Nova Scotia Utility and Review Board

IN THE MATTER OF Section 35(A) of *The Public Utilities Act,* R.S.N.S. 1989, c.380, as amended

- and -

IN THE MATTER OF An Application by Nova Scotia Power Inc. for Approval of Capital Work Orders:

CI 39323, Digby Wind Project
CI 39626, Digby Wind Project Substation
CI 39627, Digby Wind Project Transmission Line
CI 39628, Digby Wind Project Interconnection

NSPI Reply Submission

January 21, 2011

TABLE OF CONTENTS

1.0 SUMMARY

On January 14, 2011, Nova Scotia Power Inc. (NSPI, the Company) and the intervenors filed their closing submissions in this proceeding.

On behalf of customers, NSPI has worked diligently and in the interests of customers to comply with the Renewable Electricity Standard (RES) by relying on the significant effort and resources of its affiliates to construct and commission the Digby Wind Project (the Project), which is the lowest cost renewable energy generation project developed in Nova Scotia since the introduction of the RES in 2007. NSPI now seeks approval to include the Project, as filed, in the utility rate base for the benefit of customers.

The Application and Evidence in this proceeding, supported by the forthright testimony of Rob Bennett, President and CEO of Nova Scotia Power, compellingly demonstrate that NSPI and its affiliates have delivered demonstrable benefit to NSPI customers by engineering and constructing the Project, on time and under budget. There is no evidence before the Board that calls into question the value of the Project or the involvement and actions of NSPI's affiliates – no opposing evidence was filed and no contrary statements were elicited from NSPI witnesses during cross examination by intervenor representatives.

The intervenor submissions each support approval of NSPI's capital work order application for the Project by the Nova Scotia Utility and Review Board (UARB, the Board). None of the four submissions received recommend that the UARB decline the Application.

The submissions of Quetta and NSDOE do not challenge any aspect of NSPI's Evidence and are supportive of UARB approval of the Project, as filed. The submissions of the Avon Group and the Consumer Advocate are supportive of UARB approval of the Project but request either additional direction be given by the UARB or that certain aspects of NSPI's request for approval be denied. NSPI's reply to the arguments raised by the Avon Group and the Consumer Advocate is set out below in this submission.

2.0 FACTUAL CORRECTIONS

There are several statements made in the closing submission of the Consumer Advocate that require correction before turning to the Consumer Advocate's and the Avon Group's requested conditions on approval.

1. The Consumer Advocate states, "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."[1] This is a mischaracterization of NSPI's evidence and NSPI does not adopt these statements by the Consumer Advocate. NSPI was asked this question by Board Counsel in the hearing and provided the following response:

> **MR. OUTHOUSE:** And would you agree with me that the amount which goes into rate base as a result of these proceedings, if the application is proved, should be no more than it would have cost if NSPI had acquired the asset directly from SkyPower in the first place, rather than have the NSL intermediary?
>
> **MR. BENNETT:** I believe that what we've proposed is that the project be acquired at cost without any profit or margin to Emera from company 324. My belief is that everything that 324 has done to move the project ahead is prudent, cost effective and has resulted in a project that is valuable for customers. So I'm not ---
>
> **MR. OUTHOUSE:** Okay.
>
> **MR. BENNETT:** --- certain about the comparison, but I believe that they've demonstrated value, we've demonstrated value. The costs are only being transferred over at cost without any additional expense to customers.

[1] Consumer Advocate Closing Submission, page 4.

MR. OUTHOUSE: Okay, so there's two aspects to it, and I'll come back to one in a moment.

The first question I want to be clear about is this; when the accountants finish dotting the"i's" and crossing the "t's" on 324, it will have no assets, no liabilities, and it won't have dividended out any monies?

MR. BENNETT: That's right.

MR. OUTHOUSE: And my other question that arises out of this is whether or not the structure that was employed here by the organization, which is a term you've used and I'll use it too, not meaning NSPI specifically, but the structure that was employed here, has it added cost to the final project as compared to a direct transfer of these assets into NSPI and a management of the project by NSPI from day one?

MR. BENNETT: I believe the project, as it has been executed with the support of NSP's affiliates and Emera, has resulted in a better valued project for customers.

MR. OUTHOUSE: Better valued than if NSPI had done it directly?

MR. BENNETT: NSPI would have executed the project, I'm sure, very well but there would have been higher risks for timeline completion, a possibility of missing the eco-energy credits, additional complications in the bankruptcy process, risk of transfer of ownership back to the original owner of the project up until March, all of those things would have created complications that are more difficult to deal with within a regulated enterprise.

So I think that Emera provided a great service to Nova Scotia Power, not a service out of charity but a service out of good business and necessity. It saw a need for Nova Scotia Power to have a mechanism for compliance with the RES.

Our company operates in compliance with the laws and all of our organizations will do everything they can to ensure that we do that. And this was one way that Emera could participate and support Nova Scotia Power and its customers by ensuring that we had an option to comply and by ensuring that a valuable project got done and got done well.

> So I think that there has been value added by Emera's involvement, not expense.[2]

This response provides important context for the Board as it makes its decision about this Application. It is critical to the integrity of the regulatory process that the Board's decision reflects the evidence that has been placed on the record before it. In this case, the only evidence available to the Board is from NSPI. Casual summaries and vague descriptions are not sufficient to overcome the sworn testimony, including filed evidence and undertakings of NSPI.

2. The Consumer Advocate states, "There is no disagreement that the construction contract awarded to EUS, including the bonus payment, must meet the standards set by the Code in order for the cost to be included in rate base and ultimately recovered from ratepayers."[3]

The Code of Conduct is a UARB-approved document that applies only to NSPI. The Code of Conduct does not apply to the transaction between Emera Utility Services (EUS) and 3240383 Nova Scotia Limited (324 NSL), as suggested by the Consumer Advocate. The Board's jurisdiction does not extend to the activities of these private companies which are not public utilities. The Board's jurisdiction in respect of the Code of Conduct is applicable to decisions made by NSPI to engage in transactions with its affiliated companies. NSPI's Evidence, which is the only evidence available to the Board in this proceeding, does not support the above statement made by the Consumer Advocate. NSPI disagrees with the suggestion that the UARB's oversight extends to non-regulated contracting parties.

3. The Consumer Advocate states that NSPI has not come before the UARB prepared to "to make full disclosure and answer all questions".[4] In particular, the

[2] Transcript, page 128, line 14 - page 131, line 11.
[3] Consumer Advocate Closing Submission, page 2.
[4] Consumer Advocate Closing Submission, page 2.

Consumer Advocate states that the NSPI policy panel "was unable to give details as to how and when the contract [between 324 NSL and EUS] was negotiated or how the values were determined."[5]

This statement is not supported by the evidence. Undertaking U-5 was provided by NSPI in answer to the Consumer Advocate's request. Undertaking U-5 provides full disclosure and answer on this issue. The Consumer Advocate has ignored this evidence, which is the only evidence available to the Board on this topic in this proceeding.

4. The Consumer Advocate also states that the EUS contract price came in at the amount of the engineering analysis and that this supports a conclusion that "the parties were simply matching the engineering cost analysis".[6]

The only evidence available to the Board on this topic in this proceeding is that EUS was provided the original engineering cost analysis before the contract was signed between 324 NSL and EUS.[7] The initial engineering cost analysis prepared by CBCL was prepared for SkyPower and became owned by 324 NSL when the Project was purchased from SkyPower. This original estimate had not been adjusted for the revised scope of work and cannot be interpreted to match the EUS price. EUS did <u>not</u> have the revised engineer's estimate, adjusted for the revised scope of work, at the time it contracted with 324 NSL on February 9, 2010. It is incorrect to say that the EUS contract was "simply matching" the CBCL engineering cost analysis. The revised CBCL estimate was prepared <u>after</u> NSPI requested that 324 NSL obtain it when NSPI was performing its due diligence prior to taking assignment of the EUS contract in April 2010. CBCL provided the revised estimate to 324 NSL on May 5, 2010. The EUS contract had already been executed on February 9, 2010.

[5] Consumer Advocate Closing Submission, page 2.
[6] Consumer Advocate Closing Submission, page 3.
[7] Undertaking U-1.

NSPI respectfully suggests that the May 5, 2010 CBCL estimate demonstrates that the EUS price is the lowest reasonable price for the Project. The CBCL estimate provides independent, objective evidence that the EUS price matches the engineers' expectations for the cost of the project. Further, the original CBCL estimate was well below the bids received for the original design, so it is reasonable to conclude that CBCL's estimate would be the lowest cost for the Project construction.

5. At page 3, the Consumer Advocate's closing submission states that EUS appeared satisfied that their price was "within the market range that's appropriate", which references pages 46-47, and page 49 of the transcript. A review of these pages reveals that the quoted testimony was from Mr. Bennett who was testifying to NSPI's due diligence in assessing the EUS price, and not to what EUS did or thought. The Consumer Advocate ignores the preceding passage of the transcript. Mr. Bennett was speaking on behalf of NSPI respecting the work done by NSPI, and explaining the work done by NSPI to confirm that the EUS price was within an appropriate market range:

> **MR. BENNETT:**
>
> […]And we, in our evidence, have explained that the project is different today than it was even contemplated at the time of these bids and we have re-analyzed the bids and done a comparison that shows that the final cost of the project construction is lower under the contract today than it would have been under any of the bids that were provided before even after re-engineering, substantially lower, which I can, with confidence, say that I have faith that the price that's been paid by the project for construction is within a market range that's appropriate.[8]

NSPI respectfully reiterates that the conclusions in this process must be based upon facts that are in evidence, not generalizations or inferences that cannot withstand scrutiny.

[8] Transcript page 46, lines 7-17.

6. At page 3 of its submission, the Consumer Advocate states that there was no effort to follow up on the suggestion by Mr. Desdunes that "two of the original bidders were prepared to make a substantial reduction in their bid price."[9] The referenced email is Attachment 1 of CA IR-3. There is no evidence that two of the original bidders to the SkyPower solicitation were prepared to make substantial reductions in their price. The email states that two bidders "identified a number of areas where a comprehensive engineering analysis would likely result in a significant reduction in project construction costs."[10] Further, the email references two companies, one of which was an original bidder to the SkyPower solicitation. See CA IR-3, Confidential Attachment 2 which provides a table showing the original bidders to the SkyPower solicitation. The Consumer Advocate states, "[t]here was no effort to follow up the suggestion in the email from Mr. Desdunes".[11] This statement ignores Undertaking U-3 which was provided by NSPI in answer to the Consumer Advocate's request. Undertaking U-3 provides the only evidence available to the Board on this topic in this proceeding, and it confirms that a comprehensive engineering analysis was done, which resulted in a significant reduction in project construction costs.

7. The Consumer Advocate also states at page 3 of its closing submission that "NSPI was unable to provide any evidence confirming that the EUS price did not include any mark-ups by EUS on amounts being charged by subcontractors."

Again, this statement is not supported by the evidence. This statement ignores Undertaking U-2 which was provided by NSPI in answer to the Consumer Advocate's request. Undertaking U-2 provides the only evidence available to the Board on this topic in this proceeding, and it confirms that that the EUS price did not include specific mark ups on subcontractor work.

[9] Consumer Advocate Closing Submission, page 3.
[10] CA IR-3, Attachment 1.
[11] Consumer Advocate Closing Submission, page 3.

8. Page 4 of the Consumer Advocates submission states, "[…] 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)".[12]

   The Consumer Advocate has again chosen to omit reference to the undertaking that NSPI provided in answer to his undertaking request. NSPI's Undertaking U-5 is the only evidence available to the Board on this topic in this proceeding. Contrary to the Consumer Advocate's statement, NSPI has provided evidence as to how the bonus came into being and how the amount was arrived at as it. Undertaking U-5 provides full answer and disclosure on this issue.

   As confirmed in Undertaking U-5, 324 NSL and EUS negotiated a reduction to the base contract amount, with the difference being assigned to associated risk to be borne by EUS. This made EUS, not 324 NSL (and not NSPI customers), bear the risk of late completion. EUS reduced its original contract price in respect of several key contract components. Per the revised contract price, EUS would only earn the additional amount if substantial completion was attained on December 20, 2010. This also reflected a change in the substantial completion date from December 31, 2010. The contract also contains penalties if the Project were to be late.

3.0 POINTS OF REPLY

In the following section, NSPI provides its reply to the issues raised by the Avon Group and the Consumer Advocate.

1. NSPI acted in the best interest of customers in taking assignment of the EUS contract.

[12] Consumer Advocate Closing Submission, page 4.

2. The P50 assumption is appropriate.

3. The regulatory process includes a final costing.

1. NSPI acted in the best interest of customers in taking assignment of the EUS contract.

The all-in price for the EPC contract was not adjusted upwards to include an incentive payment. Rather, the opposite occurred. 324 NSL and EUS negotiated a reduction to the base contract amount, with the difference being assigned to associated risk to be borne by EUS. This made EUS, not 324 NSL (and not NSPI customers) bear the risk of late completion. EUS reduced its original contract price in respect of several key contract components. Per the revised contract price, EUS would only earn the additional amount if substantial completion was attained on December 20, 2010. This also reflected a change in the substantial completion date from December 31, 2010.[13]

As part of its due diligence in considering an assignment of the EPC contract in April of 2010, NSPI requested that 324 NSL engage CBCL to prepare a revised engineering estimate for the project. NSPI was able to confirm that the EUS contract was lower than the estimate prepared by CBCL. It was also able to confirm that the EUS contract was $4 to $10.5 million lower than the adjusted tenders received through the SkyPower solicitation.[14]

The Consumer Advocate states at page 3 of its closing submission that, "A price that is within market range does not meet the criteria of the Code that requires a price that is the best available option". NSPI respectfully submits that the EUS contract was the best available option, and that there is no evidence to the contrary. The Code requires the transaction, not just the price, to be the best available option. The EUS price, and certainly the transaction between NSPI and 324 NSL that assigns the EUS contact to

[13] Undertaking U-5.
[14] Transcript, page 198, lines 3-11.

NSPI, is compliant with the criteria set out in the Code of Conduct. Section 6.7 of the Code of Conduct states:

> NSPI will charge and be charged prices which reflect fair market value (FMV) for all nonregulated utility goods, services, leases, asset transfers, or other exchanges of value provided to or from affiliates, provided that in all cases NSPI shall charge for such goods and services no less than its fully allocated costs.[15]

The Code of Conduct further provides at Section 6.8:

> NSPI shall determine and document all FMV prices through the use, where practicable, of competitive tendering or quotes; otherwise NSPI shall use the most direct alternative means of establishing FMV pricing, including without limitation bench marking studies, catalog pricing or recent market transactions.[16]

Based upon the evidence in this proceeding, the EUS price represents fair market value, as established through a comparison of the EUS price to the CBCL engineering analysis and through a comparison of the EUS price to the competitive tenders received by SkyPower. This analysis is consistent with and satisfies the requirements of sections 6.7 and 6.8 of the Code of Conduct.

The Avon Group argues that one cannot tell if the EUS contract is the "best available option" in the absence of a competitive solicitation. This argument misstates the test for determining the appropriateness of an affiliate transaction on a number of levels. Price is only one relevant factor in the review of an affiliate transaction. Further, a competitive solicitation is not an absolute requirement of the Code of Conduct. As set out at Section 6.7 and 6.8, NSPI can use alternate means to establish that the price obtained reflects fair market value, as set out above.

[15] Exhibit N-8, NSPI's Revised Code of Conduct governing Affiliate Transactions, approved by Order of the UARB dated February 24, 2009. section 6.7.

[16] Exhibit N-8, NSPI's Revised Code of Conduct governing Affiliate Transactions, approved by Order of the UARB dated February 24, 2009, section 6.8.

The Consumer Advocate further argues that "NSPI has failed to justify the bonus as being a best available option". The incentive payment is a commercial term within a much broader transaction with an affiliate. The Code of Conduct requirements should not be assessed against each isolated term within a contract. The assignment of the EUS contract to NSPI, with the incentive provision being only one term of many within that contract, provides demonstrable benefit to NSPI customers. It is the overall transaction, being the transfer of the Project from 324 NSL to NSPI, which should be reviewed against the Code of Conduct.

The Consumer Advocate requests that the UARB "[r]e-affirm in clear terms that Nova Scotia Power and its affiliates must meet the criteria set out in the Affiliate Code".[17] Throughout the Consumer Advocate's closing submission there are suggestions that Emera affiliates bear a burden to appear before the Board to confirm that their actions comply with the Code of Conduct. These submissions suggest an improper extension of the UARB's jurisdiction. There is nothing within the Board-approved Code of Conduct that compels an affiliate of NSPI to appear before the UARB to justify its business activities to show that its transactions withstand Code of Conduct scrutiny. Even when an affiliate contracts with NSPI, it is NSPI to which UARB oversight applies, and it is NSPI that bears the onus of showing its transactions with affiliates were the best available options for NSPI customers.

At page 6 of its closing submission, the Avon Group states, "The best comparator to the EUS contract would be CBCL's re-scoped engineering estimate given that the bids are not an apples to apples comparison." Avon further acknowledges that the EUS contract is lower than the revised CBCL estimate.

NSPI's analysis of the EUS contract is contained within CA IR-3. The incentive was an appropriate and prudent commercial term designed to assign a portion of the risk associated with construction of the Project to EUS. EUS has completed the Project ahead of schedule and customers are receiving the benefit of fuel savings earlier as a result.

[17] Consumer Advocate Closing Submission, page 5.

Further, the ecoEnergy funding has been achieved; at $10 million over the life of the project, a demonstrable benefit to customers far in excess of the incentive itself. The assignment of the EUS contract to NSPI was the best option available to NSPI customers.

NSPI requests that the Board resist the requests of the Consumer Advocate and the Avon Group to disallow the value of the incentive from the Project approval.

2. The P50 assumption is appropriate.

The Avon Group has requested that NSPI file a report on the validity of the P50 assumption prior to the UARB rendering its decision in this matter. Avon seeks to have NSPI correlate the site's actual output with the output assumed for the purposes of the Application. As NSPI stated during the hearing, the first month of production is slightly better than forecast in the Garrad Hassan report.[18] NSPI cautions against making a longer term judgment on the first month of data. While the first month's data might be taken to suggest that the economics are slightly more favourable than forecast in NSPI's Application, which uses the 10-year P50 yield forecast, it is too early to tell whether this will be sustained over the long term. Wind yield forecasts are based on onsite measurement, correlated to a long-term data set. In the case of Digby, the wind yield forecasts are based on 14 years of weather data.[19]

Based on early data, even though the Avon Group request would suggest that the Project economics are more favourable than forecast, NSPI urges the Board to resist Avon's call for this additional layer of analysis. The best evidence regarding long term wind production at the site is contained in the Garrad Hassan report.[20] NSPI further notes that the actual wind results will be reported in the FAM monthly reports for future reference by intervenors.

[18] Transcript, page 210, line 22 to page 211, line 3, and Transcript, page 250, line 2 – page 251, line 3.
[19] CA IR-13.
[20] NSPI Application, Appendix 11.

3. The regulatory process includes a final costing.

The Avon Group has referred to a contingency amount found in the revised CBCL engineering estimate. The Avon Group states, on page 6, that given construction has come in under budget, the contingency estimated by CBCL is not warranted. This conclusion is incorrect as the CBCL estimate does not form part of NSPI's capital costs associated with the Project. The Avon Group specifically requests a disallowance of $1.5 million contained within the CBCL engineering estimate. It would be improper for the Board to order disallowance of amounts based upon engineering estimates that are not included in NSPI's capital application. NSPI respectfully requests that the Board refuse the Avon request.

Further, contingency planning is a prudent and appropriate part of construction budgeting. As part of the regulatory process, NSPI will file its final costing with the UARB for approval. The amount to be included in rate base would only be the amount actually incurred per the final approved costing. NSPI clearly advised the Board in its testimony and in Undertaking U-12, that the final amount will be lower than filed. Customers will receive the benefit of the effort of NSPI and its affiliates to construct the Project on time and under budget. To the extent that capital costs have come in lower than forecast, this will be reflected in final costing.

4.0 CONCLUSION

NSPI has brought forward a low cost renewable project which is required for 2013 RES compliance. NSPI's evidence confirms that its actions and those of its affiliates have preserved the value in an otherwise failing low cost renewable energy project for the benefit of customers. The Project was completed ahead of time and at a cost that is lower than that anticipated by the PPA held with the original IPP. The affiliate transactions associated with this Project are an excellent example of the positive outcome that can result from NSPI's engagement of affiliates as contemplated by the Code of Conduct.

The affiliate transactions comply with the purpose of the Code of Conduct "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"[21] and the Code of Conduct principle that the transactions have "been demonstrated through sound, documented analysis to be the best available option for NSPI's customers at the time."[22]

It is not the purpose of the Code of Conduct, or provided in its principles, nor is it a reasonable regulatory test to impose on a utility that it must establish that there must be absolutely no possibility that costs could have been lower. If the UARB were to accept intervenors assertions in this regard and impose these requirements on NSPI, the probable outcome is that projects, like the Digby Wind Project, will become less likely to occur. Stopping construction in April 2010 to issue an RFP may have provided more evidence to demonstrate to intervenors that EUS offered the best available option, but most certainly, such a step would have delayed the project completion and perhaps resulted in the loss of the ecoEnergy incentive. The approach urged by intervenors would harm customers, and fail to provide the benefit that the Code of Conduct's objective is designed to achieve.

NSPI respectfully requests approval, pursuant to s. 35 of the *Public Utilities Act*, of the proposed capital expenditure of $82.8 million for the costs of the acquisition and construction of the Digby Wind Project, and confirmation that NSPI has complied with the Code of Conduct, in accordance with NSPI's Capital Work Orders more fully described in NSPI's Application dated July 23, 2010.

[21] Exhibit N-8, NSPI's Revised Code of Conduct governing Affiliate Transactions, approved by Order of the UARB dated February 24, 2009, section 1.1.
[22] Exhibit N-8, NSPI's Revised Code of Conduct governing Affiliate Transactions, approved by Order of the UARB dated February 24, 2009, section 2.2.