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From: Craig Ennis [CEnnis@bot.nf.ca]
Sent: February 28, 2012 8:55 AM
To: PUB Muskrat Falls Review
Subject: submission for consideration
Attachments: St. John's Board of Trade submission on Muskrat Falls to the PUB - February 27-2012.pdf

Good morning Ms. Blundon,

Please find attached a submission from the St. John's Board of Trade regarding the question before the PUB on Muskrat Falls.

Thank you for your attention to this and best of luck at the PUB.

Craig

BOARD OF COMMISSIONERS OF PUBLIC UTILITIES
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ST. JOHN'S, NL

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St. John's BOARD of TRADE

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PUB submission
Muskrat Falls development

February 2012

Introduction

The Public Utilities Board is being asked to examine which is the lowest cost option: a Muskrat Falls generation facility and a Labrador-Island link or an Isolated Island Option (thermal at Holyrood). This submission aims to consider things within the scope of the review without making judgment regarding the scope itself nor alternative forms of energy production/transmission; additionally it will not touch on export opportunities as per the terms of reference for the PUB.

This province does have a growing need for electricity in the near future, and we have to plan for additional capacity in the short term; in fact, by 2020. Demand efforts such as conservation can help but there is a reality that the supply must be increased. Muskrat Falls is designed to be viable as a stand-alone project without exporting power. Any excess capacity that can be sold will produce a dividend for the province that can be put into the provincial treasury to deliver public services or could be rebated to ratepayers of Nalcor.

The St. John's Board of Trade is pleased overall with the robust gated process that Nalcor is using for evaluating the potential of Muskrat Falls. In particular, we welcome that Nalcor is considering alternative energy sources/projects and is gathering as much information as possible on a Muskrat Falls project before making a decision. Using today's analytical tools and methods cannot take risk out of the equation or predict the future, but it can ensure that the best possible information is available and can be assessed prior to project sanction.

Energy Policy Context

The Board of Trade recognizes that the PUB is being asked to examine a specific question regarding a Labrador link option as compared to an isolated Island option; it is not our intention to add to the PUB's already complex task by taking the question posed to it out of context but rather it is our intention to add to the context itself.

Energy policy should largely be investment policy: investment in local businesses who have to compete nationally and globally on cost and energy is a substantial contributor to those costs; investment in the ability of residents to have reliable and cost-effective energy; and, investments in the provincial treasury through a return paid by other partners such as Nova Scotia and/or the northeast U.S. Energy policy must be visionary in its conception and application with the goal of being a net contributor to the economy of Newfoundland and Labrador, not a detriment to internal or external investment.

Broad energy policy, as determined by elected officials in government, must consider a changing environment (technology, new sources, environmental or economic risks) while fighting over-analysis and inertia based on past failings. Broad energy policy must accept that things will change and this may impact the viability or profitability of a Muskrat Falls venture, either positively or negatively. It must also reconcile resistance to moving forward with legitimate forecasting that points to additional power being needed.

Energy policy must be flexible, and so it must be recognized that a $6 billion project does not allow for a great deal of flexibility; that is, the amount of money tied up in this project may preclude other projects from being taken on. If the venture turns out to be successful, then the substantial investment is warranted. If an incorrect decision is made, government and taxpayers will have limited options to course-correct. For this reason, while the Muskrat Falls project itself must go through a gated decision-making process, so must all energy policy. This must take place and it must be clearly conveyed by government, as the policy-makers, to the people of this province to ensure support for the Muskrat Falls or any project.

Principles

Fairness

There are three types of fairness to consider in the discussion around Muskrat Falls and thermal operations at Holyrood. They are fairness:

- between different groups of ratepayers;
- to taxpayers; and,
- inter-generational fairness.

Different groups:

Ratepayers will be subjected to an "escalating supply price" (the price per MWh of power actually used by ratepayers, expressed in real dollars subject to escalation at CPI) to recover costs. Meanwhile, Nalcor and its partners will receive a return on investment faster than ratepayers will see cost reductions or rebates. Both residents and businesses will be subject to the prices charged by Nalcor; both groups of ratepayers may need special consideration to be able to absorb the substantial near-term costs of financing and building Muskrat Falls so that they are in the case of residents able to afford energy and in the case of businesses able to afford to stay in business and compete. This is a policy decision that government will have to consider, and they will have to consider different approaches for the distinct groups of ratepayers.

Taxpayers

Adding to the province's debt (whether to finance a Muskrat Falls option or an isolated island approach) will have consequences for taxpayers because taxpayers do not have a choice of what government debt to support nor do they have conservation options that may be available to ratepayers to reduce their energy expenses. Recognizing that there are still limited choices for things like home heating and industrial electricity supply, there are still some choices for ratepayers (i.e. users). Taxpayers will not have choices; that is, all residents and businesses of the province will have to bear some burden for the construction of either option whether they get direct benefit or not. There may need to be some recognition that taxpayers who will fund the project but do not receive direct benefits (i.e. a resident or business that is not in a Nalcor-serviced area) may need special consideration compared to a taxpayer that gets both the direct (more reliable service and more predictable pricing) and indirect (contribution to provincial treasury) benefits.

Inter-generational

There are a couple of questions relevant to the question of which generation will pay the most for Muskrat Falls and which will see the most benefit:

- Will younger generations stay in Newfoundland and Labrador if the cost of living is too high?
- How will people on fixed incomes afford the higher cost of living from increasing debt to pay for a mega-project like Muskrat Falls?

A similar series of questions also applies to the isolated island option:

- Will current ratepayers and taxpayers see the benefit of a Holyrood option while later generations pay environmental and potential economical (i.e. carbon tax) costs?
- When is the next time that ratepayers and taxpayers will have to pay the bill for further upgrades/re-fits and how much will that cost?

These are more likely than not to be policy decisions for the government to consider rather than Nalcor to provide direction on or answers to within the Public Utilities Board review process, but they should be considered at the PUB level when reviewing the costs and benefits of each option.

Things to consider

Infrastructure

Much of the infrastructure discussion would focus around a new build of new infrastructure for hydro generation and transmission versus renewal of existing infrastructure for the thermal process. New infrastructure will obviously cost more up front while renewing existing infrastructure may tie Nalcor to a more expensive operation in the long term. Both projects are likely to have cost over-runs as major projects that span challenging remote and rural geographies. Recognizing that, there does need to be clearer disclosure of what the cost over-runs might be and what the mitigating plans are for minimizing those over-runs, as well as further discussion on if those are manageable risks (i.e. the likelihood that they will happen, what lies within Nalcor's control or not, and the potential escalating costs if any to taxpayers and/or ratepayers).

GHG/carbon emissions

Lowering the risk of an undefined carbon tax is a benefit of Muskrat Falls which does not apply in the isolated island option. The Board of Trade is pleased that, because of Muskrat Falls, Newfoundland and Labrador will have an electricity system that will be greater than 98 per cent carbon free. The development of Muskrat Falls would avoid approximately 96 million tonnes of emissions by 2065. If there is a price put on carbon, this price would be borne by businesses and customers. It is uncertain whether there will be a price set for carbon and what that price might be, but Muskrat Falls would nearly minimize this unknown pricing risk.

Cap-and-trade opportunities

There may be opportunity in the future to participate in cap-and-trade systems with carbon producing or polluting jurisdictions (in a sub-national system) or to contribute to Canada's overall carbon competitiveness should international targets be set with penalties for non-compliance. In a sub-national system, reduced emissions would provide some flexibility so that the province could have future opportunities to sell emission capacity between provinces/territories or even states in a North American system. This would ensure environmentally friendly conditions while allowing for sales to lower the debt or increase the return on investment that would accrue, through Nalcor, to all taxpayers. This could be accomplished while production remains stabilize because Nalcor would not have to be concerned with any thresholds at which a carbon tax or similar penalty would be imposed as its operations would be nearly 100% carbon free.

With respect to Canada's overall carbon competitiveness and compliance were cap-and-trade to be applied internationally, a net contributor such as Muskrat Falls would certainly help the province leverage other gains such as financial credits in other areas, perhaps in R&D or additional alternative energies.

Commodity price fluctuation

It is not possible to predict market forces into the future, but it seems likely that fossil fuel prices will continue to fluctuate and make price smoothing difficult. From a residential perspective, it is good to be able to budget and utilities such as Nalcor and Newfoundland Power have helped residential customers via internal programs such as equalized payments. From a business and industrial perspective, these programs also help but the scale is much different in terms of energy use and therefore price fluctuation.

Businesses and the investors behind them look for clarity and consistency when making decisions Price clarity and consistency may come at a premium in the case of Muskrat Falls but there is a threshold beyond which the price cannot pass; that is to say that businesses and investors will welcome long term price stability and may be willing to absorb short-term price increases or a small premium to gain long term stability, but that threshold is probably not very high. If the cost of energy is higher in this jurisdiction than it is in others – even if it is stable – that will be a factor that keeps business and investment away.

Commodity price fluctuation must be considered in the assessment of whether Muskrat Falls or the isolated island option is selected. Fluctuation can be good for the provincial treasury with respect to oil but that is offset by the price businesses and residents pay during high-price oil times, and vice versa.

Muskrat Falls will establish long term rate stability for residential and commercial consumers in Newfoundland and Labrador. Achieving consistency may be a good public policy goal partially accomplished through Muskrat Falls, again with the caveat that stable prices that are higher than other jurisdictions will make this a less attractive business and investment environment.

Cost to consumers

Canada's electricity prices have historically been low — among the cheapest in the 34-member OECD — because the majority of the country's power comes from hydroelectric plants that were built and paid off years ago. But those power plants are aging and no longer able to meet Canada's needs. The National Energy Board predicts that power consumption will rise 23 per cent by 2020. Between now and 2020, however, more than 100 new power plants are slated to be built and thousands of kilometres of new transmission lines will be erected.

The costs of building energy assets will be borne by consumers, whether residential or business. If hydroelectricity is the most cost-effective option, then it is one this province should pursue to keep household electricity affordable and keep businesses (both industrial and non-industrial) nationally and internationally competitive.

The business community in this province is already at a disadvantage in many ways because we have to bring so many goods into our province and the transportation routes are limited. It's a price that has to be paid if the goods are sold locally and a cost that has to be added back on if we export goods. We need whatever advantages we can get, and stable electricity rates can be advantageous only if they are lower or at least on par with other jurisdictions.

This project, as conceived and articulated, will cost consumers and businesses more in the short term. However, if the cost projections and economic models are accurate, then we will accrue benefits in the long term and that is something business can live with.

Financing

Interest rates are historically low and appear likely to remain so; however, there are two primary risks – that the only direction possible is upward and that the timing and speed of an upward tick is near impossible to predict. From an interest rate perspective, it appears that moving quickly on a major project is advantageous for the overall project cost.

It is also important to understand, when discussing interest rates, that a Muskrat Falls project would be an investment in a future productive asset. Much of the discussion has focused on the debt financing of such a major venture, and the St. John's Board of Trade is on record regarding concern over provincial debt and what interest payments leave us unable to accomplish. However, in this case, borrowing to produce a long-term asset that will produce a return on investment can be considered a prudent use of public funds.

The federal loan guarantee also aids in financing as it reduces the risk that financial backers will use in assessing the borrowing rates/costs for construction. Like a low rate interest environment, the loan guarantee appears to contribute a significant amount in the near term to the finances of the project. It has been stated that the project is still financially viable without the federal loan guarantee, just that it is easier and more viable with it; if this is the case, the project should be considered with the loan guarantee as such backing would not likely come from the federal government for other projects, particularly ones using fossil fuels.

Government Policy Issues
While these are not strictly in the purview of the PUB review, the St. John's Board of Trade would be remiss if it did not raise some broader public policy issues for government to consider within the context of the project.

Specifically, the Board of Trade would like further information on the following:
- Any initiatives that may be undertaken, particularly in the first 5-10 years of the project, that would offset any higher energy costs that businesses might have to absorb if they are at a disadvantage with the energy costs in other jurisdictions (i.e. lower corporate tax rates)?
- What allowances may be made for low income and fixed income earners, again particularly in the early years of the project with more substantial project costs than revenues, to allow for their adjustment to new energy prices?

Conclusion
Much of Canada's future energy potential is located in less accessible areas, such as the north and offshore. Pursuing these supplies are likely more costly and riskier. There are already existing assets and expertise that can support the development of Muskrat Falls. There is certainly interprovincial cooperation, and there is certainly an identified need to bring more energy on-stream in a cleaner way.

This project gives us options and appears to makes sense environmentally and economically in the long term.

Nalcor is engaged in a rigorous process utilizing world class advisors and consultants like Navigant. The processes they are using are methodical and professional, and this is contributing to a tried and proven decision making process. Nalcor has not yet sanctioned the project as they a completing further analysis; however, should this analysis determine that the project is sound, that the risks can be mitigated, and that this solution can meet our energy needs in a reasonable and efficient matter, then the project should be supported and sanctioned.