

**PUBLIC VERSION  
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**BEFORE THE ADDITIONAL FACILITY OF THE  
INTERNATIONAL CENTRE FOR SETTLEMENT OF  
INVESTMENT DISPUTE (ICSID)**

**BETWEEN:**

**MERCER INTERNATIONAL INC.,**

**Claimant / Investor**

**AND:**

**GOVERNMENT OF CANADA**

**Respondent / Party**

**ICSID CASE NO. ARB(AF)/12/(3)**

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**GOVERNMENT OF CANADA**

**COUNTER-MEMORIAL**

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**August 22, 2014**

Departments of Justice and of  
Foreign Affairs, Trade and  
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## I. INTRODUCTION

### A. Overview of the Case

1. This arbitration arises out of the failure of the Claimant's plan to profit from low cost regulated rates for electricity in British Columbia. In particular, the Claimant planned to have BC Hydro purchase its "self-generated" energy without receiving anything in return. The Claimant referred to this plan as its "Arbitrage Project." It believed that its Celgar pulp mill was in a "unique"<sup>1</sup> position to purchase more electricity from FortisBC, its local utility, at low-cost regulated rates and then sell it as if it were its own "self-generated" electricity to BC Hydro or an imaginary U.S. buyer.
2. None of the Claimant's "self-generated" electricity would actually change hands in these transactions. Rather, the Claimant intended to "notionally" purchase as much electricity from FortisBC as was normally self-generated at the Celgar pulp mill. It would then pretend that this electricity was its own "self-generated" electricity so that it could sell it at a higher price. In reality, the Claimant's self-generated electricity would continue to serve its pulp mill—as it always had. This arbitrage of electricity was a simple accounting transaction.
3. FortisBC intended to obtain the additional electricity for this accounting transaction from its supplier, BC Hydro, under the terms of a low-cost long-term power purchase agreement. The Claimant then planned to buy this low-cost electricity from FortisBC and sell it back, for more than three times the price, to BC Hydro as if it were the Claimant's own self-generated electricity. This elaborate buy-and-sell scheme would provide BC Hydro with no new electricity and would ultimately have harmed both BC Hydro and its ratepayers.

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<sup>1</sup> Memo from Brian Merwin to the Board, Re: Celgar Energy Project, 20 April 2008, at 2, **R-276**.



4. The Claimant was aware that it might not be able to persuade BC Hydro to purchase its own electricity. Not to be dissuaded, the Claimant, having convinced FortisBC to increase its purchases of low cost electricity from BC Hydro, hoped that it could instead sell this electricity as its “self-generated” electricity for a profit in the United States. It was an unlikely prospect at best given the lack of transmission capacity and the need to find a U.S. purchaser willing to pay a premium for Canadian “self-generated” energy. The Claimant, however, stood to profit from the difference between the price for BC Hydro’s low cost electricity and prevailing U.S. electricity prices.

5. The Claimant was under no illusion that what it was doing was questionable. It was subject to a Ministers’ Order<sup>2</sup> requiring its Celgar pulp mill to use its self-generated electricity to remain energy self-sufficient. It was aware that FortisBC was prohibited from exporting and selling the low cost electricity it purchased from BC Hydro. It also knew that the B.C. Utilities Commission (“BCUC”) had prohibited the arbitrage of BC Hydro’s low cost electricity in Order G-38-01 as it could harm BC Hydro’s ratepayers.<sup>3</sup> It was even advised by FortisBC that the contract the Claimant and FortisBC had negotiated to facilitate its plan to arbitrage low-cost power stood a 50 percent chance of being rejected by the BCUC.<sup>4</sup>

6. Nor would the Arbitrage Project have somehow “leveled the playing field” between B.C. pulp mills. Quite the opposite in fact — if the Claimant had managed to pull off this scheme; it would have received far better treatment than any other B.C. pulp mill. Having failed to reshape B.C.’s regulatory landscape and energy policy to its own

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<sup>2</sup> Minister’s Order, In the Matter of an Application By Celgar Pulp Company for an Energy Project Certificate for the Celgar Pulp Mill Expansion, 23 May 1991 (“1991 Ministers’ Order”), at 2, **R-100**; *See also* Affidavit of the General Manager of Celgar, Robert W. Sweeney, October 12, 1990 and Application for an Energy Project Certificate (E.P.C.A.) under section 18 of the *Utilities Commission Act*, Celgar Pulp Company (“Celgar 1990 EPC Application”), s. (b), **R-97**; and Peter Ostergaard Witness Statement, dated August 21, 2014 (“Peter Ostergaard Statement”), ¶¶ 13-23.

<sup>3</sup> Mercer International Group, Celgar Electricity Opportunities, July 2007 at 9 –10, **R-278**.

<sup>4</sup> Dennis Swanson Witness Statement, dated August 22, 2014, (“Dennis Swanson Statement”), ¶¶ 63-64.

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advantage — the Claimant now seeks the same preferential treatment in this NAFTA arbitration.

7. The Claimant has, by all accounts, been a very successful participant in BC Hydro's procurement processes. In fact, the Claimant has received the same treatment from BC Hydro as its other self-generating customers – regardless of the fact that it was not a customer of BC Hydro. BC Hydro has also offered many accommodations to the Claimant.

8. At the outset of the 2008 Bioenergy Call for Power, the Claimant submitted two proposals to BC Hydro. The Arbitrage Project – renamed the “Biomass Realization Project” in all correspondence with BC Hydro – was the Claimant's first proposal. The Green Energy Project, through which the Claimant offered to build a new additional condensing turbine at its Celgar mill, was its second proposal.<sup>5</sup> Upon receiving the “Biomass Realization Project” application, BC Hydro requested a meeting with the Claimant to better understand this project. Mr. Merwin, the Claimant's representative, described how BC Hydro saw the Claimant's “Biomass Realization Project” for what it really was – nothing more than exploiting the arbitrage of existing power – and admitted in an internal email that:

[BC Hydro] do[es] not like the fact that we would be buying power from Fortis who is buying power from them and we are turning around and selling them the power.<sup>6</sup>

9. Not surprisingly, BC Hydro rejected the Claimant's “Biomass Realization Project.” However, it had no objection to the Claimant's “Green Energy Project” which would provide BC Hydro with a new source of electricity. In reaching these conclusions,

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<sup>5</sup> Lester Dyck Witness Statement, dated August 21, 2014 (“Lester Dyck Statement”), ¶ 68.

<sup>6</sup> Email from Brian Merwin to Jimmy Lee and David Gandossi, Fw: Phase I Request for Proposals: Notice to Customers of GBL, 2 May 2008, **R-279**.

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BC Hydro offered the Claimant the same treatment that it provided to all of the other proponents in the Bioenergy Call.

10. The Claimant was one of four proponents out of a total of thirteen to secure an Energy Purchase Agreement (“EPA”)<sup>7</sup> from the Bioenergy Call for its Green Energy Project. BC Hydro requested detailed information from the Claimant which it employed to set a Generator Baseline (“GBL”) for Celgar of 40 MW using the same methodology it used for every other self-generating pulp mill. BC Hydro selected the Claimant’s Green Energy Project as it would supply new or “incremental” electricity which met the terms of the Bioenergy Call – that is, additional generation above what the pulp mill normally self-generated for its own consumption. This EPA, together with an additional C\$57.7 million subsidy the Claimant received from the Government of Canada<sup>8</sup> to build this condensing turbine, currently provides the Claimant with approximately [REDACTED] in revenue per year.<sup>9</sup>

11. BC Hydro applied the same considerations to the Claimant’s “Biomass Realization Project” (*i.e.*, the Arbitrage Project) but found that this project was not eligible for the Bioenergy Call as it would not provide BC Hydro with any new electricity. In essence, the project would have required BC Hydro to purchase back its own electricity at great cost—a cost that would have then been passed on to its ratepayers.

12. Although BC Hydro had rejected its Arbitrage Project, the Claimant almost immediately entered into an agreement with FortisBC to achieve the same result. The arrangement enabled the Claimant to sell electricity FortisBC purchased from BC Hydro as its own “self-generated” electricity. BC Hydro, after learning of this agreement, filed

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<sup>7</sup> Lester Dyck Statement, ¶ 53.

<sup>8</sup> The Claimant received these funds under the Pulp and Paper Green Transformation Program which provided financing for capital investments aimed at improving environmental performance in the pulp and paper sector

<sup>9</sup> NERA Expert Report, ¶ 99.

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an application with the BCUC requesting an amendment to its long-term power purchase agreement with FortisBC, in order to prevent FortisBC from supplying BC Hydro's energy to customers that intended to use it for arbitrage. It did so because it was concerned that the Claimant's Arbitrage Project would harm its ratepayers.

13. The BCUC considered the prohibition in this agreement against FortisBC arbitraging BC Hydro's low-cost electricity and observed that, when it was originally negotiated, none of the parties could have foreseen that customers would have been able to arbitrage electricity.<sup>10</sup> The BCUC also considered its previous regulatory decisions in Orders G-38-01 and G-113-01, where it had found that arbitraging low-cost electricity in a manner that would harm other ratepayers was unacceptable. Finally, it noted that both BC Hydro and the BCUC staff had quantified the cost to BC Hydro's ratepayers of allowing FortisBC to supply this regulated low-cost energy for arbitrage at between C\$12-16 million. Accordingly, the BCUC in Order G-48-09 approved BC Hydro's request for an amendment to the agreement and prohibited FortisBC from accessing BC Hydro's low cost energy for the purpose of supplying it to customers engaged in this form of harmful arbitrage.<sup>11</sup>

14. The Claimant, however, remained intransigent, despite Order G-48-09 and would, in the following years, repeatedly appear before the BCUC with new variations of its "Arbitrage Project." In these regulatory proceedings, the Claimant would suggest that the BCUC should force FortisBC to give the Celgar pulp mill a GBL of either 1.5MW or 0 MW, thus enabling the Claimant to "notionally export" everything above this FortisBC GBL (and below BC Hydro's 40 MW GBL) to the United States.<sup>12</sup> In trying to convince the BCUC, the Claimant lauded BC Hydro's methodology for GBL determinations, but

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<sup>10</sup> BCUC, Order G-48-09 and Decision, in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 6 May 2009 ("BCUC Order G-48-09"), p. 10, **R-32**.

<sup>11</sup> *Ibid.*, s. 5.0 at 22, **R-32**.

<sup>12</sup> Celgar, Evidence Submission, in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 15 March 2010 at 11 and 24, **R-280**.

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attempted to twist it in a manner that would support its unreasonable request for a 1.5 MW GBL—a request based on 15 year old data that would bear no resemblance to its current normal operations.<sup>13</sup>

15. In subsequent BCUC proceedings, the Claimant would eventually turn against its own utility, FortisBC, shifting its position to demand that FortisBC supply Celgar with its own low-cost electricity (excluding BC Hydro's PPA electricity), which the Claimant would then arbitrage. FortisBC, in response, raised the issue of potential harm to its ratepayers. The Claimant, predictably, took the position that any harm to other FortisBC ratepayers was irrelevant and should not thwart its arbitrage plans.<sup>14</sup> In other words, when it became clear that the Claimant would not be allowed to profit at the expense of BC Hydro's ratepayers, it decided to shift the burden to FortisBC and its smaller base of rural ratepayers.

16. The BCUC repeatedly rejected the Claimant's positions concerning its entitlement to low-cost electricity. However, the BCUC directed FortisBC, in another regulatory proceeding, to attempt to develop rates in a manner that would provide the Claimant with additional access to electricity without harming FortisBC's other ratepayers. FortisBC complied with this direction, proposing a rate and a methodology that would allow it to supply all of Claimant's electricity by making matching purchases off the U.S. electricity market. By sourcing the purchases from the United States, FortisBC could address the

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<sup>13</sup> *Ibid.*, at 11, **R-280**. See also, Celgar, Letter to the BCUC in the Matter of a Complaint Regarding the Failure of FortisBC and Celgar to Complete a General Service Agreement and FortisBC's Application of Rate Schedule 31 Demand Charges, March 25, 2011 ("Celgar GSA Complaint") at 5, **R-264**; BCUC, Decision and Order G-60-14 in the Matter of an Application by BC Hydro for Approval of Rates between BC Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, 6 May 2014 ("BCUC Order G-60-14"), at 67, **R-221**. Compare Switlshoff Expert Report, ¶ 54.

<sup>14</sup> Celgar GSA Complaint at 3, **R-264** ("Celgar should not be required to concern itself with how FortisBC sources power to meet its supply obligations [...] [Were] FortisBC to secure additional energy from non-[PPA] sources for the purpose of servicing Celgar's load, the cost of which would simply be rolled into its rate base along with all other sources of power that FortisBC procures to service customer needs") [emphasis added].

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BCUC's concern that its customers would arbitrage BC Hydro's power. However, this proposal simply did not offer the same high profit, long-term, no risk, prospects for the Claimant. The latter preferred to resell BC Hydro's or FortisBC's low-cost electricity on the U.S. market as these regulated rates would fluctuate less than corresponding market prices. The Claimant, in pursuit of its arbitrage plans, would also adopt a practice of repeatedly intervening in FortisBC's regulatory proceedings. These repeated interventions, the cost of which is borne in large part by FortisBC, have had the effect of fueling an annual 1.5% rate increase in FortisBC's service area.<sup>15</sup>

17. To hide the underlying weakness of its claims and their complete disconnect from any energy policy and procurement practice, the Claimant mischaracterizes the subject matter of this arbitration by focusing on a single irrelevant metric of its own invention – the “below load access percentage.” In doing so, the Claimant appears to suggest that a provincial state enterprise must always procure the exact same percentage of a product from all suppliers regardless of their relative size, the particularities of their business or, perhaps most importantly, the amount of the product the supplier actually has for sale. This assertion is untenable. It effectively amounts to a claim for a subsidy—an “access percentage” subsidy. This “access percentage” subsidy would require BC Hydro to purchase the same percentage of electricity from every pulp mill in the province regardless of whether these pulp mills have any new electricity for sale. Such a result would be economically inefficient, contrary to good regulatory policy, and detrimental to all ratepayers in the Province.

18. Canada considers the subject matter of this arbitration to be British Columbia's provincial energy policies, BC Hydro's energy procurement practices and the BCUC's regulation of the electricity sector. In particular, certain energy policies of the B.C. Government have had a direct effect on BC Hydro's procurement of electricity. For

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<sup>15</sup> Dennis Swanson Statement, ¶152.

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example, the 2007 Energy Plan and resulting *Clean Energy Act*,<sup>16</sup> directed BC Hydro to acquire additional electricity from B.C. clean or renewable sources so as to become self-sufficient by 2016. BC Hydro's long-term resource planning and procurement of electricity is similarly central to this case. Notably, in planning to meet its self-sufficiency objective, BC Hydro chose to incentivize and procure additional electricity from biomass producers, including pulp mills, through the Bioenergy Call for Power Phase I, bilateral negotiations and the Integrated Power Offer. Also crucial to this case is the BCUC's regulation of the electricity sector, including the relationship between BC Hydro and FortisBC with respect to the provision of electricity under the PPA.

19. The Claimant, broadly speaking, alleges that two measures are inconsistent with the NAFTA. First, it asserts that BC Hydro set the GBL under the Claimant's EPA in a manner that was discriminatory, non-transparent, and arbitrary. The GBL is used to demark the electricity that a mill generates for self-supply in normal operating conditions from the "incremental" or "new" energy that BC Hydro can incentivize and procure. The Claimant alleges that BC Hydro set the GBL for the Claimant's EPA using a different methodology than for other mills.

20. Second, the Claimant alleges that BCUC Order G-48-09 imposed a "net of load" standard on the Claimant pursuant to which the Claimant can only sell its self-generated electricity to a third party once it has fully met its electricity needs. The Claimant argues that other mills have the right to sell to third parties below their loads and that the BCUC has therefore acted in an arbitrary and discriminatory manner.

21. These claims should be rejected not only because they lack merit but also on the basis that the Tribunal lacks the jurisdiction over claims directed at BC Hydro's setting of the GBL. First, the setting of the GBL is outside the scope of NAFTA because it was not an exercise of governmental authority. Rather, BC Hydro sets a GBL as part of its

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<sup>16</sup> *Clean Energy Act*, SBC 2010, c 22 ("*Clean Energy Act*" or "*CEA*"), **R-154**.

contractual negotiations and for the procurement of electricity as this delineates the amount of electricity it will be willing to purchase. The procurement of electricity from private sector biomass producers pursuant to a competitive bidding process is a commercial enterprise which falls outside the ambit of NAFTA Article 1503(2) (State Enterprises). Second, the limitation period for some of the claims directed at the setting of the GBL has expired. The GBL determination occurred well before the three year limitation period set out in NAFTA Articles 1116(2) and 1117(2). The Claimant's GBL was set on May 30, 2008 and accepted by the Claimant on June 10, 2008. The Claimant thus had three years from the later date to submit a claim; *i.e* June 10, 2011. The Claimant, however, waited until April 30, 2012, and is therefore time-barred. Even the full EPA, of which the GBL became a contractual term, was executed outside of this limitation period, namely on January 27, 2009.

22. Even if the Tribunal had jurisdiction to hear the claims, the Claimant has failed to show that any of the alleged measures breached Canada's obligations under the NAFTA for the reasons set out below.

23. First, Canada does not have any obligations under NAFTA Articles 1102 or 1103 with respect to the Claimant's GBL which was set to determine the amount of electricity BC Hydro would purchase pursuant to an EPA. NAFTA Article 1108 sets out an exemption for procurement by state enterprises from Articles 1102 and 1103.

24. Second, even if the Tribunal were to consider the alleged breaches of Articles 1102 and 1103, the Claimant's allegations have no merit. As discussed above, the Claimant bases its entire case on its claim that it is entitled to an "access percentage" subsidy – and ignores the economic and regulatory rationales that support the limits set on the arbitrage of electricity. Seen in its full and proper context, BC Hydro applied consistent, coherent and correct policies to all mills, including the Claimant, based on sound economic and regulatory principles, dealing with the arbitrage of regulated, low-cost electricity. These policies required that BC Hydro issue incentives only to increase



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generation resources and not in a way that would be economically disadvantageous to BC Hydro ratepayers. No other pulp mill in the Province has been provided this type of inventive without conforming to these policies.

25. The Claimant also ignores the fact that Articles 1102 and 1103 are designed to prohibit nationality-based discrimination against U.S. or Mexican investors in favour of either Canadian or foreign third-party investors. The Claimant fundamentally misconstrues these provisions when it argues that it need not prove that discrimination was accorded on the basis of nationality. It is not surprising that Claimant distorts the meaning of Articles 1102 and 1103 in this way, given the obvious lack of nationality based discrimination in this case.

26. Third, Canada has also not violated any of its obligations under Article 1105. The Claimant under this provision merely recycles the allegations it makes under Articles 1102 and 1103, arguing that the customary international law minimum standard of treatment includes protection against discrimination that is broader than the obligations under Article 1102 and 1103. This distorted interpretation of Article 1105 would render Articles 1102 and 1103 inutile and meaningless, and in any event the allegations the Claimant makes under Article 1105 are baseless for the reasons stated above.

27. Finally, even if this Tribunal were to find a breach of Canada's obligations, the Claimant's damages claim is significantly inflated. As explained above, but for the two measures at issue the Claimant is nonetheless bound to supply itself with electricity from its own generation assets. The measures are therefore incapable of causing the Claimant any loss. The Claimant also fails to proffer evidence of any "competitive disadvantage" it has suffered as a result of the measures. Although the Claimant's Memorial is littered with allegations of a loss of competitive advantage, it does not provide any evidence to substantiate this claim.

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28. The Claimant's quantification of damages is also inherently speculative. To make out its case for damages, the Claimant assumes that BC Hydro would purchase all of the Claimant's self-generated electricity. There is no evidence to support this assumption. Nor did the Claimant provide any evidence of a third party that would purchase the electricity at a price high enough to cover the Claimant's cost of purchasing the replacement electricity from FortisBC. Even if such a willing third party existed, the Claimant has not demonstrated how it could deliver its self-generated electricity below load to such a third party. For these reasons the Claimant's quantification is unfounded.

29. This claim for an "access percentage" subsidy is a first for a NAFTA Chapter 11 arbitration. Never has Canada faced a claim from an investor over its entitlement to a subsidy of its own creation. No doubt this is because no other Claimant has been brazen enough to advance such claims.

30. The Claimant attempted to arbitrage electricity so that it would profit from the harm it caused to BC Hydro's ratepayers. It then failed to persuade the BCUC that it should be allowed to cause the same harm to FortisBC's ratepayers. Now, the Claimant has brought a NAFTA Chapter 11 claim to shift the burden of its plans onto all Canadian taxpayers. This claim is devoid of legal merit. It is frivolous. This Tribunal should dismiss these claims and award full costs to Canada for this arbitration.

### **B. Materials Submitted by Canada**

31. Canada's Counter-Memorial is accompanied by exhibits and legal authorities. In addition, Canada submits the following Witness Statements and Expert Reports in support of its Counter-Memorial:

#### **Witness Statement of Les MacLaren:**

- Mr. Les MacLaren has been the Assistant Deputy Minister of the Electricity and Alternative Energy Division of the British Columbia Ministry of Energy and Mines since 2008, and from 1998 to 2008, has held key positions at the Ministry of Finance

and the Office of the Premier. In his witness statements, he discusses (1) the organization and structure of the British Columbia electricity sector; and (2) the implementation of provincial policy with respect to sales of energy by self-generators since the early 2000s. Mr. MacLaren's witness statement demonstrates that British Columbia policy and regulation has never supported self-generators engaging in the arbitrage of power detrimental to electricity service ratepayers.

**Witness Statement of Jim Scouras:**

Mr. Jim Scouras has held a number of key positions in BC Hydro's Power Acquisition groups since 2001, including the role of Manager, Major Power Calls within the Power Acquisitions group in 2007, when BC Hydro entered into the Electricity Purchase Agreement with Celgar Limited Partnership. In his witness statement, Mr. Scouras explains (1) BC Hydro's power acquisition functions and its approach to power acquisition, including BC Hydro's decision to implement a generator baseline policy in relation to procurement from customers with self-generation capability; (2) the issuance of the 2002 Customer-Based Generation Call for Power; (3) the 2007 Bioenergy Call for Power Phase I, including the circumstances in which BC Hydro negotiated the EPA with Celgar Limited Partnership and settled on its generator baseline; (4) the Integrated Power Offer; and (5) the negotiation of bilateral agreements between BC Hydro and customers with self-generation capability. Mr. Scouras demonstrates that the treatment of Celgar, under the 2007 Bioenergy Call for Power Phase I has been consistent with BC Hydro's policies for the procurement of power, including the setting of a GBL.

**Witness Statement of Lester Dyck:**

- Mr. Lester Dyck is the Sector Manager of Pulp & Paper and Customer Generation in the Key Accounts Management division of BC Hydro, and from 1997 to 2007, has acted as a Key Accounts Manager, managing BC Hydro's relationships with large industrial customers. Mr Dyck's witness statement explains (1) the role of the Key Accounts Manager division at BC Hydro and how it relates to other divisions; (2) the self-generation facilities of pulp mills; (3) the genesis of the generator baseline concept in BCUC Order G-38-01 and the way in which BC Hydro has applied it in its subsequent procurement processes; (4) the details of BC Hydro's Bioenergy Call for Power – Phase I (“Bio Phase I”) including the application of the generator baseline principles in that call for power and the settlement of the generator baseline in the EPA between BC Hydro and the Celgar pulp mill; and (5) the settlement of the generator baseline in the EPAs with relevant comparators. Mr Dyck explains that the

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methodology applied for setting Celgar's GBL is consistent with that used for the comparators, such that Celgar was not afforded a differential treatment.

**Witness Statement of Pierre Lamarche:**

- Mr. Pierre Lamarche held a number of key positions at the Howe Sound Pulp and Paper Ltd. mill in Port Mellon, BC from 1989 to 2009, and was the Chairman of the Joint Industry Electricity Steering Committee ("JIESC") from 2005 to 2009. His witness statement explains (1) the facilities at HSPP; (2) the terms of HSPP's 1989 Generation Agreement with BC Hydro and HSPP's inability to meet those terms; (3) HSPP's agreement to sell electricity to Powerex on an hourly non-firm basis; (4) HSPP's option to offset BC Hydro purchases with incremental generation; and (5) the role and position of JIESC in the proceedings leading to BCUC Order G-48-09.

**Witness Statement of Fred Fominoff:**

- Mr. Fominoff is the General Manager, Fibre & Energy at Howe Sound Pulp & Paper Corporation and is responsible for electricity purchases and sales, and the administration of Electricity Purchase Agreements with BC Hydro. In his witness statement, Mr. Fominoff discusses: (1) operations at the Howe Sound pulp and paper mill; and (2) the conclusion of the 2010 EPA in the context of BC Hydro's Integrated Power Offer ("IPO").

**Witness Statement of Dennis Swanson:**

- Mr. Dennis Swanson is the Director, Regulatory Affairs, at FortisBC. His witness statement provides a description of FortisBC and its involvement with the BC Government, BC Hydro, the BCUC and Celgar. Mr. Swanson explains the circumstances in which Celgar and FortisBC negotiated the agreement with Celgar to make it a full load customer so that it could sell its self-generation to market.

**Witness Statement of Peter Ostergaard:**

- Mr. Ostergaard was Assistant Deputy Minister, Energy Resources Division, in the B.C. Ministry of Energy from 1990-1996. His witness statement focuses on the circumstances in which the Celgar mill applied for, and received, a Ministers' Order in 1991 that exempted the mill from certain provisions of the *Utilities Commission Act* for the construction, maintenance and operation of a new turbo generator. In particular, Mr. Ostergaard testifies to the representations made by Celgar to the effect that it would become energy self-sufficient, following the installation of the new

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turbo generator, and how these representations were critical considerations relied upon in the decision to grant the Ministers' Order.

**Expert Report of NERA Economic Consulting:**

- Mr. James Stockard, Senior Consultant, on behalf of Pöyry Management Consulting Inc., has provided an expert report on the production processes of pulp and paper mills, including energy production. His expert report undertakes an assessment of the setting of Celgar's generator baseline in its 2009 EPA with BC Hydro, in comparison with the setting of generator baselines in the EPAs between BC Hydro and Howe Sound, Tembec and Canfor. His expert report concludes that the generator baselines assigned to the different facilities are reasonable.

**Expert Report of Pöyry Management Consulting Inc.:**

- Dr. Michael Rosenzweig, Special Consultant, on behalf of NERA Economic Consulting, has provided an expert report assessing the Claimant's regulatory theory of the case and its damages claim. He and his team have extensive experience in economic and regulatory matters, including addressing liability and damages issues. His expert report concludes that the Claimant's assertion of disadvantageous treatment is untenable, and that the Claimant cannot demonstrate that it has been economically harmed by the measures it challenges.

**II. STATEMENT OF FACTS**

**A. British Columbia's Electricity Sector**

**1. Background**

32. British Columbia's electricity sector emerged from the creation of privately-owned utilities relying on the province's extensive network of lakes and rivers to generate hydroelectric power.<sup>17</sup> Most utilities were created to provide power to the province's growing coastal urban centres, while a few others, such as FortisBC's

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<sup>17</sup> BC Electric was the first privately-owned utility to take advantage of these resources in 1898 to build a hydroelectric facility near Victoria, B.C. *See generally*, BC Hydro, Power Pioneers, *Gaslights to Gigawatts* (1998), **R-281**. Hydroelectric energy is "produced by water falling through a turbine generator." It is the dominant form of electric energy production in BC. British Columbia Utilities Commission, *Understanding Utility Regulation – A Participant's Guide to the British Columbia Utilities Commission*, Original Publication: October, 1996, Revised: July 11, 2002, ("BCUC Participant's Guide") at 50, **R-209**.

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predecessor, West Kootenay Power, were established further inland to support the development of mines and other industrial enterprises.<sup>18</sup>

33. In 1945, the B.C. Government formed the B.C. Power Commission<sup>19</sup> to expand electric coverage to underserved areas of the province. To accomplish this goal, the B.C. Power Commission proceeded to purchase, amalgamate and operate a wide range of small-scale generation and distribution utilities.<sup>20</sup> The B.C. Power Commission would eventually provide service to more than 200 small communities throughout the province. This consolidation of privately-owned utilities did not extend to FortisBC, who would remain an independent utility, currently serving approximately 5% of the province's population.

34. In 1961, when the B.C. Government sought to build a series of ambitious hydro-electric projects on the Peace and Columbia Rivers, it purchased B.C. Electric, the province's largest privately-owned utility and merged it with the B.C. Power Commission, thus creating BC Hydro. BC Hydro would subsequently complete the construction of these hydro-electric facilities and become the province's largest utility, serving approximately 95% of its population.

35. Today, publicly-owned BC Hydro and privately-owned FortisBC generate, transmit, and distribute the vast majority of the electricity in the province.<sup>21</sup> BC Hydro provides electricity to approximately 1.9 million customers in a service area that covers

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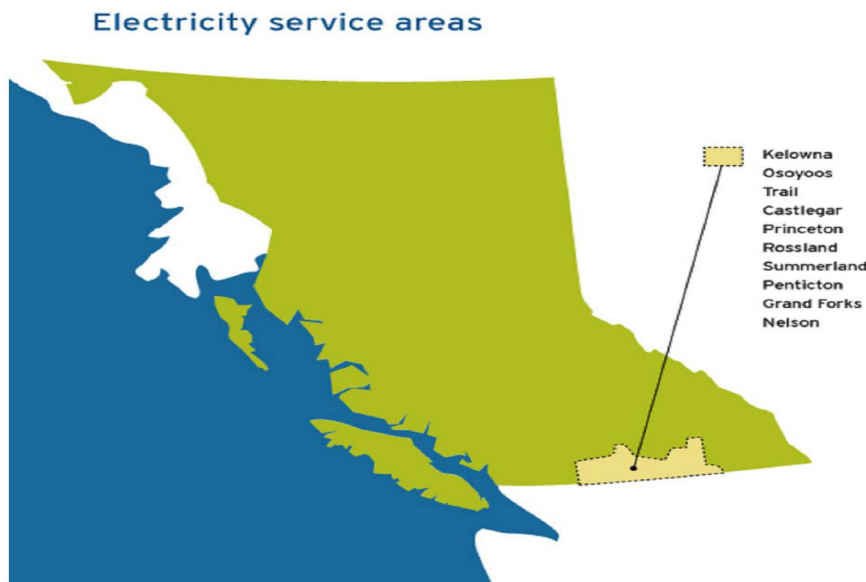
<sup>18</sup> For example, as of 1916, West Kootenay Power began to develop an economical power supply for the growing copper and gold mines in the Southern interior of British Columbia. *See*, Dennis Swanson Statement, ¶ 10.

<sup>19</sup> The BC Power Commission is not related to the BCUC and was not a public utilities commission. *See*, *Power to the People: The BC Power Commission*, **R-282**.

<sup>20</sup> BC Hydro, Corporate Information, History, **R-8**.

<sup>21</sup> British Columbia Ministry of Energy, Mines and Petroleum Resources, British Columbia Energy Policy: New Directions for the 1990s, November 1990 ("BC Energy: New Directions for the 1990s"), at 7, **R-98**: "generation and delivery [is] concentrated in two large utilities".

most of the province,<sup>22</sup> while FortisBC serves approximately 111,500 customers in its service area.<sup>23</sup> The remainder of the province's population is served by municipal electricity distributors. The figure below represents the two main service areas; with FortisBC's service territory delineated by a dotted line, in the South Central part of the province. The rest of the territory is essentially covered by BC Hydro (except for municipal electricity distributors – not represented in the figure).



36. Given the monopolies enjoyed by BC Hydro and FortisBC in their respective service areas,<sup>24</sup> the B.C. Government created a regulatory agency, the BCUC,<sup>25</sup> to ensure

<sup>22</sup> British Columbia Hydro and Power Authority, “Quick Facts for the Year ended March 31, 2013” (“BC Hydro – Quick Facts 2013”), **R-2**.

<sup>23</sup> FortisBC, Service Area, (“FBC Service Area”), **R-3**. FortisBC also provides service to approximately 48,500 customers through the wholesale supply of power to municipal distributors in the communities of Summerland, Penticton, Grand Forks and Nelson.

<sup>24</sup> BC Energy: New Directions for the 1990s at 20, **R-98**: “These monopolies arose, in part, to take advantage of the economies of scale in hydroelectric development”.

<sup>25</sup> Such regulatory agencies are very common in North America. For example, the National Association of Regulatory Utilities Commissioners, online: <<http://www.naruc.org/>>, a U.S.

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that the rates utilities charge are “fair, just and reasonable” and that the services they provide are “adequate, safe and efficient.”<sup>26</sup> As part of this “social compact,”<sup>27</sup> electric utilities submit to cost regulation of their rates, resources, expenditures and capital investments by the BCUC, in exchange for the opportunity to earn a fair return for providing services.<sup>28</sup> In this context, the BCUC’s “duty [is] to ensure that the monopoly undertakings under its supervision operate according to the best interests of the consuming public, under established principles of utility regulation.”<sup>29</sup>

37. To oversee the entirety of the province’s electric sector, the B.C. Government has tasked its Ministry of Energy and Mines with the responsibility to formulate and administer the laws, regulations and policies under which BC Hydro and FortisBC operate.<sup>30</sup> Starting in 1980, the Ministry of Energy has released four long-range policy statements (or “Energy Plans”) to guide the future of the provincial energy sector and express provincial policy objectives.<sup>31</sup>

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organisation, assembles approximately 70 state utilities commissions.

<sup>26</sup> BCUC Participant’s Guide, chapter 1 at 2, **R-209**.

<sup>27</sup> Expert Report of NERA Economic Consulting, dated August 22, 2014 (“Nera Expert Report”), ¶ 27.

<sup>28</sup> BCUC, Participant’s Guide, chapter 1 at 2, chapter 5 at 38, 44, **R-209**.

<sup>29</sup> *BC Gas Utility Ltd. v. British Columbia Hydro and Power Authority et al.*, [1995] B.C.J. No. 1194 (British Columbia Court of Appeal), ¶ 15, **R-289**.

<sup>30</sup> BCUC, Resource Planning Guidelines, December 2003, (“BCUC Resource Planning”) at 5, **R-277**.

<sup>31</sup> British Columbia Ministry of Energy, Mines and Petroleum Resources, Energy For Our Future: A Plan for BC, 2002 (“2002 Energy Plan”) at 11, **R-21**: “In 1980, the Province of British Columbia released its first energy policy. An *Energy Secure British Columbia* sought to manage energy resources for a secure supply, reduce oil imports and conserve resources. Direct government intervention in energy markets, from setting natural gas prices to building hydroelectric facilities, was the dominant policy direction. At the same time, the BC Utilities Commission was created to provide independent oversight of energy utilities.”



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## 2. BC Hydro's Role as a Public Utility

38. BC Hydro is a provincial Crown corporation created in 1961 under the *Hydro and Power Authority Act*.<sup>32</sup> The B.C. Government, as BC Hydro's owner and sole shareholder, appoints its Board of Directors and Chair.<sup>33</sup> BC Hydro reports to the B.C. Government through the Minister of Energy and Mines.<sup>34</sup>

39. BC Hydro's mandate is "to generate, manufacture, conserve, supply, acquire, and dispose of power and related products."<sup>35</sup> It operates 31 hydroelectric facilities and three thermal generating plants, which represent approximately 12,000 MW of installed generating capacity. The hydroelectric facilities, mostly built in the 1960s, 1970s and 1980s, provide over 95 per cent of the total electricity generated by BC Hydro.<sup>36</sup> Electricity is delivered to BC Hydro customers through a network of over 76,000 kilometers of transmission<sup>37</sup> and distribution lines.<sup>38</sup> BC Hydro customers are comprised of residential, commercial and, of particular importance to this case, industrial customers.

40. BC Hydro is responsible for managing its resources to meet demand on an ongoing basis. Resource planning to meet forecasted demand involves either: (1) supply-side measures or (2) demand-side measures.<sup>39</sup> BC Hydro's supply-side measures include

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<sup>32</sup> *Hydro and Power Authority Act*, R.S.B.C. 1996, c. 212, s. 3(1), ("Hydro and Power Authority Act"), **LMA-4** provides that "[BC Hydro] is for all its purposes an agent of the government and its powers may be exercised only as an agent of the government."

<sup>33</sup> Les MacLaren Witness Statement, dated July 18, 2014 ("Les MacLaren Statement"), ¶ 23.

<sup>34</sup> BC Hydro, Service Plan 2014/15–2016/17, February 2014, ("BC Hydro Service Plan"), at 7, **R-9**.

<sup>35</sup> *Hydro and Power Authority Act*, s. 12 (1.1)(a), **LMA-4**.

<sup>36</sup> BC Hydro Service Plan at 6-7, **R-9**.

<sup>37</sup> From 2003 to 2010, the BC Hydro, the British Columbia Transmission Corporation (BCTC) was responsible for planning, operating, and managing BC Hydro's transmission system. In 2010, for efficiency reasons, the BCTC was reintegrated back into BC Hydro (Les MacLaren Statement, ¶ 32).

<sup>38</sup> BC Hydro – Quick Facts 2013, **R-2**.

<sup>39</sup> BC Hydro, "Challenges and choices - Planning for a secure electricity future", March 2006, at 5, **R-290**.

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the construction or extension of generation facilities<sup>40</sup> and the acquisition of electricity from new sources.

41. The acquisition of electricity occurs through various procurement processes, including competitive call processes and standard or open offers, or through bilateral arrangements.<sup>41</sup> As of April 1, 2014, BC Hydro is party to 86 Electricity Purchase Agreements (“EPAs”) currently providing power to BC Hydro.<sup>42</sup> These agreements have been concluded with privately-owned companies that specialize in power production (independent power producers or “IPPs”), municipalities, customers with self-generation facilities,<sup>43</sup> and First Nations.<sup>44</sup> The Claimant’s Celgar pulp mill is party to one of these EPAs under which it sells a portion of its self-generated energy.<sup>45</sup>

42. “Demand-side management” (“DSM”) consists of actions undertaken by the customer to manage the volume of electricity purchased from BC Hydro.<sup>46</sup> In 1989, BC Hydro launched its Power Smart Program to provide incentives and encourage energy efficiency and conservation by its residential, commercial, and industrial customers.<sup>47</sup> For

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<sup>40</sup> For example, BC Hydro manages the Resource Smart Program to identify and implement efficiency gains at its existing facilities and thus increase their electricity generation: BC Hydro, “Challenges and choices - Planning for a secure electricity future”, March 2006 at 9, **R-290**.

<sup>41</sup> BC Hydro, Overview of BC Hydro’s Energy Procurement Practices, November 2013, (“BC Hydro – Overview of Energy Procurement Practices”) at 1, **R-107**; Jim Scouras Statement, ¶¶ 13-15.

<sup>42</sup> BC Hydro, Independent Power Producers currently supplying power to BC Hydro, 1 April 2014, **R-106**.

<sup>43</sup> Self-generation facilities are electrical power generation facilities that are installed at the same site as the customer’s plant, on the customer’s side of the Point of Delivery, and are used to supply a portion of the customer’s plant load. BC Hydro, Application to Amend Tariff Supplement No. 74 (TS No. 74) – Customer Baseline Load (CBL) Determination Guidelines for RS 1823 Customers with Self-Generation Facilities, 2 November 2012 (“BC Hydro, Application to Amend TS74”), Appendix B - Attachment B at 4, **R-87**.

<sup>44</sup> BC Hydro – Overview of Energy Procurement Practices, **R-107**.

<sup>45</sup> BC Hydro and Zellstoff Celgar Limited Partnership Electricity Purchase Agreement, Bioenergy Call for Power – Phase I, dated January 27, 2009 (“Celgar 2009 EPA”), **R-135**.

<sup>46</sup> BC Hydro, Resource Expenditure and Acquisition Plan, 7 March 2005 at 2-5, **R-292**.

<sup>47</sup> BC Hydro, Revenue Requirements 2004/05 and 2005/06 Application, Volume II, December

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industrial customers, a load displacement agreement (“LDA”) constitutes a form of DSM which incentivizes the customer to reduce its purchase of utility electricity by enhancing its ability to self-generate. For BC Hydro, DSM is its “lowest cost resource option” and the “first and best choice to meet future demand growth.”<sup>48</sup>

43. BC Hydro’s rates are among the lowest in North America.<sup>49</sup> Maintaining BC Hydro’s relatively low rates has been a priority of the provincial government for the past two decades.<sup>50</sup> Most recently, to keep BC Hydro’s rates lower than they would be if set by the BCUC, the provincial cabinet established BC Hydro’s rates for the 2013 to 2016 fiscal years<sup>51</sup> and has capped rate increases for the 2017 to 2019 fiscal years.<sup>52</sup>

44. BC Hydro’s wholly owned subsidiary, Powerex,<sup>53</sup> markets electricity and engages in electricity trading activities throughout North America.<sup>54</sup> Powerex has been involved

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2003, Appendix A at 10, **R-293**.

<sup>48</sup> BC Hydro Service Plan at 12, **R-9**, (“By helping customers be more efficient and use their power wisely, BC Hydro can reduce future demand growth and lower customer consumption. This reduces the need for future supply side investments and helps customers to reduce their energy bills.”); Jim Scouras Statement, ¶ 9.

<sup>49</sup> Data supporting this conclusion can be found in the rate comparison report available online at: BC Hydro, Unplug this Blog, “BC Hydro’s rates are among the lowest in North America”, 16 October 2013, **R-11**.

<sup>50</sup> Les MacLaren Statement, ¶ 28. For example, in 1996, the B.C. Government capped BC Hydro’s rates. It then froze these rates for the period from 1998 through 2003. See *Tax and Consumer Rate Freeze Act* [Repealed], RSBC 1996, c.446, **LMA-5**; and *British Columbia Hydro and Power Authority Rate Freeze and Profit Sharing Act*, SBC 1998, c. 4, **LMA-6**.

<sup>51</sup> Direction No. 3 to the British Columbia Utilities Commission, B.C. Reg. 105/2012, (“Direction No. 3”), **LMA-7**; Direction No. 6 to the British Columbia Utilities Commission, B.C. Reg. 29/2014, (“Direction No. 6”), **LMA-8**.

<sup>52</sup> Direction No. 7 to the British Columbia Utilities Commission, B.C. Reg. 28/2014, (“Direction No. 7”), **LMA-9**.

<sup>53</sup> Les MacLaren Statement, ¶ 16. See also BC Hydro, 2004 Integrated Electricity Plan, 31 March 2004, Part 1: Introduction and Planning Objectives at 7, **R-295**: “Powerex, trades energy outside the province. This includes selling any domestic surplus and, if cost-effective, purchasing power for domestic use. BC Hydro also uses its flexible hydroelectric storage reservoir system to buy energy when prices are low and to sell energy when prices are high.”

<sup>54</sup> “Powerex’ trading activities can generate significant revenue which is used to offset BC Hydro expenses, helping to keep BC Hydro’s rates among the lowest in North America” (Les MacLaren Statement, ¶ 16. On the other hand, to prevent any export-related rate increases, no export

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in the marketing of electricity on behalf of certain customers with self-generation facilities in the province.

### 3. FortisBC's Role as a Public Utility

45. FortisBC is a wholly-owned subsidiary of Fortis Inc., a publicly listed company and the largest investor-owned distribution utility in Canada.<sup>55</sup> It is responsible for supplying electricity to parts of the West Kootenay and Okanagan regions of B.C.<sup>56</sup>

46. FortisBC's predecessor, West Kootenay Power and Light ("WKP"), was incorporated in 1897 pursuant to the *West Kootenay Power and Light Company, Limited, Act 1897*.<sup>57</sup> In 1916, Cominco (now Teck Resources Ltd.) purchased WKP to develop an economical power supply for the growing copper and gold mines in the Southern interior of British Columbia.<sup>58</sup> In 1929, WKP received approval to expand its operations to supply other local municipalities and customers, including the Cominco smelter in Trail, BC.<sup>59</sup>

47. FortisBC owns four hydro-electric generating plants on the Kootenay River with an installed capacity of 225 MW, together with approximately 7,000 kilometres of transmission and distribution power lines.<sup>60</sup> FortisBC's customers are comprised of

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expenditures can be recovered through BC Hydro domestic rates (*Clean Energy Act*, s.4(5), **R-154**).

<sup>55</sup> Dennis Swanson Statement, ¶¶ 8, 12 ("In 1987, WKP was purchased by Missouri-based Utilicorp. In October 2001, WKP was renamed Utilicorp Networks Canada BC Ltd. The name was subsequently changed to Aquila Networks Canada BC Ltd in May of 2002. In May 2004, Newfoundland-based Fortis Inc., [...] acquired all the distribution, transmission and generation assets of the former WKP company and renamed it FortisBC.")

<sup>56</sup> FBC Service Area, **R-3**.

<sup>57</sup> *West Kootenay Power and Light Company, Limited, Act, 1867*, BC Statutes of 1897, c. 63, 60 Vict. 577, **R-206**.

<sup>58</sup> Dennis Swanson Statement, ¶ 10.

<sup>59</sup> *West Kootenay Power and Light Company, Limited, Act, 1867, Amendment Act, 1929*, BC Statutes of 1929, c. 76, 19 Geo. 5, **R-207**.

<sup>60</sup> FortisBC, *Electric Facilities*, **R-296**. FortisBC also operates and maintains two other large

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residential, lighting, irrigation, commercial and industrial customers (at both distribution voltage and transmission voltage).<sup>61</sup> Four of the province's five municipal utilities operate in its service area and are served by FortisBC.<sup>62</sup>

48. FortisBC currently uses its own generation resources and long-term contracts to meet the majority of its power supply requirements, while relying on the wholesale electricity market (i.e. imports) to meet power supply gaps (with small purchases from IPPs).<sup>63</sup> Approximately 42% of FortisBC's electricity requirements are met by its own installed capacity; 28% through power purchases from BC Hydro; 24% under a long-term power purchase agreement with Brilliant Power Corporation (providing FortisBC with access to 129 MW of capacity and 895 GWh of energy until 2056);<sup>64</sup> and 5% from wholesale market imports,<sup>65</sup> IPPs, or – to a lesser extent – customers with self-generating facilities.<sup>66</sup>

49. FortisBC primarily plans to meet increases in demand for electricity in its service area through long-term power purchase agreements.<sup>67</sup> In particular, its agreement with Brilliant Power will remain in force until 2056, while the terms of its customer relationship with BC Hydro were renewed in April 2014 for a period of 20 years. Moreover, with the 2017 completion of the Waneta Hydroelectric Expansion Project,

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hydro-electric facilities: the Brilliant Dam owned by Columbia Power Corporation and the Waneta Dam owned by Teck Cominco Ltd.

<sup>61</sup> Dennis Swanson Statement, ¶ 9.

<sup>62</sup> Dennis Swanson Statement, ¶ 9. Specifically, the City of Nelson's, the City of Grandforks', the City of Penticton's and the District of Summerland's municipal utilities.

<sup>63</sup> FortisBC, 2012 Integrated System Plan, Volume 2, 2012 Long Term Resource Plan (2012 Resource Plan), 30 June 2011, ("2012 Resource Plan") at 29, **R-212**.

<sup>64</sup> 2012 Resource Plan at 49-50, **R-212**. An amendment to this purchase agreement was made in May 1996 and provides for an additional 65 GWh of energy and 20 MW of capacity until 2056.

<sup>65</sup> A portion of these wholesale purchases are enabled by a five-year seasonal capacity block FortisBC purchased from Powerex in 2010, (2012 Resource Plan at 51, **R-212**).

<sup>66</sup> Dennis Swanson Statement, ¶ 21.

<sup>67</sup> 2012 Resource Plan at 29, **R-212**.

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FortisBC will be able to supply all if its capacity requirements beyond its own generation assets, its purchases from BC Hydro, and its purchases under the agreement with Brilliant Power, through a long-term capacity purchase agreement with the Waneta Expansion Power Corporation.<sup>68</sup> Given these long-term, high capacity arrangements, FortisBC's resource planning has not included large procurement processes targeted at IPPs or customers with self-generation facilities, such as BC Hydro's calls for power.<sup>69</sup>

50. Demand is managed in FortisBC's service area through its PowerSense program, launched in 1989.<sup>70</sup> PowerSense contributes financial incentives ranging from a portion to all of the incremental costs associated with a DSM measure that increases the energy efficiency and reduces the customer load served by the utility (*i.e.*, reduces the electricity purchased by the customer).<sup>71</sup> Because FortisBC and BC Hydro have different marginal costs of supply and planning constraints, their DSM measures differ.<sup>72</sup> For example, FortisBC's lower marginal cost of acquiring new supply and greater permissible resource options explain, in part, why large LDAs have not been concluded in FortisBC's service area.<sup>73</sup>

51. Similarly, FortisBC's rates have at times been lower and at times higher than BC Hydro's rates due to its different load/resource balances, load forecast, costs, resources

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<sup>68</sup> Dennis Swanson Statement, ¶ 23.

<sup>69</sup> Dennis Swanson Statement, ¶ 23.

<sup>70</sup> FortisBC, Final Submission, in the Matter of an Application by FortisBC Inc. for Approval of 2012-2013 Revenue Requirements and Review of 2012 Integrated System Plan, 5 April 2012, at 188, **R-215**.

<sup>71</sup> Dennis Swanson Statement, ¶¶ 24-25.

<sup>72</sup> *See generally*, BCUC, Decision re: Order G-110-12, in the Matter of An Application by FortisBC Inc. for Approval of 2012-2013 Revenue Requirements and Review of 2012 Integrated System Plan, 15 August 2012, ("BCUC Order G-110-12"), **R-58**:

[I]n the Panel's view, BC Hydro and FortisBC are different utilities, operating in different contexts. The Commission Panel is not prepared to direct FortisBC to implement the same DSM programs as BC Hydro, particularly in the industrial sector where the customer base is very different. The Commission Panel also reiterates its view that FortisBC's DSM Program, as advanced, is reasonable.

<sup>73</sup> Dennis Swanson Statement, ¶ 27.

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and customer base.<sup>74</sup> Although its rates are currently higher, FortisBC offered “lower rates than other utilities for a considerable period during the 1980’s and 1990’s.”<sup>75</sup>

#### 4. The Relationship between BC Hydro and FortisBC

52. The BCUC characterizes the relationship between FortisBC and BC Hydro as a “hybrid” relationship, sharing elements of both a utility-to-utility relationship and a utility-to-customer relationship.<sup>76</sup> The BC Hydro-FortisBC Power Purchase Agreement sets out the terms and conditions for FortisBC’s purchase of power from BC Hydro under Rate Schedule 3808. BC Hydro and FortisBC originally concluded this PPA in 1993 (“1993 PPA”) and filed it with the BCUC in the form of a BC Hydro tariff supplement.<sup>77</sup>

53. FortisBC’s purchases of electricity under the 1993 PPA were subject to a capacity limit (*i.e.*, a customer demand limit) of 200 MW.<sup>78</sup> For service provided below this capacity limit, FortisBC would purchase the electricity under Rate Schedule 3808 (*i.e.*, a

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<sup>74</sup> BCUC Order G-110-12, **R-58**:

FortisBC has gone through a period of significant capital expenditures over the last number of years in order to upgrade its generation and transmission infrastructure to provide greater safety and reliability. The bulk of this investment has now been made. In BC Hydro’s case, FortisBC testified that significant costs will be incurred by BC Hydro in the areas of new generation and refurbishment of existing plants that, when reflected in rates, will lower the disparity between FortisBC and BC Hydro rates. [...]

FortisBC operates with a different set of supply resources and with a different customer base in terms of geography, population density and the residential/commercial/industrial mix it faces. The Commission Panel has no mandate, nor does it find it appropriate, to require FortisBC to manage its utility business to produce rates or programs identical to those of BC Hydro. [...] FortisBC must design and manage its system based on the resources available to it and the needs of its customers. This, at times, may result in rates that are greater than those of BC Hydro and potentially times when they are less. [Emphasis added]

<sup>75</sup> BCUC, Order G-52-05 and Decision, in the Matter of an Application by FortisBC Inc. for Approval of 2005 Revenue Requirements, 2005-2024 System Development Plan and 2005 Resource Plan, 31 May 2005, at 59, **R-297**.

<sup>76</sup> BCUC, Order G-27-93 and Decision in the Matter of an Application by British Columbia Hydro and Power Authority for Rate Schedule 3808 and Revised Power Purchase Agreement with West Kootenay Power Ltd., 22 April 1993 (“BCUC Order G-27-93”) at 26, **R-13**. BCUC Order G-60-14, at 32, **R-221**.

<sup>77</sup> Dennis Swanson Statement, ¶ 40.

<sup>78</sup> Dennis Swanson Statement, ¶ 38.

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rate similar to the one charged by BC Hydro to its transmission customers).<sup>79</sup> Should FortisBC request service above this demand limit, electricity would be charged at rates reflecting fair market arrangements between utilities and BC Hydro would have to make reasonable efforts to provide it.<sup>80</sup>

54. The 1993 PPA stipulated that Rate Schedule 3808 electricity was solely for the purposes of supplementing FortisBC's resources to enable it to meet its service area load requirements and was not to be exported or stored.<sup>81</sup> For this reason, FortisBC was prohibited from exporting any electricity out of its service area during any given hour while FortisBC was taking Rate Schedule 3808 energy for that hour.<sup>82</sup> In other words, "[FortisBC] would [only] be free to export from its own sources of supply when it was not taking energy from B.C. Hydro".<sup>83</sup>

55. The 1993 PPA initially expired on September 30, 2013,<sup>84</sup> but its term was extended to June 30, 2014, such that it remained in effect while the BCUC completed its review of the 2014 PPA, the new Rate Schedule 3808 and their related agreements.<sup>85</sup>

56. In 2009, at BC Hydro's request,<sup>86</sup> the 1993 PPA was amended to clarify that FortisBC could not purchase BC Hydro's Rate Schedule 3808 energy for the purpose of

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<sup>79</sup> BCUC Order G-27-93, at 26, **R-13**, ("As a customer, [FortisBC] has a right to a specified amount of electricity from BC Hydro at the rates extended by BC Hydro to comparable customers.")

<sup>80</sup> Dennis Swanson Statement, ¶ 38.

<sup>81</sup> Dennis Swanson Statement, ¶ 39.

<sup>82</sup> BCUC Order G-60-14 at 10, **R-221**.

<sup>83</sup> BCUC Order G-27-93, at 13, **R-13**.

<sup>84</sup> BCUC, Order G-85-93, in the Matter of an Application by British Columbia Hydro and Power Authority and West Kootenay Power Ltd. for Approval of a Power Purchase Agreement, 1 October 1993, **R-222**.

<sup>85</sup> Dennis Swanson Statement, ¶ 40.

<sup>86</sup> BC Hydro's amendment request received the support of the industrial (JIESC), commercial (Commercial Energy Consumers Association of British Columbia), and environmental (BC Sustainable Energy Association, Sierra Club of British Columbia) groups intervening in the proceeding, as well as the support of the BC Government, represented by the Ministry of Energy,



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facilitating exports by its self-generating customers.<sup>87</sup> As a result, FortisBC could not purchase Rate Schedule 3808 energy during any given hour when it was selling that energy to one of its self-generating customers, while that customer was simultaneously exporting energy to market.<sup>88</sup>

57. In accepting the amendment, the BCUC recognized that in 1993, when the 1993 PPA was negotiated, the parties could not have foreseen that anyone other than FortisBC could simultaneously purchase Rate Schedule 3808 power while selling electricity to market.<sup>89</sup> For example, “open access” to transmission facility by customers was only made possible years later.<sup>90</sup> It was further acknowledged that, whether simultaneous sales were operated by FortisBC customers with self-generating facilities or by FortisBC itself, BC Hydro would incur the same costs in acquiring the resources necessary to provide the incremental electricity at the fixed low Rate Schedule 3808 rate.<sup>91</sup> These costs, which the BCUC estimated at C\$ 12.3 million per year,<sup>92</sup> would in turn flow through BC Hydro’s customers in the form of rate increases.<sup>93</sup>

58. The 2014 PPA, which came into effect on July 1, 2014, continues to include a 200 MW demand limit, but presents a different pricing structure for energy.<sup>94</sup> The 2014 PPA

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also intervening before the BCUC (BC Hydro, Reply Argument in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 30 January 2009).

<sup>87</sup> Dennis Swanson Statement, ¶ 76-79.

<sup>88</sup> Dennis Swanson Statement, ¶ 76-90.

<sup>89</sup> BCUC Order G-48-09 at 20, **R-32**.

<sup>90</sup> BCUC Order G-48-09 at 20, **R-32**.

<sup>91</sup> Dennis Swanson Statement, ¶ 76-90. BCUC Order G-48-09, **R-32**.

<sup>92</sup> BCUC Order G-48-09, s. 5.3 at 27, **R-32**.

<sup>93</sup> FortisBC, Responses to BCUC Information Request No. 3, in the in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 31 December 2008, (“Application to Amend”) at 5, **R-252**.

<sup>94</sup> Dennis Swanson Statement, ¶ 41 FN 46 (“Otherwise called an “inclining block pricing structure,” this new pricing structure applies to energy charges on an annual basis. The pricing structure does not apply to capacity (i.e. demand) charges. Demand is charged on the same basis

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loosen the condition according to which FortisBC is prohibited from scheduling exports of electricity out of its service area during any hour when FortisBC is taking electricity under Rate Schedule 3808.<sup>95</sup> Similarly, it also adds flexibility to the 2009 amendment adopted per BC Hydro's request. For example, the 2014 PPA allows FortisBC to purchase Rate Schedule 3808 energy during any given hour when it is selling that energy to one of its self-generating customers, while that customer is simultaneously exporting energy to market, provided that the customer is performing such sales in accordance with a negotiated and ultimately approved baseline.<sup>96</sup>

### 5. The BCUC's Regulation of Public Utilities

59. The BCUC is an independent regulatory agency that operates under and administers the *Utilities Commission Act* ("UCA").<sup>97</sup> Its primary responsibility is the supervision of B.C.'s public utilities,<sup>98</sup> such as BC Hydro and FortisBC.<sup>99</sup> Its mission is "to ensure that ratepayers receive safe, reliable and non-discriminatory energy services at

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as it was in the 1993 PPA.")

<sup>95</sup> Dennis Swanson Statement, ¶ 42 ("[D]ue to a parallel Energy Export Agreement between BC Hydro and FortisBC, the 2014 PPA allows FortisBC to export new incremental energy using entitlement capacity attributable to FortisBC's investment in new generation at the Waneta Hydroelectric Expansion Project, while FortisBC is taking electricity under Rate Schedule 3808.")

<sup>96</sup> Dennis Swanson Statement, ¶¶ 140-145.

<sup>97</sup> BCUC Participant's Guide, chapter 1 at 1, **R-209**: "The British Columbia Utilities Commission, in its present form, was established by the provincial legislature through the enactment of the *Utilities Commission Act*, R.S.B.C. 1996, c. 473." However, the BCUC was initially created in 1980 when it replaced its predecessor agency, the B.C. Energy Commission: "On May 30, 1980 the Honourable R.H. McClelland, Minister of Energy, Mines and Petroleum Resources announced the creation of the B.C. Utilities Commission replacing the former B.C. Energy Commission, under new legislation entitled the *Utilities Commission Act*" (BCUC, Annual Report 1980, 30 September 1981, at 1, **R-299**).

<sup>98</sup> The primary purpose of the *Utilities Commission Act* is to regulate public utilities, namely any person "who owns or operates in British Columbia, equipment or facilities for [...] the production, generation, storage, transmission, sale, delivery or provision of electricity [...]" (s. 1(a)). This definition excludes (i) a person, not otherwise a public utility, who generates electricity for its own purposes (i.e. that is not resold or used by others), as well as (ii) a municipality providing power within its own boundaries (s. 1(c), (d)).

<sup>99</sup> *Utilities Commission Act*, R.S.B.C. 1996, c. 473 ("*Utilities Commission Act*" or "*UCA*"), s. 23(1), **R-205**.

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fair rates from the utilities it regulates, and that shareholders of those utilities are afforded a reasonable opportunity to earn a fair return on their invested capital".<sup>100</sup>

60. The BCUC can direct utility action through the issuance of orders and decisions,<sup>101</sup> as well as regulations,<sup>102</sup> rules,<sup>103</sup> and standards.<sup>104</sup> The BCUC is also enabled to require that utilities answer all questions and provide all information deemed necessary for the purposes of administering the *Utilities Commission Act*.<sup>105</sup>

61. The BCUC operates as an administrative tribunal and is bound, like all such tribunals, by the standards of procedural fairness, the limits of its governing legislation, and the applicable provisions of the *Administrative Tribunals Act*.<sup>106</sup> It is generally considered a "quasi-judicial" tribunal inasmuch as its basic procedures emulate those of judicial courts.<sup>107</sup> These procedures can include expert testimony, cross-examination of evidence, final (written or oral) arguments,<sup>108</sup> as well as written reasons.<sup>109</sup> Its subpoena powers approximate those of courts,<sup>110</sup> and its orders are legally binding rulings.<sup>111</sup>

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<sup>100</sup> British Columbia Utilities Commission, Organization Profile, **R-1** ("BCUC, Organizational Profile").

<sup>101</sup> See, for e.g., *Utilities Commission Act*, s. 25, **R-205** ("If the commission, after a hearing held on its own motion or on complaint, finds that the service of a public utility is unreasonable, unsafe, inadequate or unreasonably discriminatory, the commission must (a) determine what is reasonable, safe, adequate and fair service, and (b) order the utility to provide it.")

<sup>102</sup> See, for e.g., *Ibid.*, s. 23(2), **R-205**: "Subject to this Act, the commission may make regulations requiring a public utility to conduct its operations in a way that does not unnecessarily interfere with, or cause unnecessary damage or inconvenience to, the public."

<sup>103</sup> See, for e.g., *Ibid.*, s. 31, **R-205**: "The commission may make rules governing conditions to be contained in agreements entered into by public utilities for their regulated services or for a class of regulated service."

<sup>104</sup> See, for e.g., *Ibid.*, s. 26, **R-205**.

<sup>105</sup> *Utilities Commission Act*, s. 43, **R-205**.

<sup>106</sup> Les MacLaren Statement, ¶ 40.

<sup>107</sup> BCUC Participant's Guide, c. 2 at 4, **R-209**.

<sup>108</sup> Les MacLaren Statement, ¶ 39-40.

<sup>109</sup> *Utilities Commission Act*, s. 124, **R-205**.

<sup>110</sup> Les MacLaren Statement, ¶ 40.

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62. The BCUC's enabling legislation provides that it is not bound by its prior decisions by way of precedent, and that it must come to its decisions on the merits and justice of each application.<sup>112</sup> Nevertheless, the BCUC closely considers past decisions when assessing the merits of an application or complaint.<sup>113</sup> On an application or of its own motion, the BCUC is also empowered to reconsider its decisions, orders, rules or regulations.<sup>114</sup> The BCUC's determinations on questions of fact in its jurisdiction are binding and conclusive on all persons and all courts.<sup>115</sup> Its orders and decisions on questions of law can be appealed to the BC Court of Appeal with leave of a Justice of that court.<sup>116</sup>

63. In discharging its duties under the *Utilities Commission Act*, the BCUC's focus is primarily economic regulation, with specific attention paid to the costs of providing safe and reliable<sup>117</sup> service and the recovery of those costs from customers.<sup>118</sup> Simply put, the BCUC sets utility rates by determining how much revenue the utility reasonably needs to cover the costs of providing service to its customers, including how much the utility should have the opportunity to earn for its investment.<sup>119</sup> In so doing, the BCUC must

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<sup>111</sup> *Utilities Commission Act*, s. 42, **R-205**: "A public utility must obey the lawful orders of the commission made under this Act for its business or service, and must do all things necessary to secure observance of those orders by its officers, agents and employees."

<sup>112</sup> *Utilities Commission Act*, s. 75, **R-205**.

<sup>113</sup> BCUC Order G-48-09, at 12, **R-32**:

[The BCUC considers that it] is prudent to examine relevant past decisions to assess the historical context of such decisions, the degree of congruence with new factual situations addressed, and whether or not there are good reasons to depart from the policy enunciations that led to the past decisions. In general, it is advantageous both for the Commission and those regulated companies that fall within its jurisdiction, to have a consistent and predictable body of decisions that will support informed decision-making in the future

<sup>114</sup> *Utilities Commission Act*, s. 99, **R-205**.

<sup>115</sup> *Utilities Commission Act*, ss. 79 and 80, **R-205**.

<sup>116</sup> *Utilities Commission Act*, s. 101, **R-205**.

<sup>117</sup> In this context, "reliability" means to ensure the security of supply now and in the future.

<sup>118</sup> NERA Expert Report, ¶ 34.

<sup>119</sup> This process involves the filing of a Revenue Requirement Application ("RRA") by a utility. After having determined the specific prices for each class by first allocating the utility's costs (i.e.,

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ensure that rates are not “unjust or unreasonable,”<sup>120</sup> or “unduly discriminatory or preferential.”<sup>121</sup> The BCUC also oversees that they provide a fair and reasonable return on any expenditure made by the utility to reduce energy demands.<sup>122</sup>

64. Because costs, such as utility capital investments, are expected to be recoverable in rates, and because the utility is entitled to the opportunity to earn a reasonable return on its capital assets, the BCUC ensures that utilities’ plans to acquire and manage resources are prudent and reasonable,<sup>123</sup> as well as reliably sufficient to meet growing customer demand.<sup>124</sup> Per sections 44.1, 44.2, 45, 56-61 and 71 of the *Utilities Commission Act*, the BCUC oversees resource planning efforts by utilities<sup>125</sup> and is mandated to ensure that expenditures are in the public interest and that any associated rate changes are necessary and appropriate.<sup>126</sup>

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its revenue requirements) to customer classes (such as residential, commercial, industrial, etc.) and dividing the costs for each class by its expected sales volumes, the BCUC designs rates that will produce the necessary level of revenues. This process may involve filing by the utility of a Cost of Service Application (“COSA”) and a Rate Design Application (“RDA”) (BCUC Participant’s Guide, c. 5 at 37, 44, **R-209**.)

<sup>120</sup> Rates unjust or unreasonable, when (i) they constitutes more than a fair and reasonable charge for service of the nature and quality provided by the utility, or when (ii) they are insufficient to yield a fair and reasonable compensation for the service provided by the utility, or a fair and reasonable return on the appraised value of its property (*Utilities Commission Act*, s. 59(5)(a)-(b), **R-205**).

<sup>121</sup> *Utilities Commission Act*, s. 59(1)(a), **R-205**.

<sup>122</sup> *Ibid.*, s. 60(1)(a)-(b)(i)-(b)(ii), **R-205**.

<sup>123</sup> BCUC Participant’s Guide, c. 5 at 38-39, **R-209**.

<sup>124</sup> NERA Expert Report, ¶ 39.

<sup>125</sup> The BCUC reviews utilities’ (i) Long-Term Resource Plans, estimating the demand for energy the utility would expect to serve and including plans of how the utility intends to supply this demand; (ii) Expenditure Schedules detailing the DSM expenditures, capital expenditures and acquisition expenditures that the public utility has made or anticipates making during the period addressed by the schedule; (iii) Applications for a Certificate of Public Convenience and Necessity (“CPCN”) outlining the extensions to its facilities that a utility plans to construct or operate; and (iv) Agreements through which the utility purchases electricity from another party.

<sup>126</sup> BCUC Resource Planning, at 1, **R-277**.

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65. Resource planning by utilities involves closing the gap between forecast electricity demand and supply in the utility's service territory.<sup>127</sup> The means of closing that gap include DSM measures put in place to reduce demand, procurement processes initiated to acquire electricity from other parties, as well as capital investments aimed at extending the life of existing generation facilities or building new facilities. The goal of resource planning is to select "cost-effective resources that yield the best overall outcome of expected impacts and risks for ratepayers over the long run."<sup>128</sup> In other words, it is intended to protect the economic interests of both consumers and their utility while producing economically efficient outcomes in the absence of a market.<sup>129</sup>

66. Overall, the BCUC "has a duty to protect the public interest and, particularly, the interests of ratepayers by ensuring that public utilities provide safe and reliable service at a reasonable price".<sup>130</sup> At the forefront of the BCUC's economic regulation of each public utility lies the "interests of persons in British Columbia who receive or may receive service from the public utility",<sup>131</sup> namely the ratepayers, both existing and future.<sup>132</sup>

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<sup>127</sup> The point at which demand for energy exactly equals energy production is called a "load-resource balance" (BCUC Participant's Guide at 50, **R-209**).

<sup>128</sup> BCUC Resource Planning, at 1, **R-277**.

<sup>129</sup> NERA, Expert Report, ¶¶ 33-40.

<sup>130</sup> BCUC Participant's Guide, c. 2 at 9, **R-209**. [Emphasis added].

<sup>131</sup> See, for e.g., *Utilities Commission Act*, ss. 44.1(8)(d), 44.2(5)(e), 44.2(5.1), 45(3.3), 71(2.1)(d), 71(2.21), **R-205**.

<sup>132</sup> When setting rates, the BCUC balances the interests of ratepayers with the interests of the utility, in order to ensure that rates are "fair and reasonable" for both the customer and its utility. When designing rates in accordance with the cost of servicing each customer class, it balances the interests of each ratepayer to ensure that "each class pays its fair share of the overall cost of providing service." Finally, when assessing the means through which utilities plan to meet customer demand, the BCUC evaluates these means, including their cost-effectiveness, in light of the interests of ratepayers, and determines whether they are in the public interest (see, for e.g., *Ibid.*, ss. 44.1(8)(d), 59(5), 60(1)(c)(iii), **R-205**).

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## 6. The Ministry of Energy's Responsibility for the Energy Sector

67. As the Government department responsible for the province's electricity, energy and mining sectors,<sup>133</sup> the Ministry of Energy is tasked with shaping the Province's electricity policy and its Minister is granted certain powers under the *Utilities Commission Act* and *Clean Energy Act*.<sup>134</sup> From time to time, the Ministry of Energy will also register as an intervener in BCUC proceedings to make submissions on energy policy.<sup>135</sup>

68. One of the Ministry of Energy's main roles is to develop and implement policies concerning electricity, including power generation, transmission, and distribution; conservation and efficiency; and energy development from clean or renewable resources.<sup>136</sup> In particular, the Ministry of Energy prepares and releases long-term Energy Plans to guide the future of the provincial energy sector and express provincial policy objectives.<sup>137</sup> Ultimately approved by Cabinet, these plans are developed by the Ministry of Energy in part through consultations with various stakeholders including other ministries and levels of government, energy, exploration and mining companies, First Nations, local communities, environmental and industry organizations, and the public.<sup>138</sup> Legislation, regulation, ministerial orders, letters of expectations or Special Directives to

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<sup>133</sup> See generally, Les MacLaren Statement, ¶ 18.

<sup>134</sup> Les MacLaren Statement, ¶¶ 18-19, 46.

<sup>135</sup> Les MacLaren, Statement, ¶ 40. As an intervener, the Ministry of Energy's submissions are not binding on the BCUC and are considered by the BCUC as part of the hearing record along with submissions of other interveners in any given proceeding. For example, the Ministry intervened in the BCUC proceeding concerning BC Hydro's request to amend the 1993 PPA (Ministry of Energy, Mines and Petroleum Resources, Final Argument, in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 23 January 2009, **R-14**).

<sup>136</sup> Les MacLaren Statement, ¶ 18.

<sup>137</sup> 2002 Energy Plan, at 11, **R-21**.

<sup>138</sup> Les MacLaren Statement, ¶ 18, 21.

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BC Hydro,<sup>139</sup> and Directions to the BCUC,<sup>140</sup> may be employed to implement, within varying timeframes, the policy actions contained in Energy Plans.

69. The Ministry of Energy, in furtherance of policy objectives, may also employ certain Ministerial powers included in both the *UCA* and the *CEA*. Of particular relevance to this arbitration, the Minister has the power to grant exemptions from BCUC regulation under Part 3 of the *UCA* (i.e., the provisions concerning the regulation of public utilities) and section 71 of the *UCA* (i.e., the provisions concerning EPAs concluded by utilities).<sup>141</sup>

70. This power is typically exercised where regulation by the BCUC is not required to protect ratepayer interests<sup>142</sup> or where regulation would be redundant.<sup>143</sup> For example, Ministerial Order M-22-0205 provides that IPPs and utility customers with self-generation capacity who enter into power sales agreements with BC Hydro are exempt from the rates, services, and resource planning obligations imposed on utilities under

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<sup>139</sup> A Special Directive is made through an Order in Council of the Provincial Cabinet pursuant to s. 35 of the *Hydro and Power Authority Act*, RSBC 1996, c 212, **LMA-4**.

<sup>140</sup> A Direction is made through an Order in Council of the Provincial Cabinet pursuant to the *Utilities Commission Act*, s. 3(1), **R-205**, which provides that the Cabinet, “by regulation, may issue a direction to the commission with respect to the exercise of the powers and the performance of the duties of the commission, including, without limitation, a direction requiring the commission to exercise a power or perform a duty, or to refrain from doing either, as specified in the regulation.” It is however impermissible for the Cabinet to specifically and expressly declare an order or decision of the commission to be of no force or effect, or to require the commission to rescind an order or a decision (s. 3(3)).

<sup>141</sup> *Utilities Commission Act*, s. 22, **R-205**.

<sup>142</sup> For example, the Minister’s Order No. M-22-0101, in the Matter of the Sale, Purchase or Production of a Power Service and an Exemption from the Provisions of Part 3 and Section 71 of the *Utilities Commission Act*, R.S.B.C 1996, C. 473, As Amended (“The Act”), 30 January 2001, (“Minister’s Order M-22-0101”), **R-18**, granted an exemption from the *Utilities Commission Act*, Part 3 and s.71, **R-205**, with respect to the production and sale of power to public utilities and wholesale customers by a hydroelectricity facility formerly fully-owned by a utility customer. This exemption was granted as long as certain terms and conditions protecting ratepayers were respected, including the fact that the hydroelectric facility would continue to fully supply the needs of the customer at utility rates and would only sell electricity surplus to these needs. These terms and conditions made additional BCUC regulation obsolete, as they already contained a strict mechanism to protect ratepayers.

<sup>143</sup> Les MacLaren Statement, ¶ 47.



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Part 3 and section 71 of the *Utilities Commission Act*.<sup>144</sup> As these IPPs and customers are selling power to a public utility, rather than serving customers, the protection of ratepayers is already guaranteed through BCUC oversight of the public utility.<sup>145</sup>

Finally, per section 125.1(4) of the *Utilities Commission Act*,<sup>146</sup> and section 37 of the *Clean Energy Act*,<sup>147</sup> the Minister of Energy may make certain regulations concerning the interpretation or application of these Acts.

### **B. The Self-Generation of Electricity by Utility Customers**

71. Rather than drawing all of their electricity requirements from their utility, some industrial customers install their own self-generation facilities.<sup>148</sup> For example, an aluminium smelter may construct a hydroelectric facility adjacent to its plant to supply

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<sup>144</sup> Minister's Order No. M-22-0205, in the Matter of the Sale, Purchase or Production of a Power Service and an Exemption from the Provisions of Part 3 of the *Utilities Commission Act*, R.S.B.C 1996, C. 473, As Amended ("The Act"), 6 June 2002, **R-16**. The 12 June 2002 letter sent by the Ministry of Energy to the BCUC, and attached to the Order, provides that the "Order exempts persons who are not otherwise a public utility, and their equipment, facilities, plant, projects or systems, from the provisions of Part 3 of the *Utilities Commission Act* (the Act) with respect to the production and sale of electricity to BC Hydro or Powerex."

<sup>145</sup> Les MacLaren Statement, ¶ 46-48. As discussed above, utilities must file agreements through which they purchase electricity for approval with the BCUC under the *Utilities Commission Act*, s.71, **R-205**, while any long term acquisition plan and resource planning initiative, including expenditures related to power purchases, are also subject to BCUC review.

<sup>146</sup> These regulations may include, *inter alia*, the types of exemptions under Section 22, the criteria to apply when determining whether a demand-side measure is cost-effective in the context of utility resource planning, and the factors a public utility must use in producing estimates regarding the long-term demand it will have to supply (e.g. *Demand-Side Measures Regulation*, BC Reg. 326/2008, **R-300**).

<sup>147</sup> These regulations may include, *inter alia*, prescribing additional resources under the definition of "clean or renewable resources" in s. 1(1) of the Act (e.g. the *Clean or Renewable Resource Regulation*, BC Reg. 291/2010, **R-301**), further describing the projects or expenditures pursued by BC Hydro that the Province has deemed to be in public interest under s. 7 and 8 of the Act (e.g. *Exempt Projects, Programs, Contracts and Expenditures Regulation*, B.C. Reg. 302/2010, **R-155**), or prescribing exclusions for the purposes of the definition of "demand-side measure" in s. 1(1) of the Act.

<sup>148</sup> Some residential and commercial customers may also install solar panels on their house or business, with the result of reducing their utility bill. However, for the purpose of this Counter-Memorial, the focus is on industrial customers.

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the electricity needs of the plant and avoid electricity purchases from its utility for the duration of the life of the hydroelectric asset.<sup>149</sup>

72. Instead of installing generation capacity adjacent to their plants, other high-consuming industrial actors, such as kraft pulp mills, can generate electricity as an interrelated by-product of their own industrial process.<sup>150</sup> This mechanism whereby a mill produces both process steam, as well as electricity, is often referred to as “cogeneration.”<sup>151</sup> In 2008, British Columbia’s pulp and paper mills met over 33 % of their electricity needs through cogeneration of electricity and steam on site.<sup>152</sup>

### 1. The Mechanics of Self-Generation by Pulp Mills

73. Kraft pulp mills manufacture pulp from wood chips or other wood fibre. These mills do so by “boiling” (or “cooking”) the wood through a chemical process which dissolves the organic matter that keeps wood together.<sup>153</sup> Once separated from each other, the organic matters found in wood serve different purposes. Cellulose is mainly used for pulp making, while lignin (together with water and chemicals) forms the basis of black liquor, which is a biomass fuel. This black liquor is then burned in the pulp mill’s “recovery boiler”<sup>154</sup> to generate steam, which is necessary for the pulping process, and to

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<sup>149</sup> In BC, Rio Tinto Alcan’s Kitimat aluminum smelter uses hydroelectricity generated at its Kemano power station: Rio Tinto Alcan, *About Rio Tinto Alcan in BC*, **R-302**.

<sup>150</sup> Pöyry Expert Report, at ¶¶12-23.

<sup>151</sup> Pöyry Expert Report, at 12. See also, the definition of “cogeneration” in BCUC Participant’s Guide, Glossary and acronyms, at 48, **R-209**: “The generation of electric power in conjunction with the use of steam in an industrial or space heating process, using waste heat from one process to drive the other” (emphasis added).

<sup>152</sup> British Columbia Ministry of Energy, Mines and Petroleum Resources, BC Bioenergy Strategy Growing Our Natural Energy Advantage, 2008, (“2008 Bioenergy Strategy”) at 10, **R-24**.

<sup>153</sup> Pöyry Expert Report, at ¶ 13-16.

<sup>154</sup> It is called a “recovery boiler” because it is specifically designed to initiate the chemical reactions required to regenerate the chemicals used in boiling wood chips into pulp, in addition to burning black liquor to produce steam for the boiling process (Pöyry Expert Report, at ¶¶ 17-19).

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initiate the chemical reactions required to regenerate the chemicals also used in that process.<sup>155</sup>

74. If other fuel sources (i.e., in addition to the black liquor) are to be used to generate supplemental steam for the pulping process and to meet the mill's energy requirements, a "power boiler" can be added to the mill.<sup>156</sup> To generate steam, the power boiler can burn hog fuel,<sup>157</sup> also a biomass fuel,<sup>158</sup> or other fuels, such as natural gas, oil or coal.<sup>159</sup>

75. As shown in Figure 2, below, the steam generated in the recovery boiler (and any power boilers) is then introduced into a turbine to reduce its steam pressure,<sup>160</sup> making it more suitable for the pulp production process.<sup>161</sup> Within the turbine, the incoming steam moves a shaft connected to a generator, thus producing electricity.

76. In all cases, mills must maintain a certain "steam balance"<sup>162</sup> (or "thermal balance") in their pulping process, whereby the steam generated by the recovery and power boilers equals the steam needed by the pulping process.<sup>163</sup>

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<sup>155</sup> Pöyry Expert Report, at 15-17. *See also* ¶ 12: "The Kraft Pulping Process was originally designed to permit the recovery and reuse of chemicals while also providing a substantial amount of energy for process needs."

<sup>156</sup> Pöyry Expert Report, at ¶ 20.

<sup>157</sup> Hog fuel is predominantly bark accumulated from debarking tree stems for higher-end wood products. It is named "hog fuel" after the wood grinding machine called a "hog" (BioCap Canada Foundation, in Collaboration with the BC Ministry of Energy, Mines and Petroleum Resources and the BC Ministry of Forests and Range, *An Information Guide on Pursuing Biomass Energy Opportunities and Technologies in British Columbia for First Nations, Small Communities, Municipalities and Industry*, Updated Version: 7 February 2008, at 78, **R-303**).

<sup>158</sup> Hog fuel is a biomass fuel, as it is derived from the solid wood production process (i.e. from the wood residuals, such as bark, that are generated during logging and sawmilling and that are not suitable for pulp production). *See generally*, Pöyry Expert Report, at ¶ 36.

<sup>159</sup> Pöyry Expert Report, at ¶ 20.

<sup>160</sup> If the turbine is not used, the pressure of the steam produced by the boilers can be reduced through the use of "pressure-reducing valves." *See*, Pöyry Expert Report, Figure 2 at 10.

<sup>161</sup> The steam generated by modern boilers is of too high a pressure to be used in the pulping process. *See*, Pöyry Expert Report, at ¶¶ 21-22.

<sup>162</sup> "In a co-generation environment, steam production and pressure is balanced with process steam

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77. If steam is generated from the boilers beyond the thermal balance (requirements) of the mill,<sup>164</sup> it can be vented (i.e. lost) or, preferably, it is introduced into the turbo-generator, to generate additional electricity.<sup>165</sup> Electricity generated beyond the thermal requirements of the industrial pulping process could, if produced in a sufficient quantity, result in the mill becoming energy self-sufficient.

Figure 1 - Energy System of a Pulp Mill<sup>166</sup>

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demands. More steam is required when process needs increase (higher production).” BC Hydro, Response to BCUC Information Request No. 1.4.1, in the Matter of BC Hydro Transmission Service Evaluation Report F-2009 (2009 Report) and British Columbia Utilities Commission Report to Government on the British Columbia Hydro and Power Authority Transmission Service Rate Program (3 Year Report), 6 November 2009, at 1, **R-304**.

<sup>163</sup> Pöyry Expert Report, ¶ 32: “Incremental power generation, beyond the requirements for the kraft process, will typically involve the installation of a condensing turbine with possible upgrades to existing Recovery and Power Boilers.”

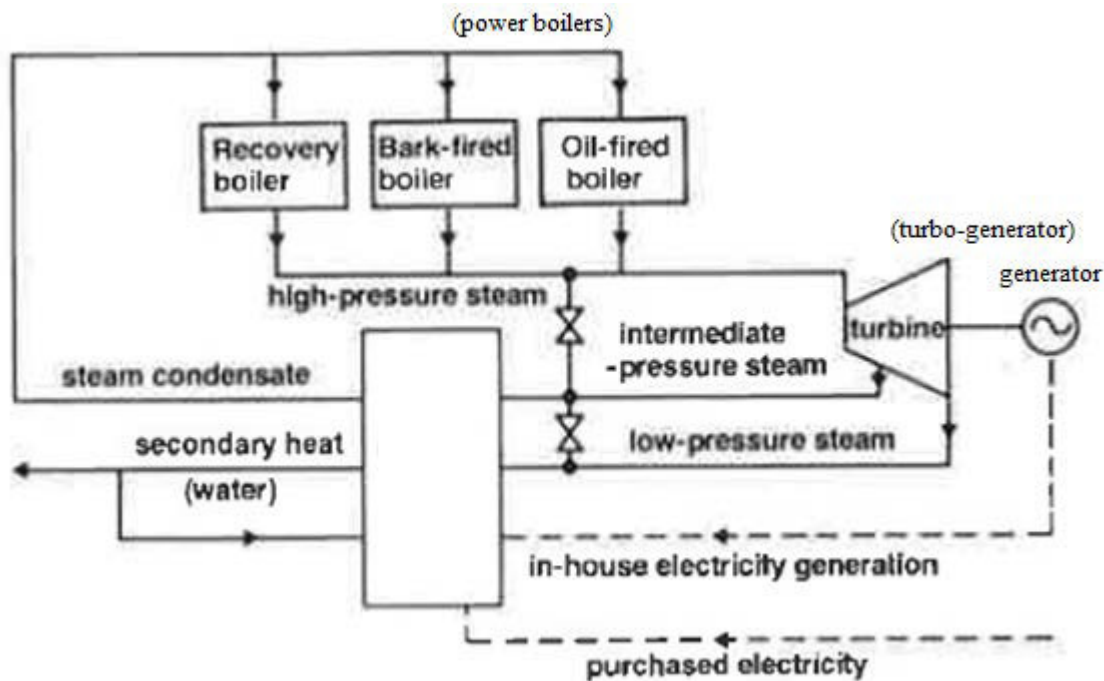
<sup>164</sup> This explains why the actual electricity generating capacity of a mill’s turbo-generator will be lower than its installed (nameplate or maximum electrical rating) capacity to account for the pulping process’ necessary steam balance. See BC Hydro, Transmission Service Rate (TSR) Customer Generator Baselines (GBLs) – June 2012 Information Report, 20 June 2012, (“BC Hydro 2012 GBL Information Report”), at bates 048120, **R-177** [Emphasis Added].

In most cases, the customer’s generating facilities were installed to meet the thermal requirements of the customer’s production process. [...]

The primary purpose of the original extraction “back-pressure steam turbines” (BPSTs) located in most of the B.C. pulp mills is to regulate the high-pressure steam produced in the recovery and power boilers down to the lower steam pressures required in the pulp making process. The output of the associated electrical power generators is therefore directly linked to the steam production and demand of the pulp making process.

<sup>165</sup> Pöyry Expert Report, ¶ 32: “Incremental power generation, beyond the requirements for the kraft process, will typically involve the installation of a condensing turbine with possible upgrades to existing Recovery and Power Boilers.”

<sup>166</sup> Pöyry Expert Report, at 10. This figure illustrates a typical kraft pulp mill’s energy system using a high pressure recovery boiler and two power boilers (bark-fired boiler and oil-fired boiler) supplying steam to a turbine, then extracted for process use, while producing electricity.



## 2. The Economic Rationale for Self-Generation

78. Although kraft pulp mills are inherently capable of (co)generating steam and electricity with the proper equipment, the amount of electricity generated beyond what is necessary to maintain thermal balance of the process will depend on the circumstances of each pulp mill.<sup>167</sup> Historically, in British Columbia, “[e]ach customer’s decision [...] has largely been influenced by the technical requirements of the customer’s industrial plant (i.e., thermal requirements) and the cost of self-generation relative to the avoided cost of purchasing electricity from [the utility].”<sup>168</sup> In that regard, pulp mills’ decision-making

<sup>167</sup> Pöyry Expert Report, ¶¶ 26-29.

<sup>168</sup> BC Hydro 2012 GBL Information Report at bates 048119, R-177.

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process is driven by economics:<sup>169</sup> Is it cheaper for the pulp mill to self-generate a portion of its electricity requirements instead of purchasing that electricity from its utility?<sup>170</sup>

79. Several factors enter into the calculation of whether the cost of self-generating electricity is lower than the cost of purchasing electricity from a utility.<sup>171</sup> For example, if contemplating the addition of generation capacity, the acquisition, installation and long-term maintenance costs of a new condensing turbine and generator are taken into account.<sup>172</sup> If sufficient capacity is already present, and the intent is to use otherwise idle capacity in order to generate electricity beyond the energy needed for the pulping process' thermal balance, the cost of fuel to burn in the boiler and generate additional steam to power the turbine, becomes a major factor.<sup>173</sup> Finally, if technical limitations

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<sup>169</sup> At that level, a pulp mill's decision-making process thus resemble that of any customer contemplating the self-generation of electricity as an alternative to purchasing electricity from the utility.

<sup>170</sup> Pöyry Expert Report, ¶ 24. *See also* BC Hydro, in the Matter of an Application by BC Hydro for Approval of Rates between BC Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, Supplemental Submissions, 13 January 2014, (“BC Hydro Supplemental Submission re 2014 PPA”) **R-305**.

<sup>171</sup> Pöyry Expert Report, ¶ 25.

<sup>172</sup> Pöyry Expert Report, at ¶ 27. *See also* BC Hydro 2012 GBL Information Report at bates 048126-048127, **R-177**:

[For example, some of BC Hydro's TSR] customers do not have sufficient generation capacity to meet their total plant electrical needs and have chosen not to make investments in new self-generation capacity because it is not economic for them to do so. Customers will not invest in new generation to displace their load if the cost of building and operating new generation is greater than the cost of purchasing embedded cost energy from BC Hydro [i.e. electricity at embedded cost-of-service rates].

<sup>173</sup> Pöyry Expert Report, at ¶¶ 36-44. *See also* BC Hydro 2012 GBL Information Report, at bates 048126, **R-177**.

[For example, some of BC Hydro's TSR] customers have generation capacity but choose not to utilize some or all of it on the basis that it would be uneconomic for them to do so. That is, even though the customer may have installed capacity, it would cost more for the customer to use that capacity to generate incremental electricity than the savings the customer would receive by displacing purchases of embedded cost energy from BC Hydro [i.e. electricity at embedded cost-of-service rates].

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impair the potential for electricity generation with the existing equipment, the costs related to improving this equipment also become a factor.<sup>174</sup>

80. Assuming pulp mills are rational economic actors, such capacity installations, fuel purchases, and equipment improvements will only be undertaken if they are cost-effective.<sup>175</sup>

Although the reasons may vary depending on the customer, economics is a primary reason for the significant amount of idled generation. The incremental costs (such as fuel, operations and maintenance, etc.) of self-generating incremental electricity are greater than the cost of the RS 1823 electricity that the customer would avoid having to purchase. Similarly, customers may choose to not invest in upgrades to existing generation or new generation opportunities if the customer's avoided cost (i.e., RS 1823 tariff rate) is insufficient to justify the investment. [For similar reasons, a customer may also decide not to invest in addressing the] operational or technical constraints that limit [the] customer's ability to fully utilize its self-generation capacity.<sup>176</sup>

81. The economic nature of this decision-making process by pulp mills, namely, whether increased generation is cost-effective relative to the avoided cost of electricity purchases,<sup>177</sup> is the same regardless of the utility. The precise dollar amount of this avoided cost (i.e. the electricity rates) will however vary from one utility to another. In other words, whether they are located in BC Hydro or FortisBC's service territory, "[c]ustomers install self-generation facilities because it is cheaper for them to self-generate a portion of their electricity requirements instead of purchasing that electricity from the utility."<sup>178</sup>

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<sup>174</sup> See Pöyry Expert Report, ¶¶ 30-32.

<sup>175</sup> I.e., when it would be economically sound to undertake them, considering all relevant factors.

<sup>176</sup> BC Hydro 2012 GBL Information Report at bates 048120, **R-177**. [Emphasis Added].

<sup>177</sup> Jim Scouras Statement, ¶ 25.

<sup>178</sup> BC Hydro Supplemental Submission re 2014 PPA at 2, **R-305**.

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82. For example, in 1993, the then-owners of the Celgar pulp mill elected to install a 52 MW turbine with the view of becoming electricity self-sufficient,<sup>179</sup> thus avoiding electricity purchases from their utility, FortisBC.<sup>180</sup> Later on, after its purchase of the Celgar mill, the Claimant pursued several capacity improvements<sup>181</sup> and additions “to meet all energy requirements in the mill.”<sup>182</sup>

### 3. The Physical Reality of Electricity Self-Generation

83. Regardless of the motives justifying the scope of a pulp mill's self-generation, the physical reality underlying its cogeneration remains the same, namely, unless the customer generates more electricity than is required by its mill, the electricity generated does not leave the mill:

Because self-generation facilities are installed to power equipment in the customer's industrial facility and are on the customer's side of the point of delivery [i.e. utility revenue meter] electricity made by these generation facilities is consumed by the customer's equipment. Self-generation output reduces the amount of electricity physically transferred, and metered, from the utility to the customer's site. Only when these generation facilities make an amount of electricity that exceeds the on-site load of the customer's equipment can there be a physical export of electricity from the customer's site to the utility's system.<sup>183</sup>

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<sup>179</sup> A similar decision-making process is also undertaken by non-pulp mill utility customers. For example, the City of Nelson, a municipal utility and a customer of FortisBC, installed a new hydroelectric generation facility “which provided incremental capacity, increased efficiency, and replacement of old generation capacity.” The decision to proceed with such an investment was “principally based on the avoided cost of purchased power” from (City of Nelson, Final Argument, in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 23 January 2009, at 23, **R-306**).

<sup>180</sup> See Section II.G.1 below.

<sup>181</sup> See Section II.G.3 below.

<sup>182</sup> Zellstoff Celgar, Celgar Latest News, January 1, 2010 *Green Energy Project Funding*, **R-229**:

The Green Energy Project is a newly-approved C\$55 million investment in the mill's power production capacity. The project mission is to meet all energy requirements in the mill allowing any excess electricity to be sold to power utilities, resulting in zero energy costs for Celgar and significant by-product electricity revenue. [Emphasis Added]

<sup>183</sup> BC Hydro Supplemental Submission re 2014 PPA, at 3, **R-305** [Emphasis Added].



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84. In other words, when an industrial customer's self-generation facilities produce electricity that is not in excess of the customer's load,<sup>184</sup> all of the electricity is consumed on site by mill equipment and there is no physical export to the grid (*i.e.* no physical metered flow of electricity from the mill to the utility's system).<sup>185</sup> In such a case, the customer is not "self-sufficient," and the utility therefore supplies the residual electricity requirements of the industrial customer (as measured by the utility's revenue meter).<sup>186</sup>

85. Conversely, if the customer is self-sufficient, no residual electricity needs to be supplied by the utility. Moreover, if the customer is capable of generating more electricity than what is required by its industrial site (*i.e.* its load), it may physically export such "excess" electricity out of the mill,<sup>187</sup> subject to obtaining the requisite utility agreements<sup>188</sup> and securing transmission capacity.<sup>189</sup>

86. In the case of a customer generating electricity above its load and seeking to sell this excess electricity, the customer could be said to operate as would an IPP with respect to this excess electricity. Like IPPs, these self-generating customers could attempt to sell electricity to BC Hydro or FortisBC. Another option would be for Powerex to purchase this electricity to trade on the open market,<sup>190</sup> or for the self-generator to attempt to

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<sup>184</sup> The "customer's load" corresponds to the amount of electricity required by the customer at a given time (BCUC Participant's Guide at 50, **R-209**).

<sup>185</sup> Lester Dyck Statement, dated August 21, 2014 ("Lester Dyck Statement"), ¶ 27. See also, BC Hydro Supplemental Submission re 2014 PPA, at 4-5, **R-305**.

<sup>186</sup> BC Hydro Supplemental Submission re 2014 PPA, at 3, **R-305**.

<sup>187</sup> The BCUC has used the term "excess" self-generation refer to any self-generated power that is not required by the customer's base load. In other words, "excess" electricity is used to "mean any power generated net of load on a dynamic basis." (BCUC Order G-48-09 Decision at 28, **R-32**). In this Counter-Memorial, "excess self-generation" is contrasted from "new or incremental" added by a self-generator pursuant to an economic decision and/or incentive agreement.

<sup>188</sup> Lester Dyck Statement, ¶32.

<sup>189</sup> BC Hydro Supplemental Submission re 2014 PPA, at 6, **R-305**.

<sup>190</sup> BioCap Canada Foundation, in Collaboration with the BC Ministry of Energy, Mines and Petroleum Resources and the BC Ministry of Forests and Range, *An Information Guide on Pursuing Biomass Energy Opportunities and Technologies in British Columbia for First Nations, Small Communities, Municipalities and Industry*, Updated Version: 7 February 2008, at 61, **R-**

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secure an outside buyer. To facilitate this export to buyers outside of BC,<sup>191</sup> the customer could decide to enter into an agreement with a third party power marketer, such as NorthPoint.<sup>192</sup>

#### 4. The Use of Incentives to Increase Self-Generation

87. Regardless of whether the customer's level of self-generation is sufficient to effect physical exports to the grid, the self-generation of electricity by an industrial customer invariably results in decreased demand for electricity from its utility. For BC Hydro – a utility required to become self-sufficient through B.C. clean or renewable electricity resources<sup>193</sup> – increasing a customer's self-generation can represent a significant benefit. Any increase in self-generation reduces the demand BC Hydro must serve and thereby helps to close the gap between electricity supply and demand. In other

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#### 303.

Powerex also buys energy from BC self-generators and independent power producers (IPPs) - especially also from green power providers (biomass energy projects will generally qualify as "green power", but should be certified under the Canadian Ecologo scheme or have equivalent certification applicable to the target market). Selling to Powerex would remove the need to wait for a BC Hydro call for power projects. Powerex may offer an indexed power price, which is based on market prices. This price insecurity may make project financing more difficult, unless it is not an issue and project proponents are ready to take such risks. Powerex can, in some instances, offer a fixed electricity price over a longer term (e.g., 10 years) but typically this is only possible whenever Powerex finds an electricity customer that agrees to purchase all the electricity generated by the facility in question for a longer period of time. Regardless of type of pricing that Powerex offers, any BC IPP (regardless of the type of generation) must be price competitive with distant markets, after wheeling costs (transmission fees), shaping, and Powerex's profit.

<sup>191</sup> The third party marketer would then pay all transmission charges and sell the power outside the province, similar to what Powerex can do (BioCap Canada Foundation, in Collaboration with the BC Ministry of Energy, Mines and Petroleum Resources and the BC Ministry of Forests and Range, *An Information Guide on Pursuing Biomass Energy Opportunities and Technologies in British Columbia for First Nations, Small Communities, Municipalities and Industry*, Updated Version: 7 February 2008, 5at 61, **R-303**).

<sup>192</sup> "NorthPoint Energy Solutions provides electrical energy marketing and trading services [...] to SaskPower [and] engage[s] in proprietary wholesale electrical energy trading in markets across Canada and the United States", NorthPoint Energy Solutions, About, **R-180**. It is a wholly-owned wholesale marketing subsidiary of SaskPower. Owned by the Government of Saskatchewan, SaskPower is the Province of Saskatchewan's principal electric utility).

<sup>193</sup> As discussed further in ss. II.E and II.F below.

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words, for BC Hydro to benefit from this additional generation, it is not necessary that the electricity be net of the self-generator's load:

Planning horizons are necessarily long, particularly where increased generation is required and must be constructed. The capital outlays involved with supplying additional capacity are significant. A variety of methods may be employed by a utility in its attempt to manage peak loads as well as loads generally to match its supply obligations. For example, to the extent that self-generators supply their own loads, the load the utility must serve is reduced by the equivalent amount. Self-generators with "excess" generation, also offer an alternate source of supply for the utility.<sup>194</sup>

88. However, significant barriers may prevent self-generating customers from increasing their level of self-generation. As discussed in above, it would not make economic sense for a pulp mill to invest in further self-generation if the cost of this investment was greater than its benefit (in the form of less electricity purchased from the utility). These barriers may be especially prevalent in regulated jurisdictions with low electricity rates, such as British Columbia, where electricity is provided on a cost-of-service basis primarily from low-cost hydroelectric generating facilities.<sup>195</sup>

89. These barriers, however, may be removed through "the implementation of appropriate economic signals to encourage customers to utilize idled generation and invest in new generation and upgrades to existing generation."<sup>196</sup> In other words, BC Hydro can remove these barriers by incentivizing increases in self-generation by pulp mills that would otherwise have had no business case (i) to bring idled capacity back

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<sup>194</sup> BCUC, Order G-191-13 and Decision, in the Matter of an Application by FortisBC for a Certificate of Public Convenience and Necessity for the Purchase of the Utility Assets of the City of Kelowna - Phase 2, 22 November 2013 ("BCUC Order G-191-13"), **R-261**.

<sup>195</sup> BC Hydro 2012 GBL Information Report at bates 048122, **R-177**. ("[t]o the extent that BC Hydro's relatively low tariff rates have been the economic barrier limiting customer self-generation, BC Hydro and its customers may not realize the full benefits of cost-effective energy and capacity supplied from customer self-generation.")

<sup>196</sup> *Ibid.*, at bates 048128, **R-177**.

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online, (ii) to install additional generation capacity, or (iii) to invest in technology alleviating the operational constraints limiting their self-generation.<sup>197</sup>

90. These “economic signals” take the form of EPAs or LDAs, which encourage customers to efficiently operate, and make prudent investments in, their existing or future self-generation assets.<sup>198</sup> Both EPAs, pursuant to which BC Hydro purchases incremental self-generation output,<sup>199</sup> and LDAs, pursuant to which BC Hydro provides incentives to its customers to make incremental self-generation output for self-supply,<sup>200</sup> are commercially negotiated agreements concluded between BC Hydro and self-generators.<sup>201</sup>

91. BC Hydro can incentivize a pulp mill under an EPA to increase its self-generation by purchasing this incremental electricity from the mill.<sup>202</sup> If the additional electricity generated exceeds the on-site load of the mill, there is a physical export of electricity from the mill to BC Hydro’s system.<sup>203</sup> In contrast, if the electricity does not exceed the mill’s load, it will be consumed by the pulp mill, but the EPA will deem it to be sold to BC Hydro.<sup>204</sup> Because this self-generated electricity is notionally leaving the mill, the mill is deemed to continue purchasing the necessary electricity from BC Hydro, while in reality, no electricity is leaving the mill and the amount of utility electricity entering the mill diminishes in proportion to the increase in self-generation.<sup>205</sup> In such a case, the

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<sup>197</sup> *Ibid.*, at bates 048123, **R-177**.

<sup>198</sup> *Ibid.*, at bates 048134, **R-177**.

<sup>199</sup> Lester Dyck Statement, ¶ 29.

<sup>200</sup> *Ibid.*, ¶ 28.

<sup>201</sup> BC Hydro, Responses to Celgar Information Request No. 1.1.2.4, in the Matter of an Application by BC Hydro for Approval of Rates between BC Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, 14 August 2013, at 1, **R-291**.

<sup>202</sup> BC Hydro, Application to Amend TS74, Appendix B - Attachment B at 2, **R-87**.

<sup>203</sup> Lester Dyck Statement, ¶ 26.

<sup>204</sup> BC Hydro Supplemental Submission re 2014 PPA at 2, **R-305**.

<sup>205</sup> BC Hydro Supplemental Submission re 2014 PPA, at 4-5, **R-305**.

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financial incentive provided to the self-generator by the EPA corresponds to the difference between the price offered for the self-generated energy under the EPA and the relatively low price of electricity supplied by BC Hydro.<sup>206</sup>

92. Under an LDA, BC Hydro incentivizes the pulp mill to increase its self-generation by entering into an agreement to provide the mill with a financial payment to make self-generation output for self-supply.<sup>207</sup> As opposed to an EPA, an LDA does not operate a deemed sale of self-generated electricity by the mill to BC Hydro. In addition, because LDAs provide payment in exchange for a decrease in utility electricity purchases, they can only be used when the customer is not already self-sufficient, i.e. when the customer would otherwise be purchasing electricity from the utility.

93. While LDAs and EPAs both result in the same physical reality (namely additional self-supply by the mill), the incentive mechanism of an LDA may be more appropriate in certain cases, especially when the customer's project involves the installation of new self-generation facilities at the customer's site.<sup>208</sup> Because an LDA provides advance funding and/or security on such advance funding, it can remove a customer's capital barriers to an installation project.<sup>209</sup> Furthermore, because LDAs may contribute funding for necessary engineering studies and provide assistance to managers with the technical aspects of the installation, they can mitigate other customer-driven barriers, such as lack of technical

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<sup>206</sup> BCUC Order G-48-09 at 10, **R-32**.

For BC Hydro, this contracted "deemed" long term purchase of electricity is attractive relative to other sources of long-term supply (such as building a new generation facility), because: "(i) it is often cost-effective; (ii) it may have a relatively high capacity value; (iii) it is located close to the load which may allow BC Hydro to avoid infrastructure costs and transmission losses; (iv) it will generally track the customer's load profile/shape to the extent that the self-generation is linked to the customer's industrial processes; (v) it may be dispatchable; and (vi) it may be brought on-line quickly, particularly in the case of idle generation." (BC Hydro 2012 GBL Information Report, at 6-7, **R-177**.)

<sup>207</sup> BC Hydro, Application to Amend TS74, Appendix B - Attachment B at 3, **R-87**.

<sup>208</sup> BC Hydro, Resource Expenditure and Acquisition Plan, 7 March 2005 at 2-21, **R-292**.

<sup>209</sup> Lester Dyck Statement, ¶ 28.

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expertise and senior management buy-in.<sup>210</sup> The financial incentive provided by the LDA takes into account the decrease in BC Hydro's revenue from the self-generator due to decreased electricity purchases. The total incentive corresponds to the advance funding under the LDA plus the savings from reduced purchases from the utility over time.<sup>211</sup>

### 5. The Protection of Ratepayers

94. Whether they are EPAs (i.e. supply-side procurement) or LDAs (i.e. demand-side measure), these agreements all share a common purpose, namely to incentivize the new or incremental generation of electricity by customers. When providing incentives in the form of EPAs and LDAs, utilities such as BC Hydro must respect their regulatory obligations relating to resource planning<sup>212</sup> – as would be the case with any other supply-side and demand-side expenditure.<sup>213</sup>

95. An EPA is an “energy supply contract” as defined in section 68 of the *UCA*, and an LDA is a “demand side measure” as defined in section 1 of the *CEA*, and section 1 of the *UCA*.<sup>214</sup> Per sections 44.2, 58 -61, and 71 of the *UCA*, these expenditures must be in the public interest and evaluated in light of the interests of current and future ratepayers.<sup>215</sup>

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<sup>210</sup> BC Hydro, Resource Expenditure and Acquisition Plan, 7 March 2005, at 4-27, **R-292**.

<sup>211</sup> Lester Dyck Statement, ¶ 28.

<sup>212</sup> NERA Expert Report, ¶¶ 34-40.

<sup>213</sup> BCUC Resource Planning, at 1, **R-277**. See, for e.g., *Utilities Commission Act*, s. 44.1, 44.2, 45, and 71, **R-205**, and *Clean Energy Act*, s. 2, 7, 8, **R-154**.

<sup>214</sup> BC Hydro, Responses to Celgar Information Request No. 1.1.2.4, in the Matter of an Application by BC Hydro for Approval of Rates between BC Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, 14 August 2013, at 1, **R-291**.

<sup>215</sup> See, for e.g., *Utilities Commission Act*, RSBC 1996, c 473, s. 44.1(8)(d), 44.2(5)(e), 44.2(5.1), 45(3.3), 71(2.1)(d) and 71(2.21), **R-205**.

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96. As such, when BC Hydro chooses to provide an incentive to remove economic barriers blocking increased self-generation,<sup>216</sup> it must be “cost-effective for BC Hydro to do so relative to other resource options.”<sup>217</sup> A cost-effective resource will “yield the best overall outcome of expected impacts and risks for ratepayers over the long run.”<sup>218</sup>

97. For EPAs and LDAs to be cost-effective, in the interests of ratepayers, and in the public interest more generally, BC Hydro must ensure that they have the effect of increasing self-generation of electricity by customers above the level of generation these customers had already decided to produce for their own specific business reasons. As explained by BC Hydro's Lester Dyck:

BC Hydro has no interest in paying a customer for electricity that it already self-generates under normal operating conditions. Payment for such “existing” electricity would add nothing to BC Hydro's resource base, and would merely transfer wealth from BC Hydro and its customers to one self-generator in exchange for nothing.<sup>219</sup>

98. As such, during the negotiation process of these agreements, a Generator Baseline (“GBL”) is set to define the amount of self-generation that the customer normally generates for self-supply.<sup>220</sup> On that basis, BC Hydro can determine the category of “new or incremental” energy that is eligible for payment in the context of an EPA or for a financial incentive in the context of an LDA.<sup>221</sup>

99. When negotiating an appropriate GBL for an EPA or an LDA with a self-generating customer, BC Hydro and the customer review the best available information at

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<sup>216</sup> BC Hydro, Integrated Customer Solutions – Process & Proposal Submission Guide (Version 1.2 - May 2013), at 5, **R-312**.

<sup>217</sup> BC Hydro 2012 GBL Information Report at bates 04827, **R-177**.

<sup>218</sup> BCUC Resource Planning at 1, **R-277**.

<sup>219</sup> Lester Dyck Statement, ¶¶ 42-43.

<sup>220</sup> Lester Dyck Statement, ¶¶ 42-43; Jim Scouras Statement, ¶ 26.

<sup>221</sup> Lester Dyck Statement, ¶ 43; NERA, Export Report, ¶ 47 (“GBL [...] represents the dividing line between historical generation and incremental or new generation”).

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the time of the power procurement process, including the customer's historical self-generation output, energy consumption data, and information relating to the customer's unique manufacturing operations.<sup>222</sup> In doing so, "[t]he goal is to define the amount of annual self-generated energy normally used by the customer to self-supply under current conditions without the prospect of the currently negotiated EPA or LDA."<sup>223</sup> Assessing normal operations in the absence of the prospective incentive of the contract is meant to protect BC Hydro and its ratepayers from a customer "gaming the system" in advance of negotiations by, for example, lowering their generation levels for the purpose of setting a lower GBL.<sup>224</sup>

### C. British Columbia's Energy Policy Prior to the Claimant's Purchase of the Celgar Pulp Mill

#### 1. British Columbia's 1990 Energy Plan

##### a) Overview

100. Starting in 1960, with the creation of BC Hydro and the first large-scale hydroelectric projects, the long-term reliability of energy supplies has consistently been at the heart of British Columbia's energy policy.<sup>225</sup> During the 1980s, pursuant to B.C.'s

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<sup>222</sup> Lester Dyck Statement, ¶ 44-46 ("When setting a GBL, BC Hydro also accounts for any existing contractual obligations the customer may have that might affect its historical self-generation output [...] Alternatively, if an existing contract will end prior to the new EPA or LDA achieving its commercial operation date, BC Hydro and the customer must determine how the customer will operate, including how much self-generation it will produce, when the existing obligations end."). See *generally*, BC Hydro, Responses to Celgar Information Request No. 1.1.2.4, in the Matter of an Application by BC Hydro for Approval of Rates between BC Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, 14 August 2013, **R-291**; BC Hydro 2012 GBL Information Report, **R-177**.

<sup>223</sup> Lester Dyck Statement, ¶ 44. See, *generally*, BC Hydro, Compliance Letter to the BCUC re British Columbia Hydro and Power Authority (BC Hydro) Application to Amend Section 2.1 of Rate Schedule 3808 (RS 3808) Power Purchase Agreement (the Application) - BCUG Order No. G-48-09, 5 October 2009, CAN031085/bates 011858 – bates 011862 at 4; BC Hydro, Application to Amend TS74 at 2, **R-87**; BC Hydro 2012 GBL Information Report, **R-177**.

<sup>224</sup> Lester Dyck Statement, ¶ 44.

<sup>225</sup> BC Energy: New Directions for the 1990s at 16, **R-98**, ("Reliable supplies of energy must be guaranteed over the long term, and the development of British Columbia's energy resources must



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first Energy Plan, this concern was advanced through the continued construction of hydroelectric facilities.<sup>226</sup> The B.C. Government's dominant policy orientation thus involved "direct intervention in the energy sector" with emphasis on increasing BC Hydro-owned generation capacity.<sup>227</sup>

101. Released in 1990, B.C.'s second policy statement<sup>228</sup> shifted the focus away from such direct intervention in favor of greater private sector involvement in securing long-term supply.<sup>229</sup> In particular, the 1990 Energy Plan encouraged cogeneration by industrial customers to "reduc[e] the need for large new generating stations and long-distance transmission" from remote new hydroelectric dams.<sup>230</sup> Emphasis was also placed on pulp and paper producers,<sup>231</sup> with potential incentive initiatives by BC Hydro offering to "buy cogenerated electricity at prices approaching the cost of new utility resources."<sup>232</sup> Higher prices, i.e. "environmental premiums," were also contemplated as a prospective option for "electricity purchased from qualifying private power facilities that ease[d] local environmental problems."<sup>233</sup>

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be carefully managed.")

<sup>226</sup> 2002 Energy Plan at 11, **R-21**. British Columbia's first energy plan ("An Energy Secure British Columbia") was released in 1980 and coincided with the creation of the BCUC.

<sup>227</sup> 2002 Energy Plan at 11, **R-21**.

<sup>228</sup> 2002 Energy Plan at 11, **R-21**: "New Directions for the 1990s appeared in 1990, with two new priorities - efficient energy and clean energy; and two left over from the previous decade - secure energy and energy for the economy. The objectives of this policy were to make markets more competitive, send better price signals to consumers, encourage cleaner fuels and energy efficiency and strengthen environmental standards." [Emphasis Added] See Peter Ostergaard Statement, ¶ 19.

<sup>229</sup> BC Energy: New Directions for the 1990s at 16, **R-98**. ("The Government's encouragement and guidance will help the private sector become more involved in developing resources and supplying energy consumers during the 1990s.")

<sup>230</sup> BC Energy: New Directions for the 1990s at 16, **R-98**.

<sup>231</sup> BC Energy: New Directions for the 1990s at 16, **R-98**. ("Cogeneration is becoming increasingly attractive to pulp and paper producers, who can dispose of their wood waste at the same time."). See Peter Ostergaard Statement, ¶ 19.

<sup>232</sup> BC Energy: New Directions for the 1990s at 16, **R-98**.

<sup>233</sup> BC Energy: New Directions for the 1990s at 16, **R-98**.

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102. As a result, customers with self-generation facilities would be “able to save on their total energy bills and earn revenue by selling surplus power back to the electric utility.”<sup>234</sup> The 1990 Energy Plan also listed “load displacement” incentives as an emerging issue and possible initiative to be pursued by BC Hydro, allowing it “to postpone new generating capacity.”<sup>235</sup>

103. In the same policy statement, the Government’s increased concern for environmental matters resulted in policy actions refining the “Energy Project Review Process.”<sup>236</sup> In particular, the Government would intensify the environmental components of its review of energy projects, including private thermal power projects.<sup>237</sup>

104. Finally, the plan also called for the opening of the province’s power transmission network (i.e. “wheeling”) “to be supported through transmission rates and service conditions to be announced by the Government and BC Hydro.”<sup>238</sup> In that regard, BC Hydro, following parallel changes in the U.S.,<sup>239</sup> requested BCUC approval to provide wholesale transmission services in its service area (i.e. the OATT).<sup>240</sup> On

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<sup>234</sup> BC Energy: New Directions for the 1990s at 17, **R-98**. [Emphasis Added].

<sup>235</sup> BC Energy: New Directions for the 1990s at 22, **R-98**.

<sup>236</sup> BC Energy: New Directions for the 1990s at 11, **R-98**.

<sup>237</sup> BC Energy: New Directions for the 1990s at 11, **R-98** (“For example, [private thermal projects] will be required to meet emission standards based on the best pollution control technology that is commercially available. For every new energy facility, siting and project approval will depend on the capacity of the local environment to tolerate further environmental impacts.”)

<sup>238</sup> BC Energy: New Directions for the 1990s at 20, **R-98**. (“A draft policy has been filed with the [BCUC] to make BC Hydro’s transmission facilities available to outside suppliers.”)

<sup>239</sup> In 1995, the U.S. Federal Energy Regulatory Commission liberalized access to monopoly-owned transmission lines: United States Federal Energy Regulatory Commission, Order 888, 24 April 1996, **R-313**.

<sup>240</sup> On November 10, 1995, BC Hydro applied to the BCUC seeking approval for a proposed WTS Tariff. BCUC, Order G-67-96 and Decision, in the Matter of an Application by BC Hydro for Approval of Wholesale Transmission Services, 25 June 1996, at 1, **R-314**; On June 25, 1996, the Commission approved the WTS Tariff but required that modifications be brought to it for re-filing within a few months. It also determined that some of its elements required further analysis and directed BC Hydro to file a new WTS tariff application in early 1997. *Ibid*, at 1, 27, **R-314**; BC Hydro filed a new WTS application to the BCUC on 17 February 1997.

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April 23, 1998, the BCUC approved BC Hydro's request. It issued similar orders with respect to FortisBC's transmission system on March 10, 1999.<sup>241</sup> In the interim (between 1990 and 1998-1999), the continuing lack of open access to provincial transmission systems meant that customers with self-generation facilities were confined to interacting with their local utility.<sup>242</sup>

105. In this general policy context, the Ministry of Energy and BC Hydro respectively approved or concluded contractual arrangements effectively incentivizing self-generators to increase their generation of energy for self-supply (and thus displace their load).

**b) 1989 Generation Agreement between BC Hydro and Howe Sound**

106. BC Hydro's first attempt at incentivizing increased self-generation by a pulp and paper customer was its 1989 Generation Agreement with Howe Sound Pulp and Paper.<sup>243</sup> This agreement provided the pulp mill with an [REDACTED] interest free loan towards the construction of two new turbo generators and a power boiler in exchange for a commitment to displace [REDACTED] (*i.e.*, effectively an LDA).<sup>244</sup>

**c) BC Hydro's 1994 Request for Proposals**

107. Five years later, in December 1994, BC Hydro issued a Request for Proposals ("1994 RFP") for the supply of electricity to the BC Hydro integrated system "with a

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<sup>241</sup> See Dennis Swanson Statement, ¶ 36; and BCUC, Order G-27-99 and Decision, in the Matter of an Application by West Kootenay Power Ltd. for Approval of Access Principles, 10 March 1998, **R-219**; and BCUC, Order G-28-99 and Decision, in the Matter of an Application by West Kootenay Power Ltd. for Approval of Transmission Access, 10 March 1999, **R-220**.

<sup>242</sup> In certain circumstance, industrial self-generators might have their facilities located adjacent to another customer which, with BCUC approval, could lead them to directly supply another facility.

<sup>243</sup> See Witness Statement of Pierre Lamarche, dated August 19, 2014 ("Pierre Lamarche Statement"), ¶ 17. See also Generation Agreement between BC Hydro and Howe Sound Pulp and Paper Limited, 1 October 1989, ("HSPP 1989 Generation Agreement"), **R-64**.

<sup>244</sup> See Pierre Lamarche Statement, ¶¶ 17-18. [REDACTED].

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view to (i) acquiring electricity supplies at significantly lower prices, and (ii) committing to acquiring new resources in accordance with social cost price guidelines.”<sup>245</sup> Through the 1994 RFP, BC Hydro was seeking electricity from independently generated sources,<sup>246</sup> and received forty-eight bids before the competition deadline of March 15, 1995.<sup>247</sup>

**d) 1997 EPA between BC Hydro and Purcell Power**

108. Pursuant to the 1994 RFP, BC Hydro concluded an EPA with Purcell Power (now Tembec) on September 5, 1997 (the “1997 EPA”) to incentivize the proposed new generation capacity at the Skookumchuck mill.<sup>248</sup> While the EPA was signed in 1997, the planned generation investments were not complete until 2001 and thus the Commercial Operation Date (“COD”) of the EPA did not occur until September 2001.<sup>249</sup> BC Hydro also concluded an ESA with Tembec in 2001,<sup>250</sup> [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

<sup>251</sup>

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<sup>245</sup> BC Hydro, Board Resolution, Purcell Power Project Supplementary Agreement to a Key Principles of General Agreement, 1996, **R-185**.

<sup>246</sup> Letter from K.S. Lail to Art Hein, Re: 1994 RFP Purcell Power Project, 22 April 1996, **R-186**. See also Report of the Independent Power Producers Review Panel, 27 August 1996, (“Independent Power Producers Review Panel Report”) at 2, **R-187**: “The justification for the RFP was more the broadly-based identification and development of provincial economic opportunities than the narrowly-based satisfaction of power supply requirements for the BC Hydro system.”

<sup>247</sup> Of the bids, thirteen were biomass projects. The others were from gas, small hydro and geothermal projects: see Independent Power Producers Review Panel Report, at 2-3, **R-187**, for a timeline and overview of the RFP.

<sup>248</sup> Lester Dyck Statement, ¶ 94-99.

<sup>249</sup> Lester Dyck Statement, ¶ 97.

<sup>250</sup> Electricity Supply Agreement between BC Hydro and Tembec Industries Inc., 14 September 2001 (“BC Hydro – Tembec ESA”), **R-188**. See Appendix: “Determination of Electricity Supplied and Taken Under RS 1821/1880”.

<sup>251</sup> See Lester Dyck Statement, ¶ 98.

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**e) Minister's Order Exemption Celgar from provisions of the UCA**

109. Celgar also made a commitment to use its self-generation to meet its entire load. On May 23, 1991, under B.C.'s Energy Project Review Process, the Minister of Energy and the Minister of the Environment issued a Ministers' Order,<sup>252</sup> which exempted Celgar's installation and operation of a new turbine from certain provisions of the *UCA*. This exemption was subject to certain conditions;<sup>253</sup> including that Celgar construct and operate the turbine in accordance with its application for an energy project certificate. The application, supported by a sworn affidavit of a Celgar representative, contained statements that Celgar would be 100 % energy self-sufficient under normal operating conditions.<sup>254</sup>

**f) Minister's Order Exempting Powell River Energy Inc. from provisions of the UCA**

110. On January 30, 2001, the Minister of Employment and Investment issued Ministerial Order M-22-0101 which granted an exemption from Part 3 and Section 71 of the *UCA* to Powell River Energy Inc. ("PREI") subject to certain conditions.<sup>255</sup> PREI had applied for this exemption [REDACTED]

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<sup>252</sup> 1991 Ministers' Order, at 2, **R-100**.

<sup>253</sup> Witness Statement of Peter Ostergaard, ¶¶ 19-22.

<sup>254</sup> Celgar 1990 EPC Application, s. (b), **R-97**. See Peter Ostergaard Statement, ¶ 20.

<sup>255</sup> Minister's Order M-22-0101, **R-18**. The Minister of Employment and Investment also issued an Order, on August 2, 1998, pursuant to which it exempted from BCUC review, under s. 71 and part 3 of the *UCA*, all contracts for the sale of electricity to BC Hydro or Powerex entered into before March 31, 2000. Minister's Order No. M-22-9801, In the Matter of the Sale, Purchase or Production of a Power Service and an Exemption from the Provisions of Part 3 and s. 71 of the *Utilities Commission Act*, R.S.B.C. 1996, c. 437, as amended ("the Act"), 28 August 1998, CAN037449/bates. The Minister's Order was subsequently amended to cover all contracts entered into before September 30, 2001. Amending Order No. M-22-9801-A1, In the Matter of the Sale, Purchase or Production of a Power Service and an Exemption from the Provisions of Part 3 and s. 71 of the *Utilities Commission Act*, R.S.B.C. 1996, c. 437, as amended ("the Act"), March 30, 2000. The scope of the Minister's Order therefore covered the 1989 Generation Agreement between BC Hydro and Howe Sound Pulp and Paper, and the 1997 EPA between BC Hydro and Tembec, which were consonant with the energy policy directives implemented in the 1990 Energy Plan.

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[REDACTED].<sup>256</sup> This investment would be made in the context of a corporate restructuring, which would result in the partial sale of interests in self-generating (hydroelectric) assets that were normally relied on to produce electricity for the Powell River pulp mill.

111. Per Ministerial Order M-22-0101, PREI was required to first supply electricity to the Powell River pulp mill (which had to accept this electricity before taking service from BC Hydro).<sup>257</sup> Moreover, sales to third parties were restricted to surplus electricity (*i.e.*, electricity not needed in the ordinary course of the pulp mill's business).<sup>258</sup> In other words, PREI was required to meet the pulp mill's entire load and could only sell electricity in excess of the pulp mill's needs,<sup>259</sup> thus ensuring that the pulp mill's full load would be displaced by PREI supply.<sup>260</sup>

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<sup>256</sup> Minister's Order M-22-0101, **R-18**.

<sup>257</sup> Minister's Order M-22-0101, **R-18**. See also Les MacLaren Statement, ¶¶ 52-53.

<sup>258</sup> Minister's Order M-22-0101, at 1 and 3 **R-18**.

<sup>259</sup> Minister's Order M-22-0101, **R-18**.

<sup>260</sup> The application and interpretation of the Minister's Order M-22-0101 was the object of proceedings before the BCUC in 2001. Culminating in BCUC Order G-90-01, these proceedings related to the meaning of surplus generation in the context of PREI's hydro-generation activities and to the notion of "arbitrage" raised in the context of BCUC Order G-38-01 (discussed further below in Section II.E.2 below. See BCUC, Order G-90-01 and Decision, in the Matter of an Application by BC Hydro for Approval of a Market-Based Rate For Self-Generation Output Sold to Market Under the Provisions of Commission Order No. G-38-01, August 9, 2001, **R-287**. Mr. David Gandossi, the Claimant's current Chief Financial Officer ("CFO"), was involved in these proceedings. See e.g. BCUC, Letter to Maclaren Energy Inc. Re: British Columbia Hydro and Power Authority ("B.C. Hydro") Application (the "Application") for Approval of a Market-Based Rate for Self-Generation Output Sold to Market Under the Provisions of Commission Order No. G-38-01, June 21, 2001, **R-284**; and BC Hydro, Letter to the BCUC Re: British Columbia Hydro and Power Authority ("BC Hydro"), British Columbia Utilities Commission Order No. G-90-01, September 21, 2001, **R-286**.

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## 2. The Impact of the 2000 Western United States Energy Crisis

### a) Overview

112. In the early 2000s, a severe energy crisis hit the Western United States,<sup>261</sup> caused by a serious drought in California that diminished the State's reserves of hydroelectric power, and created a substantial imbalance between power supply and demand.<sup>262</sup> By the summer of 2000, electricity prices in that region's deregulated markets increased substantially,<sup>263</sup> which prompted a number of energy companies to attempt manipulating wholesale electric markets and furthered the escalation in energy prices.<sup>264</sup>

113. Around that time, self-generators in British Columbia sought to take advantage of the high electricity market prices prevailing during the western electricity crisis by attempting to sell some or all of their self-generation output at market prices.

### b) The Sale of Self-Generation and the Protection of BC Hydro Ratepayers against Arbitrage

114. As discussed above, Ministerial Order M-22-0101 signaled the B.C. Government's position against sales of hydroelectric self-generation that would have required a pulp mill to purchase replacement power from BC Hydro. This issue would arise again shortly thereafter when, In February 2001, Howe Sound approached BC Hydro to arrange to sell its self-generation at market prices.<sup>265</sup> BC Hydro expressed

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<sup>261</sup> For more information on the crisis, see *The Western Energy Crisis, the Enron Bankruptcy, and FERC's Response*, online: <<http://www.ferc.gov/industries/electric/indus-act/wec/chron/chronology.pdf>>.

<sup>262</sup> Federal Energy Regulatory Commission, Document entitled *Addressing the 2000–2001 Western Energy Crisis: Chronology at a Glance*, 28 April 2005, **R-307**.

<sup>263</sup> See *The Western Energy Crisis, the Enron Bankruptcy, and FERC's Response*, online: <<http://www.ferc.gov/industries/electric/indus-act/wec/chron/chronology.pdf>>.

<sup>264</sup> Federal Energy Regulatory Commission, Document entitled *Addressing the 2000–2001 Western Energy Crisis: Chronology at a Glance*, 28 April 2005, **R-307**.

<sup>265</sup> Letter from Craig Folkestad to Jerry Peet, Re: Howe Sound Pulp and Paper (HSPP) Power Export Opportunities, 12 February 2001 at 1, **R-79**; Pierre Lamarche Statement, ¶ 28; Jim Scouras Statement, ¶ 21.

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concerns that such transaction could result in an increase of its costs of service should Howe Sound purchase additional electricity so that it could sell its existing self-generation into the market.<sup>266</sup>

115. On February 23, 2001, BC Hydro wrote to the BCUC advising it that some of its customers with self-generation capability wished to sell power they generate at market prices. BC Hydro requested that the BCUC initiate a process beginning with a workshop to determine the extent to which BC Hydro would remain obligated to serve industrial customers who wished to take their self-generation output to the market.<sup>267</sup>

116. Howe Sound, which had significantly decreased its generation in response to peaking natural gas prices,<sup>268</sup> proposed “to utilize only that part of its generation capacity which [was] idle” and that “[a]ll of the generation utilized for market sales [would] be incremental and [would] not require BC Hydro to deliver any additional electricity to Howe Sound.”<sup>269</sup>

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<sup>266</sup> Letter from Craig Folkestad to Jerry Peet, Re: Howe Sound Pulp and Paper (HSPP) Power Export Opportunities, 12 February 2001 at 1, **R-79**. (“However, I would be less than candid if I did not tell you that the management of BC Hydro does, and most likely the government as its shareholder, will have serious concerns about any proposal that will see customer self-generated power sold into the market, and with BC Hydro then being required to supply make-up power under Schedule 1821. This will be financially detrimental to BC Hydro and its other ratepayers, both in the short and long term.”); BC Hydro, Letter to the BCUC, in the Matter of British Columbia Hydro and Power Authority Obligation to Serve Rate Schedule 1821 Customers with Self-Generation Capability, 23 February 2001 (“BC Hydro’s 23 February 2001 Letter to the BCUC”), **R-81**. See also Pierre Lamarche Statement, ¶¶ 28, 30 (“Howe Sound agreed with BC Hydro that such arbitrage could have a negative effect on BC Hydro ratepayers, but that self-generators should have the ability to sell incremental or idle self-generation”); Lester Dyck Statement, ¶ 36; Jim Scouras Statement, ¶ 21.

<sup>267</sup> BC Hydro’s 23 February 2001 Letter to the BCUC, **R-81**.

<sup>268</sup> See Pierre Lamarche Statement, ¶¶ 23-26. Howe Sound was, in fact, considering shutting down its condensing turbine completely: ¶ 26.

<sup>269</sup> Howe Sound Pulp and Paper, Letter to the BCUC, in the Matter of British Columbia Hydro and Power Authority Obligation to Serve Rate Schedule 1821 Customers with Self-Generation Capability, 27 February 2001 at bates 144039-144040, **R-80**.



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117. The BCUC held a workshop on March 19, 2001 involving a numbers of interested parties, which was followed by a written hearing.<sup>270</sup> The process ultimately led to BCUC Order G-38-01.<sup>271</sup>

118. On April 5, 2001, the BCUC determined that it must act to meet the complimentary objectives of creating conditions which allow BC Hydro to safeguard its own supply for British Columbians at a low cost, assisting B.C. industries with idle self-generation capability to capitalize on current market opportunities, and helping to mitigate the potential energy shortages in the Pacific Northwest and California.<sup>272</sup>

119. The BCUC issued Order G-38-01, directing BC Hydro “to allow Rate Schedule 1821 customers with idle self-generation capability to sell excess self-generated electricity, provided the self-generating customers do not arbitrage between embedded-cost utility service and market prices”.<sup>273</sup> Further, the BCUC clarified that BC Hydro was “not required to supply any increased embedded cost of service to a RS 1821 customer selling its self-generation output to market.”<sup>274</sup>

120. The BCUC stated that it expects BC Hydro “to make every effort to agree on a customer baseline, based either on the historical energy consumption of the customer or

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<sup>270</sup> The Commission Staff Report indicated that BC Hydro “identified Section 39 of the *Utilities Commission Act*... and Section 6(a) of the Electricity Supply Agreement which require B.C. Hydro to not unreasonably refuse the service requirement of customers” and “required the Commission to review the issues pertaining to obligation to serve under the jurisdiction of the Act”. The Report also stated that BC Hydro argued that its “obligation to serve must be defined so that B.C. Hydro is not required to supply any increased embedded cost service to a customer while that customer is selling its self-generation output to market”. BCUC, Order G-38-01, in the Matter of British Columbia Hydro and Power Authority Obligation to Serve Rate Schedule 1821 Customers with Self-Generation Capability, 5 April 2001, (“BCUC Order G-38-01”), Appendix A, Commission Staff Report at 1 and 3, **R-19**.

<sup>271</sup> BCUC Order G-38-01, **R-19**.

<sup>272</sup> BCUC Order G-38-01, Appendix A, at preamble ¶ F, **R-19**.

<sup>273</sup> BCUC Order G-38-01, at 2, **R-19**.

<sup>274</sup> BCUC Order G-38-01, at 2, **R-19**. [Emphasis Added]

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the historical output of the generator”<sup>275</sup> with any customer who wished to increase its electricity generation. The baseline was intended to ensure that the self-generator did not increase its consumption of BC Hydro-supplied electricity to enable it to pursue market sales of its self-generation. The BCUC’s determinations were based on the principles that incremental self-generation in excess of the historical output of the generator can help to mitigate regional gaps between supply and demand so long as there is no arbitrage between embedded cost utility service and market prices,<sup>276</sup> which would be detrimental to the rest of BC Hydro ratepayers.

121. Accordingly, BC Hydro and Howe Sound subsequently agreed that Howe Sound could sell its incremental energy above a negotiated baseline of [REDACTED].<sup>277</sup> The baseline and the arrangement are discussed in more detail in Section IV.C below.<sup>278</sup>

122. The BCUC determined that its directions to BC Hydro in Order G-38-01 should be maintained for one year until March 31, 2002, and further directed BC Hydro to file a report on the program by March 1, 2002.<sup>279</sup> On that date, BC Hydro submitted a report to the BCUC suggesting that, while market prices for electricity had decreased since the issuance of Order G-38-01, thus diminishing incentives for customer sales of self-generated electricity, the principle nonetheless remained that such customers should not arbitrage between low embedded cost rates of BC Hydro and market prices to the detriment of BC Hydro and its customers.<sup>280</sup> Upon review of BC Hydro’s report, the

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<sup>275</sup> BCUC Order G-38-01, at 2, **R-19**.

<sup>276</sup> BCUC Order G-38-01, at 2, **R-19**.

<sup>277</sup> Consent and Electricity Purchase and Sale Agreement between Howe Sound, Powerex and BC Hydro, 12 April 2001 (“Howe Sound 2001 Consent Agreement”), **R-85**.

<sup>278</sup> Howe Sound proposed to sell idle generation that was below its mill load. BC Hydro’s involvement was thus required to reconcile the applicable tariffs and agreements because any sales would rely on BC Hydro’s system resources. *See* Lester Dyck Statement, FN 27.

<sup>279</sup> BCUC Order G-38-01, at 2, **R-19**.

<sup>280</sup> *See* BC Hydro, Letter to the BCUC, Re: BC Hydro Obligation to Serve Rate Schedule 1821 Customers with Self-Generating Capabilities – Commission Order No. G-38-01, 1 March 2002, **R-319**.

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BCUC issued Order G-17-02 pursuant to which the rules established under Order G-38-01, aimed at facilitating incremental self-generation while preventing detrimental arbitrage by customers with self-generation capability, should remain in effect until the BCUC determines otherwise.<sup>281</sup>

**c) The Sale of Self-Generation and the Protection of FortisBC Ratepayers against Arbitrage**

123. A few months after the BCUC issued Order G-38-01, Tolko Industries Ltd. (“Tolko”), formerly Riverside Forest Products Ltd., made an application to the BCUC concerning its self-generating sawmill located in Kelowna.<sup>282</sup> Tolko was a customer of a municipal utility, the City of Kelowna, which was located in the FortisBC service area.<sup>283</sup>

124. In 1999, Tolko’s predecessor entered into discussions with the City of Kelowna and FortisBC, regarding Tolko’s plans to increase its mill’s generation capacity above its historical capacity of about 2 MW in order to export all self-generated electricity above 2 MW through agreements with energy marketers or external buyers.<sup>284</sup>

125. Tolko subsequently (i) added a second turbine generator to its mill, thus increasing its generation capacity,<sup>285</sup> (ii) entered into a Letter Agreement with the City of Kelowna for the sale of incremental power,<sup>286</sup> and (iii) applied to the BCUC for

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<sup>281</sup> BCUC, Order G-17-02 in the Matter of British Columbia Hydro and Power Authority Obligation to Serve Rate Schedule 1821 Customers with Self-Generation Capability, 14 March 2002, at 2, **R-256**.

<sup>282</sup> BCUC, Order G-113-01, in the Matter of an Application by Riverside Forest Products Limited for an Exemption from Certain Provisions of the Utilities Commission Act, November 1, 2001, (“BCUC Order G-113-01”), ¶ A, **R-20**.

<sup>283</sup> Dennis Swanson Statement, ¶91.

<sup>284</sup> Dennis Swanson Statement, ¶92; BCUC Order G-113-01 at 1, **R-20**.

<sup>285</sup> BCUC Order G-113-01 at 1, **R-20**.

<sup>286</sup> BCUC, Order G-198-11 and Decision, in the Matter of An Application by Tolko Industries Ltd. – Kelowna Decision for Reaffirmation of its Ability to Sell Power Generation in Excess of the First 2 MW of Generation in each hour as per Order G-113-01, 2 December 2011 (“BCUC Order G-198-11”), at 2, **R-257**.

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exemptions from certain provisions of the *UCA* in respect of the production, purchase and sale of this incremental self-generation (which had not historically been dedicated to serving its load).<sup>287</sup>

126. Upon deciding on Tolko's application, the BCUC, in Order G-113-01, applied the principles it had set out in Order G-38-01 to a self-generator in the City of Kelowna service area,<sup>288</sup> and found that:

the exclusion of the first 2 MW of generation each hour from the definition of Incremental Power and the relatively constant production level associated with the generators will protect WKP and its customers from arbitrage with respect to the initial 2 MW or other impacts. The Commission is satisfied that an Order exempting Riverside from certain sections of the Act subject to certain conditions properly conserves the public convenience and interest.<sup>289</sup>

127. As a result, Tolko was allowed to enter into export agreements for any generation above this 2 MW baseline. Proceeding with exports would in turn entail using an accounting arrangement with its utility to "deem" the sales.

### **3. British Columbia's 2002 Energy Plan**

#### **a) Overview**

128. At approximately the same time, in 2001, the newly-elected B.C. Government set up the B.C. Energy Policy Task Force to determine whether it should deregulate the province's electricity market. In particular, it considered the privatization of BC Hydro's assets, the implementation of market pricing and the separation of BC Hydro's generation, transmission and distribution functions.<sup>290</sup> However, after witnessing the

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<sup>287</sup> Dennis Swanson Statement, ¶92; BCUC Order G-113-01 at 1, **R-20**.

<sup>288</sup> At the time, the City of Kelowna municipal utility was a wholesale customer of FortisBC.

<sup>289</sup> BCUC Order G-113-01 at 1-2, **R-20**. [Emphasis added].

<sup>290</sup> Les MacLaren Statement, ¶ 66. This Task Force submitted its final report to the Minister of Energy on March 15, 2002, with 46 recommendations, including developing new energy supplies, making markets more competitive, reforming the electricity industry, ensuring sound

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unfolding U.S. energy crisis and resultant spike in electricity prices, the B.C. Government decided that it was not in the public interest to deregulate the sector.<sup>291</sup>

129. Instead, in November of 2002, the B.C. Government released the 2002 Energy Plan to ensure the following “cornerstones:” (i) low electricity prices and public ownership of BC Hydro; (ii) a secure, reliable supply of energy; (iii) more private sector opportunities; and (iv) environmental responsibility with a guarantee of no nuclear generation in B.C.<sup>292</sup>

130. The plan set the stage for a comprehensive policy framework for establishing a “heritage contract”, which would preserve the benefit of BC Hydro’s existing “heritage” generation assets.<sup>293</sup> In particular, the B.C. Government decided that the heritage contract would be implemented through legislation and would “lock in the value of existing low-cost generation assets for an extended period.”<sup>294</sup> It tasked the BCUC with conducting an inquiry and make recommendations for heritage energy.<sup>295</sup>

131. In 2003, following the BCUC’s recommendations, the B.C. Government enacted the *BC Hydro Public Power Legacy and Heritage Contract Act*<sup>296</sup> and *Heritage Special Direction No. HC2*.<sup>297</sup> These measures prohibited the sale of BC Hydro’s generation

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environmental decisions and harmonizing government regulations (British Columbia Ministry of Energy, Mines and Petroleum Resources, *Energy for our Future: A Plan for BC*, 2002, p. 12).

<sup>291</sup> Les MacLaren Statement, ¶ 68 (“California [...] saw significant market volatility and high prices following market restructuring and deregulation”).

<sup>292</sup> 2002 Energy Plan at 3, **R-21**.

<sup>293</sup> 2002 Energy Plan at 26, **R-21**.

<sup>294</sup> 2002 Energy Plan, Policy Action No. 1, at 26, **R-21**.

<sup>295</sup> 2002 Energy Plan, Policy Action No. 1, at 26, **R-21**; Les MacLaren Statement, ¶70.

<sup>296</sup> BC Hydro Public Power Legacy and Heritage Contract Act, S.B.C. 2003, c.86, **LMA-12**.

<sup>297</sup> *Heritage Special Direction No. HC2 to the British Columbia Utilities Commission*, B.C. Reg. 158/2005, O.C. 1123/2003, (*HC2*), **LMA-13**. *HC2* requires the BCUC to treat the “Heritage Contract” as if it were a contract between BC Hydro’s distribution and generation lines of business. The terms and conditions of the Heritage Contract can now be found in Appendix A to *Direction No. 7 to the British Columbia Utilities Commission*, B.C. Reg. 28/2014, (“*Direction No. 7*”), **LMA-9**.

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assets<sup>298</sup> and ensured that the benefits of low cost generation from BC Hydro's historic assets (i.e. generation from BC Hydro hydroelectric system and storage reservoirs built in the 1960s, 1970s and 1980s) continue to flow to its ratepayers. They also provided direction to the BCUC concerning the rate setting for BC Hydro,<sup>299</sup> BC Hydro's rate of return on deemed equity<sup>300</sup> and the design of stepped rates of industrial transmission voltage customers, thus providing better price signals to large electricity consumers for conservation and energy efficiency.<sup>301</sup>

132. In addition to the continued public ownership of BC Hydro and the return of BC Hydro's formerly frozen rates into the purview of the BCUC, the 2002 Energy Plan signaled a turn toward clean energy,<sup>302</sup> generated domestically by the private sector,<sup>303</sup> and supplied to BC Hydro on a least-cost basis.<sup>304</sup> In the aftermath of the Energy Crisis, the B.C. Government's objective was to prevent over-reliance on volatile market

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<sup>298</sup> The prohibition in BC Hydro *Public Power Legacy and Heritage Contract Act* was repealed and reacted in the CEA. See *Clean Energy Act*, s. 14, **R-154**.

<sup>299</sup> *Direction No. 7* to the British Columbia Utilities Commission, B.C. Reg. 28/2014, ("*Direction No. 7*"), s.5, **LMA-9**.

<sup>300</sup> *Direction No. 7* to the British Columbia Utilities Commission, B.C. Reg. 28/2014, ("*Direction No. 7*"), s.4, **LMA-9**.

<sup>301</sup> *Direction No. 7* to the British Columbia Utilities Commission, B.C. Reg. 28/2014, ("*Direction No. 7*"), s.3, **LMA-9**.

<sup>302</sup> 2002 Energy Plan at 31, **R-21**. ("BC Clean electricity refers to alternative energy technologies that result in a net environmental improvement relative to existing energy production, [such as] biomass energy, as well as cogeneration of heat and power, [allowing] for the development of a diverse range of cost-effective and environmentally responsible resources across the province.")

<sup>303</sup> BC Hydro, 2004 Integrated Electricity Plan, March 31, 2004, p. 28 (Part 1: Introduction and Planning Objectives), **R-295**: "Provincial energy policy direction with respect to development of private sector generation accords with BC Hydro's current energy management approach of acquiring domestic long-term fixed-price contracts to meet domestic demand, rather than relying on non-firm imports".

<sup>304</sup> The 2002 Plan provided for the acquisition of new electricity supply by BC Hydro and FortisBC on a least-cost basis, with strengthened regulatory oversight of utility resource planning by the BCUC. As a result, the *UCA* was amended in 2003 to provide the BCUC with a mandate to implement the policy actions of the 2002 Energy Plan. Specifically, "[a]mendments to Section 45 of the *UCA* [now s.44.1 & 44.2] expand upon and clarify the planning requirements of utilities and the Commission's role to review filed plans to determine whether expenditures are in the public interest and whether associated rate changes are necessary and appropriate" (BCUC Resource Planning, p. 1, **R-277**).

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imports,<sup>305</sup> while furthering its comprehensive climate change plan addressing issues of environmental responsibility, including for the energy sector.<sup>306</sup> In that regard, the 2002 Energy Plan was issued when provincial electricity demand had just outstripped its domestic supply, forcing B.C. to become a net importer of electricity, despite its generous hydroelectric resources.<sup>307</sup>

**b) BC Hydro's Customer-Based Generation Call for Power**

133. In this context, BC Hydro sought proposals from the private sector, most notably from clean energy IPPs, to supply it with long-term power. BC Hydro also endeavored to incentivize increased electricity output from its customers with self-generation. With these goals in mind, on September 2, 2002, BC Hydro issued the Customer-Based Generation Call for Power – effectively a Call for Tenders.<sup>308</sup> As explained by BC Hydro's Jim Scouras, “[t]he purpose of the call was to obtain new, competitively-priced electricity under long-term agreements from non-utility generation to meet BC Hydro's future demand.”<sup>309</sup>

134. BC Hydro explained in its Call For Tender documentation that “[t]he proposed electricity supply must be incremental – that is electricity from new generation facilities or from an increase in the capacity of, or energy from, existing facilities resulting from capital modifications (other than normal capital maintenance programs).”<sup>310</sup> BC Hydro further made the acquisition of self-generation from customers in this call contingent on

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<sup>305</sup> 2002 Energy Plan at 6, 18, 19, **R-21**.

<sup>306</sup> 2002 Energy Plan at 33, **R-21**.

<sup>307</sup> BC Hydro, “Challenges and choices - Planning for a secure electricity future”, March 2006, p. 3, **R-290**: “While in the past, we have enjoyed significant surpluses of generating capability in the province, BC is now a net importer of electricity. BC Hydro has imported electricity from neighbouring jurisdictions in each of the last five years; 1,700 gigawatt-hours (GWh) in 2001, 5,200 in 2002, 1,700 in 2003, 5,100 in 2004, and 7,400 in 2005.”

<sup>308</sup> Jim Scouras Statement, ¶ 27.

<sup>309</sup> Jim Scouras Statement, ¶ 27.

<sup>310</sup> BC Hydro, Customer-Based Generation, 2002 Call for Tenders, September 6, 2002 (“2002 CBG Call for Tenders”), at 15, **R-109**.

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the customer agreeing to a baseline that was representative of its historical self-generation, which BC Hydro referred to as a “generator baseline” or GBL:<sup>311</sup>

[w]here the bidder's project involves an increase in the capacity of, or energy from, existing facilities resulting from capital modifications, it is necessary to determine the generator's historic generation capability. The historic generation capability is referred to in the Standard EPA as the Generator Baseline or “GBL”. For purposes of determining electricity eligible for sale to BC Hydro, the GBL will be deducted from the metered electricity.<sup>312</sup>

135. BC Hydro's guidelines requested contenders to submit a “GBL Application,” including their existing generation (nameplate) capacity, along with the “historical operating data for each electric generator [...] for a minimum of 3 years that represent long-term normal operating conditions.”<sup>313</sup> Based on such data, BC Hydro, in accordance with G-38-01, set GBLs with proponents based on “the annual self-generation normally used by the customer to supply its load under prevailing conditions and absent the existence of an energy supply contract that might distort the customer's normal operations.”<sup>314</sup>

136. Ultimately, the 2002 Customer-Based Generation call only resulted in three EPAs, none of which dealt with incremental self-generation.<sup>315</sup> Its relative lack of success can be traced in part to the energy and fuel price risks faced by bidders.<sup>316</sup>

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<sup>311</sup> Customer Based Generation – Overview, at bates 022486, **R-321**; BC Hydro, Energy Opportunities for Customers, Suppliers and Communities – Presentation by Bev Van Ruyven, 31 January 2004, at bates 069439, **R-298**.

<sup>312</sup> 2002 CBG Call for Tenders at 12 (emphasis in the original), **R-109**; *See also*, 2002 Call for Tenders, **R-109**.

<sup>313</sup> 2002 CBG Call for Tenders at 12 - 13, **R-109**.

<sup>314</sup> Jim Scouras Statement, ¶ 29.

<sup>315</sup> Jim Scouras Statement, ¶ 31.

<sup>316</sup> Jim Scouras Statement, ¶ 32.



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## D. British Columbia Energy Policy Following the Claimant's Purchase of the Celgar Pulp Mill

### 1. British Columbia's 2007 Energy Plan and 2008 Bioenergy Strategy

#### a) Overview

137. British Columbia's 2007 Energy Plan<sup>317</sup> and its resulting 2008 Bioenergy Strategy<sup>318</sup> reflected the B.C. Government's interest in addressing climate change through clean and renewable energy, and in making the province energy self-sufficient, while, at the same time, addressing the impacts of the mountain pine-beetle epidemic that was ravaging certain areas of the province's forests.<sup>319</sup>

138. Although there were numerous policy actions in the 2007 Energy Plan,<sup>320</sup> including renewed emphasis on clean energy and low-rates, the commitment that BC Hydro would achieve self-sufficiency by 2016 was of particular significance.<sup>321</sup> The self-sufficiency policy was ambitious and meant that BC Hydro would have to acquire a significant amount of energy from the private sector, and possibly build new generation, to ensure adequate electricity supply. The self-sufficiency requirement thus opened up opportunities for the private sector to sell clean and renewable energy to BC Hydro.

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<sup>317</sup> British Columbia Ministry of Energy, Mines and Petroleum Resources, *The BC Energy Plan: A Vision for Clean Energy Leadership*, February 2007, ("2007 Energy Plan"), **R-23**.

<sup>318</sup> 2008 Bioenergy Strategy, **R-24**. BC Hydro, *Bioenergy Call for Power – Phase I, Request for Proposals*, 6 February 2008 ("Bioenergy Phase I – RFP"), **R-25**.

<sup>319</sup> Les MacLaren, Statement, ¶¶ 76-77.

<sup>320</sup> The 2007 Energy Plan also contained commitments to: (1) extend the Heritage Contract in perpetuity to ensure ratepayers continue to receive the benefits of low-cost electricity; (2) ensure clean or renewable electricity generation continued to account for at least 90 % of total generation; (3) encourage utilities to pursue cost effective and competitive DSM opportunities; and (4) set a target for BC Hydro to acquire 50 % of its incremental resource needs through conservation by 2020. See 2007 Energy Plan at 39, **R-23**.

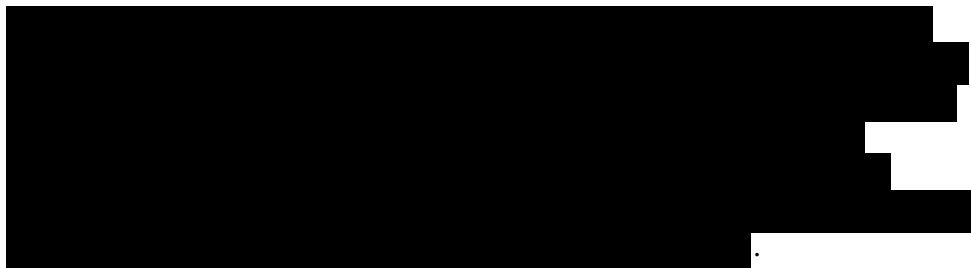
<sup>321</sup> 2007 Energy Plan at 39, **R-23**. See Jim Scouras Statement, ¶ 34.

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139. To work toward this objective, the 2007 Energy Plan directed BC Hydro to issue a Request for Expressions of Interest (“RFEOI”), followed by a Call for Proposals, for electricity from sawmill residues, logging debris and beetle-killed timber.<sup>322</sup>

140. BC Hydro issued the RFEOI in March 2007 to assess and identify potential bioenergy projects and proponents for using residual wood, including sawmill residue, logging debris and beetle-killed timber for power production.<sup>323</sup> BC Hydro received more than 80 submissions in response. It subsequently held information sessions with officials from the Ministry of Energy, the Ministry of Forests and Range and the proponents to provide more information on a potential Bioenergy Call.<sup>324</sup>

141. In the course of these information sessions, Catalyst Paper approached BC Hydro and the Ministry of Energy to propose that self-generators be permitted to sell all of their electricity to BC Hydro (*i.e.*, including electricity that these self-generators had historically consumed). The Ministry of Energy subsequently advised that the acquisition of electricity from self-generators would have to:



142. The Ministry of Energy recommended that only new or incremental self-generated electricity should be eligible under the Call for Power as this would add to

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<sup>322</sup> 2007 Energy Plan at 17, **R-23**. See Jim Scouras Statement, ¶ 36.

<sup>323</sup> Celgar, 2007 Bioenergy RFEOI Form, April 2007, (“2007 Bioenergy RFEOI Form”), **R-111**.

<sup>324</sup> A summary of the meeting can be found on BC Hydro’s website. BC Hydro, Meeting with Stakeholders on the Bioenergy Call, August 22, 2007 – Vancouver, B.C., **R-112**.

<sup>325</sup> British Columbia Ministry of Energy, Mines, and Petroleum Resources, Discussion Paper, BC’s Self Generator Sales Policy, 18 September 2007, **R-26**. (emphasis added)

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B.C.'s electricity resource supply in accordance with the objectives of the 2007 Energy Plan.<sup>326</sup>

143. On January 31, 2008, following the RFEOI and the information sessions, the Ministry of Energy and the Ministry of Forests and Range released the 2008 Bioenergy Strategy which directed BC Hydro to proceed with a two-part Bioenergy Call for Power in early 2008.<sup>327</sup>

**b) BC Hydro's Bioenergy Call for Power Phase 1**

144. On February 6, 2008, BC Hydro issued its Request for Proposals ("RFP") for the Bioenergy Call for Power Phase I with the aim of procuring approximately 1,000 GWh/year of electricity.<sup>328</sup> BC Hydro developed parameters for the Bioenergy Call in consultation with the Ministry of Energy, the Ministry of Forests and the RFEOI proponents, including the requirement that projects could be for new generation or for incremental generation from new generating units or from existing generation plants.<sup>329</sup>

145. BC Hydro required proponents submitting proposals for "incremental self-generation" (e.g., self-generating pulp mills that intended to generate additional electricity) to provide information to establish their GBL before submitting a formal RFP.<sup>330</sup> In particular, it requested information concerning their self-generation facilities, the proposed generation project, their existing contracts for the sale of self-generated electricity or for load displacement, and an estimated annual GBL. Overall, the conditions for setting GBLs under the RFP were similar to those used under the 2002

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<sup>326</sup> Les MacLaren Statement, ¶ 86.

<sup>327</sup> 2008 Bioenergy Strategy at 8, **R-24**. See also British Columbia Office of the Premier, Ministry of Energy, Mines and Petroleum Resources, Ministry of Forests and Range, New Bioenergy Strategy: A Natural Energy Advantage, Backgrounder, 31 January 2008, 2008OTP0017-000129, **R-288**.

<sup>328</sup> Bioenergy Phase I – RFP, **R-25**.

<sup>329</sup> Jim Scouras Statement, ¶¶ 37-38.

<sup>330</sup> Bioenergy Phase I – RFP, s. 13, **R-25**.

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Customer-Based Generation call as they were both informed by the same requirement: to identify the proponent's historical self-generation level under normal operating circumstances ensuring that only incremental (rather than existing) electricity is procured.<sup>331</sup>

146. After reviewing the information provided by the relevant proponents, BC Hydro notified them of its preliminary GBL determination on May 2, 2008. Proponents then had an opportunity to ask questions and to challenge the preliminary determination.<sup>332</sup>

147. On June 10, 2008, the proponents submitted 20 proposals in response to the RFP.<sup>333</sup> BC Hydro assessed these proposals in accordance with pre-established proposal handling and evaluation procedures,<sup>334</sup> and conducted an assessment to determine the development and delivery risks associated with each project. BC Hydro requested additional information from several proponents over the course of the next few months. It subsequently commenced EPA and price negotiations with respect to six projects.

148. On December 8, 2008, BC Hydro announced that it had selected four successful projects which would contribute 579 GWh/year of electricity – the PG Interior Waste to Energy project (*i.e.*, a greenfield biomass project), the Canfor Prince George pulp mill, the Domtar Kamloops pulp mill and Celgar. BC Hydro filed the EPAs together with a detailed report on the Bioenergy Call Phase I process with the BCUC on February 17,

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<sup>331</sup> Jim Scouras Statement, ¶ 45.

<sup>332</sup> BC Hydro, Report on the Bioenergy Call Phase I Request for Proposals and Application by BC Hydro For Acceptance of Electricity Purchase Agreements – Bioenergy Call Phase I Request for Proposals, 17 February 2009, at 150615, (“BC Hydro Report on Bioenergy Phase I - RFP”) **R-170**. See also BC Hydro, Draft letter RE: Bioenergy Call (Phase I) – GBL, at 1, **R-294**. The draft GBL transmittal letter indicated that the GBL [REDACTED]

<sup>333</sup> Lester Dyck Statement, ¶ 53.

<sup>334</sup> Information concerning the call's objectives and rules, along with the process for the selection of bidders was communicated in detail to the proponents, in the Request for Proposal and during information sessions held by BC Hydro. See Jim Scouras Statement, ¶ 42. See also Bioenergy Phase I – RFP, **R-25**.

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2009.<sup>335</sup> Upon review, the BCUC determined that these EPAs were in the public interest on August 4, 2009.<sup>336</sup>

**c) BC Hydro's Bilateral Agreement Related to the Bioenergy Call for Power Phase 1**

149. After the Bioenergy Call for Power Phase I, BC Hydro entered into bilateral negotiations with Tembec (Skookumchuck) and Tolko (Armstrong) in 2009 in an attempt to conclude EPAs with these self-generating customers. BC Hydro often relies on bilateral negotiations outside of the context of a competitive procurement process to acquire energy in circumstances such as opportunities associated with projects that are already contracted to BC Hydro or the renewal of existing EPAs which are soon to expire.<sup>337</sup> BC Hydro has used bilateral negotiations to conclude 11 EPAs since 2007.<sup>338</sup>

150. BC Hydro will typically consider a number of price benchmarks in the context of bilateral negotiations to ensure cost-effectiveness such as prices paid in recent calls for power. Moreover, to ensure that the transaction is fair and balanced, the negotiations will generally on an "open book" basis. The proponent will be required to provide BC Hydro with a sufficiently detailed financial model, along with supporting information and documentation requested by BC Hydro, to support the validity and reasonableness of key price and cost assumptions. These bilateral EPAs must also be filed with the BCUC for approval.

151. In this instance, BC Hydro commenced bilateral EPA negotiations with Tembec as the financial crisis worsened in early 2009. [REDACTED]

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<sup>335</sup> BC Hydro Report on Bioenergy Phase I - RFP, **R-170**.

<sup>336</sup> BCUC, Order E-8-09, in the Matter of an Application by BC Hydro for Acceptance of Electricity Purchase Agreements – Bioenergy Call Phase I Request for Proposals, 31 July 2009, **R-308**.

<sup>337</sup> BC Hydro Overview of Energy Procurement Practices, **R-107**.

<sup>338</sup> Jim Scouras Statement, ¶ 74.

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[REDACTED].<sup>339</sup> In March 2009, it temporarily shut down the pulp mill [REDACTED].  
[REDACTED].<sup>340</sup> It also indicated that it intended to terminate the 1997 EPA in September 2011, as entitled to do so under the agreement.<sup>341</sup>

152. Tembec's decision to idle its self-generation would significantly increase the amount of electricity the pulp mill would require from BC Hydro. BC Hydro viewed a bilateral EPA as an opportunity to contract additional long-term clean and renewable energy for a cost-effective fixed price, and ensure that Tembec was committed to serving part of its on-site industrial load with self-generation.<sup>342</sup>

153. BC Hydro used the Bioenergy Call for Power Phase I EPA as a precedent for the 2009 EPA it negotiated with Tembec. BC Hydro filed the 2009 EPA with the BCUC for approval on September 24, 2009,<sup>343</sup> which it would receive on November 13, 2009.<sup>344</sup> The 2009 EPA is discussed in greater detail in Section IV.C.3 below.

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<sup>339</sup> Lester Dyck Statement, ¶ 101.

<sup>340</sup> Lester Dyck Statement, ¶ 101. *See also* Inter-office Memo from David G. Keir to Lester Dyck, Frank Lin, Sylvia von Minden, CBL Governance Team Re: Tembec Skookumchuck Pulp Operations - CBL/GBL/EPA Analysis, 8 April 2009 ("BC Hydro Memo, Re: Tembec Skookumchuck Pulp"), at 3, **R-189**.

<sup>341</sup> Lester Dyck Statement, ¶ 101.

<sup>342</sup> Lester Dyck Statement, ¶ 103.

<sup>343</sup> *See* BC Hydro, Justification Report on the Tembec EPA Replacement for Incremental Energy Sales from Purcell Power Plant, in the Matter of A Filing by British Columbia Hydro and Power Authority For Acceptance of an Electricity Purchase Agreement (Tembec EPA), 28 October 2009 ("Tembec Justification Report"), **R-192**.

<sup>344</sup> BCUC, Order E-16-09, in the Matter of a Filing by BC Hydro for Acceptance of an Electricity Purchase Agreement, 13 November 2009, **R-325**.

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## 2. The Government of Canada's Pulp and Paper Green Transformation Program ("PPGTP")

### a) Overview

154. On June 17, 2009, the Government of Canada announced the Pulp and Paper Green Transformation Program (PPGTP) to provide C\$1 billion in funds to pulp mills for innovation and investment in areas such as energy efficiency and renewable energy production.<sup>345</sup> The impetus for the PPGTP was the U.S. Black Liquor Subsidy program which had provided similar subsidies to U.S. pulp mills.<sup>346</sup>

155. The PPGTP offered pulp mills a credit of 16 cents for each litre of black liquor these mills produced in 2009. Pulp mills could then invest these credits in energy efficiency, renewable energy, or environmental projects.<sup>347</sup> These projects included investments in boilers, turbines, energy efficient motors or even emissions control equipment.<sup>348</sup>

156. Natural Resources Canada ultimately provided 24 pulp mills and 98 projects with credits for black liquor production.<sup>349</sup> These pulp mills included 9 recipients in British Columbia. The Claimant's Celgar pulp mill as one of these recipients received credits for C\$ 57.7 million as described in more detail in Section II.E.6 below.<sup>350</sup>

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<sup>345</sup> Jim Scouras Statement, ¶ 66.

<sup>346</sup> See Claimant's Memorial, ¶ 313; Brian Merwin Witness Statement, dated March 28, 2014 ("Merwin Witness Statement"), ¶ 113; David Gandossi Witness Statement, dated March 28, 2014 ("Gandossi Witness Statement"), ¶¶ 48-51.

<sup>347</sup> Natural Resources Canada, "Pulp and Paper Green Transformation Program: Mission accomplished", 3 March 2014 ("PPGT: Mission Accomplished"), **R-60**. See also Natural Resources Canada, "Government of Canada Supporting Credits for Pulp and Paper Producers", **R-50**.

<sup>348</sup> PPGT: Mission Accomplished, **R-60**.

<sup>349</sup> *Ibid.*, **R-60**. For more information, see the Pulp and Paper Green Transformation Program Report on Results, September 2012, online: <<http://cfs.nrcan.gc.ca/pubwarehouse/pdfs/34045.pdf>>.

<sup>350</sup> Celgar Green Energy Project, Final Report, 17 June 2011, ("GEP Final Report") at 21, **R-55**; Claimant's Memorial, ¶ 313; Merwin Witness Statement, ¶ 113; Gandossi Witness Statement, ¶¶

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**b) BC Hydro's Integrated Power Offer**

157. After learning of the details of the PPGTP, BC Hydro reached out to self-generating pulp mills that were customers to encourage the use of PPGTP funds to increase their level of self-generation or to increase their energy efficiency. To facilitate this objective, BC Hydro launched the Integrated Power Offer ("IPO") in August 2009 to assist these pulp mills<sup>351</sup> in securing PPGTP funding. The IPO was intended to encourage projects that would provide cost effective energy to BC Hydro ratepayers as well as economic and environmental benefits to B.C.'s pulp and paper industry.<sup>352</sup>

158. BC Hydro subsequently signed letters of intent in late 2009 with pulp mills that had identified short and long term opportunities for self-generation and DSM projects.<sup>353</sup> These letters explained that, subject to completing successful negotiations, BC Hydro was prepared to enter into an agreement for energy "at a price and on terms and conditions generally consistent with the Bioenergy Call for Power Phase 1 awards", which had been approved by the BCUC.<sup>354</sup> These letters of intent also stipulated that

[REDACTED]

[REDACTED].<sup>355</sup>

159. In October 2009, BC Hydro provided the eligible customers with term sheets, project submission guidelines, and draft agreements.<sup>356</sup> [REDACTED]

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48-51.

<sup>351</sup> Because the IPO was limited to BC Hydro's PowerSmart customers, Celgar was not eligible for the Offer.

<sup>352</sup> BC Hydro, Integrated Power Offer for Pulp & Paper Customers, **R-56**. See also Jim Scouras Statement, ¶ 66.

<sup>353</sup> BC Hydro, Integrated Power Offer Letter of Intent Template ("BC Hydro's IPO Template LOI") at 1, **R-145**.

<sup>354</sup> *Ibid.* at 2, **R-145**.

<sup>355</sup> BC Hydro's IPO Template LOI at 2, **R-145**.

<sup>356</sup> Eligible IPO candidates were required to sign a Confidentiality Agreement with BC Hydro concerning both the terms of the agreements and their negotiations. BC Hydro, Integrated Power Offer Specimen Confidentiality Agreement, **R-144**. See also Jim Scouras Statement, ¶ 68.



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[REDACTED]

[REDACTED]

[REDACTED]<sup>357</sup>

160. From 2009-2013, BC Hydro conducted negotiations with pulp mills participating in the IPO. It also simultaneously engaged in due diligence and risk assessment exercises that covered issues such a fuel supply, permit requirements, environmental impact, and financial capability.<sup>358</sup> These negotiations yielded six EPAs and DSM agreements one of which was the 2010 EPA with the Howe Sound pulp mill which is examined in more detail in Section IV.C.4 below.<sup>359</sup>

161. The B.C. Government subsequently decided to exempt BC Hydro and its counter-parties from the requirement to file the IPO agreements with the BCUC through the *CEA*<sup>360</sup> as it was concerned that the delay associated with BCUC review proceedings could result in lost PPGTP funding.<sup>361</sup>

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<sup>357</sup> BC Hydro Integrated Power Offer, Electricity Purchase Agreement – Summary of Key Terms, at 1 and 3, **R-153**.

<sup>358</sup> See Jim Scouras Statement, ¶ 70.

<sup>359</sup> [REDACTED] BC Hydro, Briefing Note Re: Update on the Integrated Power Offer for Customers Eligible for Pulp & Paper Green Transformation Program Funding, 16 September 2009, at bates 163386, **R-143**.

<sup>360</sup> *Clean Energy Act*, **R-154**.

S.7(1) provides that the “authority is exempt from sections 45 to 47 and 71 of the *Utilities Commission Act* to the extent applicable, and from any other sections of that Act that the minister may specify by regulation, with respect to the following projects, programs, contracts and expenditures of the authority, as they may be further described by regulation:

...

(f) one or more agreements with pulp and paper customers eligible for funding under Canada's Green Transformation Program under which agreement or agreements the authority acquires, in aggregate, up to 1 200 gigawatt hours per year of electricity.” The exemption clause was used to ensure that eligible PPGTP recipients in BC would meet the deadlines set up by that Program.

<sup>361</sup> Les MacLaren Statement, ¶ 117.

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### 3. BC Hydro's Generator Baseline Information Report

162. On November 27, 2009, the BCUC wrote to BC Hydro to request that it "...develop guidelines for the establishment of GBLs" in order to assist it with the efficient review of GBL determinations.<sup>362</sup> This request also included a list of twenty questions that BC Hydro was to address in its proposed guidelines. BC Hydro was directed to file the proposed GBL guidelines with its next major EPA filing involving GBLs, or its next Long-Term Acquisition Plan.<sup>363</sup>

163. On July 27, 2011, BC Hydro wrote to the BCUC to explain that it had not filed its proposed GBL Guidelines as it had not had a major EPA or Long-Term Acquisition Plan filing since it had received the request of the BCUC.<sup>364</sup> BC Hydro agreed, however, that it would be helpful to file its guidelines for the determination of GBLs. To that end, BC Hydro indicated that it intended to file new tariff documents reflecting its established business practices for transmission service rate customers with self-generation facilities,<sup>365</sup> and that it would submit an information report that included the principles of GBL establishment, GBL establishment considerations for EPA customers, and a response to the BCUC's twenty questions.<sup>366</sup>

164. BC Hydro filed its GBL Information Report, reflecting its established business practices, on June 20, 2012.<sup>367</sup> In it, BC Hydro describes the economic and policy context of self-generation and GBLs, the role of the GBL in preventing arbitrage, and the

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<sup>362</sup> BCUC, Letter L-106-09 to BC Hydro, Re: BC Hydro Electricity Purchase Agreements - Generator Baselines, 27 November 2009, at bates 020477, **R-202**.

<sup>363</sup> *Ibid.*, **R-202**.

<sup>364</sup> BC Hydro, Letter to BCUC, Re: BCUC, BC Hydro Generator Baseline Guidelines, 27 July 2011, at bates 020464, **R-203**. The *Clean Energy Act*, s. 7, **R-154**, was passed on June 3, 2010.

<sup>365</sup> *Ibid.*, at bates 020466, **R-203**.

<sup>366</sup> *Ibid.*, **R-203**. BC Hydro conducted several consultation sessions with respect to these tariff submissions, including five regional sessions held during October 2010 and two half-day workshops during November and December 2010 that specifically related to the establishment of GBLs for the purposes of deliveries to BC Hydro under an EPA.

<sup>367</sup> BC Hydro 2012 GBL Information Report, **R-177**.

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difference between contracted and non-contracted GBLs. The GBL Information Report highlights the two key advantages of GBLs, from BC Hydro's perspective. First, GBLs appropriately mitigate arbitrage risks by providing a benchmark against which to measure historical consumption and generation levels.<sup>368</sup> Second, GBLs enable EPA and LDA contract mechanisms "to send price signals that encourage customers to efficiently operate, and make prudent investments in, their self-generation assets."<sup>369</sup>

165. BC Hydro also indicated in the Information Report that it did not follow a "one-size fits all" formulaic approach to GBL determinations. Instead, it emphasized that each self-generator will have unique operating circumstances that must be taken into account in order to "enable BC Hydro to mitigate economic barriers to incremental generation output while protecting BC Hydro and its customers against the risk of arbitrage."<sup>370</sup> The Information Report includes a series of illustrative examples of the types of considerations BC Hydro has taken into account when determining a contracted GBL for a customer including:

- the relationship between the customer's industrial production process and its self-generation (*e.g.* between pulp production operations and electricity generation);
- the thermal balance requirements of the industrial plant; and
- the customer's historical sales of electricity to BC Hydro or others.<sup>371</sup>

166. It was considerations such as these according to Lester Dyck which influenced the establishment of the GBLs in the EPAs concluded in each of the procurement processes described in sections B and C above.<sup>372</sup>

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<sup>368</sup> *Ibid.*, **R-177**.

<sup>369</sup> *Ibid.* at 19, **R-177**.

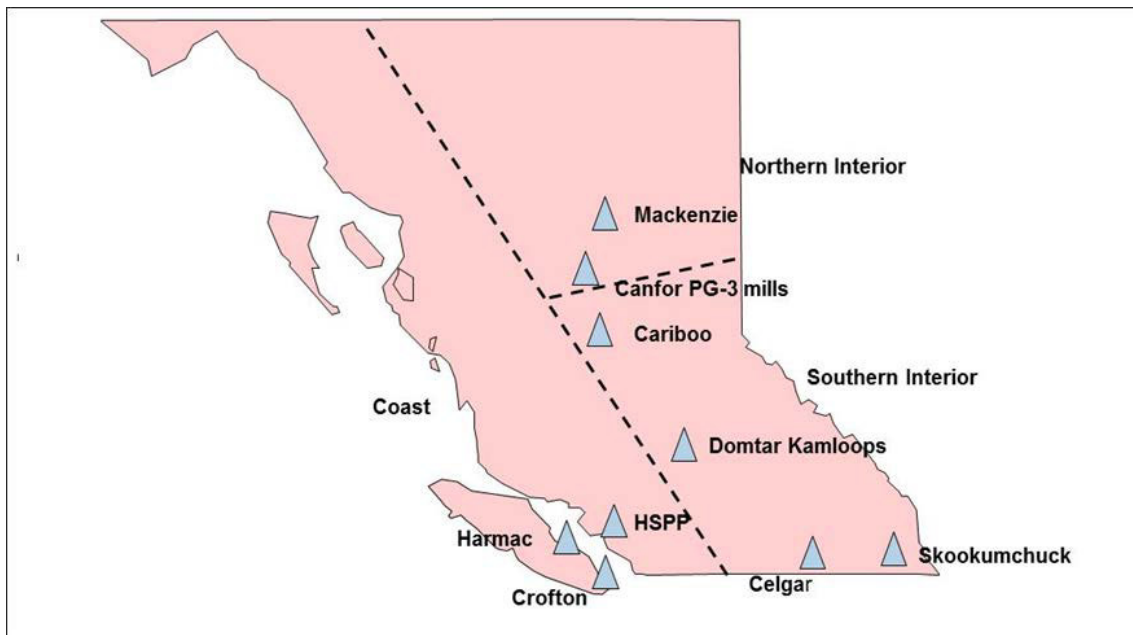
<sup>370</sup> *Ibid.* at 15, **R-177**.

<sup>371</sup> Other illustrative examples include the fuel type, supply and costs; type age and efficiency of the customer's generator; changes in control, ownership or management that may affect the operation of the customer's plant and/or self-generation; abnormal events such as events of force majeure; and market conditions, including abnormal market curtailment events: BC Hydro 2012 GBL Information Report at bates 04833, **R-177**.

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### E. The Celgar Pulp Mill

167. The Celgar pulp mill is a relatively modern pulp mill with an estimated production capacity of 520,000 ADmt/year located on the Columbia River near Castlegar, British Columbia.<sup>373</sup> Its location relative to other B.C. pulp mills is shown in the figure below.



168. This pulp mill was originally built by the Coleanese Corporation of America in 1960 as part of a major expansion in kraft pulping in British Columbia that occurred between 1955 and 1960.<sup>374</sup>

169. The Celgar pulp mill changed ownership a few times until, in late 1986, Westar Timber Ltd. decided to sell the pulp mill to Celgar Pulp Co., a joint venture of Power

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<sup>372</sup> Lester Dyck Statement, ¶¶ 137-140.

<sup>373</sup> For a full description of the mill, please see Pöyry Expert Report, ¶¶ 53-75.

<sup>374</sup> Doug Christie, "Looking West: Historical Overview of the Industry in BC", Pulp & Paper Canada, January 2004, R-326.

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Consolidated (China) Pulp Inc.<sup>375</sup> and CITIC BC, Inc., a subsidiary of the international investment corporation for China.<sup>376</sup> The ownership changed slightly again in 1989 when Stone-Consolidated Inc., a subsidiary of U.S. pulp and paper producer Stone Container Corp., acquired a 50 percent interest in Power Consolidated (China) Pulp.<sup>377</sup>

170. The pulp mill, however, was not without problems. It had repeatedly failed to meet provincial environmental effluent discharge and air emissions standards.<sup>378</sup> It was the only pulp mill in the B.C. interior without a secondary effluent treatment system.<sup>379</sup> The odour from the pulp mill was also the cause of the second worst ambient air quality in the province.<sup>380</sup> To provide the pulp mill with time to deal with these problems, the B.C. Ministry of the Environment issued a Variance Order in 1986, which gave the Celgar pulp mill 10 years to bring its effluent and air emissions into compliance with provincial regulations.

171. Celgar attempted to make progress in meeting these standards through improvements to the recovery boiler in 1988. However, this investment ultimately proved a failure from an environmental perspective.<sup>381</sup> The situation worsened for Celgar in 1989 when the province announced plans for more rigorous effluent discharge standards which the pulp mill would have to comply with by 1994.<sup>382</sup> Celgar estimated

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<sup>375</sup> Power Consolidated (China) Pulp Inc. was a subsidiary of Power Corp. of Canada, which owned Canadian pulp and paper producer Consolidated Bathurst Inc. at that time.

<sup>376</sup> See B.C. Ministry of Environment and Ministry of Regional and Economic Development, Review of Prospectus for Celgar Pulp Mill Expansion, July 1990, s. I.1, at 1-2, **R-327**. CITIC refers to China International Trust and Investment Corporation, which made foreign investments behalf of the People's Republic of China. Power Consolidated (China) Pulp and CITIC B.C. both held a 50 percent interest in the joint venture.

<sup>377</sup> *Ibid.*, s. I.1, at 1-2, **R-327**.

<sup>378</sup> *Ibid.*, s. I.2 at 2, **R-327**.

<sup>379</sup> BC Environment Briefing Note, CITIC (50% owners of Celgar Pulp) to Review Permit Amendments Issued by Order-in-Council June 28, 1991, dated July 10, 1991, at 1, **R-328**.

<sup>380</sup> *Ibid.*, **R-328**.

<sup>381</sup> *Ibid.*, **R-328**.

<sup>382</sup> B.C. Ministry of Environment and Ministry of Regional and Economic Development, Review

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that the cost of meeting these new environmental standards would be between C\$110-150 million.<sup>383</sup>

172. Power Consolidated (China) Pulp and CITIC BC, however, had acquired the pulp mill at a point in the business cycle where pulp prices were particularly strong. In 1990, for example, NBSK prices in China reached US \$800/ADmt.<sup>384</sup> The strength of the pulp market lead led to a decision in 1989 to invest C\$630 million to modernize and expand the pulp mill.<sup>385</sup> This project was intended to double production from an average of 185,000 ADmt/year to 425,000 ADmt/year while bringing the pulp mill into conformity with provincial environmental regulations.<sup>386</sup>

### 1. Celgar's Commitment to Remain Energy Self-Sufficient

173. Celgar realised that its proposed expansion to double production to 425,000 ADmt/year would be controversial in light of the pulp mill's previous inability to meet provincial environmental regulations. It was also aware that the proposed expansion would require both federal and provincial approval due to Celgar's effluent discharges into the Columbia River and its close proximity to the U.S. border.<sup>387</sup> In August 1989, it initiated the provincial permit application process with the B.C. Ministry of the

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of Prospectus for Celgar Pulp Mill Expansion, July 1990, s. I.2, at 2, **R-327**. In particular, the Ministry of Environment proposed a requirement that all mills reduce their AOX (chlorinated organics) discharges to 1.5 kg/tonne of pulp produced by 1994.

<sup>383</sup> *Ibid.*, s. I.2, at 2, **R-327**.

<sup>384</sup> Pöyry Expert Report, ¶ 59.

<sup>385</sup> B.C. Ministry of Environment and Ministry of Regional and Economic Development, Review of Prospectus for Celgar Pulp Mill Expansion (July 1990), s. I, at 1, **R-327**. Celgar also claimed that it could not finance an environmental upgrade from its operations or through external borrowing without a major capacity expansion.

<sup>386</sup> Pöyry Expert Report, ¶ 57.

<sup>387</sup> Celgar was responsible for dioxins that were detected as far South as Lake Roosevelt, Washington which had raised the ire of the United States. See BC Environment Briefing Note, CITIC (50% owners of Celgar Pulp) to Review Permit Amendments Issued by Order-in-Council June 28, 1991, dated July 10, 1991, at 1, **R-328**.

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Environment.<sup>388</sup> It was subsequently informed that the B.C. Government would form a Major Project Review Process, which would provide a comprehensive assessment of both the environmental and socio-economic effects of the proposed expansion.<sup>389</sup> The first step in this process occurred when Celgar submitted a prospectus for the proposed expansion in October 1989.<sup>390</sup>

174. As the proposed expansion included replacing the existing 3.5 MW turbine with a 52 MW turbine, Celgar decided to emphasise the benefits of this additional self-generation. It distributed its prospectus for public comment and further copies were sent to 18 different federal and provincial departments, ministries and agencies.<sup>391</sup>

175. After reviewing the prospectus for the proposed expansion, the majority of these agencies submitted comments to the Steering Committee of the Major Project Review Process. The B.C. Ministry of Energy was one of these agencies. It offered the following comments on the prospectus:

[P]ulp mill expansions have been identified as a very significant component of new electricity demand in British Columbia in the 1990s. As such, the Ministry wants to ensure that load displacement (i.e., co-generation, conservation and on-site woodwaste electric generation) is thoroughly explored before utilities are forced to build expensive new generation resources to serve expanded industrial loads. Therefore, the proponent should address the following items in detail:

[...]

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<sup>388</sup> B.C. Ministry of Environment and Ministry of Regional and Economic Development, Review of Prospectus for Celgar Pulp Mill Expansion, July 1990, s. III, at 5, **R-327**.

<sup>389</sup> *Ibid.*, s. II, at 3, **R-327**.

<sup>390</sup> *Ibid.*, s. III, at 5, **R-327**.

<sup>391</sup> *Ibid.*, at 5, **R-327**. Celgar also distributed copies to 2 U.S. federal and 2 state agencies.

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2. What are the proposed expanded mill's electricity requirements? How much of this will be generated on-site? How much will be bought from WKPL and at what cost?<sup>392</sup>

176. These comments highlight the concerns the Ministry had with respect to resource planning to meet the pulp mill's load following the expansion. It therefore requested that Celgar provide additional information concerning the pulp mill's electricity requirements and the amount of electricity it intended to self-generate and consume on site.

177. In April 1990, the Steering Committee of the Major Project Review Process determined that Celgar should submit a more detailed Stage II report.<sup>393</sup> It also recommended the establishment of an independent federal provincial review panel, which would hold public hearings and consider the environmental and socio-economic merits of the project.<sup>394</sup>

178. Although the installation of the turbine required a separate Energy Project Certificate, Celgar continued to reiterate that the proposed expansion would make pulp mill energy self-sufficient in the proceedings before the joint federal-provincial review panel. Celgar stated in July 1990 in its Stage II Report that:

The modernized mill, as designed, will be 90% energy self-sufficient. This is a large improvement over the existing mill, that produces only 11% of the energy it requires. On a small amount of electrical energy will be purchased to operate the modernized mill ... Celgar will continue to explore all energy alternatives that it believes will help it to achieve more complete self-sufficiency in energy and to maximize the efficiency of its energy usage.<sup>395</sup>

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<sup>392</sup> Memorandum from Peter Ostergaard to Frank Blasetti, Proposed Celgar Pulp Mill Expansion, 15 January 1990, at 1, **R-101**. [Emphasis Added].

<sup>393</sup> B.C. Ministry of Environment and Ministry of Regional and Economic Development, Review of Prospectus for Celgar Pulp Mill Expansion, July 1990, s. III.3, at 6, **R-327**.

<sup>394</sup> *Ibid.*, s. III.3 at 7, **R-327**.

<sup>395</sup> Celgar Pulp Company, Proposed Modernization of Bleached Softwood Kraft Pulp Mill Castlegar, B.C., Stage II Report, Volume 1, Overview and Environmental Summary, July 1990, at 35, **R-102**. [Emphasis Added]



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179. In its final report, the review panel indicated that the self-sufficiency of the pulp mill was one of the “pivotal considerations” it relied on in deciding to approve the expansion.<sup>396</sup> It observed that the new turbine “... will supply all of the mill’s electrical energy requirements except under maintenance or unusual circumstances.”<sup>397</sup> It also explained that:

Co-generation of electrical energy alongside pulp production has significant energy conservation benefits for the company and the province. The present mill relies on West Kootenay Power for the majority of its electrical power requirements-approximately 22 megavolt amperes. This will no longer be needed.<sup>398</sup>

180. The review panel, however, cautioned that the increase in on-site generation would require Celgar to obtain a separate provincial Energy Project Certificate.<sup>399</sup>

181. In the early 1990s, a proponent was required to apply for an Energy Project Certificate for an expansion to thermal electric power plant<sup>400</sup> of more than 20 MW<sup>401</sup> pursuant to section 18 of the *UCA*. The application allowed the Minister of Energy to assess the need for the project, other potential alternatives and whether there were any environmental concerns. The Minister of Energy in response to an application could: (1) refer the application to the BCUC for further review (with the concurrence of the Minister of the Environment);<sup>402</sup> (2) order the BCUC to deal with the application as an

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<sup>396</sup> Celgar Expansion Review Panel, Final Report, February 1991, at vii-viii, **R-330**.

<sup>397</sup> *Ibid.*, at 43, **R-330**.

<sup>398</sup> *Ibid.*, **R-330**.

<sup>399</sup> *Ibid.*, **R-330**.

<sup>400</sup> *Utilities Commission Act*, S.B.C. 1980 c. 60 (“UCA - 1980”), s. 17, **R-93**. (“[T]hermal electric power plant” means a facility for the generation of electricity from the combustion of natural gas, oil, petroleum products, coal, wood, or plant products or from the use of geothermal energy, and includes all associated structures, machinery, appliances, fixtures, equipment, and storage and handling facilities.”).

<sup>401</sup> *Ibid.*, s. 16, **R-93**. (“16. ... “regulated project” means ... (h) a thermal electric power plant that has a capacity of 20MW or more of electricity, (g) an addition by which 20 MW or more of electric capacity will be added to a hydroelectric or thermal electric power plant.”).

<sup>402</sup> *Ibid.*, s. 19(1)(a), **R-93**.

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application for a Certificate of Public Convenience and Necessity (if the application was made by a public utility); (3) order the exemption of the project from the provisions of the *UCA* subject to conditions which could have been included in an Energy Project Certificate or an Energy Operations Certificate; or (4) refuse to issue an Energy Project Certificate.<sup>403</sup>

182. On October 12, 1990, Celgar submitted its Application for an Energy Project Certificate for its proposed 52 MW turbine to the Minister of Energy. The Application explained how Celgar intended to operate its turbine in the following manner:

The recovery boiler will burn the organic material (i.e., lignin) in the heavy black liquor and converts the inorganic chemicals primarily to sodium carbonate and sodium sulphide. The inorganic chemicals will be removed as molten smelt. **The heat generated in burning the black liquor will be used to produce steam. The steam, when passed through a turbo-generator, will under normal conditions supply 100% of the modernized mill's electrical power requirements.**

...

**It is estimated that the expanded mill will require approximately 50 megawatts of power and will be capable of generating 50 megawatts, which will make the mill 100% self-sufficient under normal operating conditions. A tie line to the local utility will be retained. [Emphasis in Original]**<sup>404</sup>

183. Peter Ostergaard, the former Assistant Deputy Minister who was responsible for advising the Minister of Energy concerning this Application, explains that the offer Celgar made to supply 100% of its electricity was one of the main considerations that led the Minister to issue an exemption for the project from further review.<sup>405</sup> The Minister of the Environment received similar advice in a contemporaneous briefing note which

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<sup>403</sup> *Ibid.*, s. 19, **R-93**.

<sup>404</sup> Celgar 1990 EPC Application, s. (b), **R-97**. The Application was accompanied by an affidavit of the General Manager of Celgar, Robert W. Sweeney, swearing that the information in the Application was true and correct.

<sup>405</sup> Peter Ostergaard Statement, ¶¶ 19-20.

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indicates that "...[t]he Ministry should support [Celgar's] application for an Energy Project Certificate since it will provide the pulp mill with near energy self-sufficiency."<sup>406</sup>

184. After considering Celgar's Application, on May 23, 1991, the Minister of Energy and the Minister of the Environment issued a Ministers' Order, which exempted Celgar's installation of its 52 MW turbine from provisions of the *UCA* subject to certain conditions, including that: "Celgar shall [...], cause the Project to be designed, located, constructed and operated in accordance with (a) the Application."<sup>407</sup>

185. These conditions were specifically included in the Ministers' Order to ensure that Celgar honoured its commitment to remain 100% energy self-sufficient under normal operating conditions.<sup>408</sup> The Ministers' Order concluded with a clause indicating that Celgar agreed to all of these conditions and was countersigned by designated officers from Stone-Consolidated Inc. and CITIC BC.<sup>409</sup> This is consistent with Celgar's position in public statements at the time which continued to emphasize that the pulp mill would be energy self-sufficient.

186. After it developed an interest in the Celgar pulp mill, the Claimant conducted extensive due diligence in 2004 which included a review of all of the pulp mill's "environmental and operating permits."<sup>410</sup> The Claimant would have received advice on the terms and conditions of the Ministers' Order which permitted it to operate its 52 MW turbine as part of this due diligence.

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<sup>406</sup> British Columbia Ministry of the Environment, BC Environment Briefing Note, Application for Energy Project Certificate for the Celgar Pulp Mill Expansion, 16 May 1991, **R-99**.

<sup>407</sup> 1991 Ministers' Order at 2, **R-100**.

<sup>408</sup> Peter Ostergaard Statement, ¶¶ 21-22.

<sup>409</sup> 1991 Ministers' Order at 2, **R-100**.

<sup>410</sup> David Gandossi Statement, ¶¶ 27-28.

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187. On February 16, 2005, the Claimant's solicitors wrote to the Executive Director of the Environmental Assessment Office to request an amendment to the Ministers' Order to reflect that Zellstoff Celgar Ltd now owned the Celgar pulp mill.<sup>411</sup> This amendment was issued a few weeks later by the Environmental Assessment Office, which indicated that it would "... look to the new holder, Zellstoff Celgar Limited, for compliance with the conditions in the MO."<sup>412</sup>

## **2. Celgar's Cost Overruns, Production Problems and Bankruptcy**

188. Celgar completed its modernization and expansion project in mid-1993. Power Corp. a part owner of Power Consolidated (China) Pulp abandoned the project at this point, selling off its interest to Stone Container Corp. and Venepal, a Venezuelan pulp and paper producer. Power Consolidated (China) Pulp was subsequently renamed Stone Venepal (Celgar) Pulp Inc. ("Stone Venepal"). Stone Venepal would continue to operate Celgar for the next few years as a joint venture with CITIC BC.<sup>413</sup>

189. Although it did not seem so at the time, Celgar's expansion project was launched in at the worst possible moment. Pulp prices were beginning to slide and would all but collapse over the course of 1991-1992.<sup>414</sup> The pulp market eventually made a modest

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<sup>411</sup> Letter from Tom Theodorakis, Sangra Moller, Barristers & Solicitors to Joan Hesketh, Executive Director, Environmental Assessment Office, Re Celgar Pulp Company – Minister's Order, dated February 16, 2005), **R-322**. KPMG had previously assigned the Ministers' Order to 0706906 Ltd. which would become Zellstoff Celgar Ltd. on February 14, 2005. See General Assignment Agreement between KPMG Inc., in its capacity as the receiver of all the assets and undertaking of Stone Venepal (Celgar) Pulp Inc. and 0706906 B.C. Ltd., 14 February 2005 at MER00282142, Schedule B, **R-224**.

<sup>412</sup> Letter from Joan Hesketh, Executive Director, Environmental Assessment Office to Tom Theodorakis, Sangra Moller Barristers & Solicitors, dated March 2, 2005, **R-310**.

<sup>413</sup> See Pöyry Expert Report, ¶ 62. Power Consolidated (China) Pulp Inc. assumed the name Stone Venepal (Celgar) Pulp Inc. on June 16, 1993. Stone Container Corp. increased its interest in Stone Venepal from a 50 percent to 90 percent in late 1994. See Stone Container Corp., 8-K, 16 February 1995, **R-311**.

<sup>414</sup> Pöyry Expert Report, ¶ 59 and Figure 8.

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recovery in 1995 before slumping again.<sup>415</sup> It would remain weak for five years afterwards.

190. To make matters worse, the cost of the Celgar expansion project had ballooned from C\$630 million to C\$850 million of which approximately C\$750 million had been raised through debt financing.<sup>416</sup> Celgar attempted to reduce these capital costs by scoping the project in certain parts of the pulp mill.<sup>417</sup> However, these design compromises ultimately led to a somewhat higher cost of production.<sup>418</sup>

191. Celgar also struggled to operate the pulp mill efficiently following its restart in 1993. However, it would take nearly ten years for the pulp mill to achieve its design capacity of 425,000 ADmt/year of pulp.<sup>419</sup> It also produced an unusually high level of off-grade pulp that did not meet customer specifications for brightness and dirt count throughout this period, which was ultimately sold at a discount.<sup>420</sup> The pulp mill experienced some initial problems with energy self-generation,<sup>421</sup> but these did not contribute in a material manner to its financial problems.<sup>422</sup>

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<sup>415</sup> Pöyry Expert Report, ¶ 59 and Figure 8.

<sup>416</sup> [REDACTED], Project Next Step – Technical Due Diligence for Mercer International Inc., 18 November 2004, at 3, **R-315**. See “Celgar Mill in Receivership”, Pulp and Paper Magazine, September 1998, **R-334**.

<sup>417</sup> Pöyry Expert Report, ¶ 60. The design compromises included retaining a decision to retain a non-operative power boiler and an older pulp dryer.

<sup>418</sup> *Ibid.*, ¶ 60.

<sup>419</sup> *Ibid.*, ¶ 61.

<sup>420</sup> [REDACTED], Project Next Step – Technical Due Diligence for Mercer International Inc., 18 November 2004, at 4, **R-315**.

<sup>421</sup> See *KPMG Inc., Trustee of the Estate of Stone Venepal (Celgar) Pulp Inc. v. IMO Industries (Canada) Inc.*, 2008 BCCA 317, (CanLII), ¶¶ 4-6, **R-332**. The new turbine suffered a fractured blade in 1993 less than a month after it entered into operation. The supplier repaired the blade under warranty, but a second fracture in late 1994 was not repaired until the end of the year and resulted in litigation over the cost of the repairs. See also *Stone Venepal (Celgar) Pulp Inc. et. al. v. IMO Industries (Canada) Inc. et. al.*, 2002 BCSC 1368 (CanLII), **R-333**.

<sup>422</sup> Pöyry Expert Report, fn 46; *Compare*, Witness Statement of Brian Merwin, ¶ 34.

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192. Celgar continued to struggle through weak pulp markets as its indebtedness climbed to C\$1 billion.<sup>423</sup> However, the pulp mill's financial situation worsened and in 1996 CITIC BC refused to make payments on its share of the debt or to advance further operating funds.<sup>424</sup> This forced Stone Container Corp. to acquire CITIC BC's interest in the joint venture in exchange for assuming C\$273 million in debt.<sup>425</sup> In the four years preceding receivership, Stone Container Corp. would inject approximately C\$180 million into the pulp mill in an attempt to keep it operating—a gamble that failed to pay off.<sup>426</sup>

193. On July 23, 1998, Stone Venepal requested bankruptcy protection as a result of its high level of debt, operational problems and the relatively weak pulp market.<sup>427</sup> The Royal Bank of Canada and the National Westminster, the two principal creditors, subsequently engaged KPMG Inc. to act as a receiver and trustee for the pulp mill's assets.<sup>428</sup>

194. KPMG operated the pulp mill as a receiver from 1998 until Mercer acquired in 2005. Celgar's production fluctuated and frequently fell below the pulp mill's design capacity in of 425,000 ADmt /year throughout this period when it should have exceeded this level of production.<sup>429</sup> No significant investments were made in the pulp mill. The pulp mill's capital expenditures program was also limited to C\$4-6 million per year.<sup>430</sup> Celgar should have also been able to rely on its self-generation to remain relatively self-

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<sup>423</sup> "Celgar Mill in Receivership", Pulp and Paper Magazine, September 1998, **R-334**.

<sup>424</sup> See Stone Container Corp., 8-K, 19 July 1996, **R-335**.

<sup>425</sup> Stone Venepal (Celgar) Inc. acquired CITIC BC's 50 percent interest in 1997 in exchange for assuming \$273 million of the indebtedness.

<sup>426</sup> "Celgar Mill in Receivership", Pulp and Paper Magazine, September 1998, **R-334**.

<sup>427</sup> Pöyry Expert Report, ¶ 63.

<sup>428</sup> "Celgar Mill in Receivership", Pulp and Paper Magazine, September 1998, **R-334**.

<sup>429</sup> [REDACTED], Project Next Step – Technical Due Diligence for Mercer International Inc., 18 November 2004, at 12-13, **R-315**.

<sup>430</sup> *Ibid.*, at 4, **R-315**.

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sufficient in terms of energy. However, the pulp mill's erratic pulp production resulted in its self-generation becoming increasingly unreliable.<sup>431</sup>

### 3. The Claimant's Purchase of the Celgar Pulp Mill and the Normalization of Operations through Project Blue Goose

195. Mercer first learned that the Celgar pulp mill was for sale when it was approached by ██████████ concerning the pulp mill in July 2003.<sup>432</sup> The Claimant subsequently developed an interest in the pulp mill and commenced an extensive due diligence review in early 2004. It also retained ██████████ to prepare a technical due diligence report on the pulp mill.<sup>433</sup>

196. ██████████ identified several opportunities to optimize production processes and to make capital investments which would significantly improve operations. In particular, it determined that ██████████  
██████████.<sup>434</sup> The increase in pulp production and certain other projects would lead to a relatively modest increase in self-generation.<sup>435</sup> Pöyry did not identify potential energy sales as a reason to acquire the pulp mill.<sup>436</sup> Nor was Mercer focused on potential energy sales during due diligence.<sup>437</sup>

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<sup>431</sup> *Ibid.*, at 51, **R-315**.

<sup>432</sup> David Gandossi Statement, ¶ 26.

<sup>433</sup> *See Ibid.*, ¶ 28. ("We also engaged ██████████ a highly-regarded consulting and engineering company, based in Norway, to perform technical reviews on various areas. ██████████ is particularly strong in the pulp and paper industry, as it got its start in 1958 designing a pulp mill in Finland.") *See also* ██████████, Project Next Step – Technical Due Diligence for Mercer International Inc., 18 November 2004, at 4, **R-315**. Pöyry operated under the name Jaakko Pöyry- NLK at this time.

<sup>434</sup> *Ibid.*, at 3, **R-315**.

<sup>435</sup> Pöyry Expert Report, ¶¶ 72 and 74.

<sup>436</sup> Pöyry Expert Report, ¶ 74. *See* ██████████, Project Next Step – Technical Due Diligence for Mercer International Inc., 18 November 2004, at 51-53, **R-315**.

<sup>437</sup> The technical due diligence report prepared by ██████████ for Mercer International Inc. on November 18, 2004 makes no reference to potential electricity sales. For instance, the section

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197. ██████ explained that these capital investments normally would have been made after Celgar's expansion project in 1993.<sup>438</sup> Celgar, however, had been unable to commit the necessary funds in the mid-1990s due its high level of indebtedness and the fact that the pulp mill was generating a negative cash flow.<sup>439</sup>

198. After completing its due diligence, the Claimant acquired the Celgar pulp mill from KPMG on February 14, 2005. It subsequently launched project Blue Goose to implement ██████ recommendations. ██████ was also retained to develop a proposal for the capital improvements discussed above. To this end, ██████ and Celgar completed a "Strategy and Short Term Capital Plans" report in June 2005, and, a month later, Pöyry completed a Final Report for the Blue Goose Appropriation Budget.<sup>440</sup> The Claimant's Board of Directors approved ██████ recommendation ██████ on these projects in August 2005.<sup>441</sup>

199. As the Blue Goose project progressed, the Claimant also applied to FortisBC's Power Sense program for a DSM contribution in late 2006. Mr. Merwin explained Celgar's objectives for the Blue Goose project in a letter to FortisBC requesting a DSM contribution:

The components we want to install will 1. Use mill steam more efficiently, 2. Create a more steady steam flow (reliability of the mill) and 3. Recover more steam which in turn reduces Fortis demand. ... A pulp mill's energy balance is complex, Celgar being a newer mill than most in BC already requires less outside electricity purchases than most pulp mills in BC as it was built to newer efficiency standard. We want to continue to improve

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entitled "Revenues, Manufacturing Costs, and EBITDA" analyses potential pulp sales revenues but makes no mention of electricity. *Ibid.*, at 68 to 75, **R-315**. David Gandossi Statement, ¶ 30.

<sup>438</sup> Pöyry Expert Report, ¶¶ 68-70, and 75.

<sup>439</sup> *Ibid.*, ¶ 62.

<sup>440</sup> Celgar, "Blue Goose Appropriation Budget, Final Report" Prepared by ██████, 22 July 2005, at MER00085417, **R-318**.

<sup>441</sup> Celgar, Project 'Blue Goose' Presentation for the Board of Trustees of Mercer International, August 2005, at MER00085411, **R-336**.



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our mill's efficiency to keep pace with current standards. ... Celgar if located in BC Hydro territory would easily qualify for a funding contribution. What we are planning to do is very much different than the capacity projects that the BCUC ruled against which BC Hydro had undertaken with our competitors. All of their projects included increasing the burning of biomass wood waste to increase steam production and the addition of generating turbines, where Celgar's project is purely rooted in process efficiency.<sup>442</sup>

200. FortisBC would eventually contribute [REDACTED] towards an effluent cooling project, including the installation [REDACTED]

[REDACTED].<sup>443</sup>

201. The main objectives of project Blue Goose were to increase pulp production while reducing the costs associated with the chemicals used in the pulping process.<sup>444</sup> The Claimant would also achieve savings through a reduction in energy costs. However, these energy savings were not material to the justification for the project.<sup>445</sup> [REDACTED] estimated that the annual EBITDA benefits resulting from Blue Goose would total [REDACTED].<sup>446</sup> If the energy savings

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<sup>442</sup> Letter from Brian Merwin to FortisBC, 12 September 2006, at MER00026537, **R-230**.

<sup>443</sup> FortisBC, Industrial Efficiency Program Evaluation, 14 January 2013, at 27, **R-214**. Dennis Swanson Statement, ¶ 52. *See* Celgar, Letter to FortisBC, 12 September 2006, **R-337**; Letter from Brian Merwin to FortisBC, dated October 7, 2006, **R-231**; Email Exchange between Celgar and FortisBC, September 19 – October 4, 2006, **R-338**.

<sup>444</sup> [REDACTED] Celgar, Blue Goose Post Evaluation Presentation, 24 April 2007, at MER00054416, **R-339** Celgar, Project 'Blue Goose' Presentation for the Board of Trustees of Mercer International, August 2005 at MER00085415, **R-336**. *See also* [REDACTED], Zellstoff Celgar Blue Goose Optimization Project Minutes of Meeting – MOM – 03, 13 September 2005, **R-340**: "Chemical savings and mill reliability are the main drivers for the [Blue Goose] project." at MER00872425, Mercer International Group, Strategic Planning, June 2006, at MER00088558, **R-342**; (Optimizing Celgar → increase production capacity, reduce production costs)."

<sup>445</sup> Pöyry Expert Report, ¶ 74.

<sup>446</sup> Celgar, "Blue Goose Appropriation Budget, Final Report" Prepared by [REDACTED], 22 July 2005, at MER00085417, **R-318**; Celgar, Project 'Blue Goose' Presentation for the Board of Trustees of Mercer International, August 2005, at MER00085415, **R-336**.

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were eliminated, the payback for these projects [REDACTED]

[REDACTED]<sup>447</sup>.

202. Celgar completed project Blue Goose and successfully normalized its operations in early 2007—effectively ending a long period in which all investment in the pulp mill had been constrained.<sup>448</sup> Celgar would subsequently increase pulp production beyond its target of [REDACTED]<sup>449</sup> to 500,000 ADmt/year.

#### 4. The Claimant's Periodic Sales of Energy on a Net-of-Load Basis

203. As the Claimant normalised pulp production, it was increasingly able to make periodic sales of self-generated electricity in excess of the pulp mill's load requirements under two non-firm sales arrangements: (1) an Electricity Supply Brokerage Agreement with FortisBC;<sup>450</sup> and (2) a Marketing Services Agreement with NorthPoint Energy Solutions Inc.<sup>451</sup>

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<sup>447</sup> Pöyry Expert Report, ¶ 74.

<sup>448</sup> *Ibid.*, ¶ 75.

<sup>449</sup> [REDACTED]

[REDACTED] *See*, Celgar, Monthly Report – December 2009, Zellstoff Celgar Limited Partnership, 11 January 2010, at MER00006889, (chemical costs), MER00006891, (energy costs), **R-344**; Celgar, Monthly Report – December 2008, Zellstoff Celgar Limited Partnership, 12 January 2009, at MER00232945, **R-345**; Celgar, Monthly Report – December 2007, Zellstoff Celgar Limited Partnership at MER00274286, (chemical costs), MER00274289 (energy), **R-346**; Celgar, Monthly Report – December 2006, Zellstoff Celgar Limited Partnership, 12 January 2007, at MER00090064, (chemical costs), MER00090077 (energy costs), **R-347**; Celgar, Supplemental Mill Schedule (Excerpt of Monthly Report – December 2005) at MER00085141, (chemical costs), MER00085153 (energy costs), **R-348**.

<sup>450</sup> Electricity Supply Brokerage Agreement, being Schedule A to the General Service Power Contract between FortisBC and Zellstoff Celgar Limited Partnership, 1 October 2006 at MER0027933--MER00279339, **R-227**. Prior to Claimant's acquisition of the mill, Celgar sold small quantities of electricity in excess of load requirements to FortisBC under the terms of the Electricity Supply Brokerage Agreement between West Kootenay Power Ltd. and KPMG Inc. Trustee of the Estate of Stone Venepal (Celgar) Pulp Inc., 20 December 2000, at MER00280586, **R-217**.

<sup>451</sup> Marketing Services Agreement between Zellstoff Celgar Limited Partnership and NorthPoint Energy Solutions Inc., 12 July 2006, **R-349**. NorthPoint is a wholly owned subsidiary of

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204. The Electricity Supply Brokerage Agreement the Claimant negotiated with FortisBC, for example, indicated that in normal operations the Celgar mill's load is satisfied by self-generated electricity from its 52 MW turbo generator.<sup>452</sup> Similarly, under the terms of the Marketing Services Agreement, NorthPoint was to use reasonable efforts to sell Celgar's incremental electricity [REDACTED] [REDACTED].<sup>453</sup> Neither of these agreements contemplated the Claimant engaging in notional sales of the self-generated electricity that the pulp mill normally consumed during pulp production.

### 5. The Claimant's Arbitrage Project and Green Energy Project

205. After the B.C. Government announced the 2007 Energy Plan and BC Hydro commenced its bioenergy RFEOI,<sup>454</sup> the Claimant started to assess the feasibility of constructing an additional condensing turbine –a project that it would later come to refer to as its “Green Energy Project”. However, the Claimant was also aware that the addition of a condensing turbine would mean that the amount of self-generated electricity would far exceed the requirements of the pulp mill.

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SaskPower, a provincially owned Crown corporation in Saskatchewan, NorthPoint Energy Solutions, About, **R-180**.

<sup>452</sup> General Service Power Contract between FortisBC and Zellstoff Celgar Limited Partnership, 1 October 2006 at MER00279337--MER00279339, **R-226**: “The Customer operates a pulp mill at Castlegar, B.C. This mill has a total load of 46.5 MVA. Under most circumstances, this load is satisfied by the Customer's 50 MW turbo generator.” See also Letter Agreement between Zellstoff Celgar and FortisBC, Re: Celgar Electricity Project, 6 June 2007, **R-238**. This agreement also indicated [REDACTED]

[REDACTED] *Ibid.*, at MER00279339, **R-238**. The same recitation is included in the 2000 Brokerage Agreement.

<sup>453</sup> Marketing Services Agreement between Zellstoff Celgar Limited Partnership and NorthPoint Energy Solutions Inc., 12 July 2006, **R-349**. [REDACTED] [REDACTED]. Memo from Brian Merwin to Ron Zaitsoff *et al*, Re: Electricity Project, June 23, 2006 (in Electricity Memos), at MER00280479, **R-351**.

<sup>454</sup> Jim Scouras Statement, ¶¶ 34-37. For example, Celgar responded to BC Hydro's request by filling out BC Hydro's RFEOI form and submitting it to BC Hydro. See 2007 Bioenergy RFEOI Form, **R-111**.

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206. Although the Claimant submitted a response to BC Hydro's RFEOI,<sup>455</sup> it also decided to approach FortisBC [REDACTED]<sup>456</sup> to determine whether these privately-owned utilities would be interested in purchasing incremental self-generated energy from a condensing turbine. The Claimant, however, understood [REDACTED] and that there were several barriers to selling energy to [REDACTED].<sup>457</sup> This led the Claimant, in June 2007, to propose a more "aggressive approach"<sup>458</sup> that it referred to as the "Arbitrage Project".

207. As described by the Claimant, the Arbitrage Project would have required FortisBC to supply the Celgar pulp mill's full load which would then enable it to sell all of its existing self-generation from its 52MW turbine to BC Hydro or another third party.<sup>459</sup> However, in reality, the Arbitrage Project was nothing more than an accounting transaction between FortisBC and Celgar. The Claimant would continue to self-generate and consume all of this electricity at its pulp mill. FortisBC, however, would purchase enough electricity to meet the load of the pulp mill. FortisBC and Celgar would then enter into a deemed (*i.e.*, notional) exchange of this electricity for accounting purposes and the physical electricity FortisBC purchased would be sold to BC Hydro or another third party as if it were actually electricity from the pulp mill.

208. At a subsequent meeting in June 2007 with FortisBC, the Claimant attempted to persuade FortisBC that it should purchase Celgar's additional self-generation from its

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<sup>455</sup> *Ibid.*, **R-111**; and Mercer International Group, BC Hydro RFEOI Meeting, April 2007, **R-352**.

<sup>456</sup> *See* Mercer International Group, Celgar Electricity Opportunities, July 2007, **R-278**.

<sup>457</sup> Brian Merwin and Jim MacLaren, Celgar Energy Project – Preliminary Analysis, 13 April 2007 at 8, **R-353**: [REDACTED]

[REDACTED] *Ibid.*, at 8, **R-353**.

<sup>458</sup> Email Exchange between Celgar to FortisBC, June 11, 2007-September 26, 2007, at MER00292771, **R-241**.

<sup>459</sup> *See Ibid.*, **R-241**. Brian Merwin Statement, ¶ 66.

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proposed condensing turbine (*i.e.*, the Green Energy Project). It also indicated, in the alternative, that it was interested in making Celgar a full load customer.<sup>460</sup> This latter proposal appears to have been the first time Celgar raised the Arbitrage Project. The Claimant's presentation a few weeks later to [REDACTED] also focused on selling of self-generated energy from an additional turbine and only briefly mentions that Celgar was "studying" another "larger opportunity."<sup>461</sup>

209. [REDACTED]  
[REDACTED]  
[REDACTED].<sup>462</sup> It was, however, intrigued by the concept of making Celgar a full load customer provided that [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]<sup>463</sup> This initial email exchange shows that [REDACTED]  
[REDACTED]  
[REDACTED].

210. FortisBC first sought to confirm that the Arbitrage Project was financially feasible and that it would not harm other FortisBC ratepayers.<sup>464</sup> Neither of these considerations

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<sup>460</sup> See Email Exchange between Celgar to FortisBC, June 11, 2007-September 26, 2007, **R-241**. Brian Merwin Statement, ¶ 66.

<sup>461</sup> See Mercer International Group, [REDACTED], July 2007, at 13, 16-17, **R-354**.

<sup>462</sup> See Merwin Witness Statement, ¶ 66. [REDACTED] See Celgar-FortisBC Term Sheet, Draft for Discussion Purposes, 11 June 2007, **R-355**: [REDACTED]  
[REDACTED]

<sup>463</sup> Email Exchange between Celgar to FortisBC, June 11, 2007-September 26, 2007, at MER00292771, **R-241**, Compare Witness Statement of Brian Merwin, ¶ 67: After the meeting, I received an email from [REDACTED] stating that he was intrigued by the concept. He informed me that he had briefed his CEO, who was very interested in our idea, and saw no reason why Celgar could not become a full load customer." Mr. Merwin does not mention that Mr. [REDACTED] raised concerns over the arbitrage of BC Hydro's power in the same email.

<sup>464</sup> Dennis Swanson Statement, ¶ 59.

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appeared to be a concern. FortisBC then had its Regulatory Department examine the regulatory risks associated with the Arbitrage Project.

211. Mr. Dennis Swanson, Director of Regulatory Affairs for FortisBC, was responsible for conducting this regulatory research in October 2007. Mr. Swanson and his colleagues ultimately concluded that there was only a 50 percent chance that the Arbitrage Project would be approved as "... the prohibition against arbitrage in the 1993 PPA, taken together with past BCUC Orders G-38-01 and G-113-01, might lead the BCUC to reject these agreements."<sup>465</sup> These regulatory risks were explained in full to the Claimant at that time.<sup>466</sup>

212. FortisBC was also hesitant over whether it should support the Arbitrage Project from a policy perspective. FortisBC was aware that the 1993 PPA prohibited it from re-selling BC Hydro's Rate Schedule 3808 electricity (*i.e.*, engaging in arbitrage) and that the Arbitrage Project might not be acceptable from a provincial energy policy perspective.<sup>467</sup> These proposals would also place FortisBC squarely in a dispute between two of its customers (*i.e.*, Celgar and the City of Nelson); and an energy supplier (*i.e.*, BC Hydro). The 1993 PPA, however, did not contain language that explicitly prohibited FortisBC from supplying this energy to third parties who would then export it out of its service area. The Arbitrage Project also would have been profitable for FortisBC and would have permitted it to offer its ratepayers a 2-3 percent rate mitigation.<sup>468</sup> Accordingly, FortisBC decided to enter into negotiations to notionally supply this additional energy to Celgar.

213. Although FortisBC warned the Claimant of the regulatory risks associated with the Arbitrage Project, its own documents show that it was already well aware of these

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<sup>465</sup> *Ibid.*, ¶ 63.

<sup>466</sup> *Ibid.*, ¶ 64.

<sup>467</sup> *Ibid.*, ¶ 62.

<sup>468</sup> *Ibid.*, ¶ 61.

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risks. In particular, a few months earlier, in July 2007, the Claimant had advised its Board of Directors that:

[REDACTED]

[...]

[REDACTED]

[REDACTED]<sup>469</sup>

214. The Claimant's clear priority throughout this period was its Green Energy Project which it planned to sell to BC Hydro in its Bioenergy Call for Power.<sup>470</sup> However, it also continued to make plans with respect to its Arbitrage Project even going so far as to muse about how it might be able to use the Arbitrage Project to effectively "game" BC Hydro's GBL determination in the Bioenergy Call for Power.<sup>471</sup>

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<sup>469</sup> Mercer International Group, Celgar Electricity Opportunities, July 2007, at 9-10, **R-278**. [Emphasis Added]

<sup>470</sup> See Brian Merwin, Celgar Energy Project, Final Analysis, 29 October 2007, at 8, **R-356**:

[REDACTED]

<sup>471</sup> Email from Jim McLaren to Brian Merwin, Re: Sale of STG#2 and future STG# Electricity Output, 30 October 2007, **R-357**. Jim McLaren, Celgar's Energy Manager, explained in an October 2007 email to Brian Merwin that:

[REDACTED]

[Emphasis added.]

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215. The Claimant, however, around the same time learned [REDACTED]  
[REDACTED].<sup>472</sup> It also advised its Board of  
Directors that the [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]<sup>473</sup> No further discussions with [REDACTED] appear to have occurred.

216. The Claimant was prepared at the close of 2007 to submit its Green Energy Project into BC Hydro's Bioenergy Call for Power. In light of the challenges it faced in securing a U.S. third party purchaser, the Claimant decided that it might be able to persuade BC Hydro to purchase self-generated electricity from its Arbitrage Project as part of the same process.

## **6. The Claimant's Participation in Bioenergy Call for Power Phase I**

### **a) BC Hydro Determines that the Claimant's Green Energy Project is Eligible for the Bioenergy Call for Power but Rejects its Arbitrage Project**

217. As previously explained, BC Hydro issued its RFP for the Bioenergy Call for Power Phase I on February 6, 2008.<sup>474</sup> The RFP required proponents that intended to sell incremental self-generation to provide detailed information, which would allow BC Hydro and the proponent to establish their GBL before these proponents filed their RFP.

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<sup>472</sup> Email from Jim McLaren to Brian Merwin, 2006 RFP – Renewable Energy, 14 November 2007, **R-358**: [REDACTED]

<sup>473</sup> Brian Merwin, Celgar Energy Project, Final Analysis, 29 October 2007, at 8, **R-356**.

<sup>474</sup> Bioenergy Phase I – RFP, **R-25**.



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218. On March 6, 2008, the Claimant submitted its Registration Form with its estimated GBL for the Bioenergy Call for Power for both its Green Energy Project (*i.e.*, a proposal to sell to BC Hydro electricity generated by a new 48 MW condensing turbine)<sup>475</sup> and its Arbitrage Project.<sup>476</sup> The name of the Arbitrage Project, however, was tellingly changed to the “Biomass Realization Project” on all RFP documentation and correspondence submitted to BC Hydro.<sup>477</sup>

219. On April 2, 2008, BC Hydro met with, Mr. Merwin, so that it could gain a better understanding of these two proposals. Mr. Merwin explained, with respect to the “Biomass Realization Project” (*i.e.*, the Arbitrage Project), that the Claimant proposed selling self-generated electricity from its existing 52 MW turbine which had been installed 15 years beforehand in 1993 and had historically been used to serve the pulp mill’s load.<sup>478</sup>

220. Mr. Merwin nonetheless advocated the following rather irrational position in this meeting:



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<sup>475</sup> Celgar, BC Hydro Bioenergy Call for Power (Phase I) – Registration Forms, 6 March 2008 (“Celgar Bioenergy Phase I Registration”), at bates MER00278896 (Celgar Green Energy Project), **R-123**.

<sup>476</sup> *Ibid.* at bates MER00278903 (Biomass Realization Project), **R-123**.

<sup>477</sup> *Ibid.*, **R-123**; Letter from Brian Merwin to BC Hydro RFP Administrator, Re: Zellstoff Celgar Limited Partnership – Biomass Realization Project and Celgar Green Energy Project, 7 May 2008, at bates 019772 (“Celgar’s May 7, 2008 Letter to RFP Administrator”), **R-127**.

<sup>478</sup> BC Hydro, Power Acquisitions, Bioenergy RFP - Phase I Briefing Note on Celgar, 9 April 2008 (“Power Acquisitions Briefing Note on Celgar”), **R-124**.

<sup>479</sup> Memo from Adrian Hay to Brian Merwin, Re: April 2<sup>nd</sup> RFP meeting with BC Hydro, 2 April 2008, **R-360**.

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221. He then summarized the meeting for Mercer's CEO Jimmy Lee in the following manner:

[REDACTED]

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222. Mr. Merwin, however, made no mention of its efforts to negotiate an agreement with FortisBC and its plan to re-sell BC Hydro's RS 3808 energy to the United States if BC Hydro refused to purchase energy from the Arbitrage Project.

223. Mr. Merwin also accurately explained in a series of draft memoranda to his Board of Directors that the Claimant could only pursue the "arbitrage project" because of its unique circumstances:

[REDACTED]

<sup>481</sup>

224. BC Hydro, however, understood full well that "Biomass Realization Project" was really nothing more than a proposal to allow the Claimant to engage in arbitrage that ran counter to the prohibitions in BCUC's Orders G-38-01 and G-113-01.

225. BC Hydro was concerned that the Claimant's "Biomass Realization Project" would require FortisBC to purchase additional electricity, and that FortisBC, as a customer of BC Hydro, would likely meet this demand by purchasing embedded cost

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<sup>480</sup> Email from Brian Merwin to Jimmy Lee, Re: ecoLogo – Attestation of Commitment, 4 April 2008, **R-361**.

<sup>481</sup> Memo from Brian Merwin to the Board, Re: Celgar Energy Project, 20 April 2008, at 2, **R-276**. The Claimant continued to refer to the Arbitrage Project as the Arbitrage project in all of its internal correspondence.

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energy from BC Hydro under the 1993 PPA. BC Hydro explained in an April 9, 2008 Briefing Note that:

If BC Hydro were to agree to the purchase of energy from the existing generator at the Celgar mill, then BC Hydro would essentially be paying Celgar for using energy it generates to serve its own load. Assuming Celgar's average annual mill load is 300 GWh, BC Hydro's tariff rate is \$36/MWh and a contract firm energy price of \$85/MWh for the Celgar's generation output, the net cost to BC Hydro for this arrangement which results in no new energy supply, would be \$15 million per year.<sup>482</sup>

226. To avoid setting a precedent for arbitrage to the detriment of BC Hydro ratepayers, and to avoid paying Celgar without receiving any new energy in return, BC Hydro concluded that Celgar's "Biomass Realization Project" should be rejected as ineligible under the terms of the Bioenergy Call for Power.<sup>483</sup>

227. On May 2, 2008, BC Hydro advised the Claimant that its Green Energy Project was eligible for the Bioenergy Call for Power as it constituted incremental self-generation from a new condensing turbine.<sup>484</sup> It also advised the Claimant with respect to its "Biomass Realization Project" that only electricity in excess of the pulp mill's load would be eligible for the Call for Power as this self-generated energy was currently being used to supply the pulp mill under normal operating conditions.<sup>485</sup> In other words, BC Hydro advised that it was not permitted under the terms of the RFP to purchase electricity that the Claimant was generating in normal operations for the purpose of serving its own load because such energy was neither new self-generation nor incremental self-generation.

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<sup>482</sup> Power Acquisitions Briefing Note on Celgar, **R-124**.

<sup>483</sup> *Ibid.*, **R-124**. Letter from BC Hydro RFP Administrator to Brian Merwin, Re: Zellstoff Celgar Limited Partnership ("Celgar") – Biomass Realization Project, 2 May 2008, ("May 2, 2008 Letter Re: Celgar Biomass Realization Project"), **R-126**.

<sup>484</sup> *Ibid.*, **R-126**.

<sup>485</sup> *Ibid.*, **R-126**.

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228. Mr. Merwin succinctly summarized BC Hydro's response in the following manner:

Today BC Hydro sent us a letter stating our "Arbitrage Project" was an ineligible project under their guidelines. It is very clear that they do not like the fact that we would be buying power from Fortis who is buying power from them and we are turning around and selling them the power.<sup>486</sup>

The Claimant, in preparing a draft response, claimed that the "Biomass Realization Project" was entitled to different treatment because the Claimant operated in FortisBC's service area:

[REDACTED]

229. The Claimant subsequently removed this characterization in a May 7, 2008, correspondence to BC Hydro and confined itself to asserting that the self-energy from the Arbitrage Project was "new" to BC Hydro's system and that BC Hydro should purchase this energy because the Claimant believed that BC Hydro had provided "subsidies" to other customers in other circumstances.<sup>488</sup> In the alternative, the Claimant agreed to work with BC Hydro to set a GBL. To that end, it attached to its correspondence historical generation data from 2002-2007 and proposed a GBL of 33 MW based on the mill's self-generation in 2006.<sup>489</sup>

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<sup>486</sup> Email from Brian Merwin to Jimmy Lee and David Gandossi, Fw: Phase I Request for Proposals: Notice to Customers of GBL, 2 May 2008, **R-279**.

<sup>487</sup> Draft Letter from Brian Merwin to RFP Administrator, Zellstoff Celgar Limited Partnership ("Celgar") – Biomass Realization Project and Celgar Green Energy Project, 4 May 2008 at 2, **R-362**.

<sup>488</sup> Celgar's May 7, 2008 Letter to RFP Administrator at 1, **R-127**.

<sup>489</sup> Celgar's May 7, 2008 Letter to RFP Administrator, **R-127**.

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**b) BC Hydro and the Claimant Negotiate a GBL for the  
Bioenergy Call for Power**

230. BC Hydro arranged several meetings with Mr. Merwin to discuss the Claimant's historical generation data and the position of both parties concerning an appropriate GBL.<sup>490</sup> In these meetings, Mr. Lester Dyck, a Manager in BC Hydro's Key Accounts Management Division, explained that setting a GBL is not about picking any particular year, but determining what is representative of a normal current operating year based on the best available information.<sup>491</sup> BC Hydro did not agree with using Celgar's generating data from 2005 or 2006 to set the GBL as this data reflected the period leading up to and during which major plant changes were undertaken at the pulp mill (*i.e.*, Project Blue Goose). In other words, this 2005 and 2006 generating data simply did not reflect current normal operations at the Celgar pulp mill as these major plant changes were not complete until 2007.

231. BC Hydro asked Mr. Merwin whether there was any reason to expect that generation data from 2007 used for self-supply was an anomaly that would not be repeated under normal conditions on a going forward basis. Mr. Merwin stated that there was none.<sup>492</sup> BC Hydro asked Mr. Merwin about the conditions under which Celgar "normally" bought power from FortisBC and under what conditions they "normally" sold power. Mr. Merwin answered that Celgar only bought electricity from FortisBC when the self-generation facilities were down for planned maintenance or when there were temporary operating upsets. He also confirmed that the pulp mill had only ever sold self-generated electricity in excess of the pulp mill's load, which resulted in a physical export to the FortisBC system.

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<sup>490</sup> Lester Dyck Statement, ¶¶ 77-79.

<sup>491</sup> *Ibid.*, ¶ 81.

<sup>492</sup> The information submitted by the Claimant on May 7, 2008 also confirmed that the existing 52 MW generator was being used to meet the load of the Celgar Mill.

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232. Based on the information provided by Mr. Merwin, it was evident that Celgar was using its self-generation to self-supply its entire load under normal operating conditions and that it only sold electricity that was generated in excess of its load. Accordingly, BC Hydro set the Claimant's GBL for the purposes of Bioenergy Call for Power at 349 GWh/year (*i.e.*, approximately 40 MW) which reflected the Celgar's then-current normal self-generation which was also self-consumed (*i.e.*, the pulp mill's load for 2007).<sup>493</sup>

233. On May 30, 2008, BC Hydro provided Celgar with written notification that, if it chose to proceed to negotiate a contract with BC Hydro under Bioenergy Call for Power, all electricity under the Green Energy Project would be eligible for sale and its GBL would be set at 349 GWh/year using 2007 as a normal operating year.<sup>494</sup> The Claimant subsequently submitted a formal proposal on this basis on June 10, 2008.<sup>495</sup>

**c) The Claimant Receives an Electricity Purchase Agreement from BC Hydro**

234. On December 8, 2008, BC Hydro announced that it had selected four projects for EPAs under its Bioenergy Call for Power Phase I—PG Interior Waste to Energy Ltd.,<sup>496</sup> Canfor Pulp Ltd. Partnership's Prince George pulp mill, Domtar Pulp and Paper Products Inc.'s Kamloops pulp mill, and the Celgar pulp mill.<sup>497</sup> BC Hydro estimated that these EPAs would provide it with approximately 579 GWh/year of electricity which was well

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<sup>493</sup> Although Celgar actually produced slightly more than 349 GWh of self-generated electricity in 2007 (350,641 MWh to be precise), the amount in excess of 349 GWh was in excess of total mill load and was sold by Celgar to FortisBC or NorthPoint on an *ad hoc* basis. The information submitted by Celgar confirmed that its commitments to sell would expire prior to any EPA obligation with BC Hydro.

<sup>494</sup> Letter from RFP Administrator (Bioenergy Call - Phase I) to Brian Merwin, Re: Bioenergy Call (Phase I) – GBL, 30 May 2008, ("BC Hydro's May 30, 2008 Letter to Celgar"), **R-181**.

<sup>495</sup> Bioenergy Call for Power Phase 1, Commercial Proposal, Zellstoff Celgar Limited Partnership, 9 June 2008, ("Celgar Commercial Proposal"), **R-128**.

<sup>496</sup> PG Interior Waste to Energy Ltd. was unique among the successful proponents in that it was new biomass to energy project rather than a pulp mill with existing self-generation capabilities.

<sup>497</sup> See BC Hydro, Draft News Release: BC Hydro announces successful proposals in phase one of Bioenergy Call for Power, 8 December, 2008, **R-176**.

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below its Phase I target of 1,000 GWh/year.<sup>498</sup> The EPAs featured favourable pricing for the firm green energy sold, the adjusted bid prices ranging between C\$107-\$114/MWh.<sup>499</sup> The Claimant, like many other pulp mills, viewed the Bioenergy Call for Power EPAs as both attractive and profitable.<sup>500</sup> Of the four successful proponents, two of them, Domtar and Celgar, were U.S. owned pulp mills.

**d) The Claimant's Successful Application to the Government of Canada's Pulp and Paper Green Transformation Program**

235. As the financial crisis intensified in 2008, the Claimant found itself unable to secure financing for its Green Energy Project as the price of NBSK pulp fell dramatically. In May 2009, the Claimant announced the suspension of the Green Energy Project. This setback, however, proved short lived. In June 2009, the Government of Canada announced its Pulp and Paper Green Transformation Program ("PPGTP"). The Claimant immediately applied for PPGTP funding in an attempt to revive its Green Energy Project.

236. In November 2009, the Claimant entered into a non-repayable Contribution Agreement with Natural Resources Canada, under which it received \$57.7 million, \$46.8 million of which it directed toward the new 48MW condensing turbine it needed for its Green Energy Project.<sup>501</sup> As Mr. Merwin explains, the "federal government's Pulp and Paper Green Transformation Project saved our Green Energy Project, as it is unlikely we

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<sup>498</sup> See *Ibid.*, **R-176**.

<sup>499</sup> BC Hydro Report on Bioenergy Phase I - RFP at bates 150615, **R-170**.

<sup>500</sup> For instance, the Claimant considered a number of market opportunities for its self-generated electricity including the possibility of an EPA with BC Hydro. [REDACTED]

[REDACTED] Celgar Energy Project, Final Analysis, 4 October 2007, **R-363**. See also Mercer International Inc., Mercer International Inc. Announces the Selection of its Proposal for the Sale of Green Energy from its Celgar Mill, 8 December 2008, **R-364**.

<sup>501</sup> GEP Final Report at 21, **R-55**; Claimant's Memorial, ¶ 313; Brian Merwin Statement, ¶ 113; David Gandossi Statement, ¶¶ 48-51.

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would have gone forward with the [Green Energy] Project without the PPGTP assistance we received”.<sup>502</sup>

237. The subsidy from the Canadian government covered 90% of the total investment costs of the Green Energy Project and has resulted in extraordinarily high returns for the Claimant under its EPA with BC Hydro. As Dr. Rosenzweig explains, the Claimant “... has already earned excellent returns on its investments in generation assets due to both the subsidy it received from the Federal Government, as well as the incentive pricing BCH provided Celgar under its EPA which allows for annual firm energy revenues of up to about C\$ 26 million per year.”<sup>503</sup>

## **7. The Claimant's Arbitrage Project and BCUC Order G-48-09**

### **a) The Claimant's Power Supply Agreement with FortisBC**

238. On April 15, 2008, the Claimant signed a Term Sheet with FortisBC, which set out the commercial basis on which FortisBC was willing to make deemed sales (*i.e.*, notionally supply) all of Celgar's energy. This Term Sheet included, however, at FortisBC's insistence, a condition that any eventual Power Supply Agreement receive BCUC approval due to their concerns over arbitrage.<sup>504</sup> Neither FortisBC nor the Claimant informed BC Hydro that they had concluded a Term Sheet or that they were intending to file a Power Supply Agreement with the BCUC.<sup>505</sup>

239. FortisBC had also, coincidentally, been approached by the City of Nelson with a request to become a full load customer so that it could sell its self-generation from its

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<sup>502</sup> Brian Merwin Statement, ¶ 111.

<sup>503</sup> NERA Expert Report, ¶ 99.

<sup>504</sup> Zellstoff Celgar and FortisBC, Term Sheet: “Partitioning of Celgar's Existing Turbo Generator From Current Celgar Mill Load, Fully Supplying Mill Load From FortisBC And Facilitating The Sale By Celgar Of Its Entire Self-Generated Energy output to Third Party Buyer Indicative Term Sheet,” 21 April 2008, Article 9.2 at MER00042325, **R-246**: “British Columbia Utility Commission Approval – The above agreements, where applicable, will be subject to the approval of the BC Utilities commission.”

<sup>505</sup> Dennis Swanson Statement, ¶ 75.



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hydro-electric facility to market. FortisBC and Nelson concluded an agreement and filed it with the BCUC on June 24, 2008. The agreement did not involve a significant amount of energy and FortisBC did not anticipate that it would draw much attention from BC Hydro.

240. FortisBC subsequently finalized its Power Supply Agreement with the Claimant on August 21, 2008.<sup>506</sup> The Power Supply Agreement would permit FortisBC to make deemed sales to the Claimant to notionally service the full load of the pulp mill. It was also subject to a condition requiring BCUC approval as a result of the relatively high level of regulatory risk associated with the contract.<sup>507</sup> FortisBC filed the agreement with the BCUC on August 26, 2008.<sup>508</sup>

**b) BC Hydro's Application to the BCUC to Amend the 1993 Purchase Power Agreement with FortisBC**

241. On September 16, 2008, BC Hydro filed an application pursuant to subsections 58(1) and 58(2) of the *UCA* to request an amendment to section 2.1 of the 1993 PPA to prohibit FortisBC from selling BC Hydro's Rate Schedule 3808 energy to customers that were attempting to arbitrage the differential between Rate Schedule 3808 energy and market prices.<sup>509</sup> The BCUC established a public hearing process for the review of BC Hydro's Application on October 2, 2008.<sup>510</sup>

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<sup>506</sup> FortisBC-Zellstoff Celgar Power Supply Agreement, 21 August 2008, **R-248**.

<sup>507</sup> *Ibid.*, Article 15.1 (c) at 12-13, **R-248**: "Exporting Electrical Generation Output. The obligations of Celgar and FortisBC hereunder all shall be subject to the satisfaction of each of the following conditions: ... (c) all necessary approvals of the BCUC of the Power Agreements, including the BCUC Acceptance, shall have been obtained") The Power Supply Agreement defines "BCUC acceptance" in Article 1(h) as "the BCUC acceptance of the Agreement for filing on terms and conditions that do not materially alter the price or any other material terms or conditions thereof."

<sup>508</sup> Letter from Dennis Swanson to Erica M. Hamilton, Re: FortisBC Inc. Power Supply Agreement with [*sic*] Zelstoff Celgar Ltd. Partnership, 26 August 2008, **R-365**. Dennis Swanson Statement, ¶ 74.

<sup>509</sup> BC Hydro, Letter Filing Further Comments in the Matter of a Filing by FortisBC of an Umbrella Agreement for Short Term Firm or Non-Firm Point-to-Point Transmission Service

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242. FortisBC withdrew its Power Supply Agreement with the Claimant so that the BCUC could first consider the concerns BC Hydro raised with respect to the arbitrating of Rate Schedule 3808 energy by the City of Nelson.<sup>511</sup> The Claimant consented to the withdrawal as it was almost certain to standing as an intervener in the City of Nelson proceeding concerning the arbitrating of Rate Schedule 3808 energy.

243. BC Hydro argued in its application that the 1993 PPA prohibited FortisBC from exporting electricity while taking BC Hydro's Rate Schedule 3808 energy in order to prevent harm to BC Hydro's ratepayers. BC Hydro took the position that the same prohibition should also apply when FortisBC facilitated arbitrage by its customers (*i.e.*, Celgar and Nelson) to prevent the same harm to BC Hydro's ratepayers. It believed that FortisBC should not be permitted to do indirectly what it was prohibited from doing directly. It provided the BCUC with evidence that the Power Supply Agreements could result in approximately C\$16.7 million in harm to its ratepayers.<sup>512</sup>

244. FortisBC conceded in this proceeding that it would not be able to determine the extent to which the energy deemed to be supplied to Celgar or Nelson would contain Rate Schedule 3808 energy.<sup>513</sup> This position implicitly recognized that these transactions could

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(Umbrella Agreement) and a Power Coordination Agreement (PCA), and Applying for an Amendment to the Rate Schedule 3808 Power Purchase Agreement, 16 September 2008, **R-250**. *See also* BCUC Order G-48-09, **R-32**.

<sup>510</sup> *Ibid.*, **R-32**.

<sup>511</sup> *See generally* Letter from Joanna Sofield (BC Hydro) to Erica M. Hamilton (BCUC), Re: FortisBC Inc. Filing of an Umbrella Agreement for Short Term Firm or Non-Firm Point-to-Point Transmission Service and a Power Coordination Agreement, 16 July 2008, **R-366**. FortisBC filed the City of Nelson agreement before it finalised its agreement with Celgar. *See* Celgar. Final Submissions, in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 23 January 2009, **R-367**. *See* Letter from Brian Merwin to Erica M. Hamilton, Re: FortisBC Inc. filling of an Umbrella Agreement for Short Term Firm or Non-Firm Point to Point Transmission Service and the Power Coordination Agreement, dated July 11, 2008, **R-341**.

<sup>512</sup> BCUC Order G-48-09, s. 5.3 at 27, **R-32**.

<sup>513</sup> Dennis Swanson Statement, ¶ 79.

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lead to increased purchases under the 1993 PPA, and the arbitrage of some Rate Schedule 3808 energy.<sup>514</sup>

245. FortisBC, however, attempted to argue that these agreements would provide a significant benefit to its ratepayers, while having almost no impact on BC Hydro ratepayers.<sup>515</sup> It also argued that BC Hydro had an obligation to supply FortisBC with Rate Schedule 3803 energy under the 1993 PPA.<sup>516</sup> However, with respect to harm, FortisBC was ultimately forced to concede that if BC Hydro was required to pay more than \$45 MW/h for replacement energy "...there would be a risk of the increased costs flowing through to the BC Hydro ratepayer."<sup>517</sup>

246. FortisBC confirmed in the hearings that these agreements would likely lead to the negative arbitrage of BC Hydro's Rate Schedule 3808 electricity,<sup>518</sup> and ultimately conceded that the risk of increased costs could flow through to BC Hydro's ratepayers.<sup>519</sup>

247. Another intervener was the Joint Industry Electricity Steering Committee ("JIESC"), a non-profit organization comprised of large industrial customers that represents its members' interests before various bodies, including the BCUC. JIESC argued that the Power Supply Agreements would ultimately lead BC Hydro to incur increased costs by supplying increased electricity to FortisBC, which BC Hydro would then seek to recover from its customers. For this reason, JIESC supported BC Hydro's

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<sup>514</sup> *Ibid.*, ¶ 79.

<sup>515</sup> *Ibid.*, ¶ 80.

<sup>516</sup> *Ibid.*, ¶ 81. See also FortisBC, Responses to BCUC Information Request No. 3, in the in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, December 31 at Q1.7.6 (first p 6), **R-31**.

<sup>517</sup> *Ibid.*, at 5, **R-31**. See also Dennis Swanson Statement, ¶ 82.

<sup>518</sup> See e.g., FortisBC, Letter to the BCUC responding to BCUC Information Requests dated July 18, 2008, Re: Filing by FortisBC of Short-Term Firm or Short Term Non-Firm Service and the Power Coordination Agreement with the City of Nelson, 14 August 2008 at 2, **R-370**.

<sup>519</sup> FortisBC, Responses to BCUC Information Request No. 3, in the in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, December 31 at 5, **R-31**.

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position, arguing that BC Hydro's low cost electricity "should be used to serve the needs of the residential, commercial and industrial consumers of electricity in the province, and not to facilitate arbitrage activity that earns profits for certain customers at the expense of increased costs to other customers."<sup>520</sup>

248. The Claimant, in what would later become a familiar pattern before the BCUC, took the opposite extreme view, arguing that it would not be engaging in "arbitrage" at all "[a]s Zellstoff Celgar intends only to service its Mill load from energy acquired from FortisBC and to sell its own self-generation, Zellstoff Celgar will not be engaging in 'arbitrage' ..."<sup>521</sup>

**c) BC Hydro's "Side Letter Agreement" with the Claimant**

249. During the course of these BCUC proceedings, the Claimant approached BC Hydro and proposed a "side letter agreement" with respect to an exclusivity clause in the EPA. The Claimant now realized that, under the terms of its EPA, it was not permitted to sell electricity below its GBL to a third party. The Claimant thus requested the right to sell electricity below its GBL under the EPA should the BCUC decide that it was permissible for customers of FortisBC to arbitrage Rate Schedule 3808 electricity.<sup>522</sup> It also agreed to be bound by the exclusivity provision in the EPA should the BCUC determine that such arbitrage was impermissible.

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<sup>520</sup> Joint Industry Electricity Steering Committee, Final Argument, in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 21 January 2009, **R-92**.

<sup>521</sup> Celgar. Final Submissions, in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, 23 January 2009, at 29-30, **R-369**.

<sup>522</sup> Email from Brian Merwin to Bioenergy Call Re: Zellstoff Celgar Limited Partnership – Electricity Purchase Agreement, October 8, 2008, **R-131**; Letter from Brian Merwin to BC Hydro RFP Administrator, Re: Zellstoff Celgar Limited Partnership ("Celgar") – Celgar Green Energy Project, 8 October 2008, **R-132**; BC Hydro Red-line Electricity Purchase Agreement, Celgar Green Energy, 8 October 2008, **R-133**.

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250. BC Hydro and the Claimant eventually agreed to the wording of the side letter and finalized the EPA.<sup>523</sup> No other pulp mill has ever received this type of accommodation.

**d) The BCUC Protects BC Hydro Ratepayers from Arbitrage  
in BCUC Order G-48-09**

251. On May 6, 2009, the BCUC issued BCUC Order G-48-09 concerning BC Hydro's Application for an amendment to the 1993 PPA. The BCUC commenced its analysis by reviewing the existing prohibition in the 1993 PPA<sup>524</sup> and its previous regulatory decisions in BCUC Order G-38-01, G-17-02 and G-113-01.<sup>525</sup> These were the regulatory precedents that Mr. Swanson and his colleagues had discussed with the Claimant as being potentially problematic.<sup>526</sup>

252. After reviewing the relevant regulatory precedents, the BCUC concluded that permitting FortisBC customers to arbitrage Rate Schedule 3808 energy would be "unjust and unreasonable" and contrary to the "public interest" as it would cause harm to BC Hydro and its ratepayers<sup>527</sup> In particular, it observed that BC Hydro had submitted evidence which indicated that the harm to its ratepayers could amount to C\$16.7 million per year.<sup>528</sup> It also indicated that BCUC staff had estimated the harm to BC Hydro ratepayers of C\$12.3 million per year.<sup>529</sup> However, it also found that that "... the exact dollar amount of that impact is not important ..." and that the policy principles of BCUC

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<sup>523</sup> Celgar 2009 EPA, **R-135**.

<sup>524</sup> BCUC Order G-48-09, s.1.2 at 1-2, **R-32**.

<sup>525</sup> Dennis Swanson Statement, ¶ 83. BCUC Order G-48-09, s. 2.3 at 12-16, **R-32**.

<sup>526</sup> *Ibid.*, ¶ 83.

<sup>527</sup> BCUC Order G-48-09, s. 5.0 at 22, **R-32**.

<sup>528</sup> *Ibid.*, s. 5.3 at 27, **R-32**.

<sup>529</sup> *Ibid.*, s. 5.3 at 27, **R-32**.

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Order G-38-01 should apply in these circumstances to protect BC Hydro's ratepayers from harm.<sup>530</sup>

253. Although the BCUC found that self-generators in the FortisBC service area should be permitted to sell "excess" energy, it concluded that this "excess" energy should be defined as self-generated energy that was "net-of-load on a dynamic basis."<sup>531</sup> It also determined that:

The Commission Panel believes that in any short-term resolution of the policy issue addressed in the proceeding, there must be some definition for each self-generator of the historical baseline load served, or in the alternative, some means of monitoring, on a dynamic basis, excess self-generation net-of-load.<sup>532</sup>

254. It therefore found that, as an alternative to "net-of-load" sales, a self-generator could enter into an agreement with FortisBC to sell energy in excess of a "historical baseline load" (*i.e.*, a GBL). However, the BCUC concluded that it did not have sufficient evidence to make such a determination for Celgar or Nelson.<sup>533</sup>

255. The BCUC's decision meant that it ultimately agreed to BC Hydro's amendment and, by way of BCUC Order G-48-09, allowed BC Hydro's amendment to Section 2.1 of the 1993 PPA.<sup>534</sup> This meant that there was an additional restriction on FortisBC purchasing Rate Schedule 3808 power if and when its customers were selling self-generation below their loads. However, BCUC Order G-48-09 did not prevent FortisBC from supplying energy to its self-generators from FortisBC's non-Rate Schedule 3808 resources in these circumstances – a fact the Claimant would turn against FortisBC and its ratepayers in subsequent regulatory proceedings.

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<sup>530</sup> *Ibid.*, s. 5.3 at 27-28, **R-32**.

<sup>531</sup> *Ibid.* at 28-29, **R-32**. The BCUC also used the expression "net-of-load on a dynamic basis (*i.e.*, an hourly basis)" to describe this reality.

<sup>532</sup> *Ibid.* at 29, **R-32** [emphasis added].

<sup>533</sup> *Ibid.*, s. 6.2 at 30, **R-32**.

<sup>534</sup> *Ibid.*, **R-32**.

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**8. The Claimant and BC Hydro Reach an Agreement on [REDACTED]**

256. Following BCUC Order G-48-09 and the BCUC's approval of the EPA, BC Hydro entered into another special arrangement with Celgar intended at accommodating it for being located in FortisBC's service area, which they named [REDACTED].<sup>535</sup> This arrangement dealt with energy accounting issues related to the EPA and the GBL obligation as settled between the parties in the EPA. This arrangement was structured to treat Celgar, for the purposes of its payments under the EPA, as it would be treated if it was a BC Hydro customer.

257. [REDACTED]

258. The graph below summarizes the mechanics of this arrangement. [REDACTED]

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<sup>535</sup> The Claimant refers to [REDACTED] Energy in a footnote of the Memorial. Claimant's Memorial, ¶ 501, footnote 606. Brian Merwin also refers to the accommodation in a footnote of his witness statement. Brian Merwin Statement, ¶ 124, FN 52.

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[REDACTED]

259. [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

260. [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]



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**F. The Claimant Requests that the BCUC Impose a GBL on FortisBC that would permit Celgar to Engage in Arbitrage in a Manner that Would Cause Harm to Other Ratepayers**

**1. The Claimant Intervenes in FortisBC's Rate Design Proceedings to Request that the BCUC Impose a GBL on FortisBC (BCUC Orders G-156-10 and G-3-11)**

261. Although the BCUC had effectively prohibited the Claimant from engaging in arbitrage by amending the 1993 PPA, the Claimant refused to accept that it was prohibited from arbitraging this energy because of the harm it would cause to BC Hydro's ratepayers. The Claimant determined that the BCUC might be willing to replace the net-of-load on a dynamic basis standard with a "lower"<sup>537</sup> GBL that it negotiated with FortisBC (a "FortisBC GBL").<sup>538</sup> It subsequently approached FortisBC to request this FortisBC GBL of 3.5 MW.<sup>539</sup>

262. Mr. Swanson explains that FortisBC found it impossible to conclude an agreement with Celgar when it continued to insist on an extremely low GBL.<sup>540</sup>

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<sup>536</sup> Jim Scouras Statement, ¶ 65.

<sup>537</sup> See Merwin Witness Statement, ¶ 119. Mr. Merwin only mentions that Celgar requested a "lower" GBL and does not indicate that it requested a GBL of 3.5 MW.

<sup>538</sup> The Claimant appears to have been seeking an agreement with FortisBC to serve the Claimant's load in excess of the 3.5 MW FortisBC GBL. In other words, the Claimant's self-generation up to the FortisBC GBL would serve mill load, the remaining mill load between the FortisBC GBL and the GBL in the EPA with BC Hydro would be served through notional purchases from FortisBC. It is not clear whether the Claimant believed that these purchases could include Rate Schedule 3808 energy. See also BCUC Order G-48-09, **R-32**. ("The Commission Panel believes that in any short-term resolution of the policy issue addressed in the proceeding, there must be some definition for each self-generator of the historical baseline load served, or in the alternative, some means of monitoring, on a dynamic basis, excess self-generation net-of-load.")

<sup>539</sup> Dennis Swanson Statement, ¶ 148.

<sup>540</sup> *Ibid.*, ¶ 151.

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However, FortisBC has offered the Claimant a GBL of 41 MW using BC Hydro's GBL determination methodology.<sup>541</sup> However, the Claimant rejected this proposal.

263. At approximately the same time, FortisBC filed with the BCUC its 2009 Rate Design and Cost of Service Analysis for all classes of its customers.<sup>542</sup> The Claimant requested standing as intervener on the issue of FortisBC's obligation to serve the Claimant with a GBL, arguing that the BCUC should establish a GBL for Celgar as this would result in a material change to Celgar's revenue-to-cost ratio, which was relevant to the rate design.<sup>543</sup> The Claimant proposed that it would "file evidence in support of the establishment of a GBL at a specified level based upon historical data, competitive and policy considerations" as well as the effect the GBL would have on the rate design proceeding.<sup>544</sup> The BCUC subsequently approved Celgar's request to intervene on this issue.

264. As it was requesting that the BCUC impose a GBL on FortisBC, the Claimant argued that the BCUC had a sufficient factual basis to do so based on the principles set out in BCUC Order G-38-01<sup>545</sup> and the explanation Celgar provided of BC Hydro's practice of establishing GBLs for other pulp and paper mills.<sup>546</sup> The Claimant in contrast to its position in this arbitration also emphasized the importance of maintaining flexibility in GBL determinations indicating that it "... support[ed] the approach taken by BC Hydro – that GBLs are not to be determined by any set formula."<sup>547</sup> It also argued that:

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<sup>541</sup> *Ibid.*, ¶ 151.

<sup>542</sup> BCUC, Order G-35-10 and Decision in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 3 March 2010, at 1, **R-262**.

<sup>543</sup> Celgar, Letter to the BCUC, in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 15 February 2010, at 2-3, **R-371**. Celgar had already received status as an intervener in this rate design proceeding on other issues.

<sup>544</sup> *Ibid.*, at 8, **R-371**.

<sup>545</sup> Celgar, Evidence Submission, in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 15 March 2010, at 2 and 3, **R-280**.

<sup>546</sup> *Ibid.*, at 6-11, **R-280**.

<sup>547</sup> *Ibid.*, **R-280**. Compare Switlshoff Expert Report, ¶ 54: "BC Hydro appears to have proceeded

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the “determination of the GBL” should consider “unique customer circumstances.”<sup>548</sup>

The Claimant then asserted that a GBL of 1.5 MW based on its average energy sales from 1990-1992 would be sufficient to protect ratepayers from arbitrage.<sup>549</sup> It also suggested that FortisBC could simply secure the additional energy necessary to serve Celgar’s load from non-1993 PPA resources – a proposal that required FortisBC’s ratepayers to absorb the cost of Celgar’s arbitrage. The BCUC noted that Celgar later modified its position and asserted that it should receive a GBL of 0MW.<sup>550</sup>

265. After considering evidence submitted by FortisBC, the BCUC found in Order G-156-10 that the Claimant’s assertion that a GBL 1.5 MW would prevent arbitrage was false. It concluded that:

It is clear [...] that the effect of Celgar’s proposal that it be allowed to purchase the full mill load at embedded rates from FortisBC will require FortisBC to purchase an additional \$8.9 million from BC Hydro under RS 3808 at embedded (heritage) rates. While FortisBC might be indifferent financially to this proposal, it is clear that BC Hydro and its ratepayers would not be indifferent as it would oblige BC Hydro to pay incremental prices for the power or lose export opportunities. The Commission Panel considers that this would not be in the public interest.<sup>551</sup>

266. The BCUC also refused to impose a GBL on FortisBC in these circumstances. However, it encouraged the Claimant and FortisBC “[...] to establish their own GBL and,

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to set GBLs on an entirely *ad hoc* basis, making case-by-case determinations unguided and unfettered by any written process or methodology.”

<sup>548</sup> Celgar, Response to BCUC Information Request No. 1, in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 15 April 2010, Q 6.1, at 16-17, **R-372**.

<sup>549</sup> Celgar, Evidence Submission, in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 15 March 2010, at 11 and 24, **R-280**.

<sup>550</sup> See Celgar, Argument, in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 14 July 2010, ¶¶ 9, 15, **R-373**: “Celgar believes that it is entitled to a GBL of zero MW, but has elected a GBL of 1.5 MW.”

<sup>551</sup> BCUC, Order G-156-10 and Decision, in the Matter of an Application by FortisBC for Approval of a 2009 Rate Design and Cost of Service Analysis, 19 October 2010 (“BCUC Order G-156-10”), **R-228**.

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should they desire, incorporate it into a general service agreement and submit it to the Commission for approval.”<sup>552</sup> It also indicated that it was interested in the Claimant’s suggestion of having FortisBC serve some or all of Celgar’s mill load from its own resources (*i.e.*, excluding energy provided under the 1993 PPA).<sup>553</sup>

267. The BCUC in a separate determination in the same proceeding found that Celgar should be removed from FortisBC’s time-of-use rate (*i.e.*, Rate Schedule 33) and shifted to FortisBC’s normal industrial rate (*i.e.*, Rate Schedule 31). This determination was a direct result of Celgar’s failure to meet the requirements for the time-of-use rate under the FortisBC Electric Tariff. In particular, Celgar had failed to execute a written agreement with FortisBC for this service and had a poor load factor (*i.e.*, a low fluctuating load).<sup>554</sup>

268. After the BCUC issued Order G-156-10, the Claimant applied to the BCUC for reconsideration of this decision on December 3, 2010. The BCUC subsequently denied this application in Order G-3-11.<sup>555</sup> However, in doing so, it reiterated that FortisBC and Celgar should attempt to reach an agreement on a GBL in the context of a General Service Agreement so that it could be submitted for approval to the BCUC.<sup>556</sup> This practical direction did not yield a resolution, however, given the Claimant’s insistence on GBLs that were unreasonable from FortisBC’s perspective.<sup>557</sup>

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<sup>552</sup> *Ibid.*, at 115, **R-228**.

<sup>553</sup> *Ibid.*, **R-228**.

<sup>554</sup> *Ibid.*, at 66 and 67, **R-228**. Compare Brian Merwin Statement, ¶¶ 47, 133. Mr. Merwin erroneously asserts that Celgar and FortisBC executed the GSA for Rate Schedule 33 service and then appears to suggest that the BCUC’s adherence to the Electric Tariff was somehow punitive. (“When Celgar and FortisBC executed a General Service Power Contract on October 1, 2006 (which shifted Celgar from Rate Schedule 31 to Rate Schedule 33) ... After the BCUC ordered this switch from Rate Schedule 33 to Rate Schedule 31, Celgar’s annual electric bill increased dramatically, from around [REDACTED]”)

<sup>555</sup> BCUC Order G-156-10, at 2, **R-228**.

<sup>556</sup> *Ibid.*, at 10, **R-228**.

<sup>557</sup> Dennis Swanson Statement, ¶ 151.

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## 2. The Claimant Files a Complaint Against FortisBC

269. Although the BCUC had indicated that Celgar should negotiate with FortisBC, the Claimant decided instead to initiate a complaint against its utility two and half months after it received BCUC Order G-3-11 for its failure to provide it with a General Service Agreement.<sup>558</sup> It also failed to pay invoices for Rate Schedule 31 service that it received from FortisBC.<sup>559</sup>

270. Although the complaint raised a large number of issues, the Claimant's submissions concerning the failure of FortisBC to provide it with a General Service Agreement concerned the following:

- the Claimant's request that the BCUC impose a GBL on FortisBC;<sup>560</sup>
- whether FortisBC had an obligation as a utility to serve Celgar with its own embedded cost energy (*i.e.*, excluding BC Hydro's 1993 PPA energy) and the harm this could cause other FortisBC ratepayers;<sup>561</sup> and
- whether the BCUC should reconsider its decision in BCUC Order G-156-10 that moved Celgar from the time-of-use rate (*i.e.*, Rate Schedule 33) to FortisBC's normal rate for industrial customers (*i.e.*, Rate Schedule 31).<sup>562</sup>

271. The Claimant again reiterated its support for BC Hydro's approach to GBLs<sup>563</sup> and indicated that the BCUC had "extensive" evidence on the methodology BC Hydro

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<sup>558</sup> BCUC, Decision and Order G-188-11, Zellstoff Celgar Limited Partnership Complaint Regarding the Failure of FortisBC Inc. and Celgar to Complete a General Service Agreement and FortisBC's Application of Rate Schedule 31 Demand Charges, 14 November 2011 ("BCUC Order G-188-11"), **R-275**.

<sup>559</sup> FortisBC, Letter to the BCUC, Re Zellstoff Celgar Limited Partnership Complaints regarding the establishment of a General Service Agreement and a Billing Dispute, 6 April 2011, at 7, **R-375**.

<sup>560</sup> BCUC Order G-188-11 at 1, **R-275**.

<sup>561</sup> *Ibid.*, **R-275**.

<sup>562</sup> *Ibid.*, **R-275**.

<sup>563</sup> Celgar, Final Submission, in the Matter of a Complaint by Zellstoff Celgar Limited Partnership Regarding the Failure of FortisBC and Celgar to Complete a General Service Agreement and FortisBC's Application of Rate Schedule 31 Demand Charges, 15 August 2011, at 20, **R-376**.

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used for determining GBLs.<sup>564</sup> It also requested that the BCUC impose a GBL of 1.5 MW on FortisBC.<sup>565</sup> However, it also suggested that a GBL 15.4 MW or 11.6 MW could be acceptable.<sup>566</sup> The BCUC considered Celgar's arguments but found that a GBL is not a necessary component of a General Service Agreement and reaffirmed its determination that "... the issue of whether to incorporate such a GBL into a GSA [is] up to the [FortisBC and Celgar]."<sup>567</sup>

272. Having failed to persuade the BCUC that Celgar should be permitted to engage in arbitrage at the expense of BC Hydro ratepayers, the Claimant shifted its position to assert that FortisBC was required to supply it exclusively from its own embedded cost energy. FortisBC expressed concern that Celgar's ambition to export self-generated energy below the GBL in the EPA with BC Hydro, and replace it with purchases from FortisBC (excluding Rate Schedule 3808 energy), would harm FortisBC's ratepayers.<sup>568</sup> The Claimant rather predictably argued that its proposed GBL of 1.5MW would cause no such harm.

273. After considering all of Celgar's complaints, the BCUC directed FortisBC to undertake the following:

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<sup>564</sup> *Ibid.*, **R-376**.

<sup>565</sup> BCUC Order G-188-11 at 4, **R-275**: "A generation baseline (a "GBL") of 1.5MW or such other level as may be established in accordance with applicable regulatory parameters delineating self-supply obligations."

<sup>566</sup> Celgar GSA Complaint at 3, **R-264**.

<sup>567</sup> BCUC Order G-188-11 at 28, **R-275**.

<sup>568</sup> FortisBC, Final Submission, in the Matter of a Complaint by Zellstoff Celgar Limited Partnership Regarding the Failure of FortisBC and Celgar to Complete a General Service Agreement and FortisBC's Application of Rate Schedule 31 Demand Charges, 22 August 2011, ¶ 57, **R-377**: "A second issue is who should bear the incremental cost of any Non-3808 Power: Celgar or FortisBC's customer base as a whole. FortisBC itself does not believe that it is appropriate that incremental power purchase costs incurred solely to support Celgar's export activities should be blended with power purchase costs used to support FortisBC's native load customers, potentially adding unnecessary upward pressure on other customers' rates."

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- Develop a rate for Celgar based on FortisBC's industrial customers rate (i.e., Rate Schedule 31), which excluded BC Hydro's Rate Schedule 3808 energy by May 31, 2012;
  - Establish a notional matching methodology that would match sales to Celgar with energy sourced from FortisBC's own resources (i.e., excluding Rate Schedule 3808 energy) by March 31, 2012;
  - Consult with FortisBC's customers to develop guidelines on the level of entitlement for self-generating customers to FortisBC's embedded cost power; and
  - To design a stepped transmission rate and also a standby rate for Celgar by May 31, 2012.<sup>569</sup>

274. Finally, the BCUC determined, with respect to Celgar's complaint concerning Rate Schedule 31 service,<sup>570</sup> that FortisBC should invoice Celgar: "... on an interim and refundable basis beginning March 31, 2011, the date when the Complaint was filed, and ending when the Commission approves the new rate for Celgar that excludes PPA Power from its resource stack, and/or an Agreement forwarded by the parties. Any differences between the interim rate and that ultimately approved by the Commission are subject to refund/recovery, with interest ...".<sup>571</sup>

### 3. FortisBC issues Guidelines for Establishing Entitlement to FortisBC's Embedded Cost Energy and FortisBC's Application for Stepped and Stand-By Rates

275. After receiving BCUC Order G-188-11, FortisBC expended considerable time and effort in complying with the BCUC's direction.<sup>572</sup> FortisBC subsequently filed with the BCUC its proposed guidelines for establishing a self-generator's entitlement to

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<sup>569</sup> BCUC Order G-188-11 at 50, 51, **R-275**.

<sup>570</sup> *Ibid.*, at 11, 14 and 18, **R-275**: "In view of the foregoing, the Commission Panel determines that there is no pre-existing agreement in effect which modifies the billings to Celgar under RS 31 after January 2, 2011 [...] Accordingly, the Commission Panel determines RS31 is valid for Celgar, even in the absence of a signed, written agreement between Celgar and FortisBC. [...] The Commission Panel therefore determines that FortisBC's invoicing of Celgar for services delivered since January 2, 2011 is appropriate."

<sup>571</sup> *Ibid.*, at 18, **R-275**. [Emphasis Added].

<sup>572</sup> Dennis Swanson Statement, ¶ 125.

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FortisBC's non-PPA embedded cost power.<sup>573</sup> These guidelines concerned the amount of FortisBC's embedded cost energy a self-generator such as Celgar was entitled to use to supply its load as well as its methodology for acquiring non-BC Hydro PPA energy and matching that to the load of a self-generator.

276. FortisBC indicated in its proposed guidelines that a self-generator such as Celgar could request that it receive electricity to serve up to 100 percent of its load from FortisBC's non-PPA embedded cost energy. Not surprisingly, this position received the Claimant's full support.<sup>574</sup> FortisBC, however, also indicated that it would use the rate design process to protect other FortisBC ratepayers. This was unacceptable to Celgar which asserted that FortisBC had no obligation to protect its other ratepayers from harm when designing these rates.<sup>575</sup>

277. Although the B.C. MEM and BC Hydro expressed skepticism that FortisBC's proposal would be workable and prevent harm to ratepayers, the BCUC approved FortisBC's proposal to permit self-generators to supply up to 100 percent of their load with FortisBC's embedded cost power. The BCUC also found that:

[T]he issue of arbitrage is appropriately addressed in the stepped transmission rate design that FortisBC is directed to file by March 31, 2013. The Commission Panel directs that this rate design must accord with the Fair Treatment provision of the APA which, in the Commission Panel's view, prevents against self-generators arbitraging the [non-BC Hydro embedded cost power] to the detriment of other FortisBC ratepayers.<sup>576</sup>

278. This again reaffirmed the BCUC's emphasis on preventing harm to other ratepayers.

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<sup>573</sup> BCUC, Decision and Order G-202-12, in the Matter of FortisBC Inc, Guidelines for Establishing Entitlement to Non-PPA Embedded Cost Power and Matching Methodology (Compliance Filing to Order G-188-11), December 27, 2012 ("BCUC Order G-202-12"), at 1. **R-265.**

<sup>574</sup> *Ibid.*, at 4-5, **R-265.**

<sup>575</sup> *Ibid.*, at 7, **R-265.**

<sup>576</sup> *Ibid.*, at 8, **R-265.** [Emphasis Added].



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279. FortisBC also explained its proposed methodology for matching sales to a self-generator to its non-PPA resources. In particular, FortisBC indicated that it would match 100 percent of the energy with a matching block purchase of energy from either its own surplus energy or the Mid-C market.<sup>577</sup>

280. Celgar opposed the proposal to source notionally matched energy from the Mid-C market asserting that FortisBC only had an obligation to ensure that the energy supplied directly to Celgar was not BC Hydro's 1993 PPA energy.<sup>578</sup> Celgar proposed that FortisBC could increase its purchases of BC Hydro 1993 PPA energy for its other customers while supplying Celgar from its other resources. This proposal was effectively the same proposal that Celgar had made and the BCUC had rejected in Order G-48-09. The BCUC approved FortisBC's proposal and directed it to design a stepped and standby rate that would protect its other customers from arbitrage.<sup>579</sup>

281. As an alternative to the stepped and standby rate, FortisBC also filed its own proposed GBL for Celgar employing BC Hydro's GBL calculation methodology. FortisBC submitted that:

FortisBC believes that a GBL of approximately 41 MW is appropriate for Celgar based on historical generation and energy consumption. Such a GBL would ensure that generation that was previously used by Celgar to serve load would continue to do so, and would thereby mitigate arbitrage of FortisBC embedded cost power. Generation that is incremental to this historical level would be available to the customer for export.<sup>580</sup>

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<sup>577</sup> *Ibid.*, at 12, **R-265**.

<sup>578</sup> *Ibid.*, at 13, **R-265**.

<sup>579</sup> *Ibid.*, at 15 **R-265**.

<sup>580</sup> FortisBC, Reply to Submissions in the Matter of a Filing by FortisBC of Guidelines for Establishing Entitlement to Non-PPA Embedded Cost Power and Matching Methodology (Compliance Filing to Order G-188-11), July 4, 2012, p. 25, **R-266**.

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282. The BCUC in rejecting this proposal observed that FortisBC and Celgar remained “unable” to reach an agreement on a GBL and that the BCUC did not have a basis upon which to “force such an agreement or dictate what a GBL should be.”<sup>581</sup>

283. Although FortisBC filed a proposal for stepped and standby rates on May 28, 2013,<sup>582</sup> the BCUC subsequently suspended its review of certain elements of the FortisBC application while it considered BC Hydro and FortisBC’s new PPA, which also raised issues relating to self-generation in FortisBC’s service area. The BCUC proceedings concerning the new PPA are discussed in greater detail below.

284. After further consideration, the BCUC issued Order G-67-14 concerning the remaining elements of FortisBC’s proposed stepped and stand-by rates for industrial customers on May 26, 2014.<sup>583</sup> The BCUC decided that stepped rates should not be implemented but approved many elements of the proposed stand-by rate.<sup>584</sup> However, it deferred a decision on a number of issues, including the availability and restrictions on stand-by service, as well as the determination of contract demand for Celgar.<sup>585</sup> The FortisBC self-generator rate (excluding BC Hydro’s 1993 PPA energy) was raised again by the BCUC on June 30, 2014 when it sought submissions on whether this rate was relevant to the retroactive invoicing for Celgar and whether it should continue to delay consideration of this rate or include it in the FortisBC Self-Generation Policy Application (which is explained in more detail below).

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<sup>581</sup> BCUC Order G-202-12 at 11, **R-265**.

<sup>582</sup> BCUC, Order G-12-14 and Decision, in the Matter of an Application by FortisBC for Stepped and Stand-By Rates for Transmission Voltage Customers, February 3, 2014, at 2, **R-267**.

<sup>583</sup> BCUC, Order G-67-14 and Decision, in the Matter of an Application by FortisBC for Approval of Stepped and Stand-By Rates for Transmission (Voltage) Customers, 26 May 2014, (“BCUC Order G-67-14”), **R-211**.

<sup>584</sup> *Ibid.*, **R-211**.

<sup>585</sup> *Ibid.*, **R-211**.

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#### 4. BCUC Proceedings Concerning the 2014 BC Hydro-FortisBC PPA

285. As explained above, BC Hydro and FortisBC completed their PPA negotiations to replace the 1993 PPA in May 2013 and BC Hydro submitted the new PPA (“2014 PPA”) to the BCUC for approval on May 24, 2013.<sup>586</sup> The 2014 PPA was negotiated under the same basic parameters as the previous 1993 PPA.<sup>587</sup> Section 2.5 of the 2014 PPA superseded Section 2.1 of the 1993 PPA, as amended by Order G-48-09.<sup>588</sup> Just like Section 2.1 of the 1993, Section 2.5 of the 2014 PPA was based on the principle that energy purchased by FortisBC under the PPA would be used solely for the purpose of supplementing FortisBC’s resources for it to serve its service area load, and should not be used for arbitrage purposes, whether by FortisBC itself or one of its customers.<sup>589</sup> But unlike Section 2.1 of the 1993 PPA, Section 2.5 of the proposed 2014 PPA did not maintain the net-of-load on a dynamic basis criterion of Order G-48-09, limiting FortisBC’s access to PPA power when supplying power to self-generating customers engaged in market sales below their loads. Rather, the new provision called for the establishment, by FortisBC of a generator baseline policy consistent with how BC Hydro establishes such baselines for its own customers. Therefore, under the 2014 PPA, FortisBC would be prohibited from purchasing PPA energy from BC Hydro only where it provided service to such self-generating customers below this baseline.<sup>590</sup>

286. Section 2.5 of the proposed 2014 PPA quickly became a contentious issue in this proceeding. On December 13, 2013, the BCUC requested that BC Hydro and the interveners in the proceeding provide submissions on this specific issue.<sup>591</sup> In response,

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<sup>586</sup> Pursuant to the *Utilities Commission Act*, s 58 to 61, **R-205**.

<sup>587</sup> BCUC Order G-60-14, at i and 15-24, **R-221**.

<sup>588</sup> *Ibid.*, at 17, **R-221**.

<sup>589</sup> BC Hydro, Application for Approval of New Power Purchase Agreement (PPA) with FortisBC Inc., Appendix A at 13, **R-320**.

<sup>590</sup> *Ibid.*, **R-320**.

<sup>591</sup> BCUC, Letter, in the Matter of an Application by BC Hydro for Approval of Rates between BC

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Celgar argued against the insertion of a baseline requirement in the 2014 PPA, which, as its argument proceeded, would be “derived from untested and unreviewed guidelines, unilaterally issued by BC Hydro without public comment”.<sup>592</sup> It made further submissions against the GBL settled on with BC Hydro in the 2009 EPA, and again suggested that it should be entitled to sell electricity generated below its EPA GBL to third parties,<sup>593</sup> notwithstanding the fact that it had not been able to reach an agreement with FortisBC on the issue despite repeated encouragement from the BCUC to do so.<sup>594</sup>

287. Celgar also minimized the potential harm to BC Hydro ratepayers that would result from such transaction, relying on the allegations that (1) the surplus energy supply position in which BC Hydro finds itself would prevent the occurrence of such harm; (2) the prevailing low market prices meant that BC Hydro would be no worse off in the event it should purchase make-up power to facilitate Celgar's arbitrage; and (3) FortisBC did not anticipate replacing electricity supplied to self-generating customers engaged in market sales with PPA power, with or without a prohibition to that effect in the agreement, since the incorporation of a stepped rate mechanism in the 2014 PPA would deter it from relying extensively on PPA purchases.<sup>595</sup>

288. On May 6, 2014, the BCUC rendered Order G-60-14 and an accompanying decision, in which it reaffirmed its findings in G-48-09 and G-38-01 to the effect that self-generating customers, including those located in FortisBC's service territory, “should not be permitted to arbitrage between embedded cost rates and market prices to the

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Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, 13 December 2013, at 2, **R-324**.

<sup>592</sup> Celgar, Further Submissions, in the Matter of an Application by BC Hydro for Approval of Rates between BC Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, 27 January 2014, at ¶ 2, **R-329**.

<sup>593</sup> *Ibid.*, ¶¶ 43-56, **R-329**.

<sup>594</sup> *Ibid.*, **R-329**.

<sup>595</sup> *Ibid.*, ¶¶ 84-96, **R-329**.

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detriment of other ratepayers”.<sup>596</sup> The BCUC also determined that the evolving self-generation policies in FortisBC’s service area contributed to the challenge of preventing harmful arbitrage of PPA energy, and therefore directed FortisBC to initiate a consultation process with its customers to develop and apply to the BCUC for approval of self-generation policies for the FortisBC service area which would address the risk of arbitrage.<sup>597</sup> It also approved BC Hydro’s 2014 application conditional on BC Hydro initiating a consultation process for the establishment of guidelines for the new 2014 PPA Section 2.5.<sup>598</sup> Celgar requested a re-consideration of Order G-60-14, which was later denied by the Commission.<sup>599</sup> It subsequently filed notices of application for leave to appeal BCUC Orders G-60-14 and G-93-14 with the B.C. Court of Appeal

#### **5. BCUC Proceeding Concerning Tolko Industries Ltd. (Kelowna)**

289. As outlined above, the BCUC decided in Order G-113-01 that the Riverside (Kelowna) sawmill was exempt from certain provisions of the *UCA* for sales of self-generated electricity above a 2 MW historical self-generation baseline. The BCUC determined that sales above this baseline would be “incremental” to Riverside’s historical generation such that West Kootenay Power and its customers would be protected from arbitrage.<sup>600</sup> Riverside was subsequently acquired by Tolko Industries Ltd. (“Tolko”) in late 2004. However, this sawmill (now known as Tolko (Kelowna)) only sold self-

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<sup>596</sup> BCUC Order G-60-14, at 100, **R-221**.

<sup>597</sup> *Ibid.*, at 104, **R-221**.

<sup>598</sup> *Ibid.*, at 100, **R-221**.

<sup>599</sup> BCUC, Order G-93-14 and Decision in the Matter of an Application by Zellstoff Celgar Limited Partnership for Reconsideration of Order G-60-14 Approval of Rates between BC Hydro and FortisBC Inc. with regards to Rate Schedule 3808, Tariff Supplement No. 3 – Power Purchase and Associated Agreements, and Tariff Supplement No. 2 to Rate Schedule 3817, July 10, 2014, **R-271**.

<sup>600</sup> BCUC Order G-113-01, at 1, ¶¶ C and F, **R-20**.

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generated energy to the City of Kelowna and FortisBC on a net-of-load basis in the period following BCUC Order G-113-01 (*i.e.*, from 2001-present).<sup>601</sup>

**a) Tolko's Application to Reaffirm its Rights to Sell Energy In Excess of its GBL (BCUC Order G-198-11)**

290. In early 2011, Tolko (Kelowna) approached FortisBC concerning the potential sale of its self-generated energy.<sup>602</sup> [REDACTED]

[REDACTED].<sup>603</sup> In light of its experience with the Celgar and City of Nelson agreements, FortisBC refused to enter into a power purchase agreement without BCUC approval. It therefore requested that Tolko seek reaffirmation of BCUC Order G-113-01 in light of the net-of-load standard set out in BCUC Order G-48-09.<sup>604</sup>

291. Tolko, therefore, applied to the BCUC on March 2, 2011 to request the reaffirmation of its ability to sell incremental energy in excess of the 2 MW baseline.<sup>605</sup> BC Hydro and Celgar both requested to intervene in this proceeding.<sup>606</sup> The question to be answered by the Commission was whether Tolko's 2 MW baseline should be reaffirmed in light of BCUC Order G-48-09.<sup>607</sup> Tolko argued that the BCUC's decision in Order G-48-09 did not apply to Tolko's sales of self-generation as it was not a direct customer of FortisBC, and rather purchased electricity from the City of Kelowna.<sup>608</sup>

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<sup>601</sup> Dennis Swanson Statement, ¶ 95.

<sup>602</sup> *Ibid.*, ¶ 96.

<sup>603</sup> See Email from Standing Offer to Leon Cender Re: Tolko Project – Fortis Customer, 8 March 2011, **R-379**.

<sup>604</sup> Dennis Swanson Statement, ¶ 96.

<sup>605</sup> BCUC Order G-198-11 at 1, **R-257**.

<sup>606</sup> BCUC Order G-113-01, **R-20**. BC Hydro, Notice of Intervention, in the Matter of An Application by Tolko Industries Ltd. – Kelowna Decision for Reaffirmation of its Ability to Sell Power Generation in Excess of the First 2 MW of Generation in each hour as per Order G-113-01, 30 March 2011, **R-380**.

<sup>607</sup> BCUC Order G-198-11, Appendix A at 2, **R-257**.

<sup>608</sup> *Ibid.*, **R-257**.

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292. The BCUC in Order G-198-11 reaffirmed the 2 MW baseline.<sup>609</sup> Celgar did not oppose Tolko's request, which the BCUC found to be of importance in reaching this decision.<sup>610</sup> However, Celgar took this proceeding as an opportunity to bring forward its arguments that it should be awarded a GBL in relation to FortisBC. Celgar argued for instance that:

if a GBL is available to Tolko it must also be available to Celgar. Therefore, the conclusion that the net of load on a dynamic basis criteria applies to all self-generators should then be followed by a conclusion that a GBL is available to direct and indirect customers of FortisBC, as an alternative to the net of load on a dynamic basis criteria.<sup>611</sup>

293. But having disposed of Tolko's application on the basis that the directions of Order G-48-09 do not apply in respect of sales of self-generation by Tolko, an indirect customer of FortisBC, the BCUC did not make any determinations in relation to Celgar's arguments.

**b) FortisBC's Application to Purchase the Utility Assets of the City of Kelowna and Celgar's Intervention Concerning Tolko (Kelowna)**

294. FortisBC became interested in purchasing the City of Kelowna's utility assets around the same timeframe.<sup>612</sup> This purchase required FortisBC to obtain a Certificate of Public Convenience and Necessity from the BCUC.<sup>613</sup> It, therefore, applied for BCUC approval of its proposed purchase of the City of Kelowna's distribution assets on November 13, 2012.<sup>614</sup>

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<sup>609</sup> *Ibid.*, **R-257**.

<sup>610</sup> *Ibid.*, Appendix A, at 2 and Appendix 1 at 1, **R-257**.

<sup>611</sup> Celgar, Final Submission, in the Matter of An Application by Tolko Industries Ltd. – Kelowna Decision for Reaffirmation of its Ability to Sell Power Generation in Excess of the First 2 MW of Generation in each hour as per Order G-113-01, 17 June 2011, ¶ 7, **R-394**.

<sup>612</sup> Dennis Swanson Statement, ¶ 99.

<sup>613</sup> *UCA*, s. 45(1), **R-205**.

<sup>614</sup> FortisBC, Application to the BCUC for a Certificate of Public Convenience and Necessity for

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295. On December 2, 2012, Celgar requested intervener status, alleging that it would be affected by the proceeding since Tolko (Kelowna) would become a direct customer of FortisBC, which with respect to sales of self-generation would place them in same situation as Celgar. In particular, Celgar argued that as a FortisBC customer it would be receiving differential treatment in light of the Tolko (Kelowna) 2 MW baseline. It therefore requested that “issues related to 3808 [i.e., PPA] purchases by FortisBC from BC Hydro [be] fully considered [by the BCUC]”.<sup>615</sup>

296. After considering FortisB’s application, the BCUC issued Order G-4-13, which conditionally approved FortisBC’s Certificate of Public Convenience and Necessity.<sup>616</sup> However, it also decided that it would hold a second phase concerning the issue of potential discrimination between FortisBC customers.<sup>617</sup> In this second phase, Celgar submitted that “service to Tolko based on levels exceeding a GBL and not exceeding load requirements will be discriminatory to Celgar”.<sup>618</sup> In turn, it argued that “the Commission Panel [needed] to determine whether FortisBC [had] been willing to enter into *bona fide* negotiations for a GBL for Celgar” and that such issue was central in this proceeding.<sup>619</sup>

297. On November 22, 2013, the BCUC issued Order G-191-13 and determined that:

[g]iven the Panel’s conclusion that the ability to sell self-generation on a ‘net of load’ basis is not equivalent to the ability to sell self-generation

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the Purchase of the Utility Assets of the City of Kelowna, 13 November 2012, **R-381**; *See also* BCUC Order C-4-12, in the Matter of an Application by FortisBC Inc. for a Certificate of Public Convenience and Necessity for the Purchase of Utility Assets of the City of Kelowna, 26 March 2013, at I, **R-382**.

<sup>615</sup> Celgar, Letter from Robert Hobbs to the BCUC Requesting Intervener Status, in the Matter of an Application by FortisBC Inc. for a Certificate of Public Convenience and Necessity for the Purchase of Utility Assets of the City of Kelowna, 7 December 2012, **R-383**.

<sup>616</sup> BCUC Order C-4-12, in the Matter of an Application by FortisBC Inc. for a Certificate of Public Convenience and Necessity for the Purchase of Utility Assets of the City of Kelowna, 26 March 2013, **R-384**.

<sup>617</sup> BCUC Order G-191-13, at 2, **R-261**.

<sup>618</sup> *Ibid.*, at 15, **R-261**.

<sup>619</sup> *Ibid.*, at 23-24, **R-261**.



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pursuant to a GBL which is less than load, from the perspective of the customer, the Panel finds that once Celgar and Tolko became customers of the same utility, they were, as two self-generating customers, under substantially similar circumstances and conditions. The Panel further finds that FortisBC offering service on different bases to these two customers will constitute a situation of “undue discrimination, preference, prejudice or disadvantage” in respect of this service, within the meaning of section 59(4)(b) of the Act.”<sup>620</sup>

298. The BCUC again refused to accede to Celgar’s request that it compel FortisBC to determine a GBL for Celgar. Although it revoked Tolko’s 2 MW baseline in light of the purchase of the City of Kelowna’s assets by FortisBC, the BCUC nonetheless found that this determination was without prejudice to the ability of FortisBC to negotiate an agreement to prevent arbitrage with its self-generating customers such as Tolko (Kelowna) and Celgar.<sup>621</sup>

**G. The Claimant Attempts to Convince British Columbia to Permit Arbitrage through Political Pressure**

299. Despite the B.C. Government’s unequivocal position against arbitrage, the Claimant not only challenged this position in BCUC regulatory proceedings, but also continued to lobby the B.C. Government to allow it to arbitrage between embedded-cost of service rates and higher market prices.

300. Mercer’s persistent lobbying of BC took place in cooperation with other self-generators through the Pulp and Paper Self-Generation Working Group, and individually through Mercer’s meetings with various B.C. Ministers, and with Mr. Les MacLaren, Assistant Deputy Minister of the Electricity and Alternative Energy Division of the Ministry of Energy.

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<sup>620</sup> *Ibid.*, Appendix A at 21, **R-261**.

<sup>621</sup> *Ibid.*, Appendix A at 22, **R-261**.

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## 1. Mercer's Lobbying of B.C. Government through the Pulp and Paper Working Group

301. At the end of 2007, the BC Government, BC Hydro, and pulp and paper industry representatives formed the Pulp and Paper Self-Generation Working Group (“Working Group”)<sup>622</sup> in response to a “Position Paper on Electricity Conservation & Generation”<sup>623</sup> presented by the Pulp and Paper Task Force (“Task Force”), a pulp and paper industry association chaired by Mercer’s chief financial officer, Mr. David Gandossi.<sup>624</sup> The Working Group was mandated to review electricity generation and conservation pricing options and to provide recommendations to the BC Government about how industrial self-generation should be managed.<sup>625</sup>

302. In its paper, the Task Force had made a number of key recommendations aimed at – as it stated – “helping BC achieve its Energy Plan Goals” and provide for the “revitalization of BC’s [pulp and paper] sector”.<sup>626</sup> The paper suggested for instance that “[a]ll existing [pulp and paper actors’] generation output should receive a value equivalent to BC Hydro’s [higher] Tier Two industrial power rates.” Another key recommendation concerned incremental generation and conservation, which the paper suggested should be priced at the highest rate offered by BC Hydro to independent power producers in EPAs concluded during the Bioenergy Call for Power.<sup>627</sup>

303. In essence, the Task Force’s recommendations amounted to a request for a significant subsidy, an after the fact financial reward for the investments made by pulp

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<sup>622</sup> David Gandossi Statement, ¶ 59. Pulp and Paper Working Group on Self-Generation, Summary Notes – January 25 Conference Call, 28 January 2008, **R-385**. See also Working Group on Pulp and Paper Self-Generation Sales Policy, DRAFT Terms of Reference, 30 January 2008, **R-386**.

<sup>623</sup> Pulp and Paper Task Force, Position Paper on Electricity Conservation & Generation, 22 November 2007, (“Position Paper on Electricity Conservation & Generation”), **R-28**.

<sup>624</sup> David Gandossi Statement, ¶¶ 7, 55.

<sup>625</sup> Les MacLaren Statement, ¶ 92.

<sup>626</sup> Position Paper on Electricity Conservation & Generation, bates 063273, **R-28**.

<sup>627</sup> *Ibid.*, bates 063275, **R-28**.

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mills in generation assets, regardless of the business decisions which initially guided their investments. Pursuant to the Task Force's recommendation, industrial self-generators such as Celgar should have been allowed to serve their entire load with embedded cost power purchases from their utility irrespective of the portion of their loads that they had historically self-supplied, *i.e.*, to arbitrage utility-supplied power.

304. However, as Mr. MacLaren points out in his witness statement,

The Task Force's recommendation was unacceptable to the BC Government whose position was (and remains) that the sale of existing self-generation historically used to meet a self-generator's load is not an option, given that it would increase revenue requirements for the utility and thereby put upward pressure on rates. Accordingly, the BC Government's position was that only incremental electricity generation (*i.e.*, incremental to the amount of generation historically used to meet mill load) should be valued at market prices.<sup>628</sup>

305. That message was made clear at the February 7, 2008 Working Group meeting about the self-generation of electricity, where the Ministry of Energy explained that the "Direction from the Ministers" was that: (1) they were "[n]ot looking at re-pricing electricity"; (2) the "treatment of incremental power is already clear"; and (3) they were "[n]ot looking for a solution that just pays more for what is already being produced".<sup>629</sup>

306. The Ministry reiterated its position in a June 24, 2008 Working Group meeting where it advised that "incremental generation is, and should be, priced on the margin but that neither re-pricing of existing generation nor arbitrage against heritage power prices is acceptable".<sup>630</sup> A similar message appeared in a September 23, 2008 draft MEM Briefing Note which stated, "The Provincial government has made its view clear that new,

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<sup>628</sup> Les MacLaren, Statement, ¶¶ 90.

<sup>629</sup> Pulp & Paper Task Force on Self-Generation, Draft Meeting Notes, 7 February 2008, at 1, **R-387**.

<sup>630</sup> Pulp & Paper Self-Generation Working Group, Draft Meeting Notes, 24 June 2008, **R-30**. As an active member of the Working Group, Mercer would have received these Meeting Notes. *See also* David Gandossi Statement, ¶ 60.

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incremental supply should be, and is, valued at market prices but re-pricing of existing supply is not an option; and the government cannot support approaches that facilitate arbitrage against low heritage prices”.<sup>631</sup>

307. Both the relevant, contemporaneous documents and Mercer's Memorial materials<sup>632</sup> make it clear that Mercer fully understood the anti-arbitrage position of BC, BC Hydro, and the BCUC.

## 2. Mercer's Persistent Lobbying of the B.C. Government

308. In the years following, and in spite of, Order G-48-09 and the B.C. Government and BC Hydro's clear stand against arbitrage, Mercer nevertheless continued to lobby the Government.

309. Mr. MacLaren was one of the recipients of Mercer's lobbying efforts,<sup>633</sup> and describes a meeting with David Gandossi and Brian Merwin, on October 1, 2008, during which Celgar's representatives argued aggressively in favor of re-pricing existing generation at the Celgar mill, alleging that the continuation of self-generation had otherwise become uneconomic due to fuel costs and overhead.<sup>634</sup>

310. But a briefing note of the Ministry of Energy, dated October 20, 2008, demonstrate that, despite Mercer's lobbying, the B.C. Government's policy position remained unchanged. It did not support the re-pricing to market of utility-supplied electricity, at low embedded cost.<sup>635</sup>

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<sup>631</sup> British Columbia Ministry of Energy, Mines and Petroleum Resources, Draft Briefing Note for Information, 23 September 2008, at 3, **R-388**. See also David Gandossi Statement, ¶ 60.

<sup>632</sup> Claimant's Memorial, ¶¶ 260-262.

<sup>633</sup> Les MacLaren Statement, ¶¶ 103-113.

<sup>634</sup> *Ibid.*, ¶ 104.

<sup>635</sup> British Columbia Ministry of Energy, Mines and Petroleum Resources, Briefing Note for Decision, Re: Progress Report on the Pulp & Paper Self-Generation Working Group, 20 October 2008, **R-35**. Around the same time Celgar was also attempting to convince other pulp mills of

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311. One year later, in September 2009, Mercer met with the Minister of Forests and Range and provided briefing materials supporting its contention that competitor mills had been given preferential treatment by BC Hydro in the purchase of their self-generated electricity.<sup>636</sup> Mercer, in turn, lobbied the government seeking the recognition – some 16 years later – of the investment made by the previous owners, in 1993, toward the new 52 MW turbine. Mercer's argument posited that the resulting increased generation should be recognized as incremental, which would entitle Celgar to a GBL of 3.5 MW.<sup>637</sup>

312. One month later, on October 29, 2009, Brian Merwin met again with Mr. MacLaren and staff with the Ministry of Energy, at which time he advocated for a GBL between 3 MW and 20 MW as “a fair solution to level the playing field”.<sup>638</sup> Mr. Merwin took the position that a 3 MW GBL was warranted as this would reflect the level of generation from Celgar's previous turbine which had operated prior to 1993. Mr. Merwin's alternative position made the case for a 20 MW GBL, which – he argued – would put Celgar on an equal footing with Howe Sound Pulp and Paper.<sup>639</sup>

313. Mercer's lobbying efforts continued and on November 24, 2009, its representatives met with the new Minister of Energy, Mines, and Petroleum Resources, Blair Lekstrom, and the Minister of Forests and Range, Pat Bell. Once again, Mercer

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their scheme to re-price existing generation. These efforts also failed. As Mr. Fominoff at Howe Sound describes, “After discussing it internally, Howe Sound decided that the possibility of convincing the government to agree to the proposal [to sell below-GBL generation] was extremely remote, and would face opposition from all other BC Hydro ratepayers. We did not invest any resources in pursuing this proposal.” (Witness Statement of Fred Fominoff, ¶ 40).

<sup>636</sup> Email Exchange between Celgar and Ministry of Energy, Re: Meeting with Les MacLaren next week, 22 October 2009, **R-36**. In that same month, Mercer also met with BC Hydro to complain about the alleged “unlevel playing field” it faced because it was a customer of FortisBC, not BC Hydro.

<sup>637</sup> British Columbia Ministry of Energy, Mines and Petroleum Resources, Briefing Note re Celgar Existing Generation, 1 September 2009, **R-37**; Ministry of Energy, Mines and Petroleum Resources Briefing Note Re: Celgar Existing Generation, 1 September 2009, **R-38**; Mercer Presentation, Celgar's Existing Generation, Presentation to Minister Bell, September 2009, **R-39**.

<sup>638</sup> Mercer International, Leveling the Playing field – Briefing Note, 26 October 2009, at 8, **R-41**.

<sup>639</sup> *Ibid.*, **R-41**.

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represented that it should obtain a GBL between 3 MW and 20 MW. But by letter dated February 22, 2010, Minister Lekstrom reiterated that government policy does not support re-pricing existing self-generation.<sup>640</sup>

314. On August 17, 2011 David Gandossi and Brian Merwin met with the Minister of Energy, Mines and Petroleum Resources, Rich Coleman. Mr. Merwin insisted that Celgar lacked the opportunities given to its competitors in BC Hydro territory and, once more, requested the establishment of a lower GBL for the Celgar mill. However, he provided no suggestion as to how to set such a lower GBL, nor did he explain how this would affect the GBL in Celgar's EPA with BC Hydro.<sup>641</sup>

315. Finally, Brian Merwin organized a meeting with Minister Rich Coleman, originally scheduled for January 24, 2012, during which Mr. Merwin intended to request an amendment to the EPA allowing for below GBL sales with make-up power served by (non 1993 PPA) FortisBC resources.<sup>642</sup> However, Mr. Merwin cancelled the meeting at the last minute, as Mercer had decided to submit a NAFTA claim.<sup>643</sup>

316. In the end, as Mr. MacLaren explains in his witness statement:

Throughout the Ministry's meetings with representatives of Mercer, Ministry staff listened to Mercer's concerns about the generation baseline in the EPA between Celgar and BC Hydro as well as Mercer's concerns regarding the development of the rules governing sales of self-generation in

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<sup>640</sup> Letter from Minister Blair Lekstrom (Ministry of Energy) to David Gandossi and Brian Merwin, 22 February 2010, **R-42**. See also Les MacLaren Statement, ¶ 109; British Columbia Ministry of Energy, Mines and Petroleum Resources, Briefing Note for Decision, 11 January 2010, **R-389**.

<sup>641</sup> Mercer International, Presentation and Meeting with Minister Rich Coleman, Re: Celgar Energy Issues, 17 August 2011, **R-43**. See also British Columbia Ministry of Energy, Mines and Petroleum Resources, Briefing Note for Information, 25 August 2011, **R-390**.

<sup>642</sup> Letter from Brian Merwin (Mercer) to Olha Lui (BC Hydro) re Electricity Purchase Agreement between Zellstoff Celgar Limited Partnership and British Columbia Hydro and Power Authority, 23 January 2012, **R-45**.

<sup>643</sup> Email from T. Myers to L MacLaren, 24 January 2012, **R-46**; Briefing Note, Celgar Pulp Mill Power Generation, **R-47**. See also Les MacLaren Statement, ¶ 112.

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FortisBC's service territory. The Ministry determined, however, that there was no compelling reason to change to the generation baseline in the EPA.<sup>644</sup>

317. Mercer's persistent efforts to lobby government officials to overturn restrictions on its ability to arbitrage were ultimately unsuccessful and B.C. Government policy has remained consistent with respect to the arbitrage of energy by self-generators.

### III. THE TRIBUNAL LACKS JURISDICTION TO HEAR CERTAIN OF THE CLAIMANT'S ALLEGATIONS

#### A. Concise Statement of Canada's Position

318. The Claimant bears the burden of proving that the measures which it is challenging unambiguously fall within the ambit of the Tribunal's jurisdiction.<sup>645</sup> The Claimant has failed to meet that burden with respect to the GBL that was set by BC Hydro for two reasons.

319. First, BC Hydro is a state enterprise and thus, pursuant to Article 1503(2), the Tribunal only has jurisdiction to consider its actions which are an exercise of "regulatory, administrative or other governmental authority [...] delegated" to it by Canada. The setting of Celgar's GBL by BC Hydro was not an exercise of delegated governmental

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<sup>644</sup> *Ibid.*, ¶ 113.

<sup>645</sup> *ICS Inspection and Control Services Limited (U.K.) v. The Argentine Republic* (UNCITRAL) Award on Jurisdiction, 10 February 2012, ¶ 280, **RA-18** (emphasis added) ("[A] State's consent to arbitration shall not be presumed in the face of ambiguity. [...] Where a claimant fails to prove consent with sufficient certainty, jurisdiction will be declined."). See also *Apotex Inc. v. The United States of America* (UNCITRAL) Award on Jurisdiction and Admissibility, 14 June 2003, ¶ 150, **RA-4**; *Methanex Corporation v. United States of America* (UNCITRAL) Preliminary Award on Jurisdiction, 7 August 2002 ("Methanex, Award on Jurisdiction"), ¶¶ 120-121, **RA-28**; *Bayview Irrigation District et al v. United Mexican States*, (ICSID Case No. ARB(AF)/05/1) Award, 19 June 2007, ¶¶ 63, 122, **RA-5**; *Grand River Enterprises Six Nations, Ltd, et al. v. United States of America* (UNCITRAL) Award, 12 January 2011 ("Grand River, Award"), ¶ 122, **RA-16**; *Tulip Real Estate Investment and Development Netherlands B.V. v. Republic of Turkey* (ICSID Case No. ARB/11/28) Decision on Bifurcated Jurisdictional Issue, 5 March 2013, ¶ 48, **RA-43**. This principle has been long established at the International Court of Justice. See *Case concerning Certain Questions of Mutual Assistance in Criminal Matters (Djibouti v. France)* Judgment, I.C.J Reports, 4 June 2008, ¶ 62, **RA-8** ("The consent allowing for the Court to assume jurisdiction must be certain... whatever the basis of consent, the attitude of the respondent State must 'be capable of being regarded as 'an unequivocal indication' of the desire of that State to accept the Court's jurisdiction in a 'voluntary and indisputable manner'" (internal citations omitted)).

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authority, but a commercial decision in the context of procuring electricity. Second, the Claimant submitted its claims relating to the establishment of Celgar's GBL more than three years after it first acquired knowledge of a purported breach of the NAFTA. These claims are, thus, time-barred pursuant to Articles 1116(2) and 1117(2).

320. Finally, if the Tribunal finds that it does have jurisdiction over the setting of Celgar's GBL, then neither Article 1102, nor Article 1103, applies to this measure pursuant to the exemption for procurement set out in Article 1108.

**1. The GBL Set by BC Hydro for the Claimant is Not Subject to the Obligations in NAFTA Chapter 11**

**a) NAFTA Chapter 11 Applies Only to BC Hydro When it is Exercising Delegated Government Authority**

321. NAFTA Articles 1116 and 1117 permit a Claimant to bring a claim concerning monopolies or state enterprises pursuant to Articles 1502(3)(a) and 1503(2). The Claimant asserts that both of these provisions are applicable.<sup>646</sup> BC Hydro is not, however, a "privately-owned"<sup>647</sup> or federal "government"<sup>648</sup> monopoly which would fall under Article 1502(3)(a). No dispute exists as to the fact that BC Hydro is a "state enterprise".<sup>649</sup>

322. NAFTA Article 1503(2) provides that a NAFTA Party:

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<sup>646</sup> Claimant's Memorial, ¶ 402.

<sup>647</sup> BC Hydro is not a "privately-owned monopoly" as it is a provincial Crown corporation established pursuant to the *Hydro and Power Authority Act*. See *Hydro and Power Authority Act*, ss. 2-3, **LMA-4**.

<sup>648</sup> NAFTA Article 1505 (Definitions) defines a "government monopoly" as a monopoly that is "owned, or controlled through ownership interests, by the federal government of a Party or by another such monopoly." [Emphasis Added]

<sup>649</sup> NAFTA Annex 1505 (Country Specific Definitions of State Enterprises) provides that, for Canada, "state enterprise" means "a Crown corporation within the meaning of the *Financial Administration Act* (Canada), a Crown corporation within the meaning of any comparable provincial law or equivalent entity that is incorporated under other applicable provincial law."



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shall ensure [...] that a state enterprise that it maintains or establishes acts in a manner that is not inconsistent [...] with NAFTA Chapter Eleven wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it [...].

323. This provision nonetheless does not apply as BC Hydro's setting of Celgar's GBL was not an exercise of delegated "regulatory, administrative or other governmental authority."<sup>650</sup> As the *UPS* tribunal explained, Article 1503(2) has:

the effect of narrowing the range of the actions of State enterprises [...] that are covered by it. Not all actions of all [...] State enterprises which are claimed to be inconsistent with the obligations of the Parties under the Agreement as a whole [...] are caught. The provisions operate only where the monopoly or enterprise exercises the defined authority and not where it exercises other rights or powers. They have a restricted operation.<sup>651</sup>

324. The *UPS* tribunal concluded that activities having "a commercial character rather than a governmental one" are not covered by Article 1503(2).<sup>652</sup> In considering which activities are commercial as opposed to governmental, the tribunal referred to those "rights and powers which [the state enterprise] shares with other businesses" such as "the rights to enter into contracts for purchase or sale and to arrange and manage their own commercial activities."<sup>653</sup> In that case, the Tribunal held that it did not have jurisdiction over the commercial activities of Canada Post.

325. In interpreting a provision similar to NAFTA Article 1503(2), the Tribunal in *Ulysseas* reached a similar conclusion.<sup>654</sup> In that case, the challenge was to actions taken

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<sup>650</sup> NAFTA 1503(2). [Emphasis added].

<sup>651</sup> *United Parcel Service v. Canada* (UNCITRAL) Award on the Merits, 24 May 2007 ("*UPS, Award*"), ¶ 72, **RA-46**. [Emphasis Added]

<sup>652</sup> *Ibid.*, ¶ 73, **RA-46**.

<sup>653</sup> *Ibid.*, ¶ 74, **RA-46**.

<sup>654</sup> *Ulysseas, Inc., v. The Republic of Ecuador* (UNCITRAL) Final Award, 12 June 2012 ("*Ulysseas, Award*") ¶ 124, **RA-44**. The Tribunal was constituted pursuant to a dispute between an American Investor and the State of Ecuador under the 1993 Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment signed ("1993 United-States – Ecuador BIT"). Article II(2)(b) of the 1993 United-

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by Ecuador's National Electricity Council ("CONELEC"), a regulatory body with the mandate of regulating and controlling electric power activity in Ecuador.<sup>655</sup> In determining whether the acts of CONELEC were covered under the treaty, the Tribunal explained that while there was no dispute that CONELEC had, in other instances, exercised delegated governmental authority, its decision to enter into a contract with the claimant in that case, and its performance under that contract "is to be attributed only to it, not to the State of Ecuador, unless it uses governmental authority in its dealings with the investor."<sup>656</sup>

326. Further, the *Jan de Nul* Tribunal reached a similar conclusion with respect to the meaning of the term "delegated governmental authority" under Article 5 of the International Law Commission Articles on State Responsibility. In that case, the Tribunal considered a claim against Egypt based on the conduct of the Suez Canal Authority ("SCA"), an entity that the Egyptian government created by statute to maintain the Suez Canal.<sup>657</sup> The claim involved the SCA's exercise of its statutory mandate as it related, in particular, to a contract to widen and deepen the canal.<sup>658</sup> The Tribunal found that "the fact that the subject matter of the Contract related to the core functions of the SCA, i.e. the maintenance and improvement of the Suez Canal" (functions established by Egypt) was "irrelevant" to the issue of whether the SCA was exercising a governmental

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States – Ecuador BIT provides that "[e]ach Party shall ensure that any state enterprise that it maintains or establishes acts in a manner that is not inconsistent with the Party's obligations under this Treaty wherever such enterprise exercises any regulatory, administrative or other governmental authority that the Party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions, or impose quotas, fees or other charges."

<sup>655</sup> *Ibid.*, ¶ 129, **RA-44**.

<sup>656</sup> *Idid.*, ¶ 137, 139, **RA-44**.

<sup>657</sup> *Jan de Nul N. V. Dredging International N.V. v. Arab Republic of Egypt* (ICSID Case No. ARB/04/13) Award, 6 November 2008 ("Jan de Nul, Award"), ¶ 45, **RA-20**.

<sup>658</sup> *Ibid.*, ¶ 46, **RA-20**.

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authority.<sup>659</sup> In particular, it held that “[w]hat matters is not the ‘*service public*’ element, but the use of ‘*prérogatives de puissance publique*’ or governmental authority.”<sup>660</sup>

**b) BC Hydro Did Not Exercise Delegated Governmental Authority in Negotiating a GBL with the Claimant**

327. The Claimant argues that BC Hydro’s setting of the GBL for Celgar was an exercise of delegated governmental authority for two reasons. First, the Claimant argues that BC Hydro was directed by the BCUC to negotiate and establish GBLs with self-generators and thus was acting pursuant to delegated governmental authority. Second, the Claimant argues that, even without this specific direction from the BCUC, the setting of GBLs is inherently governmental, rather than commercial in nature. Neither of these arguments have any merit.

**(1) The BCUC Did Not “Delegate” Governmental Authority to BC Hydro in Issuing Order G-38-01**

328. The Claimant argues that BCUC Order G-38-01 constitutes a delegation of authority within the meaning of Article 1503(2) because it “expressly ‘directs’ BC Hydro to negotiate and thereby determine GBLs with its customers.”<sup>661</sup> However, the Claimant mischaracterizes the BCUC’s regulatory duties and powers and Order G-38-01.

329. The BCUC is a regulatory commission that administers the *UCA* and regulates public utilities, like BC Hydro, in order to ensure that they provide safe, reliable and non-discriminatory energy services at fair rates.<sup>662</sup> In meeting its mandate, the BCUC may make rules governing conditions to be contained in agreements entered into by public

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<sup>659</sup> *Ibid.*, ¶ 169, **RA-20**.

<sup>660</sup> *Ibid.*, ¶ 170, **RA-20**.

<sup>661</sup> Claimant’s Memorial, ¶ 413.

<sup>662</sup> Les MacLaren Statement, ¶ 39; *Utilities Commission Act*, ss. 23-26, 58-61, **R-205**; *See also* British Columbia Utilities Commission, Organization Profile, **R-1**.

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utilities for their regulated services.<sup>663</sup> In other words, the BCUC may make rules that govern the terms and conditions of a public utility's service to its customers.

330. BCUC Order G-38-01 sets out rules concerning the terms and conditions of BC Hydro's service to its customers—it indicates that BC Hydro should allow its self-generating customers to sell excess self-generated electricity on the condition that self-generators do not arbitrage between embedded cost utility rates and market prices. Neither the BCUC, nor Order G-38-01, are capable of “delegating” to BC Hydro the legal authority to determine whether arbitrage exists which would harm other ratepayers. Rather, Order G-38-01 sets out a rule that BC Hydro follows when it enters into an EPA to acquire self-generated energy—the negotiation of a GBL ensures that the proposed acquisition is less likely to harm other ratepayers. The GBL, however, remains of no force until it, like other EPA terms and conditions, receives the approval of the BCUC. It is the BCUC that remains responsible for determining whether an EPA is in the “public interest” and whether the GBL adequately protects other ratepayers from harm.

**(2) The Setting of the Claimant's GBL by BC Hydro  
was Not Governmental in Nature**

331. The Claimant also alleges that the setting of Celgar's GBL was an exercise of “regulatory, administrative or other governmental authority” because it was not a prerogative under which a private party could act,<sup>664</sup> is a power to impose quotas,<sup>665</sup> limits a utility's obligation to serve and is hence regulatory,<sup>666</sup> and limits a self-generator's access to embedded cost power and hence serves no legitimate purely

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<sup>663</sup> Utilities Commission Act, s. 31, **R-205**.

<sup>664</sup> Claimant's Memorial, ¶ 416.

<sup>665</sup> *Ibid.*, ¶ 416.

<sup>666</sup> *Ibid.*, ¶ 417.

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commercial purpose.<sup>667</sup> None of these characterizations render the setting of Celgar's GBL an exercise of "governmental authority".

332. BC Hydro, like other juridical persons, has the capacity, rights and power to contract for anything on any terms, subject to applicable laws and regulations. Its contracts, however, as a public utility are subject to additional regulation.<sup>668</sup> That does not, however, make its actions "governmental in nature." British Columbia's regulated market still functions in accordance with basic commercial principles. In that regulated market, BC Hydro is responsible for delivering an adequate power supply to meet the needs of its current and future customers. Accordingly, it must procure some of its electricity needs in order to meet demand. It makes little economic sense, for example, for BC Hydro to procure electricity that it has already supplied or must then replace. Such a transaction would contribute nothing to BC hydro's generation resources.

333. If another commercial actor was required to supply electricity in B.C.'s regulated market and it had an opportunity to purchase incremental self-generated electricity, it would almost certainly negotiate a term of condition serving the same purpose as a GBL in order to avoid adverse financial impacts to its bottom line. In setting a GBL, BC Hydro is thus behaving as any commercial actor would in similar circumstances.

334. Nor did Celgar have a quota or a limitation imposed on it when it *elected* to enter into contractual negotiations with BC Hydro. That BC Hydro set a limit on the amount electricity it was willing to purchase so that the EPA was more likely to be approved by the BCUC does not make such a limit "governmental in nature."

335. For these reasons, the GBL that was set by BC Hydro under its EPA with Celgar was not an exercise of delegated governmental authority.

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<sup>667</sup> *Ibid.*, ¶ 419.

<sup>668</sup> Hydro and Power Authority Act, s. 12(1), **LMA-4**.

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**B. The Claimant's Claim Relating to the Setting of Celgar's GBL is Time-Barred Under Article 1116(2) and 1117(2)**

**1. NAFTA Articles 1116(2) and 1117(2) Set a Strict Three-Year Time Limit for Submission of a Claim to Arbitration**

336. NAFTA Articles 1116(2) and 1117(2) both indicate that a claimant may not make a claim if:

[M]ore than three years have elapsed from the date on which the investor [or the enterprise] first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor [or the enterprise] has incurred loss or damage.

337. These provisions are a jurisdictional pre-condition to a Chapter Eleven claim.<sup>669</sup> If a claim is not made within three years, an absolute time bar applies.

338. The word "first" means "earliest in occurrence, existence."<sup>670</sup> It identifies the start of a period or event, and not the middle or end of a continuing situation. The inclusion of "first" to modify the phrase "acquired knowledge" in these provisions was a deliberate drafting choice intended to mark the beginning of time when knowledge of a breach and loss existed. The approach mandated by Articles 1116(2) and 1117(2) is thus to pinpoint the moment at which knowledge of an alleged breach and loss were first acquired, and to bar claims made more than three years after that point in time. All three NAFTA Parties agree with this interpretation.<sup>671</sup> Past NAFTA awards also support this approach.<sup>672</sup>

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<sup>669</sup> *Methanex*, Preliminary Award on Jurisdiction, ¶ 120, **RA-27**.

<sup>670</sup> *Shorter Oxford Dictionary*, 5<sup>th</sup> ed. (Oxford University Press, 2002), at 965, **R-283**.

<sup>671</sup> See *Merrill & Ring Forestry L.P. v. Canada* (UNCITRAL) 1128 Submission of the United States, 14 July 2008, ¶ 5, **RA-26**; *Merrill & Ring Forestry L.P. v. Canada* (UNCITRAL) 1128 Submission of Mexico, 2 April 2009, **RA-25**.

<sup>672</sup> See *Grand River Enterprises Six Nations, Ltd, et al. v. United States of America* (UNCITRAL) Decision on Objections to Jurisdiction, 20 July 2006 ("*Grand River*, Decision on Objections to Jurisdiction"), ¶ 77, **RA-17**.

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## 2. The Claimant's Allegations Against the Setting of its GBL by BC Hydro are Time-Barred

339. The Claimant's allegations concerning its GBL are time – barred. BC Hydro set the Claimant's GBL during the Bioenergy Call for Power Phase I.<sup>673</sup> As part of that process, interested proponents were required to set a GBL with BC Hydro prior to submitting a proposal on June 10, 2008. The Claimant initiated that process on March 6, 2008, proposing a GBL of 34.3 MW for the Celgar mill.<sup>674</sup> After several in-person meetings<sup>675</sup> and further exchanges of information,<sup>676</sup> BC Hydro set the GBL for the Celgar mill at 40 MW on May 30, 2008.<sup>677</sup> On June 10, 2008, Celgar submitted a proposal under Bioenergy Call for Power using the GBL that was set by BC Hydro.<sup>678</sup> The GBL remained unchanged until the EPA was signed by both BC Hydro and the Claimant on January 27, 2009, still more than three months before the cut-off date.<sup>679</sup>

340. BC Hydro and the Claimant set the GBL on May 30, 2008 and the Claimant subsequently agreed to it on June 10, 2008. That the Claimant decided to wait until April 30, 2012 to file its NAFTA claim is not Canada's fault. It is the Claimant's responsibility to bring its claim in accordance with the provisions of the NAFTA, which it failed to do. The Tribunal thus does not have jurisdiction to hear claims relating to BC Hydro's setting of Celgar's GBL.

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<sup>673</sup> Bioenergy Phase I – RFP, **R-25**.

<sup>674</sup> Celgar Bioenergy Phase I Registration, **R-123**.

<sup>675</sup> Lester Dyck Statement, ¶¶ 81-82.

<sup>676</sup> See for example May 2, 2008 Letter Re: Celgar Biomass Realization Project at bates 028581, **R-126**; Celgar's May 7, 2008 Letter to RFP Administrator, **R-127**.

<sup>677</sup> BC Hydro's May 30, 2008 Letter to Celgar, **R-181**.

<sup>678</sup> Celgar Commercial Proposal, **R-128**.

<sup>679</sup> The Claimant filed its Notice of Arbitration on April 30, 2012. Accordingly, the three year limitation period only extended back until April 30, 2009.

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**C. NAFTA Articles 1102 and 1103 Do Not Apply to the GBL Measure as it is Exempted under NAFTA Article 1108.**

341. The Claimant's allegations concerning Celgar's GBL determination also falls within the exception set out in Article 1108(7)(a) for "... procurement by a Party or a state enterprise." If the conditions of Article 1108(7)(a) are met, the obligations of Articles 1102 and 1103 do not apply to the measure.<sup>680</sup> As Canada demonstrates below, when Article 1108(7)(a) is properly interpreted, it is evident that this procurement exclusion applies to the measures challenged by the Claimant.<sup>681</sup>

**1. The Ordinary Meaning of "Procurement"**

342. NAFTA Chapter Eleven does not define "procurement." The ordinary meaning of the term has, however been specifically considered in both the *ADF* and *UPS* arbitrations.<sup>682</sup> In *ADF*, the tribunal was faced with a challenge under Articles 1102 and 1106 to U.S. domestic content requirements on steel that was to be used by a foreign investor in a highway interchange project by the State of Virginia. The Tribunal looked to the ordinary meaning of the term "procurement" and explained:

In its ordinary or dictionary connotation, "procurement" refers to the act of obtaining, "as by effort, labor or purchase." To procure means "to get; to gain; to come into possession of." In the world of commerce and industry,

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<sup>680</sup> *ADF Group Inc. v. United States of America* (ICSID Case No. ARB (AF)/00/1) Award, 9 January 2003 ("*ADF*, Award"), ¶ 162, **RA-1**.

<sup>681</sup> Canada also notes that the Claimant's Article 1102 and 1103 claims are precluded by Article 1108(7)(b), which applies to subsidies. Canada does not believe that British Columbia's regulatory framework governing electric utilities accords subsidies. However, if the Claimant's characterizations are correct, then its claim is that it received less favourable treatment could be caught by the exception. For example, the Claimant's argument that all mills in British Columbia should be accorded the same level of "access percentage" is really nothing more than a request for a subsidy. Although the Claimant attempts to camouflage the subsidy component of its argument (Claimant's Memorial, ¶¶ 427-428), it was more open about this nature of its claim in both its Notice of Intent (¶¶ 4-6, 14, 40-41, 54, 56, 79) and its Notice of Arbitration (¶¶ 4-6, 17, 45-46, 59, 61, 87). In fact, even in its Memorial, it continues to rely on WTO case law relating to subsidies (Claimant's Memorial, ¶¶ 620-627). Pursuant to Article 1108(7)(b), NAFTA Articles 1102 and 1103 do not apply to measures involving subsidies. Accordingly, if the Claimant's characterizations are correct, which they are not, then it is nonetheless precluded from bringing its claims under Articles 1102 and 1103.

<sup>682</sup> *ADF*, Award, ¶¶ 160-174, **RA-1**; *UPS*, Award, ¶¶ 121-136, **RA-46**.



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“procurement” may be seen to refer ordinarily to the activity of obtaining by purchase goods, supplies, services and so forth.<sup>683</sup>

343. The Tribunal in *UPS* adopted a similarly broad interpretation of the term “procurement”. In *UPS*, the Tribunal was faced with a challenge to the material handling, data entry and duty collection services provided by Canada Post for the Government of Canada.<sup>684</sup> The Tribunal held that Article 1102 did not apply to these measures because they constituted procurement by a Party or state enterprise pursuant to Article 1108. In coming to this conclusion, the Tribunal relied on the fact that the service in question was provided pursuant to a “commercial fee-for-service contract”<sup>685</sup> that covered services provided to the government, such as duty collection.<sup>686</sup> It came to this conclusion despite the fact that the service was provided for the benefit of, and paid for by, the persons or companies importing goods by mail rather than by the government.<sup>687</sup>

344. Thus, the ordinary meaning of the term “procurement” covers all measures constituting or involving the lease or purchase of goods or services for any purpose, regardless of whether the government ultimately paid the cost, and regardless of whether the government retained possession of the end product.

**2. The Setting of a GBL Satisfies the Test Under Article 1108(7)(a) as it is a Term of the Procurement of Electricity By a State Enterprise**

345. BC Hydro sets a GBL in the context of an EPA to establish the amount of energy it will purchase from a self-generator under this agreement. The GBL is therefore a

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<sup>683</sup> *ADF*, Award, ¶ 161, **RA-1**.

<sup>684</sup> *UPS*, Award, ¶¶ 121-136, **RA-46**.

<sup>685</sup> *Ibid.*, ¶¶ 132-134, **RA-46**.

<sup>686</sup> *Ibid.*, ¶ 132, **RA-46**.

<sup>687</sup> The fee is described as “the government’s efforts to help recover costs from those who benefit from services, and is similar to arrangements in the United States and other countries.” Canada Postal Guide – Customs Requirements, **R-285**; Canada Border Services Agency, Importing by Mail, **R-391**.

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contractual term of the EPA that falls squarely within the procurement exception in Article 1108(7)(a).

346. For example, the Request for Proposal (“RFP”) for the Bioenergy Call for Power Phase I stated that the GBL would define the energy eligible for sale/purchase under the Call. In particular, section 14 of the RFP defined as “Eligible Projects” those that involved “[n]ew self-generation, or incremental self-generation, in any event excess of the Customer’s GBL at a Customer’s facility to serve the Customer’s industrial load at the facility”.<sup>688</sup> The Specimen EPA Adaptations Schedule similarly provided that “eligible energy” excluded energy up to the GBL. The setting of a GBL thus defines the amount eligible for sale. As explained by Lester Dyck, BC Hydro has no interest in procuring “existing” electricity,<sup>689</sup> which would add nothing to BC Hydro’s resources. It follows that the GBL is a mechanism that defines the amount of “incremental” or “new” electricity that BC Hydro is willing procure.

347. The facts of this case somewhat resemble those of the *ADF* case. In *ADF*, the Department of Transportation of the Commonwealth of Virginia (“VDOT”) was required to comply with a “Buy America” statutory provision in order to benefit from federal funding assistance for the construction of the Springfield Interchange project.<sup>690</sup> In order to do so, VDOT and the main contractor included a provision in their contract aimed at ensuring compliance with these domestic content requirements. This provision was, in turn, incorporated into the sub-contract entered into by the main contractor and the foreign investor, a sub-contractor.<sup>691</sup> The Tribunal determined that the construction of the

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<sup>688</sup> Bioenergy Phase I – RFP, s. 14, **R-25**. [emphasis added].

<sup>689</sup> Lester Dyck Statement, ¶¶ 42-43.

<sup>690</sup> *ADF*, Award, ¶ 52, **RA-1**.

<sup>691</sup> *Ibid.*, ¶ 58, **RA-1**.

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Springfield Interchange project constituted or involved procurement within the meaning of Article 1108(7)(a).<sup>692</sup>

348. Like in *ADF*, what is at issue here is a condition contained within the procurement. In this case the contract is the EPA and the condition is the GBL, which determines the “incremental” or “new” electricity that BC Hydro is willing to purchase over an agreed period of time in order to add electricity to its resource stack so that it can meet customer demand going forward.

349. The setting of a GBL by BC Hydro thus satisfies the test under NAFTA Article 1108(7)(a) as it is a term of the procurement of electricity by a state enterprise.

### **3. The Claimant's Interpretation of Article 1108(7)(a) is Incorrect**

350. The Claimant argues that the definition of “procurement” must necessarily exclude anything that fits the definition of delegated governmental authority. It supports this argument with nothing more than the unsubstantiated assertion that the “NAFTA Parties purposefully distinguished between ‘procurement’ measures and ‘government authority’ measures.”<sup>693</sup>

351. The Claimant's argument is not supported by the text of the NAFTA and would render Article 1108(7)(a) meaningless any time a state enterprise exercises delegated governmental authority. There is no reason why the exercise of delegated governmental authority by a state enterprise could not include direction to procure certain goods or services. If BC Hydro's actions are found to be an exercise of delegated governmental authority and therefore subject to the obligations of NAFTA Chapter 11, then this Tribunal should at a minimum find that the procurement exception applies to the GBL determinations by BC Hydro.

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<sup>692</sup> *Ibid.*, ¶ 164-166, **RA-1**.

<sup>693</sup> Claimant's Memorial, ¶ 431.

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**IV. THE CLAIMANT HAS FAILED TO PROVE THAT CANADA HAS BREACHED ARTICLES 1102 OR 1103**

**A. Concise Statement of Canada's Position**

352. The Claimant has alleged that, in violation of Articles 1102 and 1103, BC Hydro and the BCUC accorded the Celgar mill treatment that was less favourable than the treatment accorded, in like circumstances, to other Canadian and foreign investors and investments. As is shown below, the Claimant has failed to prove the most basic elements of its claims.

353. The Claimant challenges two instances of treatment. First, it argues that the GBL set by BC Hydro in the context of its EPA was treatment less favorable than that accorded, in like circumstances, to other investors and investments. To make its case, however, the Claimant mischaracterizes the treatment as the "Below Load Access Percentage," which is an irrelevant metric of the Claimant's own invention that ignores sound economic and regulatory principles that guide energy procurement and validate limits on arbitrage. When properly characterized, the treatment accorded by BC Hydro was consistent across all self-generators. While the Claimant relies on irrelevant factors to crop its comparative analysis to only three mills – Tembec, Howe Sound and Canfor - the treatment accorded by BC Hydro has been consistent across many more.

354. Under the second instance of treatment, the Claimant alleges that the BCUC accorded less favourable treatment when it issued BCUC Order G-48-09. It is a serious matter to allege that an independent regulatory commission has engaged in nationality-based discrimination contrary to the NAFTA; such allegations call into question the integrity of the body and its members. No foundation regarding this allegation exists for the Claimant, who is again forced to mischaracterize the treatment it was accorded in order to make out a claim. Contrary to the Claimant's interpretation, BCUC Order G-48-09 did not "impose" upon them a "net of load" standard, but concerned the conditions under which FortisBC can purchase electricity from BC Hydro.

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Under both instances of treatment, the Claimant ignores the fact that Articles 1102 and 1103 are designed to prohibit nationality-based discrimination. The rationale for the Claimant's strategy is obvious – there is no evidence of any discrimination on the basis of nationality. To the contrary, the evidence shows that all investors, including the Claimant and another U.S. investor, were treated in the exact same manner throughout BC. To the extent that there were different outcomes as a result of the consistently applied measures, those outcomes are the product of the unique circumstances of each self-generator.

**B. The Claimant Must Prove the Three Essential Elements of a National Treatment and Most-Favoured Nation Treatment Claim**

355. NAFTA Article 1102 sets out the obligation to accord National Treatment to "investors" and "investments of investors" of another NAFTA Party. In particular, this provision provides that:

1. Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favourable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favourable than the most favourable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

356. NAFTA Article 1103 requires the NAFTA Parties to accord Most-Favoured-Nation Treatment to investors or investments of another NAFTA Party and is similar to the obligation to provide National Treatment in Article 1102. It indicates that the treatment accorded to investors or investments of investors of a NAFTA Party must be no

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less favourable than that accorded, in like circumstances, to investors or investments of “any other Party or of a non-Party.”

357. NAFTA Articles 1102 and 1103 require the Claimant to prove three separate elements.<sup>694</sup> First, it must establish that Canada accorded it and domestic or non-U.S. foreign investors “treatment”. While the term treatment is not expressly defined in NAFTA, in light of Article 1101, any complained of “treatment” must be a “measure,”<sup>695</sup> *i.e.* a “law, regulation, procedure, requirement, or practice,”<sup>696</sup> that is “adopted or maintained” by some person or entity for which Canada is responsible at international law. As such, consistent with these requirements and its ordinary meaning,<sup>697</sup> treatment requires “behaviour in respect of an entity or person.”<sup>698</sup> The concept of “treatment” has been interpreted as meaning that a “practical impact is required to produce a breach of Article 1102.”<sup>699</sup>

358. Second, the Claimant must prove that the treatment accorded to the Claimant or its investment was “less favourable” than the treatment accorded to domestic or other foreign investors. The ordinary meaning of according treatment “no less favourable” is treatment that is at least as favourable as the treatment of the relevant comparator to which it is being compared. This meaning was echoed in Canada’s Statement on

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<sup>694</sup> *United Parcel Service v. Canada* (UNCITRAL) Award on the Merits, 24 May 2007 (*UPS – Award*), ¶ 83-84, **RA-46**: “Failure by the investor to establish one of those three elements will be fatal to its case. This is a legal burden that rests squarely with the Claimant. That burden never shifts to the Party, here Canada.”

<sup>695</sup> NAFTA Article 1101.

<sup>696</sup> NAFTA Article 201.

<sup>697</sup> The ordinary meaning of “treatment” is “the process or manner of behaving towards or dealing with a person or thing,” see *Shorter Oxford Dictionary*, 5<sup>th</sup> ed. (Oxford University Press, 2002), definition of “treatment”, at 3338, **R-283**.

<sup>698</sup> *Siemens A.G. v. The Argentine Republic* (ICSID Case No. ARB/02/8) Decision on Jurisdiction, 3 August 2004, ¶ 85, **RA-40**.

<sup>699</sup> *S.D. Myers, Inc. v. Canada* (UNCITRAL) First Partial Award, 13 November 2000, (*S.D. Myers – First Partial Award*), ¶ 254, **RA-38**.

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Implementation of the NAFTA,<sup>700</sup> and has been affirmed by UNCTAD.<sup>701</sup> As such, contrary to what the Claimant alleges, the Claimant is not entitled to “best in jurisdiction” treatment.<sup>702</sup>

359. Finally, the treatment in question must have been accorded to the Claimant or its investments and to the comparator investor or investments “in like circumstances”. As noted in Canada’s Statement on Implementation of NAFTA, the basis for a comparison of the treatment accorded is the “like circumstances” test.<sup>703</sup> In practice, determining whether treatment is accorded “in like circumstances” is a factual question. A Tribunal’s assessment of the factors that are material to the “like circumstances” analysis necessarily relates to the breach alleged and the nature of the treatment at issue.<sup>704</sup> As a result, NAFTA Chapter Eleven tribunals have considered a number of different factors in this analysis, including policy objectives pursued by the measure at issue.<sup>705</sup>

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<sup>700</sup> Canada, Department of Foreign Affairs, *Statement on Implementation: North American Free Trade Agreement*, Vol. 128, no. 1, Ottawa: Canada Gazette, 1994, (“NAFTA – Statement on Implementation”) at 148, **RA-32**.

<sup>701</sup> United Nations Conference on Trade and Development, UNCTAD/ITE/IIT/11 (Vol. IV) *National Treatment* (United Nations: New York and Geneva, 1999) (“UNCTAD – National Treatment”) at 37, **RA-45**.

<sup>702</sup> Claimant’s Memorial, ¶ 478; FN 559.

<sup>703</sup> NAFTA – Statement on Implementation, at 148, **RA-32**.

<sup>704</sup> *Pope & Talbot Inc. v. Canada* (UNCITRAL) Award on the Merits of Phase 2, 10 April 2001 (“*Pope & Talbot – Award on the Merits Phase 2*”), ¶ 75, **RA-36**: “Circumstances are context-dependent.”

<sup>705</sup> S.D. Myers - First Partial Award, ¶ 248, **RA-38**; *Pope & Talbot – Award on the Merits Phase 2*, ¶¶ 77, 79, 87-88, **RA-36**; *GAMI Investments, Inc. v. United Mexican States* (UNCITRAL) Final Award, 15 November 2004 (“*GAMI – Award*”), ¶ 114, **RA-14**. See also Organisation for Economic Co-Operation and Development, *National Treatment for Foreign-Controlled Enterprises*, OECD: 1993 (“*OECD – National Treatment for Foreign Controlled Enterprises*”) at 22, **RA-34**: “More general considerations, such as the policy objective of the Member countries, could be taken into account to define the circumstances in which comparison between foreign-controlled and domestic enterprises is permissible inasmuch as those objectives are not contrary to the principle of national treatment.” ; and United Nations Conference on Trade and Development, UNCTAD/ITE/IIT/11 (Vol. IV) *National Treatment* (United Nations: New York and Geneva, 1999) (“UNCTAD – National Treatment”) at 33, **RA-45**.

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360. Neither Article 1102, nor Article 1103, prohibits all forms of discrimination. National Treatment and Most-Favoured Nation Treatment prohibit nationality-based discrimination. Therefore, to sustain a claim the Claimant must demonstrate that British Columbia "... intended to favour domestic investors by discriminating against foreign investors."<sup>706</sup> In past NAFTA Chapter Eleven arbitrations, all three NAFTA Parties have repeatedly agreed that the National Treatment obligation is designed to protect against discrimination on the basis of nationality.<sup>707</sup> The statements of the NAFTA Parties on Article 1102 apply equally to the MFN obligation under Article 1103.

**C. The Claimant has Failed to Prove that BC Hydro's Setting of its GBL is Inconsistent with NAFTA Articles 1102 or 1103**

361. The Claimant alleges that BC Hydro treated the Celgar mill less favourably in the setting of its GBL than it treated Howe Sound and Skookumchuck<sup>708</sup> in the setting of their GBLs, and Canfor in the conclusion of its LDA. As shown above, the setting of Celgar's GBL was not an exercise of delegated governmental authority, and accordingly, this Tribunal has no jurisdiction to consider it. However, even if it were to be considered,

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<sup>706</sup> *Methanex Corporation v. United States of America* (UNCITRAL) Award on Jurisdiction and Merits, 3 August 2005 ("*Methanex - Award*"), Part IV, Chapter B, at 6, **RA-28**.

<sup>707</sup> See, for example, *Methanex Corporation v. The United States of America* (UNICTRAL) Rejoinder of the United States of America, ¶ 152, **RA-49**: "the function of the national treatment provision is to address discrimination on the basis of the nationality of ownership of an investment"; *Methanex Corporation v. The United States of America* (UNICTRAL) Fourth Submission of the Government of Canada Pursuant to NAFTA Article 1128, 30 January 2004, ¶ 5, **RA-50**: "[Article 1102] prohibits treatment which discriminates on the basis of the foreign investment's nationality"; and *Methanex Corporation v. The United States of America* (UNICTRAL) Submissions of the United Mexican States, January 30, 2004, ¶ 16, **RA-51**: "Where a breach of Article 1102 is alleged, it is less favourable treatment based on the Claimant's Canadian nationality *only* that can give rise to a finding of breach of Article 1102" (emphasis in the original). See also *Loewen Group Inc. et al. v. United States of America* (ICSID Case No. ARB(AF)/98/3) Award, 26 June 2003 ("*Loewen, Award*"), ¶ 139, **RA-22**: "We agree also with Professor Bilder when he says that Article 1102 is direct [sic] only to nationality-based discrimination and that it proscribes only demonstrable and significant indications of bias and prejudice on the basis of nationality."

<sup>708</sup> The Skookumchuck mill is currently owned by Paper Excellence, the company that also owns the Howe Sound mill in Port Mellon. Since Tembec was the owner of the mill at the time of the treatment challenged by the Claimant with respect to the Skookumchuck mill (*i.e.* 2009), Canada maintains references to Tembec throughout the Counter-Memorial.



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the Claimant has failed to prove that BC Hydro's treatment of Celgar was inconsistent with Canada's obligations under Articles 1102 or 1103. BC Hydro treated all investors the same regardless of their nationality, and any different outcomes were the result of the particular circumstances in which the treatment was accorded to Celgar and to Howe Sound, Skookumchuck, and Canfor.

**1. Canada Accorded Treatment on a Consistent and No Less Favourable Basis**

**a) The Claimant Mischaracterizes the Treatment that Celgar and Its Alleged Comparators Received**

362. The Claimant alleges that the treatment that Celgar and its comparators received was the level of access to embedded cost power self-generators maintain while selling their own electricity.<sup>709</sup> Accordingly, it insists that the "Below-Load Access Percentage" is the appropriate metric by which to compare the treatment. This metric is the Claimant's own invention, which it uses to avoid all of the real issues that confront its case, namely the economic and regulatory principles that govern BC Hydro's procurement of electricity. As Dr. Rosenzweig explains, the Claimant constructs a straw man, which it then attempts to cut down.<sup>710</sup>

363. The 2007 Energy Plan required BC Hydro to become self-sufficient and to ensure that at least 90% of the electricity generated in BC is from clean energy resources.<sup>711</sup> In response, BC Hydro sought to acquire clean energy, including from biomass, by

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<sup>709</sup> See, for example, Claimant's Memorial, ¶ 346: "With its issuance of Order G-48-09 on 6 May 2009, and its approval of Celgar's EPA and its GBL provisions on 31 July 2009, the BCUC subjected Celgar to two separate and independent measures, each operating to eliminate Celgar's access to embedded cost utility electricity while selling its below-load electricity, and otherwise to prohibit Celgar from selling that below-load electricity to anyone" [emphasis added]; ¶ 5: "A 'generator baseline' or 'GBL' is a term used by BC Hydro in its electricity purchase contracts with self-generators, at the express direction of the BCUC, to delineate the level of self-generated electricity a customer must use to self-supply its own load and below which it cannot sell to *any* person or entity."

<sup>710</sup> NERA Expert Report, ¶ 27.

<sup>711</sup> 2007 Energy Plan, **R-23**; Section II.D.1, above.

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concluding EPAs with self-generators through various procurement processes, including Bioenergy Call for Power Phase I and the IPO.<sup>712</sup>

364. In accordance with the *UCA*, BC Hydro's acquisition of this energy in EPAs had to be on a cost efficient basis in order to protect customers from unfair electricity rates,<sup>713</sup> including excessive rates resulting from the harmful effects of the arbitrage of embedded-cost power.<sup>714</sup> Accordingly, as part of the negotiations of the EPAs, BC Hydro set GBLs with customers with existing generation based on current normal levels of self-generation as of the time of the negotiations in order to identify the incremental generation it can incentivize under the agreements.

365. BC Hydro does not set a GBL in order to determine how much embedded cost power a mill can purchase. Rather, BC Hydro sets a GBL at a mill's normal levels of self-generation to identify the appropriate level beyond which to incentivize incremental generation and, accordingly, to ensure that the EPA does not result in harm to other ratepayers. BC Hydro has no interest in purchasing existing self-generation because that would add no electricity to its resource pool and would merely transfer wealth from BC Hydro's ratepayers to the seller for nothing in return.<sup>715</sup>

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<sup>712</sup> See Section II.D.1, above.

<sup>713</sup> *UCA*, s. 59, **R-205**. See also NERA Expert Report, ¶¶ 63-64, 67; Special Direction No. 10 to the British Columbia Utilities Commission, B.C. Reg. 245/2007, s.3, ("Special Direction No. 10"), **LMA-10**. Special Direction No. 10 prohibited the BCUC from declaring a bioenergy contract unenforceable solely on the basis of the price for the energy. Despite the fact that the government contemplated a likely premium for biomass EPAs, they were nonetheless less expensive and more readily available than building entirely new supply: BC Hydro Report on Bioenergy Phase I - RFP at bates 150619-150626, **R-170**.

<sup>714</sup> BCUC Order G-38-01, **R-19**.

<sup>715</sup> In order to purchase and replace all existing self-generated electricity produced by forest sector companies, BC Hydro estimated in 2008 that its electricity rates would need to increase by approximately 10 percent: Les MacLaren Statement, ¶ 91. The Claimant is effectively seeking the right to sell electricity it has not only historically self-generated for the mill, but that it is required to use for the mill's operations: 1991 Ministers' Order, **R-100**.

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366. Thus, while the EPA is designed to incentivize generation that would otherwise not have been economically viable for the contracting mills, the GBL is the gauge for the economic efficiency of the incentive. An incentive that is too low (*i.e.* a GBL that is too high) would fail to bring about the desired additional generation, while too great of an incentive (*i.e.* a GBL that is too low) would fail to protect ratepayers.<sup>716</sup> What constitutes an effective incentive for one mill may not constitute an effective incentive for another. In these circumstances, the treatment in question is the methodology for setting the GBL amount, and not the “Below-Load Access Percentage” that may result from the application of that methodology.

**b) BC Hydro Applied a Consistent Methodology to set GBLs for All Investors**

367. BC Hydro applied the same methodology and considered the same factors in setting GBLs with all self-generators. In particular, BC Hydro worked with each mill in the context of EPA negotiations to determine the amount of self-generated energy it used to self-supply in the course of normal operations, on an annual basis, as of the time of the negotiations. The amount of energy used to self-supply was assessed in the absence of the prospect of the currently negotiated EPA, and accounted for the unique operations of each mill.<sup>717</sup>

368. The Claimant argues that BC Hydro used a different methodology for its Celgar mill as compared with other mills. In particular, it alleges that BC Hydro used different standards (*e.g.* net-of-load vs. historical usage), different baseline periods, and different data to establish the GBL for its mill than was used for other mills.<sup>718</sup> The Claimant's argument conflates the specific outcomes for different mills with the consistent methodology that was applied in each case.

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<sup>716</sup> NERA Expert Report, ¶ 49.

<sup>717</sup> Lester Dyck Statement, ¶¶ 44-46.

<sup>718</sup> See Claimant's Memorial, ¶¶ 540-541, 575-576.

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369. Pulp mill configuration, technical operations and pre-existing contracts – data specific to each mill – impact a mill’s “normal” operations, as well as its responsiveness to incentives. A mill’s normal operations are the product of decisions made by the mill’s owner/operator in response to prevailing market pressures and opportunities.<sup>719</sup> In the application of a consistent methodology, the fact that one mill’s “normal” might lead to a different outcome does not demonstrate differential treatment, let alone less favourable treatment.

370. For example, the Claimant argues that BC Hydro ignored its methodology and arbitrarily subjected Celgar to a “net-of-load” standard for its GBL.<sup>720</sup> In reality, Celgar’s GBL was set in the same manner as for every other mill on the basis of its normal usage of self-generation as of the time of the negotiations.<sup>721</sup> Celgar submitted data to BC Hydro that demonstrated that its generation exceeded the level of its load in the most current year of operations, and confirmed that the data represented normal operations.<sup>722</sup> Adjusted downward and set at the level of its load, Celgar’s GBL therefore reflected its current use of self-generation. It is not proof of less favourable treatment that other mills submitted data to BC Hydro that demonstrated their current normal operations, and that their GBLs were accordingly set to reflect them.

371. After requesting the production of documents concerning the self-generation of all B.C. pulp mills and sawmills,<sup>723</sup> the Claimant received extensive documentation

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<sup>719</sup> Pöyry Expert Report, Section 4, ¶¶ 24-44.

<sup>720</sup> See Claimant’s Memorial, ¶¶ 540-541, 575-576.

<sup>721</sup> See Lester Dyck Statement, ¶ 88; Pöyry Expert Report, ¶¶159-160. See also NERA Expert Report, ¶52 and Appendix 2 at pp 3-4, 10, 17, 21.

<sup>722</sup> Celgar’s May 7, 2008 Letter to RFP Administrator, **R-127**. See also Lester Dyck Statement, ¶¶ 78, 80.

<sup>723</sup> Claimant’s Document Request Category 3 requested “[a]ll documents establishing the terms and conditions under which individual Self-Generators in BC are permitted to purchase and sell electricity, including documentation of the data and basis on which all GBLs, CBLs, and load displacement requirements were computed. This request includes but is not limited to documents identified in Document Requests 3.1-3.17.” Document Requests 3.1.1-3.1.11 requested documents specifically relating to the following mills: Howe Sound Pulp & Paper (Port Mellon); Tembec,

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demonstrating that BC Hydro set GBLs in a consistent manner. The Claimant now asserts that the Tribunal should limit its analysis of GBLs to three comparators. This stands in marked contrast from its previous position that:

[T]he relevant comparator[s] [are] investors in the same economic or business sector as the Celgar mill, who serve as its market competitors. That includes without doubt all other pulp mills in British Columbia with electricity co-generation facilities, that also purchase electricity;<sup>724</sup>

372. This analysis, however, has been undertaken by Dr. Rosenzweig in his expert report, which concludes that BC Hydro consistently used the same approach to set GBLs in all of the EPAs it negotiated:<sup>725</sup>

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Inc. (Skookumchuck); Domtar (Kamloops); Tolko (Armstrong); West Fraser/Cariboo Pulp & Paper (Quesnel); Conifex Timber Inc. (MacKenzie); Nanaimo Forest Products Ltd./Harmac; Nechako Lumber (Vanderhoof); Canfor Pulp (Pince George pulp mill); Catalyst Paper (Powell River); and Canfor (Northwood): Claimant's Document Request Category 3 requested "[a]ll documents establishing the terms and conditions under which individual Self-Generators in BC are permitted to purchase and sell electricity, including documentation of the data and basis on which all GBLs, CBLs, and load displacement requirements were computed. This request includes but is not limited to documents identified in Document Requests 3.1-3.17." Document Requests 3.1.1-3.1.11 requested documents specifically relating to the following mills: Howe Sound Pulp & Paper (Port Mellon); Tembec, Inc. (Skookumchuck); Domtar (Kamloops); Tolko (Armstrong); West Fraser/Cariboo Pulp & Paper (Quesnel); Conifex Timber Inc. (MacKenzie); Nanaimo Forest Products Ltd./Harmac; Nechako Lumber (Vanderhoof); Canfor Pulp (Pince George pulp mill); Catalyst Paper (Powell River); and Canfor (Northwood): Claimant's February 4, 2013 Request for Documents, in *Mercer International v. Canada* (ICSID Case No. ARB/12/03), **R-374**.

<sup>724</sup> Request for Arbitration, ¶ 85.

<sup>725</sup> Chart from NERA Expert Report, ¶ 55. See also BC Hydro 2012 GBL Information Report, Appendix A at bates 048140-048141, **R-177**.

### Comparison of Process Used By BC Hydro to Set GBLs for Comparison Mills

Company	Mill	GBL Set Based on:		Agreement with BCH Provides:	
		Amount of Load Self-Supplied in Absence of a Contract <sup>1</sup>	A Current Normal Operating Year Using Information Available at Time of Negotiation <sup>1</sup>	Incentives Required to Increase Generation or Utilize Idle Capacity <sup>2</sup>	Incentives That Protect Ratepayers <sup>2</sup>
<b>Pulp and Paper Mills:</b>					
Canfor	Northwood	✓	✓	✓	✓
Canfor	Prince George	✓	✓	✓	✓
Cariboo	Quesnel	✓	✓	✓	✓
Catalyst	Powell River	✓	✓	✓	✓
Domtar	Kamloops	✓	✓	✓	✓
Howe Sound	Port Mellon	✓	✓	✓	✓
Mercer	Celgar	✓	✓	✓	✓
Nanaimo	Harmac	✓	✓	✓	✓
Tenbec	Skookumchuck	✓	✓	✓	✓
<b>Saw Mills<sup>3</sup>:</b>					
Conifex	Mackenzie	n/a	n/a	✓	✓
Nechako	Vanderhoof	n/a	n/a	✓	✓
Tolko	Armstrong	n/a	n/a	✓	✓

**Notes:**

<sup>1</sup> These criteria reflect the general process used by BCH as I have described above.

<sup>2</sup> These criteria represent the overarching policy goals of the GBL process.

<sup>3</sup> None of the three sawmills had generation facilities prior to their first agreement with BCH, so the first two columns are not applicable, as the mills' agreements do not contain GBLs.

373. The evidence confirms that, in negotiating the GBL provisions in each EPA, BC Hydro applied a methodology that was consistent and that conformed with the principles of incentivizing incremental generation and of preventing arbitrage of incremental embedded cost electricity that causes harm to ratepayers. To the extent that the outcomes differed, it is because of the unique circumstances of each case.

#### c) BC Hydro's Consistent GBL Methodology Had No Regard for the Nationality of the Investor

374. The Claimant has equally failed to meet its burden to demonstrate discrimination on the basis of nationality. BC Hydro's application of its GBL methodology had no

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regard for the nationality of the negotiating counterparty.<sup>726</sup> There was no difference in treatment between any of the mills, which necessarily precludes the existence of a significant benefit to nationals over non-nationals arising from that treatment, a requirement for showing that there has been a breach of Article 1102 or 1103.

375. To demonstrate even further that there has been no discrimination in favour of nationals over non-nationals, the Tribunal need look only to the treatment accorded to the Domtar mill in Kamloops, owned by an American company. Like the Claimant, Domtar participated in the Bioenergy Call for Power – Phase I. In order to submit a bid under that call, a GBL had to be set with BC Hydro. To that end, Domtar submitted information relating to its self-generating assets and worked with BC Hydro to establish the level of generation it produced in normal operations at the time of negotiations. Domtar's bid into the Bioenergy call was accepted, resulting in the 2009 EPA with a GBL of [REDACTED] GWh/year.<sup>727</sup> In fact, Domtar and the Claimant were only two of four proponents out of 20 to win a contract under the Bioenergy Call for Power – Phase I.<sup>728</sup> Like the Claimant, Domtar received the same treatment as all Canadian-owned mills with EPAs with BC Hydro. There is no evidence to support a claim that U.S. investors were treated less favourably than domestic or other foreign investors by BC Hydro.

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<sup>726</sup> Lester Dyck Statement, FN 65: "I was not aware at the time of the Bio Phase I negotiations that Celgar was owned by an American company."

<sup>727</sup> BC Hydro and Domtar Pulp and Paper Products Inc., Electricity Purchase Agreement, Bioenergy Call for Power – Phase I, dated January 27, 2009, **R-136**. [REDACTED]

<sup>728</sup> See BCUC, Order E-8-09, in the Matter of an Application by BC Hydro for Acceptance of Electricity Purchase Agreements – Bioenergy Call Phase I Request for Proposals, 31 July 2009, **R-308**; and BC Hydro Report on Bioenergy Phase I - RFP, **R-170**. The Claimant won the biggest contract of the four: Celgar is able to sell 238 GWh/year of firm energy under its EPA, as compared to 201 GWh/year for Domtar, and 70 GWh/year for Canfor (Prince George). In addition, Celgar's opportunity to sell firm energy is greater than that of Skookumchuck [REDACTED]: Tembec Justification Report, **R-192**; and Howe Sound [REDACTED]: BC Hydro and Howe Sounds Pulp and Paper Limited Partnership, Electricity Purchase Agreement, Integrated Power Offer, 7 September 2010 ("Howe Sound 2010 EPA") at Appendix 2 (Energy Profile), **R-62**.

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## 2. The Claimant's "Like Circumstances" Analysis Posits Irrelevant Factors and Ignores Other Factors

376. While the methodology applied by BC Hydro in setting GBLs was the same in all instances, the results of the application of its methodology were different because of the unique factual circumstances of each of the mills to which the methodology was applied.<sup>729</sup> For this reason, as explained below, the differences that the Claimant has identified in the treatment that was accorded are all due to the fact that the treatment was not accorded in like circumstances.

377. In its Memorial, the Claimant identifies three factors as relevant to its "like circumstances" analysis: that comparators operate in the same business or economic sector; that they produce competing goods or services; and that they are subject to a comparable legal regime or requirements.<sup>730</sup> Under this rubric for analysis, the Claimant concludes that (1) NBSK pulp mills in British Columbia, (2) that produce and sell self-generated biomass-based green electricity, and (3) that invested in self-generation capacity prior to BCUC Order G-38-01, are in "identical" circumstances to the Celgar mill.<sup>731</sup> The Claimant's conclusions posit at least two irrelevant factors.

378. First, the Claimant's arbitrary identification of mills that invested in self-generation capacity prior to BCUC Order G-38-01 is irrelevant for the purposes of evaluating the consistency of BC Hydro's GBL methodology. BC Hydro is mandated to procure incremental electricity from self-generators with existing capacity; it is immaterial whether the investment in the existing generation assets was made prior, or

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<sup>729</sup> See *Electrabel v. Hungary*, ICSID Case No. ARB/07/19, *Decision on Jurisdiction, Applicable Law and Liability*, 30 November 2012, ¶ 8.31, **RA-12** (rejecting allegations of unfair discrimination on the basis that the treatment was applied equally to all generators but that, given that their individual circumstances differed, it was "inevitable that the effect of the Decrees upon each of them would reflect such differences.")

<sup>730</sup> Claimant's Memorial, ¶ 454.

<sup>731</sup> *Ibid.*, ¶¶ 474-5.



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subsequent, to G-38-01.<sup>732</sup> Relying on this criterion ignores at least four other kraft pulp mills in BC that produce and sell self-generated biomass-based electricity, and otherwise meet the Claimant's test for "like circumstances": Domtar's Kamloops, Canfor's Northwood, Nanaimo Forest Product's Harmac, and Cariboo's Quesnel.<sup>733</sup> Only Skookumchuck and Howe Sound fit the Claimant's bill. Canada also notes that the Claimant compared itself to investments made after G-38-01 in its Request for Arbitration.

379. Second, the Claimant limits its analysis to other NBSK pulp mills in British Columbia, arguing that only mills in direct competition with the Celgar mill are relevant to its claim under NAFTA Articles 1102 and 1103. While these mills may compete with the Claimant's pulping business, the treatment at issue relates to incentivizing incremental electricity from self-generators, regardless of whether that generation comes from an NBSK pulp mill with self-generation capacity or some other type of mill with self-generation capacity. Canada again notes that the Claimant did not limit its comparison in this way in its Request for Arbitration when it compared itself to Tolko, a sawmill located in FortisBC territory.<sup>734</sup>

380. Canada does not dispute that whether companies operate in the same sector, compete and are subject to the same legal regime may be relevant to an analysis of whether they were accorded treatment in like circumstances. However, they are not the only relevant factors to consider in this case. The national treatment obligation requires a comparison of *all* the relevant factors surrounding a State's treatment of the investment.<sup>735</sup> Similarly, the *Pope & Talbot* tribunal acknowledged that being in a

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<sup>732</sup> See NERA Expert Report, ¶ 72.

<sup>733</sup> Indeed, these four mills are also NBSK mills, situated in BC Hydro's service territory, that produce and sell self-generated biomass-based green electricity: BC Hydro 2012 GBL Information Report, Appendix A at bates 048140-048141, **R-177**. See also NERA Expert Report, ¶ 73.

<sup>734</sup> Request for Arbitration, 30 April 2012, ¶ 89: "Some of these competitors are Canadian-owned (such as Tembec, Canfor, and Tolko)."

<sup>735</sup> OECD – National Treatment for Foreign Controlled Enterprises, **RA-34**.

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common business or economic sector was pertinent, but expressly cautioned that it was only the “first step.”<sup>736</sup>

381. The Claimant ignores numerous other relevant factors in concluding that Howe Sound and Skookumchuck were accorded treatment in like circumstances to that accorded to the Claimant. For example, the Claimant ignores (a) the location of the Claimant's investment in FortisBC's service territory; (b) the different types of energy product sold; (c) the technical and operational particularities of the mills it identifies as being in like circumstances; (d) the contractual particularities of those same mills at the time their GBLs were established; and (e) the policy and regulatory framework at the time at which the challenged treatment was accorded.

382. As is shown below, the differences that resulted from the application of BC Hydro's uniform methodology for the setting of GBLs were the natural consequence of the unique circumstances of each mill.

**3. BC Hydro's Consistent Application of its GBL Methodology for Skookumchuck's 2009 EPA and Celgar's 2009 EPA Led to Different Results because of the Unique Circumstances of Each Mill**

383. BC Hydro and Tembec bilaterally concluded an EPA in August 2009.<sup>737</sup> Earlier that year, the Skookumchuck mill was shut down due to severe market downturn [REDACTED] [REDACTED] [REDACTED],<sup>738</sup> and indicated that it would exercise its right to early termination of the 1997 EPA in 2011.<sup>739</sup> Under such circumstances, [REDACTED]

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<sup>736</sup> Pope & Talbot – Award on the Merits Phase 2, ¶ 78, **RA-36**.

<sup>737</sup> BC Hydro and Tembec Electricity Purchase Agreement, 13 August 2009, (“Tembec 2009 EPA”), **R-198**.

<sup>738</sup> Lester Dyck Statement, ¶ 101.

<sup>739</sup> *Ibid.*; See also Email from Matt Steele to Kevin Wallace, Norman Wild, Lester Dyck *et al.*, Re: Information for Tembec Meeting, 16 March 2009, **R-191**.

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[REDACTED],<sup>740</sup> [REDACTED]  
[REDACTED]. Negotiating a new EPA was therefore an attractive option for BC Hydro.<sup>741</sup>

384. To ensure consistency with the other EPAs it had recently concluded with customers with self-generation, BC Hydro proposed, and Tembec accepted, that the terms and conditions from Bio Phase I - including the setting of a GBL - be incorporated into a new replacement EPA.<sup>742</sup> BC Hydro set Skookumchuck's GBL at 14 MW/h (122.6 GWh/year) for the new EPA on the basis of the mill's current normal operations [REDACTED]  
[REDACTED].<sup>743</sup>

385. The Claimant argues that BC Hydro used divergent baseline periods and different data sets to measure generation levels when it set the GBLs for the Skookumchuck and Celgar mills, resulting in a "Below-Load Access Percentage" for Skookumchuck of [REDACTED] (compared with Celgar's 0.0%).<sup>744</sup> In the Claimant's view, this amounts to less favourable treatment because, were the same "Below-Load Access Percentage" to be applied to Celgar, its GBL would be [REDACTED], rather than 349 GWh/year.<sup>745</sup>

386. The Claimant's argument is flawed. As described above, its "Below-Load Access Percentage" ignores not only the purpose of the GBL and the principles that inform BC Hydro's methodology, but also the unique circumstances of each mill's operations. The Claimant's use of a percentage calculated on the basis of Skookumchuck's GBL, which reflects the current normal operations of that mill, to demonstrate that Celgar's GBL was

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<sup>740</sup> BC Hydro Memo, Re: Tembec Skookumchuck Pulp, **R-189**; Lester Dyck Statement, ¶ 102.

<sup>741</sup> Tembec Justification Report, at 152600, **R-192**.

<sup>742</sup> *Ibid.*, **R-192**; Lester Dyck Statement, ¶ 104.

<sup>743</sup> Tembec 2009 EPA, **R-198**; Lester Dyck Statement, ¶¶ 106-109.

<sup>744</sup> Claimant's Memorial, ¶ 541.

<sup>745</sup> Expert Report of Brent Kaczmarek dated 31 March 2014 ("Kaczmarek Expert Report"), ¶197, Table 14.

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set too high is arbitrary and fails to recognize that the mills' different current normal operations necessarily lead to different outcomes.

**a) The Mills Had Different Current Normal Operations**

387. The Claimant relies on Mr. Switlishoff's conclusion that BC Hydro used a [REDACTED] baseline period for Skookumchuck's GBL, and argues that BC Hydro ignored the mill's actual recent operating history, opting instead to consider a "hypothetical analysis of a steam and generation configuration that never actually existed."<sup>746</sup> This, the Claimant argues, amounts to better treatment for Skookumchuck than for Celgar. The Claimant both inaccurately casts the treatment, and ignores the fact that, where Skookumchuck had a pre-existing agreement that affected its normal operations, Celgar did not.

388. To set the GBL for Skookumchuck, as for Celgar, BC Hydro looked for a normal operating year as of the time of the negotiations to assess how much electricity was generated for self-supply under current conditions. Rather than the "[REDACTED] baseline period" identified by the Claimant, BC Hydro and Tembec agreed that [REDACTED], was representative of Skookumchuck's normal pulp operations, and therefore steam production in [REDACTED] was used as a basis for the GBL.<sup>747</sup>

389. Skookumchuck had been operating under a major pre-existing contract since 2001. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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<sup>746</sup> Claimant's Memorial, ¶ 541; Expert Report of Elroy Switlishoff, ¶ 164.

<sup>747</sup> Lester Dyck Statement, ¶¶ 106-107.

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

390. In contrast, Celgar's actual recent generation data accurately reflected its current normal operations. It did not have a pre-existing agreement that affected its operations, and submitted data to BC Hydro that confirmed that 2007 represented normal operations going forward.<sup>749</sup> In both cases, BC Hydro looked for current normal operations to assess what would be incremental generation to incentivize under the EPAs to the benefit of ratepayers. To the extent that Skookumchuck had a pre-existing contract that affected its historical operations, and Celgar did not, the treatment accorded to the Skookumchuck and Celgar mills in the setting of their GBLs for their 2009 EPAs was not accorded in like circumstances.

**b) The Claimant's Other Arguments Fail to Demonstrate that BC Hydro Acted Inconsistently with NAFTA Articles 1102 or 1103**

391. The Claimant further argues that Skookumchuck has been treated more favourably because of the "highly unusual shape" of its GBL.<sup>750</sup> In comparison, the Claimant alleges that BC Hydro "determined" Celgar's GBL [REDACTED]

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<sup>748</sup> Lester Dyck Statement, ¶ 106: "The obligations in the existing contract were about to disappear, [REDACTED]"

[REDACTED] See also Pöyry Expert Report, ¶¶ 135-6.

<sup>749</sup> Celgar's May 7, 2008 Letter to RFP Administrator, **R-127**.

<sup>750</sup> Claimant's Memorial, ¶¶ 536-538, 541.

[REDACTED]

[REDACTED]<sup>751</sup>.

392. The Claimant's argument ignores material facts and must be rejected. All mills make a one-time selection of the type of firm energy commitment they will make in their contract, *i.e.* hourly or seasonal.<sup>752</sup> For contract management purposes, each mill must then propose a corresponding shape to its annual GBL. In making its selections, each mill assesses its ability to meet the contractual obligations, as it bears the risk of paying penalties for non-delivery. Celgar selected a seasonal firm energy delivery obligation, and proposed a corresponding seasonal shape to its GBL.<sup>753</sup>

393. Not only did BC Hydro accept the shape Celgar proposed for its GBL, but Celgar's contract allows it to modify the shape of its GBL once every year.<sup>754</sup> Thus, if the Claimant wants a shape like Skookumchuck's, it is free to make such a proposal. That Celgar has failed to avail itself of its contractual rights is no fault of Canada's.

394. Finally, the Claimant argues that Skookumchuck's GBL allowed Tembec to increase its purchases of embedded cost power from BC Hydro so that it could engage in arbitrage harmful to BC Hydro's own ratepayers, contrary to BCUC Order G-38-01. The Claimant states that BC Hydro "understood that the 2009 EPA was not consistent with the directive of Order G-38-01, and that it submitted misleading information to the [BCUC]" to justify the agreement.<sup>755</sup>

395. The Claimant's allegation is misguided. While Tembec's purchases of electricity from BC Hydro [REDACTED], it is inapt to compare, as the Claimant does, the level of Tembec's purchases from BC Hydro when

<sup>751</sup> Claimant's Memorial, ¶ 541.

<sup>752</sup> Lester Dyck Statement, ¶¶ 63-64.

<sup>753</sup> Celgar Commercial Proposal at MER00015621, **R-128**.

<sup>754</sup> Celgar 2009 EPA, s. 7.10, **R-135**.

<sup>755</sup> Claimant's Memorial ¶ 534. *See also* ¶¶ 529-535, 602-608.

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Skookumchuck operated under the 1997 EPA and had access to cheap hog fuel to the level of purchases from BC Hydro under the 2009 EPA.<sup>756</sup> While the 1997 EPA was disappearing, [REDACTED]. The appropriate comparison is what Tembec would have consumed absent any incentive agreement under the conditions prevailing at the time of negotiations. Given the prevailing high hog fuel prices, Tembec would have purchased electricity from BC Hydro at the same rate that it currently purchases under the 2009 EPA.<sup>757</sup> When appropriately compared, there is no detrimental arbitrage.<sup>758</sup> The Claimant fails to address these relevant facts and overstates its case.

**4. BC Hydro's Consistent Application of its GBL Methodology for Howe Sound's 2010 EPA and Celgar's 2009 EPA Led to Different Results because of the Unique Circumstances of Each Mill**

396. Howe Sound and BC Hydro concluded an EPA on September 7, 2010 in the context of BC Hydro's IPO.<sup>759</sup> In the years leading up to the EPA, Howe Sound's generation [REDACTED]

[REDACTED]<sup>760</sup> [REDACTED]  
[REDACTED]  
[REDACTED]<sup>761</sup> [REDACTED]

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<sup>756</sup> Lester Dyck Statement, ¶¶114-117; Pöyry Expert Report, ¶¶128-130.

<sup>757</sup> NERA Expert Report, Appendix 2, p 8, FN 27.

<sup>758</sup> See Pöyry Expert Report, ¶ 136.

<sup>759</sup> Howe Sound 2010 EPA, **R-62**.

<sup>760</sup> See Witness Statement of Fred Fominoff, dated August 19, 2014 ("Fred Fominoff Statement"), ¶¶ 15-19; Lester Dyck Statement, ¶ 124.

<sup>761</sup> Fred Fominoff Statement, ¶ 20: [REDACTED]

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397. BC Hydro and Howe Sound therefore negotiated an EPA, which, along with the PPGTP funds Howe Sound received, made [REDACTED].<sup>762</sup> The EPA was negotiated on the basis of terms and conditions that were generally consistent with the Bio Phase I EPAs, including a GBL.<sup>763</sup> Howe Sound's annual GBL was set at [REDACTED] on the basis of the mill's current normal operations.<sup>764</sup>

398. The Claimant again argues that BC Hydro used divergent baseline periods and different data sets to measure generation levels when it set the GBLs for the Howe Sound and Celgar mills, resulting in a "Below-Load Access Percentage" for Howe Sound of [REDACTED] (compared with Celgar's 0.0%).<sup>765</sup> In the Claimant's view, this amounts to less favourable treatment because, were the same "Below-Load Access Percentage" to be applied to Celgar, its GBL would be [REDACTED], rather than 349 GWh/year.<sup>766</sup>

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<sup>762</sup> Howe Sound received \$45.5 million in PPGTP funds: Fred Fominoff Statement, ¶ 24. The Celgar mill's EPA with BC Hydro, along with its PPGTP funds, made the Claimant's investment in the Green Energy Project not only financially viable in the context of current prevailing conditions (*i.e.* the financial crisis in 2008), but also profitable. Accounting for the PPGTP funds and the benefit of an EPA with BC Hydro, the Claimant's internal rate of return on its Green Energy Project increases five-fold, from 9.2% to 45%: NERA Expert Report, ¶ 101 (45% represents the adjusted IRR that ignores the \$11 million the Claimant received but does not attribute to its Green Energy Project).

<sup>763</sup> Fred Fominoff Statement, ¶ 26. *See also* Letter from BC Hydro Power Authority to Fred Fominoff, 6 November 2009, **R-63**.

<sup>764</sup> Calculated on the basis of 365 operating days: [REDACTED]

[REDACTED] : Fred Fominoff Statement, ¶¶ 35-36, FNs 21, 22; Lester Dyck Statement, ¶ 131; *See also* Email from Scott Janzen to Fred Fominoff, Re: GBL, 24 June 2010, **R-70**.

<sup>765</sup> Claimant's Memorial, ¶ 576.

<sup>766</sup> Kaczmarek Expert Report, ¶197, Table 14.



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399. The Claimant's argument is flawed. As described above, its "Below-Load Access Percentage" ignores not only the purpose of the GBL and the principles that inform BC Hydro's methodology, but also the unique circumstances of each mill's operations. The Claimant's use of a percentage calculated on the basis of Howe Sound's GBL, which reflects the current normal operations of that mill, to demonstrate that Celgar's GBL was set too high is arbitrary and fails to recognize that the mills' different current normal operations necessarily lead to different outcomes.<sup>767</sup>

**a) The Mills Had Different Current Normal Operations**

400. The Claimant argues that BC Hydro's use of a [REDACTED] baseline period for Howe Sound is more favourable treatment than the one-year, calendar year 2007 baseline period used for Celgar's GBL.<sup>768</sup> The Claimant posits that the selection of any other year or combination of years for Celgar's GBL would have yielded it a lower GBL, which would have allowed it to sell at least part of its existing generation.<sup>769</sup> This argument again suggests that GBL determination should be arbitrary rather than principled, and ignores the fact that the Howe Sound and Celgar mills had different current normal operations when they negotiated their respective EPAs.

401. To set the GBL for Howe Sound, as for Celgar, BC Hydro looked for a normal operating year as of the time of the negotiations to assess how much electricity was generated for self-supply under current conditions. [REDACTED]

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<sup>767</sup> For example, the Claimant's "Below-Load Access Percentage" fails to account for the composition of the mills. Unlike Celgar, Howe Sound is not physically able to supply all parts of its operations with the biomass generation capacity of its kraft mill because the site also has thermo-mechanical pulping and paper making machines that are primarily energy consumers. While the load of Howe Sound's kraft mill averages around [REDACTED] MW - comparable to Celgar's load - the load of the entire facility is three times that size. Howe Sound is thus required to purchase significant amounts of electricity from BC Hydro to serve the rest of its load. A GBL amount below the mill's total load is thus a natural consequence of the mill's composition. *See* Fred Fominoff Statement, ¶¶ 9-14.

<sup>768</sup> Claimant's Memorial, ¶ 576.

<sup>769</sup> *Ibid.*, ¶ 630.

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[REDACTED] .<sup>770</sup>

[REDACTED]

[REDACTED]

[REDACTED] .<sup>771</sup> [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] .<sup>772</sup> [REDACTED]

[REDACTED]

[REDACTED] .<sup>773</sup>

402. In Celgar's case, the mill was undertaking projects in the years prior to the negotiation of its GBL to normalize operations following a long period in receivership, when little capital investment was made and minimal maintenance was undertaken.<sup>774</sup> Given that there were significant down times in 2005 and 2006 while the improvements were being implemented, neither of those years represented the mill's current normal operations.<sup>775</sup> Instead, calendar year 2007 represented current normal operations for Celgar.<sup>776</sup>

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<sup>770</sup> Fred Fominoff Statement, ¶¶ 31; Lester Dyck Statement, ¶ 128.

<sup>771</sup> Lester Dyck Statement, ¶ 128; Fred Fominoff Statement, ¶ 32. *See also* Howe Sound Pulp and Paper LP, Generation Baseline Calculations, 1 August 2006 to 31 July 2009, ("Howe Sound Generation Baseline Calculations"), **R-66** and Howe Sound Pulp and Paper, Generation Data (2005-2012), **NERA-52**.

<sup>772</sup> Fominoff Witness Statement, ¶¶ 15-20, 32-33; Lester Dyck Statement, ¶ 129; Pöyry Expert Report, ¶¶ 105-108.

<sup>773</sup> [REDACTED]  
[REDACTED] Lester Dyck Statement, ¶ 129, FN 138.

<sup>774</sup> Pöyry Expert Report, ¶¶ 65-70.

<sup>775</sup> Pöyry Expert Report, ¶75: "[T]he Blue Goose Project should be largely considered as normalization of Celgar operations after being investment constrained financially and by obligations and objectives of bankruptcy trustees"; Lester Dyck Statement, ¶ 81; Celgar's May 7, 2008 Letter to RFP Administrator at bates 019774, **R-127**.

<sup>776</sup> Pöyry Expert Report, ¶ 160.

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403. Celgar was not treated less favourably than Howe Sound in this regard because, in both cases, BC Hydro sought to protect ratepayers by paying only for incremental generation, which was determined by assessing the unique circumstances of each mill. The use of a [REDACTED] for Howe Sound increased its GBL.<sup>777</sup> Had BC Hydro used a [REDACTED] for Celgar, it would have decreased its GBL, allowing the mill to sell generation it was currently using to self-supply, contrary to G-38-01 and the BC Government's policy against re-pricing existing generation.<sup>778</sup> Setting Celgar's GBL on the basis of its normal operations in 2007 and Howe Sound's GBL on the basis of a [REDACTED] ensured that BC Hydro was not paying something for nothing in return.

404. The Claimant further argues that Celgar was treated less favourably than Howe Sound because, rather than measure its mill load (as it claims BC Hydro did for Celgar), BC Hydro measured [REDACTED]  
[REDACTED]<sup>779</sup> This argument again mischaracterizes the manner in which Celgar's GBL was set, and ignores the different circumstances of Howe Sound's [REDACTED] and Celgar's sales of excess energy to NorthPoint/FortisBC.

405. Howe Sound had sold energy to Powerex [REDACTED] under an enabling agreement to which BC Hydro consented on the condition that Howe Sound sell only incremental electricity generated above [REDACTED].<sup>780</sup> [REDACTED]

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<sup>777</sup> Fred Fominoff Statement, ¶ 32: [REDACTED]

<sup>778</sup> Les MacLaren Statement, ¶¶ 90-91.

<sup>779</sup> Claimant's Memorial, ¶ 576.

<sup>780</sup> BC Hydro's consent was required because "Howe Sound's proposal was to produce self-generation output in excess of the amount normally made for self-supply, but not in excess of mill load. The transaction between Howe Sound and Powerex was based on the amount of electricity

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[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]<sup>781</sup> In the years leading up to the negotiation of the 2010 EPA,  
[REDACTED]<sup>782</sup>.

406. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]<sup>783</sup> [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

407. In contrast, Celgar generated excess electricity under normal operating conditions. On an annual basis, Celgar's normal operations included supplying 100% of its load and selling any electricity generated in excess of its load.<sup>784</sup> Indeed, Celgar did not require a

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Howe Sound generated above the [REDACTED] threshold and the price that that Powerex would pay Howe Sound for it. However, the separate transaction between Powerex and an electricity purchaser (be it in the U.S. or Alberta) would have to rely on BC Hydro system resources because all of the electricity generated by Howe Sound (including that in excess of [REDACTED]) would be consumed on site by the mill. As such, BC Hydro's involvement and consent was required to reconcile the applicable tariffs and agreements": Lester Dyck Statement, FN 27.

<sup>781</sup> Pierre Lamarche Statement, ¶¶ 38-40.

<sup>782</sup> [REDACTED]  
[REDACTED]: Fred Fominoff Statement, ¶ 34, FN 20. *See also* Howe Sound Generation Baseline Calculations, **R-66**.

<sup>783</sup> Lester Dyck Statement, ¶ 130; Fred Fominoff Statement, ¶ 34.

<sup>784</sup> Celgar's May 7, 2008 Letter to RFP Administrator at bates 019774, **R-127**; Lester Dyck Statement, ¶ 87. The Celgar mill's total generation in 2007 was 350,641 GWh, and it was a net

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sales contract to incentivize it to generate the quantities it was generating; it was using its generation to supply its load for other reasons.<sup>785</sup> The *ad hoc* sales of Celgar's excess energy thus formed part of the mill's normal operations. That the Howe Sound and Celgar mills required different incentives historically is a natural consequence of their unique operating circumstances.

408. In any event, Celgar's net exports, on an annual basis, were subtracted from its total generation to arrive at the level of its load.<sup>786</sup> In this way, it received the same treatment as Howe Sound.

**b) The Claimant's Other Arguments Fail to Demonstrate that BC Hydro Acted Inconsistently with NAFTA Articles 1102 or 1103**

409. The Claimant argues that BC Hydro permitted Howe Sound to "capture the full benefit of its investments in self-generation made following Order G-38-01" by allowing it to arbitrage incremental generation capacity it added in 2010.<sup>787</sup> Celgar, it posits on the other hand, was refused the ability to capture the full benefit of its investments in self-generation following Order G-38-01, particularly treating the "benefits of its 2005-07 Project Blue Goose investments as belonging in part to BC Hydro and FortisBC ratepayers."<sup>788</sup>

410. The Claimant's argument ignores that BC Hydro's GBL methodology assesses what is currently normal in the absence of the prospective EPA.<sup>789</sup> Unlike Howe Sound's 2010 boiler investments, the Claimant's Blue Goose project was an investment decision

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exporter of electricity, selling 1,377 GWh: Data Chart, **R-182**.

<sup>785</sup> See, NERA Expert Report, Figure 1 ("Celgar's Cost of Purchasing Load from FortisBC vs. Supplying Load with Self-Generation"), ¶ 79, which demonstrates that Celgar could generate electricity for cheaper than it could buy it from FortisBC.

<sup>786</sup> Data Chart, **R-182**; Lester Dyck Statement, ¶ 87.

<sup>787</sup> Claimant's Memorial, ¶ 576.

<sup>788</sup> *Ibid.*, ¶ 576.

<sup>789</sup> See ¶ 364 and 367, above; Lester Dyck Statement, ¶ 44.

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made and implemented by Celgar on the basis of its own cost/benefit analysis, independently of any external incentive such as the prospect of a long-term electricity sales agreement.<sup>790</sup> The increase in generation attributable to the Blue Goose project was a part of “normal operations” going forward without an EPA incentive. A more apt comparison to Howe Sound’s 2010 generation projects is Celgar’s own Green Energy Project, which both required and received an external incentive (*i.e.* the 2009 EPA). Properly compared, it is clear that Celgar was not treated less favourably.

**5. Canfor’s 2004 LDA and Celgar’s 2009 EPA are Not In Like Circumstances**

411. In March 2004, BC Hydro and Canfor concluded a load displacement agreement under which BC Hydro paid an incentive of \$49 million towards the construction of new generating equipment at its Prince George pulp mill.<sup>791</sup> In exchange, Canfor was obligated to self-generate 390 GWh/year for a period of 15 years.<sup>792</sup> The \$49 million incentive reflected the net present value of BC Hydro’s cost-savings from not having to supply Canfor with 390 GWh/year for 15 years.<sup>793</sup> Thus, if Canfor did not meet its obligation to generate 390 GWh/year, forcing BC Hydro to supply the difference, Canfor would owe penalties to BC Hydro.<sup>794</sup>

412. [REDACTED]  
[REDACTED] <sup>795</sup> [REDACTED]

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<sup>790</sup> See Pöyry Expert Report ¶¶ 71-75.

<sup>791</sup> The total project cost was \$81.4 million: Power Smart Incentive Program Agreement Between BC Hydro and Canfor Corporation, 15 March 2004 (“Canfor 2004 LDA”), **R-156**.

<sup>792</sup> The total load of the Canfor Prince George pulp mill was [REDACTED]. The benefits to BC Hydro as a result of this arrangement were estimated to outweigh the cost by a factor of over 3:1: BC Hydro’s receipt of 390 GWh/year of electricity load displacement was at a significantly lower cost (1.5¢/kWh) than new sources of generation (5.5¢/kWh): Letter from Richard Stout to William Grant Re: British Columbia Hydro and Power Authority (“BC Hydro”) Canfor Forest Products Ltd. (Canfor) Power Smart Load Displacement Project, 12 November 2003, **R-157**.

<sup>793</sup> *Ibid.*, **R-157**.

<sup>794</sup> Canfor 2004 LDA, s. 11, **R-156**.

<sup>795</sup> Letter from Brett Robinson to David Calabrigo, Re: Reset of 2004 PG Cogen Project Baseline,

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[REDACTED]

[REDACTED]. BC Hydro and Canfor thus signed an amendment to the LDA, [REDACTED]<sup>796</sup> [REDACTED]  
[REDACTED]<sup>797</sup> [REDACTED]  
[REDACTED] >.

413. [REDACTED]  
[REDACTED]  
[REDACTED]. The EPA included a GBL, which was set at [REDACTED]<sup>798</sup>.

414. The Claimant argues that BC Hydro "[REDACTED]  
[REDACTED]"<sup>799</sup> This is false. In setting the GBL for Canfor, BC Hydro assessed [REDACTED]  
[REDACTED]  
[REDACTED]<sup>800</sup> [REDACTED]

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12 August 2008, at bates 070175, **R-166**. The project generated [REDACTED] in the first 15-month period, [REDACTED] in the subsequent 12-month period, and [REDACTED] in the following year: Draft Letter Agreement between BC Hydro and Canfor Re Amendment of Prince George Load Displacement Agreement, 16 October 2008, at bates 070124, **R-167**.

<sup>796</sup> Power Smart Incentive Program Amending Agreement No. 2 between BC Hydro and Canfor LP, 4 February 2009, **R-158**.

<sup>797</sup> Ibid.

<sup>798</sup> BC Hydro and Canfor Pulp Limited Partnership, Electricity Purchase Agreement, Bioenergy Call for Power – Phase I, dated February 4, 2009, **R-137**.

<sup>799</sup> Claimant's Memorial, ¶ 582.

<sup>800</sup> [REDACTED]  
[REDACTED]: Lester Dyck Statement, FN 31.

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[REDACTED].<sup>801</sup> [REDACTED]

[REDACTED].<sup>802</sup>

415. The Claimant also erroneously argues that BC Hydro [REDACTED]

[REDACTED].<sup>803</sup> While Canfor was paid a \$49 million incentive in exchange for an obligation to generate 390 GWh/year, [REDACTED]

[REDACTED]

[REDACTED].<sup>804</sup> The Claimant is therefore incorrect to assert that BC Hydro already paid for generation [REDACTED].

416. Next, the Claimant argues that because “BC Hydro did not obtain a LDA with Celgar, it cannot require Celgar to provide any load displacement services without treating Celgar less favourably than those whom it paid” to provide load displacement services.<sup>805</sup> The Claimant’s argument is flawed.

417. The Claimant assumed the obligation to self-supply its own electricity needs when it invested in the mill in 2005. Pursuant to the 1991 Ministerial Order, it is under a legal obligation to do so. It is therefore incorrect for the Claimant to state that BC Hydro has required Celgar to provide “load displacement services.” The Claimant is energy self-sufficient under normal operating conditions in accordance with the commitments it assumed.

418. Moreover, it does not make sense for the Claimant to suggest that it should obtain a retroactive subsidy from BC Hydro for the load it displaces. Not only would this be a

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<sup>801</sup> Canfor had submitted to BC Hydro that [REDACTED] and [REDACTED] provided information in support of this submission.

<sup>802</sup> Lester Dyck Statement, ¶ 45.

<sup>803</sup> Claimant’s Memorial, ¶ 582.

<sup>804</sup> Canfor 2004 LDA, s. 11.5, **R-156**.

<sup>805</sup> Claimant’s Memorial, ¶ 586.



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payment for nothing in return, but the Claimant is not within BC Hydro service territory and is therefore not eligible for a LDA with BC Hydro in the first place. The only utility with which it would make sense to negotiate a LDA is FortisBC. However, in order for FortisBC to provide a load displacement incentive to Celgar, the incentive would have to be cost-effective relative to FortisBC's marginal cost. As explained by Mr. Swanson in his witness statement, FortisBC has a different marginal cost of supply and different planning constraints (compared to BC Hydro), thus making DSM a less cost effective resource, which explains, in part, why LDAs have not been concluded in FortisBC's service area.<sup>806</sup>

419. The Claimant's attempt to characterize the Canfor LDA as more favourable treatment is without merit. The Canfor LDA is not treatment that was accorded in like circumstances.

**6. The Claimant's Allegations Related to Other Agreements are Misplaced**

**a) Skookumchuck's 1997 EPA is Not Inconsistent with NAFTA Articles 1102 or 1103**

420. When Tembec acquired the Skookumchuck mill in 1999, it assumed responsibility for an EPA that had been concluded in 1997 between BC Hydro and Purcell Power Corp., a joint venture affiliated with the prior owner of the mill ("the 1997 EPA").<sup>807</sup> As negotiated, the 1997 EPA provided the necessary incentive to construct an independent power producing plant at the Skookumchuck mill.<sup>808</sup> [REDACTED]

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<sup>806</sup> Dennis Swanson Statement, ¶ 27.

<sup>807</sup> Electricity Purchase Agreement between Purcell Power Corp. and BC Hydro, 5 September 1997, at bates 016965-017008, **R-190**. The EPA was concluded pursuant to BC Hydro's 1994 RFP: Lester Dyck Statement, ¶¶ 93-97.

<sup>808</sup> Letter from W.D. Stothert to Gregg Moe (BC Hydro), Re: BC Hydro Request for Proposals, 15 March 1995, **R-393**. The Project [REDACTED]

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[REDACTED]

[REDACTED],<sup>809</sup> [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]<sup>810</sup>.

421. The 1997 EPA is not treatment accorded in like circumstances with Celgar's 2009 EPA. The 1997 EPA's structure is unique, and its embodiment of characteristics of both of BC Hydro's modern EPAs and LDAs renders it an inapt basis for comparison. Moreover, the 1997 EPA was negotiated and concluded prior to BCUC Order G-38-01, before the concepts of "customer baseline" and GBL were introduced into the regulatory landscape. As such, it is not treatment accorded in like circumstances.

**b) Howe Sound's 1989 Generation Agreement is Not Inconsistent with NAFTA Articles 1102 or 1103**

422. In 1989, Howe Sound concluded a Generation Agreement with BC Hydro ("the Generation Agreement"),<sup>811</sup> under which BC Hydro offered Howe Sound an interest-free construction loan of [REDACTED] to install electricity generation equipment.<sup>812</sup> In exchange, Howe Sound was required [REDACTED]

[REDACTED]<sup>813</sup> [REDACTED]

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<sup>809</sup> BC Hydro – Tembec ESA, **R-188**. See Appendix.

<sup>810</sup> BC Hydro Memo, Re: Tembec Skookumchuck Pulp, at bates 037395, **R-189** [REDACTED]  
[REDACTED]. See Lester Dyck Statement, ¶ 98, for an explanation of the operation of the 1997 EPA with the 2001 ESA.

<sup>811</sup> HSPP 1989 Generation Agreement, **R-64**.

<sup>812</sup> See BC Hydro, Inter-Office Memo Re: Howe Sound Pulp and Paper Generation Agreement, 10 November 1989, at 072476, **R-343**; HSPP 1989 Generation Agreement, Clause 5.01 at 016612, **R-64**.

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[REDACTED]<sup>814</sup>, [REDACTED]  
[REDACTED]<sup>815</sup>, [REDACTED]  
[REDACTED]<sup>816</sup>.

423. The Generation Agreement was negotiated and concluded prior to BCUC Order G-38-01, before the notion of self-generating customers selling electricity was even contemplated by BC's utilities or regulators, and thus necessarily before the concept of the "customer baseline" was introduced into the regulatory landscape. As such, it is not treatment accorded in like circumstances with Celgar's 2009 EPA.

**c) Howe Sound's 2001 Enabling Agreement Is Not Inconsistent with NAFTA Articles 1102 or 1103**

424. In mid-2000, electricity market prices in the western United States began to spike due to energy shortages. The BCUC responded with Order G-38-01, and Howe Sound negotiated agreements with Powerex and BC Hydro that permitted it to sell electricity only in excess of a [REDACTED] MW hourly threshold.<sup>817</sup> BC Hydro and Howe Sound agreed to [REDACTED] MW on the basis of the mill's normal usage at the time of negotiation.<sup>818</sup>

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<sup>813</sup> The mill's total plant load was greater than the capacity of the generation equipment. As BC Hydro considered the generation potential at the Port Mellon site to be substantial and at a much lower cost than its eventual large project alternatives, its promotion of customer generation at Howe Sound's mill was consistent with its direction to "[develop] the lowest cost resources that also provide reasonable conformity to BC Hydro's load growth and defer major generating projects." Inter-Office Memo Re: Howe Sound Pulp and Paper Generation Agreement, 10 November 1989, at 072476, **R-343**. See also Briefing Note for Howe Sound Pulp & Paper Generation Agreement and Powerex Enabling Agreement, 12 October 2001, **R-331**.

<sup>814</sup> Briefing Note, Howe Sound Pulp and Paper (HSP) Generation Agreement Termination, 16 February 2010, at 0143051, **R-199**; Pierre Lamarche Statement, ¶ 18.

<sup>815</sup> Pierre Lamarche Statement, ¶¶ 18-22.

<sup>816</sup> HSPP 1989 Generation Agreement, s. 7 at 016616-20, **R-64**. See also Pierre Lamarche Statement, ¶ 17.

<sup>817</sup> Consent and Electricity Purchase and Sale Agreement between HSPP, Powerex and BC Hydro, 12 April 2001, at bates 021823-021833, ("Howe Sound 2001 Consent Agreement"), **R-85**; Purchase Transaction Enabling Agreement between Powerex Corp and Howe Sound, 12 April 2001, **R-84**; BC Hydro's consent was renewed on an annual basis until 2007: Consent and Electricity Purchase and Sale Agreement between HSPP, Powerex and BC Hydro, 28 February 2002, **R-160**; Consent and Electricity Purchase and Sale Agreement between HSPP, Powerex and

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425. To arrive at the [REDACTED] MW baseline, Howe Sound and BC Hydro looked at current generation data to assess how much electricity the mill was generating to self-supply under the prevailing conditions.<sup>819</sup> When natural gas prices spiked in mid-2000,

[REDACTED]

[REDACTED].<sup>820</sup> At the time of negotiations in 2001, [REDACTED]

[REDACTED].<sup>821</sup> The parties agreed that [REDACTED] MW represented the level of electricity that the mill generated [REDACTED]<sup>822</sup>

[REDACTED].<sup>823</sup> The [REDACTED] MW was therefore an estimate of what was “idle” generation under G-38-01.<sup>824</sup>

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BC Hydro, 31 March 2003, **R-161**; Consent and Electricity Purchase and Sale Agreement between HSPP, Powerex and BC Hydro, 31 March 2004, **R-162**; Consent and Electricity Purchase and Sale Agreement between HSPP, Powerex and BC Hydro, 31 March 2005, **R-163**; Consent and Electricity Purchase and Sale Agreement between HSPP, Powerex and BC Hydro, 1 April 2006, **R-164**; Consent and Electricity Purchase and Sale Agreement between Howe Sound Pulp and Paper and Powerex, 16 April 2007, **R-69**.

<sup>818</sup> Howe Sound 2001 Consent Agreement, at bates 021834-021842, **R-85**.

<sup>819</sup> Pierre Lamarche Statement, ¶¶ 33-37; Lester Dyck Statement, ¶ 40.

<sup>820</sup> [REDACTED] See Pierre Lamarche Statement, ¶¶ 18-24; Lester Dyck Statement, ¶ 39.

[REDACTED] Pierre Lamarche Statement, ¶ 26.

[REDACTED] : Pöyry Expert Report, Henry Hub Chart (¶ 42); Pierre Lamarche Statement, ¶ 39.

<sup>821</sup> Pierre Lamarche Statement, ¶ 36.

<sup>822</sup> *Ibid.*, ¶ 37.

<sup>823</sup> Lester Dyck Statement, ¶ 40. See also Fred Fominoff Statement, ¶ 34.

<sup>824</sup> Lester Dyck Statement, ¶ 34. See also Pierre Lamarche Statement, ¶ 33: [REDACTED]

[REDACTED]

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426. BC Hydro applied the same principles in negotiating Howe Sound's [REDACTED] MW hourly threshold as it did in negotiating the GBL in Celgar's 2009 EPA and, in this respect, the treatment was not less favourable. In addition, Howe Sound had [REDACTED]  
[REDACTED]  
[REDACTED]. The arrangement [REDACTED]  
[REDACTED]  
[REDACTED]. Howe Sound's Powerex arrangement in 2001 earned [REDACTED]  
[REDACTED],<sup>825</sup> which is far below Celgar's 2009 EPA price of \$107/MWh. This hardly demonstrates nationality-based discrimination against the Claimant.

**d) Howe Sound's Use of Incremental Generation to Avoid Power Purchases Is Not Inconsistent with NAFTA Articles 1102 or 1103**

427. In 2006, BC Hydro implemented stepped rates for its transmission service customers (there are generally large industrial customers such as pulp and paper mills).<sup>826</sup> Under the new rate, each customer's normal electricity purchases (represented by a unique, customer-specific customer baseline load ("CBL")) were divided into two tranches of power: Tier 1 and Tier 2.<sup>827</sup> The customer pays the lower Tier 1 rate for all purchases up to 90% of its CBL, and the higher Tier 2 rate for anything in excess of 90%. The tiered rate is designed as a mechanism to incentivize energy conservation, energy efficiency, and load displacement by providing Tier 2 bill savings to those customers that implement such measures and reduce their purchases to below the CBL level.

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<sup>825</sup> Howe Sound 2001 Consent Agreement, at bates 021834-021842, **R-85**; Purchase Transaction Enabling Agreement between Powerex Corp and Howe Sound, 12 April 2001, **R-84**.

<sup>826</sup> BC Hydro, Application to Amend TS74, at pp 4-5, **R-87**.

<sup>827</sup> BC Hydro looks at 365 days of historical energy purchase data to arrive at the CBL, and adjusts for unusual events, such as force majeure, strikes, and for DSM savings.

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428. Howe Sound and BC Hydro signed a letter agreement in March 2007<sup>828</sup> [REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]<sup>829</sup>

429. The Claimant argues that it has been accorded less favorable treatment because “BC Hydro and the Province have not afforded Celgar the same flexibility.”<sup>830</sup> The Claimant’s argument is, however, misguided because the Claimant is a customer of FortisBC and it is therefore not possible for BC Hydro or BC to agree with Celgar to an arrangement that would allow Celgar [REDACTED]  
[REDACTED]. It is not possible for the Claimant to be accorded “the same flexibility” because it is not a BC Hydro customer. Moreover, the Claimant only purchases electricity from FortisBC when its generators are not operating. The Claimant would not, therefore, have any [REDACTED]  
[REDACTED] from FortisBC.

**D. The Claimant Has Failed to Establish that BCUC Order G-48-09 is Inconsistent with NAFTA Articles 1102 or 1103**

430. It is a serious matter to allege that an independent regulatory commission has engaged in nationality-based discrimination in a manner that is inconsistent with the NAFTA. These kinds of allegations call into question the integrity, impartiality and

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<sup>828</sup> Letter from Lester Dyck to Pierre Lamarche, Re: HSLP Generation letter agreement, 14 March 2007, **R-89**.

<sup>829</sup> *Ibid.*

<sup>830</sup> Claimant’s Memorial, ¶ 575, point 3.

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independence of the regulatory commission and its members. It is important, therefore, that such claims have a serious foundation.

431. No such foundation exists for the Claimant's allegations against the BCUC concerning BCUC Order G-48-09. In particular, its assertion that BCUC Order G-48-09 accorded it less favourable treatment than that accorded to the other pulp mills, is baseless. This is because the Claimant, once again, mischaracterizes the treatment. The actual treatment that the BCUC accorded in Order G-48-09 concerned BC Hydro and FortisBC—not the Claimant, who was only an intervener in this proceeding. The Claimant further minimizes critical facts, hiding in a footnote the fact that the less favourable treatment of which it complains disappears in the face of its “Seller Consumed Eligible Energy” arrangement with BC Hydro.<sup>831</sup> Moreover, the Claimant has failed to provide any evidence, let alone prove, that BCUC Order G-48-09 constitutes nationality-based discrimination in violation of Canada's obligations under NAFTA Articles 1102 and 1103.

**1. The Claimant's Attempt to Mischaracterize Canada's Consistent Treatment**

**a) The Claimant Mischaracterizes BCUC Order G-48-09**

432. As explained above in Section II.E.7.d, the BCUC amended the 1993 PPA between BC Hydro and FortisBC in Order G-48-09 to limit FortisBC's access to BC Hydro's Rate Schedule 3808 energy if and when FortisBC facilitated its customers' notional sale of self-generated energy below their load. The 1993 PPA already prohibited FortisBC from purchasing BC Hydro Rate Schedule 3808 energy at any time that FortisBC was exporting power, to protect BC Hydro's ratepayers from harm.<sup>832</sup> The

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<sup>831</sup> *Ibid.*, FN 606.

<sup>832</sup> A similar prohibition exists in the Electricity Supply Agreements governing BC Hydro's supply of electricity to its industrial customers. *See* s. 24 of B.C. Hydro Electric Tariff Supplement No. 5, Agreement for Customers Taking Electricity Under Schedule 1821, Accepted for Filing by BCUC, 27 November 1998 (BCUC Order No. G-89-1998), **R-122**. (“The customer shall not sell, or otherwise dispose of for compensation, all or part of the Electricity supplied pursuant to this

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application resulting in Order G-48-09, however, was raised in response to an issue that had not been foreseen at the time of the conclusion of the 1993 PPA:<sup>833</sup> FortisBC facilitating the arbitrage of BC Hydro's Rate Schedule 3808 energy by its customers so that these customers could engage in deemed or notional sales of their self-generated energy into Alberta or the United States.

433. After observing that this application could be viewed as having precedential value for all provincial self-generators,<sup>834</sup> the BCUC considered its previous decisions concerning the sale of self-generated electricity and generator baselines in BCUC Orders G-38-01,<sup>835</sup> G-17-02 and G-113-01.<sup>836</sup> It then turned to examining the potential harm to BC Hydro's ratepayers. The BCUC observed that BC Hydro had estimated the level of harm to its ratepayers equivalent to C\$16.7 million per year.<sup>837</sup> Moreover, BCUC staff using a different calculation methodology estimated the harm attributable to BC Hydro ratepayers at C\$12.3 million per year.<sup>838</sup> FortisBC also eventually conceded that there was some potential for harm to BC Hydro's ratepayers.<sup>839</sup> The Claimant, of course, was always aware that its Arbitrage Project would harm BC Hydro's ratepayers.<sup>840</sup>

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Agreement to any other person directly or indirectly without prior authorization from the British Columbia Utilities Commission and notice to B.C. Hydro.”)

<sup>833</sup> BCUC Order G-48-09, s. 4.1, at 20, **R-32**. (“[G]iven the industry practices, regulation and transmission capabilities that were present in 1993 when the PPA was executed, the Commission Panel is of the view that the parties to the PPA could not reasonably be expected to have addressed the possible sale of power, not in excess of load, by self-generating customers of FortisBC. Had the issue been posed by one of the parties at that time, the response probably would have been: “But that’s impossible!”)

<sup>834</sup> BCUC Order G-48-09, s. 2.2, at 8, **R-32**.

<sup>835</sup> BCUC Order G-48-09, s. 3.1, at 12-15, **R-32**.

<sup>836</sup> BCUC Order G-48-09, s. 3.1, at 15-16, **R-32**.

<sup>837</sup> BCUC Order G-48-09, s. 5.3, at 27, **R-32**.

<sup>838</sup> BCUC Order G-48-09, s. 5.3, at 27, **R-32**.

<sup>839</sup> FortisBC, Responses to BCUC Information Request No. 3, in the in the Matter of an Application by BC Hydro to Amend Section 2.1 of Rate Schedule 3808 Power Purchase Agreement, December 31 at 5, **R-31**. See also Dennis Swanson Statement, ¶ 79.

<sup>840</sup> See Email from Brian Merwin to Don Debiegne, Re: Debiegne IR\_s.doc, dated November 5,



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434. The BCUC ultimately found that "...the exact dollar amount of that impact is not important ..." as it determined that the policy principles set out in G-38-01 were applicable in these circumstances.<sup>841</sup> In order to prevent this "unjust or unreasonable" result, the BCUC held that, under the 1993 PPA, it would not be permissible for FortisBC to purchase additional power in order to supply self-generators who also sell electricity, unless the self-generator sells its power on a "net of load" basis.<sup>842</sup> However, the BCUC did not prohibit FortisBC from servicing the increased demand from self-generating customers with additional power from sources other than BC Hydro's Rate Schedule 3808 energy, nor did the BCUC direct Celgar to do anything or to refrain from doing anything.

435. BCUC Order G-48-09, therefore, actually concerns the conditions under which FortisBC can access BC Hydro's Rate Schedule 3808 energy under the 1993 PPA. Although the amendment to the 1993 PPA limits the circumstances under which FortisBC can access Rate Schedule 3808 energy, BCUC Order G-48-09 has no effect on FortisBC's ability to draw on its other resources to supply electricity to its self-generating customers if FortisBC was to agree to facilitate notional sales of their electricity. In Order G-156-10 and several other Orders issued subsequent to G-48-09, the BCUC has repeatedly encouraged Celgar and FortisBC to negotiate a service agreement that could include GBL mechanisms, and to submit the agreement for approval.<sup>843</sup> The parties have been unable to reach agreement.

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2008), at bates MER00292750, **C-214**: "It would be our preference that you not ask question 10, 11, 12 and 27 re the detailed calculation of harm. Our guess is that they could show "harm" by Celgar and maybe Nelson."

<sup>841</sup> BCUC Order G-48-09, s. 5.3, at 27-28, **R-32**.

<sup>842</sup> Canada also notes that BCUC Order G-48-09 was also intended to be a short-term solution to an issue that would be addressed in the new PPA between BC Hydro and FortisBC, which was being negotiated to replace the 1993 PPA, set to expire in 2013. The new PPA includes specific provisions with respect to the sale of electricity by self-generating customers of FortisBC. *See* BCUC Order G-48-09, s. 2.3 at 10, **R-32**.

<sup>843</sup> *See* BCUC Order G-156-10 at 115, **R-228**; BCUC, Order G-3-11, in the Matter of an Application by Zellstoff Celgar Limited Partnership for Reconsideration of Commission Order G-

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436. The Claimant attempts to ignore the parties to whom Order G-48-09 actually applied in order to mischaracterize the treatment the BCUC accorded in the hopes of making out a claim under NAFTA Articles 1102 and 1103. The Claimant's characterizations are deeply flawed for two reasons.

437. First, the Claimant asserts that Order G-48-09 "required" BC Hydro to use a "net of load" standard when it set a GBL for the Celgar mill under the 2009 EPA, and that this was contrary to the "historical usage" standard the BCUC "required" BC Hydro to use for its own customers under BCUC Order G-38-01.<sup>844</sup> The Claimant's assertions however, make little sense. BC Hydro set Celgar's GBL at 349 GWh/year using its normal methodology on May 30, 2008<sup>845</sup> and the Claimant filed its response to the RFP using this GBL on June 10, 2008.<sup>846</sup> BC Hydro was not even aware that FortisBC was negotiating agreements with Nelson and Celgar at that time. It was not until FortisBC filed its agreement with Nelson with the BCUC on June 24, 2008<sup>847</sup> and later its agreement with Celgar on August 26, 2008<sup>848</sup> that it became concerned over the risk of FortisBC's customers arbitraging RS3808 energy. Even then it was not until September

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156-10 and the Reasons for Decision regarding the FortisBC Inc. 2009 Rate Design and Cost of Service and Analysis Application, 12 January 2011, at 10, **R-263**; BCUC Order G-188-11, at 28, **R-275**; Dennis Swanson Statement, ¶¶ 111, 114.

<sup>844</sup> Claimant's Memorial, ¶¶ 589-590. ("BC Hydro computed Celgar's GBL consistently with the net of load standard it had requested the BCUC to apply to self-generating customers of FortisBC, including Celgar, and which the Commission adopted and required BC Hydro to use.")

<sup>845</sup> BC Hydro's May 30, 2008 Letter to Celgar, **R-181**.

<sup>846</sup> Celgar Commercial Proposal, **R-128**.

<sup>847</sup> FortisBC, Letter to the BCUC, Re: Filing of Umbrella Agreement for Short-Term Firm or Non-Firm Point to Point Transmission Service Agreement dated April 18, 2008 between FortisBC Inc. and the Corporation of the City of Nelson; and Power Coordination Agreement dated May 14, 2008 between FortisBC Inc. and the Corporation of the City of Nelson, 24 June 2008, **R-247**; Dennis Swanson Statement, ¶ 71-72.

<sup>848</sup> See Dennis Swanson Statement, ¶ 74.

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16, 2008 that BC Hydro filed its application that would eventually lead to BCUC Order G-48-09.<sup>849</sup>

438. Perhaps more importantly, as described above, Order G-48-09 did not “require” BC Hydro to do anything. Rather, the BCUC in Order G-48-09 accepted an amendment to the 1993 PPA, which limited FortisBC’s access to power under that agreement under certain conditions. This had nothing to do with BC Hydro’s negotiation of the GBL in the Celgar EPA.

439. Second, the Claimant argues that Order G-48-09 established a new standard for self-generators in FortisBC territory that requires them to meet their loads first before selling any electricity. It contrasts this with Order G-38-01, which “allowed mills to access embedded cost utility electricity while selling electricity based on their historical usage.”<sup>850</sup> As explained above, Order G-48-09 does not require self-generators in FortisBC territory to meet their loads before selling electricity. Instead, BCUC Order G-48-09 prevents FortisBC and its self-generating customers from arbitraging BC Hydro power sold to FortisBC under the 1993 PPA, while not changing FortisBC’s ability to draw on its other resources (which represent roughly 72% of its resource stack)<sup>851</sup> to meet the increased demand of its self-generating customers.

440. FortisBC has explained in the context of subsequent BCUC regulatory proceedings that it has practical problems serving its self-generators from its own resources as it was difficult for it to devise a methodology that ensures that BC Hydro’s Rate Schedule 3808 energy is excluded.<sup>852</sup> FortisBC has also found it difficult to develop a solution that would not harm its own ratepayers<sup>853</sup> - while responding to the Claimant’s

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<sup>849</sup> BCUC Order G-48-09, s. 1.1, at 2, **R-32**.

<sup>850</sup> Claimant’s Memorial, ¶ 589.

<sup>851</sup> Dennis Swanson Statement, ¶ 21.

<sup>852</sup> Dennis Swanson Statement, ¶ 79.

<sup>853</sup> Dennis Swanson Statement, ¶ 122-123.

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unprincipled assertions that it has no obligation to do so.<sup>854</sup> However, FortisBC has developed a proposal to serve the Claimant with 100% of Celgar's load by sourcing matching blocks of energy from its own surplus energy or the U.S. Mid-C market.<sup>855</sup> The BCUC is still in the process of considering this proposal.<sup>856</sup>

**b) The Claimant Fails to Prove that G-48-09 Constitutes Less Favourable Treatment**

441. As explained above, the Claimant mischaracterizes the treatment it was accorded under Order G-48-09. The Claimant's argument that it was accorded less favourable treatment disappears when the actual treatment is examined. Contrary to the Claimant's belief, the principle underlying Order G-38-01 and Order G-48-09 is the same:<sup>857</sup> it is impermissible to arbitrage embedded cost power at the expense of ratepayers.

442. The BCUC leaves it to the utilities to develop mechanisms to prevent the arbitrage of embedded cost power within their own service areas, and to submit them to the BCUC for approval as required. For BC Hydro, the BCUC allows it to set GBLs at a pulp mill's historical level of self-generation to allow customers to make sales of electricity that they would not otherwise have made, while at the same time ensuring that BC Hydro need not supply them with increased levels of embedded cost power that would ultimately harm other ratepayers. BC Hydro has used GBLs in the context of EPAs and LDAs, which incentivize the production of incremental self-generation on the electric system.

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<sup>854</sup> The Claimant asserted that FortisBC's only obligation with respect to other ratepayers was to provide them with notice. BCUC proceeding to consider FortisBC Inc. Guidelines for Establishing Entitlement to Non-PPA Embedded Cost Power and Matching Methodology (Ministry of Energy and Mines, Comments in the Matter of a Filing by FortisBC of Guidelines for Establishing Entitlement to Non-PPA Embedded Cost Power and Matching Methodology (Compliance Filing to Order G-188-11), 22 June 2012) at 7, **R-49**. See Dennis Swanson Statement, ¶¶ 128-130.

<sup>855</sup> Dennis Swanson Statement, ¶¶ 131-133.

<sup>856</sup> BCUC Order G-67-14 at 64, **R-211**. Dennis Swanson Statement, ¶ 138-139.

<sup>857</sup> BCUC Order G-48-09, s. 5.0, at 22. **R-32**. ("The Panel is of the view that the general principles enunciated in Order G-38-01 ought to be extended to customers of FortisBC.")

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443. For FortisBC, the BCUC has on several occasions invited, and most recently directed,<sup>858</sup> FortisBC to develop policies for its service territory that balance the interests of self-generators and other ratepayers. Such policies could include a GBL mechanism, or any other means to prevent arbitrage.<sup>859</sup> The BCUC has consistently held that any GBL or other arbitrage-preventing mechanism should be tied to an agreement with the customer's utility.<sup>860</sup> FortisBC has attempted on several occasions to reach an agreement with the Claimant, but the Claimant has consistently taken extreme and uncompromising positions in these discussions.<sup>861</sup> The Claimant's failure to come to an agreement with its privately owned utility on these issues is no fault of Canada's.

444. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED],<sup>862</sup> [REDACTED]

[REDACTED]

[REDACTED],<sup>863</sup> [REDACTED]

[REDACTED]

[REDACTED],<sup>864</sup> [REDACTED]

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<sup>858</sup> BCUC Order G-60-14, at 103-104, **R-221**.

<sup>859</sup> BCUC Order G-191-13, Appendix A at 4, **R-261**.

<sup>860</sup> *Ibid.*, Appendix A, at 20, **R-261**.

<sup>861</sup> Dennis Swanson Statement, ¶ 149.

<sup>862</sup> *Ibid.*, ¶ 79.

<sup>863</sup> The Claimant speciously describes [REDACTED] as one in which BC Hydro [REDACTED]  
[REDACTED]: Merwin Witness Statement, FN 62; Claimant's Memorial, FN 606.

<sup>864</sup> Dennis Swanson Statement, ¶ 63, FN 72 [REDACTED]  
[REDACTED]

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[REDACTED].<sup>865</sup> The Claimant is thus treated the same as BC Hydro's customers, with whom it insists on being compared.<sup>866</sup> Further, [REDACTED]  
[REDACTED]  
[REDACTED], there cannot be damages arising out of the alleged breach.<sup>867</sup>

445. In any event, what the Claimant actually seeks in this NAFTA arbitration is, in fact, more favourable treatment than what has been accorded to any other mill. As Dr. Rosenzweig explains, the "Claimant is asking to be granted what amounts to a subsidy from BCH... Acceding to it would simply transfer wealth from BC ratepayers to Claimant's shareholders. Ratepayers would pay more for electricity and Claimant would not be providing anything of economic value in return."<sup>868</sup> No mill in either BC Hydro service territory or FortisBC territory is permitted to arbitrage embedded cost power in this manner.

**c) The BCUC Had No Regard for the Nationality of the Investor when it Issued G-48-09**

446. In its Memorial, the Claimant offers an interpretation of like circumstances intended to narrow the field of potential comparators down to a handful of pulp mills in

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[REDACTED]

<sup>865</sup> Jim Scouras Statement, FN 72; BC Hydro serves the load growth of its customers with GBLs: Lester Dyck Statement, FN 17.

<sup>866</sup> Under certain conditions, [REDACTED]  
[REDACTED]

<sup>867</sup> NAFTA Article 1116; *Case Concerning the Factory at Chorzow (Germany v. Polish Republic)* (1928), Judgment, PCIJ (Ser. A) No. 17 ("*Case Concerning the Factory of Chorzow*") at 47, **RA-10** ("reparation must, as far as possible, wipe-out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.")

<sup>868</sup> NERA Expert Report, ¶¶ 6-7.

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BC Hydro's service area.<sup>869</sup> None of the Claimant's potential comparators operate in FortisBC's service area. This is due to the fact that such a comparison would be fatal to its NAFTA Article 1102 and 1103 claims. However, this lack of enthusiasm for the most relevant comparators did not always exist.

447. The Claimant, in its Request for Arbitration, repeatedly compared the BCUC's regulatory treatment of Celgar to that received by the Tolko (Kelowna) sawmill, which operated until recently in the City of Kelowna's service area. As a municipality providing services within its boundaries, the City of Kelowna is not a public utility within the meaning of the *UCA*, and is not regulated by the BCUC.<sup>870</sup> Nevertheless, the Claimant argued that:

This unequal treatment cannot be rationally explained by the fact that the Celgar Mill is located outside BC Hydro's service territory. Indeed, the Commission continues to discriminate against the Mill even within FortisBC's territory. This is confirmed by a new Commission decision issued on December 1, 2011 involving the Canadian-owned company Tolko Industries Ltd., which operates a sawmill that includes a biomass plant in Kelowna, BC.<sup>871</sup>

448. The Claimant then proceeded to detail the regulatory treatment Tolko (Kelowna) received for more than two pages, explaining that the BCUC's treatment of Celgar was "discriminatory" in comparison to the treatment received by Tolko.<sup>872</sup> It then argued under the heading, "Canada's Breach of Obligations Under Articles 1102 and 1103" that its competitors included Canadian-owned companies such as "... Tembec, Canfor and Tolko."<sup>873</sup>

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<sup>869</sup> Claimant's Memorial, ¶¶ 473-475.

<sup>870</sup> *UCA*, s. 1, ¶ (c), **R-205**.

<sup>871</sup> Request for Arbitration, 30 April 2012, ¶ 72.

<sup>872</sup> *Cf.* Claimant's Memorial, ¶ 472 ("Given the interdependencies between pulp production and electricity generation in an NBSK mill, it makes little sense to compare BC's regulatory treatment of Celgar to, say a sawmill with self-generation, such as Tolko's sawmill in Kelowna.")

<sup>873</sup> Request for Arbitration, 30 April 2012, ¶ 89. [Emphasis Added]

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449. The Claimant made this argument at that time because it suited its case. The BCUC had recently issued Order G-198-11, which had reaffirmed Tolko's right to sell above a 2MW GBL on the basis that none of the parties had opposed this request and the fact that Tolko was only an indirect customer of FortisBC (*i.e.*, it was a customer of the City of Kelowna, which is not regulated by the BCUC and which was served by FortisBC).<sup>874</sup> Although the Claimant has never applied to the BCUC for the relief Tolko sought and obtained, the Claimant chose to make an argument comparing itself to Tolko and alleging that the differences in treatment were discriminatory.<sup>875</sup> It also made numerous requests for documents concerning the Tolko sawmill.<sup>876</sup>

450. The reason Tolko now appears nowhere in the Claimant's Memorial is due to what happened afterwards. FortisBC subsequently purchased the City of Kelowna's utility assets, which made Tolko a direct customer of FortisBC. The BCUC then decided in BCUC Order G-191-13 that it would be discriminatory for FortisBC to offer or provide service to Tolko on the basis of a GBL without having consistent self-generation policies

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<sup>874</sup> BCUC Order G-198-11, Appendix A, at 2 and Appendix 1 at 1, **R-257**.

<sup>875</sup> Request for Arbitration, 30 April 2012, ¶¶ 72-76,89.

<sup>876</sup> Claimant's Document Requests sought: "All BC Government documents from February 23, 2001 until February 4, 2013, concerning whether and to what extent Tolko is or should be permitted to sell self-generated power while purchasing embedded cost power..." (Request 3.17); "All BC Hydro, BCUC, or MOE documents concerning whether and the extent to which Tolko could sell self-generated power while purchasing embedded cost power, prior to the issuance by BCUC of Order G-48-09, and all communications between BC Hydro or MOE and Tolko relating to the issue" (Request 3.17.1); "All BC Hydro, BCUC, or MOE documents between 2009 and February 4, 2013, analyzing or addressing whether the BCUC Order G-48-09 Decision's amendment to Section 2.1 of the 3808 Agreement applies to Tolko, and all communications between BC Hydro or MOE and Tolko relating to the issue" (Request 3.17.2); and "All communications between 2001 and February 4, 2013, between or among Senior BC Hydro Officials relating to the position of the BC Government, including BC Hydro, with respect to electricity sales and/or purchases by Tolko, including but not limited to the current FortisBC Application to the BCUC for a Certificate of Public Convenience and Necessity for the Purchase of Utility Assets of the City of Kelowna." Claimant's February 4, 2013 Request for Documents, in *Mercer International v. Canada* (ICSID Case No. ARB/12/03), **R-374**.



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applied equally to Celgar, and revoked Tolko's GBL.<sup>877</sup> Accordingly, Tolko now receives exactly the same treatment as the Claimant.

451. In a similar vein, it is worth noting that FortisBC also withdrew from its agreement with the City of Nelson to facilitate the arbitrage of BC Hydro's Rate Schedule 3808 with Nelson's Bonnington Falls hydro-electric facility after Order G-48-09. Canada does not contend that Nelson, a municipality with a hydro-electric facility, is in like circumstances with the Celgar pulp mill. However, the treatment of Nelson is identical to that received by Celgar as both had agreements with FortisBC that were scrutinized by the BCUC in the proceedings resulting in Order G-48-09. This identical treatment is strong evidence that the difference the Claimant complains of has nothing to do with nationality-based discrimination.

452. The Claimant alleges that the BCUC's regulatory treatment of FortisBC's access to Rate Schedule 3808 energy in Order G-48-09 has resulted in *de facto* nationality-based discrimination. The most relevant comparator in such a case would be other self-generators in the FortisBC service area to determine whether the BCUC Order G-48-09 has somehow caused such discrimination. The fact that the outcome for each of FortisBC's self-generating customers, including Tolko (Kelowna) and Nelson, is identical to the outcome for the Claimant demonstrates that no such *de facto* nationality-based discrimination occurred.

## **V. THE CLAIMANT HAS FAILED TO DEMONSTRATE A VIOLATION OF ARTICLE 1105(1) – MINIMUM STANDARD OF TREATMENT**

### **A. Concise Statement of Canada's Position**

453. The Claimant alleges that two measures breached NAFTA Article 1105: the setting of the Claimant's GBL by BC Hydro under the EPA, and BCUC Order G-48-09. The Claimant alleges that it was entitled to a stable regulatory framework at the time it

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<sup>877</sup> BCUC Order G-191-13, at 3 and Appendix A, at 4, 22, **R-261**.

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made its investment, which it asserts was altered by BC Hydro and the BCUC. In making these claims, the Claimant simply recycles the baseless allegations and factual mischaracterizations it employed in its arguments with respect to Articles 1102 and 1103. Indeed, the Claimant appears to ask the Tribunal to find a breach of Article 1105 because it cannot establish a claim of nationality-based discrimination. This argument has no merit and should be rejected by the Tribunal. As Canada has explained above, and as it further describes below, none of the challenged measures are arbitrary, unfair, discriminatory or non-transparent, let alone of the egregious and shocking nature required for the high threshold of Article 1105(1) to be met.

**B. Article 1105(1) Requires that Canada Accord to the Investment of the Claimant the Customary International Law Minimum Standard of Treatment**

454. NAFTA Article 1105(1) (“Minimum Standard of Treatment”) states: “Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”

455. The proper interpretation of Article 1105 was definitively confirmed by the NAFTA Free Trade Commission (“FTC”) in its 2001 binding Note of Interpretation.<sup>878</sup> The FTC Note provides:

- 1) Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

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<sup>878</sup> NAFTA Article 1131(2). The Claimant acknowledges that the Note of Interpretation is binding on this Tribunal. Claimant’s Memorial, ¶ 643. It could not reasonably have done otherwise. Since the release of the Note of Interpretation, NAFTA tribunals have acknowledged its binding effect. *Methanex*, Award, ¶, Part IV, Chapter C, ¶20, **RA-28**; *Mondev International Ltd. v. The United States of America* (ICSID Case No. ARB(AF)/99/2) Award, 11 October 2002, (“*Mondev*, Award”), ¶ 100 *et seq.*, **RA-30**; *Loewen*, Award, ¶ 126, **RA-22**; *Waste Management, Inc. v United Mexican States* (ICSID Case No. ARB(AF)/00/3) Award, 30 April 2004, ¶ 90 *et seq.*, **RA-47**; *International Thunderbird Gaming Corp. v. United Mexican States* (UNCITRAL) Final Award, 26 January 2006 (“*Thunderbird*, Award”), ¶ 192 *et seq.*, **RA-42**; *Glamis Gold, Ltd. v. United States* (UNCITRAL) Award, 8 June 2009 (“*Glamis*, Award”), ¶ 599, **RA-15**.

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- 2) The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
  - 3) A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).<sup>879</sup>

456. The FTC Note of Interpretation confirms that Article 1105(1) does not create an open-ended obligation.<sup>880</sup> Article 1105 is an “objective” standard of treatment for investors. As stated by the Mondev Tribunal, it is not for the Tribunal to “apply its own idiosyncratic standard in lieu of the standard laid down in Article 1105(1)”.<sup>881</sup>

457. The threshold for proving a violation of the customary international law minimum standard of treatment under Article 1105(1) is high. It does not allow for NAFTA tribunals to second-guess government policy and decision-making. As the *S.D. Myers* Tribunal explained, “a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.”<sup>882</sup>

458. Similarly, the *Glamis* tribunal summarized the minimum standard of treatment as it currently exists under customary international law: “[A] violation of the customary international law minimum standard of treatment, as codified in Article 1105 of the NAFTA, requires an act that is *sufficiently egregious and shocking* – a gross denial of

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<sup>879</sup> NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter Eleven Provisions, 31 July 2001, **RA-31**.

<sup>880</sup> *S.D. Myers*, First Partial Award, ¶ 261, **RA-38**.

<sup>881</sup> *Mondev*, Award, ¶ 120, **RA-30**.

<sup>882</sup> *S.D. Myers*, First Partial Award, ¶ 263, **RA-38**.

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justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reason as to fall below accepted international standards and constitute a breach of Article 1105.”<sup>883</sup>

459. The Tribunal in *Cargill* also confirmed that a breach of Article 1105 only occurs in cases of “gross misconduct,” manifest injustice,” “bad faith,” or “willful neglect of duty.” Similarly, the *Thunderbird* tribunal observed that “the threshold for finding a violation of the minimum standard of treatment still remains high,” holding that the conduct of the host state would have to be “manifestly arbitrary or unfair”.<sup>884</sup> In that case, mere “arbitrary” conduct of an administrative agency was insufficient to constitute a breach of Article 1105(1); rather, as that Tribunal explained, the government action must amount to a “gross denial of justice or manifest arbitrariness falling below acceptable international standards” in order to breach the minimum standard of treatment.<sup>885</sup>

460. Finally, the tribunal in *Mondev* held the same, explaining that the “test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome bearing in mind [...] that international tribunals are not courts of appeal”.<sup>886</sup>

461. The use by all of these tribunals of adjectives such as “egregious,” “shocking,” “gross,” “blatant,” “complete,” and “willful” is no accident. NAFTA tribunals since the FTC Note of Interpretation have confirmed that the threshold for a violation of Article 1105 is very high and all have recognized the high level of deference to be accorded to domestic authorities in governing affairs within their own borders.

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<sup>883</sup> *Glamis*, Award, ¶ 627, **RA-15**.

<sup>884</sup> *Thunderbird*, Award, ¶¶ 194, 197, **RA-42**.

<sup>885</sup> *Thunderbird*, Award, ¶ 194, **RA-42**.

<sup>886</sup> *Mondev*, Award, ¶ 127, **RA-30**.

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**C. The Claimant Bears the Burden of Establishing the Existence of a Rule of Customary International Law**

462. The Claimant acknowledges that customary international law is the applicable source of law to determine the minimum standard of treatment of aliens owed in Article 1105.<sup>887</sup> In order to prove the existence of a rule of customary international law, two requirements must be met: consistent state practice and an understanding that such practice is required by law (*opinio juris*).<sup>888</sup>

463. The burden of proving the existence of a rule of customary international law rests on the party that alleges it. The International Court of Justice has explained that “the Party which relies on a custom of this kind must prove that this custom is established in such a manner that it has become binding on the other party.”<sup>889</sup> Scholars agree on this principle.<sup>890</sup> Previous NAFTA tribunals have confirmed the same.<sup>891</sup> As the Tribunal in *Cargill* explained, where the existence of custom has not been demonstrated, “it is not the place of the Tribunal to assume this task. Rather the Tribunal, in such an instance, should hold that Claimant fails to establish the particular standard asserted.”<sup>892</sup>

464. The Claimant asserts that the minimum standard of treatment afforded to foreign investors by customary international law contains “four pillars,” which it defines as protection against treatment that is “discriminatory,” “arbitrary,” “grossly unfair, unjust

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<sup>887</sup> Claimant’s Memorial, ¶ 643.

<sup>888</sup> *International Court of Justice*, Statute of the International Court of Justice, 3 Bevens 1179; 59 Stat. 1031; T.S. 993; 39 AJIL Supp. 215 [1945], Article 38(1)(b), online: United Nations, Office of Legal Affairs <[http://legal.un.org/avl/pdf/ha/sicj/icj\\_statute\\_e.pdf](http://legal.un.org/avl/pdf/ha/sicj/icj_statute_e.pdf)>, **RA-41**.

<sup>889</sup> Case Concerning Rights of Nationals of the United States of America in Morocco (*France v. United States*), Judgment of August 27, 1952, [1952] I.C.J. Rep. 176 at 200, **RA-9**.

<sup>890</sup> Nguyen, Quoc Dinh, Dallier & Pellet, *Droit International Public*, 6th ed., (L.G.D.J. 1999) at 330, **RA-33**.

<sup>891</sup> *ADF*, Award, ¶¶ 183-184, **RA-1**; *UPS*, Award, ¶ 84, **RA-46**; *Glamis*, Award, ¶¶ 601-603, **RA-15**.

<sup>892</sup> *Cargill, Incorporated v. United Mexican States* (ICSID Case No. ARB(AF)/05/2) Award, 18 September 2009, ¶ 273, **RA-6**.

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or idiosyncratic,” and “non-transparent.”<sup>893</sup> The Claimant, however, submits no evidence of state practice or *opinio juris* to support its assertion, but instead merely cites various investment treaty arbitral awards in support of its position.<sup>894</sup>

465. This reliance on awards, however, falls far short of what is required to fulfill the Claimant's burden of proving a rule of custom. Arbitral awards cannot *create* customary international law – only states can create custom. As Lauterpacht writes, “[d]ecisions of international courts are not a source of international law...[t]hey are not direct evidence of the practice of States or of what States conceive to be the law.”<sup>895</sup> Similarly, the *Glamis* tribunal explained that: “[a]rbitral awards . . . do not constitute State practice and thus cannot create or prove customary international law.”<sup>896</sup> While arbitral awards may contain valuable analysis of State practice and *opinio juris* in relation to a particular rule of custom, they cannot by themselves substitute for actual evidence of state practice and *opinio juris*.<sup>897</sup>

466. The Tribunal should not accept the Claimant's approach to proving custom. Rather, it should insist that the Claimant adduce evidence of state practice and *opinio juris* to support its contention that the protection of foreign investors against the “four pillars” of treatment (*i.e.*, treatment that is discriminatory, arbitrary, grossly unfair, unjust or idiosyncratic, and non-transparent) form part of the international minimum standard

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<sup>893</sup> Claimant's Memorial, ¶ 650.

<sup>894</sup> In particular, the Claimant cites to the decisions in *S.D. Myers* and in *Chemtura*. The Award in *S.D. Myers* was, however, issued *before* the *FTC Note of Interpretation* and its interpretation of Article 1105 is therefore moot. Moreover, the *Chemtura* passage cited by the Claimant in its Memorial (Claimant's Memorial, ¶ 656) does not discuss the minimum standard of treatment under customary international law, but merely contains the tribunal's conclusion that *Chemtura's* allegation of regulatory unfairness was unfounded based on the explanations provided in a witness testimony.

<sup>895</sup> Lauterpacht, Sir Hersch, *The Development of International Law by the International Court* (London: Stevens, 1958) at 20-21, **RA-21**.

<sup>896</sup> *Glamis*, Award, ¶ 605, **RA-15**.

<sup>897</sup> See *Case Concerning Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of The Congo)*, Judgment on Preliminary Objections of 24 May 2007, [2007] I.C.J. Rep, ¶¶ 88-91, **RA-7**.

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under customary international law. Failure to do so must result in the dismissal of the Claimant's Article 1105 claim.<sup>898</sup>

467. In particular, the Claimant posits that “discriminatory treatment” that does not contravene NAFTA Articles 1102 and 1103 can nonetheless violate the minimum standard of treatment at customary international law. The Claimant argues: “As Article 1105 is not limited by Articles 1102 and 1103, Article 1105 must prohibit additional types of discriminatory treatment.”<sup>899</sup> The Claimant acknowledges the “dearth of specificity with respect to the elements that must be established to establish discriminatory conduct that violates NAFTA Article 1105”<sup>900</sup> but nonetheless hypothesizes that discriminatory treatment would violate Article 1105 if it is “unfair and inequitable” or “manifest.”<sup>901</sup>

468. The Claimant provides no state practice or *opinio juris* to support its hypothesis that “discriminatory treatment” forms part of the minimum standard of treatment under customary international law. The Claimant's argument has also been rejected by NAFTA tribunals. For example, the tribunal in *Grand River* held that “neither Article 1105 nor the customary international law standard of protection generally prohibits discrimination against foreign investments.”<sup>902</sup> Similarly, the tribunal in *Methanex* found that “the plain and natural meaning of the text of Article 1105 does not support the contention that the ‘minimum standard of treatment’ precludes governmental differentiations as between nationals and aliens.”<sup>903</sup> And finally, the tribunal in *Glamis* held that “nationality-based

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<sup>898</sup> The Claimant also relies on non-NAFTA arbitral decisions interpreting standalone Fair and Equitable Treatment (“FET”) clauses to support their contention that Article 1105(1) contains a protection against the “four pillars.” See Claimant's Memorial, FN 741. Such awards are not, however, relevant in the context of NAFTA Article 1105 because they apply a different FET standard.

<sup>899</sup> Claimant's Memorial, ¶ 654.

<sup>900</sup> Claimant's Memorial, ¶ 653.

<sup>901</sup> Claimant's Memorial, ¶ 655.

<sup>902</sup> *Grand River Award*, ¶ 209, **RA-16**.

<sup>903</sup> *Methanex Award*, ¶ 14 to 16, **RA-28**.

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discrimination...falls under the purview of Article 1102,”<sup>904</sup> and not Article 1105. For these reasons, the Claimant’s contention that Article 1105 prohibits “discriminatory treatment” is not well founded.

469. The Claimant also argues that the minimum standard of treatment includes an obligation to provide a stable regulatory environment for foreign investors. The Claimant argues that at the time it made its investment it had “various legal protections”<sup>905</sup> that were subsequently altered contrary to the minimum standard of treatment. Not only has the Claimant failed to prove that such an obligation exists at customary international law, NAFTA tribunals have found the opposite:

In a complex international and domestic environment, there is nothing in Article 1105 to prevent a public authority from changing the regulatory environment to take account of new policies and needs, even if some of those changes may have far-reaching consequences and effects, and even if they impose significant additional burdens on an investor. Article 1105 is not, and was never intended to amount to, a guarantee against regulatory change, or to reflect a requirement that an investor is entitled to expect no material changes to the regulatory framework within which an investment is made. Governments change, policies change and rules change.<sup>906</sup>

470. In sum, the threshold for a violation of Article 1105 is very high and deference is owed to domestic authorities in governing affairs within their own borders. The Claimant bears the burden of establishing the existence of a rule of customary international law and that Canada has breached that rule. The Claimant has done neither.

#### **D. The Claimant Has Failed to Prove a Breach of Article 1105**

471. The Claimant affixes labels such as “discriminatory”, “arbitrary”, and “non-transparent”, to describe the measures it seeks to impugn in the hope that the Tribunal

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<sup>904</sup> *Glamis Award*, fn. 1087, **RA-15**.

<sup>905</sup> Claimant’s Memorial, ¶ 665.

<sup>906</sup> *Mobil Investments Canada Inc. & Murphy Oil Corporation v. Canada*, See above ¶47 (ICSID Case No. ARB(AF)/07/4) Decision on Liability and on Principles on Quantum, 22 May 2012 (“*Mobil*, Decision on Liability and on Principles of Quantum”), ¶ 153, **RA-29**.



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will gloss over the actual facts. Neither the setting of the Claimant's GBL by BC Hydro, nor BCUC Order G-48-09 can be described as anything other than fair and consistent. None of the measures complained of by the Claimant substantiate a claim that Canada has breached the customary international law minimum standard of treatment.

**1. The Claimant is not Entitled to a "Stable Regulatory Environment" under NAFTA Article 1105, and In Any Event the Regulatory Environment did not Change**

472. The Claimant alleges that the regulation of electricity procurement by BC Hydro from self-generators unfairly changed since the Claimant made its investment in 2005. In particular, the Claimant argues that when it made its investment, "the only official governmental pronouncement regarding self-generation was BCUC Order G-38-01...[which] did not apply to FortisBC or to Celgar."<sup>907</sup> It also alleges that at the time of its investment it had "various legal protections" under the *UCA* and the 2002 Heritage Contract, to conclude the 2008 Power Supply Agreement with FortisBC.<sup>908</sup>

473. As explained above, there is nothing in Article 1105 that prevents the Ministry of Energy, BC Hydro or the BCUC from changing the rules governing the procurement of electricity from self-generators, even if those changes would have consequences for an investor.<sup>909</sup> In any event, the Claimant's position is disingenuous as it knew, or ought to have known, as a result of "extensive"<sup>910</sup> due diligence with respect to "operating permits"<sup>911</sup> that the Ministers' Order legally obligated it to remain 100 percent energy self-sufficient under normal operating conditions.<sup>912</sup> Moreover, the regulatory risk

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<sup>907</sup> Claimant's Memorial, ¶ 666.

<sup>908</sup> Claimant's Memorial, ¶¶ 665, 666, 670, 671.

<sup>909</sup> *Mobil*, Decision on Liability and on Principles of Quantum, ¶, **RA-29**.

<sup>910</sup> Gandossi Witness Statement, ¶ 28.

<sup>911</sup> Gandossi Witness Statement, ¶ 27.

<sup>912</sup> See Ostergaard Witness Statement, ¶¶ 14-23; 1991 Ministers' Order, R-100; and Celgar 1990 EPC Application, R-97. ("It is estimated that the expanded mill will require approximately 50 megawatts of power and will be capable of generating 50 megawatts, which will make the mill 100% self-sufficient under normal operating conditions." [Emphasis in Original])

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analysis that the Claimant presented to its Board of Directors concerning its Arbitrage Project indicated that:

[REDACTED]

[...]

[REDACTED]

[REDACTED]<sup>913</sup>

474. This analysis shows that the Claimant was fully aware that the BCUC could reject its project and even speculates that the B.C. Government might move to prevent the project on the basis that it was inconsistent with provincial policy.

475. The Claimant was also separately advised by FortisBC that there was only [REDACTED] [REDACTED]<sup>914</sup> Mr. Swanson recalls that FortisBC was "... [REDACTED] [REDACTED] [REDACTED]<sup>915</sup> Moreover, FortisBC fully discussed these regulatory risks and the likelihood of success with the Claimant at that time.<sup>916</sup> It follows that the Claimant was never under the illusion that the existing regulatory regime would

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<sup>913</sup> Mercer International Group, *Celgar Electricity Opportunities*, July 2007, at 9-10, **R-278**. [Emphasis Added]

<sup>914</sup> Dennis Swanson Statement, ¶ 63.

<sup>915</sup> Dennis Swanson Statement, ¶ 63.

<sup>916</sup> Dennis Swanson Statement, ¶ 64.

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approve its project. The Tribunal should reject the Claimant's misleading assertions concerning this regulatory regime in British Columbia.

## **2. BCH's Determination of Celgar's GBL did not Violate Article 1105**

476. As explained above, BC Hydro's determination of Celgar's GBL in the context of the EPA negotiations is not a measure subject to the jurisdiction of this Tribunal. However, even if it was, it was completely consistent with the requirements of Article 1105. In fact, BC Hydro's measures would abide by Article 1105 even on the basis of the Claimant's inappropriately described standard.

477. The Claimant argues that BC Hydro accorded discriminatory treatment in contravention of the customary international law minimum standard of treatment. The Claimant's allegations are, however, identical to the claims it makes under Articles 1102 and 1103; namely that

- BC Hydro used a different "net of load" standard to determine the 349 GWh/yr ( or 40 MW) GBL under the 2009 EPA;<sup>917</sup>
- BC Hydro set the 349 GWh/yr (or 40 MW) GBL "on a different basis, with a different methodology, using a different baseline period, of different duration, than other pulp mills;"<sup>918</sup> and
- BC Hydro "[took] from Celgar by regulatory action and without compensation valuable load displacement services that BC Hydro has paid other mills to provide."<sup>919</sup>

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<sup>917</sup> Claimant's Memorial, ¶ 657.

<sup>918</sup> Claimant's Memorial, ¶ 657.

<sup>919</sup> Claimant's Memorial, ¶ 657.

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478. Essentially, the Claimant asks the Tribunal to find a breach of Article 1105 in lieu of its discrimination claim under Articles 1102 or 1103. As explained above, the Claimant has failed to prove that it should be accorded protection from “discriminatory treatment” under Article 1105. However, even if such an obligation exists, the Claimant’s arguments are without merit for the reasons Canada explained under NAFTA Articles 1102 and 1103 (Section IV above).

479. The Claimant also argues that BC Hydro violated the customary international law minimum standard of treatment because it kept confidential the GBLs set under its EPAs with other mills. The Claimant alleges that such treatment is “non-transparent” and thus contrary to Article 1105, arguing that “BC Hydro jealously protected its information advantage through confidentiality obligations set out in each EPA, which were imposed as a standard term on each counter-party. No mill can even argue that another was treated more favourably.”<sup>920</sup>

480. Again, the Claimant has not established that there is an obligation at customary international law for a state to act “transparently” in all its conduct. There is no rule of customary international law that requires a certain level of transparency of state enterprises. However, even if there was such an obligation, the Claimant has offered no reason to believe that it would require the NAFTA Parties to forego protection of the business commercial information that is inherent to virtually all commercial negotiations.

481. In any event, BC Hydro’s determination process was transparent because:

- Its GBL policy was laid out in the BCUC’s publicly available G-38-01;<sup>921</sup>
- The GBL concept was laid out in the Bioenergy Call for Power materials and discussed by Mr. Dyck during oral information sessions;<sup>922</sup>

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<sup>920</sup> Claimant’s Memorial, ¶ 668.

<sup>921</sup> BCUC Order G-38-01, **R-19**.

<sup>922</sup> Bioenergy Phase I – RFP, **R-25**. Lester Dyck Statement, ¶¶ 69-70.

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- The Claimant had sufficient understanding and confidence as of March 2008 to submit an estimated GBL of 300.2 GWh/year (or 34.3 MW) in its registration form; and
  - BC Hydro had numerous discussions with the Claimant regarding the setting of Celgar's GBL, and provided the Claimant with reasons as to how Celgar's GBL was settled.<sup>923</sup>

482. To the extent that any party-specific information was kept confidential, it was done so for valid policy and statutory reasons. Indeed, commercial entities negotiating with BC Hydro typically require confidentiality agreements to protect certain business information that could prove detrimental to their position if it were disclosed either to their competitors or the public. As Fred Fominoff explains in his witness statement:

A confidentiality agreement is important in the context of negotiating an EPA because, during the course of negotiations, Howe Sound was expected to share sensitive information such as production data, operational costs, operating strategies, and capital investment options. It was my expectation at all times that BC Hydro would not disclose to any third party confidential business information belonging to Howe Sound that it learned during the negotiation process.<sup>924</sup>

483. Howe Sound, of course, is not alone in that regard. Pöyry also indicates that, in its experience, pulp producers would normally expect this form of business confidential information to be kept confidential.<sup>925</sup> Mercer itself in this arbitration has insisted that certain sections of the parties' Memorials be redacted to protect the confidentiality of some of its commercial information.

484. Moreover, the Claimant's non-transparency complaint disregards the confidentiality obligations to which BC Hydro is bound in accordance with the Call for

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<sup>923</sup> Lester Dyck Statement, ¶¶ 69-83.

<sup>924</sup> Fred Fominoff Statement, ¶ 25.

<sup>925</sup> Pöyry Expert Report, ¶51: "In Pöyry's experience with pulp and paper mills, operational and commercial information of this nature is considered highly sensitive. When sharing this type of information in the context of contract negotiations, the mills would expect that it be kept confidential."

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Power,<sup>926</sup> as well as relevant provincial statutes concerning confidentiality.<sup>927</sup> British Columbia, BC Hydro, and the BCUC have consistently respected their statutory confidentiality obligations in that regard.

485. The Claimant also argues that BC Hydro violated Article 1105 because it failed to provide “reasons” when it set the GBL for its EPA with the Claimant and that its use of generation data from the year 2007 was “arbitrary” because it included generation from “Project Blue Goose.”<sup>928</sup> The Claimant has failed to prove that lack of reasons constitute arbitrary treatment at customary international law, but in any event BC Hydro provided the Claimant with reasons and its use of generation data from the year 2007 was not arbitrary. Mr. Dyck explains that 2007 was:

... the first full operating year for Celgar following completion of the Blue Goose efficiency improvement projects. The principles we applied when setting all GBLs under Bio Phase I included determining what is normal at the time of negotiations and in the absence of the prospective contract. Celgar’s Blue Goose Project, which was geared toward enhancing pulping efficiencies, was undertaken in the normal course of business operations. Celgar did not need the incentive of an EPA to make that investment. Paying for electricity efficiencies resulting from that project would thus not fall within the parameters of Bio Phase I - it was not “incremental,” but “existing” energy. We would be paying them for electricity they would have generated anyway, without an EPA, and getting nothing in return. BC Hydro was clear about the eligibility requirements of the call, and explained them to Mr. Merwin on several occasions. Moreover, in those discussions, Mr. Merwin confirmed that 2007 represented normal operations for Celgar going forward.<sup>929</sup>

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<sup>926</sup> Bioenergy Phase I – RFP, s. 22.8, **R-25**.

<sup>927</sup> S.21 of BC’s *Freedom of Information and Protection of Privacy Act*, RSBC 1996, c.165, requires public bodies to refuse to disclose the business commercial information of third parties that could, inter alia, “reasonably be expected to ... harm significantly the competitive position or interfere significantly with the negotiating position of the third party” or that could “result in undue financial loss or gain to any person or organization”, **R-309**. Similarly, s. 142.93 of BC’s *Forest Act*, RSBC 1996, c.157, **R-323**, sets out a similar restriction on the public disclosure of such information provided to it pursuant to the Act.

<sup>928</sup> Claimant’s Memorial, ¶ 678.

<sup>929</sup> Lester Dyck Statement, ¶ 86.

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486. The Claimant's subsequent disagreement with the reasons provided does not make the GBL set by BC Hydro somehow "arbitrary" and contrary to NAFTA Article 1105.

487. Finally, the Claimant argues that BC Hydro accorded it treatment that was "grossly unfair, unjust or idiosyncratic,"<sup>930</sup> alleging that during the EPA negotiations BC Hydro was not a "disinterested party" and that it had "unequal bargaining power" that it used to withhold information from the Claimant in order to give favourable deals to other mills on the basis of their "political connections."<sup>931</sup> The Claimant provides no support for these serious accusations of impropriety and political interference, which should be dismissed outright.

### **3. The Challenged Measures of the BCUC do not Violate Article 1105**

488. In addition to claims against BC Hydro, the Claimant also alleges that various Orders of the BCUC violated NAFTA Article 1105. First, the Claimant argues that the BCUC violated Article 1105 when it "applied a net-of-load regulatory standard to Celgar" which was "different than the historical usage standard they applied to other pulp mills."<sup>932</sup> Second, the Claimant argues that the BCUC's present deliberations on a "Made-for-Celgar only rate"<sup>933</sup> may violate Article 1105 should the proceedings not be decided in Mercer's favour. Finally, the Claimant argues that the BCUC has continued "to draw additional arbitrary distinctions," citing Order G-198-11 as one example.<sup>934</sup>

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<sup>930</sup> Claimant's Memorial, ¶ 650.

<sup>931</sup> Claimant's Memorial, ¶ 668.

<sup>932</sup> Claimant's Memorial, ¶ 657.

<sup>933</sup> Claimant's Memorial, ¶ 681.

<sup>934</sup> Claimant's Memorial, ¶ 673.

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489. While the Claimant's characterization of these proceedings is inaccurate,<sup>935</sup> its allegations against the BCUC pertain solely to its decisions and not the process in which those decisions were made. Challenging the decision of an administrative tribunal is not, however, a valid basis on which to allege a violation of the minimum standard of treatment. As the tribunal in *Mondev* aptly noted, "international tribunals are not courts of appeal"<sup>936</sup> and the tribunal in *Glamis* stated that, "it is not for an international tribunal to delve into the details and justification for domestic law."<sup>937</sup> The regulation of utilities in British Columbia is complex and the BCUC is a highly specialized administrative tribunal. Article 1105 is not a place for NAFTA tribunals to second-guess the decisions of such quasi-judicial bodies. Tellingly, the Claimant decided not to appeal in the British Columbia court system virtually all of the decisions of which it now complains.

490. Nor does the Claimant challenge the process in which the BCUC made its decisions. For example, the Claimant does not suggest a denial of justice or a failure in due process. The Claimant does not make these arguments because they would be contrary to the evidence. As Mr. Swanson explains, the Claimant has not been denied an opportunity to be heard:

Celgar has also adopted a practice of intervening in any FortisBC regulatory process that might provide an opportunity for it to advance its ambition of arbitraging its self-generated energy at the expense of BC Hydro or FortisBC ratepayers. This regulatory practice by Celgar (i.e., multiple interventions and repeated attempts to expand the scope of BCUC proceedings) is costing FortisBC ratepayers a rate increase equivalent to 1.5 % every year. For FortisBC, these costs not only include representation before the BCUC, they also include part of the BCUC's costs and the interveners' costs, such as Celgar's.<sup>938</sup>

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<sup>935</sup> See Counter-Memorial, Sections II.E.7 and II.F.

<sup>936</sup> *Mondev*, ¶ 127, **RA-30**. NAFTA – Notes of Interpretation, **RA-31**.

<sup>937</sup> *Glamis*, Award, ¶ 762. **RA-15**.

<sup>938</sup> Dennis Swanson Statement, ¶ 152. [Emphasis in original].



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491. This NAFTA claim, is nothing more than an extension of this abusive pattern of litigation. For the foregoing reasons, the Claimant's arguments against the BCUC under NAFTA Article 1105 are without merit.

**VI. THE CLAIMANT HAS FAILED TO PROVE THAT IT HAS SUFFERED ANY LOSS**

492. The Claimant alleges that two measures breach the NAFTA — the GBL that was set under its EPA with BC Hydro, and BCUC Order G-48-09.<sup>939</sup> Canada has already explained why the Tribunal does not have jurisdiction over these measures and in any event why Canada has not breached its obligations under the NAFTA. However, even if this Tribunal found that it has jurisdiction and that Canada has breached the NAFTA, the Claimant must still demonstrate that pursuant to Articles 1116 and 1117 –it “has incurred loss or damage, by reason of, or arising out of” these measures. Canada explains below how the Claimant has failed to discharge this burden and that its damages claim should therefore be dismissed.

**A. The Claimant Bears the Burden of Proving that the Alleged Breaches Caused the Losses it Seeks to Recover**

493. In the *Chorzow Factory* case, the Permanent Court of International Justice established the now widely accepted principle that “reparation must, as far as possible, wipe-out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.”<sup>940</sup> This principle has been followed by NAFTA tribunals.<sup>941</sup>

494. The burden for establishing damages rests with the Claimant. As the *UPS* tribunal explained, a claimant must “show that it has persuasive evidence of damage from

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<sup>939</sup> Claimant's Memorial, ¶ 390. See also Kaczmarek Expert Report, ¶ 79.

<sup>940</sup> *Case Concerning the Factory at Chorzow (Germany v. Polish Republic)* (1928), Judgment, PCIJ (Ser. A) No. 17 (“Chorzow Judgment”) at 47, **RA-10**.

<sup>941</sup> See e.g., *S.D. Myers*, First Partial Award, ¶ 311, **RA-38**.

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the actions alleged to constitute breaches of NAFTA obligations.”<sup>942</sup> The tribunal in *S.D. Myers* also confirmed that the burden is on the claimant “to prove the quantum of the losses in respect of which it puts forward its claims.”<sup>943</sup>

495. The Claimant must also establish the quantum of its loss with sufficient certainty.<sup>944</sup> The quantum alleged “must be probable and not merely possible,”<sup>945</sup> and thus cannot be remote or speculative. As tribunal in *Amoco v. Iran* noted, “[o]ne of the best settled rules in the law of international responsibility of States is that no reparation for speculative or uncertain damage can be awarded.”<sup>946</sup> It is for this reason that “Tribunals have been reluctant to provide compensation for claims with inherently speculative elements.”<sup>947</sup>

496. The Claimant must also demonstrate that Canada *caused* the loss or damage claimed. NAFTA Articles 1116 and 1117 state that loss or damages must be incurred “by reason of, or arising out of” the alleged breach. NAFTA tribunals can thus only “direct

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<sup>942</sup> *UPS*, Award, ¶ 38, **RA-46**. See also, *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/04/05) Decision on the Request for Correction, Supplementary Decision and Interpretation, 10 July 2008, (“*ADM*, Decision on the Request for Correction”), ¶ 38, the Tribunal concluded that “the claimant has the burden of proving the quantum of damages”, **RA-2**.

<sup>943</sup> *S.D. Myers*, First Partial Award, ¶ 316, **RA-38**.

<sup>944</sup> Generally, a NAFTA claimant is held to the “preponderance of evidence” standard, which is equivalent to the “balance of probabilities” standard applicable in civil litigation: Sergey Ripinsky with Kevin Williams, *Damages in International Investment Law*, (London: British Institute of International and Comparative Law, 2008) at 162-163, **RA-37**.

<sup>945</sup> *Mobil* Decision on Liability and on Principles on Quantum, ¶ 437, **RA-29**.

<sup>946</sup> *Amoco International Finance Corporation. v. Islamic Republic of Iran, et al.* (15 Iran-U.S.C.T.R 189) Award No. 310-56-3, Iran-United States Claims Tribunal, 14 July 1987 (“*Amoco v. Iran*, Award”), ¶ 238 (WL), **RA-3**.

<sup>947</sup> Draft Articles on Responsibility of States for Internationally Wrongful Acts, with commentaries, Yearbook of the International Law Commission, 2001, Vol. II, Part Two, U.N. Doc. A/CN.4/SER.A/2001/Add.1 (Part 2) (“*ILC Draft Articles*”), Article 36, Commentary 27 at 258-259, **RA-19**. See also Marjorie M. Whiteman, *Damages in International Law*, Vol. III (Washington: U.S. Government Printing Office, 1943) at 1766, **RA-48**; *Amoco v. Iran*, Award, ¶ 238 (WL), **RA-3**.

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compensation in the amount of the loss or damage actually incurred,”<sup>948</sup> and compensation is due “only in respect of harm that is proved to have a sufficient causal link with the specific NAFTA provision that has been breached.”<sup>949</sup> If there is no causal link between the alleged breach and the alleged loss, a tribunal must deny the claim.

### **B. The Claimant Has Failed to Prove Damages**

497. The Claimant posits three alternative damages scenarios.<sup>950</sup> First, the Claimant argues that but-for Order G-48-09 it would have put into effect its 2008 Power Supply Agreement with FortisBC and thus would have, in all probability, sold 100% of its below-load electricity into market.<sup>951</sup> Second, it argues that but-for a discriminatory GBL set by BC Hydro it would have been accorded the same “best treatment” as that accorded to Howe Sound and Tembec, assuming that the appropriate benchmark for determining “best treatment” is its fictitious “below load access percentage” subsidy.<sup>952</sup> Finally, the Claimant posits that but-for a discriminatory GBL it would have been accorded a lower GBL had BC Hydro used the same methodology that it accorded to Howe Sound and Tembec.<sup>953</sup>

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<sup>948</sup> *Marvin Feldman v. United Mexican States* (ICSID Case No. ARB(AF)/99/1) Final Award, 16 December 2002, ¶ 194, **RA-13**.

<sup>949</sup> *S.D. Myers, Inc. v. Canada* (UNCITRAL) Second Partial Award, 21 October 2002 (“*S.D. Myers*, Second Partial Award”), ¶¶ 140-145 (emphasis added), **RA-39**. See also *Feldman*, Award, ¶ 194, **RA-13**; (where the Tribunal stated that the amount of loss or damage must be “adequately connected” to the breach); *Pope & Talbot, Inc. v. Canada* (UNCITRAL) Award in Respect of Damages, 31 May 2002, ¶ 80, **RA-35**; (where the investor had to prove that the loss or damage claimed was causally connected to the breach alleged by the investor).

<sup>950</sup> Claimant’s Memorial, ¶¶ 693-699.

<sup>951</sup> Claimant’s Memorial, ¶¶ 693-694.

<sup>952</sup> Claimant’s Memorial, ¶¶ 695-698.

<sup>953</sup> Claimant’s Memorial, ¶ 699. In its Memorial, the Claimant alleges that BC Hydro violated NAFTA Article 1105 because it acted in a non-transparent and arbitrary manner when it set the GBL for the Celgar mill. The Claimant has not, however, quantified any losses associated with these claims. The Claimant also alleges that the actions of BC Hydro “re-order[ed] the competitive positions of the different self-generating pulp mills” and “harmed [Celgar’s] competitive position in the BC pulp industry.” See Claimant’s Memorial, ¶¶ 111, 332, 347, 383-384 and 610. The Claimant also does not quantify any losses associate with the claims. Moreover, the Claimant’s

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498. Canada submits that all of the Claimant's damages scenarios are flawed for several reasons:

- the Claimant has committed to serve its own load even in the absence of the alleged unlawful measures and thus cannot be awarded damages based on below-load sales;
- the Claimant's quantification of loss but-for Order G-48-09 is highly speculative and therefore invalid;
- the Claimant's "below load access percentage" amounts to a subsidy and is not an appropriate benchmark for quantifying damages;
- the Claimant has failed to quantify its losses for BC Hydro setting a GBL other than 0MW for Celgar; and
- the Claimant's quantification contains methodological and calculation errors.

These serious failings in the Claimant's damages analysis are outlined in more detail in the sections that follow.

**1. The Claimant's Commitment to be 100 Percent Self Sufficient Means that Damages are *De Minimis***

499. As explained in **Section II.E.1** above, the Celgar Pulp Company's proposed installation of the 52MW turbine at the pulp mill in the early 1990s required it to apply for an Energy Project Certificate from the Minister of Energy.<sup>954</sup> Celgar in its application for the new turbine represented that it would make its pulp mill "100% self-sufficient under normal operating conditions."<sup>955</sup> The Energy Project Co-ordinating Committee

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argument takes no account of the effect that Canada's \$57.7 million subsidy to the Claimant and the preferentially high prices in its EPA have had on the mill's competitive position.

<sup>954</sup> See generally *UCA* - 1980, Part II. **R-93**; and Ostergaard Witness Statement, ¶¶9-12. The Minister for Energy was required to make his decision in conjunction with input from the Minister of the Environment.

<sup>955</sup> Celgar 1990 EPC Application, **R-97**. The Application was accompanied by an affidavit of the

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responsible for reviewing the Application and making recommendations to the Minister viewed it favourably due to the pulp mill's commitment that it would "supply 100% of the modernized mill's electrical requirements."<sup>956</sup>

500. On May 23, 1991, a Ministers' Order was issued exempting the new turbine from sections 19(1)(a) and 17(1) of the *UCA* conditional on Celgar building and operating the project in accordance with the detailed description in the Application, including Celgar's representations that the mill would be 100% self-sufficient under normal operating conditions.<sup>957</sup> The Ministers' Order and conditions therein were subsequently assumed by the Claimant in 2005.<sup>958</sup> It follows that the Claimant is now under a legal obligation to operate its 52MW turbine so that the pulp mill remains 100% self-sufficient under normal operating conditions.

501. Given that the Claimant is legally required to use the 52 MW turbine to remain energy 100 percent energy self-sufficient, the vast majority, if not all of its electricity from this turbine is not eligible for sale. This suggests that the Claimant's damages are essentially *de minimis*.

## 2. The Claimant's Quantification of Loss But-For Order G-48-09 is Speculative and Therefore Invalid

502. The Claimant alleges that BCUC Order G-48-09 violated Canada's NAFTA obligations and that:

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General Manager of Celgar, Robert W. Sweeney, swearing that the information contained in the Application was true and accurate.

<sup>956</sup> *Ibid.*, s. (b), "Chemical Recovery." **R-97** Ostergaard Witness Statement, ¶¶ 16-17 and 19-20.

<sup>957</sup> 1991 Ministers' Order at 2, **R-100**; Ostergaard Witness Statement, ¶ 20.

<sup>958</sup> Letter from Tom Theodorakis, Sangra Moller, Barristers & Solicitors to Joan Hesketh, Executive Director, Environmental Assessment Office, Re Celgar Pulp Company – Minister's Order, dated February 16, 2005, **R-322**. KPMG had previously assigned the Ministers' Order to 0706906 Ltd. which would become Zellstoff Celgar Ltd. on February 14, 2005. See General Assignment Agreement between KPMG Inc., in its capacity as receiver of Stone Venepal (Celgar) Pulp Inc. and 0706906 B.C. Ltd. 14 February 2005 at MER00282142, Schedule B, **R-224**.

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[a]bsent Order G-48-09, Celgar would have put into effect its 2008 Power Supply Agreement with FortisBC, which was due to be implemented no later than January 2009, and from that time forward would have been in a position to sell all of its electricity at market prices while having full access to embedded cost utility power to meet its load.<sup>959</sup>

503. The Claimant, as mentioned above, is under a legal obligation to be self-sufficient in normal operating conditions and thus, but-for Order G-48-09, it could not have legally put its Arbitrage Project into effect. Moreover, [REDACTED]

[REDACTED]. Putting these measures aside, the Claimant's quantification of damages but-for Order G-48-09 is nonetheless invalid.

504. The Claimant under this hypothetical would need to find a willing buyer for its generation below the 40 MW GBL in its EPA with BC Hydro.<sup>960</sup> In its damages quantification, the Claimant assumes that BC Hydro would purchase, as firm energy at prices reflected in the EPA, 100% of the Celgar mill's below-GBL energy in perpetuity.<sup>961</sup> The Claimant's assumptions are beyond speculative, they are total fantasy.

505. EPAs serve as an incentive for self-generators to produce incremental electricity output. The assertion that BC Hydro would have purchased the Claimant's notional self-generation (*i.e.*, its own 1993 PPA energy) at these prices is ridiculous. BC Hydro's procurement policies mandated that BC Hydro procure only "incremental" or "new" energy so that it could add electricity to its resource stack. The Claimant's assumption that BC Hydro would have purchased the Claimant's "existing" electricity is thus wrong

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<sup>959</sup> Claimant's Memorial, ¶ 694.

<sup>960</sup> This is the hypothetical situation considered in this section: it has *not* been found that Celgar's existing GBL amount with BCH is problematic and is valid, so it would be up to Celgar to find a buyer for the below-GBL generation it wants to arbitrage.

<sup>961</sup> Kaczmarek Expert Report, ¶ 155 and Excel model, **NERA-61**. Mr. Kaczmarek applies this assumption in perpetuity from 2009 forward.

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especially when BC Hydro was the actual source of this electricity.<sup>962</sup> [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]<sup>963</sup>.

506. The Claimant's assumption that BC Hydro would purchase the electricity into perpetuity<sup>964</sup> is also deeply flawed.<sup>965</sup> This assumption constitutes roughly one-third of the Claimant's entire damages calculation.<sup>966</sup> However, the Claimant's EPA with BC Hydro terminates in 2020 and it is highly speculative to assume that BC Hydro will both need and be willing to re-contract with the Claimant at the end of its current EPA term. It is also speculative to assume that the Claimant would receive the same electricity price in a subsequent EPA since market conditions may be different in the future. It is for reasons like these that investment tribunals have refused to award damages outside the limits of a disputed contract.<sup>967</sup>

507. Given that BC Hydro would not, in all probability, purchase this electricity, then the Claimant's actual options for selling its power in the but-for scenario are far less remunerative than what it assumes. In its Memorial, the Claimant suggests that, but-for Order G-48-09, it could sell its below-GBL energy to a third party.<sup>968</sup> However, the Claimant proffers no evidence

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<sup>962</sup> NERA Expert Report, ¶ 120.

<sup>963</sup> Lester Dyck Statement, ¶ 72.

<sup>964</sup> Kaczmarek Expert Report, ¶¶ 192, 193, 196. "We assume that Celgar is able to purchase and sell below load energy into perpetuity (i.e., beyond the expiration of the BC Hydro EPA)."

<sup>965</sup> The Claimant's assumption in their damages quantification also conflicts with their position in other sections of the Memorial. See e.g., Claimant's Memorial, ¶ 427 ("Mercer is not even claiming that BC Hydro was required to have purchased more energy from Mercer in the 2009 EPA.").

<sup>966</sup> NERA Expert Report, ¶ 132.

<sup>967</sup> *CMS Gas Transmission Company v. Argentina* (ICSID Case No. ARB(AF)/01/8) Award, 12 May 2005, ¶¶ 199 & 439, **RA-11**.

<sup>968</sup> Kaczmarek Expert Report, ¶¶ 6, 85, 86, 89.

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- that it had any customers for its electricity;<sup>969</sup>
  - of the amount of electricity any customers would have purchased;
  - of the terms of any contracts it might be able to enter into;
  - that it could have obtained the required permit from the National Energy Board to export electricity; or
  - that it would have been able to obtain transmission access to deliver its electricity at economical rates.<sup>970</sup>

508. Even if the Claimant could make such sales, it has not provided evidence that it would be able to contract at a price that would make it economically efficient for the Claimant to sell its output rather than self-supply; that is, that the price at which a third-party would be willing to purchase from the Claimant would exceed the cost to the Claimant of buying the replacement electricity from FortisBC. As explained above, the rate for sales from FortisBC to the Claimant is currently before the BCUC and until a decision is reached, it is not possible to know whether the Claimant would elect to sell its below-GBL energy to a third-party buyer. The Claimant's own expert confirms this indicating that "[u]ntil it knows the rate it must pay for access to utility electricity while selling self-generated electricity, Celgar cannot determine whether or not it is even economical for it to sell its own electricity."<sup>971</sup>

509. For these reasons, the Claimant has failed to present any evidence of harm caused by Order G-48-09. Its assumption that BC Hydro would purchase 100% of its below-

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<sup>969</sup> Mercer merely vaguely refers in its Memorial to potential sales to Northpoint and [REDACTED] power marketers and yet it provides no evidence regarding the feasibility of such sales. See Claimant's Memorial, ¶ 298.

<sup>970</sup> NERA Expert Report, ¶ 122, FN 181. Dr. Rosenzweig indicates that "... firm transmission access out of BC is 100% subscribed and has been 100% subscribed for several years. With firm access to outside markets not feasible, Celgar realistically would have to choose between two unattractive options: making sales out of BC on a non-firm or ad hoc basis, or making firm sales but paying significant penalties when it could not secure transmission." See also Brian Merwin, Celgar Energy Project, Final Analysis, 29 October 2007, at 8, **R-356**.

<sup>971</sup> Switlishoff Expert Report, ¶ 87.



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GBL energy at firm energy prices forever is entirely false. In all probability, but-for Order G-48-09, the Claimant would continue to supply its own electricity needs with self-generation (as it is legally obligated to, in any event).

**3. The Claimant's "Below Load Access Percentage" is Not an Appropriate Benchmark for Quantifying Damages**

510. The Claimant also asserts that BC Hydro breached Canada's obligations when it

set Celgar's GBL too high relative to the treatment BC Hydro...afforded to comparators Tembec and Howe Sound both in terms of the overall result and the specific methodologies applied. This discriminatory, unfair and inequitable treatment consists of many separate elements, including the application of different regulatory standards, and exercises of discretion in selecting GBL baseline periods, baseline durations, and computation methodologies that were unfavorable to Celgar.<sup>972</sup>

511. The Claimant thus argues that it is entitled to compensation equivalent to the "best treatment" that was accorded to Howe Sound and Tembec and "submits that the appropriate benchmark for best treatment should be the Below-Load Access Percentage."<sup>973</sup>

512. The "below-load access percentage" is, however, an ill-formed basis on which to make an assessment of damages. The metric is one entirely of the Claimant's own invention - a straw man created for the sole purpose of knocking it down.<sup>974</sup> The purpose of a GBL is not to determine the level of "access" a mill has to electricity below its load, but is to demark "new" from "existing" electricity so that the former can be incentivized and procured while the latter excluded from purchase/sale because it would be economically inefficient (paying for something that already exists) and harmful to ratepayers. The Claimant's "benchmark" ignores all of the economic, regulatory, and

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<sup>972</sup> Claimant's Memorial, ¶. 695.

<sup>973</sup> Claimant's Memorial, ¶. 698. Kaczmarek Expert Report, Tables 1, 2, 3, 20.

<sup>974</sup> NERA Expert Report, ¶ 27.

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mill-specific issues, which were integral and necessary considerations of BC Hydro's GBL-setting process and cannot be used as a basis to quantify damages.

513. The Claimant also fails establish any relationship between BC Hydro's "exercises of discretion in selecting GBL baseline periods, baseline durations, and computation methodologies" and the Below-Load Access Percentage. The Claimant merely assumes that, had BC Hydro employed the same methodology for all mills, every mill would have the same "below-load access percentage." The Claimant is wrong. BC Hydro's use of "baseline periods" and "baseline durations" had nothing to do with the degree of below-load "access." If the Claimant wishes to argue about different baseline periods and durations that is fine, but it cannot make a claim that BC Hydro applied these elements differently and then seek damages on the basis of a methodology that BC Hydro didn't apply to anyone.

514. Finally, using the Below-Load Access Sales Percentage to quantify damages would in any event lead to absurd results. For example, Howe Sound's mill load is [REDACTED] [REDACTED].<sup>975</sup> The reason for this difference is that Howe Sound has a thermomechanical pulp line and paper machine, which accounts for [REDACTED] MW of its electricity needs. The Claimant does not have a thermomechanical pulp line or a paper machine. Because of this difference, Howe Sound's "below-load access percentage" will necessarily be higher. In fact, unlike the Claimant, Howe Sound's generators do not even have a nameplate capacity to meet the mill's electricity needs. Using Howe Sound's "below-load access percentage" to quantify the Claimant's loss would therefore provide them with an unjustifiable windfall - the two mills are completely different.

515. For these reasons, the Claimant's invented "below-load access percentage" is an ill-formed basis on which to quantify the Claimant's losses.

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<sup>975</sup> Fred Fominoff Statement, ¶ 14.

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**4. The Claimant has Failed to Quantify its Losses had BC Hydro Applied the Same Methodology to set a GBL for Celgar as it had for Other Mills**

516. In its third damages scenario, the Claimant states that, “[s]hould the Tribunal reject the below-load access percentage as an appropriate benchmark, it may itself re-compute Celgar’s GBL by eliminating each discriminatory or unfair element that went into its calculation.”<sup>976</sup>

517. While the Claimant says that it has “provided all of the raw data necessary,”<sup>977</sup> it does not itself calculate a GBL (or numerous hypothetical GBLs) without the various elements that it considers discriminatory or unfair. The Claimant thus fails (1) to identify the element that it considers to be discriminatory or unfair, and (2) to quantify its losses in the absence of that element.

518. Instead, the Claimant proffers two “examples” that could potentially be used by the Tribunal to quantify losses under its third damages scenario. Neither has merit. First, the Claimant argues that “the Tribunal could conclude that Celgar should have been treated like Tembec in its 2009 EPA...and have its GBL set based on its 2001 level generation-to-load.”<sup>978</sup> The Claimant misunderstands how the GBL was set for Tembec under the 2009 EPA. BC Hydro did not use “2001 generation-to-load” data to set the GBL, but used data from ██████████ to determine how Tembec would operate in normal conditions; i.e. it set the GBL using current data at the time the EPA was negotiated. The Claimant’s treatment in this regard was no different - BC Hydro also used current data at the time the EPA was negotiated to set the GBL for the Celgar mill.

519. Second, the Claimant argues that the Tribunal should use the Claimant’s “2001 level of generation-to-load” to set a new GBL for the Celgar mill because generation data

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<sup>976</sup> Claimant’s Memorial, ¶ 699.

<sup>977</sup> Claimant’s Memorial, ¶ 699.

<sup>978</sup> Claimant’s Memorial, ¶ 699.

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from the year 2001 was used to set the threshold for Howe Sound above which it could make *ad hoc* sales to Powerex. The Claimant's comparison is not apt. Generation data from 2001 was used under the Powerex agreement because that agreement was signed in 2001, and thus 2001 generation data was the most current data available at the time. It is absurd for the Claimant to assert that the GBL under its EPA should have been set using Celgar's generation levels in 2001, prior to the Claimant's investment and during the mill's receivership. Moreover, none of the recent EPAs signed by BC Hydro set GBLs based on generation data from 2001.<sup>979</sup> For example, the GBL under Howe Sound's 2010 EPA was set using current generation data, the same as for Tembec, and the same as for Celgar.

520. Thus, neither of the Claimant's "examples" have merit. Nor is it Canada's responsibility to conjure alternative "examples" to assess the Claimant's quantum of damages. It is the Claimant's responsibility to quantify its losses; it is not Canada's responsibility to play a guessing game. The Claimant has thus failed to quantify its losses in the but-for scenario where BC Hydro used the same methodology to set a GBL for Celgar as it had for other mills.

### **5. The Claimant's Quantification is Based on Methodological and Calculation Errors**

521. Even if it is determined that the Claimant has been harmed, the Claimant's quantification of loss is unreliable due to methodological and calculation errors. First, the model proffered by the Claimant's damages expert, Navigant, requires him to forecast a number of other speculative elements, including the price of pulp,<sup>980</sup> pulp production

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<sup>979</sup> The Claimant also alleges that BC Hydro was required under BCUC Order G-38-01 to set all GBLs under every EPA according to generation levels that existed in the year 2001 (see Claimant's Memorial, para. 699). Essentially, the Claimant argues that BC Hydro has acted contrary to Order G-38-01 in all of its EPAs, even the EPAs approved by the BCUC. The Claimant's interpretation of Order G-38-01 and its accusation that BC Hydro has violated that Order have no merit.

<sup>980</sup> Kaczmarek Expert Report, ¶ 143.

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volumes,<sup>981</sup> the cost of fibre, the cost of chemicals, the Canada-US exchange rate, the volume of electricity sales,<sup>982</sup> the volume of electricity consumption, administrative costs, and personnel costs. Each of these elements is speculative and unnecessary. As Canada's expert explains, the Claimant's expert overdesigns his model.<sup>983</sup>

522. Second, Navigant's quantification is deficient because it makes a number of quantification errors, all of which undermine its accuracy and reliability. Those errors, detailed at length in NERA's expert report, include three in its cash flow.

523. The first error occurs where Navigant fails to account for all of the energy produced by Celgar in its "Actual Scenario." As Canada's expert explains, this omission has the consequence of ignoring tens of thousands of megawatt hours of Celgar's energy which therefore overstates the actual scenario quantum.

524. Navigant commits a second cash flow error because it ignores the structure of Celgar's EPA whereby Celgar is penalized for under-generation. By ignoring penalties for under-generation, the Claimant overstates its damages assessment.

525. Finally, Navigant assumes that the Claimant would be permitted to buy electricity from FortisBC under a tariff that it was specifically barred from using; Navigant's model allows Celgar to purchase electricity under RS 31 and the remainder at RS 33 based on an agreement with FortisBC that was never approved by the BCUC. In fact, in 2010, the BCUC explicitly stated that Celgar was ineligible to purchase under RS 33.<sup>984</sup>

526. Due to both the number and the gravity of the errors in Navigant's report, the Claimant's damages assessment is without merit and should be dismissed.

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<sup>981</sup> Kaczmarek Expert Report, ¶ 149.

<sup>982</sup> Kaczmarek Expert Report, ¶ 153.

<sup>983</sup> NERA Expert Report, ¶¶ 148-149.

<sup>984</sup> BCUC Order G-156-10, s. 8, **R-228**; NERA Expert Report, ¶¶ 128-131.

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\* \* \*

527. Due to both the number and the gravity of the errors in Navigant's report, Canada submits that Mercer's damages claim is without merit and should therefore be dismissed.

**VII. COSTS**

528. NAFTA Article 1135 allows a Tribunal to award costs in accordance with the applicable arbitration rules.


529. Canada requests that the Tribunal order the Claimant to pay the arbitration costs for this NAFTA arbitration and to indemnify Canada for its legal fees and costs.

530. Canada respectfully requests the opportunity to submit a more detailed submission on costs in the future so that it can fully address all relevant considerations.

**VIII. CONCLUSION AND PRAYER FOR RELIEF**

531. For the foregoing reasons, Canada respectfully requests that the Tribunal dismiss the Claimant's claims in their entirety and with prejudice, order that the Claimant bear the costs of this arbitration, including Canada's costs for legal representation and assistance, and grant any further relief it deems just and proper.

Respectfully submitted on behalf of  
the Government of Canada  
this 22 day of August, 2014.



A handwritten signature in black ink, appearing to read 'M. Owen', is written over a horizontal line.

**Michael Owen**  
**Adam Douglas**  
**Jasmine Wahhab**  
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**Foreign Affairs, Trade and**  
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