DCN PRESENTATION TO THE
NEW BRUNSWICK ENERGY COMMISSION
THURSDAY, FEBRUARY 17, 2011

Good afternoon Commissioners

The subject matter of my submission is the regulation of utilities in New Brunswick.

First, I will outline the current situation with respect to regulation of utilities in New Brunswick and with reference to other jurisdictions in Canada and the U.S.
Second, I will examine what has happened in New Brunswick as an example of why the current situation should not be allowed to continue

I strongly recommend that New Brunswick adopt as a matter of policy, to be reflected in meaningful legislation, the full regulation of utilities by an independent regulator reserving to government only the power to speak to policy. As will be seen in my submission this is not something new in New Brunswick but unfortunately has been sadly lacking from our present regulatory regime where only partial regulatory authority resides in the Energy and Utilities Board.

What is Regulation? When any company occupies a monopoly position in the marketplace, it has usually been determined by government that monopoly supply is appropriate. Nevertheless, some form of control must exist so that customers are not exploited. It has often been said that the regulator must act as the surrogate for competition. In a competitive market customers may choose an alternative supplier if they become unhappy with the quality or price of the service being offered. It is the role of the regulator to ensure that customers are, generally, at least as satisfied as they would be in a non-monopoly situation.

In April of 2003 The P.E.I. government directed the Island Regulatory and Appeals Commission, ("IRAC"), to investigate the regulatory options available to that government and provide an assessment of various regulatory systems available to it going forward. At the time there was no regulation of the electrical utility on PEI. The power rates were simply set at 110% of those in New Brunswick.

I should note that this procedure of asking the regulator to investigate a question and report back to government with various alternatives, giving the pro and cons of the each alternative, is a common use of made of a regulator by governments in other jurisdictions. As noted later in my submission the State of Maine recently followed such a process in respect of competition in the electricity market.

In the PEI situation the IRAC retained the services of Mr. John Murphy, a consultant, to do a literature search and report his findings to that Board. The Board then forwarded the report, together with its comments, to the Executive Council. As a result of this report, the PEI government passed legislation giving IRAC complete regulatory authority over the privately owned electric utility, Maritime Electric.

What do I mean when I say "complete regulatory authority"? It means not only does the regulator approve the rates of the utility, but it also has general supervisory authority over the utility and the authority to review capital investment.
I have attached and marked “A” table 1 from IRACs report showing the types of regulation in each Province in 2003.

Presently in New Brunswick the EUB does not have either general supervisory authority or the power of capital review. Saskatchewan is the only other province where this power is not given to an independent regulatory tribunal.
Has the regulator in New Brunswick ever had complete regulatory authority over a utility? The answer is yes - absolutely. The best example of this NB Tel. NB Tel was regulated by the Public Utilities Board, predecessor of the present EUB, from the 1920's through to 1987.

What was the PUB able to do with its general supervisory power over NB Tel that the EUB cannot do with NB Power?
1] It could investigate any matter concerning the utility and bring it to a public hearing before the Board if the Board felt it necessary.
2]It could investigate customer complaints and require the utility to accommodate the customer if the complaint were well founded.
3] There was ongoing communication between the company and the Board. Board staff would meet at least quarterly with Company staff to obtain updates on the progress of the utility's compliance with Board orders.
4] The Board received copies of management financial reports quarterly.
This kind of constant oversight from the regulator is one of the greatest strengths of regulation - the awareness of the utility's staff that they might be questioned on each decision that they make by folks extremely knowledgeable in the running of the utility.

I have not had time to research every U.S. jurisdiction to see if there is a state that does not have a regulator or that the regulator does not have general supervisory powers and capital review. In my experience of 30 years on the NB Pub, I have never been aware of any that do not have such authority. After all, US utilities are all privately owned with very few exceptions.
I am now going to do a short review of the history of regulation of utilities in New Brunswick over the last two decades.

The McKenna government exposed NB Power to rate regulation, as promised in its 1987 election platform. As a result the PUB undertook a series of generic hearings to review a number of key areas of the utility's operations as no data was then available to the Board. This was done to settle certain matters in advance of the rate hearings to avoid taking up time with such matters during the rate hearings.

During 1991, 1992, and 1993 the following essential hearings were held:

1 Accounting and Financial Policies
2 Depreciation Policies
3 Capacity Planning Process
4 Cost Allocation and Rate Design
5 Customer Service Policies

There were also two general rate applications heard during the period: the first taking 16 days and the second taking only 9 days - showing the benefits of the just described generic hearings. The participants in the generic hearings also became much more knowledgeable in respect of the regulatory regime.

Government then removed the Board's general supervisory powers and brought in the so called 3% cap rule. In simplified terms this rule allowed the utility to raise its rates by an amount not exceeding 3% each year without triggering a rate hearing before the Board. There was no public review of the necessity for the rate increases.
The Public Utilities Board had the authority in 2001-2002 to review and provide a recommendation in respect of all capital expenditures proposed by NB Power where the proposed capital expenditure would exceed $75,000,000.

NB Power appeared before the Board to support its proposal to refurbish Coleson Cove. The Board recommended the project proceed with several caveats. However, the Board did not have ongoing general supervisory authority over the utility following the delivery of its recommendation. If the Board had had such authority, in my opinion, the refurbishment would have played out differently than it did.

In the same manner NB Power had to appear before the Board to seek a recommendation in respect of the proposed Point Lepreau refurbishment. The Board's recommendation was that it was not in the public interest for the refurbishment to proceed based on the information provided to the Board by NB Power.
The next general rate application made by NB Power did not happen until 2005 with the decision of the PUB being handed down in 2006.

The Energy and Utility Board has held one general rate application beginning in 2007 with the decision being handed down in February of 2008.

The EUB has been asked to review two 3% increases proposed by NB Power since the 2008 decision but the wording of the legislation did not offer the EUB an opportunity to perform the oversight and review normally accorded a regulator in such situations.
Therefore, in the nearly 18 years between 1994 and today, NB Power has only been subjected to full regulatory oversight of its utility business on two occasions.

The successive governments of Premiers McKenna, Lord, Graham and now, Alward, have chosen not to delegate general supervisory powers over NB Power to the Board but have instead have retained that power in government.

I am now going to provide a summary overview of what I consider to be government's poor track record in performing its general supervisory function in respect of NB Power.

I have included in the hard copy of my comments of today a document marked “B” included as exhibit E as a part of the Board's 2006 NB Power rate decision. It shows that NB Power lost $398 million dollars between 1994 and 2005 and this was in addition to the $450 million write down on Point Lepreau. Neither the McKenna government nor the Lord government insisted that the utility appear before the Board for a drastically needed rate increase in excess of the 3% rate cap.

During the latter years of the McKenna-Theriault regime, and continuing during the Lord regime the government pursued the goal of attempting to create a competitive electricity market in New Brunswick by legislation. This end was pursued by government and Legislature committees. This was in direct contrast to how this objective was pursued in other North American jurisdictions. For example, the Legislature of the State of Maine directed the Maine Public Utilities Commission to hold hearings all over the state and report back to the Legislature within one year with a report setting out three ways that competition in the electricity market in the state could be introduced listing the pros and cons of each method.

In the early 2000's the legislation in New Brunswick was enacted and the market was opened. However, rather than allowing the newly created Distribution Corporation (DISCO) to deal directly with the non utility generators (NUGs) and thereby give a start to competition the government assigned the NUG contracts to the Generation Corporation (GENCO). Therefore all the electricity generated in New Brunswick was controlled by GENCO. There was no practical way for competition to develop in the generation of electricity in New Brunswick.

As a result of a very complex legislative regime required to set up this non-competitive, so-called competitive ,market the government removed the ability of the regulator to examine 80% of the costs incurred by NB Power in providing services to people of the Province, namely, the cost of generating power. In addition, the government is now allowing NB Power to operate as a vertically integrated utility notwithstanding the creation of 5 separate corporations and the contracts between them.

When NB Power finally applied for a general rate increase in excess of the 3% cap in 2005 it was in serious financial difficulty with respect to its revenues. It asked for a 11.4% increase in rates. The Board sat for 58 hearing days and spent hours and hours dealing with various rate scenarios and their impact on various rate payers. One of the objectives of the Board during such a hearing was to ensure that those rate payer classes causing the cost to NB Power should bear a reasonable portion of the cost of providing the service to them. { Revenue to cost ratios }
Near the end of the hearing, before the Board had handed down its decision, Premier Lord issued a press release in which he stated in part: `... regardless of the outcome of a hearing of the Public Utilities Board ... Government will cap the rate increase at eight percent". Premier Lord couldn't wait for the Board to hand down its decision to exercise his ratemaking authority. Included with the package of materials I provided you with as a part of my submission is a sheet marked "C" . This sheet shows the rates, as they were prior to the application, those proposed by Disco, those approved by the Board and lastly those produced as a result of the Governments order. Sheet "C" shows clearly that the government imposed caps did two things. First, it denied the utility the revenue it needed and secondly, it showed how the Board was trying to bring greater equity on an interclass basis by bringing the revenue to cost ratios closer to unity for all classes. The government imposed caps reversed that effort.

It was Premier Lord who decided that the refurbishment of Point Lepreau would go ahead notwithstanding the Board's recommendation to the contrary. It is of interest that the expert retained by the government, to review the boards recommendation, Dr. Jeffery of British Nuclear, stated that: "Your Board's decision was spot on".

In passing I would note that the Graham government tried to sell NB Power with limited advice. It actually signed a Memorandum of Understanding with the Government of Quebec. If that transaction had gone ahead as proposed in the MOU no regulator would have been able to set "just and reasonable rates" after the first 5 years of the transaction. Section 2.5 of the MOU provided that: "[T]he cost of the distribution service will include ... the recovery of the deferred expense account referred to in section 5.3". Section 5.3 mentions a $525 million deferral account which contained the costs incurred during the refurbishment of Point Lepreau, including the cost of purchased replacement power and the wages for the plant staff during the outage. Neither the Large Industrial class of electricity customers nor the Municipal wholesale customers take their electricity from the distribution network, but take electricity from the Transmission network . Even though the Large Industrial class consumes approximately 40% of the power used in New Brunswick they would not have been responsible for any payments in respect of the deferral accounts.

Today, the government of Premier Alward is promising that rates will not rise for three years. This is in spite of a monster debt and NB Power having lost $117 million last year. NB Power's OM&A accounts have increased 8% year over year last year. OMA are the accounts that the management can control. This 8% growth cries out for regulatory supervision. And all the while the Point Lepreau deferral account grows minute by minute.

I would suggest to you that successive governments have done an absolutely terrible job of supervising our monopoly electric utility. Why will government not trust the two Groups in NB who know most about electric utilities, NB Power and the EUB, to look after the setting of rates and the running of the utility? The Board is required by proper regulatory legislation and common law to balance the needs of the utility and the needs of the rate payer.

Clearly, in the vast majority of jurisdictions in North America, governments trust these two groups to run the Utility and Government's only role is to speak to policy matters through legislation.

Interesting observations regarding the differences between political and quasi-judicial regulation are contained in a paper presented by Dr. R.E. Olley at the CAMPUT 1990 Regulatory Educational Conference. I consider the following excerpts to be of particular interest.

> "Political regulation of a utility offers the great advantage of being inexpensive, rapid, and quickly responsible to the political realities with which all utilities must live. It lacks, however, several features of third party regulation.
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> First, political regulation does not offer many of the other advantages of quasi-judicial regulation through a board or commission. Almost universally, the members of the political committee have many other tasks. Because of that, they do not have the opportunity to develop the requisite expertise to actually perform the technically detailed tailoring of the utility's performance to the public interest.
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> Second, and very important, political regulation does not leave the managers and board of directors of the utility subject to managerial review. Under third party regulation, objective public explanation is often demanded; under political regulation it is all but never required.
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> Third, political fails to provide for due process. It is not open, there is no significant notice of intended changes in the utility's behaviour or operations, there is no assurance of – and usually not even an attempt to provide – objective debate, and there is not even a

> hint that arguments by members of the public will be listened to with attention and evaluated analytically.
> Finally, and very importantly, political regulation does not feel as if it is fair in any sense, from the viewpoint of consumers and users. The utility is seen to be employed for political purpose, and otherwise not regulated at all.
> In short, political regulation, relative to third party regulation, removes the detailed technical and analytic review process from regulation, with all of the potential consequences that flow therefrom to create latitude for whimsical behaviour by the government in power and arbitrary conduct by the managers and boards of directors.
> The quasi-judicial third party regulator has enormous advantages compared to the political regulatory process, in picking the public interest optimal set of trade-offs. It has focus, expertise, openness, and the respectable legal framework within which to operate.
> The quasi-judicial regulator occupies such an important position because it develops expertise but even more importantly because it uses that expertise in one of the most highly respectable ways of making findings and decisions in a democratic society, namely the judicial, within the framework of law and rights which safeguard so much of the reasonable functioning of society.
> While there is a broad range of actual performance by different regulators and on different aspects of the process, the median capability, so to speak, is that of expertness, highly acceptable process, and separation from at least the most egregious of immediate short run political and commercial pressures.
> Should third party regulators regulate crown utilities? The answer is almost certainly "Yes", in the abstract, because the benefits of quasi-judicial process are very great – outweighing the cost in all likelihood. Third party Board regulation provides an effective mechanism to make complex detailed trade-offs. However, in particular, the answer may be "No", unless the definition of the regulator's authority makes it clear how it may deal with utility initiatives which emanate directly from discrete government pronouncements."

Thank you for your patience and kind consideration in hearing me today.

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