

Before the

ADDITIONAL FACILITY OF THE  
INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

**Mercer International Inc.,**

Claimant,

v.

**Government of Canada,**

Respondent.

ICSID Case No. ARB(AF)/12/3

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**SECOND WITNESS STATEMENT OF BRIAN MERWIN**

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I, Brian Merwin, hereby declare as follows:

1. I offer this supplemental testimony to respond to facts and arguments alleged in Canada's Counter-Memorial Submission.

**I. CELGAR'S ARBITRAGE PROJECT AND THE SALE OF CELGAR'S SELF-GENERATED ELECTRICITY**

2. In the first paragraph of its Counter-Memorial, Canada misrepresents Celgar's Arbitrage Project. Citing to a 2008 memo I presented to Mercer's Board, Canada makes the following false statement: “{Mercer} believed that its Celgar pulp mill was in a ‘unique’ 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.”<sup>1</sup> This false characterization of Celgar's plans to sell its self-generated electricity and accusations of “gaming” the system appear throughout Canada's Counter-Memorial.<sup>2</sup>

3. The Arbitrage Project that I was exploring for Celgar in 2007 and 2008 in no way contemplated selling FortisBC's energy to BC Hydro (or other third parties) as if it were Celgar's own self-generated electricity. The Arbitrage Project did examine the possible sale of Celgar's *own* self-generated electricity to third parties, while simultaneously purchasing electricity from Celgar's utility (Fortis BC) to meet the pulp mill's electricity needs. Canada's suggestion that Celgar had orchestrated a scheme to sell FortisBC's electricity as its own is not

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<sup>1</sup> See Counter-Memorial ¶ 1; R-276 at 2.

<sup>2</sup> See, e.g., Counter-Memorial ¶ 222 (“{Celgar's} plan to re-sell BC Hydro's RS 3808 energy to the United States if BC Hydro refused to purchase energy form the Arbitrage Project.”); ¶ 214 (“{Celgar was} 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.”).

only false,<sup>3</sup> it also betrays a fundamental misunderstanding and misrepresentation of the modern electricity market and distribution system.

4. A metering system, which is monitored by FortisBC, measures Celgar's power sales to FortisBC. The metering system consists of three separate meters: two at our plant, which are connected to each of Celgar's two generators and measure the amount of electricity those two generators physically produce, and one at our point of interconnection with FortisBC, measuring net inflows and outflows from the FortisBC system. This metering system assures that Celgar sells only the electricity that it generates, and not electricity it purchases from its utility. Regardless of the physical flows of the electricity, Celgar can only sell the electricity it generates — the electricity that registers at the meters connected at the plant's generators.

5. Once an electricity schedule is set for the sale of a specific number of megawatts of Celgar's self-generated electricity, FortisBC ensures that the number of megawatts scheduled matches the meter at Celgar's plant, and, in this manner, Celgar sells its own self-generated electricity, not the electricity generated by others, no matter where the electricity ultimately flows from a physical standpoint.

6. As an added clarification, only after BC Hydro assigned Celgar a net-of-load GBL, and prohibited Celgar's below-GBL electricity sales to third parties in the parties' 2009

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<sup>3</sup> In its Counter-Memorial, Canada misrepresents one of my emails from 2008 as an “admission” that the Arbitrage Project was a scheme to sell BC Hydro the power that it was selling to FortisBC. See Counter-Memorial ¶¶ 8, 228; R-279, Email from B. Merwin to J. Lee and D. Gandossi (2 May 2008). In the referenced email, I was describing BC Hydro’s erroneous position against the Arbitrage Project — not what the Arbitrage Project actually entailed. I note that later in the email, I am clearly referring to BC Hydro’s argument: “{O}ur regulatory consultant and myself believe this is an argument BC Hydro won’t win.” R-279, Email from B. Merwin to J. Lee and D. Gandossi (2 May 2008). I believed strongly that BC Hydro would not be successful in opposing the Arbitrage Project because we would be buying power from FortisBC to supply our industrial load to make pulp, and we would be selling the output of our generator — **our power** — to a third party. We were not attempting simply to buy power cheaply from FortisBC (who bought it cheaply from BC Hydro) and reselling it. We had a right to purchase power for our mill and sell the generation output power from our generator.

Electricity Purchase Agreement (“2009 EPA”), and the BCUC issued Order G-48-09, did I realize the irony of my preliminary thoughts in 2007 and 2008 about Celgar’s potential Arbitrage Project. I had believed that Celgar could potentially [REDACTED]  
[REDACTED]  
[REDACTED]. Now, Celgar’s “unique” position is diametrically opposed to that which I had originally believed to be the case: Celgar is the only BC pulp mill that is formally banned from purchasing *any* replacement power from its utility, while no such restriction exists for our BC pulp mill competitors.

## **II. THE SIGNIFICANCE OF CELGAR’S GBL**

### **A. GBL as Mere Demarcation Point**

7. In this arbitration proceeding, Canada appears to define GBL in a variety of different manners.<sup>4</sup> But in 2007 and 2008, when Celgar was registering and submitting a proposal for BioEnergy Power Call Phase I, (*i.e.*, during the BioEnergy Power Call Phase I

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<sup>4</sup> See, e.g., Counter-Memorial, ¶ 19 (“The GBL is used to demarc 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.”); Counter-Memorial, ¶ 23 (“Claimant’s GBL . . . was set to determine the amount of electricity BC Hydro would purchase pursuant to an EPA.”); Counter-Memorial, ¶ 98 (“{A} Generator Baseline (“GBL”) is set to define the amount of self-generation that the customer normally generates for self-supply.”); Counter-Memorial, ¶ 120 (“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.”); Counter-Memorial, ¶ 134 (“{The GBL} was representative of {a customer’s} historical self-generation . . . . For purposes of determining electricity eligible for sale to BC Hydro, the GBL will be deducted from the metered electricity.”); Counter-Memorial, ¶ 145 (“{GBLs} identify the proponent’s historical self-generation level under normal operating circumstances ensuring that only incremental (rather than existing) electricity is procured.”); Counter-Memorial, ¶ 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.”); Counter-Memorial, ¶ 365 (“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.”).

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Request for Expressions of Interest),<sup>5</sup> BC Hydro had provided no definition of a GBL or how it would be determined. All they had told us was that a GBL expressed a demarcation point above which BC Hydro would consider a generator's electricity eligible for sale.<sup>6</sup> Nothing more. The purpose of the GBL, as BC Hydro explained at the time, was to encourage new and incremental self-generation from biomass in British Columbia in order to carry out the mandate of the Energy Plan.<sup>7</sup> BC Hydro did not present the GBL as the amount of electricity that a mill must utilize only for self-supply, and was forbidden from selling to third parties — that is, as I explained in my original witness statement, until after BC Hydro had selected Celgar as one of the successful bidders and we began negotiating the terms of the EPA with BC Hydro.<sup>8</sup>

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<sup>5</sup> See R-111, Mercer International BioEnergy RFEOI Form (April 2007). There is no mention of a GBL or even the notion of a GBL in the Request of Expression of Interest form.

<sup>6</sup> See Merwin Witness Statement, ¶ 90 (“Celgar had understood that the purpose of a GBL was simply to serve as a demarcation point that defined the amount of firm energy BC Hydro would purchase, which would be equal to the amount of Celgar’s generation above the GBL.”); C-63, BC Hydro, Report on Bioenergy Call Phase I: Request for Proposals (Appendix A) (6 February 2008) 6 of 36 (“Customers intending to submit a Proposal involving incremental self-generation servicing their industrial load must have their existing generation base line (“GBL”) determined by BC Hydro to confirm eligibility. Customers must provide data required by BC Hydro to determine the Customer’s GBL for the applicable industrial facility or facilities. BC Hydro will notify Customer Proponents of BC Hydro’s data requirements, which Customers should submit to the RFP Administrator, all by the dates indicated on the RFP Schedule.”); 6-7 of 36 (“BC Hydro will consider Projects that meet the following eligibility requirements: . . . New 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 (i.e. load displacement) and/or effect net energy export to the System (i.e. Customer Projects), but excluding generation projects, where the current output is under contract through a load displacement or demand side management agreement with BC Hydro.”); R-116, BC Hydro’s BioEnergy Call, Kamloops BC at 22 (20 February 2008) (“The purpose of the GBL is to define incremental generator output that can be considered for a prospective energy sale.”).

<sup>7</sup> See R-24, BC BioEnergy Strategy, at 6-8 (“Through the implementation of the BC BioEnergy Strategy, Government will create new economic opportunities {and} will establish British Columbia as the hub of a global supply network of bioenergy resources, technologies and services. . . . Unused biomass from Canada’s forestry and farming operations that is not otherwise required for soil health or ecosystem restoration could provide as much as 27 per cent of our national energy needs. . . . BC Hydro will issue a two-part Bioenergy Call for Power early in 2008. This call will follow up on the March 2007 Request for Expressions of Interest for power production to convert underutilized wood into electricity.”).

<sup>8</sup> See Merwin Witness Statement, ¶ 104.

8. In February 2008, BC Hydro issued its Preliminary GBL data sheet, which also contained no definition of the GBL.<sup>9</sup> Celgar thus went about completing the form based on the very little information we had regarding the ultimate significance of the preliminary data we were providing.<sup>10</sup> By completing the form, Celgar did not and could not understand that it was proposing a measure below which it would not be permitted to sell its self-generated electricity to third parties.<sup>11</sup> As I previously testified, “Celgar had no understanding that it would not be permitted to sell energy below its GBL to third parties, such as Puget Sound or to other third parties through NorthPoint. Indeed, Celgar was actively exploring both opportunities at the time.”<sup>12</sup>

9. It is also important to clarify that, in accordance with the information that was available to Celgar at the time, we understood that Celgar’s GBL-related data and other proposals were nothing more than a suggested starting point for potential negotiations. In this regard, the Preliminary GBL Data sheet stated: “Actual GBL will be subject to further review by BC Hydro, and will require BC Hydro approval.”<sup>13</sup> I note that Canada also concedes in its Counter-Memorial that, after BC Hydro notified BioEnergy Phase I bidders of their assigned preliminary GBLs, “[p]roponents then had an opportunity to ask questions and to challenge the preliminary determination.”<sup>14</sup> This approach made sense at the time, as we had little to no information available to us regarding the specific manner in which BC Hydro would actually calculate GBLs, for Celgar and for others.

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<sup>9</sup> See R-113, BC Hydro BioEnergy Call for Power (Phase I) Addendum I, at 5-8.

<sup>10</sup> See R-123, Letter from Celgar to BC Hydro RFP Administrator (6 March 2008).

<sup>11</sup> See Merwin Witness Statement, ¶ 90.

<sup>12</sup> Merwin Witness Statement, ¶ 90.

<sup>13</sup> R-113, BC Hydro BioEnergy Call for Power (Phase I) Addendum I, at 5.

<sup>14</sup> Counter-Memorial, ¶ 146 and n. 332.

10. I note that the Specimen Electricity Purchase Agreement (the “Specimen EPA”) for BioEnergy Call Phase I included an exclusivity provision limiting the self generator’s ability to sell energy to third parties other than BC Hydro.<sup>15</sup> I recall reviewing the Specimen EPA and its exclusivity provision at the time it was issued (May 2008). I did not consider the exclusivity provision to be significant or relevant to a limitation on sales of Celgar’s below-GBL electricity, however, as the term “GBL” nowhere appears in the Specimen EPA’s exclusivity provision. I construed the provision to apply only when BC Hydro was committing to purchase all of the Seller’s electricity. It would not have occurred to me that BC Hydro thought it had the authority to buy only some of our self-generated electricity and tell us we could not sell the rest to anyone else. Indeed, I repeatedly made it expressly clear to BC Hydro during the BioEnergy Phase RFP process and EPA negotiations that Celgar intended to sell to third parties any of its electricity that BC Hydro did not purchase through the EPA.<sup>16</sup>

11. Mr. Scouras is misinformed when he asserts in his witness statement that “BC Hydro never accepted Celgar’s suggestion that it could sell energy below its GBL to third parties.”<sup>17</sup> However, his failure to appreciate the facts is perhaps understandable as our negotiations with BC Hydro generally were with Martin Kincade, not Mr. Scouras. I personally

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<sup>15</sup> See R-114, BC Hydro BioEnergy Call for Power Phase I Specimen EPA § 7.4.

<sup>16</sup> See R-127, Letter from B. Merwin to BC Hydro (7 May 2008) (“{W}e have the ability to sell our self-generation and will do so whether or not BC Hydro deems it eligible for its Bioenergy Call process.”); Merwin Witness Statement, ¶ 90 (“Celgar had no understanding that it would not be permitted to sell energy below its GBL to third parties, such as Puget Sound or to other third parties through NorthPoint. Indeed, Celgar was actively exploring both opportunities at the time.”); ¶ 103 (“When it became apparent that BC Hydro was unwilling to agree to any GBL other than one tied to Celgar’s 2007 load, Celgar accepted the net-of-load GBL, but with the express understanding that Celgar intended to sell to other parties that portion of our below-load self generation that BC Hydro was not interested in buying. BC Hydro accepted this during the negotiations, and we finalized contract language reflecting agreement on this point in a provision which allowed Celgar to sell electricity below its load to third parties.”).

<sup>17</sup> Scouras Witness Statement, ¶ 53.

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negotiated the EPA for Celgar, mainly with Martin Kincade and his team for BC Hydro, and not with Mr. Scouras. Thus, Mr. Scouras would not know everything that transpired in the negotiations.

12. To support his incorrect assertion, Mr. Scouras points to a September 25, 2008 draft of the Celgar-BC Hydro EPA, which contained an exclusivity provision prohibiting Celgar from selling below-GBL energy to third parties.<sup>18</sup> What Mr. Scouras does not explain, however, is that although BC Hydro initially inserted into the draft EPA an exclusivity clause that prohibited Celgar from selling below-GBL electricity to third parties, Celgar made clear from the parties' first negotiations that Celgar would not accept BC Hydro's control over its below-GBL electricity — that it was a deal breaker. Celgar continued pressing this issue with the BC Hydro team, until they finally agreed to remove the offending exclusivity language in October 2008.

Mr. Scouras fails to acknowledge the October 28, 2008 e-mail I received from Martin Kincade of BC Hydro, or < [REDACTED] > of the draft EPA, which Mr. Kincade transmitted with that email (and which was included as Exhibit C-209 to Mercer's Memorial). < [REDACTED] > of the draft EPA included the text for Section 7.4(b) to which Celgar and BC Hydro had agreed, allowing Celgar to sell below-GBL energy to third parties.<sup>19</sup> Mr. Kincade did not copy Mr. Scouras on that e-mail.<sup>20</sup> I can only assume that Mr. Scouras' incorrect account regarding the draft EPA's

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<sup>18</sup> See R-129, Letter from BC Hydro to Celgar (25 September 2008); R-130, Draft BC Hydro - Celgar EPA, version Van01:2538687:v5, at § 7.4(b).

<sup>19</sup> See C-283, E-mail from Martin Kincade to Brian Merwin re Celgar EPA (28 October 2008, 4:40 pm) < [REDACTED]

>; C-209, Electricity Purchase Agreement between BC Hydro and Celgar, at § 7.4(b) (Draft, Version 7).

<sup>20</sup> See C-283, E-mail from Martin Kincade to Brian Merwin re Celgar EPA (28 October 2008, 4:40 pm).

exclusivity provision<sup>21</sup> reflects his lack of first -hand knowledge of Celgar's negotiations with BC Hydro.

13. It was <REDACTED> of the EPA — the version that expressly permitted Celgar to sell below-load GBL energy to third parties — that was to be the final text to be presented to the BC Hydro Board of Directors on November 19, 2008.<sup>22</sup> Just before the presentation to its Board, however, BC Hydro insisted on changing the text of Section 7.4, in a new Version 8 of the draft EPA, to preclude Celgar from selling its below-GBL energy to a third-party.<sup>23</sup> I remember this change well, as I was on vacation with my family at the time, and this 11<sup>th</sup> hour highly significant change disrupted that vacation.

#### **B. BC Hydro's Supposed "Current Normal" Standard**

14. Similar to the information that BC Hydro made available to Celgar regarding the significance of the GBL, the information that BC Hydro made available to Celgar regarding the standards that it would employ to determine Celgar's GBL was generally absent, and any information that BC Hydro disseminated was vague and inconsistent. In fact, BC Hydro never articulated, either in the documents it distributed or in oral comments it made our EPA negotiations, any standard or methodology it would employ for its GBL determinations.

15. I understand that Canada now contends that, since 2001, the applicable standard for BC Hydro's GBL determinations has been that of "current normal operating conditions." I

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<sup>21</sup> See Scouras Witness Statement, ¶ 54 ("BC Hydro never agreed to Celgar's proposed amendment [sic], and the final version of the EPA, which Celgar and BC Hydro signed on January 27, 2009, retained the original language of the exclusivity provision of the draft EPA that was submitted to Celgar on September 25, 2008. Hence, Mr. Merwin's allegation to the effect that BC Hydro "amended" this provision at the last minute and departed from previously agreed language is inaccurate.").

<sup>22</sup> See Merwin Witness Statement, ¶ 104.

<sup>23</sup> See Merwin Witness Statement, ¶¶ 104-105.

do not understand how Canada could make such an assertion, in light of (1) the fact that BC Hydro never articulated (either in writing or orally) such a standard to Celgar at any point during entire course of the BioEnergy Phase I process and EPA negotiations, and (2) the information that BC Hydro did provide concerning its GBL determination standards gave the impression that BC Hydro would consider a number of years — what seemed like an average of three years of operational data — not simply one year of data or only “current” data.

16. In fact, given what BC Hydro led Celgar to believe, I was particularly shocked and disturbed when Mr. Dyck informed me that BC Hydro had only considered one year (2007, the year prior to our BioEnergy Phase I registration) of operational data in assigning Celgar’s GBL. As I explained in my original witness statement, Celgar met with BC Hydro in May and June 2008 to express its objections to the assigned GBL. During all of those meetings, BC Hydro never once explained that BC Hydro had applied a “current normal” standard to determine Celgar’s GBL. Mr. Lester Dyck only assured me that BC Hydro had treated all pulp mills exactly the same in determining their GBLs. I only found out later that this was not true, and that BC Hydro did not treat all of the other pulp mills the same as Celgar in determining their GBLs. BC Hydro treated us far less favorably.

17. I can also clarify that BC Hydro never considered whether Celgar’s electricity generation was “normal” in terms of Celgar’s economic or financial circumstances, and BC Hydro never communicated in writing or orally that economic or financial data regarding the Mill’s operations would have been relevant to its calculation of Celgar’s GBL. BC Hydro therefore never requested (nor did Celgar know to offer) information regarding Mercer’s [[REDACTED]] due to our business decision to keep the mill running [[REDACTED]]

[REDACTED] ], instead of idling the mill until pulp prices improved.<sup>24</sup>

18. I note that Lester Dyck testifies that, in our discussions regarding the calculation of Celgar's GBL, "Mr. Merwin confirmed that 2007 represented normal operations for Celgar going forward"<sup>25</sup> I would only clarify that Mr. Dyck never explained that by "normal" he meant that Celgar would "normally" choose to operate the mill that level (i.e., Celgar would generate excess steam to generate surplus electricity) regardless of whether Celgar had contractual arrangements to sell the excess electricity it generated. When Mr. Dyck asked me that question, I had no idea that he would disregard our electricity sales contracts. I had no understanding of the context of his question, as BC Hydro failed to disclose to me what it now describes as its "current normal operating conditions" GBL standard.

19. If I knew then what know today, I would have told him that we did not have sufficient information on whether our 2007 operations were normal. We had just installed new equipment and made process improvements as a result of Project Blue Goose, and we did not yet have sufficient experience to determine the reliability of the new plant configuration, nor had we had sufficient time to evaluate whether problems might arise., I would never have agreed that one year's operations could reflect our projected long-term performance. I also would have made clear that, absent our contracts with FortisBC and NorthPoint, we would not have generated the electricity we sold to them. Of course, it was Celgar's first time negotiating with BC Hydro, and we had no idea what BC Hydro's unwritten GBL rules and standards might be. We were negotiating under an invisible standard.

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<sup>24</sup> See Merwin Witness Statement, ¶¶ 94, *et seq.*

<sup>25</sup> Dyck Witness Statement, ¶ 86.

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20. Indeed, if we had known then what we know now — that British Columbia would treat its self-generated electricity more restrictively than that of its competitor pulp mills — Mercer would have [[REDACTED]]

[REDACTED]  
[REDACTED]  
[REDACTED] ]]

once it became apparent that British Columbia would discriminate against Celgar, placing more restrictive conditions on Celgar's access to embedded cost utility power than it placed on other BC pulp mills. Additionally, when the PPGTP opportunity presented itself, [REDACTED]

[REDACTED]  
[REDACTED] ] For instance, [[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED] ]]

21. There were numerous other projects in which Celgar could have invested, and which would have put Celgar on a different path, developing and maximizing a different set of competitive advantages, instead of attempting to build on our electricity generation competitive advantage in being a modern mill potentially able to generate more power than any other mill. Because Celgar is being treated differently, economically speaking, despite generating significantly more power per tonne of pulp, the revenue we realize per tonne of pulp actually is less than what our competitors receive.

**III. MERCER HAS NEVER UNDERSTOOD THAT CELGAR IS OR HAS BEEN SUBJECT TO A SELF-SUFFICIENCY COMMITMENT DUE TO THE 1991 MINISTERS' ORDER**

22. I was shocked to learn that Canada claimed in its Counter-Memorial that Celgar is subject to an alleged energy self-sufficiency commitment due to a Ministers' Order issued in 1991. Canada's Counter-Memorial was the first time I ever heard of such an allegation. During my tenure at Mercer, I have never understood that Celgar had committed itself to be, or was otherwise obligated to be energy self-sufficient, by virtue of any statements Celgar had made or under any order of the Ministries of Energy and Environment. Moreover, since the beginning of my employ at Mercer, no one at Celgar has ever communicated to me any understanding that Celgar is bound by any Ministerial energy self-sufficiency commitment or requirement, and no regulatory authority has ever informed Celgar or Mercer that such an energy self-sufficiency commitment exists. I do not believe that, prior to BCUC Order G-48-09 and our 2009 EPA, the Celgar Mill has ever been under any kind of energy self-sufficiency requirement.

23. And, even after reading Canada's argument concerning this issue, I still am not clear on what specific commitment Canada believes Celgar made, or whether it believes we have met that commitment over the intervening 23 years. I also cannot understand why no one at the Ministry of Energy has ever mentioned this supposed obligation over the past six years as we have been arguing over Celgar's sales of self-generated electricity at the BCUC and before the Ministry itself. If any real obligation existed, I think they would have called it to our attention before now.

#### IV. CELGAR'S ELECTRICITY SALES THROUGH NORTHPOINT

24. As I explained in my original Witness Statement, starting in 2006, NorthPoint became Celgar's electricity sales broker.<sup>26</sup> In its initial engagements with NorthPoint, Celgar focused selling [REDACTED]

[REDACTED]<sup>27</sup> But, as the improvements from the Blue Goose Project came fully on line in 2007, Celgar was able to generate increasing volumes of electricity, and, more importantly, all of the electricity Celgar generated became more reliable.<sup>28</sup> As a result, in 2007, Celgar began exploring [REDACTED]  
[REDACTED] [[REDACTED]] [[REDACTED]]<sup>29</sup>

25. As our electricity generation became more reliable, Robert Friesen, the NorthPoint representative responsible for overseeing Celgar's brokerage agreement, began identifying longer-term electricity sales opportunities for us. In mid 2008, once we were finalizing our agreement with FortisBC to become a full load customer, Mr. Friesen identified [[REDACTED]]  
[[REDACTED]] for Celgar to sell its entire generation (*i.e.*, above- and below-load electricity) as trial sales for the Power Supply Agreement that Celgar and FortisBC both expected to be able to implement.<sup>30</sup> Mr. Friesen advised that NorthPoint expected [[REDACTED]]  
[[REDACTED]]<sup>31</sup>

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<sup>26</sup> See Merwin Witness Statement, ¶ 50.

<sup>27</sup> See Merwin Witness Statement, ¶¶ 52, 59.

<sup>28</sup> See Merwin Witness Statement, ¶¶ 58-60.

<sup>29</sup> See Merwin Witness Statement, ¶¶ 60, 66, 82.

<sup>30</sup> See Merwin Witness Statement, ¶¶ 73, 82; C-343, Emails between Mercer and NorthPoint (23-24 June 2008).

I note that Mr. Swanson claims FortisBC was concerned that the BCUC would reject the FortisBC-Celgar PSA and that his assessment was "that there was only a 50% chance that the BCUC would approve the {PSA}." D. Swanson Witness Statement, ¶ 63; see also Counter-Memorial ¶209 and n. 463. Mr. Swanson further claims that such concerns were communicated

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**V. WITHOUT ELECTRICITY SALES CONTRACTS, CELGAR WOULD HAVE REFRAINED FROM GENERATING ADDITIONAL ELECTRICITY**

26. I understand that Canada does not dispute that a proper determination of a self-generator's GBL would involve deducting the self-generator's electricity sales from its generation. Such generation, by definition, is not used to meet the self-generator's own load. Nevertheless, in calculating Celgar's GBL, BC Hydro failed to deduct the electricity sales Celgar made to FortisBC and via NorthPoint, allegedly because "Celgar did not require a sales contract to incentivize it to generate the quantities it was generating; it was using its generation to supply its load for other reasons. The *ad hoc* sales of Celgar's excess energy thus formed part of the mill's normal operations."<sup>32</sup>

27. Canada's characterization of Celgar's sales to FortisBC and to third parties via NorthPoint is incorrect. First, those electricity sales were not *ad hoc*; they were sales that were executed in accordance with express contractual agreements.<sup>33</sup> Second, Celgar did, in fact,

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to Celgar "at all times." D. Swanson Witness Statement, ¶64. If certain individuals within FortisBC were concerned regarding the regulatory viability of the PSA, such concerns were not communicated to Celgar. Because my contacts with FortisBC were with [[REDACTED]], Mr. Swanson may not be aware that the concerns he may have had regarding the PSA were not communicated to Celgar. In fact, as late as July 17, 2008, and after BC Hydro had expressed regulatory concerns to FortisBC regarding the PSA, [[REDACTED]] stated that "all our key people . . . are feeling like we are on terra firma." C-214, Email chain involving [[REDACTED]] and Brian Merwin at MER00292757. On August 21, 2008, Celgar and FortisBC signed their 30-year Power Supply Agreement. C-220, Power Supply Agreement between Celgar and FortisBC Inc. (21 August 2008).

<sup>31</sup> See Merwin Witness Statement ¶ 83. C-343, Emails between Mercer and NorthPoint (23-24 June 2008).

<sup>32</sup> Counter-Memorial, ¶ 407.

<sup>33</sup> Merwin Witness Statement, ¶ 47, 50-53 (regarding Celgar-FortisBC 2000 and 2006 Brokerage Agreements and 2006 Celgar-NorthPoint Marketing Services Agreement). I note that Mr. Swanson states that "Celgar failed to execute the 2006 General Service Power Contract and Electricity Supply Brokerage Agreement. This failure would later be the subject of regulatory proceedings before the BCUC and constitute one of the main reasons for which the BCUC cancelled Celgar's access to Rate Schedule 33 service." D. Swanson Witness Statement, ¶ 51. While it is true that FortisBC and Celgar failed to sign the Brokerage Agreement that they had developed in 2006, as was submitted by both FortisBC and Celgar during the BCUC proceedings

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require contractual electricity sales agreements with FortisBC and NorthPoint to “incentivize” the generation of its surplus generation. Without these electricity sales contracts, Celgar would not have generated the surplus electricity that it ultimately sold through the contracts.

28. There are costs (hog fuel costs and the operation and maintenance costs associated with running a power boiler at full capacity) associated with producing the discretionary, excess steam that generates electricity surplus to the Mill’s own needs. Additionally, discretionary natural gas was burned to enhance power output at certain times when pricing in the market was high enough. Without the FortisBC and NorthPoint electricity sales contracts, Celgar would have [REDACTED] [REDACTED] Thus, without the FortisBC and NorthPoint electricity sales contracts, Celgar would have [REDACTED] [REDACTED] ] For these reasons, without the FortisBC and NorthPoint electricity sales contracts, Celgar’s steam and electricity generation data would have been significantly different in 2007 and other years than actually occurred.

29. Mr. Dyck fails to consider that Celgar has no internal need for the discretionary steam it produces to generate the electricity it sold to FortisBC and NorthPoint. The Mill’s minimum steam needs are defined by its thermal balance requirements. Thus, a different way to look at the issue is to ask what electricity would the Mill have generated if it only produced steam sufficient to meet the Mill’s thermal balance requirements, Focusing on 2006 through

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Footnote continued from previous page  
to which Mr. Swanson refers, FortisBC and Celgar had in practice executed the unsigned 2006 Brokerage Agreement, as both parties abided by the unsigned agreement they had reached.

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2008, for example, if Celgar had only produced an amount of steam sufficient to meet the pulp mill's thermal balance needs, the Mill would have generated [[REDACTED]]

[REDACTED] The following is a spreadsheet with the relevant data I considered in calculating Celgar's thermal balance electricity generation levels for 2006 through 2008:

Date	Energy Produced in Excess of Steam Balance (GWh)	Celgar Actual Electricity Generation (GWh)	Celgar Annual Electricity Generation Restricted to Thermal Balance (GWh)
2006	[REDACTED]	290.4	[REDACTED]
2007	[REDACTED]	350.6	[REDACTED]
2008	[REDACTED]	374.4	[REDACTED]

30. I note that while Celgar did not need "incentives" from BC Hydro to undertake its 1992-94 Expansion and Modernization and to invest in improvements, projects and operations that would lead to increased amounts of electricity generation (although Celgar's bankruptcy perhaps suggests that it did), Mercer did rely on a market "incentive" to increase the Mill's electricity generation after it bought the Mill in 2005. Prior to the Blue Goose improvements coming on line in 2007, Celgar conducted research regarding the potential market for its self-generated electricity.<sup>34</sup> Celgar's research led to its brokerage agreement with NorthPoint, and the sales of Celgar's self-generated electricity gained through that brokerage agreement served to "incentivize" Celgar's increased generation of electricity.

## **VI. CELGAR'S BELOW-349 GWH/YEAR GBL ELECTRICITY WAS AVAILABLE FOR IMMEDIATE SALE TO BC HYDRO**

31. By letter dated May 7, 2008, I sent Celgar's response to BC Hydro's rejection under BioEnergy Phase I of the electricity generated by the Biomass Realization Project. In that

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<sup>34</sup> See Merwin Witness Statement, ¶ 60.

communication, among other objections, I explained that “The Biomass Realization Project does not relate simply to the supply of electricity from our existing 52 MW Generator and the Celgar Green Energy Project does not involve solely the supply of energy from a new 35 MW generator. Rather, the two generators will function in conjunction with one another. Both generators new and existing will be powered with steam from a common Power Boiler and Recovery Boiler.”<sup>35</sup> Naturally, any electricity that BC Hydro would purchase from the Green Energy Project turbine would have to wait until the Green Energy Project turbine was installed (in September 2010).<sup>36</sup> If, however, BC Hydro had assigned a lower GBL to Celgar, the additional amount of self-generated electricity Celgar would have been permitted to sell BC Hydro would have been available for immediate distribution and sale.

## VII. CELGAR’S 10 YEAR EPA

32. The BioEnergy Phase I process allowed bidders to propose EPA terms between 5 and 20 years,<sup>37</sup> and Celgar proposed a 10-year term in its Commercial Proposal of 9 June 2008.<sup>38</sup> Celgar specifically selected a 10-year term, because we were confident that BC Hydro would renew Celgar’s EPA at the end of its term, and that Celgar would be able to obtain higher prices for its biomass based electricity than those included in its 2009 EPA (in which annual price increases were tied to changes in the Consumer Price Index).

33. I was confident that BC Hydro would renew Celgar’s EPA at the end of the 10-year term, because in 2007, the BC government had announced plans to become energy self

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<sup>35</sup> R-127, Letter from B. Merwin to BC Hydro and Power Authority, at 2 (7 May 2008).

<sup>36</sup> See Merwin Witness Statement ¶¶ 108, 113.

<sup>37</sup> See R-117, BC Hydro, BioEnergy Call Phase I: Proponent Information Session (26 March 2008), at 49.

<sup>38</sup> See R.-128, Celgar Commercial Proposal, at 4 (9 June 2008).

sufficient by 2016 and to purchase green energy to meet a growing shortfall of provincially generated electricity.<sup>39</sup> In light of Celgar's competitive prices for its biomass-based electricity, I expected BC Hydro would not be in a position to refrain from renewing the Celgar EPA. Celgar was the second lowest bidder for BioEnergy Phase I, BC Hydro's first competitive power call for bioenergy. Celgar has a competitive advantage over many other biomass based electricity generators, as Celgar produces the vast majority of its electricity by burning mostly black liquor and, proportionally speaking, only small quantities of hog fuel. Black liquor is a reliable, highly efficient, and low cost fuel. Other BC pulp mills and other biomass based electricity generators rely much more heavily on burning natural gas or hog fuel to generate electricity. Celgar even has a competitive advantage with the hog fuel it uses to generate electricity, as it largely produces its own hog fuel in its upgraded wood room.<sup>40</sup>

34. Celgar's selection of a 10-year term for its EPA was also based on its conclusion that biomass based electricity prices would continue to increase. Since 2003, there had been a consistent and significant increase in BC Hydro's EPA prices. Celgar expected those price increases to continue, particularly given forecasts of rising biomass based electricity prices due to a decrease in the supply of timber and a related rise in wood prices in the wake of the mountain pine beetle infestation.<sup>41</sup> Although the mountain pine beetle infestation in British Columbia led to a considerable amount of timber that required harvesting (and a concomitant

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<sup>39</sup> See C-297, Memorandum from B. Merwin to J. Lee (Mercer CEO) and D. Gandossi (Mercer CFO) re BC Hydro Bid Price and Terms (7 June 2008) at Recommendation Nos. 4-5.

<sup>40</sup> See Merwin Witness Statement, ¶¶ 61, *et seq.*

<sup>41</sup> See C-333, British Columbia Committee on Timber Supply, Growing Fibre, Growing Value (2012) ("Over the next decades the timber supply in the interior will continue to decrease. When beetle-killed pine is no longer salvageable, the province's overall supply of mature timber will be reduced, and 10 to 15 years from now it is forecast to be 20 percent below the pre-infestation levels, a reduction that may last up to 50 years."); C-329, Timber Supply and the Mountain Pine Beetle Infestation in British Columbia 2007 Update, available at [http://www.for.gov.bc.ca/hfp/mountain\\_pine\\_beetle/Pine\\_Beetle\\_Update20070917.pdf](http://www.for.gov.bc.ca/hfp/mountain_pine_beetle/Pine_Beetle_Update20070917.pdf).

short-term increase in wood supplies and decrease in wood prices), forecasters expected the wood supply in the mid-term to decline, leading to higher prices for wood.<sup>42</sup> Rising wood fiber costs lead to higher biomass-based electricity prices.

35. Celgar's assumptions regarding BC Hydro's likely desire to renew the 10-year EPA were confirmed during the EPA negotiation process, when BC Hydro repeatedly requested that Celgar consider a 20-year term (or, in the least a term longer than 10 years).<sup>43</sup> We declined BC Hydro's requests to extend the term of the contract.

36. I understand that BC Hydro has more recently asserted that it will be able to renew its bioenergy EPAs at lower electricity prices based on the assumption that the self-generators' initial capital investment in its existing generation projects will have "fully or largely recovered over the initial term of the EPA."<sup>44</sup> This assumption is incorrect. In accordance with Canadian financial accounting practices, turbine generators typically are depreciated over a 20-year period. Celgar therefore used a [[REDACTED]]

[REDACTED]

[REDACTED]

[REDACTED]

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<sup>42</sup> See C-333, British Columbia Committee on Timber Supply, Growing Fibre, Growing Value (2012) ("Over the next decades the timber supply in the interior will continue to decrease. When beetle-killed pine is no longer salvageable, the province's overall supply of mature timber will be reduced, and 10 to 15 years from now it is forecast to be 20 percent below the pre-infestation levels, a reduction that may last up to 50 years."); C-329, Timber Supply and the Mountain Pine Beetle Infestation in British Columbia 2007 Update, available at [http://www.for.gov.bc.ca/hfp/mountain\\_pine\\_beetle/Pine\\_Beetle\\_Update20070917.pdf](http://www.for.gov.bc.ca/hfp/mountain_pine_beetle/Pine_Beetle_Update20070917.pdf).

<sup>43</sup> See C-330, Letter from BC Hydro to Celgar, at 2 (30 July 2008); C-296, Letter from BC Hydro to Celgar (15 August 2008); R-129, Letter from BC Hydro RFP Administrator to Brian Merwin, re: Bioenergy Call for Power, Phase I – Meeting Request (25 September 2008).

<sup>44</sup> See C-298, BC Hydro, 2013 Integrated Resource Plan (November 2013), Chapter 4, at 4-15.

[REDACTED] ]

## VIII. MERCER'S 2014 PERFORMANCE

37. Celgar's pulp production and sales, and in turn electricity generation and sales, were lower than normal in the first half of 2014.<sup>45</sup> This downturn in performance largely was due to changes in Celgar's workforce, and a number of unanticipated mechanical breakdowns. In July 2013, Celgar instituted layoffs at the Mill, eliminating 80 jobs. Following that workforce reduction, Celgar's employees required training to take on additional responsibilities. Mill operations experienced a slow down as employees were acclimating to new job responsibilities. Additionally, during the first half of 2014, an unexpected increase in significant mechanical breakdowns occurred, and a slower than usual start up followed the annual June maintenance shutdown. Celgar anticipates that pulp production will return to historical levels, beginning with the second half of 2014, as its workforce has gained relevant training and experience and major mechanical failures are not likely to reoccur for some time.

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<sup>45</sup> The following table provides Celgar's annual pulp production for 2009 through 2013.

YEAR	2009	2010	2011	2012	2013
<b>Annual Pulp Production (ADMT)</b>	466,855	502,107	488,007	490,018	447,935

Celgar's pulp production through June 2014 was 212,932 ADMT, which is about 10 percent down from our historical pulp production levels.

**IX. CORRECTION OF MILL OPERATION DATA**

38. In reviewing the gas consumption figures included in Annex A to my Witness Statement and the Memorial, I noticed errors with respect to the gas consumption figure reported for the year 2000. The correct annual combined gas usage for steam production figure for the year 2000 should read 1,932,904 GJ, (not 3,799,135 GJ as noted in my original Witness Statement). The correct figure is indicated in the Revised Annex A, attached to this Second Witness Statement and the Reply.

The information furnished above is faithful and true in its entirety and was developed on the basis of my best knowledge.

In Vancouver, British Columbia, on the 15 day of December, 2014.

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Brian Merwin

**Annex A (Revised)**

Celgar Mill Historic Data									
A	B	C	D	E	F	G	H	I	
Year	Turbine Generator #1 Output (MWh/year)	Turbine Generator #2 and Turbine Generator #3 Output (MWh/year)	Annual Purchases from FortisBC (MWh/yr)	Physical Export Power Sales (MWh/yr) (before losses)	A+B+C-E	Celgar Annual Mill Load (MWh/yr)	Natural Gas Used for Steam Production (GJ/yr)	Pulp Production (ADMT/Yr)	Electricity Intensity (MWh/ADMT)
1990	15,949	-	114,161	-	130,110	713,923	174,235	0.75	
1991	13,890	-	122,320	-	136,210	708,154	151,695	0.90	
1992	10,583	-	129,746	-	140,329	1,926,553	132,570	1.06	
1993	5,866	31	190,905	-	196,802	2,342,843	183,335	1.07	
1994	-	236,253	98,256	-	334,509	2,187,618	356,654	0.94	
1995	-	308,810	22,303	20,100	311,013	2,272,132	374,054	0.83	
1996	-	287,352	28,599	25,597	290,354	2,182,835	352,173	0.82	
1997	-	251,348	57,712	12,250	296,810	2,084,008	381,576	0.78	
1998	-	231,310	28,306	10,985	248,631	1,859,556	295,647	0.84	
1999	-	301,600	19,824	22,470	298,954	2,071,780	396,096	0.75	
2000	-	278,780	31,878	17,892	292,766	1,932,904	410,414	0.71	
2001	-	190,507	88,704	4,384	274,827	1,360,898	352,263	0.78	
2002	-	223,970	93,702	3,948	313,724	1,038,254	402,458	0.78	
2003	-	258,666	71,400	4,914	325,152	946,846	422,504	0.77	
2004	-	271,326	59,220	14,028	316,518	769,525	434,117	0.73	
2005	-	300,192	54,432	26,202	328,422	655,373	444,694	0.74	
2006	-	290,413	61,523	22,213	329,723	629,254	438,855	0.75	
2007	-	350,641	22,560	23,926	349,275	303,006	476,242	0.73	
2008		374,359	24,636	36,470	362,525	432,937	485,893	0.75	
2009		359,897	26,259	35,372	350,783	472,353	466,855	0.75	
2010							502,107		
2011							488,007		
2012							490,018		
2013							447,935		