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Subject: Duke Point 3

February 4, 2005
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Ref. Project 3698354; Closing Argument by Erik Andersen; Intervenor

The Commission has been attempting to critically examine a proposal by BC Hydro to contract for a new source of electrical energy, allegedly needed to meet a short-term supply gap in the 2007/2008 period, on Vancouver Island. BC Hydro has represented that following an examination of several private sector proposals, the one from Pristine/Duke Point Power is the least costly and thereby the best choice. By this judgment BC Hydro is representing to the Commission that this chosen project is in the best interests of the public.

In a global sense this proposal lends itself to a two part examination. First there is the justification as presented by the so called "Electric Load Forecast",

prepared by BC Hydro in October of 2004. Second is the examination of the costs of the chosen strategy to see if it indeed meets the test of being the least cost solution.

Future Demand for Electricity on Vancouver Island

The document titled "Electric Load Forecast; 2004/05 to 2024" is a misrepresentation of future demand on Vancouver Island. The Commission heard considerable evidence as to how this document was prepared and knows full well that it is only a mathematical projection pulled from a larger projection. The big assumption made by BC Hydro is that a profile of users formulated to serve a model that encompasses almost a quarter of the North American continent can be used to profile the users of the very much smaller and different regional market, Vancouver Island. This is a case where "think globally but act locally" was forgotten.

On the topic of forecasting, economists make a huge distinction between simple mathematical extrapolations and the intellectual rigor needed to prepare a useful and honest forecast. David Hendry of the University of Oxford states that "The main challenges facing a theory of economic forecasting, however, are to explain the re-curring episodes of systematic mis-forecasting observed historically, and to develop methods which avoid repeating such mistakes in future." There was never any evidence from BC Hydro that after ten years of making a consistent error in their forecasts they were developing methods to avoid making these mistakes.

The Economic Cycle Research Institute makes the point that a recent IMF study concluded "The record of failure to predict recessions is virtually unblemished." The Institute goes on to say that "The reason for this failure is simple. Most economists forecast by extrapolating economic trends. This methodology has its merits, predicting a turning point is not one of them." During the course of these hearings I do not recall a substantive discussion about the use of leading indicators and how the so called forecast would be affected by developments inside and outside the region. Australian economists use three leading indices; the ABS Composite Leading Index; the NATSTAT Leading Indicator and the Westpac-Melbourne Institute Leading Index. Additionally, I like to use the Baltic Dry Cargo Index. Components of the three Australian Indices include data such as housing finance approvals, job vacancies, new telephone installations, the real money supply, real unit labor costs and the inverted real interest rate.

A further factor influencing future consumption of electrical energy on Vancouver Island is the projected costs of alternative energies. The substitution principle was never a part of crafting the demand schedule that supports the need for more production.

The so called forecast by BC Hydro did not recognize the almost unique demographics of this region. Vancouver Island is more and more populated by older people, who by virtue of being in retirement, have a much lower labor

market participation rate than for the rest of BC. BC Hydro mention a 70% factor but the North American rate stands just over 65% as of now and they know this as well as I do.

Evidence was given the Commission of the historical volatility of the new housing industry on Vancouver Island yet BC Hydro did not seem to think it appropriate to net out a portion of the present consumption to remove the non-permanent part of this demand.

The topic of demand management was presented by a number of intervenors as it represents a simple, no/low cost method of closing the perceived supply/demand gap. Interval metering (in home digital

price read-outs) are now being installed in Victoria, Australia as a method of encouraging customers to modify their demand by reducing usage in peak periods. This means the acceptance and application of the notion that a rational person responds to price fluctuations. BC Hydro is a retailer that does not behave as one. This shortcoming offers a multitude of interesting opportunities to encourage conservation.

In conclusion I do not think BC Hydro have made a believable case for need for the proposed electricity generation facility planned for Duke Point. To sanction the investment of \$300million based upon such a shoddy projection of future needs is irresponsible.

Costing Analysis of the Proposed Duke Point Generation Plant

As the Commission well knows, critical examination of the costs for the chosen option, Duke Point Power, has been made so difficult by BC Hydro that this part of the exercise has been the ultimate in frustration for the intervenors. BC Hydro has conducted an appraisal of generation options "sub rosa" and asked the public to blindly accept their word that their choice is the best one.

The first and most glaring aspect of this generation plan is the use of natural gas to drive electricity generation turbines. BC Hydro is very sanguine about the future costs of natural gas even after the intervenors have shown how volatile prices have been. Answers to questions made it clear that the customers of BC Hydro will be fully responsible for future gas prices. In evidence BC Hydro suggested they expect the price of natural gas to drop by as much as 50%. This expectation seems at odds with the current rush to construct LNG facilities along the coasts of North America. These new and expensive facilities are being built in the belief that future gas prices in North America will remain high as there is an on continent shortage of natural gas supplies. Should the expectation of lower future gas prices be correct then by extension a person would be reasonable in thinking this would be caused by a very weak economy. BC Hydro can't have it both ways; lower gas prices because of a weak economy and a projection of booming demand.

A cost of this facility at Duke Point will be pollution. Considerable evidence was introduced by intervenors that a great deal of environmental damage would result from the operation of this plant. It was never too clear if BC Hydro felt it

had a social obligation to incorporate environmental costs into their analysis but we all know they will be there. At the least it must be acknowledged by the Commission that "green credits" will be a cost to this natural gas generation option and that some of the other options would by contrast produce these credits as revenue for their financial models.

An indirect cost associated with this natural gas fired generation plant is negation of expensive advertising by both the Federal and Provincial Governments designed to represent Canada and British Columbia as environmentally friendly places to live in and visit. Recently we have Rick asking us to take up the "one ton challenge" and I suppose we intervenors are doing our part by objecting to this proposed plant. We have the two governments talking the talk on the one hand and a crown corporation aided by financing from the likes of the CPP walking a different walk on the other hand. This disconnection between the mouth and the hand is truly breathtaking.

While not so much a cost item it must have occurred to the Commission that this Duke Point facility will aggravate our energy dependency on Vancouver Island. By increasing our energy reliance upon off-Island sources we only build ourselves future problems. It would perhaps be acceptable if other on-Island energy options did not exist but we all know that is not true. We are about to see \$300 million spent on old technology rather than use it to show-case some on-Island opportunities. Shame, shame and shame.

Summation

This hearing has been a trial of sorts for those of us who believe we are representing the best interests of the public. We can't help feeling that the strategy adopted by BC Hydro was to circumvent any serious examination of the need and merits of new on-Island generation. Hiding behind processes only generates suspicion in the minds of the public.

As to the appalling choice of pollution producing natural gas as the primary energy source we can only wonder at the difference between the worlds we think we wish to live in and the one BC Hydro would have us live in.

End this nonsense now.

Sincerely
Erik Andersen, Economist