MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA HYDRO
2004 GENERAL RATE APPLICATION

Before Board Panel:
Graham Lane - Board Chairman
Len Evans - Board Member
Robert Mayer - Board Member

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APPEARANCES

R.F. Peters	)Board Counsel
Patti Ramage	)Manitoba Hydro
Byron Williams	)CAC/MSOS
Michael Anderson (np)	)Manitoba Kewatinook Ininew Okimowin (MKO)
Peter Miller	)TREE
Randall McQuaker (np)	)
Garnet Boyd (np)	)IBEW 2034
John Osler	)Manitoba Industrial
Patrick Bowman	)Power Users Group
Tamara McCaffery	)
Jurgen Feldschmid (np)	)CCEP

TABLE OF CONTENTS

LIST OF EXHIBITS

LIST OF EXHIBITS (cont'd)

LIST OF UNDERTAKINGS

LIST OF UNDERTAKINGS (cont'd)

--- Upon commencing at 9:05 p.m.

THE CHAIRPERSON: Good morning everyone. We have two (2) new exhibits from Manitoba Hydro. Thank you very much. Manitoba Hydro Undertaking 22 which I have as Exhibit 26; is that right, Ms. Ramage?

MS. PATTI RAMAGE: That's my understanding also.

--- EXHIBIT NO. MH-26: Response to Undertaking 22.

THE CHAIRPERSON: Thank you. And Manitoba Hydro Undertaking 23 would be Exhibit 27; is that correct?

MS. PATTI RAMAGE: Yes.

--- EXHIBIT NO. MH-27: Response to Undertaking 23.

THE CHAIRPERSON: Okay. Will no further ado we'll move back to Mr. Williams. And just to remind everyone, we had talked about returning from our lunch at one o'clock and breaking at 3:00 given the election and some other events. Thank you.

MS. PATTI RAMAGE: Before Mr. Williams jumps on the mic, just so that the record is clear, Exhibit 26 is the projected balance sheet for -- with Manitoba Hydro with no Winnipeg Hydro acquisition and Exhibit 27 is the projected operating statement.

THE CHAIRPERSON: Thank you.

MS. LYN WRAY: I should just clarify that the Exhibit 27 subtracts the IFF-02-1 which includes Winnipeg Hydro from an operating statement in which there is no Winnipeg Hydro. So, the net income differences at the bottom reflect the -- in the initial years, the decrease in net income if we had not acquired Man -- Winnipeg Hydro and in subsequent years the addition to -- or rather the deduction from net income if we had not acquired Winnipeg Hydro. I'll have to read the transcript to see if I got that right.

But what I'm trying to make the point is that the negatives in the bottom line are if we had not -- in the bottom line in the initial years are if we had not acquired Winnipeg Hydro.

THE CHAIRPERSON: In other words, Ms. Wray, just so I follow this, in 2003 the schedules suggest that if Manitoba Hydro had not bought Winnipeg Hydro, Manitoba Hydro's results would have been worse?

MS. LYN WRAY: Yes, in those initial years and in the later years somewhat better. But if you add the bottom line, I think it supports our contention that the purchase was, overall, bottom line neutral on the operating statement.

THE CHAIRPERSON: Thank you, very much. Mr. Williams...?

MANITOBA HYDRO PANEL, Resumes;

MR. BYRON WILLIAMS: Yes. Thank you and good morning, Mr. Chair and Members of the Panel.

Perhaps before I start, through you to Mr. Singh, it looks like we're out of water in the -- in the back there. So, going through OM&A is kind of thirsty work so I'd appreciate it.

For the benefit of the Panel as well, Hydro and the PUB, to start with I'll be doing a bit of clean up from yesterday and I'll be referring again to Hydro Exhibit 24 which provides a breakdown between productivity and what was related to the pension.

I'll also be referring to the CAC/MSOS reference materials and, to start with, Tab 23. So if the Hydro Panel could bring those to hand.

CONTINUED CROSS-EXAMINATION BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Mr. Derksen, if we go to the extreme right of Exhibit -- Tab 23, Ms. Ramage. Now, Mr. Derksen, if we go to the extreme right of Exhibit 24 we see the Manitoba Hydro 2005/06 updated forecast for O&A costs attributable to electrical operations and that is reported as 295.7 million; is that correct?

MR. WILLIE DERKSEN: Yes, sir, that's what shows on the schedule and that's correct.

MR. BYRON WILLIAMS: Now, based upon my discussion with Mr. Warden yesterday, my understanding is that excludes now the OM&A that would be attributed to subsidiaries for 05/06; is that right?

MR. WILLIE DERKSEN: Yes, they're excluded from that number.

MR. BYRON WILLIAMS: And could you indicate the figure that is excluded? Like, if we were to add back in the subsidiaries, how much that OM&A would be?

MR. WILLIE DERKSEN: It's approximately $11 million dollars related to subsidiaries.

MR. BYRON WILLIAMS: So it's the same figure as for '03/'04? Or '03 -- yeah '03/'04 that we got yesterday.

MR. WILLIE DERKSEN: Yes, it's a similar figure.

MR. BYRON WILLIAMS: And I believe we agreed yesterday that the going forward benefits from the pension costs reduction are about $5.4 million moving ahead.

MR. WILLIE DERKSEN: Yes. I think they're -- the number that we came up with is $5.1. I think I had said approximately half (1/2) of the $10.9.

MR. BYRON WILLIAMS: Okay, thank you. And just so I can follow this. If you can now turn to Tab 23 of the CAC/MSOS Schedule, Book of References, which is Schedule 4.2 of the Hydro Application.

And if I take $309 million, two hundred fifty-seven (257) which is the bottom number in right-hand column, which is what Hydro originally had forecast for ’05/’06, and I wanted to reconcile that with the figure that appears in Exhibit 24.

The first thing I would do would be to subtract about $11 million for subsidiaries which would get us down to approximately $299.3 million. And then I would subtract another $5.1 for the future pension benefits and that gets me down to about $294.2.

So, when we’re trying to do a kind of a rough calculation, the numbers don’t quite reconcile and I wonder if you can explain to me, the difference?

MR. WILLIE DERKSEN: First of all, the $295.7 shown in our Exhibit 24, there is an error in that calculation. The capitalized overhead that’s shown in that -- on -- on -- in that column is shown as $60 million and that inadvertently had included the gas capitalized overhead. And so the corrected number is 298.3. The 295.7 should read 298.3 with the difference being in the capitalized overhead line.

MR. BYRON WILLIAMS: But that increases the gap between my calculation as we attempt to reconcile those numbers.

MR. WILLIE DERKSEN: It increases the gap, yes, that's correct.

MR. BYRON WILLIAMS: And the explanation for that additional $4.1 million, is what?

MR. VINCE WARDEN: Mr. Williams, maybe just for clarification. As we've indicated, the corrected number, because of that capitalized overhead change is $298.3. So, essentially what we're now attributing to electric operations is $298 million. From that we subtract the subsidiaries, which we have previously agreed was $11 million. Two hundred and ninety-eight (298) minus eleven (11) brings us back to the three oh nine (309) number that we had -- that we have on Schedule 4.2.

MR. BYRON WILLIAMS: But perhaps my confusion --

MR. VINCE WARDEN: Or, I'm sorry, adding -- add two hundred ninety-eight (298) plus eleven (11). Sorry about that. It brings us back to three oh nine (309).

MR. BYRON WILLIAMS: Perhaps my confusion is though that yesterday you said that the five (5) -- today it's $5.1 million in terms of on-going pension benefits were not reflected in the forecast in the original application. And now -- now it appears that it is.

MR. VINCE WARDEN: We’ll just take one (1) minute on that, please, Mr. -- Mr. Williams.

(BRIEF PAUSE)

MR. VINCE WARDEN: Sorry about that. Would you mind repeating your last question?

MR. BYRON WILLIAMS: Yesterday when I spoke with Mr. Derksen, his evidence was that the -- of the $10.9 million in pension benefits reported in Exhibit 24, some of those were an ongoing productivity benefit that had not been reflected in the original application.

And so when we’re trying to reconcile the Exhibit 24 and the figure of now two ninety-eight point three (298.3), if you add on 11 million, that gets you to 309.257, but we haven’t accounted for the -- the productivity benefits from the pension.

MR. VINCE WARDEN: That’s correct. And I think maybe our position is that -- and we’ve had some -- Mr. Derksen and I had a bit of discussion about this, is that the three oh nine (309) does not reflect any reductions for -- for the ongoing pension reduction.

So, the three oh nine (309) -- excuse me --

the two ninety-eight (298), which is attributable to electricity operations for ’05/’06 is comparable to the two ninety-six (296) in ’04 -- in the previous year ’04/’05 that we’ve agreed previously is attributable to electricity operations.

MR. BYRON WILLIAMS: You’ll have to repeat that. Sorry, Sir.

MR. VINCE WARDEN: Well, I think yesterday we established that the number attributable to electricity operations was two ninety-six (296). At least that’s what my notes indicate and we -- we might want to review that just to make sure we’re all totally clear on that.

But -- but I was just giving you the context of the two ninety-eight (298) -- the two hundred and ninety-eight (298) number that we’ve now agreed is applicable to electricity operations for ’05/’06 is comparable to 296 in the previous year, ’04/’05.

And I can take that back to previous years, just for clarity, if you want to do that.

MR. BYRON WILLIAMS: What I’d just appreciate if you could do, Mr. Warden, is -- is add -- would it be possible in terms of this Exhibit 24, to add another column, being Manitoba Hydro 2004/05, Updated Forecast for continuity sake?

MR. VINCE WARDEN: Yes, I think that would be helpful. We'll do that.

--- UNDERTAKING NO. 32:   Add another Column, being Manitoba Hydro 2004/05, Updated Forecast.

MR. BYRON WILLIAMS: And just so I can be absolutely sure about this. The -- this Exhibit reflects the productivity benefit from the 5.1 pension cost reductions, but the original application doesn't. Is that correct?

MR. VINCE WARDEN: No. This Exhibit -- Exhibit Number 24, is consistent with Manitoba Hydro's approved integrated financial forecast which has been submitted as part of the Application.

MR. BYRON WILLIAMS: And then just one (1) more question so I understand. But the original application did not include the 5.1 million in pension benefits?

MR. VINCE WARDEN: That's correct.

MR. BYRON WILLIAMS: Okay, thank you.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: Just if we -- we may want to keep one (1) finger on Tab 23 of the Book of References. And -- and as I recall your evidence from yesterday, at page 812, the 307 OM&A Cost Report for 2005/05, includes subsidiaries. Is that correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: Now, I want to turn back to Tab 7 of the Book of References, specifically to the response to CAC/MSOS/MH-I-18C, that would be in Tab sec -- Tab 7, the third page from the end.

And we see the figures for 2002/03 actuals being 263 million and my understanding based upon your evidence at page 808 is -- is that that figure excludes subsidiaries, correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: And then what you were doing in this Interrogatory Response are reconciling between the 2002/03 actual of two sixty-three (263) and the 2003/04 forecast of three-oh-three point six (303.6). And you list a number of variances in this calculation and I don't see subsidiaries in there.

So, I'm wondering how you get back up to the figure -- so I'm wondering where subsidiaries are in terms of the calculation?

MR. VINCE WARDEN: Mr. Williams, the comparable figure to the two sixty-three (263) excluding subsidiaries for 03/04 is two eighty-three (283). Now, the difference between the two eighty-three (283) and the three-oh-three (303)--

MR. BYRON WILLIAMS: We went through part of that yesterday, so I think I have that under control. What I can't understand is you were asked to explain the variance in this Interrogatory Response between a 2002/03 actual of 263 million and a 2003/04 forecast from Schedule 4.2 of 3.03.6 million and there's no subsidiaries, at least to my eye, in there?

MR. VINCE WARDEN: I agree. It would have been better for us to explain the difference between the two six -- two, sixty-three (263) and the two eighty-three (283) which would have been comparable numbers because the two sixty-three (263) and the three-oh-three (303) are not, as we've just discussed, comparable.

They're not -- they're not on the same terms. So, I would have expected, yes, that the subsidiaries should have been part of that explanation and they don't appear to be.

We'll have to -- we'll have to look at that a little bit further unless Mr. Derk -- Mr. Derksen has the answer immediately. We'll have to -- we'll have to look at that a little bit further.

MR. BYRON WILLIAMS: Would you undertake to do that for -- for this variance analysis and for the -- the variance between the 02/03 actual and the forecast as reported in CAC/MSOS/-I-18C and also for the variance between the 03/04 and 04/05 forecasts, which is on the next page, just so you can satisfy myself and my witness that the subsidiaries are in there somewhere.

MR. VINCE WARDEN: We will do that, yes.

--- UNDERTAKING NO. 33: Provide an explanation of the variance between the 02/03 actual and the forecast as reported in CAC/MSOS/-I-18C and also for the variance between the 03/04 and 04/05 forecasts.

MR. BYRON WILLIAMS: Now, I'd like to, as one last piece of clean up from yesterday, turn your attention to the table which is called CAC/MSOS Exhibit 4 which is reported OMA costs which is the table that had a variety of reported OMA figures; do you have that, Mr. Warden? That would be CAC/MSOS Exhibit 4 reported OM&A costs?

MR. VINCE WARDEN: Yes, we have it here.

MR. BYRON WILLIAMS: It's not in the book of references for those looking around in puzzlement. It's -- it was -- I've got the thumbs up now from Mr. Peters so he's with me.

Mr. Warden, the one thing I wanted to double check on was when we were trying to understand, for the benefit of my clients, the difference - and I'll -- I'll draw your attention to the 2001/02 column - the difference between the CAC/MSOS -- the response to I-15 and I-16 which is 248 million and the 2002 Annual Report being 258 million which is a difference of about $10 million.

And I may have been inadvertently responsible for this. I think we left the impression that that was solely attributable to the payroll tax and I wonder if it, upon reflection, it might be more accurate to assume that part of that's from the payroll tax and part of that is from the Centra Gas adjustment? Would you agree with that?

(BRIEF PAUSE)

MR. WILLIE DERKSEN: Yes, I'd agree with that, that's correct.

MR. BYRON WILLIAMS: And just for the purposes that when we get to Mr. Harper's -- Harper's evidence, we're not talking at cross-purposes, I wonder if you can indicate in terms of the preparation for the 2002 CSP, Corporate Strategic Plan, the target, whether or not that took into account the adjustments, both for the Centra Gas, as well as for the payroll tax adjustment, Mr. Derksen, could you double check on that, sir?

MR. WILLIE DERKSEN: I'll check on that.

--- UNDERTAKING NO. 34: To determine whether or not the Corporate Strategic Plan took into account the adjustments for Centra Gas and for the payroll tax adjustment.

MR. BYRON WILLIAMS: Thank you. Moving right along, still in the OM&A book of references of CAC/MSOS, I'd like you, Mr. Warden, to turn your attention to -- to Tab 20, which is the reference from the transcript, Volume I, pages 82 to 93, and specifically, I'd ask you to turn to page 89.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: Do you have that, sir?

MR. VINCE WARDEN: I do.

MR. BYRON WILLIAMS: And starting at -- at line 13, and this is something that -- the quote that I'm going to read in, I'm going to ask you to confirm that I've read it correctly, and then I want to go over it with you in some detail.

So, starting at line 13 of page 89,

"I know that Manitoba Hydro operates a very lean utility, and to demonstrate this, consider that over the past year -- five (5) years, operating maintenance, administrative expenses have increased at an average annual of 1.9 percent per year. This rate of increase is identical to the average annual increase in the Manitoba Consumer Price Index, over the same five (5) year period. So, despite the tremendous growth in the utility that I referenced earlier, Manitoba Hydro was able to hold its year over year increase in operating costs to the rate of inflation. By way of comparison, the two (2) other major hydraulic generation utilities in Canada, Hydro Quebec, and BC Hydro, have average increases in their operating, maintenance and administrative costs of 6 percent and 6.9 percent respectively, per year, over the past five (5) years. I should add that this comparison is based strictly on information contained in the annual reports of those two (2) utilities, and there’s probably very good reasons why the operating and administrative costs were

so much higher than Manitoba Hydros.
However, I think this comparison helps to demonstrate the effectiveness of Manitoba Hydro's cost control efforts for the benefit of all ratepayers."

Now, I know I read that fast, Mr. Warden, but did I read it correctly?

MR. VINCE WARDEN: You read it better than I did.

MR. BYRON WILLIAMS: And I appreciate your comments in terms of the -- at page 90, in terms of the comparability of these -- this data, and I do want to explore that for a couple minutes.

In terms of you noted that you were referring -- the data from Hydro Quebec and BC Hydro was based upon their annual reports for the past five (5) years. Would I be right in concluding that those are the 1999, 2000, 2001, 2002 and 2003 Annual Reports, sir?

MR. VINCE WARDEN: Yes, I believe that's true, both Hydro Quebec and BC Hydro have different fiscal year ends. BC Hydro is the same as Manitoba Hydro's, March 31st, Hydro Quebec is December 31st.

But, yes, the -- the year ends we were referencing were 1998 to 2003.

MR. BYRON WILLIAMS: So, you were comparing the 1998 through the 2003 years, correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: And in looking at the Hydro Quebec and BC Hydro numbers, you look solely at the Annual Reports, you didn't kind of try and delve into any kind of understanding of what was responsible for changes in OM&A, within those organizations?

MR. VINCE WARDEN: Yes, and that's why I -- qualified my answer -- or my statement to some extent. They were strictly numbers pulled from their Annual Report.

MR. BYRON WILLIAMS: Thank you. And just -- and this is a minuscule detail, but were those simple averages, or were they compounded, the averages that you presented?

MR. VINCE WARDEN: They would have been the compounded rate inc -- or increases.

MR. BYRON WILLIAMS: So, I'm going to get to your calculation of the 1.9 percent in -- in just a minute. But I'm going to ask you to do a favour for me and pretend that instead of being the VP Finance for Manitoba Hydro, that you're the BC Finance for BC Hydro.

And I'm going to ask you to look at the annual reports for Manitoba Hydro in terms of their OM&A for the same period of time. The 1998 through the nin -- 2003 years and -- and work with me through the calculations for that, Mr. Warden. Okay?

MR. VINCE WARDEN: We can do that, however, you know, it’s -- we’re obviously we -- we’ve encountered over that period of time acquisitions of Centra Gas and Winnipeg Hydro, so the numbers are very distorted.

I’m not aware of any similar acquisitions at BC Hydro or Hydro Quebec during -- during that period of time.

MR. BYRON WILLIAMS: And I guess why we’ll do it, Mr. Warden, just so you understand is because first of all we want to -- to do that calculation just to give some sense of -- of reference. And then I think it will be helpful in -- in having you to explain your 1.9 percent calculation as well.

So, I’m going to ask my -- my paid friend, Mr. Osler and my voluntary frie -- friend, Doctor -- or Mr. Singh, to distribute a table which is -- which contains references from the excerpts from the annual reports of Manitoba Hydro and for the 20 -- 1998 through the 2003 years.

THE CHAIRPERSON: Mr. Williams, before we begin, if we could label this CAC/MSOS Exhibit Number 5. Is that okay?

MR. BYRON WILLIAMS: It’s okay with me if my friend, Ms. Ramage, if that’s okay with her as well. I can assure her that these are excerpts from the record.

And what -- what I might suggest instead of labelling it as an exhibit right now, Mr. Chairman, is I have -- Mr. Warden, I have the -- the numbers actually in my book of references and I could go through them with you and then that might be a more appropriate time to mark it as an exhibit so that the Board has confidence that I'm not misleading them with these -- with this table.

MR. VINCE WARDEN: That's fine.

CONTINUED BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Mr. Warden, you can start, if you're looking, you could start at Tab 26 of the CAC Book of References.

And you can see that this is an excerpt from the 1999 Annual Report. And you'll agree with me that the OM&A reported in this Annual Report for 1998 is 211.4 million, while the OM&A for 1999 is 222.8 million. Is that correct, Sir?

MR. VINCE WARDEN: Yes. However, it may be more efficient to go the most recent annual report of Manitoba Hydro. That is the one (1) that's published and filed with this proceeding. Because as we've talked about earlier, there are certain re-classifications that take place from time to time; one (1), the payroll tax, the Centra adjustment, we just talked about.

So, the -- it -- it's fairly common to -- to look at the stats page as we would have done with BC Hydro, Hydro Quebec and update those numbers. There are some minor differences that -- that appear. If we go to the --

MR. BYRON WILLIAMS: Excuse me, Mr. Warden, and I certainly will give you an opportunity to do that. But I'd like to just work through this calculation.

MR. VINCE WARDEN: Sure, I was just trying to help you here, speed things along, but we can go through this if you like.

MR. BYRON WILLIAMS: And the -- the difference between the 1998 and 1999, you'll agree, is about 11.4 million. So if I divide that by 211.4, that leads to about five (5) point -- a 5.4 percent increase in reported costs in that year. Would that -- you'll accept that, subject to check?

MR. VINCE WARDEN: I'll accept that.

MR. BYRON WILLIAMS: Now if you move back one (1) tab, to Tab 25, we see the report from the 2000 Annual Report. Mr. Warden, just back one (1) tab in the Book of References.

And you'll see the reported OM&A for 1993 and that year is 223 million and you'll confirm that that for -- for 1999, excuse me, whereas the reported OM&A for the year 2000 is 231 million; is that correct, sir?

MR. VINCE WARDEN: Yes, correct.

MR. BYRON WILLIAMS: Yielding a difference of $8 million dollars which if you divide that by two twenty-three (223) yields a three point six (3.6) increase which you'll accept subject to check?

MR. VINCE WARDEN: Yes, I will.

MR. BYRON WILLIAMS: And if you flip back now to Tab 15 of this CAC/MSOS book of OM&A references you'll agree with me that the reported OM&A for electricity for the year 2000 is 234 million whereas the reported OM&A for electricity for 2001 is 245 million yielding an $11 million dollar increase as reported in this annual report; is that correct, sir?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: And if I divide the 11 million by two hundred and thirty-four (234) that would give, subject to check, a 4.7 percent increase, correct?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: And flipping now up to the 2001 -- or to Tab 24, you'll see the reported results for the 2002 Annual Report, Mr. Warden, and you could confirm for me that the report amounts for OM&A for 2001 are 246 million with the report amounts for 2002 being 258 million for a $12 million dollar difference; will you -- correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: And you'll accept, subject to check, that 12 million divided by 246 million is about a 4.9 percent increase, correct?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: And, finally, Tab 13 -- and before we do Tab 13, Mr. Warden, I'll -- we'll agree that Winnipeg Hydro, or at least part of Winnipeg Hydro would be reflected in this figure, correct? And I'll give you a chance to talk about it later but the OM&A results for 2003 would be -- reflect Winnipeg Hydro, correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: So, you'll agree though that reported in the annual report are 248 million in terms of electricity operations for 2002 and 272 million for 2002, correct?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: And that difference if -- would be about 24 million which divided by 248 million yields a 9.7 percent increase, subject to check?

MR. VINCE WARDEN: I'll accept that, yes.

MR. BYRON WILLIAMS: Now, and if you'll note the asterisk at the bottom of this table, the Corporation's response to CAC/MSOS/-I-10A it's noted that the -- for the part year of Winnipeg Hydro for the 02/03 year, the cal -- the -- the expenses associated with it were 19.6 million.

So, you'll agree with me that 272 million minus two hundred and fifty-two (252) -- minus, excuse me, 19.6 million yields 252.4 million, correct?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: And if we were to take the difference from two forty-eight (248) in 2002 to the adjusted 252.4 million, would you agree with me that that would yield an increase of about 1.8 percent, subject to check?

MR. VINCE WARDEN: I'll accept that, yes.

MR. BYRON WILLIAMS: And, Mr. Warden, just I wonder if you would accept, subject to check, that if I did the calculation of the cumulative increase for the electricity segment OM&A costs just based upon this table, being the five point four (5.4) -- the 5.4 percent in -- from 1998 to 1999, the 3.6 percent from 1999 to 2000, the 4.7 percent from 2000 to 2001, the 4.9 from 2000 to 2002 and the 1.8 percent being the adjusted Winnipeg Hydro factor, I'd come up with a, subject to check, on a compounded basis, a 4.5 percent increase annually, roughly?

MR. VINCE WARDEN: That looks about right, yes.

MR. BYRON WILLIAMS: And I wonder if, in this calculation, if you'd agree with me that if we substituted for the change from 2002/2003 the 9.7 percent increase we would probably come up with something in the range of 5.5 or 5.6 percent?

MR. VINCE WARDEN: I believe we -- we’ve calculated that to be 5.2 percent compounded, yes.

MR. BYRON WILLIAMS: That’s probably right. I was going off a simple average.

And, Mr. Warden, you and I have had a lot of discussions about OM&A and adjustments and -- and figures like that and I wonder if -- and I don’t know if you have the calculation by which you performed the 1.9 percent annual increase with you or not, but I wonder if you could do this for my clients and for Mr. Harper which would be to provide us, using -- provide us with the calculations and the -- the OM&A figures that you used from 1998/99, 2000, 2001, 2002 and 2003 and provide us with the calculation you -- you did to achieve that 1.9 percent annual increase?

And I wonder, at the same time, if you could also provide, when you do that, an explanation for the difference between the OM&A figures that you were using and the OM&A figures that are reported in your annual reports?

MR. VINCE WARDEN: Yes, I can do that.

--- UNDERTAKING NO. 35: Provide the calculations and the OM&A figures used from 1998/99, 2000, 2001, 2002 and 2003 and with the calculation used to achieve that 1.9 percent annual increase and also provide an explanation for the difference between the OM&A figures that were used and the OM&A figures that are reported in the annual reports.

MR. BYRON WILLIAMS: Mr. Chair, subject to the comments of My -- My Friend, Ms. Ramage, I'd ask that this be introduced as an exhibit at this point in time?

THE CHAIRPERSON: Ms. Ramage, do you have any problem with that? Will be Exhibit CAC/MSOS-5. All of the items on it have been verified by the dialogue between the parties.

--- EXHIBIT CAC/MSOS-5: Reported Manitoba Hydro electricity segment OM&A costs.

MR. BYRON WILLIAMS: And I'm sure, to Mr. Mayer's relief, we're going to be able to largely put this set -- this book of references away. I will refer to it a little bit in the latter part of my cross-examination so don't throw it away.

But if you might step it aside and I -- I ask My Friends, Mr. Osler and Mr. Singh, I have, for the second part of my cross, a much smaller book of references that I think would be more manageable for -- for this next section.

THE CHAIRPERSON: Thank you, Mr. Williams, and this -- this book is helpful.

MS. PATTI RAMAGE: Mr. Chair, I don’t -- I don’t think you go my comments in terms of the exhibit and -- and that’s simply that Manitoba Hydro doesn’t object.

But I think in terms of its heading, "reported Manitoba Hydro electricity segment OM&A costs" we should indicate where that’s reported because, as Mr. Warden attempted to do in his evidence was to indicate that the steps in the more recent financial report might not match these that we -- we should be indicating where in the title, that these came from, the respect annual reports or it should be noted on the record that that’s where they came from and are not the most updated figures.

MR. BYRON WILLIAMS: Yeah and certainly if -- it does say in the source on the side, Ms. Ramage, but we’re certainly -- we accept that, for the record.

And, you know, I don’t mind changing the title either if that accommodates you.

THE CHAIRPERSON: The Board completely understands the practice of restatements over time and so I don't think there's a concern. Number 5. Mr. Williams...?

CONTINUED BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Yes. I wonder if -- I've never done two books of reference before so -- but I wonder if I could ask you to turn to Tab 1 of the CAC/MSOS second book of references and specifically to the Hydro Panel, I'm not sure who in particular, you'll agree with me that in this response Hydro is providing both the values and the calculations used to calculate both debt equity ratio and gross interest coverage. Is that correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And, Ms. Wray, these are -- again, I'm trying not to trench where you spoke with Mr. Peters, so -- but we may briefly flutter across it before we get to my question.

So, I'll direct your attention to page 2 of this response. And we see the definition of gross interest coverage being, operating surplus, plus net interest expense, plus capitalized interest, divided by net interest expense and capitalized interest. Is that correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And again, I'm sure this is trite, but all else being equal, you'd agree with me that interests in the interest expense due to borrowing, will decrease the interest coverage ratio? All other things being equal?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And that’s whether the borrowing is for assets under construction or for assets in service. Correct?

MS. LYN WRAY: That’s correct.

MR. BYRON WILLIAMS: So -- and if one (1) were, of course, wanting to efface with a reduction in the interest coverage ratio, the only way to increase that ratio would be to increase the operating surplus by some mean or the other. Correct?

MS. LYN WRAY: Yes. Unless you can find a way of independently lowering the interest payments.

MR. BYRON WILLIAMS: Thank you for that and for the clarification. And in terms of increasing the operating surplus, of course, we can either do that by increasing revenues relative to costs, or we could also do it by reducing costs relative to revenues. Correct?

MS. LYN WRAY: Correct.

MR. BYRON WILLIAMS: Turning to page 1, where you’ve -- of this response to CAC/MSOS 1-26. We’ve got the calculation for the debt equity ratio. And Ms. Wray, I’m going to maintain, I think, the principal of it, but re-state it slightly and I wonder if you’ll just follow through with me.

If I'm trying to calculate it, I would take my take my long -- at -- for the -- the top is up -- the numerator. I would take the long term debt, plus the short term debt, and then subtract the sinking funding vestment minus the other investment. Would that be satisfactory?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And in calculating the denominator, I would add together the long term debt and the short term debt. Subtract the sinking fund investment and other investment, and then add on retained earnings and unamortized customer contributions. Correct?

MS. LYN WRAY: Correct.

MR. BYRON WILLIAMS: And just for illustrative purposes, I'm going to go through one (1) of the calculations for the year and then I'm going to adjust it slightly, Ms. Wray. So you -- just so you know where I'm going.

We'll go to the '06 fiscal year ended March 31st, '06. So if I'm trying to calculate the debt equity ratio, I would take the long term debt of seven (7) -- seven zero one six (7016), plus the short term debt of two seventy-three (273), and then subtract the sinking fund investment of six hundred and twenty-eight (628) and the short term investment of zero (0), to get the numerator.

Correct?

MS. LYN WRAY: Correct.

MR. BYRON WILLIAMS: And for the denominator, I would take the long term debt of seven zero one six (7016), the short term debt of two seventy-three (273), subtract the sinking fund investment, subtract the zero (0) of short term investment. And then add on the eight hundred and thirty (830) in retained earnings. And the two hundred and sixty-four (264) in unamortized customer contributions. Correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And that would yield a ratio -- it's reported here as point eight six (.86), it's probably just slightly less than point eight six (.86).

MS. LYN WRAY: Yes, on a rounded basis, it's an 86 percent debt ratio.

MR. BYRON WILLIAMS: And, Ms. Wray, now I want to explore with you the impact of -- of borrowing -- increasing the debt by $300 million as a result of increased capital spending.

So, to do that, all other things being equal, I would change the calculation on the top by -- instead of using the figure -- long term debt of seven zero one six (7016), it would be seven three one six (7316)? Is that -- is that correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And for the denominator, again, the one (1) adjustment I -- I would make would be that the seven zero one six (7016) would be then seven three one six (7316). Correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And would you accept, subject to check, that if I performed that calculation, I would get slightly more than point eight six (.86) in terms of a debt equity ratio?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: So, by borrowing an additional $300 million to fund capital, I am slightly increasing the debt equity ratio, but not by a huge amount?

MS. LYN WRAY: Yes, that's correct. It takes quite a bit to swing our debt ratio by a percent.

MR. BYRON WILLIAMS: Now, I want to perform that same $300 million calculation if I need to borrow $300 million to offset a reduction in retained earnings of $300 million, okay, Ms. Wray?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And so again, for the numerator, I would -- instead of the figure of long term debt of seven-zero-one-six (7016), I would change that to seven-three-one-six (7316), correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And for the denominator, the first adjustment I would make in terms of the long term debt, which again, I would adjust from seven-zero-one-six (7016) to seven-three-one-six (7316), correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And the second adjustment I would make would be in terms of the retained earnings, because I've lost $300 million, so I would subtract -- take the figure of eight thirty (830) and subtract three hundred (300) and yield the figure of five thirty (530), is that correct?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And if I perform that calculation, and I see you're quicker on the calculator than I am, but would you accept subject to check, that the debt equity ratio would be about point eight nine (.89)?

MS. LYN WRAY: I haven't done the calculation, but that wouldn't surprise me.

MR. BYRON WILLIAMS: So, would it be fair to conclude that increases in debt due to asset growth, don't have the same impact on the debt equity ratio, as increases in debt to offset losses in retained earnings, all other things being equal?

MS. LYN WRAY: Yes, in our particular case -- and that's partly influenced by the fact that our equity base is relatively small in relation to our assets as a whole, so the equity ratio is more sensitive than the -- than the debt portion of the ratio.

MR. BYRON WILLIAMS: Okay, thank you for that. I'd like to turn to Tab 2 of the Book of References, and again, I'll be trying not to trench upon any area where Mr. Peters has gone before.

But, Mr. Warden, during the first day of the Hearing, and we'll elaborate on this in a second, but you advised parties that the net income shortfall for '03/04, would be in excess of 400 million, as opposed to the 355 million forecast in Manitoba Hydro -- the inter-grid financial forecast, '03/01, is that correct?

MR. VINCE WARDEN: That's correct.

MR. BYRON WILLIAMS: And I think we've provided a slight bit more precision to that number in Hydro Exhibit number 19, where we've -- Hydro's advised that it's somewhere between 400 million and 430 million, correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: And when you were asked about the implications of this increased loss, which appears to be at least $50 million at page 176 of the transcript, lines 5 to 8, you indicated, and you can confirm that I've read this correctly:

"Yes, it's certainly important to Manitoba

Hydro in terms of our retained earnings, and it's going to make it that much more difficult to achieve the targets we've set out."

Did I read that correctly, sir?

MR. VINCE WARDEN: You did.

MR. BYRON WILLIAMS: I'm doing very well at this today, sometimes I have had problems. I see Ms. Wray nodding her head in approval.

Mr. Warden, as I understand it, the reasons that the increased loss makes it more difficult to make your target are twofold, and the first is that when you have a loss of an additional, let's say $50 million, retained earnings are further reduced, thereby increasing the contributions you required to restore the debt equity ratio to its desired level. That would be one (1) of the reasons why it's more difficult, correct?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: And another reason, and I believe Ms. Wray talked about this on day one (1) of the transcript, would be that the shortfall in net income will increase debt levels by a comparable amount, is that correct?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: And as Ms. Wray discussed in I think day one (1) of the transcript, this debt will lead to higher interest costs in future years, which will reduce future net income levels and make the replenishment of the retained earnings more difficult. You'd agree with that?

MS. LYN WRAY: It depends on whether the debt was increased by losses or by investment in capital, if you invest in capital then in many cases you do so to either preserve or increase revenues in future years. So, I think you would have to take that into account before answering your -- your question.

MR. BYRON WILLIAMS: And perhaps I wasn't clear, and I thank you for that clarification, Ms. Wray, but I was speaking in terms of the additional $50 million, in terms of the -- the loss due to the -- to the '03/04 year.

So, in that context, with a loss in terms of net income, this debt would lead to higher interest costs in future years, which will reduce future net income levels, and make the replenishment of the retained earnings more difficult, you'll agree with that one (1)?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And as I understand it, just for examples sake, Hydro's current long term borrowing rate is roughly 7.45 percent, correct?

MS. LYN WRAY: Yes, that's our projected long term borrowing rate.

MR. BYRON WILLIAMS: So an additional $50 million loss will lead to about a 3.725 million in interest expense in future years?

MS. LYN WRAY: Yes, if it’s to the degree that it’s long term borrowing.

MR. BYRON WILLIAMS: And, Mr. Warden, in Ms. Wray’s direct evidence, I believe, or in her evidence on day one (1), when she spoke of needing to start the restoration of -- of retained earnings journey, and obviously from your perspective, the journey will be longer and more difficult, as a result of the additional adverse development in terms of ’03/04, would you agree with that?

MR. VINCE WARDEN: I’ll agree with that, yes.

(BRIEF PAUSE)

MR. BYRON WILLIAMS: Mr. Lane, I’m coming now -- I’ll finish off one (1) little section, and then I’m coming to a convenient break, so I’ll kind of aim for 10:15 or so, and --

THE CHAIRPERSON: Very good.

CONTINUED BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: I wonder if I can turn you to Tab 4 of the second book of references of CAC/MSOS, and that’s Manitoba Hydro’s response to MIPUG-29. And you’ll confirm with me that in this Information Request, Hydro was asked to indicate the rationale, and this is Part C of that Response, I should be clear.

Hydro was asked to indicate the rationale for filing of the present Application, later than November 2003. And Manitoba -- is that correct, Mr. Warden, in terms of the question?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: And Hydro's response in part, was that one (1) of the main reasons for not filing the Application, I'll go to number 1, the second line, was that if the PUB chose to uphold its decision to reduce rates, eliminate the winter ratchet, and eliminate the limited use of billing demand rate option as of April 1st, 2004, these would significantly impact revenues, and in turn the proposed rates being requested.

And is that right, sir? That was your answer?

MR. VINCE WARDEN: That was the answer, we were definitely trying to keep the Rate Application to a minimum, and the receipt of that Order was a factor in that decision making process.

MR. BYRON WILLIAMS: And if we turn to Tab 5, of the Book of References, we see Hydro's Response to CAC/MSOS-I-54, and it appears from Hydro's Response, that the total reduction in revenue, as a consequence of the PUB's decision, would range somewhere in ’03/04, around 6.5 million, up to in ’05/06, about 6.8 million, is that correct, sir?

MR. VINCE WARDEN: That’s correct.

MR. BYRON WILLIAMS: And Manitoba Hydro as indicated in the previous Response, considers this a significant impact upon revenue, which would also have had an impact on the level of rate increase requested, is that correct?

(BRIEF PAUSE)

MR. BYRON WILLIAMS: And I’m just repeating the Response from the Interrogatory Response before, sir.

MR. VINCE WARDEN: That’s certainly the way we answered the Interrogatory, Mr. Williams, yes.

MR. BYRON WILLIAMS: And you were trying to answer it correctly and accurately, to the best of your knowledge?

MR. VINCE WARDEN: Yes, we always do that.

MR. BYRON WILLIAMS: Now I just want to get a scope -- a sense of scope. If we look at -- just to compare versus, the $6.5 -- $6.8 million from the revenue loss.

If we were to look at a -- Manitoba Hydro borrowing $100 million to -- to replenish a loss of earnings, based on its long term cost of debt of 7.45, that would result in an increase in annual interest costs of roughly $7.45 million. Would that be right, Sir?

MR. VINCE WARDEN: Based on a long term rate, yes.

MR. BYRON WILLIAMS: Mr. Chairman, I'm a bit ahead of time, but this is a -- a nice spot for a break.

THE CHAIRPERSON: Thank you. Let's come back in fifteen (15) minutes.

--- Upon recessing at 10:02 a.m.
--- Upon resuming at 10:22 a.m.

THE CHAIRPERSON: Okay, Mr. Williams. We got a short day today so we might as well get back at it.

MR. BYRON WILLIAMS: Thank you, Mr. Chairman, and I did want to thank, my friend, Ms. Fernandez for that supply of water when I was at my most desperate for defying the Vice Chair. I appreciate that.

CONTINUED BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Mr. Warden, if you could turn to Tab 6 of the much shorter second Book of References of CAC/MSOS and I want to talk with you for a couple of minutes about good debt and bad debt.

And perhaps I'll refer you to the bottom of page 85 and, again, we'll go through our routine if you can scrutinize my reading and then we'll use that as, kind of, the frame of reference for the questions that follow.

We see at the bottom of page 85 Ms. Ramage is asking you

> "Mr. Warden, are you concerned about the level of Manitoba Hydro's debt?"

And your response at page 86 is

> "No. No, I'm not concerned and I'd like to explain why. Unlike investor owned companies who raise capital through equity markets to fund their growth, Manitoba Hydro is a Crown Corporation and it doesn't have share capital as issue -- as a source of funding. For Manitoba Hydro to grow it relies on debt financing which is the lowest cost of capital available and thanks to that source of debt financing Manitoba Hydro has grown tremendously since its formation in 1961."

And then, Mr. Warden, I wonder if you can turn with me to the next page which is a reference from page 203 of the transcript and I'll direct you to your response to -- on page 203 starting at line 16 in response to a question of

Mr. Robert Mayer

"Well, Mr. Mayer, if I can, I'm not sure I'm going to answer your question quite as directly as you might like. But if we -- any time we're expanding as we are with -- expect to be with Wuskwatim, then, of course, reducing debt is -- is not possible nor is it desirable because debt is good; that's where we get our source of funds. So borrowing for purposes of growth, as I indicated earlier is a good thing to do. It's good for Manitoba Hydro, good for its ratepayers."

And, Mr. Warden, did I read that correctly?

MR. VINCE WARDEN: You appear to have read the transcript correctly. I'm sure I didn't have all those pauses in my --

MR. BYRON WILLIAMS: Yes, and of course you're grateful for me for restating your position. What I want to talk about is in terms of what you meant of "debt is good" it's a -- my understanding was that -- and I'll give you -- I'll give you some examples to help us flesh this out.

But when you're talking about increasing debt, you're talking about it being positive in the context of satisfying and providing for growth of Manitoba Hydro; is that right?

MR. VINCE WARDEN: That’s right.

MR. BYRON WILLIAMS: And I’m going to give you two (2) examples of this and by one, there would be circumstances where you require capital to reliably meet domestic customers’ needs, for example, investments in additional transmission capacity to meet growth; that would be one example, correct?

MR. VINCE WARDEN: Okay.

MR. BYRON WILLIAMS: And in -- in an example like that, those added sales may or may not cover the cost of the facilities, including the debt, but there is value in that domestic customers are receiving the -- the service they need; correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: So you -- such increases in debt may not necessarily lead to lower rates but there’s still a value being provided in that context by the borrowing?

MR. VINCE WARDEN: Yes, I agree with that.

MR. BYRON WILLIAMS: And another example would be something like the advancement of Wuskwatim, assuming that your numbers are right. It’s incurred in terms in order to provide long term financial benefits to domestic customers, so that would be another example where incurring debt is -- is of value and good for Manitoba Hydro?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: So the debts for facilities that will allow for increased sales and revenue and that's good debt?

MR. VINCE WARDEN: Good debt.

MR. BYRON WILLIAMS: I wonder when we're, kind of, looking at debt, good debt would be, if you'd agree with me, where we're meeting -- we're adding value in the sense of either meeting domestic needs or increased sales and revenue; would that be an appropriate definition?

MR. VINCE WARDEN: To export customers are you referring to?

MR. BYRON WILLIAMS: Yes.

MR. VINCE WARDEN: Yes, I agree.

MR. BYRON WILLIAMS: I apologize for that.

MR. LEN EVANS: Excuse me, I wonder if I could just interject a question at this appropriate time. We're talking about debt and I was curious. Do we have any idea as to where the debt is being held? I mean, what percentage is being held by Manitoba -- in Manitoba, what percentage, say in the rest of Canada, what percentage of the rest of the world? Do we have any idea of that breakdown?

MR. VINCE WARDEN: Yes, approximately 45 percent of our debt is held in the US. All the Hydro bonds we know, for sure, are held within Manitoba. The rest of the debt within Canada would be widely held though and not necessarily with -- within the Province of Manitoba. In fact, probably not within the Province of Manitoba.

MR. LEN EVANS: So, overall, thank you. Overall is your rough estimate of what percentage would be in Manitoba?

MR. VINCE WARDEN: It would be very low. Probably around 10 percent it would be the maximum.

MR. LEN EVANS: The idea, of course, is for 100 percent to be held in Manitoba. Presuming the interest rates are comparable. That's just a editorial comment.

MR. VINCE WARDEN: Okay, we'll accept that.

CONTINUED BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: You -- you might have some comments about matching revenues to debt in terms of risk diversification, I suspect, Mr. Warden.

Just in terms of foreign expenditure like Wuskwatim to be of benefit -- to be beneficial. Would you agree with me that for the capital expenditures and associated debts, associated with Wuskwatim, for that to be rate beneficial, the increased revenues have to not only cover the cost of the facilities but they also should provide additional net income in order to satisfy the financial targets of the company, such as its debt equity ratio?

MS. LYN WRAY: Yes, I think generally speaking, that's correct.

MR. BYRON WILLIAMS: And I -- I guess that's part of the -- the balancing act. Because increases of -- of debt generally, absent increases in -- in income, lead to deterioration in the debt equity and interest cover ratios. Correct?

MS. LYN WRAY: Generally, yes.

MR. BYRON WILLIAMS: Now, Mr. Warden, we talked about good debt and -- and I guess there's other debt which is necessary, but perhaps we -- I'll suggest to you, is -- is not necessarily good debt. And that might be something like the losses in 2003/04 which lead to increased debt with no increase in overall system value. Would you agree with that?

MR. VINCE WARDEN: Yes, to the extent that we have to borrow to finance current operations, that's not good. We -- we wouldn't want to do that on a consistent, year over year, basis or we'd be in big trouble, but, we do recognize that in our business it's going to happen occasionally.

MR. BYRON WILLIAMS: And given that it's going to happen occasionally, that's one (1) situation where you might relax your financial targets, such as interest coverage to -- to recognize this reality.

MR. VINCE WARDEN: Well we don't relax the targets. Our targets are -- are the targets -- it's that we accept that the actuals -- the actual performance against those targets could deviate over the short term.

MR. BYRON WILLIAMS: Yes, I guess in -- you don't need to turn to it, but your reference to PUB 118-B, you indicate that in the case of drought, which can be expected to happen periodically, you're willing to accept a temporary decline in interest coverage as long as the corporation takes reasonable steps to return to its targeted coverage in a reasonable time-frame. Would that be a fair statement of your position?

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: I wonder, Mr. Warden, if you'd agree that -- or maybe this is Ms. Wray -- but in terms of assets or financing costs in -- associated with assets under construction. For example, Gull, Wuskwatim or Kanawapa, and the capitalization of interest costs, would you agree that these will impact and lead to a deterioration in both the debt equity and ITC ratios in the short term?

MS. LYN WRAY: In the short term, but once the project is in service and earning revenue, that would be recovered.

But -- and I can't recall your question, but if you mentioned interest coverage, I don’t think it would lead to a deterioration of that -- no, maybe it would, because there -- there’s -- it’s gross interest coverage, which includes capitalized and interest expense. So, yes, there would be perhaps a temporary deterioration to be recovered once the plant comes into service.

MR. BYRON WILLIAMS: And again, to the -- to the extent that either of these ratios, debt equity or gross interest coverage influence the level of rate increases in the near term, an associated -- like the debt associated with expenditures like Wuskwatim, Gull or Conawapa could have some impact on rates in the near term?

MS. LYN WRAY: To the degree that we were justifying our rate increase, they rigidly threw financial targets, that could be the case. However, there are, as you know from the Wuskwatim hearing, there is potential to have the debt ratio increased by up to 2 percent for a small length of time, without that having any impact on rates.

MR. BYRON WILLIAMS: And I thank you for that answer, and we’ll -- we’ll probably go into that in a -- in a few minutes.

But given that -- that potential, you’ll agree with me, and not necessarily in the context of this specific Rate Application, but there is, to the extent that large capital projects put pressure on debt equity ratios and interest coverage -- gross interest coverage, you've -- notwithstanding their long term potential benefits, there is a question of inter-generational equity raised in the sense that we -- we have to be cognizant that we don't want to be raising the rates in the short term, to make today's customers pay for benefits that tomorrow's customers might enjoy.

MR. VINCE WARDEN: And that's why we used judgment whenever we submit a Rate Application, as you know, this Application has been submitted at a -- and for each of the years, the test years, our targets are not obtained. So, targets are -- are just that, they're guidelines that we strive for over the long term, but we'll certainly make sure that there are no inter-generational issues that affect ratepayers.

MR. BYRON WILLIAMS: And so just for example, in term -- just as with droughts, Manitoba Hydro might relax or accept a temporary decline in interest coverage, provided you meet the long term goals, at a time of significant capital expenditure for projects that add significant value over the long term, you will also tend to be more flexible in terms of your -- your targets?

MR. BYRON WILLIAMS: Yes, and as a matter of fact, we -- we qualify our targets and -- and indicate just that, that we do deviate from those targets during periods of intensive capital construction.

MR. BYRON WILLIAMS: Ms. Wray, I'm not sure of this, but I suspect that My Friends from MIPUG may have some more questions on this next subject than I do, but if memory serves me right, during the Status Update Hearing, I recall that your evidence in terms of the subject of the special payment to the Province, I remember turning it up in fairly vivid detail in the context of debates and question periods at the Manitoba Legislature. Is that your recollection as well?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And I'm not sure if this is better directed to you, Mr. Warden, but I wonder if -- if the Corporation ever feels torn or divided between what it sees as the interests of itself and its rate payers, versus the interest of its ultimate owner, the Province of Manitoba?

MR. VINCE WARDEN: No, we don't feel torn.

MR. BYRON WILLIAMS: Was torn too hard of a word, perhaps a little stretch from time to time, Mr. Warden?

MR. VINCE WARDEN: Well, I think in response to similar questioning from Mr. Peters, I did indicate it would be nice for us to have predictability in the payments that are made to the Province, so that we could plan for that over the long term.

MR. BYRON WILLIAMS: Okay, fair enough, thank you.

MS. LYN WRAY: Mr. Williams, since you've raised this issue, I notice that on Tab 7, you've quoted page 1683 from the status update, the evidence regarding the special payment. And I just, for completeness of the record, would want to also refer to page 2444 of the -- the same Hearing, which clarifies my response that's recorded here on 1683, and which I said on lines 12 to 15:

> "If the question had been phrased, 'what's the interest expense associated with the payments to the government funded by export revenues' then the answer would be 'there's no interest expense'"

MR. BYRON WILLIAMS: Thank you for that Ms. -- for that clarification, Ms. Wray. Now, earlier we discussed how the payment or the -- excuse me, the somewhere between six point five (6.5) and $6.8 million rate reduction as a consequence of the order flowing from the status update constituted a significant enough impact on revenues to cause Hydro to hesitate in its filing for this Application because of potential impacts on revenues and rate increases; do you recall that, sir, Mr. Warden?

MR. VINCE WARDEN: Yes, that was the response to the Interrogatory that we discussed earlier. Yes.

MR. BYRON WILLIAMS: And we also agreed that a $100 million reduction in revenues due to a loss of earnings had about a $7.5 million impact in terms of additional borrowing and reduced net income, all other things being equal; correct?

MR. VINCE WARDEN: Correct.

MR. BYRON WILLIAMS: So I take it that you'd agree that a $200 million reduction in revenues, again, would have about a $15 million impact in terms of additional borrowing and reduced net income, all other things being equal?

MR. VINCE WARDEN: All other things being equal, yes, I'll agree with that.

MR. BYRON WILLIAMS: And that $200 million would be roughly the amount that was ultimately received by the Province in terms of the special payment; correct?

MR. VINCE WARDEN: 203 million was the -- two hundred and three point five (203.5) to be precise, was the amount we paid the Province, yes.

MR. BYRON WILLIAMS: I see that number's emblazoned in your brain, Mr. Warden. Mine as well. I wonder if you'd agree with me that if the Corporation considers a six point five (6.5), $6.8 million impact on -- on earnings to be a significant impact that a $15 million impact would also be a significant impact?

MR. VINCE WARDEN: Well, we talked earlier as well about everything being relative and if six point five seven (6.57) is significant then fifteen (15) is also significant in terms of our bottom line.

MR. BYRON WILLIAMS: And if that 6.5 million was a potential driver in terms of the rate increase that Manitoba Hydro is seeking, you'd agree as well that the significant $15 million has to be a driver as well; correct?

MR. VINCE WARDEN: Well, we take into consideration all factors when we determine the amount of the rate increase -- that we're going to request of the Public Utilities Board.

The Order -- awaiting that Order was one (1) of the factors we took into account. I think I also indicated earlier that there was a lot of discussion within the Corporation as to whether we should be requesting more because of the state of our -- our retained earnings and how they were affected by the -- by the drought.

So there's many, many factors we take into account when we approach the Public Utilities Board with a rate application.

MR. BYRON WILLIAMS: And I thank you for the entirety of that answer and one (1) of those factors was the -- the $15 million hit in terms of the special payment to the Province; correct? You can't have a $15 million gap in your net income and not take that into account?

MR. VINCE WARDEN: You said the $15 million hit in terms of the payment to the Province?

MR. BYRON WILLIAMS: In terms of the borrowing associated with the payment to the Province; sir?

MR. VINCE WARDEN: I'm not sure, you probably explained this to me, but your -- your calculation of the 15 million, would you mind going over that one (1) more time for me?

MR. BYRON WILLIAMS: We went through that borrowing $100 million would lead to $7.45 million --

MR. VINCE WARDEN: Yes.

MR. BYRON WILLIAMS: -- and that two hundred (200) would be around 15 million; correct?

MR. VINCE WARDEN: Oh, I'm sorry. You're saying 15 million?

MR. BYRON WILLIAMS: Excuse me.

MR. VINCE WARDEN: I thought I heard 50 million; sorry.

MS. LYN WRAY: I think that the $15 million relates more to the reduction in available export revenues that, as a result of the government taking money from those export revenues in the amount of about half.

So, yes, that, had we been able to retain all of those ex -- 400 million odd export revenues, we would have been 15 million better on our interest expense and that would have made a slight difference to the $400 million plus loss, that we're approaching this Application with.

MR. BYRON WILLIAMS: So, it's one (1) of the factors, the variety of factors that went into the Board's considerations?

MR. VINCE WARDEN: That's correct. Well, to clarify, one (1) of the factors -- would you be specific in what you're suggesting as one (1) of the factors?

MR. BYRON WILLIAMS: We're going to the -- the drive -- what's driving the need for the rate increase. You've talked about a variety of factors, the impact of the drought, you've talked about the PUB decision, in terms of the reduced revenues. And another factor has to be -- that has to be taken into account is the $15 million reduction, one-five (15).

MR. VINCE WARDEN: Well, I can tell you that we at the Board level, at Executive level of Manitoba Hydro, we did not dwell on that issue at all. The $200 million/$203 million payment is history. It was -- it was made, it was made for all kinds of good reasons.

We look at the relative level of our retained earnings, relative to the risk that we face going forward, and Mr. Cormie, and Mr. Surminski talked extensively about the -- the risk and the impact of drought, should we encounter another drought on Manitoba Hydro. We just cannot go forward with that level of risk confronting the Corporation, without an -- an increase of the magnitude that we're asking here.

So, the increase that we're asking for is very modest in terms -- in terms of the risk that we, as a Corporation, are facing.

But the payment -- I want to be clear, the payment did not factor into that decision making process.

MR. ROBERT MAYER: Mr. Warden, can we cut to the chase, but for the drought, would we have been here?

MR. VINCE WARDEN: The drought was the driving factor in us appearing before this Board. However, there was a limit to the number of years we could forego a rate increase. There's no doubt at some point we would have to appear.

Now, if we had a level of earnings that was in our previous forecast, the forecast that was prepared in the fall of 2002, which I believe was $70 million net income at that time, we may have been able to forego an increase for one (1) more year, possible. So the drought was the driving factor behind us appearing here today.

CONTINUED BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Just a final question on this area, Mr. Warden. You talked earlier about how the loss of an additional amount of -- in the amount exceeding the 355 million, in terms of '03/04 would make your path longer and more difficult, in terms of achieving your targets.

Would you also agree that the loss of in excess of $200 million in terms of the special payment to the Province, has made your path longer and harder?

MR. VINCE WARDEN: Well, anything that reduces our retained earnings is going to have an impact on -- on the path we take, and the time it takes for us to restore those retained earnings. I certainly agree with that.

At the time the payment was made, the drought, we did not foresee the drought occurring, and it seemed like it was manageable at that time, and still is manageable. It does mean that we're going to have to work harder towards rebuilding those retained earnings, given the drought that we've -- we've just been through.

MS. LYN WRAY: Just to put things in context, that reduction in the amount of export revenues that we were able to retain, the $15 million interest that you have alluded to, amounts to less than 4 percent of the -- of a loss of 400 million. So, as Mr. Warden said, the overwhelming driving force in our need for a modest rate increase is the drought.

Just referring again to the IFF that we produced in 2002, IFF-02, we did do some risk analysis in which we estimated what the additional rate increases would be, if we were to have a drought equal to the worst on record, and that would be somewhat worse than what we've had, because it would extend longer, but nonetheless.

That -- in that document, we estimated that we would need additional rate increases of 2.9 percent, every year of the forecast, in order to recover from a drought of that magnitude. So, it's no surprise that we're coming forward now looking for a rate increase as a result of a drought.

Where the surprise may lie is that we're asking for a rate increase that's only half (1/2) percent more than we've had in previous forecasts.

I'm sorry, 1 percent more than we've had in previous forecasts. With half (1/2) a percent more in the second year.

MR. BYRON WILLIAMS: Ms. Wray, and again we will be moving on, but the interest associated with the borrowing for $400 million would be about $30 million. Is that right? Assuming your long term loss?

MS. LYN WRAY: Our -- yes, I'm not sure where your $400 million is coming from, but yes --

MR. BYRON WILLIAMS: You just used the figure $400 million, two (2) seconds ago, Ms. Wray.

MS. LYN WRAY: Yes, I was referring to -- and

I maybe misspoke, but I was referring to the -- the level of export revenues that were coming in at the time that the government payment was announced.

I believe those export revenues were in the order of $400 million. The special payment was about half (1/2) of that, so that's where the $400 million came. The interest expense would be related to the $200 million that was taken off those export revenues.

THE CHAIRPERSON: Mr. Williams, with all due respect, I think the Board is reasonably well appraised of the -- of the issue.

CONTINUED BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: I'd like to turn to -- and these are questions more of clarification, in terms of the debt associated with the purchase of Winnipeg Hydro.

And just, again, this is for Mr. Harper's assistance. At -- and the figure you used, I believe, in your discussions with Mr. Peters yesterday was $186 million. And that figure is also reported in Tab 8 of the CAC/MSOS Book of References, being $186 million, as well. Is that right?

MR. VINCE WARDEN: That's correct.

MR. BYRON WILLIAMS: Now if we turn to Tab 9, which is the -- the response of Manitoba Hydro to PUB 65, we're -- and you were asked to provide a schedule that details new debt borrowings for the year 2001/02 through 2005/06.

We see on the second page of that, that on -- under number seven (7), there's a reference to $166.8 million in terms of Manitoba Hydro bonds issued to the City of Winnipeg. And you may have discussed this with Mr. Peters, but we're not clear in terms of the difference between the one sixty-six point eight (166.8) and the one eighty-six (186). I wonder if you could reconcile that, please.

MS. LYN WRAY: I'm just guessing, but I think the difference may be book value versus fair market value. I'll just double check that.

(BRIEF PAUSE)

MS. LYN WRAY: Yes, the par value of the long term debt at acquisition was 166.8 million. To move that up to fair market value, given the interest rates that were embedded in that debt, would take you to 186 million.

MR. BYRON WILLIAMS: So the one eight-six (186) is fair market value, Ms. Wray? Is that?

MS. LYN WRAY: Yes, those interest rates in some cases would have been higher than the interest rates prevailing at the time. So that results in a fair market evaluation of the principle of the debt.

MR. BYRON WILLIAMS: And if -- if I could just turn over one (1) more tab, which would be Tab 10. And the second page of Tab 10 being the response to CAC/MSOS-I-16, on the second page of that, page 2 of 2, talks about additional Winnipeg Hydro long term debt of $140 million. And where do -- where does that figure compare to the two (2) we've -- we've gone through previously, Ms. Wray?

MS. LYN WRAY: Sorry, Mr. Williams. Could you just direct me to that hundred and forty (140) number -- oh I see it, on item 3.

That would be net of sinking funds of approximately $45.6 million.

MR. BYRON WILLIAMS: And I think you did go through a bit of that with Mr. Peters. So I apologize if there's any duplication.

Just in terms of -- if one (1) were to, keeping in mind the corporation's long term target of a debt equity ratio of -- for Winnipeg Hydro or -- or long term debt equity ratio of 75/25.

In terms of the equity associated with amass -- the borrowing, how much equity would Manitoba Hydro have to increase its equity by, kind of to balance out against Winnipeg Hydro, the purchase?

What figure should I be using? Should I be using one eighty-six (186) versus sixty-two (62), should I be using one sixty (160), Ms. Wray, that's the kind of direction I'm trying to seek from you?

MS. LYN WRAY: The only -- the only number that I have at the back of my head is that at the end of the forecast period, our debt ratio is 2 percent higher, as a result of the acquisition of Winnipeg Hydro, but our equity levels are pretty much the same, that's the bottom line neutrality that we've been talking about.

So, I -- I could do the back calculation, but I won't do it on the stand, because I always get it wrong.

MR. BYRON WILLIAMS: Would you undertake to do that, Ms. Wray, that would be of assistance?

MS. LYN WRAY: Yes, just to clarify, what you're looking for is -- could you maybe just repeat again what you're looking for.

MR. BYRON WILLIAMS: Yes, and I apologize for the imprecision in my original question. What I'm trying to get is in order -- you know, assuming a debt equity target of seventy-five/twenty-five (75/25), to balance out the debt incurred by the purchase of Winnipeg Hydro, what would the equity of Manitoba Hydro need to be increased by. Is that fair?

MS. LYN WRAY: Well, I -- I think what I would do is go back to the statements that we filed already, which are really the IFF-02 statements, because that's the only ones we have with and without Winnipeg Hydro, and I would look at what we would have to do on the equity side to -- to get to the same debt ratio by the end of the IFF period.

That would yield positive net -- that would require positive net income, presumably, from the Winnipeg Hydro transaction, to -- to balance it out.

MR. BYRON WILLIAMS: Okay, thank you, Ms. Wray.

--- UNDERTAKING NO. 36: Assuming a debt equity target of seventy-five/twenty-five (75/25), to balance out the debt incurred by the purchase of Winnipeg Hydro, what would the equity of Manitoba Hydro need to be increased by.

MR. BYRON WILLIAMS: And, Mr. Warden, in terms of -- or to Mr. Warden or Mr. Wray -- Ms. Wray, I apologize for that.

The -- and perhaps we can just turn to the next tab, which is Tab 11, which is CAC/MSOS-MH-I-76, and I think during the course of the last few days we've tried to get at this question a number of ways, but Manitoba Hydro, in its Response to this Interrogatory, provides a number demonstrating that the essentially bottom line mutual impact to the acquisition on projected electric operations, and I wonder if you could define for me, Mr. Warden, what you actually mean by bottom line neutral?

MR. VINCE WARDEN: Well, over the long term, the impact on ratepayers should be, essentially, zero.

MR. BYRON WILLIAMS: And by impact on ratepayers, do you mean in terms of a contribution to equity as well?

MR. VINCE WARDEN: Yes.

MS. LYN WRAY: I think what -- what we were looking at in terms of our analysis was over the long term, close to zero on the -- the income statement. That was what we meant by the term, bottom line neutral.

MR. BYRON WILLIAMS: And if you were going to go that additional step of -- of making it in terms of a contribution to equity, there would have to be something over and above that calculation?

MS. LYN WRAY: Yes, if you wanted to make a profit on the transaction, you would -- you would be -- well, we would have done the deal differently.

MR. BYRON WILLIAMS: And I just wonder, Ms. Wray, if you would consider that a --a profit, or if part of the costs are kind of -- if part of the consequences of purchasing a new asset or increasing the debt levels requiring a consequent increase in equity, somehow you have to recover that equity, correct?

MS. LYN WRAY: Well, this was a unique transaction with the Winnipeg -- with the City of Winnipeg, and we considered it sufficient to -- to have a net bottom line, and as it turns out, a small increase in the debt ratio, which would not have any impact on ratepayers.

MR. BYRON WILLIAMS: They all do I guess, one (1) way or the other, Ms. Wray.

But I wonder, in terms of your calculation of CAC/MSOS-I-76, yesterday, in -- in I believe it was Mr. Derksen's conversations with Mr. Peters, you talked about potential benefits -- additional benefits from the -- from the purchase in the range of $2 million through enhanced revenues and O&M reductions -- or through enhanced revenues, excuse me.

And I wonder if that $2 million figure is -- is in the calculation that goes into CAC/MSOS-I-76?

MS. LYN WRAY: No. There are some things missing from this calculation. I think overall they are relatively minor and -- and probably net out. So the revenue benefits are not in this calculation.

On the other hand, our -- our estimate of taxes is a little bit on the low side. We didn't include all of the municipal taxes. So I think, on balance, those thing would net out or perhaps even be to Manitoba Hydro's favour.

MR. BYRON WILLIAMS: Just a few questions to -- to wrap up, by few I mean less than half an hour. Ms. Wray in the rebuttal evidence of Manitoba Hydro, and I don't have this in the book of references, but at page 7 of 38, I wonder if you could turn to that for a second?

Do you have that; Ms. Wray?

MS. LYN WRAY: Yes.

MR. BYRON WILLIAMS: And I'm just going to ask you to turn your attention to lines 24 through 28 and you can just confirm I've read this correctly,

"CAC observes that it's particularly important for capital expenditures which are undertaken for export purposes to be evaluated in terms of their impact on rates. Manitoba Hydro notes that the financial analysis for Wuskwatim submitted at the current CEC hearing provide exactly that type of evaluation with respect to rate and financial statement impacts at and subsequent to the project's proposed in service date of 2010."

Did I do okay on that, Ms. Wray?

MS. LYN WRAY: You read it perfectly.

MR. BYRON WILLIAMS: And this is -- would you confirm that the financial analysis done was based upon IFF 02-01, i.e. before the drought?

MS. LYN WRAY: I think that's correct, yes.

MR. BYRON WILLIAMS: And, as a consequence, it wouldn't include any consideration of the impacts of the Wuskwatim advancement in conjunction with the drought; would that be fair?

MS. LYN WRAY: No, but what we were looking at were incremental impacts on the Corporation's debt ratio and interest coverage. So, we believe that those incremental impacts would be, broadly speaking, the same.

MR. BYRON WILLIAMS: I've got a couple of questions about capital or changes in debt levels and I'd ask you to return to the original OM&A Book of References and specifically Tabs 11 and 12. Tab 11 being the response to CAC/MSOS-I-15 and 15(b) which is about four (4) pages in.

And this isn't going to be any questions of earth -- earth shattering consequence but where I'm referring to is at Tab -- Tab 11 of the CAC/MSOS reference material OM&A. Mr. Peters is now with us. And the response to 15(b).

And I -- this is -- these are more questions of clarification but at the top of page 2 of -- of that response we see a reference to a debt balance of sixty-one -- the variance of being 61 million and the suggestion that the explanation for that variance is in the response to I-15(c).

And to Manitoba Hydro, I'm sure the explanation is in I-15(c) but neither Mr. Harper or I could understand it. So, I wonder if -- if to assist Mr. Harper you might provide an additional response in terms of the -- the explanation for that variance?

You could do that by way of undertaking, Mr. Derksen, if that would be acceptable.

MR. WILLIE DERKSEN: I believe the response is just trying to indicate that there is a very small variance on a very large number of -- of debt and the response to 15(c) talks in more detail about the -- about the financing requirements. It doesn't specifically relate to the sixty-one (61), but the implication is that it's such a small amount that it's very difficult or -- or very detailed to come up with -- with that specific number.

MR. BYRON WILLIAMS: Okay, thank you for that explanation.

Mr. Chairman, subject to the undertakings which I have asked, which were numerous. I believe that concludes our questions.

THE CHAIRPERSON: Thank you, Mr. Williams. Before moving on I've just --

(BRIEF PAUSE)

THE CHAIRPERSON: Thank you very much, Mr. Williams, and again we appreciate the books that you put together. They're very easy to follow. We're going to move on, now, to MIPUG. Ms. McCaffrey...?

MS. TAMARA MCCAFFREY: Thank you. Good morning Mr. Chair and members of the Panel. If you'll allow us a moment, we have some materials that we'd like to distribute as well.

THE CHAIRPERSON: Very good.

(BRIEF PAUSE)

THE CHAIRPERSON: By the way, while we're waiting, I'll just fit in one (1) little piece of information. Apparently there's a fire drill scheduled for tomorrow morning at 9:50 a.m. Mr. Singh has intervened and we have permission by the Fire Warden to remain in the building.

But we would suggest that those with Manitoba Hydro that may be in the other room, may want to join us within this room, for that period of time and we'll be sort of sequestered for the brief period time in which the fire drill will be in effect.

I'm assured that we will be safe during the period.

(BRIEF PAUSE)

THE CHAIRPERSON: Ms. McCaffrey, you have these exhibits to enter?

MS. TAMARA McCAFFREY: I do. I have exhibits, I was going to have them entered as I progressed through the -- the cross-examination. The material --

THE CHAIRPERSON: That's fine.

MS. TAMARA McCAFFREY: -- has been distributed with respect to excerpts from Board Orders, they don't need to be marked as exhibits, they're just going to be things that we'll be referring to, it's just for the ease of reference.

We do have a couple of exhibits to mark, and they are tables that have been prepared by Inter-Group Consultants, that will help us just with the cross-examination.

If you like, I can have them marked exhibits now, or do it during the course of my cross-examination.

THE CHAIRPERSON: Why don't we do it now.

MS. TAMARA McCAFFREY: That's fine. With respect to the table entitled, Manitoba Hydro Capital Expenditure Forecast, perhaps we could have that marked as exhibit -- MIPUG Exhibit 6.

THE CHAIRPERSON: Yes, MIPUG Exhibit 6, Manitoba Hydro Capital Expenditures Forecast.

--- EXHIBIT NO. MIPUG-6: Manitoba Hydro Capital Expenditures Forecast.

MS. TAMARA McCAFFREY: And then with respect to the second table, the Government Charges and Dividends, Special Payment, 2000/2003, MIPUG Exhibit 7.

THE CHAIRPERSON: MIPUG Number 7, Government Charges and Dividends, Special Payments 2000 to 2003.

MS. TAMARA McCAFFREY: Thank you.

--- EXHIBIT NO. MIPUG-7: Government Charges and Dividends, Special Payments 2000 to 2003.

MS. PATTI RAMAGE: If we could just back up for a moment, I don’t think Manitoba Hydro had all the exhibits at hand when they were assigned numbers.

MS. TAMARA McCAFFREY: Sorry, did you need me to -- to repeat the exhibits? Certainly. Manitoba Hydro Capital Expenditure Forecast, it would be the Exhibit 6. And the Government Charges and Dividends Table would be MIPUG Exhibit 7.

MS. PATTI RAMAGE: Thank you.

(BRIEF PAUSE)

CROSS-EXAMINATION BY MS. TAMARA McCAFFREY:

MS. TAMARA McCAFFREY: All right. Good morning, Members of the Hydro Panel, I'd like to start our discussion today with talking a little bit about financial targets.

Essentially, as I understand it, and Mr. Warden, you probably agree with me that there are essentially three (3) financial targets that drive Hydro's process, that is the debt equity ratio, the interest coverage target and the capital coverage target, is that fair?

MR. VINCE WARDEN: Yes.

MS. TAMARA McCAFFREY: And as I understand it, sir, the interest coverage and the capital coverage targets are annual short term targets?

MR. VINCE WARDEN: Correct.

MS. TAMARA McCAFFREY: And those targets measure your progress in a certain direction, relative particularly to the debt equity ratio, is that fair to say? They're a useful reference for that?

MR. VINCE WARDEN: That's fair to say, the better those targets are, the more favourable those short term annual targets are, the more favourable will be in terms of achieving our debt equity, that's fair, yes.

MS. TAMARA McCAFFREY: And certainly, sir, as I understand it, the progress towards the debt equity ratio, that seventy-five/twenty-five (75/25) target, is the key when you’re assessing the financial health of the Corporation, is that fair?

MR. VINCE WARDEN: Over the long term that’s fair, yes. The other measures we talked about are the short term measures.

MS. TAMARA McCAFFREY: And of course with respect to assessing the financial health of the Corporation, you’ve hit the nail on the head I think, when you used the term, you have to look at things over the long term, you can’t just look at one (1) year -- one (1) year in isolation, correct?

MR. VINCE WARDEN: I agree with that, yes.

MS. TAMARA MCCAFFREY: And, of course, in order to have meaningful financial targets long term, sometimes those targets have to be adjusted to reflect the current realities of the situation. Is that right, Sir?

MR. VINCE WARDEN: Well, we don’t typically adjust our targets year to year. I think we talked earlier about the targets that remain the targets. We realize the achievement of those targets may be affected by current conditions.

MS. TAMARA MCCAFFREY: That’s precisely what

I was -- was actually getting to, Mr. Warden. Thank you. In terms of adjustments, I'm thinking specifically of the date at which those targets are forecast to be attained.

MR. VINCE WARDEN: Yes.

MS. TAMARA MCCAFFREY: For example, sir, we know that in the 2002 Status Update Hearing, you sought to attain your debt equity target in the year 2005/06 and now that target date has been moved back to 2011/12 as per your IFF-03. Is that right?

MR. VINCE WARDEN: That's right.

MS. TAMARA MCCAFFREY: Now, Mr. Warden, did I understand you correctly last week? Did you say that you were currently looking at revising your targets or your date for attaining those targets again before going back before your Board this Fall?

MR. VINCE WARDEN: No, I -- I think I indicated that we would review those targets as we do every year when we -- when we present the integrated financial forecast to our Board. So we -- we'd either reaffirm those targets or recommend changes.

MS. TAMARA MCCAFFREY: Any idea, at this point, which way you're going to be going with that? That is whether they're going to have to be revised or?

MR. VINCE WARDEN: No, we would, at this point, I'd prefer to have the IFF-04 in hand before I make decision on that.

MS. TAMARA MCCAFFREY: Appreciating that a -- a decision has not been made on that yet, that's what you're telling us. Is that right, Mr. Warden?

MR. VINCE WARDEN: Yes, the targets remain as they are as approved in IFF-03.

MS. TAMARA MCCAFFREY: And -- and you can't give us a hint as to whether you think you're going to have to move back the dates or anything at this point?

MR. VINCE WARDEN: No, I can't give you a hint.

MS. TAMARA MCCAFFREY: Fair enough.

I think my point here though, Sir, is -- is that the targets are dynamic. They're not set in stone. And they have to be sometimes modified at least with respect to the dates for attaining those targets, depending on changes in circum -- in circumstances that may arise from year to year and you'd agree with that?

MR. VINCE WARDEN: Well, yes. And I think history has proven that to be the case.

MS. TAMARA MCCAFFREY: And because that's just one (1) of the realities of -- of the situation, bond rating agencies don't get too nervous over an adjustment of financial targets. That is, when the date was moved back from 2005/06, 2011/12, that wasn't a -- a cause for panic?

MR. VINCE WARDEN: I wouldn't use the word panic. They certainly questioned us on that -- on that change in target. The bond rating agencies like to see steady progress towards the attainment of targets and they were satisfied that we were doing the right things towards attaining those targets.

MS. TAMARA MCCAFFREY: Exactly. Thank you.

And in terms of -- they were satisfied that steady progress was being made towards the targets, of course, they're looking at the big picture. They're looking at the picture, long term, as opposed to one (1) year in isolation. Right?

MR. VINCE WARDEN: Yes.

MS. TAMARA MCCAFFREY: And they're satisfied with that notwithstanding the drought that Manitoba Hydro has had to deal with in this past year?

MR. VINCE WARDEN: Yes, they understand that drought is a part of our business and we were able to satisfy them that we will recover from that drought.

MS. TAMARA MCCAFFREY: And they do understand that drought is part of your business and because it's part of your business, it's something that you plan for. Correct?

MR. VINCE WARDEN: We do.

MS. TAMARA MCCAFFREY: And you budget for it and you design your system capabilities with drought in mind as well. Is that fair?

MR. VINCE WARDEN: We do, yes.

MS. TAMARA MCCAFFREY: Mr. Cormie, you indicated, sir, that the drought that was recently experienced was a one (1) in thirty (30) year event?

MR. DAVID CORMIE: Yes.

MS. TAMARA MCCAFFREY: And as I understand it, sir, between 1987 and 1992 there was a considerably worse drought that we experienced in the province of Manitoba; is that right?

MR. DAVID CORMIE: Yes, I believe that was the -- that period included the second worse drought on record. It also was the worst five (5) year on record.

MS. TAMARA MCCAFFREY: Now, and when you look at that drought and then you look at this drought, this recent drought, I appreciate, must have caused you a great deal of stress with all the responsibilities you have and the admirable way in which you managed the system during that time, but I think you'd agree with me, sir, that -- that fortunately for all of us here this recent drought could not be considered a catastrophe; is that fair to say?

MR. DAVID CORMIE: Catastrophe in which way?

MS. TAMARA MCCAFFREY: Well, lights stayed on in Manitoba?

MR. DAVID CORMIE: It was not a catastrophe from that perspective.

MS. TAMARA MCCAFFREY: And, again, part of the -- part of the reasons -- the effects and we'll go through the ways in which Manitoba Hydro was able to deal with this drought in a moment, but part of the reason that Manitoba Hydro was able to deal with the drought, successfully as I think you did, was because you do plan for droughts and you did plan -- you do plan for droughts in terms of your levels of reservoir?

MR. DAVID CORMIE: Yes. And we made it through the last drought because we were planning for the worse drought on record -- a repeat of the worse drought on record and combined with a severe winter.

And we didn't have a severe winter and we had water conditions that were slightly less severe as what we had planned. So we made it through the year, from a customer's perspective, in pretty normal manner.

MS. TAMARA MCCAFFREY: And not only did the lights stay on in Manitoba, you were also able to meet your long term sales obligations as well; right?

MR. DAVID CORMIE: Yes, we did.

MS. TAMARA MCCAFFREY: Now, I bet there was a -- and I know, in fact, that there were a number of other tools in the tool kit that you could have pulled out had things -- had the drought progressed into this year or -- or increased in its severity over time.

Would you agree with that, sir? There was also a number of other things you could have turned to, had the situation become more dire?

MR. DAVID CORMIE: The -- our -- our gas plants in Manitoba ran only about 5 percent of the time and one of the options that we were prepared to use was to run them 100 percent of the time and that was one of the tools that were left in the tool kit.

And we chose not to use that because it’s a very expensive, kind of a last resort, option.

MS. TAMARA MCCAFFREY: And, of course, so you didn’t even have to run that plant full out and you didn’t have to draw-down your reservoirs either, as it turned out, you were -- you were prudently hoarding them in case things continued; is that right?

MR. DAVID CORMIE: Yes. The reserves we keep in reservoir storage are there as a last resort.

MS. TAMARA MCCAFFREY: And we were a long way away from a last resort because we know you didn’t have to dip into those -- those reserves -- those reservoirs and, of course, there was no public decree to cut back on power usage and there was no need to pay people not to use power like they’ve had to do in California.

We were a long way from that type of scenario;

isn't that right, Mr. Cormie?

MR. DAVID CORMIE: Yes, we were.

MS. TAMARA MCCAFFREY: Is there anything else in that tool kit that we haven't covered so far?

MR. ROBERT MAYER: Rolling blackouts?

MR. DAVID CORMIE: Rolling blackouts would have been something that we would have undertaken, only having drained reservoirs.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: Did you talk to any of your customers that had the ability for self-generation of power about doing more of that in order to take some of the pressure off Manitoba Hydro's load?

(BRIEF PAUSE)

MR. VINCE WARDEN: No, we didn't.

MS. TAMARA McCAFFREY: And I suppose that's something else too, that you could have looked at as well, had you needed to, is that right, sir?

MR. DAVID CORMIE: We had -- we had gone through some emergency planning scenarios and looked at the amount of energy that was available through diesel generation and -- and if my memory serves me right, the quantities of power and energy that were available, were relatively small.

We had examined it and -- and chose not to go to that extent. Most of that self generation is diesel fuel, and if it wasn't already running to serve the customer's load requirements, it was very expensive, and probably more expensive than running our gas turbines.

MS. TAMARA McCAFFREY: I was thinking specifically about one (1) of your customers, Tolko, they have the ability to do some self generation, as I understand it?

MR. DAVID CORMIE: Yes, but I'm not -- I don't have a memory of what quantities are available there though.

MS. TAMARA McCAFFREY: Fair enough.

(BRIEF PAUSE)

MS. TAMARA McCAFFREY: All right. So, if this -- drought that occurred in 2003 was a one (1) in thirty (30) year drought, do you have any numbers for the probability or likelihood of an energy crisis, a real crisis occurring, and the type of thing that would result in you having to drain those reservoirs down and start looking at rolling blackouts and so on?

What would -- what would the probability of such a scenario be occurring, do you have any numbers on that?

MR. DAVID CORMIE: Well, if the -- the probability of the worst drought on record were to reoccur, and that -- that drought -- there's -- I think we have ninety-two (92) years of river flow records, and so let's say that the chance of that is a one (1) in a hundred (100) event.

And -- and then given that we maintain reserves for a severe winter, and we operate conservatively, I think the odds of -- of actually running short are -- are significantly less than one (1) in a hundred (100).

MS. TAMARA McCAFFREY: Because you plan --

MR. DAVID CORMIE: We --

MS. TAMARA McCAFFREY: Oh --

MR. DAVID CORMIE: -- we also know that there are antidotal records available prior to modern measurements of stream flows, that began in 1912, and -- and we also have records of tree rings that go back into the 1700s and both those records indicate to me that droughts of greater severity and of longer duration are possible.

And -- and so we are very careful not to assume that the drought of record that has occurred since 1912 is the worst case. And that -- that's one (1) of the guiding principles that I have -- have taken, and Manitoba Hydro has followed, that we -- we don't know what the -- the ultimate risk of drought is and we have to be very careful.

It’s not one (1) that we -- that we -- we have assigned an acceptable level of probability and are operating accordingly, we -- we take the view that the system is designed and has a fixed capability, that there are significant risks beyond that capability. And -- and become very, very cautious once we do get into a drought situation, and only are able to breathe a sigh of relief, once the rains come, as they have this year.

MS. TAMARA McCAFFREY: And -- and I think we’re -- we’re probably all grateful for that approach and your good work, Mr. Cormie.

You said the odds would be considerably less than a one (1) in a hundred (100) chance of actually running -- running out of power in Manitoba. You can’t -- you can’t give us what -- I know you plan for the one (1) in a hundred (100) chance. You plan for the five (5) year drought. Do you think it would be one (1) in a thousand (1000) or ...?

MR. DAVID CORMIE: I -- I brought up the historical records because if you go back to the 1700s and you assume that those river flows could repeat.

Clearly our power system is not capable of surviving a drought that occurred three (3) or four hundred (400) years ago.

So, you know, whether it’s -- it’s greater than a hundred (100) but I don't -- you know, I -- I know it's not infinitely small. It's -- it's between one (1) in a hundred (100) and one (1) in three hundred (300).

If you assume that, that is the worst drought that's possible, the one (1) that occurred in the 1760's.

MS. TAMARA MCCAFFREY: Thank you.

MR. ROBERT MAYER: Mr. Cormie, in the interim, I do happen to recall, however, living in a community where we had what they call the one hundred (100) year rain, two (2) of them, two (2) month's apart.

So I take it the -- the playing the odds is sort of a fool's game in that regard because those are just statistics and they can get skewed at any time.

MR. DAVID CORMIE: Yes, and -- you know, we -- we have to be careful not to say that the drought won't repeat next year and you could have the one (1) in thirty (30) year drought this year and next year you could have the one (1) in two hundred (200) year drought.

Just over the very, very long term, if you add them up and do the division, you -- you find out that's how frequent. But it doesn't tell you when they will occur.

THE CHAIRPERSON: But, Mr. Cormie, in -- in your -- your caution has certain limits because you're enter -- undertaking export arrangements.

MR. DAVID CORMIE: Yes, and when we discuss the reliability of supply with our customers, we make it clear to them that our ability to deliver is based upon a -- a history of river flows that's about a hundred (100) years long.

And they're comfortable as long as the drought that we experience is within the range that's been defined by the history that -- that -- in during those -- during those conditions that we will continue to deliver.

One (1) of the conditions in the new extension sale to the -- to Northern States Power was that if river flow conditions occurred worse than were described in historical record, that that would be treated as a force majeure event, an act of God. And that we would -- we would not be obligated to continue selling them power if a drought of greater magnitude and severity were to occur than that which occurred in the historical record.

THE CHAIRPERSON: That's very good to know. By that, you're talking about back to 1912?

MR. DAVID CORMIE: Yes -- yeah, and -- and we go over that information with them. They need to understand the risk of supply from us and they're comfortable that -- that, yes, there are the risks but they're such low probabilities then -- and -- and they're alternative is to build a -- a thermal power generating station that also has risks.

And they're -- and they just want to make sure that -- that they understand what they are and they're consistent with the risk tolerances.

THE CHAIRPERSON: Did this amendment take -- take place subsequent to your knowledge of this drought?

MR. DAVID CORMIE: No, it didn't. It -- we negotiated that in the summer of 2002 -- the -- the fall of -- and that was prior to this drought.

THE CHAIRPERSON: Thank you. Sorry, Ms. McCaffrey.

MS. TAMARA MCCAFFREY: Not at all, Mr. Chair.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: The next area I was going to talk about, but I think what I'll do is ask you instead to update one (1) of your -- one (1) of your graphs and then come back to it after lunch.

So I'm going to refer you to Tab 7 of Manitoba Hydro's Volume I. And I'm looking at Figure 7.33, which is at page 6 of 7 at that tab. And it's the Nelson Churchill Drainage Basin, Manitoba Energy and Reservoir Storage Graph. It's -- it falls off at about January 2004 and I wondered if it would be possible to get an update of that for our discussions?

MR. DAVID CORMIE: Yes, we can provide an update.

MS. TAMARA MCCAFFREY: Thank you.

--- UNDERTAKING NO. 37: To provide an updated version of the Nelson Churchill Drainage Basin, Manitoba Energy and Reservoir Storage Graph.

MS. TAMARA MCCAFFREY: Now, you've had a drought and we know that there's costs that exceed $440 million or exceeding $400 million. I take it then, this might make it easier for you, Mr. Warden, to justify the reserve levels in your revenue requirement than it would be say, in a flash or non-drought years?

You can say -- you can say to ratepayers, you see, we need these reserves because look, here's a drought and it's a good thing we had them; is that fair to say?

MR. VINCE WARDEN: Yes. And I think we've already said that to ratepayers in various press announcements.

MS. TAMARA MCCAFFREY: So, now, would it be easier then, sir, to go down to the Broadway now and tell the Minister of Finance and your Crown Corporate Counsel why you need those reserves now that you've had a drought?

MR. VINCE WARDEN: Well, we don't typically have those types of discussions with the Minister of Finance or the Crown Corporation's counsel. So they don't -- they don't question the wisdom of the Board of Manitoba Hydro in -- in establishing those target reserve levels.

MS. TAMARA MCCAFFREY: I'm just, of course, referring to, in terms of government charges, and looking at -- at the money that Hydro builds into the reserves and wondering if any kind of dialogues goes on between Hydro and the government with respect to, you know, wait a minute, you're looking at taking a special payment but we need these reserves for X; does that kind of information exchange occur?

MR. VINCE WARDEN: Well, the government is certainly aware of what our financial targets are and of our financial position at any given time.

MS. TAMARA MCCAFFREY: Fair enough. Now, you'd agree with me, sir, that there's a difference between charges that get built into costs and dividends that are below the line or paid out of earnings; is that fair to say?

MR. VINCE WARDEN: Yes.

MS. TAMARA MCCAFFREY: Dividends are taken when there's been a good year as opposed to government charges, like water rentals, debt guarantee fee, in your case, they have to be paid regardless; is that right?

MR. VINCE WARDEN: The water rents, debt

guarantee fee, yes, have to be paid regardless. They are influenced, however, by the -- by the amount of water available for generation. So -- at least the water rental fee is.

Dividends, as you called them, are not typically taken by -- by the Province. This was the -- I think, as we've talked about extensively in these proceedings, the special payment was -- was a one-time event and was -- there was special legislation that provided for that.

MS. TAMARA MCCAFFREY: All right. I'm going to draw to your attention now, please, to MIPUG Exhibit-7 which is the government charges and dividends special payments 2000/2003 table?

MR. VINCE WARDEN: Yes, I have it here.

MS. TAMARA MCCAFFREY: All right. So what I want to do now is just go through this -- this chart briefly before lunch just so that we can get an idea of what we're looking at here.

And in terms of reference, the other reference point would be the Public Utility Board Exhibit 9, you don't need to turn to it but if you need a reference there was some information provided from that table that we have used here in this table.

So let's go through this table now. You can see there in the first -- the first section of the chart -- of the table it's Manitoba Hydro for the fiscal year ending March 31st and it shows the government charges between the years 2000 to 2003.

You see that, Mr. Warden?

MR. VINCE WARDEN: I do.

MS. TAMARA MCCAFFREY: Now, you'll look at the last two (2) lines in this section and you'll see that the second last line is the charges that exclude dividends versus total revenues?

MR. VINCE WARDEN: Yes.

MS. TAMARA McCAFFREY: Okay. In terms of excluding dividends, we're not talking here about the special payment, just so that we're -- we're all clear in that understanding.

But you see in that the year 2000, sir, government charges amounted to about 10.7 percent of total revenues for Hydro; is that -- is that right?

MR. VINCE WARDEN: I haven't double checked that calculation for 2000, but I'll -- I'll accept that.

MS. TAMARA McCAFFREY: Okay, subject to check then.

And then we see that it went down slightly in 2001 and then the 2002 were up to 15.23 percent and then at 15.14 percent in 2003. You -- you see that there, sir?

MR. VINCE WARDEN: I do, yes.

MS. TAMARA McCAFFREY: Now, with respect to taking into account the -- the special payment, which we haven't done so far. Looking at the last line of that section, you can see that when we take that special payment into account in 2003, now the percentage of Government charges, including this so called, if I can call it a dividend, has now jumped up to 29.91 thou -- 29.91 percent, correct, sir?

MR. VINCE WARDEN: Correct.

MS. TAMARA McCAFFREY: And you can see that the table demonstrates that between the years 2000 and 2003, we've seen an increase in government charges of 70.8 percent, for Manitoba Hydro?

(BRIEF PAUSE)

MR. VINCE WARDEN: Yes, I'll accept that.

MS. TAMARA McCAFFREY: Now, let's have a look at BC Hydro now, where we see that the charges excluding dividends, the percentage from the total revenues, was 12.84 percent in 2000, and then they dropped down quite significantly to 5.44 percent 2001 and 6.24 percent 2002, and then ending off at 9.14 percent 2003. You see that there, Mr. Warden?

MR. VINCE WARDEN: I do.

MS. TAMARA McCAFFREY: Now, when we take the dividends, because BC Hydro is regulated based on a rate of return on equity basis, different from Manitoba Hydro, when we take the charges that include dividends, the percentage of total revenues is at 2000 22.7 percent, but then it drops again quite significantly in 2001, to 10.15 percent, then 11.52 percent. And then finally in 2003, 16.81 percent, and that's including dividends; is that fair to say, sir?

MR. VINCE WARDEN: Yes, I'll agree with that. BC Hydro was making very large export sales during that period of time, but, yes, those are the numbers. I agree with that.

MS. LYN WRAY: I guess the other observation one could make about the year 2000 is that despite much lower revenues, government payments were -- were still at the same kind of level. So, it's different circumstance from Manitoba Hydro, where for example, if you look to the 2003/4 year, our charges are 14.3 percent, that would reflect the fact that as our -- as we have a drought, our water rentals do go down. But that doesn't seem to have been the case with BC Hydro, looking at these numbers, there's seems to have been an extraction of monies from that utility, even though they were having much lower revenues.

MS. TAMARA McCAFFREY: Well, you would agree with me, Ms. Wray, that essentially there’s been a decrease overall between 2000 and 2003, in terms of Government charges being paid from BC Hydro to the tune of around 9.8 percent; would you say that?

MS. LYN WRAY: Well arithmetically that’s true. I think what’s missing from these numbers though, and -- and of course we can’t get it for the other two utilities, is the numbers for 2003/4 and the two (2) test years. And the two (2) test years for Manitoba Hydro are 15 percent and 15.2 percent, which are actually a decline from the percentages that you see in the preceding couple of years.

MS. TAMARA MCCAFFREY: And, again, you’re using the -- you’re talking about the 15 percent though in the context of government charges excluding, of course, the -- the payment to the Province of Manitoba?

MS. LYN WRAY: Yes. That’s --

MS. TAMARA MCCAFFREY: And when we look, however, at BC Hydro and now we’re going to look briefly at Hydro Quebec, the bottom-line is here is that when you look at these utilities, their payments to -- to the Government including dividends are roughly in the same range as Hydro’s payments to the Government excluding the special payment; would you agree with that, Ms. Wray?

MS. LYN WRAY: Well, I guess what I see from these numbers is that the 2003 numbers which are in around 15 to 16, 17 percent are -- are a little bit higher than Manitoba Hydro's without the dividend payment.

And then going forward, assuming that they don't change their percentages, we would be very much in line, if not a little bit less.

MS. TAMARA MCCAFFREY: But, Ms. Wray, what I -- what I asked you is that you'd agree with me that their -- essentially their ranges, we've got Hydro Quebec 2003 15.42 percent including dividends, BC Hydro which was considerably less than that in 2001 and 2002 but going up to 16.81 percent in 2003.

Again, I know that they're in the ballpark with Manitoba Hydro's 15.14 percent without the government special payment; is that not correct?

MS. LYN WRAY: I would agree with those percentages. But, again, to have a -- a full picture of those other utilities, we had a rate increase for BC Hydro approved of 7.23 percent for April 1st, '04 and they're seeking another 1.67 percent for April 1, '05.

So if we're looking at how government payments might affect rate increases, I think those -- those need to be taken into account as well as -- as well as Hydro Quebec's 3 percent approved rate increase for January 1, '04.

To get a full picture I think we need to look at both rate increases and -- and government payments.

MR. ROBERT MAYER: Ms. McCaffrey, perhaps you could tell us, you are now number three (3) who's run through this extraordinary payment in 2003; is it your position that, for some reason or other, this was not required by Hydro and therefore -- or was not required and therefore shouldn't be included in the revenue requirement?

And if that isn't what your point is, would you please tell us what your point is?

MS. TAMARA MCCAFFREY: Well, I'd be happy to tell you that. I was going to save it for argument but I'll get right -- right too the point. I think one of the concerns I think that ratepayers may have, and certainly our customers may have, is the notion that we're building up reserves and building up reserves and there's a risk that those reserves may be -- may be depleted.

And depleted by government -- by unexpected government charges. And there seems to be a trend of increasing payments in this province that I think that -- that we need to be aware of taking into account that Hydro doesn't have control over the government payment and this Board doesn't have control over the government payment.

However, the fact remains that it's there and people need to appreciate the impact that it has. And, again, we are seeing a trend of increases in government payments, a significant increase of seventy (70) -- over 70 percent just over the past -- in the past three (3) years.

So, I think it is -- it is relevant and in terms of building up reserves based on a reve -- revenue requirement ratepayers may have some degree of scepticism about that and in this forum I think it’s appropriate -- appropriate to look at it so that the -- so that the implications are understood by everybody.

MR. ROBERT MAYER: We recognize then MIPUG’s political statement respecting the Government taking funds from the -- from the Corporation it wholly owns and would point out that that didn’t prove to be overly effective last June.

MR. VINCE WARDEN: I might just also point out that I think I -- I pointed this out earlier in cross-examination from Mr. Peters is that we had a water rental rate freeze agreement with the Province that ended March the 31st, 2001. And after that freeze ended payments -- water rental charges effectively doubled but were only brought up to the level of BC Hydro at that point in time.

So, there were reasons for the -- the increases that we’re seeing in this exhibit. And I just want to be clear on that.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA McCAFFREY: That’s fair -- fair enough, and I -- I have the comments from the Board, and I think it might be prudent to -- to move forward then, to the next area of cross-examination.

THE CHAIRPERSON: I think it would be fair to say, Ms. McCaffrey, that we're -- we're aware of the connection to revenue requirement and the potential affect on rates. And I think we understand fairly well the -- the issues respecting to the rate -- special rate payment, and the -- have received the information with respect to the comparisons of the other jurisdictions.

So, I think we have a significant amount of information on this particular matter at this point.

MS. TAMARA McCAFFREY: Thank you.

CONTINUED BY MS. TAMARA McCAFFREY:

MS. TAMARA McCAFFREY: Now, we've talked about financial targets at length, I think. And, Mr. Warden, in 1996 when your debt equity target of seventy-five/twenty-five (75/25) was reviewed at that time, there was lots of discussion, I think you'll recall, about the environment in which Manitoba Hydro operated in, including the mark environment, policy environment. Do you recall that in 1996, during that time?

MR. VINCE WARDEN: Well, could you be a little more specific, and maybe it will refresh my memory going back to ’96. I’m not -- I’m not sure I’m specifically recalling the discussion that you’re referencing.

MS. TAMARA McCAFFREY: Well, specifically, there was talk about potential changes in regulation, there was talk about the issues of -- of the export market, and how they were going to be regulated. There was talk, perhaps of some changings to the Manitoba Hydro Act.

MR. VINCE WARDEN: In -- in general terms, I’ll agree that we talked around those subjects, yes.

MS. TAMARA McCAFFREY: Was there some talk about Manitoba Hydro in a monopoly environment, versus in an environment where they were subject to competition?

MR. VINCE WARDEN: Yes.

(BRIEF PAUSE)

MS. TAMARA McCAFFREY: Now, financial targets can relate to the market in which the utility operates, is that fair to say? It’s one (1) of those things that may reflect the extent to which utility is subject to competition, or it may also reflect the protections to which a certain utility enjoys, such as the debt guarantee fee?

Would you say that those kind of considerations may inform the financial target, such as debt equity ratio?

MR. VINCE WARDEN: Yes, I'll -- I'll agree with that.

MS. TAMARA McCAFFREY: So, in this context then, sir, there's currently some rumours about changes to the Manitoba Hydro Act being discussed. Are you able to at all give us any indication of -- of where that is at?

OBJ MS. PATTI RAMAGE: I would have to object to that question. I don't think it's relevant to these proceedings, and I would suggest it's -- until amendments to any piece of legislation are actually introduced, they don't become relevant to a proceeding.

MS. TAMARA McCAFFREY: Inasmuch as -- as a potential change to the regulation of Hydro, perhaps, for an example to a rate of return on equity could be coming in as soon as in the next year or two (2), could have very significant impacts on ratepayers. It could impact whether the debt equity target of seventy-five/twenty-five (75/25) is a reasonable one (1), because of course if you build up equity, then you're going to have a higher percentage -- more money going out to ratepayers. So, I would submit, Mr. Chair, that -- that June 22, 2004, there is some relevance.

We're certainly not asking for any commitment here, but I think if there's going to be some imminent changes in the wind, if changes are in fact imminent, I thin it would be useful to bring that out at this time.

MS. PATTI RAMAGE: The Witness simply can't speak to what the Government may or may not do, Mr. Chair.

THE CHAIRPERSON: Yes, I was going to say that legislation is obviously relevant to what we do and -- and what Hydro does.

But it's pure speculation as to what a government may propose to a legislature or not and I -- I think it's a bit unfair to pose the questions to the Panel. But that doesn't detract from the -- the thoughts and the concerns that ratepayers or intervenors may have with respect to such matters.

MS. TAMARA MCCAFFREY: Thank you.

(BRIEF PAUSE)

MS. TAMARA MCCAFFREY: I -- I may be going out on a limb here, but just to give it one (1) more college try, can you at least give us an indication of when or -- or if changes to the Hydro Act are being contemplated if in fact -- you don't have to tell us anything about them, but if there's any indication of --

THE CHAIRPERSON: Ms. McCaffrey, I -- I do think that's a little bit unfair of -- of the Panel. The legislation could be proposed at any time by -- by any government and -- and any different types of circumstances.

What we can deal with is sort of what is, is, so to speak.

MS. TAMARA MCCAFFREY: Thank you. I'll move on.

(BRIEF PAUSE)

MS. TAMARA MCCAFFREY: Now, it's five (5) to twelve (12). The next area I have to cover is going to take a little bit of time. I leave it to the Board's discretion if you want me to break it now and then come back, perhaps at five (5) to one (1), or do you want me just to --

MR. DAVID CORMIE: Ms. McCaffrey, we have an -- the exhibit that you asked for. If you want us to hand that --

THE CHAIRPERSON: Why don't you distribute the Exhibit and then we will break for lunch. We'll number it and then we'll have a break for lunch?

MS. TAMARA MCCAFFREY: That's fine, thank you.

THE CHAIRPERSON: Mr. Singh, what number are we up to?

(BRIEF PAUSE)

THE CHAIRPERSON: Ms. Ramage, if I may, the updated chart, the Nelson Churchill Drainage Basin; is it twenty-seven (27)?

MR. HOLLIS SINGH: Twenty-eight (28).

THE CHAIRPERSON: This would be twenty-eight (28)? Manitoba Hydro --

MS. PATTI RAMAGE: Mr. -- I'll go with Mr. Singh.

THE CHAIRPERSON: Okay. I'm -- I'm sure he's accurate. Then the -- the revised CAC/MSOS MH-I-26 be filed as Exhibit 29?

--- EXHIBIT NO. MH-28: Updated chart, the Nelson Churchill Drainage Basin

--- EXHIBIT NO. MH-29: Revised CAC/MSOS-MH-I-26

MS. PATTIE RAMAGE: Oh, if -- if I could just explain that the revised CAC/MSOS-I-26, was revised because we noted that in Mr. Williams -- I don't know if it was Volume I or Volume II, it escapes me, there was so much paper, that part way down the chart, and I don't have what we had filed in front of me, but I understand that when these numbers were converted from a Excel over to Word, it repeated, I think, it was the Figure 1.55, and this just corrects to -- to provide the accurate interest coverage in the last column.

THE CHAIRPERSON: Well, we appreciate that. Well, we'll stand down now and we'll recommence at one o'clock. Thank you.

--- Upon recessing at 11:58 a.m.
--- Upon resuming at 1:05 p.m.

THE CHAIRPERSON: If we could resume now, just to remind everyone again, that we'll be breaking at 3:00 today. Ms. McCaffrey, anytime you're ready.

MS. TAMARA McCAFFREY: I'm ready.

CONTINUED BY MS. TAMARA McCAFFREY:

MS. TAMARA McCAFFREY: Mr. Warden, you're one (1) of my favourite people to talk to on this Panel, I just want you to know that right off the bat.

MR. VINCE WARDEN: I'm so flattered.

MS. LYN WRAY: I was going to say, be afraid, be very afraid, Mr. Warden.

(BRIEF PAUSE)

MS. TAMARA McCAFFREY: Oh, well, I'm not sure that's a compliment, so --

And I'm going to -- I'm going to be speaking to you momentarily about -- reserve provision amounts at Hydro, so you can start turning your mind to that.

And just before I go there though, I'd like to just clean up the one (1) area that we left off at before the break. Now, that we have an updated copy of the Nelson/Churchill Drainage Basin, Manitoba Hydro Exhibit 28, and of course it looks like I'm going to be speaking to you, Mr. Cormie.

If everyone has -- has this graph before them now, can you just explain to me, sir, what the vertical units on this graph represent?

It says, energy and storage gigawatt hours, but --

MR. DAVID CORMIE: That's in terawatt hours in -- that's in the thousands of gigawatt hours.

MS. TAMARA McCAFFREY: Okay.

MR. DAVID CORMIE: I apologize for that.

MS. TAMARA McCAFFREY: Okay.

MR. DAVID CORMIE: Is that what you were asking about?

MS. TAMARA McCAFFREY: Yes, that was my first question. Now can you just --

MR. ROBERT MAYER: What was that term, I haven't heard that one (1) before?

MR. DAVID CORMIE: A terawatt hour is a thousand (1,000) gigawatt hours.

CONTINUED BY MS. TAMARA McCAFFREY:

MS. TAMARA McCAFFREY: So, it says gigawatt hours on the graph --

MR. DAVID CORMIE: It should be thousands of gigawatt hours.

MS. TAMARA McCAFFREY: -- but it's actually terawatt hours, or a million megawatt hours?

MR. DAVID CORMIE: Millions of megawatt hours.

MS. TAMARA McCAFFREY: Okay. Can you just tell us briefly what this graph tells us? Can you explain this graph to me.

MR. DAVID CORMIE: There are eighteen (18), at least eighteen (18) reservoirs in Western Canada, including those under direct control of Manitoba Hydro, whose contents eventually flow through the generators on Manitoba Hydro's -- on the rivers that Manitoba Hydro has its generating stations.

And water in reservoir storage has -- has potential. The water that's in the reservoirs on the Winnipeg River, eventually will flow through the six (6) Winnipeg River plants, and then through the five (5) Nelson River Plants. And so it has the potential to generate power at nine (9) generating -- sorry, six (6), at the six (6) Winnipeg River plants, and the five (5) on the Nelson, and fourteen (14) generating stations, yeah.

And as it falls -- as it makes its way to the sea. And various reservoirs have -- the water from those reservoirs flows through various generating stations, and -- and we can calculate the potential energy that is in storage in each of the reservoirs.

And so this graph just shows the total energy in all the reservoirs, the total potential energy at -- at any one (1) time. And going back to the nineteen (19) -- 1976, when Manitoba Hydro began regulation of the -- of the Churchill River diversion and Lake Winnipeg regulation.

The chart shows the average of those twenty-six (26) years, that's the -- the line that goes through the middle of the grey shaded area. The grey shaded area shows the range of energy in storage since 1976.

The top of the grey area being the years of highest water supply, and the bottom of the grey shaded area, being the years of low water supply. And then overlaid on top of that we've had -- we show the results of 2002/03, shown in a very light grey line, and then 2003/04 and then on the left hand side, results to the 1st of June of 2005.

MS. TAMARA McCAFFREY: Thank you for that explanation, sir. So, just -- just to be sure that I understand this. Looking at the graph, it looks like in April of ’03 you had 6 terawatt hours in storage; is that right?

MR. DAVID CORMIE: That is correct.

MS. TAMARA MCCAFFREY: Okay. And then it -- it seems that by -- in the course of the following year then you increased it to 8 terawatt hours; is that right?

MR. DAVID CORMIE: At the start of this year it was at -- it was at just under eight (8), yes.

MS. TAMARA MCCAFFREY: Okay. And as of April of ’04 it looks like it was just at eight (8), now that you’ve updated the graph?

MR. DAVID CORMIE: April ’04 is -- is just under eight (8), yes.

MS. TAMARA MCCAFFREY: Sir, I understand that in the winter of ’03 you already knew that the snow pack was poor; is that right?

MR. DAVID CORMIE: As re -- you’re talking about January of ’03, yes.

MS. TAMARA MCCAFFREY: That’s right.

MR. DAVID CORMIE: Yes, the snow pack on the Prairies was -- was very low, yes.

MS. TAMARA MCCAFFREY: And I see that at the end of the 2002/2003 fiscal year in April it looks like your levels were at a twenty-five (25) year low; was that right, sir?

MR. DAVID CORMIE: That’s correct.

MS. TAMARA MCCAFFREY: So it’s just -- it seems to me and I’m going to give you and invite you to explain this, but it seems to me that taking levels down from eight (8) to six (6) when snow pack was poor might have been seen as a risky thing to do; can you reassure us that taking the reservoirs down to those levels was within the realms of prudence in how you manage the system? Can you explain that to us?

MR. DAVID CORMIE: We -- we -- we drew the additional 2 terawatt hours out of storage over the winter of 2003 having consideration for the fact that we new had a new transmission line in service and that our combustion turbines at Brandon now had additional capability that -- and we were confident that coming into the spring of 2003 with 6 terawatt hours in storage we could still meet the Manitoba load requirements should a drought of 40/41 magnitude occur in 2003/2004.

So I -- I was aware that as -- as we went through the winter the lack of snow on the ground increased the likelihood of a drought but I still considered the probability of drought to be quite low. Snow -- snow melt run off only accounts for a small portion of the total water supply to -- to Manitoba Hydro’s river systems. And the failure of the snow melt doesn't necessarily mean that there will be a lack of spring run off.

And a good example was this year, it wasn't until March 28th that we finally received significant rainfall and snowfall in the river valley to -- which turned a -- what we expected to have been a very low spring snow melt run off on the Red River into a very high one.

And so winter snow pack accumulation, the lack of that would tend to lead to lower run off but it doesn't guarantee it. And so there was heightened risk of -- of -- of significant drought but there wasn't a certainty.

And so it was a calculated operation on our part to -- to draw water out of -- additional water out of storage knowing that there may -- there may be a high replacement cost but the probabilities were not significantly different than what we had previously assumed.

MS. TAMARA MCCAFFREY: Would you, with hindsight, of course, we've talked about that, would you -- would you maybe have done it differently now and perhaps not drawn it down to those levels and perhaps might -- would you do it differently in the future if faced with the same situation?

(BRIEF PAUSE)

MR. DAVID CORMIE: With -- with the certain knowledge that there was a drought and -- and my reluctance to put the power system at risk, I don't believe I would have. With that certain knowledge, it wouldn't -- wouldn't make sense to -- to draw the reservoirs down.

But, it was within the capability of the power system to tolerate and it was a -- it was a -- it was an issue of -- of -- a financial issue more than a reliability issue.

Given the same financial circumstances, I would have -- I would have done -- done the same calculations and I would've operated the same way.

MS. TAMARA MCCAFFREY: And I guess what I'm hearing from you through all this though is that you didn't put the capability of the system at risk?

MR. DAVID CORMIE: I -- I don't believe I did, no.

MS. TAMARA MCCAFFREY: Thank you for that.

In any event you built the reservoirs back up from six (6) to eight (8) terawatts in '03/'04. Correct, Sir?

MR. DAVID CORMIE: There's additional water in storage this Spring, more than there was last Spring, by two (2) terawatt hours. Yes.

MS. TAMARA MCCAFFREY: Sir, I'm -- I'm

interested to know, what is the additional value of that power that was laid up in that period?

MR. DAVID CORMIE: That was an -- an issue that we addressed I think on day one (1) or day two (2). And it’s still too early to know whether -- what the final outcome of that will be.

In -- in March of 2003, our average import price was around sixty dollars ($60) a megawatt hour. And so that water that was taken out of storage was displacing purchases at that cost or greater.

This Spring power purchases were of lesser value. I think we’re in a thirty-eight dollar ($38) range. And so -- well, I -- I guess the question is time will tell what that -- that value be. Whether it will have tremendous value or whether it will have little value.

MS. TAMARA MCCAFFREY: Okay thank you.

Now with respect to --

MR. DAVID CORMIE: I -- just, if I could interrupt one (1) more time.

MS. TAMARA MCCAFFREY: Certainly.

MR. DAVID CORMIE: Because the -- you know, once we -- once you’re in a drought, it -- it’s -- we want to be very cautious about -- assuming that the drought is over until it’s really over.

And -- and droughts start. They have a

duration and they -- they end sometimes quite dramatically like happened in -- in 2002. And it was clear over one (1) weekend that -- that water conditions had turned around.

Because the -- we -- we did have a near normal snow pack this Winter, but there were certain areas of our watersheds that were still in -- in drought and it wasn't until the end of March when the Red River Valley got three (3) inches of rainfall that it was clear to me that the -- the risk of drought this year was significantly reduced.

And so to continue to draw water out of storage through February and March, it wasn't obvious during -- at that time, that we were in that position. It only became obvious early in April once the -- the measurements came back on the Red River situation and continued rainfall after that, that it was clear that -- that this potentially was a surplus situation.

MS. TAMARA MCCAFFREY: Okay, thank you for that Mr. Cormie. You've given us sort of a -- a range of the -- whether, you know, sixty dollars ($60) per megawatt hour versus thirty-eight dollars ($38) per megawatt hour, this year.

I understand that it fluctuates and you can't know exactly what the value is until you sell it. Is that -- that basically what you're -- what you're telling us, sir? But is that sort of a reasonable range to look at anyway, somewhere in the forty (40) to sixty (60) dollar per megawatt hour range?

I won't hold you to it if --

MR. DAVID CORMIE: Yes and it -- and it could be significantly more than that, if it -- if that water is used to displace gas fired generation, it would be a hundred dollar ($100) power.

MS. TAMARA McCAFFREY: Okay. So, if we're talking here about 2 million megawatt hours, if we look at the value of between forty (40) to sixty dollars ($60) per megawatt hour, that could lead to a value of somewhere between eighty (80) and $120 million, assuming that math is correct. Does that seem like a reasonable estimate, of what it might be worth?

MR. DAVID CORMIE: Yes, it's worth a lot.

MS. TAMARA McCAFFREY: Now, it doesn't actually -- it has value, but it doesn't show up on the balance sheet as an asset, correct?

MR. DAVID CORMIE: That's correct.

MS. TAMARA McCAFFREY: So, you don't have a pure matching of cost to revenue, because there's a cost there, but -- but the value of the revenue or the asset isn't on the other side of the ledger, is that fair to say?

MR. DAVID CORMIE: Well, Manitoba Hydro doesn't own the water, so it's never an asset. We only have the right to generate electricity from the water.

MS. TAMARA McCAFFREY: Well, I appreciate that, it's not an asset.

MR. DAVID CORMIE: Whereas if you had coal in a coal pile, we have bought and paid for that and the coal's sitting there and it's in inventory. This is not, from an accounting perspective, inventory.

MS. TAMARA McCAFFREY: No, oh, I appreciate that. And I think that's the point that I'm trying to -- to make, and -- and what flows from that is that one (1) year financial results doesn't necessarily depict the value that's in Hydro's system?

MR. DAVID CORMIE: That's true, yes.

MS. TAMARA McCAFFREY: And again, that's why we do things like look at ten (10) year forecasts to get the whole picture here correct?

MR. DAVID CORMIE: Yes, and I -- and I think that's why we like to look at the financial consequences of a drought over five (5) years rather than -- because that $1.1 billion that Mr. Surminski has testified to, can hit the bottom line, spread over two (2) years, over three (3) years, over four (4) years, it -- but we know that over five (5) years, there's at least 1.1 billion in risk there.

MS. TAMARA McCAFFREY: Okay. Thanks very much for that.

THE CHAIRPERSON: Mr. Cormie, just to reiterate something you said before, I'm looking at this same graph, I think you testified before that there was no guarantee we were actually out of this situation yet?

MR. DAVID CORMIE: That's -- yes, that's true.

THE CHAIRPERSON: And that would speak to some degree, I would imagine, to the prudent view of the reservoir levels?

MR. DAVID CORMIE: Yes, and -- and once you're in a drought, and the decision to say, well you know, it's over, it can really only be done in hindsight.

I'm hoping that we're in that state now, and I think Mr. -- Mr. Warden is hoping that too.

THE CHAIRPERSON: It's one (1) of those rare situations where you could say everyone is on the same page?

MR. ROBERT MAYER: I know a Toronto lawyer who represents Pembachicamak (phonetic), who doesn't agree with that.

MS. TAMARA McCAFFREY: Thanks.

CONTINUED BY MS. TAMARA McCAFFREY:

MS. TAMARA McCAFFREY: Thank you very much for your assistance, Mr. Cormie. Now, Mr. Warden, I told you I wanted to talk to you a little bit about reserve provision amounts in terms of relative to risk.

Now, the reason why I'm asking you to think about that, was because in 19 -- or not in 19 -- in the Board's Order 7/03, at page 89, that's part of the hand -- the material that we handed out. I'm sorry we -- we don't have them tabbed, but there's only -- there's just excerpts from a couple of Board Orders there and not too voluminous.

You should have excerpts from Board Order 7/03, I'd like you actually just to go right to page 89.

MR. VINCE WARDEN: Yes, I have it here.

MS. TAMARA McCAFFREY: Thanks very much. Now, that Section 21.4 is the section that I'm talking about, where we talked about risk analysis and reserve levels. And just so that we get the context of this discussion, Mr. Warden, just directing your attention to the first paragraph, if you don't mind, I'm going to have a crack at sort of reading it in, just so we can move along and get the context for this discussion.

The Public Utility Board in that order indicated that:

> "There is merit in quantifying specific reserve provisions that are required to cover the major contingencies or risks, I guess Hydro faces. The specific amount should be based on a process that identifies and quantifies at least the

major risks at a high level.

To do otherwise would be tantamount to establishing a reserve provision, at an arbitrary amount. Defining specific reserve amounts for contingencies may also help prevent reserve provisions from being depleted for other purposes."

You followed along with that paragraph as I read it, Mr. Warden?

MR. VINCE WARDEN: I did.

MS. TAMARA MCCAFFREY: Now, jump a paragraph to the bottom paragraph and here's the directive that I want to ask you about.

The Board has indicated that Hydro should develop a policy to identify a reserve provision amount and, in particular, to set the circumstances under which it can be drawn down or increased. Keeping in mind, of course, the statutory limitations in the Manitoba Hydro Act.

The Board expects that Hydro would have the required data in one (1) form or another. I'm not reading verbatim now, but then the Board directed Hydro to prepare a document to quantify the specific reserve provisions required to cover the major risks and contingencies faced by Hydro. And to file that document with the Board by no later than December 31, 2003.

I haven't seen that, Mr. Warden. Can you tell us how Manitoba Hydro has responded to that. And I'm -- I'm -- I'm using the specific language here of -- of a document that seems to evaluate a reserve provision amount relative to a particular risk. Where is Hydro at with that, Sir?

MR. VINCE WARDEN: Well, I think we discussed earlier the fact that Manitoba Hydro has prepared one (1) risk management report which has been filed with this Board; and is in the process, in fact has completed, updating that report for -- for purposes of presenting to Manitoba Hydro's Board this week. That report will be filed with this Board at that time.

There is, however -- it is a process that we're going through in terms of -- of -- I think I referred to as an evolution with a risk management report before. And I also indicated that according to an analysis done by Deloitte Touche that we're considered to be leading edge amongst utilities in Canada.

We haven't though, at this point in time, quantified all the risks. That's the net -- next step in terms of how this report will evolve.

We have identified all the major risks and it's fairly extensive list of -- of risks the corporation faces, but in terms of quantifying each of those risks, that will be one (1) of the next major tasks.

We do know though that the most significant risk we face, or at least one (1) of the most significant risks we face, is drought and that's been quantified anywhere from $1.1 to $2 billion depending on -- on the circumstances of when that drought might be encountered by Manitoba Hydro.

So, with that risk confronting us, it sort of dwarfs the other risk that we might face. Although there are other infrastructure risks that probably are even greater than that.

As long as our reserve levels, or retained earnings, are -- are well below that $2 billion mark that we know we could face, there seems to be little urgency in terms of quantifying all the rest of the risks because we -- we're not there. We're not at $2 billion in our -- with our retained earnings.

And as matter of fact, with the loss that we encountered in '03/'04, our retained earnings is going to be in the $800 million -- down to the $800 million level. Which is well below the comfort level that I and other members of -- of Manitoba Hydro have.

So, long answer to your question but it's -- it's a report that we will be filing with this -- this Board immediately following the -- the Board meeting at Manitoba Hydro this week.

MS. TAMARA MCCAFFREY: Will this report

contain policy? Will this report contain policy with regards to reserve provision amounts and how they could be drawn down or increased? How or when? Will it have that kind of information or data in it, sir?

MR. VINCE WARDEN: Well, there is a risk management policy that's contained in that report. But as to how reserves or retained earnings are drawn down, there's nothing really very complex about that.

Retained earnings are -- are drawn down whenever the Corporation incurs a loss, a loss in operations, or the special circumstance that we -- we talked about extensively earlier.

But otherwise drawing down the retained earnings is a pretty standard process as far as -- as far as accountants and others are concerned.

MS. TAMARA McCAFFREY: Okay, I just want to make the distinction between retained earnings and reserve provision amounts. And that's why I'm using very specific language about that. Reserve provision amounts are sort of like a -- it's like a bank account right, they're put away for that -- not a rainy day, but the antithesis of -- to guard against the risks.

I'm talking specifically about the reserve provision now, it's how much do you need with respect to specific risks, when those amounts can be touched or used and for what.

MR. VINCE WARDEN: Okay, well we don’t have -- at Manitoba Hydro we don’t have specific reserves designated for special occurrences. That is all of our -- we use the term reserves and retained earnings interchangeably. In fact, reserves is kind of an outdated term now, retained earnings is what we referred to, what we’ve previous referred to as reserves are now called retained earnings.

MS. TAMARA McCAFFREY: I see that the distinction seems to becoming blurred as time goes on, and I’m of course using the specific language that this Board used in their Order of 7 of 2003 and they’re specifically talking about identify reserve provision amounts, relative to risk. And of course the rationale for that in that paragraph that I read into the record.

Your answer, that’s not -- you’re not going to be including that policy for -- for that, or you’re not going to prepare it in that -- in that way, you’re -- you’re telling me that you’re not even wanting to use the term reserve provision amount, you’d rather talk about retained earnings.

MR. VINCE WARDEN: Well, I don’t -- I don’t --

MS. TAMARA McCAFFREY: To be clear, where’s Hydro at with this?

MR. VINCE WARDEN: I don’t -- I don’t have a problem with reference to reserve provisions, it's just simply that as I pointed out that term is used interchangeably with retained earnings, and we interpreted this to be just that, to be our retained earnings.

And we will, as I indicated, quantify the amount of -- of retained earnings that are necessary, to ultimately address all of the risks of the Corporation, but we're a long, long ways away from that at this point in time. That is a long, long ways away from having retained earnings sufficient to address all of those risks. The quantification part will be -- will be done relatively soon.

MS. TAMARA McCAFFREY: This $2 billion figure that you -- that you've talked about throughout the Hearing, that's not the result of a financial study or model is it? Or is it in the process of being studied now? Where does that number come from?

MR. VINCE WARDEN: No, I'm referring to the -- I'm referring to the number that Mr. Surminski put on the record earlier.

MS. TAMARA McCAFFREY: Which is I -- I got the impression that that was sort of an estimate, as opposed to the result of any financial model that's been run.

MR. VINCE WARDEN: It is, but we know with the experience of this drought, that the number is going to be higher than the $1.1 billion that we've used in the past. I don't think as we've indicated previously, the magnitude of the drought impact was greater than all of us at Hydro expected in '03/04 fiscal year.

MS. TAMARA McCAFFREY: So, I take it then that Hydro's in the process of refining and quantifying that risk, in terms of before you present a figure like that to your -- to your Board?

MR. VINCE WARDEN: Yes.

MS. TAMARA McCAFFREY: All right. We're going to move the area of capital expenditures now. And the reference for this discussion will be the MIPUG Exhibit 6.

THE CHAIRPERSON: Ms. McCaffrey, if you wouldn't mind, I'd like to give an exhibit number to this eclectic series of extracts from the Board, because it's relevant for some of our discussions specifically.

This would be MIPUG --

MS. TAMARA McCAFFREY: Exhibit 8, I believe, Mr. Chair.

THE CHAIRPERSON: -- 8. Eight (8) then.

--- EXHIBIT NO. MIPUG-8: Series of extracts from the Board

MR. ROBERT MAYER: Just dealing with that particular exhibit, and maybe somebody can refresh my memory. The portion Ms. McCaffrey read from the Order 7/03, it seems to me that after we did the -- we made the decision on the request for the review of that order, we changed a number of those time lines, was this one (1) of them?

(BRIEF PAUSE)

MR. VINCE WARDEN: Mr. Mayer, I think we're going to have to double check that.

(BRIEF PAUSE)

THE CHAIRPERSON: I think we'll just put that in abeyance. Just continue.

MS. TAMARA MCCAFFREY: Certainly, I can -- I can move along and then we can get back to that.

MR. VINCE WARDEN: Actually, Mr. Mayer, I do recall that now. We responded to that directive that we had filed our risk management report and we believe that the filing of that risk management report responded and satisfied that directive.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: But for the fact that it doesn't actually do what that directive asks you to do in terms of quantifying reserve provision amounts and also indicating a policy for how those specific reserve provision amounts can be drawn down or when they need to be increased?

MR. VINCE WARDEN: I believe, Ms. McCaffrey, in our response we explained the status of that.

MS. TAMARA MCCAFFREY: I think we have your response on the record, Mr. Warden, thank you. Going to this table now at Exhibit 6, Manitoba Hydro's capital expenditure forecast, let's go through the table together.

(BRIEF PAUSE)

MS. TAMARA MCCAFFREY: You would have received a copy of -- of this document at the end of last week so I'm not sure which of you is most comfortable answering the questions. Perhaps Ms. Wray, you can let me know who -- who I should be directing my questions to on capital expenditures or maybe you, Mr. Warden?

MR. VINCE WARDEN: We'll probably all jump in at the appropriate time.

MS. TAMARA MCCAFFREY: That would be great. Okay. All right, let's go through the table together then. What this table is -- is demonstrating or attempting to demonstrate is a comparison between the 2002 status update capital expenditure forecast and the capital expenditure forecast that we had before us in this General Rates

Application.

So, with that in mind, if we could just go through a few lines for the sake of clarity. You'll see that lines 1 to 6 list various items of capital expenditures. And in column A -- A to D they demonstrate -- or I should say, A to B they demonstrate what the amount of capital spending was over, first, in column A, a three (3) year period from 2001 to 2004.

And then it takes an average annual spending amount based on that three (3) year average. And then we go over to the columns C and D. And here we're doing the same thing but we're just looking at it over a long term forecast so we're looking at what the total of capital expenditures were according to the certain items in millions over 2001 to 2012, an eleven (11) year period.

And then, again, column D, we're just taking an annual spending amount based on an average taken of those amounts; that process is repeated then for columns E to F which is the 2003 to 2006 period and then columns G to H, which looks at the long term 2003 to 2014.

So just having gone through just a little bit of that clarification on the record, what does this table come down to?

If you look at line 6, Mr. Warden, or, Ms. Wray, the total capital spending for the three (3) year period between 2001 and 2004, is $1.169 billion, or roughly $390 million a year, would -- would you agree with that? Anybody?

MR. VINCE WARDEN: Yes, I'll accept that.

MS. TAMARA McCAFFREY: And so then when we look at the longer term, that number is $3.766 billion over that eleven (11) year period, or roughly $342 million a year, agreed?

MR. VINCE WARDEN: Agreed.

MS. TAMARA McCAFFREY: Now, we do the same thing again for the figures that are before us with respect to this Hearing, only the number's a little higher. We look at the total capital spending being $1.686 billion over 2003 to 2006, which averages out to being about $562 million a year, agreed?

MR. VINCE WARDEN: Yes.

MS. TAMARA McCAFFREY: And moving along then to the final two (2) columns in row 6, we've got $5.824 billion projected to be spent on capital expenditures over an eleven (11) year period between 2003 and 2014, or roughly $529 million a year, agreed?

MR. VINCE WARDEN: Agreed.

MS. TAMARA McCAFFREY: All right. So that gives us sort of an overall level of spending, but now we're going to look at what's happened in lines 7, 8 and 9, and if you look at line 7, first of all, you'll see that the capital spending relating to new generation and major transmission, which I think we all agree are -- are sort of special cases, are taken out of the mix.

So in -- with respect to the 2001 to 2003, column A, that total is a $132 million, that relates to -- that is the total of that $1.169 billion. From that you would remove $132 million for capital spending that relates to new generation and major transmission, which then would give you a total of normal sort of day to day operations, electric capital spending of one (1) -- just over a billion dollars, one-zero-three-seven (1.037), agreed, Mr. Warden?

MR. VINCE WARDEN: Agreed.

MS. TAMARA McCAFFREY: And similarly, when we do that on a sort of an annual payment basis, the annual spending then of -- just for normal capital spending, exclusive of special projects, we have about $346 million a year on average from the 2001 to 2004 period, agreed?

MR. VINCE WARDEN: Yes.

MS. TAMARA McCAFFREY: All right. Now, again, and over the eleven (11) year period, the annual amount is reduced about $53 million a year, so that you have the total normal electric capital spending being about $280 million a year, and that's over the forecast that we had in 2000 -- in the 2002 Status Update Hearing, that's the eleven (11) year sort of forecast, would you agree with that, sir?

MR. VINCE WARDEN: I do.

MS. TAMARA McCAFFREY: All right. Now, let's compare that with what we have before us in this Hearing, all right. And you see there's quite a few changes now, going forward. Let me know if you need -- if you need a minute, Mr. Warden, to consult with one (1) of your associates.

Here we've taken out the new generation and major transmission line on line 7, has changed from 132 million, we now have it at $459 million, or roughly $153 million a year. So, that's the amount being spent on generation and -- and transmission, that's taken out of the mix, if we want to get down to the normal electric operations, is that fair?

MR. VINCE WARDEN: Yes.

MS. TAMARA McCAFFREY: All right. And then in addition, we have the Winnipeg Hydro acquisition. So, that adds about $72 million over that three (3) year period between 2003 to 06, or roughly $24 million a year, is that fair, sir?

MR. VINCE WARDEN: It is.

MS. TAMARA McCAFFREY: Okay. And in addition, we've included improvements to Point Dubois, which is about $8 million over that three (3) year period or roughly $3 million a year, fair enough?

MR. VINCE WARDEN: Yes.

MS. TAMARA MCCAFFREY: And, again, we can do the same thing for the columns in G and H but there are -- they're pretty self-explanatory and they're on the record.

I'm going to go now directly to line 10 and you can see there that the total amount of -- of spending, non related to special projects, is still, in 2003 to 2014, line 10 $3.4 billion over that eleven (11) year period or $310 million per year; you see that, sir?

MR. VINCE WARDEN: Yes, I do.

MS. TAMARA MCCAFFREY: Right. So then when we look at the difference then that are summarized in the -- in the block at the bottom of the column what we're seeing then is, at least over the short term, between 2003 and 2006 roughly $110 million in increase in capital expenditures over that three (3) year period.

Or an increase of $37 million a year, and that's excluding new generation and Winnipeg Hydro; would you agree with that, sir.

MR. VINCE WARDEN: I agree with that.

MS. TAMARA MCCAFFREY: And, of course, when we look at the longer term forecasts, the numbers are not going to be as -- as certain because, of course, when you look at the long term there could be new projects that come up that aren't foreseen and -- and -- and all the rest of it.

So the estimates become a little more of an estimate and a little less certain; is that fair to say as well, Mr. Warden?

MR. VINCE WARDEN: Yes. The further out we go in the forecasts, the less certain the numbers are. And, typically, new projects are -- are added each year.

MS. TAMARA MCCAFFREY: Right. Thank you.

MR. ROBERT MAYER: Presumably you complete some too so they come off the list?

MR. VINCE WARDEN: Sure.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: Now, let's go to Manitoba Hydro -- or MIPUG Exhibit 8 and that first page in that package is an excerpt from the Board Order 51/96 of April 15, 1996 and that's page 37 or Section 11.8 Board Findings, with respect to that Order.

Do you have it, Mr. Warden?

MR. VINCE WARDEN: I have it here. Yes.

MS. TAMARA MCCAFFREY: Terrific. Would you mind, sir, casting your eyes down the page to the bottom paragraph please?

Now, the Board encouraged Hydro to reduce their capital expenditures during a period of non-expansion; that is we're not -- outside of generation and transmission, the Board's encouraging Hydro to reduce their capital expenditures.

If Hydro's to improve the debt equity ration then the Board stated that this was to be accomplished by controlling internal expenditure such as capital projects and not solely by increasing rates to consumers; you reviewed that order, sir?

MR. VINCE WARDEN: I did.

MS. TAMARA MCCAFFREY: And just to, kind of, sum it up with respect to this order, the Board Order recommended in section 20 of its order which is the next page of that except and it's found on page 66 of Order 51/96 bullet two (2).

The Board recommended that Manitoba Hydro stringently limit its capital expenditures where safety and reliability constraints allow and apply itself to reducing its long term debt with urgency. You -- do you recall that Order, sir, now that you've had a chance to read it again?

MR. VINCE WARDEN: Yes, I do.

MS. TAMARA MCCAFFREY: Mr. Oster is kindly handing me a Kleenex because I have a little cold so I apologize to everybody for the sniffling.

MS. PATTI RAMAGE: It may be a trite point but, Ms. McCaffrey, you referred to it as an Order, this is the recommendations section of Board Order 51/96.

MS. TAMARA MCCAFFREY: You're quite correct. It's a recommendation; that's right.

MR. ROBERT MAYER: And I think the Board recognizes that it has no theoretical -- it has no power over capital expenditures of Manitoba Hydro as indicated by the Court of Appeal, if I recall correctly.

MS. TAMARA MCCAFFREY: Right you are Mr. Mayer, but of course, with respect to a progress towards debt equity ratios and impact on retained earnings, reserves and impact again to ratepayers, I -- I suggest that there is still some relevance with respect to this area.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: Carrying on then. So we see, anyway, a pretty strong link in the Board's mind in any event between capital expenditures, reducing long term debt and progress towards your debt equity ratios. Would you agree that, that connection seems to be pretty strong at least in the mind of the Public Utility Board in 1996?

MR. VINCE WARDEN: Well, I think it's that linkage is strong as communicated through this Order. I think that also prompted me and others to -- to file a debt management strategy. Because I think it's the whole issue of debt has been somewhat misunderstood in the past. And I'm hoping through these proceedings all of us now have a better understanding.

We talked about good debt and bad debt. And there is very good debt and with respect to -- with respect to capital expenditures, and those capital expenditures that are necessary to sustain safety, reliability of the system, debt incurred for that purpose is good.

It also is the reason that I -- I referred specifically in my direct to the review of the Crown Corporation's Council and the comprehensive review that the Crown Corporation's Council undertook and led them to conclude that all the expenditures included in Manitoba Hydro's capital expenditure forecast are those -- and again I'll quote from their report:

> "Those deemed necessary to provide a safe and reliable supply of energy in efficient and sustainable development manner."

So, I would -- from that, taking those -- those comments of the Crown Corporation's Council, the debt management strategy paper that's been filed with these proceedings and the recommendations to the Board together. I -- I would say that we have responded to the -- to the recommendations of the -- of the Board.

MS. TAMARA MCCAFFREY: And you're saying that, notwithstanding the fact that your capital expenditures went up by about $37 million a year, which doesn't include capital expenditures relating to generation and transmission?

MR. VINCE WARDEN: Yes, but again I reiterate following a comprehensive review of the Crown Corporation's Council, they concluded that all -- all those capital expenditures included in our 2004 forecast were necessary.

MS. TAMARA MCCAFFREY: Now, looking at the next page in that -- that summary of -- of excerpts that you received as MIPUG Exhibit 8. I'm taking you now to Board Order 703, and we have a comparison there on page 16 of that Order, Mr. Warden. With capital expenditures between the 1996 GRA, where they averaged approximately $250 million a year. I'm referring to the line right below the table on that page.

Then the Board notes that in the CFO-11 at the Status Update Hearing, capital expenditures averaged approximately $350 million per year.

So, again, we -- we see this trend that we've talked about on the table, of capital expenditures going up. Correct, Mr. Warden?

MR. VINCE WARDEN: Yes, again, for -- for good reason.

MS. TAMARA McCAFFREY: So you would also agree with me that it's trite to say that although the Board seemed to be asking Hydro to, outside of generation and transmission, necessary for safe and reliable service, where the Board suggested that Hydro pared back, Hydro didn’t pare back, and in fact continued to increase, and continues to increase today, their capital expenditures, even outside of special projects, such as Winnipeg Hydro and new generation to major transmission projects, agreed?

MR. VINCE WARDEN: But again, only to provide a safe and reliable supply of energy.

(BRIEF PAUSE)

MS. TAMARA McCAFFREY: Again, sir, the theme continues then on page 87 of Board Order 7/03, the Board takes note at Section 21.2 of this Order, that the achievement of the seventy-five/twenty-five (75/25) debt equity target, should include a strategy for the reduction of the level of its debt. That’s just the same thing that we heard in 1996 and we heard it again in 2003.

The Order goes on to say, and this is going to the next paragraph, the second sentence:

> "The Board is particularly concerned with the dramatic increase in long term debt from 5.17 billion in 1997, to $6.43 billion in 2002. Again, the Board encourages Hydro to consider appropriate debt minimization strategies."

And then the Board notes that:

"The Corporate strategic plan includes a reference to reducing debt and improving equity to meet the target. Accordingly, the Board will direct Hydro to file a detailed debt management strategy with the Board by not later than December 31st, 2003."

I've read that -- that section of the Order correctly, sir?

MR. VINCE WARDEN: Yes, I believe we've responded to that now, and I hope everybody has a better -- better understanding of debt and why it's increased as it has at Manitoba Hydro.

MS. TAMARA McCAFFREY: Well we have -- we have your position on that, but the reality is, is that the debt management strategy that you filed, doesn't deal in any way with reducing capital expenditures, as I understand it, it's more something that deals with how you manage your debt, that is your debt costs and so forth, is that correct, sir?

MR. VINCE WARDEN: Well, I believe that's what was requested by this Board is to file a debt management strategy, and that's what we've done.

MS. TAMARA McCAFFREY: But didn't the Board Order, sir, also say though, that your progress towards your long term debt equity ratio ought to be made in the context of a strategy for reducing Hydro’s debt, and again, taking away Winnipeg Hydro, taking away new generation and transmission, Hydro’s not doing that. In fact, they’re increasing their capital spending at the end of the day, is that not --

MR. VINCE WARDEN: I think that’s why we’ve gone to some length here to explain that debt, although intuitively one might think debt as being bad, debt in some cases, in many cases for Manitoba Hydro is good, and therefore, I’m hoping that with the information that’s been filed before this Board, any concerns they’ve had about Manitoba Hydro’s debt in the past, will be alleviated.

And as we’ve talked about as well, the capital expenditures, the external independent review of capital expenditures has been conducted, should also alleviate any concerns about capital expenditures in Manitoba Hydro.

MR. ROBERT MAYER: Mr. Warden, this is starting to sound like the good touch, bad touch movies they show young school children, but having said that, looking at -- at the exhibit that Ms. McCaffrey is referring to, on -- on -- I don’t know what you call that, line G or column G, but your major expenditures for the eleven (11) year average, new generation and major transmission, we agree that doesn’t sort of count in what we’re talking about now.

But your next two (2) major portions are power supply, transmission and distribution. And I realize this may be a -- a difficult question to answer on short notice but of what looks to be like twenty-six (26) -- is it 26 million.

How much of that would be supply side enhancement which we recognize a number of other organizations have been encouraging Hydro to undertake at the maximum level?

MR. VINCE WARDEN: You're right. Some of that would be included in there. I don't have the number off-hand. We could certainly get that for you though.

MR. LEN EVANS: Mr. Chairman, well you see, Mr. Warden kept -- has said several times now, debt is good. There is bad debt, but we're talking really about good debt.

Economists, and I understand where you're coming from. Economists refer to that Act as an investment. So really you're talking about investment, when you talk about good debt equals investment. Which is real investment. I don't mean buying financial instruments, but I mean putting plant equipment in place to produce electricity.

MR. VINCE WARDEN: Yes, it's -- that's a very good point, Mr. Evans. As a matter of fact, the capital expenditures that, when we reference that on our financial statements, we refer to that as investments and fixed assets.

THE CHAIRPERSON: Mr. Warden, following that, I would imagine that on each capital expenditure forecast of any materiality or -- or plan the corporation would determine some form of, at least, internal rate of return on the project support proceeds?

MR. VINCE WARDEN: For those that are subject to a rate of internal rate of return, we certainly do that, yes.

We have hurdle rate -- what we call hurdle rates at Manitoba Hydro so, if -- unless it's for -- strictly for reliability, safety issues, we have a -- a specified hurdle rate that a project must pass before we proceed.

And that hurdle rate depends on the level of risk that, that project might entail.

THE CHAIRPERSON: I imagine capital, with respect to existing generation and transmission, to -- to define it properly could presumably include enhancements or major repairs that would intents to increase it's life?

MR. VINCE WARDEN: That's correct, yes.

THE CHAIRPERSON: Thank you.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: Well, let's talk about supply system enhancements then.

In this document that's -- wait a minute.

The last document in the package is documents just that come from Hydro's appendices. It's the capital expenditure forecast CEF-03-1 for the years 2003/04 to 2013/14.

MR. VINCE WARDEN: Yes, I have it here.

MS. TAMARA MCCAFFREY: Now supply system enhancements are those things that -- that Mr. Mayer's been speaking about and -- and the Chairman. These are things that -- that you do to enhance your ability to generate your supply power. Is that -- is that right?

MR. VINCE WARDEN: Yes, that's correct.

MS. TAMARA MCCAFFREY: Now, if we have a look at this and they also can increase output -- electrical output. Is that right, Sir?

MR. VINCE WARDEN: Yes.

MS. TAMARA MCCAFFREY: All right. So if we have a look at your capital expenditure forecast then. It looks to me like there are -- I don't know -- would it be fair to say that there's -- there's a hundred (100) or so capital -- hundreds, maybe, of capital expenditure projects on the go at the given time with Manitoba Hydro?

MR. VINCE WARDEN: Oh yes, very definitely there's hundreds on the go at any given time.

MS. TAMARA MCCAFFREY: Now, going through this, and now I may be wrong, but I see only about four (4) of these hundreds of capital expenditure projects that relate to system supply enhancements.

Notably, under the heading, Power Supply, below the first block of projects, there's Great Falls and GS, which I believe stands for generating station rehabilitation. Is that a -- would that be considered an SSE?

MR. VINCE WARDEN: Yes, that -- that project would involve a -- a generator that has -- needs -- needs rewinding and one (1) of the largest costs of an outage of that nature is the loss production costs.

So, we take the opportunity when the generator needs to be rewind, to upgrade the turbine at the same time and potentially enhance its output capability and it's efficiency.

So it's done, not only for reliability, but also as a -- as an -- as an enhancement project as well.

MS. TAMARA MCCAFFREY: And the costs of that project total $27.7 million; is that right, Mr. Cormie? Or Mr. --

MR. HAROLD SURMINSKI: It is part of -- of a long term plan and much of that has been expended already.

MS. TAMARA MCCAFFREY: Yes, I see that it seems to be wrapped up in about 2007; is that right, sir?

MR. HAROLD SURMINSKI: Yes. And the

expenditures of 6 million, 2 million and two (2) so it’s about ten (10) out of that twenty-seven (27) remaining.

MS. TAMARA MCCAFFREY: Right. Okay. And going to the next line "Pine Falls Generating Station Rehabilitation"; another SSE, I take it?

MR. HAROLD SURMINSKI: Yes, we have two (2) units there that we will -- we will be looking at. We have done at least two (2) already.

MS. TAMARA MCCAFFREY: And Kelsey Generating Station improvement and upgrades, just about --

MR. ROBERT MAYER: You missed Grand Rapids.

CONTINUED BY MS. TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: Grand Rapids, that’s another -- that’s another one then, an SSE? But it’s complete as I understand; is that right, that money’s already spent?

MR. HAROLD SURMINSKI: Essentially, yes.

MS. TAMARA MCCAFFREY: So I’m more looking -- looking forward to the future than -- so the next one that I’m looking at here is Kelsey?

MR. HAROLD SURMINSKI: Yes, that is a very large Supply Side Enhancement. One may consider that to be at the extreme large end of that classification because it is really redeveloping or possibly redeveloping that.

MS. TAMARA MCCAFFREY: That cost about $121.1 million?

MR. HAROLD SURMINSKI: Yes, correct.

MS. TAMARA MCCAFFREY: And then the big one seems to be Point Dubois generating station improvements and upgrades and that has a price tag of about $421.2 million which, as I understand it, that -- that project isn't totally committed to yet, is that right, Mr. Surminski?

MR. HAROLD SURMINSKI: Yes, that's right. We -- we don't know exactly which -- which of the options we will undertake.

MS. TAMARA MCCAFFREY: And, of course, that was already netted out in the earlier table that we went through together with respect to the capital expenditures, Mr. Warden.

So you'd agree with me though, that absent Point Dubois which makes up the majority of that, and you can correct me if I've missed any, like SSE's going forward -- but you can agree with me that the amount of SSE's in this capital expenditure forecast is -- is minimal; is that fair to say?

MR. HAROLD SURMINSKI: Yes, I would agree. It's small relative to the numbers that you were dealing with.

MS. TAMARA MCCAFFREY: Okay. And -- and with respect to Kelsey as well, I should add, just for the sake of clarity that $121.1 million, approximately 96 million of that relates to actual SSE's and the rest would be more for normal maintenance associated with the generating station; am I correct in my understanding?

(BRIEF PAUSE)

MS. TAMARA McCAFFREY: Would you like to get back to me with respect to that answer, or --

MR. HAROLD SURMINSKI: We are trying to determine where you got your $90 some million out of that total. Can you explain that?

MS. TAMARA McCAFFREY: I think Mr. Bowman can help me.

(BRIEF PAUSE)

MS. TAMARA McCAFFREY: We don't have the reference. Mr. Bowman received -- got it from some of the materials, he believes it was a Response to an Interrogatory from the Public Utility Board. We can come back with that -- with that reference, if you like?

MR. HAROLD SURMINSKI: Yes, and we could respond if we -- if we see the information.

MS. TAMARA McCAFFREY: Fair enough. So, having said that then, at the end of the day, just to sort of wrap up this point.

We have, Mr. Warden, you've been stating your position throughout this Hearing and I want to make sure that it's clear, at least in my mind that -- what it is you're trying to say.

Essentially you're saying then that, yes, you're increasing your debt, even outside of generation and transmission, even outside of SSE, Supply System Enhancements, yes, you're increasing your debt, but this is a good thing, and you're hoping that everyone will have a better understanding of what debt means and why it's a good thing, at the end of this Hearing.

Am I accurately getting your point?

MR. VINCE WARDEN: I think you've captured what I'm trying to express, yes, thank you.

MS. TAMARA MCCAFFREY: So then the Public Utility Board has been under a misunderstanding since at least 1996, with respect to what's going on here, in terms of increasing your capital expenditures, and increasing your debt, and it's potential impacts to ratepayers?

MR. VINCE WARDEN: I wouldn't characterize it as a misunderstanding. I think it's the value of these Proceedings before the Public Utilities Board, we all have an opportunity to express our views, and certainly our views are influenced by -- by what transpires at these Proceedings.

And I think as we go forward, hopefully we'll all have a better understanding of the operation of Manitoba Hydro and why we're here and -- but, I think the understandings that were conveyed in past Proceedings, hopefully we can elaborate in this Proceeding, and everybody will have a better understanding at the end.

MS. TAMARA McCAFFREY: Thank you for your answer, sir. I'm going to move on now to the final area.

THE CHAIRPERSON: Ms. McCaffrey, just before you -- if I may, Mr. Warden, when you talk about debt, my understanding of what you're saying, debt is nothing more than the means by which to accomplish something, in other words, increasing debt in the perspective -- in the way that you're stating it, is simply the means by which you are able to increase your investment in plant?

MR. VINCE WARDEN: Yes.

THE CHAIRPERSON: To produce either increases in reliability, net earnings to export, or enhanced life, which presumably would sort of reduce average cost for ratepayers over a period of time.

Am I expressing what you're getting at, when you're talking about good debt? Since you don't have any other means, you don't have the means to attract capital at no cost, debt in a sense has become Manitoba Hydro's financing means?

MR. VINCE WARDEN: Absolutely, yes. And you know, in the debt management strategy paper that we put together, we indicated how that debt compares to assets, our total investment and fixed assets. And the investment of fixed assets has been growing at a rate faster than the growth in our debt, so nobody should be alarmed by the growth in our debt over that period of time.

THE CHAIRPERSON: You refer in many places in your material, to the net depreciated assets having a replacement value of several times the balance sheet?

MR. VINCE WARDEN: Yes. Yes, I've said that.

THE CHAIRPERSON: Do you -- is there a number that you could provide in respect to the insured value of your fixed assets?

MR. VINCE WARDEN: We essentially -- we provide self-insurance on our fixed assets so there's no number that I can provide in that regard.

I can -- if you'd look though just as by way of an example, when we constructed Kettle Generating Station, we put that into service in -- in 1974. The last unit was placed in service in 1974. The total installed cost of Kettle was about $350 million.

We know today when we're looking at building

Conawapa, we’re talking about a -- which is roughly equivalent in size to Kettle, a little bit larger. The cost of that plant will be around $3 billion.

So we can see how the value of investment in plant -- a plant that’s going to be around for a very long time and serving customers for a very long time, has increased and yet we’re still carrying Kettle at it’s original capital cost.

THE CHAIRPERSON: Mr. Warden, some of the confusion related on the fact that Manitoba Hydro does not have the objective of a private utility. With a private utility, my understanding is, the objective is maximization of shareholder wealth. Is it fair to portray Manitoba Hydro’s purpose is that achieving lowest cost generation and supply?

MR. VINCE WARDEN: Well, maximizing shareholder wealth through low rates, I think we have essentially the same objective, really. And we do that at the same time as providing a safe and reliable source of supply.

THE CHAIRPERSON: I -- I think you may have misunderstood me. All I’m saying is that, if you were a private utility, through your rates you would be attempting to maximize your net income. Okay?

MR. VINCE WARDEN: Yes.

THE CHAIRPERSON: Okay, that's not the goal of Manitoba Hydro.

MR. VINCE WARDEN: No.

MS. TAMARA MCCAFFREY: Can I?

MR. VINCE WARDEN: The -- the goal, just to elaborate a little bit on that point though. The -- the reason that an investor owned utilities want to maximize net income is to increase the wealth of their shareholders. Our shareholders are the people, the Province of Manitoba.

And through maintaining low rates we're doing just that, we're increasing the wealth of Manitobans through -- through low rates.

THE CHAIRPERSON: Just -- just following up and just pursuing this mode of discussion, if you want. I think it may help me in understand the point that you're making.

In a different environment, the mark-up if you want, on the depreciated value of your asset to a replacement value would be reflected in rates, but that's not reflective of your goal. We can't see the marked-up replacement value of your assets in your rates because that's not your objective.

MR. VINCE WARDEN: Our objective is not to maximize the bottom line, that's correct.

THE CHAIRPERSON: Thank you.

MS. TAMARA MCCAFFREY: Thank you, Mr. Chair.

CONTINUED BY TAMARA MCCAFFREY:

MS. TAMARA MCCAFFREY: Would you agree then, Mr. Warden, just following up from that then that the Public Utilities Board's directives in 1996 and then again in 2003, following the 2002 status update hearing.

And again, I -- I won't read the directives again, but they're in part of that handout that I had -- that I'd given you. The directive at Section 22 of Board Order 703, at page 109, the very first directive.

Just for -- just for your reference. It's the same as the directive in 1996. That when the Board directs Hydro to limit and control it's cost, or control it's capital spending outside of new generation transmission, and special projects like that, that are necessary for the safety and reliability of the provision of power.

Would you agree with me, sir, that, that kind of directive is consistent with some Prairie conservatives and ideals, but -- but more importantly providing power at cost, which is again, as -- as the Chairman has -- has pointed out, the objective of Manitoba Hydro?

MR. VINCE WARDEN: Yes, and we believe we've responded to that directive.

MS. TAMARA MCCAFFREY: All right. I'd like to move on to a final area then and I'd like to talk about asset retirement obligations.

Mr. Derksen, -- Mr. Derksen, we heard from you that Mr. -- we have from you that Manitoba Hydro intends to treat this as a -- as a change in the presentation of the balance sheet as opposed to a change in substance; is that -- am I right in that?

MR. WILLIE DERKSEN: We will certainly conform to the CIC section that requires us to consider ARO obligations and our view is that it's going to be substantially a balance sheet change and have very little impact on the income statement.

MS. TAMARA MCCAFFREY: So it's not Manitoba Hydro's intention to transfer money that has been set aside for taking these assets down and remediating the site at some point in the future? It's not your intention to transfer this money then to retained earnings; is that fair to say?

MR. WILLIE DERKSEN: Yes, that's correct.

MS. TAMARA MCCAFFREY: Now, do you have some knowledge of how other utilities have responded to this new directive, for example, in British Columbia?

MR. WILLIE DERKSEN: Well, we have very briefly reviewed the application that BC Hydro has prepared and they've indicated, I believe, that they've transferred $250 million, I think was the number, into retained earnings as a result of applying this section of the handbook.

MS. TAMARA MCCAFFREY: Now, have you had discussions with your auditors with respect to what your interpretation of the provision is because it's obviously not consistent with what happened in BC?

MR. WILLIE DERKSEN: We have not addressed this issue specifically with our auditors this year. We did have some discussions. There was a forum held last summer in Calgary and we had some broad discussions with other utilities and had some correspondence with them.

And our understanding was that most of those utilities would have a similar approach to the one that we're proposing.

MS. TAMARA MCCAFFREY: Well, that's comforting to hear that, Mr. Derksen. You'd agree with me that, of course, that the effect of this, if what happened in BC, happened in Manitoba, the effect of this would be tantamount to taking money that ratepayers have set aside, if I can put it that way, to pay these future costs and it would be taking this money away and resulting in the future when the assets actually have to be taken down.

There will be no liability left to draw down for that purpose, so ratepayers could effectively end up having to pay for this twice, if what happened in BC happened in Manitoba?

MR. WILLIE DERKSEN: Well, I don’t know the specifics of what has happened in BC so I’m careful to comment on that. But if what they have done was to reclassify some of the accumulated depreciation account into retained earnings as a result of applying this new accounting directive, we would disagree with that approach.

MS. TAMARA MCCAFFREY: And agree with my summation that the result of it would essentially mean that ratepayers would end up having to pay twice if that were to happen?

MR. WILLIE DERKSEN: Yes, that would be my opinion is that, yes, ratepayers have already paid for some of the costs of that remediation -- removal and remediation. And if that were taken into retained earnings as a result of -- of such a transfer as you described, ratepayers would end up paying twice for that.

However, again, I don’t know for sure exactly what BC has done.

MS. TAMARA MCCAFFREY: Given the risk of somebody, such as your auditor, taking a different interpretation of that section, there is -- you know there is that risk, such as interpreting it in the way that it was interpreted in British Columbia, would it be helpful, sir, if this Board confirmed in its Order that the amounts that have been set aside out of rates over time in the past for asset retirement and remediation be retained as a liability to ensure that they are used for that intended purpose?

Would that be helpful to Manitoba Hydro?

(BRIEF PAUSE)

MR. VINCE WARDEN: Ms. McCaffrey, maybe I can just elaborate a little bit on what Mr. Derksen has stated. I have personally had some discussions with our external auditors on this subject in the preparation for the Audit Committee at the Board meeting. And at Manitoba Hydro, it’s quite different from BC Hydro, we have only set aside, so to speak, a liability of approximately $15 million, for decommissioning of thermal generating stations.

And if we were to establish a liability for ultimate decommissioning of all of our facilities in accordance with the CICA guideline, it would, as we indicated earlier, only be a balance sheet reference, very little impact if any on the -- on the operating statement.

The external auditors are -- are very comfortable with where we’re at today with this -- this issue, and we’ll be talking about it further with them in the new year. However, the impact will be very minimal for Manitoba Hydro.

And in any event, we would never contemplate transferring such a provision into retained earnings. So, in our view, that would just be incorrect.

MR. ROBERT MAYER: Mr. Warden, we've -- this is about the second or third time during the course of these Hearings we've heard about this little problem.

The only former dam I ever heard of was Pinawa, and looking -- and I don't know who owned Pinawa, and I'm not entirely sure what happened to it, and I'm not sure what remedial costs were incurred there, but how do you -- you don't blow up a dam because that's going to create all kinds of problems. What do you -- who had Pinawa, and what in fact did they do with it?

MR. VINCE WARDEN: Pinawa was owned by the Winnipeg Electric Company, Mr. Mayer. And the water that was flowing down the Pinawa channel was -- was a diversion from the Winnipeg River, and was -- it was deemed in the early 1950s, it was better left in the river and generated at Seven Sisters, where they had at the generating station, was twice what it was at the smaller Pinawa Plant, and so the Plant was retired and -- and the water diversion ceased, and -- and the power is now generated at Seven Sisters.

MR. ROBERT MAYER: Thank you, I've been wanting to ask that question for a number of years.

CONTINUED BY MS. TAMARA McCAFFREY:

MS. TAMARA McCAFFREY: And I have no further questions, other than to confirm that the reference for the $96 million figure, came from PUB-I-77.

That -- that was the reference, it's page 2 of 15, and that's the reference to Kelsey, PUB-MH-I-77, page 2 of 5, just towards the bottom of the page there's a reference to Kelsey and it depicts in the fourth column that the enhancement cost is $96 million.

It's not a material point, but just for the sake of the -- the reference.

MR. HAROLD SURMINSKI: I would like to add, there are additional items that have been missed here in the supply side enhancement. The Brandon and the Selkirk license review process.

MS. TAMARA MCCAFFREY: Give me a moment and I'm going to -- I'll get that document in front of me, and -- and you can point out what -- what I missed, okay.

(BRIEF PAUSE)

MS. TAMARA MCCAFFREY: All right, carry on, Mr. Surminski.

MR. HAROLD SURMINSKI: You're -- you're back to your document --

MS. TAMARA MCCAFFREY: Yes, I --

MR. HAROLD SURMINSKI: Yes.

MS. TAMARA McCAFFREY: -- you've got Brand -- you said Brandon?

MR. HAROLD SURMINSKI: Brandon, Unit 5, license review of $9.5 million, and the Selkirk Generating Station license review of $33.9 million. They -- they should also be classified as supply side enhancement.

MS. TAMARA McCAFFREY: Okay, thank you for that, I thought that was the possibility that we may have missed a couple, but I just put -- it doesn't diminish the point though, does it, sir, that the -- the amount of capital expenditures relating to SSEs is a very small proportion of your overall capital expenditures in this forecast, is that correct, sir?

MR. HAROLD SURMINSKI: Yes, if you average it over the period, over the number of years, it averages to a relatively small number.

MS. TAMARA McCAFFREY: Sure.

MR. ROBERT MAYER: And -- excuse me, and why wouldn't Brandon Unit 5 rehabilitation and Selkirk GS rehabilitation be supply side enhancement?

MR. HAROLD SURMINSKI: And they possibly could. We don't -- yeah, you could classify those also.

MS. TAMARA MCCAFFREY: And then, for the record, Mr. Mayer, those two (2) projects that you've referenced to, Brandon Unit 5 Rehabilitation is $2.2 million and Selkirk Generating Station Rehabilitation would be $5.1 million.

MR. ROBERT MAYER: That would appear to be the case.

MS. TAMARA MCCAFFREY: And, again, just the point -- the point remains the same; that the proportion is -- is very small of the total capital expenditure forecast. Thank you very much, Mr. Surminski. Thank you, Mr. Warden and other members of the Panel, Mr. Cormie; that completes the questions on behalf of MIPUG.

MS. PATTI RAMAGE: Mr. Mayer, if I could perhaps pose a question to you and that's, I'm wondering if with the information we've just provided on the supply side enhancement, is that sufficient to respond to your earlier question or are you still looking for an undertaking?

MR. ROBERT MAYER: That's fine.

THE CHAIRPERSON: Thank you, Ms. McCaffrey. In our order, the next we have is Mr. Anderson for MKO. Mr. Anderson, I don't know whether you were here when we indicated that we were shutting down today at three o'clock.

MR. MICHAEL ANDERSON: Mr. Chair, thank you. Board Counsel has advised me of that. We have been staying in touch through the proceedings.

THE CHAIRPERSON: Do you want to start now or would you prefer to begin afresh tomorrow?

MR. MICHAEL ANDERSON: I'm prepared to begin now, but I did have some documents that I wanted to refer to, so it might be best for all parties if I circulated them now, let them have a chance to review them.

If there's any comments they could make them either now or early -- first thing in the morning, but I'm at your pleasure, Mr. Chair. But I have some administrative details to deal with right now.

THE CHAIRPERSON: Okay, why don't you circulate them right now and then we'll begin with your cross-examination tomorrow morning.

And in the next little while we have, I think Mr. Peters has been trying to work out a revised schedule, have you made any progress, Mr. Peters?

MR. BOB PETERS: It's under that heading of work in progress. We -- we are working towards it. I'm going to speak with my friends from Manitoba Hydro and then I'll be back to the Board to advise of the number of additional dates that we need from the Board members. So in five (5) or ten (10) minutes I'll be back to the Board on it.

MS. PATTI RAMAGE: While Mr. Anderson is circulating, Manitoba Hydro also has a, I believe, it's five (5) undertakings we'll be circulating as long as that's okay with the Board?

THE CHAIRPERSON: Yes, let’s do that now.

(BRIEF PAUSE)

MR. ROBERT MAYER: Just out of curiosity, is anybody using recycled paper?

(BRIEF PAUSE)

MR. ROBERT MAYER: In order to save time a little later, this Manitoba Hydro Undertaking 29 and 30, when you’re showing capacity factor of point six eight (0.68), does that mean 68 percent of capacity, or 0.68 percent of capacity?

MR. DAVID CORMIE: That’s 68 percent, so if we ran it the equivalent of full out put, 68 percent of the hours in that month.

THE CHAIRPERSON: Ms. Ramage, we might as well at least number these ones that we have here. I’ve got them sorted by Undertaking 17, then 29 and 30, then 30 -- then 27 and then 34. So, with respect to Manitoba Hydro Undertaking number 17, which is a revision of the Table in PUB-MH-I-64-A, that’s Exhibit number 31.

MS. PATTI RAMAGE: Thirty-one (31).

THE CHAIRPERSON: Okay.

--- EXHIBIT NO. MH-31: Response to Undertaking 17.

THE CHAIRPERSON: Then following along, Manitoba Hydro Undertakings 29 and 30, which is the Generation Capacity Factor for the Brandon, would be Exhibit number 32.

--- EXHIBIT NO. MH-32: Responses to Undertakings 29 and 30.

THE CHAIRPERSON: Manitoba Hydro Undertaking Number 27, which is the Henry Hub Chart, would be Exhibit Number 33.

--- EXHIBIT NO. MH-33: Response to Undertaking 27.

THE CHAIRPERSON: And, Manitoba Hydro Undertaking Number 34, which is a breakdown of the additional staff, would be Exhibit number 34.

--- EXHIBIT NO. MH-34: Response to Undertaking 34.

THE CHAIRPERSON: And I believe that brings us up to date with --

MS. PATTI RAMAGE: Yes, it does. And just so as to avoid confusion, an earlier undertaking, which was filed as Manitoba Hydro Exhibit 3 -- 23 rather, indicated it was Manitoba Hydro Undertaking 17, you'll see that number twice, that is back to the confusion between transcript and our record keeping.

So, if it's numerically in our record keeping, the Manitoba Hydro Exhibit number 23, was in fact Undertaking Number 21, but I believe listed in the transcript is 17.

THE CHAIRPERSON: Let's not go there.

(BRIEF PAUSE)

THE CHAIRPERSON: Unless I hear from Mr. Singh, I'll assume everything is fine. We'll receive MKO's distribution and then we'll have a quick look at that, and then at that point in time we will adjourn.

(BRIEF PAUSE)

THE CHAIRPERSON: We've been fairly orderly until now, so a little bit of chaos and confusion won't hurt anyone. Ms. -- oh -- while Mr. Singh is rushing about trying to organize the impossible, Mr. Warden, if I could just ask you, it's a really simple statement, just for confirmation, with all this talk about capital expenditures, okay.

You've got to appreciate that I'm new to this process right now, but I'm assuming that just normal repairs and maintenance, things that don't add extra production capacity or don't extend the life, they would be written off against income in the period in which they are incurred?

MR. VINCE WARDEN: Yes, that's correct.

THE CHAIRPERSON: Thank you.

(BRIEF PAUSE)

THE CHAIRPERSON: And again, just trying to make use of even open spots like this, when it comes into DSM, for example, expenditures related to demand side management, are they by policy, sort of aggregated and them amortized over a period of time, or is there some division between what comes against the current period and what is accumulated and amortized?

MR. VINCE WARDEN: Typically -- typically what we'll do with demand side management expenditures is to accumulate the costs for a fiscal period and then capitalize those in the next subsequent period and amortize those costs over fifteen (15) years, yes.

THE CHAIRPERSON: And you wouldn't be making distinctions, if I recall your earlier evidence, you just put them in a big ball, and it wouldn't matter so much if they were for a specific client base, it would just be the aggregate total?

MR. VINCE WARDEN: That's -- that's correct. Well, I should just clarify though. If it's for a specific customer class, when the cost of service study is done, it will be allocated to that -- the costs will be allocated to that class.

THE CHAIRPERSON: So that division would be made by customer class?

MR. VINCE WARDEN: That's right.

THE CHAIRPERSON: Thank you.

(BRIEF PAUSE)

THE CHAIRPERSON: Mr. Anderson is going to speak to this tomorrow, and I'm wondering, Mr. Anderson, do you want to give these exhibit numbers now, to make it easier for yourself tomorrow?

MR. MICHAEL ANDERSON: If you wish, Mr. Chair, that would be fine, thank you.

THE CHAIRPERSON: The only reason I'm suggesting to doing that, there's quite a group here, and if we do that at least we know everyone has it and it might make your time more efficient tomorrow.

MR. MICHAEL ANDERSON: They are in the

sequence as well, that I intend to call upon them, Mr. Chair, so that would be helpful.

(BRIEF PAUSE)

THE CHAIRPERSON: So then following along, Mr. Anderson, if you could just -- if I say something you disagree with, just please indicate so.

MR. MICHAEL ANDERSON: I will, Mr. Chair, thank you.

THE CHAIRPERSON: Okay. The first paper I have is a copy of a news release by the Manitoba Government, dated May 28th, 2001, relating to the equalization of electricity rates. We would call it MKO-2.

--- EXHIBIT NO. MKO-2: News Release by the Manitoba Government dated May 28th, 2001, relating to the equalization of electricity rates.

THE CHAIRPERSON: The second paper I have here is a map, Churchill/Nelson River Drainage Basin, there’s two (2) pages to it, and I would call that MKO-3.

--- EXHIBIT NO. MKO-3: Two page map entitled, Churchill/Nelson River Drainage Basin.

THE CHAIRPERSON: The third document I have is another map entitled, Existing Generation. I would entitle that, MKO-4.

--- EXHIBIT NO. MKO-4: Map entitled, Existing Generations.

(BRIEF PAUSE)

THE CHAIRPERSON: I'm on a roll right now, Mr. Mayer, I think we'll just stay along.

The next one (1) we have a sort of a -- we have a graph here, the first graph is entitled, Southern Indian Lake, it's water levels by month, and we will call that MKO-5.

--- EXHIBIT NO. MKO-5: Graph entitled Southern Indian Lake, Water Levels by Month.

THE CHAIRPERSON: MKO-6, will be another copy of a news release related to Ferry Service Closed by Low Water Levels, it's dated September the 5th, 2003. That's six

(6).

--- EXHIBIT NO. MKO-6: News Release related to Ferry Service Closed by Low Water Levels, dated September the 5th, 2003.

THE CHAIRPERSON: And 7, another map, Percent of Average Precipitation, which will be MKO-7.

--- EXHIBIT NO. MKO-7: Map, Percent of Average Precipitation.

THE CHAIRPERSON: And the final document I have is another map, description by way of map, Accumulated Precipitation and that will be MKO-8.

--- EXHIBIT NO. MKO-8: Map, Accumulated Precipitation.

THE CHAIRPERSON: Is that right, Mr. Anderson?

MR. MICHAEL ANDERSON: That's correct, Mr. Chair, thank you.

THE CHAIRPERSON: Okay. Then we'll stand adjourned until tomorrow morning, and again tomorrow morning, we have dispensation to sit through the fire alarm at 9:50, and we'll begin at 9:00 a.m. Thank you very much.

MR. BOB PETERS: And if I could ask, Mr. Chairman, that representatives of the interested parties, as well as Manitoba Hydro just remain behind, so we can attempt to finalize our schedule. I should note that Peter Miller is not here, and I will endeavour to be in communication with him further.

So we'll -- we'll bring that forward to the Board after Council has met.

THE CHAIRPERSON: Thank you, Mr. Peters.

MS. PATTI RAMAGE: Mr. --

THE CHAIRPERSON: Ms. Ramage ...?

MS. PATTIE RAMAGE: Before everyone leaves, despite our best efforts, we're not all accountants and we appear to have missed the number thirty (30) in -- when doing the Manitoba Hydro exhibits. I think -- I'm not sure what Mr. Singh's preferred method of dealing with it. He's going to have to deal with Mr. Barron when he gets back, but we could leave thirty (30) as just intentionally omitted, or we can back all the exhibits up one (1).

MR. BOB PETERS: My suggestion, Mr. Chairman, is the next time Manitoba Hydro has an undertaking to be marked, we'll just fill out the number thirty (30) with that and we'll --

THE CHAIRPERSON: So we'll call number thirty

(30) a place mark then for -- for now -- exhibit to come.

MS. PATTI RAMAGE: I'm not familiar with that term.

THE CHAIRPERSON: Try again, we'll adjourn again.

--- Upon Adjourning at 2:45 p.m.

Certified Correct

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Carol Wilkinson
Court Reporter