NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF: **IN THE MATTER OF THE MARITIME LINK ACT**

- and -

IN THE MATTER OF: **AN APPLICATION by NSP MARITIME LINK INCORPORATED for approval of the Maritime Link Project**

Review and Consideration of Energy Access Agreement and Related Information

From: MPA Morrison Park Advisors Inc.
Board Counsel Consultant

Date Due: **Thursday, November 7, 2013**

Copies: 1 electronic copy (PDF searchable)
7 hard copies

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Introduction

In its Decision delivered on July 22, 2013, the NSUARB concluded that while the proposed Maritime Link project as presented was the lowest cost alternative for Nova Scotia electricity ratepayers,[1] there was doubt about a critical aspect of the arrangement; namely, access to market-priced energy over and above the Nova Scotia Block and Supplemental Energy specifically agreed to. While the Board concluded that it is reasonable to expect access to Market-priced Energy after 2041 (because of the substantial amount of power that will be available to Nalcor after the expiry of its Churchill Falls contract with Hydro Quebec), it found that there is substantial uncertainty about such access in the period from the expected completion of the project in 2017 until 2041.[2] The Board made it a Condition of Approval that "NSPML obtain from Nalcor the right to access Nalcor Market-priced Energy (consistent with the assumptions in the Application as noted in NSUARB IR-37 and Figure 4-4) when needed to economically serve NSPI and its ratepayers; or provide some other arrangement to ensure access to Market-priced Energy."[3] Moreover, the Board required that meeting this condition should not result in additional costs to Nova Scotia ratepayers, because it was simply a legal recognition of the assurances given by NSPML during the hearings that such Market-priced Energy would indeed be available.[4]

On October 21, 2013, NSPML delivered a Compliance Filing, which included an Energy Access Agreement (the "Agreement") between Nalcor Energy, Emera Inc. and Nova Scotia Power Incorporated. In addition, NSPML, NSPI and Nalcor presented additional information at the Technical Conference held in Halifax, Nova Scotia on October 28, 2013.

At the behest of Board Counsel, MPA Morrison Park Advisors Inc. has reviewed the Compliance Filing, and considered the additional information provided at the Technical Conference. Our objective was to understand whether and to what extent the problem

[1] See page 56 of the Decision.
[2] See page 65 of the Decision.
[3] See page 73 of the Decision.
[4] Ibid.

of uncertainty with respect to access to Market-priced Energy has been addressed in the Agreement, and also whether the proposed arrangements increase the costs expected to be borne by Nova Scotia electricity ratepayers, or otherwise detract from the proposed Maritime Link project originally proposed to the NSUARB.

Critical Features of the Agreement

In our view, the critical terms of the Energy Access Agreement are:

- Nalcor commits to make available to NSPI 1.2 TWh of non-firm energy per year on average over the course of the Agreement, which is expected to last approximately 24 years between 2017 and 2041;[5]
- Annual availability of energy could be up to 1.8 TWh, but could be as low as 0 TWh in any given Contract Year (September 1 – August 31) depending on the Nalcor Forecast of Available Energy;
- Nalcor commits to provide NSPI with a rolling 24-month forecast of expected available non-firm energy, on a monthly basis;
- Once per year, in the month of June, NSPI has the option to issue a solicitation for non-firm energy for the following Contract Year, and Nalcor commits to bid into that solicitation, based on Nalcor's May 31 Forecast, up to a maximum of 1.8 TWh;
- In NSPI's solicitation, Nalcor may bid any price for its energy, up to and including the MassHub price, or the higher price of any alternative liquid market opportunity available to Nalcor;
- If there is an extended dry period or some other system difficulty, and it appears that there will be insufficient energy available for export from Newfoundland and Labrador to meet Nalcor's commitment to NSPI over the term of the Agreement,

[5] Note that if the Agreement lasts 24 years, then in order to achieve at least 1.2 TWh per year on average, Nalcor will be required to make available at least a cumulative total of 28.8 TWh over that time period. If the Maritime Link is a year late, and hence the Agreement lasts only 23 years, then the cumulative total requirement would be 27.6 TWh. This calculation is relevant because Nalcor may offer more or less than 1.2 TWh in any given year, up to a maximum of 1.8 TWh. So, for example, if 1.8 TWh were offered for the first 16 years, then it would not matter how much was offered in the remaining years, because 28.8 TWh would have already been offered.

then Nalcor will declare that there will be a "Variance".[6] In this event, Emera shall be responsible for the first 300 GWh per annum of any shortfall, and Nalcor shall be responsible for the remainder;[7]

- In the case of a Variance, if Emera chooses to satisfy its obligation to offer up to 300 GWh of energy through the construction of new intermittent energy facilities in Nova Scotia (including wind, solar and tidal power facilities), then Nalcor will offer up to 100 MW of balancing services under a fixed price contract;[8]
- Even in the event that Nalcor satisfies the commitment to provide at least 1.2 TWh per Contract Year on average before the term of the Agreement is completed (by providing more than 1.2 TWh per year in the early years, for example), Nalcor must still offer its Forecast Available Energy in NSPI's annual solicitation throughout the full term of the Agreement.

<u>Energy Availability Implications for Nova Scotia Ratepayers</u>

The critical risk of concern to the Board was that Market-priced Energy would not be available from Nalcor. From the evidence presented to the Board, it appeared that Nalcor would have such energy, at least in the early years of the Maritime Link agreement, but there were two notable circumstances that might result in Market-priced Energy being unavailable to Nova Scotia:

- load growth in Newfoundland and Labrador could reduce the available supply of energy for export, and
- Nalcor could choose to sell their available energy to another market instead of to Nova Scotia.

Nalcor has attempted to address the first concern by describing their system, and their planning commitment: they will be a 100% renewable energy jurisdiction (water and wind), and therefore must build infrastructure such that reliable power (i.e., the minimum

[6] See s. 7 of the Agreement.
[7] Note that NSPI may also choose to satisfy Emera's obligation to provide access to 300 GWh of energy in the event of a Nalcor Variance, as per s. 7(f)(i) of the Agreement. However, this is an option, not an obligation, and in any case any action by NSPI would be subject to regulatory approval.
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expected annual power production based on 60 years of available water data) is at or above the combination of their expected domestic load and firm export contracts (which includes the Nova Scotia Block and Supplemental Energy).[9] This means that if domestic load grows dramatically, Nalcor's policy would lead them to build additional wind or water power facilities to increase their firm energy production, otherwise they would risk being short of power in a dry year.

The result of this approach to electricity planning and generation is that in good years (i.e., years in which precipitation and wind are plentiful) there will be substantial surplus energy available for export at market prices, and in bad years there may be little or no surplus energy, but the supply should never fall to the point that Nalcor's firm commitments will be in jeopardy (unless annual precipitation drops below the lowest level on the entire historical record for a sustained period of time).

Assuming this to be the case, it is reasonable to believe that Nalcor will have at least 1.2 TWh per year on average available for export to Nova Scotia over the term of the Agreement.[10] Even if there are a few bad years in the mix, the historical record of precipitation suggests that there will be more than enough good years to ensure that the total is reached, and likely well before the Agreement has run its full term. Nalcor has agreed to the amount, presumably because they believe it will be achievable.

However, there is no guarantee that at some point Nalcor and the Newfoundland and Labrador government will not change their policies with respect to electricity system design and construction. While it may be unlikely, it is possible that the province might at some point wish to build some fossil fuel-fired electricity generation facilities, especially given the significant potential for development of oil and natural gas

[9] Please see pp. 14 - 15 of the Compliance Filing, and slides 3 - 6 of the Nalcor Presentation from the Technical Conference on October 28, 2013.

[10] Note that in MPA Response to CANWEA IR-1, MPA calculated, based on publicly available information, that Nalcor could have up to 55 TWh of surplus energy available for export between 2018 and 2041, and less than 1.8 TWh available in only 7 of those 24 years. These publicly available figures are based on historical average precipitation, and will obviously vary depending on actual precipitation over time.

resources in the waters offshore of the province. In that eventuality, it should be assumed that the ability of the Nalcor system to deliver surplus energy for export could be reduced. However, the commitment to 1.2 TWh per year on average over the term of the Agreement will still apply.

If at some point Nalcor forecasts that it will not meet its commitment to make available to NSPI an average of at least 1.2 TWh of Energy per Contract Year, then a Variance can be declared, which creates obligations on Emera to offer up to 300 GWh of energy per year for the remaining years of the Agreement to help to make up the expected shortfall in Market-priced Energy. In effect, Nalcor and Emera have jointly assumed final responsibility for the supply of Market-priced Energy to Nova Scotia ratepayers in accordance with the terms of the Agreement. Regardless of the division of this risk burden between the two Parties, the risk does not fall on the Nova Scotia ratepayer.[11]

On the second issue, concerning the possibility of Nalcor contracting with other potential targets for its exports, the Agreement is conclusive and binding: Nalcor must offer power into NSPI's annual solicitation, and cannot commit that power to anyone else on a multiyear basis. In fact, the first 1.8 TWh of Nalcor surplus energy expected to be available in any given Contract Year must be offered to NSPI through its annual solicitation process, and can only be sold to someone else (either on a spot market basis or through a short-term contract) if NSPI has already refused to buy it through the solicitation process. This amounts to a right-of-first-refusal for NSPI (through the special once-per-year mechanism of the solicitation), and is an extremely significant and valuable element of the Agreement.

[11] It is relevant that Emera, and not NSPI, ultimately bears this burden. Construction of new facilities in Nova Scotia can be a solution to such a shortfall in the case of a Variance, but only with the consent of the Board, which will presumably only consent to new construction if it is lower cost than other market-priced sources. It is also relevant to note that the Balancing Services Agreement that is part of the mechanism to potentially deal with a Variance is a remote possibility, and ultimately just another option in favour of the Nova Scotia ratepayer: surplus energy must be short for an extended period of time, such that a Variance is declared; power must be in such short supply and at high prices such that new intermittent construction is the cheapest option for Nova Scotia, and Nova Scotia must have a need for Balancing Services. In this unlikely scenario, Nova Scotia will benefit from having the Balancing Services option, but need not make use of it if other options are cheaper.

Energy Price Implications for Nova Scotia Ratepayers

It should be noted that none of the provisions of the Agreement establish prices for the energy in question, except with respect to establishing a ceiling on Nalcor's bid prices in response to NSPI's annual solicitation. In fact, in all likelihood, the energy that is obtained in the annual solicitation will likely be priced in relation to the MassHub price, because it is liquid, publicly known, and its forward prices are forecast by a variety of market players. In other words, an annual solicitation could result in, for example, a commitment to provide 1.5 TWh of energy over the course of the next Contract Year, during off-peak hours, at a price of "MassHub – X". Nalcor, or an alternative winner of the solicitation, would be offering to commit to a price in relation to the MassHub price, but that price would be floating at any given time during the following 12 months.[12]

NSPI could have chosen to follow this exact procedure (i.e., annual or other periodic solicitations), even without the Agreement in place. Nalcor would face the same pricing pressures, and the same competitive landscape within which to sell their surplus energy. However, there are two crucial differences with the Agreement in place: Nalcor is disclosing its expectations about power availability through its forecasts, to NSPI's benefit; and Nalcor is specifically committing to participate in the annual solicitations, instead of seeking alternative long-term buyers of its power.

Under the Agreement, NSPI is under no obligation to purchase any specific amount of power, under any terms. However, if NSPI chooses not to hold a solicitation in relation to a particular Contract Year, then Nalcor is not obligated to participate in any other NSPI solicitation or similar process at other times throughout that Contract Year (though Nalcor may choose to). Similarly, if NSPI only requires 1 TWh of energy, but Nalcor is capable of offering more in that year, NSPI is not required to accept it. However, in this case, the total amount of Nalcor energy offered (up to a maximum of 1.8 TWh) still counts against Nalcor's cumulative obligation under the Agreement.

[12] Note that this is a simplification for example purposes only. NSPI might ask for specific amounts of energy on a monthly basis, a certain amount off-peak vs. on-peak, etc. The solicitation could take many possible forms, and the pricing structure could be entirely different as well (though in our view pricing in relation to MassHub is the most likely outcome for the solicitations).

In effect, the Energy Access Agreement provides an option to NSPI and its Nova Scotia ratepayers, without additional costs as compared to the absence of the Agreement. As contended by NSPML during the Maritime Link hearing, this option may have been present all along because of the nature of the Maritime Link and the location of Nova Scotia in the transmission path, but the Agreement provides legal certainty with respect to the existence of the option.

NSPI may choose not to make use of this option for economic reasons. The option is limited because it may be exercised no more than once per year and only in June, and it may not be advantageous for NSPI to determine its purchases of non-firm energy in that manner. For example, it might make more sense for NSPI to buy some of its non-firm energy on a daily basis, as required. Nalcor's offer to the NSPI solicitation may be priced at a certain discount to Masshub in September, for example, but at a different discount (or none at all) at other times of the year. It will be up to NSPI to make the decision whether it wishes to structure deals for 12 months at a time, or risk taking different prices (and facing other levels of power availability) based on market conditions.

Regardless of the amount of energy requested by NSPI in its solicitation, Nalcor has made the critical commitment that it will not contract its surplus energy to any other potential buyer on a multiyear basis. If NSPI chooses not to buy Nalcor's energy on a 12-month basis, then NSPI will have to compete with others to purchase that energy from Nalcor on some other basis, if it so chooses. But once per year, at a minimum, Nalcor will be offering a substantial block of energy to NSPI.

Conclusion

It is our view, based on the materials provided in the Compliance Filing and at the Technical Conference, that the Energy Access Agreement has addressed the concern that Market-priced Energy be available to Nova Scotia ratepayers through the Maritime Link over the term of the Agreement. The Agreement amounts to a right-of-first-refusal for NSPI, albeit under specific limited conditions. The provisions related to the cumulative amount of energy over the life of the Agreement provide further protection to Nova Scotia ratepayers, giving substance to the representations about the benefits of the Maritime Link originally argued before the Board. Further, it is our view that the Agreement does not impose additional costs on Nova Scotia ratepayers that were not already evident in the Maritime Link transaction, nor does it otherwise detract from the proposed Maritime Link project originally proposed to the NSUARB.

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Assuming this to be the case, it is reasonable to believe that Nalcor will have at least 1.2 TWh per year on average available for export to Nova Scotia over the term of the Agreement.[10] Even if there are a few bad years in the mix, the historical record of precipitation suggests that there will be more than enough good years to ensure that the total is reached, and likely well before the Agreement has run its full term. Nalcor has agreed to the amount, presumably because they believe it will be achievable.

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NSPI may choose not to make use of this option for economic reasons. The option is limited because it may be exercised no more than once per year and only in June, and it may not be advantageous for NSPI to determine its purchases of non-firm energy in that manner. For example, it might make more sense for NSPI to buy some of its non-firm energy on a daily basis, as required. Nalcor's offer to the NSPI solicitation may be priced at a certain discount to Masshub in September, for example, but at a different discount (or none at all) at other times of the year. It will be up to NSPI to make the decision whether it wishes to structure deals for 12 months at a time, or risk taking different prices (and facing other levels of power availability) based on market conditions.

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