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January 14, 2011

VIA E-MAIL
25394

Ms. Nancy McNeil
Regulatory Affairs Officer/Clerk
Nova Scotia Utility and Review Board
1601 Lower Water Street, 3rd Floor
Halifax, NS B3J 3S3

Dear Ms. McNeil:

Re: Nova Scotia Power Inc. - Digby Wind Project
(NSUARB - NSPI - P-128.10)

This is the submission of the Consumer Advocate following the hearing in relation to the above applications.

In summary, it is the position of the Consumer Advocate that under the provisions of the Revised Code of Conduct governing Affiliate Transactions (the "Code") the burden is on Nova Scotia Power Inc. to establish that the granting of the construction contract (the "contract") to Emera Utility Services ("EUS"), including payment of the bonus, met the test that the contract be demonstrated through sound, documented analysis to be the best available option for NSPI's customers. It is the contention of the Consumer Advocate that NSPI has applied the wrong test and has not satisfied the burden.

It is the request of the Consumer Advocate that the Board disallow the recovery of the $1M bonus paid to EUS.

The reasons for the Consumer Advocate's position are as follows.

For ease of reference pages of the transcript which are relied upon by the Consumer Advocate have been copied and are attached as an appendix to this submission. Reference to the page numbers is to the typed numbers at the top of each page. The portions referenced have been highlighted. Some of the transcript evidence is confidential. The attachment with the pages is only being made available to parties entitled to access the confidential material.

APPLICABILITY OF THE CODE

There is no disagreement that the construction contract awarded to EUS, including the payment of the bonus, must meet the standards set by the Code in order for the cost to be included in rate base and ultimately recovered from ratepayers. The applicable provisions of the Code that apply in these circumstances are as follows:

> "1.1 The primary purpose of this Code of Conduct is to ensure that all transactions Nova Scotia Power Inc. (NSPI) enters into with affiliates are designed and carried out in a manner reasonably expected to produce demonstrable benefit to NSPI customers, when compared with all other available options.
>
> ...
>
> 2.2 NSPI will only enter into affiliate transactions when doing so has been demonstrated through sound, documented analysis to be the best available option for NSPI's customers at the time."

The burden is on NSPI to present to the Board sound, documented analysis that the contract and the bonus are the best available option for NSPI customers.

There is good reason why such a stringent test has to be met. Affiliate transactions can easily be manipulated or masked to make it difficult for outsiders to determine what lead to the transaction and the extent to which benefits may be created or transferred among affiliates. To offset that NSPI, and its affiliates, must come before the Board prepared to make full disclosure and answer all questions.

They have not done so in this case. Their policy panel repeatedly was unable to give details as to how and when the contract was negotiated or how the values were determined (see pages 74-77).

It appears that the project was initially taken over either Emera or the numbered company ("324"). We do know that 324 was set up solely to facilitate obtaining the wind project from the original developer. It was to be a shell company which would have no retained earnings or assets.

In order to facilitate the project, Emera awarded the construction contract to EUS rather than calling for new bids or going back to any of the original bidders.

WRONG TEST

We can only speculate as to how the original price was obtained for the contract. It is not probable that EUS and Emera did any negotiating. It certainly was not the situation of two unrelated parties each pushing the other to obtain the best advantage. Rather the evidence, such as it is, suggests a number was picked based on the value determined by the engineering analysis (see evidence of Mr. Bennett at p. 31-32, see also p. 33-36).

The fact that the initial EUS contract price came in at the amount of the engineering analysis supports the conclusion that the parties were simply matching the engineering cost analysis. When that question was put to Mr. Bennett, he acknowledged that he did not know whether EUS merely bid the amount that they were told they had to meet. (p. 31-32)

Both EUS appear to have been satisfied that the number was "within the market range that's appropriate" (see p. 46-47, 49).

A price that is within a market range does not meet the criteria of the Code that requires a price that is the best available option. There is a significant difference between asking an affiliate to meet a given price and asking it to provide its best price.

Indeed a test of a market range gives sufficient variance or "looseness" that it could lead to pricing that while within the market range would still permit inappropriate affiliate transactions that would provide unwarranted benefits to an affiliate at the expense of ratepayers.

According to the evidence, EUS must have begun work by either the end of 2009 or early 2010. It began work prior to the project being transferred to NSPI. At the time of the transfer NSPI looked at the contract price and merely endorsed the view previously arrived at, that being that the price was within the market range. By doing so they also applied a test that does not satisfy the Code.

Because it appears the contract price was "picked" rather than negotiated, and "picked" on the rationale that it was in a market range, it made it all the more important for NSPI to test or investigate the number to see if it was as low as the work could be done for in the circumstances.

There was no effort made to follow up the suggestion in the email from Mr. Desdunes (Exhibit N-3 attached to response to CA IR-3, attachment 1) suggesting that two of the original bidders were prepared to make a substantial reduction in their bid price (see transcript p. 44-46, 48, 50). Approaching those two bidders to inquire as to what reductions they were prepared to make is not bid shopping in the circumstances that occurred. The original project was abandoned. Emera/324 was entitled to make inquiries of interested contractors, as well as making inquiries of its own subsidiary.

Nor did anyone make any attempt to test or determine if the individual components making up the EUS contract price were as low as possible and had been stripped of any duplication. No effort was made to analyze the individual aspects of the bid. (p. 35)

Nor was NSPI able to provide any evidence confirming that the EUS price did not include markups by EUS on amounts being charged by subcontractors (p. 39)

Bonus

The use of bonuses is not unusual in commercial contracts. Their main justification, however, is to induce faster or cheaper performance over and above basic contractual obligations.

For example, in the two examples where NSPI had previously used a bonus, it was only payable if the contracting party were able to either perform faster or cheaper (see response to U-4). They were not entitled to the bonus simply for performing the basic contract according to its terms.

In this case, the only evidence we have as to the rationale for the bonus is the statement in Article A3 of the EUS contract (Exhibit N-1, Appendix 10, p. 3). Mr. Bennett was unable to say how the bonus came into being or how the amount was arrived at (see p. 55-56). That provision makes it clear that EUS would receive the bonus for achieving Substantial Completion by December 20, 2010. But achieving Substantial Completion by that date was required as a basic contractual obligation (see Schedule D to contract). It was not a condition of the bonus that it would have to do anything other than to perform the contract.

Because NSPI failed to produce any evidence or witnesses that could demonstrate through sound, documented analysis to be the best option for ratepayers, we are left to speculate that the bonus, at some point in time, was inserted to try to make the contract price lower but to permit EUS to still recover the original price with a portion being dressed in the wording of a bonus.

It was for NSPI to put before the Board witnesses and evidence that would satisfy both the Board and stakeholders that there was a reason and a need for a bonus and to be able to test that position on cross-examination. NSPI has failed to justify the bonus as being a best available option.

Consulting Fees

Included in the project costs for which NSPI seeks recovery is the amount for professional consulting (see response to CA IR-12, Exhibit N-1, Appendix 2, p. 3). According to Mr. Bennett, those fees related to work performed by in-house legal counsel, part of which was for negotiating both the purchase of the project from Scotia Windfields, as well as the resale from 324 to NSPI (see p. 59-61).

NSPI agrees that it should not be entitled to recover from ratepayers any costs over and above what would have been incurred had NSPI acquired the project directly. Any additional costs incurred as a result of the two-step process of acquiring the project should not be for ratepayers.

At least a portion of the consulting fees would offend that principle, in that they were fees generated on both the initial transfer to 324 and on the retransfer to NSPI.

REMEDY SOUGHT

In the circumstances, the evidence does not justify NSPI being able to recover the full costs relating to the EUS construction contract.

Further, the inability of the Board and stakeholders to be able to have a true presentation and analysis of the EUS contract transaction is a result of NSPI failing to recognize the correct criteria to be applied under the Code and the onus which it must be prepared to discharge in the case of affiliate transactions. It failed to put before the Board and ratepayers sufficient evidence to permit a proper analysis of the contract.

As a result it is the request of the Consumer Advocate that the Board:

a. Deny recovery of the $1M bonus which has been paid to EUS. That adjustment will also adjust for any over recovery of consulting fees.

b. Reaffirm in clear terms that Nova Scotia Power and its affiliates must meet the criteria set out in the Affiliate Code are to be complied with and confirming that the text for affiliate transactions is the "best available" criteria and not simply a market range criteria.

All of which is respectively submitted.

Yours truly,

John Merrick

JM:dlb

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