

Ronald Penney
[REDACTED]

David Vardy
[REDACTED]

March 1, 2016

Honourable Dwight Ball
Premier
Government of Newfoundland and Labrador
Confederation Building
St. John's, NL

Dear Premier,

In light of the stark fiscal reality facing the province it is vital that all options to reduce financial exposure and risk be considered. Our purpose in writing is to propose that your government's review of Muskrat Falls be extended to include a Blue Ribbon Panel with expertise in large energy projects, mandated to consider a range of options. Government needs to provide itself with choices which can curtail the risk and avoid accepting the responsibility which rightfully belongs to your predecessors. We recognize that the previous administration appointed an oversight committee consisting of civil servants, but civil servants are employed by the government and their obligation is to support government policy. They are not independent.

In the context of its review of "Dark NL", the PUB appointed the Liberty Group to report on why the outages occurred, including weaknesses in management at Nalcor. Their findings were most disturbing, sufficiently so to warrant your reconsideration of the organizational structure for the province's hydroelectric assets, removing Nalcor and reverting to the original structure, with NL Hydro fully regulated and fully mandated to operate the power generation and high voltage transmission system on the Island and in Labrador.

In addition, as a second phase of the PUB's work, the Liberty Group is reviewing the reliability of the system after interconnection. We believe that they will recommend that the Holyrood thermal plant remain in place for emergency power after interconnection, rather than converting the plant to be used solely as a synchronous condenser. This will result in additional cost, driving the current \$9.05 billion much higher. NP also supported this viewpoint in their recent rate filing on the power supply uncertainties created by the project, as follows:

This includes the technical uncertainty related to interconnection to the North American grid. It also includes the uncertainty related to supply reliability following the proposed decommissioning of the Holyrood thermal generating plant.

It has been argued that the project is too important in creating employment to stop it now. Based on Nalcor's monthly progress reports the cost for each job at Muskrat Falls is close to half a million dollars. We cannot rationalize this as a make work project.

Nor can sunk costs be used to rationalize the project. Sunk costs are irrelevant. The only costs that count are the future costs, the incremental costs to complete, and the costs of shutting the project down. These costs include the cost of procuring replacement energy and the negotiated cost of cancelling construction contracts. No doubt these costs will be high but government must measure what the final costs will be before proceeding. If the final cost escalates into the \$12 to

15 billion range, then the savings which could be achieved by an early shutdown may be considerable.

Many energy projects have been suspended since the collapse in oil prices so there is no shortage of expertise in the curtailment of large energy projects. Ernst and Young could easily tap into this expertise. The Economist recently reported (January 23, 2016) on the suspension of \$380 billion (US) in energy projects.

We recommend that the Blue Ribbon Panel assess both the cost of stopping the project and the cost to complete it, as well to conduct a benefit cost analysis of the options available to government. The services of Ernst and Young should be made available to the panel along with any other resources which the panel may deem necessary, which would likely include engineering expertise. The scope of the work of Ernst and Young would need to be expanded in order to facilitate a full benefit cost analysis of the options, including full and partial suspension.

If the panel recommends continuation of the project it should recommend how the PUB might play an oversight role similar to that exercised by the Utilities and Review Board of Nova Scotia. The UARB continues to monitor the progress of the Maritime Link.

Our PUB was marginalized from the start and should now be given an expanded oversight role not only over the capital cost but also over the sale of export power. Such oversight over the sale of export power would ensure that exports are designed so as to produce maximum revenues and use them to reduce rates charged to ratepayers in Newfoundland and Labrador.

If the panel recommends that the project proceed then it should recommend how a case might be made for further federal engagement and for the raising of the cap on the loan guarantee to ensure that the loan guarantee covers, at a minimum, the same proportion of final cost as was guaranteed under the November 2012 loan guarantee agreement. Based on current estimates this would call for an increase from \$5 billion to \$7.5 billion in the amount of debt financing which could be accessed at the federal government's low borrowing rate.

In addition, the panel should examine the potential for greater federal participation, including an increase in the cap on the loan guarantee but also the reactivation of the Lower Churchill Development Corporation as a means of injecting federal equity, in addition to the loan guarantee. The province might also want to promote an enhanced federal role in building long distance inter-provincial lines across the country as a means of improving market access for the province's hydroelectric and wind power. Such investments would be a good candidate for funding under the new federal infrastructure program.

This Blue Ribbon Panel would need executive authority to access the necessary information and the relevant personnel on an urgent basis. In order to be effective the Panel must work on an expedited and phased basis, submitting its report on "cost to finish" and "cost to stop" within 60 days. Only through timely intervention can the province change the course of the project and reduce the final cost and the overall risk of the project.

During our recent meeting with the Minister we discussed the need for an expanded oversight process. We also raised with her the subject of the North Spur, which is a latent danger to life and limb, as well as a threat to the integrity of the dam structure at Muskrat Falls. We do not believe this matter has received the attention it deserves and we are supporting the advice of Jim Gordon, an eminent power engineer who has worked on 150 hydro projects worldwide. He

recommends that a review board comprised of world class geotechnical experts be appointed to examine the measures which are being used to remediate the North Spur.

We look forward to the opportunity to discuss these matters with you in the hope that the proposed action will mitigate the rising financial risks and the threat to personal safety arising from this project.

This letter has been copied to the Minister of Natural Resources.

Respectfully,

Ron Penney and David Vardy