

**IN THE MATTER OF THE ELECTRICITY REVIEW ~ A SUBMISSION ON BEHALF OF THE MUNICIPAL
ELECTRIC UTILITIES OF NOVA SCOTIA CO-OPERATIVE ~ DECEMBER 2014**

Thank you for the opportunity to offer this submission. The Municipal Electric Utilities of Nova Scotia Co-operative has been an active and engaged participant in matters concerning electricity; our staff and consultants continue to take part in proceedings and technical conferences to represent the interests of our ratepayers.

We are encouraged that your Department has undertaken a wide review of the market in Nova Scotia. We are confident the Province can be well served in such a review and that superior mechanisms can be established to make the market work.

It is important to recognize that monopoly regulation is essentially perverse in that it is possible to encourage an unintended result. Regulation is intended to be “a surrogate for competition” in industries where “a natural monopoly” is thought to exist. Natural monopolies are sectors where the public good is served by building one or very few systems to supply a good or service because unfettered competition and duplication of systems would inflate costs and make for severe economic inefficiency. Railroads, highway systems, telephone companies, electric utilities, pipelines, water utilities are examples. More recent economic thinking has held that some functions of these monopolies such as the commodities they deliver can and should be opened to competition for price efficiency, while the carrier remains a monopoly. So telephone messages can be transmitted by Telco A over infrastructure owned by Telco B for a tariff. Many of these regulated monopolies have been deregulated to some extent with varying degrees of success or failure.

The form now in place in Nova Scotia is “cost of service” where utilities are able to recover prudently incurred costs and may, if well managed, earn a fair and reasonable rate of return fails to align the interest of an investor owned utility (IOU) with that of ratepayers. The Regulator seeks to ensure that all investments are reasonable and prudent and necessary for the purpose of serving the customers and that other costs are likewise reasonable and prudent. The IOU can best serve the shareholders by maintaining and increasing rate base which can easily burden ratepayers with higher costs. Almost half of Nova Scotia Power's revenue requirement is for fuel expense but in theory at least the Company should make no profit on these transactions. The Company can only do so if they are able to manage better than forecast. They forecast a fuel budget, it is contested by the intervenor representatives and Utility and Review Board staff and consultants, and if they are skillful or fortunate, there is some margin on fuel. The Fuel Adjustment Mechanism was intended to limit NSP's incentive to game this process and to incent the Company to manage fuel in alignment with ratepayer's interest. For some years now the FAM has been suspended through a series of "Settlement Agreements" involving various deferrals that, perversely, allow NSP to create regulatory assets that enable the Company to earn its Average Weighted Cost of Capital (AWCC, about 8.6% with monthly compounding) on the deferred amounts. Recognizing

that this is a bad bargain akin to buying groceries with card credit, the MEUNSC has not supported recent settlements.

Nova Scotia needs to determine which assets in the electricity structure should be in public ownership and which work best in private hands. For example, Nova Scotia's interconnection to the rest of North America is weak. We recognize congestion in New Brunswick exacerbates the situation. Transmission is the highway of commerce for electricity and we're on a back road. NSP would likely riposte that the Maritime Link will increase connectivity but it chiefly effects the creation of another rate base; the interconnection is to a limited supply fenced in by an intransigent jurisdiction. Newfoundland can testify to that.

We submit the transmission system should be a public asset. In saying that, we remind parties that there is not one structure, not one meter of wire, not one bolt in that asset category that has not either been funded by rates over time or is not amortized by rates. We are paying for it now. The revenue requirement for the NSP recovers all these costs including the credit cost and return on investment. Of course, this is true of some other NSP assets as well; distribution assets could be thought of in the same wise. Generation we believe is different, that is the truly variable part of the business where risk resides and those who take on that risk should reap the rewards.

To expand upon the ownership issue, NSP has an approved debt equity structure of 65:35%. Since the Company has a book value of almost \$4B, the shareholder has about \$1.4B in equity, the balance is debt funded thru bond markets. The ratepayers pay all the costs of carrying this debt, and NSP is able to earn 8.75-9.25% on their equity which the ratepayers also pay. The company's fuel costs are recovered in rates, as are all operating and maintenance costs. Then, since the Company is taxable, in order to pay the dividend (+/- \$110M, see 9.1% of \$1.4B) post taxes the ratepayers pony up the \$45M or so in taxes required. This is a simplified version, subject to check as to precise numbers, but essentially accurate. If NSP were still a crown corporation the debt service cost might be lower, the dividend would be a matter of policy, and no income taxes would be paid. These could translate into a significant rate reduction were the Company to be nationalized. Perhaps 10%. We recognize the risks of crown ownership, that it is difficult to be lean and mean as a crown and difficult to keep patronage out of the structure. To these objections we assert that these are matters of governance and that there are extremely successful crown utilities across Canada. There are issues arising from affiliate transactions which are as troublesome as patronage ever was.

We recognize that such an extreme action as nationalization is unlikely, without truly understanding why. Perhaps if the Province moves to some form of Performance Based Regulation the interests of the ratepayers and the shareholder can be more closely aligned. The persons who manage NSP are good at what they do; if the path to profits is by striving to supply low cost, reliable energy they will make every effort to achieve that and we suspect they would have some success. PBR is complex but it allows policy makers to delineate society's goals and structure the regulatory regime to accomplish them.

We would describe the Nova Scotia Wholesale Market as open but illiquid; we (Municipal utilities) are enabled to buy from suppliers other than NSP but various constraints make it difficult to do so. One is the interconnection thru New Brunswick, it is not reliable for imports due to capacity limitations both on the intertie and in southeast NB. Another is that no one can afford to build market serving generation assets without having either long term Power Purchase Agreements (PPA) in place or at least a liquid market to sell into. Additionally the Renewable Energy Standard (RES) has been a barrier to economic imports of electric energy; since there are no RES compliant generators with capacity to sell, economic imports for the Munis have been effectively blocked since 2010.

We have experimented with creating RES compliant energy to enable demand control imports but the high probability of curtailment of imports creates too much risk to support the enterprise. We recommend that a goal of the Province be to sponsor a more robust and available interconnection to the rest of the North Eastern Power Pool. NSPI customers would at times benefit from this as well. We recognize that to the extent NALCOR can export thru NS & NB import flows will be enabled but that is an uncertain outcome some years out.

Respectfully submitted on behalf of MEUNSC

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