

August 15, 2019

Sent by email

Harris Centre
Memorial University

Re: Commission of Inquiry Respecting the Muskrat Falls Project

Dear Sir or Madam,

The Canadian Federation of Independent Business (CFIB) is a non-partisan and not-for-profit organization that represents independently-owned small- and medium-sized enterprises. We represent 110,000 members across the country and have approximately 2,000 members in Newfoundland and Labrador.

When the Muskrat Falls development project (Project) is completed, there will be potential to produce 824 MW of electricity for use inside and outside Newfoundland and Labrador. Given the concerns associated with cost over-runs and the delayed completion of the Project, the provincial government announced the Muskrat Falls Commission of Inquiry (Inquiry) with an established terms of reference in 2017. The Inquiry has commissioned the Harris Centre to conduct public consultations as part of its deliberations. The Canadian Federation of Independent Business (CFIB) is submitting its views on behalf of its membership.

Currently, Newfoundland and Labrador has some of the lowest electricity rates (depending on the class) in Atlantic Canada, despite a significant increase in 2018 (see Table 1). Even if the provincial government is able to keep electricity prices at the Atlantic Canadian average, as it has suggested, ratepayers in the province could expect a significant increase. Assuming other jurisdictions increase their current electricity prices by two per cent a year to 2021, the following increases could occur in Newfoundland and Labrador: Residential - 21 per cent; Small Power - 32 per cent; Medium Power - 36 per cent; and Large Power - 10 per cent.

Table 1:

Forecasted Atlantic Canadian Average for Electricity Prices (2018-2021)

Province	Residential (\$)		Small Power (\$)		Medium Power (\$)		Large Power(\$)	
	2018	2021	2018	2021	2018	2021	2018	2021
NL	13.52	16.35	12.47	16.44	13.04	17.68	8.91	9.77
NS	16.41	17.41	15.44	16.39	17.15	18.20	10.26	10.89
NB	12.97	13.76	13.49	14.32	14.50	15.39	7.86	8.34
PE	16.83	17.86	17.54	18.61	18.32	19.44	9.51	10.09
Average	15.40	16.35	15.49	16.44	16.66	17.68	9.21	9.77

Source: CFIB analysis using Hydro-Québec's annual report titled, *Comparison of Electricity Prices in North American Cities*, April 2018. Small- and medium-sized enterprises could be categorized as Small Power or Medium Power customers for the most part.

We know from our [research](#) that the use of electricity is most prevalent by SME owners for their operations. However, some do use oil often to complement electricity use. Intuitively, electricity is an inelastic service for small business owners. Due to the nature of business operations, we know the vast majority of business owners cannot reduce their electricity consumption easily. Regardless of how high the rates may go, a large number will find it difficult to lower their electricity use by switching to another reliable energy source or adopting conservation measures. This is different than the industrial customers who have the resources to find ways to reduce their electricity consumption or even remove themselves from the electricity grid and produce their own energy.

In 2012, the Government of Newfoundland and Labrador sanctioned the Project at a forecasted cost of \$6.2 billion (excluding financial costs) with first power by 2017. However, the Project is currently estimated to cost at least \$10.1 billion (excluding financial costs) and full power is expected by 2020. The structure of the project, including agreements with the federal government, means the customers of Newfoundland Power will bear full responsibility of the Project's cost. In various submissions to the provincial Board of Commissioners of Public Utilities (PUB), Nalcor has estimated electricity rates will have to rise to 22.9 cents per kilowatt hour (kWh) to generate \$744 million in 2021.

Essentially, without mitigation, electricity costs for customers are expected to almost double. In 2017, CFIB conducted [research](#) that showed an effective doubling of electricity rates will mean a collective increased cost of \$179 million per year. To reduce the effect of Muskrat Falls development on electricity rates, there is a substantial amount of focus being placed on rate mitigation. This simply means that rather than the ratepayer paying, revenues will be generated, in whole or in part, through taxation. The Inquiry's Terms of Reference allows the Commissioner to consider "the need to balance the interests of the ratepayers and interests of the taxpayers in carrying out a large-scale publicly-funded project." However, the focus on rate mitigation has been largely centred on revenue generation. What is being discounted is the need to find savings within provincial government departments, agencies, boards and commissions and the implications on public service delivery.

Regarding the discussion on rate mitigation, comments made by Professor Brandon Schaufele to the Inquiry on July 16, 2019 were particularly striking as it relates to the balance between the ratepayer and taxpayer. He provided some economic background on the economic effects of having the ratepayer or taxpayer bear the burden. His conclusion is the provincial government and the PUB have to consider the rate and tax implications of any decisions and there will likely be a trade-off between paying for the Project and how to apply that cost to all groups in society equally. Professor Schaufele recommends the government should allow for higher rates should be raised to offset the potential increases in taxation and associated costs.

Professor Schaufele's presentation to the Inquiry raised the concept of Ramsey pricing. Under this concept, different customer classes would be charged different rates depending on their price elasticity of demand. In this regard, industrial and commercial customers will pay less and residential customers will pay more. Cross-subsidization in the Newfoundland and Labrador market currently exists, but it is different than what the Ramsey pricing rule would suggest. Most SMEs are classified as General Service 2.1 or General Service 2.3 customers. According to [Newfoundland Power's 2019-2020 General Rate Application](#), customers in those classes will respectively pay 8.4 per cent and 9.2 per cent more than the cost to provide them with service (page 5-6). This is inherently unfair to SME owners, but the PUB has accepted this since 1997.

The Inquiry's Terms of Reference requires the Commissioner to look into "whether the determination that the Muskrat Falls Project should be exempt from oversight by the PUB was justified and reasonable and what was the effect of this exemption, if any, on the development, costs and operation of the Muskrat Falls Project." It is clear that regulatory oversight has an important role to play in ensuring a large-scale project is completed on time and on budget. For comparative purposes, the Maritime Link portion of the Muskrat Falls project underwent review by Nova Scotia's Utility and Review Board (UARB). According to [Emera Newfoundland and Labrador's October 2018 quarterly report](#) to the UARB (the latest available publicly), the Maritime Link is forecast to come in on budget, if not under budget.

Regulatory oversight in the energy sector is very important, but yet, the Lower Churchill project (which includes Gull Island) has been exempt since 2000. It is interesting to note the PUB did not review the Maritime Link project because it was exempted from review in 2013, as were the other components of the Muskrat Falls development project. These exemptions are allowed as per section 5.2 of the *Electrical Power Control Act*. In addition to them, Order-in-Council 2013-343 disallows the PUB from reviewing any future changes in electricity rates associated with the Muskrat Falls project to ensure appropriate cost recovery. Further, subsection 5.1(2) of the *Electrical Power Control Act* gives the provincial government the authority to direct the PUB to implement any policies, procedures and directives related to the Project.

Nalcor is also treated differently than other government bodies as it relates to access to information. Section 5.4 of the *Energy Corporation Act* outlines the process by which information deemed to be commercially sensitive can be obtained; it is highly restrictive. As CFIB noted in its submission during the 2014 review of the provincial access to information legislation, there should be an appropriate balance between transparency and business practice. However, commercial entities have to recognize that transparency within government bodies is a necessity and the release of some commercially sensitive information is a cost of doing business with government. To add to the lack of transparency at Nalcor, subsections 5.4(6) and 5.4(7) of the *Energy Corporation Act* allows the chief executive officer to determine what information can be released publicly should the provincial Auditor General conduct a review within Nalcor.

Based on the above, CFIB recommends the following for consideration by the Commissioner:

- **The provincial government should provide a full, transparent and independent analysis of rate mitigation in Newfoundland and Labrador.** Despite the work of the PUB on rate mitigation, it is only providing options to mitigate rate increases due to the Project and the provincial government is not bound to adopt any recommendations presented by the regulator. The provincial government's rate mitigation plan presented in April 2019 is unrealistic because it is unknown whether the options will generate sufficient revenue and there is a requirement to negotiate the involvement of the federal government. Further, the plan does not address the growing costs of Muskrat Falls beyond 2021. In addition, the presentation by Professor Schaufele raises doubt that full rate mitigation (ie. allowing rates to grow to 13.5 cents/kWh in 2021) is the best option for Newfoundlanders and Labradorians. There has also been very little discussion on where the provincial government can find savings to ensure rates and/or taxes do not have to increase to the fullest extent being contemplated.

- **The PUB should change its 1996–1997 (Order No. P. U. 7) to allow for a revenue-to-cost ratio of zero per cent (ie. 100).** It is unfair that small business owners pay more for electricity than it costs to deliver to them. As they face higher costs for an inelastic service, in conjunction with other initiatives, reducing the revenue-to-cost ratio can help lessen the effect.
- **The provincial government should reform the legislative and regulatory framework to provide greater oversight on large development projects in hydroelectricity.** The lack of government oversight is a key contributor to the cost over-runs and schedule delays experienced with the Muskrat Falls development project. The provincial government can immediately rescind the exemptions provided to the Lower Churchill development project implemented on 2000, as well as the exemptions adopted specifically for the Muskrat Falls development project (including related Orders in Council). At the earliest opportunity, the Minister of Natural Resources should seek approval from the House of Assembly on amendments to the *Electrical Power Control Act* rescinding subsections 5.1(2) and 5.2. The Minister of Natural Resources should also, at the earliest opportunity, introduce into the House of Assembly amendments to the *Energy Corporation Act*, specifically section 5.4, ensuring Nalcor is more transparent and can be held more accountable by the public.

In conclusion, the costs of the Project have to be paid and small business owners are likely to bear the brunt of any increases, whether in rates or taxes. From the small business perspective, rate or tax increases will require owners to analyze and decide how much any costs can be passed on to the consumer (who is, for the most part, also a ratepayer and a taxpayer) as part of the business adjustment process. The Inquiry's value has been in creating an understanding of how the Muskrat Falls project has been managed. Its conclusions and recommendations should be beneficial in the future if the provincial government decides to undertake another large-scale development project like Gull Island hydroelectric development or an underground tunnel linking the island of Newfoundland to Labrador.

We trust the views and information presented in this letter will be helpful to the Inquiry and would be happy to discuss further if necessary. I can be reached by email at vaughn.hammond@cfib.ca or by phone at (709) 753-7764.

Sincerely,



Vaughn Hammond
Director of Provincial Affairs, Newfoundland and Labrador