BEFORE THE ADDITIONAL FACILITY OF THE

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTE (ICSID)

BETWEEN:

MERCER INTERNATIONAL INC.

Claimant

AND:

GOVERNMENT OF CANADA

Respondent

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

SECOND WITNESS STATEMENT OF JIM SCOURAS

March 30, 2015

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I, Jim Scouras, declare as follows:

1. As explained in my first witness statement, from 2001 to 2013 I held various managerial positions within BC Hydro's Power Acquisitions group culminating with my role as Manager of Commercial Acquisitions.[1] In these roles, I was responsible for leading the design and implementation of multiple BC Hydro power procurement processes, including the Bioenergy Call for Power Phase I ("Bioenergy Phase I").

2. As a Manager in the Power Acquisitions group, I was responsible for all aspects of the Bioenergy Phase I Call, including oversight of the evaluation of each of the 20 proposals submitted by proponents in the Call as well as the negotiation of subsequent Electricity Purchase Agreements ("EPAs") with selected proponents. As part of this process, I supervised numerous employees as they carried out the procurement mandate of the Power Acquisitions group. One of those employees was Martin Kincade, who acted as Project Manager for Bioenergy Phase I, and was involved in the evaluation of the proposal submitted by Celgar and coordinating the negotiation of the terms of the Celgar EPA.

3. In his second witness statement Mr. Merwin suggests that I am not credible to testify about the negotiation of the exclusivity provision in the Celgar EPA or Side Letter Agreement because I did not liaise directly with Mr. Merwin on these issues. Mr. Merwin is mistaken. I was very familiar with and involved in all material and significant aspects of Mr. Kincade's discussions with Celgar concerning its proposal in Bioenergy Phase I, including the exclusivity provision in the EPA and the Side Letter Agreement. As the Manager responsible for the Bioenergy Phase I Call, I was Mr. Kincade's direct supervisor and oversaw his work. As such, it was my responsibility to be familiar with the details of the contractual negotiations, and Mr. Kincade and I discussed these matters on a frequent, if not, daily basis. Mr. Merwin is thus mistaken when he suggests that I do not have detailed knowledge of the negotiation related to the changes sought by Celgar for the exclusivity provision in the EPA or of the Side Letter Agreement.

[1] I provide an overview of the Power Acquisition function within BC Hydro in my first witness statement (Jim Scouras First Statement ("Jim Scouras Statement I"), ¶¶ 8-16).

4. In Section A of this witness statement, I describe in detail the negotiations between BC Hydro and Celgar that culminated in the Side Letter Agreement. In Section B, I explain how Mr. Merwin fails to address the Side Letter Agreement in his testimony. In Section C, I explain the nature, scope and effect of the Side Letter Agreement. In Section D, I will correct two factual mischaracterizations the Claimant makes with respect to the Standing Offer Program and the Power Smart Program. In Section E, I will correct the Claimant's mischaracterization of how generator baselines ("GBLs") were set in BC Hydro's 2002 call for power. And finally, in Section F, I will explain how a number of assumptions that Claimant's expert, Mr. Brent Kaczmarek, makes in his expert reports are incorrect.

A. NEGOTIATION OF THE SIDE LETTER AGREEMENT

5. In my first witness statement I explained certain details of the Bioenergy Phase I process.[2] The Request for Proposals ("RFP") was issued by BC Hydro on February 6, 2008, and targeted the procurement of 1,000 GWh/year of firm energy.[3] We released an RFP schedule, which detailed the various steps in the call process. Interested proponents were to submit bids into the Call by June 10, 2008. BC Hydro held two information sessions in February/March 2008 to provide detailed information on the Call, including the purpose and method of setting a GBL in an EPA for proponents.[4]

6. As discussed in my first witness statement, these sessions dealt with, among other things, GBL issues including the purpose and method of setting a GBL in an EPA for customer projects.[5]

7. Pursuant to the RFP schedule, BC Hydro released a Specimen EPA on its website on May 7, 2008. The Specimen EPA reflected BC Hydro's standard terms and

[2] Jim Scouras Statement I, ¶¶ 36-45.

[3] BC Hydro, Bioenergy Call for Power – Phase I, Request for Proposals, 6 February 2008, p. 1, **R-25**.

[4] It is my understanding that Mr. Merwin and Celgar's counsel attended the workshop (*see* Jim Scouras Statement I, ¶ 42, fn. 46).

[5] Jim Scouras Statement I, ¶ 42.

conditions, in definitive agreement form, for the EPA.[6] Section 7.4 of the Specimen EPA contained the following "exclusivity provision":

> "7.4 Exclusivity - The Seller shall not at any time during the Term commit, sell or deliver any Energy to any Person, other than the Buyer under this EPA, except:
>
> (a) Pre-COD Energy sold to third Persons in accordance with section 7.1;
>
> (b) during any period in which the Buyer is in breach of its obligations under section 7.3; and
>
> (c) during any period in which the Buyer is not accepting deliveries of Eligible Energy from the Seller due to Force Majeure invoked by the Buyer."[7]

8. The exclusivity provision prevents proponents from selling their self-generated electricity to parties other than BC Hydro except in limited circumstances. BC Hydro has used a standard exclusivity provision in all of its power procurement processes since 2007 and every EPA signed since then has contained such a provision. The main purpose of the exclusivity provision is to provide certainty to BC Hydro that it will have the security of supply that it has contracted for with project proponents.

9. Without an exclusivity provision a proponent could elect to sell its electricity to a third party and not BC Hydro, even if the proponent would incur liquidated damages under the EPA. Such a scenario would result in BC Hydro not receiving the full benefit of the electricity under the EPA and would, thus, significantly undermine the firmness of the security of supply that BC Hydro is seeking to achieve with an EPA. The exclusivity provision provides greater certainty that BC Hydro will in fact receive the benefit of the electricity under the EPA and protects BC Hydro's procurement of electricity.

10. The same holds true whether or not the EPA has a GBL – the exclusivity provision is necessary to provide BC Hydro with the certainty it is seeking for the energy BC Hydro is procuring under the EPA. Moreover, to suggest that an EPA with a GBL

[6] BC Hydro, Bioenergy Call for Power Phase 1, Specimen Electricity Purchase Agreement, **R-114**, ("The Specimen EPA reflects BC Hydro's preferred terms and conditions, in definitive agreement form, for the EPA.").

[7] Specimen EPA, s. 7.4 – Exclusivity, **R-114**.

should allow a customer with self-generation to sell electricity to third parties below the GBL is nonsensical from a utility perspective. In such a situation, the self-generator would be seeking to have BC Hydro provide additional power from its resource stack to meet the customer's sale to the third party below the GBL. BC Hydro would then be providing additional electricity to meet the self-generator's transaction with the third party. This additional service obligation to be undertaken by BC Hydro would entirely erode the purpose of the EPA, which is to procure additional electricity for BC Hydro's resource stack.

11. Addendum 8 to the RFP, which was issued in conjunction with the Specimen EPA on May 7, 2008, explained that proponents wishing to submit a bid on June 10, 2008, could propose variations to the Specimen EPA. If a proponent wished to propose any variations, it was required to "download the document and prepare a revised version, redlined or otherwise clearly marked to show proposed revisions."[8] On May 28, 2008, BC Hydro held a proponent workshop, which included an overview of the Specimen EPA and a discussion of the key contractual provisions. It is my understanding that Mr. Merwin and Celgar's counsel attended the workshop.[9]

12. On June 10, 2008, Celgar submitted a proposal into the Bioenergy Phase I Call, which incorporated the 349 GWh/year GBL set in conjunction with BC Hydro's Key Accounts Management group.[10] Mr. Merwin testifies that he accepted the 349 GWh/year GBL "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

[8] BC Hydro, Bioenergy Call for Power (Phase 1) – Addendum 8, **R-121**, ("Proponents wishing to submit with their Proposal any variations to the Specimen EPA should download the document and prepare a revised version, redlined or otherwise clearly marked to show proposed revisions, and identifying clearly 'Essential Variations' and 'Value Variations'.").

[9] Jim Scouras Statement I, ¶ 42, fn. 46.

[10] BC Hydro, Bioenergy Call for Power (Phase 1) – Addendum 8, **R-128**. In a matter unrelated to the Side Letter Agreement, I have been made aware of the fact that at the time Celgar made its bid into the Bioenergy Call for Power it held a Ministerial Order pursuant to which it had committed to use one of its turbines for self-supply. If that is correct, then I would have expected Celgar to disclose this fact when it submitted its proposal which included a GBL. BC Hydro relied on Bioenergy Phase I Call applicants to identify the permits and orders that related to their self-generation. In my view, it would have been Celgar's responsibility to raise relevant authorizations or exemptions relating to its ability to self-generate electricity.

interested in buying."[11] It is unclear to me how Mr. Merwin could have had this understanding in light of the exclusivity provision in the Specimen EPA. Nor would BC Hydro have conveyed to Mr. Merwin that the exclusivity provision would not apply to Celgar. Contrary to Mr. Merwin's understanding, when Celgar submitted its bid on June 10, 2008 it did so along with a redlined copy of the Specimen EPA which showed no revisions to the exclusivity provision at section 7.4 of the Specimen EPA.[12]

13. In his second witness statement, Mr. Merwin states that he reviewed the Specimen EPA and "did not consider the exclusivity provision to be significant or relevant to a limitation on sales of Celgar's below-GBL electricity."[13] He states: "I construed the provision to apply only when BC Hydro was committing to purchase all of the Seller's electricity."[14] Section 7.4 of the Specimen EPA does not, however, make any such distinction; it limits the sale of all electricity to BC Hydro with only limited exceptions. Had that in fact been Mr. Merwin's understanding, it is unclear why Celgar did not strike out the exclusivity provision in the redlined EPA it submitted with its bid into the Bioenergy Phase I process on June 10, 2008.[15]

14. BC Hydro received 20 proposals from proponents in the Bioenergy Phase I on June 10, 2008. To determine which proposals would advance to the next phase of the Call, we considered, among other things, bid prices,[16] fuel plans,[17] and risk assessments.[18]

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[11] Merwin Statement I, ¶ 103; Merwin Statement II, fn. 16. Mr. Merwin also testifies that after Celgar made its bid into the call it "continued to argue for alternative GBLs, including for BC Hydro to treat the additional electricity resulting from the Blue Goose Project as new generation, and not include it in the GBL" (*see* Merwin Statement I, ¶ 102). I am not, however, aware of any correspondence between the date of Celgar's bid into the Bioenergy Phase I Call (June 10, 2008) and its signature of the EPA and Side Letter Agreement (January 27, 2009) that indicates any objections to the GBL from Celgar. I have also spoken with Lester Dyck and Martin Kincade on this issue, neither of whom recall any such objections.

[12] Letter from Jimmy Lee to BC Hydro, June 10, 2008, **R-472**.

[13] Merwin Statement II, ¶ 10.

[14] Merwin Statement II, ¶ 10.

[15] Letter from Jimmy Lee to BC Hydro, June 10, 2008 attaching a redlined copy of the Speciment Electricity Purchase Agreement (EPA), **R-496**.

[16] Used to calculate an adjusted firm energy bid price in order to determine relative cost-effectiveness.

[17] Assessed the achievability of fuel plans and their impact on existing biomass users.

15. Of the 20 proposals, 10 advanced to the next phase of the Call. Meetings were held in August 2008 to discuss evaluation concerns and identify additional information requirements. Following the receipt of further information from the selected proponents, BC Hydro re-evaluated the 10 proposals and eliminated four proposals based on excessive risk and/or unacceptable bid prices. Celgar's proposal was one of the six proposals that advanced to the next phase of the Bioenergy Phase I Call.

16. On September 25, 2008, BC Hydro sent a draft EPA to Celgar and suggested an in-person meeting to conduct a "page turn" of the agreement and to discuss any issues.[19] The draft EPA contained the same exclusivity provision as the Specimen EPA, but with an additional exception at subsection 7.4(b):

> "7.4 Exclusivity - The Seller shall not at any time during the Term commit, sell or deliver any Energy to any Person, other than the Buyer under this EPA, except:
>
> (a) Pre-COD Energy sold to third Persons in accordance with section 7.1;
>
> (b) that portion of the Energy generated in any Season during the Term after COD that is less than the Seasonal GBL, and greater than the Mill Load, in each case for that Season;
>
> (c) during any period in which the Buyer is in breach of its obligations under section 7.3; and
>
> (d) during any period in which the Buyer is not accepting deliveries of Eligible Energy from the Seller due Force Majeure invoked by the Buyer."[20]

17. This additional exception in subsection 7.4(b) was included in the draft EPAs sent out to all remaining proponents with customer projects in the Bioenergy Phase I Call. Subsection 7.4(b) simply recognizes that during the term of the EPA, for a customer project with a fixed GBL, a situation may arise where a customer's mill load has decreased below its GBL. If this situation were to arise, a customer would have generation in excess of its mill load, but below its GBL, and the sale of such excess generation to a third party was an acceptable exception under the exclusivity clause.

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[18] Assessed First Nations, finance and construction/permitting risk to determine potential "showstoppers."

[19] Letter from BC Hydro to Brian Merwin dated September 25, 2008, **R-129**.

[20] Letter from BC Hydro to Brian Merwin dated September 25, 2008, **R-129**; Draft BC Hydro Electricity Purchase Agreement, Bioenergy Call for Power – Phase I, Celgar Green Energy, September 25, 2008, **R-130**.

18. On September 30, 2008, Mr. Kincade and other BC Hydro representatives met with Mr. Merwin and other Celgar representatives, largely to discuss the draft EPA. Among other things, the parties discussed the exclusivity provision which Mr. Merwin raised as an issue. To the best of my knowledge, this was the first time that Mr. Merwin had raised concerns about the exclusivity provision.

19. On October 8, 2008, Mr. Merwin sent a redlined version of the draft EPA with several proposed changes, including to the exclusivity provision:

> "7.4 Exclusivity - The Seller shall not at any time during the Term commit, sell or deliver any Energy to any Person, other than the Buyer under this EPA, except:
>
> (a) Pre-COD Energy sold to third Persons in accordance with section 7.1;
>
> (b) that portion of the Energy generated in any Season during the Term after COD [redacted]
>
> (c) during any period in which the Buyer is in breach of its obligations under section 7.3; and
>
> (d) during any period in which the Buyer is not accepting deliveries of Eligible Energy from the Seller due Force Majeure invoked by the Buyer."[21]

20. Mr. Merwin's proposed amendment would exempt from the exclusivity provision all of Celgar's below-GBL electricity to a third party. This substantive EPA revision raised serious concerns for BC Hydro. First, the proposed change would have provided Celgar a broader exception to the exclusivity provision than was being offered to any of the other proponents. No other proponent in the Bioenergy Phase I Call was going to be provided with any such amendment to the exclusivity provision of the EPA. We were thus concerned with giving Celgar preferential treatment.

21. Second, allowing such third party sales had the potential of eroding the procurement of additional electricity under the EPA. While Celgar is not a load customer of BC Hydro, it is a load on the BC Hydro system because BC Hydro supplies electricity to FortisBC through the 1993 Power Purchase Agreement signed between BC Hydro and FortisBC. Concurrent with the EPA negotiations with Celgar, FortisBC was

[21] Letter from Brian Merwin to BC Hydro RFP Administrator dated October 8, 2008, **R-132**, Draft BC Hydro Electricity Red-line Purchase Agreement, Bioenergy Call for Power – Phase I, Celgar Green Energy, October 8, 2008, **R-133**.

seeking to use energy supplied by BC Hydro under the 1993 PPA to enable FortisBC self-generating customers (which included Celgar) to make below-load export market sales. Although FortisBC was prohibited under the 1993 PPA to make export sales itself while taking PPA energy, FortisBC was looking to purchase additional low-cost power from BC Hydro under the 1993 PPA and resell it to its self-generating customers to enable such customers to export the electricity to third parties. By modifying the exclusivity provision to allow any sales to third parties below Celgar's GBL, Celgar effectively wanted BC Hydro to supply additional power to meet Celgar's export sales to third parties. This additional draw on BC Hydro's electricity resources would have negated the benefit of procuring any additional electricity supply from Celgar under the Bioenergy Phase I EPA.

22. Third, BC Hydro was concerned that Mr. Merwin's proposal would be interpreted as an admission by BC Hydro that Celgar was permitted to engage in the arbitrage of BC Hydro power. As explained in the previous paragraph, FortisBC was hoping to buy low-cost power from BC Hydro pursuant to the 1993 PPA so that its customers would be enabled to export self-generated power. Without an exclusivity provision, BC Hydro was concerned that such export sales by FortisBC's self-generating customers would constitute arbitrage of PPA energy, which would be harmful to BC Hydro and its ratepayers.

23. Finally, at the time of the negotiating the EPA, the issue of FortisBC's right to purchase additional 1993 PPA power from BC Hydro to allow FortisBC to facilitate export sales by FortisBC's self-generating customers was being reviewed by the British Columbia Utilities Commission ("BCUC") through a public hearing process.[22] We were thus concerned that agreeing to Mr. Merwin's exclusivity revisions might prejudice our position in that proceeding.

24. In preparation for a follow-up meeting with Celgar, we wrote a letter to Mr. Merwin on October 17, 2008 identifying our issues with his redlined EPA. With respect to

[22] The resultant proceeding became the "BC Hydro Power Purchase Agreement to Amend Section 2.1 of Rate Schedule 3808" pursuant to BC Hydro's application dated September 16, 2008.

Mr. Merwin's proposed change to the exclusivity provision we wrote: "Your ability to sell power below GBL, regardless of Mill Load, remains a concern for us."[23]

25. At the meeting held on October 21, 2008, Mr. Merwin maintained his objection to the exclusivity provision. He argued that Celgar's right to arbitrage BC Hydro power through the 1993 PPA should be decided by the BCUC. We told Mr. Merwin that Celgar's proposed amendment could potentially undercut the additional electricity BC Hydro was looking to procure under the EPA. We also told him that we did not want to prejudice our position in the ongoing BCUC proceedings regarding export sales by FortisBC's self-generating customers. Nonetheless, we wanted to be responsive to the interests of Celgar because we did not want to forgo the opportunity to procure its incremental energy. A go-forward option that was tabled to resolve this impasse was to sign an accompanying "Side Letter Agreement" with the EPA that would allow the parties to conclude the EPA without each party prejudicing its interests in the ongoing BCUC proceeding.[24] Shortly after the October 21st meeting, BC Hydro began working on a draft Side Letter Agreement.

26. While a resolution to the exclusivity provision was being worked out between BC Hydro and Celgar, the parties continued to advance discussion on other issues in the draft EPA. To that end Mr. Kincade sent a revised draft EPA to Celgar on October 28, 2008, addressing a number of issues, [redacted] Mr. Merwin is correct that the revised EPA draft sent by Mr. Kincade included the subsection 7.4(b) exclusivity language proposed by Mr. Merwin on October 8, 2008.[25] However, he is incorrect in asserting that this version "was to be the final text" and that BC Hydro "expressly permitted Celgar to sell below-load GBL

[23] Letter from BC Hydro RFP Administrator to Brian Merwin, RE: Bioenergy Call for Power - Phase I, Celgar Green Energy Project, dated October 17, 2008, **R-134**.

[24] In his second witness statement, Mr. Merwin alleges [redacted] (Merwin Statement II, ¶ 12). While removal of the provision was discussed at the meeting [redacted] as this would have, among other things, prejudiced BC Hydro's position in front of the BCUC.

[25] Merwin Statement II, ¶ 12.

energy to third parties."[26] Not only were the parties at that time still negotiating a number of provisions in the EPA, including the exclusivity provision and Side Letter Agreement, but Mr. Kincade's email to Mr. Merwin attaching the draft EPA clearly stated that the draft was subject to further review and modifications.[27] Had Mr. Merwin actually believed at that time that the negotiations were finished I would assume he would have protested any further negotiations of the EPA. He did not.

27. On November 7, 2008, we provided Mr. Merwin with a first draft of the Side Letter Agreement which expressed BC Hydro's agreement that should the BCUC determine that FortisBC could offset the diversion of a customer's self-generation to third party sales, then section 7.4(b) of the EPA would be amended to enable Celgar to make such third party sales, subject to any conditions that may be included in a BCUC order.[28] Along with the draft Side Letter Agreement, we concurrently sent Mr. Merwin another revised draft EPA using the subsection 7.4(b) exclusivity provision from the initial draft EPA provided to Celgar on September 25, 2008.[29]

28. On November 10, 2008, Mr. Moller, Celgar's legal counsel, provided us with a redlined copy of the EPA, which accepted section 7.4 in its original form as proposed by BC Hydro. He also provided us with a redlined copy of the Side Letter Agreement, stating:

> "We have amended the Side Letter to reflect that in the event that a electricity supply agreement between Celgar and FortisBC is accepted for filing by the BCUC, which provides that Celgar is entitled to purchase its Mill Load requirements from FortisBC while generating power for this party sales, then the Mill Load limitation under Section 7.4(b) shall no longer apply."[30]

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[26] Merwin Statement II, ¶ 13.

[27] **C-283** ("Please find attached a clean and redline version of the latest contract draft. Please note that this remains subject to review and revision by BC Hydro and its advisors.").

[28] Email from Martin Kincade to Brian Merwin, November 7, 2008, **R-473**, MER00031151-MER00031152.

[29] Email from Martin Kincade to Brian Merwin, November 7, 2008, **R-474**, CAN372789; Clean copy of the EPA, **R-475**, MER00189330**;** Redline version of the EPA, **R-476**, MER00189428

[30] Letter from K.C. Moller to BC Hydro, November 10, 2008, **R-477**, CAN370914.

29. On November 13, 2008, we wrote to Celgar responding to Mr. Moller's letter of November 10, 2008, enclosing further revisions to the draft Side Letter Agreement. The letter stated:

30. On November 14, 2008, Mr. Moller proposed a minor insertion to the wording of paragraph 3 of the Side Letter Agreement.[32] On November 18, 2008, we wrote again to Celgar providing a "revised, clean and redlined side letter" for consideration along with a revised EPA.[33] On the same date, Mr. Moller wrote back stating "I have reviewed the latest changes to the EPA and Side Letter with my client and we are content with your final revisions."[34]

31. Mr. Merwin alleges in his testimony that it was in the "11th hour" that BC Hydro "insist[ed] on an amendment to [the EPA] that would prohibit Celgar from selling any below-GBL electricity to third parties."[35] He implies that BC Hydro somehow pressured Celgar into agreeing to the exclusivity provision. As my explanation above confirms, Mr. Merwin is mistaken. Celgar was made aware of the exclusivity provision when BC Hydro released the Specimen EPA on May 7, 2008, before Celgar had even made its bid into the Bioenergy Phase I Call. Nor am I aware that at any time during the negotiations did Celgar indicate that negotiations were proceeding too quickly. To the contrary, after careful, deliberate and timely negotiations, the parties

[31] Email from Martin Kincade to Brian Merwin, November 13, 2008, **R-478**, CAN372833.

[32] Email from Kim Moller to BC Hydro, November 14, 2008, **R-479**.

[33] Email from Martin Kincade to Brian Merwin et al, November 18, 2008, **R-480**, CAN372846.

[34] Email from K. Moller to M. Kincade and B. Merwin, November 18, 2008, **R-481**, CAN371023.

[35] Merwin Statement I, ¶¶ 103-104; Merwin Statement II, ¶ 13.

were able to agree on the EPA and the Side Letter Agreement.[36] Both documents were sent to BC Hydro's Board of Directors and were approved on November 19, 2008. On the following day, we advised Mr. Merwin that our Board had [redacted] >[37] On December 8, 2008, BC Hydro announced that it had selected four Bioenergy Phase I proposals for EPA awards, including Celgar's bid. The EPA and Side Letter Agreement were both signed by BC Hydro and Celgar on January 27, 2009.[38]

B. MR. MERWIN FAILS TO DISCUSS THE SIDE LETTER AGREEMENT IN HIS TESTIMONY

32. When Mr. Merwin recounts the negotiation of the EPA's section 7.4 exclusivity provision in his second witness statement, he fails to make any mention of the Side Letter Agreement. Section 7.4 of the EPA and the Side Letter Agreement were, however, negotiated together – the two go hand in hand. It is unclear to me why Mr. Merwin would omit from discussion this important agreement (which I discuss in more detail below) in relation to the Celgar EPA.

33. In my view, BC Hydro has acted entirely reasonably in its negotiation of the EPA and Side Letter Agreement with Celgar. In fact, no other pulp mill to date in any BC Hydro power procurement process (including the Bioenergy Call for Power Phase I) has been given the same preferential treatment. To the contrary, every mill that has signed an EPA with BC Hydro has been subject to the same exclusivity provision found in section 7.4 of the 2009 EPA with Celgar. No other EPA proponent has been offered a similar Side Letter Agreement with BC Hydro.

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[36] In fact, Mr. Moller wrote BC Hydro on November 18, 2008, stating: "On Friday we suggested that the drop dead date for our client's Director approval be November 26, subject to confirmation. I have received confirmation that such date is achievable and will insert it in the Offer Letter." **R-481**, [CAN 371023] BC Hydro had also expressly stated its desire to give Celgar "as much time as possible to review" the EPA and Side Letter Agreement (*see* **R-478**, CAN372833).

[37] Letter from BC Hydro to Brian Merwin, November 20, 2008, **R-482** [Bates # 028879].

[38] BC Hydro and Zellstoff Celgar Limited Partnership Electricity Purchase Agreement, Bioenergy Call for Power – Phase I, dated January 27, 2009 ("Celgar 2009 EPA") **R-135**, Side Letter Agreement between BC Hydro and Zellstoff Celgar Limited Partnership, RE: Electricity Purchase Agreement, with Effective Date of January 27, 2009 ("EPA"), dated January 27, 2009, bates 026183-026184, **R-138**.

C. THE EFFECT OF THE SIDE LETTER AGREEMENT

34. The Side Letter Agreement establishes two essential principles. First, the Side Letter Agreement states that the inclusion of section 7.4(b) of the exclusivity clause is "without prejudice" to the right of Celgar

> "(i)…to take a position *in any other pending or future regulatory proceeding before the BCUC*, the effect of which if such position were to prevail in that proceeding, would be that (A) FortisBC may supply electricity to [Celgar] to serve the [Celgar's] Mill Load, in circumstances where [Celgar] sells self-generated electricity diverted from serving Mill Load, (B) [Celgar] may sell such self-generated electricity in those circumstances, and (C) section 7.4(b) of the EPA in its present form should have no force or effect."[39]

35. Second, the Side Letter Agreement states that

> "If the BCUC makes an order *in any pending or future regulatory proceeding* upholding the position described in paragraph (1)(i) above, then subject to the outcome of any reconsideration or appeal thereof, the Parties shall execute and deliver an agreement amending the EPA to substitute the alternate section 7.4(b) for that section in the present EPA, which amendment shall be filed with the BCUC under section 71 of the UCA and shall be subject to acceptance by the BCUC."[40]

36. It is my understanding that Celgar has attempted to exercise its rights under the Side Letter Agreement before the BCUC. For example, in the BCUC G-188-11 proceedings, Celgar requested that the BCUC set a GBL between FortisBC and Celgar so that Celgar could exercise its rights under the Side Letter Agreement.[41] BC Hydro had agreed that "if the Commission upholds [Celgar's] GBL Application, the BC Hydro will fulfill its commitment to amend [Celgar's EPA] by replacing

[39] Side Letter Agreement between BC Hydro and Zellstoff Celgar Limited Partnership, RE: Electricity Purchase Agreement, with Effective Date of January 27, 2009 ("EPA"), dated January 27, 2009, bates 026183-026184, ¶ 1, **R-138**. [Emphasis added]

[40] Side Letter Agreement between BC Hydro and Zellstoff Celgar Limited Partnership, RE: Electricity Purchase Agreement, with Effective Date of January 27, 2009 ("EPA"), dated January 27, 2009, bates 026183-026184, **R-138**, ¶ 2. [Emphasis added]

[41] Letter from K.C. Moller, Re: Zellstoff Celgar Limited Partnership ("Celgar") Complaint Regarding the Failure of FortisBC Inc. ("FortisBC") and Celgar to Complete a General Service Agreement and FortisBC's Application of Rate Schedule 31 Demand Charges (the "Complaint") – Project No. 3698636, dated September 1, 2011, p 2, **R-483**.

paragraph 7.4(b) with the 'alternate 7.4(b)' in accordance with the EPA Side Letter."[42]

37. While I am not familiar with these BCUC proceedings, it is my understanding that the BCUC agreed that Celgar should be allowed to "sell all or a portion of its generation below the BC Hydro GBL into the market and supply its mill from FortisBC resources, not including BC Hydro PPA power."[43] To that end, the BCUC mandated FortisBC to establish a rate with Celgar for the cost of the electricity that would replace Celgar's sales.[44]

38. In light of this decision, Mr. Merwin wrote BC Hydro on December 6, 2011, requesting "that BC Hydro enter into an amendment agreement effecting the changes to the EPA contemplated by the Letter Agreement."[45] While a rate had not yet been established between FortisBC and Celgar per the BCUC's Decision and Order, [redacted] Hence, BC Hydro initiated discussions with FortisBC with respect to determining how the accounting would be done for Celgar's EPA sales to BC Hydro in conjunction with the rate and services to be provided by FortisBC.

39. These discussions, however, never concluded. On January 26, 2012, the Claimant filed its Notice of Intent under the NAFTA against the Government of Canada and did not follow up with respect to its request to amend its EPA.

40. It is my understanding that the Claimant alleges in this NAFTA case that BC Hydro prohibited Celgar from selling its below-GBL electricity to third parties.[46] In my view, this assertion is incorrect and misleading. I have reviewed the Claimant's Reply

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[42] FortisBC Inc., "2009 Rate Design and Cost of Service. Reply Argument of BC Hydro", July 23, 2010, p. 6, line 7, **R-484**.

[43] BCUC, Decision and Order G-188-11, November 14, 2011, p. 49, **R-275**.

[44] BCUC Order G-188-11, ¶ 4, **R-44**.

[45] Letter from Brian Merwin to BC Hydro, December 6, 2011, **R-485**, CAN003246.

[46] *See* e.g. Claimant's Reply, ¶ 36. ("Mercer takes issue…with the restriction BC Hydro placed on Celgar's sales of its below-GBL energy *to third parties*, effectuated through the GBL and related exclusivity provisions in Section 7.4(b) of the 2009 EPA.").

and note that the Claimant only mentions the Side Letter Agreement once in a footnote.[47] As explained above, neither does Mr. Merwin address the agreement in his witness statement. It is, however, not possible to understand the nature or scope of the EPA's exclusivity provision without the Side Letter Agreement, which was executed concurrently with the EPA.

D. THE CLAIMANT'S ALLEGATIONS RELATING TO THE STANDING OFFER PROGRAM AND POWER SMART PROGRAM

41. It is my understanding that Mercer suggests that BC Hydro, through its Standing Offer Program (which I discuss briefly in my first witness statement),[48] agreed to purchase "existing" rather than "new" electricity.[49] In doing so, Mercer points to minor changes to the language of some of the Standing Offer Program Rules which were made in 2014.[50]

42. Mercer is mistaken. Section 2.7 of the current Standing Offer Program Rules clearly states:

> "[I]f there is any existing generation located Behind the Customer Load, a generator baseline will be set for each month based on the historical generation of the existing generation facility. BC Hydro will only purchase energy from incremental generation added to the existing generation in excess of the generator baseline. The generator baseline will not be adjusted to reflect variations in the customer's energy consumption".[51]

This eligibility requirement was not a change from the initial set of Rules. The Standing Offer Program Rules that were first issued in April 2008 provide in Section 3.3, under the heading "Eligible Generation", that:

> "If Common Generation Facility is behind a Customer Load:
>
> …

[47] *See* Claimant's Reply, fn. 699, where they acknowledge that "resolution of Celgar's below-GBL sales" were left to the BCUC.

[48] Jim Scouras Statement I, ¶ 14.

[49] Claimant's Reply, ¶ 168.

[50] *See* Claimant's Reply, fn 3, ¶ 168.

[51] BC Hydro, "Standing Offer Program; Program Rules," version 2.5, November 2014, p 4, **R-486**.

> a generator baseline will be set for each month based on the historical generation of the existing generation facility and if a portion of the electricity from the Common Generation Facility is under contract to a third party, the existing contracted electricity. The generator baseline will not be adjusted to reflect variations in the customer's energy consumption."[52]

43. Thus, for an "existing generation facility" the Standing Offer Program Rules have consistently included a requirement for a GBL based on the historical generation of the existing generation facility. BC Hydro's EPA with the Louisiana-Pacific Canada Ltd. sawmill in Golden, B.C., which was concluded in May 2011, is an example of an agreement under the Standing Offer Program with a self-generator and this agreement includes a GBL.[53] Contrary to Mercer's allegation, BC Hydro has applied the same GBL principles for Standing Offer Program contracts as used for the EPAs with other self-generating customers.

44. Mercer also suggests that under its Power Smart Program, BC Hydro enters into load displacement agreements "without regard to whether the self-generator could or would have installed the generation on its own."[54] Mercer is again mistaken – we would not enter into a Load Displacement Agreement if we believe that the customer would proceed with the project on its own without a BC Hydro financial incentives.

E. THE CLAIMANT'S ALLEGATIONS RELATING TO THE GBL SETTING METHODOLOGY APPLIED BY BC HYDRO UNDER THE 2002 CALL FOR POWER

45. It is my understanding that Mercer alleges that how GBLs were set under BC Hydro's 2002 Customer-Based Generation call for power was different than how BC Hydro set GBLs in the Bioenergy Phase I Call. Specifically, they allege that BC Hydro assessed three years of operating data in the 2002 call, but only one year of data in the Bioenergy Phase I Call.[55]

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[52] BC Hydro, Standing Offer Program Rules, 11 April 2008, pp. 4-5, **R-487**.

[53] BC Hydro LP Golden Biomass Electricity Purchase Agreement Standing Offer Program, 6 May 2011, Appendix 4 **R-488**.

[54] Claimant's Reply, ¶ 168.

[55] *See* e.g. Claimant's Reply, ¶ 22.

46. Mercer is again mistaken. In both calls BC Hydro assessed at least three years of data when setting GBLs. The purpose in both calls was to use historical data to identify the customer's generation output used to self-supply its plant load over a 365-day period under normal current operating conditions. As I discussed in my first witness statement,[56] only three EPAs were signed through the 2002 Customer-Based Generation call and none of them were with self-generators with GBLs.

F. CERTAIN FACTUAL ASSUMPTIONS IN MR. BRENT KACZMAREK'S EXPERT REPORT ARE WRONG

1. Mr. Kaczmarek's Assumptions Relating to Seller Consumed Energy are Wrong

47. I briefly explained Seller Consumed Energy in my first witness statement[57] and will elaborate on my discussion of that arrangement here.

48. Following BCUC Order G-48-09, [redacted] Although the EPA permitted Celgar to sell to BC Hydro electricity above its GBL, BCUC Order G-48-09 prohibited FortisBC from serving Celgar with energy purchases from BC Hydro under the 1993 PPA to meet the increased mill load while Celgar was simultaneously selling power. As a result, FortisBC took the position that it could only schedule net of load export sales for its self-generating customers and that it was unable or unwilling to serve Celgar's load if Celgar was simultaneously exporting.

49. In order to accommodate Celgar for being unable to schedule EPA sales above its GBL and below its increased load level, BC Hydro entered into [redacted] with Celgar pursuant to which [redacted][58]

[56] Jim Scouras Statement I, ¶¶ 24-33.

[57] Jim Scouras Statement I, ¶¶ 60-63. *See* also Canada's Counter-Memorial, ¶¶ 256-260.

[58] BC Hydro entered into this arrangement in order to allow the EPA to function with the GBL agreed to by the parties and to reach a resolution with Celgar on how to do the accounting under the agreement. [redacted]

[redacted]

50. It is my understanding that Mr. Kaczmarek assumes that if Celgar had negotiated a lower GBL with BC Hydro in April/May 2008, a year before the BCUC issued its Decision in Order G-48-09, then BC Hydro would have still entered into the Seller Consumed Energy arrangement with Celgar.[59] This assumption is false. Seller Consumed Energy was not offered as part of the Bioenergy Phase I Call, but was an imperfect solution offered by BC Hydro to Celgar in a very unique circumstance. BC Hydro did so in this circumstance [redacted] If Celgar had negotiated a lower GBL with BC Hydro, a different accounting arrangement would have been needed between BC Hydro, FortisBC and Celgar. [redacted]

[redacted]

[59] Kaczmarek Statement II, ¶ 93 ("[I]f the Tribunal finds that Celgar's GBL was set too high but that BCUC Order G-48-09 is appropriate under the NAFTA, then we would expect the parties to continue [the Seller Consumed Energy] arrangement.").

[60] [redacted]

[redacted]

2. Mr. Kaczmarek's Assumptions Relating to BC Hydro's Incentivized Prices Biomass-Generated Electricity are Wrong

51. In his second expert report, Mr. Kaczmarek implies that BC Hydro was willing to pay high prices for biomass-generated electricity out of a concern that proponents in the Bioenergy Phase I Call for Power would elect instead to participate in other calls outside of British Columbia.[61] BC Hydro's prices were not based on this concern. While we did examine the prices for biomass-generated electricity in other calls, we did so only to assess the reasonableness of Bioenergy Phase I power prices and not out of a concern that proponents might elect instead to participate in such other calls.

3. Mr. Kaczmarek's Assumption that BC Hydro would Buy Celgar's Below-GBL Electricity is Wrong

52. In his second expert report, Mr. Kaczmarek assumes that Celgar's below load generation would be an attractive source of green energy for BC Hydro. Mr. Kaczmarek states that were it not for the "unlawful measures" BC Hydro would have likely purchased Celgar's below load electricity because 1) BC Hydro would want this electricity to remain within BC Hydro's system, 2) Celgar's self-generated electricity could be offered at a lower cost than that of other generators, and 3) Celgar's below-load GBL self-generated electricity would serve to help BC Hydro meet its resource stack.[62] Mr. Kaczmarek's analysis is completely flawed.

53. First, BC Hydro is not interested in buying existing self-generated electricity. This would be completely contrary to our GBL-based procurement practice for existing self-generators and would contravene government policy and BCUC rulings dealing

[redacted]

[61] Kaczmarek Statement II, ¶¶ 79-83.

[62] Kaczmarek Statement II, ¶¶ 51-59.

with arbitrage. Presuming the BCUC concluded that it was permissible for FortisBC to use PPA energy to facilitate its customers' export sales does not change the eligibility requirements under BC Hydro's procurement processes. As discussed in my first witness statement, BC Hydro was only seeking new or incremental self-generation from customer projects, not "existing" electricity.[63] Second, if BC Hydro were seeking to buy existing self-generated electricity on the system, Mr. Kaczmarek needs to compare Celgar's offered price to the price that other self-generators would be offering for existing self-generation. The prices would certainly not be the same as prices that were offered for "new" or "incremental" generation on the system. And third, purchasing existing electricity does not contribute to BC Hydro's resource stack, as Mr. Kaczmarek alleges. As explained above, at the time of negotiating the EPA FortisBC was looking to supply its self-generating customers with replacement electricity sourced from PPA power. BC Hydro would essentially be selling lower cost electricity and then buying it back from Celgar at higher prices.

54. The end result of Mr. Kaczmarek's analysis is that BC Hydro would be procuring existing self-generation from a customer project (which the customer is already generating to meet its own load), paying a price for energy that is not benchmarked to a price for existing generation, and then concurrently agreeing to "serve" the customer's freed-up load at embedded cost rates. Such a proposal makes no sense from a business perspective and certainly would not pass regulatory scrutiny by the BCUC. Furthermore, it would be contrary to B.C. government policy regarding the sale of existing self-generation historically used to meet a self-generator's load.[64]

* * *

[63] Jim Scouras Statement I, ¶¶ 44-45. *Also see* Bioenergy Call for Power – Phase I RFP document, ¶ 14, dated February 6, 2008, **R-25**.

[64] Les MacLaren Statement I, ¶ 90.

55. I affirm that the information provided above is true and correct.

AFFIRMED BEFORE ME)
at the City of Vancouver,)
in the Province of British Columbia,)
this 30th day of March, 2015.)
)
)
)
)

A Commissioner for taking Affidavits for British Columbia.

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JIM SCOURAS