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# Tough times call for tough decisions

## The province's fortunes have shifted - can we still afford Muskrat Falls?

*Ron Penney; David Vardy*

The report of the Public Utilities Board's consultants, the Liberty Group, released by the board on Dec. 17, concluded that the power outages experienced last winter may recur because of low power reserves. Media coverage of the report, including that of The Telegram on Dec. 19, indicated that: "the electrical grid is susceptible to blackouts for the next three winters."

Such reporting suggests that Muskrat Falls will be a panacea for these outages, a conclusion which is unwarranted by the evidence to date. The Liberty Report reached no such conclusion. No credible business case has been presented to support Muskrat Falls, nor can it be rationalized as a cure-all for blackouts and supply outages.

The December report confirmed the findings of the Liberty Interim Report of April 24, to the effect that Hydro has done a very poor job of maintaining our generation and transmission assets.

Media coverage has ignored the fact there is another report to come on reliability after interconnection with Muskrat Falls.

We, along with Newfoundland Power and other interveners, urged the PUB to expand its review to include what we feel is the most important long-term reliability issue facing the island - and, in particular the Avalon Peninsula - and that is whether Muskrat Falls can provide reliable electric power without a large block of emergency power located on the Avalon Peninsula (and not elsewhere on the island or in Nova Scotia). We expect the advice will be that we will require continued generation at Holyrood. If we are right, any argument that Muskrat Falls was the least-cost alternative can no longer be supported.

It has long been our view that the review of Muskrat Falls did not support the conclusion that it was the least-cost option. The review failed to address all of the supply options (e.g., demand side management, additional purchases from Quebec, natural gas, small hydro, and wind). The review assumed that the generation plant at Holyrood would be taken out of service. In light of the similar weather conditions here and in the Maritimes, we should discount dependence on emergency power from Nova Scotia as a substitute for Avalon-based reserves.

The other key recommendations of the Liberty December report relate to corporate governance.

The first supports what we recommended in our presentation to the PUB. Hydro should have a full-time CEO and not a CEO who spends less than 20 per cent of his time running Hydro and who has no particular expertise in running a public utility. Liberty recommends "that this executive needs to be in place soon, and that finding a leader with proven, top level utility executive experience to fill it is essential."

It is disquieting when the only response to this recommendation comes from the present CEO, who muses that this is something that might come at a later date, when Muskrat Falls starts to produce power. It is inappropriate for the present CEO to comment on this. This is an issue on which either the board of Hydro or the provincial government should make a decision, not Ed Martin.

Liberty Consulting also recommends that there be some board members appointed who serve only on the Hydro Board (and not on the parent board) and that board members be appointed who "would expand the breadth and depth of skills and experience to ensure effective board oversight of Hydro's operations" and that there be at least one person on the board with expertise in the electricity business. The clear implication of that recommendation is that Liberty's assessment of the present board membership is that they lack those skills and experience.

We note that Premier Paul Davis said he is considering the governance issues raised in the Liberty Report and we hope he will act on them quickly. However, the new premier is faced with other weighty issues which link the supply of electricity with the revenues from offshore oil production and with the financial and economic health of the province, namely those arising from the global collapse of crude oil prices.

The PUB was presented with two alternatives, the preferred choice of Nalcor being the interconnected option, relying on Muskrat Falls for generation, without Holyrood. The second was a combination of energy sources, including small hydro developments and refurbishing of the Holyrood thermal station.

If Holyrood generation is still required, augmented by the new turbine generator, then the resulting higher cost of the interconnected option further undermines the analysis supporting the sanctioning of Muskrat Falls. This will add to the 40 per cent increase in the cost of Muskrat Falls between Premier Danny Williams' announcement of November 2010 and the new cost estimates released by Nalcor on June 26.

Another fundamental change in the analysis supporting the sanctioning is the downward shift in crude oil prices which occurred in late 2014 and is expected to continue for an extended period of time.

The shaky business case for Muskrat Falls is further weakened by the recent collapse of petroleum prices in two respects. First, the global changes in energy markets will increase the gap between electrical energy costs in the rest of the world compared with the high and rising costs of electrical energy from Muskrat Falls, increasing the risk of the project.

Second, the economic and fiscal impact of lower oil prices will weaken the capacity of the province and its people to repay projected costs, currently estimated at $8.3 billion. Many private-sector companies in the resource sector, such as Cliffs Natural Resources and Husky Energy are reviewing their commitments to major capital projects, without being bound by the tyranny of sunk costs.

In light of the fundamental changes in global energy markets, with a 50 per cent drop in the price of Brent crude, we believe that the Davis administration must reconsider the wisdom of proceeding with this project.

These changes are of such import and their impact on the fiscal and economic position of the province is of such gravity as to demand an immediate review by a blue ribbon panel.

This panel should report within 90 days and in advance of the presentation by the minister of finance of his 2015 budget.

In reaching its recommendations the panel will need to evaluate the costs committed to date to determine how much flexibility remains to reduce the obligations of the province, the penalties associated with cancellation, as well as the amount of funding required to complete the project.

This panel should be mandated to advise government as to whether the project should (1) continue as planned, (2) be revised by eliminating or delaying certain components or whether (3) the project should be terminated forthwith. The premier has informed the public that "everything is on the table," and surely this must include these options relating to Muskrat Falls, along with other expenditure and taxation measures, as the province navigates its way through "stormy" economic and financial waters, roiled by global energy markets.

*Ron Penney is a former provincial deputy minister of justice and a former city manager with the City of St. John's. David Vardy is a former Clerk of the Executive Council and chair of the provincial Public Utilities Board.*