Standing Committee on Crown Corporations

Hansard Verbatim Report

No. 50 – June 26, 1998

Legislative Assembly of Saskatchewan

Twenty-third Legislature

STANDING COMMITTEE ON CROWN CORPORATIONS
1998

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Channel Lake Petroleum Ltd.

The Chair: — Good morning, colleagues. We will reconvene our hearings into the Channel Lake circumstances. Today we have two expert witnesses who will be testifying before the committee. And we will have an opinion on both the discount rate and the long-term gas supply contract.

Before I do that, I would like to just deviate a little from normal procedure just to expedite matters in the Clerk's office.

As committee members will know, I've been trying to arrange witnesses. And it has been somewhat difficult to determine the exact time that Mr. Anguish will be available on Monday because he is moving from Yellowknife to Calgary and he's facing a 22-hour drive once his movers have completed loading all his possessions into the moving van.

So what I would propose is to change the agenda for Monday to give us a little bit more comfort in terms of the availability of that witness. And I'm proposing that we change the agenda so that rather than meeting from 10 to 12 and 1 to 5 on Monday, that instead we meet from 2 to 5 and either 6 to 9 or 7 to 10, as the committee determines. Is that acceptable to committee members? Would you like an hour, or two hours for a meal break? One hour?

A Member: — One and a half . . . an hour and a half.

The Chair: — An hour and a half. All right. I will send out a revised notice of agenda.

A Member: — Compromise.

The Chair: — This is definitely a committee of politicians, isn't it. We will meet then from 2 to 5 and 6:30 to 9:30 on Monday, June 29. And I will send out that revised notice.

I will then proceed with the swearing in of the witness. Ms. Stewart, welcome to Regina. And I understand that you've spoken with our legal adviser, Mr. Ted Priel, and you have some idea of the way the committee flows and the proceedings for this morning.

I have a customary statement that I read to all witnesses and then I will swear you in.

Ms. Stewart, witnesses should be aware that when appearing before a legislative committee your testimony is entitled to have the protection of parliamentary privilege. The evidence you provide to this committee cannot be used against you as the subject of a civil action.

In addition, I wish to advise you that you are protected by section 13 of the Canadian Charter of Rights and Freedoms which provides that:

> A witness who testifies in any proceedings has the right not to have any incriminating evidence so given used to incriminate that witness in any other proceedings, except in a prosecution for perjury or for the giving of contradictory evidence.

A witness must answer all questions put by the committee. You are advised that you may be recalled to reappear again before this committee at a later date if the committee so decides. You are reminded to please address all comments through the Chair. Thank you.

Do you wish to affirm or to swear?

Ms. Stewart: — Swear.

The Chair: — Do you swear that the evidence you shall give on this examination shall be the truth, the whole truth, and nothing but the truth, so help you God?

Ms. Stewart: — I do.

The Chair: — Thank you. So, once again, welcome to Regina. The clerk has distributed copies of the opening statement for both Ms. Stewart and Mr. Cherry — Curry, rather. I'm sorry. I'm sure that it happens a lot. I apologize, Mr. Curry.

Ms. Stewart, would you like to make an opening statement before we entertain questions from the members?

Ms. Stewart: — Yes, I would. I'll basically tell you who I am, what my expertise happens to be in this issue, some of my past experience, the conclusions that I drew from this exercise, and then I will be open to any questions that you might have. I might also go through a bit of the process that I used in coming to my conclusions. Okay.

First of all, I'm a graduate in civil engineering from 1976. And I have worked in the oil and gas industry for 20 years — predominately in the gas industry, beginning with TransCanada PipeLines in their facilities planning department. I then moved on and worked for Canadian Utilities for about — it was nine years, moving through various positions to the point of becoming the manager of their gas supply planning.

In that position I was responsible for economics, contracts, markets, pricing, and the development of rates. Okay.

In 1989 I went to work at Sproule Associates where I remain today. And in that capacity I am responsible for evaluating oil and gas properties; actually developing the types of cash flow that are analysed in assessing value for properties. I'm also responsible for developing all of the energy pricing that's used in these evaluations and special projects that come our way.

I have taught this course on evaluation of oil and gas properties for I think it's about six years now. We have a course that's taught by a number of people at Sproule. The areas that I'm responsible for are pricing, profitability, indices, and the uses of evaluations which also applies to the evidence I'm giving today.

I've appeared as an expert witness before the National Energy Board, the energy utility board in Alberta, the Ontario Energy Board, and also the B.C. (British Columbia) energy board.

I was approached last week by Ted Priel and asked if I could give expert testimony on the question of appropriate discount rates. I agreed that I was quite capable of doing that and he sent me a copy of a report done by Gilbert Laustsen Jung which provided a before-tax cash flow as well as a few profitability indices on the Channel Lake Petroleum corporation.

He also gave me a brief review of the circumstances surrounding the development of this report and the sale of Channel Lake. I was also referred to Barry Munro at Ernst & Young because I needed some information on tax pools before I could come up with a proper assessment of the value of Channel Lake assets.

I received these documents and I proceeded with what I would consider an appropriate analysis to come up with a before-tax discount rate to be used in evaluating Channel Lake Petroleum Ltd. That process begins not with just looking at the before-tax discount rate. It begins with looking at the after-tax value of the corporation.

A corporation has to pay taxes to the provincial and the federal government. It is considered a cost to the corporation and you cannot assess a reasonable return on an investment without looking at all of these costs.

So I went through the process of taking their before-tax cash flow which was developed by Gilbert Laustsen Jung and calculating the after-tax cash flow.

Before I go on I want to make it clear that the provision of a before-tax cash flow is normal process, all right. When someone is putting an asset up for sale, it is more common than not to just develop a before-tax cash flow that's put into the data room for anybody to examine and a prospective buyer will typically — to get a second opinion on that cash flow — and the assessment of taxes is left to the individual buyers. So I calculated the after-cash flow.

Sproule's opinion, my opinion, what I teach, assesses value at 10 per cent to 12 per cent after-tax cash flow. That is our opinion. I provided a couple of documents on discount rates for people who are interested in delving into that in more depth. The cash flow value was calculated and then I received some information on tax pools — tax pools that are acquired through prior activity. The cash flow that you have here is the future, all right. The tax pools that remain in a corporation from past activity can shelter that future income.

I do not have the financial records of Channel Lake. Barry Munro suggested that the $25 million that had originally been paid by Channel Lake for the assets that they were producing would likely still remain in the corporation since a wholly owned subsidiary of SaskPower would be non-taxable. That is an assumption. Someone might want to clarify specifically what the tax pools are and I could tell you the value of them. But the value in this report uses the 25 million bucks.

Having calculated the after-tax value of the cash flow, having calculated the value of the tax pools, the summation of those numbers give me the estimated value. From those numbers you can translate that into a before-tax discount rate. Over the years these types of calculations are done all the time and as a result rules of thumb have developed for before-tax cash flow analysis. And as I mention in my report, it makes for a quick decision and often bad judgement.

So we always look at the after-tax. And I have then determined the before-tax and in my opening conclusions in my letter point out that on a before-tax basis the appropriate discount rate would range between 13.4 and 15.6 per cent.

The Chair: — We will now move to questioning from the various political parties.

Mr. Gantefoer: — Thank you, Madam Chair. Welcome, Ms. Sproule, or Ms. . . . I'm in the same trouble as . . . Ms. Stewart. I saw Ms. Sproule on top of the sheet.

Ms. Stewart: — I'd be honoured to be Ms. Sproule.

Mr. Gantefoer: — Thank you. I apologize, Ms. Stewart. The determination of value in these types of property is based primarily on the potential cash flow rather than physical assets. Is that largely correct?

Ms. Stewart: — That's largely correct, yes. Other than the tax pools that remain in the company are a function of the physical assets and so they will affect the value as well.

Mr. Gantefoer: — But their impact would be largely on the cash flow because it would, depending on the tax pool available, would have an impact on the net cash flow if you like.

Ms. Stewart: — Absolutely.

Mr. Gantefoer: — So ultimately it flows back to that cash flow type of a situation.

Ms. Stewart: — Agreed.

Mr. Gantefoer: — Okay. Now when we interviewed the gentleman from Gilbert Laustsen and he talked about his report and the fact that, you know, that he had in general rules, had established a range of discounts rather than focusing too narrowly on picking a specific one. He indicated as I recall that he did that because there were other circumstances potentially in the market-place that would motivate a buyer, a potential buyer, to choose high, low in the range for outside reasons. Would that generally happen in the gas industry?

Ms. Stewart: — I didn't hear the testimony of the fellow from Gilbert Laustsen Jung. It surprises me that he would suggest that the range of discount rates were suggested for a specific purpose. Gilbert Laustsen Jung is an evaluation company, very same as Sproule. And you would see that there is a very broad range. The calculation of the net present value is generated by a computer instantly. And that range is always provided and it very rarely is different other than very broad. So it gives the opportunity for anybody to interpret the document in any way they choose.

Mr. Gantefoer: — So if a buyer had other motivations, they may choose to pick a lower number in the range than a buyer that is looking solely at the academic net present value of the asset.

Ms. Stewart: — A buyer is free to do what they choose, for sure.

Mr. Gantefoer: — Now I understand in early — well actually as currently is the case — but royal trusts were very aggressive in the gas properties field in early 1997. Is that true?

Ms. Stewart: — They have been aggressive through 1997; I think it started a little earlier than that.

Mr. Gantefoer: — But that was probably at a time where . . . I don't know if you could say they were peaking, but certainly it was when a great deal of activity was occurring.

Ms. Stewart: — Yes, agreed.

Mr. Gantefoer: — In the royal trust properties, would they pay what I would call a premium, in that they perhaps would accept a lower discount rate than would be normally the practice?

Ms. Stewart: — The assessment I mention in one paragraph here, other considerations, and I do mention royalty trusts. I don't know whether you would call it a premium in that they're accepting a premium. They have different criteria. They are able to provide tax deferral which might allow them to increase the value slightly.

Mr. Gantefoer: — Would that not have a similar effect to a tax pool then within the company?

Ms. Stewart: — Yes.

Mr. Gantefoer: — So that would have a positive impact on the net cash flow which would allow them to accept the lower discount rate.

Ms. Stewart: — A lower before-tax discount rate. Yes.

Mr. Gantefoer: — Now in some of the documentation — and I'm sure that you wouldn't have this — one of the offers for Channel Lake that was proposed was from a TOM Capital Associates who were proposing a royalty trust type of purchase. And they were talking something in a 12 per cent discount rate.

What would have been the discount rate offered by royalty trusts in early 1997?

Ms. Stewart: — There's evidence on that information here in terms of what I extracted from the Sayer report. And the Sayer report provides a history of 1997. And I summarized just one aspect of it in this report of mine and it is in table 4. And these numbers were extracted from their summary of their evaluation where they look at numerous transactions that take place in a year and then analyse them.

They don't always have all of the information to do the analysis but they do a fairly decent job in my opinion. And they recorded that in 1997, 71 per cent of the transactions were at a discount rate, before-tax discount rate of less than 15 per cent; 26 were in the range of 15 to 20 per cent; and 3 per cent were in the range of 20 to 25 per cent.

So if the point you're trying to make is, could a discount rate of a lesser value than the ones I suggest in here be used, perhaps so. Definitely so, according to these numbers. Also higher ones could have been used too.

Mr. Gantefoer: — Is there a breakdown from the Sayers Securities report that breaks it down further to identify where the 71 per cent of transactions had occurred less than 15 per cent? Does it break it down to say that a certain amount of them are 10 per cent, 12 per cent, or . . .

Ms. Stewart: — It doesn't get down into that detail in their annual report. I have a copy if you want to look at it. They have some sample transactions at the back and it is a little more specific, but it is still just bracketing within five percentage points.

Mr. Gantefoer: — So then the less than 15, would they be almost totally between the 10 and 15 per cent range?

Ms. Stewart: — No, there were some less than 10 per cent as well.

Mr. Gantefoer: — So there were actually some less than 10.

Ms. Stewart: — Yes. Just in their summary, they didn't include it that way and it was impossible for me to interpret the data to give a better split.

Mr. Gantefoer: — So over two-thirds of the transactions through the entire year were discount rates before tax of less than 15 per cent?

Ms. Stewart: — Of the ones that Sayer analysed, yes.

Mr. Gantefoer: — Would they be a representative sample or is there some way . . . or would there be some reason to conclude that their sample wasn't representative of what the global transactions may be in that period?

Ms. Stewart: — I assume it's a representative sample.

Mr. Gantefoer: — Now — and again I'm not in the oil and gas industry so I do not understand all the ebbs and flows — but it strikes me as that the gas, from what I understand of the gas industry, there's a fair bit of volatility in terms of, you know, it can be either in a decreasing kind of a market or an increasing market in relative short-term so could there have been . . . What happened in the general trend over the course of the 1997 year?

Would it be fair to say that it was a stable year, that towards the end of '97 the discount rates were increasing or would they be decreasing? Would you have an assessment from your experience about . . . sort of the trend through the fiscal year 1997?

Ms. Stewart: — I didn't look at the trend over 1997 so it wouldn't be fair for me to comment. I guess I could say I don't think there was a dramatic change between the beginning of the year and the end of the year based on just living through 1997, but I didn't analyse any data.

Mr. Gantefoer: — Okay. So then it would also likely be reasonable to say that these figures represent fairly accurately transactions that would have occurred during the period at which Channel Lake was being offered for sale?

Ms. Stewart: — Yes, but I would like to add a qualifier, okay.

Sayer will be looking at transactions that are in the public domain and not all transactions are.

Many are negotiated between companies and between parties privately. Properties will be traded where you're just dealing with the trading of reserves rather than the whole value. Companies, where they know there is specific strategic reasons for dealing with one company over another, will trade. And none of those would be captured in this information.

Mr. Gantefoer: — So it would seem that, comparing this information to what you indicated as a rate it is potential that the actual transactions that were occurring in 1997 were at the lower end of the discount rate rather than the higher end, given that 71 per cent were less than 15 per cent.

Ms. Stewart: — In comparing with that information, yes. I have to emphasize, though, that specifically determining whether or not these properties would have sold for the higher end . . . Just because the average is at the higher end doesn't mean this specific property would have sold at the higher end.

Mr. Gantefoer: — I appreciate that — 3 per cent sold between 20 and 25 per cent so it could fit into that. I think we said this might be representative.

Ms. Stewart: — Right — 26 per cent sold between 15 and 20 per cent.

Mr. Gantefoer: — Yes. And 3 per cent sold over 20.

Ms. Stewart: — Yes.

Mr. Gantefoer: — So I mean I realize there is a statistical chance that that might be the case but we, I thought, agreed that this would be representative and two-thirds of the properties had sold for less than 15.

Ms. Stewart: — We agree that two-thirds of the properties sold for less than 15. We don't agree that Channel Lake would have sold for less than 15.

Mr. Gantefoer: — I accept that. Now in terms of evaluating the cash flow, are there other circumstances that would enter into the cash flow that would be considered as well, particularly if they were a condition of the transaction? For example, if the long-term gas supply contract — which is not in your expertise and so I'm not asking you to comment on the appropriateness of it in terms of its value — but when the DEML (Direct Energy Marketing Limited) people were before us they indicated that they valued it at approximately $500,000 a year over the 10 years, which would be $5 million. Now I'm not arguing or debating their number, if it's low or high or indifferent.

But if that type of an agreement is a condition of the transaction as separate from being negotiated in isolation, does the cash flow embedded in that agreement also have to be considered as to the valuation of the company being sold?

Ms. Stewart: — Yes. I'm going to try and feed back what I hear, to make sure I'm answering that correctly. I was looking at the cash flow generated from the Channel Lake oil and gas properties and that is one item, all right, and that's all I have evaluated. If there are other components that are being sold, the value of that would be determined in isolation and would add it together. In the same way that I looked at the after-tax future cash flow and then added the value of tax pools. Those are two components on the bill. There could be a third component. But that's the one you said . . . you know, I haven't looked at.

Mr. Gantefoer: — And in your mind and your expertise as a person involved with this evaluation, if the long-term gas contract is a condition of the sale as opposed to an independently negotiated contract, it becomes conditional on the sale that it is implemented — it is a condition of the sale, a condition precedent. Is that then . . . whatever value is embedded in there, does that then become one other of the factors in the global evaluation of the company because it is tied to the sale?

Ms. Stewart: — If I were trying to assess the value, I would look at them as individual components and I don't believe that the value of one component would influence the value of the other component. Assuming you have two parties who can . . . who are independent and are negotiating with each other and are not unduly influenced for any other reason, then the components of an individual transaction should add up to the sum of the whole. So I don't think I would . . . like I wouldn't have changed the value of the cash flow just because another component was a condition of the sale.

Mr. Gantefoer: — But if the condition, that other component that is the condition of the sale, has a significant impact on the cash flow, would that not be considered in the same way as the tax pool would have an impact on the cash flow and consequently would factor into the evaluation of the overall value of that transaction?

Ms. Stewart: — I'm going to back up because I don't . . . I see this very clearly, right, and I keep hearing the questions come back in a different way. And I'm not sure whether I'm now understanding your question.

I have a cash flow, it has a value. I have tax pools, it has a value. I have a contract, it has a value, right. A plus B plus C equals the total value. If I have a value in the contract, I don't change the value in the cash flow, even if the value in the contract is a precedent.

Mr. Gantefoer: — So I hope I'm not misunderstanding you. I'm trying to get to that item D that you indicated.

Ms. Stewart: — Total.

Mr. Gantefoer: — The total. And what I was asking you is you've considered item A which would be the cash flow; B, the tax pool. And you indicated to me that you had not considered C, the potential value of the contract.

Ms. Stewart: — I have not determined the value of that contract, correct.

Mr. Gantefoer: — Yes. But theoretically, if there is a value imbedded in that contract, it would influence the final outcome.

Ms. Stewart: — Yes, it would influence D.

Mr. Gantefoer: — Yes. We're on the same wavelength. Thank you. So that because they're tied together, because the contract is tied to Channel Lake as the tax pool is tied to Channel Lake as to the cash value of the reserves are tied to Channel Lake, they would all be factors potentially to be considered in that ultimate evaluation of price.

Ms. Stewart: — Yes.

Mr. Gantefoer: — Thank you.

Could you indicate finally where the discount rates are currently. Has that shifted at all in what's actually happening? If you had looked at a Sayers Securities report for the current time, are there more of them in that less than 15 per cent? Is the industry very aggressive today? Or where is it at today?

Ms. Stewart: — All right. We are living in interesting times today. Specifically to the discount rates, I don't think they have changed dramatically today. The issue, I guess the major issue today is price — right. And price will change the before-tax value and the after-tax value. But that hasn't created a sudden dramatic change in the discount rates. It also would not change the approach in my method of setting value on a corporation.

Mr. Gantefoer: — Okay. One other question I forgot in our last exchange of comments. If you were given a number, a cash flow value of that long-term contract, item C if you like, in our discussion, would you be able to assign a current value on it if that was given to you?

Ms. Stewart: — Yes.

Mr. Gantefoer: — Thank you very much.

The Chair: — Mr. Gantefoer, do you have any further questions of Ms. Stewart? Mr. Hillson, will you begin your questioning then please.

Mr. Hillson: — Ms. Stewart, first of all I just want to make sure that I understand you right here.

Ms. Stewart: — Sure.

Mr. Hillson: — If we were to sum up your report in one line, would it be that the discount rate used here is at the high end, but none the less within range?

Ms. Stewart: — Clarify discount rate used here. Initially I thought you were talking about my discount rate. What do you mean, discount rate used here?

Mr. Hillson: — Oh, in the valuation of the Channel Lake assets and the Channel Lake sale.

Ms. Stewart: — Used by who?

Mr. Hillson: — Oh, used by the purchaser and seller at the time. Okay, you didn't look at the agreement itself then.

Ms. Stewart: — No, I have not seen the sales documents.

Mr. Hillson: — I'm referring to paragraph 2. The Gilbert Laustsen report reflects the before-tax cash flow associated with established reserves, discounted at 15 per cent plus half a million.

Ms. Stewart: — Okay, all right.

Mr. Hillson: — So that's where I'm taking the figure from.

Ms. Stewart: — Sorry, yes.

Mr. Hillson: — And what I understand you to be saying is that is at the high end but within range. Is that . . .

Ms. Stewart: — Yes.

Mr. Hillson: — Okay. So that is, in a nutshell, your conclusion.

Ms. Stewart: — That's right.

Mr. Hillson: — And the range you have given us is 13.4 to 15.6.

Ms. Stewart: — That's correct.

Mr. Hillson: — And if you wish to used the board, I see you have it here.

Ms. Stewart: — Well I teach, and as I explained, I'm always comfortable if there's a white board behind me.

Mr. Hillson: — Could you just show us what the 13.4 to the 15.6 figures do.

Ms. Stewart: — What they do. Okay. That is such a broad question. I'm wondering if you're . . .

Mr. Hillson: — I think that is table 1, isn't it, or not?

Ms. Stewart: — You just want to move through table 1?

Mr. Hillson: — You don't . . . I specifically used 13.4 to 15.6. But I think that's table 1 that we're talking about, is it not?

Ms. Stewart: — Yes. Well I progress. I think it's probably easier if I move back and . . .

The Chair: — Ms. Stewart, we are having a *Hansard* recording of this. I think that that microphone is sensitive enough to pick up your voice, but you might wish to just speak just a little louder.

Ms. Stewart: — Yes, they asked me to try and speak in this direction as well.

Okay, what I'm going to put down here then will be the discount rates, as well as the values. But rather than going back to that original table which is dealing strictly with the cash flow value, I'm going to be looking at the values after I have added in the tax pools, and that would be on table 2 where we have after-tax.

I think the crucial numbers are these two discount rates that we use on an after-tax cash flow that ends up with the values of

19.9 to 21.8. Right? And then in moving . . . and that is at a 10 per cent discount rate on the after-tax cash flow. Then what you do is through an iterative procedure you can determine the discount rates that you would have to use on the before-tax cash flow to achieve these values. Does that answer your question?

Mr. Hillson: — I think so, but you're saying that if we had a discount rate of 10 per cent on after-tax, that gives us the figure of 21.8 million.

Ms. Stewart: — Correct.

Mr. Hillson: — Which is of course the figure we're working from. And you say that would be equivalent to a before-tax discount rate of 13.4.

Ms. Stewart: — That's right.

Mr. Hillson: — Then I think I understand you.

Ms. Stewart: — Good.

Mr. Hillson: — Now I wonder if you can explain for me, at the top of page 4 of your letter refers to the initial purchase of the Channel Lake assets. I think that's what we have called Dynex.

Ms. Stewart: — Yes.

Mr. Hillson: — You say, created tax pools which remain in the corporation. By that I think you mean SaskPower.

Ms. Stewart: — I think they would have remained in Channel Lake.

Mr. Hillson: — In Channel Lake. Okay. That's what I was . . . Okay. Would you explain what you mean by these tax pools and if they have a value that can be placed on them.

Ms. Stewart: — Yes. When you buy reserves or you buy the right to develop reserves, then the cost of that acquisition is described by I guess the tax Act as a Canadian oil and gas property expense. You are allowed to use that tax pool to form tax deductions in the future. The tax deduction allowable on what we call a COGPE expense, Canadian Oil and Gas Property Expense, is 10 per cent per year on a declining balance.

Mr. Hillson: — Okay.

Ms. Stewart: — Would you like me to explain what the CCA (capital cost allowance) one is?

Mr. Hillson: — Please.

Ms. Stewart: — Okay. Most of the tangible costs associated with developing oil and gas assets — gathering systems, pump jacks, surface equipment — gets classified as a class 41 expenditure and it's eligible for a tax deduction each year, essentially at 25 per cent.

The federal government also has a little thing called the first year rule, which means you can only get half the rate in the first year. And so in the first year on a class 41 asset, you'd get a 12.5 per cent of the capital cost and then you'd decline the balance and every year thereafter you'd get 25 per cent.

Mr. Hillson: — Okay, so then if I can come back to what you say at the bottom of page 3 and top of page 4, the 25 million originally paid by SaskPower for Channel Lake created a tax pool which that whole sum remained at the time SaskPower divested itself. Is that . . .

Ms. Stewart: — I assumed that.

Mr. Hillson: — Because it is a public corporation?

Ms. Stewart: — I was told by Barry Munro in Ernst & Young, and perhaps this can be confirmed later, that you know, SaskPower is a Crown corporation, is not taxable and therefore Channel Lake wouldn't have to use any of these taxes; they didn't use them.

Mr. Hillson: — So it wasn't used up.

Ms. Stewart: — And you don't have to use them; you can save them for later years. But I guess I don't know for sure whether they did that or whether it got lumped up some place else and it's no longer in Channel Lake.

Mr. Hillson: — Sure, okay, but . . . okay, I think I understand you now. The 25 million created certain tax advantages which of course, you say, a public corporation doesn't need.

Ms. Stewart: — Doesn't need.

Mr. Hillson: — So they're still available when it goes back into private hands.

Ms. Stewart: — Right.

Mr. Hillson: — Okay, I think I'm following you now.

Ms. Stewart: — Good.

Mr. Hillson: — And in terms of the original purchase of Channel Lake, now I believe that was tied in with a bankruptcy, so was there any discount rate applied to that purchase, do you know? Or would that not apply because of the circumstances under which the Dynex assets were initially acquired?

Ms. Stewart: — I don't know anything about the transaction. I didn't look at the deal. I didn't see the cash flow. Barry Munro talked a little bit on the telephone and I said it didn't seem to apply, so I didn't listen clearly. So I don't know much about it.

Mr. Hillson: — And if I can come back to the tax pool of 25 million, can you put a dollar figure on that or not?

Ms. Stewart: — I put a dollar figure on it.

Mr. Hillson: — I'm sorry, okay. Pardon me. Well then, okay, show me then on your . . .

Ms. Stewart: — Table 2.

Mr. Hillson: — Table 2, yes.

Ms. Stewart: — All right. I have the future value of the cash flow at 15.8 to $14.3 million. That would be the value of Channel Lake if they had no tax pools, right. So if there were no tax pools, I would go to this chart on the board and replace the 21.8 and 19.9 with 15.8 and 14.3. But since there was a value in these tax pools on the 10 per cent discount rate, 4.7 for the COGPE pool, 1.3 for the CCA pool, I get a total of 21.8.

Mr. Hillson: — Okay.

Ms. Stewart: — And if these numbers varied someone could easily go in and change the arithmetic.

Mr. Hillson: — Okay, I'm glad I came back to that then. So the 21.8 is including the value of the tax pool.

Ms. Stewart: — Yes.

Mr. Hillson: — The CCA and the COGP.

Ms. Stewart: — COGPE. We all call it COGPE.

Mr. Hillson: — COGPE — COGPE, okay.

The 13.4 to 15.6 of course is the range you have given, and this is of course detracting nothing from you, but that is an opinion rather than a computer figure I assume. That's your best professional judgement, is that correct?

Ms. Stewart: — I would call it a very good opinion.

Mr. Hillson: — I have no doubts on that, Ms. Stewart. Okay.

Can you tell me what . . . can you give me an idea what percentage of sales would have fallen within that range.

Ms. Stewart: — I wish I could identify that specifically, and I can't. The information . . . I've provided some information; that's all the information I have.

Mr. Hillson: — But it's always subject, as you say, to a willing seller and willing buyer.

Ms. Stewart: — Yes.

Mr. Hillson: — Let me put it this way then. Are you confident that the vast majority of sales would have fallen within the range you have supplied us?

Ms. Stewart: — The vast majority?

Mr. Hillson: — Yes.

Ms. Stewart: — No, I wouldn't say that. And I think that goes back to what we were talking about a little bit before in terms of the percentage of the sales in each area. But there's no way of determining specifically where Channel Lake will fall in within that range.

Mr. Hillson: — But again, your view is that it may be somewhat at the higher end of the scale but it is within range.

Ms. Stewart: — Yes. You know, one of the . . . like even within these various discount rates, the assessment of value is going through the process that I am going through. And you have seen how the value of the tax pools affect the total value. It goes up.

Well in the oil and gas industry, there are situations where companies are not exceedingly successful and so the relationship between the value of the cash flow and the tax pools changes dramatically.

So if you have a company that doesn't have an exceedingly valuable future cash flow because they haven't been successful at the well bit, you can have a situation where a corporation has large tax pools and a small cash flow, and that can create the perception that they're using an excessively high discount rate. But when analysed on an after-tax basis, it comes right back to they pay 10 to 12 per cent after tax. But the discount rate, that you have to apply before tax goes up because they've got such large tax pools relative to the cash flow.

Mr. Hillson: — You supplied us with some background information in addition to your report, and the background information is to explain for us why a discount rate would normally be adopted by the industry in sales transactions. And as I understand it, discount rates refer to risk assessment.

Ms. Stewart: — You will incorporate a risk component in your discount rate, yes.

Mr. Hillson: — Okay. And on the top of the first backgrounder you gave us, there is a listing there of some of the components, and some of which I think we would understand and others which, like Monte Carlo simulation, I'm not sure that would mean . . . it doesn't mean too much to me. I'm not sure about other members of the committee. Is it important for us to understand that in terms of this inquiry?

Ms. Stewart: — Not particularly, and I'll give you a reason why. In my assumption at the beginning, and certainly as described by the Gilbert Laustsen Jung, most of these properties or the value is associated primarily with proven developed producing properties.

You will also pay for undeveloped land in a sales transaction. There isn't much of that in this analysis so it doesn't really apply. In looking at undeveloped land, at that stage, you're trying to figure out and interpret perhaps some seismic, invest risk capital in drilling the initial well. You don't even know if you're going to find a pool, so you're in a much riskier situation. And at that stage you would be more likely to use a Monte Carlo simulation to assess the risk of that particular investment.

Mr. Hillson: — Whereas here the properties are mature and developed.

Ms. Stewart: — More mature and more developed. And it wouldn't be as common to apply that detailed an analysis to this type of a property, though someone could.

Mr. Hillson: — So what would be the main factors that apply to this particular transaction?

Ms. Stewart: — In determining value?

Mr. Hillson: — In determining risk assessment.

Ms. Stewart: — Price. The type of reserves. Past performance of reserves in similar areas. Maybe the tax rate. Are you going to have tax reductions? That could increase the value.

Mr. Hillson: — Ask them.

Ms. Stewart: — Let's see. Those are the main ones. Mainly the risk associated with the reserves and whether or not the projected production will actually be achieved and whether or not the projected price will actually be achieved.

Mr. Hillson: — Okay. So those are the factors that particularly apply here. In addition, in some other cases you would be looking at a factor of, you don't know for certain how much reserves you're actually buying.

Ms. Stewart: — Right.

Mr. Hillson: — And that doesn't particularly apply to us in this case.

Ms. Stewart: — There is a risk, right? It's not entirely dispensed with. But it is smaller than the risk associated with undeveloped property.

Mr. Hillson: — Okay. Thank you, Ms. Stewart. I think you have taken us through a rather difficult area and I think you have explained it in such a way that we are able to follow your testimony.

The Chair: — Thank you, Mr. Hillson. I'll move now to the government side. Who is leading the questioning? Mr. Kowalsky.

Mr. Kowalsky: — Thank you very much. I just want to double-check here and get the bottom-line interpretation of your evaluation of the Channel Lake properties. And I go to page 4 and table 2. What you're telling me there is that the Channel Lake property, according to your evaluation, was worth between 21.8 million and 19.9 million. Is that accurate? Is that an accurate interpretation?

Ms. Stewart: — Yes, you're interpreting . . . I only hesitate because with that question I'm wondering whether I should list the critical assumptions that come up with this because they are mentioned in my letter.

Mr. Kowalsky: — No, I understand that.

Ms. Stewart: — Okay.

Mr. Kowalsky: — And I also understand that there is a number of variables, and I also understand that a lot of these are subjective criteria.

Ms. Stewart: — Fair enough. This is my assessment.

Mr. Kowalsky: — But your range would be that if you were providing advice to somebody who was buying or a prospective seller, that the company was worth between 19.9 and 21.8 million bucks?

Ms. Stewart: — Sorry, I do have to qualify that. I would direct them to find out more information on the tax pools, but within the time frame that I had that wasn't possible. So before I would make an offer on this I would find out specifically what pools were in and then I would do the evaluation. But since time wasn't available, I had some guidance on the pools. I provided information that then anyone can also adjust according to actual.

Mr. Kowalsky: — Okay. Is it customary for a company who's selling a property like this to get an evaluation done and then to provide the evaluation to prospective customers?

Ms. Stewart: — Yes. Not only is that typical, that's almost how it always happens unless two companies decided they're just going to negotiate together. And that's common as well.

Mr. Kowalsky: — And is it customary for sales to occur — end sales to occur which exceed their evaluated range? In your experience, when you provide your customers with a range such as this one, is it often the case where the company would get way more depending I suppose on the tax pool, like you mentioned, but is over and above that. Is it customary?

Ms. Stewart: — There are often other considerations that will result in a sale that is higher than what I put here, and I list some examples of that in the report as well. But also there are situations when they are less.

Statistically these days, for 1997, statistically for all of the sales that I have information, it would suggest that more properties have sold for values higher than this, though a significant number have also sold for less.

Mr. Kowalsky: — Okay, so this gives them a starting point.

Ms. Stewart: — Yes.

Mr. Kowalsky: — Okay. Thank you.

The Chair: — Are there any other questions from . . . do any members of the committee have any further questions? Mr. Goohsen, do you have questions of Ms. Stewart?

Mr. Goohsen: — I have a couple.

The Chair: — Good. I think given the area that you represent in the province. you probably have more of a hands-on feel for all of this. Mr. Goohsen, will you move the microphone closer to you please? Thank you.

Mr. Goohsen: — I think what the Chair is referring to is the fact that Channel Lake is really not a lake. It's really a name of a company, and the actual physical assets come from the area of the province that I come from, or closer to that Medicine Hat area and Hatton. It doesn't mean I know anything about it though.

Ms. Stewart: — They seem to think you do.

The Chair: — I was willing to give you the benefit of the doubt.

Mr. Goohsen: — Well I actually would go back to the reserve. And when you do your determination, of course you have to have an evaluation of reserve and that percentage of risk factor. And you indicated I think, if I heard you right, that there's a low risk factor in this field because it's established. What did you base that on?

Ms. Stewart: — Low risk factor. I assumed that Gilbert Laustsen & Jung have developed a reasonable and fair assessment. I think I also mentioned that a perspective buyer would get a second opinion, and then by that would confirm whether he thought the reserves were in the right order of magnitude.

There is less risk on a proven reserve than there is on a probable reserve. And there's less risk in a probable than there is in a possible. So in terms of reserve definitions, the reserves reflected in this report by Gilbert Laustsen & Jung are at the lower end of this risk scale.

Mr. Goohsen: — And that risk of course though would be established by a buyer and a seller by employing probably a geological engineer who would try to determine how much the actual gas is under the ground left to be recovered and put into a gas line to be sold to a customer. To put it in simple language, it's the volume of gas that's still left in the ground.

Ms. Stewart: — The volume of producible gas.

Mr. Goohsen: — Producible gas.

Ms. Stewart: — Yes.

Mr. Goohsen: — That's a good point. Because some of it can't be recovered. However, as technology improves, we're quite sure that we can sell the rest of it because we'll be able to get it.

But it's also been stated in this case that the field is pretty well closed; that there's no room for expansion; that there are no more reserves that can be tapped out of this particular field. It would seem to me that a potential buyer would want to look at that a little more closely because leases are still available in the area and there might be more value to that than shows on the surface. Or would I be wrong there?

Ms. Stewart: — I don't think that you're wrong in general terms in that a buyer would look at the reserves, they would look at the location of the reserves, they would look at the quality of the reserves, they'd look at upside potential synergies with other companies and with themselves. All of those things would be looked at.

What I have to say is that I cannot comment on these reserves. Sproule did not have time to go into an assessment of these reserves and it is beyond us at this stage to speak to the risk of these specific reserves other than in general terms.

Mr. Goohsen: — But there is potential for that risk to be higher or lower depending on what is actually out there?

Ms. Stewart: — Yes.

Mr. Goohsen: — Good. I guess I may as well make my point and I do believe that we have more gas and oil than we have presently stated as a fact in not only south-west Saskatchewan but all over the province. I think our reserves are a lot greater than what most people are willing to admit and that the profitability for industries wanting to come to this province is certainly available. And that's just a kind of a personal plug I put in for the province because we've lots more potential. We're going to catch up to Alberta, you see, after a while. You don't have to comment on that.

Ms. Stewart: — You have a long ways to go.

Mr. Goohsen: — Oops. That's the fault of the politics, not the reserves. Anyway I think I made my point. You did it for me. Anyway, in this area of taxation though, basically what you're saying here is that in Saskatchewan because the Power Corporation is a non-taxable entity, they have reserves that are based on equipment and because of the declining sliding rate that is used by the tax department — a 25 per cent rate normally, that would be four years you'd have all of your equipment written off tax wise — but in this case it wouldn't because it's on a declining basis so it takes five or six years. And . . . how long?

Ms. Stewart: — It takes forever.

Mr. Goohsen: — It takes, well yes, that's because it's infinitesimal at the end.

Ms. Stewart: — Right. And but even essentially it takes a lot longer than six years. I would always look at least 10 years before . . .

Mr. Goohsen: — To recapture the bulk. Let's talk about bulk because like you said you can never, ever finish. The only way you can do that is if you die and the corporation . . .

Ms. Stewart: — And on a Canadian, on the COGPE, Canadian oil and gas property expense, with a 10 per cent.

Mr. Goohsen: — Okay, how many years would that take? That portion of it?

Ms. Stewart: — I happen to have a cash flow that shows those. Maybe you'd like to look at it.

Mr. Goohsen: — Well just give us an idea of what you have.

Ms. Stewart: — All right. On a COGPE, I would say you're getting the bulk out in 10 . . . no, sorry, in a class 41 you're getting the bulk out in about 10 years. Someone going to define bulk?

And on the COGPE, after 20 years you're still getting $270,000 tax deduction on a $20-million investment.

Mr. Goohsen: — Okay. I heard you say a little while ago I think that you estimated it at $25 million worth of tax pool. Where did you get that number from?

Ms. Stewart: — The 20 million?

Mr. Goohsen: — No, a little while ago you had that up to 25.

Ms. Stewart: — Yes. It's just split out, so let me describe the numbers again for you.

Mr. Goohsen: — Okay.

Ms. Stewart: — The $25 million was the price that they paid for the Dynex assets. Typically those assets are split 80 per cent COGPE, 20 per cent class 41 so that gives me 20 million in the COGPE pool and 5 million in the class 41 pool. So when I was running the value of the tax pools I used 20 million on COGPE and that's the cash flow I'm looking at. And in the year 2017 I get a tax deduction of $270,000.

Mr. Goohsen: — Okay. But I guess if that's when it came into Channel Lake as an entity or subsidiary of SaskPower, now the more years that SaskPower held that company and the assets, the more tax pool there would be which they could then use as a leverage to improve the price to resell.

Ms. Stewart: — Other capital investments could result in other tax pools as well.

Mr. Goohsen: — Yes. And of course the reserves might diminish but we're assuming that those things would be stable and that just this entity would increase over time — the tax pool.

Ms. Stewart: — Yes.

Mr. Goohsen: — I guess the thing is that most of us here probably never considered the tax angle as a very important part of the transaction whereas today we now I think assume that that was probably a very good reason why different people would be looking at this purchase from different views. And of course most of them, if they needed tax breaks and have profitability in their own corporations, could certainly use this to a great advantage. Is that true?

Ms. Stewart: — Yes.

Mr. Goohsen: — So that a company that had been running a fairly profitable business themselves, would they have a better advantage from this tax pool than a company that was in a poor position, or would it be the other way around?

Ms. Stewart: — You're starting to get into some very complex tax issues that they hire tax lawyers for. And I have to explain that first of all when a corporation buys Channel Lake, they can use all of the tax pools in Channel Lake to shelter the revenue that is in Channel Lake. And if there is undeveloped land, any additional production from that undeveloped land can be sheltered by these tax pools.

But one of the things you're insinuating there is that you could just roll the tax pools into another successful company. You can't do that directly, you know, there's streaming rules and things like that.

On the other hand, synergies between companies can allow them to optimize tax pools and ensure that tax pools don't get stranded.

Mr. Goohsen: — So that you basically would never lose them but you may have to follow some tax rules to get there.

Ms. Stewart: — Yes, be very cautious. Sometimes they lose them too. They try not to.

Mr. Goohsen: — Well the smart ones wouldn't or they'd sell them to somebody else who knew how to do it.

The situation where a company that was purchasing these assets were itself facing bankruptcy and were in very poor condition financially and needed these assets plus a contract to be able to sell, in order to leverage further borrowings from the banks to keep themselves solvent, would these tax pools work as an advantage with the bankers in that circumstance?

Ms. Stewart: — It's getting into a very detailed question and I just feel uncomfortable answering it directly. Let me explain, you know, once again, there's a value in the tax pool. There will always be a value in a tax pool so long as there is revenue that can be used. And it is important to know what those tax pools are in setting value. And the industry knows that and they will look at it.

And if you get a copy of the Sayer report, in the examples back there, they even list some of the tax pool issues that are addressed in some of the transactions.

Mr. Goohsen: — But the bottom line is it's a real value that's transferable, that the bank would use as a living, live, breathing asset.

Ms. Stewart: — Yes. I've never worked in a bank, to know what banks think about tax pools. And their perspective is very different in that they're aimed at getting their money back one way or another. And if you have no cash flow in a company, you can't use the tax pools. So one has to be a little cautious on setting the value. You have to have revenue, then there's value in the tax pool. If there's no revenue, there's no value in the tax pool.

Mr. Goohsen: — I get to ask the unusual questions because they make me come last and all the good ones and easy ones have already been asked.

Ms. Stewart: — Well these are the only ones I really slowed down on.

Mr. Goohsen: — That's because I'm usually at the bank asking for the money, you see.

Anyway, I wanted just to go back just for a second to the type of company that would be interested in buying these assets. And when a company that is facing financial difficulties themselves — needing to buy assets that they could use then to beef up their own financial picture so that the bank would stay with them in further extending loans and that sort of thing or whatever is necessary — if they were to be buying this asset, would they pay a higher premium for that then to get it than a company of course that didn't need to stave off a bank foreclosure?

Ms. Stewart: — Okay. Now I understand why I was getting confused here. You're talking about a company that's moving towards insolvency buying another company.

Mr. Goohsen: — Yes.

Ms. Stewart: — And that is not the norm. I'm not saying that that doesn't happen but typically it's the other way around. The company that has extra cash is out there looking at opportunities for growth.

I think a situation where the insolvent company or the company that is less solvent is buying assets would likely be limited by the amount of cash that he has available and what the bank will give them. I'm really speculating on a situation I haven't thought a great deal about.

Mr. Goohsen: — Well again, if it wasn't . . .

The Chair: — I'm assuming that this is simply a hypothetical question out of perhaps personal interest and . . .

Mr. Goohsen: — No, it's got to do actually in basis of fact from the questions that have been asked and are on record in the Crown reports and the *Hansard*. So I'll get to the point.

The Chair: — Okay, if you can try to focus questions I would appreciate it. Thank you.

Mr. Goohsen: — Very directly DEML, who bought the assets of Channel Lake from SaskPower, have been reported to us to having been in some financial trouble themselves. And so it's unusual as you say for a company that is on the verge of insolvency to be buying assets to try to stave off insolvency.

So it is a reversal of a normal and usual transaction. That's why we're here. Everything about this whole process has been pretty unusual.

Ms. Stewart: — Yes, I wasn't aware of that circumstance.

Mr. Goohsen: — Okay. So that is directly what I was getting at is the transaction in point for why we are here and why they would be doing that. And how the assessment of the values would assist them in such a way to make them the buyer rather than somebody else that, in a normal case, would have assets to buy with.

And we're trying to understand why, in one case, Stampeder offered more money and was turned down. We're trying to understand why this company got the asset when in fact were near insolvency. We're trying to understand you see why these things happened.

And there are the tax pools now that could be a potential as an asset for the banks to look at. There is the contract where they guarantee to be able to sell the product that they've just bought back to the persons that they just bought the company from. Then actually gas being the product.

Those are all things that make it reasonable for a company going into insolvency to bid, perhaps, a higher price even.

Ms. Stewart: — Yes.

Mr. Goohsen: — In order to get those assets. And our role is to understand.

Ms. Stewart: — In a speculative way, yes. But I don't know.

The Chair: — I'm sorry, I'm going to cut off this line of speculation. Mr. Goohsen, your time actually, technically is over with this witness.

Mr. Goohsen: — I have no further questions.

The Chair: — All right, thank you. I wasn't hearing a question, I was hearing a lot of hypotheticals in your last comments.

So I would ask at this time, do any committee members have any further questions of Ms. Stewart?

Mr. Tchorzewski: — Yes. I just thought it important that we clarify for the record that, although there have been — and I'm not here to defend DEML in anyway or anyone else — although there have been allegations that DEML was in financial difficulty, there was no such evidence presented here. And I think it's important that that be corrected on the record.

And in fact when asked by committee members, DEML denied that they were in financial difficulty. So in the event that — and I'm not being critical of Mr. Goohsen because I knew where he was going — in event that sort of the latter comments are misinterpreted I thought it important that we correct that in the interest of protecting witnesses who have been here so they're not damaged by the fact that they were here.

The Chair: — Thank you, Mr. Tchorzewski.

Once again I'm going to poll committee members. Are there any questions that any members have of Ms. Stewart? No.

Ms. Stewart, we are according all witnesses who appear before this committee the opportunity to make a closing statement. That may either be verbal right now or in writing which I would like tabled with the Clerk before July 6. Did you want to make a closing statement?

Ms. Stewart: — Not particularly. I think the questions have clarified what I have provided in the written documents and it's not that long of a report. And it sort of stands as a closing statement.

The Chair: — Thank you very much then and have a good flight back to Calgary. Since your plane doesn't leave till 2 you do have an opportunity to do a little local shopping here if you wish.

Committee members, I propose now that we take a break until . . .

Mr. Gantefoer: — Madam Chair, if I could suggest for consideration that I think it's entirely possible that we could complete the testimony this morning if we don't take too long of a coffee break or any coffee break, and I would suggest we carry on.

The Chair: — I think just for the convenience and ease for our staff, as well as committee members, that we'll have a 10-minute break, well actually a 9-minute break now. We will be back here at 10:30 precisely.

The committee recessed for a period of time.

The Chair: — We have already this morning heard testimony from Ms. Nora Stewart of Sproule Associates of Calgary and now we do have another expert, also from Calgary: Mr. Don Curry, who will be providing further testimony on the long-term gas supply contract.

Mr. Curry, I noted that you were present earlier this morning so you've seen the proceedings. I don't think I have to explain them to you, but I do have to read you the customary statement to witnesses and then I will swear you in.

Mr. Curry:

Witnesses should be aware that when appearing before a legislative committee your testimony is entitled to have the protection of parliamentary privilege. The evidence you provide to this committee cannot be used against you as the subject of a civil action.

In addition, I wish to advise you that you are protected by section 13 of the Canadian Charter of Rights and Freedoms which provides that:

> A witness who testifies in any proceedings has the right not to have any incriminating evidence so given used to incriminate that witness in any other proceedings, except in a prosecution for perjury or for the giving of contradictory evidence.

A witness must answer all questions put by the committee. You are advised that you may be recalled to appear again before this committee at a later date if the committee so decides.

You are reminded to please address all comments through the Chair. Thank you.

Mr. Curry, did you wish to swear or to affirm?

Mr. Curry: — To swear.

The Chair: — Do you swear the evidence you shall give on this examination shall be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. Curry: — I do.

The Chair: — Thank you. As committee members are aware, we have already circulated a copy of Mr. Curry's report. Mr. Curry, did you wish to make an opening statement before I allow for questions from the members.

Mr. Curry: — Yes, please. I hope you're not too disappointed. I'm not Don Cherry. This isn't going to be a version of "Coaches Corner." But I would like to briefly summarize my credentials and my background, and summarize my findings on looking at this gas supply and management agreement.

I graduated from Carleton University in Ottawa with a honours B. Comm. I ended up in the banking industry for about four years. I came out to Alberta during the boom, as a banker, worked as assistant manager for their Treasury Branches in Calgary, and then I got lured into the oil and gas industry.

I worked for Shell resources for about four years with one of their subsidiary companies. Then I took about a year off and worked at an educational institution. And then I joined the oil and gas industry again and I've been responsible for basically marketing natural gas since 1988.

I've usually been . . . I worked with Ocelot Energy which was a big producer here in Saskatchewan up until about 1988. I'm currently doing a fair amount of work for a company called Union Pacific Resources which bought Norcen Resources earlier this year which is a big producer in the Hatton area in Saskatchewan.

I left Ocelot in 1993. I've been acting as a gas marketing consultant since that time and typically I have been representing producers who have some gas production. They either want to get it to market or obtain transportation so my advice is usually then with regard to natural gas producers or suppliers.

With respect to the contract, I guess in summary I spent a lot of time going through the details of the contract. In my conclusion, the contract is a commercially reasonable contract for both parties. With regard to the marketing fee, it might be at a little bit of the higher end of the spectrum that I have seen, however there are certain features of the contract which warrant such a marketing fee.

I have summarized in here, for me, what are the important salient points of a gas marketing agreement and the term, the conditions under which delivery must be made and which take obligations occur.

I'd like to make a distinction between a marketer and a producer. DEML is the marketer. Typically what a marketer is trying to do is create volume, do deals, make volume, make a margin on the deals. A producer is trying to make sure that production is sold. And they want to make sure it's sold at the highest price possible so that they recover all their operating and capital costs, and make a profit.

So the difference there between a producer and a marketer is that a marketer is more concerned about, not the prices per se, but is more concerned about the margin — any marketing fee they make or the difference between what they buy gas at and sell it at.

In this case we've got an agreement here between SaskPower, which is like an LDC (local distribution company), and a marketer. Now if I look at this contract from the point of view of a producer, the problems I would see with it as a producer are the fact that there is no obligation to take by SaskPower.

As a producer I like to get into contracts where the takes are uniform, and they're consistent, and they're done on a daily basis, and there's a high load factor. So as a producer I might not find this contract very attractive. If I were to enter into this deal, I probably would want a very high marketing fee to account for the fact when they're not taking I've got to do other things with my gas.

As a marketer this has a little bit of a different appeal. A marketer will aggregate volumes and buy volumes, and then they will flip it over to another, another buyer. And in this case where SaskPower isn't taking, DEML will go and sell the gas on the spot market.

Looking at this from the marketer's point of view, I think the 3 per cent marketing fee is a little bit high compared to some of the other deals I have seen. However, given the low load factor, I would think as a marketer I would probably want at least that kind of marketing fee to cover off the days when I have to sell that gas to another buyer.

Looking at it from the point of view of the contract and its intrinsic worth, if . . . to me, if I were to enter into a contract that already exists, if I were to get into this deal, what I would be looking at in terms of upside would be whether or not the conditions under which this gas would be sold is above the market price.

The way this gas is being purchased on behalf of SaskPower and the way it's being sold back to them is essentially based on market conditions. There are some baseload contracts which would be term contracts every year or possibly more. I'm not quite sure — I don't have the details on that — but they would be at market prices. The balance of the volumes would be based on current market conditions. So in that respect, I see nothing in the contract that would give it any intrinsic worth beyond a market price contract.

The worth for a marketer is the marketing fee. For a producer, if I were to get into this contract as a producer, I would first of all have to have a lot of production to accommodate the swings in takes by the purchaser and I would probably have to have some other reasons why I would want to get involved with an LDC like SaskPower. As a producer this is not a very attractive contract because of the low load factor. And I believe the load factor is around 27 per cent based on their estimate.

I'm going to just point out some of the most salient features for me with regard to a marketer. Essentially Direct Energy has to supply gas at the inlet of the TransGas system which is the transmission system here in Saskatchewan, and they can do that at various points, one of them being Empress, which is the connection between Nova and TransGas at the Alberta/Saskatchewan border.

Another one is the TransGas energy pool, which is kind of a melting pot on the TransGas system. Another one is Many Islands, another pipeline that TransGas owns and the storage facility.

For a marketer these things are important because it means that you have to have the ability to deliver to these places; you have to have transportation. And that's where DEML can manage transportation on these various pipelines.

The delivery obligation by DEML is quite onerous. They have to be able to meet the requirements of SaskPower on any given day. Their requirements on an annual basis are about 200,000 10^3; however, on any given day that works out to about 550 10^3 a day on average. However on any given day, it might be necessary for DEML to supply 3,000 10^3. That is quite a swing in supply.

The take obligations on SaskPower are really limited; they don't have any, other than for the baseload volumes. DEML can not go and sell the baseload volumes that SaskPower doesn't take. SaskPower has to sell that into the spot market. If those prices are less than what the contract price would be, then SaskPower has to cover the loss. But essentially they do not have to take any volume.

The marketing fee is based on a sliding scale, 3 per cent on the first 6,000 GJs (gigajoule) a year, which is approximately 81 per cent of their estimated annual requirements. So the marketing fee of 3 per cent is on a very big percentage of the volume. And then it's a sliding scale of 2 per cent and 1 per cent thereafter.

I guess some of the features which make it attractive for DEML that I can see, one of them is the marketing . . . the management fee. The other is transportation. DEML would have to contract for transportation of these various pipelines to get the gas to SaskPower. SaskPower isn't taking a uniform volume every day so some days there's going to be transportation available.

DEML can utilize that transportation for other purposes for other markets, and that may be advantageous depending on what the markets are doing. However if there's a loss in that transportation DEML has an obligation to try and litigate any unutilized demand charges, but if there is a loss SaskPower is responsible for it. So that's kind of a nice feature for DEML.

Storage? Now I must comment here. I've looked at both the draft contract that was supposed to be effective April 1, '97 and the final version of the contract, the executed contract which is effective June 1, 1997. There were some changes in there and the initial version had a lot more flexibility for DEML with regard to storage. The final version, it looks like SaskPower negotiated some things in their favour and essentially they will allow DEML to park gas if the storage is not being utilized by SaskPower. The draft contract had a clause in there where DEML could actually use their storage and maximize it, however the final version only allows that when SaskPower isn't using it and it's only for parking purposes.

Parking gas is essentially where you put gas in today or this month. You usually try to park gas in a low-price environment and bring it back out in a high-price environment and you make a margin on it. That's assuming normal conditions where the prices in the summer are going to be lower than the prices are in the winter.

The feature of the contract that it also changed between the draft and the final was the shared savings. If DEML can purchase gas at prices below the dealing market price as published in recognized publications, then the savings are shared equally with SaskPower and DEML. The earlier version had I believe . . . DEML captured 75 per cent of those savings.

Other services which DEML provides are low balancing, backstopping, removal permits, nominations, invoicing, administration, and marketing expertise.

In a commercial transaction like this I see benefits for both parties. And I imagine both parties have a different view of what the benefits are to them.

But for SaskPower to go out and contract for these volumes of gas would be a difficult chore in the sense that they cannot offer a very high load factor. So it would be a lot of administration on their part to try and obtain gas supplies. They'd be out there in the spot market subject to the swings and fluctuations of the spot market. So the advantages to them I see, are one source and one reliable source of gas supply.

For DEML, the advantages to them are they do have a lot of sources of gas supply. They contract gas with various parties. They can move markets around and they get the management fee.

I think one more thing I'd like to comment on here is the term of the contract. The contract is essentially a 10-year term. It's a 10-year, 4-month term. However there is a notice period of one year, and the notice cannot be given till November 1, 2007. So it essentially makes it an 11-year contract. The contract cannot be expired until October 31, 2008.

One other feature of the contract which I found interesting was that if SaskPower were to do something with their electrical generating facilities such that they were to sell them prior to November 1, 2002 or, if they were to use 50 per cent less of the gas power electrical generating facilities than are owned as of April 1, '97, either party may terminate the contract. However SaskPower must pay DEML $500,000 for each year prior to 2002 that the agreement is terminated. If this happens after 2002 there is no such penalty.

In conclusion I would say the benefits . . . it's a commercially reasonable contract. As a producer I might be looking at this thing as less of an attractive contract than I would as a marketer such as DEML. For SaskPower I think it's an acceptable arrangement for them. It's a way of centralizing their gas purchasing and it's a way of ensuring reliability of supply.

The Chair: — Thank you very much, Mr. Curry. I will now move to questioning from the MLAs (Member of the Legislative Assembly).

Mr. Gantefoer: — Thank you, Madam Chair. Welcome, Mr. Curry.

You've covered I think in your opening remarks a great deal of the technical background of the contract, so it'll make my line of questioning fairly simple and rather short.

I note with interest two coincidental numbers perhaps, when Mr., I think it was Dufresne or Drummond from DEML, was asked the question . . . what was this contract worth to them on an annual basis? He used a number of $500,000 per year which would indicate to me the before-tax profit that was anticipated under the contract. And I note as well that $500,000 comes up as a penalty if under the conditions you outlined, the contract is broken.

Would it be fair to say that the value of this contract is in the magnitude of $500,000 per year, or would you estimate it to be higher or lower than that?

Mr. Curry: — That's an interesting question. To me, when two parties enter into a commercial transaction, that contract has value to each party. And the value that each party places on that contract depends on what their particular objectives are.

To say that this contract has a value of $500,000, to me doesn't explain anything. First of all, it's not a profit. I would think if you're trying to figure out what revenue is associated with this kind of contract to DEML, that's a fairly easy exercise. You'd look at the estimated annual volume, you'd make an estimate on what the price is, and you'd just calculate the management fee.

That would give you I think what you're looking for, what you call a value. However, to me that doesn't represent necessarily profit for DEML, because that doesn't cover any of their overhead or any of their costs. And for SaskEnergy that might be an outlay of funds they may have to make in a particular year depending what the gas price was. However, the value to them of having that security of supply is hard to measure, but it may have a greater value than whatever that outlay of that management fee was.

So contract to me, if you say it has a value of $500,000, to me, all that shows is that that's the potential revenue and management fees that DEML could collect. It doesn't mean to me that I would be willing to step into this contract and replace DEML and pay $500,000 for the right to do so. Or in fact that I would even step into this contract as a producer. So value is kind of a nebulous term here. I think the $500,000 that you're seeing with regard to the penalty might be something that has been somehow determined that might be the revenue that might be lost if the contract was terminated.

Mr. Gantefoer: — The question as was presented to DEML I believe was . . . What was the net income or the income before tax to DEML by having this 10-year contract? And the answer was something in the magnitude of $500,000 per year. It was their numbers, not mine.

Mr. Curry: — I can arrive at that number by approximately taking the estimated volume, assuming a gas price of $2 which it currently is right now — and in fact one-year prices are much higher than that — multiplying that price times the estimated annual volume, times the management fee, and you come up with in the range of 400 to $600,000.

Mr. Gantefoer: — So that's in the range then of the estimated before-tax income to DEML.

Mr. Curry: — The revenue.

Mr. Gantefoer: — Yes. Now as it's a management contract, they would not have a great deal of physical expenses against it other than their management. It would be decision-making management in place of making the decisions to put the gas . . . make the gas available to SaskPower according to their requirements and those sorts of things. But it's not as if you have a lot of physical expenses in the development of the field or things like that.

Mr. Curry: — It wouldn't be hard assets like that involved. It would be people, time.

Mr. Gantefoer: — Thank you. Now DEML obviously wanted this contract because they made it a condition of the purchase of the property. Would that be fair to assume?

Mr. Curry: — Okay, I'm going to . . . I'm not quite sure of the details there. I understand from what has happened here that they did make that a condition of the purchase, however, I guess this gets back to my opening remarks about a marketer versus a producer.

A marketer is really concerned about volume. They'll do as many deals as they can as long as they can make some margin in there. And the more deals they do . . . they'll do a deal and go on to the next one. So for them to get a deal is important, to get volume, to get a deal in place. So in that respect, yes, it was attractive to them to have some kind of arrangements in place where they could buy and sell gas.

Looking at it from the producer's standpoint, that's different.

Mr. Gantefoer: — This isn't the issue.

Mr. Curry: — Yes.

Mr. Gantefoer: — DEML isn't the producer.

Mr. Curry: — Right. Well they were trying to be with buying Channel Lake I presume.

Mr. Gantefoer: — But in terms of this arrangement, I mean the producer's point of view is relatively irrelevant because that's not the situation. DEML is acting as a marketer to SaskPower.

Mr. Curry: — Right.

Mr. Gantefoer: — So I mean that just gets us off on a tangent that is I think largely irrelevant. So for DEML, by their estimate and your general concurrence that this would have a value to them on a before-tax basis of 4 to $600,000. Their number was $500,000.

The penalty in the event that the contract is broken is $500,000 . . . might be a reasonable number to assume that DEML valued this contract or potential income to them before tax somewhere in the magnitude of $500,000 a year.

Mr. Curry: — I think that might be reasonable to assume that they would have anticipated that.

Mr. Gantefoer: — Now because it was a condition of the sale as opposed to an independently negotiated contract, in my questioning that you heard earlier, that this was a further factor that should have been considered in the value of the whole transaction. Would you agree with that position?

Mr. Curry: — Could you elaborate? A further factor in the value of the transaction by who? By DEML?

Mr. Gantefoer: — The value of the transaction as testimony from Ms. Stewart this morning indicated that she considered three factors in coming up with the final value. The actual values of the cash flow in the Channel Lake company itself, the value of the COGPE tax pool, and the value of the CCA tax pool. And depending on which discount rates you use, came up with a value.

And in the discussion that I had with her, she said that was like A is the tax pool, B is the value of the assets, a C factor which is the value of the contract was not considered. And I'm suggesting that if you look at the numbers that were provided by Ms. Stewart, the before-tax cash flow under the A and B parts of the situation, the A part was somewhere around three to three and a half million dollars a year. When you added in the two tax pools, that moved it up somewhat because of the value of those tax pools.

And that there was a further $500,000 a year that wasn't considered, which is this long-term gas supply contract, in the establishment of value. Follow the direction I'm at?

Mr. Curry: — Yes, I see where you're heading, yes.

Mr. Gantefoer: — So that if you added that 500,000 to these numbers on the two factors considered in the value of the company, my math is just real rough, but it's somewhere between 12 and 15 per cent more than the 21.8 or whatever number. So potentially that should have been considered in terms of establishing value.

Mr. Curry: — When I look at this I see no intrinsic value to the contract other than . . .

Mr. Gantefoer: — Cash flow.

Mr. Curry: — Other than there's a revenue going to DEML and there's responsibility taken away from SaskPower. The contract to me . . . where I look for value in a contract is where there's arrangements in place where gas is purchased or sold at less or higher than market prices.

That's not the case here. To me SaskPower . . . SaskPower has value in this fact in this contract because it was reliability, but if they didn't have this contract they might be spending the same amount of money anyway to get the gas they need. For DEML, the value is the fact they've got a deal in place. If they didn't have this deal they'd have to go and find other deals. But the $500,000, it represents somebody's estimate of what the revenue could be alone under the management fee.

Mr. Gantefoer: — So the value to DEML is the cash flow generated by the management fee?

Mr. Curry: — Correct.

Mr. Gantefoer: — And that was not considered in the formula for the establishment of the value of the total Channel Lake transaction?

Mr. Curry: — To my knowledge I guess it wasn't.

Mr. Gantefoer: — Okay. So we had evaluation based on tax pools, revenue coming out of the gas assets of Channel Lake, but excluding the cash flow value of the 10-year contract?

Mr. Curry: — I think that is correct but if I were to look at that transaction on the purchase, I would give the gas management agreement very little value in it because they had to buy that gas anyway.

Mr. Gantefoer: — But from DEML's standpoint, from DEML's standpoint, that had value?

Mr. Curry: — From DEML's standpoint . . .

Mr. Gantefoer: — And the valuation of the gas assets and of the tax pools are all based on cash flow. The third cash flow value that was there . . .

Mr. Curry: — For DEML . . .

Mr. Gantefoer: — . . . for DEML was the value of the long-term gas supply contract and if it had no value then why in the world would they ever insist that it would be part of the sale?

Mr. Curry: — No question. It had value for DEML in the sense that they were able to generate revenue because they had a deal in place.

Mr. Gantefoer: — Thank you very much.

The Chair: — Mr. Gantefoer, do you have further questions? You're finished. All right, thank you very much. Mr. Hillson, will you question the witness, please?

Mr. Hillson: — Thank you, Madam Chair. Mr. Curry, yes, I wanted to read to you just following up on the questions you've already answered, and may I begin by saying that in the commercial world we are often forced to assign dollar values to things that really don't have intrinsic cash value. I mean that's the way the commercial world operates, is it not?

Mr. Curry: — Exactly.

Mr. Hillson: — And of course in the insurance world too we compensate for, say, loss of an arm or a leg and we put a dollar figure on it, although of course arms and legs don't really have a dollar value as such.

Mr. Curry: — Correct. And I think this is the problem we have here. From DEML's standpoint you can probably measure what the revenue is from this contract. From SaskPower's standpoint it's hard to measure the benefits that they're getting from this deal. But presumably if they've negotiated in good faith, they would have determined that the benefits to them are comparable to what they're paying out to get those benefits.

Mr. Hillson: — So I accept your starting proposition that this doesn't really have an intrinsic dollar figure that we can pull out of the air or press a button on the computer and get it to spit out. I follow you on that. However while accepting that, Direct Energy itself has said the following. This appointment on a cost-plus basis will generate net margins to DEML in excess of 500,000 a year.

Now is that a statement you concur in?

Mr. Curry: — I can see where they would get revenue of $500,000 a year. And that's revenue just simply based on the 3 per cent marketing fee times the estimated volumes. That's not profit, that's revenue. And that would assume a certain gas price.

Mr. Hillson: — Now they're saying net margins. That's why . . . just let me read it again because I realize that it may have come at you fast and if you want me to pass it down I will. This appointment on a cost-plus basis will generate net margins to DEML in excess of 500,000 a year.

And I think perhaps in terms . . . I'm reading, Madam Chair, from the Direct Energy Marketing Limited opening statement, and this is appendix tabbed as 17. I think in fairness I should pass it down to the witness. There is a letter here from Direct Energy to National Bank of Canada and you may wish to sort of hold it before you comment on my question.

Mr. Curry: — Okay. I'd just like to comment on the word "margins." Marketers use that word. And typically it's used for the difference between when they buy gas and they sell gas, and they're usually looking for margins. In this case they're classifying I believe the management fee as a margin.

And I'm going to have to I guess restate that I believe what they're saying here, they're using the word margins which I usually use to describe the difference between a purchase price and a sales price. In this case this deal doesn't quite work that way. They're buying gas at the market price, they're reselling it to SaskPower at that price, plus they're collecting a 3 per cent fee on it.

And I'm going to state that I am interpreting this word "margins" to mean that management fee. And that management fee, based on the volumes that I've seen that SaskPower's estimated, given current market prices, could generate revenues or the word they use here, margins, of $500,000 a year. That is not profit.

Mr. Hillson: — So you don't seem to concur on the word "net" then. You seem to be saying that you view it as a gross, not a net.

Mr. Curry: — Yes. To me, I cannot see how they'd get $500,000 profit.

Mr. Hillson: — Now of course this is a letter from Direct Energy to the National Bank, but you're saying that you don't think you agree with that statement.

Mr. Curry: — Well I'm not quite sure what it means there. I think if they're using margin the way they typically do for the difference between what they're buying and selling at and it's just a gross number, it's not a profit number.

Mr. Hillson: — Well yes, but of course I'm focusing in on the word "net" which we normally take to mean that's the profit built in here as opposed to the gross figure from which of course you always have to deduct one's expenses.

So it's the word "net" that jumps out at me. And that seems to be a word that you don't accept.

Mr. Curry: — No. I would accept possibly $500,000 in revenue, and that's using current market prices; $500,000 in profit first of all seems very high. And secondly, I don't know how you would calculate the profit at any rate. Let's assume that $500,000 of revenue is accurate. I don't know what their costs would be. We know there are some costs.

Mr. Hillson: — But they're soft costs, aren't they?

Mr. Curry: — Yes, they're people costs.

Mr. Hillson: — Yes. They're . . .

Mr. Curry: — And there'd be a lot of people costs involved in administering this deal.

Mr. Hillson: — I think we've already established though there are no hard costs as such. They're all soft costs that are, as you say, difficult to ascertain.

Mr. Curry: — Right.

Mr. Hillson: — When you're talking about, say, the salaries of staff, they're on the payroll anyway and they're doing other things, so exactly how much of their staff component is for the management of this contract is difficult if not impossible . . .

Mr. Curry: — I don't know. You'd have to get that information from DEML. But I would say that if they didn't have this deal, they wouldn't have as many people on staff.

Mr. Hillson: — Of course. Okay. However — and I think this goes back to Ms. Stewart — in a sense in the commercial world everything is worth what a willing seller will sell for and a willing purchaser will purchase for.

Mr. Curry: — Right.

Mr. Hillson: — So how much in the commercial world has an arm's length transaction . . . what value has an arm's length transaction placed on it? And in this case we have a willing purchaser apparently putting a value of 500,000 a year on the 10-year supply contract.

Mr. Curry: — If that is indeed what they calculate that to be worth. I would assume the other side would not have entered into this agreement if they didn't think that the benefit to them was probably comparable.

Mr. Hillson: — Right. But I mean this is what a willing purchaser is saying it's worth to them — 500,000 a year. So in a sense, in the commercial world that's what you have to go by.

Mr. Curry: — In the commercial world you can say that's what revenue we're going to get on this. How much are we going to keep as profit? That's what . . .

Mr. Hillson: — Well, except . . .

Mr. Curry: — . . . you have to work out.

Mr. Hillson: — Except, again, they use the word "net."

Mr. Curry: — Yes, well.

Mr. Hillson: — That gives you problems?

Mr. Curry: — Yes.

Mr. Hillson: — Okay. But at least if we're going by what this willing purchaser has said, they're saying this nets out in excess of 500,000 a year. That's their assessment of the situation. And that's what they're prepared to value it at. Is that correct?

Mr. Curry: — It would seem that's what they think they're going to get in terms of revenue. I don't think that's what they're saying they're getting in profit.

Mr. Hillson: — Notwithstanding the fact they use the word "net."

Mr. Curry: — Notwithstanding that fact.

Mr. Hillson: — Okay. So you have doubts that it will net out at 500,000, in excess of 500,000 a year.

Mr. Curry: — In terms of profit I have serious doubts.

Mr. Hillson: — Okay. Thank you. I think we've probably gone about as far as we can do with that. But I want to now refer to your letter, sir. And you may have already covered this, but on the bottom of page 2 there is a sentence, "However, there are other provisions in the Agreement which confer additional benefits on DEML."

Mr. Curry: — Right.

Mr. Hillson: — Would you just expand on that for me, please? And perhaps that refers to the headings on the next page.

Mr. Curry: — Okay. First of all, the most obvious benefit to DEML is the 3 per cent marketing fee ratcheted downwards, depending on the volumes, to 2 per cent, 4 per cent.

Mr. Hillson: — Can I interrupt you just there for a second. As I understand it the volumes that SaskPower's dealing with do not exceed the 3 per cent level. So, like, at least going on the basis of historic purchases that the 3 per cent will apply for all of the purchases of SaskPower's?

Mr. Curry: — Based on the estimate I've seen in the documents here — right in the contract actually — no. They would exceed the . . . they would have some gas, actually about 19 per cent of it at least would be at something less than 3 per cent.

Mr. Hillson: — Nineteen per cent.

Mr. Curry: — Yes.

Mr. Hillson: — Okay. Would be over the, is it 6 million gigajoules?

Mr. Curry: — That's right, 6 million GJs. Now this is based on the contracted estimate of 200,000 10^3 per year. They also say in there by the year 2007, they'll be up to 500,000; there's no indication how it steps up to that. But based on the 200,000, 81 per cent of the volumes would be at the 3 per cent management fee.

Mr. Hillson: — And the rest at 2.

Mr. Curry: — Well the rest at 2 until they hit another 6 million and then after that it would be 1 per cent. Based on the 200,000 per year they wouldn't get into the 1 per cent area.

Mr. Hillson: — At any rate I interrupted you, so carry on, Mr. Curry.

Mr. Curry: — Okay, so that's the obvious benefit to DEML for a marketing agreement like this. And typically a marketer will enter into an agreement where they either charge a marketing fee, which they've done here; or they play an arbitrage game where they buy at one price and sell at a different price to the buyer. So they've got a revenue stream locked in here with that management fee.

The other benefits to DEML — and they are kind of highlighted on the next page — there's transportation and storage. Transportation can be a valuable asset if you don't have any risks associated with it.

Mr. Hillson: — Now transportation as I understand it would be in effect renting time on the pipeline. Is that correct or what do you mean by that phrase?

Mr. Curry: — You're buying space on the pipeline.

Mr. Hillson: — Buying space.

Mr. Curry: — Right. And typically on transportation contracts, you have a demand charge; you pay for it whether you use it or not. So in this case here, DEML would have contracted for some transportation on NOVA and TransGas. And depending on that level of transportation — and that's where SaskPower has input into what level of contracting they will do — but given that there's a certain volume of transportation they have contracted for, when it's not being utilized by SaskPower, Direct Energy can use it for other markets.

Mr. Hillson: — Pardon me again for interrupting you, but I just want to make sure I'm following you. For example, if Direct Energy has booked with the pipeline on the basis that it might be a severe winter and consequently high demand by SaskPower, then it turns out not to be a harsh winter so there is excess space on the pipeline, what happens then when they use that excess space to service other contracts besides SaskPower?

Mr. Curry: — Well DEML can use it. First of all they have an obligation to mitigate the demand charges. So if they can recover all the transportation cost, that will be transferred back to SaskPower. However, here's where the transportation can have some value. If they have some transportation on NOVA from AECO (Alberta Energy Company) to Empress and that typically goes for about 13 cents a GJ, if they can buy gas at AECO and sell it at Empress for 15 cents, they made 2 cents. But it doesn't always have value, sometimes it has a negative value. But in this case it doesn't matter, SaskPower is responsible for the full cost.

Mr. Hillson: — Okay, so if there is dead time on the pipeline . . .

Mr. Curry: — SaskPower has to pay for it.

Mr. Hillson: — SaskPower picks that up.

Mr. Curry: — Right.

Mr. Hillson: — If there is excess time on the pipeline that Direct Energy has managed to market elsewhere at a profit that's Direct Energy's profit.

Mr. Curry: — That's Direct Energy's profit.

Mr. Hillson: — So that's why you're saying the transportation . . .

Mr. Curry: — May have an additional value which is hard to quantify.

Mr. Hillson: — So would I be correct then in saying it would be in Direct Energy's benefit to then have space on the pipeline booked according to peak demand?

Mr. Curry: — It would probably be to their benefit, yes. But I would think, and we don't have details on that, but I would think that the way this should be approached, SaskPower has to give an estimate of what their baseload requirements are to Direct Energy, I believe three or four months prior to the contract year. They prudently should probably only be contracting for transportation for something around that volume depending on the scarcity of transportation available. Those details we're not aware of.

Mr. Hillson: — Okay, that's fine. So does that pretty much explain the transportation component from your standpoint?

Mr. Curry: — Yes. It may have some value greater than the cost, and then DEML would be able to capture that, and if it has value less than that DEML isn't at risk. So that's what the value is there to DEML.

Mr. Hillson: — So the potential profit goes to DEML, the potential risk is still held by SaskPower.

Mr. Curry: — Right.

Mr. Hillson: — Okay, but could we then go on to the second factor there, storage.

Mr. Curry: — Storage. It appears that DEML is allowed to park gas in the storage facility, that would be TransGas's storage facilities, if SaskPower is not using their full storage capacity.

Again this allows the opportunity for you to park gas in a low-priced environment and sell it in a high-priced environment. So what you'd like to do then is probably park gas in the months of August and September and sell it in December.

Now they can do that to the extent that SaskPower lets them, if SaskPower isn't utilizing their storage.

Mr. Hillson: — So, you are saying that storage is basically free. There is no . . . there's out-of-pocket expenses but outside that there is no rental as such charged for storage.

Mr. Curry: — Well the out-of-pocket expenses would be parking fees. Typically a storage contract, you're allowed to withdraw and inject so much gas. If you want to do some parking there's usually an additional fee for it. So they would reimburse SaskPower for those costs. But where the upside could occur, let's assume that the parking fee is 5 cents which is kind of a typical fee — it ranges 5 to 10, 15 cents. Let's just assume you put gas into storage today at $2. You pay SaskPower the parking fee of, let's say, 10 cents, so it's $2.10. Take that gas out in December and sell it at 2.40. You've made a profit in there.

Mr. Hillson: — So I think you already point out here that it would be to the benefit of Direct Energy to buy when prices are at their low point in the cycle?

Mr. Curry: — Right, and to utilize parking if they can, if SaskPower has it available to them. And there's also a risk. They could park gas in the summer and you could have a mild winter like we did this winter, and sell gas for less or a lower price. But that's not SaskPower's risk, that's DEML's risk.

Mr. Hillson: — Okay. Now . . . and I appreciate you've already told us that you have difficulty assigning a dollar figure to the 10-year supply contract, but can I ask you this. If you were entering into a supply contract — completely independently; it wasn't tied in with the sale as it is here, just a 10-year supply contract — would you expect a 10-year supply contract for SaskPower to look pretty much as this does or would you expect it to be somewhat different?

Mr. Curry: — I would say, if I were to enter into a deal with SaskPower for 10 years, I would want something along these lines to make it worth my while to do this.

Mr. Hillson: — Okay, and if you were SaskPower?

Mr. Curry: — If I were SaskPower, I would really have to assess how much it would cost me to set up a marketing department in order to buy my gas independently because their buying requirements are very unique in the sense they could . . .

Mr. Hillson: — Because of fluctuations.

Mr. Curry: — Yes. And that requires a lot of work to try and buy gas on that basis.

Mr. Hillson: — And the 10 years strikes me as a long time to be tied in in the commercial world. Does that figure of 10 years surprise you at all?

Mr. Curry: — A lot of gas . . . We're tending to more in the gas market I find . . . we're tending more to shorter term contracts. That seems to be a trend. However, I have been involved in contracts that were 20 years, and typically electrical companies like to buy long-term supply.

Mr. Hillson: — So the fact that it's a 10-year contract doesn't strike you as inordinately long?

Mr. Curry: — Not for this kind of transaction, no.

Mr. Hillson: — And from a standpoint of SaskPower again, as opposed to the standpoint of the supplier, for a utility to go out and seek a supply contract, are these the sort of terms that you would be seeking?

Mr. Curry: — I would think that SaskPower probably has other 10-year contracts in place with other suppliers.

Mr. Hillson: — . . . of the contract besides the 10 years.

Mr. Curry: — Yes, I would think that this is not unreasonable. From DEML's perspective, the longer term they can get, the better, because that means they've got a deal in place.

From a buyer's perspective like a utility, it means reliability. Although SaskPower probably does buy a lot of gas on a one-year basis or less — other utilities do as well — but a 10-year contract is not unreasonable for a utility to enter into.

Mr. Hillson: — And the other terms of the contract concerning, say, storage, transportation, the 3 per cent, those are also within market range in your view?

Mr. Curry: — Yes.

Mr. Hillson: — Although perhaps somewhat on the generous side but within range, is that . . .

Mr. Curry: — The 3 per cent might be a little bit on the generous side, but when I look at the load factor here I think it's probably warranted. And when I say the load factor, I mean they could take up to 3,000 10^3 in one day. They might only take 500. That's 2,500 10^3 that DEML's got to find a market for.

Mr. Hillson: — And what about the provisions regarding transportation and storage? Are they again on the generous side but within range, or how would you characterize this?

Mr. Curry: — Those are kind of typical in deals with utilities or co-gen facilities. Typically the seller has the right to those transportation privileges if the buyer isn't using them. And usually there is an obligation on the part of the seller to mitigate those transportation charges.

If there isn't an incentive there, here's what happens. If there isn't an incentive, you contract for so much transportation space. SaskPower has to pay for it. If there isn't an incentive for DEML, if SaskPower's not taking the gas, DEML will just let that space sit idle. So they'll be paying for it. So there's got to be an incentive there for them to mitigate, and this is their way of mitigating that.

Mr. Hillson: — And what is the incentive to mitigate in this contract?

Mr. Curry: — Pardon?

Mr. Hillson: — And what is the incentive to mitigate?

Mr. Curry: — Well the incentive to mitigate here is that they can use that transportation. And if there's a profit there, they're able to capture it.

Mr. Hillson: — Oh, I follow you. Yes. That . . .

Mr. Curry: — But even if there isn't a profit, there is a clause in the contract stating they have an obligation to mitigate. They're supposed to use best efforts. So if the transportation costs 13 cents but the market value is only 6 cents, they have to do that so that they reduce SaskPower's costs by 6 cents.

Mr. Hillson: — Okay, I follow you. So it is to the advantage also of Direct Energy that there not be dead time on the pipe-line?

Mr. Curry: — Exactly.

Mr. Hillson: — Okay. I think I follow you. Thank you, sir. I have no further questions.

The Chair: — Thank you, Mr. Hillson. I'll now move to Mr. Shillington, please.

Hon. Mr. Shillington: — I just want to be sure I understand your testimony. It's been most useful actually.

I've always understood the term netback to mean the difference between the price at which I buy something and the price at which I can sell it before the deduction of any other expenses. In this case it's defined to be 3 per cent, but that is before the deduction of any expenses.

And I gather that you played out something that I guess that is useful. And a bit of simple arithmetic tends to confirm that because you take 3 per cent of the traditional volumes of gas used by SaskPower, SaskPower bought from them, that gives you 400 to $600,000.

Mr. Curry: — Right. I'm using actually the estimate. I don't know historically what they bought the last couple of years. I'm using estimates that's in the contract of 20,000 10^3 a year.

Hon. Mr. Shillington: — Right.

Mr. Curry: — Of their annual requirements.

Hon. Mr. Shillington: — As I say, this has been useful. What members opposite have been doing — I make this comment not so much to you but generally — is been taking . . . they asked DEML how much . . . what they expected to get . . . their revenue as distinct from their profit was 400 to $600,000.

Members opposite have been taking that figure, adding it up over 10 years, that's five million, calling the contract worth $5 million. To put it mildly, what one hopes to get in revenue from a contract doesn't make it worth 10 cents.

The question which I have for you is . . . Ernst Young were here. They did not, in preparing the balance sheets, ascribe any value to the contract and they gave several reasons for that. But one of them was that there was no commitment to take any given volume.

I gather you're saying the same thing when you say the contract has no intrinsic value. You're saying the same thing as Ernst Young said in their accounting language — that they didn't ascribe any value to it in the balance sheets.

Mr. Curry: — I assigned . . . I'm of similar mind. If I look at this thing I see no value in this contract . . . if I were to enter into this contract, other than can I do all these things that I'm obligated to do, given the management fee, and have that cover all the costs I would incur in order to do all these things.

Where I would look for value in this contract would be . . . If I were to step into this thing, I would be looking at, if there was some way where the market . . . where the sales price of SaskPower is different from what the market price is. That's where you can make some money. However, in this contract that's not the case.

Hon. Mr. Shillington: — It's cost plus.

Mr. Curry: — So the 3 per cent marketing fee has to cover your costs in order to do all these things.

Hon. Mr. Shillington: — And without doing a . . . would you agree that without doing quite a detailed analysis of DEML's financial statements, it'd be very difficult to know what profit they might expect on this, impossible really?

Mr. Curry: — I couldn't, I couldn't make a guess at it.

Hon. Mr. Shillington: — Do you know what is sort of an average profit on revenue in the . . . there is an industry here, isn't there? There's an industry which is in the business of buying gas and reselling it to utilities. DEML isn't the only one who does this sort of business?

Mr. Curry: — Well, marketers do it, producers do it.

Hon. Mr. Shillington: — Is there a rate of return which a prudent investor might want to see in a company engaged in this business as a factor of revenue?

Mr. Curry: — Well, rule of thumb for marketers — now if a marketer is doing this as opposed to a producer, producers will do it as well — for a marketer . . . I'm involved with Union Pacific fuels which moves more gas than anybody here in Canada and they are looking for, as a rule of thumb, they try to make 3 cents on a deal, on each deal.

Hon. Mr. Shillington: — That's sort of their profit or that's their . . .

Mr. Curry: — That's not a profit; that's just the difference between what they buy it at and sell it at.

Hon. Mr. Shillington: — Yes. I was trying to lead you to speculate on what the marketer's profit might be on that revenue, but I guess that's well beyond the scope of your analysis.

Mr. Curry: — Yes. I think if a marketer can make 3 cents on every deal, they'll definitely have a profit. It all depends on the . . . We have various marketers with different kinds of operations. And they not only just do deals where they make 3 cents, they make calls on futures prices and they try to do derivative trading. But if a marketer makes 3 cents on every deal, the only thing that limits the profit is how many people they require to do those deals.

Hon. Mr. Shillington: — Was it your evidence as well that it would be difficult to assign or sell this contract to another company and expect to receive a . . .

Mr. Curry: — Cash value for it?

Hon. Mr. Shillington: — . . . a cash value for it.

Mr. Curry: — Yes. If somebody approached me and said, here you can have this contract here for the remaining period, depending who I was representing, I would take a hard look at it but I definitely would not consider putting any cash on the table to get into this . . . to get it.

Hon. Mr. Shillington: — Thank you very much.

The Chair: — Thank you.

Mr. Tchorzewski: — Thank you. Just two questions, Mr. Curry. I guess I want to begin by saying that in the interests of an honest and objective conclusions, which we're going to have to draw as a committee, your evidence here today and Ms. Stewart's evidence have been very valuable because we needed to know.

And that's why the committee asked for some expert advice on whether the 50 per cent discount was appropriate, and it has been reported to us that it was because it's in the range, and whether the 10-year agreement is reasonable. And you have provided us with your view that indeed the 10-year agreement is a reasonable one.

But in your conclusion on page 1, you make reference to the benefits to SaskPower are principally the lack of obligation to make . . . to take a minimum volume of natural gas warrants such a management fee.

Is this provision, where there is no obligation to take a minimum amount, a common thing or is this kind of an exception?

Mr. Curry: — Typically we try to get in a contract, we try get as high a load factor as possible, highest take as possible. And a lot of contracts, you'll see they specify a certain volume; a certain percentage has to be taken every year. And if not, there's some other way of dealing with it, and often it's called a GIC (guaranteed investment certificate) or a reservation fee. Where if they don't take a specified volume, they have to pay a certain amount on the volume they didn't take.

For SaskPower, their loads fluctuate so widely that I think the benefit of them not having an obligation like that, it's hard to quantify, but it's definitely worth a high management fee.

Mr. Tchorzewski: — Right. And a good contract usually is of benefit to both parties. I mean if you're in business, both parties benefit in some way.

Mr. Curry: — Presumably. Unless it's a frustrated . . . You would assume that both parties entered into it reasonably.

Mr. Tchorzewski: — So if I would have to draw a conclusion in the decision that we have to make eventually, one would be able to conclude obviously DEML has some benefit out of this contract but that it's probably a good contract for SPC (Saskatchewan Power Corporation)?

Mr. Curry: — I think it is as well.

Now if their management strategy was such that said we don't want to rely on others, we want to be in the business ourselves of marketing — that's a different decision — then they would do this themselves. But that can lead to other factors. When you get into the business of marketing, it's very tempting to get into speculation.

Mr. Tchorzewski: — As they did in fact find out.

Mr. Curry: — Right. So assuming that you make the assumption that this is not your business, I think they've entered into a reasonable contract.

Mr. Tchorzewski: — Thank you very much. I think Mr. Kowalsky has a question.

The Chair: — Thank you.

Mr. Kowalsky: — Thank you. I just want to follow up a little bit on the discussion that you're having at this time, Mr. Curry.

So SaskPower would indicate to DEML now that they needed a certain amount of gas per day and they would pay the price that is in effect for that particular day?

Mr. Curry: — Yes. Some volumes are done on a year basis, and that's called the baseload volume. Some of those baseload contracts are done on a year basis. And so that would be based on the current market price at the time for one-year deals.

Typically one-year deals go from November to October. So part of their supply would be based on those one-year prices, and the rest of the supply would be based on either daily, maybe even monthly pricing. Might take a volume for a month. So they're based on market prices at the time.

Mr. Kowalsky: — And so in here you mention that there could be shared savings.

Mr. Curry: — Yes.

Mr. Kowalsky: — If for example, and I guess that would mean that if DEML would find a deal some place, through arbitrage or some other way that there could be a saving, that there would be, on a daily price basis, then SaskPower would benefit 50 per cent from that saving and DEML would benefit 50 per cent.

Mr. Curry: — The contract specifies reference to a publication called *Natural Gas Market Report*, which is produced by Enerdata out of Toronto, and that is what we kind of use in marketing for . . . what the indexes are, what the prices are, for the day.

Lately we'll see a lot of fluctuation in the day prices. So DEML might go out and buy a chunk of gas say at 9 o'clock in the morning whereas the average price of deals done for the day might be 5 cents, 10 cents higher. And if that is the case, as published in this *Natural Gas Market Report*, if that is the case, that 5 cents saving would be shared between those two.

But I don't think, from what I can see, there's any allowance in here for DEML to speculate in terms of trying to make these savings. They can for example say, well I'm going to go and buy next month's gas today and then if the price moves against me, I'll flow that to SaskPower.

I don't have enough details here on each deal, but they buy gas on a daily, monthly, and a yearly basis. And if they can buy gas on a daily basis less than what the weighted average price is in this publication, there'll be a savings.

Mr. Kowalsky: — What you're saying is, if DEML wants to speculate, that's . . .

Mr. Curry: — It's outside the scope of . . .

Mr. Kowalsky: — Outside the scope. But if there's a saving on any particular day, then half the saving flows to SaskPower.

Mr. Curry: — That's correct.

Mr. Kowalsky: — Now you also mentioned here that there are other services, and the language kind of interests me. And I wonder if you wouldn't spend a moment explaining here.

Mr. Curry: — Okay.

Mr. Kowalsky: — What is load balancing, I mean in the industry?

Mr. Curry: — All right. What DEML is going to do here, they're going to buy gas from a variety of sources and they're going to have to meet the requirements of SaskPower during that day.

Let's just say that SaskPower needs 100 units. DEML would have gone out to say maybe 20 different parties and contracted 5 here, 10 there, 12 there, to get the 100 units. However one of those parties fails to deliver their portion, let's say it's 5. They're now short 5 to deliver to SaskPower. DEML is going to step in and from some other source fill in for that person that defaulted. So SaskPower will be kept whole. They'll get their gas while DEML has used somebody else to fill in for somebody who failed.

Mr. Kowalsky: — They have to do the work and they have to do the backfilling I guess.

Mr. Curry: — Yes.

Mr. Kowalsky: — Thank you very much. What about backstopping?

Mr. Curry: — And backstopping is a similar thing where they have to make . . . have arrangements in place where they can have gas available in case somebody fails.

Mr. Kowalsky: — And that means again that that does not become SaskPower's worry.

Mr. Curry: — No.

Mr. Kowalsky: — It's DEML's worry. SaskPower benefits because they don't have to have personnel doing that.

Mr. Curry: — Right. If SaskPower were to do this directly and somebody failed they'd be short the gas.

Mr. Kowalsky: — Good. And then you have this term here, removal permits.

Mr. Curry: — When you produce gas in any of the provinces, you have to get a permit to remove it from the province. In fact in B.C. you have to actually get one just to sell it even if it's in the province. But in Saskatchewan you have to have a removal permit to move it outside the province, and you have to let the government know what price and volume you're selling so that the proper royalties can be calculated.

And in this case DEML will be buying gas in Alberta in some cases, and so they would have to get removal permits from the Alberta government.

Mr. Kowalsky: — Thank you. And nominations.

Mr. Curry: — Nominations are where you deal with the various pipelines and you place nomination which basically tells the pipeline how much gas is going from one party to another on that pipeline. This is done daily.

Mr. Kowalsky: — So the expenses incurred in these four items would be largely . . . well a lot of it would be administration just having the people there.

Mr. Curry: — Having the people to do this work.

Mr. Kowalsky: — But effectively what the deal does then is it removes any speculation in gas from . . . or any losses that might occur from speculating in gas, removes that from SaskPower.

Mr. Curry: — Well SaskPower doesn't have any ability here to do that unless they do it outside the scope of this — if they do that on their own. What it does for SaskPower, it removes a lot of the risk of them not getting gas. If they don't get the gas, they're going to have some brownouts or something like that here in the province.

It removes that risk because the obligation is on DEML to ensure that the gas is there for whatever SaskPower requires.

Mr. Kowalsky: — And by removing that risk what it does is it ensures that there's going to be fuel here when it's needed.

Mr. Curry: — Right. Now there could still be a failure and there's provision in the contract for that, if there is a failure on DEML's part. But presumably . . . well they would have a better capability of handling somebody who fails to supply than SaskPower would because they've got such a diverse supply going to this.

Mr. Kowalsky: — Well this has been very valuable. Thank you very much, Madam Chair.

The Chair: — Thank you, Mr. Kowalsky. Are there any other government members who wish to address questions of Mr. Curry? Mr. Goohsen, did you wish to put any questions? Okay.

Mr. Goohsen: — Madam Chair, I would ask Mr. Curry, by your résumé, you worked as a banker and so you would see this contract in somewhat different eyes than perhaps a layman might. And I guess my question to you would be, when a company would come to a bank to establish a line of credit, which I suspect a company like this would need to have, would they not . . . I'll ask you that question I guess first.

Mr. Curry: — Yes.

Mr. Goohsen: — So they would be very dependent on a rather sizeable line of credit in this type of business because they would have to pay people for gas perhaps if they didn't produce it themselves out of this new adventure that they'd just gone into. But as marketers they would have to pay for the gas, use their line of credit, then of course sell it, repay the line of credit, take their profit, and operate normally.

So it would be to their advantage for them to use a net figure on a contract rather than a margin and try to convince the bank that this contract was more valuable as collateral for a line of credit. Would that be true?

Mr. Curry: — Okay, I'm going to answer that question I think maybe a little differently.

When I was a banker, what I'm looking for is repayment ability and credit of the borrower. Now in this case, if I were to look at this as a banker, I see that DEML has got a guaranteed revenue stream for 10 years. So that has some merit to me as a banker whether I'm going to lend them money. However I would also want to see what their unit costs are — things like that.

So it's got some merit in a sense. They've got a guaranteed revenue stream but we don't know what the net profit is on the deal. And what I would do is to compare it to other contracts, other type management fees. And since I'm in marketing I kind of know what they are. I know that this is typical. So it has merit to a banker in that sense, that there's a 10-year deal with a guaranteed revenue stream.

Mr. Goohsen: — So with this contract you'd be more likely to grant them a line of credit than without it?

Mr. Curry: — Let's say it's a positive factor in determining whether or not they're going to get credit.

Mr. Goohsen: — So the next line of question I wanted to ask you is about the storage in the gas . . . in the pipeline system. Are there any other methods of storing natural gas?

Mr. Curry: — Other than?

Mr. Goohsen: — Parking in gas lines.

Mr. Curry: — Well we're not talking parking in gas lines. That's another thing altogether. That's called packing and drafting. And there are certain limitations the pipelines put on to prevent doing that, but parking is actually parking in the storage facility or the caverns.

Mr. Goohsen: — Okay, what is the storage . . .

Mr. Curry: — I believe in Saskatchewan you have various types of storage facilities. You have some salt caverns here and you also have some old wells. And there is different characteristics of these storage fields and caverns. Some have high deliverability, some have bigger reservoirs. But essentially when you're parking gas you're putting it into one of those facilities and you're leaving it there for a short period of time.

Mr. Goohsen: — So in Saskatchewan you have worked with Ocelot that has had a fairly significant background to work in Saskatchewan. These caverns, there would be a fairly significant amount of them. They would be available to store gas in to be sure that we have a supply other than going directly to the production well.

And in fact of course if all the pipelines froze up we would be totally dependent on those caverns as our supply for heating our homes in the winter perhaps. Is there any reason why those caverns . . . My first question is, who would own those caverns?

Mr. Curry: — I believe that the storage facilities in Saskatchewan are owned by TransGas and I believe they're operated by TransGas. In Alberta we have about four or five different storage operators that are owned by companies, public companies.

Mr. Goohsen: — Would there be any reason why SaskPower could not go to TransGas or whoever owned those caverns and buy gas parked in those caverns to be used in the event that they required it?

Mr. Curry: — To buy the gas from the people who have the gas in storage?

Mr. Goohsen: — To buy the gas and then perhaps rent storage in that cavern or . . .

Mr. Curry: — Well SaskPower does have storage in those caverns. When you rent storage though you've got to be careful about . . . you have to pay for the space that you rent.

SaskPower would have a delicate balancing act here to figure out what their peak day requirements are and what their average day requirements are. You don't want to go and contract for too big a volume in storage because you have to pay a lot of money if you don't take it all out.

Mr. Goohsen: — What I'm trying to understand is why do we need a company like DEML as a middleman taking a profit out of something that you could buy storage for, put into storage, and take out as you needed it, and quite easily do that at a reasonable day-to-day cost of gas. Or even buy it in the summertime when it's cheap, store it, and then use it in winter when gas is normally high, and not be speculating but simply buying.

Mr. Curry: — That's what SaskPower does. They do have storage contracts in place where they do put gas into storage. In fact, that's what DEML does for them. They have an obligation to put in 120,000 10^3 by each October 31. That is what SaskPower has determined would meet their requirements in the winter time.

The problem you run into is, if the weather is different from what you anticipate, and it always is, they could have a situation where by the end of March they haven't used all that gas they put into storage and they've had to pay for that space.

So this allows DEML to utilize that space if SaskPower isn't using it. There might be a profit in it for DEML, but it also mitigates the cost that SaskPower would otherwise incur. So there might not be a profit in it for DEML.

The Chair: — Mr. Goohsen, your questions are only tangentially related to the terms of reference of this inquiry, so will you focus them or wrap them up please.

Mr. Goohsen: — Well I would like to know what the logic is to having a company like DEML handle this when SaskPower is already doing it directly themselves. There's the logic is my question.

Mr. Curry: — Well SaskPower is having DEML fill up their storage capacity. And DEML is the one who's buying the gas for them to make sure that they have enough storage by the time the gas season starts in November.

The logic that I see for SaskPower is they don't have to be bothered with buying gas for storage plus their daily requirements and also to manage that storage. If they have excess storage capacity, rather than them going out to the market-place and trying to find somebody who will use it and see what kind of price they can get for it, DEML will do that.

Mr. Goohsen: — Okay. Well, Madam Chair, the point that has been made I guess is that if you don't use as much gas as you thought you were going to and the winter is soft, somebody probably is going to have a supply of gas that they're going to basically have to pay storage charges for because it has been produced and it's laying there.

Whether it be DEML that absorbs those losses or SaskPower that absorbs those losses, there's no question in my mind that in the end the consumer will have to pay for those losses in order for the system to continue to operate. So it doesn't make any difference if those losses are in DEML or if they're in SaskPower, eventually the consumer pays for it. So the logic of selling this whole operation to DEML on the assumption that you needed to guarantee a supply is a bogus argument.

The Chair: — Mr. Goohsen, today our purpose is to receive testimony from witnesses and to ask them questions, not to stake out rhetorical positions or make statements. So do you have a further question of the witness?

Mr. Goohsen: — Yes, I do. And a different line of questioning altogether.

The Chair: — This will be the last time I ask you this question, Mr. Goohsen.

Mr. Goohsen: — Would you like to qualify that?

The Chair: — Go ahead.

Mr. Goohsen: — I'm up to it today. If you were going to take a look at the motives of SaskPower selling Channel Lake, as a consultant that would look into all of these things — and no doubt you have looked at the broader picture — at the point of sale basically what SaskPower is stuck with is a dog that they want to get rid of in a hurry, and they have to sweeten the deal in order to get a buyer. And sweetening the deal would include these contracts. Would that be a normal thing for companies to do that want to unload properties in a hurry?

Mr. Curry: — I don't think I can comment on that.

Mr. Goohsen: — All right. In the event then that they decided that they wanted to sell a company in a hurry, is there any examples in your history of expertise where you would see that a company like SaskPower might sell their assets for a half million dollars less to one company than was bid by another company? Would there be any circumstances that you could see that would be logical to pass up an extra half a million dollars?

Mr. Curry: — Okay. My experience in the sale of assets like that, there might not be logic per se but there are reasons why companies will do that and there are other, I guess, benefits that they might see why they would do that. In this case I'm not quite sure what, what the circumstances are.

But I know for example just on the marketing side, if we put out bids for something, we bid on supplying say to a utility like SaskPower, we might be the lowest price but they might not accept it. They're not obligated to do so. There might be other reasons.

Mr. Goohsen: — And I guess we're trying to figure out what those reasons might be because the auditor of course raised a red flag, and that's why we're here. He saw that there was something unusual.

One of the things he might've seen unusual is that a company like Stampeder has offered a half a million dollars more for this company but they were turned down. And we're trying to decide, I guess in our minds, is there some logical reason why that would have happened? Or was there some illogical reason?

And I just thought maybe from your experience you would see some reason why that could happen?

Mr. Curry: — The reasons that I could see that they would have to consider would be how reliable are they in moving gas; how much access do they have to Saskatchewan production — if I were SaskPower I think it's one of the objectives of the contract is to get as much Saskatchewan production as possible; what are their transportation arrangements; what are their arrangements with other producers; what is the relationship in terms of any parent company? I think with Stampeder you have to look at are they are a real production company plus a marketer.

But I'm not quite sure what they went through, but those are the kinds of things that probably they would take into consideration.

Mr. Goohsen: — So there might be some explanation.

Mr. Curry: — Yes.

Mr. Goohsen: — So if we keep on digging, we may still find a better answer.

That's all the questions I have, Madam Chair.

The Chair: — Thank you very much, Mr. Goohsen. That was just right in under your allotted 15 minutes.

Mr. Gantefoer: — Just briefly, Mr. Curry, I want to follow up on the value of the contract. And not to be argumentative, but would it be fair to say that for a company, given DEML in the marketing of gas, they would have to conduct a certain amount of transactions, to do a certain volume of business just to have a break-even position? That overhead costs of the personnel, office space, hard and soft costs, would require a certain level of business just to break even. Would that be fair?

Mr. Curry: — That would be a correct statement, and that level of business could vary depending on what their margins are.

Mr. Gantefoer: — It would depend on the margins but there would be a certain level that would be there.

Once you've established a level of business, would DEML likely regard a long-term gas contract like they have with SaskPower as a relatively small amount of their global business? Would that be fair, in your experience of the size of volumes of business that the marketers do?

Mr. Curry: — Okay, that volume on average is about 20 million a day, which in itself is not that big a deal. You consider that some of these marketers . . . Direct Energy probably was doing close to a bcf (billion cubic feet) a day. Probably down from that now. But their peak is around 90 million a day, which is a significant volume.

Mr. Gantefoer: — So that even to be able to meet the requirements of the contract with these swings in demand, they would have to be transacting a large amount . . .

Mr. Curry: — A fair amount of business, that's correct.

Mr. Gantefoer: — . . . of business outside of this.

So that if I was DEML and I looked at the 10-year contract with SaskPower, I would likely not have to allocate a whole lot of new resources in order to take care of that. I've got my people taking care of a tremendous amount of contracts already. I have the logistics, the technology, the software, and all the mechanisms to handle large amounts of product, to add the SaskPower contract to it is not going to substantially change my overhead. Would that be fair?

Mr. Curry: — I would think, sir, in this case they have a critical mass already of staff. Taking on this contract does require a lot of administration because of the fluctuations in load. If this was, say their baseload requirement was all they did and that was a steady thing, they probably wouldn't have to hire anybody.

But I would think to manage this contract — you know you'd have to ask them — but I would think they need some extra people.

Mr. Gantefoer: — The point I'm making is, is when you pick up these extra contracts, they become much more profitable than what a base critical mass contract may be.

Mr. Curry: — You've got economies of scale which . . .

Mr. Gantefoer: — Exactly. So that when you look at these kind of contracts, they become much more profitable in and of themselves than what the base contract might be.

Mr. Curry: — That might be true because the incremental costs aren't as great as administering the critical mass you had to create.

Mr. Gantefoer: — Thank you.

The Chair: — Thank you, Mr. Gantefoer. Are there any other questions from any committee members?

A Member: — Move the adjournment.

The Chair: — Before you do, Mr. Curry thank you very much for coming to the committee. Do you have a closing statement that you wish to make at this time?

Mr. Curry: — Yes, I think I'd just like to summarize here my reactions to what's happened here today and my review of this.

I think we could get into a philosophical debate of whether or not SaskPower goes into these kinds of arrangements. I mean various companies have different methods of dealing with it. B.C. Gas for example is a company I deal with in British Columbia, a large utility. They have their own marketing department; that's the route they've chosen to go, so they go and do their own contracting. SaskPower has that option.

However some utilities go into these kinds of arrangements and given that they do that, this arrangement is similar to what I've seen elsewhere, so there's nothing unusual about it. The debate whether or not they should have got into it I think is something else. And that's management . . . strategic kind of decision.

The Chair: — Thank you very much, Mr. Curry.

I have a motion for adjournment from Mr. Tchorzewski. All those in favour, please indicate. Thank you.

We will meet again Monday, June 29 at 2 p.m.

The committee adjourned at 11:56 a.m.