

YUKON UTILITIES BOARD

**YUKON ELECTRICAL COMPANY LTD.
GENERAL RATE APPLICATION 2008-09
HELD AT HIGH COUNTRY INN
WHITEHORSE, YUKON
OCTOBER 8, 2008**

VOLUME 2

PAGES 133 - 256

BEFORE BOARD MEMBERS:

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APPEARANCES:

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| Yukon Electrical Company Ltd. | Loyola Keough |
| Yukon Energy Corporation | John Landry |
| City of Whitehorse | Thomas Marriott Greg Garbutt |
| Dept. Energy, Mines and Resources | Val Mather |
| Leading Edge Projects Inc. | John Maissan |
| Utilities Consumers' Group | Roger Rondeau |

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1 **(PROCEEDINGS RESUMED OCTOBER 8, 2008, 9:10 A.M.)**

2 MS. SHANKS: Please be seated.

3

4 **Preliminary matters**

5 MS. SHANKS: Good morning everyone. I would like to call this hearing back to
6 order. With respect to a few preliminary matters, we will have a normal break this
7 morning at 10:30 a.m. and we'll break for lunch from 12:00 p.m. to 1:30 p.m. with an
8 afternoon break at approximately 3:30 p.m. and we will look to adjourn today around
9 5:00 p.m.

10 The Board has suspended the YECL panel from yesterday to allow for the two YECL
11 expert witness panels on rate of return and depreciation to appear today. Depending on
12 how far we progress on the cross-examination today on these two panels, we may,
13 depending on time, resume on cross-examination of the suspended YECL panel from
14 yesterday.

15 In terms of order of cross-examination, for YECL's first panel on rate of return and
16 capital structure, UCG has requested due to time management purposes that they appear
17 first for cross, and the Board will resume with the order for cross-examination, which we
18 outlined in yesterday's session, which was the order of registration.

19 As well, before I turn the mike over to Mr. Keough, based on submissions from
20 parties yesterday, the Board will have, for this proceeding, simultaneous argument due
21 October 27 with simultaneous reply due November 10. I will now turn the mike over to
22 Mr. Keough.

23 MR. KEOUGH: Thank you, Madam Chair. Good morning, and good morning,
24 Board Members.

25 Yukon Electrical is pleased to present its panel number 2 to speak to rate of return/
26 capital structure matters. The panel, as I indicated yesterday, is comprised of Ms. Kathy
27 McShane, who is being presented as an expert witness in this area, and Mr. Freedman. He
28 may not have much left after yesterday, testifying to these matters, but hopefully they
29 will be, after questions on these matters related to the company positions — he is there to
30 handle those.

1 Madam Chair, the testimony of Ms. McShane is located under Tab 8 of the
2 application Exhibit B-1, Section A, Attachment 1. As well, Ms. McShane prepared
3 responses to a number of information requests that were directed to that report. I think I'll
4 adopt the same approach as yesterday and, when I have her adopted evidence, just do it
5 generally; that she will speak to the Information Responses that were prepared by her
6 related to that report, instead of trying the cumbersome approach of going through each
7 IR.

8 Now, I should, just for clarification purposes, make sure that we're on the same page.
9 Ms. McShane is an expert recognized in the areas of rate of return/capital structure and
10 has presented testimony in a number of jurisdictions in Canada and the U.S. I am in your
11 hands again. I can have her take you through her resumé and experience and expertise in
12 this area to have her accepted as an expert, or you can dispense with that and confirm that
13 she is accepted as such. I am in your hands.

14 MS. SHANKS: I think that we can dispense with that process in this case.

15 MR. KEOUGH: Thank you. I think in that case, Madam Chair, we can probably
16 have Ms. McShane sworn. I think Mr. Freedman is still under oath in general. I confirm
17 that for him, so I think he doesn't need to be re-sworn, if you will.

18 MS. SHANKS: Can we please swear in the witness.
19

20 **YECL WITNESS SWORN:**

21 **KATHLEEN C. McSHANE, SWORN**

22 **DAVID FREEDMAN, RESUMED**
23

24 MS. SHANKS: Mr. Rondeau, are you prepared to proceed with your cross — or
25 your undertaking, sorry.

26 MR. KEOUGH: Madam Chair, I was just going to have her adopt her evidence
27 — have Ms. McShane adopt her evidence first.
28
29
30

1 **YECL Panel 2 examined by Mr. Keough**

2 Q MR. KEOUGH: Ms. McShane, do you have before you a copy of the materials
3 — the testimony you prepared — being your Attachment No. 1, under Tab 8 of Exhibit
4 B-1?

5 A MS. McSHANE: Yes, I do.

6 Q MR. KEOUGH: And do you also have before you the relevant Information
7 Responses that you prepared related to that evidence?

8 A MS. McSHANE: Yes, I do.

9 Q MR. KEOUGH: And were those materials prepared by you or under your
10 direction?

11 A MS. McSHANE: Yes, they were.

12 Q MR. KEOUGH: And do you have any changes, corrections or updates to make to
13 those materials?

14 A MS. McSHANE: I have two corrections, if I could, please. The first is on page
15 32, lines 836 and 837, and the corrections that I'll make to those two lines carry over into
16 the table. On line 836, there's a number 2.7X; it should be 2.6X. And then on line 837,
17 the number 2.5X should be 2.7X.

18 And then in Table 10, if you look at the very right-hand column that's entitled "EBIT
19 Interest Coverage", the first three numbers in that are out of order, so I'll correct them
20 from top to bottom: they should be 2.6X, 2.7X and 2.5X. Actually, these corrections were
21 provided in response to an IR, YUB-YECL-43.

22 The other correction is on page 37, and this is in Footnote 34. The date reads
23 presently "November 30, 2007" and it should say "April 28, 2008". And on the next line,
24 where it says 130 basis points, it should say 160 basis points.

25 And those are all my corrections.

26 MR. KEOUGH: With those corrections, do you adopt those materials as your
27 testimony in these proceedings?

28 MS. McSHANE: Yes, I do.

29

1 MR. KEOUGH: And Mr. Freedman, I just want to confirm that you are prepared
2 to speak to any rate of return/capital structure questions that arise, from the company's
3 perspective.

4 MR. FREEDMAN: Yes, I am.

5 MR. KEOUGH: Thank you. Madam Chair, I think the witnesses are now
6 available for questioning.

7 MS. SHANKS: Thank you very much. In that case, we'll proceed with UCG. Mr.
8 Rondeau, are you prepared for your cross-examination?

9 Sorry — Mr. Landry, did you have some comments?

10 MR. LANDRY: Madam Chair, if I may, we have had discussion among the
11 Intervenors who are intending to cross this panel. And, as you indicated, Mr. Rondeau
12 will go first; Mr. Marriott will go second, if that pleases the Chair, and I will follow up. I
13 believe Mr. Maissan has a few questions, too, and I'll follow up after Mr. Maissan.

14 MS. SHANKS: Okay, that's fine. Mr. Rondeau, are you prepared to proceed?

15 **YECL Panel 2 cross-examined by Mr. Rondeau**

16 MR. RONDEAU: Good morning. First of all, I'd like to thank the Board and all
17 of the interested parties for accommodating my request to be first in line. Good morning,
18 panel, Ms. McShane and Mr. Freedman.

19 Ms. McShane, as you're well aware, the ratepayers will be paying the bill for your
20 contract, so bear with me. I have a few personal questions before I start.

21 Q First of all, you and your firm were contracted by YECL to prepare the testimony and
22 provide evidence for this hearing. Is that correct?

23 A MS. McSHANE: Yes.

24 Q MR. RONDEAU: If I can ask you to please let us know how much the contract
25 was for.

26 A MR. FREEDMAN: The estimate for that contract, I think, for providing IRs, was
27 \$100,000.

28 Q MR. RONDEAU: \$100,000. Thank you. Does this price include all travel,
29 lodging, and meal expenses for the witness at this hearing, or is this extra?

30 A MS. McSHANE: The estimate, I believe, included all of the costs.

1 Q MR. RONDEAU: Can you please explain, in simple, layperson's terms, how a fair
2 rate of return is determined?

3 A MS. McSHANE: I am taking my time so that I can make it as layman as possible.
4 I think that, first of all, when you consider the term "rate of return", the term "rate of
5 return" refers to the return on the assets that are devoted to public service. It relates to the
6 capital structure, the cost of debt and the cost of equity.

7 When you determine a fair return, you have reference to three principles or standards:
8 whether or not a utility is able to attract capital at reasonable rates and on reasonable
9 terms; whether the return allows the utility to maintain its financial integrity and credit
10 worthiness; and whether the return comports with returns that are available to other
11 investments of comparable risk.

12 In the context of those principles, you would start perhaps and look at what an
13 appropriate capital structure is for a utility of the risk profile that you're dealing with, and
14 to do that you would look at such factors as what the capital structures are maintained by
15 other companies in the industry and what the resulting debt ratings are. That gives you
16 some sense of whether those utilities have indeed been able to maintain a certain degree
17 of creditworthiness. You would look at the capital structures that have been adopted for
18 regulatory purposes for other utilities; you would look at guidelines perhaps, as I did in
19 this testimony for capital structures for particular debt ratings and, having established
20 what an appropriate capital structure for a particular company is, then you would look at
21 what the fair rate of return on equity is. In doing that, you would look at different tests
22 that are typically used by regulators: the capital asset pricing model; the discounted cash-
23 flow test; and various forms of comparable-return tests. From that analysis, you would
24 come to an assessment on what the fair return on equity is. That would be what you
25 would do if you were going through the entire process from start to finish, including a
26 full, in-depth determination of what the fair return on equity is.

27 In this particular instance, we didn't do that. We concentrated on the capital structure
28 part and took, as a given, the formula-based return on equity from Alberta.

29 Q MR. RONDEAU: Are you aware of the economic concept of "opportunity cost"?

30 A MS. McSHANE: Absolutely, yes.

1 Q MR. RONDEAU: Can you please explain that for us and how it reflects the
2 concept of fair return as well?

3 A MS. McSHANE: The opportunity cost can be defined as the return that you
4 would be able to achieve as an investor, if you put your money in an investment of
5 comparable risk. So it is the principle that underlies comparable returns — the standard
6 part of the fair return standard.

7 Q MR. RONDEAU: Could you please tell us how YECL obtains its capital and
8 how it compares to other utilities you have provided testimony for?

9 A MS. McSHANE: I'm not sure I understand the second part of the question. I'll
10 answer the first part, and then maybe you could explain a little bit what you mean by the
11 second part.

12 It obtains its capital from ATCO Electric, which in turn obtains its capital from CU
13 Inc., as far as debt is concerned and would have any equity financing provided to it — if
14 it was required that it go to the equity markets, Canadian Utilities Inc. would go to the
15 equity market.

16 Q MR. RONDEAU: So, it's through the corporate conglomerate structure.

17 A MS. McSHANE: If you mean by that that YECL does not go out directly to the
18 capital markets, but receives capital from its parent companies, that's true.

19 Q MR. RONDEAU: Yes.

20 A MS. McSHANE: And the second part of the questions was: how does that
21 compare to other companies?

22 Q MR. RONDEAU: Yes, would other firms, like — the other firms that you have
23 provided testimony for — is this normal practice that these firms use their parent
24 companies for debt financing?

25 A MS. McSHANE: For debt financing?

26 Q MR. RONDEAU: Yes.

27 A MS. McSHANE: Depends — there is a fairly wide range of practice. Just to
28 give you a couple of examples, let's take the parent company Fortis Inc., which has a
29 number of utility subsidiaries. Fortis Inc. treats each of their major subsidiaries, which

1 would include Terasen Gas in B.C., FortisBC, an electric utility in B.C., FortisAlberta,
2 Newfoundland Light and Power, and Maritime Electric.

3 It expects each of those companies to operate on a stand-alone basis, and each of
4 those companies goes out and raises debt in its own name. So they are Maritime Electric
5 debt issues; they are Newfoundland Power debt issues.

6 Some companies are too small to do that so, although if we looked at Enbridge Gas
7 Distribution, yes, it goes out and gets its own debt, but there is also a small gas utility,
8 which belongs to the Enbridge family, Gassez Faire Inc., which is provided debt capital
9 through the family chain — I've forgotten at exactly what level. So it really depends on
10 the company.

11 Q MR. RONDEAU: Let's go back to YECL. You say that they get their financing
12 from ATCO, who in turn gets their financing from CU Inc. Now, in other words, ATCO
13 is the middle person — right?

14 A MR. FREEDMAN: Can we just clarify that — it would ATCO Electric.

15 Q MR. RONDEAU: Yes. Would ATCO Electric be the middle man in this case?

16 A MS. McSHANE: The middle man. Well, if we're talking about debt, I guess
17 that's right. CU Inc. would raise the debt in the market. It would mirror down issues to
18 ATCO Electric, ATCO Gas, ATCO Pipelines to the extent that each of those operating
19 subsidiaries required new debt to support their operations. ATCO Electric, in my
20 understanding, provides debt to Yukon Electrical.

21 Q MR. RONDEAU: In a normal economy, the middle person gets a cut off of all
22 this, so my assumption then is that ATCO is taking a bit of the debt financing for their
23 own corporate entity.

24 A MR. FREEDMAN: There is no cut. ATCO Electric just mirrors down CU Inc.
25 debt. It gets the debt and mirrors it down to ATCO Electric and ATCO Electric just
26 mirrors down that debt with that debt, the terms of that issue, with an estimate of the issue
27 costs associated with that issue, to Yukon Electrical. So, there is no cut, as it were. It's
28 just mirroring down the costs.

29 Q MR. RONDEAU: How is YECL's overall cost of capital determined?

1 A MS. McSHANE: I am not sure I understand the question. When you say how is it
2 determined, do you mean how is it calculated, how is —

3 Q MR. RONDEAU: Correct. What I'm getting at is does the cost of debt reflect the
4 cost of equity, as well, in the formulas used?

5 A MS. McSHANE: The cost of debt is equal to the debt that has been issued by
6 ATCO Electric to Yukon Electrical over time, based on the needs of Yukon Electrical.
7 So, it's the embedded cost or actual cost of issues that have been mirrored down to
8 Yukon Electrical. So, that's the debt portion.

9 The capital structure portion of the cost of capital is going to be based on what the
10 Board here determines to be the appropriate split between debt and equity, based on the
11 considerations that have been put forth in my testimony in the testing of those bases. So if
12 the Board, for example, were to approve a capital structure that was split 52.5% debt and
13 47.5% common equity, then Yukon Electrical would manage its capital structure in such
14 a way to maintain that actual capital structure that the Board adopts.

15 As far as the rate of return on common equity, in this particular instance I've made a
16 proposal that the Board adopt a formula-based return for the purposes of these two
17 specific test years, using the Alberta formula and adding an incremental risk premium for
18 Yukon Electrical specifically.

19 Q MR. RONDEAU: Does the Board have a say on the percentage rates of debt that
20 ATCO Electric charges to their subsidiary?

21 A MS. McSHANE: I'm not sure the extent to which the Board has a say over the
22 rates. I mean, I think they certainly can — as far as I know, they can speak to the
23 principles of what should be the cost of debt. I mean, I suppose they have some say in
24 whether or not the costs incurred were prudent or not, because I'm pretty sure that's an
25 issue that's dealt with before other regulators.

26 Q MR. RONDEAU: So in other words you're telling me that Yukon Electrical goes
27 to their parent company and they get a loan, and they don't go out into the common
28 market to get a loan. It would seem to me that this is not very prudent.

29 A MS. McSHANE: It's not prudent for them to get the money through their parent,
30 as opposed to going into the debt market themselves?

1 Q MR. RONDEAU: Not when there's no competitive market being used.

2 A MS. McSHANE: Okay, so we know that the parent company, CU Inc., has some
3 of the highest debt ratings in the country. We certainly can test that cost against the cost
4 that other utilities would incur to raise debt, because you can look at the yields for other
5 companies — FortisAlberta, for example. You could see what it's costing them to raise
6 new debt as a somewhat lower rated company.

7 If there were any question in my mind that Yukon Electrical could get money cheaper
8 than getting it through their parent company, I mean, I would be the first to suggest that
9 that's what they should do. But in this particular instance, I mean, we're dealing with a
10 very highly rated company with lower spreads than virtually any other utility in the
11 country, so I don't think there's any question that Yukon Electrical isn't getting the most
12 competitive rates out there.

13 Q MR. RONDEAU: Well, I'm just a little guy here and I can get a better rate than
14 6.6%.

15 A MS. McSHANE: For 30-year money? You could go out today and go to your
16 bank and say, "I'd like a 30-year loan and I don't really want any terribly restrictive terms
17 and conditions on it," and you think you could get that for less than 6.6%?

18 Q MR. RONDEAU: I'm not certain about 30-year —

19 A MS. McSHANE: I mean, that's what the number — I mean, we're looking to
20 finance — or, I'm not looking to finance, but Yukon Electrical would be looking to
21 finance long-term assets, and so the rate that's being forecast here is a rate for 30 years.

22 Q MR. RONDEAU: Upon YECL's request, you used benchmarking as your
23 starting tool. Is that correct?

24 A MS. McSHANE: For the rate of return on equity, yes. Rather than go through a
25 full, in-depth ROE analysis for this company, which is a small company, knowing that,
26 relatively coincident with this case, there were two major rate-of-return cases that were
27 going on in the country, which were going to review how the formula that's been adopted
28 by a number of regulators — how it may or may not meet the fair-return standard. Rather
29 than, for a company with a \$30-million rate base, go through that at this time, it just
30 seemed efficient — cost efficient — to seek to use one of the formulas that was already in

1 place for the time being for these two test years, and see how these two major
2 proceedings before the National Energy Board and before the Alberta Utilities
3 Commission — what the outcome of those was.

4 Q MR. RONDEAU: Have you had such experience before as a benchmarker or using
5 benchmarks?

6 A MS. McSHANE: Yes. For example, in British Columbia, the BCUC has a low-
7 risk utility benchmark ROE, and they have a number of utilities that are regulated by that
8 commission. I have, on occasion, done the same type of thing for utilities other than the
9 low-risk benchmark utility in order to set the differential risk premium between the low-
10 risk benchmark utility and the particular utility in question. Also, we proposed the same
11 type of benchmarking approach in the Northwest Territories for the two Northland
12 Utilities this past year.

13 Q MR. RONDEAU: Does benchmarking use performance measurement of the
14 utilities' operations in their determination?

15 A MS. McSHANE: Not in this case. This is — when I use the term “benchmark” in
16 this context, I don't mean benchmarking in the same sense as when you benchmark costs,
17 for example, against other utilities. You are looking at your cost structure and you're
18 saying, “How do my costs compare to other utilities?” That's benchmarking. When I use
19 the term “benchmark utility”, I am using the term in the context of what is a return for an
20 average-risk Canadian utility. That's what I mean by “benchmark”.

21 Q MR. RONDEAU: So what indicators did you use, then, for this benchmarking
22 purpose?

23 A MS. McSHANE: Do you mean what did I look at to determine whether Yukon
24 Electrical was the same risk as the benchmark?

25 Q MR. RONDEAU: Basically, yes.

26 A MS. McSHANE: That's what the whole testimony is about. I mean, I looked at
27 various business risk factors in comparison to, sort of, the typical utility in the country.

28 Q MR. RONDEAU: Did you look at productivity indexes or —

1 A MS. McSHANE: No, because that's not what I was doing. I was looking at the
2 cost of capital — fair rate of return. I wasn't looking at benchmarking in the sense that
3 you're talking about.

4 Q MR. RONDEAU: So, in using this type of tool, you're telling me that a company
5 that is totally inefficient, either in their management or in the way they run their utility,
6 and a company that is super efficient can still get the same rate of return?

7 A MS. McSHANE: That's a question that's a bit different. First of all, I would say
8 that when I estimate the cost of capital, my assumption is prudent, efficient management.
9 I don't view it as my role to recommend a cost of capital that's lower, because there
10 should be a penalty for poor management. That's not my job, in terms of determining
11 what the cost of capital is.

12 Q MR. RONDEAU: Back to YECL requesting that this benchmarking process be
13 used — on page 1 and page 8 of your testimony, you have a statement: "YECL requested
14 this for the express purpose of these two test years to use benchmark return on equity
15 established by the EUB as a point of departure." Is this correct?

16 A MS. McSHANE: Yes, but — I think we're sort of getting hung up on this word
17 "benchmark". I could take that word "benchmark" and replace it with "generic", and the
18 whole concept of benchmarking that you're talking about would disappear, but the
19 request would be the same. What Yukon Electrical was seeking to do was to take, as a
20 point of departure, the AUC's generic return on equity, as determined by their automatic
21 adjustment formula as the basis for setting Yukon Electrical's return for 2008 and 2009.
22 It really doesn't have anything to do with the concept of "benchmarking".

23 Q MR. RONDEAU: I understand. Is this your normal procedure in developing
24 expert opinion of fair return, by using one scenario rather than a number of
25 methodologies?

26 A MS. McSHANE: No, this is — as I tried to explain a little bit earlier, the typical
27 approach would be to start at first principles and go through and estimate the cost of
28 equity using a battery of different tests to come up with what the cost of equity was. In
29 the interests of efficiency in this particular case, knowing that there were two major cost-
30 of-capital proceedings going on in the country that were going to review all of these

1 issues in depth, it was determined that we would not seek to go through that entire
2 process in this case.

3 Q MR. RONDEAU: Did YECL then also give you direction that they desired to
4 raise their equity, lower their debt?

5 A MS. McSHANE: I think what they asked me to do was to figure out what I
6 thought the appropriate capital structure was, because it hadn't been reviewed in a long
7 time.

8 Q MR. RONDEAU: There was no direction given?

9 A MS. McSHANE: No. The direction was, "Tell us what you think the appropriate
10 capital structure is for this company."

11 Q MR. RONDEAU: I see YECL many times say, "We're stand-alone" or "We
12 should be considered different." Why should the rate of return from the EUB be
13 representative for this little stand-alone company here that seems to pick and choose
14 when they want to be recognized as a different entity or when they don't have to be?

15 MR. KEOUGH: Madam Chair, I'm going to let these general observations go at
16 this point, even though I'm not sure there's an evidentiary record to support the general
17 statement. I'll give Mr. Rondeau the benefit of the doubt, but if these general
18 characterizations continue, I may ask for evidentiary references.

19 MR. RONDEAU: I understand, thank you.

20 Q I will ask then — what I was getting at was a bit of a preamble that maybe I should
21 have bit back. How does the EUB rate of return relate to YECL?

22 A MS. McSHANE: What the EUB has done, which is very similar to what has been
23 done in other jurisdictions, including British Columbia, including the National Energy
24 Board, is that what the regulators have attempted to do is to say, "Let's look at all the
25 various tests for determining a fair return on equity and let's see if we can't come up with
26 a rate of return on equity that's essentially representative of an average-risk Canadian
27 utility."

28 We'll set that return and then, in future years, what we'll do is we'll adjust it, based
29 on changes — in the case of all these formulas so far — based on the change in long-term
30 Canada bond yields. Then what we'll do is we'll look at all of the individual utilities that

1 we regulate, and we will do one of two things: we will set the capital structure for each of
2 those utilities, based on their differential business risk from the average, so that that
3 generic rate of return on equity applies to the utility, or we will have a combination of
4 differences in capital structure and some premium to this generic return on equity to
5 reflect the differences in risk.

6 So the EUB ROE is really a number that is intended to represent the ROE for an
7 average-risk Canadian utility. What I have done is to say, “Okay, there’s that average-risk
8 Canadian utility number. What capital structure do I need to have for YECL so that that
9 generic ROE number applies?” I could have presumably done the same thing had I
10 started with the National Energy Board formula, because it does the same kind of thing.
11 So, we are still maintaining the stand-alone principle, because the risk aspects of YECL
12 that are unique to it are applied either in the capital structure or as an increment to this
13 average risk utility return.

14 Q MR. RONDEAU: Traditionally, does not the capital structures of regulated
15 utilities in Alberta contain a higher proportion of preferred shares than those utilities in
16 other jurisdictions?

17 A MS. McSHANE: If by “traditionally” you mean prior to the *Public Utilities*
18 *Income Tax Transfer Act* being eliminated, yes. Historically, in Alberta, utilities had up to
19 30% preferred shares. The reason for that was that you maximize the amount of income
20 tax that you would pay to the federal government and to the provincial government. By
21 collecting in your rates a large income tax allowance, you had much better cash flows
22 than you would have had if you had had a high debt component. You then paid the tax to
23 the government. Under PUITTA, the tax came back to the province and the provinces had
24 a choice of what they did with the money. In Alberta, they returned those dollars to the
25 ratepayers. So, effectively the utilities in Alberta were able to be double-A rated. They
26 were the highest rated companies — utilities — in the country. They were able to
27 maintain somewhat lower common equity ratios, but that’s all gone.

28 That law was eliminated quite a while ago and many of the utilities in Alberta no
29 longer have preferred shares at all. The ATCO utilities in Alberta have between 6% and
30 10%, but some of them have none.

1 MR. RONDEAU: Yes, I have that in Attachment 1-1 — that ATCO has these
2 preferred shares.

3 Q Does Yukon Electrical have preferred shares in their mix?

4 A MS. McSHANE: No, not any more.

5 Q MR. RONDEAU: Ms. McShane, would you state that, by using this
6 benchmarking tool, or generic rate, as the only tool that you used, that you met the needs
7 and broad expectations of ratepayers or stakeholders?

8 A MS. McSHANE: Could we back up, and let's break that question down. When
9 you say it's the only tool that I used, do you mean that it's the only tool that I used for
10 purposes of looking at the rate of return on equity, as opposed to the capital structure,
11 where I used various tools?

12 Q MR. RONDEAU: Yes.

13 A MS. McSHANE: Well, I think, yes. In this particular instance, given the state of
14 the determination of ROE throughout the country that, for the purpose of these two test
15 periods, this is an approach that probably balances the ratepayers' and equity investors'
16 interests.

17 Q MR. RONDEAU: Does not financial literature support the use of more than a
18 single method in determining fair rate-of-return principle?

19 A MS. McSHANE: It absolutely does. And these benchmark returns, we have to
20 remember, are the result of long, involved hearings in front of multiple different
21 regulators. So, it's not as if there is just some number that's picked out of the air without
22 recognition of the fact that not so long ago \$5 or \$6 million in Alberta was spent to go
23 through this analysis with five experts on the Intervenor side and five experts on the other
24 side.

25 So in principle I agree with you that if you did such a study from first principles that
26 you would take all these tests and perform them again. It just didn't make sense, in terms
27 of economic efficiency to do that in this forum, given that B.C. had done it in 2006;
28 Alberta had done it in 2004; it had been reviewed in Ontario; and there are two more
29 cases that are underway that may or may not change the very nature of these benchmark
30 returns.

1 Again, I'll repeat, it just did not seem to be economically efficient to go through all of
2 that analysis in this forum for a \$28- to \$30-million utility.

3 Q MR. RONDEAU: Is any of this evidence before this Board — from these other
4 rate cases?

5 A MS. McSHANE: No, but all of the decisions are available.

6 Q MR. RONDEAU: In preparing your evidence, Ms. McShane, did you run other
7 methodologies — your normal way of doing things — to see if this particular benchmark
8 or generic term, specifically asked for by YECL, was in the range?

9 A MS. McSHANE: The quick answer is not specifically, no, but I do this all the
10 time, so I know what the likely outcome of a study would be if I performed all the tests. I
11 can assure you that the resulting ROE would be something considerably higher than the
12 number that's in the formula. I mean, I think I made it clear in this testimony that I think
13 that the rate of return that the formula produces is too low.

14 Q MR. RONDEAU: So, conventionally, you come up with a range of rate of return.
15 It's not just set?

16 A MS. McSHANE: So, do you mean conventionally you would apply various tests
17 and those tests would have different answers and they would give you a range?

18 Q MR. RONDEAU: Yes.

19 A MS. McSHANE: That would be the traditional approach, yes.

20 Q MR. RONDEAU: What I would like to get at is: what is this range?

21 A MS. McSHANE: If I were going to, today, estimate what I think a fair return on
22 equity would be for an average-risk utility, based on all the tests, it would likely be in the
23 range of — and I'm going to make it relatively broad — I would say 9.5% to 11%.

24 Q MR. RONDEAU: Now, if you were hired by the Utilities Consumers Group,
25 would your range be the same or would you use the lower end?

26 A MS. McSHANE: The number would still be 9.5% to 11%.

27 Q MR. RONDEAU: Okay, let's go back to cost of capital. Can you explain to us
28 what is meant by the weighted average cost of capital?

29 A MS. McSHANE: The weighted average cost of capital is the percentage of debt
30 in the capital structure times the cost of debt, which gives you the weighted debt

1 component plus the percentage of equity in the capital structure times the cost of equity.
2 That would give you the weighted equity component. You would add those two together
3 and you would get the weighted average cost of capital. You can measure it a number of
4 different ways with respect to the treatment of an income tax. You could have an after-tax
5 weighted average cost of capital, in which case you would look at the weighted debt
6 component on an after-tax basis or you could look at a pre-tax weighted average cost of
7 capital, in which case you would gross up the equity component by the statutory
8 federal/provincial corporate tax rate.

9 Q MR. RONDEAU: Would you agree that regulators' price-setting rule would
10 generally depend on the utility's capital structure?

11 A MS. McSHANE: I don't understand what you mean by a price-setting rule. Do
12 you mean — are you talking about rates or are you talking about the return on rate-based
13 portion of the revenue requirement?

14 Q MR. RONDEAU: I'm talking about the return, yes.

15 A MS. McSHANE: So, sorry, are you saying — asking — if the cost rates on debt
16 and equity are a function of the capital structure?

17 Q MR. RONDEAU: Yes.

18 A MS. McSHANE: Yes, they are.

19 Q MR. RONDEAU: Would you then say that a utility corporation can influence this
20 rate of return, or price setting, by choosing its financial mix?

21 A MS. McSHANE: I'm not quite sure how to answer that question. The choice of
22 financial structure will determine what the cost rates for debt and equity are, which they
23 will incur. Theoretically, there is a capital structure which would minimize the cost to
24 capital, although it's probably in a relatively broad range and nobody purports to be able
25 to precisely identify what the number would be, in terms of the debt-equity split that
26 would minimize that cost.

27 Q MR. RONDEAU: Would not implementing these judicious choices not — would
28 it have the abilities to add profits to the utility?

29 A MS. McSHANE: I'm not understanding what you're asking.

1 Q MR. RONDEAU: Well, by choosing a particular capital structure, you can
2 increase the amount of returns coming back into the utility.

3 A MS. McSHANE: Are you saying that you use a different capital structure than
4 the regulatory capital structure?

5 Q MR. RONDEAU: Well, the normal structure has been a 60/40 split. What I'm
6 trying to get at is: why all of a sudden are you changing this capital structure?

7 A MS. McSHANE: Oh, well that's a different question. The reason, to boil it down,
8 I guess, into one simple statement, is the basic reason that we're proposing a change in
9 the capital structure is things have changed; markets have changed. What we would
10 consider to be comparables have changed; the markets have become much more global;
11 we're no longer just looking at comparisons with other Canadian utilities. You have to be
12 aware of and compete with utilities across North America.

13 We have all of these companies in the utility infrastructure area that are going to be
14 going out and raising billions of dollars in utility pipe and transmission and new
15 generation, and you need, as a utility, to offer a capital structure that's comparable,
16 competitive.

17 Q MR. RONDEAU: Are you aware that the current bank rate of Canada dropped
18 half a percent today?

19 A MS. McSHANE: Yes, I'm aware that the bank rates in Canada, the United States
20 and various European countries dropped today. This is not an indication that the cost of
21 capital is going down.

22 Q MR. RONDEAU: Would you agree, however, that the capital market conditions
23 have changed significantly between the date of your filing this testimony and today's
24 date?

25 A MS. McSHANE: Yes, they have changed significantly.

26 Q MR. RONDEAU: Would this cause you to revise your estimated cost of equity?

27 A MS. McSHANE: When you say "my estimated cost of equity," do you mean would
28 this cause me to, if I were going through this whole process that we've been talking about
29 — these various tests — would the 9.5% to 11% change? Or, are you saying would the
30 formula produce a different number today?

1 Q MR. RONDEAU: I'm asking if the formula would produce different numbers.

2 A MS. McSHANE: The formula would produce slightly lower numbers today than
3 it did when I originally prepared the evidence, because long-term government bond
4 yields, which are the underpinning of the formula, are the investment of choice at the
5 moment because investors are fleeing to the safety of government bonds and pushing
6 those yields down.

7 So a formula that is based on long-term government bond yields, as the formulas in
8 Canada are, would produce a slightly lower ROE today than when the evidence was
9 prepared.

10 Q MR. RONDEAU: By "slightly lower," how much do you mean — one-quarter,
11 one-half, 1%?

12 A MS. McSHANE: 15 basis points, I think. I think if you used the most recent
13 forecast, you'd produce an ROE of 9.1% versus 9.25% that was in the initial testimony.

14 Q MR. RONDEAU: Now, do not these bond rates change not only monthly but
15 daily?

16 A MS. McSHANE: Do the bond yields change daily?

17 Q MR. RONDEAU: Yes.

18 A MS. McSHANE: Yes.

19 Q MR. RONDEAU: Okay, let's talk about risk for awhile. Can you please
20 define "utility risk" for us?

21 A MS. McSHANE: I can define "risk", or "business risk" — I guess "risk".
22 Risk is the probability that the return the investor will achieve will fall short of what he
23 expects, or that he will not be able to recover his full investment.

24 Q MR. RONDEAU: Can you please reference UCG-YECL-30 as well as
25 Attachment 5 of YUB-YECL-35(b), page 13.

26 A MS. McSHANE: Sorry, so the first one is —

27 Q MR. RONDEAU: One at a time.

28 A MS. McSHANE: One at a time.

29 Q MR. RONDEAU: UCG-YECL-30.

30 A MS. McSHANE: Okay, I have that.

1 Q MR. RONDEAU: Okay, this gives you some returns of YECL.

2 A MS. McSHANE: Yes.

3 Q MR. RONDEAU: Now, the other one I'm asking you to look up is YUB-YECL-
4 35(b), Attachment 5, page 13. It is a chart showing Canada-U.S. allowed return
5 differential between 1992 and 2007.

6 MR. FREEDMAN: Could you just repeat that number again?

7 MR. RONDEAU: 35(b), Attachment 5, page 13. If you're having trouble finding
8 that particular chart, which is in your evidence, it's also in Utilities Consumers Group
9 Exhibit C3-9, page 4.

10 A MS. McSHANE: I think I have both of the pieces you are looking at.

11 Q MR. RONDEAU: Okay. You define "risk" as something "to the probability of
12 failing to achieve the anticipated rate of return." Is that correct?

13 A MS. McSHANE: That's part of it.

14 Q MR. RONDEAU: Part of it?

15 A MS. McSHANE: The other part was the probability of failing to recover the full
16 investment.

17 Q MR. RONDEAU: Okay, if we look at YECL's rate of return since 1998 — and I
18 also have 1996 and 1997. Their returns were even higher, so YUB — I'll come to that
19 later. Let's just look at what we have in front of us here. Now, would you agree that from
20 1998 to 2007, YECL basically received a higher rate of return than the Canadian
21 average?

22 A MS. McSHANE: They earned a higher rate of return than the allowed returns for
23 the typical Canadian utility. Whether they earned a higher rate of return than the typical
24 Canadian utility earned — that I can't tell you from this data.

25 Q MR. RONDEAU: I'm sorry, there's a difference between an allowed rate of
26 return — in other words, it's typical that these utilities overearn? Is that what you're
27 telling me? I didn't quite understand your answer.

28 A MS. McSHANE: Utilities do have the ability to earn more than what they're
29 allowed and indeed they will try their darnedest to earn more than they're allowed. I
30 mean, that's —

1 Q MR. RONDEAU: Then why do we go through all this process of determining
2 what the rate of return should be?

3 A MS. McSHANE: Because, in the first instance, the utilities should be allowed a
4 reasonable rate of return that reflects their cost of capital. I mean, you're not supposed to
5 set a return that's below the cost of capital and say that it's up to the utilities to beat it.

6 Q MR. RONDEAU: Well, isn't it normal procedure that, in proceedings that I've
7 dealt with in front of the CRTC, at least a portion of these overearnings are returned to
8 the ratepayers?

9 A MS. McSHANE: It really depends totally on the jurisdiction and what the rules
10 are in that jurisdiction. So you could be right about the CRTC; I don't recall how that
11 worked. That's certainly true in Newfoundland; it's not true in Ontario, unless there's
12 something specifically built into an arrangement that those utilities have.

13 Q MR. RONDEAU: Okay, let's go back to risk. If you look at the last two years,
14 YECL earned almost 2% higher than the average allowed return for other utilities. Now,
15 if they're earning such a great return, how can you say they have all this risk that you're
16 speaking about?

17 A MS. McSHANE: We have to understand that this company's rate of return has
18 not been determined for a long time.

19 Q MR. RONDEAU: Have they ever been lucky.

20 A MS. McSHANE: Have they ever been lucky?

21 Q MR. RONDEAU: Certainly yes, they have. Look at the statistics right in front of
22 you.

23 A MS. McSHANE: I don't understand what you mean by, "have they been lucky".

24 Q MR. RONDEAU: Well, they've been reaping a high return for eight years.

25 A MS. McSHANE: But the returns are lower than the last determined rate of return.

26 Q MR. RONDEAU: Certainly, but they certainly don't reflect what's happening in
27 other jurisdictions.

28 A MS. McSHANE: No, they haven't come back to have the rate of return redetermined
29 in that they haven't come back for new rates. This is a first time.

30 Q MR. RONDEAU: That's what I'm saying. It's to their benefit, not to their —

1 All this talk about risk, you're always saying that there's a risk to the utility. Do your
2 conclusions ever consider the risk to ratepayers?

3 A MS. McSHANE: Implicitly, of course it does, because the cost of capital, when
4 you look at that, you look at how the risk is shared between ratepayers and shareholders
5 so, implicitly, the more risk that's borne by the shareholder, the higher the rate of return
6 is. I mean, that's implicit in the approach.

7 Q MR. RONDEAU: But that's to the detriment of the ratepayer.

8 A MS. McSHANE: Sorry, I don't know what you mean by that.

9 Q MR. RONDEAU: Well, if you consider higher risks for the utility, it gives a
10 higher rate of return, which in turn the ratepayer pays for.

11 A MS. McSHANE: But maybe if I gave you an example, it would be clearer what I
12 was trying to say. Suppose I had two utilities, and one of them is what I will refer to as a
13 full cost-of-service utility, and that means whatever their costs are in any given year, the
14 next year, if their rates were set on a different set of costs than what their actual incurred
15 costs were, the next year those additional costs would be passed through to the
16 ratepayers. We've had utilities like that in Canada.

17 On the other side, let's take a utility which has — they forecast their costs, whatever
18 their costs are get put into rates; there are no deferral accounts; there are no fuel
19 adjustment clauses, so customers pay those rates and that's all they're responsible for. If
20 the costs of the utility are way different from what went into the rates, that's the utility's
21 problem. So those are kind of your two extremes.

22 So the utility that is able to pass all of its costs on the following year to ratepayers is a
23 lower risk utility and it's going to have a lower rate of return than the utility that has
24 absolutely no deferral account protection whatsoever. In the latter case, it's the utility
25 that's bearing the risk; in the first case, it's the customers that are bearing most of the risk
26 — at least on a year-to-year cost of service basis.

27 Q MR. RONDEAU: Does YECL have a deferral account?

28 A MS. McSHANE: It has some deferral accounts so it's —

29 Q MR. RONDEAU: Protected.

30 A MS. McSHANE: It's not fully protected, nor is it fully unprotected.

1 Q MR. RONDEAU: But it certainly helps modify.

2 A MS. McSHANE: The deferral accounts will help modify the risk level. I don't
3 think there's anybody that would disagree with that, and that would obviously be taken
4 into account in the determination of what the proper rate of return is.

5 Q MR. RONDEAU: Have you taken this into account?

6 A MS. McSHANE: Absolutely have, yes.

7 Q MR. RONDEAU: Does rate-of-return regulation generally shift the risk from the
8 utility to the ratepayers?

9 A MS. McSHANE: In relation to what? I mean, is there a comparison?

10 Q MR. RONDEAU: Well, comparison to caps, comparison to other types of
11 regulation — price caps.

12 A MS. McSHANE: Yes, I think it would be fair to say that, all other things equal, a
13 utility that was price-cap regulated would be riskier than a utility that is cost-of-service
14 regulated.

15 Q MR. RONDEAU: How about one that runs on an incentive or performance base?

16 A MS. McSHANE: It depends. I mean, it's hard to make a very overly general
17 statement. It depends how broad the incentives are; it depends if the incentives are just
18 simply add-ons so that the cost of service is still basically a floor. It's difficult to make a
19 general conclusion from that.

20 Q MR. RONDEAU: Okay, I believe I heard you say that increasing the rate of
21 return and the cost of capital for a utility doesn't increase the risk to ratepayers. Did I get
22 that correct?

23 A MS. McSHANE: I don't think that's what I said. If we're talking about the same
24 exchange, what I said was that the higher the risk to ratepayers, the lower the cost of
25 equity, and the lower the rate of return — and vice versa. And if you think of it in terms
26 of how the risks — the fundamental risks — are shared between investors and ratepayers
27 — so, if the regulatory framework is set up in such a way that the majority of the risk
28 falls on ratepayers, then the overall rate of return should be lower for a utility of that kind
29 than where most of the risks remain with the investors.

1 MS. SHANKS: Mr. Rondeau, I don't want to interrupt your line of questioning,
2 but I note that we're at 10:30 a.m. — time for the break. But I don't want to interrupt the
3 flow. Do you have an idea of how much more time you'd need on this section?

4 MR. RONDEAU: Probably half an hour — 15 minutes to half an hour.

5 MS. SHANKS: Would this be an appropriate time for a break, in terms of your
6 questioning?

7 MR. RONDEAU: Fine with me.

8 MS. SHANKS: In that case, we'll break for 15 minutes and look to return about
9 10:45 a.m.

10 (PROCEEDINGS ADJOURNED)

11 (PROCEEDINGS RESUMED)

12

13 MS. SHANKS: Please be seated. Mr. Rondeau, you've indicated you have
14 between 15 and 30 more minutes. Is that right?

15 MR. RONDEAU: I believe so, yes.

16 MS. SHANKS: Could you please proceed?

17 Q MR. RONDEAU: I think we left off talking a bit about risk, so I've a few more
18 things on that. Would you agree that investment risk can be lowered with diversification?

19 A MS. McSHANE: Within the context of the capital asset pricing model, yes. I
20 mean, that is the premise and, yes, investment risk to an individual is reduced by
21 diversifying. So a risk of a portfolio is less the more diverse it is.

22 Q MR. RONDEAU: Would you not, in turn, say that the Canadian Utilities
23 conglomerate is a diverse organization or firm?

24 A MS. McSHANE: Sure. I mean it has aspects of diversification so that if, because
25 it's involved in different utility sectors, something doesn't go well in the gas area,
26 chances are things might go better in the electric sector. So yes, there is an element of
27 diversification within Canadian Utilities Ltd.

28 Q MR. RONDEAU: I have a profile here of Canadian Utilities and it definitely is
29 diverse — everything from power generation to utilities to industrials to high-tech and

1 energy services. What I'm getting at is the cost of capital. Should it not be seen that this
2 conglomerate is so diverse, could they not offer a better capital cost than 6.6%, which is
3 what I see in the books?

4 A MS. McSHANE: Sorry, so you're saying because Canadian Utilities Ltd. — is
5 that what you were looking at?

6 Q MR. RONDEAU: Yes.

7 A MS. McSHANE: So let me understand the question. Are you asking me if Canadian
8 Utilities Ltd. would have a lower cost of debt than CU Inc. because it's more diverse, or
9 are you saying that you don't think the 6.6% — or suggesting that the 6.6% is not
10 indicative of the level of diversification of CU Inc.?

11 Q MR. RONDEAU: That's what I'm saying, the latter.

12 A MS. McSHANE: The latter?

13 Q MR. RONDEAU: Yes.

14 A MS. McSHANE: Okay, so CU Inc. is, as I said before, the highest rated utility of
15 all the investor-owned utilities in the country. And part of the reason that it's the highest
16 rated utility of all the investor-owned utilities in the country is because it is diverse and it
17 also reflects what it's diverse in.

18 So it already has the lowest cost of long-term debt of any of the investor-owned
19 utilities, and I don't know how you would get to the conclusion that — I mean, the
20 market determines that cost. CU Inc. says, "I need to raise some debt on behalf of my
21 various utility subsidiaries." It goes to the market; the market's already pricing existing
22 debt that it has. So it's all market based and it's the lowest rate of any investor utility. I
23 don't know how you'd come to the conclusion they could get it any cheaper.

24 Q MR. RONDEAU: Market rates are going down. Am I correct in that?

25 A MS. McSHANE: No. Not market rates for utilities. No, they're not.

26 What we're seeing is that the long-term Treasury bond yields have been going down.
27 As I suggested in our discussion earlier, what we've seen is a flight to safety and, by
28 "safety" — these are government securities that investors are moving to in Canada and
29 the United States — in the developed economies. But the spreads between long-term
30 Treasury notes and long-term Canada bonds have been going up, so that the cost of debt

1 for utilities is actually higher now than it was, say, a year ago when government bond
2 yields were considerably higher than they are now. So, you have lower Treasury and
3 government bond yields in Canada and higher spreads, leading to higher costs of utility
4 debt.

5 Q MR. RONDEAU: Okay, you've already answered my next question. What I was
6 going to ask you is if you look at the financing rates for two years' prior, they were in the
7 lower 5% range and now, for the two test years, we are seeing 6.6%. Would you say that
8 is a normal increase in capital costs for electrical utilities? In other words, that would be
9 from 5% to 6 — a 1.5% increase.

10 A MS. McSHANE: Is it normal? I would say there's nothing about this market right
11 now that's normal. Is it reasonable? It's clearly within the range of what the spreads are
12 and the outlook for the spreads. So what we've seen since the last time CU Inc. issued
13 long-term debt is a large increase in the spreads.

14 Q MR. RONDEAU: It would be consistent with other electrical utility costs of —

15 A MS. McSHANE: Yes, what you've seen is that, for all the utilities, there has been
16 an increase in the spread and if you look at the individual companies and where they fit,
17 relatively speaking, to each other, the spreads are higher for CU Inc. than they were, but
18 they're still lower than for all the other investor-owned utilities.

19 Q MR. RONDEAU: Now, if you were to use the capital asset pricing model for
20 determining rate of return, would you use this 6.6% debt costs?

21 A MS. McSHANE: No, because the capital asset pricing model is a return-on-
22 equity model that's based on taking an estimate of the risk-free rate and adding to that an
23 estimate of the risk premium for the market as a whole, multiplied times the relative risk
24 of your investment that you're dealing with. We call that "relative risk adjustment — the
25 betas. Just by virtue of the capital asset pricing models' parameters, you use the yield on
26 a long-term Canada bond, because that's the proxy for the risk-free rate, not the yield on
27 a corporate bond, which is a risky investment.

28 Q MR. RONDEAU: You spoke of "beta". Can you tell me what the average beta
29 for an electric utility would be at this time?

30 A MS. McSHANE: Not in simple terms, no.

1 Q MR. RONDEAU: Can you give me a ballpark?

2 A MS. McSHANE: I can give you a ballpark number of what I would expect it to
3 be, and that would be between 0.6 and 0.7.

4 Q MR. RONDEAU: Okay, if we go back — I don't know if you were aware that
5 UCG filed some evidence that was disallowed, but the Board stated that we could use it
6 as a reference?

7 A MS. McSHANE: I did see the filing, yes.

8 Q MR. RONDEAU: I'm just going to go through — the basic reason for this was to
9 just have this flow a little easier. There are four common principles that are advocated in
10 this —

11 A MS. McSHANE: Do you have a copy of it that I could have in front of me?

12 Q MR. RONDEAU: I would prefer to keep this one in front of me, but I can give
13 you the four methods.

14 MR. KEOUGH: Mr. Rondeau, I can provide her with my copy.

15 Q MR. RONDEAU: Okay, thank you. On the second page — third page, I
16 guess. You'll see the four types of measurements used. Are these the normal
17 measurements, methodologies, that you would use in determining your rate of return?

18 A MS. McSHANE: Yes.

19 Q MR. RONDEAU: Okay. Now, if we look at comparable earnings, first of all,
20 we can also go back to UCG — excuse me. Pardon me — YUB-YECL-35(b) — it was
21 the chart showing Canada-U.S. average allowed rate of return.

22 A MS. McSHANE: This is Attachment 5, page 13 of 38?

23 Q MR. RONDEAU: Correct.

24 A MS. McSHANE: Okay, I have that.

25 Q MR. RONDEAU: Now, in this particular chart, it shows that for 2007 the average
26 return is 8.71.

27 A MS. McSHANE: Average allowed return — in Canada.

28 Q MR. RONDEAU: So that would be a comparable figure — am I correct?

29 A MS. McSHANE: It would be one number. I mean, we could get into a long
30 discussion about whether it's a comparable number. I would say that it's one number, but

1 because it basically is a number that's generated by a formula, then it has a lot less
2 substance as a comparable than a number, which — for example, the U.S. number would
3 be the result of a whole bunch of rate-of-return proceedings, each of which looked at all
4 of the various tests.

5 Q MR. RONDEAU: In other words, the Canada one is not?

6 A MS. McSHANE: That's exactly right. The Canada one essentially is the allowed
7 rate of return for utilities that flowed out of automatic adjustment formulas.

8 Q MR. RONDEAU: I'm just going back to the range that you gave us earlier. You
9 said somewhere between 9.5% and 11%.

10 A MS. McSHANE: Well, you asked me the question if I had done all the tests —

11 Q MR. RONDEAU: Yes.

12 A MS. McSHANE: — myself, where would I have come out in terms of a generic
13 benchmark return, and I said somewhere in the range of 9.5% to 11%.

14 Q MR. RONDEAU: But this comparable one already sets lower — like 75 basis
15 points lower.

16 A MS. McSHANE: Now which are we talking about?

17 Q MR. RONDEAU: 8.71%.

18 A MS. McSHANE: Oh, well again, 8.71% is just a number that comes out of a
19 formula.

20 Q MR. RONDEAU: So are yours.

21 A MS. McSHANE: No, they're not. Mine are numbers that would come out of
22 applying all the various tests — comparable earnings, risk premium, capital asset pricing
23 model, discounted cash flow — and coming up with an estimate of the return on equity,
24 looking at all the various market factors that would go into the cost of equity. The 8.71 is
25 simply what happened to the yield on long-term Canada bond yields between 2007 and
26 2006, and let's apply a formulaic differential to those two numbers and come up with a
27 new ROE for 2007. But it's not a number that comes out of looking at all of these tests
28 that you pointed to on this presentation.

29 Q MR. RONDEAU: Okay, let's go to the second test, the risk premium. Now,
30 during the 1996-97 GRA, for which we attended, the risk premium was determined to be

1 3%. Can you tell us how the dynamics of YECL have changed to demand what you're
2 now asking for, a 4.75 risk premium?

3 A MS. McSHANE: Sorry, what are we talking about, 1996-97?

4 Q MR. RONDEAU: The risk premium was determined to be 3%.

5 A MS. McSHANE: By whom? The Board? By negotiated settlement?

6 Q MR. RONDEAU: It was through a negotiated settlement, yes.

7 MR. KEOUGH: Mr. Rondeau, do you have a reference for that, please?

8 MR. RONDEAU: Not with me, but that can be —

9 A MS. McSHANE: I'm sorry — so assuming for the moment — and I'm going to
10 take this subject to check — assuming for the moment that the underlying risk premium
11 in the negotiated settlement was 3%. And the underlying risk premium in the proposed
12 ROE is —

13 MR. RONDEAU: 4.75.

14 A MS. McSHANE: So that's 9.25 minus 4.5: 4.75? Okay. My calculator still works.
15 Part of what's happened is — I mean, this is — the risk premium that underpinned,
16 assuming that it was 3% in 1996-97, was not that different from the risk premium that
17 underpinned formulas at the time, because interest rates were much higher.

18 So a lot of the change in the risk premium from then to now is a function of the fact
19 that these formulas are based on the assumption that there's not a one-for-one relationship
20 between equity risk premiums and interest rates, that the lower interest rates are, the
21 higher the risk premium is, everything else being equal. I mean, that's the basic
22 assumption when you have an automatic adjustment factor that's less than one.

23 So basically what it's saying is that there is not a one-for-one relationship between
24 interest rates and the cost of equity. The cost of equity does not move as quickly down
25 and up as the cost of debt. There are other factors than interest rates that impact on it. So
26 that's the major reason for the difference between a lower risk premium back in 1996,
27 when government interest rates were higher and the higher risk premium under a formula
28 today.

29 Q MR. RONDEAU: So that's a general determination when long-range bond rates
30 are high, risk is lower?

1 A MS. McSHANE: I guess the general principle is that there are other factors that
2 determine the cost of equity than just the yield on long-term government bonds. When the
3 formulas were put in place, there was a recognition that there wasn't this one-for-one
4 relationship. It's difficult to precisely say what it is. The 75% change, which underpins
5 most of these formulas, is basically sort of a compromise between some people who
6 thought the return on equity should move 100% of the change in government bond yields
7 and people who said that the evidence tended toward showing that the relationship was
8 50/50. With more years of experience and observation behind us, it does look like it was
9 more 50/50 than 75%.

10 Q MR. RONDEAU: If you would like to look at Section 8, Attachment 1-1,
11 Schedule 5, page 3 of 3, it's a comparison table.

12 A MS. McSHANE: This is my testimony, is it?

13 Q MR. RONDEAU: I believe so, yes.

14 A MS. McSHANE: Sorry, what is the page you would like me to look at?

15 Q MR. RONDEAU: Page 3 of 3.

16 A MS. McSHANE: I have that.

17 Q MR. RONDEAU: What we're looking at here is the Canadian Utilities' rate of
18 return and the equity risk premium. I stated 3% for here, just to make you feel a little bit
19 more comfortable. According to this it was 3.61% in 1996 for the Canadian Utilities.
20 Now if you look at 2008, the risk premium has jumped to 4.08%. This is a far cry of an
21 increase than what you're requesting.

22 A MS. McSHANE: Sorry, I'm not following where you're going on this. You are at
23 2 —

24 Q MR. RONDEAU: 3.61% —

25 A MS. McSHANE: I have that, yes.

26 Q MR. RONDEAU: 4.08% at 2008.

27 A MS. McSHANE: 4.08% at 2008?

28 Q MR. RONDEAU: Is it 4.68% — sorry?

29 A MS. McSHANE: Yes.

1 Q MR. RONDEAU: I need my glasses. I think it is. Okay, so it's up a percentage
2 point, approximately.

3 A MS. McSHANE: Yes, okay. So this is the effective risk premium. It went from
4 3.6% to 4.7%.

5 Q MR. RONDEAU: Yes, approximately.

6 A MS. McSHANE: Yes.

7 Q MR. RONDEAU: All right. So that's approximately 1% of an increase. Now our
8 figures for Yukon Electrical are 4.75%.

9 A MS. McSHANE: So it's within 5 basis points of this number.

10 Q MR. RONDEAU: It's 3 —

11 A MS. McSHANE: If I look down here at the 2008 number, which says that the
12 equity-risk premium in 2008 is 4.68% and what you're suggesting to me was what was in
13 my testimony is 4.75%, right?

14 Q MR. RONDEAU: Yes.

15 A MS. McSHANE: So if I take 4.75 and subtract 4.68 from it —

16 Q MR. RONDEAU: Correct.

17 A MS. McSHANE: That's a seven basis points difference. It's de minimus.

18 Q MR. RONDEAU: Correct. My eyes — sorry. Now, back to the debt-to-equity ratio
19 for a minute here — I asked you how the dynamics of YECL had changed to ask for such
20 an increase in risk premium. I would also like to ask you how the dynamics have changed
21 in order to change the capital structure of YECL.

22 A MS. McSHANE: Okay. YECL asked me to take a look at first principles — or,
23 some first principles — at what the capital structure should look like. In other words,
24 from my perspective, that meant, yeah, you would look at what the past capital structure
25 was, but your basic focus should be, "If I were going to determine this capital structure de
26 novo, what would I look at?"

27 I would look at how risky is this company relative to other utilities in Canada? I
28 would look at what the allowed capital structures are today of other utilities in Canada, so
29 that gives me a sense of — based on what other people are allowed, where should I sit? I
30 would look at what the debt rate agencies are saying are the proper parameters for capital

1 structure based on what they require to get to certain debt ratings. So we looked at
2 Moody's and we looked at Standard & Poor's and what their guidelines were for utilities
3 of approximately the risk level of Yukon Electrical. And we looked at what the actual
4 capital structures of utilities were, in conjunction with what their debt ratings are.

5 So it's one thing to say, "Well, so-and-so's adopted equity ratio is 35." Well, if so-
6 and-so's adopted equity ratio is 35, and they're rated double-B, and it's really important
7 to be an A-rated utility so you can go to the capital markets when you need the capital,
8 35% is only an indication that it's not enough. So we looked at what the market was
9 saying now about what the capital structure should be.

10 The other dynamic we looked at more today than we would have looked at, say, 10
11 years ago — clearly, there is greater globalization of capital markets today than there had
12 been 10 years ago. And, in part, this has been strengthened in Canada by the removal of
13 the foreign property rule in 2005, which has meant that where debt issuance prior to that
14 by Canadian companies was typically bought up solely by Canadian institutions that had
15 a foreign property cap — so what they did was they bought all of the Canadian debt and
16 saved their foreign property investment for equities.

17 So now the debt market is much more open than it was before globally, so there really
18 is a much stronger argument for looking not just to capital structures of other Canadian
19 companies, but to other utilities that are in comparable risk categories.

20 Q MR. RONDEAU: Does YECL have a debt rating?

21 A MS. McSHANE: No, it doesn't, but its parent does.

22 MS. SHANKS: Mr. Rondeau, I know we're coming up to your half an hour
23 estimate of time remaining. I am just wondering —

24 MR. RONDEAU: I think I have four more questions.

25 MS. SHANKS: Thank you.

26 MS. McSHANE: I will try to give short answers.

27 Q MR. RONDEAU: We spoke about betas a little bit. Would this — you told us the
28 beta was between 6 and 7, you would estimate. How would the actual equity costs be
29 determined to apply that beta to — what number? For example, the debt is 6.6. Is that
30 what you would use, or would you use some other figure?

1 A MS. McSHANE: Sorry, I am totally confused by that.

2 Q MR. RONDEAU: To come up with your risk premium. The beta times —

3 A MS. McSHANE: Oh, what would I multiply the beta times?

4 Q MR. RONDEAU: Exactly.

5 A MS. McSHANE: Well, a market risk premium of about 6.5%?

6 Q MR. RONDEAU: Is it normal practice that firms, subject to rate of return
7 regulation, have lower betas and lower average cost of capital?

8 A MS. McSHANE: Than what?

9 Q MR. RONDEAU: Than companies that are regulated under price caps or incentive?

10 A MS. McSHANE: Yes, that's true. I mean, I've seen studies that have shown that
11 — it's hard to know exactly how much of that is country specific versus regulatory
12 framework specific, but the studies I've seen suggest that if you're subject to price cap,
13 then you would be — everything else being equal — riskier than a company that was
14 subject to cost-of-service regulation. That should, if you had the same capital structures,
15 translate into a higher beta for the companies with price caps.

16 Q MR. RONDEAU: Is YECL regulated under rate-of-return structure?

17 A MS. McSHANE: Yes.

18 Q MR. RONDEAU: Is it also normal practice for regulators using rate-of-return
19 regulation to set a target rate of return lower than that that earned by the average firm and
20 still expect investors to be interested?

21 A MS. McSHANE: I'm sorry, I'm having a little issue with that question. I don't
22 understand what you're asking.

23 Q MR. RONDEAU: What I'm getting at is if these folks up front were regulating
24 with a cap, would they not set a lower return?

25 A MS. McSHANE: Lower than they would —

26 Q MR. RONDEAU: Pardon me — a higher return than they would set with the
27 rate-of-return structure?

28 A MS. McSHANE: They might or they might not. What I believe, in terms of what
29 constitutes higher risk, is not universally shared. I mean, I've seen regulators come to the

1 conclusion that implementing incentive regulation does not increase the risk, and they
2 haven't changed their rate of return, so there is a difference of point of view on that issue.

3 Q MR. RONDEAU: Yeah, I accept that. The last thing I want to question you on is
4 what you call the "stand-alone principle". Can you tell us who YECL plans on buying
5 their computer technology from?

6 A MR. FREEDMAN: Yukon Electrical uses ATCO I-Tec to support the company
7 and I-Tek infrastructure.

8 Q MR. RONDEAU: Can you tell us who YECL plans on buying their new smart
9 meters from?

10 A MS. McSHANE: I don't know.

11 Q MR. RONDEAU: Is it an ATCO family member?

12 A MR. FREEDMAN: I'm just checking the business case. They're using ATCO.
13 AMR has been installed in ATCO Electric, but whether they're purchasing — if that's
14 what your question is getting at, if they're purchasing the meters from a third party,
15 which I believe they would be, but they are using the knowledge gained within ATCO
16 Electric to assist in the implementation of this project. But the actual meters would be a
17 third party.

18 Q MR. RONDEAU: Can you get back to us on that for sure — an undertaking?

19 MR. KEOUGH: Madam Chair, this is really not the subject matter of this panel.
20 The Yukon Electrical general panel that contains other witnesses with more detailed
21 information on the business case for AMR may be able to provide an answer to this
22 question. It's really not within Mr. Freedman's bailiwick to deal with the AMR issue, and
23 it certainly is not a capital structure rate-of-return item.

24 I'm not saying Mr. Rondeau is not entitled to a response to his question, but I think,
25 on the general panel, the other witnesses may be able to assist him in providing the
26 answer, because he seems to have gotten into a specific capital project here.

27 MR. RONDEAU: I'd say that this goes directly to the heart of the stand-alone
28 principle.

1 MS. SHANKS: Mr. Rondeau, I concur with Mr. Keough. I assume that was your
2 last question for the rate-of-return/capital panel this morning, and you can take your other
3 questions up with the company panel — Panel 1 —that we suspended at the moment.

4 You mentioned that you had five more questions to go, or four more, actually, and I
5 count five with that one.

6 MR. RONDEAU: Well, this is — I'm almost finished with this particular stand-
7 alone principle. I'd like to finish this up, if I could. It's just a matter of a few minutes.

8 MS. SHANKS: I would like no more questions to go forward to this panel on the
9 purchase of the meters.

10 MR. RONDEAU: No, I'm not asking any more on that.

11 MS. SHANKS: Thank you.

12 MR. RONDEAU: I will hit the other panel when that comes through.

13 What I — where was I now?

14 Finally, my last question is — actually, it isn't my last, but I want to ask —

15 MS. SHANKS: Mr. Rondeau, how many more questions do you actually have?
16 Because you mentioned you had, like, four more questions, and I've counted more than
17 four already, some of them not even related to this rate-of-return panel.

18 MR. RONDEAU: It's lumped together. It is related, because it is on the stand-
19 alone principle.

20 MS. SHANKS: How many more questions? How much more time are you
21 requiring, Mr. Rondeau?

22 MR. RONDEAU: Just a couple of minutes; if you bear with me.

23 Q Who does YECL plan on borrowing its money from to pay for all these other capital
24 projects?

25 A MR. FREEDMAN: Yukon Electrical, as has been mentioned earlier, receives its
26 financing through its parent company, ATCO Electric, and ATCO Electric gets that
27 financing from CU Inc.

28 Q MR. RONDEAU: Ms. McShane, hearing this, can you still stand in front of
29 this Board and say that YECL should be considered a stand-alone company?

30 A MS. McSHANE: Yes.

1 MR. RONDEAU: Thank you.

2 MS. SHANKS: Thank you, Mr. Rondeau. This brings us to the next Intervenor
3 for cross-examination. We have Mr. Marriott representing the City of Whitehorse.

4 MR. MARRIOTT: Good morning, Madam Chair, panel.

5 Panel, I'm mindful that Ms. McShane is here with us for as short a period as possible,
6 from her perspective. So I don't think I'll ask necessarily all the questions I might have of
7 you, Mr. Freedman, if that's alright. I may save some of those questions for the main
8 panel.

9 MR. KEOUGH: I know we're trying to accommodate travel schedules, but the
10 general statement makes me very uncomfortable. Yesterday — I read portions of the
11 transcript. Yesterday I was very uncomfortable with Mr. Freedman being required to
12 respond to depreciation questions, as an example, and interpret and speak to Mr.
13 Kennedy's evidence, when Mr. Kennedy wasn't here. Should a situation like that arise
14 again, I'm not sure I'm going to find it acceptable. So I'm afraid I'm going to have to tell
15 Mr. Marriott that if he's got rate of return/capital structure questions for Mr. Freedman,
16 he should probably pose them.

17 MR. MARRIOTT: I'm happy to do that. I was just trying to be helpful to Ms.
18 McShane. And certainly I wasn't intending to ask Mr. Freedman any questions about Ms.
19 McShane's evidence. But I'll be guided by my friend, if that is what he would prefer. I
20 think it's somewhat artificial, quite frankly, to have Mr. Freedman sit on two panels and
21 then refuse to answer certain questions because it's not the right panel, but what have
22 you. We'll deal with that.

23 MR. KEOUGH: Well, Mr. Marriott, in all fairness, I do think the subject matter
24 of his appearance here, on this panel, is quite clear. If there is any ambiguity, we will
25 straighten it out, but I do not think there is any confusion about what he is speaking to in
26 his role on this panel.

27 **YECL Panel 2 cross-examined by Mr. Marriott**

28 Q MR. MARRIOTT: Well, then, Mr. Freedman, my first question is for you. How
29 close to the filing of this application were your forecasts made, and were they updated as
30 nearly as possible to the filing date?

1 A MR. FREEDMAN: I believe we said in the application that the forecasts were
2 based on 2007 actual results, and we updated forecasts to about the end of February of
3 2008.

4 Q MR. MARRIOTT: Now, specifically, if we turn to your application, which was
5 filed on April 30, 2008, on page 8-2, there is a forecast there. If you look under the
6 heading “Cost of Debt,” we’re told that: “Yukon Electrical’s forecast embedded cost of
7 debt of 6.60% for the test period is based on Foster and Associates Inc.’s 4.55% Long
8 Canada Bond yield forecast, a 200 basis point spread and 5 basis points for issue costs.”
9 Now, that forecast — when was that made?

10 A MR. FREEDMAN: That was made in the time frames that I’ve outlined. We
11 based it basically to the end of February 2008. There was nothing that happened prior to
12 the filing that would have warranted us to change that forecast.

13 Q MR. MARRIOTT: Now was that forecast made by the company having seen Ms.
14 McShane’s intended filing or was Ms. McShane asked specifically to prepare a forecast
15 for the embedded cost of debt for the test period for the company?

16 A MR. FREEDMAN: Ms. McShane wasn’t asked to do the embedded cost of debt
17 for the company, but in her testimony she had come up with a forecast of the long Canada
18 bond yields of 4.55%, which is what we used for the forecasted issue costs in the test
19 period — for the forecasted debt rates in the test period.

20 Q MR. MARRIOTT: And the 200 basis point spread came from where?

21 A MR. FREEDMAN: That was internal. We used information within the ATCO
22 Group. ATCO Gas was in the midst of a proceeding, and they had provided evidence on
23 where they thought spreads were going and how they had started. We had started to see
24 the spread getting wider, and that’s where we decided to follow — really — their lead
25 and that they were in front. They had prepared a GRA and used the 200 basis point
26 spread. We used that information to arrive at our forecast for Yukon Electrical.

27 Q MR. MARRIOTT: All right. So the 200 basis points didn’t come from Ms.
28 McShane; that came internally, you are saying?

29 A MR. FREEDMAN: That’s correct.

1 Q MR. MARRIOTT: Mr. Freedman, yesterday there was an undertaking to Mr.
2 Landry to advise what the last Board-approved capital structure for YECL was. Do you
3 have that answer yet?

4 A MR. FREEDMAN: No, I do not.

5 Q MR. MARRIOTT: Now, in Ms. McShane's report, on page 36 she states that the
6 actual common equity ratio for YECL has historically been approximately 40%. I take it,
7 Ms. McShane, that the company would have told you that? It's page 36.

8 A MS. McSHANE: Yes, I see that. I'm trying to recall. I mean, I knew that it had
9 been close to 40% previously. I am sure we had a discussion about what it had been
10 historically.

11 Q MR. MARRIOTT: All right. And Mr. Freedman, can you confirm that YECL's
12 actual capital structure has historically been approximately 40%?

13 A MR. FREEDMAN: Yes, I can confirm that.

14 Q MR. MARRIOTT: Sir, do you know what the actual capital structure of YECL is
15 now?

16 A MR. FREEDMAN: It's in that 40% range. If we look at Schedule 8.1 of the
17 application, that's what it would indicate at the end of 2007.

18 Q MR. MARRIOTT: Mr. Freedman, are you familiar with the last proved capital
19 structure for YECL's sister company NUL(NWT) and NUL(YK)?

20 A MR. FREEDMAN: Yes. I believe they would be around 40%. The last approved
21 ones, though again, they have put in evidence in their respective proceedings for 2008-09,
22 as well.

23 Q MR. MARRIOTT: So the last approved ones were 40%? Is that what you are
24 saying?

25 A MR. FREEDMAN: That is correct.

26 Q MR. MARRIOTT: Is that also the actual capital structure of those companies?

27 A MR. FREEDMAN: At the end of 2007, that would be correct.

28 Q MR. MARRIOTT: Now, Ms. McShane, in your report, in several places, your
29 recommended common equity ratio is at the – and I'll quote you – “upper end” of a range

1 of 47.5% to 52.5%. And you use that phrase, “the upper end of that range” several times.
2 Do you recall that?

3 A MS. McSHANE: Yes.

4 Q MR. MARRIOTT: Now, is it part of your training to give a recommendation in a
5 range rather than to hit on one distinct number when you are giving testimony of this
6 nature?

7 A MS. McSHANE: Typically I do it within a range, because none of this is a
8 precise science.

9 Q MR. MARRIOTT: And so the reason that you give a range is exactly that — that
10 it is not an exact science but an analysis that incorporates your opinion and judgement so
11 that there may not be a single correct answer as to exactly what the common equity ratio
12 should be. Would you agree?

13 A MS. McSHANE: I would agree that typically it falls within a range, yes.

14 MR. MARRIOTT: Thank you.

15 Q Now, does that imply that were the Board to approve a common equity ratio
16 anywhere within the range that you have given them that, in your opinion, such a decision
17 would be reasonable?

18 A MS. McSHANE: Clearly, the upper end of the range in conjunction with no
19 increment to the AUC ROE is more consistent with all of the — I think it is more
20 consistent with the financial parameters that are warranted for an A rating. But I don’t
21 think – one couldn’t say categorically that 47.5% would be unreasonable.

22 MR. MARRIOTT: Thank you.

23 Q Now, I’d like to take you, Ms. McShane, in your report to a section that you have on
24 debt rating where you discuss what YECL’s debt rating might be on a stand-alone basis
25 and what it would take to equate YECL to the benchmark utility with a credit rating of A.
26 I’m talking about your Section VII. So, if I have mischaracterized that section, maybe
27 you could correct me, but that is the way that I took it.

28 A MS. McSHANE: Sorry, section which please?

29 MR. MARRIOTT: It is Roman numeral VII starting at page 29.

30 A MS. McSHANE: This is the rating agency guidelines other-than-debt ratio?

1 MR. MARRIOTT: Yes.

2 A MS. McSHANE: Okay. Yes, I have that.

3 Q MR. MARRIOTT: So, starting on that page, you indicate that other financial
4 metrics beside common equity ratios are taken into account by debt-rating agencies and
5 you discuss cash flow coverage ratios, specifically FFO interest coverage ratios and FFO
6 – I'm not sure how to say this – is it FFO over total debt?

7 A MS. McSHANE: Yes. You'd say "FFO to total debt".

8 Q MR. MARRIOTT: Okay. FFO to total debt.

9 Now perhaps you could help us with FFO? What does that stand for?

10 A MS. McSHANE: It stands for funds from operations, and I was a little bit
11 concerned because I would have thought I would have put a definition of that in here, but
12 I don't see one right now.

13 Q MR. MARRIOTT: If it was, I missed it.

14 A MS. McSHANE: Okay, well I apologize for that. It obviously should have been
15 defined. Funds from operations is equal to net income plus non-cash flow items of the
16 income statement. So it would include depreciation and deferred taxes — those would be
17 the two major non-cash items that one would add back to net income to get funds from
18 operations. It's the cash flow coverage ratios that the debt rating agencies are particularly
19 concerned with when they do debt ratings.

20 Q MR. MARRIOTT: Okay. So then you tell us, starting at line 783 of that page 29,
21 that you've estimated the FFO interest coverage and FFO/total debt ratios for YECL
22 based on common equity ratios of 47.5% and 52.5%, using in each case a benchmark
23 return of 8.75% and an embedded cost of debt of 6.83%. So that explanation goes over
24 onto the next page.

25 As well, you also used the forecast appreciation expense for 2009. So, did I just grab
26 that correctly?

27 A MS. McSHANE: Yes.

28 Q MR. MARRIOTT: And your results were that YECL's FFO interest coverage
29 ratios are 4.2X at a 47.5% common equity ratio and 4.7X at a 52.5% common equity ratio
30 — correct?

1 A MS. McSHANE: Yes.

2 Q MR. MARRIOTT: And then you tell us that those ratios are at the upper end of
3 Standard & Poor's guideline range, that guideline range being shown in Table 7 on the
4 previous page 29.

5 A MS. McSHANE: Correct.

6 Q MR. MARRIOTT: That table also shows Moody's guideline range, which has a
7 higher midpoint than Standard & Poor's does.

8 A MS. McSHANE: Correct.

9 Q MR. MARRIOTT: Now, you also tell us that the 4.2 and 4.7 ratios that you
10 calculated compare favourably to the achieved ratios of other Canadian transmission and
11 distribution utilities and you give us the number for that — or the ratio for those other
12 utilities at 3.8X as compared to the 4.2X and 4.7X.

13 A MS. McSHANE: Correct.

14 Q MR. MARRIOTT: Now, is the 3.8X a number that is found somewhere in your
15 attachments or schedules?

16 A MS. McSHANE: I believe so, yes.

17 Q MR. MARRIOTT: Could you give us the cross-reference to that?

18 A MS. McSHANE: It's on Attachment 1-1, Schedule 2, page 1 of 2.

19 Q MR. MARRIOTT: Thank you. Now, with respect to the calculation of the FFO
20 interest coverage ratios and the FFO/total debt ratios, can you provide us with the
21 calculations that you used to arrive at the 4.2X and 4.7X for the FFO Interest Coverage
22 ratio and the calculations that you used to compute the 22% and 25% FFO/total debt
23 ratio?

24 A MS. McSHANE: Yes, I can.

25 Q MR. MARRIOTT: Would you like to do that in writing?

26 A MS. McSHANE: Yes, I would.

27 Q MR. MARRIOTT: Okay. I take that as an undertaking, please. I thank you for
28 that. Could I also ask you to determine — I will let you make your note. Would you
29 undertake to let us know what capital structure would YECL have to have to bring its

1 FFO interest coverage ratio down to the 3.8 average, using the same or better cost of debt
2 — 8.75% return on equity and the other inputs, as you did in the original calculations?

3 A MS. McSHANE: I can do that.

4 Q MR. MARRIOTT: Now, if I could return to Table 7 at page 29, can we agree that
5 for the FFO interest coverage ratios and from the perspective of the debt-rating agency,
6 the higher the ratio, the better — that is, 4X would be better than 3.8X?

7 A MS. McSHANE: Yes.

8 Q MR. MARRIOTT: And for the FFO/total debt ratio from the perspective of the
9 debt-rating agency, is the higher the percentage, the better?

10 A MS. McSHANE: Yes.

11 Q MR. MARRIOTT: Can you tell me what happens to the FFO interest coverage
12 ratio if the embedded cost of debt that you use is lower than the 6.83% that you used for
13 your calculations as shown in the report?

14 A MS. McSHANE: You mean if the embedded debt cost goes down, but nothing
15 else changes?

16 Q MR. MARRIOTT: Yes, all else being equal.

17 A MS. McSHANE: All else being equal, it would go up.

18 Q MR. MARRIOTT: And what would happen to the FFO/total debt ratio if the
19 embedded cost of debt were to go down, all else being equal? Does the ratio, expressed as
20 a percentage, go up or down?

21 A MS. McSHANE: Sorry, could you say that again?

22 Q MR. MARRIOTT: What would happen to the FFO/total debt ratio if the
23 embedded cost of debt goes down? Does that ratio, expressed as a percentage, go up or
24 down?

25 A MS. McSHANE: I have to think about that one for just a second. The FFO/total
26 debt ratio is not impacted by the embedded cost of debt except to the extent that your net
27 income goes up, because your revenue requirement hasn't been adjusted for a lower
28 embedded debt cost. But if you think of the FFO as being net income plus depreciation
29 plus anything else that is non-cash — which the major thing tends to be deferred taxes —
30 and let's say utility comes in every couple of years for revenue requirement and it's

1 allowed every year to earn 10%. So its net income is always based on 10% and whatever
2 the changed embedded debt cost that occurs is taken into account in the new revenue
3 requirement, so that it always earns 10%.

4 So, in that case, the embedded cost of debt has absolutely no impact on the FFO/total
5 debt ratio at all.

6 Q MR. MARRIOTT: Okay. Now in your explanation at the bottom of page 29, I
7 took you to say that you were calculating both of these ratios using the various inputs that
8 you list there and over onto the next page, one of which was that embedded cost of debt.
9 So I took from that that it had some impact, but —

10 A MS. McSHANE: Sorry, it does on the FFO interest coverage, but it doesn't on
11 the other one.

12 Q MR. MARRIOTT: Thank you.

13 Now, let's talk about the other ratio that you say at page 31, starting at line 812, I'm
14 quoting you, "is still considered an important quantitative financial ratio" and that is the
15 EBIT, or earnings before interest and taxes, I think you discussed very briefly with Mr.
16 Rondeau. Or at least I think I heard that; or no, that was in your corrections that I heard
17 you talk about that — this morning, just as you started your testimony.

18 A MS. McSHANE: Correct. That's right, yes.

19 Q MR. MARRIOTT: That's how I know how to pronounce it. Now, on page 31,
20 you calculate the EBIT coverage ratios for YECL of 2.8X at a common equity ratio of
21 47.5% and 3.2X at a common equity ratio of 52.5%, and then on page 32, you tell us that
22 an EBIT coverage ratio in the range of 2.8X to 3.2X would be somewhat higher than the
23 average EBIT coverage ratio for the other Canadian electric utilities. Correct?

24 A MS. McSHANE: Yes.

25 Q MR. MARRIOTT: And that's still true, despite your corrections this morning?

26 A MS. McSHANE: Yes, because the corrections were simply — the numbers were
27 reversed. They were all the right numbers, just next to the wrong groups of companies.
28 So the conclusions are all the same and there really wasn't any material change in the
29 numbers.

1 Q MR. MARRIOTT: And if the embedded cost of debt used in the calculation of
2 the EBIT coverage ratios goes down, the ratio goes up, right?

3 A MS. McSHANE: All other things being equal, correct.

4 Q MR. MARRIOTT: All other things being equal.

5 A MS. McSHANE: But, for example, we know that tax rates are going down so, as
6 tax rates go down, the coverage goes down as well. So you know there are dynamic
7 things happening that are working both ways.

8 Q MR. MARRIOTT: Now, the higher the ratio — that is, the EBIT ratio — the
9 better from the perspective of the debt-rating agency and the company, presumably,
10 right?

11 A MS. McSHANE: The higher the EBIT or pre-tax interest coverage ratio, the
12 better.

13 Q MR. MARRIOTT: You agree. Sorry, just to be clear on the record, you're
14 agreeing with that.

15 A MS. McSHANE: Yes.

16 Q MR. MARRIOTT: If the Board were to approve a lower forecast embedded cost
17 of debt for the test period than the 6.60% stated on page 8-2 of the application, do you
18 agree that that would have the effect of lowering the overall embedded cost of debt of
19 6.83?

20 A MS. McSHANE: I mean, generally speaking you're right. Yes, you're right. It
21 would have some small impact on the embedded cost, and the indicated interest coverage
22 ratio would be slightly positively impacted.

23 Q MR. MARRIOTT: And the small impact on the embedded cost would be to
24 lower that embedded cost, right?

25 A MS. McSHANE: Yes, that's right.

26 Q MR. MARRIOTT: Okay. Now, Ms. McShane, answer this if you know the
27 answer, obviously, and tell me you don't know, if you don't know.

28 If a company like CU Inc. were to raise \$200 million by the sale of debentures, how
29 long would you expect that process to take — from a decision made to undertake that to
30 the sale of the debentures?

1 A MS. McSHANE: I would say no more than a couple of weeks.

2 Q MR. MARRIOTT: Mr. Freedman, do you have any knowledge about how long
3 that sort of thing would take?

4 A MR. FREEDMAN: From an active perspective, ATCO Electric would then seek
5 Board approval, and that process takes a bit longer. But your question specifically related
6 to how long does it take for — maybe you could just say it again.

7 Q MR. MARRIOTT: Sure, I'll just say it again. If CU Inc. decided that it wanted to
8 raise \$200 million — or let's say \$325 million — by the sale of debentures, how long do
9 you think it would take from the time they made that decision to the time that they
10 actually sold the debentures?

11 A MS. McSHANE: Most of these utilities now have ongoing prospectuses filed, so
12 that takes a lot of the time that might otherwise have been involved out of the picture.
13 They'd have to go to the investment bankers and see what kind of interest there is and get
14 a feel for — you know — how the tenor of the market is, whether the demand is there;
15 they may do a bit of a presentation to the investment bankers. But I would think that that
16 whole process probably — you know, they want it to occur within a relatively short
17 period of time because they don't want information that shouldn't be leaked to the market
18 leaked to the market.

19 Q MR. MARRIOTT: So I was asking Mr. Freedman if he had a different number
20 from your two weeks or —

21 A MR. FREEDMAN: No. I was only getting to the next stage of that process,
22 where we seek Alberta Utilities Commission approval for that issue. But for your
23 question I concur with what Ms. McShane says.

24 MS. SHANKS: Mr. Marriott, I notice that we're coming up to the lunch hour. I
25 hate to disturb you when you've already just started. Is this a good time for a break, in
26 terms of your line of questioning?

27 MR. MARRIOTT: Yes, this would be fine.

28 MS. SHANKS: In light of where we are in addressing the first panel this morning
29 that YEC has presented, and we still have the depreciation panel this afternoon, I'm
30 wondering if — what I'd like to do is shorten the lunch hour and return at 1:00 p.m. As

1 well, I'd just like to put people on notice that, depending on where we are in the
2 proceeding this afternoon, we may have to sit a little bit past 5:00 p.m. or into the evening
3 because we would like to give time to the depreciation panel as well.

4 So, in that case, come back after lunch at 1:00 p.m.

5

6 (PROCEEDINGS ADJOURNED)

7 (PROCEEDINGS RESUMED)

8

9 MS. SHANKS: Please be seated. Would you like to proceed, Mr. Marriott?

10 MR. MARRIOTT: I would, thank you.

11 Q Panel, could I get you to look at Schedule 8.3 in the application, please?

12 A MR. FREEDMAN: Yes, I have that.

13 Q MR. MARRIOTT: Mr. Freedman, in Schedule 8.3, YECL is forecasting an Issue
14 T with a principal amount of \$2.125 million and a coupon rate of 6.55% due to expire in
15 2038, and an Issue U with a principal amount of \$5.2 million and a coupon rate of 6.55%
16 due to expire in 2039. Are those forecasts unchanged?

17 A MR. FREEDMAN: The 2009 forecast would be unchanged. The forecast that we
18 presented here at the time we did the application is unchanged, but actual events have
19 dictated that this won't occur as was planned at the time we filed the application for
20 Series T. The number is \$2,150,000, and I thought you may have said a different number.

21 Q MR. MARRIOTT: I may have said that. Yes, you are right — 2.15 million.

22 A MR. FREEDMAN: Correct.

23 Q MR. MARRIOTT: Now you say things have changed and that won't occur as
24 forecast. What has changed?

25 A MR. FREEDMAN: Well, what's changed is that the markets have changed and in
26 discussions with CU and ATCO, it does not look likely that there will be an issue in
27 November from CU Inc. That has changed.

28 Q MR. MARRIOTT: When you were doing those forecasts — you mentioned
29 earlier the forecasts for inclusion in Schedule 8.3 for those two issues. The forecasters
30 were internal forecasters — is that correct — within the company?

1 A MR. FREEDMAN: Correct.

2 Q MR. MARRIOTT: And when I say “within the company”, was that YECL people
3 or did you also consult with ATCO Electric or CU Inc. staff?

4 A MR. FREEDMAN: Now for which forecast are we discussing the actual — the
5 size of the debt issue?

6 Q MR. MARRIOTT: Well, for the forecast cost of the issues that you forecast for
7 the test periods, that being the Issue T and Issue U.

8 A MR. FREEDMAN: The forecast cost — we got the debt-yield forecast from Ms.
9 McShane’s evidence and the spread was internal with, you know, the people in ATCO
10 Electric as well as within the ATCO group, whether the 200 basis point spread was a
11 reasonable spread to forecast.

12 Q MR. MARRIOTT: So in making those forecasts, nobody at YECL talked to
13 somebody at CU who might know how much they could actually get money for, for the
14 purpose of mirroring down first to ATCO Electric and then to YECL?

15 A MR. FREEDMAN: Well, you know, the general manager, myself in my role as
16 supporting Yukon Electrical, we’d have had discussions with ATCO Electric and ATCO
17 Gas, and also staff within ATCO Ltd.

18 Q MR. MARRIOTT: CU Inc.?

19 A MR. FREEDMAN: ATCO is the parent company; one and the same.

20 Q MR. MARRIOTT: Okay. Mr. Freedman, are you aware that, on August 18 of
21 2008, ATCO Electric made two applications for authority to issue debentures in principal
22 amounts totalling \$125 million?

23 A MR. FREEDMAN: Yes, I am.

24 Q MR. MARRIOTT: And one of those was for \$50 million to yield 5.563% and one
25 for \$75 million to yield 5.58% — correct?

26 A MR. FREEDMAN: Yes, that is correct.

27 Q MR. MARRIOTT: And are you aware that in each of those applications the
28 treasurer of CU Inc. swore an affidavit advising that on May 26, 2008 — which is less
29 than a month after YECL filed its application, that CU Inc. had completed the sale of

1 \$200 million principal amount of 5.58% debentures and \$125 million principal amount of
2 5 — just a minute; I have to check something here.

3 I'll start that last question again, because I need to get this right.

4 So are you aware that, in each of the applications, the treasurer of CU Inc. swore an
5 affidavit advising that on May 26, 2008, CU Inc. had completed the sale in the one case
6 of \$200 million at a principal amount of 5.58% debentures and, in the other case, of \$125
7 million principal amount of 5.563% debentures? Are you aware of that?

8 A MR. FREEDMAN: Yes, I am.

9 Q MR. MARRIOTT: So in the applications made by ATCO Electric that we spoke
10 of, in essence what was happening was that CU Inc. was mirroring down at those rates
11 that we just mentioned a total of \$125 million of the \$325 million that CU Inc. had raised
12 pursuant to those two sales.

13 A MR. FREEDMAN: That's correct.

14 Q MR. MARRIOTT: Has YECL already received — or does YECL expect to
15 receive — some of that \$125 million mirrored down to YECL from ATCO Electric at
16 either 5.563% or 5.58%?

17 A MR. FREEDMAN: At the time, Yukon Electrical did not get any of these funds
18 mirrored down. There was still the expectation at that time that there would be
19 subsequent offerings by CU Inc. later in the year. So that did not occur at that time.

20 Given the situation that is occurring in the financial markets now, and given that we
21 have followed up with ATCO and CU Inc. as to whether there is going to be potential for
22 future issues — and that does not seem likely — what's occurring now is that we are
23 going to mirror down retroactively to the date of this issue the \$2,150,000 debt issue that
24 was in this application at the weighted average rate of these two issues, which would
25 come to 5.573% plus .05 issue cost, for a weighted average rate of 5.623%. And that is in
26 the process of happening.

27 Q MR. MARRIOTT: I accept what you've just told me, but the part that I do find a
28 little interesting is that CU Inc. would sell this \$325 million worth of debentures which,
29 as I understand it, was done in May of this year. And it was done for the purpose — it
30 would seem — of mirroring down that debt to ATCO Electric and ATCO Gas.

1 Yet, in doing that, they did not take into account that YECL was needing at that time,
2 and they knew they needed at that time, the \$2.125 million for this year, at least. And
3 you're saying that the expectation was that there would be yet another issue which,
4 presumably, would also have to include money mirroring down to ATCO Electric, which
5 would include that \$2.125 million. That's what you're saying.

6 A MR. FREEDMAN: It is \$2,156,000.

7 A MR. MARRIOTT: I'm sorry, pardon me, \$2,156,000.

8 Q MR. FREEDMAN: Yes. Earlier on in the year, CU Inc. went to the markets with
9 the forecast at that time to get a debt issue. Yukon Electrical didn't, at that time, get
10 anything mirrored down from ATCO Electric given that the understanding was at that
11 time that there would be further debt issues later in the year, and ATCO Electric could
12 use that money to finance their own capital programs. But given the situation now,
13 Yukon Electrical is in the process of following up with ATCO Electric to now get that
14 debt issue — the \$2,150,000 that Yukon Electrical requires mirrored down retroactively
15 for that issue.

16 A MR. MARRIOTT: Madam Chairman, I have copies of those two applications that I
17 mentioned from ATCO Electric to the Alberta Utilities Commission. I don't have a lot of
18 copies. I do have them electronically and I can circulate the electronic version to the
19 distribution list tonight. If it is acceptable, I'd like to mark those as an exhibit – either
20 collectively or singly – it doesn't matter to me, but probably collectively is just as
21 convenient.

22 MS. SHANKS: Do we have an exhibit number?

23 MS. LEMKE: C2-13.

24 MS. SHANKS: C-13.

25 **EXHIBIT NO. C2-13:**
26 DOCUMENT TITLED APPLICATION TO THE ALBERTA
27 UTILITIES COMMISSION FOR AUTHORITY TO ISSUE A
28 5.563% DEBENTURE
29

1 MR. MARRIOTT: I'm just going to ask Mr. Garbutt, for people's benefit, to
2 perhaps distribute the few copies that we have. Perhaps we'll distribute a hard copy on to
3 the Board's staff, the panel and to Mr. Keough. I think we have enough for that.

4 These are lengthy documents. I wasn't sure how much paper I could bring on the
5 airplane.

6 MS. SHANKS: I don't think there is extra baggage on documents, yet.

7 Q MR. MARRIOTT: Now I'd like to switch to some different areas of questioning.
8 Just some confirmation, Mr. Freedman. Ms. McShane, in her evidence at page 17,
9 indicated that 70% of Yukon's population is in Whitehorse. What percentage of YECL's
10 15,000 customers are in Whitehorse?

11 A MR. FREEDMAN: On page 17?

12 Q MR. MARRIOTT: Well, I don't think that is going to help you.

13 A MR. FREEDMAN: No, it's not. I was just going to look at the reference. I am not
14 aware of that —

15 Q MR. MARRIOTT: It is fair to say, though, that the large percentage of YECL's
16 customers are in Whitehorse?

17 A MR. FREEDMAN: A significant — yes, that would be fair to say.

18 Q MR. MARRIOTT: Of those who live outside of Whitehorse, any idea how many
19 of those live in mining communities?

20 A MR. FREEDMAN: I'm not aware of that.

21 Q MR. MARRIOTT: Would it be fair to expect that to be a small portion of
22 customers? A small portion of the small number who live outside Whitehorse. Would that
23 be fair?

24 MS. SHANKS: I would think that would be fair, subject to check.

25 Q MR. MARRIOTT: You don't think so?

26 MS. SHANKS: No, I do think so.

27 MR. MARRIOTT: Thank you. Alright, we'll take that subject to check then.

28 Q Now, on page 20 of the Foster Associates' report, it indicates that "lost load due to
29 energy efficiency and conservation efforts reduces the utilities earnings." I guess my

1 question for you, Mr. Freedman, is does YECL view conservation and energy efficiency
2 as a threat to its business or as an opportunity?

3 A MR. FREEDMAN: Mr. Babyn may be better placed to respond to that one, but I
4 wouldn't see that Yukon Electrical would view it as a threat.

5 Q MR. MARRIOTT: All right. Now would you agree that the backup generation
6 owned by YECL mitigates its supply risk?

7 A MS. McSHANE: Are you asking me or Mr. Freedman or either one of us?

8 Q MR. MARRIOTT: I would say either one of you, but perhaps you both have a
9 view.

10 A MS. McSHANE: I have a view. I mean, I think that, all else equal, having backup
11 generation obviously mitigates what the risk would otherwise be.

12 Q MR. MARRIOTT: Do you agree, Mr. Freedman?

13 A MR. FREEDMAN: I'll agree.

14 Q MR. MARRIOTT: And with respect to regulatory risk in the last years, did
15 YECL face any regulatory risk when they weren't before the regulator?

16 A MS. McSHANE: I guess, I mean, there are two parts to that. Do they face risk or
17 do they incur any risks — regulatory risks? I would say that you always face regulatory
18 risk, whether you're out of the — you know, you don't come in for a rate case or not. I
19 don't have any reason to believe that, in that particular point or that particular time frame,
20 there were any particular regulatory risks that they incurred.

21 A MR. FREEDMAN: During the course of this proceeding, our capital assets from
22 1996 are being tested through the course of this proceeding so, to that effect, there are
23 regulatory risks.

24 Q MR. MARRIOTT: All right. Just a quick follow-up on something that Mr.
25 Rondeau asked you about, Ms. McShane. He asked you about the fees for service
26 provided in this hearing by Foster Associates, and we heard that the estimate was
27 \$100,000. Is that estimate still likely to be accurate?

28 A MS. McSHANE: I would say that based on the number of Information Requests
29 that were received and the fact that I had travelled to the hearing up here, that it's
30 probably pretty close.

1 Q MR. MARRIOTT: Okay. Now, we've heard that you took, as a point of
2 departure — and I think those are the words in your report, Ms. McShane — the EUB
3 generic return on equity, and I think we have on the record, but just to confirm, if this
4 Board were to set the same rate of return on equity and capital structure for YECL as the
5 AUC, or its predecessor, AEUB, set for ATCO Electric, that would be 8.75% return on
6 equity and a deemed equity ratio of 37%. Is that right?

7 A MS. McSHANE: If you're asking me if those are the most recent numbers for
8 ATCO Electric, that's right, they are — for distribution — ATCO Electric Distribution.

9 Q MR. MARRIOTT: Right. ATCO Electric Distribution. Now —

10 A MS. McSHANE: Excuse me — plus ATCO Electric Distribution has preferred
11 shares, which Yukon Electrical doesn't have.

12 Q MR. MARRIOTT: So when we go to page 26, just to be clear, of your report, you
13 make a statement there I want to ask you about. You see that Table 4 and then, just below
14 that, there's a statement: "If the capital structure for each of the utilities in Table 4 above
15 were adjusted to eliminate the incremental equity risk premiums, the allowed equity
16 ratios would be approximately 46 to 47%."

17 Now, the table does include Alberta taxable distributors; their equity ratios are 37%;
18 and there are no incremental equity risk premiums attached to those — correct?

19 A MS. McSHANE: Correct.

20 Q MR. MARRIOTT: Now, going to pages 14 and 15 of your report, Ms. McShane,
21 there you discuss the size of YECL and the unlikelihood that it could get debt financing
22 on its own and so forth. Then you say, "Nevertheless, the appropriate capital structure
23 and return on rate base for Yukon Electrical needs to recognize the cost benefits that
24 Yukon Electrical's ratepayers receive." That is what they receive from CU affiliation.

25 Are you saying that because the debt portion of the capital structure is recognized at
26 its actual cost, that shareholders should be compensated for financial services by an extra
27 return on the equity portion of capital structure?

28 A MS. McSHANE: What I'm saying is that the capital structure for any of the
29 utilities that are owned by CU Inc. should be set in such a way that each one reflects —
30 or, provides its own contribution to the financial integrity of the entity that raises the

1 capital. The point I'm trying to get across is that if you have different businesses of
2 different business risks and the credit rating of the parent company — the one that issues
3 the capital — is A or A+, then if you're going to have different capital structures for each
4 one of those utilities, it needs to be set in such a way that there is not a subsidy from the
5 parent company to the particular utility.

6 So it would be unfair, for example, if you were going to pass along to ratepayers a
7 cost of debt that's equal to a rating of A to deem a capital structure for that utility that's
8 not even an investment-grade capital structure. The capital structure that you try to set
9 should be consistent with the debt rating of the parent company, so that there is a
10 matching of the financial risk that's taken on and the cost of debt that's passed to
11 ratepayers.

12 Q MR. MARRIOTT: Would you agree that YECL pays its share of corporate
13 management costs?

14 A MS. McSHANE: I'm sure that it does. Nobody is saying that they should pay CU
15 Inc. separately for financial services. All I'm saying is that each utility's capital structure
16 should: (a) reflect its own business risks, and (b) be consistent with the rating and with
17 debt cost that it incurs. So maybe I can give you an example.

18 Q MR. MARRIOTT: I think I've got your answer. You've told me that now twice,
19 so I got that part. I was just asking a simple follow-up question.

20 A MS. McSHANE: No, that would be something that they would pay for other
21 services, not for cost of debt.

22 Q MR. MARRIOTT: And Mr. Freedman, maybe you could answer — YECL does
23 support ATCO affiliates by purchasing services from them, right?

24 A MR. FREEDMAN: I think it's — I'd almost put it the other way around, ATCO
25 Electric supports Yukon Electrical by providing Yukon Electrical support.

26 Q MR. MARRIOTT: For which YECL pays, obviously.

27 A MR. FREEDMAN: Correct.

28 Q MR. MARRIOTT: Now, at page 18 of your report, Ms. McShane, you indicate
29 that "Yukon Electrical currently has no industrial customers of its own," and then you
30 say, "the economic base of the Yukon will have secondary impacts on the residential and

1 commercial customer load.” So are you saying, then, that YECL is only indirectly at risk
2 for mine closures, for example?

3 A MS. McSHANE: It would be indirectly at risk for changes in the industries that it
4 doesn’t directly serve.

5 Q MR. MARRIOTT: And Mr. Freedman — or Ms. McShane if you like — when a
6 mine closes, does the secondary impact on the commercial and residential load manifest
7 itself at the same time as the mine closes, or does it take some time for that effect to be
8 felt?

9 A MS. McSHANE: I haven’t done a study of this, but intuitively there would a lag.

10 Q MR. MARRIOTT: Can we just turn to another point? Ms. McShane, you talk on
11 page 20 of your report about supply and physical risks. With respect to supply risks, are
12 you aware that 90% of YECL’s power is purchased?

13 A MS. McSHANE: Yes.

14 Q MR. MARRIOTT: Does that then mean that 90% — sorry, the risk profile of
15 YECL with respect to supply would then be 90% of a wires-only electric utility?

16 A MS. McSHANE: Yes.

17 Q MR. MARRIOTT: Thank you. And of course we don’t need to go through all of
18 the deferral accounts, but you do agree that YECL has several deferral accounts, which
19 help it to mitigate risk?

20 A MS. McSHANE: Yes.

21 Q MR. MARRIOTT: Now just in terms of risks and different modes of operation of
22 different companies, do diesel generation plants usually face the same capital cost
23 overruns that would be more common with hydro, nuclear or large coal-fired units?

24 A MS. McSHANE: I haven’t done a study of that. I am not in a position to speak to
25 whether — if you’re talking about proportionally, I don’t know what the relationship
26 would be between a diesel plant and coal-fired or hydro. Knowing what I know about
27 nuclear, the experience with cost overruns is very large. There aren’t any nuclear utilities
28 in any of the Canadian samples of companies that I’ve looked at, so that wouldn’t really
29 be a consideration.

1 Q MR. MARRIOTT: With respect to coal-fired generation, would it be common for
2 coal-fired generation to have fuel cost deferral accounts?

3 A MS. McSHANE: Yes. I am trying to think who we would even be looking at, but
4 typically utilities have a mixture of different types of generation and the fuel automatic
5 adjustment clauses cover all types, including natural gas, if they have number 6 fuel oil or
6 coal.

7 Q MR. MARRIOTT: Turning to page 21 of your report, one of the points that you
8 make there, Ms. McShane, is that: “Yukon Electrical has a significant amount aerial
9 infrastructure, i.e., exposed distribution lines” and then you talk about the “heavily treed
10 service territory”.

11 Would that be true also of ATCO Electric, (a) that they have a significant amount of
12 aerial infrastructure and (b) that there are lots of trees in ATCO service territory?

13 A MS. McSHANE: There is no reason for me to believe that there is a material
14 difference between the two. I don’t know of any differences in the geographic base that
15 would lead me to believe that ATCO Electric is any different.

16 Q MR. MARRIOTT: Just a couple of quick questions on some other utilities that
17 have appeared in the report — some of which you’ve said maybe aren’t as comparable as
18 others. Just so that I get your understanding of some of these companies — would you
19 agree that FortisAlberta is a pure-wires company?

20 A MS. McSHANE: Yes.

21 Q MR. MARRIOTT: And Hydro One, is it a distribution and transmission wires-
22 only utility plus some diesel generation? Is that fair?

23 A MS. McSHANE: I guess. Yes. I think they’ve got some remote communities that
24 they serve with diesel generation. I’m not quite sure where that fits in their regulatory
25 structure, but they have separate capital structures and ROEs for distribution and for
26 transmission.

27 Q MR. MARRIOTT: Now, at pages 23 and 24 of your report — actually, going to
28 page 24 and starting at line 635, you refer to a recent Northwest Territories Power
29 Corporation decision for the 2007-08 test year. I think in an IR response you confirm that
30 the decision that you were talking about was Decision 13-2007.

1 Do you recall that?

2 A MS. McSHANE: Yes, I do.

3 Q MR. MARRIOTT: Now, I'd just like to show you an excerpt from that decision.
4 It is not very long. I'm going to ask Mr. Garbutt to distribute some copies of that excerpt
5 and I'll just ask you a couple of questions about that.

6 MS. SHANKS: Would you like to mark that as an exhibit, Mr. Marriot?

7 MR. MARRIOTT: It can be marked as an exhibit if you choose. It doesn't need
8 to be because it is, of course, something we can refer to anyway. But if it is convenient, I
9 would be happy to.

10 MS. SHANKS: I'll leave it up to you.

11 MR. MARRIOTT: I'm not sure what your practice is, but certainly we've marked
12 some of the other excerpts from this decision so maybe it is most convenient to do that.

13 MS. SHANKS: Right, and in this case, we'll mark it. That would be C2-14.

14 **EXHIBIT NO. C2-14:**
15 DOCUMENT TITLED PUBLIC UTILITIES BOARD
16 OF THE NORTHWEST TERRITORIES,
17 DECISION 13-2007, DATED AUGUST 29, 2007

18 MR. MARRIOTT: C2-14.

19 So, just a couple of points, Ms. McShane. This Decision 13-2007 is the one that you
20 are referring to at page 24, and in page 24 at line 638, you say that the Public Utilities
21 Board of the Northwest Territories adopted a common equity ratio of 48.86% and an
22 incremental equity risk premium of .05% for NTPC which you would call a higher
23 business-risk utility than Yukon Electrical.

24 Q The first point is that it seems when I reviewed this decision that actually the number
25 was slightly different than what you had in your testimony. At page 30, if I could take
26 you there, the common equity that the company was proposing — and I think this was
27 your testimony — for 2007/08, is listed there at 48.59%. At the conclusion of this excerpt
28 at page 34, in the second last paragraph on that page, it says, "... the Board accepts the
29 capital structure proposed by NTPC..." So, I think that is correct, or am I missing
30 something?

1 A MS. McSHANE: No, I think that is right.

2 Q MR. MARRIOTT: Okay. And then do you agree that — we go to that page 34.
3 Part of the Board’s explanation for the adoption of the 48.59% common equity ratio is as
4 follows: “The Board considers, with the eventual retirement of the high cost sinking fund
5 debt, the coverage ratios and the financial risk of the utility would likely improve.
6 Therefore, the capital structure accepted by the Board should not be viewed as solely
7 reflecting NTPC’s business risks but rather as one that takes into account NTPC’s
8 particular circumstances with respect to high cost debt.”

9 Do you accept that that was part of their rationale for their decision?

10 A MS. McSHANE: Yes, that’s what they said.

11 Q MR. MARRIOTT: Also at that page 34, at the top of that page, the Board states:
12 “The Board notes NTPC’s effective cost of long-term debt somewhat exceeds the
13 requested cost rate on equity.” Do you recall that was the particular circumstances of that
14 case?

15 A MS. McSHANE: That’s my recollection, yes.

16 Q MR. MARRIOTT: Just while we’re talking about that decision, if you look at
17 page 32. Do you recall that, in that same part of the decision, the Board comments on
18 your evidence that NTPC’s average for 2003 to 2006 interest coverage ratio was 1.7X?

19 A MS. McSHANE: Yes, it’s lower, partly because of the high debt cost and partly
20 because it’s not taxable.

21 Q MR. MARRIOTT: Now, is the ratio the Board is referring to there the EBIT
22 interest coverage ratio?

23 A MS. McSHANE: Yes.

24 Q MR. MARRIOTT: And that 1.7X for NTPC, you would agree, is a far cry from
25 the 2.8X that you calculate for YECL at a 47.5% equity ratio?

26 A MS. McSHANE: Absolutely, yes.

27 Q MR. MARRIOTT: Thank you. Just maybe to drive home this point, in
28 circumstances where the cost of debt exceeds the cost of equity, does a higher deemed
29 equity ratio result in a greater cost to the customer, or does it result in a lower cost to
30 customers?

1 A MS. McSHANE: Sorry, could you say that again, please?

2 Q MR. MARRIOTT: Where the cost of debt exceeds the cost of equity —

3 A MS. McSHANE: Yes —

4 Q MR. MARRIOTT: — does a higher deemed equity ratio result in a greater cost to
5 the customer or a lower cost to the customer?

6 A MS. McSHANE: Are we talking about for a utility that's not taxable? If it's not
7 taxable, I mean, there's no additional cost that you have to add on to the equity return
8 component.

9 Q MR. MARRIOTT: See, I would have thought this was relatively simple. If you
10 have to spend more for equity than you do for debt, from a customer's point of view
11 when you're paying for all of these costs, wouldn't it be to their advantage to actually pay
12 for more — sorry, I said that wrong.

13 When you have to pay more for debt than you do for equity, and if the customer is
14 paying all of those costs, if the customer pays for more equity versus less debt,
15 presumably the customer is better off.

16 A MS. McSHANE: No, see that's where it is simple if the utility is not taxable.
17 Let's say, the embedded cost of debt is 10.5 and the return on equity is 8.5, right, so if
18 you don't have a tax allowance, you can have as much — you might as well have 100%
19 equity, because it's cheaper. But I don't think it's as simple as that when there's a tax
20 allowance that's attached to the equity, because if, let's say, the tax rate is 35%, you
21 would have to work out where — depending on what the relationship between after-tax
22 cost of equity is and the debt cost — you would have to figure out at what point the pre-
23 tax cost of equity and the cost of debt equated to figure out what the sort of break-even
24 point was, where you would be better off with more debt than equity — or more equity
25 than debt.

26 Q MR. MARRIOTT: So your answer essentially is that it depends.

27 A MS. McSHANE: If you're taxable.

28 Q MR. MARRIOTT: If you're taxable.

1 And you would agree that the circumstances in that NTPC case that the Board refers
2 to, where the effect of cost of long-term debt was higher than the requested cost rate on
3 equity doesn't apply to YECL?

4 A MS. McSHANE: No, the embedded cost of debt is lower.

5 Q MR. MARRIOTT: Yes.

6 Now in your evidence on page 21 you characterize the Yukon Utilities Board's
7 regulation of YECL as even-handed. Is that another way of saying that YECL's
8 regulatory risks are low compared to those faced by other electrical utilities?

9 A MS. McSHANE: No, it's saying that they're not greater. I mean, I don't see
10 anything — there are obviously some regulatory jurisdictions — if you looked at them
11 you could say, "Yes, this regulatory jurisdiction is materially more supportive than others
12 or this one has a reputation for handing down decisions that are clearly not balanced
13 between customers and shareholders." All I was saying here was that, from my own
14 reading of decisions, there's no reason to say that it's more or less than average for
15 regulatory jurisdictions in the country.

16 Q MR. MARRIOTT: Lastly, can I take you to page 17 of your report, please? And
17 Mr. Freedman, you can comment on this if you like, obviously. The question is a fairly
18 simple one: would you agree that YECL is nearly twice as big as NUL(YK) and eight or
19 nine times as big as NUL(NWT), whether you look at sales or rate base?

20 A MS. McSHANE: That's true; however, we are talking about companies that, for
21 all intents and purposes from an investor's perspective, would be viewed as a group of
22 very small utilities compared to the bigger utilities that are also in this table on page 17.

23 Q MR. MARRIOTT: Thank you, Madam Chair, and thank you, panel, those are my
24 questions.

25 MS. SHANKS: Thank you, Mr. Marriott.

26 MR. LANDRY: Madam Chair, I was speaking to Mr. Maissan, and we switched
27 again. We decided that I would go first to see if I could deal with some things, and then if
28 he had some questions, he'll follow up, if that's okay.

29 MS. SHANKS: Please proceed — whatever suits your fancy.

30 MR. LANDRY: It's going to take a couple of seconds to get us —

1 MR. KEOUGH: Will there be any binders coming over the podium?

2 MS. SHANKS: Some people just can't resist, Mr. Keough.

3 MR. LANDRY: Madam Chair, just as a preliminary point — I had a quick
4 conversation with Mr. Keough about this. I gather Mr. Keough's position is that if there
5 are any questions of the company in relation to capital structure, that we should put it to
6 Mr. Freedman while he's on this panel. That is not what my original intention was. I was
7 going to basically wait until Ms. McShane was off, but I'll try as best I can in the
8 circumstances to accommodate that.

9 **YECL Panel 2 cross-examined by Mr. Landry**

10 MR. LANDRY: So, panel, I'm going to try to separate the questions I have for
11 Ms. McShane and you, Mr. Freedman. I'm going to start effectively with you, Ms.
12 McShane.

13 I'm looking at your evidence, Ms. McShane. If you would please turn to pages 4 and
14 5 of that evidence, that's where I'd like to start. Just as you're getting there, you talked
15 this morning, in some questions and answers with Mr. Rondeau — I thought I was clear
16 when I read this. I wasn't as sure after the questions and answers, and that's not a
17 criticism; I just wasn't sure I was completely clear on it, so I wanted to make sure I'm
18 clear on the two different approaches that you discuss on pages 4 and 5, okay? That's
19 what I'd like to talk to you about first — or ask you some questions about.

20 Q As I understand it, Ms. McShane, you talk about two different approaches here. And
21 from your perspective — I refer you to page 5, line 133, 134, 135. Your view is that each
22 approach is equally as valid. Is that a fair statement?

23 A MS. McSHANE: Yes, I think that either approach can be equally valid, as long as
24 there is sort of an after-the-fact testing to make sure that the results are internally
25 consistent.

26 Q MR. LANDRY: And just so I understand it, the one approach, the examples that
27 you use here — and I think there are others — are the NEB and the Alberta Board and
28 basically sets a benchmark, and then once that benchmark is set, they adjust the capital
29 structure to accommodate the various risks. Is that a fair overview of them?

30 A MS. McSHANE: Yes.

1 Q MR. LANDRY: And that sort of explains something to me — not having
2 appeared recently in Alberta. That's why we see in your schedules where you're just
3 reporting on what the various Boards have done — effectively the same type of rate of
4 return for a number of electric utilities.

5 A MS. McSHANE: Correct.

6 Q MR. LANDRY: I was wondering why they were all the same, but now, at least, I
7 understand that. So using the one that we've heard, for example — ATCO Electric was
8 8.75%. A number of other electric utilities have the same percentage rate of return that
9 has been approved by the Board.

10 A MS. McSHANE: Correct. Ten other ones, because I think there were 11
11 altogether that were covered by that formula.

12 Q MR. LANDRY: Then again, going second — what I understand, as you said,
13 second equally valid approach. The example you use in your evidence is the BCUC as
14 one of the Boards that uses this approach. You, in effect, take the capital structure as a
15 given, and then you effectively adjust the rate of return to deal with the business risks that
16 we were talking about before.

17 A MS. McSHANE: That would be nice if that's the way it worked, but it's not
18 really. For all intents and purposes, there are very few places in Canada that use actual
19 equity ratios any more. So the utilities that are regulated in B.C., the capital structure is
20 still a deemed capital structure, even though the rate of return on equity that's allowed
21 may be different from the benchmark low-risk utility. For example, Pacific Northern Gas
22 has — at least had — 45% to 50% common equity ratio actual, but for rate-making
23 purposes, it was only allowed to earn 40%.

24 Q MR. LANDRY: I apologize. I didn't mean to misstate it. I see that you say on
25 page 4 of your evidence — it also talks about how it could be either the actual capital
26 structure that is approved or a deemed capital structure, and you've given the example of
27 Pacific Northern Gas as a deemed one. I am referring to lines 115 to 117, and I quote:
28 "The actual or deemed capital structure then becomes the key measure of the utility's
29 financial risks".

30 A MS. McSHANE: Right.

1 Q MR. LANDRY: And that's correct, is it?

2 A MS. McSHANE: Yes.

3 Q MR. LANDRY: Again, to make sure I understand the difference between the two
4 — and maybe it's just that I'm used to hearing it in the B.C. jurisdiction and it might be
5 different in Alberta, I don't know, so please help me with it. When you talked about this
6 — and I can't remember if it was in response to Mr. Marriott or in response to Mr.
7 Rondeau — you talked about setting a benchmark rate. Obviously, both do that, but you
8 said relative to an average-risk utility. Now my experience in B.C. — and I know it's
9 noted in the YUB decision when they dealt with the BCUC approach last time — that
10 they used the expression "low-risk utility". Is there any difference in your mind between
11 the two?

12 A MS. McSHANE: Not really, because the testimony that was provided on all sides
13 in both the generic proceeding in Alberta and the determination of the rate of return for
14 the low-risk utility benchmark in B.C. was, I mean, effectively determining the same
15 thing. When everybody spoke about what the beta was for the benchmark, I mean, it was
16 the same concept. BCUC refers to it as the low-risk utility benchmark, but in a sense, if
17 you look at what it is in Alberta, it's the same ROE for a broad spectrum of utilities, so it
18 could easily be called the average-risk utility benchmark.

19 Q MR. LANDRY: I guess the point I was making though, Ms. McShane, is that the
20 BCUC approach, at least in the 2005 decision here, was adopted by this Board. It talks
21 about low-risk utility. That's what it says and that's my understanding.

22 A MS. McSHANE: That's what they call it.

23 Q MR. LANDRY: That's what they call it. You don't necessarily see any difference
24 between a low-risk utility and an average-risk utility that you referred to when you were
25 talking about benchmarks earlier? I am just trying to see if we have a difference here or
26 the same.

27 A MS. McSHANE: It's not as easy a question to answer as you might think. In
28 principle, obviously there would a difference between a low-risk utility and an average-
29 risk utility, just by virtue of the words.

30 Q MR. LANDRY: I would have thought so.

1 A MS. McSHANE: Right. But the approach that was taken in B.C. to develop what
2 they call the low-risk utility benchmark return and the data that was adduced by the
3 various parties to come up with this ROE number is the same. They were the same
4 samples, the same approach that was used to develop the benchmark number in Alberta,
5 which applies to a wide range of utilities — which seems to me that once you say it
6 applies to a wide range of utilities that sort of makes it an average-risk utility. So that's
7 all I'm saying.

8 Q MR. LANDRY: Ms. McShane, I was having difficulty because when you used
9 the concept of "average", you used it in relation to BCUC and the Alberta Board, and I'm
10 just trying to figure out whether or not you misspoke, whether there's a fundamental
11 difference between the two or whatever. I'm just trying to get the record clear, that's all.

12 A MS. McSHANE: I suspect that the BCUC views the low-risk utility benchmark
13 as a somewhat different concept, perhaps, than the AUC, but for all intents and purposes
14 it's the same number.

15 Q MR. LANDRY: Your point of view is that both jurisdictions, in the way they're
16 doing benchmarking — if I can use that expression —

17 A MS. McSHANE: Right.

18 Q MR. LANDRY: You know, I'm not trying to get too specific here, but
19 fundamentally they're trying to get at the same thing.

20 A MS. McSHANE: Correct.

21 Q MR. LANDRY: Okay. So that's really — in other words, you know, obviously
22 there were two different jurisdictions.

23 A MS. McSHANE: Right.

24 Q MR. LANDRY: Many of the rate-of-return experts were the same but there were
25 nuances but, fundamentally, they were trying to get to the same benchmark.

26 A MS. McSHANE: As was the National Energy Board — right.

27 Q MR. LANDRY: Exactly. But between BCUC and the AUC now, they were
28 trying to get to the same thing.

29 A MS. McSHANE: I would say that yes, they were trying to get —

1 Q MR. LANDRY: Now, I think they had their hearings in different years, which of
2 course —

3 A MS. McSHANE: Absolutely they did, yes.

4 Q MR. LANDRY: Sorry.

5 A MS. McSHANE: Yes. One was in 2005 and one was in 2003-04.

6 Q MR. LANDRY: Right.

7 A MS. McSHANE: The Alberta one was earlier.

8 Q MR. LANDRY: And so they would have had different numbers in the market at
9 that point in time, obviously, that would have been bandied about for things like the
10 yields on long Canadas, and that type of thing?

11 A MS. McSHANE: Sure.

12 Q MR. LANDRY: Yes. I just want to now change a little bit and go to pages 36 and
13 37 of your evidence. Again, this is sort of where you — I don't know if it's — I'll just
14 check. I know you come to conclusions at the end, but this is where you sort of really
15 sum up your position, if I can put it on this — not your position, your opinion, on both
16 the capital structure and what is the appropriate percentage rate of return. A fair
17 statement?

18 A MS. McSHANE: Within the context of the methodology that was being used
19 here, which was to accept the benchmark as —

20 Q MR. LANDRY: I accept that, and I do understand, Ms. McShane, and I've heard
21 it before from other rate-of-return experts that perhaps you're not a fan of the benchmark
22 concept, but that's where you started in this case.

23 A MS. McSHANE: Correct.

24 Q MR. LANDRY: And just so I understand, so we started with 8.75% and then,
25 using the Alberta concept, if I can call it generically that, you looked at the capital
26 structure and you tried to determine, using all of the methodology that you outline in your
27 evidence, a way in which to adjust the capital structure to reflect effectively the business
28 risk and the financial risk that you identified in your evidence — a fair statement?

29 A MS. McSHANE: Well, to come up with a capital structure.

30 Q MR. LANDRY: Right.

1 A MS. McSHANE: Yes.

2 Q MR. LANDRY: Yes. And at the end of that process, what you found was, at an
3 8.75% rate of return, there would need to be a capital structure which had a higher
4 component of common equity, and you said that component should be on the upper range
5 of 47.5 to 52.5, i.e., 52.5 — a fair statement?

6 A MS. McSHANE: Not exactly.

7 Q MR. LANDRY: Okay.

8 A MS. McSHANE: Although admittedly some of the financial ratios that were
9 calculated are dependent or premised on an 8.75% ROE, I would take issue with your
10 characterization that it's the capital structure that's required at 8.75.

11 Q MR. LANDRY: Okay.

12 A MS. McSHANE: The capital structure, to a great extent, is independent of the
13 ROE.

14 Q MR. LANDRY: I think I understand that nuance but if I could take you to your
15 evidence — I may have made my question too complicated, and so I'd like to take you to
16 your evidence.

17 If you go to page 36 at the top, on line 942, you say, "As previously discussed, I have
18 estimated the common equity ratio that would fully compensate for Yukon Electrical's
19 business risk" — which I understand you are trying to do to effectively — off that
20 benchmark, you are dealing with the capital structure — "i.e. the upper-end of a range of
21 47.5% to 52.5%.". And you then go to a common equity ratio of 52.5%. So I'm assuming
22 it is sort of your starting point before you adjust the rate of return from 8.75% to 9.25%
23 — is that not?

24 A MS. McSHANE: Yes, so it's 52.5% at 8.75% before the adjustment.

25 Q MR. LANDRY: So, I took that, Ms. McShane, that at that point in time, before
26 you go over to the next part where we talk about incremental equity risk premium that —
27 given that benchmark, you — in your opinion — based on the analysis that you had done,
28 that that would require a common equity ratio of 52.5%.

29 A MS. McSHANE: Sorry, I missed that. I apologize.

1 Q MR. LANDRY: As I understand the approach, you start with 8.75%, and then
2 you go into the capital structure, and you try to deal with the capital structure to reflect
3 the business and financial risk that exists for that company.

4 A MS. McSHANE: Yes. But the point being — the 8.75% is basically taken as a
5 given.

6 MR. LANDRY: Right.

7 MS. McSHANE: Okay.

8 Q MR. LANDRY: And you are down in the capital structure, and you take that as a
9 given. You do your various analysis and because of the business and financial risks of
10 this company, you determine that it needs a 52.5% equity.

11 A MS. McSHANE: Correct. Right.

12 Q MR. LANDRY: Now, okay, I'm with you there. Now I want to see — and I
13 understand that it is very much the Alberta type of approach that goes on, if I understand
14 Alberta.

15 A MS. McSHANE: I think that is fair to say, yes.

16 Q MR. LANDRY: Okay, but then you departed from that.

17 A MS. McSHANE: I did.

18 Q MR. LANDRY: As I understand it, the reason — at least, the reason that I see
19 here, and maybe I'm not reading this correctly. But the reason that you departed from that
20 is reflected in lines 944 to 945 of page 36 where you say: "A common equity ratio of
21 52.5% represents a material departure from the actual common equity ratio of
22 approximately 40% that has been historically maintained." You see that? I am taking this,
23 and I'd like you to comment on this. I'm taking this — that was the departure from —
24 well, instead of going to 52.5%, given that the historic level was 40%, we'll go to 47.5%
25 and then adjust the rate of return. Is that a fair summary?

26 A MS. McSHANE: That is a fair summary.

27 Q MR. LANDRY: Now, as I understand the next paragraph — and again, please
28 help me with this — what you are effectively saying in the next paragraph is that because
29 Canadian regulatory bodies have, in your opinion, and in the opinion, you say, of many
30 shareholders — and we heard that includes ATCO and CU — allow such low returns that

1 it is unlikely – well, that’s my word. But let me try it and see where we go. It is unlikely
2 that a shareholder would want to invest that amount of equity into a company that only
3 received an 8.75% return.

4 A MS. McSHANE: Fair enough.

5 Q MR. LANDRY: So, in order to incent a shareholder to, in effect – and I know
6 this is all just looking at it and trying to analyze it out. But in order to incent a
7 shareholder to effectively invest in this utility, I guess, you look at it and say, “Well,
8 we’ll go to, say, 47.5% and then we’ll adjust by way of 50 basis points the rate of return
9 on equity to 9.25%.”

10 A MS. McSHANE: I don’t know if I would have described it as “in order to
11 incent,” but the fact of the matter is that you’ve got a range of capital structures that are
12 appropriate for the risk. And by getting to the bottom end of the range, you’ve
13 accomplished getting the level of financial risk to a level that is in the range. But at the
14 same time you do that, you still have this gap in return requirement that needs to be made
15 up, and it has to be made up in the common equity return.

16 Q MR. LANDRY: That would get away from this difficulty that you identified at
17 page 36 — that shareholders might not want to invest that amount of equity at that low
18 rate of return.

19 A MS. McSHANE: Well, it addresses it. I don’t know that it takes care of it in total,
20 because even at that level of return, the returns are still relatively low when you look at
21 the range of comparables.

22 Q MR. LANDRY: Well, yes, and your comparables would include going down into
23 the United States, from what I understand, would it?

24 A MS. McSHANE: Yes, it would.

25 Q MR. LANDRY: But not in Canada. If we take Alberta and British Columbia, the
26 comparables would be off of these various approaches we’ve talked about.

27 A MS. McSHANE: Yes, because they’re all governed by the same kind of formula.

28 Q MR. LANDRY: That’s right.

29 A MS. McSHANE: Right.

1 Q MR. LANDRY: Just so I — I fear about going into this too far because I'm not
2 so sure you and I would disagree; I'm just not sure that I know this well enough to be
3 able to say it. But I just want to have some idea of — when we look at BCUC and AUC,
4 because of the approaches — and you've told the Board that fundamentally — I'm
5 talking the benchmark now — sorry, I'm not going from there. They're fundamentally
6 trying to get to the same point.

7 A MS. McSHANE: I think so, yes. That would be my take on it.

8 Q MR. LANDRY: And effectively — and they take basically the same approach to
9 get there. Is that a fair statement? They look at long-term — if I understand it — 10-year
10 Government of Canada bond yields and recent spreads in relation to that.

11 A MS. McSHANE: The formulas to get from one year to the next are virtually
12 identical. I don't know that there is any difference in them. There might be a difference in
13 the way they measured the 10- and 30-year spread. The difference would be in what tests
14 they gave most weight to when they set the initial return and what the level of the market
15 risk premium was at the time they set the initial return, so that you might have a different
16 base level, off of which the same incremental changes take place every year.

17 Q MR. LANDRY: But, like I say, effectively, they were trying — albeit, like you
18 say, with those differences coming to the same sort of benchmark. But, as I understand it
19 — and I'm looking at the actual calculations that were made in November 2007 for 2008
20 — I look at it as — because of the difference in when they had the hearings and the
21 different assumptions they were using. But it looks like the BCUC approach results in a
22 minor — it results in a lower benchmark rate of return than AUC.

23 A MS. McSHANE: It does. I think it's about 12 basis points.

24 Q MR. LANDRY: Now, as I understand it, what's happening in Alberta is that the
25 Alberta Board — many of the utilities are joining in. They're actually taking a look at the
26 whole thing again.

27 A MS. McSHANE: That's my understanding, yes.

28 Q MR. LANDRY: So there is a proceeding that's on the go now?

29 A MS. McSHANE: It's been started. The utilities are supposed to file evidence on
30 the 20th of November for the hearing next May.

1 Q MR. LANDRY: And you're part of that proceeding? You're going to be filing
2 evidence on behalf of one or more parties? Or do you know? I'm sorry, I didn't mean to
3 embarrass you. I thought it had already happened.

4 A MS. McSHANE: No. At this point it looks like I'll be filing some capital
5 structure evidence.

6 Q MR. LANDRY: I see. Okay. But you'll be involved in the hearing, I guess is the
7 —

8 A MS. McSHANE: To some extent, yes.

9 Q MR. LANDRY: Now again, I'd like you to confirm with me that, as of yet at
10 least, a similar type of proceeding has not been started in British Columbia.

11 A MS. McSHANE: Another review?

12 Q MR. LANDRY: Yes.

13 A MS. McSHANE: No, it was just reviewed with a new number in 2006.

14 Q MR. LANDRY: That's right. Now, just again really to clear the record a little bit,
15 because there are some extracts from earlier decisions, Ms. McShane, of this Board
16 where you did testify, and you probably don't have it there; Mr. Freedman might have it;
17 I'm not sure. It's Exhibit C1-11. Mr. Freedman, the green binder.

18 Just so we have one, there's a number here, but one that we can refer to is Tab 2 of
19 that exhibit. I'm not going to ask your view on various rates of return and all that sort of
20 thing, Ms. McShane.

21 A MS. McSHANE: Good.

22 Q MR. LANDRY: I understand that's a long time ago, but I just want to make sure
23 that it's clear, given your discussion with Mr. Rondeau this morning, if you go to page
24 18, as an example, Ms. McShane, where the Board is summarizing your evidence — and
25 I'm not going to get into any of the controversial areas. I'm going to get into just
26 basically the approach that you took at the time.

27 And it says in the second paragraph: "Ms. McShane relied upon three tests in
28 developing her rate of return recommendation(s):" Do you see that?

29 A MS. McSHANE: Yes.

1 Q MR. LANDRY: And it talks comparable earnings test, the discounted cash flow
2 test and equity risk premium test.

3 A MS. McSHANE: Yes.

4 Q MR. LANDRY: So, relative to the discussion you were having with Mr. Rondeau
5 this morning, effectively what you did is you did the full-blown type of analysis to come
6 to ultimately a rate of return, as opposed to what's happening in the markets in Alberta
7 and British Columbia, where you have this automatic adjustment mechanism.

8 A MS. McSHANE: Right. I mean, this was back before all these formulas came
9 into effect, when in every rate case, regulators put their mind to the full extent of what
10 was going on in the marketplace.

11 Q MR. LANDRY: The full extent of the type of things that you debated in these
12 generic rate-of-return hearings that you went to over the last number of years, right?

13 A MS. McSHANE: Yes.

14 Q MR. LANDRY: And for the purposes of this discussion, if I look at page 16 of
15 that same decision — and again without getting into the detail — effectively what you
16 have is you have the utilities. Both YEC and YECL in these circumstances would have
17 had this capital structure that they had in place, and you would have been using that
18 capital structure for the purposes of your discussions and the various tests that you went
19 through.

20 A MS. McSHANE: Yes. So, in this case —

21 Q MR. LANDRY: This is YECL, by the way, just so you know. There's two before
22 you get —

23 A MS. McSHANE: Right. Because I could tell that by looking at 4.2, just because
24 it's got all this preferred shares, which YEC never would have had.

25 Q MR. LANDRY: Right.

26 A MS. McSHANE: So at this point in time, we were still dealing, at least with
27 YECL, with actual capital structure.

28 Q MR. LANDRY: Exactly. But what I'm saying is you'd have an actual capital
29 structure, which I see is accepted for the Board ultimately, that you would have been
30 using for the purposes of doing your rate-of-return analysis.

1 A MS. McSHANE: Right, and that was more common in those days than it is today
2 — to have an actual capital structure.

3 Q MR. LANDRY: If I could just take you for a moment to one of the attachments
4 — to your evidence. Let me see if I can find it here; I have a hard time reading the upper
5 right-hand corner of the attachments because they are so small. I think it is Section 8,
6 Attachment 1 — I can't read that — 1.1, Schedule 5, page 1 of 3. Let me tell you what it
7 is: it's the "Equity Return Awards and Capital Structures Adopted by Regulatory Boards
8 for Canadian Utilities". I am told it's the third page in from the back of your —

9 A MS. McSHANE: Yes, I have that.

10 MR. LANDRY: Does the Board have that? I apologize for not being able to —

11 MS. SHANKS: I'm sorry, we need the reference.

12 MR. LANDRY: I'm sorry; I've got a better copy of this. Actually, no, I don't.
13 It's called "Equity Return Awards and Capital Structures Adopted by Regulatory Boards
14 for Canadian Utilities".

15 MS. SHANKS: Just for clarity, is that Schedule 1, page 5?

16 MR. LANDRY: I think it's Schedule 5, page 1 — pretty close.

17 MS. SHANKS: I just wanted to make sure you were listening.

18 MR. LANDRY: You and I are both using our glasses, that's why.

19 Q Just as importantly, do you have that, Ms. McShane?

20 A MS. McSHANE: I do.

21 Q MR. LANDRY: I just want to go here to, again, point out something you clarified
22 at the beginning of my questioning. If we look under "Electric Utilities", we have this
23 8.75 amount. You've given 6 adopted ROEs, but they're all 8.75% for the Alberta
24 utilities. I am looking here at AltaLink, ATCO Electric Transmission Distribution,
25 EPCOR Transmission and Distribution, FortisAlberta — and FortisAlberta, sorry. Right?
26 That's the benchmark we were talking about.

27 A MS. McSHANE: Right.

28 Q MR. LANDRY: And then you have the percentage of common equities. To use
29 the one that you referred to, just so everyone understands how to use this document, you

1 are saying that for ATCO Electric, probably the most relevant one would be “ATCO
2 Electric Distribution”. That would be the closest to YECL? Is that a fair statement?

3 A MS. McSHANE: Closest of all of the electrics in Alberta?

4 Q MR. LANDRY: Yes.

5 A MS. McSHANE: It would be closer than “Transmission”.

6 Q MR. LANDRY: And for them you have 56.1% debt, 6.9% preferred and 37%
7 common.

8 A MS. McSHANE: Yes.

9 Q MR. LANDRY: In terms of preferred and that type of scenario, is the cost
10 preferred less than debt or more than debt, or is it hard to determine because of various
11 tax consequences.

12 A MS. McSHANE: It depends on the timing. It can be similar to debt.

13 Q MR. LANDRY: Well, that was one of the reasons why preferred were used at
14 one point in time.

15 A MS. McSHANE: Yes, and now the rationale — well, the reason they were used
16 so extensively in the past was because of the special tax law that no longer exists. Today,
17 they are used because they can be a cost-effective alternative to debt, which gives support
18 to the equity ratio and results in a lower cost of debt.

19 Q MR. LANDRY: Yes, the way I understand it — and please help me with this if I
20 am wrong — is that effectively preferred is in terms of cost is more akin to debt than it is
21 to equity. Is that a fair statement?

22 A MS. McSHANE: I think that is fair. I mean, it has got a tax allowance.

23 Q MR. LANDRY: I understand that. But equity, obviously, is —

24 A MS. McSHANE: Common equity.

25 Q MR. LANDRY: Yes. Common equity. Sorry, I apologize. You are right.

26 Common equity is obviously — and I use this just to explain it and not to take a
27 position on it — okay — but it is the most expensive of the three — the cost.

28 A MS. McSHANE: Yes. It is the most expensive of the three.

1 Q MR. LANDRY: Presumably it would be common equity — the next most
2 expensive would be preferred and then debt. Sometimes preferred and debt are relatively
3 close. Is that a fair statement?

4 A MS. McSHANE: It can be, yes, depending on the state of the preferred market.

5 Q MR. LANDRY: So, again, just looking at this so that you have the Alberta
6 utilities and then you've given a couple of examples — I guess of the BCUC, I don't
7 know how many you gave here — but let me just see — three or four?

8 A MS. McSHANE: I don't know that there are any more than what are here.

9 Q MR. LANDRY: I'm not sure of that, but I'll leave that for the moment. You've
10 got three examples, at least, here. This is reflecting, as you say, the equity returns
11 awarded by the BCUC using the approach we talked about earlier and the capital
12 structures that were used to get those equity returns.

13 A MS. McSHANE: Correct. You are right, there are a couple that aren't there —
14 Terasen Gas (Vancouver Island) is not there.

15 Q MR. LANDRY: I didn't mean — I just don't think that there are only three.

16 I'd like to just talk to you a little bit about the risk issue, Ms. McShane. I am trying to
17 look at it from the perspective — since we have two utilities in the Yukon, I'd like to talk
18 about risk relative to those two utilities. You know, obviously, you were here before both
19 YEC and YECL, but these utilities both just operate in the Yukon.

20 A MS. McSHANE: Yes, I think, actually, YECL —

21 Q MR. LANDRY: Actually —

22 A MS. McSHANE: YECL goes into BC.

23 Q MR. LANDRY: Good point.

24 A MS. McSHANE: But yes, for all intents and purposes —

25 Q MR. LANDRY: For all intents and purposes they operate in Yukon — that is a
26 proper correction and I accept that.

27 You know that, obviously, the Yukon is not interconnected to either the Northwest
28 Territories, Alaska or British Columbia.

29 A MS. McSHANE: Correct.

1 Q MR. LANDRY: Now, if you could to page 18 of your — I would like to reference
2 a couple of things. One is on page 18 and 19 and the other is on page 20, Ms. McShane,
3 just so that it is clear in the record where I am going. If you could go to line 496 on page
4 18 and you say at the bottom in the sentence starting near the end of that line, “The
5 opening of the new Minto Mine in late 2007 is expected to have a positive impact on the
6 economy, but will correspondingly increase the potential volatility in the economic
7 performance of the Yukon.” Do you see that?

8 A MS. McSHANE: I do.

9 Q MR. LANDRY: I’m sorry, do you see that where I’m referring to?

10 A MS. McSHANE: Yes, I do.

11 Q MR. LANDRY: Obviously, that was one of the pieces of information you took
12 into account to talk about the business risk of Yukon Electrical.

13 A MS. McSHANE: It was a piece of information that I took into account, yes.

14 Q MR. LANDRY: If you go over to page 20 — at the bottom of page 20, Ms.
15 McShane, at line 548, “The presence of generation assets in rate base generally increases
16 the business risk of Yukon Electrical relative to a pure distribution utility ...” Do you see
17 that?

18 A MS. McSHANE: Yes.

19 Q MR. LANDRY: I guess that at one level — and again, without getting too down
20 into the detail — the concept is that generation is a bit riskier than wires, if I could put it
21 that way?

22 A MS. McSHANE: Yes.

23 Q MR. LANDRY: Now, you know that the new Minto Mine is going to be a
24 customer of Yukon Energy?

25 A MS. McSHANE: Yes.

26 Q MR. LANDRY: So in effect, relative to Yukon Electrical, it’ll be if there’s an
27 issue there in the future, that would be an indirect effect on Yukon Electrical.

28 A MS. McSHANE: Correct.

29 Q MR. LANDRY: Would it be fair to say — well, let me ask you this, Ms.
30 McShane. You know that Yukon Energy is primarily a generator and a transmitter —

1 A MS. McSHANE: Yes.

2 Q MR. LANDRY: — as opposed to a distributor?

3 A MS. McSHANE: Yes, it is.

4 Q MR. LANDRY: So as a general proposition and relative to what you know in the
5 Yukon, would you agree that the risk of Yukon Energy and the way in which you've
6 analyzed Yukon Electrical is riskier?

7 A MS. McSHANE: Yes.

8 MR. LANDRY: Ms. McShane, those are all the questions I think I have for you,
9 but I do have some questions for Mr. Freedman, going along with Mr. Keough's
10 suggestion earlier. So, Mr. Freedman, over to you again.

11 Now, I gave my friend a copy this morning of a document that I was intending to give
12 to your whole panel but, since we're going to be talking about capital structure and rate of
13 return, I'd like to refer to that. It is an extract, just so you know, Mr. Freedman, from the
14 filing that was made by Yukon Electrical and Yukon Energy back in the 1996-97 hearing.

15 Now, here's my suggestion how we deal with this, because I don't want to be unfair
16 to you. I'm going to ask you questions about this. I don't think they're overly
17 controversial. I just want to get them for the record. But if you feel you need some of
18 your other panel members for the first panel, then I have no difficulty with that, as long as
19 Mr. Keough is okay with that.

20 MR. KEOUGH: Let's see how it goes.

21 MR. LANDRY: Okay. So, Madam Chair, if I could have this next extract marked
22 as Yukon Energy's next exhibit, please?

23 Q MS. SHANKS: Do we have a number?

24 A MS. LEMKE: C1-16.

25 MS. SHANKS: C1-16, so marked.

26 **EXHIBIT NO. C1-16**
27 DOCUMENT TITLED YUKON ENERGY CORPORATION
28 AND THE YUKON ELECTRICAL COMPANY LIMITED
29 1996/97 GENERAL RATE APPLICATION, VOLUME 1,
30 OCTOBER 1995

1 MS. SHANKS: You're starting to make me even feel old up here with all these
2 old documents.

3 MR. LANDRY: Well, the truth of the matter is there are a few people, including
4 some members of the panel, who were here too. I won't mention who. Mr. Freedman,
5 were you there?

6 MR. FREEDMAN: I was old enough to be there.

7 Q MR. LANDRY: Now, Mr. Freedman, what I wanted to do was I just wanted to
8 make sure we cleared up something on the record, which relates to — and this is not a
9 criticism of Ms. McShane — but it relates to a statement in Ms. McShane's evidence that
10 she referred to, both in response to some of my questions and in response to questions
11 earlier. It is on page 36 of her evidence. You don't have to turn there; I'll give it to you.
12 She says, "A common equity ratio of 52.5% represents a material departure from the
13 actual common equity ratio of approximately 40% that has been historically maintained."
14 That's where I'm starting from.

15 Let's talk about capital structure. It has become a fairly significant issue here.
16 Obviously the last time that capital structure from YECL's point of view that was before
17 this Board where, in effect, they approved the capital structure, would have been 1996-97
18 — correct?

19 A MR. FREEDMAN: That's correct.

20 Q MR. LANDRY: Yes. There was a capital structure obviously there and then there
21 was a capital structure in the two previous hearings that would have been adopted or
22 approved — the hearing in 1993-94 and the hearing in 1991-92, correct?

23 A MR. FREEDMAN: Correct.

24 Q MR. LANDRY: Okay. I want to take you to those, so that we can at least, relative
25 to what has been before the Board and debated before the Board, we can correct that
26 statement of Ms. McShane. If you go to, as a starting point, the 1991-92 — it's Tab 2 of
27 Exhibit C1-11 — and the page reference, Mr. Freedman, is page 16. You will see, Mr.
28 Freedman, that the actual common equity percentage of the capital structure approved by
29 the Board at that time was 35.17% for 1992 and 34.13% for 1991.

1 A MR. FREEDMAN: When we refer to capital structure and percentages, we tend
2 to exclude the no-cost capital, so it would be these numbers adjusted slightly, given that
3 no-cost capital is not a significant percentage.

4 Q MR. LANDRY: Would it be fair to say that we're talking in the 34% to 35%
5 range?

6 A MR. FREEDMAN: That's fair.

7 Q MR. LANDRY: So that's the starting point. It's my understanding — and you
8 may have to get this confirmed for the record, Mr. Freedman —

9 Madam Chair, I had another exhibit that I wanted to — I was going to give it to my
10 friend before the next panel came on. It does refer to this issue, as I'm looking at it. Since
11 I'm going to be asking questions on this, it's probably a good time to do it, but I haven't
12 given it to my friend yet, so if I could just have a moment to explain to him what I'm —
13 Madam Chair, we're going to try this exhibit with this panel. It's effectively a table that
14 we have put together reflecting older decisions and some of the actuals that we have in
15 this proceeding, so if we could have that marked as the next exhibit.

16 MS. SHANKS: That's C1-17, so marked.

17 **EXHIBIT NO. C1-17:**
18 DOCUMENT TITLED YECL MID-YEAR
19 CAPITAL STRUCTURE – HISTORY SINCE
20 1992 AND TEST YEAR FORECASTS (%)

21 MR. KEOUGH: Madam Chair, just for the record, again, it would be helpful to
22 get aids to cross in advance. It really is not appropriate or fair, whether or not this
23 jurisdiction has a requirement that those be distributed in advance. I may be suggesting to
24 you that you should, because it's just not efficient. As well, this document does contain
25 reference to decisions that are not on the record. Apparently, my friend had a real
26 problem with that yesterday when Mr. Grattan was going to refer to materials from a
27 decision that wasn't on the record. Now, today, he is producing a document relying on
28 decisions that are not the record. We have to have some semblance of balance here. I
29 really do think that clearly these documents weren't produced two minutes ago or this
30 minute and parties can make them available. It just would be helpful to the process and

1 fairer to the parties if that were the case. I certainly would encourage you to suggest that
2 that is fair.

3 MS. SHANKS: Thank you, Mr. Keough, the Board takes note of your comment.

4 MR. LANDRY: Madam Chair, just so that we don't get too far along here in
5 terms of what we tried to do. This actually was finished about two minutes ago and it was
6 going to be for the other panel. We thought we had some time to give it to Mr. Keough.
7 For the record, I am not here to try to surprise anybody. Mr. Grattan's reference was to
8 argument in a proceeding, not in terms of the actual decision.

9 Q Okay, we're going to try this, Mr. Freedman, so I would like you to take a look at
10 Exhibit C1-17. Now what we've done here, Mr. Freedman — you can see at least in the
11 first two lines the decision that I just referenced for you?

12 A MR. FREEDMAN: Yes, I see that.

13 Q MR. LANDRY: And what I did, just so you know — and that's where I got
14 caught, and I thought we might as well use this as the next point.

15 The next you'll see is Decision 1993-8 from 1993 — it's effectively for 1993 and
16 1994 test years at that time. And you have the capital structure that was effectively
17 approved for those. I don't have that decision to give it to you now, so I would accept —
18 I mean, it's up to you, but subject to check —

19 A MR. FREEDMAN: That's fine.

20 Q MR. LANDRY: Okay. And then what we have in the next one — I'd like you to
21 refer to the exhibit that was passed out a couple of minutes ago, which is C1-16, and if
22 you could turn to page 2-27 at the upper top. Just so you know, sir — and again, if you
23 want to put this on to other members of your other panel — this is from the GRA, as filed
24 in 1996-97 — and it's talking about the capital structure.

25 Again, this is where this issue of preferred shares sort of began to arise. You'll see
26 that the capital structure that is discussed there, and this number that's being put up for
27 1996-97 is effectively what's being talked about there. Would you confirm that?

28 A MR. FREEDMAN: Yes, I can confirm that that's on page 2-27.

1 Q MR. LANDRY: Right. And, sir, were you around in the ATCO days when this
2 whole issue of preferred came up and the need to begin getting out of preferred because
3 of a change to the income tax rules?

4 A MR. FREEDMAN: Yes — I was not in regulatory, but I was within the ATCO
5 Group, yes.

6 Q MR. LANDRY: And, as I understand it, what was being proposed here at the time
7 was, because of these changes, the concept was that they were going to get out of
8 preferreds which, as we know with YECL, that's what they did do. Is that a fair
9 statement?

10 A MR. FREEDMAN: Yes, Yukon Electrical got completely out of preferreds.
11 ATCO Electric still does have a small —

12 Q MR. LANDRY: A small amount of preferreds.

13 A MR. FREEDMAN: In the range that Ms. McShane talked about — 6% to 10%.

14 Q MR. LANDRY: Okay. And you see the quote in the last line of that top
15 paragraph, where it says: "The majority of the preferred share reduction has been
16 transferred to debt as interest payments on debt are tax deductible and result in a lower
17 overall revenue requirement for our customers." See that?

18 A MR. FREEDMAN: Yes, I see that.

19 Q MR. LANDRY: And that makes sense to you?

20 A MR. FREEDMAN: Yes, that makes sense. Ms. McShane talked about some — I
21 mean, we're not [inaudible] ATCO Electric here but there are some circumstances where,
22 you know, maybe some preferred does make sense. But in this case, that's what it said
23 here, and that's what we've done.

24 Q MR. LANDRY: Okay. Now, I didn't want to put it on this page because, again,
25 this is going to be subject to check, and it's not necessary for the rest of my cross-
26 examination. But it's my understanding that in 1999, sir, in your regulatory filing — that
27 is, when I say "you," I mean YECL's regulatory filing — that the capital structure — or
28 at least the percentage of common in debt — that was referred to in that regulatory filing
29 was 42.56% common equity and 56.50% debt. Again, if you're comfortable doing this,

1 we can take it subject to check, or you can actually just hold off on that and we can deal
2 with it as an undertaking. I can go either way, sir.

3 A MR. FREEDMAN: I could take these, subject to check.

4 Q MR. LANDRY: Thank you. And as you can see, sir — and obviously this is
5 subject to check — but effectively by 1999 at least, which is the only one that I could get
6 my hands on, the preferred issue has now sort of gone away.

7 A MR. FREEDMAN: Correct.

8 Q MR. LANDRY: Now, I want to go back, Mr. Freedman, to a decision in 1996-97,
9 which effectively adopted, after reviewing it, the negotiated settlement. So if you could
10 go to Exhibit C1-11 again, Tab 5. What I'd like to refer you to, obviously, effectively
11 what the Board did is effectively approve the various things in the settlement agreement,
12 but I want to relate to capital structure, since this was the last time that YECL was before
13 this Board on capital structure. If you could go to the second page of the settlement letter
14 attached.

15 A MR. FREEDMAN: Yes, I see that.

16 Q MR. LANDRY: Do you see that? And under "Capital Structure", and I'll quote,
17 it says, "The Companies agreed to back preferred shares out of their capital structure as
18 soon as feasible. As the preferred shares are refunded, the Board is to consider
19 appropriate common equity levels at future GRA hearings, having regard to the most
20 efficient capital structure for the future." Do you see that?

21 A MR. FREEDMAN: Yes, I see that.

22 Q MR. LANDRY: Now, on top of that, sir, I've put in Exhibit C1-17, which is the
23 table that we produced. The actuals up to 2007, and you can see that the common equity
24 percentages are in the ballpark 41% to 43% — correct?

25 A MR. FREEDMAN: Yes, I see those numbers.

26 Q MR. LANDRY: So in effect what has happened since the last time you were
27 before the Board, or Yukon Electrical was before the Board — the last time you were
28 before the Board there was an equity ratio of 35% to 37%, and now in terms of actuals,
29 you're in the ballpark of 41% to 43% since that time. And finally you're asking for
30 another additional increase of common equity up to 47.5% — correct?

1 A MR. FREEDMAN: That's correct.

2 Q MR. LANDRY: So, sir, when whoever did inform Ms. McShane that historically
3 it was at 40%, in fact at least before this Board historically it had been less than 40% —
4 correct? And what I mean by that, when capital structures were approved by this Board.

5 A MR. FREEDMAN: Well, they'd said "approximately 40%", and I think once the
6 preferred shares were out of that capital structure, that is kind of the target that Yukon
7 Electrical, as a company, was always looking toward. You know, it has been slightly over
8 that, but from Yukon Electrical's perspective, that was approximately 40%.

9 Q MR. LANDRY: Do I understand what you're saying, sir, that you think that,
10 looking at this from the last time you were before the Board, 35% to 37% common equity
11 is approximately 40% common equity?

12 A MR. FREEDMAN: No, I think it was — I would have to check. That ratio
13 reflected a component of preferred shares. I would have to check the order of decisions,
14 but Yukon Electrical has been filing its annual filings with the Yukon Utilities Board
15 showing capital or common equity structure of around 40%, so that is what has actually
16 taken place.

17 Q MR. LANDRY: But, sir, I see a fairly significant dividing line between what was
18 actually approved by this Board and what you've actually been doing since the approval
19 by the Board in terms of your capital structure. Do you not agree with that?

20 A MR. FREEDMAN: I just have to get — there obviously is a difference between
21 37% and 40%. What I'm struggling with is the approvals we filed with the Yukon
22 Utilities Board are our results on an annual basis. I think as far as where they —

23 Let me back up. This negotiated settlement says the companies agreed to back
24 preferred shares out of their capital structure and that's what we've done.

25 Q MR. LANDRY: Well, sir, I'm not suggesting you're trying to overstate
26 something here, but I took what was said in the 1996-97 negotiated settlement that that
27 was something that was going to be debated in future GRA hearings — what percentage
28 of that would ultimately go to common equity.

29 A MS. McSHANE: I am not sure, from my perspective — I mean, the fact is that
30 for at least the past five years, we've had over 40% equity. So, historically, over that

1 period we've had 40% equity and, to get from 40% to 52.5% equity is a large jump. So,
2 whether it's five years, 10 years or 15 years, if you're looking at what my evidence says,
3 which is where this reference comes from, I don't really know what the relevance of
4 going back to 1993 is. Sure, back in 1993, the common equity ratio was 35%, and there
5 was 20-odd percent preferred shares, but we're talking about what the capital structure
6 had been for the last five years and what the difference is between 40% and 52.5%.

7 Q MR. FREEDMAN: Mr. Freedman, just so I understand and make sure that it's
8 clear on the record, if we take the actuals from 2003 to 2007, effectively the rates of
9 return that we talked about yesterday during our questioning — right? — which ranged
10 ballpark 9% to 10.5% or 10.7%, something like that during that time frame, effectively
11 what happens by Yukon Electrical increasing their common equity is that return is earned
12 on more money, correct?

13 A MR. FREEDMAN: Not since we didn't come in for a GRA or a revenue
14 requirement. In fact, we were not earning money in that increased return since the last
15 approved return was based on the rates in place in 1996-97.

16 Q MR. LANDRY: And what that return was? What was that return? 11.25%?

17 A MR. FREEDMAN: Correct.

18 We filed with the Utilities Board every year thereafter and kept our rates at those
19 existing rates.

20 Q MR. LANDRY: 11.25%?

21 A MR. FREEDMAN: That is correct.

22 Q MR. LANDRY: And approximately somewhere between 35% and 37% common
23 equity?

24 A MR. FREEDMAN: Correct.

25 Q MR. LANDRY: What happened after that? Whatever your return is, you have
26 more equity in your business.

27 A MR. FREEDMAN: But we're not earning a return on — I mean, we're managing
28 with cost increases. We're managing — through that whole period, things are changing.
29 Costs are going up, there's other things going down and there is sales coming in. We filed
30 with the Utilities Board: we have the option to come in front of the Board to seek an

1 increase in rates or we have the option to carry on and manage the company at the
2 existing rates. We filed these results with all the changes and interested parties have the
3 option if they have a concern with these actual results to suggest that maybe it is time for
4 Yukon Electrical to come in front of the Board. So that is how we have been operating in
5 the interim. So, the equity structure has gone up but that increase hasn't been reflected in
6 increased rates because we were always operating on the existing rates in place in 1996.

7 Q MR. LANDRY: Let me just try one question and I'll link to that, sir. I am
8 looking at Exhibit C1-12, for the record. You don't necessarily have to refer to it. It
9 shows that the actual return on equity that YECL earned was 10.5% in 2003. This
10 document that we are just referring to says that in 2003 you had 42.8% common equity.

11 A MR. FREEDMAN: But again, that is the actual return that I'm trying to explain
12 that the approved rates of what we are allowed to have a return on — the fact that we can
13 manage the business with slightly different rates is — there is a difference.

14 Q MR. LANDRY: It is always dangerous trying to figure out where I'm trying to
15 get to. I'm just trying to get some answers on the record. You have a 10.5% rate of return
16 in 2003. Correct? Can we go there?

17 A MR. FREEDMAN: Correct.

18 Q MR. LANDRY: You have, in that year, the equity percentage that you earned
19 that return on was 42.86%. Do you see that in Exhibit C1-17?

20 A MR. FREEDMAN: That —

21 Q MR. LANDRY: That is the only question I am asking you, sir.

22 A MR. FREEDMAN: And —

23 Q MR. LANDRY: Is the answer yes or no, please? Just start there and then maybe
24 we can talk after that.

25 A MR. FREEDMAN: No, well. Well, I'll start there that Yukon Electrical's equity
26 component in their capital structure had gone to 42%. With a 42% capital structure in that
27 year they earned the return you mentioned.

28 Q MR. LANDRY: And just so we're clear, I want to get it clear in the record —
29 that is the 10.54%.

30 A MR. FREEDMAN: Correct.

1 Q MR. LANDRY: Let's leave it at that. I don't want to get into an argument with
2 you on whether or not you should or should have not been back before the Board or what
3 your rates were from that. I just wanted that on the record and we'll —

4 MR. KEOUGH: In fairness, Mr. Landry, you may not want to get into an
5 argument but the witness is entitled to give a complete answer. You have asked a
6 question. I would ask that you not interrupt him and let him finish, please.

7 MS. SHANKS: I think the question has been answered.

8 MR. KEOUGH: Madame Chair, with all due respect, I think that my friend is
9 cutting the witness off and not letting him finish the complete answer and I just don't
10 think that is fair to the witness.

11 MR. LANDRY: I'll move on.

12 MR. KEOUGH: I know you'll move on. I'd like a ruling as to whether or not the
13 witness can finish his answer.

14 MR. LANDRY: I thought the ruling had already been made, I'm sorry.

15 MS. SHANKS: In my mind, the ruling has been made and the question has been
16 asked and the question has been answered.

17 Q MR. LANDRY: Sir, just a couple of quick questions, and I reference in Exhibit
18 C1-17, the equity percentage that is forecast. You can see in your document, and it shows
19 — and this is where it gets a little confusing to me and I just want you to help me out a
20 little bit here.

21 In 2008 you have 44.29% common equity; and in 2009 you have 46.86% common
22 equity. But as I understand that, sir, that is a mid-year equity percentage.

23 A MR. FREEDMAN: Could you just repeat these numbers again?

24 Q MR. LANDRY: Do you have the document?

25 A MR. FREEDMAN: Yes.

26 Q MR. LANDRY: It's 44.29% for 2008; 46.86% for 2009 for equity, mid-year.
27 That's what I understand this to be.

28 A MR. FREEDMAN: It is mid-year, but if I look at Schedule 8.1 of the application,
29 it's 46 — I'll just check my eyes. That's correct. These are the right numbers; these are
30 mid-year.

1 Q MR. LANDRY: And then I have, sir, as you can see at the bottom here, an
2 extract from page 8-2 of your application, where it says, “Yukon Electrical has targeted
3 47.5% equity structure by the end of 2008.” That’s what your understanding is?

4 A MR. FREEDMAN: That’s correct, yes.

5 Q MR. LANDRY: What I’d like you to give me, sir, because the other ones are all
6 end-of-year, what is your end-of-year equity percentage for 2008 and 2009 in your
7 forecast? I couldn’t find it. And, quite frankly, Mr. Freedman, just to move this on,
8 because I know other people have some questions, if you could just take that as an
9 undertaking and get back to me, that’s fine.

10 A MR. FREEDMAN: I don’t know the 2008. I’ll undertake that. The 2009 is what
11 we were targeting. It would be the 47.5 at the end of 2009, but I’ll — Let me get back to
12 you.

13 Q MR. LANDRY: Thank you. You’re okay with the 2009 number? It’s only the
14 2008, or do you want to come back with both?

15 A MR. FREEDMAN: I’ll just undertake to give you both these numbers.

16 MR. LANDRY: Okay. Just give me one second.

17 MS. SHANKS: Mr. Landry, I hate to interrupt — do you have an idea of how
18 much longer you have in your cross?

19 MR. LANDRY: I was just hoping I was going to be able to say “no longer”, but
20 if you could just give me one second.

21 In my attempt to — Madam Chair, in my attempt to try to accommodate what Mr.
22 Keough mentioned earlier, and it was all in a bunch of different questions, I think, I have
23 all the questions I need of Mr. Freedman on the capital structure. So on that basis I’m
24 finished my cross-examination.

25 MS. SHANKS: Thank you. Mr. Maissan, do you have any questions you would
26 like for cross-examination on this panel?

27 MR. MAISSAN: Yes, I do.

28 MS. SHANKS: Do you have an idea of how long your cross might take?

1 MR. MAISSAN: Given my experience, I can't be exact — I would say probably
2 somewhere between half an hour and an hour and a half.

3 MS. SHANKS: I note that it's 2:57 p.m. and I'd like to take a 10 to 15-minute
4 break. Fifteen minutes, and we'll meet back in this room at 10 minutes after 3:00.

5

6 (PROCEEDINGS ADJOURNED)

7 (PROCEEDINGS RESUMED)

8

9 MS. SHANKS: Please be seated.

10 Mr. Keough, did you have something that you wanted to add?

11 MR. KEOUGH: I did, Madam Chair. I think I have an obligation not only to my
12 client but to the process to formally register an objection with the Board regarding what I
13 consider the inability of the witnesses to give complete answers that are in the full
14 context. I don't do this lightly, Madam Chair, but I've kicked around this game for quite
15 awhile and I think it is unfair to the witnesses to not allow them to respond fully to
16 questions and put them in proper context. I think they should be allowed to do that. I
17 think the Board should want the full and complete record.

18 So I'm going to register the formal complaint and request that in the future they be
19 permitted to do that. Thank you.

20 MS. SHANKS: Mr. Maissan, are you prepared to proceed with your cross-
21 examination?

22 **YECL Panel 2 cross-examined by Mr. Maissan**

23 MR. MAISSAN: Yes, I am, and for everyone's assistance what I'll be doing is
24 I'll be using my IRs as a guide to cross-examination so you may want to bring those IRs
25 up, and I will also be referencing Section 8 and Ms. McShane's evidence.

26 To begin with, my first question is related to Leading Edge-YECL-29 on Section 8,
27 references Schedule 8.2 and 8.3.

28 Q The question was related to long-term Canada bond yields and consumer price index.
29 The information was provided, but in a footnote it says that the annual CPI rate, there is
30 no relation on the long-term Canada Bonds in any given year. I was a bit confused by that

1 because I thought that there was a relationship. I just wanted to ask the panel whether this
2 is indeed correct. Is there no relationship, or is there?

3 A MS. McSHANE: There is a relationship between the expected rate of inflation in
4 the yield, so if you had a 30-year bond yield, the 30-year bond yield would be related to
5 the expected rate of inflation over the 30 years.

6 Let's say I were looking at the 30-year bond yield in January of a given year — so the
7 yield would reflect the average rate of inflation that I expected over the next 30 years. If I
8 look at the average yield on long Canadas after the fact, over that year that started
9 January 1, and I look at what the actual rate of inflation turned out to be during that
10 corresponding year, that rate of inflation may have turned out not to be any of the 30 that
11 I had expected at the beginning of the year.

12 So that is what was intended when it said that it doesn't bear any relationship to —
13 the actual CPI doesn't bear any relationship to the yield on long-term Canadas in any
14 particular year.

15 Q MR. MAISSAN: Over the long term, if CPI is expected to be higher, you would
16 expect bond deals to be higher, and if you expected CPIs to be lower, then bond deals
17 would be lower.

18 A MS. McSHANE: All other things being equal, and the other thing being equal is
19 what the supply and demand for capital is. So if you looked at, for example, the yield on
20 inflation-protected bonds — those change also with respect to the supply and demand for
21 capital in the economy. And the yields will reflect the supply and demand for that
22 specific category of fixed income security. So if institutional investors, for example,
23 require long-term, risk-free bonds as part of their portfolio, and the government is in
24 surplus — so the supply of long-term government debt has gone down, but the demand
25 hasn't gone down — that would push those yields artificially down, as I would
26 characterize it. So there were those three factors that will impact the yields on long-term
27 government bonds.

28 Q MR. MAISSAN: So CPI is indeed one of the factors.

29 A MS. McSHANE: Yes — expect inflation.

1 Q MR. MAISSAN: There was a brief discussion this morning about the current
2 financial crisis, or however we want to characterize it, and it's probably going to have
3 some impacts on interest rates — short term, if not long term — and inflation rates, et
4 cetera. Can you think of how this will affect long-term Canada bonds?

5 A MS. McSHANE: The one influence on long Canada bonds is, as I discussed
6 earlier today, there is this flight to safety. As a result of a flight to safe securities, like
7 long-term Government of Canada bonds, that has a tendency to push those yields down
8 because people demand them more.

9 On the other hand, given the whole bail-out process and what the obligations of the
10 various governments are going to be, we have the potential for offsetting increases in
11 rates of inflation. And how that is actually going to play through — I don't think that this
12 process has progressed far enough that anybody really has a very good handle on it. So all
13 I can say to you is that, at this point, there appear to be forces on both sides.

14 Q MR. MAISSAN: You don't expect people to be fleeing to the security of regulated
15 utilities?

16 A MS. McSHANE: Well, the interesting thing is that — again, as I discussed earlier
17 today — utilities are less risky than some other securities. Utility bond yields are actually
18 higher today than they were a year ago, despite the fact that long-term government bond
19 yields are lower. So you haven't seen the decline in the cost of debt capital for public
20 utilities the way you've seen the decline in the yield on long-term government bonds. If
21 you look at the dividend yields on utility stocks, they are higher today than they were a
22 year ago, because the prices of utility stocks have gone down — some by 15% to 30%.
23 So the cost of equity capital by those two indicators is higher today than the trend in
24 government bond yields alone would suggest.

25 MR. MAISSAN: Thank you.

26 Q Referencing Schedule 8.9, line 7 — this is probably for Mr. Freedman — it's talking
27 about the O&M lag in 2006-07. We see that since the last GRA it has gone down from 19
28 days to 5 days. I understand that the customers will now benefit as it's gone down from
29 19 to 5. The question was really: what's happened? Where has the benefit gone in the

1 intermediate years, as the lag has reduced from 19 to 5? Has that benefit not accrued to
2 Yukon Electrical?

3 A MR. FREEDMAN: So some of the causes for that were — you know, there have
4 been better payment methods and we're getting revenue quicker. Again, when a company
5 is out for the long term, there are some things that would benefit Yukon Electrical; there
6 are some things that would go to its detriment: you know, inflation through that period
7 and increased costs for that period. Yes, to the extent — you know, we did the study for
8 this application, so that would have been over time and we had experienced better
9 payment, we were getting our revenues in a wee bit quicker; as well I think there was the
10 purchase power. The lag on that has increased so, over time, the fact that that has come
11 down would have reduced our working capital requirements over time. To the extent that
12 they happened a bit earlier than this application, that benefit might have gone to Yukon
13 Electrical.

14 Q MR. MAISSAN: Pardon the pause. A number of these questions have been
15 answered and I won't repeat them, so I'll just leaf through. My next question references
16 Leading Edge-YECL-40. This is page 14, line 373 of your evidence, Ms. McShane. It
17 seems to be implying that Yukon ratepayers would be worse off if served by another
18 utility. Based on the discussions this morning, can I assume that that would be true if they
19 were served by another investor-owned utility as opposed to perhaps a government-
20 owned utility?

21 A MS. McSHANE: Well, if we are talking simply about the cost of debt, the cost of
22 debt raised by CU Inc. is lower than the cost of debt of any other investor-owned utility
23 in the country, which is not to say that CU Inc. should own everything in the country,
24 because there are obviously pluses and minuses in every company. But on the cost-of-
25 debt side, the cost of debt is lower when raised by CU Inc. than all other investor-owned
26 utilities.

27 Q MR. MAISSAN: And is it not also true that there are many government-owned
28 utilities that have lower cost of debt than CU?

29 A MS. McSHANE: Yes. I mean, there is a whole philosophical discussion we could
30 have about that. Some government-owned utilities recognize that by guaranteeing the

1 debt to their 100% owned companies, there is a cost that is being borne by taxpayers;
2 therefore, to offset that cost, they charge a guarantee fee to the utility. So, at the end of
3 the day, the total cost of debt that's paid by the utility may not be equal to the cost that
4 the government actually can raise the debt at. Some just say our cost is your cost; charge
5 your ratepayers that cost. So for those companies for sure the cost that the ratepayers
6 actually end up paying is less than what CU Inc. would raise debt at.

7 Q MR. MAISSAN: Mr. Freedman, this next question relates to Leading Edge, LE-
8 YECL-41. Ms. McShane, in her evidence on page 19, line 501, references GDP, but I
9 didn't find any reference to GDP being used in any of your sales forecasts. Do you use
10 GDP in your sales forecasts?

11 A MR. FREEDMAN: I believe it is looked at and it is a factor, but it is not — you
12 know, the forecast process is described in Section 2, and it is not one of the key things,
13 but I think it is looked at. But subject to check, I could confirm that. But it is not one —
14 you know, the forecast process is outlined in Section 2, you know, so you can look at
15 historical and they look at use per customer and things like that.

16 Q MR. MAISSAN: But what I'm really wondering is whether GDP, which was
17 used by Ms. McShane in assessing the business risk in YECL, is all that relevant given
18 that it is not used to any material extent in their forecasting?

19 A MS. McSHANE: Is that question addressed to me?

20 Q MR. MAISSAN: Either of you, yes.

21 A MS. McSHANE: Well, I tried to explain in the response to LE-YECL-41 why I
22 look at GDP. I recognize that it is not necessarily used by individual utilities for purposes
23 of doing one- to two-year forecasts of growth — you know they might use something
24 much more grassroots or go right to the customers or indicators of that nature. From my
25 own perspective, what I'm trying to do is establish how would an investor look at this
26 utility vis-à-vis other utilities? And, we know that one of the things that investors are
27 interested in is how diverse is the economy that the utility operates in. How volatile is the
28 economy? I am not trying to look at YECL in a vacuum. That doesn't really do me any
29 good. I need to know how it compares to other companies. So by looking at the volatility
30 and breakdown of GDP in different geographical areas, I can get a sense of how

1 relatively diverse the economy served by X utility are compared to Y. How volatile,
2 relatively speaking, they are, so that gives me a comparative sense of the economic base
3 that the utilities serve.

4 Q MR. MAISSAN: For the utilities that you normally do these assessments for, or I
5 guess for the regions that you are assessing in which your client utilities operate, I don't
6 know much about volatility. What is volatile in terms of GDP? Is it changes of what
7 percentage, et cetera? Can you give me a —

8 A MS. McSHANE: Well, let us say that if we looked at the Canadian economy, that
9 what we would tend to see over — like take the last business cycle. Although, we haven't
10 really had — knock on wood — recently, a real recession, but we've had some periods of
11 downturn. So we would see growth rates in the range of say 1 to 5%. Well, if you looked
12 at individual provincial economies — take Newfoundland and Labrador — I mean, their
13 growth rates have been 24% down to -8%, and that is largely because there has been a
14 real emphasis on a single industry in the last few years, that being oil and gas. So that sort
15 of gives you some sense of how a volatile economy might compare to the overall
16 Canadian economy.

17 Q MR. MAISSAN: In answer to LE-YECL-42, you provide a graph with about 11
18 years of information, which is more than the five years provided in the tables, which was
19 all we were to receive for this analysis. But it seems to me, looking at the Yukon GDP for
20 a period of 10 years — 11 years ago being the closure of the Faro mine — the GDP
21 seems to have been well within the kind of range — substantially smaller than what you
22 describe for Newfoundland, and yet you describe this as being volatile. Could you
23 elaborate?

24 A MS. McSHANE: Sorry — elaborate on what?

25 Q MR. MAISSAN: Well, for Newfoundland, you were talking about -8% or 9%
26 and +24% as being volatile. Here we see — you know, with the exception of the closure
27 of the Faro mine — Well, it's hard to read the scale, but maybe something like -2% to
28 +5%, which seems an awful lot steadier, yet you also consider this volatile?

29 A MS. McSHANE: I would consider that the Yukon economy has been relatively
30 volatile, yes — relative to if you took all of the provinces together — and territories.

1 Q MR. MAISSAN: Okay, what sort of range would you expect in the provinces?
2 What would you consider not volatile, I guess?

3 A MS. McSHANE: I'm having difficulty putting my finger on numbers. I know
4 when I looked at all of the individual provinces, the Yukon was in the upper half of the
5 range of volatility over the past 10 years.

6 Q MR. MAISSAN: And Yukon being relatively small, that is not surprising, is it?

7 A MS. McSHANE: Oh no, absolutely not. That's really sort of the point — it's
8 small and not that diverse and therefore subject to volatility by its very nature.

9 Q MR. MAISSAN: Yes, but given that we're within the top half for a very small
10 jurisdiction, it sounds like maybe we're really doing quite well. And certainly, when we
11 look at sales forecasts, such as Schedule 3.1, we see fairly steady growth. That's why I
12 was surprised with the judgement that we were volatile. You know, except for the Faro
13 mine closure 11 years ago, I thought we were relatively stable.

14 A MS. McSHANE: That wasn't my take on the analysis I'd done of all the
15 provinces, no.

16 Q MR. MAISSAN: Thank you. LE-YECL-43: On page 20, line 525 of your
17 evidence, you talk about the conservation programs and the disincentive. In your
18 response to my question, you state, in part: "... increasing emphasis on energy efficiency,
19 conservation and reducing peak load increases the risk of lost sales and, therefore, the
20 risk to the Company's earnings, as the recovery of fixed costs is tied to the amount of
21 electricity sold." And you go on.

22 So is it your understanding, based on your discussions with the Company that that is
23 the reason why they are not doing energy conservation and efficiency programs — active,
24 other than the passive ones described?

25 A MS. McSHANE: No, I got no such impression.

26 Q MR. MAISSAN: Could you please elaborate on your response, then, because
27 you're saying there is a disincentive to Yukon Electrical in your response to me here.

28 A MS. McSHANE: There is a disincentive to anyone. It wasn't necessarily aimed at
29 Yukon Electrical, in particular. I mean, it's an issue where, on the one hand, it makes
30 economic sense to encourage conservation. I mean, the best use of resources is not to

1 waste them. On the other hand, from the perspective of a corporate entity, part of whose
2 function is to produce a reasonable return for its shareholder, reducing the amount of
3 sales goes against that objective.

4 Q MR. MAISSAN: So are you saying that it's normal for a utility to put the
5 shareholder above the ratepayer?

6 A MS. McSHANE: No, I'm saying it's a normal objective to want to increase sales
7 to maximize profits. I mean, that's just normal behaviour.

8 Q MR. MAISSAN: All right. And how would the utilities then balance the interests
9 of the ratepayer in that?

10 A MS. McSHANE: Well, the way that the balance has been achieved in some
11 places is to provide deferral accounts for lost revenues due to conservation, to provide
12 additional returns on investments that are made for conservation purposes and the most
13 significant, I would say, change that's come about in the last five years or so is this whole
14 concept of decoupling, where rates are decoupled from sales so that the utilities will
15 recover their fixed costs irrespective of how much they sell, because that removes the
16 disincentive for conservation.

17 Q MR. MAISSAN: Thank you. I am referring to Schedule 4.2 in the application,
18 which lists diesel costs. Would you accept, subject to check, that of the communities
19 served by diesel generation by Yukon Electrical, the lowest cost for fuel alone in any of
20 these communities is about 22.9 cents per kilowatt hour?

21 A MS. McSHANE: I haven't looked at that specifically, but I don't have any reason
22 to disagree with you.

23 Q MR. MAISSAN: All right. Can you explain to me how lost sales in these
24 communities, where fuel alone costs 22.9 cents per kilowatt hour, is going to result in
25 harm to Yukon Electrical — financial harm?

26 A MS. McSHANE: So, if I'm given a pricing and the pricing is that it's going to
27 cost me 22.9 cents to consume this extra kilowatt hour of electricity, so I won't do it. The
28 company has forecast certain sales, customers consume because the price signal says "too
29 expensive", so the earnings for Yukon Electrical — I mean, they are only going to pay

1 for the power they purchase presumably — the fuel they purchase. Their returns would be
2 lower than they had anticipated because of the conservation.

3 Q MR. MAISSAN: Surely you're aware that the rates charged in these diesel
4 communities are substantially less than 22.9 cents per kilowatt hour? The rates charged to
5 customers in diesel-served communities are substantially less than —

6 A MS. McSHANE: Because they are not community rates? You mean, because they
7 are a —

8 Q MR. MAISSAN: Postage stamp.

9 A MS. McSHANE: — a postage-stamp-type rate.

10 Q MR. MAISSAN: Yes. So in these communities, where it costs 22.9 cents for fuel
11 alone to generate electricity, the revenue for each kilowatt hour is substantially less than
12 that. How can the company lose money by conservation and efficiency programs? I don't
13 see where the disincentive is to the utility for energy conservation and efficiency
14 programs in communities where it costs them more to generate each kilowatt hour than
15 they get in revenue. I am just trying to understand where the disincentive is.

16 A MS. McSHANE: I understand what you're saying. The price signal doesn't pass
17 directly through as if it were priced at the margin. If it were priced at the margin, which
18 would be the cost of the next — how do you measure diesel — gallon of fuel oil, then
19 obviously that disincentive would be that much stronger. I was trying to make the point
20 that when you have rates that are, in and of themselves, high, then high rates will be a
21 price signal to conserve. I take your point that they are not priced at the margin, so the
22 disincentive is not as strong as it would be if it were a marginal cost rate, rather than a
23 postage-stamp rate.

24 Q MR. MAISSAN: So you think that there is still a disincentive for Yukon
25 Electrical to have efficiency and conservation programs in diesel-served communities?

26 A MS. McSHANE: Yes. I think there is if, as a general proposition, there is a
27 disconnect between the profit motive, which is to sell more, and encouraging
28 conservation.

29 Q MR. MAISSAN: Right. And that is the situation in Yukon today, is it not?

30 A MS. McSHANE: Yes, it is.

1 Q MR. MAISSAN: Thank you. On line 534, page 20 of your evidence, you talk
2 about risks. My question in LE-YECL-44, I ask about the issues that — what are those
3 risks, essentially, given the reserve for injuries and damages? You say the existence of
4 the reserve for injuries and damages is not always the fundamental supply and physical
5 risks faced by Yukon Electrical and you go on from there. I was just wondering if you
6 could be a bit more specific in describing what those risks are.

7 A MS. McSHANE: Well, the risks go to the risks associated with the diesel plants
8 and the fact that, unlike utilities in the rest of Canada and U.S., that Yukon Electrical and
9 Yukon Energy are not connected to the North American grid. Those are the two main, in
10 addition to just the geographic area and the rugged territory that both of the utilities serve.

11 Q MR. MAISSAN: Yes, in fact, there are coverages in response to LE-YECL-27.
12 We find that even premature cylinder failures or piston liners are covered under the
13 reserve for injuries and damages. It seems to me that once those kinds of things are
14 captured in reserve for injuries and damages, then the residual risk really is quite small —
15 multiple generators in these communities. It seems quite a bit in terms of engine impact is
16 being covered. That is why I was interested in just what these other risks were, because
17 they seemed pretty insubstantial to me.

18 A MS. McSHANE: What I understand was that the reserve for injuries and
19 damages was to cover, was as I described in the response. It was supposed to be — I have
20 lost the question we were referring to: what was the number?

21 Q MR. MAISSAN: 44.

22 A MS. McSHANE: 44, sorry. That it was the purpose of the reserve “to replace
23 third party insurance for sudden and accidental failures where the cost of third party
24 insurance is prohibitively high or third party insurance is not available.” So essentially, it
25 was supposed to replace third party insurance.

26 Q MR. MAISSAN: Right, and that is in place. So the business risks that are being
27 described in your evidence are the residual risks.

28 A MS. McSHANE: The risks that would not be covered by—

29 Q MR. MAISSAN: — reserve for injuries and damages.

30 A MS. McSHANE: By insurance.

1 Q MR. MAISSAN: Or insurance.

2 A MS. McSHANE: On the operational side, yes.

3 Q MR. MAISSAN: Can I please refer you to page 20, line 541 of your evidence?

4 A MS. McSHANE: Yes, I have that.

5 Q MR. MAISSAN: The statement says that Yukon Electrical's diesel plant at
6 Stewart Crossing provides backup generation capacity to the Mayo-Dawson grid. I ask
7 for confirmation of that in Leading Edge-YECL-45 and the response is that is not
8 confirmed. Is that an error in your evidence?

9 A MS. McSHANE: Actually, it's funny you should ask that, because I sat there
10 with my testimony and I read these answers and I thought "That doesn't make sense —
11 why would they have let me say that if that wasn't true?" Then I re-read the statement in
12 the testimony and I think that what the issue was is that it is just poorly worded. What it
13 was meant to say was that the diesel plant at Stewart is backup generation capacity for
14 Stewart, and it's backup to what is on the grid, as opposed to what the question seemed to
15 ask, which was, "Did the diesel plant provide generation capacity into the grid?" That is
16 what the company said was not confirmed.

17 Q MR. MAISSAN: Correct. When I read your evidence, it told me that it provided
18 backup generation capacity to the grid, and that's why I was looking for confirmation. In
19 fact, it provides backup generation capacity to Stewart Crossing in case the grid is not
20 available.

21 A MS. McSHANE: Correct, and that is what the sentence was intended to mean,
22 but I could see why you would not take that from that sentence, because it was poorly
23 worded.

24 Q MR. MAISSAN: In LE-YECL-47, I asked if Northwest Territories Power
25 Corporation and Yukon Energy are lower risk utilities than YECL. You say no. Are they
26 the same risk or are they higher risk?

27 A MS. McSHANE: They would be higher risk.

28 Q MR. MAISSAN: Higher risk. Thank you.

29 Referring to LE-YECL-49, your evidence, page 35, line 928 — I think this is where
30 you talk about Canadian utilities generally getting a lower return than you think is

1 appropriate, given the situation in the U.S. and perhaps globally. If Canadian utilities
2 continue to be treated in this way, do you think it appropriate that Yukon Electrical be
3 treated the same way other Canadian utilities are treated?

4 A MS. McSHANE: I find it very difficult to answer that question. I think I
5 answered the question as best I could in the response. Every Canadian utility has the right
6 to an opportunity to a fair return that meets all three standards. If the whole universe of
7 Canadian utilities is allowed returns that don't meet that standard, would Yukon
8 Electrical be the only one that is? I don't know how to meaningfully say that. I would still
9 say that it has a right to a fair return that meets those standards, irrespective of what is
10 going on with other companies.

11 Q MR. MAISSAN: So you would prefer that this Board not be consistent with other
12 Canadian utilities boards?

13 A MS. McSHANE: Well, I think that we could have a long philosophical discussion
14 about this, but I think part of what's happened is that, by virtue of the formulas, we've
15 had this convergence of returns. Everybody feels comfortable that the returns that are
16 produced by the formulas are all within a relatively narrow range, so they must be okay.
17 But once you get outside the formula environment — and you don't even need to go
18 outside of Canada — you look at the utilities whose returns are not determined by
19 formula. You look at the returns of utilities that are negotiating — that were never sort of
20 governed by the formulas — and they are negotiating returns. They are higher. Then you
21 go into the U.S. where returns are still being set by full blown rate-of-return cases. They
22 are higher. I would prefer that regulators sort of step back from the formula and say, let's
23 not use the formula as a default mechanism. Let's look at this stuff afresh.

24 Q MR. MAISSAN: I don't have the reference at my fingertips, I apologize, but I
25 think in your evidence somewhere, you provide a list of returns for utilities in the U.S. or
26 average returns, and you compare Canadian utility returns to that and you illustrate the
27 difference. In fact, if you look at actual returns for Yukon Electrical, are they not very
28 much in line with the actual returns, since the last GRA? Are they not very much in line
29 with the allowed returns in the U.S.?

30

1 A MS. McSHANE: Yes. I mean, they have been. Yes. But we're coming in now
2 and saying, let's set the return starting off with the formula return. So what they happen
3 to be in the past becomes sort of a moot point.

4 Q MR. MAISSAN: Okay, but they have been.

5 A MS. McSHANE: By virtue of, you know, being able to manage the business in
6 such a way that they didn't come in for rates for a number of years.

7 MR. MAISSAN: Right. Thank you. This concludes my questioning. Thank you.

8 MS. SHANKS: Thank you, Mr. Maissan.

9 At this time I'd like to move on to questions from the Utilities Board, from Board
10 staff. Cross examination. Ms. Bentivegna?

11 **YECL Panel 2 cross-examined by Ms. Bentivegna**

12 MS. BENTIVEGNA: Madam Chair, if you will just give me a moment, my
13 questions have disappeared off my screen, or a least a couple of them. So, I'm just trying
14 to get back in.

15 MS. SHANKS: We can have our second afternoon break then.

16 MS. BENTIVEGNA: Good afternoon, panel.

17 MS. SHANKS: Good afternoon.

18 Q MS. BENTIVEGNA: The first question that I had relates to ATCO Electric as a
19 parent company. Are you, Ms. McShane or Mr. Freedman, aware if ATCO Electric
20 currently has a Phase I GRA application before the Alberta Utilities Commission?

21 A MR. FREEDMAN: ATCO Electric has filed a Phase I application before the
22 AUC.

23 Q MS. BENTIVEGNA: Thank you. What is the requested cost of debt included in
24 that application for ATCO Electric?

25 A MR. FREEDMAN: I can recall, off the top, the spreads that were used were the
26 same spread of 200 basis points. The timing of the application was slightly different, so I
27 just can't recall whether it was 6.6 but it used the same methodology and it used the 200-
28 basis point spread. I just can't recall whether the 4.55% yield was used for ATCO
29 Electric. ATCO Electric is going in for 2009-10 versus Yukon Electrical going in for

1 2008-09. I do know that the spread was the same but I can't confirm the exact yield that
2 was used to get to the debt rate.

3 Q MS. BENTIVEGNA: Can I get an undertaking, if you can confirm, please?

4 A MR. FREEDMAN: I can do that.

5 Q MS. BENTIVEGNA: Thank you. What is the rate of return applied for and the
6 cost debt equity applied for, as well? Do you know?

7 A MR. FREEDMAN: I know they are placeholders, because the capital structure
8 and rate of return are being heard as part of the whole generic cost of capital proceeding
9 that is underway. So they are placeholders. Again, off the top — I would have to confirm
10 the exact numbers. The formula was 8.75%, approximately, for 2008, but I'd have to
11 confirm what we put in as placeholders. But they are just placeholders for 2009-10.

12 Q MS. BENTIVEGNA: And those placeholders would be what is in the current
13 cost of capital and rate of return for ATCO Electric. Wouldn't that be correct?

14 A MR. FREEDMAN: They would be placeholders for the 2009-10 period. They
15 will be tested as part of — not the Phase I application, but the generic cost of capital
16 filing that is going to be heard next year, but will be filed in the fall this year.

17 Q MS. BENTIVEGNA: Yes, I understand, but what — as a placeholder, the
18 numbers you'll be providing us — those are the current cost of capital and rate of return
19 that ATCO Electric has, or am I mistaken?

20 A MR. FREEDMAN: No, I don't believe we used the placeholders that were
21 currently in place for 2007 and 2008. I think we put in, in the test period, a forecast and
22 said, "These are placeholders." I don't think it was a continuation of what we had in
23 2008.

24 Q MS. BENTIVEGNA: Okay. So would you mind, then — you know, stating what
25 the current cost of capital and rate of return for 2007 and 2008 for ATCO Electric plus,
26 then, what's forecast for 2009 and 2010 — as a placeholder?

27 A MR. FREEDMAN: Well, for 2008, for ATCO Electric transmission, the equity
28 structure is 35%; for ATCO Electric Distribution, the equity structure is 37%. The return
29 on equity formula for 2008, I believe, was 8.75%. That would have been for 2008. So I

1 think — that would be the 2008. I'll undertake to provide what we put in as placeholders
2 for 2009 and 2010.

3 Q MS. BENTIVEGNA: Thank you. Now, just to follow up, I was going to ask Ms.
4 McShane if she could quantify how the return and capital structure for YECL should be
5 different for YECL versus the parent, ATCO Electric — I mean, looking at the 2008-09.

6 A MS. McSHANE: Sorry, I don't understand what you're asking.

7 Q MS. BENTIVEGNA: Well, if you could explain why this Board should grant a
8 different cost of capital structure for YECL and a different rate of return than its parent. I
9 know there has been a lot of discussion on risk and that, but I'm still not clear, so if you
10 can just clarify.

11 A MS. McSHANE: So basically what — I guess, first of all, I would say that if I am
12 going to make a comparison between Yukon Electrical and ATCO Electric, I would be
13 looking at the distribution company. I would separate that out from the transmission
14 company, because they do have separate capital structures for each one.

15 So having said that, then looking at the cost of debt — you had asked a question
16 about: how does the cost of debt for ATCO Electric compare to the cost of debt for
17 Yukon Electrical? Of course, the difference in the cost of debt — if we're talking about
18 the embedded cost of debt — has to do with the timing of particular debt issues. If I took
19 a real extreme example and said, "Yukon Electrical hasn't needed any new long-term
20 debt since 1997" for whatever reason — I mean, its embedded cost of debt could be 8%,
21 because that's the cost the last time it needed debt. And ATCO Electric's embedded cost
22 of debt might be 6.2%, because it has needed new debt issues all along the way since
23 1997.

24 So unless you really know, in-depth, what the difference in the pattern of raising debt
25 capital over time has been, I don't know that you can come to any kind of conclusion
26 about whether Yukon Electrical's embedded cost of debt is appropriate versus ATCO
27 Electric's.

28 The same concept has applied all through time that when each of these utilities have
29 needed funds, then they get those funds at the time they need them at the cost to CU Inc.
30 So the ATCO Electric and Yukon Electrical are being treated similarly.

1 With respect to the rate of return on common equity, I think there are two issues. One
2 is, you know, what's the benchmark return, and the other is, is there a rationale for adding
3 something to the benchmark return for Yukon Electrical.

4 So if we just start off with the first issue, is there something in the benchmark return
5 or the generic return on equity that's different between the two? Well, there may be a
6 timing difference in terms of what was put in the application — I don't know. But for all
7 intents and purposes, the determination of that number was the same.

8 Now, in the case of ATCO Electric, their numbers are actually, as Mr. Freedman said,
9 placeholders. Presumably they're going to be going into the generic cost-of-equity
10 proceeding and putting in their best estimate of what the return on equity that meets the
11 fair return standard should be for test years 9 and 10. Whereas what Yukon Electrical is
12 asking is simply —

13 This hearing in Alberta may not be complete until fourth quarter 2009. So let's just
14 use the Board formula that exists right now and use that as the basis for 8 and 9, and if the
15 next time we come in for a rate case, once these rate-of-return-on-equity issues have been
16 looked at, at the National Energy Board and at the AUC, we will consider some
17 difference, if necessary, in the approach that we took.

18 So that leaves us the one last issue of what the differences are in the risk. My view is
19 that the proper capital structure for ATCO Electric Distribution should not be 37%; it
20 should be something higher than that. So we have to realize that there is a dynamic
21 situation going on with regard to the capital structures in Alberta, in the first instance. So
22 what the difference is, is basically between 40% with 10% preferred shares,
23 approximately, in Alberta, and a 47.5% equity ratio and approximately 50 basis points in
24 return is largely a function of the difference in the economic base the size of the utility
25 and the small but significant amount of generation that sits in the Yukon Electrical
26 operations.

27 Q MS. BENTIVEGNA: You just said "small and significant" — I don't know?

28 A MS. McSHANE: I think I said "small but significant". If I didn't, I meant to,
29 sorry.

1 Q MS. BENTIVEGNA: I was wondering how we could be both small yet
2 significant.

3 A MS. McSHANE: Material. How's that?

4 Q MS. BENTIVEGNA: Would I be correct in thinking that ATCO Electric has
5 small generation units?

6 A MS. McSHANE: They do have some small remote communities. Having said
7 that, that was never an issue in setting the capital structure for the utilities in Alberta —
8 never mentioned once. It was strictly a distribution wires number that was applied across
9 the board.

10 Q MS. BENTIVEGNA: Can you speculate on any reason why that wouldn't be
11 mentioned, but it's significant here?

12 A MS. McSHANE: Why wasn't it mentioned?

13 Q MS. BENTIVEGNA: Well, why it wouldn't be if we're talking about the
14 different functions.

15 A MS. McSHANE: Because I think that's basically — what happened was that
16 people were looking at functions. They weren't looking at company-specific operations.
17 They were saying how does transmission as a function in Alberta differ from distribution
18 as a function in Alberta? There was no real attempt to say, well, ATCO Electric is
19 different from FortisAlberta because ATCO Electric has XYZ differences. They really
20 were sort of looked at as pretty much synonymous. Synonymous is a bad choice of word,
21 but as the same type of entity without really differentiating.

22 Q MS. BENTIVEGNA: Thank you. Now going on with the cost of capital — Mr.
23 Freedman, I think this might be more appropriate for you. How would the use of
24 extensive affiliate transactions or agreements affect business risk? Maybe this is for Ms.
25 McShane — we're talking about business risk, so whichever one of you wants to answer
26 the question.

27 A MS. McSHANE: Maybe I should start. Affiliate transactions — how do they
28 affect business risk? On principle, they shouldn't change it, but I suspect that they
29 increase it as a matter of practicality, just because of the level of scrutiny they go through
30 in the regulatory arena. They have to meet very specific code of conduct. They have to be

1 priced in a certain way. In practice, when people look at the cost to capital, affiliate
2 transactions are typically not something that get taken into account; nor is it anything I've
3 ever seen any investor look at.

4 Q MS. BENTIVEGNA: Did I misunderstand you? Did you say that it increases the
5 business risks?

6 A MS. McSHANE: I would think to some extent the fact that there is a scrutiny of
7 affiliate transactions increases the possibility of disallowance. In that sense, yes.

8 Q MS. BENTIVEGNA: Do you have any examples?

9 A MR. FREEDMAN: The level of scrutiny that ATCO Electric faces in their
10 proceedings because of affiliate transactions is a lot more significant than what a similar
11 utility is going to face. For example, our level of disclosure, for most other utilities in
12 Alberta — for I-Tek costs, there's one line in their filings for I-Tek costs — that's in the
13 uniform system of accounts. But for ATCO Electric, we file significant detail on every —
14 similar to what we filed in response to an IR — where we file all the units and the prices
15 for each and every service that we are getting from I-Tek. So that's an example of a
16 greater level of scrutiny on that particular cost.

17 And it's the same whether we get services from the ATCO head office, so there is
18 that. That's what we've experienced and, in looking at other filings, that's what we've
19 observed.

20 Q MS. BENTIVEGNA: I guess I'm still having trouble understanding how that
21 increases the business risk, the fact that there's scrutiny. So my question goes back to,
22 have these costs — are you aware of any examples where these costs have been
23 disallowed?

24 A MR. FREEDMAN: Well, yes. In this application, we are filing decreases as a
25 result of the whole process that has gone on since 2003, and it's being finalized right
26 now. So as a result of that process on our I-Tek costs, our I-Tek costs have been reduced
27 and these reductions are flowing through to customers.

28 Now, I'm not aware that similar disallowances have occurred in the Fortis I-Tek or
29 these other utilities' I-Tek costs. So, yes, ATCO has received disallowances in their
30 affiliate costs which have been passed through to customers.

1 A MS. McSHANE: I would just sort of follow up on that and just say that, when I
2 started this, saying that in practice it likely increased the business risk, I think the
3 important point, which maybe I didn't get across the way I should have, was that this is
4 not something that an investor's going to look at when he looks at risk. So while what I
5 said may be true, it is not something that gets taken into account in estimating what the
6 cost of capital is.

7 Q MS. BENTIVEGNA: All right. Thank you. Now, would you agree that YECL
8 contributes to the size and diversity of CU Inc.?

9 A MS. McSHANE: I think I already answered that question in an IR — in a very
10 small sense, sure. I mean, it logically follows, but it's so small that it would have a very
11 small impact on the size and diversity.

12 Q MS. BENTIVEGNA: Okay, but yes, and I believe that was YUB-YECL-33(c),
13 but I wanted to ask you, from your answer, it does factor in the mix. I understand you just
14 said it's small but when debt capital is raised, should the actual cost of debt be used?

15 A MS. McSHANE: So, let's say CU Inc. — we'll continue to use CU Inc., or let's
16 not. Let's use another company that actually does things a little bit differently.

17 A small gas distributor in Quebec, owned by a larger gas distributor, needs cash,
18 needs funds. Its parent goes out and raises the funds on behalf of the company and lends
19 them to the company at the cost at which that company could have gone out and raised
20 the funds on its own, with perhaps a little discount. That is an accepted principle. I mean,
21 it is the pure stand-alone principle. The small company is, in effect, taking up some of the
22 debt capacity of the parent.

23 The parent's debt cost is in reality a composite of the stand-alone costs of its various
24 subsidiaries, operating companies. So charging that company what it would have cost
25 them to go do it themselves is an acceptable principle.

26 CU Inc. doesn't do that. They have taken, through the years, they have taken the —
27 they have proceeded on the basis of mirroring down to each of the companies — they are
28 at CU Inc.'s actual cost of debt. Each of the utilities benefits from that.

29 Both approaches have merit. I can see that one can make a cost argument for charging
30 a subsidiary what it would have cost them on their own stand-alone risk basis to get the

1 money themselves. But, in this case, they're mirroring down the money at the actual cost;
2 I don't see that — there shouldn't be any real controversy over whether that is the right
3 thing to do, if that is what the company proposes to do.

4 Q MS. BENTIVEGNA: Now, would you go to 8-2 of your application. This is the
5 no cost capital. I was interested in on page 8-2, close to the bottom, or line 22 and 23,
6 where it states — this is page 8-2 — “Both the pension plan and OPEB have been
7 accounted for on the cash basis in the test period. Prior to 2008 only the pension plan was
8 on the cash basis.”

9 My question is, why did YECL change from the accrual to the cash basis for the
10 OPEB?

11 A MR. FREEDMAN: Two reasons — the first reason is that the other affiliated
12 companies, ATCO Electric, its parent company, are on the cash basis. The second reason
13 is that it reaches its revenue requirement as well. Currently, the accrual basis — and I was
14 just looking at Schedule 8.4. You can see on Schedule 8.4, line 13, have been the charges
15 that have been experienced. So that would have been the accrual basis. Then you see the
16 cash payments on line 14. These have been less than the charges. So what we did is we
17 moved to the cash basis to be consistent with the affiliate companies and with our parent
18 company and it did reduce the revenue requirement in the test period.

19 Q MS. BENTIVEGNA: With the cash basis, as I understand, you did it in relation
20 with your affiliate — the other ATCO companies. But is that consistent with the IFRS
21 system?

22 A MR. FREEDMAN: The IFRS is going to be implemented in 2011 with
23 comparative numbers in 2010. There are still issues to deal with IFRS and we're not
24 sorted all the way through it. Currently, I would say that it may be in conflict with IFRS,
25 although the ability to set up regulatory assets and liabilities under IFRS has not been
26 fully determined. Impacts, if any, by going to a cash basis are not fully known at this time
27 under IFRS. IFRS doesn't impact the test period.

28 Q MS. BENTIVEGNA: Thank you. This question relates to YUB IR No. 38(d) and
29 (e). Now, subsequent to the Information Responses of August 19, 2008, have any

1 decisions been rendered with respect to rate of return and capital structure for either
2 Northland Utilities (NWT) Limited or Northland Utilities (Yellowknife) Limited?

3 A MR. FREEDMAN: Not at this time.

4 Q MS. BENTIVEGNA: Thank you. Now earlier this morning, Mr. Freedman, when
5 you were discussing Schedule 8.3 regarding the issue of debt for the test period for 2008,
6 the forecast was for Series T to be issued. I understood you correctly — that's no longer
7 the plan after discussion with CU — and A and E that there won't be any issue.

8 A MR. FREEDMAN: What I said was that we will do an issue of \$2,150,000.
9 What I said was that it won't be at that 6.6%. ATCO Electric did receive financing in
10 May which, at that time, Yukon Electrical didn't have any of that mirrored down. But
11 given the situation we find ourselves in, and ATCO Electric and CU Inc. are not going
12 for further financing this year, which was what our understanding was back when we did
13 this filing — but that is not going to happen. So Yukon Electrical will take the
14 \$2,150,000 financing, and we will retroactively mirror down that May financing that
15 happened with ATCO Electric at the — I think the composite rate I quoted was 5.623%.
16 But it would be at the composite rate of that May financing. So we are going to do the
17 financing, but not at the rate that was in this forecast.

18 Q MS. BENTIVEGNA: All right. Will you be amending in a compliance filing,
19 then, the schedule?

20 A MR. FREEDMAN: If so directed. I mean, Yukon Electrical's position is that
21 when we prepare our filing, we prepare it with the best information available at the time
22 of the filing, and that's how we base our forecasts. So, you know, I think that would be
23 our position, and we'll await the Board's direction on that matter.

24 Q MS. BENTIVEGNA: But were there not costs included for that issuance that
25 would no longer be required in 2008?

26 A MR. FREEDMAN: Well, the cost of the issuance, we will still — when I said the
27 weighted average cost of the two issues, that will include — we will be charged the .05
28 issue costs that will come as part of that cost.

29 Q MS. BENTIVEGNA: All right. And do you still, then, maintain that for 2009, for
30 the "U" series that it would be at 6.55%?

1 A MR. FREEDMAN: Plus the .05. Yes, that is correct. That would still be our
2 forecast, even with — we do it with the information that we had at the time of the filing.
3 And given the situation now, I think that would still be our forecast for the 2009 issue.

4 Q MS. BENTIVEGNA: Thank you. Those are my questions, Madam Chair.

5 MS. SHANKS: Thank you, Ms. Bentivegna.

6 I'll ask at this time if there are any questions for the panel from the Board. There doesn't
7 appear to be any, in which case I'll hand the microphone over to you, Mr. Keough.

8 MR. KEOUGH: Thank you, Madam Chair, I have no re-direct.

9 MS. SHANKS: In that case, I'd like to thank the panel for the time they've spent
10 today — the long day we've had, and I'll excuse the panel at this time.

11 I note that it's 4:30 p.m., and we had a break at 3:00 p.m. I'd like to invite the
12 depreciation panel up at this time and see if we can't get started a little bit on the cross-
13 examination of them, and we'll see where we go with that, with perhaps another short
14 break later on.

15 I think we'll take a 10-minute break.

16

17 (PROCEEDINGS ADJOURNED)

18 (PROCEEDINGS RESUMED)

19

20 MS. SHANKS: Please be seated.

21 Mr. Keough, I'll turn the mike over to you for opening.

22 MR. KEOUGH: Thank you, Madam Chair. This is Yukon Electrical's third
23 panel, the depreciation panel, comprised of Mr. Larry Kennedy, closest to the Board, and
24 of course, Mr. Freedman, who is now becoming a familiar face. Mr. Kennedy's report is
25 located under Tab 7, Section 7, Attachment 1 and that is the Gannet Fleming report, part
26 of Exhibit B-1, the application.

27 Mr. Kennedy, like other parties this morning, or Ms. McShane, has prepared a
28 number of IR responses and again, I will not take him through each one. I want to have
29 him adopt his evidence. I will ask him to adopt the Information Responses he has
30 provided.

1 Mr. Kennedy is also a recognized expert in this area and has testified in many
2 jurisdictions. He has been around so long I know that he is a member of a depreciation
3 society, which is a rather scary thing — I'm not sure what they do, Madam Chair. Unless
4 you want, I will also not have him take you through his experience and expertise. We can
5 dispense with that and maybe save some time.

6 MS. SHANKS: That would be fine.

7 MR. KEOUGH: Alright, Madam Chair. Mr. Freedman is also on the panel and he
8 is here to speak to the company's aspects of the appreciation, specifically those he didn't
9 speak to yesterday, I suppose. Maybe, at this point, we can have Mr. Kennedy sworn, and
10 Mr. Freedman is still under oath.

11

12 **YECL WITNESS SWORN:**

13 **LARRY E. KENNEDY, SWORN**

14 **DAVID FREEDMAN, RESUMED**

15

16 **YECL Panel 3 examined by Mr. Keough**

17 Q MR. KEOUGH: Madam Chair, I will now proceed to have Mr. Kennedy adopt
18 his evidence. Mr. Kennedy, do you have before you copies of your report, that is at Tab
19 7, Attachment 1, to the YECL or Yukon Electrical application, and also copies of the
20 Information Responses you prepared with respect to that evidence?

21 A MR. KENNEDY: I do.

22 Q MR. KEOUGH: And, sir, were those materials prepared by you or under your
23 direction?

24 A MR. KENNEDY: Yes, they were.

25 Q MR. KEOUGH: And, sir, do you have changes, corrections or updates to make to
26 that evidence?

27 A MR. KENNEDY: None that I am aware of.

28 Q MR. KEOUGH: And sir, do you adopt those materials as your testimony in these
29 proceedings?

30 A MR. KENNEDY: Yes, I do.

1 MR. KEOUGH: Thank you. Before I turn the witness over, Madam Chair, I
2 understand Mr. Freedman has a clarification or correction from the transcript of your
3 depreciation evidence of yesterday.

4 MR. FREEDMAN: Yes, that is correct.

5 MR. KEOUGH: Would you please proceed.

6 MR. FREEDMAN: Yes. I would like to go to page 67 of the transcript. There
7 was an exchange between Mr. Landry and myself. The question was, "It's simply
8 effectively, in terms if it were talking about financial impact, there would be a cash
9 impact, would there not?" Let me back up. It is really on line 10, line 9 and 10, with Mr.
10 Landry, where he said, "if it was decided by this Board that it was more appropriate to
11 take the ASL approach as opposed to the ELG approach, that wouldn't impact your
12 return. Is that a fair statement?" My response was, "Yes, that would be a fair statement."

13 But, I would like to, for the record, say that yes, there would be impact on return as a
14 result of the fact that lower depreciation results in higher rate base, which in turn will
15 increase the company's return. As well, there could be a financial impact due to the effect
16 on FFO coverage ratios. So there could be that impact if we go the ASL method. I just
17 wanted to clarify the record for that.

18 Q MR. KEOUGH: Thank you.

19 Mr. Kennedy, could I take you to page 63 of yesterday's transcript? On that page, Mr.
20 Landry is summarizing, I suppose, your views with regard to the ASL and ELG
21 approaches and, given that he was summarizing what you were purported to have said, do
22 you have any comments on the summary he has made there?

23 A MR. KENNEDY: Yes, I do. Specifically at page 63 of yesterday's transcript on
24 lines 19 through 21. Mr. Landry posed the question as follows: "And, sir, would you
25 agree with me that Mr. Kennedy accepted at least the fact that both ASL and ELG were,
26 from a regulatory perspective, appropriate depreciation methodologies?"

27 I would just like to make some comments with regard to that characterization of how
28 I feel about ELG versus ASL. My evidence in the YEC case, which I think is what was
29 leading Mr. Landry to believe that ASL is an appropriate method, was very specific and
30 carefully worded at the time of that proceeding.

1 In response to Information Request in this case, YEC-YECL-17(b), I've provided a
2 quote from that study. In that study — or in that quote — I suggest that “Although, in the
3 opinion of Gannett Fleming, the equal life group (sic) procedure is superior to the average
4 service life procedure in matching depreciation expense, with the loss of service value,
5 the average life procedure ...”

6 There should be the word “service” in there. I just noticed now. “... the average life
7 procedure is also a widely accepted method.”

8 Now, something being “widely accepted” and “appropriate”, I think, are two different
9 functions. In fact, my view is that while ASL is accepted, there is no doubt in my mind
10 and in the mind of, I would suggest, many depreciation experts, that the equal life group
11 is, in fact, superior.

12 I would like to just indicate a few reasons why I think it's superior. It's superior in
13 that it provides a much closer matching to the actual consumption of the service value of
14 any asset to the depreciation expense that's recovered through tolls from the customers
15 than is the average service life. Secondly, the equal life group is becoming even more
16 important now than it was at the time of the YEC study. Right now, with the advent of
17 the International Financial Accounting Standards, and specifically International Financial
18 Accounting Standard Number 16, there are some very precise pronouncements with
19 regard to how companies shall record depreciation. They suggest that depreciation should
20 be recorded on the basis of the estimated life of each asset.

21 There is no doubt, based on the examples that I provided in my Information Request
22 response, that the equal life group provides a very exact matching of each asset within the
23 group to the depreciation expense that results. In contrast, the average service life method
24 can only be considered to very loosely comply to that standard.

25 My phone, quite literally, has been ringing off the hook since basically January of this
26 year, with utilities that have previously used average service life, seeking some opinion as
27 to whether or not they were complying with IFAS-16 in the circumstance that they would
28 convert to the equal life group. And in my view, they would.

1 I think the fight may occur in the regulatory rooms across the country over the next
2 year, as companies start to attempt to implement IFRS to see an increase in the use of the
3 equal life group.

4 Secondly, I have a very strong opinion about changing midstream. When you have a
5 company that is partly depreciated and you change a very important policy midstream, it
6 has a very large financial impact, both currently and it would defer a very large impact to
7 future customers. The regulatory concept of generation of equity, I think, is harmed (a)
8 with the use of ASL, but even exaggerated in the cases when you move from ASL to
9 equal life group. I just wanted to put that clarification on the record, such as I would have
10 yesterday, had that question been posed to myself.

11 MR. KEOUGH: Thank you. Mr. Kennedy, could you also refer to Volume 1, page
12 76, lines 16 to 18, where Mr. Landry again, I guess, suggests what your suggestion might
13 be with regard to a site removal and restoration account issue. Sir, do you have any
14 comments on Mr. Landry's suggestion regarding your suggestion?

15 MR. KENNEDY: Yes. I just want to make sure I get the appropriate line here for the
16 record. At lines 16 through 18: Mr. Kennedy suggested to you — being YECL — that
17 you need to increase the amount on a yearly basis to get that account up to even higher
18 levels than that. Is that a fair statement? I think I may have slightly misread that.

19 My response to that is that my purpose for the recommendation of net negative
20 salvage is not to get the account up. The purpose is to properly align the recovery of the
21 cost associated with an asset to the toll payers that consume that asset over its life. The
22 use of FRSR — by the time I'm finished today, I'm sure I'll misstate that acronym many
23 times — is really a phenomenon of BC Hydro and YEC. I'm not familiar with the use of
24 that type of fund, or that terminology, anywhere else.

25 However, having said that, the use of or the fact of collecting negative salvage in
26 depreciation rates is widely accepted. And I would suggest far more utilities across this
27 country and in the United States collect the costs of removal of assets in depreciation for
28 regulatory purposes than are those utilities that do not.

29

1 When the ARO concept first came out, and the Canadian Institute of Chartered
2 Accountants implemented section 31(10) a few years ago, there was a thought that the
3 regulatory compact would change to include only ARO. That may have been the case
4 even as late as when YEC was before this Board. That thinking was going out and was
5 definitely part of the thought process when BC Hydro went to the BCUC.

6 Since that time, most utilities recognize that there is, in fact, a significant difference
7 between FRSR or AROs and the recovery of the costs of retirement through tolls.

8 One is, if you will, a business obligation, or a business function. The other one is a
9 legal obligation and ARO triggers are very precise triggers — and most of them very
10 legal in nature. And so most utilities have gone down the path of having a different
11 recovery mechanism and tolls for the removal of assets than they would necessarily
12 report on their financial statements for asset retirement obligations.

13 MR. KEOUGH: Thank you, Mr. Kennedy. Thank you, Madam Chair. The
14 witnesses are available for questioning.

15 MS. SHANKS: Mr. Landry, I assume you are prepared to proceed.

16 MR. LANDRY: Madam Chair, I'm actually a little bit taken aback by the way in
17 which my friend has approached this. But, I'll see where I can go. I may have a comment
18 at the end of it.

19 **YECL Panel 3 cross-examined by Mr. Landry**

20 Q MR. LANDRY: Mr. Kennedy, you gave a fair amount of evidence in response to
21 something from the transcript on two subjects that I am not aware of that you commented
22 on in your evidence that was filed prior to today. The first relates to what you have been
23 doing and what your views are in relation to — and I'll get the acronym wrong here —
24 IFRS? Is that the new accounting —

25 A MR. KENNEDY: The International Financial Reporting Standard, yes.

26 Q MR. LANDRY: The evidence you gave about what is happening and the
27 pronouncements that are being made and the people, et cetera, et cetera — that is
28 nowhere to be found in your evidence that you filed to this point in time, is it?

29 A MR. KENNEDY: I guess the easy answer is that I don't think it is, without taking
30 —

1 Now I would just like to maybe comment on that slightly —

2 Q MR. LANDRY: Well, no, I wanted to know whether it was in your evidence.
3 That is my first question. My second question is that you've also made a lot of comments
4 about ARO and FRSR — I think you and I both have a problem with that acronym.
5 Again, I would say to you, sir, that I don't remember seeing anything about that in terms
6 of what has happened since 2005 anywhere in your written evidence.

7 MR. KEOUGH: Well, Madam Chair, it is very clear that the additional
8 clarifications that Mr. Kennedy provided arose specifically out of Mr. Landry's efforts to
9 comment on or quote or summarize or reach conclusions regarding what Mr. Kennedy's
10 views were on topics in the transcript — One of the dangers of crossing without the
11 witness being there, which I cautioned repeatedly yesterday, but he continued to plow
12 ahead. He purported to put on the record comments attributed to Mr. Kennedy, which
13 upon review by Mr. Kennedy, we felt there was a need for clarification. So if there is a
14 surprise here, it is coming out of my friend's own questioning. And, yesterday, I told him
15 repeatedly, "Why don't you wait until Mr. Kennedy gets here?"

16 MR. LANDRY: Madam Chairman, you know, these repeated interruptions of my
17 cross-examination are not being very helpful. I never said anything, but asked the
18 question of the witness — those two questions, period. They will go on the record, and
19 we'll have to decide which way we're going to go at the end of the day. All I wanted to
20 ask this witness is whether or not the clarification. You, Madam Chair, and the rest of the
21 Board can decide whether Mr. Keough's question of Mr. Kennedy, relative to the way I
22 summarized it, was an appropriate way to get this evidence out. We'll see about that
23 when we argue on the point. I just asked the question and I'd like an answer to the
24 question that I just asked: whether or not in his written evidence there is anything in
25 relation to this concept of what has happened since 2005 vis-à-vis ARO and FRSR — I
26 think I got the acronym right. It is my understanding there is and I'd like an answer to
27 that question.

28 MS. SHANKS: The Board certainly takes note of Mr. Keough's comments. I
29 think that the question can be answered, as well.

1 A MR. KENNEDY: I think I answered the question already. The answer is that
2 there is nothing in my written testimony regarding —

3 Q MR. LANDRY: That's the only question I wanted answered for this purpose,
4 okay, Mr. Kennedy?

5 A MR. KENNEDY: I haven't finished my sentence yet. There's nothing in my
6 answer regarding the comments I made on circumstances since 2005. There is a
7 significant amount of evidence in my written record on the concept of net negative
8 salvage and on the use of the equal life group and the superiority of the equal life group
9 to ASL.

10 Q MR. LANDRY: I have no difficulty with that, sir. I am talking about the
11 evidence in which you put on the record today in relation to ARO and what has happened
12 since 2005. There's nothing in your written evidence, that I'm aware of, that deals
13 specifically with that issue.

14 A MR. KENNEDY: Of circumstances since 2005? I agree.

15 Q MR. LANDRY: Well, sir, let me just take you to this statement that you seem to
16 object to. For the record, Madam Chair, the expert report that was filed by Mr. Kennedy
17 in the Yukon Energy proceeding is attached as Attachment 1 to YEC-YECL-II-2(b)(iii).

18 MS. SHANKS: Sorry, Mr. Landry, could you repeat that?

19 MR. LANDRY: I can. It is YEC-YECL-II-2(b)(iii), Attachment 1.

20 MS. SHANKS: Thanks very much. Just give us a minute to get there.

21 MR. KEOUGH: I don't mean this to be an interruption; I mean this to be helpful.
22 I am not sure that it is attached to the response — at least, my version of the response.
23 The document to which my friend refers was attached to the questions that were posed by
24 YEC to Yukon Electrical. So if you are going to the response, I am not sure you'll find it
25 — at least, it's not on mine.

26 MR. LANDRY: I could have it wrong. I have it marked on the top of mine. It's
27 definitely in the record, Madam Chair.

28 MS. SHANKS: We don't see it under the response.

29 MR. LANDRY: If we could just find it for the record. I think it's important that
30 you have it in front of you.

1 MS. SHANKS: Yes, we will find it. There's a paper/IT war here.

2 MR. LANDRY: While the Chair is looking for that, Mr. Kennedy, you have your
3 expert report?

4 MR. KENNEDY: I have it and I'm just going to ask for your indulgence, Mr.
5 Landry. I have actually got my own hard copy of this report. If we happen to get confused
6 about a page missing somewhere along the line —

7 MR. LANDRY: That won't happen.

8 MS. SHANKS: Ms. Lemke, maybe you could give us a hand here. You have to
9 realize, we are a part-time Board. It's beginning to show.

10 MR. LANDRY: It's probably our mistake, in terms of how I referenced it. I
11 apologize.

12 MS. SHANKS: Mr. Landry, could you just show us what the front of your paper
13 copy looks like there? It's C1-9.

14 Thank you. I think we all have it in one way or another.

15 MR. LANDRY: I'm going to refer to the quote that was referred to earlier but it
16 is on page I-5 — I think that is the way it is referred to at the bottom.

17 MR. KENNEDY: Yes.

18 MR. LANDRY: Do you have that sir?

19 MR. KENNEDY: I have that.

20 Q MR. LANDRY: Sir, I understand — and I'll just quote it and get you to
21 acknowledge that was there, but after that quote there is this statement. It says, "Gannett
22 Fleming agrees that toll stability," and I assume by "toll stability" — it is not a term that
23 we use up here that much; it is "rate stability." Is that fair?

24 A MR. KENNEDY: Yes. Customer rate stability, yes.

25 Q MR. LANDRY: Okay, "Gannett Fleming agrees that toll stability is an overall
26 rate making objective that needs to be considered in the development of appropriate
27 depreciation policies. As such, Gannett Fleming accepts the decision of Yukon Energy
28 Corporation to convert to the average service life procedure in the calculation of the
29 depreciation rates." Do you see that?

30 A MR. KENNEDY: I do.

1 Q MR. LANDRY: Now, the reasoning behind that, sir, was that they were worried
2 about the increase that they were requesting after they hadn't been to the Board for a
3 number of years and they wanted to try to keep that increase down as much as possible. Is
4 that a fair summary?

5 A MR. KENNEDY: I have to do two things, Mr. Landry, and then maybe I can
6 answer your question. First, Mr. "Gannett," not "Garnett," would be our firm. So it's
7 Gannett Fleming.

8 Q MR. LANDRY: I apologize for that, sir.

9 A MR. KENNEDY: Secondly, I'm going to need you to undertake with your client
10 to have me disclose maybe some of the confidential conversations we had at the time of
11 the YEC application.

12 Q MR. LANDRY: Well, sir, let's not go there. We don't need to go there
13 because you've said, "agrees that toll stability". So presumably, toll stability, i.e. rate
14 stability, was the key issue that Yukon Energy — that you're referring to here — told to
15 you, for you to come to the acceptance of their decision. That's what it says here. That's
16 the way I read it. You don't need to go any further than that.

17 A MR. KENNEDY: No, I'm just trying to recollect if that was the — I'm going to
18 back up one step, Mr. Landry.

19 I can't presume to know all the reasons that YEC directed me to use the ASL method
20 rather than the equal life group method. At the time that study was prepared, my primary
21 recommendation was for YEC to use the equal life group method, and this is why I'm a
22 bit hesitant to disclose much more than that because we'll get into conversations we had
23 with YEC.

24 Q MR. LANDRY: Sir, I don't want you to get into conversations because it is going
25 to get us into very difficult territory because I, myself, was involved in some of those
26 conversations. We don't want to go there.

27 Let me just put it to you this way; I'll try it simply: what you put in your report at the
28 time, you said, rate stability was (1) "an overall rate making objective that needs to be
29 considered in the development of appropriate depreciation policies." Correct?

30 A MR. KENNEDY: That's correct, yes.

1 Q MR. LANDRY: And you accept the decision to convert to that.

2 Now, I took that to mean, sir — and I'm asking you to agree — let's forget about
3 whether it was the only one, but that was one of the reasons, obviously, that you accepted
4 that decision. Correct?

5 A MR. KENNEDY: Oh, why I accepted the decision? Yes. Not why I made the
6 decision. That is the distinction that I was trying to make.

7 Q MR. LANDRY: Now, sir, the other thing that I would say to you, sir, is that you
8 seem to go over, very quickly, the fact that there are a number of regulatory bodies in this
9 country who have accepted ASL for various utilities, correct?

10 A MR. KENNEDY: Correct.

11 Q MR. LANDRY: And, Mr. Kennedy, that includes the BCUC as an example?

12 A MR. KENNEDY: Yes.

13 Q MR. LANDRY: It includes for BC Hydro, correct?

14 A MR. KENNEDY: Yes.

15 Q MR. LANDRY: It includes for BC Transmission Ltd.?

16 A MR. KENNEDY: Yes.

17 Q MR. LANDRY: It includes FortisBC?

18 A MR. KENNEDY: Yes.

19 Q MR. LANDRY: It's just your view that if, indeed, perhaps, in the future they're
20 going to look at it, they may change their view. Is that a fair summary of what you said?

21 A MR. KENNEDY: When you say "they're" I am not sure if you mean —

22 Q MR. LANDRY: I am talking about the regulatory commissions.

23 A MR. KENNEDY: Oh, the commissions. I can't speak on behalf — I can only
24 speak on behalf of the phone calls that are received from clients suggesting they may
25 need to take an issue to their regulatory bodies.

26 Q MR. LANDRY: They may take it to the regulatory bodies, but at least to this
27 point in time there are regulatory bodies in Canada that have accepted ASL as an
28 appropriate depreciation methodology for certain utilities?

29 A MR. KENNEDY: Oh, there is definitely, and there's definitely a number that
30 have accepted the equal life group.

1 Q MR. LANDRY: Well, I know you like to add the equal life group to every
2 question that I'm going to ask you. My question was very specific: there are a number of
3 Canadian regulatory bodies, including the BCUC, that have accepted ASL as an
4 appropriate depreciation methodology for utilities.

5 A MR. KENNEDY: Oh, yes.

6 Q MR. LANDRY: Sir, there was one other comment you made that kind of
7 surprised me a little bit and that is that you said — I'll make sure I get my notes here so I
8 get it right.

9 MR. KENNEDY: Mr. Landry, before we go on to maybe a different topic —

10 MR. LANDRY: Well, I'm going to a different topic, Mr. Kennedy. If your
11 counsel would like to redirect you, that is the appropriate way to go. You have answered
12 your question. I am going to a different topic.

13 If I could just have a moment, Madam Chair, I'm just looking for an attachment.

14 MR. KEOUGH: While we're waiting, Madam Chair, I did find that it's Exhibit
15 C1-9, for those who are still looking.

16 MS. SHANKS: I didn't know you were still looking.

17 MR. KEOUGH: No, I had found it for a while, but I just figured that I had to tell
18 everyone after I found it.

19 Q MR. LANDRY: Sir, one last question just to make a clarification for the record. I
20 trust that from what my friend has told me you were responsible for answering the
21 questions in YEC-YECL-II-1. Is that a fair statement, sir?

22 A MR. KENNEDY: Yes. I did have some support on answering those questions
23 from ATCO Electric staff or YECL staff.

24 Q MR. LANDRY: You did?

25 A MR. KENNEDY: I had some assistance, but I'll take responsibility for the
26 responses.

27 Q MR. LANDRY: And you list in that the 20 utilities that use the ASL method?

28 A MR. KENNEDY: I'm assuming you're looking at the list that's provided in
29 response to YEC-YECL-II-1.

30

1 Q MR. LANDRY: Yes, that's correct. Sir, I assume this is a mistake, sir — I don't
2 know. But the one on the second page of that — you have "Yukon Electric Company".
3 Did you mean "Yukon Energy Corporation"?

4 A MR. KENNEDY: Yes, I apologize for that.

5 MR. LANDRY: Madam Chair, those are all the questions I have.

6 MS. SHANKS: Thank you, Mr. Landry. I don't want to miss any other parties
7 that have questions for the depreciation panel. I'll call Mr. Maissan next.

8 **YECL Panel 3 cross-examined by Mr. Maissan**

9 Q MR. MAISSAN: Thank you, Madam Chair. I have only question, and that is
10 based on my ignorance of depreciation. I thought, in the evidence provided, that
11 depreciation was going to follow those curves called "Iowa curves" and I understand that
12 it's going to follow the straight-line method. I'm a bit confused now as to what Iowa
13 curves are and what is significant about all of these tables and Iowa curves produced that
14 when I looked at them, various Yukon Electrical assets didn't seem to follow those
15 curves at all. They seemed to be all over the place. I was asking why we should use the
16 Iowa curves, and now I'm totally confused as to what Iowa curves are, and what they do,
17 and how they fit into depreciation.

18 A MR. KENNEDY: You've come to the right place. I'm looking at my watch and
19 I'm going to decide if I should give you the two-minute answer or the two-hour answer.

20 Q MR. MAISSAN: Probably the two-minute answer.

21 A MR. KENNEDY: I'm going to summarize this at a high level. In our report — in
22 the Gannett Fleming report, starting at page — and bear with me for a second — starting
23 at page II-3, there is a section, entitled "Estimation of Survivor Curves". And over about
24 15 to 20 pages, I describe what an Iowa curve is and how it's calculated.

25 Rather than try to go through all of that in the next two minutes, let me just suggest
26 that an Iowa curve is used in the determination of an average service life. Its purpose is to
27 recognize the fact that utility assets are many in nature of similar homogeneous assets. If
28 you look at power poles, a utility may add hundreds, if not thousands or tens of thousands
29 in one year. And it's unrealistic to expect that they would all come out of service in the
30 same year. Some are hit by drivers in year one, some survive for hundreds of years.

1 So we have a retirement dispersion, similar to the estimation — and Iowa curves
2 really come out of the models used for the insurance industry for the mortality of human
3 beings. Just like human beings, utility assets retire due to a number of forces of
4 retirement. And the Iowa curves simply estimate and try to project that pattern of
5 retirement of the assets. Or, in the insurance industry, they use them to forecast the
6 retirement of human beings.

7 In doing that, at the end of the day, we end up with a life. So you'll see us reference
8 an Iowa curve, for example, R3-45. The "R3" represents the retirement pattern. In other
9 words, the expected amount of retirements that may come out of service earlier or after
10 the average service life, based on a pattern of projected forces of retirement. The "45"
11 recognizes the fact that after all that is considered, we end up with an overall average life,
12 or area underneath that curve, of 45. Okay? So I don't know if I've lost everybody in the
13 room quite yet, but that's the purpose of the Iowa curve — to develop that number — that
14 45 — and the pattern of retirements.

15 Once we have that, we introduce that life into a straight-line depreciation calculation.
16 So there are really two things: one is a method of depreciation, being straight-line; and
17 the second is the estimation of life using the Iowa curve.

18 Q MR. MAISSAN: What is the significance then in the estimation? I understand the
19 difference now. I thought at least half the patterns of actual retirements of the Yukon
20 Electrical plant didn't seem to come anywhere close to the shape of the curve, so how can
21 you pick a curve and say that's the appropriate one? There seems to be no relationship in
22 many of them, in most of them, in fact. A few followed, but most didn't, I would say.

23 A MR. KENNEDY: In a couple of IR responses, one of which I think was one of
24 the Leading Edge Information Request responses, we described the process we use when
25 we select the Iowa curve and the average service life. The use of the statistical mortality
26 study is only one of the tools that we have in our toolbox when we make such
27 estimations. In a number of accounts, there was insufficient experience. We haven't seen
28 enough retirements upon which we can base a meaningful statistical study of retirements.

1 In those circumstances, we use other tools in the toolbox. We compare to comparable
2 companies, or peer companies. We base it on our experience; we base it on manufacturer
3 recommendations. So there are a number of other tools in the toolbox.

4 So in response to — I'm going to get the actual response.

5 Q MR. MAISSAN: Is it LE-YECL-24?

6 A MR. KENNEDY: I think that's one of them, and I'm just going to confirm that
7 very quickly. That's one of them; and also in response to YEC-YECL-17(h). I go through
8 — in fact, in that one, we identify some of the accounts that there wasn't sufficient
9 retirement experience for. In those accounts, we described some of the other things that
10 we've used, some of the other factors we considered, those other tools in the toolbox, if
11 you will, that were used.

12 Now, I would suggest, if you look to the study, the accounts for which there was a
13 complete — in other words, we have Xs to indicate retirement experience, all the way
14 down to zero. In most cases, the selected curve would match to those. It's the ones that
15 had Xs simply across the top of the graph that we did not. And that's because they lacked
16 retirement experience.

17 MR. MAISSAN: Thank you, that was it. Thank you, Madam Chair.

18 MS. SHANKS: Thank you, Mr. Maissan. Are there any other parties before I ask
19 Board staff to cross-examine. Who would like to cross-examine the depreciation panel? It
20 appears not. In that case, I'll ask Ms. Bentivegna to proceed.

21 **YECL Panel 3 cross-examined by Ms. Bentivegna**

22 MS. BENTIVEGNA: Thank you. Good afternoon, panel. I'll be referring to YUB
23 IR No. 23. In there, it's stated that, "As the selection of these depreciation calculation
24 parameters underpins the booked amount of accumulated depreciation, Gannett Fleming
25 does not recommend changes to these policies unless a significant tolling issue results
26 from the continued use of the practices."

27 Q Now a question for you was: can that response be interpreted to mean that economics
28 can drive the application of depreciation rates, not service life?

29 A MR. KENNEDY: Depending on what you define as "economics". If you mean
30 we often introduce into a depreciation life, or a depreciation rate schedule, economic

1 forces of retirement or economic lives — that’s more traditionally done on generation
2 facilities, where there may be an operating licence, for example, or there may be a water
3 licence to drive a hydro dam. In other words, there may be some economic force other
4 than a physical force of an asset retiring that will cause a complete site to maybe retire at
5 a specified date, or may be estimated to retire at a specified date.

6 In those circumstances — and we refer to that in my world as an “economic force of
7 retirement” — we would introduce, I think, economics into such depreciation rates.

8 Q MS. BENTIVEGNA: If I can take you back to the code, it seemed to refer to
9 tolling issues or rate issues. That’s why we weren’t clear as to what it meant in referring
10 to economics — well, in referring to depreciation rates and economic strata. It was
11 because it was rates that were being referred to.

12 A MR. KENNEDY: I am trying to find that reference to rates. Excuse me.

13 Q MS. BENTIVEGNA: I think you referred to it as a significant tolling issue.

14 A MR. KENNEDY: Yes, that would be customer rates and I guess this is maybe
15 what Mr. Landry was referring to, to some extent. There can be circumstances for a use
16 of a depreciation policy that would result in a toll that’s unbearable by the marketplace.
17 It’s no use projecting a depreciation policy or recommending a policy that has absolutely
18 no hope of being accepted by a board or would drive a company to be uneconomic.

19 I could go much further on that, but I am trying to be mindful of answering the
20 question, but not getting too carried away with that.

21 Q MS. BENTIVEGNA: Would you consider — when recommending a method,
22 would you consider those types of issues?

23 A MR. KENNEDY: Of the impact it has on tolls?

24 Q MS. BENTIVEGNA: Yes, the impact it has on tolls and whether it — I think you
25 just said that the company —

26 A MR. KENNEDY: It could drive a company uneconomic?

27 Q MS. BENTIVEGNA: Yes.

28 A MR. KENNEDY: We do consider that, definitely.

29 Q MS. BENTIVEGNA: All right. In this case, what is the effect on rates, in your
30 view and in your opinion, of switching from the average service life to the ELG?

1 A MR. KENNEDY: I just want to be a little bit clear first that we're not suggesting
2 any change. We are suggesting the continuation of the equal life group in this application.
3 This utility has been using the equal life group for many, many years. So I just want to be
4 clear that this isn't a change to equal life group; this is a continuation of the equal life
5 group.

6 Now, I think maybe to answer your question, if we were to change to the average
7 service life, it's a decline of — and it was in an IR response. I am referring now to the
8 response to YEC-YECL-17(e). In that response, we suggested that: "If the ASL were
9 approved by the YUB the forecast depreciation expense for 2008 would be \$3,974,000, a
10 reduction of \$391,000 from the ELG method". Now, what I haven't done in this
11 response, but how that translates into a change in the actual toll, I'm not sure, but it
12 would have a \$391,000 reduction in the depreciation expense.

13 Q MS. BENTIVEGNA: Are you aware, Mr. Kennedy, or maybe Mr. Freedman —
14 has the Board, the YUB, approved the ELG for Yukon Electrical?

15 A MR. KENNEDY: It was previously approved for this company. The company
16 has used it in its depreciation rates right through to now. In fact, it was used by Yukon
17 Energy Corporation through to their last depreciation application. So this Board has used
18 — equal life group has been used in this jurisdiction for, as I am aware of, all applications
19 excepting the last Yukon Energy application. I want to be a bit clearer: I by no means
20 have read every regulatory decision everywhere, so there may be some kicking around
21 that I am not aware of but, to the best of my knowledge, it has been widely used in this
22 jurisdiction, except for as applied in the last Yukon Energy case.

23 Q MS. BENTIVEGNA: Are you aware whether there was any reference in the last
24 two decisions? I mean, they go back to 1996-97 rates and then before that — that was a
25 negotiated settlement — but before that I believe it was the 1992 —

26 A MR. KENNEDY: I'm not aware of any. Now, I'll be very blunt: I haven't read
27 those decisions word for word and all the way through. I'm not aware of anything or have
28 not been made aware of anything in those decisions relating to use of the average service
29 life. The fact is that the company has used equal life group through the period of those
30 decisions.

1 Q MS. BENTIVEGNA: I'm sorry, Mr. Freedman, did you want to add anything?

2 A MR. FREEDMAN: No.

3 Q MS. BENTIVEGNA: All right, thank you.

4 Now, Mr. Kennedy, are you aware whether the ELG method has been approved in the
5 NWT in the past?

6 A MR. KENNEDY: I know they currently use average service life and have since, I
7 think, the late 1990s. Prior to that, I'm not sure what they used, to be very honest. I think
8 the answer to your question is that they currently use average service life and I'm not
9 aware that they have used equal life group prior to that.

10 Mr. Freedman did remind me of something. The NWT Northland company uses the
11 equal life group. We submitted a study approximately two years ago using the equal life
12 group for that utility. But I think your question was specific to NTPC. I think that they
13 continue to use average service life.

14 Q MS. BENTIVEGNA: Now you were just mentioning Northland Utilities, so has
15 the Utilities Board in the NWT approved the ELG for Northland?

16 A MR. KENNEDY: I think they have, yes. To the best of my knowledge they have.

17 A MR. FREEDMAN: Yes, in the previous proceeding, that method was approved.

18 Q MS. BENTIVEGNA: All right, thank you. Had Northland had that method of
19 depreciation in place prior to that proceeding or was it as a result of that proceeding?

20 A MR. FREEDMAN: Again, it was in place prior to that and we provided a study
21 in the 2005-06 proceeding that continued on with that method.

22 MS. BENTIVEGNA: All right. Thank you, panel. Those are my questions,
23 Madam Chair.

24 MS. SHANKS: Thank you, Ms. Bentivegna. I will ask at this time if we have any
25 Board questions for the depreciation panel.

26 There being none, I will turn the mike back to Mr. Keough.

27 MR. KEOUGH: Thank you, Madam Chair, I have no redirect.

28 MS. SHANKS: In that case, before we adjourn for the day, I just want to give
29 notice to the parties that it looks like we'll have a full day tomorrow when we resume our

1 cross-examination of the YECL panel that we had on Tuesday. Since that is the case, we
2 will adjourn for the day and we will reconvene tomorrow morning at 9:00 a.m.

3 MR. KEOUGH: I was — sorry, Madam Chair — going to put out there that you
4 might want to start at 8:30 a.m.

5 MS. SHANKS: Well, I'm up earlier than that, if you would like to. We can talk
6 about any hour of the day, Mr. Keough.

7 MR. KEOUGH: We don't want to get carried away. I just know that there is still
8 — if the Intervenor estimates hold, we still have a ways to go, so I'm just tossing it out
9 there. I don't know what the parties feel about an 8:30 a.m. start.

10 MS. SHANKS: I have absolutely no objection to that. Is there anybody that has a
11 problem with an 8:30 a.m. time tomorrow morning? Are there flights to catch that people
12 have to have at the end of the day?

13 Well, I am hearing no objections, so in that case, it's 8:30 a.m. We can thank Mr.
14 Keough for setting our alarm clocks tonight.

15

16 (PROCEEDINGS ADJOURNED AT 5:50 p.m.)

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