MANITOBA PUBLIC UTILITIES BOARD

Re: CENTRA GAS MANITOBA INC.
2007/'08 TO 2008/'09
GENERAL RATE APPLICATION

Before Board Panel:
Graham Lane - Board Chairman
Len Evans - Board Member
Eric Jorgensen - Board Member

HELD AT:
Public Utilities Board
400, 330 Portage Avenue
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APPEARANCES

R.F. Peters		)Board Counsel
Marla Murphy		)Manitoba Hydro
Paul Kerr	(np)	)Coral Energy
Sandy Boyd		)Communications, Energy
		)and Paper Workers
		)Local 681
Kris Saxberg		)CAC/MSOS
Eric Hoaken	(np)	)Direct Energy
Karen Melnychuk		) Marketing Limited
Nola Ruzycki	(np)	)Energy Savings
		(Manitoba))Limited
		Partnership
Dave Hill	(np)	)Koch Fertilizer
Nick Gretner	(np)	)J.R. Simplot

APPEARANCES (CONT)

William Gange	)TREE and Resource
Randall McQuaker	)Conservation Manitoba
Peter Miller	)

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LIST OF UNDERTAKINGS

--- Upon commencing at 1:36 p.m.

THE CHAIRPERSON: Mr. Saxberg, if you want to reintroduce Mr. Matwichuk to us, then we'll have Mr. Singh swear him in and we'll be underway, thank you.

Welcome, Mr. Matwichuk, by the way.

MR. GREG MATWICHUK: Thank you, Mr. Chairman. MR. KRIS SAXBERG: Thank you, Mr. Chairman, Board members and ladies and gentlemen. With me is Greg Matwichuk all the way from Calgary, Alberta and he is ready to be sworn in.

CAC/MSOS REVENUE REQUIREMENT PANEL:

GREG MATWICHUK, Sworn:

THE CHAIRPERSON: Thank you, Mr. Singh. Mr. Saxberg...?

EXAMINATION-IN-CHIEF BY MR. KRIS SAXBERG:

MR. KRIS SAXBERG: Mr. Matwichuk, you are responsible for the preparation of certain written evidence in this proceeding

MR. GREG MATWICHUK: Yes, I am.

MR. KRIS SAXBERG: And there have been

three (3) separate pieces of evidence prepared for CAC/MSOS, Mr. Chairman, and I note that they've all been assigned the same exhibit number and what I would propose is that Mr. Matwichuk's evidence be given its own exhibit number and be marked as CAC/MSOS-3 and that Dr. Higgins' evidence be marked as CAC/MSOS-4 and the Mr. Stauft's evidence be marked as CAC/MSOS-5.

THE CHAIRPERSON: That's fine.

--- Exhibit No. CAC/MSOS-3: Evidence of Mr. Matwichuk

--- EXHIBIT NO. CAC/MSOS-4: Evidence of Dr. Higgins

--- EXHIBIT NO. CAC/MSOS-5: Evidence of Mr. Stauft

CONTINUED BY MR. KRIS SAXBERG:

MR. KRIS SAXBERG: In addition to your evidence, Mr. Matwichuk, you've also given answers to Information Requests posed to you by the Board and Centra.

MR. GREG MATWICHUK: Yes, sir.

MR. KRIS SAXBERG: And one (1) of the Information Requests made by Centra wasn't completed and that's CAC-15B. And I understand that you have now completed that Information Request?

MR. GREG MATWICHUK: Yes, I -- I made that available to you, sir, and it indicates "revised" at the top but really it -- it should be just updated because "B" -- "B" was incomplete and now it is complete.

MR. KRIS SAXBERG: And I'd propose to have that Information Request answer marked as the next CAC/MSOS exhibit which, by my count, would be CAC/MSOS-6.

THE CHAIRPERSON: That's fine, subject to check on the numbers.

--- EXHIBIT NO. CAC/MSOS-6: Information Request CAC-15B

CONTINUED BY MR. KRIS SAXBERG:

MR. KRIS SAXBERG: Mr. Matwichuk, do you have any corrections to make with respect to your evidence or any of the IR responses?

MR. GREG MATWICHUK: Yes, Mr. Saxberg.

Mr. Chairman, with your indulgence I do have a -- a few corrections. They are minor but they could impact the flow of the discussion, so, I'll -- but I'll just point them out and go through them very quickly.

So under CAC/MSOS Exhibit 3 which is my evidence dated May 9th, 2005 the -- there -- following are the corrections, the first on page 6 at line 6.

There's a sentence that says:

"The Board established the principle is that Manitoba Hydro as the owner of a gas utility..."

The word "the" should be removed and then it will read:

"The Board established principle is that Manitoba Hydro as the owner of a gas utility..."

The second one is on page 8 and this is a -- a question I really have to -- to the Board and -- and maybe Board staff is that there a couple of tables in my evidence that were developed based on the original Centra filing. Centra then had a subsequent update. The changes would not be significant but if the Board so wanted it, I could -- I could update all those tables. It -- it wouldn't take much but I'll -- I'd do it as an undertaking if that's satisfactory?

THE CHAIRPERSON: You're saying the changes are immaterial?

MR. GREG MATWICHUK: I'm not sure that they're immaterial but they're not significant if I can put it that way, Mr. Chairman.

THE CHAIRPERSON: Okay.

MR. GREG MATWICHUK: All right. Thank

you, sir.

--- UNDERTAKING NO. 18: Mr. Matwichuk to update tables in CAC/MSOS-3 that were developed based on the original Centra filing

MR. GREG MATWICHUK: Next one on -- is page 14 is at line 15. I -- I used a -- an abbreviation without defining it and so I better correct that, on page 15 where I have a reference to CAC, that should read CAC/MSOS because there are two (2) entities there.

Page 19 is the next one and that's at line 11 and the -- the line reads:

"Unable to categorically confirm or challenge Centra's [and it says] the appropriateness of."

The word "Centra's", apostrophe "s" should be removed so that it reads:

"Unable to categorically confirm or challenge the appropriateness of capitalized labour."

THE CHAIRPERSON: What page again was that?

MR. GREG MATWICHUK: Sorry, sir, that was page -- did I say -- I said "19" didn't I? I did.

So I have to go back to 19. Actually, why don't we do it this way. That was on page 22 so that's on the record, at line 11, of simply extracting the word "Centra's", apostrophe "s". That will take care of that correction.

I jumped ahead. I will then go back to page 19 line 7 at the question, it says:

"Please summarize the results in Tables 4, 5, 6, and 7."

That should read Tables 4, 6, 7, and 8. Now I'm back on track, Mr. Chairman.

We're off to page 31 and the next three (3) are similar to previous corrections. Page 31 line 29 "CAC" should read CAC/MSOS and then on page 32 there are two (2) similar occurrences of that on lines 4 and 5. Both should read CAC/MSOS.

Those are all the corrections in the written evidence. There are two (2) or three (3) in the IR responses. And the first one is under PUB/CAC-7, page 1 of 14.

And at the bottom, beginning with lines 23 through 25, there are references to a number of other jurisdictions that have adopted ROE formula. I had left off two (2); one (1) being Newfoundland and the other being Regie de Quebec. So that would just -- we would just include them in that list.

Then at -- go to responses to Centra at Centra CAC/MSOS-11 which is page 5 of 14. In the footnote at the bottom, it reads:

"The Board's context was a 1/3 percent increase."

That should read 1.3 percent increase.

And the final correction I have, sir, is under Centra CAC/MSOS-14 at line 11 and it says:

"In rate design a cost of service study or cost allocation study is used as a basis for rate setting,"

and the word "setting" should be removed and the word "design" in its place. So it should be -- it should state

"is used for basis of rate design."

And those are all my corrections, Mr. Saxberg.

THE CHAIRPERSON: Thank you.

CONTINUED BY MR. KRIS SAXBER:

MR. KRIS SAXBERG: And so with those changes, Mr. Matwichuk, do you adopt that evidence in its entirety?

MR. GREG MATWICHUK: Yes, I do.

MR. KRIS SAXBERG: Mr. Chairman, Board members and others, Mr. Matwichuk's resume is attached to his evidence as Appendix 7, but Mr. Matwichuk is familiar to this Board and to Manitoba Hydro having testified as an expert before on several occasions on this same topic.

So, to expedite matters, I'm wondering if we could -- if the parties don't object, simply have Mr. Matwichuk formally qualified as an expert on the topics of rate base rate of return principles, the no-harm principle and the regulatory accounting?

THE CHAIRPERSON: Ms. Murphy, do you have any problems?

MS. MARLA MURPHY: We have no objection.

THE CHAIRPERSON: Any of the other interveners? Mr. Gange...?

MR. WILLIAM GANGE: No objection.

THE CHAIRPERSON: Ms. Melnychuk...?

MS. KAREN MELNYCHUK: No objection.

THE CHAIRPERSON: Mr. Boyd...?

MR. SANDY BOYD: No objection.

THE CHAIRPERSON: I think we can dispense with it. We'll -- the Board will accept him as a witness on those points.

MR. KRIS SAXBERG: Thank you, Mr. Chairman, and we'll then take his resume as read.

CONTINUED BY MR. KRIS SAXBERG:

MR. KRIS SAXBERG: Mr. Matwichuk, please describe the purpose of your evidence; in other words, what it was that CAC/MSOS asked you to do, and then please proceed to present your evidence.

MR. GREG MATWICHUK: Thank you, Mr. Saxberg.

I was asked by CAC/MSOS to undertake an independent analysis on Centra's revenue requirement as it was filed in its current GRA before this Board. And it includes the appropriate treatment of costs and to make suggestions on how the Board might deal with items going forward, either in this proceeding or -- or subsequent proceedings.

My evidence is broken down into eight (8) areas. The first area I dealt with was the corporate allocation. And this was the subject of, actually, probably a number of hearings preceding this one. And, in that regard, there was a question with respect to how much Manitoba Hydro, as the owner of Centra, is entitled to as an equity owner from Centra and how that might be put to use, vis a vis the acquisition costs of -- of Centra by Manitoba Hydro.

And the Board, in a previous decision, had determined that the allocation for the '05/'06 and

'06/'07 test years should be 12 million.

The general principle that was established prior to that was that the Centra shareholder was entitled to a return and that return is -- can be made up of various types of various amounts but, nonetheless, is still a return. And so what I mean by that, whether it's an equity return determined by a formula, whether it's a net income amount or whether it's a -- a corporate allocation, all those amounts are effectively equity returned to the shareholder.

So in -- when I examined this I noticed that in the cost of service methodology, Centra had included the $12 million allocation plus amounts for net income and for -- ranging between 5 and -- and -- and $6 million for the net income. So what ended up happening was that there was in excess of $17 million in the revenue requirement related to -- to a return in the cost of service allocation.

Then when you looked over to the rate base rate of return methodology, there were amounts included, one (1) for the corporate allocation and one (1) for the equity amount that would result out of a formula that the Board had established for a return on equity.

And when you look at the $12 million amount from the allo -- corporate allocation and the resulting 10, 11 million -- well, let's call 11 million on average between the two (2) test years, when you look at those two (2), that adds to 23 million. Well, they're bo -- the Board had established, under good regulatory principles, and -- that the 23 million, if those two (2) are combined are excessive returns.

And what do we mean by "excessive return"? Well, all regulated entities are entitled to a reasonable opportunity to earn a fair return. And a fair return is dependent upon the business risk profile and what the Board has determined is a fair rate of return.

The fair rate of return has been established by this Board back in 1995 through a formula and that formula is adjusted every year depending, largely, on what happens to long term interest rates.

So, we have two (2) components in the rate base rate of return methodology resulting in a $23 million return amount, which ended up being in excess of what was fair because what is fair, deemed by regulatory principles and I want to keep in mind that this Board's formula is very similar, almost -- almost identical to other formulas across Canada that -- used by -- used in other jurisdictions.

And in the formula for the test years, the rate of return ended up being 8.21 percent. That's how the $11 million of fair return was determined, it was based on that 8.21 percent.

Given that the corporate allocation is also a return amount, when you add that to the fair return deemed by this Board, you get $23 million and that ends up being in and around 17, 17 1/2 percent, which is clearly excessive.

And the rates of return allowed by other jurisdictions are in the range of low 8 percent to about 8.57 percent, if I'm not mistaken but, generally speaking, in that range.

So what I did, and if -- and if maybe this -- this can assist, is if you turn to my evidence at page 11 and go to table 3, in table 3 I show the non-gas revenue requirement for each of cost of service provided by Centra's forecast, rate base rate of returns Centra forecast, and then a rate base rate of return analysis that I conducted myself in which the difference between the latter two (2) items is the $12 million.

In order to ensure that rate base rate of return reflected just and reasonable rates, I removed the $12 million allocation that was included in that, and then compared that to the cost of service Centra forecast.

And the reason I did that was that this

Board had determined that rate base rate of return regulation shall be the highwater mark in -- in determining a revenue requirement; and that's -- that's the reason for that comparison.

And the result of that comparison yielded a difference of some 4.6 million, approximately; that was for the 2007/2008 test year. And I just found another -- another correction. Down below, that should read 2008/2009. We do a similar exercise and I come up with a difference of 5.4 million.

So the upshot of that, Mr. Chairman, is that the corporate allocation is an amount that the Board deemed fair to include in cost of service regulation, but it did not suggest to Centra in past that that should be included in rate base rate of return regulation. And that only stands to reason because of the excessive return that would result.

The next area that I addressed was the operations and administrative expenses relative to a baseline. In Decision 118/03, this Board had its first formal opportunity to look at -- to review Centra's revenue requirement for setting rates purposes since the acquisition; and that was for the 2003/'04 test year.

And when the Board examined the O&A costs, it allowed $49.3 million of O&A costs and indicated that it had sufficient review of those costs to rule -- to decide that that should form a baseline on which future O&A costs should be reviewed in future General Rate Applications.

And my analysis -- part of my analysis in that regard was to say if that is a baseline for 2003/'04, how would costs look in today's terms if we inflated them using an inflation factor and also used a range of productivity factors? And I used that range so that we could look at various scenarios without trying to dictate which productivity factor should be the one utilized.

And when I went through that analysis, which is captured in Table 4, which is on page 16 of my evidence, you will -- it shows the -- the three (3) scenarios of the productivity factors using a half of 1 percent productivity factor, point five (.5); the 3/4s percent, .75 and the 1 percent productivity factor. And all of them use the same inflation factors. They all seem to be inflation factors that parties had agreed on.

And the result, in comparing the baseline O&A costs elevated for inflation offset by productivity factor, was a range of approximately three and three-quarters million dollars to about five and two-thirds million dollar differential. So that was what I would call sort of an introductory baseline analysis.

I then -- if you'll then move on to Tables 5 and 6 over the next page, I took that analysis and -- and said -- suggested that we should do this on a cost-per-customer basis. Cost- per-customer basis takes into account various factors including well -- the growth of the Company. And what we found is that about 3/4 percent on average growth each year in Centra.

And using that analysis very similar and -- and using the same productivity factors, we found that the differentials weren't as great but they were still significant and, basically, ranging between $2.19 million and $3.72 million. So those are differentials I found relative to the baseline.

The next part of the exercise that was undertaken was saying, well, what if we looked at rather than the baseline that the Board had set for 2003/'04, we looked at costs -- what costs would have achieved relative to a 2005 actual which is, on this record, the most recent published actual information.

And so we went through similar exercises, same productivity factors and round numbers we're looking at differences between 1.9 and $3.3 million. And we did a similar exercise for the actual '05/'06 costs on a cost-per-customer basis and the differentials were round numbers between 1 million and $2 million.

Now, the other aspect that we added to this analysis was to say, what if the productivity factor was zero, what would the results be? And even with a zero productivity factor, the baseline analysis back to '03/'04 results in a million dollar difference and the analysis relative to the '05/'06 actuals would result in approximately -- sorry, half a million dollars.

And that was just the test to say what -- what would the costs look like relative to inflation only? But clearly, that's not -- not practical; that's not realistic because any good business -- any successful business engages in seeking out productivities and achieve -- and if they are successful, they achieve productivities.

So that's the reason for providing a range of assumptions on productivity. I did not recommend a particular adjustment with respect to that analysis but what I wanted to alert the Board to is the range, the sensitivity of that analysis.

And, to me, what that analysis concludes is that there is some factor where a not insignificant differential exists between what Centra's filed for for O&A costs and what might be reasonably expected based on using the Board's established baseline or the most recent actual costs.

Turning topic slightly but staying with O&A costs, in reviewing the application and the IR responses it was discovered that the O&A costs included a contingency factor and -- in each of the test years and that contingency factor is estimated at $1.7 million.

Now, Mr. Chairman and Board Members, it's not -- this is a new concept to me. I've been around regulatory economics and regulatory filings for twenty (20) years. These types of things are not issues that are commonly accepted in -- in regulatory arena.

When a forecast is made a forecast should be made on the costs that a company expects to incur and the -- the uncertainty with respect to those costs is there and there is a risk that there's a fore -- what's called forecast risk naturally. And that forecast risk is taken on by the Utility but the offset, the quid pro quo to that, Mr. Chairman, is there is an equity risk premium in the rate of return on equity. The rate of return on equity includes all risks.

So when I looked at the $1.7 million, my concern is that it should by removed for each test year. Alternatively, my recommendation is -- would be to reduce the rate of return to allow for that risk reduction because if you have a contingency, you're essentially saying, I'm not absorbing $1.7 million of risk.

Next, Mr. Chairman, capitalized O&A costs. This was an issue where -- maybe I should -- I -- back up here a little and talk about a -- a concept, certainly with respect to in -- intervention.

My purpose as an analyst and -- and I -- I would contend that it's the purpose of -- of any good analyst in looking at a revenue requirement filing or any regulatory filing, for that matter, is to examine it so that you can either confirm or challenge the claims or forecasts made in those filings.

And when I came to an issue of the capitalized O&A costs, it was an issue that raised a concern because there was an element of potential risk there. It wasn't an area where I am suggesting a -- an adjustment should be made and the reason for that is, at this stage there was not sufficient evidence to allow for a conclusion to either confirm the claims of costs and forecasts or to adequately challenge them.

And so the Board, on the basis of my evidence, asked a question, well, what additional evidence would be required, and I provided the Board with that list. And so in -- in -- when I attempt to confirm or challenge, if I see that there's a risk of something, it -- it's certainly something that should be brought to the Board's attention.

And then if you've got a risk, it's a matter of any business proposition as you'd undertake, you identify the risk and you undertake some risk mitigation. And so in the case of a regulatory proceeding, the risk mitigation is to obtain additional information to enable you to confirm or challenge. And that's where I left it, sir.

The next issue was with respect to weather normalized -- weather normalization and risk. And I'm not sure whether this was just an area of confusion or interpretation of the words but, again, it became an issue of risk that should be brought to the Board's attention.

So like other gas utilities across Canada, Centra is regulated on a weather normalized basis. And in Centra's -- one (1) of Centra's statements it looked like Centra was not prepared to take on weather normalization risk at -- as one (1) might expect. And the concern was whether weather-induced fluctuations would be recovered through revenue requirement in subsequent years.

So this was -- this examination was simply a check to make sure that if there was a loss or not as great of revenue due to weather -- adverse weather conditions in one (1) year, that it was consciously picked up in a sub -- subsequent year.

I think the record is clear in this proceeding now, is that weather normalization should equal out on its own over the long term. In other words, you will have warmer years and you'll have colder years and they will result in lower return or higher return and on balance, over the long run, they should balance out on their own rather than attempting to recover any past losses or attempt to refund any past gains.

And I think that that should -- should summarize that issue.

Now, the next issue, Mr. Chairman, is debt:equity ratios. I'm not sure if this issue has totally evolved yet but it seems that the record is evolving on it. I had testified on this issue, when I last appeared before you, and the reason I testified at that time was that Centra had taken the view that a major component of equity should not be included in the debt:equity calculation and that was $121 million of share equity that was previously retained earnings.

And my evidence to you last time was that the financial community wouldn't find that acceptable, that they would look at the total equity in the debt:equity calculation. So the difference was that

Centra had calculated debt:equity ratios in the neighbourhood of eighty-six/fourteen (86/14), eighty-six/fifteen (86/15) -- sorry, eighty-six/fourteen (86/14), eighty-five/fifteen (85/15) using their method, but, the Board had established in the previous Decision 135/05 that it should be calculated including all elements of equity which would result in a debt:equity calculation of seventy/thirty (70/30).

And this was simply in the response to Centra suggesting that their debt:equity was in the range of eighty-five/fifteen (85/15) and their target was seventy-five/twenty-five (75/25) and I just wanted to clarify the record that they were actually in excess of that particular target.

And I wasn't suggesting, sir, that that either should be the target or that's an appropriate target but Cen -- it was just a response to Centra's contention that given that that is their target, they are deficient in that and I was demonstrating that they, in fact, are not deficient and the basis of my determination was first -- first was based on what the -- how the financial markets would determine it and, second, that was buttressed by, Mr. Chairman, your Board's decision in 135/05.

Next the issue was the presentation of

rate increases and, Mr. Chairman, I think what this comes down to, this is a question of whether there is a -- a rate increase of -- overall of 1 percent or 2 percent in overall revenue requirement or whether someone should desegregate the revenue requirement and determine what the rate increases are for cost of gas, non-cost of gas.

And as -- as a consumer the expectations have evolved on that. Whereas gas bills, electricity bills, utility bills generally used to have a one (1) line item saying this is what your -- your rate is and what your charge is, utilities across Canada have amended their bills to four (4) part bills, five (5) part bills, in some cases eight (8) part bills and as -- as a consumer and, certainly, I'm speaking for myself and also speaking from the perspective of -- of clients, is that consumers, they have a desire to understand what factors are impacting their bill and so they're looking for the increases. Is it an increase in the cost of gas or is it an increase in the cost of -- of running the distribution network?

And -- and I put to you, Mr. Chairman, that consumers do have that interest because they have requested these multi-part bills, the desegregation of -- of the one (1) line bill. And -- and they've -- they've spoken loudly to governments and -- and in some cases to the -- the regulators and the utilities themselves and the resolution is widespread across Canada is they want multi-part bills.

So it -- it was a comment simply to relate to the relevance of the information that if I'm getting a -- a multi-part bill I'd like to see multi-part increases particularly given that a one (1) line percentage change may not be useful information given that the cost of gas is within that component and the cost of gas is the most volatile component in that total line and that the cost of gas makes up -- or historically has made up 70 to 90 percent of the total line. So what we see today that includes the cost of gas is going to change, as we all know, quarterly.

Finally, Mr. Chairman, the -- the last area that I explored in the evidence was with respect to electronic filings. And the reason I raised this is that I wanted, Mr. Chairman, you and your -- your Board members to have the benefit of some experience in other jurisdictions, and that is the efficiency that is brought -- and effectiveness, that is brought forward by electronic filings.

And -- and I guess the other issue is improve transparency. CAC/MSOS, in one (1) of its IRs to Centra, provided an example and asked for a comparison or ask -- ask a number of questions around that compare -- that example and that example was an electronic filing, and it had the entire revenue requirement schedule by schedule all -- all the schedules are linked so that if a particular change is made in say capital taxes, it will flow through the entire model.

And that's something that is provided on a regular basis in -- in regulatory filings in -- in other jurisdictions that allow Intervenors to, again, challenge or confirm claims and forecasts. And what it can do is it can reduce the number of Information Requests, it can reduce the amount of time required for cross-examination and parties do -- no longer have to ask, what would be the impact of this or if -- what's -- what's the sensitivity of this particular element, they can test it for themselves.

So I've gone through a couple processes in the electronic filings and I -- I've seen some of the dif -- some of the difficulties, some of the learning hurdles and I wanted to make -- make sure that this Board was aware, despite all the hurdles, in -- in the end, it's -- provides a very valuable asset to the regulatory process in helping ensure that it's efficient and effective.

Mr. Saxberg, that would summarize my evidence.

MR. KRIS SAXBERG: Thank you, Mr. Matwhichuk. I have a few more questions that arise as a result of the focussing of -- of the issues in the last few days.

In this proceeding, Centra is contending that as long as they show that there's no harm to customers then the Board will have satisfied its mandate to ensure just and reasonable rates.

Do you agree with that proposition?

MR. GREG MATWICHUK: No, I'm afraid I can't agree with that, Mr. Saxberg. And the reason is, is we're talking about two (2) different concepts here, no harm and just and reasonable rates. My understanding with this statute, and -- and various other statutes that I'm familiar with, there is a requirement for just and reasonable rates imbedded right in the -- the Act.

And no harm is a concept that is usually isolated and -- and associated with something like an acquisition. When you have an acquirer company and an acquiree company and the intent is to ensure that there is no harm to the -- the ratepayers.

And where you could run into a difficulty in just simply having blanket reliance on -- on the no harm principle, is that there -- there could be -- it could be resolved that there is no harm resulting from an acquisition, but that doesn't necessarily mean that there are just and reasonable rates because there -- there could be other changes -- other impetus to rate increases, rate decreases for that matter, that wouldn't be just and reasonable and -- and in the public interest that are independent entirely -- entirely independent from a purchase acquisition.

MR. KRIS SAXBERG: Centra has filed, as Exhibit 7 in this proceedings, evidence that its requested revenue requirement will not harm Centra ratepayers.

Have you reviewed Centra Exhibit 7?

MR. GREG MATWICHUK: Yes, I did take a look at Centra Exhibit 7. And one of the things that I note about it is that in -- they've done -- they've attempted to do a -- a comparison between cost of service and rate base rate of return and what would appear to be a rate base rate of return, absent the acquisition; which, as I read in column 4, I -- I assume that's the intent there.

And a few things to say on that. Cost of service has been treated in -- in this process on an integrated fashion that Manitoba Hydro and -- and -- and Centra are integrated, and that's the way the cost of service has been presented.

And rate base rate of return would say no, wait a minute, this has got to be done on a stand-alone basis. And so they're -- we're looking at -- at two (2) different bases. So that's the -- that's the first comment.

And so rate base rate of returns, and it's -- this is something that comes right from -- from this statute; it's common with -- with other jurisdictions to have similar statutes in this regard, is in terms of the rate setting. One of the fundamental issues in -- in -- in rate setting is to ensure that there's a -- a fair rate of return. That's -- that's not an issue with respect to -- to cost of service.

But in order to establish that fair rate of return, one must do so having due regard to the stand-alone principle which is not -- which -- a principle that seems to show up in the cost of service filing.

The next concern that I have is when I look at column 4, absent the acquisition, and -- and I -- and I combine my view of that with respect -- and when I view Centra's filings to date, it seems to be that Centra has taken the view that one should look at what the revenue requirement would be if West Coast was still around.

Well, Mr. Chairman, it's -- by the end of this test year, test period, West Coast will not have been around for ten (10) years. To try to determine what West Coast would have done, in my view, is -- is very speculative. And let me try to give you some context to that thought.

Since the time West Coast sold its interest in Centra to Manitoba Hydro, West Coast sold -- West Coast was purchased -- its assets were purchased by Duke Energy. Since that time, Duke Energy sold its gas-related assets to Spectra Energy.

So, from West Coast to Duke to Spectra, we have three (3) different managements. Three (3) -- there will be -- you can be guaranteed, Mr. Chairman, there will be three (3) different management strategies, three (3) different approaches and there could be even different approaches within that ownership depending on management changes.

So what I'm suggesting to you, sir, and to be more specific with respect to the numbers is that a particular owner may have a certain emphasis on how it's going to manage a utility based on the portfolio of the rest of the -- its assets.

So, is it intending to have a high rate of return from a particular utility? Or is it intending to keep it running as is? Is it intending to desegregate it? Is it intending to have a greater level of efficiency?

Very often what happens, Mr. Chairman, when there's a takeover, an organization, certainly in the private sector, makes a purchase above book value. And you've probably heard the terminology one point one (1.1) book value, one point three (1.3) book value, sometimes even one point five (1.5) book value. Those are -- those would be one point five (1.5) would be stretching it in terms of the Utility but then one has to say, well, how am I going to get my return out of this organization? I'm only going to get a return based on my book value.

And so just to give you an example if I'm getting 10 percent at my -- at -- at book value, then if I've invested at one point five (1.5) book value, then I'm only going to get somewhere in the neighbourhood of 6 to 7 percent returned.

So I have to be confident that when I make this purchase that I can recover my investment and -- and a make reasonable return. So what will I do? I try to run it more efficiently.

So a second or third owner, and this -- this happens regularly in the business world may come along and say, okay, we are going to run it more efficiently. We are going to have lower staffing levels or we're going to reduce this component of O&A so that I can recover my costs based on current rates; in other words, I'm not going to incur as great a cost as are built into rates.

There are all kinds of other examples where regulated entities have attempted sometimes successful, sometimes not so successful in -- in boosting their return.

So my point is, sir, is that to attempt to suggest what O&A costs might be of West Coast ten (10) years hence is -- in my mind is speculative and -- and I'll leave it at that.

So similarly, what they may spend on their O&A costs may also have an impact on what they spend on their -- their capital costs because you could have an emphasis on repair and keep the thing going or you could have an emphasis on replacement. And -- and if you have an emphasis on replacement, you're building up the asset base; you're going to get a greater return.

But that -- those are two (2) different strategies, two (2) different of many strategies. And so when you have an impact on what you're spending on capital, you're going to then impact depreciation. You're going to impact capital taxes and -- and property taxes. You're going to impact income taxes as they are calculated based on the return on rate base. And same -- similarly with finance. It's a matter of how much you'd have to invest.

So all of those amounts would be impacted by whoever the owner of the day might be.

And I think I don't have any further comments on that.

MR. KRIS SAXBERG: Thank you. I -- notwithstanding your reluctance to speculate about what a -- what the privately held utility would look like today, I asked you to do your own hypothetical work on what the revenue requirement would look like under private ownership; in other words, to revise Centra-7 with -- with your own speculation.

And you have done that and I have passed out a -- a document which is labelled at the top "For Discussion Purposes" and I'd invite you to comment on the document and how it relates to Centra Exhibit 7 and, in particular, how it is that you came up with the individual absent acquisition cost estimates -- what they're based on.

MR. GREG MATWICHUK: Well, --

MR. KRIS SAXBERG: And -- and perhaps --

MR. GREG MATWICHUK: Sorry.

MR. KRIS SAXBERG: Sorry. For everyone's convenience it might be helpful to have a copy of -- of this document plus Centra Exhibit 7 at hand.

(BRIEF PAUSE)

THE CHAIRPERSON: Does everyone have it? I guess we should give it an exhibit number, too.

MR. KRIS SAXBERG: Yes, I think that would be appropriate. I believe we're up to CAC Number 7?

THE CHAIRPERSON: Subject to Mr. Singh's check, that's fine.

--- EXHIBIT NO. CAC/MSOS-7: Document labelled "For Discussion Purposes

CONTINUED BY MR. KRIS SAXBERG:

MR. KRIS SAXBERG: So, Mr. Matwichuk, if you would, please go through CAC-7 and compare it to Centra Exhibit 7 and explain the differences.

MR. GREG MATWICHUK: Okay, well I -- I see we've matching exhibit numbers, so they're aligned in -- in that regard, after that, I'm not so sure.

Now, yes, you did ask me to put together a hypothetical, Mr. Saxberg, and when I looked at it, I -- this -- this was labelled "For Discussion Purposes" because it did not involve a thorough examination of each of the line items, but the -- the focus of this would be absent acquisition column 4 in CAC/MSOS Exhibit 7.

And the O&A amount, it -- it's simply a reduction related to the contingency; that -- that's one (1) of the easier ones to -- to conclude on and that's something that, as I indicated in my summary of my evidence, is -- is an amount that I would recommend be a reduction.

The depreciation amount, now again, hypothetically, the depreciation amount involves a reduction and the amount there that was placed in -- in rates was the actual amount that -- I believe, that was achieved in '05/'06. And it sort of begged the question, would another owner have sought a depreciation study which increased depreciation rates; don't know, it depends on the owner.

I've been involved with enough regulatory organizations that they -- they are strategic, they seek timing on these things, they may or may not have sought it. So that is a depreciation element that, broadly speaking, where their depreciation rates weren't sought -- depreciation rate increases weren't sought through a depreciation study.

The capital and other taxes were -- were left as is but, again, another owner -- they could have higher, they could have lower, Mr. Chairman. I -- you know, again, it sort of emphasizes the -- the speculativeness of this.

Income taxes were left the same and that's largely because the -- the calculation I did with respect to return on equity at the bottom of 13-9-55 was very close to that of Centra's, so it ended up leaving the -- the income tax the same.

The finance expense is a significant difference and the reason for that, Mr. Chairman, is that when I look at this -- this is a significant issue to this -- this proceeding -- is that rate base rate of return assumes a standalone principle.

And standalone, one (1) of -- there are a couple elements to this; one (1) is, standalone would mean that there would be no debt guarantee and there would be no debt guarantee fee and so the debt guarantee fee would be removed from the cost of debt.

And also as a standalone one (1) has to look at what the interest rates are available in the market to a standalone entity. And having done that, I concluded that they were lower than the embedded cost of debt in -- in Centra right now. And that caused the -- the return on debt to -- to decrease.

Other -- other than that, the amounts are the same. The total one twenty-six three seven two (126,372) is lower than the Centra total of one four five three seven one (145,371) but, again, Mr. Chairman, a rigorous analysis wasn't undertaken because, really, a rigorous analysis isn't, you know, precisely possible because this is a speculative exercise.

But what it does show is that if you make certain assumptions, the number could be lower. We can make certain other assumptions, the numbers could be higher. And it's all about significant assumptions as opposed to a reasonable basis of -- of forecasting. And the reasonable basis of forecasting is what we should be using in -- in this proceeding.

So that -- that's the basis of CAC/MSOS-7, Mr. Saxberg.

MR. KRIS SAXBERG: I -- I just have one (1) question about the O&A figure that you've indicated here of 54.9 million.

Are you suggesting that a private owner would have been able to have achieved the same synergy benefits claimed by Centra?

MR. GREG MATWICHUK: Well, I'm suggesting that when I look at Centra's -- or the synergy benefits that were achieved in Centra, they actually could have been greater under a private owner because they could have been more aggressive than perhaps Manitoba Hydro was. And there are all kinds of opportunities.

It's -- it's impossible to determine what another entity might have done or might not have done. So, it's quite possible that another entity would have more synergies or -- or fewer synergies.

MR. KRIS SAXBERG: And I note there was also a change to column 2. Can you explain that?

MR. GREG MATWICHUK: Column 2, the change was to align the -- the rate base rate of return concept with the corporate allocation issue that we talked about off the top, Mr. Chairman; that that line item was removed from the rate base rate of return to be consistent with regulatory principles.

MR. KRIS SAXBERG: And, Mr. Matwichuk, Centra has indicated that it wants larger retained earnings for financial stability purposes.

Do you agree that that is necessary?

MR. GREG MATWICHUK: Centra -- could you repeat the question? I just want to make sure I understood it correctly.

MR. KRIS SAXBERG: No problem, because I

have it written down. Centra has indicated that it wants larger retained earnings for the purposes of financial stability.

Do you agree that larger retained earnings are necessary for financial stability?

MR. GREG MATWICHUK: Okay. All right. When I think of financial stability, that's not something that normally arises as a significant risk for a utility.

And the reason being is that a utility has a very low business risk structure in that it provides a services, it has regular billing, it has regular billing receipts from its customers. This is not something where we're selling cars where we could have a high risk of significant gas prices; people downgrading the level of cars that they purchase and no longer purchasing the high-end, high-profit-margin cars.

We're selling a commodity on a distribution network and -- and it's widely recognized that utilities have -- have low risk. So the question remains. Should we build up retained earnings for financial stability?

Well, retained earnings -- if it's a question of whether it's for a rainy-day fund, then I'd have significant concerns. Because, first of all, in a gas utility, there is even a lower need for a -- a rainy-day fund in a -- particularly in a jurisdiction like Manitoba than there would be for an electric utility.

And a gas utility -- and let's look at Centra, as I mentioned off the top, it has, historically, between 70 and 90 percent of its revenue requirement is its cost of gas. Well, that cost of gas is a flow-through item. So that is passed on to the customers directly.

The rest of the revenue requirement, you have to examine and say okay, well, what could go wrong there? What's -- what's the business risk? So I -- I say to myself, well, assume we have a pipeline burst and, if we had a pipeline burst, what would happen?

Well, there could be, obviously damage to Centra's assets, Centra's property. There could be collateral damage to other property. And Centra, fortunately, has insurance for that kind of event.

And even if insurance didn't cover the cost of such an event, costs like that would tend to be capitalized and deferred and amortized, however you want to put it, and collected in future rates. That's typically the way these -- these things tend to happen.

So I'm -- I'm hard-pressed under those scenarios to understand why there would be a need for a rainy day fund. Moreover, where utilities do have a rainy day fund - and most often this would be in an electricity environment - is they have what's called a rate stabilization fund and that would be for concerns where there could be rate spikes in -- in years and so what they do is they collect a little bit each year or over a certain year period and build up a fund so that it can be drawn on in -- in future years.

But again, I caution and that caution is that that would tend to be in a jurisdiction that has certain volatility with -- for example, with respect to its customer base. If you look at something like the Yukon or even PNG, Pacific Natural Gas, they -- they have a very high proportionate industrial base that -- such that, you know, for example, PNG 75 percent of its throughput was the responsibility -- or was for three (3) customers, three (3) industrial customers. So you can see that there's a -- there's a high risk there.

Manitoba, it's fairly well diversified so there's not likely to be the need for a rate stabilization. But even if you wanted to characterize it as a rate stabilization, you would have very specific criteria for how a fund is built up and very specific criteria for how a fund is drawn in; in other words, what circumstances. You wouldn't leave it very discretionary to how it's built up or how it's drawn on and I -- I think there -- I'm not aware of any evidence on -- on this record as to what specific criteria would be considered in building up retained earnings.

And the other thing in terms of financial stability comes back to -- to Centra if it's -- it's -- right now in there integrated fashion, they are protected in the capital markets and not having to be as concerned as another entity with respect to protection of capital markets because their debt is provided through Manitoba through a -- and -- and has a debt guarantee on it.

And the financial markets have recognized that. Centra no longer has its own credit rating. So that's my response, Mr. Saxberg.

MR. KRIS SAXBERG: Thank you. One (1) final question. Centra says that if you're going to use the rate base rate of return methodology the equity target should be 40 percent as opposed to 25 percent under cost of service because to do otherwise is to mix concepts.

How do you respond to that?

MR. GREG MATWICHUK: Okay. Well, -- well, first of all, the 70 -- the seventy-five/twenty-five (75/25) under cost of service is -- I want to make sure it's very clear on the record that that's Centra's target. That's Manitoba's Hydro -- Manitoba Hydro's target for Manitoba Hydro and as I understand in subsequent testimony is that that's the target that was adopted for Centra under cost of service.

Now, as far as rate base rate of return methodology goes, the sixty/forty (60/40), it has to be determined whether that is an appropriate capital structure for Centra. One has to examine what was awarded previously, what -- what credit ratings there are for the company and, you know, how -- how it's covering its -- its debt costs currently, those types of things and also -- almost -- and very importantly is the risk profile of the company and whether or not it's pay -- it's getting a debt guarantee.

So looking at those items, the risk profile of Centra was last evaluated in the '03/'04 hearing I believe and prior to that was even more rigorously evaluated in -- in GRAs where the ROE was examined outright with witnesses from both Centra and from Intervenors and in the setting of the formula.

Well, when the Board set the formula, the Board concluded that Centra's risk profile was lower than average, lower than the risk of the average gas -- gas LDC in Canada.

So given that, the Board said we're okay with sixty/forty (60/40), that is your actual, your current capital structure that you actually have, we don't want you going above the 40 percent, we're not going to award rates abo -- above an equity component of 40 percent. And -- but in keeping in mind, at that time it did not have a debt guarantee. It was out there on its own raising capital in the markets. So it did not have that -- that level of protection.

The seventy/thirty (70/30) current -- current capital structure, seventy/thirty (70/30), 30 percent equity is the proportionate amount that Manitoba Hydro has an equity investment in Centra; that's the actual investment and that is with a debt guarantee.

Centra has survivability. It's doing very well in -- in that scenario. If, on a rate base rate of return, it were to not -- it -- it were to not have the debt guarantee, well, then maybe something other than seventy/thirty (70/30) would be appropriate and -- and that would be examined, again, relative to the risks and the equity thickness in other gas utilities in other jurisdictions.

So -- so when I -- when I see that Centra's saying they're looking for sixty/forty (60/40) then certainly they have the opportunity to go to sixty/forty (60/40), but it would not make sense for this Board to award a rate -- rate of return or -- or sorry, a

-- to allow a return on rate base that has 40 percent equity when Manitoba Hydro hasn't invested up to that 40 percent. Because Manitoba Hydro would be getting a boost relative to what it has put at risk. Thank you, Mr. Saxberg.

MR. KRIS SAXBERG: And Thank you, Mr. Matwichuk.

With that, that closes our direct examination and Mr. Matwichuk is available for cross-examination.

THE CHAIRPERSON: Thank you. Okay, before we take a mid afternoon break, we will start working through the Intervenor list and first up would be Mr. Boyd.

Mr. Boyd, do you have any questions for the witness?

MR. SANDY BOYD: No, I do not.

THE CHAIRPERSON: Ms. Melnychuk, do you have any questions?

MS. KAREN MELNYCHUK: No, I do not.

THE CHAIRPERSON: Mr. Gange...?

CROSS-EXAMINATION BY MR. WILLIAM GANGE:

MR. WILLIAM GANGE: Just a couple of questions and -- and I'll be very brief, Mr. Matwichuk.

My name is Bill Gange, sir, I act on behalf of RCM and TREE. I'd like to refer you, sir, to page 23 of your written testimony. And this has to do with the weather normalization and risk.

MR. GREG MATWICHUK: Yes, sir, I have that.

MR. WILLIAM GANGE: Thank you. In -- in your testimony you've got the -- the risk of higher/lower returns was contemplated and embedded in the setting of fair returns on equity --

MR. GREG MATWICHUK: Yes, sir.

MR. WILLIAM GANGE: -- at the start of this -- the first full paragraph and at the end of the next paragraph you have the comment that Centra is compensated for weather risk and can you tell me, sir, are there any -- are you aware of any quantifications of -- of the risk with respect to weather risk?

MR. GREG MATWICHUK: Mr. Gange, typically it's not something that's -- that's quantified. Weather risk is a -- is a short-term risk as you -- as you might imagine given the fluctuations year to year and the weather risk becomes part of the overall -- is part of the overall business risk and utilities, gas utilities that have weather normalization filings or have weather normalized filings are provided a risk component in their equity risk premium for their business risk, so, it's -- it's included.

Sometimes it -- it may be referred to in proceedings and there may be deliberation -- or discussions and deliberations. Rarely -- and I'm hard-pressed to think of a decision where a Board had actually quantified but there's no doubt that it always has been contemplated as part of business risk and business risk certainly is a direct component consideration of the -- the risk profile that enters into the capital structure most often.

MR. WILLIAM GANGE: My understanding is, sir, that in -- in some jurisdictions in the United States in Oregon and Washington boards have used an estimate of approximately 25 basis points with respect to weather risk.

Are -- are -- would -- would you be familiar with that?

MR. GREG MATWICHUK: I have heard that -- that range has been discussed and I'm -- again, I'm -- I'm not familiar with the two (2) -- I'm not familiar with the specifics in those two (2) jurisdictions. I'm familiar that -- with that level of quantification having been discussed but never recall seeing it having been formalized in Board decisions.

MR. WILLIAM GANGE: In -- in general, sir, was that -- is that -- that type of a range or that -- that type of a number, 25 basis points, would that be something that you would be comfortable with as -- as setting -- as -- as a weather risk?

MR. GREG MATWICHUK: I'm not sure that sitting here today that I -- I could come to that conclusion, sir. Yeah, I -- it's -- again, there's -- it's less of a definitive element and -- and I think it would be unfair to -- to pass judgment on that as -- as to what's an appropriate amount.

MR. WILLIAM GANGE: Fair enough, sir. Thank you.

You've stated that -- that risks -- and -- and I'm not referring to -- to page 23 at this point but just generally, that risks should be identified and mitigated if possible. That's a statement that you would agree with, sir?

MR. GREG MATWICHUK: Yes, sir.

MR. WILLIAM GANGE: And would you agree that if -- if Centra's weather risk could be mitigated without harm to the customers that that -- that concept, that would be desirable?

MR. GREG MATWICHUK: Broadly speaking that sounds like that could be acceptable and I'm -- I'm trying to visualize that but maybe we're going down a road.

MR. WILLIAM GANGE: Okay.

(BRIEF PAUSE)

MR. WILLIAM GANGE: And -- and, sir, can -- can you -- is it possible for you then to comment on -- on whether the weather-adjusted rate mechanisms can -- can be used as a risk of -- of -- as a form of risk mitigation?

MR. GREG MATWICHUK: Sorry, could you repeat that question, please?

MR. WILLIAM GANGE: Can -- can you comment on -- on whether the weather-adjusted normalization mechanism can be used as a form of risk mitigation?

MR. GREG MATWICHUK: Used as a form of risk mitigation? Well, let's be clear. I think the weather normalization is a suggestion that a filing will be made based on a normal year using a ten (10) year rolling average, so, the risk of it -- a particular year being different, i.e., colder or warmer than that normal, is always there.

So I'm not sure that it's a -- a risk

mitigation mechanism at all.

MR. WILLIAM GANGE: Thank you, sir, that -- that's fine on that point. One (1) final issue is, could you comment on how ramping up of -- of gas DSM would affect the -- the productivity calculations that you've predicted?

MR. GREG MATWICHUK: I haven't looked into that, sir.

MR. WILLIAM GANGE: Okay, thank you, sir. Those are -- those are my questions, Mr. Chair.

THE CHAIRPERSON: Thank you, Mr. Gange.

So Ms. Murphy would be up next in our order. Perhaps we might as well just take our midafternoon break at this time. We'll come back in fifteen (15) minutes, thank you.

--- Upon recessing at 2:54 p.m.

--- Upon resuming at 3:23 p.m.

THE CHAIRPERSON: Okay. Now, we will move over now to Ms. Murphy unless she totally agrees with everything Mr. Matwichuk said. Ms. Murphy...?

MS. MARLA MURPHY: Sorry to disappoint you.

CROSS-EXAMINATION BY MS. MARLA MURPHY:

MS. MARLA MURPHY: Good afternoon, Mr. Matwichuk.

MR. GREG MATWICHUK: Good afternoon, Ms. Murphy.

MS. MARLA MURPHY: I want to begin by clarifying some of your recommendations. In your pre-filed evidence you recommended that the total return to shareholders, as you described it, should be restricted to the return on equity of $11 million; is that right?

MR. GREG MATWICHUK: Yes, that's the -- the principle it would be following.

MS. MARLA MURPHY: Is that still your recommendation?

MR. GREG MATWICHUK: Yes.

MS. MARLA MURPHY: And what do you view as the appropriate level of retained earnings for Centra under its current ownership structure?

MR. GREG MATWICHUK: I was not asked to review the retained earnings level.

MS. MARLA MURPHY: So you haven't considered that issue?

MR. GREG MATWICHUK: I have considered that issue and I think it was canvassed in direct.

MS. MARLA MURPHY: Perhaps you could

enlighten me, I must have missed your number?

MR. GREG MATWICHUK: Oh, we -- we didn't deal with a particular number and what I'm suggesting is, I -- I didn't examine the -- the level of retained earnings to a number.

MS. MARLA MURPHY: Okay. Looking back at the Orders, in Board Order 103/05 and 135/05, you acknowledged that the Board allowed Centra a corporate allocation of $12 million; don't you?

MR. GREG MATWICHUK: That's what the -- the Orders provided for on a cost-of-service basis, yes.

MS. MARLA MURPHY: And those Orders also allowed Centra a $3 million net income; is that right?

MR. GREG MATWICHUK: That's correct. That's my -- that's my recollection anyway.

MS. MARLA MURPHY: I can show you the Order if you like?

MR. GREG MATWICHUK: I -- I think my recollection is adequately unfuzzy to recall that.

MS. MARLA MURPHY: Thank you. You're aware that Manitoba Hydro operates an integrated utility and allocates cost to Centra; is that right?

MR. GREG MATWICHUK: That's correct.

MS. MARLA MURPHY: And you're also aware that those allocated costs formed the basis of Centra's revenue requirement?

MR. GREG MATWICHUK: That's my understanding.

MS. MARLA MURPHY: Do you recall that the cost of acquisition to Manitoba Hydro is $19 million annually?

MR. GREG MATWICHUK: I recall that -- sorry, almost mixed up there. Manitoba Hydro had done a number of calculations over the years since the acquisition as to what the annual cost would be and that num -- those numbers have changed.

MS. MARLA MURPHY: And you're aware that Manitoba Hydro is allocating $12 million of those costs to Centra in the form of a corporate allocation, correct?

MR. GREG MATWICHUK: Yes, is -- so as I understand it, the pos -- position is, is that there's a total of $19 million for the acquisition and notionally twelve have been allocated to Centra, seven to Manitoba Hydro.

MS. MARLA MURPHY: And you recall that PUB in Order 103/05 accepted that that was reasonable?

MR. GREG MATWICHUK: I don't recall that one.

MS. MARLA MURPHY: Page 76 of the Order.

MR. GREG MATWICHUK: Okay. If you don't

mind, we'll just go to it. I'm not -- I'm not doubting you, it's just that I don't recall seeing it.

Which one are you in?

MS. MARLA MURPHY: I'm in Order 135/05, page 76.

MR. GREG MATWICHUK: And where are you?

MS. MARLA MURPHY: I'm at the bottom of the page. In Order 103/05, the Board accepted the inclusion and revenue requirement of a $12 million annual corporate allocation.

MR. GREG MATWICHUK: Yes. Okay.

MS. MARLA MURPHY: Thank you.

MR. GREG MATWICHUK: I -- I see that's what it reads there.

MS. MARLA MURPHY: I wanted to ask you about your comments on the provincial guarantee fee.

On a standalone basis, Centra wouldn't be able to borrow at the Long Canada bond rate without some markup or spread, would it?

MR. GREG MATWICHUK: It would be a spread above the Long Canada's, yes.

MS. MARLA MURPHY: And Centra, under the Manitoba Hydro ownership, borrows at the Long Canada bond rate plus 140 basis points, which includes the provincial guarantee fee of 1 percent or 100 basis points; are you aware of that?

MR. GREG MATWICHUK: I'm not aware of it, but do you want to give that to me again, please?

MS. MARLA MURPHY: Sure, 140 basis points over the Long Canada bond rate.

MR. GREG MATWICHUK: And when you "long," what -- what -- are we looking at thirty (30), twenty (20)...

MS. MARLA MURPHY: Thirty (30) year.

MR. GREG MATWICHUK: Thirty (30) year. Bear with me here a second. So you're saying a hundred and forty (140) and the -- and plus the debt guarantee.

MS. MARLA MURPHY: Nope, a hundred and forty (140) includes the debt guarantee, which was going to be my next little mathematical step.

When it's 1 percent or 100 basis points, that means that Centra is borrowing at 40 basis points over the Long Canada's plus the guarantee fee, correct?

MR. GREG MATWICHUK: Centra's borrowing -- if -- okay, and that's based on assumption, I'm not aware of the evidence on that. Do you -- can you point to me where that is in the evidence?

MS. MARLA MURPHY: I probably can, but if you'll take it, subject to check, we can probably go that way.

MR. GREG MATWICHUK: Okay, let's go subject to check. Yes, I'll take it subject to check.

MS. MARLA MURPHY: Okay, thank you. You're not suggesting that Centra, on a standalone basis, would be able to borrow at 40 basis points over the Long Canada, are you?

In other words, Centra's standalone borrowing would be something more than 40 basis points over the Long Canada's?

MR. GREG MATWICHUK: Centra would be more that 40 basis points, yes, over long -- thirty (30) year Government Canada bonds, yes.

MS. MARLA MURPHY: Are you familiar with Centra's response to PUB/CENTRA-40 that was filed in this application?

MR. GREG MATWICHUK: Do you mind if I turn it up?

MS. MARLA MURPHY: No, not at all.

(BRIEF PAUSE)

MR. GREG MATWICHUK: Sorry, we're just going to procure it somehow.

MS. MARLA MURPHY: That's okay.

MR. GREG MATWICHUK: Thank you. I have

it in front of me.

MS. MARLA MURPHY: What that Information Request provides is that Centra's view is that the interest rates applicable on a standalone basis would be approximately 165 to 185 basis points over the Long Canada bond rate.

Do you see that?

MR. GREG MATWICHUK: 165 to 185, I see that.

MS. MARLA MURPHY: Do you have any reason to dispute that?

MR. GREG MATWICHUK: Short term, long term -- I don't have any reason to dispute that at this moment, no.

MS. MARLA MURPHY: Thank you. If I could ask you to turn to your CAC Exhibit Number 7. In your column 4, absent acquisition, you've calculated a finance expense at fifteen two ninety-five (15,295).

MR. GREG MATWICHUK: Yes.

MS. MARLA MURPHY: Could you provide us with your calculations in that respect, please, and in particular, the interest rates that you used? You can undertake to do that through your Counsel.

MR. GREG MATWICHUK: I will do that, thank you.

--- UNDERTAKING NO. 19: For Mr. Matwichuk to provide the calculations and interest rates used in CAC Exhibit No. 7 for the finance expense calculated at 15,295.

CONTINUED BY MS. MARLA MURPHY:

MS. MARLA MURPHY: Thanks. I'd like to turn with you to your --

MR. GREG MATWICHUK: I'm just writing this down --

MS. MARLA MURPHY: Sure, no problem.

MR. GREG MATWICHUK: -- just so that I've got it, thank you.

MS. MARLA MURPHY: I'd like to turn with you to the discussion that you had about the financial integrity of Centra.

MR. GREG MATWICHUK: Are we done with PUB-40?

MS. MARLA MURPHY: PUB-40 we're done with, yes.

MR. GREG MATWICHUK: Thank you. Where would you like to go now?

MS. MARLA MURPHY: Well, I want to test

your memory to see if you recall a discussion that you and I had back in 2005/'06 at the GRA.

MR. GREG MATWICHUK: Testing my memory, oh, I'm not sure that's --

MS. MARLA MURPHY: Testing your memory.

MR. GREG MATWICHUK: -- a good exercise for me to undertake.

MS. MARLA MURPHY: We had, what I would call, a tug-of-war.

MR. GREG MATWICHUK: And this was '05/'06?

MS. MARLA MURPHY: '05/'06. I posed a question to you about the share capital of Centra on consolidation, and for those of you who want to turn up the transcript, it's at page 1487 through 1490.

You strongly advocated, at that point, that the consolidated views were not appropriate or relevant to that hearing. Do you remember that discussion?

MR. GREG MATWICHUK: Vaguely.

MS. MARLA MURPHY: Would you like to see the transcript or are we okay?

MR. GREG MATWICHUK: I remember we had a discussion about it, but I -- I can't recall the detail.

MS. MARLA MURPHY: Do you recall your --

your opposition to the suggestion that we should be viewing that on consolidation?

MR. GREG MATWICHUK: That we should be viewing what on --

MS. MARLA MURPHY: The calculation of Centra's shared capital. Maybe it will help if I just give you --

MR. GREG MATWICHUK: Yes, we -- no, no, I'm just -- our conversation was to the effect - and you can correct me if you have it differently - that the share capital should not be -- or at least it was my view that the share capital should not be viewed on a consolidated basis.

MS. MARLA MURPHY: Yes. You said consolidation has nothing to do with this hearing. And I asked about on consolidation and the Chairman actually came to my rescue and said it's a perspective; answer her question. You ultimately said:

> "On a consolidated basis, which is unrelated to this hearing then, I think I did acknowledge it earlier anyway that, yes, there would be an elimination."

Do you remember that?

MR. GREG MATWICHUK: No, I don't remember it, but I'll take it that you read from the transcript.

MS. MARLA MURPHY: Okay. Now, today, your evidence seems to be a little bit different. When we talk about the financial integrity of Centra, you suggest that it's appropriate for Centra to rely on Manitoba Hydro.

Is that correct?

MR. GREG MATWICHUK: That's incorrect. I don't believe I said that.

MS. MARLA MURPHY: Okay, then perhaps I heard you wrong.

MR. GREG MATWICHUK: Okay. Where would you like to go?

MS. MARLA MURPHY: In your consideration of the financial integrity of Centra --

MR. GREG MATWICHUK: Mm-hm.

MS. MARLA MURPHY: -- I understood you to say that you could -- that Centra could rely on Manitoba Hydra.

MR. GREG MATWICHUK: I think I said Centra is relying on Manitoba Hydro.

MS. MARLA MURPHY: And you accept that as appropriate?

MR. GREG MATWICHUK: The perspective was this, Ms. Murphy. Centra put its position to me in rebuttal that I was advocating the seventy-five twenty-five (75/25) which is not what I was suggesting. I tried to make this clear in direct, is that under seventy thirty (70/30), which is the current actual circumstances, Centra has a debt guarantee.

If it were to go to sixty forty (60/40), then it would be inappropriate for it to maintain that debt guarantee. That's the differentiation.

(BRIEF PAUSE)

MS. MARLA MURPHY: I'm going to turn to the O&A. You took issue today with the contingency that's in the operating and administration forecast.

MR. GREG MATWICHUK: Yes, Ms. Murphy.

MS. MARLA MURPHY: Can you tell me why you didn't take issue with it when it was a negative contingency for the past four (4) years?

MR. GREG MATWICHUK: And I think it was the -- the client had asked me about it this year and said is this an appropriate amount? And I'm -- and I'm -- so, for consistency, Ms. Murphy, is what I'm suggesting, is there a contingency for a positive or a negative amount should not exist.

MS. MARLA MURPHY: I thought I heard you

say today that you'd never seen this before. This was new to you.

MR. GREG MATWICHUK: Putting a contingency in for cost, yes.

MS. MARLA MURPHY: So, were you aware that it was in Centra's forecast in the previous four (4) years?

MR. GREG MATWICHUK: I can't say that I recall it offhand.

MS. MARLA MURPHY: You indicated that you used a CPI less productivity to benchmark an appropriate level of operating expense for Centra. Is that correct?

MR. GREG MATWICHUK: Bear with me here a second. In the -- in the baseline analysis you're asking me what inflation rate I used?

MS. MARLA MURPHY: No. I'm just asking you to confirm that the way you calculated it was CPI less productivity.

MR. GREG MATWICHUK: Okay. Just bear with me here a second. I believe the answer is correct. I just want to double check something, that's all.

Subject to check, that in response to CAC/Centra-19, that that is a CPI figure which I believe it is. I just don't have that in front of me right now

MS. MARLA MURPHY: Okay. Thanks. So if

wages and other cost increases exceeded CPI and the operating cost increases were in line with CPI, given the same service levels, would that also indicate productivity?

MR. GREG MATWICHUK: Are we talking about a forecast or an actual?

MS. MARLA MURPHY: Actuals.

MR. GREG MATWICHUK: So if act -- if it actually ended up that wages escalated greater than CPI and the forecast only included CPI for wages...

MS. MARLA MURPHY: No.

MR. GREG MATWICHUK: Well, okay. That's why I'm wanting to clarify exactly what the question is.

MS. MARLA MURPHY: If the actual results of O&A were in line with CPI and the wages had, in fact, increased more than CPI, would that indicate to you that there was an element of productivity already included?

MR. GREG MATWICHUK: Already included? That's what I'm having difficulty with. So let's walk through this. You're saying that on an actual basis costs increased overall equal to CPI?

MS. MARLA MURPHY: Yes, --

MR. GREG MATWICHUK: Okay.

MS. MARLA MURPHY: -- but wages increased more.

MR. GREG MATWICHUK: But wages increased more? Okay. So that tells me that we didn't forecast the wage increase that we had actually realized.

MS. MARLA MURPHY: Might it also tell you that you had forecast inflation and built in productivity?

MR. GREG MATWICHUK: No. No, it wouldn't. I mean, and -- and I guess this gets to -- gets to the issue of my evidence is that, Mr. Chairman, one (1) of the things that I focussed on in the evidence with respect to this issue is to say just like inflation as a forecast element and what costs are affected by inflation, so, we've identified a -- a particular rate, we should also identified a particular productivity rate associated with whatever costs are impacted by that productivity.

So it's not clear. It -- it could be that result. I -- I will say that but what I'm saying is it could be any number of other results because we have to link it back. We have to link the actual back to the forecast -- what was forecast.

(BRIEF PAUSE)

MR. GREG MATWICHUK: Because, Ms. Murphy, it could just -- it could just be an indication the forecast did not -- the actual didn't reflect what happened in the forecast. It doesn't necessarily mean productivity. When we're measuring productivity, we should measure forecast to forecast and actual to actual.

(BRIEF PAUSE)

THE CHAIRPERSON: I gather that what she's saying, in my simple line of thinking, is that if a cost item was a hundred dollars and general inflation was 5 percent in a year barring anything else she'd assume the number at the end of that year would be a hundred and five (105).

MR. GREG MATWICHUK: Okay. On a forecast basis, Mr. Chairman?

THE CHAIRPERSON: Yes.

MR. GREG MATWICHUK: Okay.

THE CHAIRPERSON: But during that point in time the largest part of the cost ended up being wages and you settled a wage contract that provided, you know, the normal grid rate increases plus collar or something and it ended up being 7 percent.

So all things being equal instead of a hundred, it would have been a hundred and seven (107), so, that sort of infers something happened to cut it back down to the hundred and five (105).

MR. GREG MATWICHUK: And -- and my -- my concern, Mr. Chairman, is yes, but we're looking at a very general scenario because it was overall costs.

There could have been an overall cost -- or a cost reduction in another element that was unanticipated, so, that's why I get back to my proposition that in the forecast, it would be much better to be able to track what the pro --forecast productivity, forecast inflation and then measure against what elements were intended to be higher or lower and then you'll -- you'll be able to determine whether we've got actual productivity or just forecast productivity.

So, Mr. Chairman, that could be the result, but it's not necessarily the result. There could be a number of other elements.

CONTINUED BY MS. MARLA MURPHY:

MS. MARLA MURPHY: I want to turn with you back to your Exhibit CAC Number 7. And I think I heard you say earlier today that synergy benefits in your column 4 could've been greater under a private owner; --

MR. GREG MATWICHUK: Yes.

MS. MARLA MURPHY: -- is that right?

MR. GREG MATWICHUK: Yes.

MS. MARLA MURPHY: The Board has heard and accepted expert evidence that due to the common customer base, and the geographic location of Manitoba Hydro, that we were in a unique position to capitalize on synergy opportunities.

And you've also heard the evidence, and the Board has accepted, that Centra and Hydro have successfully achieved synergies.

Can you give examples of where synergy benefits would have been equal to or greater than those achieved under private owner?

MR. GREG MATWICHUK: No, it's not something that I could -- I could do offhand and -- and clearly, that I'm -- if I understand your question, are you talking about synergies in another purchase acquisition?

MS. MARLA MURPHY: Well, I'm taking you back to the scenario you created. You've suggested that absent acquisition, the appropriate O&A is fifty-four nine (549), which is, in fact, lower than the cost of service and the rate base rate of return under Manitoba Hydro ownership.

You suggested that the reason that you did that was that because you could have had even greater synergies under a private ownership and I'm asking you what those might have been?

MR. GREG MATWICHUK: And -- okay. And given that this was a hypothetical example, I'll -- I'll give you a hypothetical reference, is that a -- an organi -- a private organization could have been more aggressive with respect to, for example, labour costs or an -- any other element, but labour cos -- and that's typically what would take place in -- in an acquisition because a -- a private organization being motivated by the profit element is going to say, how do we achieve our returns, how do we ach -- achieve our -- our profit and how can we cut back in our costs in order to achieve the greatest synergies possible?

So, there are any number of scenarios that -- that are possible in that and I -- and this, again, the context is hypothetical. They may have been greater; they may have been less.

MS. MARLA MURPHY: And the hypothetical that Manitoba Hydro used in Centra Exhibit Number 7 was sixty-five thousand, eight hundred and fifty-two (65,852).

MR. GREG MATWICHUK: 65 million.

MS. MARLA MURPHY: 65 million. Dropped a zero.

MR. GREG MATWICHUK: Or three (3).
MS. MARLA MURPHY: Yes.
MR. GREG MATWICHUK: And -- and, yeah, and that -- that is -- is a hypothetical and -- and I think --
MS. MARLA MURPHY: Are you aware of how Centra calculated that? Did you -- did you see that in the evidence?
MR. GREG MATWICHUK: I -- I don't have it in front of me, so I -- I don't recall.
MS. MARLA MURPHY: It's calculated in the -- essentially the same meth -- method as your baseline with productivity and inflation factors applied. And it arrives at sixty-five eight fifty-two (65,852).
You aware of that?
MR. GREG MATWICHUK: Is there a reference you can give me?
MS. MARLA MURPHY: It's in attachment 1 to the rebuttal.
MR. GREG MATWICHUK: Attachment 1 to the rebuttal.

(BRIEF PAUSE)

MR. GREG MATWICHUK: I have attachment 1.

MS. MARLA MURPHY: So given the hypothetical nature of the calculation, do you have any reason to dispute the calculation that Centra arrived at? Or certainly to suggest that fifty-four nine (549) is more appropriate?

MR. GREG MATWICHUK: I have no reason to believe that either/or are more -- more appropriate.

MS. MARLA MURPHY: Can I turn with you to the next item on that list. You suggested in your direct evidence today that the depreciation and amortization number might not have changed under another owner.

Are you aware that the Public Utilities Board had ordered that Centra undergo depreciation reviews every five (5) years?

MR. GREG MATWICHUK: I'm not familiar with that Order.

MS. MARLA MURPHY: Would you think that a prudent owner of a private company would undertake a review of depreciation from time to time?

MR. GREG MATWICHUK: Yes.

MS. MARLA MURPHY: So it's reasonable to suggest that that might have changed?

MR. GREG MATWICHUK: It's -- it's possible, yes, but also having -- being familiar with individual -- the depreciation studies, there are a lot of assumptions that go into that and there's a significant debate around those assumptions as between the depreciation consultant and its client.

MS. MARLA MURPHY: I want to turn with you to your suggestions with respect to presentation and rate increases.

THE CHAIRPERSON: Ms. Murphy, if you don't mind I have one (1) question --

MS. MARLA MURPHY: Certainly.

THE CHAIRPERSON: -- to follow up on yours.

Mr. Matwichuk, let's assume that your hypothetical situation was accurate and there was another owner that did cut the operating costs and didn't change the depreciation schedule so the costs were much lower.

On a standalone basis, how does it profit the owner?

MR. GREG MATWICHUK: How does it profit the owner?

THE CHAIRPERSON: Well, if the rate of return on rate base and equity is not altered and it's a standalone operation and whatever they paid for the company doesn't play into the feature and it's a regulated company, how does the owner profit by reducing the operating costs and the rate base?

MR. GREG MATWICHUK: Given the rates that are in place, Mr. Chairman, so if they are able to reduce costs with the rates in place --

THE CHAIRPERSON: You're assuming that the rates that were in place would remain?

MR. GREG MATWICHUK: That -- yes, in that scenario.

CONTINUED BY MS. MARLA MURPHY:

MS. MARLA MURPHY: I think I understood your evidence to be that it wasn't informative to express rate increases to customers as a percentage of their total bill; do I have that right?

MR. GREG MATWICHUK: Yes, it's -- I would suggest that it's of less information or -- or less value to a consumer, to a gas customer to receive a notice of rate increase on a GRA as a one (1) line item.

MS. MARLA MURPHY: You recognize that Centra's long-standing practice has to been report changes in rates on a bill-over-bill basis?

MR. GREG MATWICHUK: Yes, and that's on a bill-over-bill basis and also that is a longstanding practice but I -- that practice precedes the four (4) part bill and when you have a multi-part bill then a customer -- what a customer is looking for -- the customers have demanded a multi-part bill, so, they're interest -- they're interested in the changes, the rate of changes in each of those parts, otherwise, they would have been satisfied with a single part bill and, therefore, the single rate increase.

MS. MARLA MURPHY: You're aware that Centra's application, if it's approved by the Board, will result in changes in each of the four (4) components in their bill?

MR. GREG MATWICHUK: Yes.

MS. MARLA MURPHY: So you're suggesting that we report to customers four (4) different rate changes for each of the classes of customers?

MR. GREG MATWICHUK: The suggestion is that rather than Centra on its notice suggesting that there is one (1) average rate increase, there are rate increases for each part of the bill.

And -- and the reason being, as I mentioned in direct or one (1) of the reasons specifically, is that the -- the one (1) line rate increase per year assumes that that rate increase will be in place for the year. That's what the -- that's what the customer -- the information that they get but as we've talked about, the cost of gas is going to change and that rate increase could fluctuate significantly because of the significant fluctuations in -- in the cost of gas.

MS. MARLA MURPHY: That's still true with what you're suggesting; isn't it?

MR. GREG MATWICHUK: Yes, it is still true but when you can segregate out the non-cost then the customer has a better indication of what -- the -- the parts of the bill that are going to fluctuate and the parts that won't fluctuate or won't fluctuate as much.

MS. MARLA MURPHY: Well, I guess that's where the difficulty lies is that when Centra makes this rate change, it changes each of the -- the rates: primary gas, supplemental gas, transportation and distribution rates.

So what you're suggesting, as I understand it, is that we would show a table of bill impacts with four (4) different rate changes for each customer class and -- and if you did it on the five (5) main customer classes, we'd have a chart with twenty (20) different rate impacts; is that what you're suggesting?

MR. GREG MATWICHUK: I'm suggesting that that would -- that would provide more information but it's -- what I'm saying to you is that the single rate change that is provided in the -- the formal application at the front of the GRA filing does not provide any valuable information to a party because they know it's going to change and they know -- and the other significant element is that it doesn't reflect the changes being requested in terms of the operations, the distribution component.

MS. MARLA MURPHY: CAC/MSOS filed evidence of Mr. Stauft in the competitive landscape proceeding, which says, in part:

"What concerns people in their daily lives is money and how much of it they have to pay. Any suggestion that customers would care about rate volatility, so about the stability of one number in a complex calculation that they probably only vaguely understand more than they care about the stability in the bottom line number that they have to pay is absurd on its face."

Are you aware of that evidence?

MR. GREG MATWICHUK: No, I'm not.

MS. MARLA MURPHY: How do you reconcile that with your position?

MR. GREG MATWICHUK: I -- I don't know how he arrived at that conclusion and what I'm said --

suggesting to you is that the reason customers wanted a multi-part bill was so that they could view the changes in those multi parts in terms of the different responsibility.

There's a commodity component, essentially, and then there's a cost of operations component and they -- they've requested that -- that change so they can -- they can see how their bill is affected by the different parts.

(BRIEF PAUSE)

MS. MARLA MURPHY: Thank you, Mr. Matwichuk, thank you, Mr. Chair. Those are our questions.

THE CHAIRPERSON: Thank you, Ms. Murphy.

MR. GREG MATWICHUK: Thank you, Ms. Murphy.

THE CHAIRPERSON: Mr. Peters...?

CROSS-EXAMINATION BY MR. BOB PETERS:

MR. BOB PETERS: Thank you. Good afternoon, Mr. Matwichuk.

MR. GREG MATWICHUK: Good afternoon, Mr. Peters.

MR. BOB PETERS: Mr. Matwichuk, your evidence is to suggest to the Board that the concept of a fair return is a complete and separate issue from the no harm principle; am I correct?

MR. GREG MATWICHUK: Yes.

MR. BOB PETERS: You don't want them to be linked in any way; would that be correct?

MR. GREG MATWICHUK: No, I don't think that's correct to be linked in any way because I think I -- what I say in my evidence is that if you had an excessive return, that could be an indicator of no harm.

I don't -- I think it's the opposite that maybe we'd -- we would say that there's -- there's not a link.

MR. BOB PETERS: That last answer puts -- so I understand it, Mr. Matwichuk, would suggest that there could still be no harm, but the return would be excessive, that's -- that's one (1) --

MR. GREG MATWICHUK: Yes, that's correct.

MR. BOB PETERS: All right. Now let's take, please -- let's stick with CAC/MSOS Exhibit 7 and have a -- a quick run at that and I'll try not to duplicate the points that my colleague, Ms. Murphy, attended.

You set out in column 1 of that Exhibit

7's CAC/MSOS, Mr. Matwichuk, a reproduction of Centra's cost of service application, correct?

MR. GREG MATWICHUK: It's a direct duplication of Centra Exhibit 7.

MR. BOB PETERS: Which you understand to be in column 1 their cost of service application.

MR. GREG MATWICHUK: Yes, that's my understanding, sir.

MR. BOB PETERS: And I'm going to go down the list with you, sir, and I'm thinking you're suggesting to this Board that it sharpen its pencil and make three (3) adjustments to that.

The first is, on operating and administration you -- you've recommended the Board remove $1.7 million from that $56.6 million number, correct?

MR. GREG MATWICHUK: Yes, that's correct.

MR. BOB PETERS: And that's the contingency that you and Ms. Murphy talked about.

MR. GREG MATWICHUK: That's correct.

MR. BOB PETERS: If -- if you were aware in prior years, speaking of hypotheticals, Mr. Matwichuk, that Centra has had a negative contingency in their O&A costs, you would have made the same recommendation in those years as you are this year, which is, don't include a negative contingency.

MR. GREG MATWICHUK: Yes, one (1) must hold to symmetry of that principle.

MR. BOB PETERS: All right. And even if the symmetry of that -- even if that negative contingency was as a result of a corporate mandate to find efficiencies or find synergies, you would not think it proper included in the O&A forecast?

MR. GREG MATWICHUK: The hesitation I'm having, sir, is that what I had talked about in -- in terms of the O&A productivity is that we should identify individual areas where we expect to have productivity and what the productivity factor was.

But I'm not ab -- so I'm not objecting to the opportunity to try to track -- to find and to track productivities, but if it's just one (1) -- one (1) -- just a single number, then I would say there's uncertainty about that -- sufficient uncertainty about that number to not include in the forecast.

MR. BOB PETERS: I take from that answer that if -- if the negative contingency was simply because there was an expectation, but unidentified as to where the synergies would show up, you think it would -- it should not be included in the O&A expense.

MR. GREG MATWICHUK: Yes, I thi -- I think a regulated utility should attempt to identify all of the elements where there is a forecasted amount.

MR. BOB PETERS: And if there is imprecision in the forecasting of the budget, you should eliminate the identified imprecision?

MR. GREG MATWICHUK: Oh, absolutely, you should identify the -- the imprecision.

MR. BOB PETERS: Now, in terms of fairness, Mr. Matwichuk, if Centra has for a number of years had a negative contingency in their O&A and they've been held to that or measured against that, and you're now made aware there's a positive contingency number, would fairness indicate that maybe there has to be some balancing out over the next short while?

MR. GREG MATWICHUK: Well, I guess, Mr. Peters, the question is -- is when do you adopt the principle and I think that's what we have to abide by is -- is what the -- what is the principle and -- and hold parties to the principle.

And in -- in my view, when I see an unidentified forecast item, I'm suggesting that it's not an item that should be included in the forecast. I -- I'm not sure -- are -- Mr. Peters, how you would go about determining when we've turned the corner on that.

MR. BOB PETERS: Okay. I have -- I have that point, but in the event the budgets were set at a time when the -- the divisions were not certain as to what they would end up with, does that allow you to say, well, the timing issue here of de -- deriving the budgets has lead to this need for a contingency and, therefore, maybe the numbers that come to the Board should be revised closer to the rate hearings rather than at the time they're filed closer to the budgeting times?

MR. GREG MATWICHUK: So did I understand you as once -- at the time of filing if there's uncertainty should there be an update closer to the -- the hearing process or during the hearing process?

MR. BOB PETERS: You can -- yes, start with that question.

MR. GREG MATWICHUK: I was glad I could ask your question.

So, yes, I mean, this is -- this is not uncommon for -- for forecast to be updated and one -- once there become better information. For example, in -- in other jurisdictions that I've worked in and are familiar with, when an organization has filed for a particular year they don't typically have the actual amounts for the immediately preceding year.

But by the time the hearing rolls around, those actual amounts are available and are typically made available and those cannot actually be very valuable in assisting both the utility in determining whether their forecast is appropriate and all interested parties including the Board.

MR. BOB PETERS: Well, and that's essentially what we have as well here with Centra, don't we, Mr. Matwichuk, where we have their '07 fiscal year forecast, but those have not been publically made available on a actual basis yet, in this jurisdiction?

MR. GREG MATWICHUK: That's my understanding, yes.

MR. BOB PETERS: In the event that the -- the budget becomes finalized in early 2008 or after this hearing has already taken place for the test year, how should the Board deal with -- with any changes in the final budget compared to what was presented in the filing?

MR. GREG MATWICHUK: Okay. Well, I -- sorry, budget for what year are we talking about?

MR. BOB PETERS: Well, let's -- let's take it back without -- let's talk about the -- a test year.

And the filing is made in advance of the test year and we won't get caught up too much in the facts of this one, but the Board looks at the information and then the budgeting for the test year is -- is firmed up or made final after the Board holds its hearing.

Should there be time for an adjustment to that? Or does the company have to live with what they filed?

MR. GREG MATWICHUK: Okay. Well, typically the budget is set in advance of the beginning of the test year and so by the time that you're into the hearing, if you are into the test year, the budget would have or should have been finalized. So I'm -- I'm kind of struggling with this set of circumstances you're providing me because I think on a practical level the budget would have or should have been -- been finalized prior to a hearing.

In -- in the -- particularly when you've got a -- a two (2) test year situation, I'll try to stay away from the facts of this hearing as you've asked me to.

But typically, the -- the process is into the first test year and so you -- you have your budget complete and, you know, signed off by all the appropriate levels into the hearing at some point, whether it's the time you file, which is often the case, or between the time you file and the time of the hearing and -- and adjustments are made.

And also, as I mentioned, you will

typically have actuals from the prior year and -- and regulators typically want to see those -- those numbers to assist them in their -- their efforts.

MR. BOB PETERS: Okay, thank you, and then I have your -- your other points on -- on the timing issues and the revisions.

So Mr. Matwichuk, going down column 1 then on CAC/MSOS Exhibit 7, in this filing before the Board you've taken no issue with the actual depreciation expense being requested by way of the updated depreciation study and the additional depreciation on the increase in plant.

MR. GREG MATWICHUK: Yeah, I was not asked to look at depreciation costs.

MR. BOB PETERS: Okay. And capital and other taxes, you're not taking issue with?

MR. GREG MATWICHUK: No, I'm not.

MR. BOB PETERS: And likewise, on income tax, you're not taking issue with that?

MR. GREG MATWICHUK: I believe that income tax is a annual amortized amount that's been approved in a prior calculation.

MR. BOB PETERS: And that amortized amount was because of a one (1) time tax liability that accrued to Centra as a result --

MR. GREG MATWICHUK: That's right, yeah, yes.

MR. BOB PETERS: -- of being purchased by a Crown corporation?

MR. GREG MATWICHUK: That's my understanding, sorry for interrupting.

MR. BOB PETERS: All right. So -- and no issue was taken by you with that?

MR. GREG MATWICHUK: That's correct.

MR. BOB PETERS: And when we get to finance expense and return on debt or the finance expense under a cost of service model, you're satisfied in this -- in this instance that that's appropriate and reasonable?

MR. GREG MATWICHUK: I wouldn't jump to that conclusion. I -- I -- I looked at the -- the -- the cost of debt and here -- here's my difficulty with the cost of debt. And again, it comes down to evidence, Mr. Peters, and -- and Mr. Chairman, is I don't believe what we've seen is -- is the full detail of the cost of debt.

And -- and -- and I'm not suggesting that there's anything wrong with it, just that we haven't seen it. It's a bit of a black box -- is that -- my understanding is that the Province of Manitoba goes out to the market. The Province of Manitoba is one (1) that procures the debt from the marketplace and then provides that debt to Manitoba Hydro and includes a debt guarantee fee.

And then Centra obtains its debt financing from Manitoba Hydro. What's not clear or in the evidence is what debt issues are being mirrored down to Centra or at what -- at what debt rates. So in other words, Centra's debt, whatever tranche or issue that we're talking about, what it -- what issue or tranche is it linked to above that that the province went to the market on and -- and charged on top of that the provincial guarantee fee.

So we're not seeing that and a concern of -- customers could be is, is there some kind of markup in there. I'm not suggesting that there is, it would just be good to be able to see that -- that debt being mirrored down and how that takes place.

There -- there is -- there are debt issues, but what we're not seeing is the corresponding debt that was issued in the marketplace.

MR. BOB PETERS: All right, just so I'm following your thought, you're familiar, and I think Ms. Murphy even asked you about PUB/CENTRA-40 where the debt issues and the -- the underlying term sheets were brought forward.

Your suggestion now is the Board might want to just look behind those term sheets and see if it can match up with what -- with what the Province of Manitoba has gone out for.

MR. GREG MATWICHUK: Yes, sir.

MR. BOB PETERS: All right, I've got your point on that.

Ms. Murphy, I think, has asked you in a polite way to -- to substantiate that absent acquisition, the debt costs would be significantly lower than they are under cost of service. Did you understand that to be her undertaking to you?

MR. GREG MATWICHUK: Yes, she gave me an undertaking to provide the calculation of that.

MR. BOB PETERS: All right, and -- and because what your point is to the Board here is, it looks likes Centra is paying above the market price for debt; that's a suggestion that could be taken from your evidence.

MR. GREG MATWICHUK: Yes.

MR. BOB PETERS: But you have nothing to substantiate that in terms of being the fact compared to --

MR. GREG MATWICHUK: Well, perhaps I can provide that in the undertaking.

MR. BOB PETERS: Okay, I -- I'm just asking, do you have -- do you also recognise in your undertaking, or will you, that Centra has to put their stake in the sand at some point in time and go out to the market for their debt; correct?

MR. GREG MATWICHUK: Right, right.

MR. BOB PETERS: And when they acquire debt, it's -- it may be a very long term debt.

MR. GREG MATWICHUK: Mm-hm.

MR. BOB PETERS: And long term debt will come at a cost and that cost will reflect the -- the term of -- over which the debt has been secured.

MR. GREG MATWICHUK: That's right.

MR. BOB PETERS: And if Centra a couple of days later finds something cheaper on the market through the good efforts of their treasurer, they may want to revise their debt, but they may have to take into account there'd be a penalty?

MR. GREG MATWICHUK: Right.

MR. BOB PETERS: And did your calculation take into account the term sheets of Centra compared to what you say would be available, recognizing there may be penalties involved or otherwise?

MR. GREG MATWICHUK: No, that wasn't specifically taken into consideration.

MR. BOB PETERS: Do I suggest then what you did is, you said, well, here's Centra's debt, if I ran down to the bank today I could get it at this interest rate which is lower than what Centra is presently paying and, therefore, they're overpaying?

MR. GREG MATWICHUK: The consideration was what long-term Canada's currently exist and what the -- the spread would be over Long Canada's for a stand-alone operation such as Centra's.

MR. BOB PETERS: And that -- that -- what spread did you assume? Well, I guess Ms. Murphy asked you that question, that she suggested to you what it -- what it might be on a stand-alone basis?

MR. GREG MATWICHUK: And I think it was a hundred and sixty-five (165) to a hundred and eighty (180), was -- was that?

MR. BOB PETERS: One sixty-five (165) to one eighty-five (185), yes.

MR. GREG MATWICHUK: One sixty-five (165) to one eighty-five (185), yeah. Okay.

MR. BOB PETERS: There's a suggestion in that same PUB/CENTRA-40 question, Mr. Matwichuk, that on a stand-alone basis, Centra would have a BBB bond rating? On li -- on line 8 of the response.

MR. GREG MATWICHUK: In worst-case

scenario, I would agree with that.

MR. BOB PETERS: Okay.

(BRIEF PAUSE)

MR. BOB PETERS: Okay. When you made assumptions as to what the -- the interest rate would be on a Centra debt, did you use the same BBB assumption?

MR. GREG MATWICHUK: Yes.

MR. BOB PETERS: Okay. And what about the debt:equity ratio, what were you -- that in -- that in -- that included a BBB assumption on a -- what debt:equity?

MR. GREG MATWICHUK: Sixty/forty (60/40).

MR. BOB PETERS: Sixty/forty (60/40). Thank you. And the -- the next line item and I want to go down, it's called corporate allocation in column 1.

It's your recommendation of the Board that that $12 million number be revised to $10.5 million; have I got that right?

MR. GREG MATWICHUK: What I'm suggesti -- yes, I mean, the answ -- the short answer is 'yes' and -- and the reason that I'm suggesting that, Mr. Peters, is that as I understood the Board's -- the -- the Board's decisions in 135/05, is that there should be a limit as to what the return should be, whether it's in cost of service or rate base rate of return.

And that limit was measured by the combination of net income and the corporate allocation in cost of service. In the rate base rate of return side, it's the amount that was determined under -- under return -- sorry, a return on equity that arises from the formula. So if we're sticking to the principle than that's -- that would be the result.

If we're dealing with a set of numbers and to take your, Mr. Peters, your line of questioning in terms of what was and what is, the rate of return that resulted from the formula back when Centra was owned by West Coast, was much higher than it would be today under the formula.

MR. BOB PETERS: And -- and what was determined when there was private ownership was the high watermark that you've referenced in your materials and that was the 14 to $16 million range, under the assumptions the Board used in the last GRA order.

MR. GREG MATWICHUK: Yes, I think the -- the high watermark was, as -- as I understood the decision, the high watermark was the return that resulted under rate base rate of return methodology which is using the -- the Board's formula and back in 1998 that happened to be 12 to $14 million.

MR. BOB PETERS: And now, if you -- and I'm Mr. Saxberg -- or I'm not sure he'd -- if he has available the book of documents that -- that was prepared when I was asking questions of witnesses, at tab 10 and 11 of that book of documents, I have reproduced schedules 5.9.3 and 5.9.4 dated May 15th and down to line 12 and follow it across, the return on equity that you say now should set the highwater mark is $10.5 million for the first test year and 11 million for the second test year.

MR. GREG MATWICHUK: Yes, that's what the evidence states.

MR. BOB PETERS: And therefore, when I go down column 1, when we get down to the net income line, that number, you suggest to the Board, should be reduced to zero?

MR. GREG MATWICHUK: Yes, that is --

MR. BOB PETERS: And you say that for two (2) reasons: one (1) is because it -- it -- if you add that to the corporate allocation of $10.5 million, it's an excessive return; and secondly, you say that it's not needed as net income because the Corporation is already at a seventy/thirty (70/30) debt:equity ratio.

MR. GREG MATWICHUK: And has the protection of the debt guarantee for which the ratepayers are paying.

MR. BOB PETERS: Thank you.

MR. GREG MATWICHUK: And that's all under the cost of service methodology.

MR. BOB PETERS: Thank you. Before I turn away, I may have -- I may have given you a wrong indication on PUB/CENTRA-40. When I asked you what, in your study, to get column 4, absent acquisition, finance expense/return on debt would be, I understood your evidence to be that you assumed a sixty/forty (60/40) capital structure.

MR. GREG MATWICHUK: That's correct.

MR. BOB PETERS: And I should make you aware that on reading PUB/CENTRA-40, the Corporation may have had a different assumption of the existing and current capital structure and came -- which you've told the Board in your view is seventy/thirty (70/30) on a standalone basis.

And if that gives a significant concern for your -- or a matter for your undertaking, please take that into account. I wanted to bring that to your attention.

MR. GREG MATWICHUK: So am I to understand that PUB-40 -- and -- and I will check into it, but PUB-40 may assume a seventy/thirty (70/30)? Or it's based on -- sorry, it's based on actual seventy/thirty (70/30) debt:equity?

MR. BOB PETERS: Yes, in terms of the -- you can take that as an assumption. I don't know that My Friend opposite would disagree when they answered the question if that was a different assumption made, but the question asked, for the interest rates applicable to Centra on a standalone basis given its current capital structure for short-term debt and long-term debt.

And I didn't want to mislead you with my questioning to suggest that it was necessarily the same assumption you had made.

MR. GREG MATWICHUK: Right and --

MS. MARLA MURPHY: I'm sorry to interject, but I just would like to be clear. I hope that that didn't just modify the undertaking that have, which is to have the absent acquisition calculation demonstrated to arrive at fifteen two ninety-five (15,295).

MR. BOB PETERS: I certainly wouldn't mess with your undertakings, Ms. -- Ms. Murphy and -- and -- and I -- and I -- I don't want to change it. In fact, I want the same answer to the undertaking because it's a question that I see here, as well, that I'd be -- the Board would like to know how you get to your number compared to where they are.

MR. GREG MATWICHUK: Right and I -- I'll provide all the -- all the details as requested.

MR. BOB PETERS: All right, thank you for that.

CONTINUED BY MR. BOB PETERS:

MR. BOB PETERS: In the column 1 that we've just gone down, Mr. Matwichuk, you've given me the suggested revisions to the Board. If we turn to column 2, the only item I want to speak to there is in Centra -- sorry, on CAC/MSOS Exhibit 7 down at the corporate allocation line in column 2, you removed the $12 million that had been included by Centra under their rate base rate of return calculation; am I correct?

MR. GREG MATWICHUK: Yes, that's correct and that's a -- that's consistent with what was demonstrated in my evidence on -- in appendix 1 and I will just double-check -- table 3.

MR. BOB PETERS: And I'm familiar with your -- with your evidence on that point.

But, the -- the reason that I understand and the Board should take from why you removed the $12 million is -- your answer was, it was consistent with regulatory principles and you are suggesting those are the principles that the Board established at the last General Rate Application for the company?

MR. GREG MATWICHUK: I think it's the principles that the -- if -- with all due respect, the principles that the Board adopted because they are longstanding regulatory principles in terms of a fair return and excess return.

MR. BOB PETERS: All right, let's not quibble about who gets credit for the -- for the principle, but -- but it's -- -- your -- your suggestion to the Board is that the $12 million should be removed from that column number 2, ostensibly because it's -- you can -- sort of double counting last time you were here and you take the same view this time?

MR. GREG MATWICHUK: It's -- it's an excessive return and effectively, just to go through the overa -- high level mechanics that the 12 million plus the 10.5 essential -- and -- or the 11 and I averaged -- I averaged it to 11 resulted in a $23 million return amount and this is what -- this is where I think the Board came into it in terms of establishing the principle, is saying that it rec -- clear recognition that the corporate allocation is a return amount.

So the corporate allocation being a return amount of 12 million plus the return on equity of approximately 11 million would give you a return of 23 million and 23 million would be excessive whether you measured it on -- in terms of dollar value or return and that return would end up being around 17-1/2 percent.

MR. BOB PETERS: Mr. Matwichuk, in your column 2 of CAC/MSOS Exhibit 7 -- and you've removed the $12 million, what you're also removing then and not asking the Board to consider is -- or are the benefits that Centra has received as a result of the acquisition by Manitoba Hydro.

MR. GREG MATWICHUK: Sorry, are we -- we're in column 2?

MR. BOB PETERS: Yes, sir.

MR. GREG MATWICHUK: And we're talking about benefits?

MR. BOB PETERS: Well, we're talking that you've removed the $12 million corporate allocation and you want to leave behind whatever benefits accrued to Centra and leave them reflected in the O&A costs or wherever else they're demonstrated in the -- in the numbers?

MR. GREG MATWICHUK: Yes, the -- the rate base rate of return is a regulatory construct to determine just and reasonable rates and -- and part of that construct is the assumption of stand-alone. Standalone and -- and also of -- of no harm.

You take all those principles together under rate base rate of return the purchased utility is not responsible for any of the acquisition components whether they're synergies or whether they're a -- acquisition costs and it's whatever costs are reasonable under the circumstances and -- and that is in shar -- sharp contrast to the cost of service which is an integrated approach.

MR. BOB PETERS: Thank you, Mr. Matwichuk. I've got your point on that and would like to turn to O&A matters. In your baseline analysis, you started with a figure of approximately $49.3 million, do I have that right?

MR. GREG MATWICHUK: Yes, sir, that's correct.

MR. BOB PETERS: Do I also have it correct that you accept 49.3 million as an appropriate O&A level for -- for Centra at the time it was established in 2003/'04?

MR. GREG MATWICHUK: Again, sir, I was -- I -- this time I was truly taking guidance from the Board and the Board had established that as its baseline. And the context around that was, previously it had trouble establishing a baseline and then it had, for its first opportunity to determine what O& -- O&A would be under the allocation methodology for O&A, and it determined when it looked at that O&A amount of forty-nine point three (49.3), Mr. Peters, that you put to me, they compared that to the 1998 O&A and they -- and it was forty eight (48) point something, but very close, and that was that 1.3 percent that I was talking about, over five (5) years.

And so the Board, as they articulated, took comfort in that very low increase over five (5) years and said, you know, the allocation methodology is what it is, it's a leap of faith, were the Board's words, and -- and but becau -- they took comfort in the very minimal increase.

So in -- in doing this baseline work, the reason I was charged with doing it, well one (1) of the reasons, was that in two (2) very short years we have a much larger 8 percent or a much larger increase anyway. I think it's more like 7 percent in the O -- in the O&A. And as -- as a result one -- one has to be more diligent and so that was -- that -- but that was the -- the context back then and -- and as a result the Board said, okay, we've -- we've done this examination. We now go forward using this as a baseline to evaluate O&A in future test years.

MR. BOB PETERS: Do I take from your evidence, Mr. Matwichuk, that rather than work from a baseline you'd like to look behind Centra Gas and look at the books, if I could, of Manitoba Hydro and you'd like to see where these costs are incurred in the first place and you'd like to follow them through the internal integrated cost allocation process of the -- of the combined Utility?

MR. GREG MATWICHUK: You used the word "prefer" so what I'm suggesting to you, sir, is that there's no evidence to indicate how the -- or there's insufficient evidence as to how the allocation methodology works. So what I'm suggesting is that we take the top dollar amount that comes out of Manitoba Hydro and then do a discovery -- adequate discovery process on how those numbers work way -- all the way down to Centra through the allocation mechanism.

So in other words, what -- what dollar amount was attributable to Centra, what dollar amount was attributable to Manitoba Hydro, but what -- what drivers were used and how they were applied to each -- to the cost items.

And the reason I'm suggesting that is I'll -- I'll give you an analogy and I think I mentioned it in the -- in the IR response is that the -- what we do have as a very good set of evidence is the cost allocation study that's used for rate design purposes.

We start with the revenue requirement at the very top end. The revenue requirement is then broken down on a cost allocation basis to all the various customer classes and then there's rate design from there. Centra describes how that process works and then they provide us all the tables to show how -- to -- to demonstrate how that process works.

And so my suggestion is the analogy should be analogous. In terms of the cost allocation of O&A we should see the top number and I'm not looking -- I'm not suggesting that we need to necessarily evaluate the -- the Manitoba Hydro number but we've got that number, then how do we move from that number to the Centra result?

MR. BOB PETERS: Is there a way to do that, Mr. Matwichuk, through the external auditors attesting to the process as being reasonable and fairly allocating the cost to the Gas Company?

MR. GREG MATWICHUK: There may be, and I emphasize "may".

And -- and one (1) reason is -- is do we -- who do we get involved? What are the objectives and what result are we -- what -- what form of result are we looking for? And -- and I'll -- if I may I'm going to give you another analogy in that regard is that I'm involved in some collaborative processes where the Board had concerns about affiliated costs that were being borne by utilities and the Board said, well, they had a conundrum because they said we can't go in and look at the -- those affiliated costs but we can have an -- an external party do that.

So what we've done is we've engaged a benchmarker. But the benchmarker is not taking directions strictly from the Utility. And this is a very important point. It's a collaborative process. We have a collaborative process committee to whom the benchmarker reports and so the collaborative process committee set out the terms of reference.

The terms of reference to any audit or report on financial items is absolutely critical and I mean no disrespect to any particular audit firm but independence is absolutely essential in -- in this -- this type of work -- who you get your instructions for -- from, who pays the invoice, who -- who's involved in setting the terms of reference, how the terms of reference are set?

So it's -- it's -- very often regulators can say, oh, well, let the auditor do this, but some regulators have discovered that that's not necessarily a good idea is saying, okay, let's decide on what the terms of reference are and -- and the rest of the process to make sure that we get the result that we're looking for so that we're after the -- sorry, after the fact we're not questioning the terms of reference or how the report was put together but we've got a great deal of assurance that that kind of engagement can be done fairly appropriately, independently, with transparency.

MR. BOB PETERS: From that answer, Mr. Matwichuk, do I take it then that if -- if the Board is persuaded that how the dollar amount gets allocated internally through Manitoba Hydro's internal allocation of O&A costs system is to be reviewed, then you're saying there should be some collaborative process established so that the ground rules are set and then results are available to everybody?

MR. GREG MATWICHUK: Generally speaking that's right. And -- and I'll give you an example. It was -- I -- I won't use their name but there was a particular big four (4) firm that had provided a report through Manitoba Hydro to this Board -- or through Centra to this Board and it included an examination of synergies. It included an examination of the -- of the allocation methodology and, Mr. Peters, the Board ruled that that report was of little or no evidentiary value.

MR. BOB PETERS: And that is your suggestion that if -- if there isn't some collaborative process to establish the -- the -- what needs to be looked at it may lead to results that aren't meaningful?

MR. GREG MATWICHUK: That's correct.

MR. BOB PETERS: All right. And in the particular case of the O&A costs, in terms of those collaborative processes, would it be the stakeholders that would generally be interested in the Centra GRA who would be -- who would be involved?

MR. GREG MATWICHUK: That would be my recommendation, yes, sir.

MR. BOB PETERS: And the scope of their analysis would be to follow the O&A costs through the -- through the system and -- and get a working document that would help understand -- help parties understand how it works?

MR. GREG MATWICHUK: A working document but there would also have to be a process in terms of selection of the party who would conduct that examination and what information they wanted in the report in advance so that they -- they weren't lacking at -- at the end stage.

MR. BOB PETERS: Mr. Matwichuk, can you tell this Board or indicate whether you can provide them examples of scope and procedures that would be utilized in such an analysis?

MR. GREG MATWICHUK: I can -- I can do two (2) things in that regard, I think, that might be helpful and you -- you can -- you can guide me on that but I can provide you how I think a scope might look and -- and it would be subject to everybody's input.

I'm not suggesting it has to be a certain way, but I can also provide you what's on the record in another jurisdiction as -- as to what a terms of reference looks like for a significant engagement like this.

MR. BOB PETERS: Well, I'll ask you to do that. I can't tell you whether it's going to have any --

MR. GREG MATWICHUK: Right.

MR. BOB PETERS: -- value to the -- to -- to my client but since you've offered, I'm going to take you up on that offer, Mr. -- Mr. Matwichuk, and ask that by way of an undertaking through your counsel to provide that information to the Board.

--- UNDERTAKING NO. 20: For Mr. Matwichuk to provide an example of scope and procedure

CONTINUED BY MR. BOB PETERS:

MR. BOB PETERS: And while you're scribbling that, Mr. Matwichuk, you were very circumspect in not circling a productivity factor that you felt would be appropriate for this gas utility on Table 4 of your evidence page 16 of 32.

And when pushed, what productivity factor do you think is appropriate for Centra Gas or are you -- don't you have sufficient information to give that advice to this Board?

MR. GREG MATWICHUK: I have not done a rigorous evaluation of the productivity factors within Centra, however, what I have seen is that or I -- I understand from Centra's evidence is that I believe it's a 1 to 2 percent productivity factor that Centra can or has -- has been able to achieve and -- and I look at the productivity factors that are achievable in other jurisdictions and the -- those kinds of productivity factors look achievable by Centra.

Now, one (1) of the concerns I have is that productivity does not appear to be present at all in the second test year, the '08/'09 because as I understand it the O&A -- and I'm speaking strictly of O&A -- all of the O&A amounts were simply escalated by 2 1/2 percent from one (1) year to the next, so by definition, there doesn't appear to be a productivity factor in there.

MR. BOB PETERS: Okay, I'll -- I won't press further because I'm -- I understand your point and I think the Board understands how you've taken that position.

On the issue of capitalized O&A costs, in my quick summary, you were critical, and I think in your direct evidence to Mr. Saxberg, you were saying you -- you couldn't accept or challenge what they've done because you needed more information and that was basically what you said to the Board so far.

MR. GREG MATWICHUK: Yes, sir.

MR. BOB PETERS: And with the rebuttal evidence from the Corporation explaining that some of the information that may have been looked at may have been misinterpreted because there was no labour costs included in the pre-acquisition years; did that assuage your concerns or allow you to accept the capitalized O&A as being reasonable?

MR. GREG MATWICHUK: I -- I think it was helpful; however, I don't think it reduces my motivation to get the addition information to be able to confirm or challenge the number. So I -- I -- I'm not -- I'm not persuaded to -- to suggest that that number is -- is reasonable, to answer your question.

MR. BOB PETERS: And you're also not -- not here telling the Board that it's unreasonable.

MR. GREG MATWICHUK: That's correct.

MR. BOB PETERS: And what you're saying to the Board is that in the PUB/CAC/MSOS Information Request that was posed of you, you set out the additional types of information that you believe would be helpful before you could come to a conclusion whether the capitalized O&A was acceptable or in need of challenge.

MR. GREG MATWICHUK: Yes, I think that accurately reflects the direct.

MR. BOB PETERS: All right. On weather normalization, have you any issues with the Corporation's use of a ten (10) year normalization cycle?

MR. GREG MATWICHUK: No, sir, I do not.

MR. BOB PETERS: Is that the standard being used in other utilities with -- with which you are familiar?

MR. GREG MATWICHUK: It varies, but it's -- it's not unusual.

MR. BOB PETERS: And you're now satisfied that the Corporation has acknowledged on the record that -- that it does not seek relief for weather induced losses?

MR. GREG MATWICHUK: I -- I haven't seen

the -- I -- I got the impression that that -- that was the case, but I haven't seen the transcript myself.

MR. BOB PETERS: Okay, thank you.

MR. GREG MATWICHUK: And so I -- I -- I would agree with that position if -- subject to check.

MR. BOB PETERS: On the issue of the capital structure and what should be the target, I'm -- I'm not clear as to whether you accept seventy-five/twenty-five (75/25) as an appropriate target for the wholly owned subsidiary of Manitoba Hydro.

MR. GREG MATWICHUK: Yes, now this was a -- a target, just to be clear, this was a target that was set by Manitoba Hydro. What I'm not aware of is the evidence for the reason for that particular target, so I'm unable to draw a conclusion as to whether the seventy-five/twenty-five (75/25) is appropriate.

MR. BOB PETERS: And even if you were told that the 25 percent equity for the parent company was to take into account the various risks that the Corporation faces, you wouldn't be able to tell whether 25 percent was appropriate unless you analyse the risks and maybe even quantified them.

MR. GREG MATWICHUK: Yeah, I'm -- I'm not convinced that a -- an equity component as low as twenty-five (25) would be within a reasonable range. The seventy/thirty (70/30), with a debt guarantee is probably closer to a -- a reasonable range.

And -- and -- and just to contrast that further, the sixty/forty (60/40), without the debt guarantee fee on a -- on a debt guarantee itself is likely more appropriate. So I think we have to sort of draw the distinctions in the scenarios.

MR. BOB PETERS: And until we get into a drag them out hearing on that matter, yours is just off the -- off the cuff observation based on this utility.

MR. GREG MATWICHUK: No, I think it's -- it's more than off the cuff, sir. Is that when I look at the -- the debt equities of other gas utilities, other gas LDC's across Canada where -- and -- and Centra's previously approved debt equity and -- and I think more importantly, Mr. Peters, is that the -- Centra itself has confirmed that the business risks are unchanged since the acquisition.

And given -- and given that, then the -- we're looking at a -- a thirty (30) to forty (40) versus whether we have a debt -- or the debt guarantee fee in or not.

MR. BOB PETERS: But I hear you saying you'd like more equity in there than their current target?

MR. GREG MATWICHUK: I would not be opposed to more than their current target.

MR. BOB PETERS: And to --

MR. GREG MATWICHUK: And -- 'cause I -- and I -- and part of the -- if I could just tell you a little bit more, Mr. Peters. Part of it is that that's Manitoba Hydro's target and -- and when one looks at Centra itself, one has question whether that -- the same target is appropriate.

And I don't think that Centra has -- has made a case as of yet to differentiate itself from that, but I -- I'm suggesting that the seventy-five/twenty-five (75/25) might be a little light.

MR. BOB PETERS: All right. I -- I hear your point on that. I wasn't going to ask you any questions about the presentation of rate increases, but I find myself, after your discussion with Ms. Murphy and your -- you answers to her.

Are you suggesting that the consumers are demanding the bills be unbundled into the various rate categories; is that your understanding?

MR. GREG MATWICHUK: I think bills have been.

MR. BOB PETERS: I'm not saying they haven't been. Is it your understanding that they -- the reason that they were unbundled was because of consumer request?

MR. GREG MATWICHUK: Consumer reaction. And ye -- yes, I am suggesting that and that -- and the reason I'm suggesting that, Mr. Peters, is that the -- being involved with consumer groups in other jurisdictions that same concern came through.

It also came through concerned registered with politicians, so the government either initiated or got involved or were part of the impetus of -- of that.

MR. BOB PETERS: And you say that even though only one (1) of the bill -- one (1) of rates composing the overall bill is -- is subject to competition whereas the rest are monopoly services?

MR. GREG MATWICHUK: Yes, and -- and I'll -- here's a -- an example from another jurisdiction, is that parties -- because there's a lot of outsourcing going on in -- in utilities and -- and most often in customer billing, is that there were productivities expected to be achieved in -- in outsourcing.

So it -- sometimes you'll have administration costs that are -- there's an administration rate that is broken out separately and so there is -- there has been a demand to break out various monopoly components.

MR. BOB PETERS: I was going to suggest to you, maybe it's -- you know, maybe it's time that the bill was bundled again and the only -- the only two (2) distin -- discrete matters would be the primary gas rate set out separate because it's subject to competition and then all of the other rate components were rebundled into one (1) rate.

MR. GREG MATWICHUK: I'd think you'd want to make sure that you understood what consumers would be asking for and it -- it --

MR. BOB PETERS: When you -- when you -- and I appreciate the -- what your suggestion is to the Board, but can you file with the Board any examples of where consumers are demanding bills to be unbundled, so that they can see the various rate components?

MR. GREG MATWICHUK: I can provide different billings structure where they -- they are unbundled, but --

MR. BOB PETERS: No, no, I'm not asking for that, but I'm --

MR. GREG MATWICHUK: Okay. I'm not clear.

MR. BOB PETERS: If you're -- if you're suggestion is that the consumers want the bill unbundled into five (5) different rate components and then when the

-- when the rates change after a GRA then those who were on certain cycles may have as many ten (10) line items on their bill, which consumers are demanding that information?

MR. GREG MATWICHUK: Okay. Maybe we're talking past each other, but I just want to be clear. What I'm -- I'm telling you, Mr. Peters, is that the trend has already been established such that bills have been broken out -- have been unbundled and I -- I took from your question that it was more of a prospective perspective, that they will be broken out.

MR. BOB PETERS: All right then. We -- we disconnect right there because --

MR. GREG MATWICHUK: Okay.

MR. BOB PETERS: -- in Manitoba we -- we've unbundled the bill and -- and Manitoba may have been one (1) of the first jurisdictions to unbundle the bill because it had competition to the core earlier than other jurisdictions.

MR. GREG MATWICHUK: And the -- the date of unbundling was...?

MR. BOB PETERS: We'll ask the next panel that.

MR. GREG MATWICHUK: Yeah, but I mean was it -- was it within the last year or --

MR. BOB PETERS: Oh, no. No, no, no.
We're -- we're talking --

MR. GREG MATWICHUK: Within the last five (5) years a number of jurisdictions have gone to unbundled bills.

MR. BOB PETERS: And -- and let's assume Manitoba was even earlier than that.

MR. GREG MATWICHUK: Okay.

MR. BOB PETERS: And I'm -- I'm suggesting that at the time Manitoba unbundled there were the requests as I recall them from brokers saying we should unbundle it all to show consumers specifically which aspects of the -- of -- of their gas supply they're paying for and how much and we'd like those to be subject to competition and, therefore, take your primary gas rate; you can show it as Centra's rate and then we can see if our rate's better.

I think the brokers, and I won't put words in their mouth, but they may have been hoping for, may still do hope to provide other -- other unbundled services that they can offer --

MR. GREG MATWICHUK: And -- and --

MR. BOB PETERS: -- by the Utility.

MR. GREG MATWICHUK: Right, and just to give a little bit of perspective on this is that there are some pure monopoly utility service providers. In other words, there's no competitive element to their bill that have components unbundled.

MR. BOB PETERS: And -- and I don't dispute that --

MR. GREG MATWICHUK: Okay.

MR. BOB PETERS: -- and I'm just wondering if you're suggestion is the consumers are demanding it, where do we -- show us that and I don't know if you can.

MR. GREG MATWICHUK: And -- and I don't think I can.

MR. BOB PETERS: All right.

MR. GREG MATWICHUK: I -- it's just -- it's been a process that's been ongoing for the past decade.

MR. BOB PETERS: Okay. I want to move on. In -- in terms of the electronic filings in response to your position in rebuttal I understood the Corporation to be saying they're not -- they're not in agreement with you on it for various reasons?

MR. GREG MATWICHUK: Could you point -- no, I -- I -- well, let me -- let me --

MR. BOB PETERS: You -- did you understand the rebuttal that they were going to agree with you and provide you with electronic filings?

MR. GREG MATWICHUK: Well, I'm -- I'm trying to establish where they addressed the electronic filings in their rebuttal.

MR. BOB PETERS: I thought they did, but it's a fair question of you to ask and I'll -- I'll look for it.

(BRIEF PAUSE)

THE CHAIRPERSON: Mr. Peters, not to rush you. We're just wondering how much time you have if we're going to try to wrap this up at 5:00 because --

MR. BOB PETERS: Oh, --

THE CHAIRPERSON: -- we've got the re-direct to come yet.

MR. BOB PETERS: Yeah, I'll be done in short order here. I'm --

MR. GREG MATWICHUK: Yeah, I -- I have the last issue as presentation of rate changes and then conclusions.

MR. BOB PETERS: Okay. I'll take it from that point. Let me -- let me rephrase the question, Mr. Matwichuk.

MR. GREG MATWICHUK: Okay.

CONTINUED BY MR. BOB PETERS:

MR. BOB PETERS: Centra -- you understand Centra not to be on the same agreement. It is not in agreement with you on providing their -- their models and spreadsheets in electronic form?

MR. GREG MATWICHUK: I think they -- in response -- in our -- maybe our reference point is a response to two (2) IRs. One (1) was CAC/MSOS-1 and I believe the other was CAC/MSOS-74 and --in -- in both they -- their view was not to provide the information but I think where there is common ground is the collaborative process and -- and that if this is to be done it -- it shouldn't be done in a GRA; it should be done in a process external to the GRA that everyone gets together and decides what's appropriate. And -- and I think that's our common ground.

MR. BOB PETERS: All right, and you're prepared to subject your spreadsheets to the same availability as you would request of the Corporation?

MR. GREG MATWICHUK: Absolutely.

MR. BOB PETERS: And the collaborative process is probably the only common ground that you have with them on this point in time and you'd prefer to do that then -- than not get them?

MR. GREG MATWICHUK: Oh, yes, absolutely

and I think the collaborative process is a good mechanism to -- to find the common ground on -- on a filing issue like this. And when I say "collaborative" it would make sense that the Board be involved in that, too, so that the Board ensures that they're getting the value -- value that they want from the electronic filings.

MR. BOB PETERS: Mr. Matwichuk, I think the last issue I have for you is -- is looking for your suggestions and advice to the Board relative to what I understand is coming down, potentially, the pipe in the accounting industry and that is a new exposure draft dealing with rate regulated accounting and rate regulated affiliates, are you aware of that?

MR. GREG MATWICHUK: I'm -- I am.

MR. BOB PETERS: Is it your understanding that there is consideration being given to -- to change what is now generally accepted accounting principals to remove the deferrals in certain -- of certain costs in rate-regulated accounting?

MR. GREG MATWICHUK: I'm aware that that is in the exposure draft and I -- I might, Mr. Peters, if you'll indulge me for a second, is to provide some context as -- for the Board and -- and people in the room as to the ex -- what exposure drafts involves.

MR. BOB PETERS: I think that'd be fair,

if that can be briefly done.

MR. GREG MATWICHUK: Yeah, very --

THE CHAIRPERSON: Yeah, we are actually quite familiar, but proceed.

MR. GREG MATWICHUK: Okay. And -- and -- I'll put it in the context of this one. The exposure draft is a -- a trial balloon in the accounting community and -- and I'm assuming, Mr. -- Mr. Chairman, that you're familiar with that process.

And the -- the trial balloon in the particular case, I'm familiar with submissions that have gone in. The accounting community has a trial balloon and so it gets responses back in terms of how this might affect various stakeholders and -- and whether -- what principals are at stake.

I've been -- I was in a meeting two (2) weeks ago th -- and one (1) of the issues was this very one that was discussed and I can say to you is that there's a great deal of controversy over this, at the very least, a great deal of controversy.

As to whether the exposure draft would be accepted and enshrined as an accounting pronouncement, I would say is not a foregone conclusion by any means. And that was the consensus in the room, particularly given the impacts that you were talking about, Mr. Peters, on utilities and ratepayers.

CONTINUED BY MR. BOB PETERS:

MR. BOB PETERS: Did you make a submission to the exposure draft?

MR. GREG MATWICHUK: I -- I have not.

MR. BOB PETERS: All right. And do you have any sense as to how that would impact this utility if the exposure draft was accepted and put into effect?

MR. GREG MATWICHUK: I haven't spent time on that issue. I was made aware that this became an issue in this proceedings by virtue of what transpired in the -- in the hearing.

MR. BOB PETERS: All right. Thank you. Mr. Chairman, I'd like to thank Mr. Matwichuk for his answers to my questions.

MR. GREG MATWICHUK: Thank you, Mr. Peters.

THE CHAIRPERSON: Thank you, Mr. Peters. Mr. Saxberg, do you have any re-direct for your witness?

RE-DIRECT EXAMINATION BY MR. KRIS SAXBERG:

MR. KRIS SAXBERG: Just two (2) questions, for clarification.

Mr. Matwichuk, you said that you're not

opposed to more equity than the current target of twenty-five/seventy five (25/75)? On what regulator methodology were you -- was that based?

MR. GREG MATWICHUK: That was, as I was mentioning to Mr. Peters, that was an assessment of relative risk. The Board has established where Centra lies relative to the risks associated with other gas LDC's across Canada and the Board has concluded that was below average risk and also in comparison relative to the debt equity structures of those other LDC's, which tend to be below 40 percent. And -- so it was an assessment of all those factors.

MR. KRIS SAXBERG: Does that -- does that relate to the rate base rate of return methodology of the cost of service methodology?

MR. GREG MATWICHUK: That relates to the rate base rate of return methodology.

MR. KRIS SAXBERG: Does it relate at all to the cost of service methodology, those comments?

MR. GREG MATWICHUK: No.

MR. KRIS SAXBERG: Okay. How would you do that thickening of the equity? How would you recommend it be done?

MR. GREG MATWICHUK: Oh, well, I think we had a conversation, I can't remember where is was in direct or cross, but the issue is that I don't you would want to award a thickening of equity without there being the underlying equity existing because otherwise you're providing a return in excess of the risk capital put forward by the owner.

So if there was to be a -- a sixty-five/thirty-five (65/35) -- or somewhere in there, I'll choose sixty-five/thirty-five(65/35) just for an example, then I think it's incumbent that there be a underlying actual 30 per -- 35 percent equity. And that could be achieved by a number of means, including leaving more income in the company or actually injecting equity in through share purch -- share purchases.

MR. KRIS SAXBERG: Thank you, Mr. Matwichuk.

MR. GREG MATWICHUK: Thank you, Mr. Saxberg.

THE CHAIRPERSON: Thank you, Mr. Saxberg, and thank you very much, Mr. Matwichuk, for your openness and diligence in answering all the various questions, very interesting.

That brings to a close the end of today and tomorrow, I believe we start off with Mr. Kuczek, is it not?

MR. BOB PETERS: Yes, Mr. Chairman,

that's the indication and Mr. Kuczek will likely be joined with his fellow members of the rate design and cost allocation panel, or at least some of them, and tomorrow we'll be starting at 9:00 a.m.

I do want to repeat a reminder that I believe I've forwarded on a couple of occasions and that is that Mr. Kuczek's availability is -- is limited to tomorrow and he's not available the first three (3) days of next week and, therefore, there will be efforts made to deal with the DSM aspects of the Corporation's case tomorrow and we will leave other matters of cost allocation and rate design until Monday.

But the matters for which Mr. Kuczek has responsibility, we will an -- attend -- we will attempt to deal with them by all parties certainly tomorrow.

THE CHAIRPERSON: Very good. Mr. Matwichuk, just before you go and, by the way, we will wait with anticipation the filings and undertakings that you've made today, as well.

Just one (1) general question, you had indicated before that you felt that the business risk of Centra Gas hadn't changed, basically, from the date of acquisition.

You're aware, for example, that in Manitoba, gas, if you want, competes with electricity for space heating and that we have a -- if you want to call it a relatively low price electricity market here --

MR. GREG MATWICHUK: Yes.

THE CHAIRPERSON: -- and the differential between electricity and gas, to put it fairly, has been somewhat narrowed over the years.

Would you consider that as a business risk?

MR. GREG MATWICHUK: That -- I would consider that a business risk, Mr. Chairman, and I would say -- have two (2) comments; one (1) is that business risk was always there, it always existed, it's just a matter of whether -- to what extent it's being realized. And two (2) is, it's not just my indication that the business risks have not changed at -- that's Centra's evidence.

THE CHAIRPERSON: No, I understand. Thank you again, sir.

MR. GREG MATWICHUK: Thank you and, Mr. Chairman, I -- I would like to thank the Board and -- and -- and Board staff for their indulgence in the timing of certain filings due to some personal circumstances and I must say, I really appreciate it.

THE CHAIRPERSON: You're quite welcome. Okay, goodnight everyone, we'll see you tomorrow at 9:00.

--- Upon adjourning at 4:55 p.m.

Certified Correct

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Ashley Guillemin