

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE PUBLIC UTILITIES ACT

- and -

IN THE MATTER OF AN APPLICATION by **NOVA SCOTIA POWER INCORPORATED** for Approval of Certain Revisions to its Rates, Charges and Regulations, including the review of the Fuel Adjustment Mechanism Audit

BEFORE:

Peter W. Gurnham, Q.C., Chair
Roland A. Deveau, Q.C., Vice-Chair
Kulvinder S. Dhillon, P.Eng., Member

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LIST OF PARTICIPANTS:

Appendix "A"

HEARING DATE(S):

September 13-14, 18-20, October 29-31 and
November 1, 2 and 9, 2012

UNDERTAKINGS:

November 19, 2012

FINAL SUBMISSIONS:

November 30, 2012

DECISION DATE:

December 21, 2012

DECISION:

Settlement Agreements approved with adjustments for pension costs and executive compensation. Three FAM related disallowances totaling \$6,503,000. See Summary of Findings starting at paragraph 460.

TABLE OF CONTENTS

1.0	INTRODUCTION.....	2
2.0	WRITTEN AND ORAL SUBMISSION FROM THE PUBLIC.....	4
3.0	BACKGROUND.....	6
4.0	SETTLEMENT AGREEMENT.....	9
4.1	The Board’s approach to settlement agreements.....	9
4.2	The GRA Agreement in the present case.....	10
4.3	Rate Stabilization Plan.....	15
4.4	Findings.....	17
5.0	PENSION COSTS.....	19
5.1	Regular Pension Plans.....	19
5.2	Supplemental Executive Retirement Plan.....	21
6.0	EXECUTIVE COMPENSATION.....	23
7.0	LED STREETLIGHTING.....	24
7.1	Evidence.....	24
7.2	Findings.....	27
8.0	LOW INCOME RESIDENTIAL CUSTOMERS.....	29
8.1	Submissions.....	29
9.0	COST OF SERVICE – BIOMASS.....	30
10.0	NATURAL GAS STORAGE.....	32
10.1	Evidence.....	32
10.2	Findings.....	34
11.0	FAM AUDIT.....	35
11.1	Introduction.....	35
11.2	Prudency Test.....	39
11.3	Lingan Derates.....	40
11.3.1	Evidence.....	40
11.3.2	Findings.....	45
11.4	Natural Gas Contracts.....	53
11.4.1	Evidence.....	53
11.4.2	Findings.....	69
11.5	Natural Gas Markets.....	73
11.5.1	Evidence.....	73
11.5.2	Findings.....	79
11.6	Natural Gas Hedging.....	83
11.6.1	Evidence.....	83
11.6.2	Findings.....	86
11.7	FAM Audit Process.....	90
11.7.1	Evidence.....	90
11.7.2	Findings.....	99
11.8	FAM Small Working Group.....	108
11.9	Remaining recommendations in FAM Audit.....	110
11.10	Disallowed Costs related to the FAM Audit.....	111
11.10.1	Evidence.....	111
11.10.2	Findings.....	115
11.11	Implementation of the FAM disallowances.....	116
11.12	Perspective.....	118
12.0	MISCELLANEOUS.....	120

12.1	Information Requests.....	120
13.0	COMPLIANCE FILING	120
14.0	SUMMARY OF BOARD FINDINGS	121
	APPENDIX A.....	133

1.0 INTRODUCTION

[1] This Decision is further to a public hearing conducted by the Nova Scotia Utility and Review Board (the “Board”) on September 13-14, 18-20, October 29-31, and November 1, 2 and 9, 2012, in the matter of an application by Nova Scotia Power Incorporated (“NSPI”, the “Company”, the “Utility”), dated May 8, 2012, for approval of revisions to its Rates, Charges and Regulations (the “Application” or “GRA”).

[2] Consistent with the Plan of Administration (“POA”) for NSPI's fuel adjustment mechanism (“FAM”), Liberty Consulting Group (“Liberty”) was engaged to do a comprehensive audit with respect to the FAM for the period covering 2010 and 2011 (“FAM Audit”). The POA provides that an audit of the FAM will be done every second year. Liberty filed its FAM Audit with the Board on July 10, 2012. The Board directed that its consideration of the FAM Audit would be consolidated into the hearing of NSPI's general rate application. This Decision also includes the Board's findings relative to the FAM Audit.

[3] The NSPI Application seeks the Board's approval of a Rate Stabilization Plan (“RSP”). The proposed RSP is a two-year rate plan, with net increases of three percent per year effective on each of January 1, 2013, and January 1, 2014. According to the Application, the increases will cover a portion of the increased costs forecast by NSPI in each of the next two years. NSPI proposes the remaining revenue requirement be deferred for future recovery commencing in 2015. The various elements of the proposed RSP are explained in further detail later in this Decision.

[4] The public hearing was duly advertised in accordance with sections 64 and 86 of the *Public Utilities Act*, R.S.N.S. 1989, c. 380, as amended (the “Act”), which read as follows:

Approval of schedule of rates and charges of utility

64 (1) No public utility shall charge, demand, collect or receive any compensation for any service performed by it until such public utility has first submitted for the approval of the Board a schedule of rates, tolls and charges and has obtained the approval of the Board thereof.

(2) The schedule of rates, tolls and charges so approved shall be filed with the Board and shall be the only lawful rates, tolls and charges of such public utility until altered, reduced or modified as provided in this Act.

Notice of hearing of application for rate changes

86 Notice of the hearing of any application, for the approval of or providing for an increase or decrease in the rates, tolls and charges of any public utility, shall be given by advertisement in one or more newspapers published or circulating in the cities, towns or municipalities where such changes are sought, for three consecutive weekly insertions preceding the date of said hearing, unless otherwise ordered by the Board.

[5] A total of 15 formal Intervenors responded to the application of NSPI. A number of these parties were represented at the hearing by counsel. The Small Business Advocate (“SBA”); the Consumer Advocate (“CA”); the Affordable Energy Coalition (“AEC”); Alton Natural Gas Storage LP (“Alton”); Avon Group (“Avon”), whose counsel represented 13 Intervenors; Halifax Regional Municipality (“HRM”); the Liberal Caucus Office; the Progressive Conservative Caucus Office; the Municipal Electric Utilities of Nova Scotia Co-operative (“MEUNSC”); and the Nova Scotia Departments of Energy and Environment (the “Province”) all participated in the hearing. The Board also received numerous submissions from members of the public opposing NSPI’s Application.

2.0 WRITTEN AND ORAL SUBMISSION FROM THE PUBLIC

[6] In the advertised Notice of Public Hearing, the public was advised that they could file submissions with the Board outlining their views regarding NSPI's Application. In response to this notification, the Board received 64 written submissions from the public and 13 individuals made presentations at the evening session on September 18, 2012.

[7] Most of the written submissions noted impacts that another rate increase would have on customers, especially on low and fixed-income customers. Some of the concerns noted were: the number of recent rate increases; executive compensation levels; rate of return and company earnings; the need for renewable energy; and employee bonuses.

[8] During the evening session, some of the same concerns were raised. Presentations were made by 10 individuals and by a representative from the Canadian Federation of Independent Business ("CFIB"), by the M.L.A. for Pictou West, and the President of the Halifax-Dartmouth and District Labour Council.

[9] The Honourable Charlie Parker, M.L.A. for Pictou West and Minister of Energy, stated that his government has heard the concerns of Nova Scotians, caused by higher electricity rates, and planned to introduce legislative amendments in the fall of 2012 to deal with executive salaries and bonuses, reducing the number of rate hearings, and dealing with the performance of NSPI in general.

[10] Leanne Hachey, representing the CFIB and 5,200 small and medium size businesses in Nova Scotia, noted that her membership cannot absorb any further increases and also cannot pass these on to its customers. She stated NSPI should find

efficiencies within its organization to pay for increased operating costs. She requested that the demand meter threshold be raised to allow additional small businesses to migrate out of this rate class.

[11] Kyle Buott, representing the Halifax-Dartmouth and District Labour Council and 25,000 union workers, stated that within the last four months his delegates have voted twice, unanimously, against the rate increase. He made three points: objecting to the process followed in the rate hearing via settlement agreement; the rate hike proposed does not reflect the cost of electricity but profit for the company; and the Board should get more input from ratepayers who live outside the Halifax area.

[12] Archie Stewart collected an electronic petition which he filed with the Board before the evening session. He noted that he was speaking on behalf of 31,334 Nova Scotia families and the Board should deny the proposed rate increase, including the Settlement Agreement.

[13] Gene McManus stated that the NSPI pension plan is being run by its employees who are also the beneficiaries of the plan. He suggested that the NSPI pension plan should be run by an independent third party.

[14] The Board considered all the comments made in the written submissions and during the evening session in making its decision on the Application. The Board is mindful of its responsibility to protect the public interest and does give due weight to the comments received from the public. The Board has to balance this with the needs of the Utility to provide a safe and reliable service at a minimum cost. No one likes rate increases; however, the Utility's costs are increasing, similar to other businesses, and rates need to be adjusted in order to recover these cost increases.

3.0 BACKGROUND

[15] NSPI is a vertically integrated, investor-owned, regulated public utility with a virtual monopoly on electricity service throughout the province. It is the primary electricity supplier in Nova Scotia, providing over 95% of the electricity generation, transmission and distribution in the province. The *Act* gives the Board broad regulatory oversight over public utilities and provides it with the authority to discharge its regulatory responsibilities. The *Act* requires the Board to use a cost for service method for setting rates. The Board must allow NSPI to recover its prudent and proper costs of providing each type of service and a return on its rate base or capital assets.

[16] In legislation, the word “shall” is mandatory. Therefore, the Board is required to determine NSPI’s costs and assets in providing each type of service.

Section 42(1) provides:

42(1) The Board shall fix and determine a separate rate base for each type or kind of service furnished, rendered or supplied to the public by a public utility. [Emphasis added]

[17] The Board must provide a rate of return to NSPI each year. Section 45(1) reads:

45(1) Every public utility shall be entitled to earn annually such return as the Board deems just and reasonable on the rate base as fixed and determined by the Board for each type or kind of service furnished, rendered or supplied by such public utility, provided, however, that where the Board by order requires a public utility to set aside annually any sum for or towards an amortization fund or other special reserve in respect of any service furnished, rendered or supplied, and does not in such order or in a subsequent order authorize such sum or any part thereof to be charged as an operating expense in connection with such service, such sum or part thereof shall be deducted from the amount which otherwise under this Section such public utility would be entitled to earn in respect of such service, and the net earnings from such service shall be reduced accordingly. [Emphasis added]

[18] This return must be in addition to NSPI’s prudent and proper operating expenses of providing the services. Section 45(2) states:

45(2) Such return shall be in addition to such expenses as the Board may allow as reasonable and prudent and properly chargeable to operating account, and to all just allowances made by the Board according to this Act and the rules and regulations of the Board. [Emphasis added]

[19] NSPI, like all other business, experiences cost increases in virtually every expense it incurs to produce electricity for the people of Nova Scotia. The *Act* requires the Board to ensure these prudent and proper costs are recovered in NSPI's rates.

[20] A fair return on rate base is important for the sustainability of the service. A low return on rate base may cause people to not invest in the Utility. It may also lead to a poor bond rating, which may cause financial institutions to increase the rate of interest on monies NSPI needs to borrow to provide the service. This may result in NSPI's rates increasing solely to cover the additional costs of borrowing money, without even addressing the increases in the operating expenses.

[21] In addition to statutory requirements to be considered during a general rate application, the Board is also guided by long-established, fundamental ratemaking principles. In its Decision dated March 31, 2005, on a rate application by NSPI, the Board explained these guidelines as follows:

In utility regulation, there are generally accepted principles which govern the rate-making exercise. The object of rate-making under a cost-of-service-based model is that, to the extent reasonably possible, rates should reflect the cost to the utility of providing electric service to each distinct customer class. In regulating NSPI, the Board is guided by these generally accepted principles as well as by case law.

A widely-accepted publication written by Dr. James Bonbright entitled **Principles of Public Utility Rates**, sets out the following guidelines for determining appropriate rates:

CRITERIA OF A SOUND RATE STRUCTURE

1. The related, "practical" attributes of simplicity, understandability, public acceptability, and feasibility of application.
2. Freedom from controversies as to proper interpretation.

3. Effectiveness in yielding total revenue requirements under the fair-return standard.
4. Revenue stability from year to year.
5. Stability of the rates themselves, with a minimum of unexpected changes seriously adverse to existing customers. (Compare "The best tax is an old tax.")
6. Fairness of the specific rates in the apportionment of total costs of service among the different consumers.
7. Avoidance of "undue discrimination" in rate relationships.
8. Efficiency of the rate classes and rate blocks in discouraging wasteful use of service while promoting all justified types and amounts of use:
 - (a) in the control of the total amounts of service supplied by the company;
 - (b) in the control of the relative uses of alternative types of service (on-peak versus off-peak electricity, Pullman travel versus coach travel, single-party telephone service versus service from a multi-party line, etc.).

[Decision, March 31, 2005, p. 14]

[22] The Board continues to make its decisions in accordance with the *Act*, and the principles noted above.

[23] After seeking an adjournment at the commencement of the public hearing on September 13, 2012, NSPI notified the Board on September 14th that it had reached a Settlement Agreement (the "GRA Agreement") on many of the outstanding issues in the NSPI Application. The GRA Agreement has the support of the CA, the SBA and Avon. The Board adjourned the hearing to provide an opportunity for all other parties to review the GRA Agreement. The hearing reconvened on September 18, 2012, at which point NSPI witnesses explained the terms of the GRA Agreement and testified with respect to the outstanding issues. However, the GRA Agreement was only executed as of October 15, 2012 and was not filed with the Board until November 2, 2012.

4.0 SETTLEMENT AGREEMENT

4.1 The Board's approach to settlement agreements

[24] In its previous Decisions, the Board has set out the principles it applies in its consideration of settlement agreements. Those principles bear repeating. In its Decision dated November 5, 2008, the Board outlined its general approach to settlement agreements submitted to it for approval:

[12] The Board's *Regulatory Rules* facilitate settlement discussions. The Board welcomes and appreciates the efforts of parties to, in good faith, settle issues, even where, as sometimes happens, a settlement cannot be ultimately achieved.

[13] Where, as here, the Agreement is supported by representatives of all of the customer classes, the Board can have confidence that the Agreement is in the public interest.

[14] Customers of NSPI and members of the public are, perhaps understandably, wary of the settlement process. Many of those customers and members of the public may not appreciate that by the time the hearing commences 80% of the rate hearing process has already happened. NSPI filed extensive evidence, as required by the Board, to support its rate request. Interested parties and Board Staff asked NSPI many hundreds of written questions (Information Requests), to which responses were filed.

[15] All of the parties who chose to do so filed evidence, including expert evidence. Written questions (Information Requests) have been asked of and answered by interested parties who filed evidence. NSPI filed reply evidence. As noted, all of this happened before the hearing was scheduled to begin so that the parties and the Board are well informed about the case in advance of any oral public hearing.

[16] The public can rest assured that the Board Members hearing the matter have also thoroughly reviewed all of the material in advance of coming to a decision as to whether to approve the Agreement as being in the public interest.

[17] Settlement agreements, while relatively new in regulatory matters before the Board, are common in the litigation process. Within the Board's adjudicative mandate, for example, assessment appeals, planning appeals and other matters are often settled. In the civil courts of Nova Scotia, a much higher percentage of cases are settled than go to trial.

[18] That is not to say that the Board would hesitate to reject a settlement agreement it did not consider to be in the public interest, however, it should be understood that a properly supported settlement is a success of the regulatory process, not a failure.

[Decision, 2008 NSUARB 140]

4.2 The GRA Agreement in the present case

[25] The GRA Agreement addresses many outstanding issues between NSPI and most of its customers. However, several issues were not resolved, including the FAM audit, pension costs, LED street lighting and the underground storage of natural gas.

[26] Notably, the GRA Agreement adopts the two year RSP proposed by NSPI.

[27] The GRA Agreement reads as follows:

**2013-2014 General Rate Application
Settlement Agreement
October 15, 2012**

Whereas NS Power filed a General Rate Application for 2013 and 2014 on May 8, 2012;

And Whereas the Board Hearing Schedule provided for Information Requests to NS Power and Responses, Testimony from Board and Intervenor consultants with corresponding Information Requests and Responses, Reply Evidence from NS Power, and Opening Statements from parties and consultants;

And Whereas the Parties to this Settlement Agreement, which include NS Power, Avon Group, the Consumer Advocate and the Small Business Advocate, desire to resolve the General Rate Application by way of this Agreement;

The Parties agree:

1. The 2013-2014 Rate Stabilization Plan is accepted and adopted, as filed, subject to the changes contained in this document. This includes a three percent overall rate increase for each of 2013 and 2014, plus a deferral of forecasted revenue requirement that is not otherwise recovered by the two rate adjustments, using the August 31 update. The deferral recovery would begin in 2015 in an amount that is equivalent to the s.21 amount in rates.
2. NSPI will identify, at its own discretion, and manage the business in order to achieve a \$27.5 million reduction in the deferral balance over the two year period. None of the reductions will be achieved through fuel forecast reductions. This will resolve all issues relating to revenue requirement, subject to items 3 and 6 (below).
3. ROE will be set at 9.0% for rate making purposes, with a 0.25 band. Therefore the ROE range will be from 8.75% to 9.25%.
4. The result of the changes in items 2 and 3 will be that the fixed cost deferral amount will not exceed \$84.8 million, which includes the financial effect of the lower ROE and the resulting lower interest costs relating to financing a lower deferral amount. For the purpose of calculating interest, the deferral will be reduced by \$13.75 million in each year of 2013 and 2014.
5. S.21 amounts will be accepted as filed. The S.21 AAA Mechanism will continue as part of the Rate Stabilization Plan, as proposed in the Application.
6. Fuel - Base Cost of Fuel will be set as per the August 31 update. Liberty's proposals regarding natural gas will be determined by the outcome of the FAM Audit process. If the UARB accepts Liberty's views in that process, the Base Cost of Fuel and therefore the revenue requirement (and deferral) will be reduced to the extent the audit outcome affects the fuel forecast for 2013 and 2014. Liberty's suggested

- reductions relating to imports are not adopted but the suggestion will be referred to the Small Working Group for study and possible changes to the forecasting methodology for future implementation.
7. The FAM Audit issues will continue to be litigated in accordance with the Board schedule for the hearing that commences October 29. The financial result of the hearing, if any, will be implemented beginning January 1, 2013 separate and apart from the Rate Stabilization Plan.
 8. NS Power's proposal to update OATT pricing, with the exception of its request for an ECRM (which has already been determined by the Board), will be accepted as filed. The matter of the MEUNSC responsibility for deferrals, in the event of departure from the system, may be determined in a future application before the UARB. Parties are free to take any position on OATT related matters in future proceedings.
 9. The SBA request for an adjustment to the R/C ratios for small business classes and narrowing of the band (0.95 to 1.05) will be referred to the Cost of Service Study proceeding.
 10. Adjustments will be made to the Large Industrial Interruptible class to ensure this class of customers receives the same 3% adjustments as experienced by other customer classes, similar to the approach taken in the 2009 GRA Settlement Agreement.
 11. The Interruptible Rider to the Large Industrial Tariff will be revised as provided in the attached September 28, 2012 letter from NS Power to the UARB.
 12. During the hearing parties to the agreement will refrain from seeking any changes to the agreement or additional reductions to revenue requirement. This settlement is without prejudice to any position that parties may take on these issues in future proceedings.

[Exhibit N-201]

[28] The GRA Agreement has an attachment related to the Interruptible Rider.

[29] In his Opening Statement at the hearing, Rob Bennett, NSPI's CEO, stated that the GRA Agreement, which incorporates the RSP, provides the Utility and its customers with the time to adjust to significant changes in NSPI's load and costs:

The Rate Stabilization Plan provides the best approach to the complex challenges we face, together, with the Board and our customers. Input costs are rising, new renewable energy is being added to the system, and load is dropping – quickly and dramatically. Any of these challenges would create upward pressure on electricity rates; and we are experiencing them all at once.

Mr. Chairman, we will continue to work on behalf of our customers to meet the challenges that will arise during this Rate Stabilization period. This agreement gives everyone time to adjust to the lost pulp and paper load, but does not solve that problem. In 2015 we will have to incorporate the lost load into general rates, including the final payment of the 2012 Fixed Cost Deferral, and any other changes in our cost structure that are forecast for that test year.

[NSPI Opening Statement, Exhibit N-123, p. 1]

[30] In NSPI's Closing Submission, counsel for the Company submitted:

The Settlement Agreement reflects agreement by the parties to accept and adopt the Rate Stabilization Plan, as filed, subject to specific changes provided in the Settlement Agreement. That includes a net 3 percent overall increase in each of 2013 and 2014, with a deferral of forecast revenue requirement, based on the Company's August 31 Load and Fuel Update filing, not otherwise recovered by the 3 percent rate increases in each of the next two years. ...

Key to the settlement is the fact that it reflects a commitment by the Company to be responsible for \$27.5 million of the original deferral of revenue requirement. The parties agreed that no deferral reductions will be made through fuel adjustments, but that the Company will identify at its own discretion, and manage the business in a manner that will achieve the \$27.5 million deferral reduction. This commitment represents a significant challenge to the Company over the next two years, and will provide a substantial long term benefit to customers.

[NSPI Closing Submission, November 23, 2012, p. 12]

[31] NSPI counsel also noted the benefits to customers of reducing the return on equity:

...This includes the agreed reduction in NS Power's return on equity (ROE) for rate setting purposes from 9.2 percent to 9.0 percent along with a change to the earnings band to +/- 0.25 percent, making the earnings band 8.75 to 9.25 percent. This change also contributed to reductions to the Company's revenue requirement for 2013 and 2014, leading to further reductions made to the deferral amount, over and above the \$27.5 million.

[NSPI Closing Submission, November 23, 2012, p. 15]

[32] The CA supports the approval of the GRA Agreement. In his view, after analyzing all of the Pre-filed Evidence, the result was not likely to be better by pursuing a contested hearing:

It is to be noted that the settlement agreement calls for a reduction in NSPI's requested revenue requirement. The Consumer Advocate and other signatories to the settlement agreement analyzed all of the pre-filed evidence and, with the benefit of assessments by expert consultants, concluded that rate increases proposed in the settlement agreement are reasonable and justified. Furthermore, it is the view of the Consumer Advocate and the settling intervenors that the agreed-upon reduction in revenue requirement was not likely to be improved through additional litigation. One important aspect of the proposed settlement agreement, as noted by Commissioner Dhillon in his questioning of the NSPI panel, is that the proposed increases are 3% class revenue increases. ...

In addition to the rate increases in 2013 and 2014, the settlement agreement also provides for deferred collection of a significant portion of NSPI's revenue requirement. Although the Consumer Advocate continues to be leery of deferral mechanisms, there was an identified and important correlation between the deferral proposed in this settlement agreement and the extinguishment of the section 21 deferral which is presently in rates. The net effect is that the deferral contemplated in this settlement will

be collected once the section 21 deferral has been paid off and therefore represents an opportunity to smooth or even out rate increases experienced by customers.

[CA Closing Submissions, November 23, 2012, p. 4]

[33] The SBA also submitted that, after a review of the evidence, the GRA Agreement represented a reasonable resolution of most issues in the Application:

The Settlement Agreement signed by the Consumer Advocate, the Avon Group, Nova Scotia Power and the SBA, was the result of much consultation and discussion and was not taken lightly. Accordingly, after assessing the Application and merits of achieving greater results by litigating before the Board, and after reviewing the experts' reports, asking numerous questions, followed by numerous hours of negotiations, the SBA was satisfied the Settlement Agreement dated October 15, 2012, represents a reasonable resolve with respect to many items referred to in the General Rate Application when compared with the uncertainty of successful litigation.

[SBA Closing Argument, November 23, 2012, pp. 1-2]

[34] Counsel for Avon noted that the GRA Agreement represents a resolution of issues between all customer classes, excluding municipal customers:

In each case, Intervenors must carefully evaluate the evidence to judge the costs and risks of challenging the Utility's application against the advantage of a negotiated settlement. With the exception of the Municipal customers, the Settlement Agreement has the support of representatives of all customer classes who participated in the process - the Avon Group (Large Industrial), the Consumer Advocate (Residential) and the Small Business Advocate (Small General, General, Small Industrial), as well as NSPI. It is a reflection of the good faith efforts of the participants that a settlement was achieved in a very compressed time frame. There were compromises among all signatories but only time will tell whether it is a "good" deal for all concerned.

[Avon Final Submissions, November 23, 2012, para. 5]

[35] Counsel for Avon also highlighted a number of the elements of the GRA Agreement which will benefit customers:

The Agreement results in an across-the-board 3% increase in each of 2013 and 2014 plus a deferral of forecasted revenue requirement not to exceed \$84.8 million (clause 4). At the end of the two years, the deferral is planned to be recovered in an amount equal to the Section 21 payment that is already embedded in rates (clause 1). As part of the Settlement Agreement, NSPI has agreed to a \$27.5 million reduction in the deferral balance spread equally over the two year period (clause 2). In addition, the ROE will be set at 9.0% plus or minus 25 basis points, i.e. 8.75% - 9.25% (clause 3). *The Settlement Agreement continues the previously agreed-upon cap on ROE through the s.21 AAA mechanism with any excess applied against the deferral (clause 5). This is an element of*

the negotiated Agreement that would not have been achieved through a contested proceeding. [emphasis added]

[Avon Final Submissions, November 23, 2012, para. 7]

[36] Moreover, Avon Counsel noted that the GRA Agreement contains two clauses which are particularly significant for large industrial interruptible customers, including a clause which provides that this class receives the same 3% increase in rates as other classes, together with revisions to the Interruptible Tariff Rider which balances the risk between NSPI and its interruptible customers respecting notices to reduce load.

[37] The Province does not oppose the settlement process and suggests that the proposed GRA Agreement is worthy of serious consideration by the Board:

Although it is not a signatory to the Settlement Agreements filed in this case, the Department of Energy does not oppose the settlement process, as outlined and applied by the Board in its past decisions. In this case, the Settlement Agreement has been executed by representatives of almost all of NSPI's classes of customers and therefore we would respectfully suggest warrants serious consideration.

[Province Closing Submissions, November 23, 2012, para. 12]

[38] The Province also noted that the GRA Agreement benefits customers. Counsel pointed out that the proposed \$27.5 million non-fuel cost reduction in NSPI's deferral is not to be achieved through reductions in forecasted fuel costs. After noting the benefits of the RSP, as described immediately below in this Decision, counsel for the Province added:

...At the same time, the revenue requirement reductions agreed to in the proposed settlement agreement will reduce the extent to which future rates are impacted as a result of the stabilization plan. These revenue requirement reductions include a lowering of NSPI's return on equity, which the Department of Energy applauds.

[Province Closing Submissions, November 23, 2012, para. 13]

4.3 Rate Stabilization Plan

[39] A major component of the NSPI Application is the RSP. Subject to the changes noted in the GRA Agreement, the 2013-2014 RSP is adopted as part of the GRA Agreement.

[40] NSPI has forecast the revenue requirement for each of the next two years instead of the traditional single year approach. The elements of the RSP are set out in the NSPI Application:

The Rate Stabilization Plan, which provides for recovery of the 2013 and 2014 revenue requirements is as follows:

- i. For each customer class, an average three percent increase on January 1, 2013 and an average three percent increase on January 1, 2014, after factoring in the 2010 FAM deferral reductions in 2013 and 2014,
- ii. Deferral of any portion of the Board approved revenue requirement not recovered by the average 3 percent annual increases. Effectively, this will continue the 2012 Fixed Cost Recovery deferral, which will continue to grow until the end of 2014, with recovery of the deferral over an 8 year period beginning in 2015,
- iii. FAM adjustments, other than for the 2010 FAM deferral reductions and the 2011 FAM imbalance both of which are reflected in the 2013 Balance Adjustment, will be deferred, to be incorporated into customer rates in 2015, and the FAM incentive will remain suspended until the end of 2014.

[NSPI Application, Exhibit N-3(i), pp. 2-3]

[41] The 2012 Fixed Cost Recovery Deferral, which accommodated uncertainty about the province's pulp and paper load, was approved by the Board as part of NSPI's 2012 general rate application. In that proceeding, the settlement agreement approved by the Board initiated the Fixed Cost Recovery Deferral. The 2012 Fixed Cost Recovery Deferral was accepted by the same parties to the present GRA Agreement.

[42] NSPI's Application provided that the RSP deferral would be \$130.7 million [Undertaking U-6]. Under the proposed GRA Agreement, the deferral will not exceed

\$47.1 million at December 31, 2013 and will not exceed \$84.8 million at December 31, 2014.

[43] NSPI's Application states that the amount of the deferral will be calculated separately for each class of customer, such that the "across-the-board 3-percent increase" will result in deferrals that accurately reflect the specific cost of serving each class of customer.

[44] Under the proposed RSP, the annual three percent adjustment will incorporate forecast decreases connected to the phase-out of the 2010 FAM Deferral. Also, the FAM will continue to operate, but additional AA and BA changes in 2013 and 2014 fuel costs will be deferred within the FAM until the RSP ends.

[45] NSPI submits that recovery of the deferral, commencing in 2015, will coincide with the end of the Section 21 Tax Deferral, which NSPI has been collecting from ratepayers over eight years ending in March 2015:

In the current situation, NS Power believes a modest, short-term deferral of increased expenses is an appropriate way to stabilize rates for customers over the next two years. We propose to begin recovering the deferred costs in 2015, just as the Section 21 Tax Deferral expires. By timing the deferral this way, and if the deferred amount is less than \$110 million, [NSPI] will be able to recover it in full over eight years, with no change in rates. In effect, as soon as [NSPI] finish[es] collecting the Section 21 Tax Deferral, [NSPI] will replace it with an eight-year recovery of the Fixed Cost Recovery deferral.

[NSPI Application, Exhibit N-2, p. 28]

[46] Counsel for Avon also submits that the RSP benefits the members of the Avon Group by providing a "predictable measure of stability" over the next two years:

From the perspective of the Avon Group, the Settlement Agreement results in a predictable measure of stability for the next two years and avoids the time, expense and uncertainty of a contested rate case. ... Members of the Avon Group shoulder their own regulatory costs, so the ability to predictably budget for energy costs over the next two years without the risks and costs of contested proceedings was attractive.

[Avon Final Submissions, November 23, 2012, para. 6]

[47] Similar reasoning was expressed by the SBA:

The SBA is further of the belief the two (2) year rate stabilization plan which calls for an overall average 3 percent rate increase for customer classes effective January 1, 2013, and further increase of 3 percent effective January 1, 2014, will help reduce litigation fatigue, and give stability for small business with respect to rate stabilizing increases for the next two (2) years. ...

[SBA Closing Argument, November 23, 2012, p. 2]

[48] Counsel for the Province refers to the RSP as a positive aspect of the GRA Agreement:

From the Department of Energy's perspective, there are many positive aspects to the proposed Settlement Agreement. The acceptance and adoption of the 2013-2014 Rate Stabilization Plan, while not avoiding rate increases, will dampen the impact of those increases. At the same time, the revenue requirement reductions agreed to in the proposed settlement agreement will reduce the extent to which future rates are impacted as a result of the stabilization plan...

[Province Closing Submissions, November 23, 2012, para. 13]

4.4 Findings

[49] The GRA Agreement represents a comprehensive resolution of many contested issues between NSPI and the Intervenors representing most of its customers. It addresses a number of significant components raised in the NSPI Application.

[50] The Board is mindful that the GRA Agreement represents a negotiated settlement by most represented customer classes, with the exception of the municipalities, whose involvement was directed to other issues in the GRA proceeding as described later in this Decision.

[51] In the Board's view, an important component which will benefit customers is the RSP, which limits across-the-board increases of 3% in each of 2013 and 2014, while deferring recovery of NSPI's remaining revenue requirement to 2015 when the Section 21 Tax Deferral will be fully retired. The net effect of the RSP is that the

revenue requirement deferral will only be collected after the Section 21 Tax Deferral has been retired. The deferral will be collected over an 8 year period beginning in 2015.

[52] Without the RSP, customers would have faced much larger rate increases, particularly in 2013. As noted by the CA, this will "smooth or even out rate increases experienced by customers". Counsel for Avon agreed that this will provide ratepayers with a "predictable measure of stability" over the next two years.

[53] In its original Application, NSPI had proposed that the deferral would be about \$124.4 million (Exhibit N-3(i), Appendix P, Attachment 2), later amended to \$130.7 million in Undertaking U-6. The GRA Agreement provides for a \$27.5 million non-fuel cost reduction in NSPI's deferral. Accordingly, the deferral will not exceed \$84.8 million at December 31, 2014, which includes additional adjustments made by NSPI in the hearing.

[54] The GRA Agreement also reduces NSPI's return on equity from 9.2% to 9.0%, along with a revised earnings band of 8.75 % to 9.25 %. This will also result in further reductions to NSPI's revenue requirement for 2013 and 2014, leading to further reductions made to the deferral amount, over and above the \$27.5 million non-fuel cost reduction.

[55] Finally, as noted by counsel for Avon, the GRA Agreement continues the previously agreed-upon cap on return on equity through the s.21 AAA mechanism, with any excess applied against the deferral. This would not have been achieved through a contested proceeding.

[56] Taking into account the evidence and the submissions, the Board is satisfied that the GRA Agreement is in the public interest and that it should be

approved. In the view of the Board, the GRA Agreement provides for rates that are just and reasonable.

[57] The Board approves the NSPI Application, except as amended by the terms of the GRA Agreement or as otherwise varied in this Decision. Rates will increase by 3% for each customer class on January 1, in each of 2013 and 2014. The Board notes that it also approves the requested changes to Accounting Policy 5900 – Tax and the proposed updated OATT pricing.

[58] The Board directs NSPI to outline in 2013 and 2014 where it has applied the \$27.5 million non-fuel cost reductions negotiated in the GRA Agreement. This disclosure is to accompany the year-end financial statements in the respective years.

5.0 PENSION COSTS

5.1 Regular Pension Plans

[59] In its Decision of November 28, 2011 (2011 NSUARB 184), the Board indicated that it would investigate the issue of pension costs in this proceeding.

[60] Peter Hayes, of Eckler Ltd., was retained by Board Counsel to examine NSPI's pension costs.

[61] Mr. Hayes noted that Company contributions to the NSPI pension plan have grown to be several multiples of what employees contribute. He goes on to say:

In managing its pension costs, I believe NSPI faces serious impediments. These impediments are largely self-imposed, and to an extent cultural, but until they are removed it will be difficult for NSPI to gain control of its pension costs. In the meantime, these costs will continue to grow at a high level.

[Exhibit N-59, p. 2]

[62] Among the impediments Mr. Hayes noted were:

- a) A management focus on the performance of plan assets at the exclusion of more holistic plan management;
- b) A lack of willingness to engage unionized employees in meaningful discussion around the reform of the pension;
- c) Certain concerns raised in confidence about the governance structure.

[63] It appears to the Board that until very recently NSPI has done little, if anything, to address increasing pension costs. The Company witnesses cited constraints of the collective agreement with NSPI's Union and the recent influence on pension expense of the financial market losses as reasons for not doing so earlier.

[64] Among other recommendations Mr. Hayes suggested the test year revenue requirement should be set at a level which reflects higher employee contribution rates.

[65] NSPI was, in fact, engaged in collective agreement negotiations during the course of the hearing.

[66] NSPI confirmed to the Board that it had reached an agreement with the IBEW on the terms of a new collective agreement which was approved on November 5, 2012. In a letter dated November 16, 2012, NSPI outlined changes to the pension plan.

Employee contributions:

- Employee contributions to the DB Plan will change from the current level of 5.4% of pensionable earnings up to the Year's Maximum Pensionable Earnings ("YMPE") plus 7.0% of pensionable earnings in excess of the YMPE as follows:
 - Effective January 1, 2013, members will contribute 6.15% of pensionable earnings up to the YMPE and 8.00% of pensionable earnings in excess of the YMPE;
 - Effective January 1, 2014, members will contribute 6.90% of pensionable earnings up to the YMPE and 8.75% of pensionable earnings in excess of the YMPE; and

- Effective January 1, 2015, members will contribute 7.40% of pensionable earnings up to the YMPE and 9.50% of pensionable earnings in excess of the YMPE.

Final Average Earnings definition:

- Effective January 1, 2013, the Final Average Earnings definition will change from the "best average four years" to the "best average five years".

[67] The Board sees these changes as a significant step in pension reform. The Board accepts these changes as adequate initial steps.

[68] NSPI, in its Final Submission, submitted that the changes that had been recently negotiated to the pension plan should be considered as part and parcel of NSPI's effort to reduce expenses by the \$27.5 million agreed to in the GRA Agreement. Clearly contract negotiations were well advanced when NSPI agreed to the GRA Agreement and the Board accepts that there does not need to be a further adjustment to the revenue requirement to reflect these changes that were achieved through negotiation.

[69] In future years these costs savings will be embedded in the revenue requirement asked of customers.

[70] The Board, however, expects NSPI in future to take additional steps to improve contributions to, and the funding of, the pension plan.

5.2 Supplemental Executive Retirement Plan

[71] Two issues arose in the course of the hearing with respect to NSPI's Supplemental Executive Retirement Plan (SERP). This plan is available to employees who earn more than approximately \$150,000 per year.

[72] Such plans are not unusual; indeed the Province of Nova Scotia provides a SERP plan for certain of its employees who earn above the pensionable payout limits permitted by the Canada Revenue Agency.

[73] The first issue is that NSPI secures this pension by purchasing a letter of credit. The letter of credit is, in part, to secure the pension plan in the event NSPI was to discontinue operations and therefore be unable to fund this obligation.

[74] The other issue is that the eligible employees of NSPI do not make any contribution towards these additional benefits. In other words, the Company, using funds paid by ratepayers, is funding 100% of this pension plan.

[75] Contrast that with the Province of Nova Scotia where employees eligible for the Province's SERP fund 50% of the contributions to the SERP with the employer paying the other 50%.

[76] With respect to the letter of credit, it appears to the Board that the letter of credit places the senior executives at NSPI in a more secure position than any other employee in the Company with respect to their pension entitlement. The NSPI employee pension plan is not secured by a letter of credit. NSPI is a regulated monopoly in the Province of Nova Scotia. The chance of NSPI going out of business is extremely remote.

[77] In the Board's view, payment for that portion of the letter of credit that secures the SERP is an unnecessary expense and is not an expense that should be borne by ratepayers. Accordingly, the Board disallows that amount from the revenue requirement.

[78] With respect to the SERP, the Board considers it unreasonable that the most highly paid employees working for NSPI make no contribution to the supplemental pension plan.

[79] NSPI is free to continue to provide that benefit. However, the Board directs that in the test years and in future NSPI must adjust the revenue requirement to deduct an amount from the SERP pension payments to reflect a deemed employee contribution to the SERP, on the assumption that the employee had contributed 50% to the pension plan and the employer 50%. In the test years, the Board, based on projected benefit payments identified in Exhibit N-3(v), believes the amount to be disallowed is \$2.05 million in 2013 and \$2.2 million in 2014.

[80] NSPI can discuss with Board Counsel the most tax efficient way of implementing this direction from the Board.

[81] These deductions and the letter of credit deduction are in addition to the \$27.5 million provided for in the GRA Agreement.

6.0 EXECUTIVE COMPENSATION

[82] The Legislature has passed amendments to the *Public Utilities Act* limiting the amount of remuneration, bonuses and other benefits that can be recovered from rates with respect to compensation of executive employees of NSPI.

[83] By regulation, the remuneration amounts are governed by amounts contained in the Province of Nova Scotia's Senior Officials Pay Plan.

[84] The Board assumes that pension payments on behalf of executives would reflect only amounts of salary permitted by the *Act*.

[85] In its Compliance Filing, NSPI is to reduce its revenue requirement to reflect the changes as a consequence of this legislation. This reduction is in addition to the \$27.5 million agreed to as part of the GRA Agreement.

7.0 LED STREETLIGHTING

7.1 Evidence

[86] The *Energy-efficient Appliance Regulations* were amended by the Province on September 10, 2012, requiring all NSPI owned streetlights to be of the LED type after December 31, 2019. NSPI proposed to implement this change over a number of years as a part of its Annual Capital Expenditure plan. The cost of this changeover is the responsibility of the municipalities based on the number of streetlights in each jurisdiction. The Union of Nova Scotia Municipalities (“UNSM”), which represents all municipalities in the Province, is objecting to the cost which NSPI plans to pass on to the municipalities.

[87] NSPI proposes to defer a decision on the LED streetlight stranded cost to a later date, stating it plans to file a capital work order with the Board:

...As explained in Appendix I of this Evidence, NS Power proposes to treat the non depreciated net book value of these streetlight fixtures as a stranded cost that constitutes a regulatory asset. We propose to defer the amortization of this asset until the Board approves the recovery of this cost through the implementation of appropriate LED streetlight conversion charges. This will happen in concert with the Capital Work Order Application for the LED streetlight conversion program. We propose to recover the capital carrying costs associated with this regulatory asset from the full service LED streetlight customers.

[Exhibit N-2, p. 130]

[88] In Appendix I of its Application, NSPI provided a *Cost of Service and Pricing Study for Unmetered Services* which included streetlights and other services such as traffic lights, ornamental streetlights, crosswalk lights, etc. The report provided

details of NSPI's proposed rate making methodology and calculations of streetlight rates.

[89] The UNSM, in its Pre-filed Evidence, noted that municipalities are struggling to provide normal services and an additional \$100 million for LED streetlights conversion is a significant burden. The UNSM has concerns with the cost of stranded assets and time allowed for conversion of these streetlights. The UNSM's understanding is that as a part of the 2012 GRA Settlement Agreement, the net book value of stranded streetlights is \$12 million and is supposed to decline over time as only LED streetlights are installed/replaced after 2011. The UNSM also noted inconsistencies when NSPI deals with the municipalities in billing and stranded asset fees for streetlights.

[90] HRM, in its Pre-filed Evidence, noted its concerns with NSPI overcharging municipalities. HRM noted its concern with respect to the total charge for streetlights. It stated that NSPI's maintenance and capital charges do not align with the actual cost for these services. HRM also disagreed with NSPI that the energy component is being subsidized by the other components of the total streetlight charge.

[91] HRM further noted that NSPI's evidence over time has been inconsistent and difficult to follow:

On the rate setting front, the LED street light conversion has exposed some of the long standing issues with respect to the lack of accounting detail in the unmetered Cost of Service. It appears NSPI has made it extremely complex to use cost of service accounting principles for a simple street light because it has not tracked the age or quantity of lights properly. The process has become very onerous, non-transparent and inefficient. Clearly NSPI has had significant challenges in determining unmetered rates over a protracted period.

[Exhibit N-54, p. 7]

[92] HRM agreed with UNSM that the issues in dispute are the stranded cost and phase-in time for LED streetlights conversion. HRM noted that its understanding of the 2012 GRA settlement is different from NSPI's understanding.

[93] Albert Dominie, a consultant for HRM, noted problems with the current pool of assets in the streetlights category. This includes types, quantity and how the stranded costs are allocated between streetlights and other assets in the pool.

[94] Mr. Dominie questioned the use of the Bank of Canada Inflation Calculator to determine the net book value of retired streetlights. He recommended the use of the Handy-Whitman Index of Public Utility Construction Costs which is also used by the Federal Energy Regulatory Commission. He explained that the Bank of Canada Inflation Calculator provides a higher actual installed cost than the Handy-Whitman Index.

[95] Mr. Dominie does not agree with NSPI's method to calculate the stranded cost of current streetlights. He proposed a true up and reconciliation process during the LED streetlights conversion by carrying out a physical survey of each streetlight to determine actual life based on the date stamp.

[96] NSPI, in its Reply Evidence, noted that the net book value of streetlights has been approved by the Board in past applications, including the depreciation hearings and it is entitled to recover these costs from its customers. It disagrees with the use of the Handy-Whitman index method and field survey proposal by Mr. Dominie.

[97] NSPI outlined the process it has followed to calculate the stranded cost of streetlights:

NS Power's approach with regards to calculating a stranded asset pool is simple and has not changed. That is, the net book value of the assets is the unrecovered investment. To determine per unit value, NS Power has proposed dividing the asset pool by the number

of lights billed in the Customer Information System. NS Power has repeatedly stated through the 2013 & 2014 GRA application that the rates should be set with the capital work order process consistent with the 2012 Settlement Agreement. In an effort to be helpful, NS Power has provided information over the last couple of years. In fact, draft regulations were only issued April 25th, 2012.

[NSPI Reply Evidence, Exhibit N-106, pp. 96-97]

[98] The Board and HRM during the hearing requested clarification on the type of streetlights being replaced after the 2012 GRA Settlement Agreement approved by the Board in the 2012 GRA. That Settlement Agreement required NSPI to install only LED streetlights when replacing the old streetlights. NSPI responded:

...So we've been continuing on using materials that were already in inventory, not buying -- not in any way, shouldn't be characterized as spending more than we should have. We're just fixing the lights that people call in and say are broken.

[Transcript, September 19, 2012, p. 547]

7.2 Findings

[99] The Board has considered the evidence filed and issues raised by the UNSM, HRM and NSPI. NSPI proposed that the matter of LED streetlights be deferred to a later date when it intends to file a capital work order with the Board. HRM does not have a problem with this approach except the amount of net book value of current streetlights which NSPI plans to use in its work order.

[100] NSPI proposed to use the current net book value of streetlights (estimated at \$23 million) based on methods and records it has used in the past including depreciation hearings. However, HRM argued that the net book value NSPI proposes to use is not correct and should be \$12 million as noted in the 2012 GRA Settlement Agreement. HRM further stated that this amount is to be confirmed by actual survey of all current streetlights, which will also determine the number and age of streetlights.

HRM also raised the issue of non-streetlight assets being in the streetlight class and whether some of the current net book value belongs to these other assets.

[101] The Board agrees that dealing with the streetlight issue as a part of a capital work order is a reasonable approach, with the exception of the net book value question. The net book value of streetlights has been calculated under the current method for a long time and any change in the net book value now would be unfair to other ratepayers. The current method has been approved in prior depreciation Decisions of the Board. The net book value amount is the responsibility of the streetlight class and any reduction in this amount would shift the responsibility to other customer classes. The Board does not agree with HRM's proposal to change the net book value of streetlights currently included in the NSPI rate base. How this amount is shared between municipalities is something NSPI should work out with them.

[102] The Board denies HRM's request to recalculate the net book value of streetlights.

[103] The second issue raised by HRM is the type of replacement streetlights used by NSPI since the Board's 2012 GRA Decision [2011 NSUARB 184]. It is the Board's understanding of the 2012 Settlement Agreement that NSPI was to use only LED streetlights when replacing the current streetlights. NSPI has stated that it has only used non-LED streetlights which were in its inventory.

[104] In the circumstances, if the non-LED streetlights were already in inventory, the Board finds this to be an acceptable approach. However, NSPI should have clarified the use of inventory with Intervenors during the 2012 GRA settlement discussions.

[105] The Board is not certain, based on the evidence, if NSPI has purchased new non-LED streetlights after the 2012 GRA Board Decision.

[106] The Board orders NSPI to confirm by February 28, 2013 that no new non-LED streetlights were ordered or purchased after the Board's 2012 GRA Decision.

8.0 LOW INCOME RESIDENTIAL CUSTOMERS

8.1 Submissions

[107] At the request of the CA item 15 was added to the Final Issues List, "Matters Related to Low Income Residential Ratepayers".

[108] The Affordable Energy Coalition, the CA and NSPI tabled a Settlement Agreement which the CA described as an agreement which addresses many long-standing issues faced by low income customers. Essentially the Agreement sets up a consultative process "with a view to resolving bill payment, credit and collection matters affecting low income residential customers". The text of the Agreement is as follows:

The following provisions are requested to be included in final Order of the NSUARB in GRA 2013 NSUARB-NSPI-P-893 - Matter M-04972 with the consent of NSPI, the Consumer Advocate, and the Affordable Energy Coalition.

Residential Low Income Issues

1. NSPI, the Affordable Energy Coalition and the Consumer Advocate, shall seek an adjournment of the hearing on the matters identified in paragraph 4 of this joint proposal in this proceeding, in order to engage in a consultative process with a view to resolving bill payment, credit and collections matters affecting low income residential consumers, and the parties reserve the right to contest any of the evidence filed with the NSUARB in this proceeding, as may be appropriate, at a future hearing.
2. The consultative process shall be non-binding and without prejudice to either side to request the matters be brought back before the NSUARB to resolve any issue in relation to Board regulations or other matters and the parties agree to the appointment of a facilitator by the NSUARB on an as-needed basis.
3. The consultative process may solicit input from other social service agencies, non-governmental organizations involved in low income energy issues, as well as other resources and supports, as agreed to by the parties.
4. The items to be discussed by the parties are:
 - a. Development of a Low-income Customer Charter;
 - b. Changes to NSPI policy regarding deposits and payment agreements;

- c. Development of joint recommendations, where appropriate, with respect to regulatory reforms, including with regard to deposits, payment agreements, interest charges and other miscellaneous charges, disconnection procedures, and requirements for the residential budget plan as they affect low income residential consumers;
 - d. Any other matters as agreed to by the parties.
5. The parties shall meet on a regular basis, at a minimum once every two months. The parties shall agree on a timetable, which shall reflect the following:
- a. The first meeting shall take place not later than November 1, 2012;
 - b. The parties shall report back regarding the status of the consultation, with any agreements reached by the parties, and to the extent that agreement is not reached, request a further appearance and hearing before the NSUARB not later than June 30, 2013, and the evidence filed on behalf of the AEC in this proceeding shall form part of the evidence at that hearing;
 - c. NSPI shall provide a proposal regarding items (b) and (c) to the Affordable Energy Coalition and the Consumer Advocate one week in advance of the first meeting;
 - d. NSPI shall provide the results of its research with respect to regulatory differences in other jurisdictions to the Affordable Energy Coalition and the Consumer Advocate not later than December 1, 2012.

[Exhibit N-116]

[109] The Board approves the Agreement which will be appended as a Schedule to the Compliance Order and acknowledges, with appreciation, the work of the Affordable Energy Coalition, NSPI and the CA in moving this initiative forward.

[110] The Board receives literally hundreds of letters and emails a year from consumers who are struggling to pay their power bills and at the same time manage the cost of home heating, medication, groceries, etc. There is only so much the regulatory system can do to respond to these concerns but this Settlement Agreement is a welcome development.

9.0 COST OF SERVICE – BIOMASS

[111] NSPI has recently constructed a 60 MW biomass plant at Point Tupper, Nova Scotia. For purposes of rate base NSPI has determined the biomass plant is being added for environmental purposes only and should be classified totally as energy.

With respect to OM&G costs, however, the classification is the same as for all other steam plants, a portion of which is classified to demand, and a portion that is classified as energy.

[112] Mel Whalen, a witness on behalf of Board Counsel, recommended that until a more complete assessment is done as part of the upcoming cost of service review, NSPI should classify the biomass plant on the basis of system load factor, the same as other thermal plants, for the following reasons:

- a) Biomass is a steam plant.
- b) Biomass makes a contribution to capacity.
- c) The biomass plant was justified in part on the grounds that it would provide firm, dispatchable power and alleviate some of the concerns with respect to adding only non-dispatchable renewable resources.
- d) Classifying the biomass as other steam plants are classified is consistent with NSPI's classification of the biomass OM&G as all other steam OM&G is classified.

[Exhibit N-42, p. 10]

[113] NSPI, in its Reply Evidence, says that even though the biomass generation is firm and is dispatchable, it considers the capacity related aspects of this plant to be of secondary importance to that of RES compliance. NSPI says classifying the asset on the basis of system load factor would mean there would be no distinction between this project and ordinary fossil fuel baseload generation.

[114] The Board notes that recent *Regulations* passed by the Province of Nova Scotia require that this plant, as opposed to being dispatchable, is essentially must-run.

[115] The Board agrees with Mr. Whalen that the characteristics of this plant are similar to any other steam plant. It makes a contribution to capacity and provides firm power, meaning that it should be classified on the basis of system load factor and

directs NSPI to do so. This issue may be reviewed in the upcoming cost of service proceeding.

10.0 NATURAL GAS STORAGE

10.1 Evidence

[116] Alton, in its Pre-filed Evidence, stated that the New England and Maritime market currently does not have a natural gas storage facility which can provide security of supply and manage the price of natural gas used by NSPI. The natural gas prices in this region have been volatile and NSPI can benefit from the use of a storage facility given the amount of natural gas used, which Alton estimates to be \$110 million annually.

[117] Alton retained Gregory W. Hopper of Black & Veatch who, in his Pre-filed Evidence, provided analysis of the Maritime and New England natural gas market and price behavior. He noted that the lack of a natural gas supply in the region could make natural gas prices rise even higher and also increase volatility.

[118] Alton also retained Jan van Egteren of Anthem Economic Consulting Inc. who, in his Pre-filed Evidence, outlined various hedges used by NSPI to reduce gas price volatility. The hedges currently used by NSPI are financial, physical and geographic hedges. He then calculated the savings NSPI could achieve by using the natural gas storage facility by buying when the prices are low and using when prices are high. He noted that there is a possibility of additional savings in case of a “basis blowout” similar to what happened in December 2010.

[119] Alton proposes to construct a natural gas storage facility off the Halifax lateral to supply gas to Tufts Cove generating station. The proposed storage facility is

being designed to store a minimum of 4 BCF of natural gas at a maximum pressure of 2,028 pounds per square inch gauge (“psig”) and a minimum operating pressure of 418 psig. The storage facility can also be used in the integration of intermittent renewable energy generation such as wind energy.

[120] NSPI, in its Reply Evidence, argued that this proceeding is not the place to discuss this issue which, in future, could be the subject of negotiations between Alton and NSPI. NSPI questioned the commissioning of the storage facility, which has an expected in-service date of April 1, 2015.

[121] NSPI disagreed with the benefits noted by Alton because in its opinion Alton has not considered certain items in its calculations to determine the cost savings.

[122] In response to Alton counsel’s question on the use of natural gas storage facility, NSPI explained:

MR. SIDEBOTTOM: I think storage can play an important part in the portfolio. The question to be asked is when is it the right time to enter into an agreement to secure storage? To date, it hasn’t been the right choice for us and our customers. There could be a point in the future when it is the right time to secure some storage. So it’s very much dependent on what’s going on at a point in time.

If gas sources were not as reliable there is an advantage to natural gas storage. Whether it completely justifies itself today or from some future date really is dependent on what your market circumstances are.

[Transcript, September 18, 2012, p. 164]

[123] NSPI further stated that:

MR. SIDEBOTTOM: To be partners with a potential supplier of that and have them be intimately knowledgeable of the value proposition to customers puts me or us in a compromised position in negotiating effectively the best overall cost to customers.

I believe we will be looking at natural gas storage and studying that in the coming year when we have more information on wind integration. But Nova Scotia Power is happy to do that at its own cost. And we would see that it is difficult to be in a co-authored study with a potential recipient of the contract at the end of the day.

[Transcript, September 18, 2012, p. 183]

...

All we're trying to say here is that we think it's appropriate to study the viability of natural gas storage. We think it's appropriate for it to be done on an impartial basis, not including the people who potentially propose to provide the storage.

[Transcript, September 18, 2012, p. 193]

[124] In its Closing Submission, NSPI objected to Alton's request to order that NSPI be part of the study because this issue is not on the Board's Final Issues List for this hearing. NSPI stated that, if approved, other parties doing business with NSPI may view the GRA as a forum to advance their interest.

10.2 Findings

[125] Alton requested the Board order NSPI to participate in a natural gas storage study being carried out by Alton and Heritage Gas. NSPI objected to this request as this item is not on the Board's Final Issues List and also may interfere in its ability to minimize fuel cost and achieve a cost effective alternative for fuel purchases.

[126] Alton argued that NSPI's fuel cost can be reduced by the use of a gas storage facility.

[127] The Board understands that the use of gas storage is a type of hedge against higher gas prices in the future. Similar to other hedges, for the gas storage to be cost effective, there are many factors and assumptions one has to make so that the cost of the hedge is beneficial to ratepayers. These include the amount of gas, price of other fuels, and the cost of storage, to note a few.

[128] NSPI purchases fuel in conformance with its Fuel Manual developed over time with input from its stakeholders. The purpose of the Fuel Manual is to reduce cost and to secure a reliable fuel supply. NSPI actions in the purchase and management of fuel are audited every two years for prudence. Directing NSPI to purchase a certain

type of fuel or follow certain procurement procedures in advance of the audit may compromise the Board's ability to make a fair judgment on the audit findings.

[129] During the hearing NSPI agreed that gas storage does have benefits, but disagreed with Alton that now is the time to enter into a long-term gas storage commitment. NSPI intends to do its own study later in 2013 after the IRP update planned for 2013. NSPI's customer load has changed substantially due to the reduction in electricity demand caused by reduction in two paper mills' production volumes in the Province. The matter is further complicated by the *Renewable Electricity Regulations* requirements. The proposed IRP update is expected to provide directions on the amount and type of generation required to keep customer cost to a minimum and also meet renewable energy targets.

[130] The Board's intention is not to micromanage NSPI. Its management needs flexibility in its operations if it is to be judged on the prudence of its actions.

[131] The Board denies Alton's request to order NSPI's participation in a natural gas study with Alton and Heritage Gas.

11.0 FAM AUDIT

11.1 Introduction

[132] It should be noted that much of the evidence regarding the FAM Audit was filed in confidence and discussed during confidential sessions of the hearing. Accordingly, the Board is only in a position to provide an overview of the evidence and a summary of its findings.

[133] The FAM has generally been described as a mechanism that allows periodic adjustments to customer rates, outside general rate proceedings, to reflect

increases and decreases in the Utility's cost of fuel, provided they are prudently incurred.

[134] In its Rate Decision dated February 5, 2007, the Board identified at least four prerequisites prior to the implementation of a FAM:

[45] For the guidance of the parties, however, and without in any way prejudging the issue, in the Board's view there are several prerequisites that must be in place in order for the Board to consider the adoption of a FAM now or in the future:

1. an adequate and appropriate fuel procurement policy at NSPI in which the Board has confidence;
2. timely disclosure of complete and adequate information by NSPI so as to ensure confidence that the procurement policy is being appropriately administered;
3. disclosure and transparency with respect to the administration of the FAM;
4. a meaningful audit process under the administration of the Board.

[46] This list is not meant to be exhaustive.

[Decision, 2007 NSUARB 8, paras. 45-46]

[135] In its GRA Decision dated November 5, 2008 the Board approved the FAM to take effect on January 1, 2009, conditional on the final approval of the Tariff and POA. A revised Tariff and POA were received on November 26, 2008 and approved by the Board in a letter dated December 11, 2008.

[136] Section 5 of the POA addresses the audit requirements and excerpts are included below:

5.0 AUDIT AND OVERSIGHT

The amounts charged through the FAM shall be subject to periodic audit to assure completeness and accuracy and to assure fuel and purchased power costs were incurred reasonably and prudently. The results of any audit shall form part of the issues for consideration by the Board in a subsequent FAM proceeding to consider the re-setting of the Base Cost of Fuel, or setting of the Fuel Adjustment Factor, or a General Rate Case at the request of NSPI or any interested stakeholder or upon Board order. Following consideration of the audit in any such hearing, the Board may make such adjustments (with interest if

appropriate) to existing balances or to already recovered amounts as it may find necessary.

Audit Process

The Board shall provide for the conduct of a Fuel Adjustment Mechanism (FAM) audit every second year. The Board shall have a qualified independent firm conduct the audit. The audit will address the financial and management/performance aspects of NSPI's fuel procurement and recovery under the FAM. The audit will include the FAM Formula, actual fuel and purchased power costs, contracts and management performance that affect the audit period from January 1, 20XX to December 31, 20XX+1. The first audit period will be for the year 2009. Subsequent audits will cover two-year periods.

Objectives and Scope of the Audit

The overall objective of the FAM audit will be to examine operational and managerial aspects of the fuel and energy procurement, management, and production functions and activities of NSPI, including any fuel or energy related affiliate transactions that involve these functions and activities directly or indirectly. The review will address adherence to good utility practice and consistency with the policies and procedures governing NSPI's procurement as described in the NSPI Fuel Manual.

The Scope of the Audit will include a review of fuel and energy procurement, fuel management, and generation production ...

...

Prior to setting the final audit scope, the auditor shall meet with NSPI and interested stakeholders.

Timing of the Audit

The first audit will commence on February 1, 2010, and subsequent audits are expected to commence in February of every second year. The final report for the first audit will be filed with the Board and Stakeholders by July 2, 2010. Final reports for subsequent audits will be filed by July 2 of every second year. The final report will evolve from a draft report which is provided to NSPI and the Board within 30 days of the filing of the final report. The draft report should contain functional area task reports, a management summary, and include findings of operating effectiveness and efficiency, as well as any recommendations for adjustments in costs or changes in functions and activities.

[FAM POA, August 13, 2010, pp. 13-15]

[137] It should be noted that the original POA anticipated that the first audit would cover 2009 and 2010 and that the draft report would be provided to NSPI and the Board "forty-five days before the final report is filed". During 2010, following stakeholder engagement, NSPI requested Board approval of certain changes to section 5 of the

POA. Specifically, those changes included recognition that the first audit covered only 2009 and also a revision to the audit timing to state that the draft report will be provided to NSPI and the Board “within 30 days of the filing of the final report”. Those changes were approved in the Board’s letter dated October 12, 2010.

[138] As noted above, the first FAM Audit was conducted in 2010 and covered the 2009 calendar year. The Liberty Audit Report, which was filed with the Board on July 2, 2010, presented Liberty’s findings, conclusions, and recommendations in eleven chapters, each of which comprised a principal area of examination and review. A total of thirty-one recommendations were included in Liberty’s Audit Report.

[139] The 2010 Audit Report was included as an exhibit in the proceeding to set the Base Cost of Fuel (“BCF”) for 2011. On page 12 of its evidence filing in the 2011 BCF proceeding, NSPI stated:

The Company generally agrees with most of the recommendations of the Report. There are recommendations that require additional context or currently have alternative solutions that the Company has carried out or is in the process of implementing. NSPI suggests that the FAM can continue to provide an effective forum for dialogue about the conclusions and recommendations of the Audit Report.

[Decision, 2010 NSUARB 219, p.12]

[140] NSPI’s response to that Audit report was contained in Appendix C of its evidence Exhibit N-10 which outlined agreement and/or comments regarding each of the recommendations.

[141] As directed by the Board, NSPI filed its FAM Audit Recommendation Action Plan on December 9, 2010. Following subsequent discussions between NSPI and Liberty, a report dated June 9, 2011 was filed by Liberty which noted that NSPI had established acceptable action plans for 25 of the 31 recommendations. Some of the

outstanding issues were resolved, but others remained and were carried over to the 2012 FAM Audit.

[142] It bears repeating that in approving the FAM in 2007, the Board highlighted the importance of transparency and timely disclosure in its approval of the FAM:

[59] NSPI now indicates it is committed to transparency and timely disclosure.

[60] The Board wishes to make it clear to NSPI that if full and timely disclosure of complete and adequate information to assess its fuel procurement practices continues to be a problem, the implementation of a FAM will not occur...

[Decision, 2007 NSUARB 174]

11.2 Prudency Test

[143] In 2005 NSUARB 27 (NSPI - P-881), the Board adopted the definition of prudence as set out in a decision of the Illinois Commerce Commission as a reasonable test to be applied in Nova Scotia.

[144] That test was set out at paragraph 84 of the Board's Decision:

The standard for determining prudency of a utility's fuel procurement practices is well established. As stated by the Illinois Commerce Commission, "prudence is that standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions had to be made....Hindsight is not applied in assessing prudence....A utility's decision is prudent if it was within the range of decisions reasonable persons might have made. ... The prudence standard recognizes that reasonable persons can have honest differences of opinion without one or the other necessarily being imprudent.

[Decision, 2005 NSUARB 27, para. 84]

[145] The Board went on to say:

[89] While the Board recognizes that the definition of imprudence varies somewhat among the jurisdictions cited, there are several fundamental principles which are common. These include:

- Were the utility's decisions reasonable in the context of information which was known (or should have been known) at the time?
- Did the utility act in a reasonable manner and use a reasonable standard of care in its decision-making process?

- The imprudency test should relate to the circumstances at the time in question and not to hindsight.

[Decision, 2005 NSUARB 27, para. 89]

[146] NSPI, in its Closing Submission in the present matter, confirmed that from its perspective this is the test the Board should apply.

11.3 Lingan Derates

11.3.1 Evidence

[147] Liberty recommended a disallowance with respect to derates which occurred at the Lingan generating plant in December 2010. Derates occur when an operator must reduce, for one or more of a variety of reasons, the anticipated level of plant output.

[148] In its FAM Reply Evidence, Liberty described the risks known to NSPI in July and August 2010, when it re-introduced the local Prince coal, after the Province relaxed the mercury limits:

The specific quality aspects of concern for the reintroduced local supply were ash, sulphur, and Btu content. Resuming its use in the Lingan fuel blend caused July and August results that failed to meet NS Power's own recognized guideline for identifying opacity risks. The operative metric was maintaining or exceeding a 1,000 parts per million concentration of SO₂ in unit stacks. Following the reintroduction of local supply, those concentrations fell well below the minimum guideline, ...

Moreover, variability in the quality of reintroduced local supply and problems in its conformity to contract specifications were known issues. The coal's Btu content fell below minimum specification in January, July, and August 2010. Ash content was at the upper limit of specification in January, was well above the limit in July, and remained at the upper limit in August. ... Experience in January 2010 (after which NS Power discontinued use), and July 2010 (when NS Power resumed use) demonstrated, particularly in light of concern about stack SO₂ levels, that what was impossible to predict was that the coal blend, including reintroduced local supply, would sustain the ability to meet opacity limits without curtailing generation...

[Liberty FAM Reply Evidence, Exhibit N-170, PDF pp. 110-111]

[149] In Liberty's opinion, NSPI was imprudent in that it did not appropriately address coal quality issues in July/August 2010 when there were signs that there were substantial risks of failure to meet opacity limits.

[150] While Liberty was mindful that NSPI was running the plant aggressively close to the limits, it stated that NSPI should have planned its coal burns to avoid the potential for problems, especially when Prince coal exhibited quality issues in July/August 2010.

[151] It bears repeating that some of the relevant evidence related to the Langan derates in the FAM Audit was filed in confidence and discussed during confidential sessions of the hearing. Therefore, the Board is only in a position to provide an overview of the evidence and a summary of its findings.

[152] Some background on the importance of coal blends will be helpful to the reader.

[153] The Langan generating facility was designed to operate at optimum efficiency while burning coal having specific characteristics. The primary fuel that the plant was originally designed to use was high sulphur coal that was available from the local mines in Cape Breton. Over the years, availability of that coal decreased while, at the same time, federal and provincial environmental regulations mandated reduced emission levels from generating stations burning fossil fuels.

[154] NSPI has regularly blended high sulphur domestic coal with low sulphur imported coal in order to optimize compliance with overall utility sulphur emission restrictions. It has also used mid-sulphur imported coal in its blend.

[155] In order to satisfy opacity limits and reduce emission levels, electrostatic precipitators are used at Lingan along with varying combinations of coal blends. Coals with various levels of sulphur, ash, moisture, and Btu are included in the blends. Changing the type of coal being burned can also change the efficiency of the plant. For example, burning coal that has a higher Btu content essentially means that higher levels of energy output can be obtained, while burning less fuel and producing lower overall emissions. However, this must be balanced against the design parameters of the generating facility and the effects of other fuels and chemicals in the fuel mix.

[156] Typically, the higher quality coals, in terms of lower sulphur, ash, moisture and higher Btu, are more expensive. Thus, coal blends must be carefully planned in order to maximize output at the lowest possible cost, while not exceeding emission limits.

[157] Further, government regulations which mandated a reduction in the mercury levels being emitted from the stacks required additional equipment and operational changes. This included altering fuel blends to reduce the mercury content and installing mercury abatement equipment along with chemical additives, such as powder activated carbon, to capture the mercury in the stack emissions. This abatement equipment and the powder activated carbon were designed to perform well with lower sulphur levels, but its use with higher sulphur coal can result in reduced performance.

[158] As of July 2010, the Province relaxed the targeted levels for mercury emission. This change identified graduated levels of mercury reduction, which also extended the compliance timeframe for achieving the revised emission target. As a

result of this, NSPI was able to use larger quantities of high sulphur, high mercury, domestic coal from the local Prince mine. Prince coal was available at a lower cost than imported coal. One of the benefits of burning this higher sulphur coal is that it improved precipitator performance so that derates due to exceeding stack opacity limits were less likely to occur.

[159] Along with managing the levels of sulphur dioxide and mercury emissions, NSPI needs to manage nitrogen oxide emissions, greenhouse gas emissions, and to ensure that the opacity of the stack emissions does not exceed the acceptable level specified in the operating permit. Clearly, a process of balancing fuel blends and chemical additives is needed in order to satisfy emission restrictions, while still maintaining efficient plant operation, maximizing energy output levels, and minimizing costs.

[160] In its Audit Report regarding derates at Lingan, Liberty stated:

NSPI experienced the derates because the station precipitators were operating at the margin of performance, and could not tolerate any changes in coal quality, coal flow rates, or additional moisture in the coal. When above normal amounts of rain were experienced in December 2010, the station had no choice but to derate in order to comply with stack opacity limits. If NSPI had taken action to make the appropriate alternative coals [i.e., blends], there would have been the necessary margin in stack performance to have continued operation at normal power levels without derating. ...

[Liberty FAM Audit Report, Exhibit N-171, p. IV-28]

[161] In response, NSPI stated that the derates were caused by an uncharacteristically high amount of rainfall in December 2010. In its view, the 1 in 30 year rainfall event increased the moisture level in the coal (which is typically stored outdoors), which, in turn, reduced the MW output of the plant because it reduced the mill grinding efficiency, reduced the mill temperatures and resulted in feeder pluggages.

[162] NSPI also noted that the quality of the local Prince coal deteriorated in the relevant time period, further exacerbating the situation. However, Liberty states this is the risk when using poorer quality coal in that it can be unpredictable.

[163] In its Reply Evidence, NSPI summarized its view of the causes of the derations:

1. Many factors - moisture, initial sizing, wear, inlet temperatures - affect the performance of coal mills. In December, 2010, the Lingan Generating Station experienced a 1-in-30 year rainfall event. When coal contains unusual moisture levels, it reduces the temperature inside the coal mill, so the coal does not dry properly. Grinding efficiency and combustion are compromised, lowering generation. Coal with increased moisture levels has a greater tendency to build up on surfaces until the coal feeders that regulate the amount of coal going into the mills begin to plug up. When a feeder plugs, the flow of fuel to the boiler slows and the units are derated.
2. In December, the ash, moisture, and sulphur content of Prince coal all increased. The increased moisture resulting from the rainfall event, together with the increased ash content, reduced the effectiveness of the precipitators and led to derations. NS Power could not reasonably be expected to mitigate the effects of a 1-in-30 year event, especially one that coincided with high ash content in the coal received from a low cost supplier. When the impact of the record rainfall event began to subside, the Lingan units returned to full load capability.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 27]

[164] While Liberty stated in the FAM Audit that its review of the documentation “disclosed no expression of concern about opacity issues at the Lingan station” leading to the December 2010 derates, NSPI replied that it had identified the moisture issue and the precipitator performance, and its action to address the issue, in its April 2011 presentation of November - December Plant Performance.

[165] NSPI engaged Dr. Stan Harding to assist in its response to Liberty’s claim of imprudence respecting the Lingan derates. He is a consultant with experience in coal generation facilities.

[166] Dr. Harding's conclusions included:

...

- The unusually high precipitation in December 2010 combined with the high moisture levels in the coal, resulted in significant boiler derates and mill pluggages during this time period.
- The load reductions noted in December 2010/January 2011 were primarily due to coal quality and high moisture-related pulverizer pluggages rather than opacity.
- The high precipitation in December 2010 would have resulted in an increase in mill pluggages and boiler derates even if a design coal was being used. ...

[Harding Report, Exhibit N-77, p. 14]

[167] NSPI also called Emily Medine as a witness on this issue. She is a consultant who regularly assists NSPI in its solid fuel management issues. In her view, Liberty ignored the impact of a 1 in 30 year rainfall event in December 2010, which she stated was the primary reason for the derates. She added that Liberty ignored NSPI's strategies for addressing all potential derates due to provincial limits on SO₂ emissions. She also noted that NSPI immediately dealt with the derates after 2010.

11.3.2 Findings

[168] The Board considers NSPI's evidence on the Lingan derating issue to be tenuous and unreliable in several respects.

[169] First, the Board has several concerns about the evidence of Dr. Harding.

[170] In Information Requests IR-6(d) and 7, Dr. Harding was asked to provide a description of the design and operational features at Lingan, including the spare mill capacity on each unit, which was designed to avoid unit operational consequences due to mill plugs. He was also asked to provide the number of pulverizers assigned to each of the four Lingan units and to provide information about the derates specifically caused by pulverizer pluggages, including the generating unit involved. He responded by stating that he had not received this information from NSPI. He stated that the issue of

spare mill capacity was outside his scope of work, although he acknowledged it was relevant to the derate issue.

[171] Based on Liberty's investigation, it confirmed that "Lingan's use of four mills per unit allows for each unit to remain at full load with one of its mills down" [Liberty FAM Reply Evidence, Exhibit N-170, PDF p. 115].

[172] Surprisingly, in questioning by Board Counsel, NSPI Fuel Panel member John Hawkins acknowledged that Dr. Harding had asked him for information about spare mill capacity, but NSPI did not provide him with that information.

[173] As a result, on an issue as important to derates as spare mill capacity, which Dr. Harding conceded was a relevant consideration, he was not provided with the information, even when he inquired about it.

[174] Another aspect of Dr. Harding's testimony which concerns the Board is that he did not test the data for seasonality. In response to questions from the Board, he testified:

MR. DHILLON: Now, did you consider expanding the database to consider the seasonality factor in the -- in your issues that maybe because a different season of the year might affect your results?

MR. HARDING: That's a good question.

No, I did not. The reasoning was the -- when I was contacted and asked to evaluate the data, the event was in December and so I had just asked for information a few months prior to that.

And when I got the rainfall information, which is shown in my report also for November/December for the previous -- I think -- five years, I didn't -- I didn't go back any farther, for example, in 2009 or '08, anything like that, no.

MR. DHILLON: So I guess did you go back five years in December each year?

MR. HARDING: Just with -- just with -- no. Just with the rainfall data to show that it was indeed, a different -- something out of the ordinary occurred in December 2010 in terms of rainfall.

...

MR. DHILLON: But if you had considered wider data and there was derating beyond July to February the following year, would that have given any indication that there are reasons in the past this issue may have arisen and that there's reason to have some kind of a study done or something?

MR. HARDING: Okay. That's a good point. I think had I noticed -- or had there been some information in this July-August-September time period that showed me that they were -- again, the -- we were focusing on de-rates due to opacity. So had there been some significant opacity de-rates -- de-rates due to opacity -- excuse me -- I would have asked for additional data.

But since -- again, as I mentioned, perhaps not the greatest consultant, I should have asked for another study, but I didn't. Once I asked for the information I had, I -- it became quite obvious to me that there was an event, something happened in December of 2010 that was different than the previous five months that I had looked at. ...

[Transcript B, November 1, 2012, pp. 1304-1306]

[175] Further, despite Dr. Harding's theory that the derates were attributable to the December 2010 rainfall, the NSPI data requested by Liberty confirmed that the moisture level of the coal in July/August 2010, or after January 2011 (when the plant was not derating), was equal to or higher than moisture levels during the December 2010 deratings:

...The response to IR-8 shows moisture data from July 2010 through June 2011. The response to this IR-8 (see attachment II-2) shows several periods in July and August 2010 and in June 2011 with moisture levels at or exceeding the December 2010 [values](when a 30-year rain was experienced)...

Thus, Lingan operated both: (a) in July and August 2010, without derating, despite equal or higher moisture levels than under the coal blend being used through the December deratings, and (b) after January 2011, without derating, despite equal or higher moisture levels than under the revised coal blend.

[Liberty FAM Reply Evidence, Exhibit N-170, PDF p. 113]

[176] Accordingly, in the Board's view, Dr. Harding's opinion that moisture and mill pluggages caused the derates is not supported by the evidence.

[177] In the end, Dr. Harding's engagement seemed to have been simply to correlate the rainfall to the derates. However, he did not conduct a root cause analysis; he did not fully investigate the pluggages (including spare mill capacity); he did not

consider seasonality; and did not evaluate ash. Despite his undoubted expertise in this field, NSPI did not provide him with the information or the necessary latitude in his scope of work to conduct an independent evaluation of the Langan derates. As a result, the Board is not able to assign much weight to his evidence, if any.

[178] The Board also concludes that it cannot accept the evidence of Ms. Medine in this proceeding. Counsel for Avon described the concerns with Ms. Medine's testimony:

40. The Avon Group respectfully submits that the objectivity of Ms. Medine's opinion that NSPI's actions were prudent during this time period is undermined by the fact that she was actively advising NSPI on the very issues (coal procurement and the Langan derates) that are central to the disallowance recommendation. ...Ms. Medine's lack of objectivity was further apparent when she consistently referred to the actions of NSPI using the pronoun "we". She is now showing a laudable degree of loyalty to the utility, consistent with her long-term engagement by NSPI, but it appears to have coloured her perspective, to the extent that she would not even acknowledge that she characterized NSPI's actions in the 2002 GRA as "imprudent" despite being presented with her sworn response to IR which described NSPI's "imprudent practices".

[Avon Final Submissions, November 23, 2012, para. 40]

[179] The Board accepts Avon's submission on this point.

[180] The Board observed Ms. Medine to be combative and non-responsive in her testimony at the hearing, as demonstrated by her refusal to acknowledge her recommendation of imprudence in the 2002 GRA hearing (where she previously appeared as a witness for Avon before being engaged by NSPI).

[181] She acted at times as an advocate, rather than as an expert witness. While the Board has accepted Ms. Medine's evidence on numerous instances in past proceedings, it concludes that her relationship with NSPI in its solid fuel activities, including the events related to the derates at Langan, coloured her objectivity in this proceeding. The Board assigns little weight to her evidence.

[182] At the hearing, NSPI urged the Board to consider the benefits to ratepayers of NSPI staff “pushing” the limits of its generation fleet. Mr. Bennett stated:

MR. BENNETT: We’re not asking for a free pass, we’re just asking for a realization that this is not easy, it doesn’t happen by itself, and when you’re pushing the limits in order to keep costs low, an unpredictable event like extremely heavy rains causes you to have to be nimble. And we’ve been as nimble as you can reasonably be without pushing costs up.

[Transcript, November 9, 2012, p. 1720]

[183] The Board is mindful that the task of “pushing” the Lingan units is a challenging one for NSPI’s staff. The Utility and ratepayers benefit from the high output that can be achieved from the successful operation of these units.

[184] However, the Board also expects NSPI to act prudently in the operation of its generation fleet, including Lingan. It is not reasonable for the Utility to push its coal plants while disregarding the known risks of its choices of coal blends over a period of time.

[185] Mr. Spangenberg noted the importance of foresight and proper operational planning in striking the appropriate balance:

MR. SPANGENBERG: ...what we’re saying is that in the middle of the year, when they started to get an indication that they were going to have some operational problems in terms of opacity, the bell should have gone off and they said, “Now, how -- what can we do at this Lingan station to make sure we don’t have trouble when the real high load period comes in the winter, in December, January and February? Because if we can’t run this unit, we’re going to have to go out and buy very expensive power from some alternate source. And we don’t know what that’s going to be, but generally the power is either going to be another combustion turbine generating more expensive power or power that you buy.”

And so the issue to them should have been, “Let’s balance the economics.” You know, inventory that you’re talking about is an issue. The existing blend of contracts coming in is an issue. Cost associated with derating the unit should be an issue and what alternate energy was going to cost you.

And they have models to perform these calculations, and they should have been doing that. So that’s -- that’s really ---

MR. MARSHALL: So are you saying the trigger for this look they should have taken that at this would have come in, what, July or so, in the summer? You say they were beginning to experience some ---

MR. SPANGENBERG: Well, this particular coal was not a surprise coal. They had been burning this coal for 10 years.

...

MR. MARSHALL: Local domestic coal.

MR. SPANGENBERG: And that's the one that should have caused them to perk up their ears and say, "Hey, we'd better worry about what's going to happen in December to make sure that we've got this economical Lingan unit available to run and that we don't have to derate it because of opacity violations."

[Transcript, October 29, 2012, pp. 100-102]

[186] The Board accepts Mr. Spangenberg's description of the appropriate balance that should be reasonably expected of NSPI in the operation of this type of coal fired plant.

[187] Based on its review of the evidence, the Board finds, on the balance of probabilities, that NSPI was aware in July/August 2010 that there were quality issues related to the Prince coal. NSPI also acknowledged "pushing" the Lingan plant in order to achieve maximum output. Notwithstanding this factual background, NSPI did not investigate and test other coal blends to mitigate the risks of the failure to meet opacity limits.

[188] In failing to mitigate the known risks of derates from using Prince coal, the Board finds that NSPI was imprudent. The Board also concludes that imprudence on the part of NSPI led to the derate of the Lingan facility.

[189] Accordingly, the Board orders a disallowance with respect to the derates.

[190] In the event of a finding of imprudence on the Lingan derate, Liberty and NSPI disagree on the calculation of the amount of the disallowance.

[191] The total \$3.6 million amount of the disallowance proposed by Liberty is based on the sum of two \$1.8 million amounts (the fact that the two amounts are identical is coincidental). The first \$1.8 million relates to corrections made by Liberty to NSPI's assumptions in its calculation of replacement energy. The second \$1.8 million disallowance was proposed by Liberty as a consequence of the fuel cost savings that NSPI could have realized if a prudent coal blend was used.

[192] In determining the disallowance, Liberty calculated a cost associated with replacement energy resulting from the 21% derating at Lingan. In its Reply Evidence, Liberty stated:

The Audit Report calculated the cost consequences of Lingan December 2010 deratings using data for the whole month. We recognized that hourly data would provide a more accurate basis for calculation, but did not have that data at the time we provided the draft report to NS Power for comment. NS Power did not comment or provide hourly data then, but did so [later] in support of its determination that the number was \$750,000.

[Liberty FAM Reply Evidence, Exhibit N-170, pp. 20-21]

[193] In reviewing its calculation of the disallowance based on NSPI's methodology, Liberty made two adjustments. The first adjustment takes account of the reduced output from specific Lingan units in calculating the amount of replacement energy. Liberty modified this adjustment slightly to reflect that NSPI's model underestimated the amount of replacement energy resulting from reduced output at Lingan. The second adjustment made by Liberty to improve the accuracy of the calculation was related to the assignment and pricing of the replacement energy to the units that provided that power. NSPI had applied a figure which reflected an average for all units in the fleet. Liberty concluded that the "true cost of the Lingan derates should be calculated at the margin, not homogenized over the other units...". Accordingly, Liberty calculated the Lingan replacement costs "at the top of the dispatch

stack rather than the average” [Liberty FAM Audit Reply Evidence, Exhibit N-170, PDF pp. 108-109].

[194] The Board considers these two adjustments in the calculation to be reasonable.

[195] Liberty also stated:

...Our basis for the proposed disallowance is NS Power’s decision to undertake operating risks without evaluating those risks and taking mitigating measures as deemed appropriate. The optimum solution could have resulted in higher or lower fuel costs. Taking the coal blend eventually utilized by NS Power in early 2011, which did indeed solve the opacity issues, our calculations show that fuel costs would have actually declined, not increased. Consideration of changed fuel costs, which NS Power appears to consider the appropriate method, would have thus produced an additional \$1.8 million of avoided costs. That approach would call for increasing the proposed disallowance by that amount.

[Liberty FAM Reply Evidence, Exhibit N-170, PDF p. 99]

[196] The \$1.8 million disallowance calculated by Liberty as replacement energy cost did not take account of replacement fuel costs. As noted by counsel for Avon, it was NSPI which suggested that Liberty should have considered how fuel costs would have changed if a fuel solution had been introduced earlier. This methodology results in an additional \$1.8 million disallowance attributed to fuel cost savings that NSPI could have realized if a prudent coal blend was used.

[197] The Board finds that it is appropriate to calculate the disallowance by considering, as NSPI suggested, how fuel costs would have changed if a fuel solution had been introduced earlier.

[198] Accordingly, the Board disallows \$3.6 million related to the Lingan derates.

11.4 Natural Gas Contracts

11.4.1 Evidence

[199] With NSPI's long term natural gas supply contract with Shell (the "Shell contract") coming to an end on October 31, 2010, NSPI issued a Request for Proposals ("RFP") in September 2008 and August 2009 to acquire replacement quantities of natural gas to supply its projected needs.

[200] Four counterparties submitted seven proposals in response to the September 2008 RFP. One of the two lowest offers ("Bid A") was withdrawn after NSPI felt it had already accepted the offer via a term sheet. The other lowest offer ("Bid B") was rejected by NSPI, largely due to NSPI's concern about associated transportation costs and potential risk of supply interruption. That particular bid included primary injection into the Maritime and Northeast Canadian Pipeline ("M&NP-CA") at Goldboro but did not include primary delivery rights to the Tufts Cove plant. However, it did include firm secondary delivery rights to points along the M&NP-CA pipeline. Its duration was for eleven years, from November 1, 2010 to October 31, 2021.

[201] In the FAM Audit, Liberty addressed NSPI's natural gas purchases and highlighted issues regarding the two low contract bids which were not taken by NSPI. In recommending a disallowance of \$5,969,252 for costs deemed to have been avoidable, Liberty identified five principal components associated with that cost determination. Those components included two base load contracts (\$3,436,000), monthly purchases (\$1,512,250), seasonal purchases (\$276,800), and daily and intra-day purchases (\$744,202).

[202] During the hearing John Adger, of the Liberty Group, was asked to explain how the \$3.4 million proposed disallowance regarding the two base load contracts was

determined. His response was a simple calculation consisting of the daily contracted supply amounts in MMBtu between November 2010 and December 2011, multiplied by the price differential between the contracts taken and the lowest offers not taken.

[203] Also during the hearing Liberty was asked to provide their calculations of Bid B with transportation attached, which illustrated how long it would take for the commodity cost savings under that bid (with the transport cost included) to offset any transportation costs that would remain if NSPI was faced with an inability to continue using that transportation component at some future time. Liberty provided that information in their Undertaking U-15 which showed that the crossover point would have occurred about five years into the contract period.

[204] Regarding Bid A, Liberty acknowledged that there was not an accepted offer that was repudiated by Bidder A. Liberty's concerns were two-fold.

[205] Firstly, in early 2009, a subsidiary of Emera, Emera Energy Inc., entered into an agreement to market the Bid A gas. This was seen by Liberty as part of a pattern where the interests of Emera affiliates were favoured over NSPI.

[206] Secondly, Liberty felt NSPI should have been more aggressive with the offeror in attempting to obtain a suitable resolution to the issue.

[207] In his Pre-filed Evidence, dated September 17, 2012, NSPI's expert witness, Leonard Crook, stated that Liberty's characterization of Bid A is incorrect in just about all particulars. With respect to the other rejected offer, Bid B which included the transportation component, Mr. Crook stated that Liberty mischaracterized the offer to make it something that it never was.

[208] Mr. Crook recommended that the Board reject Liberty's proposed disallowance of \$1,512,000 related to the first base load contract, as well as the proposed disallowance of \$1,924,000 related to the second base load contract. He also recommended rejection of the proposed disallowance of \$1,512,250 for excess monthly purchase costs and the proposed net disallowance of \$1,021,002 associated with seasonal, daily, and intra-day purchases.

[209] In his Opening Statement at the hearing, Mr. Crook stated that:

Liberty has an erroneous theory that all gas sold in Nova Scotia should be at a full Dracut netback price and NSPI overpaid whenever it bought gas at a price higher than that, although yesterday, Liberty does seem to have modified its position somewhat.

...

Liberty's recommendations for disallowances follow this logic. As others have pointed out, this theory is incorrect and Liberty's recommendations based on it should be rejected.

My testimony also challenges Liberty's allegations in the particulars of two specific decisions on bids to supply NSPI. Contrary to Liberty's assertions, the first offer, once it was clarified, not repudiated, was not at the price that we originally thought it was, but would have been at a price higher than the offer of the bidder whose NSPI -- whose gas NSPI ultimately selected. NSPI properly declined, after negotiation, to take this gas at the higher price, and the offer was withdrawn.

...

Contrary to Liberty's assertions, my recommendation to reject the second offer, which was an apparent full netback price, was based on sound judgment about the reliability of the supply and the risks associated with pipeline capacity.

...

Liberty maintains that secondary delivery rights under the M&NP Canadian tariff would have provided sufficient assurance of deliverability, but the Maritimes tariff is clear; secondary delivery rights are subordinate to primary firm delivery rights.

The issue with the contract is fairly straightforward -- is a fairly straightforward matter. I considered it an unacceptable risk to take ownership of a long-term firm gas transportation contract for the purpose of delivering gas to a point not along the pathway of that contract, simply to access what might be a favourable supply contract that itself might not be reliable.

[Transcript B, October 31, 2012, pp. 848-851]

[210] Regarding Bid A, Mr. Crook was asked about his understanding of the price stated by the offeror and about actions that should have been taken by NSPI when the offer was withdrawn. Mr. Crook confirmed that he and the NSPI team all understood the price to be the same as the price that was understood by Liberty. He also noted that this same understanding was presented to NSPI's Fuel Strategy Table where approval was granted to proceed with the contract. At that point NSPI emailed a term sheet to the offeror and understood that it had accepted the offer. It was not until about six days after the term sheet was emailed that NSPI was informed its price interpretation was incorrect.

[211] Board Counsel asked NSPI's fuel witnesses how NSPI dealt with the situation in order to ensure that its acceptance of the offer could be preserved. Ms. Trenholm stated NSPI did not want to damage the relationship with the counterparty. She confirmed that NSPI did contact Bidder A and expressed as strongly as they could their disappointment but did not feel they could negotiate a better price:

... to express as strongly as we could our disappointment, at the same time acknowledging that this is a very illiquid market.

This is actually a new counterparty for us...

...

...It wasn't to the point where it was enforceable, and that was our view, it is -- it's too bad, and it is really -- I think it as a lot of hopeful thinking, maybe, on our part that blinded us a little bit, that we didn't push on that more, to hope that we had actually got [redacted] pricing...

[Transcript, November 9, 2012, pp. 2060 - 2061]

MS. TRENHOLM: --- we had gotten an approval to transact with them... It was a simple misunderstanding, a confusion on their part.

MR. OUTHOUSE: Did you attempt to negotiate a better price? Did you attempt to use that occasion to strike a better price than you had from [redacted]?

MS. TRENHOLM: ...They weren't willing to move off of that price; that was their final price.

[Transcript, November 9, 2012, pp. 2065-2066]

[212] NSPI's primary concern with respect to Bid B, the rejected offer, was the risk of transportation interruption if the main line became full or congested.

[213] While the gas under that contract was favourably priced, indeed comparable to the price NSPI had enjoyed under the Shell contract, this contract had a transportation obligation attached to it with a secondary delivery point at Halifax. The primary delivery point was upstream of Halifax.

[214] NSPI pointed out that, to the best of its knowledge, no other market player in the Maritimes' market took an assignment of the Bid B contract.

[215] As noted, Liberty stated that, based on its analysis, the Bid B offer was sufficiently favourable in that after five years NSPI would have suffered no loss. In other words, there would have been a net benefit even if the balance of the transportation rights had become valueless at that time.

[216] This was explored with Liberty during the hearing:

THE CHAIR: It's a contract with transportation attached. And I guess my question is, is it your opinion that that contract would, after approximately five years, have proved so valuable that even if Nova Scotia Power could not get the gas to Halifax after five years, customers would have been better off with the acceptance; is that what that line is telling me?

MR. ANTONUK: That was actually the crossover point. Up to that -- if the crossover came roughly five years into the contract, on a strict economic basis, the offer that they rejected was better than the offer they accepted.

THE CHAIR: So they only needed to get the gas to where they wanted it to go for five years?

MR. ANTONUK: It was --- yes.

THE CHAIR: In your opinion?

MR. ANTONUK: Yes.

[Transcript, October 29, 2012, pp. 332-333]

[217] During cross-examination of NSPI's expert witness, Mr. Crook, counsel for the Avon Group explored the issues regarding primary and secondary delivery rights on the M&NP:

MS. STEWART:

...

I just have a few questions about the gas contract that involved transportation rights. Would you agree that curtailment of secondary firm delivery on a pipeline would only occur when the pipeline capacity was fully contracted under primary firm contracts?

MR. CROOK: Depending on the locations of the -- of the pathways. My concern about that contract was that it was firm but outside the pathway that needed to have secure deliverability to the Halifax Lateral.

...

So you were right, it has to be -- all of the shippers have to be shipping at their maximum daily quantity or our -- and that maximum daily quantity then precludes delivery of secondary -- of gas under secondary delivery rights.

MS. STEWART: And are you aware of whether or not there is today capacity on the M&NP Canada Pipeline?

MR. CROOK: The M&NP Canada Pipeline is not fully subscribed at this point.

MS. STEWART: Was it fully subscribed in 2008?

MR. CROOK: It was approximately, maybe 500, 520,000 out of the 600,000, I believe, was -- subject to check, of the maximum quantity of the pipeline. So you had some spare in there.

MS. STEWART: Has there, in your experience, been curtailment on the M&NP Canada Pipeline?

MR. CROOK: I'm not aware of any particular incident.

...

MS. STEWART: Sure, maybe I'll rephrase it. So there's been concern that there's risk associated with this contract, and the risk is that there -- because there's only secondary delivery rights, that in the event of curtailment the transportation that has been paid for would not be -- could not be used because it would only -- because there would be curtailment.

MR. CROOK: Correct.

...

MS. STEWART: Unless there is curtailment, secondary firm delivery is adequate to delivering gas?

MR. CROOK: I'm going to hedge the question -- hedge my answer a little bit on that. It should be adequate. I think, depending on the pathway, it may have some bearing on that.

...

So if you have a firm delivery pathway that goes from Goldboro all the way to Baileyville and there is some curtailment on the pipeline, then -- that is, that the pipeline is at maximum capacity, you would still be able to deliver gas to some secondary points along the way, provided there wasn't, you know, firm there already blocking you.

...

MS. STEWART: And I think your answer there, again, was with the hypothesis that there is curtailment, and I understand what you're explaining, but I'm not sure that it was responsive to the question.

So the question that I was saying was that, in the absence of curtailment, and the experience has been, and your evidence is that you are not aware of any curtailment on the M&NP CA, that without curtailment, secondary firm delivery is adequate and even possibly equal to primary firm delivery?

MR. CROOK: Yes.

[Transcript B, October 31, 2012, pp. 902-909]

[218] Following up on this questioning about transportation rights, counsel for the Province sought further clarification from Mr. Crook and asked if it was possible to have firm delivery rights on a lateral without having associated rights on the main pipeline. He replied that in order to get the natural gas to the specific lateral being discussed, transport along the mainline would be necessary. Firm delivery rights on the upstream lateral also include associated rights on the main pipeline in this instance. Mr. Crook also confirmed that payment for service anywhere on the M&NP, with a primary delivery point on the lateral, is covered by a single postage-stamp toll.

[219] Board Counsel also sought further clarification on this issue.

MR. CROOK: Well, as I say, it's a common practice in the industry that you can -- that you can deliver to secondary delivery points along your pathway as long as that secondary delivery point is available. Outside your pathway you can't.

MR. OUTHOUSE: And so when I read the tariff which says a particular customer who has a primary delivery point on the pipeline and -- primary delivery point, and then says that he can deliver anywhere else on the pipeline at a secondary delivery point that doesn't apply, that doesn't apply to this particular customer?

MR. CROOK: It applies as long as there's capacity available on the Mainline, but it doesn't -- the problem would occur is if sometime between now and 2021 some congestion would occur onto the Mainline...

[Transcript B, October 31, 2012, p. 919]

[220] Mr. Crook provided a response to Undertaking U-16 regarding available capacity on the Canadian portion of the M&NP. Mr. Crook advised that the physical capacity of the M&NP is 600,000 MMBtu per day. During 2008, the contracted capacity was 511,792 MMBtu which represents about 85% of the physical capacity. He also stated that the average daily flow throughout 2008 was 482,091 MMBtu or 80% of capacity. In addition, the average daily flow during March 2008, the peak month, was 527,383 MMBtu or 88% and on the peak day, also during March 2008, the maximum flow was 560,098 MMBtu or 93%. These figures clearly indicate that throughout 2008, capacity was available on the main pipeline to accommodate secondary delivery rights.

[221] Mr. Crook also noted that the pipeline capacity on the US side of the border was higher than the Canadian side in order to accommodate additional flows from the LNG facility at Canaport.

[222] Board Counsel sought further clarification of transportation rights:

MR. OUTHOUSE: Mr. Crook you remember yesterday when we were discussing this we were looking at 6.1?

MR. CROOK: Correct.

MR. OUTHOUSE: And it says:

"That the quantity is nominated for transportation by customers shall be scheduled by Pipeline for receipt and delivery in the following order." (As read)

And the first tier in that order, the first tier of customers:

"Firm service utilizing primary points of receipt and primary points of delivery." (As read)

Right?

MR. CROOK: Yes.

MR. outhouse: And the second (b) is:

"Firm service utilizing second points of receipt and/or second points of delivery provided, however, that if a pipeline is restricting service at a particular receipt or delivery point, then a customer utilizing that point as a primary point, regardless of the status at the corresponding delivery or receipt point, shall have priority over a customer using that restrained point as a secondary point or receipt of delivery." (As read)

In other words, and my understanding of that and you can correct me if I'm wrong obviously, is that if I have -- if both of us have primary receipt points at Goldboro and I have a primary delivery point at Halifax and you have a primary delivery point in Saint John and there's a constriction at Saint John, then you have priority over me at Saint John; is that correct? If I want to use my secondary rights to deliver to Saint John and it's a primary point of delivery for you, you have priority over me in scheduling.

MR. CROOK: You mean, if I -- mine was at Halifax?

MR. outhouse: If -- no.

MR. CROOK: I'm sorry, I ---

MR. outhouse: If your primary point of receipt -- of delivery is Saint John, my primary point is Halifax.

MR. CROOK: Yes.

MR. outhouse: And there's a constraint at Saint John, but I'm trying to get in there using my secondary delivery rights, you have priority over me because it's your primary point of delivery?

MR. CROOK: Yes.

MR. outhouse: Correct?

MR. CROOK: I believe so.

MR. outhouse: All right. But if neither of us have primary points of delivery at Saint John, but we both want to exercise secondary rights to deliver there, we're on an equal footing; are we not?

MR. CROOK: Yes.

MR. outhouse: Okay. And when you look at 6-3, and this is the part that wasn't in the tariff that's in your document. Six three (6-3) says that:

"In the event a tie for capacity exists among category A, B, C, or D customers, quantities within that category will be scheduled pro rata on the basis of the customer's MDTQs." (As read)

Correct?

MR. CROOK: Yes.

[Transcript A, November 1, 2012, pp. 937-941]

[223] In an effort to obtain a better understanding of the pipeline constraint issue, the Board requested further clarification from Mr. Crook:

THE CHAIR: So I guess once it enters the Mainline, I'm having difficulty understanding what the constraints are, then getting it to the Halifax Lateral given that there's no gas entering the Maritimes & Northeast Pipeline between Goldboro and New Glasgow, where the Halifax Lateral comes off. Could you help me with that?

MR. CROOK: My understanding is that there is a decline in pressure over the length of the line and that you can take quantities off a short distance down the line and not affect - - and by terms of the tariff then, you have secondary rights to any downstream takeoff points from your -- from the [redacted]. I'm not a pipeline engineer so I don't know exactly ---

THE CHAIR: So are you saying that ---

MR. CROOK: --- the dynamics of the flows.

THE CHAIR: So if you put 600,000 MMBtu's in at Goldboro, you're saying you can't get that to, say, New Glasgow?

MR. CROOK: Point taken. Yeah, I'm not sure then.

THE CHAIR: And you'd agree with me that no gas enters that line, or frankly, is likely to enter that line between Goldboro and New Glasgow?

MR. CROOK: That's correct.

[Transcript A, November 1, 2012, pp. 995-996]

[224] Mr. Crook was asked if he did any economic analysis of the price of gas under Bid B, compared to the contract that eventually was entered into by NSPI, to determine what the economic benefit would have been versus the risk on the pipeline. His response was that he did not do the sort of analysis that Liberty had done with respect to the benefit of the contract. Likewise, John Reed, another one of NSPI's expert witnesses, did no such economic analysis.

[225] As NSPI's generation pattern moved toward greater reliance on gas-fired units, a requirement for additional supplies of natural gas was identified. In addressing that need, NSPI entered into a number of short-term agreements resulting from bilateral negotiations, rather than through an RFP process. These purchases consisted of various forms of seasonal, monthly, daily, and intra-day agreements and involved a range of transaction pricing. In the FAM Audit Report, Liberty identified excess costs of \$276,800 for seasonal purchases, \$1,512,250 for monthly purchases, \$767,706 for daily purchases, and an intra-day saving of (\$23,504). Liberty's calculations are based on the difference between the price paid by NSPI and the price that Liberty determined NSPI could have achieved with more informed and aggressive negotiations and with access to LNG from Canaport.

[226] NSPI responded to those conclusions regarding excessive costs for natural gas by dismissing Liberty's assertions that lower prices could have been achieved. NSPI stated that it is committed to champion customer interests in the pricing of natural gas supplies and it takes the position that Liberty is confused about the operation of the natural gas market in the Maritimes.

[227] In his Pre-filed Evidence, NSPI's expert witness, Mr. Crook, addressed the excessive procurement costs identified by Liberty regarding seasonal, monthly, daily and intra-day purchases. Mr. Crook noted that the characteristics of gas contracting include various obligations such as delivery, duration, and different supply tranches which will result in gas prices that are higher than those attributed to basic gas commodity trading. He also stated that:

...My observation here is that in the daily and intraday market, where supply is short, one can expect to pay higher prices than when supply is at surplus or for previously contracted supply. The argument that these volumes also should have been priced at

[redacted] misunderstands the operations of the gas market. Liberty's recommendations for eliminating these expenditures from the FAM should be rejected by the Board.

[Exhibit N-129, p.10]

[228] Mr. Reed also disagrees with Liberty's recommended disallowances for NSPI's seasonal, monthly, daily and intra-day purchases. In his direct evidence, Mr. Reed stated:

Liberty believes that higher natural gas prices in the Maritimes that have been experienced since the expiration of NSPI's Original Shell Contract are inconsistent with the NEB's prior findings regarding exports of natural gas from Canada. Liberty states that "NSPI's expectations of [redacted] did not appear to be consistent with either the general regulatory regime for gas exports from Canada or the specifics of the authorities granted to Repsol." (Liberty Audit, p. III-5).

[Exhibit N-134, p. 25]

...it is my opinion that the changes in wholesale gas pricing in the Maritimes reflect exactly the way a functioning market would work as it moves from having a supply surplus to a supply deficit. The increasing natural gas prices in the Maritimes are not due to market flaws, but rather a shortage of indigenous supply.

[Exhibit N-134, p. 31]

[229] He went on to say that in determining these disallowances, Liberty based its finding on its interpretation of prior NEB decisions regarding natural gas exports from the Maritimes. Mr. Reed stated that he agrees:

...the NEB's policies are that the natural gas needs of Canadians are to be met on terms that are similar to those charged to export customers. However, I strongly disagree with Liberty's interpretation of these NEB rulings and how Liberty has applied its conclusions to NSPI's circumstances in this proceeding.

...

Contrary to Liberty's interpretation, the NEB has not previously concluded that purchasers of natural gas in the Maritimes are entitled to a Dracut netback price. In fact, the NEB specifically recognized in MH-2-2002 that producers/marketers selling in the Maritimes natural gas market are entitled to seek reimbursement for transportation costs to which they have committed.

[Exhibit N-134, pp. 32 - 34]

[230] In its Closing Submission, with respect to Bid A, NSPI stated that Bid A suffered from vagueness in its terms such that NSPI and the bidder had two

understandings of the offer. NSPI argued that Liberty's position with respect to Bid A was not as much about the ability of NSPI to obtain competitively priced gas but related to Liberty's concern about affiliate transactions.

[231] With respect to these affiliate concerns, NSPI noted the evidence of its expert, Mr. Reed, who found no evidence that the affiliate or NSPI violated the Affiliate Code of Conduct or conspired in any way in connection with Bid A.

[232] In the final analysis NSPI stated that:

NS Power could not have forced [Bidder A] to honour a proposal that [Bidder A] believed it had not made.

[NSPI Closing Submission, November 23, 2012, p.66]

[233] NSPI goes on to state:

Liberty initially claimed NS Power to have been imprudent in respect of the [Bidder A] offer because NS Power did not obtain the benefit of the pricing structure as that structure had initially been understood by NS Power. In contradiction to Liberty's position, the discussion could simply not get to a consideration of whether it was within the band of reasonable choices to have rejected the [Bidder A] proposal because there was no legally enforceable proposal on the table – a fact acknowledged by Liberty during its testimony. [Bidder A] withdrew its proposal and accordingly that alternative choice was simply not available. It cannot be unreasonable or imprudent not to accept an offer that no longer existed.

[NSPI Closing Submission, November 23, 2012, p. 66]

[234] With respect to Bid B, NSPI argued as follows:

NS Power had sought gas for terms of 1-5 years and up to 20,000 MMBtu/day. The [Bid B] offer had several components – one was a 4,000 MMBtu/day supply to which NS Power already had access, while the second was for a gas supply contract of 7,000 MMBtu/day of additional gas supply (non-firm for as many years as SOEP supply would support). The third and final component was 11,000 MMBtu/day of must-take pipeline capacity through a Firm Service Agreement whose term extended until 2021 – well beyond the term of the associated gas supply.

It was NS Power's and ICFI's considered view that the value of the 7,000 MMBtu/day did not outweigh the risk of committing to paying transmission costs to 2021 on a portion of pipeline that has no (firm) primary delivery rights to the Halifax lateral. In fact, NS Power's financial analysis indicated that the contract would cost customers almost \$20 million due to the capacity costs outweighing the cost of gas. Given what we now know about [Bid B], it is understandable that [Bid B] would have wanted to find a way out of its costly transportation contract.

NS Power tried, and failed, to get firm transportation to Halifax. It is also worthy to note that [Bid B's] offer to sell gas under its proposed conditions was not accepted by any other buyer.

[NSPI Closing Submission, November 23, 2012, p. 60]

[235] In its Closing Submission, Avon noted that NSPI's involvement in the regional natural gas market had been an issue of concern raised by Liberty in the 2010 FAM Audit and again in the 2012 FAM Audit. Avon also stated:

The evidence that has emerged through this process demonstrates that while NSPI has a strong understanding of the complexities of the natural gas market, it tends to take a conservative approach to its role within the market and, in some key instances, failed to undertake rigorous analysis of its natural gas contracting and hedging options. As a result, stakeholders are left to question whether NSPI has truly made every reasonable effort to ensure that it is obtaining the lowest possible natural gas prices.

[Avon Closing Submission, November 23, 2012, p. 8]

[236] Regarding NSPI's activity with natural gas contracts, Avon noted that NSPI and its expert witnesses have repeatedly stated that natural gas prices, as low as those contained in the two lowest bids from the 2008 RFP, have not been seen for several years. Therefore, prior to rejecting the bids:

One would expect that this decision would come after a serious analysis of the financial and operational risks associated with the bids. However, it appears that this is not entirely the case.

[Avon Closing Submission, November 23, 2012, p. 9]

[237] Regarding the lowest bid which had been withdrawn (Bid A), Avon stated this situation appeared to be:

...a significant miscommunication between NSPI and the counterparty, at best, or interference from an NSPI affiliate, at worst.

...In the NSPI evaluation of the RFP outcomes, this bid was ranked number one. Based on the wording of the bid and ongoing negotiations, it was widely believed by NSPI and its consultant, Mr. Crook, that the counterparty was offering gas with a deduction for both Canada and US pipeline transportation charges.

The bid was selected by staff and was presented for approval to the Fuel Strategy Table; upon approval, a term sheet was provided to the counterparty. Only then did the bidder indicate that it had only intended to deduct a portion of the transportation costs. This significantly changed the economics of the bid and, ultimately, the offer was determined to be unfavourable. It is surprising that there would be such a significant miscommunication between NSPI and a potential counterparty.

[Avon Closing Submission, November 23, 2012, p. 12]

[238] Although NSPI testified that it had discussed this situation with the counterparty and voiced its dissatisfaction with what appeared to be a change in the bid, Avon noted that:

NSPI's full reaction to the clarification with respect to the bid did not become apparent until Ms. Trenholm was under cross-examination during the audit hearing. Only then, did it come to light that NSPI voiced significant discontent with respect to the sudden change in the counterparty's bid. Ms. Trenholm stated that although NSPI was "indignant", the Utility ultimately preferred to preserve the relationship with the counterparty and so decided not to press the matter further. It is noted that both NSPI and Liberty agree that the bidding process, though advanced, had not, yet, resulted in an enforceable contract.

[Avon Closing Submission, November 23, 2012, p. 13]

[239] Regarding the rejected bid with the transportation component (Bid B), Avon noted that there was no dispute that NSPI would have accepted the bid if it did not have the specific transportation component attached to the offer. In this instance, Avon submitted that NSPI should have considered the actual capacity and forecasted capacity of the M&NP-CA pipeline as of 2008, prior to rejecting that bid.

The transportation contract had firm entry rights at Goldboro and so would be unaffected by increased use of the pipeline by Deep Panuke gas, insofar as entry rights are concerned. The issue, then, is whether potential increased gas supply to be shipped on the M&NP-CA would impact delivery, on a secondary basis, to Tufts Cove.

...We understand that Mr. Crook was suggesting that secondary delivery along the pathway between the primary injection site and the primary delivery site would have priority over secondary delivery along another "pathway" on the pipeline. This position does not appear to be supported by the tariff provisions or the logic of a postage stamp pipeline system, such as the M&NP-CA Pipeline.

Despite taking this position, Mr. Crook was not able to provide an example of priority being affected by pathways on a postage stamp pipeline in Canada...

...Little or no evidence was given with respect to sources of curtailment, either additional injections of gas between Goldboro and the Halifax Lateral or other major primary delivery rights' holders to the Halifax Lateral. Therefore, it seems that there was no particular risk of curtailment with respect to the intended secondary delivery point at Tufts Cove.

...

It is submitted that the risks associated with secondary delivery to Tufts Cove were not exceptional and that, in light of the preferential pricing of the natural gas that was being offered in the bid, one might expect that NSPI would undertake a rigorous financial analysis to determine whether the economic benefits outweigh the risks associated with the transportation portion of the contract. However, it does not appear that such an analysis was undertaken prior to rejecting the bid.

Although NSPI produced a table comparing the benefits (gas) and liabilities (transportation) associated with this bid, the Utility confirmed that this assessment was undertaken after-the-fact as part of NSPI's response to the 2012 Audit and that no economic analysis had been performed in 2008, because the "*exposure was easily understood at that time.*"

Ms. Trenholm confirmed, on behalf of NSPI, that although Mr. Crook undertook an informal risk analysis of the contract, he did not produce an in depth economic analysis, either. Further, Mr. Reed gave evidence that he did not undertake any type of analysis in relation to preparing his evidence...

[Avon Closing Submission, November 23, 2012, pp. 10-11]

[240] Avon went on to point out that Liberty's analysis determined that the risks associated with the transportation component of Bid B would be outweighed by the benefits of the natural gas contract after about five years. Avon concluded that:

... the risks associated with the transportation contract were not properly analyzed, either by NSPI or its consultants, and a contract that could have provided gas at a price that NSPI acknowledges it has not been seen in many years was rejected without the type of rigorous analysis one might expect in this situation. In these circumstances, the Avon Group supports a finding of imprudence with respect to NSPI's rejection of this contract.

[Avon Closing Submission, November 23, 2012, p. 12]

[241] The Small Business Advocate, in its Reply Closing Argument, stated:

The FAM Audit Report provided recommended finding V-1, that added fuel costs were incurred due to NSPI's inaction addressing gas market conditions, which the Board's consultant recommends should be a disallowance of \$6 million. The SBA supports this finding because NSPI has not provided sufficient evidence in this proceeding or in its closing submission that this incremental cost could not have been avoided had NSPI

pursued earlier efforts to replace expiring contracts as well as more negotiated more aggressively for more favorable pricing terms in replacement contracts.

[SBA Reply Closing Argument, November 30, 2012, p. 3]

11.4.2 Findings

a) Bid A

[242] The Board does not believe that NSPI's actions with respect to Bid A were imprudent. Based on the evidence, it appears to the Board there was never a meeting of the minds between NSPI and Bidder A on the terms of the offer. Initially NSPI, and their advisor Mr. Crook, thought NSPI had a very favourable offer and recommended it to NSPI's Fuel Strategy Table. They agreed to accept it. However, when the term sheet confirming acceptance was presented to Bidder A, it then became clear that there was not agreement on the proposal. Liberty acknowledged that there was not an enforceable contract.

[243] While it may be argued that NSPI should have more aggressively pursued Bidder A to obtain a favourable compromise price, the Board does not believe NSPI's failure to do so was sufficient to meet the test of imprudence. Concern about the future business relationship with Bidder A is a relevant concern for NSPI to have taken into account.

[244] Finally, while Liberty was right to be concerned that Bidder A entered into a subsequent contract for the same gas with Emera Energy Inc., there is no basis, in the Board's view, to find that activity frustrated the contract or that NSPI played any role in the contact between Emera Energy Inc. and Bidder A.

b) Bid B

[245] The Board is very concerned about NSPI's failure to properly analyze the costs and benefits of taking an assignment of this very favourably priced contract.

[246] For ten years under the Shell contract, which expired in 2010, NSPI enjoyed a gas price that was favourable vis-à-vis the Dracut hub. The Bid B contract would have permitted that favourable pricing to continue, albeit for a much smaller volume of gas, possibly for an additional eleven years.

[247] NSPI stated that the gas supply contract was available "for as many years as SOEP supply would support". Mr. Crook noted that the gas supply contract had renewable provisions that made it potentially attractive.

[248] NSPI spent a great deal of time explaining during the hearing, principally based on the evidence of Mr. Reed and Mr. Henning, that the evolution of the gas market in the Maritimes had taken place in such a way that gas is now being less favourably priced in the Maritimes, vis-à-vis the Dracut hub, to the point where it is virtually impossible to obtain Dracut minus bids.

[249] Based on this evidence, by foregoing the Bid B contract, NSPI has passed up an opportunity that may never present itself again, at least in the foreseeable future.

[250] What appeared to concern NSPI was the associated transportation capacity. Halifax would have been a secondary delivery point on the M&NP pipeline.

[251] The evidence, however, is that virtually all of the gas being delivered to Tufts Cove is being delivered pursuant to transportation contracts where Halifax is a secondary delivery point. While a shipper with Halifax as a primary delivery point would have priority over other shippers with only secondary delivery rights to come to Halifax, there were no such shippers. If there were to be any constraints on the M&NP pipeline,

those with secondary delivery rights would share the capacity pro rata. However, in 2008 the M&NP pipeline was not being used to its full capacity. There was never a day, based on the evidence of Mr. Crook, where the pipeline capacity was met or exceeded.

[252] Mr. Crook's principal concern seemed to be that somehow the gas would not get to Halifax. That is not logical to the Board. The gas destined for the Bid B primary location must enter the M&NP mainline. It then proceeds along the M&NP pipeline until it reaches the upstream lateral leading to the primary delivery point. The Halifax lateral meets the M&NP pipeline near New Glasgow. There is no gas being injected into the M&NP pipeline between the take off point for the upstream lateral and the Halifax lateral. In the circumstances, therefore, it is not at all clear to the Board what the risk was that NSPI thought it was avoiding. Mr. Crook as much as conceded that under questioning from the Board.

[253] Liberty prepared an analysis that showed that NSPI was better off after five years, based on this favourable pricing, as compared to other pricing it was able to obtain even if the transportation contract was useless from that point forward.

[254] It is apparent to the Board that NSPI, at the time, did no such analysis.

[255] NSPI, in its Reply Brief, included a section which attempted to criticize and undercut Liberty's analysis. The Board is very concerned that this analysis was not made available in NSPI's principal argument and, by saving it for the Reply Brief, no party had a chance to respond or comment on it. In the circumstances, while the Board has reviewed this submission, the Board gives little weight to that analysis.

[256] In the Board's view, NSPI was imprudent in failing to properly analyze the risks and benefits associated with the Bid B contract which the Board believes could have been very beneficial for ratepayers.

[257] In the circumstances the Board disallows \$903,000 related to the failure to take an assignment of the Bid B contract for the period from November 1, 2010 to December 31, 2011 (i.e., 426 days). The details of the calculation are based on confidential information. As this was a longer term contract the impact of this finding on any future test years will be the subject of consideration in future audits.

c) Seasonal, Monthly and Daily Pricing

[258] Liberty's theory in recommending a disallowance with respect to monthly, seasonal and daily purchases has as its foundation its belief that inaction by NSPI contributed to the market conditions that existed.

[259] In terms of making its recommendation with respect to disallowance, it made certain assumptions as to how the market would have worked if buyers on the Canadian portion of the M&NP had access to LNG. On a seasonal basis Liberty felt there would be opportunities for NSPI to obtain favourably priced gas recognizing the volumes of LNG flowing into the U.S.

[260] All of this evidence was filed in confidence so it is difficult to be more precise about this calculation. Essentially what Liberty did was compare the market as it was compared to the market as it could have been.

[261] In respect to the Bid A and Bid B contracts, the circumstances are fairly clear and the Board is able to make a judgment as to whether or not NSPI acted prudently. With respect to seasonal, monthly and daily purchases the evidence is much

less clear. Based on the market conditions as the Board now understands them, and as more particularly described in the natural gas market section, the Board does not believe there is a sufficient basis for it to make any disallowance based on NSPI's monthly, seasonal or daily purchases. It is not at all clear to the Board that NSPI could have achieved what the FAM Audit suggests in terms of price in seasonal, monthly or daily contracts.

11.5 Natural Gas Markets

11.5.1 Evidence

[262] As noted elsewhere in this Decision, for ten years ending in late 2010, NSPI enjoyed the benefit of what is now considered to be a favourably priced natural gas contract with Shell Canada for Sable offshore gas.

[263] Indeed, during much of the life of that contract, NSPI was in a position of selling natural gas, not just purchasing it. The Shell contract provided much more gas than NSPI, in those years, could economically use to generate electricity. Among other things the Shell contract recognized, in terms of price, that Halifax was closer to the source of supply than the trading hub of Dracut, Massachusetts. By 2008, when NSPI started the process to find replacement gas, it appeared that market conditions had deteriorated with respect to the price for gas purchases in the Maritimes. It appeared that instead of paying a price that excluded transportation on the U.S. portion of the pipeline, NSPI would be faced with prices tending to a level reflecting increasing amounts of transportation from the Canadian border to Dracut because shippers had contracted for that capacity and, with dwindling gas supplies, needed to be reimbursed for that transportation commitment.

[264] In the 2010 Audit, Liberty made a number of recommendations to NSPI, including:

1. Become more proactive in obtaining competitive market prices for NSPI gas supplies;
2. Maintain contacts with existing sources of gas supply components and work aggressively to develop new ones.

[265] In both this audit and the previous audit Liberty expressed concerns that NSPI was being too passive with respect to obtaining competitively priced gas supplies by failing to be more aggressive with gas suppliers; by failing to take sufficient steps to enforce regulatory protections to Canadians, including the National Energy Board's ("NEB") Market Based Procedure; and, in Liberty's view, deferring to Emera affiliates with respect to the operation of the gas market.

[266] Liberty described the NEB's Market Based Procedure:

The Board adopted in 1987 a new "Market-Based Procedure" (MBP) for reviewing export applications. This decision observes that:

*The fundamental premise of the MBP is that the marketplace will generally operate in such a way that Canadian requirements for natural gas will be met at **fair market prices**. However, the MBP was designed to provide for intervention if there was evidence that the market was not working to **adequately and fairly serve** Canadian needs.*

This language does not define any of the emphasized terms. It does, however, appear to add a test beyond pricing at market, observing that whatever prices the market produces must be adequate to serve and fair in treating Canadian buyers.

This decision describes the Complaints procedure in connection with export licenses as follows:

*Under the Complaints Procedure, Canadian natural gas buyers have an opportunity to intervene with respect to an application for a natural gas export license if they believe they have not been able to purchase natural gas on terms and conditions that were **similar** to those of the proposed export. [Emphasis in original]*

[Exhibit N-171, pp. III-5 to III-6]

[267] Liberty relied significantly on a 2002 decision of the NEB where the Province of New Brunswick initiated an application requesting the NEB establish rules to apply when considering applications for short term exports for incremental supplies of Nova Scotia offshore gas. Gas exported under short term exports is subject to less regulatory oversight than long term licenses. While the NEB did not intervene directly in the exports of gas, it did signal that it would take on a heightened monitoring role.

In summary, the Board is of the view that the developing Maritimes gas market faces many challenges that are not faced by buyers in the mature export market.

Given these market realities, the Board shares the concerns of New Brunswick and PEI about access to incremental gas supplies on fair market terms. Although the Board does not believe that the record in this hearing warrants direct regulatory intervention, it did raise sufficient concern that the Board believes it must enhance its monitoring efforts in Maritime Canada

[NEB Decision MH-2-2002, Exhibit N-191, p. 42]

[268] Liberty also noted the NEB's findings in the Brunswick Pipeline decision related to LNG delivered to Canaport:

The NEB stated as follows:

... the Board is of the view that one aspect for the justification of this Project is its ability to provide an opportunity for access to a new source of natural gas supply to the Maritimes. While some parties expressed concerns regarding the ability of Maritime Canada markets to access the incremental gas supply provided by the Project, the evidence before the Board indicates that Irving Oil is the largest user of natural gas in Maritime Canada. Therefore, Irving Oil's access to the gas supply supports the Board's finding that there will be Canadian access to the Project's gas supply. Furthermore, Maritime Canada could also access this new natural gas supply source, to fulfill current and anticipated future natural gas needs, through the use of backhauls, swaps and direct connection to the Brunswick Pipeline.

[Exhibit N-171, p. III-13]

[269] Among Liberty's conclusions with respect to NSPI's conduct in the natural gas market are the following:

1. NSPI has demonstrated that customers cannot rely upon it to champion their interests with respect to prices for natural gas in the Maritimes market;
2. NSPI should have been contesting and should continue to contest gas market circumstances; however there is no basis for confidence that it can be relied upon to do so even if it did undertake the effort.

[270] Liberty's view is that NSPI should have more aggressively pursued discussions with the NEB, including a possible application to the NEB, and been more active with respect to negotiations in the gas market reminding suppliers, among other things, of the Market Based Procedure.

[271] In NSPI's view, Liberty had a flawed understanding of how the U.S. Northeast and Maritimes gas market operates. NSPI submitted:

The overwhelming weight of evidence is that NS Power's gas acquisition prices were sound and the contracts it achieved during the audit period delivered excellent value to customers.

[NSPI Closing Submission, November 23, 2012, p. 51]

[272] NSPI, in its Reply Evidence, stated:

Over the past five years, the balance of supply and demand in the Maritimes has shifted. Local supplies have dwindled, and local demand has increased. ... Since January 2010, the usage of natural gas on the M&NP system (both M&NP Canada and MN&P US) has ranged from approximately 200,000 MMBtu/day to 500,000 MMBtu/day. On the other hand, estimated production of natural gas in Atlantic Canada has ranged from approximately 280,000 MMBtu/day to 340,000 MMBtu/day (excluding supply disruptions).

...

The current supply/demand imbalance, and the cost of the next available supply source, has caused the spread NS Power pays for natural gas supply ... The price for natural gas supply in the Maritimes market will remain higher than it had been previously ... until such time that supply and demand return to a more balanced state.

[Exhibit N-98, pp. 34 & 36]

[273] With respect to its activity in the gas market, vis-à-vis customers and the NEB, NSPI points to a very favourable contract it entered into with a supplier for offshore natural gas. Unfortunately, supply conditions have not enabled NSPI to take full advantage of that contract through no fault of NSPI.

[274] With respect to the interaction with the NEB, NSPI stated as follows:

NS Power has not filed a complaint with the NEB over the gas supply/pricing structure. Nor has any other natural gas customer in this market. NS Power continues to believe there are no grounds for such a complaint. Apparently all market participants and stakeholders in the Maritimes market except Liberty agree. If circumstances change in the future such that filing a complaint with the NEB may have merit, NS Power will re-evaluate accordingly.

[Exhibit N-98, p. 39]

[275] With respect to LNG gas, NSPI pointed out that it is not economic to purchase gas at international LNG prices and bring the gas to Nova Scotia.

[276] In the view of NSPI's expert witness, John Reed, the change in market pricing in the Maritimes is not due to market flaws as he says Liberty alleges, but reflect a change in the market circumstances because of the region's shortage of supply. With respect to market conditions in the Maritimes and the role of the NEB, Mr. Reed stated as follows:

...it is telling that no other market participant in the Maritimes filed a complaint with the NEB to correct what Liberty concludes are market failures. In other words, of the many sophisticated market participants that were also affected by the market conditions for which Liberty has expressed concern in the audit, not one deemed that filing a complaint had merit. ...

Therefore, since NSPI's conduct in the market was consistent with all of the other sophisticated market participants that were also affected by changing market dynamics and prices, NSPI's conduct cannot be deemed to be outside the range of reasonable behavior during this same time period. ...

Furthermore, even if NSPI had asked the NEB to intervene in 2010 and the NEB had complied, it is not at all likely that the NEB's review would have led to lower gas prices for NSPI, and, presumably, if it did, that outcome would have been some years into the future, not for 2010/2011.

[Exhibit N-85, p. 27]

[277] On November 9, 2012, the last day of hearing and in a confidential session, NSPI disclosed new and important evidence concerning its activities in the market. Unfortunately, because of its confidential nature, the Board can disclose little, if any, of this evidence in this public Decision.

[278] It turns out that NSPI had indeed consulted a leading Calgary law firm concerning a possible complaint to the NEB and received advice. In part, based on that advice, NSPI had engaged in much more aggressive behavior with possible gas suppliers concerning price leading, in its view, to favourable pricing. NSPI also explained its strategic view with respect to LNG supply and its importance for supplying additional gas to a gas constrained market and the favourable effect that may have on the Maritimes market.

[279] Liberty had been advised in March of 2012 that NSPI had contacted outside counsel in 2010 but no reference to the fact they had contacted counsel prior to negotiations with the gas supplier where the favourable price was obtained. When asked about counsel's advice Liberty was advised by NSPI it was privileged.

[280] The Board was concerned as to the extent of Liberty's knowledge of this information, which came out on the last day of the hearing and asked for an Undertaking from Liberty, who responded in part as follows:

This undertaking addresses Liberty's knowledge of contacts that Mr. Janega testified he had with outside counsel and with [redacted] about NEB authority to address market concerns. To summarize, we were not aware until reading the transcript of Mr. Janega's reported contacts with outside counsel. We were aware that NS Power did communicate with [redacted] about supply, but not as Mr. Janega described those contacts.

Regarding consultation with outside counsel, we have no recollection of Mr. Janega's having discussed with Liberty any consultations regarding authority of the NEB to address gas market issues of concern to NS Power. A search of our notes since 2008 for reference to any such discussion found none. The issue of response to market concerns has been of interest to us since late 2008, at least. See for example, the April 2009 ICF International, *Report on Planning for Future Natural Gas Supply: A Review of the Activities of Nova Scotia Power, Inc.*, submitted by NS Power to the UARB, and

discussed during this proceeding. That report came at the UARB's request, following our expressions of concern in the 2009 NS Power GRA. Thus, it is extremely unlikely that statements by Mr. Janega or anyone of this nature would have escaped attention.

We addressed market-facing actions with Mr. Sidebottom in a March 31, 2010 interview during the prior FAM audit. He cited no communications with attorneys. He did say that he viewed [redacted] favorably, and cited no problems or concerns. He stated that he and Mr. Janega sought a meeting with [redacted] following its failure to bid in the Fall 2009 gas supply solicitation.

[Undertaking U-27, November 19, 2012, p.1]

11.5.2 Findings

[281] NSPI, in their Closing Submission, stated as follows:

After years of debate about the merits, or lack thereof, of filing a complaint with the NEB, it is now clear that NS Power has, in fact, done exactly what Liberty has wanted the company to do. [Emphasis added]

[NSPI Closing Submission, November 23, 2012, p. 59]

[282] The problem is that the extent and importance of this activity was not disclosed to Liberty, the Board, or the parties until the last afternoon of the hearing. NSPI says in its submission that this should have been clear from a reading of Responses to Information Requests during the 2010 FAM proceeding. The Board has re-read those responses and, while they do disclose details of contractual negotiations with the counterparty, they do not disclose in any way the evidence that was provided by Mr. Janega on the last afternoon of the hearing and its importance and effect. Even if the 2010 FAM Information Responses did disclose this information it seems odd NSPI would suggest the Board must plumb the depths of the evidence in a prior proceeding to find it.

[283] The Board's dismay and concern about this cannot be overstated.

[284] A fundamental underpinning of Liberty's criticism of NSPI over the years was NSPI's failure, in the view of Liberty, to pursue regulatory avenues open to it and,

as a companion to that, to more aggressively pursue marketers of gas, recognizing the existence of the Market Based Procedure.

[285] In 86 pages of FAM Audit Reply Evidence, the evidence provided by Mr. Janega was not disclosed. The Board can only assume that if NSPI had been forthcoming on the consultations with a leading Calgary law firm and conversations NSPI had with the counterparty following those consultations, in the thousands of pages of evidence and IRs and in the hearing, the nature of the Audit and most certainly the nature of the hearing, one of the most rancorous the Board has ever seen, would have been very different.

[286] NSPI's actions in withholding this information are both inexplicable and inexcusable.

[287] NSPI has criticized Liberty to the point of ridicule for this recommendation in the present Audit and, previously, that NSPI should more aggressively pursue discussions with the NEB and be more active with respect to negotiations with gas marketers given the existence of the Market Based Procedure.

[288] Remarkably, NSPI now says it was, in fact, following Liberty's advice which has been given over a period of four years. The Board cannot understand what NSPI thought it was doing by withholding that information and continuing to ridicule Liberty for making the recommendation.

[289] While it may have been slow to act, it now appears NSPI was acting appropriately with respect to their consultation with the Calgary lawyers and in certain of their recent dealings with suppliers, as a consequence. However, the failure to disclose that has added significant time, cost and rancor, unnecessarily, to this hearing.

[290] In the Board's view, that conduct cannot go unsanctioned. The Board will impose a financial disallowance as more particularly described in Section 11.10 of this Decision.

[291] In its Final Submission, Avon stated as follows:

158. It is understood that there is a long-standing disagreement between NSPI and Liberty with respect to the level of engagement or aggressiveness that NSPI ought to be demonstrating in respect of the development of the natural gas market in the Maritimes. The Avon Group agrees with Liberty that NSPI has demonstrated an unreasonably passive approach to the natural gas market and that it is likely that a more aggressive approach, one that is commensurate with NSPI's purchasing power in the market, may have produced more economically priced gas contracts for NSPI customers.
159. It would be acceptable if NSPI had tried and failed but it is problematic, from the perspective of the Avon Group, that NSPI continues to insist that the market is behaving well and that there are no problems that require the Utility's intervention. NSPI's approach to natural gas market, in the Avon Group's opinion, has had detrimental effects and leads us to question whether NSPI has made every reasonable effort to obtain economically priced natural gas.

[Avon Final Submission, November 23, 2012, p. 29]

[292] That submission was made even with the knowledge provided by NSPI in the last day of the hearing.

[293] The Board accepts that the gas market in the Maritimes has in recent years posed significant challenges to NSPI and other gas users. Mr. Reed described those challenges in response to a question from Board Counsel:

In fact, the prevailing market of course represents the confluence of all of those sources of supply and what you see in the Maritimes market is that the marginal source of supply sets the prevailing price and that marginal source of supply has shifted from being indigenous production to production that's outside the region. And in fact, as you start to bid gas away from either the Portland system or Dracut, you end up having to pay a higher price. In fact you -- again that marginal resource is setting the prevailing price in the region and that marginal resource is now coming from someplace else.

I expect that actually long term certainly will be the case. We may have an interim period in which the new gas causes us to go back to a Dracut netback market for a period of time; that would be great if it did. But long term, most people expect that in fact, gas will flow from south to north, into the Maritimes and that will be a Dracut-plus pricing regime. Even though there may be production in the Maritimes, the marginal source of supply will be from elsewhere.

[NSPI Closing Submission, November 23, 2012, p. 52]

[294] The Board accepts that the pricing dynamics of the Maritimes gas market have changed over the last few years as explained by Mr. Reed.

[295] Indeed, the evidence provided by Mr. Reed has given the Board an enhanced appreciation of how the gas market is unfolding in the Maritimes.

[296] Circumstances have given NSPI limited room to maneuver with respect to gas pricing given the shortage of supply.

[297] Finally, Liberty expressed its continued concern about affiliate relationships and, in particular, Emera's relationship as owner of the Brunswick Pipeline, with the principal shipper Repsol, a company who was also a dominant player in the Maritimes gas market. These concerns are reinforced by the fact that the Maritimes market is currently not transparent and is not liquid. The market has few buyers and sellers and a dwindling supply.

[298] While the Board is, and has been, concerned about affiliate relationships and as a consequence has imposed a rigorous code of conduct on NSPI, the Board does not see evidence in this proceeding which would, applying the test of a balance of probabilities, cause it to make any disallowance because of affiliate activity.

[299] In the circumstances, the Board makes no other disallowance with respect to NSPI's gas market activity. The Board, in future, expects NSPI to do "exactly what

Liberty has wanted the Company to do” with respect to aggressively pursuing any reasonable opportunities to purchase gas at as competitive as possible prices.

[300] Again, much of the evidence on this topic was filed in confidence and, accordingly, the Board is only in a position to give an overview of both the evidence and a summary of its findings.

11.6 Natural Gas Hedging

11.6.1 Evidence

[301] A common reference point for the pricing of natural gas in the Northeast is at Dracut, Massachusetts. The Henry Hub, a distribution hub at Erath, Louisiana, is used as the pricing point for natural gas futures contracts traded on the New York Mercantile Exchange (NYMEX). The price difference between the Henry Hub and another trading hub, including Dracut, is called the “basis differential”, or simply, the “basis”.

[302] In the winter of 2010-11, there was a marked increase in the “basis differential” with Dracut as a result of a series of events (referred to as a “basis blowout”), causing NSPI’s natural gas costs to rise.

[303] Liberty found NSPI’s natural gas costs for November and December 2010, and at least January 2011, were unreasonably high due to the Company’s failure to hedge Northeast Market “basis”. As a result of this finding, Liberty recommended the Board defer NSPI’s recovery of \$12.8 million pending a study of what hedges would have resulted under a properly designed hedging program for the winter of 2010-2011 and determine based on that program whether there would have been a cost associated with what Liberty identified as imprudent.

[304] The Northeast Market “basis blowout” was described by NSPI as follows:

A series of events starting in December 2010 caused the Dracut basis differential to rise throughout the winter of 2010-2011. First, the Henry Hub did not experience its usual winter price increase, so the baseline for the basis differential was lower than normal. Second, unusually cold weather in the northeast caused supplies in the area served by the Dracut hub to tighten. Third, severe weather prevented LNG tankers from docking at the Canaport terminal in Saint John, further exacerbating the supply shortage. Finally, in February, the Trans-Canada Pipeline ruptured and exploded at Beardmore, Ontario, 190 kilometres northeast of Thunder Bay, Ontario. This temporarily cut off supplies of Western Canadian gas to the Trans-Quebec and Maritimes pipeline and the Portland Natural Gas Transmission System, which serve the northeastern US. All these factors conspired to drive up the Dracut basis in an untypical and unforeseeable manner.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 54]

[305] Liberty indicates this \$12.8 million is a place-holder based on results NSPI provided as the potential savings for the two months, November and December 2010, extrapolated over the five winter months. A study was undertaken by NSPI after the “basis blowout” event in December 2010, related to the need to hedge the “basis”. However, Liberty indicates this study did not provide the proper hedging program to accomplish the objective of reducing basis volatility at least cost, nor did it identify the appropriate financial instrument that would accomplish this.

[306] NSPI indicated they appropriately considered these risks and addressed the risks associated with the change from the long-term Shell contract that expired October 31, 2010, stating the only significant change in risk was moving from monthly to daily pricing and that there was no material impact to basis exposure.

[307] NSPI took the position that its hedging during this period aligned with the objectives and requirements of the Fuel Manual, and that the direction within the Fuel Manual does not allow them to hedge the “basis”. It claims an appropriate study was completed in anticipation of the changes related to the long-term Shell contract, indicating it retained Black & Veatch to undertake a comprehensive study of natural gas pricing risks. Black & Veatch did not identify any need to change NSPI’s approach to

basis risk or hedging. This report dated November 23, 2010 was entered into evidence during the hearing. The Board agrees the Utility's consultant on hedging objectives and risks did not identify the "basis" risks. However, the Board notes that the scope of the study does not expressly include the assessment or identification of basis risks and the study makes no mention of them.

[308] NSPI also indicated their assessment of the risks associated with the expiration of the long term contract resulted in the implementation of swing/swaps at Henry Hub.

[309] During the hearing NSPI testified that an appropriate hedging program was in front of the FAM Small Working Group and that no other party identified a need to review basis differential.

[310] NSPI has also indicated that regardless of whether their response was appropriate, the cost to hedge the basis would have cost customers more than they would have saved from putting the hedges in place. Mr. Crook stated in his Pre-filed Evidence that there are no exchange traded hedging products for Dracut. Alternatives are costly, with few market participants willing to do it for Dracut.

[311] The SBA concurred with the recommendation to conduct a study of NSPI's hedging program. However, he did not recommend setting aside the \$12.8 million, stating this estimate is hypothetical. The SBA concluded though that, if it was found through the study that there is a cost associated with the imprudence, it should be disallowed.

[312] Other parties have supported Liberty's recommendations, including holding back \$12.8 million until the recommended hedging policy is studied and the cost determined.

11.6.2 Findings

[313] In setting the context for its consideration of this issue, the Board is mindful of the discretionary nature of hedging practices. Hedging, by any party, has never been intended to safeguard a company or utility from all risks that might occur in the future.

[314] The Board understands that NSPI, like any other party involved in hedging practices, requires some latitude to exercise judgment in the development and implementation of a hedging strategy. In the hearing, hedging was described as an art, rather than an exact science.

[315] In fact, the decision to enter into any specific hedge or hedging strategy is akin to the purchase of insurance to protect against future losses. Like insurance, there is a wide range of hedging products that are available to parties to protect their positions. These products also come at a range of prices. In choosing any particular hedging product, it is appropriate for a party to consider the reasonable risks which might be encountered in the future.

[316] Further, the Board recognizes that it is not appropriate to rely solely on hindsight in an analysis about the reasonableness or prudence of a hedging strategy. No person can predict the future. Accordingly, if circumstances occur which result in losses as a result of a particular event or a series of events, it does not necessarily follow that the chosen hedging strategy was wrong or unreasonable. Conversely, windfalls which occur as a result of unexpected future events which were not hedged do

not make the hedging decision a brilliant one. Further, the size of any loss does not factor into the consideration of the appropriateness of a hedging strategy.

[317] The Board considers that the reasonableness of a hedging strategy must be analyzed in the context of the facts or circumstances known or reasonably expected by the person or utility at the time the hedging strategy was developed or applied.

[318] In this instance, NSPI was faced in 2010 with a long term natural gas supply contract with Shell, which was coming to an end on October 31, 2010. In replacing that contract, two significant elements of NSPI's circumstances changed. First, the price of the gas under the new contract would be based on daily prices, which are more volatile, rather than monthly prices that existed under the former contract. Second, because of the interplay between natural gas and coal prices, NSPI generally started using the natural gas in its generation fleet under the new contract, rather than selling the gas to third parties. The impact of this latter element caused NSPI to bear the increased costs itself, rather than being able to pass them to third parties purchasing the gas.

[319] The Board is satisfied that NSPI did consider the impact of the impending conclusion of the long term Shell contract. In order to protect from negative fluctuations of prices for its gas purchases, it entered into a hedging strategy which adopted swing/swaps. This would help reduce the risk of volatility in daily natural gas prices, effectively replacing the daily prices with average monthly prices which were more stable.

[320] While the swing/swaps did provide some protection to NSPI from the above noted monthly/daily price risk, swing/swaps did not, unfortunately, protect from a

significant change in the “basis differential”. They are not intended to operate as a direct hedge of the “basis”.

[321] However, the Board accepts the hedging evidence of NSPI that an assessment of NSPI’s program in the fall of 2010 would not have reasonably uncovered the need to hedge the “basis”. The Board finds that no one could have reasonably foreseen the combined series of events which led to the “basis blowout”.

[322] The Board notes that NSPI had the benefit of expert advice from its consultants on the issue of hedging. As described in the hearing, both Black & Veatch and Leonard Crook have expertise in this area. Both consultants assisted NSPI with the development and implementation of its hedging practices. Black & Veatch was involved in a broad sense in its periodic review of hedging generally, while Mr. Crook was more actively involved in the decision-making process by advising NSPI in relation to gas purchases and hedging risk.

[323] The Board is satisfied that it was reasonable to retain and rely on the advice of Black & Veatch and Mr. Crook.

[324] Neither expert specifically identified a potential “basis differential” as a stand-alone risk to be hedged.

[325] The Board also notes that Liberty’s position on the issue of hedging practices appeared to change from the FAM Audit report through to the hearing. Initially in its report, Liberty concluded that NSPI should have placed a hedge on the basis differential, but at the hearing their opinion seemed to change to the view that NSPI should have examined this type of hedge in anticipation of the Shell long term contract coming to an end. Given the apparent softening of Liberty’s position on this issue, the

question becomes one of possible or potential imprudence, rather than actual imprudence. However, on the balance of probabilities, the Board concludes there is not sufficient evidence to warrant a finding of imprudence.

[326] After reviewing the evidence and the submissions, the Board is satisfied that NSPI could not reasonably have foreseen the events commencing in December 2010, which would lead to a significant change in the basis differential and result in the “basis blowout”.

[327] Further, even if NSPI had applied a hedging strategy to deal with a potential blowout in the basis differential, the cost of purchasing such hedging products, to the extent they were available, may possibly have cost ratepayers more than the “basis blowout” itself, which NSPI addressed immediately, early in 2011.

[328] Accordingly, the Board finds that no imprudence disallowance should be imposed on NSPI as a result of the “basis blowout” in the winter of 2010-11. Consequently, no specific review is required to study what amount NSPI might have saved in the winter of 2010-11 if it had adopted a different hedging strategy.

[329] During the hearing, NSPI’s hedging witness panel stated that a further examination of NSPI’s hedging practices would appear appropriate on a prospective basis.

[330] On the question of a prospective study, the Board does not consider that a specific direction is necessary. The Board expects that NSPI should be continually undertaking any studies or analyses about any aspect of its fuel management practices, including hedging, if considered prudent or appropriate to lower or stabilize fuel costs.

[331] Notwithstanding the Board's findings above, it wishes to comment on one submission by NSPI on this hedging matter. In its FAM Audit Reply Evidence, NSPI suggested that "the appropriate standard for judging our hedging program is to measure its compliance with the Fuel Manual" (p. 52).

[332] However, NSPI's own expert, Peter K. Nance, of Black & Veatch, stated that the Fuel Manual does not preclude NSPI from applying a new hedging strategy:

MS. STEWART: You would agree that the fuel manual doesn't dictate a certain strategy?

MR. NANCE: No, I don't think that it dictates one strategy. I think that it has guidelines, and fairly strong ones, for certain elements of the risk -- of the hedging strategy, and I tend to -- when I think about that, what I'm thinking about are the percentages of fixed price risk, as I refer to it, that is best to be -- suggested to be managed under the program. The less -- but in -- if -- but in terms of developing an overall response, my suggestion to you would be that, yes, I believe that NSPI has the authority and the ability to do that under the manual.

MS. STEWART: And so there could be different types of hedges that are entered into and still meet the requirements for fixed price management risk management ---

MR. NANCE: Yes.

[Transcript, October 31, 2012, pp. 868-869]

[333] Thus, in the Board's view, NSPI should not rely blindly on the express terms of the Fuel Manual to prevent it from using a new or different hedging strategy that would otherwise be reasonable in the circumstances.

11.7 FAM Audit Process

11.7.1 Evidence

[334] In its Reply Evidence, NSPI asserted that Liberty's FAM Audit is "fundamentally flawed", to the extent that the Board should reject all of the FAM Audit's conclusions and recommendations (including those which were supportive of NSPI's activities related to fuel).

[335] Among other criticisms, NSPI asserted that Liberty “has not acted in accordance with professional auditing standards”; “bases its major conclusions on a misapprehension of known facts”; its “approach, conclusions, and recommendations demonstrate insufficient knowledge and expertise in the subject matter of the audit”; and that “Liberty combines a lack of industry knowledge with a misguided approach to prudence review and a pre-existing bias against utility-affiliate relationships in order to develop a conspiracy theory that unjustly maligns NS Power, Emera, and the employees and executives of both companies”: see Exhibit N-135, pp. 4-5.

[336] NSPI asserted that:

The faulty conclusions of the FAM Audit arose from methodologies that were procedurally unfair and as such, did not meet the minimum professional standards for such an audit. Other than providing NS Power an opportunity to correct factual errors in the draft report, Liberty did not put its most serious allegations to NS Power during the course of the audit. This deprived NS Power of the chance to respond to these specifics, many of which could have been shown to be false merely by pointing to data already supplied to Liberty. Liberty’s investigative methodology was flawed. It took no steps to interview the Chief Executive Officers or the Chief Human Resources Officers of NS Power or Emera, each of whom are impugned by the Report.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 5]

[337] In addition to its request that the entire FAM Audit prepared by Liberty be rejected, NSPI suggests that Liberty should not conduct any future FAM Audit duties:

Despite [Liberty’s] extensive involvement with the creation, implementation, and operation of the FAM, Liberty Consulting Group has conducted the FAM Audits. We respectfully submit that Liberty’s deep involvement in the design and operation of the FAM precludes it from meeting the POA’s requirement that an “independent firm” conduct the audit.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 9]

[338] Moreover, NSPI also requests revisions to the FAM Plan of Administration:

NS Power proposes that the FAM Plan of Administration be revised in order to bring greater discipline and clarity to the audit provisions. These changes are designed to

ensure that the Board and customers are able to obtain the benefit of a constructive and efficient review of NS Power's fuel procurement and FAM compliance, and that the Company and its employees will not experience the kind of disruption and distraction that has been experienced in this most recent audit process.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 82]

[339] NSPI submits that the following changes be made to the POA:

- Adopt the Institute of Internal Auditors (IIA) – International Standards as applicable to FAM Audits;
- Define auditor independence, objectivity, and competence;
- Require FAM Auditors to be selected by competitive solicitation (RFP) under the authority of the UARB, independently of NS Power or FAM participants;
- Require the audit scope to be established and finalized, and provided to NS Power and interested parties to the FAM, prior to commencement of the audit;
- Establish fixed parameters for the audit, in terms of the time to complete the audit, and for NS Power to correct errors in the draft audit;
- Require auditors to raise serious matters of concern, or significant negative recommendations, with management during the course of the audit so that management can respond and action can be taken to remedy matters as appropriate;
- Establish a standard for the anticipated cost of the audit, with an appropriate process for the UARB to approve additional costs when appropriate, and allow the utility to recover the costs of the audit and related processes, pursuant to the FAM;
- Prohibit hindsight forecasting by auditors;
- Require that any subsequent consulting work that arises from an audit recommendation must be undertaken by a consultant that is not the auditor.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 83]

[340] In support of its position on the auditing standards to be applied in a FAM Audit, NSPI retained Deloitte.

[341] Deloitte drafted an audit plan and testimony that outlined potential differences between their audit approach and that of Liberty, based on a review of the final report. They observed:

- For some conclusions (presented in the section below), the report does not clearly state the evidence based on which the conclusions were drawn. We did not see evidence in the Liberty Report the Auditor conducted detailed audit procedures consistent with known standards of auditing to provide assurance to the NSUARB of compliance and use of good practices by NSPI in all cases as it relates to the FAM Audit

- The report appears to present points/conclusions relating to areas that extend beyond the scope of the FAM audit outlined under Section 5 of the POA. Circumstances/ other audit evidences that led to such extended scope will need to be examined or analyzed; and
- In specific cases (e.g., conclusions on hedging program), the conclusions appear to be based on a few selected months that might have had issues rather than the whole audit period or based on a randomly selected sample. It is important to examine if the same conclusions would be drawn on a random sample; Circumstances or selection criteria which led Liberty to form opinions based on specifically selected samples needs to be better understood to validate the conclusions.

[Exhibit N-131, p. 3]

[342] NSPI had Deloitte, Ms. Medine and Mr. Reed testify to auditing standards, with Deloitte recommending the Institute of Internal Auditors Standards and the US Government Accountability Office Auditing Standards, and others referring to the National Association of Regulatory Utility Commissions (“NARUC”) standards. During its testimony, Deloitte agreed the NARUC standards would also be appropriate:

MS. RUBIN: Would you concur that the NARUC guidelines would also offer suitable guidelines to the preparation of a FAM Audit?

MR. LOBAREC: Yes, I think that’s a reasonable question and I would agree, it could. It’s more about whether or not we go from assertion to specific ordered steps and then provide evidence that’s sufficient against those steps to reach a conclusion. Any of the ordered standards could lead you to that as long as those steps are followed in concert.

[Transcript, October 31, 2012, p. 820]

[343] NSPI experts also testified they had concerns related to Liberty’s compliance with auditing standards, referring to concerns with Liberty’s Audit Report with respect to the NARUC standards. Ms. Medine stated:

The FAM Audit and the FAM Audit Report do not meet industry standards with respect to guidelines established by the National Association of Regulatory Utility Commissioners (NARUC), the U.S. General Accounting Office (GAO), and other entities in a number of material ways. The most significant issues are as follows:

- Material areas of the FAM Audit were not conducted by individuals that have sufficient expertise and relevant experience.
- Confidential information was disclosed during the course of the FAM Audit.
- The FAM Audit Report was not objective and did not have a balanced tone.

- Liberty failed to support all material findings with relevant evidence.

[Exhibit N-133, pp. 2-3]

[344] In its FAM Audit Reply Evidence, NSPI placed particular emphasis on the Deloitte opinion, stating:

Deloitte's opinion is important for the Board to consider. Deloitte is a global auditing and consulting organization with the highest reputation for professionalism and integrity. The firm assigned accomplished international experts to the review of the FAM Audit. Deloitte identifies and applies established professional auditing standards. The Deloitte assessment identifies what NS Power respectfully suggests are serious gaps in the Liberty Report.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 81]

[345] The Board notes, as did Liberty in its Reply Evidence, that despite NSPI's characterization of Deloitte's evidence, nowhere did Deloitte describe any possible gaps in Liberty's audit as serious or significant in any way.

[346] Ms. Medine claimed other utilities have encountered similar problems with Liberty audits.

[347] However, Board Counsel witness Robert E. Curry, Jr., presented a different opinion. Mr. Curry is experienced in the field of utility regulation, including as a former Commissioner of the New York Public Service Commission. Based on responses from senior officials in 11 State regulatory entities, and based on his own personal experience with Liberty, he stated:

All of the respondents spoke highly of: Liberty's professionalism; the value Liberty's reports added to the regulatory process for both the utility and the regulator; its attention to keeping Staff of the client informed of its progress; the general interaction with the utility being audited (in spite of differences in views of the subject matter of the review); and, its overall effectiveness. No respondent reported any instance of prejudice or bias either for or against the utility or its regulator. "Tough but fair" was a term used by several commentators. ...

[Exhibit N-168, p. 5]

[348] In Board Counsel's questioning of the NSPI witness panel, he referred the panel to the views of National Grid about Liberty. National Grid delivers electricity to approximately 3.3 million customers in the U.S. Northeast. In a news release about a five month independent review of its accounting systems and practices, National Grid stated:

We engaged Liberty because of their reputation as being both thorough and independent. We wanted a report that would take a critical look at those areas where we need to improve, and this will help guide us going forward.

...

The company will share the report shortly with regulators in its various US operating areas. Liberty Consulting is a nationally recognized leader in providing independent reviews of regulated businesses. Its report is based on hundreds of data requests and employee interviews, site observations of systems operations, on-site document reviews, transaction testing and numerous working sessions

[Exhibit N-207]

[349] The NSPI witness panel did not challenge National Grid's view of Liberty.

[350] The Province also suggested that some revisions may be appropriate for the documents relevant to the FAM Audit:

The issues raised during the FAM audit suggest that it may be appropriate to consider a review of some of NSPI's guiding documents. It may be advisable for the FAM small working group to consider whether the hedging practices in NSPI's Fuel Manual should be assessed. It may also be appropriate to consider whether NSPI's Affiliate Code of Conduct should be reviewed to consider whether, and to what extent such a document can address NSPI's non-transactional relations with its affiliates (i.e., the extent to which NSPI's actions or inactions may or may not be influenced by the activities of its affiliates even when NSPI is not engaged in specific transactions with them).

[Province Closing Submissions, November 23, 2012, para. 26]

[351] However, the Province was concerned with the tone of the debate respecting the audit, including NSPI's response:

NSPI's FAM Plan of Administration ("POA") is also ripe for review. In many ways, the level of debate in this case over the FAM audit, a critical element of a successfully functioning NSPI FAM, was unfortunate. From NSDOE's perspective, the tone set by the FAM report audit could have been viewed negatively. Of course, tone can be difficult to

infer from the printed word, and sometimes tone can be imputed when it is not intended. Particularly if one is not engaged in actual dialogue.

Regardless of how it viewed the FAM Audit Report, NSDOE respectfully submits that NSPI's response did not help matters. NSPI apparently took the criticism as cause for war. Rather than responding quickly and confidently - it defensively called forth a battalion of high-priced experts to wage a war of words. And the FAM process has suffered collateral damage.

[Province Closing Submissions, November 23, 2012, paras. 27-28]

[352] The CA retained David P. Vondle to make recommendations with respect to the FAM Audit process. He is a partner with SAGE Management Consultants LLC, with 25 years of management consulting experience that includes leading 31 management audits. Mr. Vondle observed the NSPI response to the Audit was unprecedented, stating:

- With few exceptions, NSPI attacks conclusions and recommendations rather than findings (facts).
- NSPI admits it did not make factual corrections when it had the chance prior to the publication of the report. Normally, utilities take this opportunity to try to influence the conclusions and recommendations as well.
- NSPI attacks the NSUARB for hiring Liberty to do the FAM audit after Liberty acted as an extension of the NSUARB in putting the FAM process in place.
- The NSPI complaint about not having the scope of the audit is NSPI's own fault. NSPI could have insisted on having the work scope, work plan and schedule before beginning its participation in the audit. Also, the Liberty FAM Audit Report for 2010-2011 had the same chapters as the 2009 Report, with the exception that Economic Dispatch and Power Purchases and Sales were divided into two separate chapters for 2010-2011. (Tables of Contents) The 2009 Report had multiple negative conclusions and one quantification of excess cost, \$220 thousand, which could have been avoided by NSPI not granting a quantity flexibility option and more diligently enforcing the maximum volume limits of solid fuel contracts. (Page VI-21). The 2009 Report also recommended retroactive adjustments to the calculation of FAM carrying costs, but did not quantify the amount. (Page X-13) NSPI should not have been surprised by the scope of the 2010-2011 Audit.
- On the FERM staff turnover issue, the NSPI Reply Evidence confirms the Liberty finding that the entire FERM senior management team plus the next level-down Solid Fuels Scheduling and Logistics Coordinator turned over in the 2010-2011 period and that two of them left for affiliate positions. In the two-year period, FERM lost 10 of 18 employees and downsized to 16 positions – only eight employees were added. This is a lot of turnover in a small unit by any measure. At the end of the two year period, only eight of 18 original employees remained and none of the senior managers.
- The NSPI ad hominem attacks against Liberty are unprecedented in my experience.

- I am not familiar with Deloitte participating in the management audit or fuel audit business. I cannot recall them bidding or winning a Commission sponsored study. Perhaps they do in Canada or Europe. For example, the New Jersey Board just pre-qualified a set of seven management audit firms for the next round of management audits. Deloitte was not one of them. However, Liberty was one of the selectees.

[Exhibit N-169, pp. 8-10]

[353] Mr. Vondle does support potential changes to the Plan of Administration, however not as put forward by NSPI, indicating that some of NSPI's requests are "unusual" or "odd".

[354] The CA submitted in its Closing Submissions that it "has seen no evidence to support NSPI's attack on Liberty" (p. 8).

[355] The SBA submitted that there is no basis to reject the FAM Audit's findings or to dismiss Liberty as the auditor. He also noted NSPI's failure to respond to the FAM Audit as contemplated in the POA:

SBA argues there has been no substantive evidence filed or testimony heard at this FAM Audit hearing which supports the removal of Liberty as a FAM Audit Consultant. The uncomplimentary and unprofessional exchange of communication between Liberty and NSPI and the consultants is unfortunate. However, the SBA argues this does not establish that Liberty did not prepare an Audit report in an expert and detailed manner and they did forward a copy of the draft Audit report to NSPI for their review and comments; however, the reply that was forthcoming was to the effect, it was not worth replying to and the matter will be responded to through litigation at the FAM Audit hearing. SBA argues the long standing position of the Board was for the Board Consultant to prepare a draft report to be sent to NSPI for review and comments before finalization. It is undisputed that Liberty did send a draft audit report to NSPI for comments.

SBA argues there was ample opportunity before the time the report was filed, even up to the hearing, to attempt to negotiate areas of concern. Unfortunately, that did not occur.

...

Accordingly, SBA argues there was no substantive evidence filed by NSPI to have Liberty removed as auditor nor is there substantive evidence to request a new audit by a different auditor, and accordingly, this Board should reject NSPI's request in that regard and deal with the Audit Report on its merits.

[SBA Closing Argument, November 23, 2012, pp. 7-8]

[356] Avon also expressed its approval of the Audit conducted by Liberty, and its confidence in Liberty:

It appears to the Avon Group that upon finding that the Liberty Audit continued to press NSPI on certain issues, particularly related to the natural gas market and affiliate relationships, NSPI embarked on a strategy which focused on reputation management for NSPI through press conferences, media releases, direct contact with customers, expert evidence, overzealous confidentiality redactions and a concerted attack on the motives and credentials of the Liberty staff who performed the Audit, culminating in a recommendation that the entire Audit be rejected and Liberty prohibited from ever performing another audit of NSPI for the Board.

At the end of the day, and after all the noise, perhaps what was most telling is that despite the massive pre-hearing efforts to undermine the expertise of the Liberty witnesses, when given the opportunity during the hearing, NSPI did not ask one question to challenge the expert qualifications of the Liberty witnesses. Not one.

The Avon Group relies very much on the experience and expertise of Liberty and while there may be other auditors who could accomplish what is done by Liberty, there would be a steep learning curve which is neither efficient nor practical. It seems to the Avon Group that with Liberty's historical experience with NSPI comes greater knowledge regarding "problem areas" and the questions to ask. If Liberty ruffles feathers, so be it.

As noted by the Board in its decision on confidentiality of the FAM Audit, the focus in regulating NSPI is to examine whether NSPI's costs are prudently incurred. That goes to the heart of the regulatory compact, and the FAM is an integral component of the costs which NSPI seeks to recover. A meaningful, transparent audit is an essential part of the FAM. The Avon Group has seen nothing in the Liberty Audit Report or its dealings with Liberty that suggest that the Audit Report is so fundamentally flawed that it should be rejected in its entirety or declared "invalid" as urged by NSPI.

In the end, at best, NSPI's strategy in responding to the Audit was distracting; at worst, it served to frustrate the process. The Avon Group would strongly urge the Board in its decision to address not only the specific recommendations made in the Audit but also the Board's expectations regarding meaningful participation in the Audit process as a requirement for continued enjoyment of a FAM so as to ensure that these tactics do not interfere with the next audit process.

[Avon Final Submissions, November 23, 2012, paras. 33-37]

[357] Further, two Intervenors specifically noted their disappointment with the fact that NSPI only provided their opinion on the remaining recommendations in the FAM Audit in Undertaking U-22 filed at the very end of the hearing.

[358] The Province stated:

A response to the FAM Audit report, like the one seen in NSPI's response to Undertaking U-22 should have been a first response, and not dragged out during the last days of the hearing. ...

The FAM POA should be reviewed and revised to ensure that stakeholders receive appropriate responses to a FAM audit from NSPI, as soon as possible, and at a very early stage in the proceeding.

[Province Closing Submissions, November 23, 2012, paras. 29-30]

[359] Avon also expressed its concern with the lateness of NSPI's position on the remaining recommendations in the Audit report:

By failing to respond substantively to the draft Audit, and by taking the position that the entire Audit should be rejected by the Board, NSPI failed to provide key information to Liberty, the Board and stakeholders. Indeed, the Utility never indicated which of the 2012 Audit recommendations it accepted. This information was not provided until the last day of evidence in response to an undertaking given during the hearing.

Of 42 recommendations, NSPI apparently agrees with 27. Some of the recommendations with which NSPI does not agree were raised in a substantive way through this hearing, but others have not been addressed at all. NSPI's failure to provide this basic information in a timely fashion has impeded the Board and Intervenor from properly examining NSPI's position with respect to the 2012 FAM Audit.

[Avon Final Submissions, November 23, 2012, paras. 31-32]

11.7.2 Findings

a) Auditing Standards

[360] The Board will first address the issue of auditing standards. While NSPI cross-examined the Liberty witness panel at the hearing with respect to its evidence related to NSPI's fuel related activities (including the activities noted above which attracted disallowances), counsel for NSPI did not challenge or question any of Liberty's witnesses on their professional qualifications, nor did NSPI counsel cross-examine the Liberty witness panel on the auditing standards or methodology applied by Liberty in the FAM Audit.

[361] NSPI relied on Deloitte's evidence. However, the Board notes that while Deloitte is a reputable auditing and consulting firm, the scope of its engagement in this matter was limited.

[362] First, Deloitte was not engaged to express an opinion on the correctness of Liberty's FAM Audit opinions:

MS. RUBIN: And you were engaged to identify deficiencies in the report rather than provide an opinion on the correctness of Liberty's opinions?

MR. LOBAREC: We were engaged to identify potential differences, based on the way we would do our work and the way we're able to observe that it was done in the report we were provided from Liberty.

[Transcript, October 31, 2012, p. 814]

[363] Second, even though Deloitte was engaged to identify "differences" in the Liberty FAM Audit Report, Mr. Lobarec, Deloitte's national leader for energy and resources across Canada, acknowledged in his testimony that they did not review any of Liberty's working papers, nor did Deloitte even interview anyone at Liberty:

MS. RUBIN: ...And is it fair to say that the -- even at the end of your work, you were only able to identify some potential differences in approach?

MR. LOBAREC: That is correct. As we've said in our report, there may be factual evidence contained in work papers or other areas that we were not able to observe that would form a more reasonable basis for reaching some of those conclusions.

MS. RUBIN: Right. And the reason for that, identifying potential differences, is because you only took a high-level review of the Liberty report; correct?

MR. LOBAREC: It's probably more because we're engaged to develop an audit plan. So it's only based on the way that we would do the work and the factual basis or evidence that we would require against a report. So I hope that answers your question.

MS. RUBIN: But what you did was a high-level review of the Liberty report?

MR. LOBAREC: We were only able to read the report, that's correct.

MS. RUBIN: Right. You didn't review any supporting work papers?

MR. LOBAREC: No, we don't have access to that.

MS. RUBIN: Okay. And did you interview anyone at Liberty?

MR. LOBAREC: No.

[Transcript, October 31, 2012, pp. 814 – 816]

[364] Notably, Mr. Lobarec of Deloitte also admitted that none of the individuals involved in the preparation of Deloitte's evidence had, in fact, ever carried out a fuel management audit on behalf of a regulator:

MS. RUBIN: Were there -- how many people were involved in the preparation of the Deloitte evidence?

...

MR. LOBAREC: It is 10.

MS. RUBIN: It's 10, okay. Now, of those 10, is it correct that none have performed fuel management audits on behalf of a regulator?

MR. LOBAREC: In -- yes, that's correct.

[Transcript, October 31, 2012, pp. 816-817]

[365] Finally, Mr. Lobarec acknowledged that there is no single standard for an auditor conducting a fuel management audit:

MS. RUBIN: ...Now, would you agree that there's not one single correct approach to a fuel management audit?

MR. LOBAREC: Yes, it is open to interpretation. The adoption of standards and the way it's done varies. I do agree with that.

[Transcript, October 31, 2012, p. 814]

[366] In light of the above, the Board assigns little weight to Deloitte's evidence with respect to the issues in this FAM Audit.

[367] Ms. Medine was very critical of Liberty's auditing methodology.

[368] As noted earlier in this Decision, the Board gives little weight to Ms. Medine's evidence.

[369] This is not Liberty's first FAM Audit of NSPI. The 2010 Audit conducted in relation to the 2009 fuel related activities was met with general agreement by NSPI. At that time, NSPI did not express any concerns with the auditing standards applied by Liberty.

[370] Further, NSPI's assertions that Liberty has an "insufficient knowledge and expertise in the subject matter of the audit" and that it has a "lack of industry knowledge" is not borne out by the evidence. In this respect, the Board accepts the evidence of Mr. Curry, whose evidence was not challenged by NSPI, that Liberty possesses an excellent reputation with at least 11 regulatory commissions in the U.S., both in terms of Liberty's professionalism and its effectiveness in the conduct of audits.

[371] It is also instructive that NSPI did not cross-examine any member of the Liberty witness panel about their professionalism, qualifications or expertise.

[372] The Board is aware of the NARUC guidelines. On the basis of the evidence before it, the Board is satisfied that Liberty's FAM Audit is consistent with the NARUC guidelines. The FAM Audit was also conducted in a manner consistent with the process contemplated under the POA approved by the Board.

[373] In addition, it is noted that NSPI's customers were satisfied with Liberty's work on this file. The Board places significant weight on the support given to Liberty by the Intervenors representing most customer classes. The CA, the SBA and Avon all support Liberty in its conduct of the present audit and in future audits. It is clear that the present audit was conducted in a manner which met the expectations of these customer classes.

[374] The Board concludes that Liberty's FAM Audit followed appropriate auditing standards.

b) Future Audits

[375] The second issue considered by the Board relates to future audits. NSPI made a number of requests for changes to the POA and to restrict the engagement of Liberty on future FAM Audits.

[376] The Board notes that the issue of POA amendments or future audits was not on the Final Issues List approved by the Board for this proceeding.

[377] On this point, the Board indicated during the hearing that it would be more appropriate to review all aspects of the FAM in a separate proceeding where the FAM and all other issues related to it (including the POA) can be examined, rather than in a piecemeal fashion. The Board maintains its view on this issue.

[378] Accordingly, the Board makes no directive at this time with respect to possible changes to the POA or future FAM Audits.

c) NSPI's Response to the Audit

[379] Another issue which arose out of the evidence and submissions respecting the audit process relates to NSPI's response to the draft Audit Report submitted to it by Liberty. The Board shares many of the Intervenors' concerns.

[380] NSPI asserts that the nature of the allegations in the Audit Report justified its decision not to comment to Liberty on the draft Report and, instead, to launch a strong reply to the Report as part of the GRA hearing, including the engagement of numerous expert consultants.

[381] On the other hand, the CA, SBA, Avon, and the Province, submit that NSPI, in failing to respond to the draft Audit Report, acted contrary to the FAM Audit process contemplated in the FAM POA. Moreover, they assert that NSPI's failure to disclose material information in the hearing process, including in its FAM Audit Reply Evidence, in its Responses to Information Requests from Intervenors, and even in its testimony under cross-examination by the Intervenors, frustrated the FAM Audit process.

[382] These Intervenors are represented by experienced counsel who, except for the SBA, have been involved in the proceedings leading to NSPI's request for a FAM and the adoption of the FAM by the Board. NSPI's strategy in responding to the FAM Audit fell far short of the expectations of these counsel.

[383] As noted earlier in this Decision, the POA provides that NSPI would be provided with a draft Audit.

[384] When provided with the draft FAM Audit in June 2012, NSPI elected not to offer any comments to Liberty. It is clear from the terms of the POA that the final FAM Audit report is to "evolve" from the draft Report. This clearly contemplates input from NSPI about the contents of the draft Report. The POA provides that NSPI has 30 days to comment. Liberty specifically requested NSPI's comments. The prior 2010 FAM Audit had proceeded in this fashion.

[385] In its evidence, NSPI claimed that it did, indeed, respond to the draft Audit Report, referring to a reply email from its counsel Rene Gallant on June 24, 2012. However NSPI chooses to characterize Mr. Gallant's email, the Board finds that it

amounted, in effect, to a non-response on the substantive issues in the draft Report. Further, it was not the type of response contemplated under the POA.

[386] In choosing this course of action, NSPI did not provide Liberty with relevant information which might have caused Liberty to change its findings and recommendations, including possibly withdrawing some of the proposed disallowances. Further, if NSPI had discussed its concerns with Liberty about the tone of the draft Report, or about some of the observations in it, the language of a final Audit Report might have been more restrained. No one will ever know because of NSPI's response.

[387] NSPI's tactical response to the draft Audit Report contributed to further difficulties in the audit process. In accordance with the POA, Liberty did provide NSPI with a draft Report of its findings. NSPI's initial non-response led Liberty to file the draft Audit Report with the Board, in effect, becoming Liberty's final FAM Audit Report.

[388] In fuel management or prudence audits, the Board expects the auditor to report disputed or unresolved issues to the Board. Faced with NSPI's non-response to the draft Audit report, it was entirely reasonable for Liberty to then file its findings with the Board.

[389] Based on its review, the Board finds that NSPI's decision to ignore the draft Audit Report did not comply with the terms of the POA and its related conduct was unreasonable. Moreover, the Board notes that all of the auditing standards or guidelines cited by Deloitte, Ms. Medine, or Mr. Vondle contemplate the audited party reviewing a draft audit report and responding to any deficiencies that should be addressed. In this case, NSPI decided, for whatever reason, to forego the opportunity to respond and to challenge all of Liberty's findings and recommendations in the hearing

(even those findings which it later acknowledged it agreed with in Undertaking U-22). In so doing, the Board concludes that NSPI's conduct was contrary to what would have been reasonably expected under the POA. It certainly was contrary to the reasonable expectations of the Board and the Intervenors. NSPI also acted in a manner which is not consistent with the spirit and intent of audits generally, including fuel management or prudence audits.

[390] Further, NSPI's course of action distracted and misdirected all parties in this proceeding from addressing some of the other important issues in the hearing. NSPI's course of action had the effect of wasting scarce resources, in terms of time, money and human resources, for all parties.

[391] At this point, the Board notes that Liberty bears some of the responsibility for the acrimonious relationship which developed over the course of the FAM Audit process between NSPI and its FAM auditor. Some of Liberty's language was provocative in a way it did not have to be. In retrospect, the Utility's response might have been more tactful and reserved if Liberty had adopted a more measured tone in its criticism of NSPI's FAM activities. This would have resulted in a more productive Audit process.

[392] Nevertheless, the tone used by Liberty in a few of its findings is no excuse for the nature of NSPI's comments respecting the FAM Audit Report. NSPI's comments and non-responsive strategy only served to escalate the rhetoric and to hinder the efficient review of the Audit Report by the Intervenors and the Board.

[393] In making these findings, it is not the Board's intention to suggest that NSPI should not challenge any finding or recommendation by a fuel management

auditor, in a hearing if necessary. However, before it embarks on such a challenge, it has a responsibility under the POA, and to its ratepayers, to provide its comments in a timely fashion on a draft Audit Report delivered to it by the auditor. Such a response would help to resolve or narrow the issues identified during the Audit and would have allowed the Intervenors and the Board to conduct an efficient review of the Audit Report.

[394] In the future, the Board expects NSPI to conduct itself in accordance with the intent and the terms of the POA, including providing a meaningful response to the draft Audit Report.

d) Non-contested Recommendations in the Audit Report

[395] Finally, the Board is concerned with NSPI's failure to comment at an early stage with respect to the remaining recommendations in the FAM Audit. While it initially issued a blanket dismissal of the entire Audit Report (including the findings supportive of NSPI's fuel related activities), it ultimately agreed, at the end of the hearing, in an Undertaking requested by Avon, to identify which recommendations it agreed were reasonable. Initially, counsel for NSPI sought to limit the scope of the undertaking and questions about the other recommendations in the Audit Report. In Undertaking U-22, filed at the conclusion of the hearing, NSPI identified the recommendations it agreed with and which ones it did not. Interestingly, however, NSPI stated in its response to Undertaking U-22, "NS Power makes no comment on the conclusions in the Liberty report." Again, NSPI's approach unnecessarily lengthened the hearing and resulted in the inability of the Board and the Intervenors to delve into an efficient and meaningful assessment of the substantive issues identified in the FAM Audit.

[396] Despite its initial blanket rejection of all Liberty's FAM Audit recommendations, NSPI appeared to adopt a more conciliatory tone after the hearing was completed. In its Closing Submission, NSPI stated:

... NS Power's response to Undertaking U-22 outlines NS Power's position on each of the recommendations contained in the Liberty audit report. Out of 42 recommendations, NS Power agrees with 27 recommendations. At least 15 of these 27 Liberty recommendations are items that had already been undertaken by NS Power...or that are existing practices or plans of the Company...

[NSPI Closing Submission, November 23, 2012, p. 27]

[397] In its Reply to Closing Submission, NSPI asked the Board for the "rejection of the disputed conclusions and recommendations from the FAM Audit Report", offering no further comment on the remaining recommendations.

[398] Counsel for Avon noted that the late filing of such information deprived the Intervenor of the opportunity to conduct a meaningful assessment of the issues and, indeed, frustrated the conduct of the FAM Audit process itself. The Province, which typically takes no position in GRA proceedings, expressed similar concerns.

[399] In the future, the Board expects NSPI to outline, no later than in its Reply Evidence, which audit findings or recommendations it agrees with and which it does not.

11.8 FAM Small Working Group

[400] Another issue arose out of the FAM Audit hearing which the Board considers should be addressed. It is apparent that NSPI has a different view than the Board about the role of the various participants in the FAM Small Working Group ("SWG").

[401] In a few instances related to its gas hedging practices, NSPI indicated its reliance on the SWG for its decisions or course of action.

[402] For example, with respect to the losses incurred by NSPI as a result of the “basis blowout” commencing in December 2010, NSPI appeared to place some of the responsibility for its decisions on gas hedging strategies on Liberty and other members of the SWG:

Liberty is also a participant in the FAM Small Working Group. Minutes of the FAM SWG for the six months leading up to the basis blowout period make no reference to any comment by Liberty, or by any other stakeholder, identifying the need for a study to examine the potential for reducing fuel cost volatility by hedging the basis differential.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 55]

[403] Similarly, in its Closing Submission, NSPI stated:

As Mr. Bennett and Mr. Sidebottom explained, the Black & Veatch study was discussed with stakeholders during FAM Small Working Group (SWG) meetings, and the results of the study were provided to the FAM SWG. No concerns or objections were raised about the study or whether it was sufficiently comprehensive or focused. Liberty also reviewed the study and agreed with the study conclusions in a December 10, 2010 memo to NS Power. Despite Liberty providing its written comments just days before the December 2010 “basis blowout”, Liberty provided no complaint or criticism that the basis differential risk had not been addressed nor that additional focused study work should be done on basis differential or any other component of risk. Clearly Liberty did not, at the time, see basis differential as a significant risk any more than NS Power did. ...

[NSPI Closing Submission, November 23, 2012, p. 45]

[404] NSPI also appeared to implicate Liberty and the SWG in the “development” of the Fuel Manual:

The Fuel Manual is a highly prescriptive document, developed in close consultation with stakeholders and Liberty, and approved by the Utility and Review Board. NS Power believes the appropriate standard for judging our hedging program is to measure its compliance with the Fuel Manual.

[NSPI FAM Audit Reply Evidence, Exhibit N-135, p. 52]

[405] The Board wishes to reiterate that the role of the SWG, or any of its individual participants, is not to manage NSPI’s fuel related activities. The responsibility for such activities lies squarely on NSPI and not on any other SWG participant. Accordingly, NSPI should not seek to cast any responsibility on the participants for

particular actions taken by NSPI or to reproach the other participants for not suggesting an alternative course of action.

11.9 Remaining recommendations in FAM Audit

[406] As noted earlier in this Decision, NSPI did not initially indicate in its Reply Evidence which findings or recommendations of Liberty it agreed with. On the last day of the hearing, in an Undertaking requested by Avon, NSPI agreed to provide an Undertaking to the Board outlining which recommendations it rejects, which it accepts, and which it has implemented. In the latter case, NSPI was to outline its action plan.

[407] NSPI filed Undertaking U-22 on November 9, 2012. As noted by NSPI in its Closing Submission, it agrees with 27 of 42 recommendations. However, Avon states that NSPI's late filing of this information has impeded the Board and Intervenors from "properly examining NSPI's position with respect to the 2012 FAM Audit".

[408] The Board directs that NSPI proceed with the implementation of the recommendations it has agreed with in Undertaking U-22. In the instances where NSPI has not provided an action plan for the recommendations with which it agrees, it is directed to file its implementation plans by February 28, 2013.

[409] In the case of recommendations which are not agreed to by NSPI, it is to file a detailed explanation why it does not agree. This is also to be filed by February 28, 2013.

[410] The Intervenors will then be permitted to provide their comments to the Board by March 29, 2013, with respect to any of the remaining recommendations.

11.10 Disallowed Costs related to the FAM Audit

11.10.1 Evidence

[411] Earlier in this Decision, the Board reviewed instances in which NSPI undertook a course of conduct which, the Board considers, was contrary to what would have been reasonably expected under the FAM POA.

[412] NSPI repeatedly refuted a recommendation by Liberty to pursue concerns with the NEB and potential sellers of natural gas about the state of the Maritimes natural gas market. Moreover, Liberty's recommendation was, in effect, summarily dismissed by NSPI, who even went as far as to assert that Liberty did not understand the regulatory regime in Canada and that this was a basis for concluding that Liberty was inept and unqualified to perform its FAM auditing duties.

[413] However, on the very last day of the hearing, the NSPI witness panel, primarily Mr. Janega, revealed that NSPI had indeed carried out a course of action over the past few years which had actually taken into account Liberty's concern on the state of the natural gas market in the Maritimes. Of particular concern to the Board, in terms of the FAM Audit generally (including the administration of the POA), is the fact that NSPI, notwithstanding its course of action to the contrary, denied that Liberty's concern was in any way legitimate or worthy of any action.

[414] NSPI maintained its dismissal of Liberty's concern during the period leading to the release of the FAM Audit, as well as in its FAM Audit Reply Evidence, in its Responses to Information Requests from the Intervenors, and in its sworn testimony in cross-examination by these same Intervenors. NSPI's revelation about its actual course of action only occurred on the very last day of the hearing during questioning by Board Counsel.

[415] NSPI's course of action distracted and misdirected all parties in this proceeding (and the public) from the real issue which should have been addressed at the hearing about the natural gas markets. Moreover, NSPI's course of action had the effect of wasting scarce resources, in terms of time, money and human resources, for all parties, notably those of the Intervenors who participated in this proceeding, including experienced legal counsel and, likely in some cases, their expert consultants. This conduct resulted in increased costs for all Intervenors, including those representing most customer classes served by the Utility.

[416] The lack of disclosure by NSPI was not restricted to the matter involving the NEB.

[417] First, it was not until the hearing that NSPI disclosed the true extent of its response with the circumstances surrounding the withdrawal of Bid A by the counterparty, as described earlier in this Decision. It was not until her testimony that Ms. Trenholm, under cross-examination, revealed NSPI's actual reaction following those events. NSPI, in fact, voiced its strong displeasure with the counterparty, but decided that its interests would best be served in the long term by preserving the relationship. However, NSPI's actions and reasoning on this issue were not fully disclosed to Liberty or the Intervenors until the hearing.

[418] Another instance of inadequate disclosure arose in the context of the Lingan derate matter. Liberty had proceeded with its analysis of the issue using NSPI's schedule of different coal blends used at Lingan over the relevant period. However, during their cross-examination by NSPI, the Liberty witness panel was presented with a different schedule of coal blends used over the same time span. This required Liberty

to reconsider its analysis in an Undertaking. It is curious that, later in the hearing, when asked about the revised schedule by Board Counsel, Marie Thomas, of the NSPI Fuel Panel, was required to be briefly excused by the Board to confirm whether the revised schedule was, in fact, the correct schedule. Fortunately, her records matched the revised schedule, but what appeared to be confusion in communication among NSPI's different representatives was disconcerting to the Board.

[419] Yet another example of poor disclosure, for whatever reason, was in relation to the gas hedging issue and the Black & Veatch report. While it was clear from a plain reading of the Black & Veatch report that the issue of the "basis differential" could not reasonably be seen as a specific issue within the scope of the engagement, NSPI, in its testimony at the hearing, specifically its Fuel Panel, nonetheless characterized the Black & Veatch report as dealing directly with the issue. The Company had not previously disclosed its reliance on that report specifically for that purpose, even though it became a central theme of its testimony at the hearing on the hedging issue.

[420] The second issue which causes great concern to the Board is NSPI's failure to follow the process contemplated by the FAM POA for the development of the FAM Audit report itself.

[421] As noted earlier in this Decision, when provided with the draft FAM Audit in June 2012, NSPI elected not to offer any comments to Liberty. It is clear from the express terms of the POA that the final FAM Audit report is to "evolve" from the draft report. This clearly contemplates input from NSPI about the contents of the draft

Report. The prior 2009 FAM Audit had proceeded in this fashion. The POA provides that NSPI has 30 days to comment.

[422] In choosing this course of action, NSPI did not provide Liberty with relevant information which might have caused Liberty to change its findings and recommendations, including possibly withdrawing some of the proposed disallowances.

[423] On a related point, NSPI initially dismissed all the other FAM Audit findings and recommendations which were supportive of the Utility's fuel related activities or those which NSPI later indicated, in Undertaking U-22, that the Utility agreed with.

[424] Again, the result of NSPI's conduct, in failing to comment on the draft Audit report, is that it unnecessarily lengthened the hearing and wasted the time, money and effort of the Intervenors in this proceeding, as well as Board Counsel.

[425] In its Closing Submissions, the CA specifically requested that the Board sanction NSPI as a result of its conduct in responding to the FAM Audit:

In its pre-filed evidence and throughout much of its testimony before the Board, NSPI aggressively challenged Liberty's experience, qualifications, ethics, and independence.

Put simply, the Consumer Advocate has seen no evidence to support NSPI's attack on Liberty. Furthermore, the Consumer Advocate sees NSPI's attack as offensive to the regulatory process itself. Clearly, a mature utility needs to understand the difference between disagreeing with an auditor's recommendations and a baseless assault on the auditor's reputation.

In such circumstances, where a utility initiates and maintains baseless attacks on auditors appointed by the regulatory body, there ought to be a consequence for the utility.

An obvious consequence would be to assess some portion of the costs of the hearing which have been generated as a result of NSPI's intransience and to have them borne by the company and its shareholders. The assessment could consist of either a reduction of the costs that NSPI could otherwise recover and/or an assessment of a portion of the costs incurred by the Board and intervenors against NSPI. The assessment could be by way of a lump sum set by the Board in consideration of all the particular circumstances.

[CA Closing Submissions, November 23, 2012, p. 8]

11.10.2 Findings

[426] The Board is responsible for the general supervision of NSPI under the *Public Utilities Act*. Section 18 provides:

Supervision of utility by Board

18 The Board shall have the general supervision of all public utilities, and may make all necessary examinations and inquiries and keep itself informed as to the compliance by the said public utilities with the provisions of law and shall have the right to obtain from any public utility all information necessary to enable the Board to fulfil its duties.

[427] While the CA requests that NSPI be sanctioned for its conduct generally, the Board considers that any such sanction should relate to specific instances where NSPI has showed imprudence or ignored direction from the Board.

[428] In this respect, the Board expects NSPI to comply with its Decisions, Orders and directives, including its oversight procedures such as the FAM Audit and the POA. In the Board's opinion, NSPI's conduct in relation to the NEB issue and the aggressive pursuit of gas supplies, and its decision not to comment on the draft Audit Report, were both unreasonable and inappropriate. Further, as noted above, its conduct on these specific points resulted in unnecessarily extending the length of the hearing and wasting the time, money and effort of the Intervenors and Board Counsel.

[429] In these circumstances, the Board finds that a sanction is warranted as against NSPI. In accordance with its jurisdiction under s. 18 of the *Public Utilities Act*, as well as its mandate under the *Act* generally, the Board concludes that a disallowance of \$2 million is appropriate and it so orders.

[430] In determining the disallowance of \$2 million, the Board has relied, in part, on its evaluation of unnecessary costs incurred by the CA, SBA and the Board as a

result of NSPI's response to this FAM Audit. Likewise, NSPI, itself, would also have incurred unnecessary costs.

11.11 Implementation of the FAM disallowances

[431] As a result of the Board's findings earlier in this Decision, disallowances have been made as against NSPI with respect to its imprudence and its conduct in relation to directives by the Board. These disallowances must now be implemented in this Decision.

[432] As noted earlier, the Board has approved the GRA Agreement. Further, in a separate proceeding, by Order issued December 10, 2012, the Board has approved the 2013 FAM Actual Adjustment (AA) and Balance Adjustment (BA) recovery values. Both of these approvals were made subject to any further adjustment arising from this Decision.

[433] There are several options to implement the disallowances.

[434] The SBA recommended as follows:

SBA points out while the overall amount of imprudence disallowance amounts are small as a percent of revenues they still maintain an important monetary issue for small businesses of Nova Scotia. Small businesses have felt the hard impact of the current economic climate. Increases in electric rates associated with raising [sic] NSPI costs and the losses of large customer loads will present the SBA's constituents with yet [another] straw to add to a burdened back. SBA suggests that the manner to return the benefits of any disallowance is to first go to offset or wipeout the 2012 FAM AA adjustment. This would reduce the specter of looming future rate increases and the potential for the timing of recovery in 2015 to coincide with any other increases, including fuel prices. NSPI's business customers need stability as much as they would benefit from lower rates. SBA believes this is especially true of the small businesses where there is less medium and long term business and financial planning. This would allow the 3% already agreed upon to be implemented.

If there are disallowances in excess of the 2012 FAM AA adjustment SBA urges the Board to consider providing the benefit of the returning funds for disallowances to customer classes as a single month rebate within two months of the Board issuing a decision. This would provide a more pronounced benefit to SBA's small business constituents, an economic stimulus of sorts.

[SBA Closing Argument, November 23, 2012, p. 24]

[435] In its Closing Submissions, the Province “urged the Board to ensure that any savings that result from the FAM Audit be passed along to customers as soon as possible”.

[436] The political parties who participated in this proceeding submitted that any disallowance should be returned to ratepayers immediately.

[437] With respect to the fuel-related disallowances totaling \$4,503,000 for the Lingan derates and the Bid B natural gas contract, this amount must be applied to the 2013 FAM Balance Adjustment (“2013 BA”).

[438] The Board notes that applying this fuel disallowance to the 2013 BA will actually reduce the fuel deferral to be collected from ratepayers starting in 2015. This deferral of the fuel disallowance is consistent with the manner adopted by the Intervenor for the non-fuel reductions they negotiated in the GRA Agreement.

[439] More importantly, applying the fuel disallowance amount against the deferral will benefit ratepayers by reducing the deferral amount attracting interest and the 9% rate of return for NSPI.

[440] A different implementation procedure applies for the \$2 million disallowance arising from NSPI’s conduct contrary to the POA.

[441] While some Intervenor may have suggested different alternatives were available to the Board, it considers that this disallowance must be applied against NSPI’s 2012 earnings.

[442] The Board has decided that the 2012 revenue requirement is to be adjusted for purposes of applying clause 26 of the 2012 Settlement Agreement. Clause 26 reads as follows:

Subject to necessary adjustments to incorporate paragraph 7 above, the s.21 AAA Mechanism will continue to operate on a go forward basis until the s.21 amount is fully paid. Amounts in excess of both the range of return on equity and in excess of the room available in the s.21 AAA Mechanism will be returned to customers.

[Decision, 2011 NSUARB 184, p. 13]

[443] The threshold for triggering payment under clause 26 of the 2012 Settlement Agreement will be \$2 million lower than it otherwise would have been. If NSPI otherwise over earns in 2012, an additional \$2 million will be applied to the deferrals for the benefit of ratepayers.

[444] The Board notes that while this \$2 million disallowance does not provide a direct benefit to ratepayers going forward, it could, as explained above, benefit ratepayers if there is an impact on the treatment of the s. 21 amount under the 2012 Settlement Agreement.

[445] The Board directs the implementation of all the disallowances as described in this section.

11.12 Perspective

[446] NSPI's fuel budget over the two year period covered by the Audit is approximately \$1 Billion or \$500 Million per year. The Liberty Audit recommended a disallowance of approximately \$10 million in fuel spending, approximately 1% of the budget. Liberty recommended further investigation of the hedging issue. While Liberty made other recommendations in the Audit, it did not question 99% of the fuel spending undertaken by NSPI and indeed, parts of the Audit were very complimentary to NSPI's fuel acquisition activities.

[447] From the outset NSPI chose to focus its own and the public's attention on this 1% - ignoring the balance of the Audit and indeed trashing the whole Audit.

[448] NSPI also chose to focus on reputation; its own reputation alleging defamation, which lead to a separate preliminary hearing in August, and attacking Liberty's reputation, alleging bias, incompetence, and irresponsibility, among other things.

[449] Power rates are, at the best of times, a top of mind issue with the public in Nova Scotia. The majority of the members of the public are NSPI's customers.

[450] NSPI is free, and must be free, to conduct any case before the Board in the manner that best suits it.

[451] However, having read the comments of the CA, SBA and Avon, who are all regular parties to these proceedings, and having reflected on the matter, the Board cannot help but observe that NSPI's relationship with the public and other parties to most of these proceedings has suffered damage.

[452] One of the conditions attached to the approval of the FAM was "a meaningful audit process under the administration of the Board". The Board and customers expect the Board's auditor to ask the tough questions and to identify areas where costs might have been avoided. Simply because the Audit recommends a disallowance, does not mean the Audit is flawed or biased. In making a disallowance the Board is not finding that NSPI's fuel team are not competent or professional. They are both competent and professional.

[453] Credit rating agencies and others who follow these proceedings should understand this perspective. The FAM Audit process approved without question 99% of NSPI's fuel costs. The Audit was critical of only 1%. The Board has, in the result,

accepted two recommendations for disallowance, amounting to much less than 1%. NSPI has a functioning FAM.

12.0 MISCELLANEOUS

12.1 Information Requests

[454] The Board observed a practice NSPI adopted in this hearing which had not been prevalent in the past by answering an IR as follows:

NS Power will provide this information to the Board upon request.

[Exhibit N-32, IR-33]

[455] Such an answer is not responsive or helpful to the questioner. An IR is either “in scope” and relevant and deserves an answer or is “out of scope” and irrelevant, in which case NSPI can refuse to answer it. NSPI should take a position in the original answer which, if the questioner disagrees, can be further reviewed by the Board at the request of the questioner. The response noted above simply delays proceedings which are often on a very tight time schedule. This is not acceptable.

13.0 COMPLIANCE FILING

[456] The rates approved in this Decision are effective January 1, 2013 and January 1, 2014, respectively.

[457] NSPI is directed to file a Compliance Filing as soon as conveniently possible.

[458] The Formal Intervenors must provide comments, if any, no later than three full business days thereafter.

[459] Further, the Board directs NSPI to outline in 2013 and 2014 where it has applied the \$27.5 million non-fuel cost reductions negotiated in the GRA Agreement. This disclosure is to accompany the year-end financial statements in the respective years.

14.0 SUMMARY OF BOARD FINDINGS

Settlement Agreement

[460] This Decision deals with the Board's consideration of both NSPI's general rate application and of the FAM Audit Report.

[461] NSPI's Application requested the Board's approval of a Rate Stabilization Plan ("RSP"). The RSP is a two-year rate plan, with net increases of three percent per year effective on each of January 1, 2013, and January 1, 2014. According to the Application, the increases will cover a portion of the increased costs forecast by NSPI in each of the next two years. NSPI proposed the remaining revenue requirement be deferred for future recovery commencing in 2015.

[462] NSPI reached a settlement agreement ("GRA Agreement") with most of its customer classes, including the CA, the SBA and Avon.

[463] The Board approves the GRA Agreement, which adopts the two year RSP proposed by NSPI and represents a comprehensive resolution of many contested issues between NSPI and the Intervenors, who indicated that, without the RSP, customers would have faced much larger rate increases, particularly in 2013. They stated that the RSP will "smooth out rate increases experienced by customers" and provide a "predictable measure of stability" over the next two years.

[464] The GRA Agreement provides for a \$27.5 million non-fuel cost reduction in NSPI's deferral account balance. The deferral of forecasted revenue requirement will not exceed \$47.1 million at December 31, 2013 and will not exceed \$84.8 million at December 31, 2014.

[465] In the Board's view, an important component of the GRA Agreement which will benefit customers is the RSP, which limits across-the-board 3% increases in each of 2013 and 2014, while deferring recovery of NSPI's remaining revenue requirement to 2015. The recovery of the deferral, commencing in 2015, will coincide with the end of the Section 21 Tax Deferral, which has already been included in existing rates over eight years ending in March 2015. The deferral in the RSP will be collected over an 8 year period beginning in 2015.

[466] The GRA Agreement also reduces NSPI's return on equity from 9.2% to 9.0%, along with a change to the earnings band of 8.75 % to 9.25 %. This will also result in further reductions to NSPI's revenue requirement for 2013 and 2014.

[467] The rates approved in this Decision are effective January 1, 2013 and January 1, 2014, respectively. Rates will increase by 3% for each customer class on January 1, in each of 2013 and 2014.

Pension Costs

[468] In last year's general rate Decision, the Board indicated that it would investigate the issue of pension costs in this proceeding. It appears to the Board that until very recently NSPI has done little, if anything, to address increasing pension costs.

[469] NSPI confirmed to the Board that it reached an agreement with the IBEW on the terms of a new collective agreement which was approved on November 5, 2012, including changes to the pension plan.

[470] The Board sees this change as a significant step in pension reform. The Board accepts these changes as adequate initial steps.

[471] In future years these costs savings will be embedded in the revenue requirement asked of customers. However, the Board expects NSPI in future to take additional steps to improve contributions to, and the funding of, the pension plan.

[472] Two issues also arose in the course of the hearing with respect to NSPI's Supplemental Executive Retirement Plan (SERP). This plan is available to employees who earn more than approximately \$150,000 per year. The Board considers it unreasonable that the most highly paid employees working for NSPI make no contribution to the supplemental pension plan.

[473] NSPI is free to continue to provide that benefit, however, the Board directs that in the test years and in future NSPI must adjust the revenue requirement to deduct an amount from the SERP pension payments to reflect a deemed employee contribution to the SERP, on the assumption that the employee had contributed 50% to the pension plan and the employer 50%. The Board understands the amount to be disallowed is \$2.05 million in 2013 and \$2.2 million in 2014.

[474] Also, NSPI secures the SERP pension by purchasing a letter of credit, using funds paid entirely by ratepayers. In the Board's view, payment for that portion of the letter of credit that secures the pension is an unnecessary expense and is not an expense that should be borne by ratepayers. Accordingly, the Board disallows that amount from the revenue requirement.

[475] These deductions are in addition to the \$27.5 million provided for in the GRA Agreement.

Executive Compensation

[476] The Legislature has passed amendments to the *Public Utilities Act* limiting the amount of remuneration, bonuses and other benefits that can be recovered from rates with respect to compensation of executive employees of NSPI.

[477] In its Compliance Filing, NSPI is to reduce its revenue requirement to reflect the changes as a consequence of this legislation, including pension payments on behalf of executives.

LED Streetlighting

[478] The Board agrees that dealing with the streetlight issue as a part of a capital work order is a reasonable approach with the exception of the net book value question.

[479] The Board denies HRM's request to recalculate the net book value of streetlights currently included in the NSPI rate base. How this amount is shared between municipalities is something NSPI should work out with them.

[480] In a second issue raised by HRM, the Board orders NSPI to confirm by February 28, 2013 that no new non-LED streetlights were ordered or purchased after the Board's 2012 GRA Decision.

Low Income Residential Customers

[481] The Board approves the Settlement Agreement filed by the Affordable Energy Coalition, NSPI and the CA, which sets up a consultative process "with a view to resolving bill payment, credit and collection matters affecting low income residential customers".

Cost of Service – Biomass

[482] The Board finds that NSPI's recently constructed 60 MW biomass plant at Point Tupper, Nova Scotia, has similar characteristics to any other steam plant. The Board directs that it should be classified on the basis of system load factor, because it makes a contribution to capacity and provides firm power.

Natural Gas Storage

[483] The Board denies the request of Alton Natural Gas Storage L.P. to order NSPI's participation in a natural gas study with Alton and Heritage Gas.

FAM Audit

[484] The Liberty Consulting Group was engaged by the Board to conduct the FAM Audit for the period covering 2010 and 2011. The FAM Plan of Administration ("POA") provides that an audit of the FAM will be done every second year.

[485] The Board made a number of findings in relation to the FAM Audit Report. The Board noted the importance of transparency, as well as the full and timely disclosure of complete and adequate information, in its original approval of the FAM.

[486] Credit rating agencies and others who follow these proceedings, including the public, should understand that the FAM Audit process approved without question 99% of NSPI's fuel costs. The Audit was critical of only 1%. The Board has, in the result, accepted two recommendations for disallowance, amounting to much less than 1%. In making a few disallowances, the Board is not finding that NSPI's fuel team are not competent or professional. They are both competent and professional. NSPI has a functioning FAM.

Lingan Derates

[487] The Board finds, on the balance of probabilities, that NSPI was aware in July/August 2010 that there were quality issues related to the Prince coal. NSPI did not investigate and test other coal blends to mitigate the risks of the failure to meet opacity limits.

[488] In failing to mitigate the known risks of derates from using Prince coal, the Board finds that NSPI was imprudent. The Board also concludes that imprudence on the part of NSPI led to the derate of the Lingan facility.

[489] The Board orders a \$3.6 million disallowance with respect to the Lingan derates.

Natural Gas Contracts

[490] With NSPI's long term natural gas supply contract with Shell coming to an end on October 31, 2010, NSPI issued a Request for Proposals to acquire replacement quantities of natural gas to supply its projected needs. One of the two lowest offers ("Bid A") was withdrawn after NSPI felt it had already accepted the offer via a term sheet. The other lowest offer ("Bid B") was rejected by NSPI, largely due to NSPI's concern about associated transportation costs and potential risk of supply interruption.

[491] The Board does not believe that NSPI's actions with respect to Bid A were imprudent. Based on the evidence, it appears to the Board there was never a meeting of the minds between NSPI and Bidder A on the terms of the offer. Liberty acknowledged that there was not an enforceable contract.

[492] However, with respect to Bid B, the Board is very concerned about NSPI's failure to properly analyze the costs and benefits of taking an assignment of this very favourably priced contract.

[493] Liberty prepared an analysis that showed that NSPI was better off after five years, based on this favourable pricing, as compared to other pricing it was able to obtain even if the transportation contract was useless from that point forward.

[494] In the Board's view, NSPI was imprudent in failing to properly analyze the risks and benefits associated with the Bid B contract which the Board believes could have been very beneficial for ratepayers.

[495] The Board disallows \$903,000 related to the failure to take an assignment of the Bid B contract for the period from November 1, 2010 to December 31, 2011 (i.e.,

426 days). As this was a longer term contract the impact of this finding on any future test years will be the subject of consideration in future audits.

[496] Finally, the Board does not believe there is a sufficient basis for it to make any disallowance based on NSPI's monthly, seasonal or daily purchases.

Natural Gas Markets

[497] On the last day of hearing, and in a confidential session, NSPI disclosed new and important evidence concerning its activities in the natural gas market. Unfortunately, because of its confidential nature, the Board can disclose little, if any, of this evidence in this public Decision. This evidence was not previously disclosed to Liberty, the Intervenors or the Board.

[498] NSPI's actions in withholding this information are both inexplicable and inexcusable. In the Board's view, that conduct cannot go unsanctioned. The Board will impose a financial disallowance to NSPI, as described below.

[499] However, on the substantive issue related to natural gas markets, the Board makes no other disallowance with respect to NSPI's gas market activity.

Natural Gas Hedging

[500] The Board is satisfied that NSPI could not reasonably have foreseen the events commencing in December 2010, which would lead to a significant change in the "basis differential" and result in the "basis blowout". Accordingly, the Board finds that no imprudence disallowance should be imposed on NSPI with respect to this issue.

FAM Audit Process

[501] The Board concludes that Liberty's FAM Audit followed appropriate auditing standards. The FAM Audit was also conducted in a manner consistent with the process contemplated under the POA approved by the Board. In addition, the Board noted that Liberty's work on this file was supported by the Intervenors representing most customer classes.

[502] The Board makes no directive at this time with respect to possible changes to the POA or future FAM Audits. The Board indicated during the hearing that it would be more appropriate to review all aspects of the FAM in a separate proceeding where the FAM and all other issues related to it (including the POA) can be examined, rather than in a piecemeal fashion.

[503] The Intervenors and the Board were disappointed with NSPI's response to the FAM Audit. In failing to respond to the draft Audit Report, NSPI acted contrary to the process contemplated in the FAM POA. Its conduct was also contrary to the reasonable expectations of the Board and the Intervenors. NSPI also acted in a manner which is not consistent with the spirit and intent of audits generally, including fuel management or prudence audits.

[504] Further, NSPI's course of action distracted and misdirected all parties in this proceeding from addressing some of the other important issues in the hearing. NSPI's course of action had the effect of wasting scarce resources, in terms of time, money and human resources, for all parties.

[505] In the future, the Board expects NSPI to conduct itself in accordance with the intent and the terms of the POA, including providing a meaningful response to the

draft Audit Report, along with an indication of which audit findings or recommendations it agrees with and which it does not.

[506] The Board notes that Liberty bears some of the responsibility for the acrimonious relationship which developed over the course of the FAM Audit process between NSPI and its FAM auditor. Some of Liberty's language was provocative in a way it did not have to be. In retrospect, the Utility's response might have been more tactful and reserved if Liberty had adopted a more measured tone in its criticism of NSPI's FAM activities. This would have resulted in a more productive Audit process.

Remaining Recommendations in the FAM Audit

[507] The Board directs that NSPI proceed with the implementation of the remaining recommendations it has agreed with in Undertaking U-22. In the instances where NSPI has not provided an action plan for the recommendations with which it agrees, it is directed to file its implementation plans by February 28, 2013.

[508] In the case of recommendations which are not agreed to by NSPI, it is to file a detailed explanation why it does not agree. This is also to be filed by February 28, 2013.

[509] The Intervenors will then be permitted to provide their comments to the Board by March 29, 2013, with respect to any of the remaining recommendations.

Disallowed Costs Related to FAM Audit

[510] The Board expects NSPI to comply with its Decisions, Orders and directives, including its oversight procedures like the FAM Audit and the POA. In the Board's opinion, NSPI's conduct in relation to the NEB issue and its decision not to

comment on the draft Audit report were both unreasonable and inappropriate. Its conduct on these specific points resulted in unnecessarily extending the length of the hearing and wasting the time, money and effort of the Intervenors and Board Counsel.

[511] In these circumstances, the Board finds that a sanction is warranted as against NSPI and concludes that a disallowance of \$2 million is appropriate.

Implementation of the FAM Disallowance

[512] With respect to the fuel-related disallowances totaling \$4,503,000 for the Lingan derates and the Bid B natural gas contract, this amount must be applied to the 2013 FAM Balance Adjustment ("2013 BA").

[513] The Board notes that applying this fuel disallowance to the 2013 BA will actually reduce the fuel deferral to be collected from ratepayers starting in 2015. This deferral of the fuel disallowance is consistent with the manner adopted by the Intervenors for the non-fuel reductions they negotiated in the GRA Agreement.

[514] More importantly, applying the fuel disallowance amount against the deferral will benefit ratepayers by reducing the deferral amount attracting interest and the 9% rate of return for NSPI.

[515] A different implementation procedure applies for the \$2 million disallowance arising from NSPI's conduct contrary to the POA. This disallowance must be applied against NSPI's 2012 earnings.

[516] The threshold for triggering payment under clause 26 of the 2012 Settlement Agreement will be \$2 million lower than it otherwise would have been. If NSPI otherwise over earns in 2012, an additional \$2 million will be applied to the deferrals for the benefit of ratepayers.

Other Revenue Requirement Reductions

[517] As noted earlier in this summary, the reductions in pension costs and executive salaries will lower the test year revenue requirements, in addition to the \$27.5 million provided for in the GRA Agreement.

[518] An Order will issue following the Compliance Filing.

DATED at Halifax, Nova Scotia, this 21st day of December, 2012.

Peter W. Gurnham

Roland A. Deveau

Kulvinder S. Dhillon

APPENDIX A

**NOVA SCOTIA POWER INC.
2013 RATE APPLICATION – INCLUDING THE FAM AUDIT P-893/M04972**

LIST OF PARTICIPANTS

Affordable Energy Coalition

Alton Natural Gas Storage LP

Avon Group

(Avon Valley Greenhouses Ltd.)
(Canadian Salt Company Limited)
(CFK Inc.)
(Crown Fibre Tube Inc.)
(Halifax Grain Elevator Limited)
(Imperial Oil Limited)
(Lafarge Canada Inc.)
(Maritime Paper Products Ltd.)
(Michelin North America (Canada) Inc.)
(Minas Basin Pulp & Power Company Ltd.)
(Oxford Frozen Foods Limited)
(Sifto Canada Corp.)
(Nustar Terminals Canada Partnership)

Bowater Mersey Paper Company Limited

Cape Breton Explorations Ltd.

Consumer Advocate

Halifax Regional Municipality

Municipal Electric Utilities of Nova Scotia Co-operative

Municipality of the District of Yarmouth

Nova Scotia Department of Energy and Nova Scotia Environment

Nova Scotia Liberal Caucus

Nova Scotia Power Inc.

Progressive Conservative Caucus Office

Small Business Advocate

Strait Area Mayors & Wardens and Town of Port Hawkesbury

Union of Nova Scotia Municipalities