New Brunswick Board of Commissioners of Public Utilities

Hearing

In the Matter of a Board Order to Review Enbridge Gas New Brunswick Inc. Financial Results at December 21, 2002 and December 2003

PUB Premises, Saint John, N.B.
October 28th 2004, 10:00 a.m.

CHAIRMAN: David C. Nicholson, Q.C.

COMMISSIONERS: Ken F. Sollows
H. Brian Tingley

BOARD SECRETARY: Lorraine Légère

.... CHAIRMAN: Good morning, ladies and gentlemen. This is an adjourned hearing, what started out to be simply an argument day, it's evolving into something else, in reference to this Board's review of Enbridge Gas New Brunswick Inc. financial results for the 2002 and 2003 fiscal periods.

Could I have appearances for Enbridge please?

MR. HOYT: Len Hoyt from McInnes Cooper on behalf of Enbridge. I'm joined by Andy Harrington, Ms. Shelly Black, Kathy McShane, all of whom were here on September 30th.

And in addition today Mike Gruttner, the Manager of Operations of EGNB is with us.

CHAIRMAN: Thank you, Mr. Hoyt. Maritime Natural Gas Pipeline Contractors Association. I understand from the Secretary that we had notification that came in this morning. And, Mr. Hoyt, you have given a copy of that notification that we had. They are not going to appear today.

MR. HOYT: There is a cover letter there that indicates that.

CHAIRMAN: Yes. And Mr. Easson, the Board's financial consultant is here. And Ellen Desmond is here as Board Counsel. Then of course there are the normal numbers of staff, Mr. Goss and Mr. Lawton.

Mr. Justice Stevenson some time ago gave a decision that said that administrative tribunals could make their own rules of procedure provided that all of the parties were aware of those rules and were not taken by surprise.

So we are certainly doing that today. Because what started out to be just an oral discussion day, if you will, so that we laymen could understand AFUDC accounting has now turned into a situation where there is further evidence that is being offered to the Board, et cetera.

And as I said to Mr. Hoyt prior to the beginning of the proceeding today, one of the reasons I have never particularly cared for written proceedings is that things will come up and you don't have the opportunity to get further evidence concerning any problem that may arise from what you have got in writing.

Now we happen to be presented with the opportunity today. And I believe, Mr. Hoyt, after our discussions the last day we were here, you came back to the Board and indicated should there be anything asked of staff, should there be anything initial done.

And staff said well, you probably should, or at least we indicated if you wanted to you could. And as a result you filed a good deal more of evidence.

MR. HOYT: Our understanding, Mr. Chair, was that that is what the Board wanted. I did approach Board staff. And it was suggested to me that I put a request in writing just seeking clarification as to whether the Board wanted more information about the Vanier Highway Pipeline.

A letter came back indicating that that was the case. So that is why it was submitted.

CHAIRMAN: Certainly. I guess maybe the classic test that is presented in regulated utility cases is whether or not something is a prudent expenditure or it isn't.

And just for the future, Mr. Hoyt, I guess we all should be terribly cognizant of that. And when we come to do a review, if there is any area that you feel, because of the financial consultant's review, that may be questioned on prudency, that you put in some evidence right off the top on it.

However, certainly the Board, as we have indicated, wants to get all the matters out and give everybody an opportunity to discuss them. And we will deal with that new evidence a little later on in this hearing.

I discussed with you, Mr. Hoyt, before the proceeding started that I felt that perhaps the best thing for us to do is to focus on the AFUDC question now. Because both Ms. McShane is here and Mr. Easson. And if we were to adjourn over to -- because of the new evidence, et cetera, that sort of thing, I wouldn't want to keep them waiting in line.

And, Mr. Easson, we have asked you to appear today to give an explanation to we laymen of exactly what difficulties that you had with the method in which EGNB was handling the AFUDC question and lead us through it. We are not going to have you sworn, as we did not have Ms. McShane sworn either. We don't want it to turn into a cross examination thing.

And I think Mr. Hoyt understands that certainly if he wants to put some questions to you that assist in the Board's appreciation of where you are coming from as versus where the applicant is coming from, that is fine.

Now how would you like to proceed? What is the best way for you to present --

MR. EASSON: Well, I have some evidence on all three of the issues that you discussed at the hearing on September the 30th.

CHAIRMAN: Mmmm.

MR. EASSON: I'm fine to start with the AFUDC question.

CHAIRMAN: Mmmm.

MR. EASSON: It doesn't matter where I start. But I would like to have some input into the other --

CHAIRMAN: Certainly.

MR. EASSON: -- areas as well.

CHAIRMAN: Well, let's deal with --

MR. EASSON: Just brief input.

CHAIRMAN: Yes. Let's deal with them one at a time then and go from there.

MR. EASSON: Very good. We have been talking about AFUDC for the longest time. In fact the issue was first raised in 2001. And in that year the figure of AFUDC capitalized was fairly significant. It was 1,168,000.

And in the two subsequent years 2002 and 2003 we have had a lesser amount. Because there has been a lesser construction program than in 2001. But the figures are 158,000 in 2002 and 102,000 in 2003. So that is the order of size that we are dealing with right now. But if there were to be a significant construction program that figure would again become a very large figure.

I would like to take the opportunity to read into the record page 246 of -- an extract from page 246 of Bonbright. Is that --

CHAIRMAN: Yes. Have you got extra copies of that as well?

MR. EASSON: Yes. I have got copies for everybody.

CHAIRMAN: Great. Pass them around to Mr. Hoyt and Ms. McShane. Good old Bonbright.

MR. EASSON: Now, Mr. Chairman, I have a number of handouts that I would like to pass out at various intervals. Will they be given exhibit numbers --

CHAIRMAN: I think we will.

MR. EASSON: -- to keep them clear?

CHAIRMAN: To keep them -- the Board had two exhibits, 1 and 2 at the adjourned hearing. I'm going to, for the sake of clarity and the record, and I will do this after, I will -- they were exhibits 1 and 2.

I'm going to make them A-1 and A-2 just for applicant. And then anything that you have put in or have put in today will be under B for Board.

So this would be -- the excerpt from Bonbright would be B-1. Okay. Go ahead.

MR. EASSON: So the extract from the page 246 of Bonbright's textbook entitled Principles of Public Utility Rates. And I do believe that Bonbright is a recognized expert writer in this matter.

The heading is AFUDC Versus CWIP. And it reads "Two methods. FERC and other jurisdictions recognize that there are two alternate regulatory practices by which these carrying charges of debt, interest and reasonable equity return on construction capital are recovered in rates. One method capitalizes the carrying charges incurred during the construction period as allowance for funds used during construction (AFUDC).

AFUDC is recorded part as current income, part as an offset to interest expense, but no cash payments are made by ratepayers during construction. The payments from ratepayers to recover the carrying charges begin when the completed plant goes on stream. The entire cost of the plant (including AFUDC) is added to rate base, and it earns a rate of return on investment and is depreciated over the life of that plant."

That is the principle that I'm going to deal with today.

CHAIRMAN: Let me just -- no one on the applicant's side of the house here has any question about that being an appropriate definition of AFUDC?

MR. HOYT: No. That is fine.

CHAIRMAN: Good. Thank you.

MR. EASSON: So what we have been accounting for over the last -- what we have been -- let me start again. What we have been dealing with for the last three years is an accounting issue. It has nothing to do with cost of capital which seems to be brought in and to my mind muddies the waters.

CHAIRMAN: Mmmm.

MR. EASSON: But it is an accounting issue pure and simple. And this is the day you have all been waiting for. Because I have prepared an illustration of how this is accounted for.

And what I will do is I will pass out various pieces of my handout as we go along in an attempt to keep us all basically on the same page.

CHAIRMAN: Good.

MR. EASSON: Okay. So the first one, this is -- I have named my illustrative company ABC Co. It is very imaginative I know. But we will start with that.

CHAIRMAN: Okay.

MR. EASSON: So the first exhibit here which I -- would be B-2.

CHAIRMAN: That would be B-2.

MR. EASSON: And that will be accompanied by B-3.

CHAIRMAN: Hang on, Mr. Easson. Just for the sake of the record, B-2 is --

MR. EASSON: If we may call it illustration of accounting for AFUDC, ABC Co.

CHAIRMAN: Okay. And then that is a four-page --

MR. EASSON: Four pages called General Ledger. We are actually going to do a set of books. I can see

Mr. Sollows can't wait. So that's B-3.

Now this is a very simple basic illustration. I have been doing accounting for 40 years. So it is simple to me. But it is not necessarily simple to everybody else. So if you have any questions or are confused by anything please let me know.

CHAIRMAN: That, Mr. Easson, is the premise we start from.

MR. EASSON: Well, I tried to road-test this on my wife who I think knows less about accounting than anybody. And I realized it is not as simple as I thought it was. For example the first --

CHAIRMAN: Hang on just a second. I'm busy marking here.

This will be B-3.

MR. EASSON: B-3.

CHAIRMAN: Yes. And that is a one-page exhibit.

MR. EASSON: And that is the second part of the illustration of accounting for AFUDC. These are the journal entries.

MR. HOYT: And, Mr. Chairman, if the applicant does have questions as Mr. Easson proceeds, are we able to ask them as we go along? Or would you prefer we wait?

CHAIRMAN: Well --

MR. EASSON: If it helps the understanding of what is going on, as long as we --

MR. HOYT: And the questions I think would be best to come from Ms. McShane. It will keep it away from --

CHAIRMAN: Why Mr. Hoyt?

MR. HOYT: -- the nature of cross examination. And I think they might mean a lot more than Mr. Easson.

MR. EASSON: Or Ms. Black, Shelley.

MR. HOYT: Shelley as well.

MR. EASSON: Either one.

CHAIRMAN: Yes. Now do you want to hand the mike back to that table then. Okay. So we just marked B-3 which you characterize as being the journal entries?

MR. EASSON: Journal entries, yes.

CHAIRMAN: All right.

MR. EASSON: So I would just like you to imagine that you have been handed a whole bunch of documents, bank statements, invoices, et cetera and you are being asked to do the accounting, which happens a lot. It is known as a shoebox audit.

So in this shoebox audit you have received all of the documents. And you need to make the entries to record in the accounts the documents that you have received, such as the bank accounts.

So in the first journal entry number 1 on B-3 is a simple -- the bank account was deposited with $1 million which was received from investors for share capital. So the entry there is debit bank account, credit share capital.

Now that is the one that threw my wife. Because she said well, when I get my bank statement it is the opposite way around. And of course the bank shows deposits as a credit because they owe that money to you. You are a creditor. So when you reflect it in your own books you record it as an asset because it is your money.

So that takes care of the first entry. Nobody has any problem with that one I expect.

And the second one is also a deposit to the bank account. Because we are assuming on the first day of the year the company had made a loan at the bank and has the million dollars of long-term debt.

So if I then take you back to B-2, you can see that in the general ledger for that day, having recorded these entries, you have a bank account which records the subscription for capital and the loan received. And you have a balance of $2,000.

CHAIRMAN: 2 million?

MR. EASSON: Sorry. 2 million. I stand corrected.

CHAIRMAN: I'm following you, Mr. Easson.

MR. EASSON: It was not a deliberate mistake. And the offset of those deposits is you have long-term debt of $1 million. And you have cash received as share capital for $1 million.

So you have got a $2 million balance sheet of assets represented by 1 million of the share capital or equity and 1 million of long-term debt.

Through your analysis you have discovered that the company has invested in property, plant and equipment throughout the year in the amount of $1,500,000. The cash used to pay -- and if you then turn to page 2 of the general ledger which is B-2, we record the property, plant and equipment as an asset by crediting the bank account. So the credit to the bank account is the cheques issued for the property, plant and equipment.

And when you look back to general ledger, ABC Co., you now have an account called property, plant and equipment. It has cash expenditure of $1,500,000. And we reduce the bank balance accordingly. So we credit the bank the plant purchases.

End of the year we have paid the interest on long-term debt. The debt we assume was at 8 percent outstanding for a full year. So the cost is $80,000.

So if you look further down the page we now also have an income and expense account, all interest on long-term debt. So that is debited with the 80,000 which is again credited to the bank because it is an outflow of cash, which leaves us with a balance of $420,000 in the bank account. The company has decided to use the AFUDC method of accounting for the cost of capital during construction.

So we then come to the entry number 5 which is recording the AFUDC. So we have done a very simple calculation down below. We have said the average balance of fixed assets for the year was 1,500,000 divided by 2. So it was $750,000.

We have worked out a weighted average cost of capital, $1 million of debt at 8 percent, $1 million of equity to prove return of 12 percent. So we have an average rate of

10 percent which gives us an AFUDC figure of $75,000.

So what we do -- and this is what EGNB does -- we debit property, plant and equipment. So if you look under the property, plant and equipment account on page 3 of B-2 you will see that the AFUDC, which I have written AFUFC, AFUDC allocation is 75,000 bringing the recorded value of the property, plant and equipment to 1,575,000.

If you then look further down below, at the bottom of the page you will see that there is a new income and expense account entry which is the allocation to fixed assets of 75,000. We are calling it an AFUDC credit.

Now at this point I would like to emphasize to you what we have done. We have created an asset or added value to an already recorded asset of $75,000. We have said the asset which cost a million 5' really has a value of 1,575,000 because of the cost of capital used during the time of construction.

So since we have created an asset we have to have an offsetting credit. That credit can only be on the income statement. And this is where EGNB records their credit in the limited partnership financial statements.

So if I were to move ahead we have now decided that we can prepare some financial statements. And there are some financial statements for ABC Co. as of the 31st of

December which I would like to go through.

And shall we call this B-4, Mr. Chairman?

CHAIRMAN: B-4.

MR. EASSON: B-4. ABC Co. balance sheet and income statement.

MR. EASSON: Shall I proceed?

CHAIRMAN: Yes.

MR. EASSON: If you keep page 3 of exhibit B-2, the general ledger open, you can easily see that the general ledger accounts that we have created are used for producing the financial statements which I have now filed. So if you go down the page of B-2, page 3, you will find over on the balance sheet, bank account 420,000. That's the balance after all of the expenditures for the year. Property, plant and equipment is a million-575-thousand.

When we prepared the income statement we end the year with a slight loss. If you go down to the income statement immediately below, you will see that the statement consists of the AFUDC credit of 75,000 that we created, and we add interest on long-term debt of 80,000, which has resulted in a loss for the year of $5,000.

So through the last entry that I showed you on B-3 we recorded this as a debit to the deferral account. We have assumed that we are in a greenfield situation and the company has a deferral account just as Enbridge does.

So we have a deferral account shown as an asset and on the other side of the balance sheet, liabilities and equity, we have the original long-term debt and we have the share capital of a million dollars.

And all auditors and accountants love this because it balances. Is everybody with it so far? Are we okay?

So for regulatory purposes we would be determining the rate base for the year so that we could calculate the return on equity for the company. I have deliberately not recorded this because I am trying to illustrate only the AFUDC part of the equation.

So we have property, plant and equipment of 1,575,000 and we have a deferral account of 5,000, which is a rate base of 1,580,000. The proof of this is that we started with $2,000,000, we then lived with 420,000. So we have expended $1,580,000. The company is entitled to recover all of that expenditure on fixed assets through depreciation and the deferral account. So we are happy. At least I am.

So that is the situation that we have which I think should be the final situation as far as the AFUDC is concerned.

The next hand-out is -- and I have lost track already, Mr. Chairman -- would it be B-5?

CHAIRMAN: Mr. Hoyt, when Mr. Easson is through his presentation we can give you a break and whatever.

MR. EASSON: And at the same time I will give you -- to keep this all straight, Mr. Chairman, B-5 is --

CHAIRMAN: How do you characterize it?

MR. EASSON: This one is an illustration of accounting for AFUDC, journal entries, the EGNB proposed regulatory adjustment. And I will also hand out B-6 which is a continuation of the general ledger that we have just been looking at, and this is called general ledger, the EGNB approach. That will be B-6. May I have a couple of moments, Mr. Chairman?

CHAIRMAN: Certainly. Whatever you need.

MR. EASSON: I have noticed an error in it and if you would be so kind, if you would go up under deferral account --

CHAIRMAN: Sorry. We are on --

MR. EASSON: On the general ledger on B-6.

CHAIRMAN: B-6, yes.

MR. EASSON: The third item down is the deferral account.

CHAIRMAN: Yes.

MR. EASSON: That figure should be 80,000, not 5,000. So the entry that Enbridge is proposing to us, to which I take exception, is number 6 on B-5, I think it is.

CHAIRMAN: Yes, that's correct. Yes.

MR. EASSON: In the year 2001, EGNB simply removed the AFUDC credit from the income statement and credited equity. In this case they have created an expense account called AFUDC expense and credited equity in an account called regulatory adjustment.

So what they are doing here is they are offsetting the AFUDC credit that was created when we booked the asset the AFUDC. And as we will see when we get to the financial statements, this increases the loss for the year to $80,000. And I will pass that now, the financial statements according to Enbridge, which I would guess is --

MR. SOLLOWS: Are we finished looking at --

MR. EASSON: I think you need these just to see what the result is, Mr. Sollows. B-7, Mr. Chairman.

CHAIRMAN: B-7.

MR. EASSON: So on B-6 you will observe that --

CHAIRMAN: If you would wait a minute, Mr. Easson, while the clerk gets --

MR. EASSON: I apologize.

CHAIRMAN: -- Ms. Desmond gets the hand-outs to us. Go ahead, Mr. Easson.

MR. EASSON: You will see that on B-6 we have an account --

a new account at the bottom of the balance sheet section which is called equity (regulatory adjustment), and that is credited with the elimination of the AFUDC credit. And that is offset down in the income statement by an account called AFUDC expense.

Now from B-7 you can see that in the income statement the effect has been we now no longer have an AFUDC credit or income. We only have interest on long-term debt of 80,000. So that becomes the loss for the year. And the 80,000 is transferred to the deferral account. The difference obviously being between 5 and 80,000 is the 75,000 of AFUDC which has been eliminated.

And the proof of this if we go again below the income statement we now have rate base regulatory purposes which consists of property, plant and equipment of the same figure of 1,575,000. We have a deferral account of 80,000. So we are now saying the rate base is 1,655,000, which is the basis for calculating the return on equity.

However, our expenditure is still the same as it was under the first example, which is 1,580,000. Therefore the rate base is overstated by 75,000, which is the amount of the AFUDC which has been eliminated.

MS. MCSHANE: Could I ask one question here just to clarify? The example that you have developed here, it's my understanding from reading it that none of this plant that you have set forth in these financial statements is in rate base, yet, is that right? It's still construction work-in-progress.

MR. EASSON: No. We had a very simple example here, and you have to assume that it all came into service on the last day of the year, without charging depreciation.

MS. MCSHANE: That's fine. So for purposes of the determination of the amount of the AFUDC, effectively what you are saying is that this plant that has been purchased has been in construction work-in-progress throughout the year.

MR. EASSON: Throughout the year.

MS. MCSHANE: So --

MR. EASSON: We are not -- I am trying to simplify it so that we are only dealing with the AFUDC.

MS. MCSHANE: I understand. And I'm just trying to understand from my own perspective so that I can follow the example. So my question is then that until the very last year of -- sorry -- the very last day of the year there is no rate base because all of the plant is in construction work-in-progress?

MR. EASSON: Well that would be fair to say, but, you know, obviously in real life it would be much more complicated.

MS. MCSHANE: Right. And I'm trying to make sure that --

MR. EASSON: I mean I don't think by making this more complicated it would make it easier for the Board to understand.

MS. MCSHANE: Right. I don't disagree with you, that obviously we want to keep it as simple as possible. But for purposes of understanding whether this is a correct interpretation of what Enbridge does I just want to make sure that it's clear that this example, except for the last day of the year, has all of this plant in construction work-in-progress.

MR. EASSON: Well that's fair enough if you want to say that, but the purpose of the illustration is to show how the AFUDC income is booked and how it affects the income statement and the deferral account, and that if you eliminate the AFUDC credit the impact that it has on the balance sheet on the deferral account. And I think it does.

MR. SOLLOWS: May I ask a question? If there -- and I think it comes to your questions for clarity in my own mind -- if this was not year one or year zero in a company but instead an ongoing company that had already $10,000,000 worth of plant equipment that was in their rate base, would it materially affect this presentation?

MR. EASSON: Well it would affect it. I mean all the figures would be bigger and more complicated.

MR. SOLLOWS: But in terms of the difference at the end.

MR. EASSON: You would have depreciation, you would have -- et cetera, et cetera.

MR. SOLLOWS: But in terms the difference that is made at the end where you prove the rate base --

MR. EASSON: Yes.

MR. SOLLOWS: -- it wouldn't materially affect that? There would be a lot more additions and subtractions in it, but there would be the same net difference?

MR. EASSON: Yes. The entry that -- the entry which is in question is entry number 6 on B-5 which removes the credit by creating an expense, and crediting the equity of the company. So if you look at the balance sheet of B-7 you will now find that the company's shareholders equity is 1,075,000. That's where the 75,000 has gone in this example and that's where it has gone in the Enbridge regulatory accounts. I think that is incorrect. I think that is an erroneous entry.

CHAIRMAN: Shall we take a break now, Mr. Easson?

MR. EASSON: I'm trying to continue, if you wish, unless you would like to have a break.

CHAIRMAN: No, no. There was a pause. I'm trying to sense the mood of the crowd, that's all. Go ahead.

MR. EASSON: Now would Mr. Hoyt like to have a break and come back?

MR. HOYT: No, I would prefer you proceed with your presentation and then take a break.

MR. EASSON: Okay. Now I think the purpose of the regulation is to be fair to the shareholders of the company, the investors, and I think it's intended also to be fair to the ratepaying public. What I see is that the ratepaying public is being overcharged because of an erroneous accounting entry. There is no necessity for it. The investors have lost nothing if we reverse this account because it's simply something that has been created on paper. It hasn't expended any money.

So I would urge the Board to review this and I know a decision was given for 2001 but I think that the decision for 2002 and 2003 should be that this erroneous entry should be reversed for regulatory purposes.

There were a number of comments in the transcript which if you permit I will deal with, or try to deal with. And there were some examples given by Ms. McShane which I would also like to take a look at.

On page 35 of the transcript Ms. McShane deals with one of my responses to an interrogatory by saying that what I have produced is not a revenue requirement, this is simply a financial statement. This is the example of NB Power. And Ms. McShane is absolutely right. It is a financial statement. And I should have added the fact that NB Power has appeared before this Board in past hearings on rate matters, and it does not reverse the AFUDC credit that it records in their case only as a question of interest -- interest incurred. It leaves the credit in income which reduces its revenue requirement. And if I can give you a recent example which you could look up -- unfortunately I was doing this at home and I didn't have all of the information available to me, but it can be looked up.

But in the OATT hearing before this Board information was filed by NB Power which included a credit for AFUDC and we -- during Board cross-examination of completing the record, Dr. Morin was asked whether the credit for AFUDC should be included in the income statement, and he responded in the affirmative. And for those who don't know Dr. Morin, Dr. Morin has written a -- what I believe is called a seminal work on cost of capital and I'm sure Ms. McShane is very familiar with that. There is a section in his book which we could photocopy during the break if you wish where he describes AFUDC and the credit thereof, how it should be recorded, and it basically agrees with Bonbright.

The other example which I gave was a very old NBTel set -- well it wasn't a set of financial statements I must admit but it was an extract from the filing where the AFUDC credit was left in the financial statements, the calculation of the revenue requirement. Ms. McShane was confused because she obviously didn't have all of the information from that filing and she was wondering if the actual common equity was the total common equity of the company. I can assure you that all of the required regulatory adjustments were made in the case of NBTel as they were for EGNB. So that we are dealing with a level playing field there. And I can assure you on this because, Mr. Chairman, I was the dinosaur who prepared the report.

CHAIRMAN: Do you have a copy of that NBTel report, Mr. Easson, or does the Board have it here?

MR. EASSON: The Board should have it here but I certainly have a full copy back in my office.

And on page 41 the Chairman said that so again it becomes clearer, the difference here is that of course the purpose of the NBTel statement are different from the purposes of Enbridge statements now as they understand it. And of course that is correct. NBTel was a mature utility. It was filing for a rate increase with a future test period. What we are doing with Enbridge of course is we are looking backwards and we are reviewing what has happened in the past year. There is no requirement to make a revenue requirement to -- because there is no question of rate increase in the case of Enbridge.

And if I can look at the examples which were provided by Ms. McShane, the Enbridge example, it is no surprise --

CHAIRMAN: Just a minute. We have to locate --

MR. EASSON: Yes. I'm sorry. I have two pages that were e-mailed to me. Regulated revenue 2003 historical year --

CHAIRMAN: Mr. Easson, slow down just a minute. The Board secretary has to assist us in locating -- would you repeat what it is that you are looking for?

MR. EASSON: Yes. There are two pages --

CHAIRMAN: Just a second. We don't know --

MR. SOLLOWS: The first two exhibits from the last hearing, exhibit 1 and exhibit 2?

MS. BLACK: Exhibits A, B and C.

MR. SOLLOWS: In the original filing?

MS. BLACK: I believe.

MR. HOYT: It's -- I believe it's the Enbridge Gas Distribution example that is attached to Board IR4 to EGNB.

CHAIRMAN: IR4 to EGNB dealing with -- yes, okay.

MR. HOYT: It's the three examples that Enbridge provided and it's the Enbridge Gas Distribution.

MR. SOLLOWS: In response to Interrog September 9th?

CHAIRMAN: Interrogatory number 4 and what attachment again was it, Mr. Hoyt?

MR. HOYT: There is three. It would be the first -- I believe it is the first one.

CHAIRMAN: He just said I believe it's the first one.

MR. HOYT: A.

CHAIRMAN: A. All right. Just everybody let Mr. Hoyt and company find out what we are referring to here.

MR. GOSS: Tabs A, B and C.

MR. SOLLOWS: Tab A in the binder.

CHAIRMAN: I want just to say what I always say to insurers when they come in here is number your pages sequentially. So it's A and -- okay. Attachment A and what page would it be, Mr. Easson?

MR. EASSON: Well I didn't have what you have but I received and e-mail and this was attached to an email.

CHAIRMAN: Okay. Mr. Goss, he is referring to the page 1 in attachment A.

MR. EASSON: It's headed Regulated Revenue 2003 Historical Year, page 3 of 4 and 4 of 4. Now as you would expect, this illustrates that the AFUDC was removed to arrive at regulated revenues. Well it's no surprise, I'm sure, that Enbridge will be consistent in this and that they would not show something different in one company than in another.

But having listened to my evidence, you would wonder why this would be accepted by the regulator. I mean, I cannot argue with this, that it is clearly marked on page 4 that interest during construction is eliminated.

Now the next one that I received through the mail is the Heritage Gas. And I did receive subsequently the full filing.

CHAIRMAN: And that's tab B.

MR. EASSON: If that's tab B --

CHAIRMAN: Yes.

MR. EASSON: This is page 3 -- sorry, it's item 3, revenue requirements.

CHAIRMAN: Right.

MR. EASSON: There was no balance sheet provided. And these are extracts from various parts of the filing. If everybody is on that page, if -- the pages are in order. This is one page marked page 47. This is part of note 2 to the general tariff application. Actually, it's note 2 to the financial statements. And it's note 2, subsection

(G), which refers to the company's accounting policy with regard to allowance of funds used during construction. And in fact the company does follow that -- that policy, because if you fast forward to page 43 --

CHAIRMAN: Sorry. Mr. Easson, repeat that? I missed you. I lost you. I am referring to --

MR. EASSON: Okay. I will read --

CHAIRMAN: -- I am looking at G. Allowance for funds --

MR. EASSON: Used during construction.

CHAIRMAN: Right. The corporation capitalizes an important -- an imputed carrying costs and assets under construction. This rate is subject to NSURAV review. The amount capitalized is disclosed on the income statement is allowance for funds used during construction. The recognition of an allowance of funds used during construction is in accordance with generally accepted accounting principles, as they apply to regulated utilities.

So if you look forward to page 43, which is two pages ahead, you will find that under revenue there is an allowance for funds used during construction of $175,000. Now given the policy that was enunciated there, it's fair to assume that that AFUDC was included in property, plant and equipment in the balance sheet, but we are not provided with the balance sheet. But I think it's a fair assumption to make.

So that I think Ms. McShane's point was that even though they have the two hundred and -- the $175,000 of AFUDC in the income statement for the company, that by the time we get to the revenue requirement, it is eliminated. And again if Heritage Gas was appearing before this Board, and I had received this, that would be a question that I would have raised to the attention of the Board, well why?

If you -- and I regret to say that I find this income statement very confusing. Because if you go back to page 43, we have a revenue deficiency accrual of 243,000. Allowance for funds used during construction of 175'. Operating and maintenance expenses, which were capitalized a hundred percent. Interest of 152. Corporation capital taxes 21. The net expense of 173. So the accrual for revenue deficiency is $70,000 higher then the net expense. And I have to assume, and perhaps Ms. McShane can confirm this, that the difference of 70,000 is caused by the return on equity, which is -- which is being recorded as part of the deferral account.

If I am losing you, I am losing myself a bit. But when you go forward to schedule 3.1, which is the second page of this submission, you will see that the total revenue requirement is 243,000. And that's calculated on the basis of 21,225 income and other taxes. So there is no claim for interest. And a proposed return on rate base of 221,000.

So I really don't see what the submission proves, quite frankly.

If we may then turn to Atco, again I have --

CHAIRMAN: That's under tab C, Mr. Easson.

MR. EASSON: C, I would guess, yes.

CHAIRMAN: In ours, yes.

MR. EASSON: Again, we have partial information. If you refer to schedule 9, pages 1 of 2 and 2 of 2, and I think Ms. McShane's contention is if you look at page 2 of 2, that because in this reconciliation, the AFUDC is added back, that means it's the policy of Atco not to include the AFUDC in income. But we are given no reasons for this. And the figure of AFUDC in this particular example is 257,000. And somewhere I think I saw that there was a revenue requirement -- yes, on the next page. A utility revenue requirement of 806 million. It might be that this figure is so insignificant, it's a mature utility that it really doesn't make very much difference whether you include the AFUDC or not. But again the principle should be followed. And that is that the -- that the AFUDC should be included as an income item.

The final matter I would refer to is the Ernst & Young report dated September 13th 2003.

CHAIRMAN: Can you hold just for a minute while we track that down.

MR. EASSON: I have a number 4 in the corner, but I am not sure what that means.

MR. TINGLEY: What was the date on that, Mr. Easson? What was the date?

MR. EASSON: It was September 16th 2003, Mr. Tingley.

CHAIRMAN: You are just referring to the letter?

MR. EASSON: Yes. It's the letter of -- it's on three pages with some appendices.

CHAIRMAN: Yes. We have two dated the same date.

MR. SOLLOWS: Three. I have three pages.

CHAIRMAN: Yes. Okay.

MR. SOLLOWS: September 16th 2003?

MR. EASSON: 2003. That's correct. So the conclusion on page 3 is, although Enbridge's method of preparing its regulatory statements is not the traditional method -- and I would warn you that the expression, traditional method is an invention of Ernst & Young. Because never anywhere else is it referred to as a traditional method. It's the method. So to continue the quote, it results in the same recovery from ratepayers, and therefore does not result in an excess recovery from ratepayers. And how they arrive at this conclusion based on their report is a mystery to me. Because this report is full of misconceptions.

And if you would look at just page 2, our understanding of Enbridge's regulatory statements. The second paragraph reads, in the last sentence, AFUDC is also removed from the audited statements, as this is recovered from the ratepayer through amortization once the asset is put in use.

Now the AFUDC in the income statement is a credit. So how they can amortize that to the ratepayer I have no idea. The AFUDC is not removed from the audited statements. If it were removed, you would remove the credit. Then you would remove the debit in the assets. That's the only way you could remove it. So to say that the AFUDC is removed as it's recovered through amortization is a complete misconception.

And further on, under the heading, "Our Assessment", which starts at the bottom of page 2 and goes on to page 3, they say, this AFUDC is recovered from the ratepayer through amortization over time. If Enbridge were to include the AFUDC in the regulatory statement as an income item (essentially crediting the customer with an income item) and then "recover it", it through amortization these amounts would net to zero, which does not provide Enbridge with a return on the capital investment -- being invested.

On, of course, the transaction should net to zero. As I mentioned to you and we were going through my example after step 5, you are creating an asset out of thin air. You are saying the $75,000 of cost of capital, which we are adding to the asset base. It has to net to zero, because you can't simply create assets and charge them to the customers. So from the income statement point of view, what you are recording is a credit, which essentially defers until future years recovery of the cost. So this is another of their misconceptions.

And as we have seen, EGNB capitalizes overhead expenses as to property, plant and equipment. This is not -- and I am not going into the capitalized expense issue here. But Enbridge does in fact capitalize overhead expenses. And if we look at page 10 of 14 of the regulatory statements, if you would like to do that --

MR. HOYT: What year, Jim (Mr. Easson)?

MR. EASSON: 2003.

MR. SOLLOWS: 10 of 13?

MR. EASSON: It's 10 of 14.

MR. SOLLOWS: Oh. That would be --

MR. EASSON: That's the -- my recollection is it's the departmental detail of overhead expenses. It comes down to a total, and line 13 reads, capitalized in --

CHAIRMAN: Whoa, whoa. Let us get it, Mr. Easson, please.

MR. EASSON: Oh, I am sorry.

MR. SOLLOWS: 10 of 14. It's the next one over.

CHAIRMAN: Yes. Thank you.

MR. EASSON: So on line 10 of 14, line 13 reads, capitalized in property, plant and equipment, 11,184,000. Do you see that?

CHAIRMAN: Yes.

MR. EASSON: And the net figure is the figure of overhead expense, which is actually included in the income statement, which is page 1 of 14. If you turn to 1 of 14, you will see that the net figure there -- and I am not sure what line. I think the first line of expenses.

CHAIRMAN: Oh, we have lost you.

MR. SOLLOWS: 2,879' -- yes, I see it. Operating and maintenance expense.

MR. EASSON: Line 7.

MR. SOLLOWS: Line 7. Operating and maintenance expenses, 2,879,000. That's the net figure after capitalization.

Now does the 11,184' charged to property, plant and equipment and the 11 million 184 credit on page 10 of 14 net to zero? Of course it does. It has to. Can't have it in two places.

Would it be fair if Enbridge reversed its credit and said well let's put this in the regulatory adjustment and will also charge the 11,184,000 to the ratepayers through the deferral account? Of course not. And they don't attempt to. And why don't they attempt to? Because the answer is obvious. They don't need to. And you don't need to reverse the AFUDC credit either.

And the point that they are also missing in Ernst & Young is that the AFUDC is added to the base of the property, plant and equipment. It forms part of rate base and it earns a return on equity at the approved rate by the Board.

So, personally I would not pin much faith on quoting this report as a basis for saying that what Enbridge is doing in reversing the AFUDC credit is correct.

So just in conclusion on the AFUDC issue I just want to remind the Board in its decision of October 17, 2003, the Board and I quote, "directed EGNB for 2002 and future years, to prepare its income statement for regulatory purposes in the traditional manner, showing AFUDC as an income item." Now that may not have been as clear as it ought to have been. But, first of all, the description of the traditional method itself is not clear in the E&Y report. The question is should EGNB be allowed to reverse the AFUDC credit, either by eliminating it or by creating an expense, which is recorded as part of regulatory equity? I think my evidence will convince you that it should not be allowed to do that.

The entry will prove -- if left would prove to be unfair to the customers and should be reversed so that the AFUDC credit remains an income for regulatory purposes. The company is whole, the investors are whole. And the ratepayers will be whole.

And I thank the Board for their attention.

CHAIRMAN: Thanks, Mr. Easson. We will take a break. And how long a break do you think you want, Mr. Hoyt?

MR. HOYT: I would suggest about half an hour.

CHAIRMAN: Commissioner Sollows?

MR. SOLLOWS: I am just going to offer a suggestion. It would certainly be helpful in terms of my understanding of the problem. When I ask the question as to whether this was a field operation or an ongoing company with an existing rate base, I saw clear disagreement between the parties here. And so it would be very helpful to me if you could address that issue in terms of the exhibits that we have just seen today in as simply as possible showing how carrying an existing balance in not a greenfield situation -- an existing balance on the plant, property and equipment would affect the conclusions that were drawn under these exhibits?

I guess what I am saying is these exhibits seem to have been quite clear to me. And so if we can -- if there is a -- where the point of argument is going to be made, if it could be made in terms of these exhibits, it would be very helpful I think.

MR. EASSON: May I address that question?

CHAIRMAN: You may, but just a second, I want to make a sidebar here. That's a professorial way of dealing with things, make them more complex. I think the question should be put to both Mr. Easson and Ms. McShane, do they in fact believe that other than the way Mr. Easson described it there would be any change if it were an ongoing corporation, and if so, then Commissioner Sollows' suggestion is fine. But is it --

MR. EASSON: My response to that is EGNB is an ongoing corporation. We have had an issue with AFUDC in three successive years. The treatment is slightly different, but it's really no different in the sense that the AFUDC credit is eliminated. It doesn't matter if the company has been going for a hundred years, the issue is still the same. If you are creating AFUDC by increasing the value of property, plant and equipment, you have a credit. That credit should remain in the income statement. As far as I am concerned, that is all I can say.

CHAIRMAN: Ms. McShane, do you want to add a further level of complexity to the examples that are set forth in B-1 through 7?

MR. HOYT: I think it would be best if we took the half hour and we will address that.

CHAIRMAN: Okay. And if half way through the half hour you think you might need a little more time we will break for lunch.

MR. HOYT: Thanks.

CHAIRMAN: Thank you.

(Recess)

CHAIRMAN: Good afternoon. Mr. Hoyt?

MR. HOYT: What we would like to do, Mr. Chair, would be to have Ms. McShane go through a couple of issues with

Mr. Easson on his presentation this morning.

And then I have got some closing comments or brief comments at the end, if that would work for the Board.

CHAIRMAN: Okay. Sure. Why don't you have Ms. McShane, if she is able to, just go over to that chair there. It makes for the passing of the mike back and forth a lot easier.

MS. MCSHANE: Thank you. I would just start out and I would just make a comment about the Bonbright statement. And essentially I don't have any problem with the way the Bonbright describes AFUDC versus CWIP.

I would just point out that when you record AFUDC in the manner that Bonbright suggests, what you are doing is you are essentially accounting for all of the capital that is financing utility-related plant including the rate base as well as the construction work-in-progress, which is not what Enbridge includes in its regulatory statements. In its regulatory statements, it only includes the cost of capital that is related to the rate base.

So there would be no reason in the regulatory statements to include AFUDC as a revenue item, at least -- and that is, you know, what we were trying to show in some of the examples that we had provided.

Can I go on? Or do you want to say something?

MR. EASSON: Is that a question?

MS. MCSHANE: Just interrupt me anytime you want to --

MR. EASSON: Okay. I stand by my presentation.

MS. MCSHANE: Okay. We went through the presentation. And if I could I would just like to make a couple of comments on that. The first thing that we did was we took B-4.

MR. EASSON: B-4, the financial statements.

CHAIRMAN: Well, give Mr. Easson an opportunity to see it before you bother handing it out to us or whatever, just so he can make a comment before we even get it, okay. I'm being inundated with paper.

MS. MCSHANE: May I explain to Mr. Easson what we have done in the off chance that it is not clear? Or do you want me to wait till you get a copy?

CHAIRMAN: Well, any problem with us getting a copy now, Mr. Easson?

MR. EASSON: Oh, I have no trouble with you having a copy. But we would need to see what it is we are trying to achieve with the various changes.

MS. MCSHANE: Okay.

CHAIRMAN: So this, we have already marked it as A-3 which is a doctored copy of B-4.

MS. MCSHANE: That is correct. It is a doctored copy of B-4.

CHAIRMAN: You go ahead and explain to Mr. Easson what you are doing.

MS. MCSHANE: Essentially what we did here was to recognize that given the example that Mr. Easson presented, that there would be essentially no rate base during this year. That is why I had asked the question before.

You had said that you would put the plant in rate base at the end of the year. But just for simplicity of exposition we assume that effectively there was no rate base during this year of your example.

MR. EASSON: If you like.

MS. MCSHANE: Pardon me?

MR. EASSON: If you like.

MS. MCSHANE: Well, it just -- I think it made it a lot clearer to understand what was going on rather than bring in the complexities of having just a little bit of rate base at the end of the year and having to deal with the averages of, you know, say a twelfth of the plant in service.

So what happens then is that, if you look in the second quarter of this doctored document to the right, there is an income statement for regulatory purposes for this year, this illustrative year. In that income statement, because there is no rate base, there is no cost of capital requirement.

And because EGNB, as do other utilities, doesn't include the AFUDC revenue in their regulatory statements, there is no revenue. There are no expenses. There is no deferral.

So when you look at the balance sheet at the end of the year there is nothing to put in the deferral account. So if we go to the financial side of that statement, which would be in that same second quarter of the page, you would not have that transfer to the deferral account of $5,000. Because there is no deferral. Because there is no revenue requirement in that year. And therefore there is no revenue deficiency.

So because there is no transfer to the deferral account for financial statement purposes, there is a loss. So that if we come down to the third of the quarter, third quarter of the page, the property, plant and equipment on the left-hand side of 1,575,000, we don't have any problem with that number. But there would be no deferral account as I said. So the total assets would be $1,575,000.

And then at the very bottom where we have this comment or the title Proof of Rate Base we would have cash proceeds from debt and equity of 2 million, balance of cash a year-end of 420,000 but the loss which would translate into negative retained earnings of $5,000 would then balance to $1,575,000.

MR. EASSON: When I went through my example I demonstrated how you need to use journal entries to effect the changes you are going to make.

MS. MCSHANE: Right.

MR. EASSON: You have supplied none of those here. If you didn't have a deferral account you would have a deficit, that is correct.

But in the situation that we are dealing with, from day one it was approved that any losses incurred by EGNB would be recorded in a deferral account for future recovery.

So it is quite incorrect to say that you would have retained earnings. Because in the first year of existence there was a deferral account. It was immediately booked. So I don't see how you can say that you would have a deficit --

MS. MCSHANE: Because --

MR. EASSON: -- in year one.

MS. MCSHANE: Because there -- the way the company accounts for the deficiency is only in relation to the cost of capital that is related to rate base. So --

MR. EASSON: Yes.

MS. MCSHANE: -- it is incorrect to say that in the first year they would have had a deficiency that would have been transferred into the deferral account. There would not have been.

MR. EASSON: Okay. Actually what happened in the first year is all of the expenses were capitalized as part of property, plant and equipment, except for the capital tax. I believe it is the capital tax was the last figure that was booked. And that was transferred to the deferral account.

Now equally at the bottom of the page here we have got -- the rate base for regulatory purposes you simply scratched out the deferral account. But to make it balance you have taken a figure of retained earnings deficit off the change in cash.

MS. MCSHANE: That is correct.

MR. EASSON: What journal entries do you look to produce for me to show me how this is done?

MS. MCSHANE: I haven't actually done the entries. But you can see that there is a loss in that year for financial --

MR. EASSON: Yes.

MS. MCSHANE: -- statement purposes of $5,000. So the loss becomes a negative retained earnings.

MR. EASSON: Now see, what we are actually talking about here is Ms. McShane is bringing in the question of return and cost of capital to the rest of it.

And I deliberately left that out so that this would be clear as to the principle involved of recording AFUDC, how it is recorded as income, and how it is recorded as an asset. And the impact of reverse --

CHAIRMAN: Would it help matters, Mr. Easson, if the Board took a break and asked that the journal entries to which you refer were prepared by Ms. McShane?

MR. EASSON: If Ms. McShane can prepare them it would be advantageous.

CHAIRMAN: Can we do that?

MS. MCSHANE: It is fine by me.

CHAIRMAN: Okay. Let us know when you are ready.

(Recess)

CHAIRMAN: Okay. We have taken a break and we are back and go ahead, Mr. Hoyt.

MS. MCSHANE: Okay. So the journal entries that we would make would be the debit AFUCD 75,000, debit retained earnings of 5,000, and credit interest expense 80,000.

MR. SOLLOWS: What is wrong with those entries?

MR. EASSON: The $75,000 entry is the one that I have described as being erroneous. That is the entry that I say we shouldn't be making. The $80,000 leaves me perplexed because you are taking your interest expense that you have incurred and you are charging it to retained earnings. That's another erroneous entry. I have never in regulatory or other accounting ever seen an entry like that in 40 years.

CHAIRMAN: Okay. I will just interrupt there for a second.

Mr. Hoyt, if you would like to get a copy of those entries and give them to Madam Legere, why she will get some copies made for us.

MS. BLACK: Well we haven't actually got the entry written out. It's more of a scribble.

MR. SOLLOWS: Would it be -- he has got a journal thing for B-5. Would you be able to go on that page and just sort of write it in.

MS. BLACK: Sure.

MR. EASSON: Please put it on the one headed EGNB approach.

CHAIRMAN: What is the exhibit number? B-5?

MR. SOLLOWS: B-5.

CHAIRMAN: Okay. If you would write it in on B-5 and --

MR. SOLLOWS: Right now you have shown it as items 6 and 7 AFUDC expense and the deferral account. Is there something that you would add to that?

MS. BLACK: Our entry would be different than that.

CHAIRMAN: Okay. I guess what I am saying --

MR. EASSON: I would stop at entry 6 on the first page.

CHAIRMAN: What I am saying is that if you have some journal entries for us to follow along on, why that would make it easier for me and good for my homework. So if you have got something that we can make a copy of we would appreciate it.

MS. MCSHANE: Okay. Before we leave today, would that be sufficient.

CHAIRMAN: No. Right now. I want to see this and follow it through. Sorry.

MR. DESMOND: Just a format something like that maybe.

CHAIRMAN: If you want to take a copy of -- what is that -- B-5 --

MR. DESMOND: B-5, and just change it.

CHAIRMAN: And change it and we will give it a new exhibit number and Bingo, we are in business. Wonderful. We will wait while the secretary gets them made.

(Pause)

CHAIRMAN: This is an amended portion of exhibit B-5 and we will call it exhibit A-4. Okay. Ms. McShane, referring to A-4, would you go through those entries again?

MS. MCSHANE: I can have Shelly go through them but I mean we just prepared them because we were asked to. We really had no intention of spending any time on these. We were simply making the point that the approach that Enbridge would go through would not create an amount in a deferral account for this period.

CHAIRMAN: Well that being as it is, I would like you to go through the entries that you have made so we can see the logic of them.

MS. MCSHANE: Okay. I am going to let Shelly go through them.

CHAIRMAN: Okay. Sure.

MS. BLACK: So on this exhibit A-4, the first two entries that Mr. Easson had detailed, numbers 6 and 7, Enbridge Gas New Brunswick would not have made those entries, and instead would make the following entry. We would debit AFUDC to remove the AFUCD revenue from the income statement, credit interest expense to also remove that expense, and then we would debit retained earnings to book the 5,000 loss for the year.

CHAIRMAN: Mr. Easson, any comments on that?

MR. EASSON: I assume that Ms. Black is saying that entry number 6 is eliminated?

MS. BLACK: Yes.

MR. EASSON: Yes. Okay. Because it's not crossed out. Well my comments are that the portion of the entry that relates to AFUDC is the one that I have described in earlier testimony as being erroneous. You have created an asset and now you are removing the credit that relates to that asset. And in effect you are putting the $75,000 into equity. The only difference between the situation I described and this one is that in addition Enbridge is suggesting that they would take the interest expense, they wouldn't claim it as an expense and they would debit it to retained earnings also. And that is the entry -- that is the first time I have ever seen it and it actually makes no sense. I'm sorry to say that.

CHAIRMAN: Ms. McShane, carry on.

MS. MCSHANE: We sort of got side tracked a little bit here with this. Just bear with me for a moment.

CHAIRMAN: You Americans would call it a side bar.

MS. BLACK: When we were discussing this exhibit A-3, Jim, when we were talking about --

MR. EASSON: Sorry. A-3. Yes.

MS. BLACK: Before we had a recess there, we were talking about how in year one in this example there would be no deferral account. But then we refer back to EGNB's actual experience where we did book a deferral account. So the only point I wanted to make there was we did not book a deferral account because of AFUDC or because of interest on long-term debt. We simply booked a portion of the -- or something to the deferral because of cost of service, and cost of service included in that year --

MR. EASSON: I'm sorry. I'm not following you, Shelly.

MS. BLACK: Well we were mixing up sort of this illustrative example.

MR. EASSON: You are talking about year 2000 now?

MS. BLACK: Yes.

MR. EASSON: The actual? The actual results for 2000?

MS. BLACK: That's right. Where you brought up the fact that we did book a deferral account even thought there was no rate base.

MR. EASSON: I'm not sure what the connection is. I can tell you why you had a deferral account. Tim Walker had already made his entries for the -- for closing out all of his overhead and maintenance expenses into fixed assets, property, plant and equipment.

MS. BLACK: No, I know why we had --

MR. EASSON: And at the last moment -- if I may finish -- at the last moment I brought to his attention that there would have been some capital taxes incurred in the year and that he should book them as an expense, which he did. But because he closed out, he then took the last figure which was the capital tax and he transferred that to the deferral account. That's why you have the deferral account. It has nothing to do with return on the rate base.

MS. BLACK: My only point was we did have a deferral account because we had some costs of service. Costs of service included this deemed capital tax. It did not included AFUDC or interest on long-term --

MR. EASSON: I'm sorry, I am losing you.

MS. BLACK: We had a deferral account --

MR. EASSON: Yes.

MS. BLACK: -- because we did have an amount into cost of service which was in fact deemed capital taxes.

MR. EASSON: Yes.

MS. BLACK: But in this illustrative example we would not have had a deferral account because we would not have booked AFUDC or interest on long-term debt. That's the only point.

MR. EASSON: That's your example. That's your example. You are saying here that your income statement for regulatory purposes would have been zero whereas in fact you had an interest cost of $80,000 which is recoverable as a prudently incurred expense.

MS. BLACK: But not recoverable through the deferral. That was my only point.

MR. EASSON: You don't think it's recoverable through the deferral?

MS. MCSHANE: No. Not -- no, it wouldn't be because the only interest expense that would be recoverable through the deferral account would be the interest expense that was associated with rate base. And I think that's basically where we seem to have --

MR. EASSON: I think where -- this was -- I could have made this as complicated as you want. We could have been here for three days going through the entries. There is no intentions of having anything to do with return on rate base, cost of capital, the rest of it. It's just to illustrate what happens when you book AFUDC and what happens when you eliminate it. It's taking it to a level which it was never intended to be to say whether you have the deferral account or whether you have a rate base or anything else. That's just really complicating the issue which is very simple. If you create an asset by booking AFUDC, then you do not eliminate the credit because, as I have said in three reports, the ratepayers are being charged twice, once when the property, plant and equipment books the AFUDC and the other time when you remove the credit and increase your deferral account. Now whether or not in your case you would have had a deferral account is purely problematic.

MS. MCSHANE: I still think that what we haven't taken account of here is the fact that there really are -- and you keep saying that it's not a cost of capital issue, but it is a cost of capital issue because there is a cost of capital that is associated with financing that construction work-in-progress. And I don't think there is any disagreement between us that investors have a right to recover that cost, that it is a true cost and I think --

MR. EASSON: May I cut this. Sorry. I understand where you are going, Ms. McShane. Do you want to carry on?

MS. MCSHANE: Well I think that I would like to at least finish my point.

MR. EASSON: All right. Please go ahead.

MS. MCSHANE: So essentially what happens is there are two, if you will, streams of income that are created. One is the income from construction work-in-progress and one is the income from rate base. And when you look at a revenue requirement you are looking only at the revenues that you are allowed to collect from customers on the base of what is in rate base. So only the cost of capital that is attributable to rate base is included in the regulatory financial statements. But you have to be able to recover ultimately the cost that is associated with financing the CWIP as well.

If you assume that for ratemaking purposes that you can take your operating revenues and subtract from that essentially the AFUDC revenue to come up with what your earnings are, you are taking away the opportunity to earn a return on the assets that have been invested in the utility.

MR. EASSON: Well with all due respect, Ms. McShane is a cost of capital expert and I recognize that. For the purposes of this illustration we do not need any issue related to cost of capital and it is simply muddying the waters, as far as I am concerned.

I have no argument whatever with the theory that she has just propounded, but for the purposes of recording AFUDC and maintaining it in the books you do not need to have any regard whatsoever to cost of capital. It's a simple accounting issue.

Ms. McShane is a cost of capital expert. I believe that I have expertise in accounting and this is an accounting issue.

MS. MCSHANE: Could I say one thing?

CHAIRMAN: Oh yes. You can say two or three more things.

MS. MCSHANE: All right. So you think it's an accounting issue and I think it's -- I mean, clearly it's an accounting issue, but I also believe that appropriate recovery makes it a cost of capital issue. However, what I would like to propose to see if we could come to some --

MR. EASSON: Agreement?

MS. MCSHANE: -- agreement on, you know, how we can both be satisfied is if you have had a chance to look at the presentation that Shelly made at the end of the proceeding on September 30th, to see if that presentation would be agreeable to you and -- because it does treat AFUDC as a revenue item, but it deals with the entire capital that is utility related and therefore the deficiency that is arrived at is the same, but it does I believe account for the AFUDC in the manner that you believe is correct. I don't know if you have had a chance to look at that or not.

MR. EASSON: I did look through it. I don't want to repeat the things six or seven times today what I have said. I stand by my evidence. And you do not need to have any regard to the return on rate base of cost of capital for purposes of understanding this illustration. That is all this is. It is an illustration.

CHAIRMAN: How does Mr. Easson's proposed method of dealing with this mean that the two streams of revenue to which you referred -- one, you are talking about a rate of return on rate base. And then the stream of income to deal with the AFUDC. How is that wiped out? How is -- because --

MR. EASSON: They are added together actually.

CHAIRMAN: Pardon me?

MR. EASSON: Well, they are added together. You cannot offset one income item against another income item. They just accumulate --

CHAIRMAN: No. Okay. Look, I'm the layman up here. And I'm hearing that one of them is not dealt with. And to me, AFUDC you simply add it to the cost of the capital which later will be added to the rate base on which the rate of return will be earned.

MS. MCSHANE: Maybe I can -- hopefully I can give you a simple example.

CHAIRMAN: Well, with all due deference --

MS. MCSHANE: Actually I know perhaps --

CHAIRMAN: But all due deference, Mr. Easson has come here today with a set of examples.

MS. MCSHANE: Right.

CHAIRMAN: And I'm asking you to look at that and tell me where it is that that stream is cut off. How is it cut off? Is that the difference between the two positions?

MR. EASSON: There was never any attempt to put it in. Because we wanted to have as simple an illustration as possible.

CHAIRMAN: So we are still stuck with that.

MR. EASSON: We could go on and make all sorts of other assumptions and make journal entries to book if we wanted. But that wouldn't change the basic underlying principle that I have been trying to deal with.

CHAIRMAN: Mmmm.

MS. MCSHANE: I mean, I agree that I'm not sure that you could take this simple example and demonstrate the point that I'm trying to make. Because it is not set up in such a way to be demonstrated.

CHAIRMAN: That doesn't surprise me at all, Ms. McShane. Anybody got a possible path to clarity here that they can throw out?

Because I think -- surely the feeling that I had when we entered on this process is that there was a basic fundamental difference in the two approaches.

And if we could isolate that and take a simple example for the sake of people like myself who have to sit in judgment on this, that would be great. It doesn't look like that is going to happen.

MR. EASSON: Well, if I may --

MS. MCSHANE: Could I make just one suggestion? And I don't know if you have had a chance to look at this. But this was our response to PUB 4 where we had put a little simple example together which tried to show what the difference would be.

CHAIRMAN: You mean the one that starts on page 2 of that Interrog?

MS. MCSHANE: Yes, exactly.

CHAIRMAN: So what you want Mr. Easson to do is to go through that and point out to you --

MR. EASSON: I have no intention of going through it.

CHAIRMAN: Pardon me?

MR. EASSON: Well, this is four pages. I would have to study it. I simply wouldn't --

CHAIRMAN: No, no. But whether it happens here today or not, Mr. Easson, I'm just trying to establish something. In other words they want -- Enbridge would like you to go through this and adapt this to show, rather than dealing with adapting your fiscal --

MR. EASSON: Right.

CHAIRMAN: -- step by step this morning.

MR. EASSON: May I ask a question of --

CHAIRMAN: Sure.

MR. EASSON: -- Ms. McShane and Shelley?

CHAIRMAN: Yes.

MR. EASSON: Would you tell me what is wrong with the entries that I presented to the Board and in which way they are erroneous, just to illustrate the example that I have given.

There is not one entry in there which is wrong. The difference between Enbridge and myself comes in the entries that I put under the EGNB approach.

And it should be clear to you, if you look at those, what is happening, and the result on the financial statements that I presented, my approach and the EGNB approach.

And if you compare those two, that clearly illustrates the problem that I'm trying to describe.

CHAIRMAN: Is that a fair and simple description of the differences?

MR. HOYT: I'm not so sure that it is, based on my understanding.

CHAIRMAN: It is all right. Mr. Hoyt just said that he is not sure that that is a fair representation of the problem.

MS. MCSHANE: I might be able to do this with B-7 and show what we would do differently with that.

MR. EASSON: You mean you are doing something differently?

MS. MCSHANE: Yes.

MR. EASSON: That is exactly what you are doing now.

MS. MCSHANE: That is not my understanding, no.

MR. EASSON: Oh, that is interesting.

MR. HOYT: Mr. Chairman, I just might have one other suggestion. And that -- a few moments ago Ms. McShane alluded to the recast -- actually EGNB 2003 statements that were adopted to try to follow the Ernst & Young traditional manner suggested by an accounting firm that was hired independently by the Board, to try to confirm that what really is at issue here is a presentation question as opposed to the actual accounting issues.

And I think it would be worthwhile to go through that example to determine what in that Mr. Easson disagrees with. It has tried to take -- well, it has taken the Enbridge statements and used what Ernst & Young has suggested should be done to those statements and deals with AFUDC. It is a statement or an example that was provided shortly after the hearing on September 30th.

But to suggest that, you know, it would take some time to study it and so on -- well, you know, it has been a couple of weeks since the example was provided. And I think it is important as well that a number of things that EGNB put on the record on September 30th be responded to.

And that to me seems to be the most simple example, or at least it is consistent with an independent organization suggestion as to how this thing should be resolved.

CHAIRMAN: Well, with due respect, Mr. Hoyt, Mr. Easson is independent as well. Even though he has provided consulting services to the Board he is an independent professional person. So I just want to say that.

But I thought that at the very beginning of -- after the examples were presented, Mr. Easson gave his comments on the Ernst & Young report, and that he said it was fallaciously based, certain parts of it.

MR. HOYT: He made some general statements about the report itself but did not address the specific recasting of the numbers that EGNB provided to the Board at the last hearing.

MR. EASSON: Mr. Chairman, to go through an example like that you would have to accept all of the concepts set out by Ernst & Young. And as I have told you, there are a number of them which are misconceptions.

What I felt that I was doing today was coming to the Board to make a presentation of my point of view. EGNB had their opportunity on September the 30th, made their -- presented their point of view.

And right now I think we are just getting into an argument. And I think that the Board should -- the Board has a lot of evidence presented to it. I believe that if the Board were to study that they would come to a conclusion without any further recasting or examination. I think we are really --

CHAIRMAN: We are treading water right now, that is for sure.

MR. EASSON: Exactly.

CHAIRMAN: We are going to take a break.

(Recess)

CHAIRMAN: Commissioner Sollows has a couple of questions.

MR. SOLLOWS: I'm not sure it is even a couple. But I guess --

CHAIRMAN: Not many more.

MR. SOLLOWS: Yes. Really just one question. If I -- we have all agreed -- everybody here agrees on the basic principle that the utilities invested money, and therefore to be kept whole should recover that money.

What I'm not clear on is how there is any loss to Enbridge if they account for it in the way that is proposed in I guess exhibits -- it would be 3, 4 -- 2, 3 and 4.

So I guess what I would like you to illustrate to me is how Enbridge actually doesn't get its -- I guess it's $80,000 worth of interest out of the ratepayers eventually through this process?

CHAIRMAN: Those are as set forth in B-2, 3 and 4?

MR. SOLLOWS: B-2, 3 and 4, yes.

CHAIRMAN: Either one of you can answer that.

MS. MCSHANE: So I'm looking at B-4 originally or A-3 I guess it is now.

CHAIRMAN: Well no. Let's -- well okay, if you want to refer to that to clarify your answer to the question --

MR. SOLLOWS: Okay.

CHAIRMAN: -- to Mr. Sollows, fine. But I would rather keep it simple. I won't use the rest of that adage.

MS. MCSHANE: That's very sweet of you.

MR. SOLLOWS: He is referring to me.

CHAIRMAN: No, no. I'm the simple one here and I need to have it simple. So that's what I'm trying to say.

MS. MCSHANE: The way I interpret this is that if you look at the income statement which is the second part there.

MR. TINGLEY: Are we on B-4?

MS. MCSHANE: B-4 or A-3. But the lefthand side so with no changes.

MR. EASSON: Well I do believe the question was directed to B-4.

MR. SOLLOWS: Yes. B-3, B-4 and B-5 is really what I -- or no, B-2, B-3, B-4, I think.

MS. MCSHANE: That is fine. B-4 then. That Enbridge, under this example, is not charging customers for this entire interest on long-term debt in this year, this illustrative year. In fact, they are not charging them any interest. But they have to recover it later. So what I understand that Mr. Easson is suggesting is that essentially you take the revenues that you receive from your operating, your gas deliveries. And then you take out your expenses and you -- whatever income you have at that point, you subtract from it, the revenue that -- the paper revenue that you have gotten from AFUDC to figure out what your loss is for the year.

MR. SOLLOWS: And then that loss goes into a deferral account, does it not?

MS. MCSHANE: Right.

MR. SOLLOWS: And is recovered from customers --

MS. MCSHANE: Yes.

MR. SOLLOWS: Okay.

MS. MCSHANE: Yes. But the revenue requirement that you are starting with, right, which includes a return on capital, doesn't include a return of the construction work-in-progress.

MR. SOLLOWS: Because it isn't in the rate base yet.

MS. MCSHANE: Right. So you are taking income from construction work-in-progress and using it as an offset, if you will, to the loss on your operating, or your deliveries. So it's trying to use the return on -- that you are entitled to on one set of assets to offset the income on another set of assets which are the rate based assets. So it's kind of double counting it.

MR. SOLLOWS: What are the other assets that are rate based, are going into the rate base?

MS. MCSHANE: The construction work-in-progress because you are earning -- you are allowed to earn that return on the -- or accrue the return on them before they go in to rate base because you are actually expending funds.

MR. SOLLOWS: You are expending the money and so you are -- it really is an expense to you and it --

MS. MCSHANE: Right. It is out-of-pocket expense.

MR. SOLLOWS: It gets spent and then it goes into basically the cost of the project that when the project comes in service it goes into the rate base.

MS. MCSHANE: Right. And then you start to recover --

MR. SOLLOWS: For that.

MS. MCSHANE: -- later. It's deferred.

MR. SOLLOWS: But my problem is when I look at this in B-4 that's what it seems to do for me. I don't see where the argument is here. Because you have got the -- of the 80,000 that you actually spent, you have got 75,000 going into the AFUDC as a credit and you have got 5,000 going into deferral, which is going into the rate base when you can eventually have enough customers that they would have a hope of being able to pay it.

MS. MCSHANE: I mean, I guess my big concern is not so much this exhibit as what Mr. Easson is suggesting that

Enbridge actually does, which was on B-7.

MR. SOLLOWS: Okay. But I guess where I am coming from, if you don't have a concern with B-4, B-5 and B-6, why aren't we just doing it that way and then we don't have an issue?

MS. MCSHANE: And I -- I guess because to my mind it's -- if I look at what the general regulatory approach is across the country, the tendency is to keep these -- you start with regulatory statements and you keep them separate from your financial statements. Yes, sometimes companies have to reconcile them, but typically they are totally separate as in some of these examples that we have presented.

But I think that if -- that is why I suggested to Mr. Easson that perhaps if he looked at this example or the revision of the presentation, which is really fairly consistent, isn't that right, on B-4, that we probably could come to an agreement that if the presentation was done that way, that we would end up at approximately the same place.

It's not really this B-4 that is the huge issue. It is B-7. Where Mr. Easson is suggesting that because of the way he understands Enbridge to do its accounting, that the increase in the deferral account is -- what was it -- 80 --

MR. EASSON: May I --

CHAIRMAN: I want Ms. McShane to finish because -- do you agree with B-2, B-3, B-4 as an appropriate accounting treatment of that example?

MS. BLACK: No, Mr. Chairman, we don't agree with the exhibits as -- with the method as they are laid out in these exhibits. I would like to say for accounting purposes, financial accounting purposes, I don't think we have any quarrel with Mr. Easson. This is exactly how we account for AFUDC in the partnership books.

But when it comes to regulatory accounts, this is not proper.

CHAIRMAN: That is your position then?

MS. BLACK: That is our position.

CHAIRMAN: I gathered that.

MS. BLACK: Yes.

MR. SOLLOWS: But just so that I'm clear, is the basis of your position is that you don't feel that under this treatment that I'm looking at on the income statement on B-4 doesn't leave -- you feel it leaves your company whole in as much as your representations to your partners but it does not leave your company whole in as much as it represents -- representation to this Board or to the public?

MS. BLACK: It's not consistent with the regulatory framework, yes.

MR. SOLLOWS: I don't know what that means.

CHAIRMAN: You mean the adjustments from financial accounting to regulatory accounting?

MS. BLACK: That's right.

CHAIRMAN: Is that what you are saying?

MS. BLACK: Yes, for instance, our cost of capital is regulated.

MR. SOLLOWS: Right but --

MR. EASSON: Is this a good point?

CHAIRMAN: You are going to have your turn, Mr. Easson. We are trying to narrow this down a little here.

MR. SOLLOWS: But again, I understood from Ms. McShane that really this presentation as it is done here does leave the company whole in as much as it accounts for the -- the allowance for funds used during construction and whatever is -- that you have had to borrow is in the deferral account, goes into the deferral account in any case. So again, I am not seeing how there is an injury to Enbridge by accounting for it this way irrespective of the differences between the way you account for it with respect to your partners and you account for it with respect to the regulator.

MS. MCSHANE: As long as the total -- as long as you measure

-- the deferral account is based on the total revenues plus the AFUDC minus the total capital expense, not just the -- or the total capital cost, not just the capital cost related to rate base to figure out the deficiency, then I would agree that that would work.

It is when you want to take the deficiency and reduce it by the AFUDC revenue that the shareholder is not kept whole.

MR. EASSON: Is it now my chance?

CHAIRMAN: Yes. All right.

MR. EASSON: All right. I prepared the EGNB approach based upon the financial statements that were presented to me and the regulatory trial balances that were presented to me. So I made sure that the entries that I have put here are the entries that Enbridge have made.

Now if you look back at the regulatory financial statement, page 1 of 14.

MR. SOLLOWS: 1 of 14.

CHAIRMAN: So that is the --

MR. EASSON: Schedule A, page 1 of 14 --

CHAIRMAN: Yes.

MR. EASSON: -- column A, line 12. You have an item of expense described as allowance for funds used during construction. Now they have no such expense.

The reason you have line 12 is that Enbridge -- the journal entry that I have shown you there. They debited expense and credited equity. And that is the nub of the problem.

MS. BLACK: Yes. And we agree that that entry is inappropriate. But that entry was only made in an attempt to comply with the Board order requesting that we present AFUDC in the traditional manner.

CHAIRMAN: And that is -- all right. You agree then that that is an inappropriate entry?

MS. BLACK: Yes.

CHAIRMAN: And that was made because of the way you interpreted what Ernst & Young had to say?

MS. MCSHANE: No.

MR. HOYT: We don't know what the traditional manner even was.

CHAIRMAN: Now which is the answer?

MS. BLACK: We did not know what the traditional manner was.

CHAIRMAN: No. But you had in front of you the Ernst & Young --

MS. BLACK: No.

MS. MCSHANE: No.

CHAIRMAN: Oh, you did not? All right.

MR. SOLLOWS: This is a response to the last Board order.

You interpreted that as saying this is the way you should do things.

And perhaps the last Board order shouldn't have left that room for interpretation if we didn't want it that way. Is that what I'm hearing?

MS. BLACK: Yes.

MR. EASSON: I agree with that.

MR. SOLLOWS: Okay.

MS. MCSHANE: And that is why, when we did see the report, that we did file the revised presentation where you won't see that entry that Mr. Easson is talking about on line 12 anymore.

MS. BLACK: 12.

CHAIRMAN: Let me ask you this. And it goes before your time, Ms. Black, I believe. But what happened in the previous year, Mr. Easson?

MR. EASSON: In the previous year the entry made was to eliminate the credit which you would see on line 3. So what is now on line 3, 102,000 would have been zero.

So rather than create an expense to offset the income, the income was directly eliminated by an entry which credited equity.

MR. HOYT: Which I believe, Mr. Chair, is the manner that EGNB believes that it should be presented. The presentation for 2002 and 2003 was only an attempt to comply with what that Board order said. EGNB believes that how they presented it in 2001 was correct.

CHAIRMAN: So we should go back and look at 2001 again.

MR. EASSON: We don't want to touch 2001.

But I forget what the number is. But the last one we looked at was the last of my B's. I think it was B-7 answers Commissioner Sollows' question.

CHAIRMAN: B-7?

MR. EASSON: Yes. On B-4 the company is whole and so are the ratepayers. When you turn to B-7 the company is more than whole and the ratepayers are down $75,000.

And that is the effect of making the entry which records the 102,000 in Enbridge's financial statements of created expense.

MR. SOLLOWS: And what I'm hearing here is that that the 102' is not the way -- I mean, it was perhaps a misinterpretation of a prior direction. Is that --

CHAIRMAN: The way it was handled.

MR. SOLLOWS: The way it was handled.

MR. EASSON: It is entirely possible that it is misinterpretation. But I thought that when -- the Board was dealing with a situation where the AFUDC was eliminated in the amount of $1,000,000 and said okay, but next year you do it a different way.

Well, the different way has to be that you don't eliminate the income. Instead it has been interpreted that we should create an expense. And AFUDC by its nature cannot be an expense.

CHAIRMAN: Yes.

MS. MCSHANE: Well, it is an expense in the sense that it has an offset as it is a cost of capital, right. So it is a cost in that sense.

MR. EASSON: If you like.

MS. MCSHANE: Pardon me?

MR. EASSON: If you like.

MR. SOLLOWS: It is a cost but not an expense in the accounting term.

MS. MCSHANE: No, not an expense --

CHAIRMAN: We are talking --

MR. EASSON: A deferred expense.

MS. MCSHANE: The only other I guess comment I wanted to make was to go back to the example that we had presented in our slides on September 30th which -- I don't know. Did you get a chance to look at those?

MR. EASSON: No, I didn't.

CHAIRMAN: Oh, dear, Ms. McShane. Steer us in the right direction.

MS. MCSHANE: Okay. This would be exhibit 2?

MR. HOYT: A-2.

MS. MCSHANE: A-2. So the --

MR. TINGLEY: What page --

MS. MCSHANE: I'm on -- I'm sorry. These aren't numbered. 1, 2, 3 -- the fourth page which has the title "CWIP Versus AFUDC."

And the first page of this, all we did was to take Mr. Easson's response to EGNB's IR Number 3 and reproduce it. Because it was difficult to put on a slide.

MR. EASSON: Well, may I give the context of this? I was asked in an Interrogatory if I could supply any information which said that there was a -- what was your question? It was is there a equivalence in the two systems charging CWIP or AFUDC?

And I happen to have something from a training course I have been on. And I supplied that, but only because I was asked. This is not my evidence. I provided it simply because I was asked. And this does in fact show that the two methods are equivalent.

And I think I read in the transcript Ms. McShane agreed that they are. So I didn't think we needed to go through this any further.

MS. MCSHANE: And you are right. Well, the question was "Is it your opinion that the AFUDC method and the CWIP method are equivalent?"

And you said "In my opinion they are approximately equivalent." And you gave this example which --

MR. EASSON: Yes. This one very neatly agrees to the cent.

MS. MCSHANE: Right. So we put this on a slide just because to try to make a slide out of the copy was problematic.

So moving on to the second page, what we tried to show was how EGNB recovers its AFUDC over time to arrive at the present value that is on your first slide.

MR. EASSON: Okay.

MS. MCSHANE: Do you have -- I mean, I'm leaving it open for you to indicate whether you have any problem with --

MR. EASSON: Well, I haven't studied this. If you wanted me to I could. And I could get back to you. But you seem to come down to the same net present value at the end.

MS. MCSHANE: Well, using the EGNB approach, yes, that is correct. We would come down to the same net present value as the example of the AFUDC approach on the original filing that you made.

MR. EASSON: Yes. You would have to -- I mean, this is an illustration of equivalence. It isn't showing you what happens in the books.

In other words if you remove the AFUDC from the income statement then you don't have equivalence.

MS. MCSHANE: What we were trying to show here is that what we understood that you were suggesting is that we are essentially being asked to credit the AFUDC revenue to the income which in fact, if you look at the page entitled "AFUDC Per Board's Financial Consultant" would result in a net present value which is negative. Because essentially you have got a revenue or an AFUDC --

MR. EASSON: Okay. But let's perhaps try and clear this up. You are talking about from the company's point of view. If the company were to go the CWIP route or the AFUDC route there would be a difference. And that is why I said they are approximately equivalent.

But if you remove the CWIP from the income statement then you disadvantage the ratepayers. That is my statement. Nothing to do with whether the methods are equivalent or not equivalent.

MS. MCSHANE: And I'm not using the example here to try to show whether they were equivalent or not. I was using the example of the AFUDC method to say that the way you presented the AFUDC method --

MR. EASSON: Yes.

MS. MCSHANE: -- in this filing -- this example -- is the way that Enbridge recovers the return from AFUDC.

But what we understood that you want to do is essentially take that off by saying well, you have got this AFUDC revenue. So you can reduce -- well, then if that is not what you are saying --

MR. EASSON: What I'm saying is -- I don't know if I have to say it again. It has nothing -- I don't really think -- I mean if you want me to go home and check through this and give you my reaction to it, I would be glad to do it. But that doesn't change anything that I have shown you on B-4 or B-7.

We are not disadvantaged. Commissioner Sollows' question was on B-4 "In what way is the company disadvantaged?" And there was no answer. They are not disadvantaged.

If you turn to B-7 the ratepayers are disadvantaged. We can put that into a comparison of CWIP and AFUDC in the company and prove that it gives a negative return. I don't know. But I would be glad to check the numbers for you.

MS. BLACK: But the company is disadvantaged if we follow B-7. We do not recover AFUDC. And AFUDC represents the cost of capital for assets under construction. If we were to follow the method outlined in B-7 --

MR. EASSON: Recover AFUDC in depreciation.

MR. SOLLOWS: Just one moment. You have lost me. Just a second. Because you said B-7.

CHAIRMAN: B-7 is your --

MS. BLACK: Oh, I'm sorry. I got my numbers wrong.

CHAIRMAN: No wonder we have got it wrong.

MS. BLACK: A-7.

MR. SOLLOWS: B-4?

MS. MCSHANE: B-4.

MR. SOLLOWS: Is what your point is relating to B-4, is it?

MS. BLACK: I believe your question was in regards to --

MR. SOLLOWS: B-4.

MS. BLACK: Was it B-4? I'm sorry.

MR. SOLLOWS: And so can you start again from the top there? Because when you said B-7 I stopped listening and tried to get your attention. So if you would start again from the top then I would be able to --

MS. BLACK: Okay. I believe your question was how is the company disadvantaged if we --

MR. SOLLOWS: In B-4.

MS. BLACK: -- follow the method outlined in B-4? And the company is disadvantaged. Because the return for assets under construction, AFUDC is not recovered.

And that is exactly what we were attempting to show in this slide, exhibit 2, that we actually recover a negative net present value. We are not compensated for the cost of capital.

MR. EASSON: And my response to that is that the AFUDC forms part of the property, plant and equipment on which there was a cash outlay of a million 5'.

And the company will depreciate 1,575,000 over the estimated useful life of the assets.

MR. SOLLOWS: It is in there.

MR. EASSON: That is how you get your 75,000.

MR. SOLLOWS: That is where the 75' came from, is my understanding of it --

MR. EASSON: Yes.

MR. SOLLOWS: -- is that 75,000 of AFUDC ended up as part of the property, plant and equipment that at the in-service date, all about that interest that you expended got dumped into the project cost.

And then that is going to be spread out over the service life of the assets and recovered from the ratepayers?

MS. BLACK: Yes. Correct.

MR. SOLLOWS: So you are kept whole?

MS. BLACK: We are on that side. But if you are going to reduce --

MR. EASSON: If you go to B-7 --

MS. BLACK: If you are going to reduce the revenue requirement by an equivalent amount then you are not kept whole. They cancel each other out.

MR. EASSON: In the next year your revenue requirement would include a charge for depreciation of the property, plant and equipment --

MS. BLACK: Yes.

MR. EASSON: -- of which $75,000 of AFUDC is a component.

MR. SOLLOWS: Right. And that is where I'm coming from. And it sort of -- this is why I'm really -- this is good, if we can carry on this line until we settle it.

I'm still not following how there is an injury to the company here. Because this interest does just get added into the overall capital cost of the project, gets depreciated, taken out of income in that way.

MS. BLACK: But it has been completely offset in year one by what Mr. Easson is suggesting.

MR. EASSON: But I dealt with that as one of the issues from the Ernst & Young report. They say they offset. Well, of course they offset. They have to offset.

MR. SOLLOWS: If they didn't you would be looking at --

MR. EASSON: The capitalized expenses, which we don't seem to be getting to, but the capitalized expenses have a $14 million offset in the income statement.

MS. BLACK: Could we actually just go back to the slide, exhibit 2?

CHAIRMAN: We have a feeling we are getting somewhere. And that is why we are trying to continue this. You certainly can have the right to go back to that in a few minutes. But I -- you know, try and deal with where Commissioner Sollows is coming from.

MR. SOLLOWS: So it is pretty --

CHAIRMAN: And I think I'm there too frankly. Go ahead. You are doing a wonderful job. Just go ahead.

MR. SOLLOWS: You know, I think we have accounted for the $75,000. That is recovered out by depreciation. The remaining 5,000 is going into a deferral account that is going to be recovered when you have got enough ratepayers to actually be able to recover it.

MS. BLACK: The only point I would like to make there is AFUDC is not taken into consideration when calculating the deficiency for that year.

MR. SOLLOWS: So your point is that you just look at the end of the year to figure out how much you are deficient. And you want to take that total amount without regards to AFUDC and put it in the deferral account.

MS. BLACK: Well, you start with your revenue requirement.

MR. SOLLOWS: But just a second. You have already got that

75,000 as being taken care of through the depreciation of plant, property and equipment. So you can't do it both ways.

MS. MCSHANE: But it is being deferred. So you are not collecting it right away. So you have to keep financing it. So there is a present --

CHAIRMAN: Well, but you have interest expense in the current year.

MS. BLACK: Which only relates to rate-based assets.

MS. MCSHANE: Right. Which you are not -- which only --

CHAIRMAN: Before the adjustments we are talking about. It is the total financial picture, is it not?

MS. MCSHANE: No.

CHAIRMAN: Let's go back to the -- let's stop talking and let's start looking at the sheets and see. I mean, what is the interest during the year? Interest on long term income statement that would be --

MR. EASSON: For the purposes of the illustration only, the interest was assumed to be completely deductible. For regulatory purposes.

CHAIRMAN: Go ahead, Professor Sollows. Carry on with it.

MR. SOLLOWS: Again of that $80,000 in this -- this example $75,000 has gone into property, plant and equipment, and is going to be recovered from the rate payers in due course.

MR. EASSON: I would correct that figure. 40,000 would have been the portion of the cost of capital capitalized which related to debt. There was also --

MR. SOLLOWS: Equity.

MR. EASSON: -- equity in there as well.

MR. SOLLOWS: So it's not interest on long-term debt, it's a combination of --

MR. EASSON: Combination of weighted interest account.

MR. SOLLOWS: -- interest and return on equity. So the property, plant and equipment is going to come into the rate base presumably as soon as it is functional --

MS. MCSHANE: Right.

MR. SOLLOWS: -- and the AFUDC credit covers the interest that you have had to pay to build that equipment from the first cash outlay until it has come into service. And all of that money is accumulated --

CHAIRMAN: Into capital.

MR. SOLLOWS: -- put into property, plant and equipment and then depreciated, if I understand it correctly. So you are getting the interest for that?

MS. MCSHANE: You will get it, yes, eventually. But --

MR. SOLLOWS: Which is the normal course of business.

MS. MCSHANE: Right. But then what is being asked to have happen is to take it back by --

CHAIRMAN: What do you mean take back?

MS. MCSHANE: By taking the AFUDC revenue that is a book entry and deducting that from the revenue requirement --

MR. SOLLOWS: On the income statement. What you are saying is that --

MS. MCSHANE: -- on a regulatory --

MR. SOLLOWS: -- there is that $75,000 credit is what is at issue here.

MS. MCSHANE: Right.

MR. SOLLOWS: Yes. And --

CHAIRMAN: Not the regulatory statement.

MS. MCSHANE: See the example that we have been looking at that Mr. Easson developed is looking at the total cost of capital, but when -- again when Enbridge figures out what its losses for the year, they are only looking at the cost of capital on the elements that have actually entered into rate base. So they are not already saying, well we have spent in total a million dollars in interest expense. They are simply looking at what the interest expense that is applicable to the rate base assets is. Not the interest expense that is applicable to the construction work in progress.

Whereas in the example from B-1 to B-7 I mean, we are looking at that total capital cost. And so when Enbridge put together its new presentation it took account of the total interest expense in the fashion that --

CHAIRMAN: Ms. McShane, in all due deference you are looking at B-1 to B-4 --

MS. MCSHANE: Okay.

CHAIRMAN: -- and then purportedly B-5, 6 and 7 are EGNB's approach.

MS. MCSHANE: Sorry.

CHAIRMAN: And I'm mixed up enough anyway, let's not get me any further. And I -- frankly we seem to be going around Robin Hood's barn here. I mean, I --

MR. HOYT: Mr. Chairman, I think we are close here to what the differences are. It may be worth just pursuing a little bit further.

CHAIRMAN: Certainly, if that's the case.

MR. SOLLOWS: I'm not sure though that I'm in a position where I can continue to question, because what -- and normally Chair would tell me that I shouldn't be questioning, just listening.

CHAIRMAN: Somebody has to be a sacrificial lamb.

MR. SOLLOWS: That's me today, is it? Tag you are it. So --

CHAIRMAN: If I can interrupt here just a sec.

MR. SOLLOWS: Go right ahead. While I collect whatever thoughts I have.

CHAIRMAN: I hear you saying that it's where we go from the simplistic example which I like because it is simple that Mr. Easson has presented before us to the regulatory adjustments that we run into the difficulty, is that correct? Ms. Black is saying yes and Ms. McShane is neutral.

MS. BLACK: Yes. That is correct, and I appreciate that Mr. Easson has tried to present a simple example, but what is missing from the example is a revenue requirement, statement of revenue requirement.

CHAIRMAN: Okay. Let's be very simplistic here. So the difference of opinion then occurs in those particular adjustments. And can you narrow it down to one or two entries?

MS. BLACK: Yes. I mean --

CHAIRMAN: Why doesn't the Board retire. People have a flight -- when do you go to Montreal?

MR. EASSON: 5:00 o'clock.

CHAIRMAN: You have got 25 minutes yet.

MR. EASSON: With due respect, Mr. Chairman, I have argued this for three years with Enbridge, and that's why we are here today.

CHAIRMAN: All right. Yes. The Board is going to withdraw. Mr. Hoyt has optimism in his eyes. See what you can come up with, Mr. Hoyt. I think we are getting down to where we are really narrowing it down to a small frame.

(Recess)

CHAIRMAN: We want everybody in the room to look at B-3.

MR. SOLLOWS: If you don't mind I am going to carry on here a little bit to see if I can get this resolved in my own mind. And to do this I am going to jump from the simplified example that we have, I think it is in -- I think it's actually in B-4. That's why I couldn't find it. And your schedule A, page 1 of 14, which is your statement of income for regulatory purposes for the fiscal year ended December 31st 2003.

Now looking at this and trying to take that simplified presentation in B-4 and map it over to schedule -- this schedule A, page 1 of 14, I think I -- and looking at the revenue, there is an allowance for funds used during construction. Is that I guess agreed by everyone that that is sensible, sort of match what we see in this simple example?

MS. BLACK: Yes.

MR. SOLLOWS: Okay. And the issue seems to be recording it as an expense down here on line item 12 which we have already heard was perhaps a -- you know, a straightforward and honest attempt at maybe a less than precise order of the Board that was open to interpretation and it was interpreted a certain way. And if we -- all these other expenses nobody is arguing about. They are all very legitimate. So the difference between revenues and expenses give you well, either an income or a loss, it's been loss. And all these other things don't much matter gas sales and customer service. We will just leave that stuff out of it for now.

You have got this loss showing here as the difference between revenues and expenses. If you include it as an allowance for funds used during construction that loss would be -- if you include line 12 that loss is reduced, correct?

MS. BLACK: If you only include line 3 without line 12, then it would be reduced.

MR. SOLLOWS: Right. The question really comes down to is down here at the bottom where we get into this cost of capital, what we are trying to get to is how many times is that 102,000 counted in there?

MS. BLACK: That 102,000 is not included in line 26 or 27.

MR. SOLLOWS: It's not in either of it?

MS. BLACK: No. That cost of capital only relates to assets in the rate base.

MR. SOLLOWS: Okay. Is that your understanding?

MR. EASSON: That's correct. Including the 102'. So the 102' is in rate base --

MR. SOLLOWS: The allowance for fund used during construction --

MR. EASSON: Has assimilated throughout the year and has been recorded in CWIP and ultimately into property, plant and equipment. And the return has been calculated --

MR. SOLLOWS: It's in --

MR. EASSON: -- the return on the 102' to the extent that it was in existence during the year is included in lines 26 and 27.

MS. BLACK: That's correct. The return on the 102'.

MR. SOLLOWS: Right. So the 102' is in there. It's in the rate base and it's taken care of.

MS. BLACK: The 102' is in the rate base. But it's not in line 26 or 27.

MR. SOLLOWS: Okay.

MR. EASSON: Because of line 12.

MR. SOLLOWS: Because of line 12. But that's the whole point, isn't it?

MR. EASSON: Exactly.

MR. SOLLOWS: Certainly there should be a return for the

102,000, if that's what I guess this is thousand dollars. What seems to be happening here though is because you have included it on line 12, and therefore increased the loss, and then put that whole loss now into your deferral account, which is eventually going to be repaid by the ratepayers, it would seem that you are double counting?

MS. BLACK: Now when the regulatory deferral account is calculated, it's based on a revenue requirement. And the revenue requirement is based on assets in rate base. AFUDC does not come into the equation, because that relates to a different stream of revenue.

MR. SOLLOWS: So when you say the contribution to your deferral account is not going to be just something like line -- wherever your net loss is here -- minus 5.9 million, it's going to be some more complicated number that comes from the -- where are your -- I guess we would have to look at your assets.

MR. EASSON: I see where you are going here, Mr. Sollows. But if you look down at the lines 24 through 28.

MR. SOLLOWS: Okay.

MR. EASSON: The loss before cost of capital is 5906. Under my proposal that line would be 5 million 804. You then -- that 5 million 804 has been included in the deferral account on the basis on which it arose during the year.

MR. SOLLOWS: Okay. Month by month or whatever?

MR. EASSON: It's reasonably -- yes. There is a reasonable assessment of that. You then take the cost of capital that you calculate on your average rate base, debt and interest, and you then add it to the loss and then you put -- see line 28 is increase in deferral account.

MR. SOLLOWS: Right.

MR. EASSON: 16,266.

MR. SOLLOWS: So this 3 million and 6 million are really the --

MR. EASSON: The return on rate base.

MR. SOLLOWS: -- return on the rate base --

MR. EASSON: And the allowed --

MR. SOLLOWS: -- and that you would have been allowed if you actually had a going concern here. And so that return is being added and deferred for later recovery?

MR. EASSON: Yes.

MS. BLACK: Yes. That's our authorized return.

MR. SOLLOWS: Right.

MR. EASSON: And if you had to prepare a revenue requirement for the following year, you would estimate what your rate base was on a monthly basis, take the approved regulated cost of debt, calculate that. And you would work out what is your return on equity on the rate base. And that would be your starting figure for the revenue requirement. Profit, gross it up for tax, add the expense --

MR. SOLLOWS: The standard process.

MR. EASSON: -- depreciation, including AFUDC, et cetera, et cetera.

MR. SOLLOWS: Right.

MS. MCSHANE: Can I ask a question here? So I am sorry, where was the interest expense in there?

MR. EASSON: It would be an expense.

MS. MCSHANE: Was it in the return on rate base?

MR. EASSON: It would not be in the bottom line.

MS. MCSHANE: We -- I am interested in how you are developing your revenue requirement?

MR. EASSON: Well, as I described it. Let's start with what our return on equity would be estimated to be. We would add the income taxes.

MS. MCSHANE: Yes.

MR. EASSON: So we got the pre-tax income.

MS. MCSHANE: Yes.

MR. EASSON: All your expenses including your allowed interest on long term debt.

MS. MCSHANE: Which is also based on rate base?

MR. EASSON: Based on rate base, yes.

MS. MCSHANE: Based on rate base. Okay. I am with you.

MR. EASSON: Plus all of your -- all of your expenses.

MS. MCSHANE: Okay.

MR. EASSON: So that gives you your revenue requirement.

MS. MCSHANE: So I totally agree with what you just said.

MR. SOLLOWS: We are getting somewhere.

MS. MCSHANE: All right. So now I --

MR. EASSON: So now we have got the revenue requirement for the year.

MS. MCSHANE: Now I have a question. All right. So I have got the revenue requirement. And let me just pretend for a minute that I am a mature utility. Don't have a revenue deficiency account. Okay. So I set my rates for the next year based on my revenue requirement, right? Which includes, the way I understand it, the return on rate base, plus the tax allowance, plus the O&M and general and operating expenses.

MR. EASSON: Depreciation.

MS. MCSHANE: Sorry. Depreciation. Is that it?

MR. EASSON: Yes.

MS. MCSHANE: Okay.

MR. SOLLOWS: And depreciation includes --

MR. EASSON: And interest on debt.

MR. SOLLOWS: -- AFUDC?

MS. MCSHANE: Depreciation includes that portion of AFUDC which has been accrued in the past.

MR. SOLLOWS: Come into the rate base.

MS. MCSHANE: That's correct.

MR. SOLLOWS: That's right. Yes.

MS. MCSHANE: So the year has ended and I am -- my revenues from my rates were exactly equal to my revenue requirement. Okay. So now I go and I do my regulatory financial statements. Do I -- do I determine that I have over-earned, because I have had some AFUDC revenue as well?

MR. EASSON: Well, I think what you would have done, when you are doing your revenue requirement, when you are doing your test year, you would have known what your construction program would be. You would estimate the expenditure. You would calculate your AFUDC. And that would be part of the revenue requirement -- the revenue requirement estimate you made for the next year.

MS. MCSHANE: Okay. So perhaps that's where we are falling apart here, because to my -- to my understanding, virtually no utility in this country does that. Their revenue requirement is based exactly on the items that we first agreed were in the revenue requirement.

MR. EASSON: NBTel did it.

MR. SOLLOWS: Didn't we ask --

CHAIRMAN: The ones that I am familiar with.

MR. EASSON: Yes.

MS. MCSHANE: Well, so the difference I think then in where we are coming from is, the revenue requirement from your mind has to then include some interest expense associated with the construction work in progress?

MR. EASSON: Well, of course, it would.

MS. MCSHANE: Well see --

MS. BLACK: Enbridge Gas New Brunswick's does not.

MS. MCSHANE: Does not.

MR. EASSON: Of course it does?

MS. MCSHANE: No, it does not. I am sorry. It does not. That's why we take the rate of return on rate base, apply to the rate base. There is no interest expense in the revenue requirement for construction work in progress.

MR. EASSON: Well, first of all, we have never done a revenue requirement for EGNB.

MS. BLACK: We have not submitted --

MR. EASSON: What we are looking at is a historical basis, not a perspective basis.

MS. MCSHANE: I agree.

MR. EASSON: It's a historical basis. If you look at 1 of 14, line 26, regulated cost of debt, 3,990,000, that is added to the -- that is added to the rate base as an expense.

MS. MCSHANE: Sorry. I don't understand added to the rate base?

MR. EASSON: The next line is authorized return on equity. That is added to the deferral account as an expense.

MS. BLACK: Only because we have a deferral account that it is added to the rate base.

MR. EASSON: The deferral account. Did I -- I said what?

MS. BLACK: You said rate base.

MR. EASSON: Oh, I am sorry. Deferral account. Which is included in the rate base.

MS. BLACK: Right.

MR. EASSON: So both of those expenses are recorded in the deferral account.

MS. BLACK: But they do not include AFUDC.

MR. EASSON: No, of course not. AFUDC is a separate calculation, which we have arrived at up here in line 3. It's got nothing to do with rate base.

MS. BLACK: But I think that our point was that --

MR. EASSON: The CWIP -- the cost of financing the CWIP, which is included ultimately in property, plant and equipment. So you are taking certain -- certain costs and saying that we will defer these to future years.

MS. MCSHANE: For which you --

MR. EASSON: But what you are doing is you are not giving the customer the benefit of the credit from that deferral. But you will in future years charge them the depreciation.

MS. BLACK: Okay. If I could just go back a few steps. I think we had agreed that in the revenue requirement, there was no AFUDC in there. Is that correct, Jim (Mr. Easson)? In EGNB's revenue requirement we do not include --

MR. EASSON: Right now if you did a revenue requirement?

MS. BLACK: Yes.

MR. EASSON: Well, if you had an -- you had an estimate of the construction you would be carrying out in the following year, you would be required to calculate what you estimated the AFUDC to be.

MS. BLACK: Okay.

MR. EASSON: Yes.

MS. BLACK: And while we have never submitted a schedule for revenue requirement, we have calculated it internally for purposes of calculating the deferral?

MR. EASSON: Yes. Calculating the cost of your property, plant and equipment, yes.

MS. BLACK: And that revenue requirement does not include any cost of capital --

MR. EASSON: Well, you keep talking about a revenue requirement. And I think we are confusing revenue requirement with something else. And I think it may be return on equity. The equity portion of your rate base.

MS. BLACK: That is part of the revenue -- overall revenue requirement.

MR. EASSON: Yes.

MS. BLACK: Yes, as I described it as a starting figure.

CHAIRMAN: If you are going to make your -- 5:00 or 6:00?

MR. EASSON: 5:05. We have an extra five minutes. Ms. McShane is on the same plane.

CHAIRMAN: I guess we are going to have to adjourn if anybody has any hope of catching a flight.

MR. EASSON: If I might, I would just like to make some comments about the capitalized expense issue.

CHAIRMAN: Well I -- really, Mr. Easson, it is quarter after 4:00.

MR. EASSON: And it will be very quick. I have a very fast taxi driver waiting for me.

MR. HOYT: But if he makes comments, Mr. Chair, I am going to want to make comments.

CHAIRMAN: We are going to adjourn sine die, which means a date to be set. And we will find out or maybe something will evolve from where we have just gotten ourselves, okay? So off you go.

(Adjourned)

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

Reporter