankers with something like 65 percent debt as opposed to the current 100 percent debt and an equity component of

something like 35 percent.

As to the latter, a portion of the current 100 percent debt is to be swapped for a form of higher cost equity, to be secured with some form of non-voting divided-yielding instrument held by the Electric Finance Corporation.

Now for convenience sake, let's refer to this as an upstairs event. It is an event in respect of which neither you nor any intervenor is involved. Indeed the applicant is at the event. But they are not an active participant.

In contrast, Mr. Chairman, all of us are participating in what I will call a downstairs event. And what is going on downstairs? Well, at this event New Brunswick Power has asked you to approve a deemed capital structure which is to be used solely for the purpose of calculating rates.

And let's be very clear. What is going on upstairs has nothing to do with what is going on downstairs. There is no obligation which requires New Brunswick Power Transmission to achieve downstairs what is decided upstairs. In fact because what is going on downstairs is limited to ratemaking purposes.

This is important. And it is important firstly because Bill 30 doesn't specify that for ratemaking purposes the Province, the Electric Finance Corporation or

any other entity can dictate to you and your colleagues what the capital structure of NB Power Transmission should be for ratemaking purposes.

All it says that if New Brunswick Power Transmission's capital structure, as determined by you, includes an equity component, the transmission revenue requirement must include a return on that equity, the reasonableness of which is also for you to decide.

Secondly you will know, and Dr. Morin helpfully reminded us, that actual capital structures for utilities, the ones that are determined upstairs, may very well be different from the capital structures which may be adopted or deemed downstairs for those utilities by their regulators.

Whether they happen to coincide or are slightly or materially different is not in the context of ratemaking significant. The capital structure deemed for ratemaking purposes will result in a return on that capital for inclusion in the revenue requirement. It may be the cost of debt. It may be the cost of equity. Or it may be a combination thereof depending upon the structure.

But the point, Mr. Chairman, as with all other components of a revenue requirement approved for the purpose of determining rates, is that the result must be

just and reasonable.

As Dr. Morin puts it, the utility is only entitled to recover, and I quote "a reasonable return on its invested capital and must necessarily reflect the cost of the funds obtained and employed."

So let's turn to capital structure. In discussing the position of the applicant we know that historically its target debt to equity ratio approved by this Board has been 80/20, while its actual structure has varied from year to year due to operating results. And currently we all know that it is financed 100 percent by way of debt.

As of April 1, New Brunswick Power proposes that for ratemaking purposes you should approved a deemed capital structure of 65 percent debt and 35 percent equity for New Brunswick Power Transmission. And it asserts to you that such structure is consistent with the commercialized transmission service to be provided.

So instead of continuing to recover in its revenue requirement finance charges based on 100 percent actual debt structure, New Brunswick Power says the determination of finance charges should reflect a deemed debt component of only 65 percent, and of course an equity component of 35 percent.

As to debt, the estimated finance charges that New

Brunswick Power Transmission wants to recover next year total 19.4 million. And you heard Mr. Nettleton yesterday as to what our clients believe should be recovered in this respect. And so what we are now focusing on is the other return element, return on equity.

Dr. Morin was retained in part to recommend an appropriate debt equity ratio for such a deemed capital structure within the context of a proposed price cap regime. It is his opinion to you that a 65/35 structure is consistent with deemed structures fixed by other Canadian regulators as well as actual capital structures of Canadian and U.S. utilities.

I want to summarize for you and then explain the first position of JDI and its CME colleagues. Our clients respectfully submit that for ratemaking purposes effective April 1, New Brunswick Power Transmission should continue to determine its revenue requirement and hence its rates on an actual cost of service basis, that is to say on a structure which reflects the reality of 100 percent debt.

Mr. Chairman, in the competitive market with which JDI and its CME colleagues are familiar, shareholders do not automatically earn a rate of return simply for showing up. In like manner, until New Brunswick Power Transmission is able to demonstrate to you and to its stakeholders that it

is providing a cost-effective service on the basis of actual operating results, and by comparison to international best in class benchmarks, in our respectful submission the company should not enjoy the privilege of earning a return on a deemed equity component of a deemed capital structure.

Dr. Yatchew put it this way. "In my view, it would be inappropriate to embed a payment for return on equity within the rate structure or any other additional feature of a commercialized operation on the revenue side until the company ensures that commercial type processes have been instituted on the costs and operations side. Such processes would include benchmarking against top quarter utilities, incentives within the company that are tied to performance and demonstrable productivity improvements."

Quite obviously there is a fundamental difference of opinion in the matter of capital structure which the Board is obliged to resolve.

On this point it is essential to understand the applicant's evidence on its need to attract capital in the next couple of years in the context of restructuring. Both of these, that is to say, the need to attract capital and the restructuring, suggest that the actual capitalization of New Brunswick Power today, that is to

say 100 percent debt, should remain applicable for NB Power Transmission for ratemaking purposes effective April 1.

Let's again remember that New Brunswick Power says there will be no actual change in the actual financing of the transmission assets. And there will be no actual equity infusion. These assets are unencumbered today notwithstanding the existing 100 percent debt financing on them.

What we need to focus on, as Dr. Morin told us, is the ability of New Brunswick Power Transmission to attract capital. And the starting point is April 1.

We are told that as of March 31, 2003 the transmission business unit or New Brunswick Power Transmission's total long-term debt is \$237.9 million. This capital has already been attracted.

And New Brunswick Power Transmission's obligations concerning that debt are and will remain guaranteed by the Province. It is legacy debt. And Ms. MacFarlane told you that it is efficient financing.

Now we are told that as of March 31, 2004, that is to say during the first test year or the first year of New Brunswick Power Transmission's supposed stand-alone existence, its total long-term debt will be \$247.9

million, an increase of some \$10 million or 4 percent over this year.

What happens is that \$7 million of what New Brunswick Power calls existing debt is going to be retired next year. And New Brunswick Power Transmission will incur \$17 million of what it calls new debt for a net increase of \$10 million.

Thus New Brunswick Power Transmission needs a capital structure that will allow it at reasonable rates to attract \$17 million of incremental capital in the first year of its existence -- excuse me -- \$10 million.

Now Ms. MacFarlane sought to persuade you that in this first, year of the -- of the existing debt, 164.4 million is guaranteed and that 83.5 million -- that is to say 66-and-a-half million dollars this year and the \$17 million to be issued in 2004, that that's new debt to be incurred by stand-alone New Brunswick Power Transmission without the benefit of a guarantee.

She actually told you that this 83-and-a-half million dollars of new debt will be issued by the transmission company to bondholders. Well we say this, just exactly how is it that New Brunswick Power Transmission, which is to be created only for April 1, can issue 66-and-a-half million dollars of debt in the fiscal year which ends on

March 31, 2003? It can't. The evidence is that in the next two years beginning April 1 New Brunswick Power needs to attract \$17 million of new capital in 2004 fiscal year and \$15 million in the next fiscal year, for a total of \$32 million of new capital.

Ms. MacFarlane told you that as to the \$17 million issue next year that the province may keep that issue. At the very least the size of any foreseeable new capital requirements for New Brunswick Power Transmission after April 1 are such that they will be private placements.

We know from Bill 30 that the Electric Finance Corporation will be the holder of the so-called equity in New Brunswick Power Transmission and will be the recipient of any dividends to be paid out of any allowed return on equity. This is an extremely important fact.

Ask yourself why EFC, a new Crown corporation, should be the lucky party? What is it bringing to the party? It is simply exchanging a portion of existing New Brunswick Power debt having an effective interest rate of 8.2 percent, as Mr. Nettleton has described it for you, for so-called equity, which if you approve this application will earn a return of 11 percent.

Ask yourself, is there in fact in the real world any difference in the way that New Brunswick Power

Transmission will be financed in the immediate future as compared to how New Brunswick Power finances its affairs and assets today? Is there any credible evidence for example that the value of the government guarantee fee is worth the 280 basis point difference between 11 percent and 8.2 percent? No.

Ask yourself also about the arbitrage opportunity inherent in an 11 percent after tax return on this so-called equity investment. Once again, Mr. Chairman, there is not going to be any actual infusion of cash into New Brunswick Power Transmission. Indeed we know that the province, if at all, intends to consider equity infusions only on a project basis. EFC is only going to resource any new equity infusions into this company based on new financial commitments it makes by issuing new debt. And it does that by raising debt on behalf of the province at rates as low as five percent all-in, as Ms. MacFarlane has told us. So by approving an 11 percent after tax return on equity in a deemed capital structure of 65, 35, the cost to ratepayers of financing more than one-third of the transmission rate base will increase by one-third more than what is in fact the case.

You are asked, Mr. Chairman and members, with respect, to create an enormous fiction for rate purposes, one that

provides the EFC with a minimum 280 basis point arbitrage opportunity.

It is a fiction that is not, in our respectful submission, in the best interests of the citizens of this province because their transmission rates are going to rise dramatically in order to pay for the opportunity.

At the same time you are asked to approve a capital structure for ratemaking purposes which will not promote proper pricing signals because the cost of transmission services will not reflect the actual embedded cost of providing the service. And it was Dr. Morin who told you that rates which don't reflect actual costs are inefficient.

Now if existing legacy debt was going to be torn out and refinanced completely and there was in fact going to be an equity infusion into the company, this would be a much different case. Equity infusion would be based on the market value of New Brunswick Power Transmission. But that's not what is happening here. If it were the case, perhaps we wouldn't be here arguing that a deemed capital structure creates a fictional cost, because there would in fact be actual equity invested in the market value of the utility.

Perhaps we wouldn't be arguing so strenuously about

what the fair return is to an equity investor because we would be able to actually see and compare the price earnings ratio of the equity performed as compared to the market and utility sub-indices, let alone similarly situated publicly traded electrical utilities.

And perhaps we wouldn't be arguing as strenuously that transmission rates based on a revenue requirement which include a return on real equity are not just and reasonable.

But that just isn't the case, and it's not going to be the case in the future.

We submit, Mr. Chairman, that you should not create the legal fiction that for rate making purposes allows NB Power Transmission to swap existing debt with the EFC for so-called equity that will earn an 11 percent after tax return for those purposes. New Brunswick Power has not submitted any credible evidence which would allow you to conclude that such a transaction results in just and reasonable rates.

And this is why we submit that as of April 1 the actual capital structure of New Brunswick Power Transmission, 100 percent debt, should remain intact at least and until new capital is required to be financed with actual equity dollars.

Ms. MacFarlane tells us a hundred percent debt capital structure has been the most efficient capital structure for the existing assets while the government guarantee is in place. That government guarantee is not going away in respect of the debt capital on April 1 of New Brunswick Power Transmission, and the efficiency therefore remains.

The deliberate and controlled way to introduce the concept of equity to New Brunswick Power Transmission is to do so over time. That's what Minister Volpe said when he introduced Bill 30 into the legislature. Quote, "In time each of the corporations will be required to pay dividends to the shareholder."

If equity is in fact required by New Brunswick Power Transmission as a component to replace some portion of the legacy debt, then that is when and how it should be introduced. Until then for ratemaking purposes we submit that the actual capital structure should continue to be reflected in the transmission rates charged by New Brunswick Power Transmission.

Perhaps Ms. MacFarlane put it best when she told you this. Quote, "The intent though is as the debt attrits over time as issues mature the portion of the debt represented by -- the portion of the debt that remains in the subsidiary company as it matures, if there is not

sufficient cash to restore that obligation, the entity will refinance it in their own name on their own credit. So the government guarantee over time as the debt attrits will disappear. Question: Over time?

Ms. MacFarlane: Over time. Question: And so over time the expectation as I understand your explanation here, Ms. MacFarlane, is that New Brunswick Transmission Corporation over time will be refinancing the obligation in its own name to bondholders? Ms.

MacFarlane: That's correct."

Now if the capital structure remains as it is, what is the impact on New Brunswick Power Transmission's revenue requirement, having regard to the positions of JDI and CME that Mr. Nettleton has discussed?

If you look at page 1 of the aid to argument, Mr. Chairman, under the column JDI CME Case 1, there are three consequences, resulting in a total revenue requirement of 72.4 million dollars.

First, the finance charges are 19.3 million dollars. The amount of debt and the effective rates on that debt are both lower, as Mr. Nettleton has described to you, and this is all shown on pages 5 and 6 of the aid to argument. Second, the return on equity on line 6 of page 1 in a 100 percent debt structure is obviously nil. There is no equity on which a return need be earned. Third, the

payment in lieu of taxes on line 4 is also new, for reasons which are set out on page 2 of the aid to argument. Essentially finance charges exceed the level of net income and accordingly there is no effective tax liability.

Now Mr. Chairman, in the event that you are persuaded that a deemed capital structure is appropriate for New Brunswick Power Transmission, we make the following alternative submission.

It is Dr. Yatchew's opinion that if a deemed capital structure and embedded return on equity is appropriate for New Brunswick Power Transmission, it should be structured 70 percent debt and 30 percent equity or marginally lower in the equity side than that recommended by Dr. Morin.

Dr. Yatchew believes that a 70, 30 structure would be appropriate for New Brunswick Power Transmission due principally to the negligible default risk of the company and otherwise the very small risk of a transmission utility.

Let me expand on this point. New Brunswick Power Transmission will be a Crown corporation whose owner guarantees 100 percent of its existing capital obligations on April 1.

Let's just assume as against the evidence that New

Brunswick Power's cash flows more than support its debt, that New Brunswick Power Transmission finds itself approaching a default situation. Who is it that is going to pull the trigger on the company? The Province?

There is no risk, as New Brunswick Power's witnesses told you, of New Brunswick Power Transmission not recovering its prudently incurred costs, including of course its fair and reasonable costs of debt.

Under its application, New Brunswick Power proposes to have New Brunswick Power Transmission recover a return on equity of \$12.6 million next year. On the same assumptions Dr. Yatchew's 30 percent equity ratio would produce an allowed return component of \$10.8 million of course based on an 8.25 percent return.

Neither Dr. Yatchew or Dr. Morin, at least by his curriculum vitae, have spent time at the helm of a commercial organization. Neither of them is a bond rater. However, both witnesses are clearly astute individuals who we submit do not tender opinions on matters of capital structure lightly, and who endeavor to do so with reference to empirical evidence. So let's look at that.

In his presentation Dr. Yatchew told you, and Dr. Morin does not disagree, major Canadian gas pipelines have, on the basis of the 30 percent deemed equity

component in their deemed capital structures, been able to attract capital in the marketplace for some considerable time.

Dr. Morin wanted you to know that there has been a recent increase to 33 percent following a recent generic review of the appropriate equity ratio for Canadian gas transmission companies.

There has been no such generic review, Mr. Chairman. Rather the National Energy Board in its RH-4-2001 decision of June 2002 determined to adjust Trans-Canada Pipelines' capital structure from 30 percent equity to 33 percent.

Dr. Morin says that such a change was "warranted". But he doesn't say why. A review of that decision, Mr. Chairman, makes it very clear that this recent adjustment for Trans-Canada was due to the competitive and hence risk environment in which it now operates.

On the contrary there is not wire-to-wire competition in the electricity business in New Brunswick, nor will there be. In this respect New Brunswick Power Transmission and Trans-Canada are not comparable. Rather New Brunswick Power Transmission is more comparable to the Trans-Canada that existed prior to the decision to which Dr. Morin referred.

A 70, 30 capital structure for New Brunswick Power

Transmission at the appropriate time would also be consistent with the Regie's decision for Hydro Quebec TransEnergie, where the Regie accepted TransEnergie's position that a 30 percent equity would be appropriate.

You will recall that in Mr. Hashey's view TransEnergie is the best comparator for New Brunswick Power Transmission.

The 30 percent equity that was approved by the Regie was within Dr. Morin's recommended range for that client but lower than his actual recommendation of 32 1/2 percent.

Undoubtedly, Mr. Chairman, your staff can point me to many other examples of 30 percent equity wedges on deemed capital structures.

We wish to address the concern that has been expressed on more than one occasion in this record as to the adequacy of a 30 percent or even a 35 percent equity component of a deemed capital structure for New Brunswick Power Transmission.

In theory we suppose that such a concern should exist about any deemed equity structure for the very reason that it is not real.

The concern, as we understand it, proceeds from the premise that an inadequate or thin capitalization of New

Brunswick Power Transmission for ratemaking purposes could be a critical mistake given the absence of a government guarantee on any new debt going forward and the perceived need for the company to be actively seeking capital in debt markets which are still feeling the effects of Enron.

The concern suggests that a better real world approach would be, assuming a deemed capital structure for ratemaking, to increase the equity wedge so as to create a thicker cushion against any future failure by New Brunswick Power Transmission.

Mr. Chairman, we agree that there is some confusion between the real world and the notion of a thicker equity component of New Brunswick Power Transmission's deemed capital structure.

In the real world we must recognize that New Brunswick Power Transmission is not a new business with the attendant risks entailed in that position.

New Brunswick Power Transmission's revenue, while not guaranteed, is largely assured. And there is no prospective shortfall in revenue which prompts this application.

Recall as well NB Power Transmission's constant load forecast and Dr. Yatchew's uncontroverted evidence on price elasticity.

We must again recognize that your decision on a deemed capital structure has nothing to do with actual equity. And neither does the restructuring. In the real world we submit that there is little prospect of New Brunswick Power Transmission's failure.

In any event, deemed equity for ratemaking purposes, both by definition and in the circumstances of this utility, simply does not provide a cushion. The real world, from a capital attractive perspective, is as

Ms. MacFarlane told you, "There is only one issue that NBP has that comes due next year that would require refinancing. And our preliminary discussions with Debtco -- and again none of this has been agreed, is that they would -- the Province would keep that issue. So that would mean in the first year none of these new companies would have to go to market other than for short-term borrowing."

Therefore, Mr. Chairman, your decision in this case must, we submit, proceed on the basis that in fiscal year 2004 New Brunswick Power Transmission will issue \$17 million of new debt -- that must be the new issue to which Ms. MacFarlane refers -- and in the following year will issue \$15 million of new debt, for a total over the two-year period of \$32 million.

So albeit without benefit of its owner's guarantee, New Brunswick Power Transmission, on the evidence before you, is in the fortunate circumstance over the next two years of having to potentially refinance debt obligations equivalent to a minor portion of its current capital.

The reality, sir, with respect, is that New Brunswick Power Transmission doesn't really have bonds to sell right up front. And the evidence on this point does not therefore support a thicker equity wedge for ratemaking purposes, even assuming this would be of benefit to the company, which it will not be.

Now if you approve a 70, 30 capital structure for New Brunswick Power Transmission, what is the impact on the company's revenue requirement?

Again, Mr. Chairman, on page 1 of the aid to argument under the column "JDI/CME Case 2" there are two consequences, actually three, resulting in a total revenue requirement of \$81.9 million.

First, in light of the deemed capital structure, the finance charges, in accordance with Mr. Nettleton's submissions, will be \$14.7 million. The amount of debt and the effective rates of that debt are lower, as shown on pages 5 and 6 of the aid to argument.

Second, you will see on line 5 that on a 30 percent

equity wedge at 8.25 percent the allowable return on equity is \$8.1 million.

Third, due to the return on deemed equity, the payment in lieu of taxes on line 4 is \$6 million for the reasons set out at page 2 of the aid to argument.

The calculation of that \$8.1 million of allowable return on equity, Mr. Chairman, may be found at page 9 of the aid to argument.

On the issue of capital structure there are a couple of other considerations I wish to mention.

We have heard evidence from Dr. Morin to the effect that one of his reasons for recommending a 65, 35 ratio is to maintain New Brunswick Power Transmission's current bond rating. Of course New Brunswick Power Transmission doesn't have a current bond rating. Indeed the evidence is quite thin on this point and for good reason. Ms. MacFarlane told you that New Brunswick Power Transmission won't have to go to the market.

While acknowledging that matters such as capital structure, both deemed and actual, is a relevant consideration for bond raters, JDI and its CME colleagues submit that determinations in this regard are the result of many factors in the real world. As Dr. Yatchew told you, specific debt equity structures have an impact on a

company's total cost of capital. Hypothetical structure A may decrease or it may well increase that cost.

But as well he told you that markets also consider the question of company cost performance, benchmarks, efficiencies and whether or not a particular structure provides incentives for management to seek cost reductions or improvements.

Dr. Yatchew's evidence is that there is not necessarily an optimal capital structure. It may be that the market is concerned as to cash flow of a regulated utility such as New Brunswick Power Transmission. But in our view the source of that cash flow, such as a thick equity wedge or efficiencies driven by a thinner equity wedge, is of lesser consequence.

A second factor flows in our submission from your broad public interest mandate. The regulation of New Brunswick's electricity market is not wholly defined by the affairs of New Brunswick Power Transmission. Transmission is but one link in the chain which also includes generation, nuclear generation and distribution, all of which according not only to Dr. Morin but intuitively as well are riskier undertakings than transmission.

As Dr. Yatchew said, your decision as to whether New

Brunswick Power Transmission should have a deemed capital structure, and if so, the appropriate components of that structure, will necessarily establish the lower bounds for potential deemed capital structures of other regulated but riskier links in the chain. This is evident in the embedded cost study filed by New Brunswick Power which reflected a 55, 45 capital structure for New Brunswick Power Generation, 45 equity -- 45 debt, 55 equity, as well as an assumed 11 percent return on equity.

And finally, let's again remember to consider this question in light of the evidence on what capital New Brunswick Power Transmission actually needs in the next couple of years.

Before I turn to the issue of risk, Mr. Chairman, I would like to make a couple of comments in response to one or two points that my friend Mr. Hashey made on capital structure.

You will recall that he referred to the Cragg article which he put to Dr. Yatchew and which said that the risks of inadequate transmission investment are the greatest at the early stage of restructuring. The hypothesis in that article of course is not one that was tested and brought forward by the applicant to be tested in its case. It forms no part of New Brunswick Power or Dr. Morin's

evidence that New Brunswick Power Transmission is under capitalized, does it? I don't think so. If it did we would have expected to see investment advisers or investment bankers here on behalf of the company. But there was no such evidence. What we know is that New Brunswick Power Transmission on April 1 will be created with significant unencumbered assets with which it can attract capital and that its application is not premised on any revenue shortfall.

Secondly, Mr. Hashey cited Dr. Morin's comments as to how the investment community is nervous and jittery about the electricity industry due to the uncertainties of restructuring. And so, Mr. Chairman, are ratepayers. We certainly agree that some caution is appropriate when contemplating major changes in an initially restructured market, like putting a price cap regime in place for three years, and I will come to that. And again, I'm not sure how relevant the jitteriness of the investment community is in light of Ms. MacFarlane's evidence that New Brunswick Power Transmission will not be going to the market next year.

Mr. Hashey also said that exhibit A-58 -- you will recall that, Mr. Chairman, that is the latest smoke signal from the Province's investment bankers -- he said that

that confirms -- because the current upstairs capital structure is thought to be 60, 40, and the current upstairs recommended return on equity is ten percent, he said that confirmed the earlier speculation about what the Province's investment bankers might recommend.

If this is at all relevant to your task of determining just and reasonable rates for New Brunswick Power Transmission, why haven't we had an opportunity to test it? Why haven't the authors of the smoke signals been brought to you so that you can ask them questions to test the veracity of these suggestions?

With respect, Mr. Chairman, for the purposes in which we are engaged, exhibit A-58 is of no probative value whatsoever.

Let me turn now to the issue of risk. Dr. Morin recommends that on the 35 percent deemed equity component, you award New Brunswick Power Transmission a return of 11 percent. He does so in part based on his assessment of the company's risk -- I shouldn't say the company because it hasn't yet been created, but his anticipation of the risk environment in which it will operate. So let's discuss that environment.

In the context of a regulated utility, risk generally encompasses three sub-headings, business risk, regulatory

risk and financial risk. Dr. Morin agrees with the National Energy Board's definitions of these three categories of risk laid out in its RH-4-2001 decision. He also agrees that Canadian data remains the most relevant information or benchmark in determining a regulated cost of capital.

With respect to business risk, Dr. Morin has concluded that 90 percent of New Brunswick Power Transmission anticipated revenue stream is relatively stable. As I mentioned, and indeed Mr. Marshall told you, this application is not prompted by any revenue shortfall. It is only in respect of the non-firm portion of New Brunswick Power's export sales that Dr. Morin believes that New Brunswick Power Transmission's revenue is subject to forecasting risk. That said, of course, Dr. Morin acknowledges at the same time that New Brunswick Power's generating costs are likely to remain competitive in the future.

So it may be that TransEnergie has less forecasting risk, as Mr. Hashey said in his argument, but surely the better question, Mr. Chairman, is the extent of New Brunswick Power Transmission risk, which we submit is minimal in this regard.

In concluding that New Brunswick Power Transmission's

business risk is comparable to the utility industry generally, Dr. Morin reflects what he refers to as the "competitive threat from Sable Island natural gas." He concedes, however, that high transportation costs for natural gas and high conversion costs mitigate this threat.

Now, Chairman, one of the ironies in this area is that New Brunswick Power has been with the Province a staunch supporter of the development of a natural gas market in New Brunswick, and has supported both the Sable Island and Maritimes and Northeast's projects, the latter of which is part of the threat to which Dr. Morin refers. That support extended to a 75, 25 deemed capital structure approved by the National Energy Board for Maritimes and Northeast Pipeline.

I mention that because you will recall that Dr. Morin in re-examination wanted you to know that because of this thin equity ratio, as he called it, the National Energy Board determined to award Maritimes and Northeast Pipeline a 13 percent return on equity. What we want you to know is this. Yes, it did do that, and it did it for five years. But firstly the 25 percent equity component was recommended to minimize rates. And second, the 13 percent is due to the fact that Maritimes and Northeast Pipeline

was a greenfield pipeline and its only supply source was new and untested, and so was its market.

So from the point of view of comparative risk, suffice it to say there is nothing new or untested or greenfield about New Brunswick Power Transmission's supply or markets.

Indeed, New Brunswick Power's sales forecast which you considered in last year's proceeding were in fact premised upon the existence of laterals extending from the Maritimes & Northeast main line into the northeast and northwest regions of the province. New Brunswick Power acknowledges that its sales forecasts would change for the better -- for the better -- if these laterals were not built. And in assessing Dr. Morin's views on this topic of business risk, you will of course wish to take into account the current prospect of further necessary gas supplies for New Brunswick to underwrite the threat to New Brunswick Power Transmission's market.

Finally, New Brunswick Power is concerned that its customers may elect to bypass the transmission system, or indeed seek alternate providers of power. In the event of the latter this of course doesn't necessarily mean or imply that New Brunswick Power Transmission will lose a revenue customer. And our clients understand that in the

event that a large customer should leave the system entirely, that Bill 30 confirms the company will be compensated.

In the submission of JDI and CME then, Mr. Chairman, New Brunswick Power Transmission's anticipated business risk, that is to say, the realization of its expected future income, is at the lower end of the applicable range for a wires only company that is not subject to competition.

Before I move to regulatory risk, let me again, as will be my habit this morning, Mr. Chairman, respond to a couple of points that Mr. Hashey made on business risk.

He said that a great deal of our cross examination of Dr. Morin and a great deal of Dr. Yatchew's evidence concerned pipelines. He was implying that we were overly concerned about pipelines. But that Dr. Morin wasn't.

I will leave it to you to review Dr. Yatchew's evidence to see how much discussion is contained in that evidence about pipelines. But as to Dr. Morin, let's just look at the evidence. Because in my submission, Dr. Morin extensively relied upon and referred to gas utilities and pipelines for various purposes.

He specifically compared the risk of New Brunswick Power Transmission to the business risk of gas utilities.

He used gas distributors and gas transmission companies' information for his determination of beta.

He looked at gas distribution data and just 31 National Energy Board decisions on gas transmission matters in respect of his risk premium determination. And he looked at U.S. gas utility data in respect of his discounted cash flow check on his return on equity.

So be critical about the amount of our cross examination of Dr. Morin if you wish. But don't imply that we were cross examining on something that didn't form a substantive part of his evidence. Because it did.

And it did because Dr. Morin views pipelines as reasonably comparable risk entities to wires companies.

And Mr. Hashey, with respect, may want to distance his client from Dr. Morin on this point, but please don't misstate the evidence to make the point.

Let me turn to regulatory risk in respect of which you are faced with Dr. Morin's opinion that New Brunswick Power Transmission is above average. A small, but I would say symbolically important component of his opinion, Mr. Chairman, is attributed to the implementation of the proposed price cap regime as against the more conventional and perhaps more conservative method of regulation which our clients urge you to adopt for the moment.

Dr. Morin also suggests that there are a number of issues concerning New Brunswick Power Transmission which will arise in the next year or two on which your views are unknown. Perhaps that uncertainty may be alleviated, Mr. Chairman, by the fact that according to Dr. Morin in cross examination, none of those issues require decisions by this Board. So where is the regulatory risk?

There certainly, in our view, can be no suggestion that New Brunswick Power Transmission faces any discrete regulatory risk associated with its affiliate's activity in the lucrative export market in which New Brunswick Power will presumably continue to participate.

At the end of the day, Mr. Chairman, New Brunswick Power Transmission's regulatory risk, in our submission, comes down to the likely ability of the company to recover its prudently incurred costs.

Dr. Morin concedes that this will be the case for the company going forward. If that is so, then in our submission, his contention that New Brunswick Power Transmission is above average anticipated regulatory risk should be rejected.

And thirdly let me deal with financial risk. In the area of financial risk, being the variability of returns available to New Brunswick Power Transmission's owner,

after recognizing the fixed charge burdens on the company, Dr. Morin says New Brunswick Power Transmission is particularly vulnerable and accordingly has greater than average financial risk.

Well simply put, Mr. Chairman, there is no evidence in this record that New Brunswick Power Transmission will not be able to service its debt, both legacy and new, as has been the case historically for New Brunswick Power. That being so, there is simply in our view no basis for concluding that a supposed stand-alone New Brunswick Power Transmission suffers any undue financial risk.

Let me comment briefly on a couple of my friend's submissions on the issue of financial risk, leaving aside the issue of forecasting risk.

Mr. Hashey, as I understood it, told you that Dr. Yatchew agreed that TransEnergie doesn't have to go to the open market to raise capital, but that New Brunswick Power Transmission will. That TransEnergie is larger than New Brunswick Power Transmission and that accordingly Dr. Yatchew agrees that New Brunswick Power has higher risk, which he subsequently described as New Brunswick Power Transmission being more risky than TransEnergie and which he ultimately described as New Brunswick Power Transmission being significantly more risky than

TransEnergie.

Let's look at the evidence. At transcript 2071, Dr. Yatchew said that New Brunswick Power Transmission has moderately more risk than TransEnergie. Dr. Morin said, and Mr. Hashey referred to this in his argument, described TransEnergie as sort of less risky than New Brunswick Power Transmission.

It does the applicant no service, sir, with respect, to overstate the evidence and to attribute that overstated evidence to my witness.

I don't know whether TransEnergie has to go to the market. And I certainly acknowledge that the size of an issuer is relative -- relevant in that event. But New Brunswick Power Transmission does not, according to the evidence, have to go to the market.

An applicant's argument -- indeed any party's argument, Mr. Chairman, should conform with the evidence.

So with respect to business, regulatory and financial risk, it is based on the evidence of JDI and CME, which I say is a better view of New Brunswick Power Transmission's anticipated risk, and we submit you should address the matter of return, which I will deal with now.

It is 10:30, Mr. Chairman. Would you wish to take a break or I am quite happy to carry on for a bit.

CHAIRMAN: How much longer do you anticipate your summation will take in total?

MR. SMELLIE: An hour, sir, an hour and fifteen.

CHAIRMAN: Let's take a break now.

MR. SMELLIE: Thank you.

(Recess)

CHAIRMAN: You can go now, sir.

MR. SMELLIE: Thank you, Mr Chairman. The topic now is the matter of return. And by way of introduction we know that the fate of New Brunswick Power's request for a return of 11 percent on its proposed 35 percent deemed equity component also hinges on Dr. Morin's evidence.

Now Dr. Morin of course is a well known return witness to Canadian utility regulators. He has appeared over many years before the National Energy Board, the CRTC and a variety of provincial tribunals, particularly on matters concerning cost of capital, although not so much in the area of performance-based regulation.

Mr. Hashey told you the Dr. Morin recommends a return on equity for New Brunswick Power Transmission of ten-and-a-half to 11 percent on a 65, 35 deemed capital structure. What he specifically recommends is 11 percent, principally because of the incremental risk, which he says is precipitated by his recommended price cap. Thus his

recommendation is made in the context of his proposed price cap.

It necessarily follows from this, Mr. Chairman, that Dr. Morin believes that this is the time, as he says, New Brunswick Power Transmission will be a brand new company going out to a brave new world on its own stand-alone merits for implementing a riskier form of regulation and traditional cost of service or rate of return methodology.

In his view this level of return is necessary to enable the company to attract capital on reasonable terms and we have dealt with that point.

He also says 11 percent is commensurate with returns on comparable investments. These are the criteria which he as an expert on return matters opts to extract from important Canadian and U.S. Supreme Court decisions on the meaning of a fair return, which he says are applicable to the Crown owned transmission company in New Brunswick. Mr. Hashey did mention these principles in his argument, although he chose not to mention the equally important principle conceded by Dr. Morin that ratepayers are entitled to services at the lowest possible cost.

Dr. Morin clearly enunciated the principles which apply to the cost of debt to be recovered in transmission rates, and Mr. Nettleton has dealt with those. The ease

with which cost of debt is calculated, at least in Dr. Morin's view, was contrasted with the more difficult task of calculating the return on any equity portion of a deemed capital structure, particularly in the case where there are no pure play transmission companies to which the firm can be compared.

One aspect of this, however, is clear. Intuitively, as Dr. Morin is fond of saying, transmission undertakings are far less risky than distribution or generation firms. And the latter require a much higher return than the former because it's at the lower end of the risk spectrum.

It is Dr. Morin's view that the capital asset pricing methodology, or CAPM, and risk premium methods are the preferred practical approach for determining a fair return on equity, assuming of course the premise of a deemed capital structure for rate making purposes. On those bases he says the Board should fix a return of 11 percent, having regard to the incremental risk of price cap.

His risk premium of five percent for New Brunswick Power Transmission is based on two components, a market risk premium of 6.7 percent and a beta for the firm of .67. And as I turn to the wonderful world of beta for a couple of minutes, Mr. Chairman, perhaps you and your colleagues could turn to page 10 of the aid to argument.

Dr. Morin's beta of .67 is derived from his assessment of historical betas of comparable utilities and those of electric utilities prior to deregulation. Dr. Yatchew, you will recall, disagrees on the point and recommends the use of a beta for New Brunswick Power Transmission at the appropriate time of in the range of .35 to .5.

We need to understand the reasons for these differing opinions, Mr. Chairman, in order to properly assist you in your determination on this important question. So let me begin with Dr. Morin's beta evidence.

Based on various samples he considers that the appropriate beta for the transmission company lies in the upper half of a range of .60 to .70, and he selected .67 which implies that in his view the New Brunswick Power Transmission company will be slightly more than two-thirds as risky as the entire market. His beta you will recall is a Value Line adjusted beta as against raw beta, consistent with the empirical literature which suggests that raw betas are poor predictors. His adjustment -- or excuse me -- Value Line's adjustment reflects the theory that individual betas tend to regress or gravitate to 1.0 or the market as a whole. Indeed this adjustment is an explicit component of Value Line's definition of beta.

With this evidence, Mr. Chairman, we have several

concerns.

Our first concern is that the components of Dr. Morin's average Value Line beta of .67 are, simply put, mathematically incorrect and inconsistent. His first sample of Canadian energy utilities reflected an average beta of .60, excluding two thinly traded companies, Fortis and Pacific Northern Gas, which if they had been included would have decreased the beta estimate for the group. And we certainly wouldn't want that.

The problem with this sample, perhaps due to his slavish adherence to Value Line who he acknowledges has been known to make mistakes, is that Dr. Morin insists on including as utilities in his sample both Nova Chemicals and Canadian National Resources Limited because that's how Value Line defines the group. He takes this position notwithstanding the fact that he admits that neither of these companies are utilities, and that the average beta for this first sample properly excluding these two firms, is .54, or ten percent less risky than what he, or Value Line, asserts for this group.

His second sample of Value Line betas concern natural gas distribution utilities and his third sample concern U.S. electrical utilities prior to deregulation.

As to his second sample Dr. Morin's only error was in

reporting the sample average beta of .64 as .63 in his recapitulation.

As to the third sample Dr. Morin again erred in reporting the sample average of .70 as .68 in his recapitulation.

Dr. Morin's fourth beta sample group concerned gas transmission companies, the average beta of which he says is .65, which correctly found its way into his recapitulation. The problem here, Mr. Chairman, is that the sample was not in fact limited to transmission companies, as he suggested. Indeed the sample included the largest pure gas distributor in the United States and several other firms that are more distribution than transmission oriented. Here Dr. Morin claims that distribution and transmission are very similar, although he earlier suggested that transmission companies are less risky than distribution companies. And we are talking here about the quantification of relative risk, aren't we?

Perhaps a more material error in this fourth sample group was Dr. Morin's inclusion of a pure oil and natural gas producer whose Value Line beta of 1.0 -- in other words as risky as the entire market -- clearly biased the sample average upwards. And we wouldn't want that, would we? At the very least KCS Energy was not properly a

member of this group and the average beta of .65 should on this account alone be corrected to .63.

Dr. Morin then calculated an unlevered beta for his first sample group, which he says is .22, which in turn provided a beta range for New Brunswick Power Transmission at a 30 to 35 percent equity ratio of .63 to .73, which he once again incorrectly recorded in his recapitulation as .63 to .81.

The problem here, Mr. Chairman, is that this important sample includes Fortis, Pacific Northern Gas, as well as Nova Chemicals and Canadian Natural Resources Limited. Remember these? If these companies were not properly part of Dr. Morin's first sample group, then clearly they should not form part of this one either, no matter what Value Line says. In our submission the correct unlevered beta for this group, using Dr. Morin's 35 percent equity recommendation, is .49. And he agrees with that calculation.

Page 10 of the aid to argument, Mr. Chairman, reflects in our submission these necessary corrections to Dr. Morin's beta evidence. As against his selection of .67, page 10 shows the correct average beta as .62, or eight percent lower. Is this a minor difference, one that might be described as di minimis? Well Dr. Morin's beta of .67

led to the low end of his equity return range of 10.5 percent for New Brunswick Power Transmission.

However, a beta for New Brunswick Power Transmission of .62, on Dr. Morin's assumptions, equates to a return of 10.2 percent or 30 basis points lower. Assuming for the moment a .5 increase to that rate due to the increased risk of implementing a price cap regime, a correct beta would result in a return for New Brunswick Power Transmission of 10.7 percent, which on a 35 percent equity ratio would equal a return of 12.3 million, or \$300,000 less than that applied for. That's not what our clients consider to be minor.

You will recall Dr. Morin's attempt to address these various inaccuracies in his beta estimates. He did so on re-examination, but he only corrected those of his errors which were typos and in his favour, choosing to ignore the more substantive issues. He said the typos reduce his beta for New Brunswick Power Transmission from .67 to .66. Indeed they do. But as I have noted, the scope of his inaccuracy extends well beyond that.

This is not, Mr. Chairman, about playing games, as Dr. Morin suggested. This is about ensuring that you have the best evidence available, which in our view should be the result of accurate calculations as one would expect from a

professional of Dr. Morin's stature. He is held out as an expert and he has proffered his opinion on various issues of importance to the public interest of this province.

Value Line is a commercial provider of data which can apparently bias beta upwards. You should, we submit, be circumspect about Dr. Morin's beta evidence, and the record suggests, with respect, that you would be in reasonable company if you did so.

We say this in light of our discussion with him concerning a number of important Canadian regulatory decisions in which Dr. Morin was involved on behalf of utilities which relied on his evidence and his expert opinion.

The National Energy Board has not accepted Dr. Morin's recommendations on capital structure or on return on equity for Trans-Quebec Maritime Pipeline on any of the occasions where he gave evidence for that company.

Neither has the CRTC chosen to accept Dr. Morin's recommended capital structure, recommended market risk premium estimates or Value Line betas of which he is so fond.

More recently the Regie in Quebec fixed a 30 percent deemed equity ratio for his client TransEnergie on the recommendation of the utility but as against Dr. Morin's

proposed 32 1/2 percent. Neither did the Regie accept his recommendation on either beta or return on equity.

Perhaps of greater concern in the world of beta, Mr. Chairman, is Dr. Morin's position that adjusted betas based on regression towards the market, that is Value Line betas, are the only way to calculate a risk premium for New Brunswick Power Transmission.

The evidence, we submit, does not support this theory and prompts and inquiry as to why he is so fixed on the point.

It is reasonably clear there is a consensus that raw betas are poor statistical predictors and are outperformed by adjustment betas.

That was the conclusion reached by Dr. Kryzanowski and Dr. Jalilvand in their May 1986 paper published in the Financial Review.

You will recall of course that Dr. Morin considered this paper, at least for the purposes of his written evidence, to be a "comprehensive study". Studies such as this are of course vitally important in matters concerning return.

Because as Dr. Morin told you, the determination of risk premium, of which beta is an integral part, is essentially an empirical exercise based on analyses of such comprehensive, relevant and reliable data together with a dose of informed judgment.

In any event, sir, the agreed upon premise is that adjusted betas are a lot better than unadjusted or raw betas. The question is what sort of adjustment provides the best predictor?

Now our discussion of this study with Dr. Morin was extensive and while at times confusing, at least in the questioning, the evidence is nevertheless clear. There are numerous ways to adjust raw betas.

But according to Kryzanowski the best beta predictor is not that which assumes betas tend to gravitate to the market or 1.0, as Dr. Morin suggests, and as Value Line defines the term, but that which assumes the beta of a particular firm will gravitate toward the mean or average of the industry in question. For utilities this translates to the weighted average of a firm's raw beta and a utility average beta.

The point, Mr. Chairman, is an evident one. We know that Value Line tends to push low betas upwards. Since utilities are typically about two-thirds as risky as the market, according to Dr. Morin, it must follow that Value Line betas will always have the ultimate effect, when plugged into the CAPM formula, of a higher return on equity for the firm.

Conversely, if one adjusts raw betas to the utility

mean, which according to Dr. Morin will be about one-third less risky than the market, it must also follow that such adjusted betas will ultimately result in a lower return for the firm in question.

In the course of our discussion I think it became apparent to Dr. Morin where we were headed with this, which prompted him to do a bit of an about-face and to suggest to you that the Kryzanowski study which he relied upon in his written evidence is "very, very stale."

Now Dr. Yatchew put it far better than I could when he told you a couple of things. First he told you that

Dr. Kryzanowski's evidence before your colleagues in Nova Scotia last year affirmed the very position which Dr. Morin now asserts is stale.

That is, the best forecast of a firm's beta is obtained is obtained by adjusting for industry betas and not towards the market beta of 1.0. New Brunswick Power did not contest this point.

Remember as well Dr. Yatchew's weather analogy and his intuitive notion that adjusting one firm's beta towards the average of all firms, no matter their business, can lead to some rather perverse forecasts.

Again we submit that you should view with caution Dr. Morin's insistence on the use of Value Line adjusted betas to determine return on equity.

A further concern about Dr. Morin's selected beta of .67 for New Brunswick Power Transmission arises out of his focus on Value Line betas for a five-year period ending in 1997 which showed the effect of restructuring, deregulation and increasing competition, at least in the United States, reflected in increasing beta values.

But Mr. Chairman, you are asked to determine a risk premium for New Brunswick Power Transmission in 2003, more than six years later. And Dr. Morin simply tells you that the best predictor today for New Brunswick Power Transmission is .67 or conveniently just less than the .7 for the group of utilities he considered up to but not later than 1997.

Dr. Yatchew's estimate of beta for New Brunswick Power Transmission is .35 to .5 which he in part bases upon a consideration of Canadian utility betas for the 10-year period ending in 2001, over which period the average is .4.

It is true, Mr. Chairman, that there has been volatility in markets since 1997, just as there were various factors and culprits at play in the five year period which Dr. Morin choose to rely on.

In response to Mr. Sollows' request, Dr. Morin provided an update to his 1992 to 1997 analysis in the

form of providing the median 2002 Value Line beta for his group of U.S. electric utilities which was .55, just below where his analysis began in 1992 and materially less than .67.

So Dr. Morin selects .67 as an appropriate beta for New Brunswick Power Transmission and effectively says, let's just ignore what happened after 1997 in the electricity business because of volatility.

We submit that on balance, Mr. Chairman, the evidence on timing and trends supports a beta for New Brunswick Power Transmission that is much closer to .5 than .7.

Even if you assume a 6.7 percent risk premium, a beta for New Brunswick Power Transmission of .5 results in an equity risk premium for the firm of 9.35 percent or 90 basis points below the low end of Dr. Morin's proposed 10.5 percent, assuming a risk-free rate of 6 percent.

The next step in finding a fair return on equity for a firm, having determined its relative risk or beta, is to determine and find the market risk premium, which taken together with beta in turn permits a calculation of the firm's risk premium.

Dr. Morin's CAPM approach uses both an historical and prospective component for this feature, an approach with which JDI and CME do not disagree.

As Dr. Yatchew says, we look at the question from an historical perspective, looking back to determine the level of premium actually earned and prospectively as well to determine what was expected to be earned.

Dr. Morin contends on the basis of four Canadian and two U.S. compilations or studies, four of which are historical and two of which are prospective, that the market risk premium to factor into the determination of a return on equity for New Brunswick Power Transmission for ratemaking purposes is 6.7 percent.

He believes that the U.S. result should be weighted substantially given the integration of Canadian and U.S. economies and increasing globalization.

Based on a beta of .67 this in turn leads him to conclude that the risk premium for New Brunswick Power Transmission should be 4.5 percent.

Dr. Morin then compared this result with data concerning U.S. electric and gas utilities and allowed risk premiums by Canadian and U.S. regulators in the order of 4 1/2 to 5 percent, which he ultimately concludes as being an appropriate range of risk premium for New Brunswick Power Transmission.

In this last respect we note Mr. Sollows' discussion with Dr. Morin on his exhibit RAM-7 which concluded that

the risk premium for U.S. electric utilities from 1931 to 2000 was 5.7 percent.

Having reflected on the point we are persuaded that Mr. Sollows' conclusion that a more accurate finding in this regard would be an equity risk premium of 3 to 4 percent is the correct one.

JDI and CME submit that while U.S. data is by no means irrelevant, Mr. Chairman, Canadian data, as the National Energy Board has found, ought to be principally relied upon.

As the Board said at page 35 of its June 2002 RH-4-2001 decision concerning TransCanada Pipelines, "The Board acknowledges the continued trend towards globalization of markets. However the Board is persuaded that Canadian market data continue to be the most relevant benchmark in assessing the cost of capital for Canadian pipelines. In particular the Board notes that less than 15 percent of TransCanada's common shares are held by foreign investors outside of Canada, almost all of which are held in Canadian portfolios of U.S. money managers."

That is Dr. Morin's evidence on risk premium. What about Dr. Yatchew's evidence?

He brought your attention to the recent seminal work entitled "Triumph of the Optimists" which finds that over

the course of 20th Century, the Canadian market risk premium is 4.5 percent, or some 220 basis points lower than Dr. Morin's conclusion of 6.7 percent.

As well, Dr. Yatchew brought to your attention a number of peer reviewed studies, which conclude that the risk premium is actually much lower than previously thought. You will remember the quintet, the works including those of noted economists, Blanchard, Fama & French, Claus and Thomas, who put the U.S. equity risk premium in the range of 2 1/2 to 4.3 percent. The upper bound of which is some 240 basis points lower than Dr. Morin's conclusion.

It bears mention, and I will come back to it, that these studies use a variant of the discounted cash flow methodology, which also factored also into Dr. Morin's conclusion at least as a check.

So both witnesses, Mr. Chairman, have regard to the discounted cash flow methodology.

We submit, sir, that the empirical studies brought to your attention by Mr. Yatchew are entitled to considerable weight in your deliberation. You will also recall the crossover, as I might call it, between Drs. Yatchew and Morin in the respect of the work of Ibbotson.

Relied on by Dr. Morin in his conclusion that the market risk

premium is 6.7 percent, Ibbotson was also noted by Dr. Yatchew as being a very-well recognized authority in this field. What Dr. Yatchew specifically brought to your attention is the recent study by Dr. Ibbotson and Chen, which concludes that U.S. equity risk premium is just below 4 percent, or about 270 basis points below Dr. Morin's conclusion.

For convenience, Mr. Chairman, a summary of the various risk premia data relied on by both Drs. Yatchew and Morin is reproduced at page 11 of the aid to argument.

On the strength of the extensive information and data which he considered, Dr. Yatchew concludes that a reasonable range for the equity risk premium is 4 to 6 percent, or some 70 to 270 basis points below Dr. Morin's conclusion. Together with his beta estimate of .35 to .5 for New Brunswick Power Transmission, Dr. Yatchew concludes that a reasonable return on deemed equity at the appropriate time would be in the range of 7.1 to 8.7 percent. And he specifically recommends 8.25 percent. And as I mentioned earlier, the effect of this level of return on New Brunswick Power Transmission's revenue requirement is shown at page 9 of the aid to argument and carried forward to page 1.

You will also appreciate that Dr. Yatchew used a risk

free rate in his calculation of 5.7 percent, whereas Dr. Morin uses 6 percent, which difference concerns the timing of their respective evidence more than anything else. Clearly we are some ways down the road from Dr. Yatchew's evidence and Dr. Morin's is even remoter.

You will no doubt, Mr. Chairman, if necessary have current data available to you as to the risk free rate that should be applied.

Nevertheless, you will appreciate assuming a risk free rate of 5.7 percent for the moment that Dr. Yatchew's conclusion of an 8.25 percent return on deemed equity represents an implicit risk premium for New Brunswick Power Transmission of 255 basis points, whereas, Dr. Morin's specific recommendation of 11 percent represents an implicit risk premium of 530 basis points.

Dr. Morin concedes that Dr. Yatchew has arrived at his conclusions relying on the views of reputable and leading economists found in leading publications. He also correctly observed that the Triumph of the Optimist speaks in terms of geometric risk premium and that the arithmetic equivalent for the Canadian equity risk premium for the 20th Century is 6 percent, which is of course recognized by Dr. Yatchew is his range of 4 to 6 percent.

You will be pleased to know, Mr. Chairman, that I am

not going to discuss arithmetic and geometric rates.

So there is not fundamental disagreement between Drs. Yatchew and Morin on the approach to return on equity.

Dr. Morin chooses, however, to reject the judgment of Blanchard and Fama & French and their opinions that the equity risk premium in the U.S. is lower than previously thought. He simply says they are wrong.

JDI and CME urge you to remember that Dr. Morin is a Value Line guy. And that the evidence strongly suggests an upward bias in his return estimates consistently proffered to Canadian regulators on behalf of his utility clients. We understand that. But equally we ask you not to lose sight of the fact that those Canadian regulators have consistently found reason, shall we say, to disagree with his judgment.

Simply put, Mr. Chairman, you have the evidence on beta. You have the evidence on market risk premium. And you have the evidence on an appropriate risk premium from New Brunswick Power Transmission.

It will therefore fall to your judgment to make the ultimate determination. We simply ask that you have regard for the extensive, and in our view, persuasive empirical evidence brought to your attention by Dr. Yatchew concerning the determination of reasonable return on equity for the firm as and when you

determine that its inclusion in New Brunswick Power Transmission revenue requirement is appropriate.

That evidence, in our summation, fairly establishes that a return on 30 percent deemed equity, if there is to be a deemed capital structure of 8.25 percent is sufficient for New Brunswick Power Transmission in the circumstances which will prevail at and after April 1, 2003.

And if you need a reality check on this point, Mr. Chairman, please don't forget Dr. Yatchew's observation that over the 20th Century the inflation adjusted return on Canadian equities as a whole was 6.4 percent. With current inflation at about 2 percent, this is highly consistent with his recommendation of 8.25 percent for New Brunswick Power Transmission, which is a company, of course, that is considerably less risky in Dr. Morin's opinion than the market as a whole.

Let me turn to a couple of Mr. Hashey's remarks on this evidence.

Mr. Hashey said that Dr. Morin used a number of tests to determine return on equity for New Brunswick Power Transmission, but Dr. Yatchew used only one and Dr. Morin's evidence was much more extensive. He said that Dr. Morin goes beyond CAPM, and he says that CAPM is the one on which he places the least reliance.

With respect, Mr. Chairman, my friend has again misread the evidence. First, Dr. Morin used the CAPM, risk premium and DCF methods, the latter of which he used as a check. That is so. But Dr. Yatchew didn't just use the CAPM methodology, because as he said in his evidence, he relied heavily on the DCF variation used by Blanchard, Fama & French and Claus and Thomas. Transcript 2106 to 2109.

So he used the DCF variation and he used CAPM. Did he use risk premium? I am sorry, Mr. Chairman, Dr. Yatchew's evidence is all over risk premium. That's what Triumph of the Optimist is all about.

Dr. Morin's more extensive discounted cash flow evidence consists of two pages. And yes, there is an appendix on DCF. But his evidence consists of two pages on the point. What does he say in his evidence and in his appendix? At page 27 of his evidence he says it's difficult to implement the discounted cash flow in Canada. And he even has something to say about Mr. Hashey's assertion that CAPM was the one that he relied upon least. He says at page 29 of his evidence that while he applied the discounted cash flow as a check, he relied principally on the CAPM and risk premium method. And at page 38, he acknowledged that there are practical limits with the DCF

methodology, and again he says that he relied principally on the CAPM and risk premium methods.

Now again, Mr. Chairman, I understand that my friend wants to critique Dr. Yatchew, and I even understand that he might want to get some distance away from the CAPM in light of Dr. Yatchew's evidence, but please, don't do so on evidence which not only doesn't support the submission, but is quite contrary to it.

I turn now to my last substantive topic, sir, price cap regulation. At the outset, it is of course the case that under both the Public Utilities Act and Bill 30 you have, and you will have specific authority to implement such an alternative form of regulation. But simply because you have that authority is not per se evidence that you should grant New Brunswick Power's request for its new transmission affiliate. It is, as Ms. MacFarlane told you, a matter of your discretion.

The price cap method is well described by Dr. Morin in his evidence. It would see transmission rates set in accordance with a predetermined formula linked to an exogenous, aggregate measure of inflation, the consumer price index, an exogenous productivity factor equal to one-half CPI, and would include a provision for exogenous uncontrollable factors.

The theory of a price cap, as we all know, is to promote efficiency, and to provide the firm with incentives which are unaffected by its own decision. In this case we should not forget that the formula is also constrained by an earnings sharing mechanism controlled principally by the return on deemed equity, which you are asked to approve as an essential ingredient of the scheme.

In summary what this means is that New Brunswick Power Transmission will be the sole beneficiary of the firm's earnings between 10 and 12 percent. On the down side, ratepayers will share losses equally with the firm between 10 and 9 percent. And on the up side, will share gains equally with New Brunswick Power Transmission between 12 and 14 percent. Outside of these deadband parameters there will be no sharing.

On the down side, New Brunswick Power Transmission is free to come to you for rate relief below 9 percent. On the up side, and notwithstanding the incentive nature of the scheme, anything over 14 percent will go to ratepayers.

We spent some time, Mr. Chairman, in preparing argument looking to find rate of return established by a regulator in this country of 14 percent or better. We couldn't find one.

On the up side there is a certain if frail analogy to New Brunswick Power's current regulatory regime, in which up to the threshold of 3 percent, New Brunswick Power is not impacted by any external regulatory approval requirement.

Under the proposed price cap regime, up to the threshold of 12 percent, any gains are entirely for the company's benefit.

Now you have heard from Dr. Yatchew, candidly, performance-based or incentive regulation is a good idea, and can improve on traditional methodologies. He told you, and he was not challenged on this in the evidence, that the empirical evidence suggests that price cap regulation is beneficial in the private sector in the way of declining costs, improved financial performance and reductions in rates.

Well if this is the case, Mr. Chairman, what issues are there that we need to deal with? Fortunately, the precise details of the price cap mechanism were not really at issue. The question isn't what. Rather, the principal questions are whether and when. In other words, is April 1, 2003 and for three years thereafter, the appropriate time to introduce a form of incentive regulation for New Brunswick Power's transmission affiliate. And on this

point there is considerable disagreement.

Obviously any regulator faced with a proposal to implement a price cap regime must determine going in rates. Because once the regime is in place, rate proceedings are, at least in theory, not required. We have said this before, Mr. Chairman, but it bears repeating. In our submission, considerable care must be taken to ensure that the going in rates for New Brunswick Power Transmission are set correctly. Our sense is that if they are not, there can be various domino effects that will only exacerbate the initial mistakes over time, particularly for ratepayers.

In the cases with which we are familiar, and Dr. Morin gave you an example concerning the establishment of a price cap regime in the field of telecommunications, regulators have usually had available to them a record of tested, historical cost of service data to assist in establishing correct and accurate going in rates before implementing incentive based methodologies.

No witness in this case disagrees with the view that it's important to get it right at the outset of a price cap regime. JDI and CME certainly think so. We stress again that if implemented, the proposed price cap will not see this company likely appear before you for three years,

save for exceptional circumstances. With respect, Mr. Chairman, it is not as Mr. Hashey says, readily reviewable, nor is that the intention of price cap.

Now unfortunately, this case is not like the majority because the test of historical cost of service data on New Brunswick Power's transmission operations is simply not available, and it hasn't been available since 1993. Because since then New Brunswick Power has avoided the need for regulatory approval for any rate increase. Interestingly, this was a fact that Dr. Morin was not aware of until after he filed his price cap evidence.

The evidence of our clients underscores how important this concern is. Mr. Mosher told you that while New Brunswick Power ratepayers know what future transmission rates New Brunswick Power Transmission wants to charge, they don't have any real idea what the transmission component of the company's current bundled rates are. The best evidence on a cost of service basis is that ratepayers are facing a 15 percent increase.

If one accepts, Mr. Chairman, that going in transmission rates should be based on actual prudently incurred costs, as we do, the problem is that there is no historical tested record of what those incurred costs are. And so we submit that one is legitimately entitled to ask

whether this is the right time to implement a price cap formula.

Dr. Earle, in discussing the selection of an appropriate test year, told you that the first important criteria, irrespective of rate methodology, is whether costs can be verified as prudently incurred. This is pretty basic stuff, he said. But the problem here is the lack of record for 10 years of whether transmission costs are or have been prudently incurred by New Brunswick Power.

Dr. Yatchew tells you that there are two methods of establishing going in rates in order to set P0 correctly in the price cap formula.

One, using thoroughly tested historical transmission data for New Brunswick Power. And, two, using external benchmarking.

Dr. Yatchew doesn't recommend external benchmarking of transmission costs to set P0, Mr. Chairman, correctly simply for the fun of it. Nor, as Mr. Hashey argued, for delay sake. He is, leaving aside the obvious benefits of benchmarking for the moment, impelled to that conclusion. Because as he says, setting P0 on the basis of thoroughly tested historical transmission data for New Brunswick Power simply isn't an option.

Dr. Morin, as you know, simply says that you don't

need to benchmark the transmission company. Because once his price cap formula is in place things will look after themselves, because there is no longer any link between rates and costs.

Mr. Hashey says that the price cap is based on initial rates. The response to these assertions, Mr. Chairman, quite frankly, is that we aren't concerned here with P1, or rates for a subsequent period, but with P0, the going in rates and the costs on which those rates are to be based.

Dr. Morin is, quite frankly, silent on this point. He simply says the system is foolproof once it's in place. But surely, if not intuitively, this depends on the validity of the system's components, in other words, P0 going in. But perhaps Dr. Morin's silence may relate to the misapprehension that he may have been under, namely that New Brunswick Power has had its rates determined on a regular basis under a cost of service methodology so P0 was readily obtainable. But that, of course, isn't the case.

So let's discuss benchmarking. You have heard considerable evidence on the subject whether as to costs in general or benchmarking in respect of return issues. Particularly given the fact that this is the first

occasion since 1993 on which New Brunswick Power has sought your approval of rates, during which period there has been no opportunity to test the company's cost data, and in the context of its application to establish a new price cap framework, for a new transmission entity, which may not be before you again until they approach April of 2006, JDI and CME submit that the notion of benchmarking is a compelling one. Given the absence of tested historical data, one is compelled in our view to consider external benchmarking as a reasonable means of ensuring that the starting point is correct. Whether we are contemplating a particular form of price cap regulation, another form of incentive regulation or, indeed, in the circumstances, traditional cost of service.

So what is the evidence on benchmarking? Dr. Morin, as I have mentioned, says that benchmarking simply isn't necessary because the transmission company's proposed price cap methodology of setting rates for transmission service results in rates being disconnected from the utility's costs.

At the same time, Mr. Chairman, Dr. Morin concedes that prices which do not reflect the cost of providing service will be inefficient, since erroneous signals will be sent concerning consumption.

In any event, Dr. Morin, goes on to say that once implemented his price cap regime will establish benchmarks which are external to New Brunswick Power Transmission. But again, Mr. Chairman, isn't this precisely the point? Or perhaps more accurately doesn't this just beg the starting point question?

It does us no good to talk about what will happen after a price cap regime is in place if the going-in rates are not based upon accurate going-in costs, particularly given the disconnect between rates and costs to which

Dr. Morin refers and notwithstanding the potential inefficient consequence.

New Brunswick Power agrees that ensuring its transmission rates are as low as possible is important, and agrees that a governing legal standard for your consideration is that its transmission ratepayers are entitled to service at the lowest reasonable cost.

Dr. Morin didn't conduct any review of historical transmission-related costs of New Brunswick Power before recommending a price cap regime, perhaps because he was under the assumption that you had been engaged in that.

He simply says you have a choice, Mr. Chairman. Either set the rates at existing levels or conduct a thorough and complete review of actual data and costs in

order to determine accurate going-in transmission rates.

As to both options, Mr. Chairman, we are right back to where we started. There is no data to review and no discernable existing rates for transmission other than the ones that suggest prices are going up by 15 percent.

Since 1993, according to Dr. Morin, New Brunswick Power has achieved high levels of efficiency, although he doesn't give us the luxury of any detail.

He also says that company's management today has a limited ability to reduce its costs. But that is another matter to be dealt with later.

Presumably these high levels of efficiency are the reasons why Dr. Morin also didn't undertake any analysis which would allow him to conclude that his proposed price cap regime will in fact create incentives which would lead to efficiency gains for the company. Indeed he says that there is no direct link between rates and the company's likely productivity.

In all of this confusion, Mr. Chairman, JDI and CME have serious concern about New Brunswick Power's costs. And we submit they are well founded.

Since New Brunswick Power was last before you for a rate approval, when it has been under what it calls at least a quasi price cap regime, the cost of power provided

to its large industrial customers has continuously and steadily increased year over year and is amongst the highest in Canada. New Brunswick Power takes no exception to this evidence.

And against all of this, New Brunswick Power is clear on benchmarking. Beyond what is contained in this application, external benchmarking would neither be useful nor valuable.

Dr. Morin goes further and says that the benchmarking exercise or the metrics resulting from such an exercise would be meaningless, a theme which Mr. Hashey echoed yesterday.

Now why is that? In a word, it is apparently because New Brunswick Power considers its Transmission entity to be unique amongst transmission wires companies.

You have heard from both Dr. Morin and Ms. MacFarlane that matters of climate, rural assets and customer density make it difficult, and the results are therefore meaningless, to find external benchmarks which emulate New Brunswick Power Transmission's system.

While Dr. Morin concedes that benchmarking is common practice for all firms, an opinion with which we agree entirely, he does not agree that incentive regulation invariably involves some form of benchmarking.

As a final observation on the company's evidence on this issue, we are obliged to submit that you should not be impressed, Mr. Chairman, by the last-minute attempt to assert that New Brunswick Power in fact benchmarks quite well.

How did that happen? Again you will recall that New Brunswick Power is a member of the Canadian Electricity Association's benchmarking group.

We were told by Mr. Marshall that key performance indicators resulting from a study undertaken by this group weren't provided to you because most of the data concerned distribution and did not include transmission data.

Subsequently, after cross examination had been concluded, Ms. MacFarlane came back to tell you that the company had looked at this material again. And she asserted that the CEA study in fact positions New Brunswick Power in the middle on almost all fronts.

So a study which is said by one witness in a transmission rate hearing not to be relevant is converted by another witness into something of value relevant to the important issue of getting going-in transmission costs correct.

And the question, Mr. Chairman, is where is the study? In our submission, the evidence of New Brunswick Power as

to the need for an efficacy of benchmarking, before implementing a price cap regime, is simply not credible.

Clearly the company acknowledges that benchmarking is a common undertaking, a point with which Dr. Yatchew agrees. And it is to his evidence that we now turn.

Dr. Yatchew tells you that benchmarking was an initial impetus for incentive-type regulation in the sense that determinations of a regulated utility's relative efficiency required comparisons to or evaluations against other firms.

Dr. Yatchew tells you, and despite Dr. Morin's view, it is not in serious dispute, in my submission, that international benchmarking is an accepted practice in the regulation of transmission and distribution.

Not only is it not in dispute, Mr. Chairman, but exhibit JDI 17, the -- Jamasb and Pollitt paper, demonstrates that this is clearly the case. Contrary to Mr. Hashey, this evidence does not concern larger industries of some unknown stripe. It concerns electric transmission companies.

Dr. Yatchew went on to explain that there are various techniques available in order to conduct benchmarking analyses in order to identify best practices of other firms.

But surely, Mr. Chairman, this evidence has to defer to the unique characteristics of New Brunswick Power Transmission which make benchmarking meaningless, doesn't it?

Well aside from exhibit JDI 17 which certainly suggests that transmission undertakings in various countries, in various settings with various degrees of uniqueness can be the subject of effective benchmarking, Dr. Yatchew's own paper attached to his evidence, which New Brunswick Power did not ask a single question on, clearly demonstrates as one might expect that the models and methodologies available, and I quote, "are quite capable of taking an accounting of these factors and provide valuable information about who is more efficient and who is less efficient."

So JDI and CME submit that the best evidence you have is that benchmarking in relation to transmission can be and is being undertaken, notwithstanding different characteristics of different firms, and most importantly that the results will be beneficial.

The question that remains, sir, is why New Brunswick Power is so hesitant, indeed critical of benchmarking? We suppose that undertaking a benchmarking exercise would delay the implementation of the proposed price cap. And

indeed Mr. Hashey alluded to that yesterday.

Well, we submit with respect that doing it right is more important, especially since during the time it will take to conduct such an exercise, New Brunswick Power Transmission is at little risk if any of underrecovering its prudently incurred costs.

We suppose it is possible as well that New Brunswick Power is simply reluctant to see the results of such an exercise.

Well in either case the evidence, Mr. Chairman, suggests no reason to avoid, and a number of compelling reasons that require New Brunswick Power Transmission to undertake benchmarking prior to implementing a price cap or other incentive form of regulation.

A second concern about the timing of a price cap for the company relates to Dr. Yatchew's evidence, that experience suggests price cap regulation has been beneficial in the private sector.

On the other hand he says there is little evidence that price cap regulation has been effective in the public sector. This evidence was not challenged by New Brunswick Power. The public sector of course is where New Brunswick Power Transmission as a Crown-owned utility will live.

Is this just a fanciful notion on Dr. Yatchew's part?

We submit the answer is clearly no. His evidence was not seriously challenged in any event. And Mr. Hashey in fact acknowledged the point in his argument.

Dr. Morin agrees that in the United States, and to the extent that it is in place in Canada, experience with price caps is in the private sector. Moreover, he couldn't point to any evidence which suggests that price cap regulation works in the public sector.

We take this to mean that he does not disagree with Dr. Yatchew.

But really he does. Or he tried to. Because in his opinion -- and you will remember of course that performance-based regulation is a recent addition to his consulting experience -- there is no reason why the price cap formula shouldn't work in the public sector, because after all we are trying to emulate -- sorry, there is no reason why the price cap formula should not work in the public sector, because after all we are trying to emulate the private sector.

Come again? It is no answer, in our submission to Dr. Yatchew's legitimate concern, that there is little evidence which supports the efficacy of price cap regulation in the public sector to say well, I think it should work because it works in the private sector. If anything that response just begs the question again.

We submit that Dr. Yatchew's explanation is far more probative. The key he told you is incentives, which is what price cap regulation is all about.

Dr. Yatchew's evidence is that shareholders can in the private sector, and in various ways, exert pressure on their companies to influence behavior and create incentives.

In the public sector conversely the potential for incentive creation is much more limited. Specifically it is much more limited in this case because New Brunswick Power Transmission's owner, the Province, is a captive owner.

No ultimate taxpayer of New Brunswick Power Transmission can sell their shares in the firm. Nor is New Brunswick Power Transmission likely to be a takeover target.

Finally, shareholder interests in New Brunswick Power Transmission are considerably more diffuse than in the private sector.

Let me make a couple of comments on Mr. Hashey's submissions concerning price cap.

He gave you several observations about the evidence of Dr. Morin and Dr. Yatchew which are worthy of comment. He cited Dr. Morin's evidence that a problem with traditional

modes of regulation is the significant regulatory cost to the utility.

Mr. Nettleton and I talked long and hard, Mr. Chairman, and we could think of no utility in this country which is ultimately as responsible for its regulatory costs. They are passed on to ratepayers.

With respect to Dr. Yatchew's evidence on benchmarking, Mr. Hashey said, well this is going to take some time, it's going to cause delay and it will be terribly expensive. And Dr. Yatchew didn't evaluate the cost of benchmarking.

At transcript 2080 Dr. Yatchew said, reasonable benchmarking information can be obtained "in short order". There was no contesting that evidence.

Mr. Chairman, last night I carefully read Dr. Yatchew's evidence and Mr. Hashey's relatively short cross-examination of him. And I found no reference whatsoever to the cost of benchmarking. There is no evidence at all on the point. Mr. Hashey could have asked him, but he didn't.

And as an aside, I'm quite happy to have Dr. Yatchew provide you with that information, but for the moment, Mr. Chairman, let's not speculate.

Mr. Hashey said that Dr. Yatchew's concerns about implementing price cap were more applicable to generation

where competitive factors are more relevant. Well there is certainly, Mr. Chairman, no evidence on this point for New Brunswick Power. And in fact if Mr. Hashey is right I guess Jamasb and Pollitt are wrong and so is Yatchew.

And finally on this point, Mr. Chairman, generation, yes, indeed it will be competitive, and indeed transmission will be regulated, and the term of course is price cap regulation. Mr. Hashey correctly noted in his cross-examination of Dr. Yatchew where Dr. Yatchew admitted that his capital structure and return on equity recommendations are dependent on price cap being in place. The clear implication is that New Brunswick Power and Dr. Morin's position is different. Well it isn't.

Look at Dr. Morin's evidence at page 7. He was engaged to recommend a price cap and the level of return on equity components for use in the price cap. So Dr. Morin and Dr. Yatchew are singing from the same songbook.

Mr. Nettleton and I listened carefully to Mr. Morrison and Mr. Hashey yesterday as to what the application seeks. The application is for relief in part, Mr. Chairman, for a return on equity and a capital structure for use in a price cap regime. And unless he is going to endeavour to amend the application in his rebuttal, that is what the relief is that is being sought.

I have 10 minutes, sir.

It is often said, Mr. Chairman, that the devil is in the details.

Dr. Yatchew noted that as against Dr. Morin's bold declaration that under a price cap formula there will be a "unleashing" of incentive forces for New Brunswick Power Transmission, but Dr. Morin didn't bother -- or perhaps he forgot to tell you how this is going to happen. Perhaps it's because in his view, that is to say Dr. Morin's, New Brunswick Power is already very efficient. Certainly we know that Dr. Morin undertook no analysis in support of that declaration, nor did he bother to review any of the company's human resource policies to ascertain the degree to which, if any, the price cap formula might create incentives.

Surely, Mr. Chairman, if New Brunswick Power is as efficient as Dr. Morin says it is, the evidence on the detail would have been readily available.

With respect, Mr. Chairman, our clients at least on this point don't have a warm and fuzzy feeling about letting the new New Brunswick Power Transmission loose for three years pursuant to a price cap formula.

Indeed this is a question you asked of Dr. Morin. And the answer was, well you have authority over the company. With respect, in our submission this is not a satisfactory

response in light of the evidence before you.

But to this point we believe it clear that you cannot assume the efficacy of price cap methodology in the public sector, that is for New Brunswick Power Transmission. Looking at New Brunswick Power's track record we submit simply confirms what Dr. Yatchew told you.

First we have Dr. Morin's opinion that the company has already achieved high levels of efficiency and in the result that management has limited ability to decrease costs. Well if that is so, Mr. Chairman, then we submit it doesn't auger well for the forces which we tell you will be unleashed on April 1.

Second, we know that New Brunswick Power today opts to include only about four percent of its regular employees in its incentive pay program, none of which are below the director level. So far as that program is concerned something less than five percent of the total payroll is incentive based. Particularly in view of the company's position that the current regulatory regime is a proxy for performance based regulation, or at least a regime in which prices are disconnected from costs, neither does this bode well. Intuitively compensation and human resource policies are key incentives or levers in any firm.

That New Brunswick Power limits its incentive compensation in this fashion under what it says is a form of performance based regulation simply does not support the supposed need to implement the price cap regime, at least not now.

Neither does the evidence brought to your attention by Mr. Mosher, the AMPCO study, which shows the steady increase in New Brunswick Power's costs to its industrial customers since 1993. We also note the company's recent announcement of January 23rd that this trend will continue into next year by way of an overall 2.6 percent rate increase effective April 1, presumably in respect of the non-transmission portion of its operations.

Simply put, there is no evidence, whatever one may call the current regime, of any cost reductions or savings over the same period in which Dr. Morin claims New Brunswick Power has achieved high levels of efficiency.

We well understand, Mr. Chairman, your observation that the current regime is not strictly a price cap. Nevertheless New Brunswick Power seems to believe that it is operated under a performance based opportunity for the last decade. The empirical evidence, however, suggests that performance based regulation is not successful in this example of the public sector.

So what are our recommendations? Now JDI and its CME colleagues, Mr. Chairman, are familiar with incentive or performance based compensation and related matters in their own operations. As Mr. Mosher told you, our clients are not unalterably opposed to New Brunswick Power Transmission operating under a price cap regime, but we submit that on this record and having regard for New Brunswick Power's character as a public sector Crown corporation, it is premature to implement a proposal for a price cap regime for its transmission affiliate.

We submit that the price cap approach will remain premature until such time as you have a credible record or historical baseline of New Brunswick Power Transmission costs, and until such time as it has provided you with a complete and credible benchmarking study against best-in-class transmission companies.

So far as we can determine, Mr. Chairman, in no Canadian jurisdiction has an alternative form of regulation been implemented without an adequate initial experience with deregulation or restructuring. Certainly in Alberta we know for a fact that this is the case, and Dr. Yatchew told you that such a step was deferred by the Regie in Quebec and that Ontario has also approached the issue with a degree of controlled or deliberate caution.

Equally to our knowledge neither has any Canadian jurisdiction done so in the absence of stakeholder consent expressed by way of a negotiated settlement between the utility and those stakeholders, resulting from an appropriate degree of consultation.

So for all of these reasons, Mr. Chairman, we submit that you should deny the application to implement the proposed price cap regime at this time.

In overall conclusion, Mr. Chairman, we began our submissions yesterday by summarising the position of JDI and its CME colleagues on the issues of consequence for them in this proceeding. There have been a lot of issues and we have taken some considerable time to explain in detail the reasons which underlie those positions with reference to the extensive evidentiary record before you. And we are obliged for your patience and attention in the last day or so as we did.

The aid to argument provides you and your colleagues with an appropriate road map concerning the positions of JDI and CME, and accordingly our task is virtually complete.

What we would like to do is to leave you with one final reality check before you begin your real task of deciding what the transmission regulatory landscape will

look like on April 1.

Today transmission services in New Brunswick are provided by New Brunswick Power, a vertically integrated utility which in our view has the following six fundamental characteristics. New Brunswick Power provides an essential service. New Brunswick Power is a Crown corporation. New Brunswick Power's revenue requirement is subject to your oversight and accordingly its recovery of prudently incurred costs is reasonably assured. New Brunswick Power is a monopoly. New Brunswick Power's assets are unencumbered. New Brunswick Power is 100 percent financed with debt capital and its obligations in this regard are guaranteed by the province.

In its 2002 fiscal year on revenues of about \$1.3 billion New Brunswick Power earned about \$20 million before taxes which it was not liable to pay. On April 1st 2003, these same transmission services will be provided by a subsidiary of New Brunswick Power to be called New Brunswick Power Transmission, which some describe as a different or stand-alone entity.

Perhaps, but on April 1st New Brunswick Power Transmission will provide an essential service. New Brunswick Power Transmission will be a Crown corporation. New Brunswick Power Transmission's revenue requirement

will be subject to your oversight and accordingly its recovery of prudently incurred costs will be reasonably assured. New Brunswick Power Transmission will be a monopoly. New Brunswick Power Transmission's assets will be unencumbered. New Brunswick Power Transmission will be 100 percent financed with debt capital and its obligations in this regard will be guaranteed by the province.

For its 2004 fiscal year on revenues of \$137 million New Brunswick Power Transmission wants you to authorize it to earn \$22.9 million before taxes.

So what has changed? Well to earn about \$3 million more than its predecessor parent, New Brunswick Power Transmission will use only 6.89 percent of New Brunswick Power's assets.

What hasn't changed? In a word, nothing. None of the six fundamental characteristics are going to change. Just as there is now no actual equity invested in New Brunswick Power, there will not be any actual equity invested in New Brunswick Power Transmission.

Just as there is today no cushion in New Brunswick Power for rate making purposes, there should be no cushion for rate making purposes in New Brunswick Power Transmission.

Just as establishing a deemed capital structure and

return on equity for rate making purposes would not have changed that reality for New Brunswick Power, neither will such an arrangement change the reality of April 1st for New Brunswick Power Transmission.

In each case, Mr. Chairman, the change that such a structure brings would have been and will be to burden ratepayers, while not enhancing the financial integrity of either the vertically integrated or so-called stand alone entity.

This is the reality in our submission, which requires considerable caution as you approach the intersection between the dual principles of affording New Brunswick Power Transmission a fair return on invested capital, while ensuring that its ratepayers receive transmission services at the lowest reasonable cost.

JDI and CME wish you well in your difficult task, Mr. Chairman and Board members, and we are confident that your decision will reflect the best interests of New Brunswick as a whole.

As with counsel preceding, Mr. Chairman, and on behalf of Mr. Nettleton and myself and our clients, I want to thank you and your colleagues, Ms. Legere, Mr. MacNutt, the court reporters, for your courtesy and assistance and patience throughout this hearing. And on behalf of myself

and Mr. Nettleton in our particular character as RFA's as I call it, Really From Aways, I want to extend my particular thanks to not only you but indeed to everybody for the welcome and collegiality you have shown to us on this our first but I suspect, and indeed expect, not our last appearance before your Board.

I thank you very much.

CHAIRMAN: Thank you, Mr. Smellie. We will break for lunch now and come back at 1:30.

(Recess)

CHAIRMAN: Mr. Zed?

MR. ZED: Mr. Chairman, Commissioners: Thank you for the opportunity to revisit in a summary fashion the evidence relating to Nova Scotia Power's representations with respect to this application for an Open Access Transmission Tariff. Let me reiterate that Nova Scotia Power has been inter-connected to NB Power for more than 40 years, and throughout that time, the mutual cooperation of the parties has resulted in a more reliable and efficient system than either province could support on its own. It is important to Nova Scotia Power, and we assume important as well to NB Power, that cooperation continue for the mutual benefit of our respective ratepayers.

The restructuring of North American electricity

markets has caused both utilities and their Joint Operating Committee to be especially active in revising procedures to accommodate the new realities of the marketplace while still retaining the benefits of our inter-connection. The process of restructuring has moved more quickly in New Brunswick than in Nova Scotia, nonetheless in Nova Scotia we are moving in the same direction, albeit at a slower pace. We at Nova Scotia Power can attempt to quicken the pace as Mr. Connors testified we have done, but we are nonetheless tied to that government process.

That process is defined by the Nova Scotia Government which has announced that the market will open in 2005, as hopeful as we might be that it will occur sooner.

At the outset of this hearing our evidence dealt with two issues that we identified as significant to us and with which we were apparently at odds with NB Power. These two issues were, firstly, with respect to "inadvertent energy". And secondly, the concept of "reciprocity" contained in the proposed tariff gives us difficulty.

Dealing briefly with the issue of inadvertent energy, we hope that the Board accepts the matter as being resolved. After hearing NB Power's clarification of their

views on cross-examination, it appears that their view of inadvertent energy exchange is exactly the same as ours. Provided that the Board is agreeable with this situation, NB Power and Nova Scotia Power are prepared to resolve the issue through the Joint Operating Committee.

In other words, so long as the Board expressly recognizes that inadvertent energy exchange is a non-scheduled flow of energy between two inter-connected power systems, and a natural consequence of their operations, we are satisfied to leave it at that.

The Board has asked NB Power to clarify this issue by expressing the concept of inadvertent energy in the tariff itself. They have done this in the modifications to the tariff that they circulated. And it appears to address the issue to our satisfaction.

Further the Board has asked NB Power to consider posting "inadvertent energy" flows on a monthly basis. We have no objection to this approach and welcome it as a practical solution to avoid any further confusion.

The second issue we raised was like the first, a very serious one, but unlike the first, it does not appear to be capable of resolution by agreement without intervention from this Board.

This issue, unlike those being debated by the other

Intervenors, does not require detailed financial arguments or analysis. Our issue is both more general, and in our respectful submission, fundamental to the success of this market. That issue is reciprocity. For no matter how correct the financial aspects of this tariff, without competition markets do not achieve the desired results, that being lower prices for customers.

Let there be no misunderstanding of our position on reciprocity.

In order for NB Power to adopt a FERC compliant tariff, one of the hallmarks of such a tariff is to contain provisions requiring reciprocity. We take no issue with this.

In a mature market where all neighbouring jurisdictions are fully FERN compliant, reciprocity is of course not an issue, we support the concept. However, in our case, Nova Scotia, as has been testified, is in the midst of a restructuring process happening at a slower pace than has happened here in New Brunswick. It is for this reason alone that we require a waiver of the reciprocity requirement in the tariff.

We submit that it is in the interest of the public that such a waiver be granted by this Board.

This is recognized clearly by Market Design Committee when they stated in part, and I quote, "to increase the

possibility of more suppliers and hence the prospects for achieving a workably competitive market and provide greater opportunity for customers to obtain competitive prices, the Market Design Committee recommends" -- that reciprocity not be a requirement at this time."

In other words, even if this Board, to paraphrase one of the parties, gets it right with respect to other issues, markets like New Brunswick cannot afford to prohibit participation if they are to develop. And that is what you are being asked to do, prohibit participation.

When questioned on the issue of reciprocity, Mr. Whalen, testifying directly on behalf of NSPI, and Mr. Connors, testifying on behalf of Emera Energy, clearly set out the Nova Scotia timetable for restructuring. It is an inescapable conclusion, based on the evidence, that Nova Scotia may not be a reciprocating jurisdiction until the year after next, although Mr. Connors has clearly indicated that Nova Scotia Power has requested the Electricity Market Governance Committee to allow for Nova Scotia Power to file an Open Access Transmission Tariff as early as 2004. In other words, we are attempting to influence the Nova Scotia process to move towards FERC compatibility as quickly as possible. However that process will unfold as it unfolds. And beyond making our

representations we are not in overall control of that process.

With respect to NB Power's seeming intransigence on this issue, what can Nova Scotia Power do but await the ultimate outcome of a government-sanctioned process.

Let me be clear. Other than the timing, there is no other issue of compliance. To this end, Nova Scotia Power's evidence was clear that they would willingly adopt the appropriate standard of conduct prior to doing business in this market. So really, the request from Nova Scotia Power is for this Board to grant a waiver of the reciprocity requirement only for the appropriate time.

This request is in line with the MDC's recommendation and is consistent, more importantly consistent with the goal of bringing more players to the market to stimulate this competitive market. This application is about opening and creating such a competitive market for the ultimate benefit of ratepayers. How is this achieved by eliminating one of the major potential participants?

So then it becomes what is the appropriate time? We would suggest to this Board that the waiver be granted until the process in Nova Scotia is complete and it is both practical and permissible for Nova Scotia Power to file a compatible Open Access Transmission Tariff. In the

meantime, Nova Scotia Power would be prepared to report on a regular basis to keep the Board advised of progress being made in this regard.

While we would have thought this to be a reasonable request, NB Power takes what we suggest is the unusual position of suggesting that this Board is not the proper party to make such a determination. Their testimony is to the effect that the concept of reciprocity is to be administered under the tariff and that it is only the Applicant who can make such a decision. With respect to a waiver, we suggest, as our evidence clearly states, that for them to so hold ignores the market realities which appear to have already interfered with their decision.

How can we be comfortable leaving fate to the applicant which is clearly seeking to further enhance its dominant position in the market? This is very much like their proposed grandfathering of their capacity reservations on the MEPCO tie. That is anti-competitive. Likewise, it is anti-competitive to ask this Board to sanction a lessening of competition by prohibiting one of very few potential participants in this market from participating.

Now when we presented our witness panel, NB Power appeared to modify their position slightly. They

introduced new wording offering on its face to grant a waiver of reciprocity, however, a close reading of that indicates it is conditional upon Nova Scotia Power adopting an open access transmission tariff within a time frame that we cannot possibly comply with.

The amendments include a change -- the amendments to the tariff submitted last week include the suggested change. In it NB Power states that reciprocity will be granted subject to certain conditions, one of which is that Nova Scotia Power be FERC compliant by January 1, 2004. However, if for reasons beyond our control we cannot comply, NB Power in their amendment proposes that we then apply to this Board submitting both our tariff and our code of conduct. It is the tariff filing that obviously is the problem. That is the problem in the first place.

The revision therefore contains the same circular argument that we discussed at the hearing. How can we submit our tariff until we know what our electricity market place will look like? Their amendment is really no better to us than their original position.

As Mr. Connors testified we cannot comply by January 1st 2004 unless we apply to the Utility and Review Board in Nova Scotia in advance of any report from our market

design committee.

Mr. Connors testified clearly that while this may be legally possible, it is not practically so. What more evidence do we need than NB Power's current position in this regard that the matter should be resolved by an independent body and not by NB Power. To accept their authority on such a request is once again to deny this market of one of several large potential users. This is directly contrary to the market design committee's recommendation and obviously counter productive to the establishment of an open and active market.

In conclusion, we are asking this Board to recognize the timing difference between the opening of the markets in New Brunswick and Nova Scotia and accommodate us through an appropriate board managed transition. We submit that it is appropriate for the Board to issue the waiver requested.

Once again I would like to thank the Board and all involved for their cooperation and professionalism throughout. And that is all our comments today. Thank you very much.

CHAIRMAN: Thank you, Mr. Zed. Did I read recently that your Market Design Committee in Nova Scotia has recommended that OASIS not -- need not be established?

MR. ZED: One of the -- that's one of the ongoing discussions at the electricity market governance committee, and you did read that. One of the thoughts for the Board's information is simply that neither New Brunswick nor Nova Scotia may be large enough to sustain a system, and if it is necessary then one of the avenues being explored by that committee is to see whether or not they could contract with the Nova Scotia -- or sorry, the New Brunswick system for service should that be necessary.

So I think what they have looked at is very simply that it is a very expensive proposition given the size of the market and I think the wondering is still going on whether it justifies establishing an independent OASIS system.

Obviously if it is a requirement in this market that they be -- either have one or contract for one, then that will be done.

CHAIRMAN: Okay. The second thing is to your knowledge is there a prohibition in Nova Scotia as there was under the old Electricity Act here that you couldn't have a generator unless you had Cabinet permission, over so many horsepower? That prohibition is not in Nova Scotia, is it?

MR. ZED: I'm not aware that it is, but I can certainly

undertake to find out?

CHAIRMAN: Would you check on that?

MR. ZED: Yes, I will.

CHAIRMAN: Otherwise it is just as your witness, Mr. Connors said. It would be a practical reason that they wouldn't approach the Nova Scotia Board prior to the government finally making a decision on the form of the market place. It is practical. There would be no legislative prohibition against your client making an application to the Nova Scotia Board.

MR. ZED: I would say I have heard the opposite opinion expressed but Mr. Connors' opinion is that they are legally -- I think he expressed to this Board that they are legally entitled to make such an application. But from a practical point of view, he is not sure what the Board would do with it given the ongoing process.

CHAIRMAN: Thank you, Mr. Zed. Mr. Belcher, do you want to come down to mike number 5?

MR. BELCHER: Good afternoon, Chairman, Commission. I would like to begin by thanking you for letting me participate in these proceedings in a cost effective manner for our region. Also I would like to apologize if my lack of case management has caused any inconvenience on the parties.

The Northern Maine ISA generally supports the filing

of this open access transmission tariff. And we have been through this. And we realize that this is just the beginning of opening the markets in New Brunswick. And what we hope, it's just the beginning of eliminating any pancaking by establishing a regional transmission group or some type of a transmission arrangement between all the provinces in the Maritime region, Northern Maine and including MEPCO too.

My comments will be somewhat brief. And to begin with we would like to address the reciprocity. We understand in order for a market to be successful you need many suppliers. And certainly reciprocity will limit the number of suppliers. However, what NB Power appeared to present is consistent with FERC policy. And if it's consistent with FERC policy, the ISA supports that.

Ironically, through NEPOOL and the New England participants, I have personally argued reciprocity regarding New Brunswick Power. And it was always worked around because New Brunswick Power sold at the border. And I would assume that this case would hold similar here for New Brunswick. If anyone from any of the other provinces wanted to sell, they could always sell to a marketer at the border.

And for the ISA it really doesn't -- shouldn't affect

us. Because if we wanted to buy say from Emera Power, we could purchase it at the border of Nova Scotia and New Brunswick and pay the wheeling charges to get across. So we support the reciprocity issue in this case.

Second of all, I would like to talk about the transmission reservations. The ISA supports New Brunswick's position on the reservations being gone through the developments of RTG's and other transmission tariffs, existing contracts have to be honoured or grandfathered. Especially in this case. NB Power has indicated that the OASIS system was used to grant these contracts. And just by its name, OASIS, implies that it was fair.

However, there has been issues in the United States of hoarding.

And I think the Commission should certainly be aware of the fact that just to gain competitive advantages there is a possibility of buying up these reservations and not using them. And the FERC tariff, the way it's written does allow for ways for that transmission be sold back, or those reservations to be sold back. And there are some anti-hoarding cases in the United States that have been argued.

A third thing we would like to address is the energy imbalance pricing. New Brunswick Power Schedule 4

outlines the services for energy imbalance. Although the energy imbalance is somewhat consistent with other jurisdictions, we do have some concerns that it is different for network service and point-to-point. And it appears to give the advantage to network service, and it may make a customer lean towards network service.

However, the ISA currently has a contract which we have discussed here in these proceedings called the products and services agreement, PSA. And that contract has been in place or used since our market implementation on March 1st 2000. Under that contract which provides for ancillary services including energy imbalance, the ISA region has enjoyed actual lower clearing prices than NEPOOL. In fact in the last 12 months our clearing prices have been lower than NEPOOL.

This products and service agreement allows us to settle our markets on an hourly basis and give a clearing price, so that the customer knows exactly what he is trading and what it cost him in any hour.

The way the Schedule 4 was originally proposed, we would not be able to do that. New Brunswick has come forward and added some language. New Brunswick Power has come forward and added some language to Schedule 4 that allows us to do that, and we certainly support that. And

we would ask the Commission if they would approve that additional language in Schedule 4.

The next issue we have -- I want to discuss is the ancillary services, the proxy unit versus embedded costs. And we understand this is a complex issue. And currently under our PSA we are buying ancillary services through the products and services based on an embedded cost study. However, that study or those costs are a cap, or what we call the default rate.

In Northern Maine you have the ability either to provide for your own ancillary services or bid into the market. And the ISA as the administrator of the market goes out and solicits bids. So what this cap has done is it has given us stable prices, plus it gives the ability for marketers to come in and bid under that cost. Those costs have been confidential. We never published them. I believe CEP is a people billed -- or a company is billed under them could eventually back into them. The ISA was never really privy to the cost of service.

When we originally received those prices, we looked at them, compared them to costs in NEPOOL. Plus we knew in general what the cost for a new unit would be to supply those ancillary services. And we recognized that it was a default rate, and that it did give us stability. And we

accepted them as were. And the PSA does give us the ability to go back and ask for those costs or to look at them. But we never really looked at the cost of service studies. We thought they were reasonable.

But as far as using proxy unit versus embedded costs, the ISA basically supports the proxy unit. The reason for this is that ancillary services are going to be subject to the market. Whereas the core transmission rate is essentially a monopoly rate through the monopoly portion of the company. The ancillary services are going to be what we see as a cap, it's just what we have now.

We feel that -- and with using long run marginal costs to develop those, we feel is the best pricing to show any other market participant, or anyone who wants to bid into this market, what the proper price signals are.

And we like long run marginal costs of the proxy unit, in fact we feel that price is transparent. It's based on a new combustion turbine. The ISA did not go into any detail on the cost of service of those that New Brunswick Power has proposed, because it's really not our issue. That is up to the suppliers or the people who is going to be buying it. We are independent.

But there are many, many estimates of the costs of these services out there. For instance, NEPOOL publishes

what they call the GTF, generation task force, which gives prices for new combustion turbines. There has been many long run marginal cost studies published in the State of Maine. It's public record. And FERC has also had them published.

We do have some concerns about costs based on long run marginal cost. And the fact that they typically will not equal the actual cost to provide those services. And when that occurs, there is some type of revenue reconciliation to calculate what rates are going to be charged. That reconciliation could be a proportional methodology or inverse elasticity demand. There is many methodologies out there. But what it does is it puts the rates or the cost back, so that the proper revenue requirement is going to be collected.

Now it appears that from the two embedded studies that New Brunswick has presented, that their long run marginal costs don't equal their embedded costs. And there is going to be some revenue gap there. It also appears that NB Power is willing to take on that risk.

And their methodology of revenue reconciliation is the ability to compete in the market. And if that's the risk they want to take, then so be it. But we feel long run marginal cost is the proper way to price ancillary services. And

we support that methodology.

Concerning rate of return, performance based rate making, debt equity, base O and M, or OM&A costs, I believe they are called in this jurisdiction, we really don't have an opinion on it.

One thing I can say though is we would prefer the core transmission rate be based on what is called a rate formula. It's very popular in the United States. And essentially you go through a proceeding. You determine what is going to be in that revenue requirement based on a formula. The formula is spelt out and put in the tariff.

And then every year when the FERC form 1 is published, which I believe is by April 1st, those rates or the costs are dropped into that formula which includes a fair rate of return, which isn't 18 percent. And those rates are developed. And they are based on the prior year. And it's about a four month lag, a regulatory lag and which is made up by calculation of your working capital, your working cash and that's it. It's done every year. There are no arguments.

The arguments and the proceedings are done to establish what costs go into it. It provides clear transparent rates based on average cost for the core transmission monopoly company. And it's very simple once

you go through the proceedings. Also I feel it allows for in the future for a regional transmission group that something like this would have to happen because you would have many jurisdictions combining their revenue requirements.

The other thing it does, it isolates the rates from forecasts which are wrong by definition. I come from Maine. Delivery rates down there are 3 to 5 cents higher than the actual cost because they have all these embedded stranded costs in them which were based on forecasts of oil in 1986. And it's tragic. You know, the prices, they used to be the lowest in New England. They used to be very similar to the rates here in New Brunswick and Nova Scotia, and they should be. The demographics are very much the same. The climate is the same. The costs for all the materials and supply all the services are pretty much the same. But they are 3 to 5 cents higher because somebody thought the fad of basing costs on forecasts or the Greek alphabet was the way to go. And we are talking about a service that is essential. Not only to, you know, to people living, but to make products and services and to keep your economy going. It's a very, very dangerous way to go. It's great if it all works fine, but how many cases has it?

So as far as rate design and cost of service for the core transmission, the ISA would like to see some type of rate formula developed, which is done in a lot of jurisdictions. All of NEPOOL does it. And it's very clear. Everything is spelt out. You have a committee where they get together once a year and they put in their costs. It's all audited. It's all right out there.

Next is network service. The ISA is very encouraged there now that New Brunswick Power is offering network service. It's a great product.

We do have a couple of concerns of what they have proposed. The reason network service exist is it's easy. It's simple. It's like unlimited Internet access. You pay your 19.95, you jump on, you use it any time you want. You don't have to worry about what time of day or when you are using it or if you have gone over on penalty charges.

And that's what network service is. It's for the customers with lots of load. New Brunswick Power Disco would be a very good case of it.

We don't feel you should have to schedule that hourly. By definition you shouldn't have to do that. You are billed based on past month's peak demand. And in the case -- in this jurisdiction I believe it's going to be net noncoincident peak demand. And that's it.

For example, Houlton Water Company purchases network service from Maine Public Service. And that's it. They tell them who their network resource is. It's WPS. That's where we will be getting our energy and our delivery. Maine Public Service says fine. They read the meter, whatever the peak demand is, they bill them. Houlton Water does nothing else. It's all taken care of. They don't have to get on and then schedule every hour what their load is. That portion of it is done through WPS, when they schedule in the energy markets and their imbalance is charged out through imbalance through that. So we don't feel that you should have to schedule network service. The transmission customer shouldn't have to. That's all taken care of in your energy market. In your ancillary services market. I might be somewhat confused, but I believe that I was told that you would have to schedule your network service.

The second issue we have with network service, and maybe New Brunswick Power can clear this up in rebuttal, is it appears that their expansion policy is pretty much the same as point-to-point, where they are proposing they could pay the higher of, rather than rolling in any network expansions or network upgrades.

And the rolling in simply means that if you are

network customer, you are being billed on your peak demand every month, if you have an increase in load, or if you want to increase your load, then any additional cost of that -- because you are network customer rolled into the revenue requirement and paid by everyone. If you are point-to-point customer, and you want a network expansion, or you need to upgrade the system, you pay what they call the higher of.

And the higher of is simply they calculate what the new -- the cost of that expansion is. If it's higher than the existing rate, you pay it. That way no other customer is responsible for it or has to incur those costs. And if it's equal to or less than the average rate, then you just pay the average rate.

And if the expansion was actually less than what the average rate is, the other customers gain, because this is an additional revenue collected.

Our last issue kind of phases in with the network service. And that is the use of what to use for the load? And I believe in -- the market committee is the one who was pretty much put in this net noncoincident peak load. And we understand why loads would have to do that inside the province.

But where loads are metered hourly and they are known, for example, wholesale customers, large retail customers,

and adjacent regions or markets, we feel CP data -- the coincident peak ought to be used. It's fair. There is a reason why it's -- you know, it's been the traditional the billing determinant for many years, since really the beginning of the transmission service. It eliminates uncertainty. It eliminates the error on rate design by having to come up with a coincident factor to apply, which all puts error in and is -- the transmission customer might not collect its costs. Might overcollect its costs.

So we would really like to see that at least adjacent markets and wholesale markets be billed on CP. That data is all there. And in the United States they essentially are billed on CP too for nonmetered load, because what they do is they go in and they do load study and they allocate these costs based on their estimated CP, and then they determine and put them in the rates or they bill them on energy or peak demand. That's just a matter of rate design.

But we feel that the wholesale customers, they should be on the CP. It sends the proper signal. If you want some demand -- you know, some demand side management, you need to have the proper pricing. And if you want load reduction at peak times, they need to be billed on that ability. And certainly for regions that have like --

Northern Maine or Maritime, certainly should be the proper way to bill.

Additionally, we would like to address the calculation of the load ratio share for ancillary services for Maritime Electric and Northern Maine. I am throwing Maritime Electric in there, because there are very similar to how we operate. Their operating reserves currently -- the total load for the Maritime region is used as a denominator to determine your load ratio share of the operating reserves. That includes Nova Scotia, Maritime Electric, Northern Maine and New Brunswick. The reason for this is we all pool our resources. So that's the fairest way to do it. And New Brunswick Power's filing may have removed Nova Scotia from the denominator, which in turn makes Northern Maine's load ratio share almost double. And if costs are going to be based on embedded costs that will make our rates double, which certainly would qualify as rate shock.

So we feel that the load ratio share for our operating reserves are to be done just the way it is now and that includes the total load for the Maritime region.

In conclusion I would like to say the ISA has had an excellent relationship with New Brunswick Power, and the PSA and New Brunswick Power's co-operation has what I call

a very successful small market operating in northern Maine. Gives us cap prices, or the ability to predict our prices. They are stable. They are lower than NEPOOL's. They are not subject to spikes. We have no problem paying our fair share. We understand. We are all from the industry. We understand where all these cost of service studies -- and what is included them.

And we just -- and we would really like to see these -- this stability preserved. And we would like -- and we feel that it will be, if we -- if these adjacent markets have the ability to work within the spirit and the guidelines of the open access transmission tariff and work out some of these seams issues or what they are between us and New Brunswick Power, as long as they don't discriminate against any other customers. And New Brunswick recovers their cost. And we don't impose any subsidies on other customers.

And that is very critical to our region. The region that we represent, it does not have a robust economy. In fact it's economically depressed. The average salary is I believe around 19,000 US. And any blitz can cause some hardships. And we would just like to see that our stable market be preserved and have the ability to work inside the tariff, but also to address some of these seams

issues in the future and now.

And I thank you for your time.

CHAIRMAN: Thank you, Mr. Belcher. Well subject to what the parties have to say, the Board's intention would be to adjourn now and come back either at 1:00 o'clock or say 11:30 tomorrow. And if we have some questions that we want you to address, we would give you a heads up at that time, and then we would go through the list of the Intervenors again and allow them to give some rebuttal as to what their fellow Intervenors have said if they wish to, and also to address the Board's questions that we want you to address, and would conclude with Mr. Hashey's rebuttal and addressing of the questions.

Now anybody any comments on that procedure? Mr. MacDougall?

MR. MACDOUGALL: Yes, Mr. Chair. Just on the timing tomorrow, I had mentioned last week that Thursday morning was quite difficult for myself. I also believe Mr. Howard is going to try and come tomorrow morning to be here for the rebuttal piece. So 1:00 o'clock would certainly suit us better than 11:30. And we don't mean to delay anything.

CHAIRMAN: No.

MR. MACDOUGALL: We certainly don't wish to do that, but

1:00 would be a lot more appropriate from our respect.

CHAIRMAN: Thank you. Any other?

MR. HASHEY: I respect that request.

CHAIRMAN: Well we will adjourn until 1:00 o'clock tomorrow. Mr. Hashey?

MR. HASHEY: Just to clarify, Mr. Chairman, there may be questions that

you want to direct to NB Power. And I respect that from the Board.

My only difficulty would be that two of my major advisors in this

matter can't be here tomorrow, and it might be that we would have to

ask to respond to those --

CHAIRMAN: Well the kind of question I think the Board would be putting,

and I haven't talked to my fellow Commissioners about it yet at all or

to staff, but is just ask you address some hypotheticals, or to for

instance comment on things that Mr. Belcher has just said, et cetera.

Things that we still have some questions and want to make sure they

are addressed and you share with us your ideas before we adjourn.

Now I don't think you need your experts, Mr. Hashey. I am sure

you and Mr. Morrison will probably be quite knowledgable and be able

to address those yourselves.

MR. HASHEY: I hear laughter from this side and it's probably correct.

CHAIRMAN: Which side is the laughter coming from?

MR. HASHEY: Unfortunately it's from my left, not my right on this occasion.

CHAIRMAN: Anyway I don't really see that as a problem. But if you think it is then go ahead. But just --

MR. HASHEY: Well if there is something we can't answer, we will just have to ask for the opportunity to make some calls possibly. That's all.

CHAIRMAN: So we will reconvene in this room tomorrow at 1:00, and I would hope that we would conclude tomorrow. Thank you very much.

MR. HASHEY: 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