

David Morton  
Chair, Site C Review Panel  
British Columbia Utilities Commission  
Vancouver, British Columbia

October 16, 2017

Dear Sir,

Thank you for the invitation to present during your Inquiry into Site C. This short note relates to issues other than those I addressed in my two submissions and oral testimony.

I write on two matters. These relate to the costs of project termination and potential sunk costs.

On the first matter, there was considerable discussion at the technical meetings, on October 13-15, 2017, of the costs incurred to date and whether these have been accurately measured, but little consideration of contractual obligations and how contractual commitments may impinge on the comparisons of the costs of continuing, terminating or suspending the project. This is a matter which is crucial when discussing the Muskrat Falls project, when attempts are made to consider the option of terminating or suspending the project. My concern is less with costs that have been incurred and more with those costs which will be incurred if the project is terminated or suspended and nothing I have seen or heard has allayed this concern. I felt compelled to share these thoughts even though it is late in the day and the matter may already be well in hand.

The matter in question relates to how contractual obligations are measured and renegotiated in order to avoid imposing unnecessary costs on the ratepayer, in the event a decision is taken to terminate or suspend. It is sometimes posited that the contractor will seek to protect the expected profits and that what BC Hydro will need to do is to offer compensation by providing compensation for all costs incurred to date, plus an allowance for foregone profits. Public disclosure of profit expectations will always be problematic but such expectations will play a key role in settling disputes surrounding project cancellation. Measuring costs incurred and commitments made in fulfillment of ongoing contracts may be equally problematic. Most projects have provisions for contract cancellation but it is facile to argue that the existence of such provisions negates the need for further examination of the question.

Perhaps the BCUC has reviewed all contracts for engineering design, procurement, construction and management associated with Site C, bearing in mind that many of them impose large obligations for all parties. If not may I suggest that the Commission examine each contract and assess how BC Hydro has estimated the cost of terminating or suspension in their measurement of the options? In performing its due diligence on estimating costs and schedules the BCUC should ask a number of basic questions, including the following:

- ✓ Is there a standard contract or are bespoke contracts negotiated for each project, perhaps depending on their scale and complexity?
- ✓ Are there standard cancellation clauses or do they vary depending on the nature of the project?
- ✓ What formula is provided for compensating the supplier when BC Hydro cancels the project unilaterally and not by mutual agreement?
- ✓ What penalties exist for termination?

- ✓ To what extent is there provision for dispute resolution and, if so, have the parties agreed on resolution principles which allow for clarity in calculating costs or damages?
- ✓ How many disputes already exist and how has BC Hydro provided for their resolution in cost estimates provided to the Commission?
- ✓ Have any contracts already been renegotiated and does their resolution offer insights into how future disputes might be resolved?
- ✓ Has BC Hydro made appropriate provision for settlement of disputes surrounding renegotiating and termination of contracts in measuring the costs of termination or suspension?

The second matter relates to sunk costs versus future costs and how the Commission should deal with these in its final report to government. Reference was made at the hearing by BC Hydro on the negative corporate impact of absorbing the sunk costs in an entity with a relatively small equity base. It is important to separate the issues of who should bear sunk costs and the impact thereof from the fundamental economic analysis of the options. In this fundamental analysis it should be clear that sunk costs are irrelevant when making decisions about future action. Bygones are bygones and options should be evaluated based on the future costs and benefits. Sunk costs do have consequences and must be recovered but they should be separated when making comparisons with other projects.

I understand that the final submission in this proceeding will be made later today by BC Hydro. Thank you for your indulgence in considering this brief note and placing it on the record.

With respect,

David Vardy  
Concerned citizen  
St. John's