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From : "Thompson, Robert"
To : "Kieley, Chris" , "emartin@nlh.nl.ca"
Subject : Alignment
Attachment : Energy Plan.doc;

Ed:

Thanks for your call this morning.

Attached are my questions and a few observations. No doubt these questions have already occurred to you and your team and much analysis is already available. This exchange will allow me to catch up, both on the logic of the vision and the analytical underpinnings. I have focused on the overarching theme and some of the main issues which fall out from that theme.

Wednesday is a good day for me if you want to get together then. Perhaps 9:30am. I have an outside meeting before then. i can come by your office.

Robert

a. DC Link

The chart on p.11 of the presentation to the Premier in mid-August seems to indicate that the DC link can stand on its own as a reasonable investment by the province. It will keep power rates low, it will not require a taxpayer subsidy, and it will be the foundation investment for an alternative access point to the North American grid.

My questions are mainly to help me understand the assumptions behind the chart. Is a federal subsidy or guarantee assumed; is the full cost of the link allocated to island-based ratepayers; what price of oil lies behind the BAU case; at what price would the BAU case be equivalent to the DC link; can wind and small hydro satisfy demand growth on the island and for how long; would wind and small hydro be cost-effective in comparison to a DC link; what is the opportunity cost in foregone export revenue; and would it make more economic sense to use export profits as a subsidy for provincial ratepayers rather than build a DC link?

If the answers to these questions show that other options might be competitive or better than a DC link, are there strategic issues which need to be factored into the decision-making? What weight should be placed on the security and stability of 100% non-renewables? And what weight should be placed on building the foundation for alternative access to the North American market?

Alternatively, if the DC link stands on its own as a viable investment, with capital to be repaid by NLH from normal business, is the overarching vision applicable here? Capital from oil surpluses will not be necessary?

b. Access to North American Grid

On a general level the question is: given the cost and risk associated with an alternative link to the North American grid, will the higher achievable prices generate more value than the profits likely to be obtained by going through Quebec?

Before getting into matters of Quebec's possible future strategy and tactics, is it less expensive to transit power through Quebec to get to other customers? If so, there is a cost premium (or value loss) for NL by taking an alternative route. What is the size of this value loss?

Is it a reasonable fear that Quebec can and will extract rent from the resource by virtue of its geography, regulatory powers, political strength, etc., above and beyond the reasonable costs of transit, such that the alternative route to the North American grid is better for NL?

If this fear or risk is real, how can it be addressed? Is it necessary to commit resources and build the alternative route, or is it better to develop the credible threat of doing so? What other legal and political resources are available?

The implication of the "overarching theme" is that the surpluses for non-renewables are needed to finance the alternative route. This implies that it is a cheaper source of capital than can be obtained in the marketplace. The opportunity cost to the taxpayer will need to be factored into the overall calculations.

c. Fiscal Surplus

Has there been an assessment of the potential fiscal surplus? And is this surplus adequate to meet the financial requirement of the alternative route?

The Department of Finance should be asked to develop a long term forecast of provincial expenditures, the amount of expected petroleum revenue which will be required to maintain balanced budgets, and the surplus which can be allocated for other purposes.

Analysis is also needed on the benefits associated with paying down the provincial debt with the petroleum-generated surpluses, or foregoing this opportunity in favour of investing in renewable energy assets and infrastructure.

A policy discussion is also needed on whether part of the surplus will be allocated to other social and economic purposes (e.g., education, poverty reduction, health care), and thus removed from either debt reduction or renewable energy investment. Assumptions about this can be made in the financial analysis.

2. Other Issues

a. Energy-driven Industrial Development

I assume this term means "energy intensive" such as an aluminum smelter.

If the price of power to these industries is full cost plus regulated rate of return, the big question is foregone export revenue. Such foregone revenue can also be discussed in terms of subsidy-per-job-created in the new industry. Without question it is good to use energy prices as a way to attract industry if the net economic benefits outweigh the foregone revenue, and the subsidy per worker is reasonably low. Perhaps the energy plan needs to contain a policy statement rather than stand-alone targets. It will be important that each industrial development make sense in terms of net economic benefits.

The other point here is that we should be assessing the idea of energy intensive industries against other approaches to industrial policy. For example, should the export revenue be used instead to help build a world-beating marine technology and services industry, with investments in associated R&D, education, labour force, etc. Low cost renewable energy will also help this sector, but not through specific deals. It is not essential to resolve all these debates in the Energy Plan itself, as long as the Energy Plan is an enabler for such choices in the future.