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Get past the bombast

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Commentary

Premier Shawn Graham and his counterpart Jean Charest of Quebec announced on Oct. 29 a deal that would lower electricity rates in New Brunswick and transfer most of NB Power's ominous liabilities to Hydro-Québec. For its part, Hydro-Québec says the takeover is a good investment.

The agreement has whipped up a storm of controversy. Premier Danny Williams of Newfoundland and Labrador promptly spoke up against it. He condemned Quebec's "despicable power grab" and attacked Mr. Graham for what he called "complete capitulation," having "agreed to sell away" his province's future. New Brunswick's Conservative opposition leader, David Alward, was initially non-committal, but sensing the political storm brewing, piled on accusing the Liberal Premier of having "sabotaged the interests of its fellow Atlantic provinces so viciously in this transaction." Nova Scotia's Premier Darrell Dexter has joined with Premier Williams in demanding written guarantees that power exports through New Brunswick will be unaffected.

Protests against the sale of NB Power have broken out at the legislature, at MLAs' offices, on Facebook and on news websites. Prominent in the protests are union groups, perhaps motivated by the realization that Hydro-Québec's labour productivity is more than 50 per cent better than NB Power's with respect to generation and 20 per cent better with respect to customer service.

Polling data released over the last two weeks show strong public antipathy toward the deal, putting the Graham government on the ropes.

Prince Edward Island Premier Robert Ghiz, bucking the wave of hysteria, is negotiating with Hydro-Québec to find ways of bring down his province's sky-high power rates, although with much of the island supplied by a privately-owned utility, the potential is unclear.

What is behind all this controversy?

THE DEAL

Under the agreement, Hydro-Québec would take over NB Power's $4.75-billion debt as well as its current obligations. In return, Hydro-Québec would receive NB Power's hydroelectric stations and its transmission and distribution assets. Upon completion of the refurbishment of the Point Lepreau nuclear generating station, expected now in February 2011, Hydro-Québec would take over the nuclear operation. New Brunswick would see its high-cost coal- and oil-fired generation downsized initially and potentially eliminated in the longer term.

Consumers would benefit. Residential, small-business and institutional consumers would get a five-year rate-freeze, followed by regulated rates adjusted for inflation. New Brunswickers concerned about long-term residential rates might note that in recent years, Hydro-Québec's rates have risen faster than inflation. New Brunswick's large industrial users, key employers in the province, would enjoy a rate reduction of about 30 per cent.

All consumers would be exposed to the market cost of any additional supply needed to meet load growth and some of the cost consequences of the Point Lepreau refurbishment. For industrial customers, the market cost of additional supply kicks in if load grows by 3 per cent over last year, when sales were depressed by tough economic conditions. For general service customers, demand would have to grow by about 10 per cent above the average sales over the last five years for the market cost to kick in, thereby creating substantial head room for growth.

Given low prevailing market prices for power, the cost of supplying near term load growth would be modest, although in the longer term, this cost could grow. Depending on how power rates are designed in future, this structure could result in new industrial customers coming into conflict with existing industrial customers.

After five years, all consumers would pay for the transmission and distribution component of their services based on a regulated private utility model. Unfortunately, the deal does not clarify what this component of the rate will be based upon.

The deal stipulates open access to the transmission network in New Brunswick and market competition for future electricity supply in excess of a guaranteed block of power that Quebec would provide in perpetuity.

THE BACKGROUND

New Brunswickers have seen NB Power pounded by crises, particularly over the last decade and a half. Bad technology choices and catastrophic contracting failures have resulted in a legacy of inefficient investment, very high operating costs and rates among the highest in Canada, with prospects of rising substantially higher.

NB Power's existing assets-per-customer are bloated compared with its closest counterparts in Canada, Nova Scotia Power and SaskPower. This factor is driving NB Power's high and rising debt. NB Power's spending has put future generations at risk if the status quo remains.

As the most oil-dependent large utility on the continent, NB Power and its customers have been pounded by fluctuating oil prices. Recognizing this weakness, NB Power announced in 2001 a plan to convert its largest oil-fired station to an alternative fuel called Orimulsion, which comes solely from Venezuela. As approximately $750 million was being spent to ready the plant for this fuel, a massive strike pitted Venezuelan state oil workers against President Hugo Chavez's government. The resulting supply interruption forced NB Power into the red.

Heedless of this danger signal, the utility continued to pour money into the Orimulsion scheme. In 2003, Venezuela announced it would not sign any new sales contracts. NB Power had only a memorandum of understanding with Venezuela, not a binding contract. To his great credit, the CEO who inherited this mess, David Hay, eventually negotiated a deal rescuing about half of the money sunk into the refurbishment.

When NB Power's nuclear reactor, Point Lepreau, succumbed to premature aging, NB Power turned to Atomic Energy of Canada Ltd., the federal Crown corporation, to refurbish it. The project ought to be nearing completion; it will take another 18 months or more, with costs mounting rapidly. Replacing the foregone power caused by this delay could cost as much as $1,000 per customer; Hydro-Québec would absorb some of that cost. New Brunswick is pleading with the federal government for money to compensate for AECL's poor performance, but the prospects of that are uncertain.

NB Power's Grand Lake generating station is adding to the pressures on NB Power: it is the most polluting coal station in North America per unit of output and it probably also one of the highest cost.

Although the utility has done better for the past five years, its overall earnings over the past 15 years have been negative. In its most recent fiscal year, NB Power declared a profit, but it is dangerously dependent on the success of the nuclear refurbishment project.

Many reform efforts have foundered. The previous Conservative government toyed with imitating Alberta's competitive power market but did not follow through; nor did its Liberal successor. And proposed public-private partnerships for plant refurbishments never found takers.

Politically motivated rate freezes have abounded, though in the past five years, rates have risen by 27 per cent, much more than inflation.

Refurbishment of NB Power's largest hydro-electric facility will apply upward pressure on rates if the status quo, remains but not under the deal. Future problems in operating the aged but refurbished nuclear station and constraints on carbon emissions, should either or both develop, would do the same.

THE STUMBLING BLOCKS

Political reaction to the deal has engulfed Eastern Canada.

Premier Williams believes Quebec is intent on thwarting Newfoundland's ambitions to develop further hydroelectric generation in Labrador.

Like his predecessors, he feels aggrieved over the 1969 contract that premier Joey Smallwood signed with Quebec to develop Churchill Falls in Labrador. The Supreme Court of Canada has twice affirmed the validity of that contract. Williams's government wants to develop new hydro capacity on the Lower Churchill. His extreme reaction to the New Brunswick-Quebec combination arises from his fear that Quebec will do something to harm his planned development.

The Newfoundland government has doubts about its own scheme. Its 2007 energy plan was issued when natural gas prices were double what they are today and when New England and Ontario were projecting electricity shortages in the near future. Even in those favourable circumstances, the Newfoundland scheme relied heavily on federal-government financial help.

Today, with market prices for power off sharply and electricity consumption falling, the prospects for the Lower Churchill have softened. Newfoundland had a chance to bid on access to a new international transmission line connecting New Brunswick to Maine two years ago, part of a possible route to market for Labrador power. Premier Graham points out that Newfoundland had that opportunity to buy capacity on this cross-border line, but declined.

Nova Scotia has also complained about Quebec's ability to act as spoiler of potential power exports to the United States. That province has some modest wind and tidal power developments, but the practical prospects for its becoming a major exporter of renewable electricity to New England appear remote.

In any case, the reaction of both Newfoundland and Nova Scotia seems to be based on ignorance of the open transmission access provisions in both the proposed deal and the requirements of the U.S. Federal Energy Regulatory Commission. Quebec, a major exporter of electricity to the United States, must have a FERC licence to export it there, which makes FERC the key transmission regulator for Hydro-Québec.

FERC's rules require companies selling power in the United States to prove that they will not have undue influence on the market and require that they allow open access to their transmission systems, including to Newfoundland and Nova Scotia. Given Hydro-Québec's existing and planned business interests in the United States, FERC's rules are more than sufficient to restrain any imperialist tendencies on the part of Hydro-Québec.

Shawn Graham has done his own initiative a disservice by springing it on the public. Had the province announced that the utility was for sale and invited proposals in a transparent fashion, the public might have been more confident in the outcome.

THE UPSHOT

Most of the political opposition to the NB Power-Hydro-Québec deal is hyperbole and should not be taken too seriously. The uproar from ordinary New Brunswickers is a different matter.

Premier Graham has serious work to do if the deal is to be rescued. Neighbouring provinces deserve assurances over the details of transmission access. Cost allocation and regulatory rules for transmission and distribution services must be clarified. The public needs and deserves to see that legitimate concerns are being taken seriously. Otherwise this deal may fail, at great cost to New Brunswick.

The province faces a pressing need to cut electricity liabilities, improve efficiency, and slash the long-term costs of providing power. None of the critics of the proposed Quebec-New Brunswick agreement have offered any real alternatives, let alone one better than the deal now on the table.

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Comments as posted to the TJ site:

Little Guy – Brian no longer works with AIMS but did. He now heads up the MacDonald Laurier Institution in Ottawa. I hope you will make a donation. Perhaps we should have been clearer on Grand Lake. Our point is that until oil prices shot up recently, GL was eating money. Your facts are wrong on oil usage. Of the fuels used by NB Power in generation, oil constituted 32.45% (08/09). State by state fuel use for power production by sector current to 2007 is available here: http://www.eia.doe.gov/cneaf/electricity/epa/epa_sprdshts.html
Note that the category "Petroleum" reported in this EIA data set includes pet coke, unlike the NBP data. You will note that no continental state in the US has an oil+petcoke reliance remotely close to NB Power's oil reliance. It is also interesting to note that from

1998 to 2008, oil use by utilities in the US has declined by 79%. See:
http://www.eia.doe.gov/cneaf/electricity/epm/table2_2_a.html
Tom Adams, Toronto on 05/12/09 04:40:10 PM AST

Monkey in Blue – Your concern as to who is advising Premier Graham is a concern I share, although you are wildly off in Brian's case. Graham needs access to experienced expert advice on public utility regulation. This is where the MOU requires most refinement.

Mr. McCready - Congrats on having a real name. My bias is in favour of a cleaner, cheaper power system. Thanks for asking.

Tom Adams, Toronto on 05/12/09 04:41:43 PM AST