Intelligence MEMOS

From: Jim Feehan

To: Electricity Policy Analysts, Ratepayers and Politicians

Date: February 25, 2020

Re: **THE MUSKRAT FALLS ELECTRICITY PROJECT: A HARD LESSON**

Arm's length independent assessments of megaprojects are crucial for government decision-making. Governments that give them little weight risk imposing enormous burdens on the public, especially when projects are publicly funded. Muskrat Falls illustrates this.

In December 2012, backed by a $5 billion loan guarantee from the federal Conservative government, the provincial PC government authorized the Muskrat Falls project. A provincial Crown corporation, Nalcor, would build a dam and generating facilities on the Churchill River as well as transmission lines across southern Labrador and subsea cable to the island of Newfoundland. The power would be delivered to Nalcor's subsidiary and public utility, Newfoundland and Labrador Hydro, for sale to island ratepayers, and surplus power exported by a second subsea cable to Nova Scotia.

Nalcor and the government claimed the project was needed, assured people that the investment was worthwhile and played down its risk. A joint federal-provincial environmental assessment panel and the province's Public Utilities Board (PUB) both disagreed. Their government-mandated reports raised serious doubts and did not endorse the project but it was authorized anyway.

Various individuals and groups also opposed the project. I had argued that efficient pricing of electricity and conservation would make the project unnecessary and any incremental demand growth could be met by on-island renewable energy projects at greatly lower risk. Those ideas, like the concerns of more vociferous and persistent critics, held no sway.

From the start, project execution was problematic. There were cost overruns, delays, and community protests over environmental concerns. In 2016, Nalcor's board of directors resigned, citing a lack of confidence by the new, Liberal, provincial government, and did so immediately after having let the CEO go. The new executive discovered that the project was in even worse shape than reported.

At that stage, a second loan guarantee, for $2.9 billion, was agreed to by the now Liberal federal government. That provided sufficient funding for completion and possibly saved the cash-strapped province from fiscal disaster. Meanwhile, the cost escalation sparked fears among ratepayers that electricity rates would have to double to pay for the project.

Thereafter, the provincial government established a commission of inquiry into Muskrat Falls, which is due to report by March 31, 2020. It also directed the PUB to report on rate mitigation and it sought further assistance from Ottawa. As guarantor of long-term loans totaling $7.9 billion, the federal government is entangled in this otherwise provincial project.

Two weeks ago, at a press conference in St. John's, the two governments announced that Ottawa was going to help. Many people in the province were expecting to see federal dollars on the table.

Not so.

What was announced was that the two governments were developing a financial restructuring plan and assessing options for setting electricity prices. Expect finalization before year's end.

Only days earlier, the PUB reported to the provincial government on ways to mitigate electricity rate increases from Muskrat Falls. The project is years late and technical problems may delay it further. The latest completion cost estimate is $12.7 billion, versus $6.2 billion when reviewed.

If, as required under the existing loan guarantee arrangements, the full project cost is passed on to island ratepayers, electricity rates will soar. On project completion, which might be in 2021, residential rates could jump to about 22.9 cents a kilowatt-hour from the current 13.1 cents, and escalate thereafter. In a place where more than 70 percent of people heat their homes with electricity, this is alarming. Faced with similar proportionate increases, commercial, institutional and industrial ratepayers are worried too.

Holding residential rates to a target of 13.5 cents, the PUB concluded, would cost hundreds of millions of dollars annually, even with the project taking a zero return on investment equity.

The core problem with Muskrat Falls was the unwillingness of the former provincial government and Nalcor's previous leadership to recognize the project's weak foundations. They acted as cheerleaders. Most tellingly, they and the federal government at the time paid little heed to the joint review panel and the PUB.

Those independent institutions did their jobs. Overriding their advice should have been a major hurdle but it was not.

Whenever a review does not support a megaproject, it ought to trigger a required process of second thought if a government does not accept that advice. Unfortunately, no such mechanism was in place for Muskrat Falls.

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