

Plugging in the International Northeast



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*“What’s Working and What’s Not Working in Regional
Cooperation”*

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Introduction

It's a pleasure to be here today to join your debate as to whether regionalism (the notion that there is a natural economic region that embraces Atlantic Canada, New England and New York) – whether regionalism, in light of the continuing evolution of power markets, can provide solutions to the energy challenges that face us?

Before turning to my specific topic I want to say that every topic or idea under discussion here today – whether it be cross border markets, restructuring, breaking down monopolies, opening competition or other aspects of regionalism, – ought to be put to the same test – Will it serve society's need to have and maintain an electrical power supply that is secure, reliable and affordable?

Competition is not an end in itself. Restructuring is not an end in itself. Regionalism is not an end in itself.

Each of these only makes sense if it serves the more fundamental goal of ensuring that our homes, our businesses, our economies are driven by a supply of electrical energy that is secure, reliable and affordable.

I'm here to talk specifically about “What's Working and what's Not Working in Regional Co-operation”.

Emera Context

Let me begin with the corporate context for my comments.

Emera operates two regulated electric utilities which together comprise over 90% of our business. Nova Scotia Power is a fully integrated utility, providing the vast majority of electricity generation, transmission and distribution in Nova Scotia. We serve 450,000 customers - close to a million people. The utility was once a provincial crown corporation, but was privatized in 1992. It operates as a monopoly under a traditional cost of service, regulated rate of return, rate base structure.

Bangor Hydro is a pure transmission and distribution (T&D) utility serving over 100,000 customers as the second largest electric utility in Maine. Emera's acquisition of Bangor Hydro in 2001 solidified our interest in the US market. We became the first Canadian company to acquire a US electrical utility. Maine's electric market was restructured in the late 1990s. Generation was separated from transmission and distribution and now runs in a competitive environment. T&D, itself, continues to be a regulated monopoly.

Customers pay separate charges for energy, transmission, distribution and stranded costs. Of these, distribution rates are set under a performance based rate structure.

Emera also operates unregulated businesses, most notably Emera Fuels, our oil products retail company, and our energy marketing business (active on both sides of the border). Through Emera Energy we also oversee our interest in the Maritimes and Northeast Pipeline.

While our Head Office is in Nova Scotia our focus continues to be on the entire Northeast Market.

As a result we have seen where regional cooperation is thriving and where it is flagging.

Market Opportunities

Let's look at that market for a moment.

Geography and timing have come together to give Maritime Canada tremendous advantages. To one side of us lies one of the continent's largest and hungriest energy markets. New England and the Mid-Atlantic States are a market of 52 million people.

On our other flank lies one of the top three natural gas basins in North America.

From an electricity perspective the differing demand profiles of the Maritimes and New England are another compelling reason to take a broad view of what constitutes our economic region. Here in the Maritimes, we have a winter peak creating the need for winter imports. NEPOOL has a summer peak as air conditioners are turned to 'high'. NEPOOL has an appetite for power when Maritime generators usually have capacity to spare.

Maritimers have much in common with New Englanders. The pipelines and transmission lines that link our north/south communities are a visible reminder of our traditional ties of a common history, culture, commerce and family.

So it is only natural for us to think of power market cooperation as building upon Maritime Canada's long and successful trade and ties with New England and New York.

Emergency Cooperation

Another thing that ties us together in the Northeast is the weather.

At Nova Scotia Power we certainly faced some weather recently. In doing so, we were reminded of one aspect of regional cooperation that is working extremely well.

Hurricane Juan struck Nova Scotia less than six weeks ago. This Category Two hurricane, with winds of over 150 kilometers per hour and gusts of 176, made landfall

virtually on the shores of Halifax Harbour. It then cut a swath of destruction across the middle of our province leaving HRM, Truro, the Pictou and much of northeast Nova Scotia reeling in its wake.

As a natural disaster it was unprecedented in our modern Nova Scotian experience.

Images of the destruction - homes ruined, wharves swept away, boats sunk or cast on-shore, farms destroyed, railroad cars over turned, sidewalks washed away - and everywhere you looked the largest of trees, uprooted and tossed about, while power poles were snapped in two like matchsticks.

But more vivid in our recollections in the years to come will be the images of our people and how they responded to this catastrophe. Ordinary citizens rallied to each other's aid, clearing debris, repairing damage, sharing food, and offering support. Police, Fire, EMO, other Municipal and Government workers, and the armed forces together with our own Nova Scotia Power employees (and those of other utilities) united together. And everywhere there were volunteers. Giving freely of themselves. These are the images of Juan that will last the longest - images of our citizens showing their commitment and their courage.

For Nova Scotia Power, it was the most devastating storm in our history. Juan knocked power out to about two-thirds of our customers. Hundreds of thousands of people endured the largest outage we've ever faced.

The winds of Juan followed the backbone of our transmission system as it crosses our province. Three of our five main high capacity transmission lines were brought down.

120-foot high transmission towers crumpled like paper.

Seventeen smaller transmission lines, 45 major substations, more than 100 feeder lines and much of the thousands of kilometers of local distribution line in the storm's path were damaged.

We were forced to essentially rebuild large portions of our transmission and distribution system. One Lineman said that the repair effort was like trying to do 80 years worth of construction work in about five days.

That meant assembling the largest team ever gathered to restore electricity in Nova Scotia. And that is where regional cooperation came to the fore.

Our mutual assistance agreement with NB Power provided the means to quickly acquire assistance from that utility. Between Monday and Wednesday 20 power line crews arrived from NB Power. Saint John Energy also dispatched crews. Still more crews came north over the border – 5 from Bangor Hydro and 10 from Central Maine Power.

I would be remiss if I did not also mention the significant numbers of US and Canadian power line and forestry crews from private companies who also turned out on short notice.

The cooperation across the Northeast and beyond was not limited to personnel. The success of our materials management was aided by the immediate response from other utilities. We began to request supplies even before the storm hit. Juan had no sooner passed by when trucks and planes departed with supplies from NB Power, Hydro Quebec, Hydro One and Newfoundland Power. Their prompt response to this emergency ensured that there was always sufficient material in the supply chain to meet all requirements.

The support of these utilities was a big reason power was restored so quickly for most of our customers. By noon on the second day 50 percent of our customers had their power restored. Within five days, 95 percent of our customers were back on line.

The actions of NB Power, Saint John Energy, Central Maine Power and Bangor Hydro were a powerful demonstration of what's working well in regional cooperation – that in the face of the greatest challenge Nova Scotia Power has ever had, we could count on other utilities in the region to help get the job done.

We are extremely grateful for their support.

Reliability

It should not be surprising that another area of longstanding regional cooperation has been maintaining the reliability of the grid.

We saw regional cooperation work well for us during the massive August blackout. For a brief time the system in Maine and Maritime Canada was in serious jeopardy. While Toronto and New York City and many communities in between went dark, system operators in this end of the world worked together to ensure that much of New England and all of the Maritime provinces successfully islanded. They prevented the blackout from affecting our customers.

The value of regional co-operation may also be measured by the success of the Northeast Power Coordinating Council. Although the voluntary nature of groups like this has been politically questioned I think that NPCC has served us well across the Northeast.

Presently Congress is considering legislation that will empower FERC to assume responsibility for reliability within the US. The same legislation would direct the US President to negotiate reliability treaties with Canada and Mexico. I am not sure how this will play out for regional cooperation. Our engineers and technical people have generally functioned quite well without the need for diplomatic intervention. Time will tell.

Returning to Hurricane Juan for a moment, the damage to Nova Scotia Power's T&D system was so great the system demand for power dropped suddenly to below 400 MW. Our system operators worked quickly with their counterparts in New Brunswick Power to move the sudden surplus of electricity into New Brunswick and beyond. This ensured that our plants could continue to stay on line so that they would be instantly available to our customers as they had their service restored.

So, whether in these dramatic situations, or simply hour after hour, day by day, system operators across the Northeast work cooperatively every day to maintain a reliable and secure system.

Cooperation to resolve Seams issues

Anytime there are adjoining markets with a demand to flow electricity between the two there are concerns about how seamless that flow will be.

One aspect of regional co-operation that is working reasonably well is the effort across New York and New England and into Atlantic Canada to reduce these operating seams.

Transmission Infrastructure

To maximize opportunities for customers, regional cooperation must extend to meeting the infrastructure requirements needed to create a more regionally integrated electricity market.

We need greater, two-way access to the United States. With stranded generation in Maine and our need for power at certain times of the year up here, the United States needs access to us. Building additional transmission capacity will be good for energy consumers on both sides of the border. It will improve the reliability of the regional grid and provide enhanced market access on both sides of the border for generators and customers. That's why Emera is partnering with NB Power, to pursue the development of a second international transmission line connecting New Brunswick and Maine.

We are planning a high voltage transmission line from Point Lepreau, New Brunswick to Orrington Maine. The total cost of the project is estimated to be \$95 million US of which the US side, Emera's share is \$65 million US

Bangor Hydro will be the builder, owner and operator of the US side of the line. NB Power has already received approval from the National Energy Board for the Canadian side.

The process on the US side of the border is anything but sure. Siting of transmission lines in the United States is far more complex than it is in Canada. With a host of factors in play, approval of some major US transmission projects can take a decade or more.

We are optimistic about our ability to successfully navigate these regulatory, legal and political waters in a timely manner, but if something needs fixing within the United States surely it is transmission capacity and the regulatory approval process.

Generating Capacity

Changing environmental requirements are another factor affecting electricity generation in the northeast. New limits on air emissions will certainly change the fuel portfolios for utilities like Nova Scotia Power. We will find ourselves using more natural gas and generating more electricity from renewable sources like wind power.

Demand is growing across the Northeast. Since 1999, about 10,000 MW of electricity has been attracted to the New England market. Here in the Maritimes, demand is also growing, albeit at a slower pace. But generation capacity has not increased much here in recent years. Now utilities like Nova Scotia Power and NB Power face decisions about what investments to make in new generation.

A number of factors play into these decisions – cost, reliability of fuel supply, environmental requirements and even the changing regulatory framework. What’s to say that generation to meet demand in the Maritimes has to be located here?

To date there has not been any meaningful cooperation across the region with regard to new generation. We may be missing an opportunity.

Air Emissions Policy

Tighter Air Emissions standards are another area calling out for regional cooperation.

Canada has ratified the Kyoto Accord. The United States has not.

The reality is that emissions don’t respect borders.

The impetus behind Kyoto is a good thing - it will lead to an atmosphere that is less threatening to our climate, to our ecosystem, and to our health. It will lead us to find cleaner and better ways to generate electricity, to power our transportation systems, and to fuel our economy.

There is great uncertainty as to how we will meet our Kyoto obligations in Canada.

Under Kyoto, the rules prevent us from entering into a credit trading system with countries that have not ratified the treaty. For the purposes of Kyoto, Canadians cannot build a credit trading system with our largest economic partner. We can trade with Russia but not America. Does that make sense? Or is it simply bad public policy?

If we cannot find a way to build a system of credits that allows us to do business with our largest trading partner this will be a huge obstacle in the way of finding economic solutions to our regional energy challenges.

Economic Barriers

More work can be done to reduce economic barriers that divide us. Look at the tariffs established by ISO New England. To move energy into the Maine market, for example, the fee is approximately 3 to 5 percent of the market price. But to move energy into the Maritimes, the fee is around 10 to 15 percent of the market price. This differential is distorting the natural economics of the market and creating unnecessary barriers to entry. By reducing the economic burdens on market participants, we will see an increase in the flow of electricity and boost the value of generation resources on both sides of the border.

There are great differences in price between the provinces and states of this region. Nova Scotia Power's 3% general rate increase in 1992 was the first since 1996. During the same period the consumer price index for Nova Scotia rose over 13%. By Northeastern North American standards, electricity rates in Nova Scotia and New Brunswick are very competitive.

How regionalism impacts pricing can become an obstacle to greater regionalism. Consider for example the fate, last year of NERTO. ISO New England and the New York ISO attempted to create a transmission organization spanning all of New York and New England only to see it prematurely put to death. One reason for its demise was the fear that while electricity prices might drop in New York, they might increase in New England.

The lesson for all of us is that regional co-operation won't succeed if customers are convinced that they will lose as a result.

Market Restructuring

What about market restructuring? Looking only at Atlantic Canada there has been little regional co-operation in matters of market restructuring. A driver underlying the move to restructure markets across North America is the notion that by participating in larger markets customers should gain greater benefits. Whether in fact this has occurred or not is a whole other topic. But it is ironic that on our side of the border market restructuring has proceeded without us talking much to each other. Nova Scotia's Electricity Marketplace Governance Committee (of which I was a member) only included representatives of Nova Scotia industry. Representation from other jurisdictions was excluded. New Brunswick did likewise in its process of market structure review.

We should broaden participation as we continue to debate market restructuring.

Maine's power market, where we do business as Bangor Hydro and Emera Energy Services, has been restructured, so our efforts there focus on making it function as well as

possible. The reality though, is that electricity pricing is very high in Maine, to the point where it is stifling the economy.

Our performance based ratemaking agreement provides for modest annual decreases in electricity prices over the next five years. But beyond that, a third of the overall cost paid by customers for electricity reflects the recovery of stranded assets.

In Maine customers may have choice, but they are also paying the high costs of stranded assets.

I think we can cooperate in sharing information so we learn lessons and ensure our search for reasonably priced, reliable energy is not waylaid by costs we hadn't considered.

Regulatory Overlap

We are awash in a sea of regulatory overlap.

No matter how much we seek to cooperate we will not achieve market efficiency until we create real regulatory efficiency.

Each province has its own regulator charged with serving a public interest that has been traditionally defined by provincial boundaries.

While US markets benefit from FERC's nationwide perspective, local interests seem to constantly work against larger interests.

If we are going to have a truly integrated market that spans the borders of both Canada and the United States, then we must cooperatively establish a regulatory framework that ensures the market can function effectively. That doesn't mean that the regulatory structure in each state or province has to be the same. Far from it. But we can aim for regulatory structures that ensure cooperation among jurisdictions, eliminating or at least reducing impediments to the regional market.

The necessity of congruent energy policy and regulation was discussed at the Conference of New England Governors and Eastern Canadian Premiers in 2002. They directed a committee address the synchronization of energy-related regulations. Unfortunately we have only seen cautious steps toward establishing a truly regional approach.

It costs energy companies and their customers a great deal to navigate these muddy waters. It also increases risk. For companies that have choices as to where to spend their capital these forces can act as a real disincentive to invest.

Political/government

Another obstacle to regional co-operation is what some call "stroke of the pen" risk. This refers to the growing tendency of politicians in some jurisdictions to override and

undermine the specialist role of regulators. A commentator in *The Economist* last July said “the recent turbulence in government policy on industries spanning telecoms, energy, finance and the media suggest that politicians are exerting their influence over regulatory decisions more than ever before”.

Some of this is welcome, but more of it creates an environment of uncertain regulatory policy in which one is unable to rely on precedent, making planning more challenging and hampering investment. Regional co-operation will be discouraged if business has to worry about political uncertainty – about longstanding regulatory policy being upset without notice – in other states and provinces.

NB Power/Government

The *Economist* focused on the United States but this is not to say that politicians on this side of the border are above reproach.

For example, when FERC undertook its wholesale power market reform in the middle 1990s it determined that non-discriminatory open access transmission service was the most critical element of a successful transition to competitive wholesale electricity markets. So it required transmission owners under its jurisdiction to adopt open access transmission tariffs.

The benefits of such a tariff are such that customers can access sources of generation beyond those of the utility that controls the transmission system. In New Brunswick the advent of an open access transmission tariff should mean that utilities such as Saint John Energy or large industrials that are to have retail choice will be able to access power from suppliers other than NB Power.

Earlier this year the NB PUC approved the OATT proposed by NB Power with one important change. The regulator understood that if non-discriminatory access is to be provided then other parties beyond NB Power should have access to the intertie with the United States. Over NB Power’s objection the regulator, after an open, public and fair hearing ruled against NB Power. It said that NB Power Generation would have to compete on an equal footing with other generators for capacity on the intertie. This is very important for the emerging market in New Brunswick. It would enhance the means by which those who are supposed to have competitive choice can access other sources of power than those provided by NB Power.

This was a victory for customers in New Brunswick – one in which our subsidiary Emera Energy had led the way. Then government stepped in and with the flick of a wrist directed the NB PUC hold another hearing – on the same issue – this time presumably to give the decision that government wants!

With a stroke of the pen, government in collaboration with its own utility has undermined confidence in the independence of the New Brunswick regulatory process. Needless

uncertainty has been injected into the course market development will take in New Brunswick. Will it really operate to the benefit of New Brunswickers as part of the larger regional energy market?

PUCHA

As a company with utility subsidiaries in both Canada and the United States we have seen another obstacle to regionalism. That impediment is the Public Utility Holding Company Act – or PUHCA – a piece of legislation adopted under Roosevelt in 1935 and generally considered (including by the SEC, whose mandate includes administering it) to be long over due for repeal.

The Act puts unrealistic controls on companies that own more than a single utility – controls on financing, inter-company transactions and acquisitions. Controls no other companies in any other industries face.

As part of our purchase of Bangor Hydro, Emera became subject to PUHCA. One practical implication is that Nova Scotia Power may ‘not derive any part of its income, from the generation, transmission or distribution of electric energy for sale’ in the United States. That means Nova Scotia Power cannot sell NSPI produced generation directly in the US. We can sell NSPI generation to a non-affiliate at or before the Canada-US border, but this unnecessary third party involvement often slashes the profit margin on the transaction, rendering it uneconomic. Thus a piece of archaic legislation is acting to prevent transactions that would provide benefits on both sides of the border. US customers are denied less expensive power and Nova Scotia customers lose the benefit that export sales bring in lowering local electricity costs.

How is this in the public interest of the Northeast region?

PUHCA is limiting business’ ability to integrate, deliver full value to our customers and sell electricity competitively in the northeast U.S.

The Customer Seam

As we look at regional cooperation there is a final consideration – perhaps the most important consideration – that will operate as either a help or a hindrance – to the success of regional markets.

This is all about providing reliable electricity at affordable rates.

Too often the debate over integrated monopolies on one hand and models of restructuring on the other, gives only lip service to the interests of real customers. The debate takes place in the hallowed halls of public policy – think tanks, regulatory bodies, government offices, etc, where real customers are sometimes overlooked.

Regional cooperation requires a more customer centric approach.

At Emera we have heard from large US consumers that in much of the discussion of market restructuring the “customer” receives less attention than deserved. End use customers are very interested in accessing mechanisms that would allow them to see the wholesale market and take advantage of price signals.

Retail competition usually allows customers a choice of marketers but the choices rarely include meaningful real time pricing, interruptability or other structures that put a greater measure of control in the hands of customers.

Ultimately we believe customers will drive or derail regionalism. After all they will foot the bill for whatever occurs. Emera suggests that to the extent there is a disconnect between end use customers and processes for regional cooperation, that disconnect needs to be addressed. Regionalism will offer no long term solutions if it doesn't embrace a more customer centric approach to all customers.

Tie It Together-Ending

In summary, there is a lot which is working well in regional cooperation. At Emera we are very optimistic about the ability of those in this region to work well together. We see opportunities for even greater cooperation in the time ahead.

Staying on the path to success means keeping our focus sharply on the customers – whether we are government, regulators, utilities, ISOs, etc. If we want whatever we seek to do cooperatively to succeed – it must serve the needs of our customers to have an electrical power supply that is secure, reliable and affordable.

Thank-you.