



The Churchill Falls Contract: What's to Come?

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Churchill Falls



34 million MWh a year

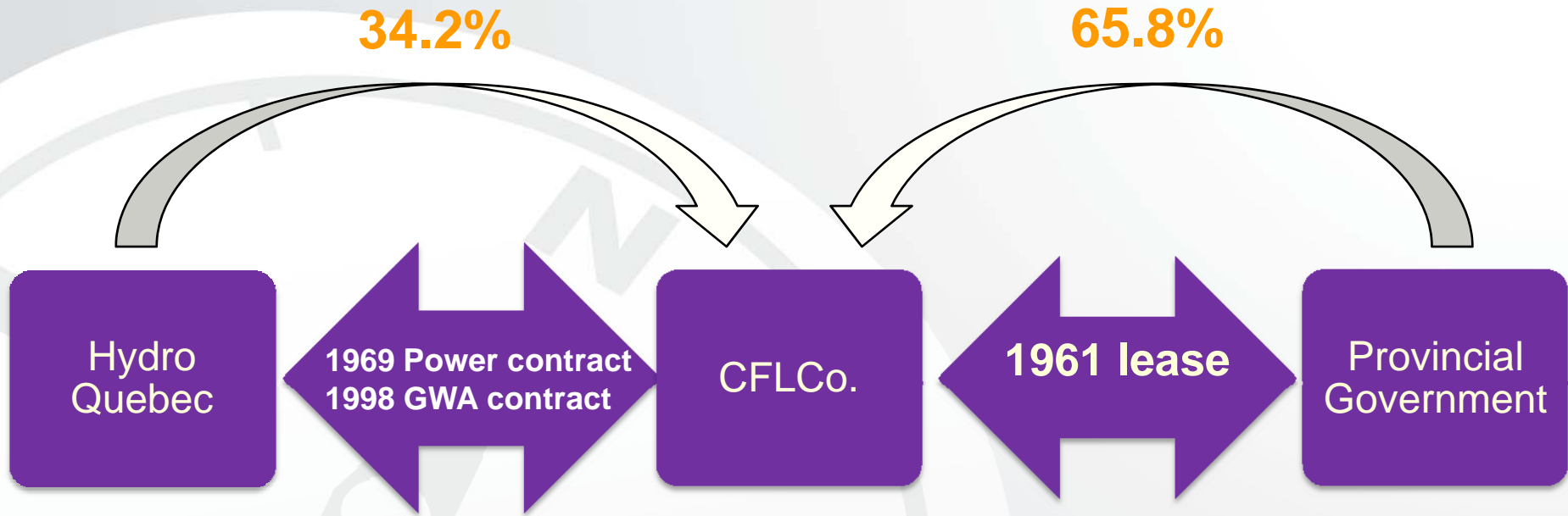
**90% to Hydro-Quebec
for \$80 million a year**

**but worth
\$1.2 billion if valued at \$40
per MWh**

Presentation

- **The Current Situation**
- **A Brief Chronology**
- **The Letter of Intent**
- **The Contract**
- **Ownership**
- **The Renewal Clause**
- **Implications of the Status Quo**
- **Options to Explore**

Current Situation



Brief Chronology

- **1953** **Brinco is formed**
- **1958** **HFPCo (later CFLCo)**
 Brinco 80%; Shawinigan 20%
- **1961** **Lease is granted**
- **1961-66** **Up and Down Negotiations with
parallel political spats**
- **1966** **Letter of Intent**

The Letter of Intent (1)

A Quid Pro Quo Agreement

- **Hydro Quebec got:**
 - a low-price, (less than alternatives)
 - a very long term (44 year term, minimum)
 - the right to complete the project
 - right of first-refusal following the end of the term
- **CFLCo got:**
 - completion guarantee (HQ to lend/guarantee)
 - assistance with interest
 - HQ loans to help if revenue is insufficient to pay debt/operating expenses
 - exchange-rate risk (shared with HQ)

The Letter of Intent (2)

- **What NFLD Stood to Get**
 - **Power for local development**
 - **Construction jobs**
 - **Revenue from**
 - **Horsepower tax (approx.\$2.5 million p.a.)**
 - **Rental (8% on pre-tax net income)**
 - **Provincial CIT+ the rebate of federal CIT.**

The Letter of Intent (3)

- **Parties' Assessment of the Letter of Intent**
 - **Hydro Quebec**
 - **“a life raft”**
 - **“most favourable agreement possible”**
 - **Smallwood**
 - **“praise be to God”**

The Contract (1)

- **Construction starts immediately late 1966**
- **Negotiations continue concurrently**
- **Brinco/CFLCo's finances decline by end of 1967**
- **Mid April 1968, meaningful negotiations are over**
- **By July 1968, the deal is done**
- **May 22, 1969, contract is signed**

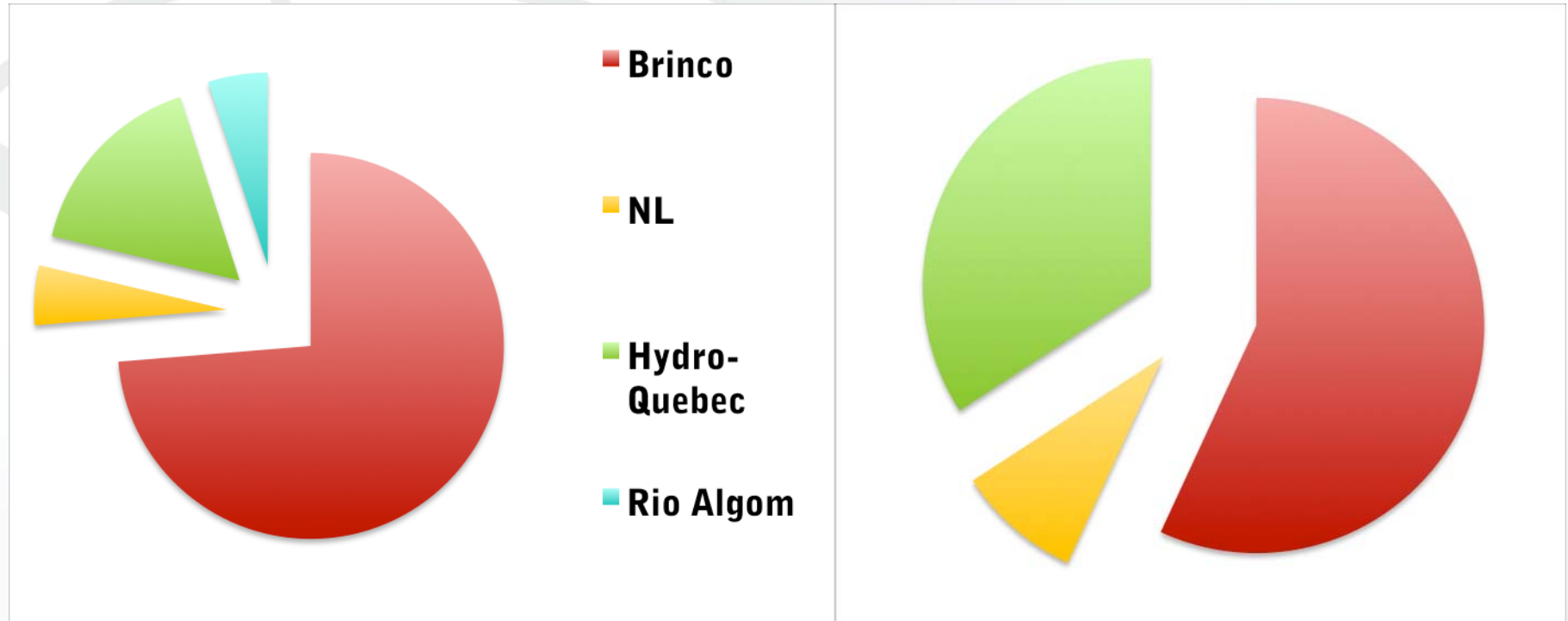
The Contract (2)

- **Two Substantial Changes:**
 - **Ownership:** HQ now owned 34.2% and stood to get free shares if it has to lend to CFLCo with the possibility of gaining 50.1%
 - **Renewal:** A new “renewal clause” for 25 years, fixed reduced price of \$2.00 per MWh

Ownership of CFLCo (1)

October 1966

May 1969



Ownership of CFLCo (2)

- **Acquisition by Hydro-Quebec**
 - **1964 “nationalization”**
 - **1968, HQ demanded 25.7% or no deal**
 - **1968, HQ made conditions on the General Mortgage Bonds unattractive to others**
(HQ bought all of them with the “bonus shares” to give it 34.2%)
 - **Smallwood was “adamant” in getting shares and “violently contended” not to fall relative to HQ – but did**

Ownership of CFLCo (3)

- **Possibility of HQ getting 50.1%**
 - **The contract gave HQ new bonus shares if called on to assist CFLCo with loans**
 - **If any such loans exceeded \$124 million then Brinco would have to sell holdings to HQ to give it 50.1% ownership**

Renewal (1)

- **Before, and as of, the Letter of Intent:**
 - “... quantity and price as ... mutually agreed”
- **To Feb. 1968**
 - no change
- **March 1/68**
 - A “do or die condition”
- **March 11/68**
 - CFLCo says profitability “stripped to the underwear”
 - CFLCo counter-offer on renewal
- **April 19/68**
 - HQ’s demand is in the contract

Renewal (2)

- **\$2 per MWh was lower than in 1964**
- **HQ's assessment:**
 - “ It is an extremely advantageous rate...even at this time.”
- **Smallwood: (After the fact – July 12, 1968)**
 - “...pretty cheap power”

Implications of the Status Quo

- **2016 to 2041**
 - Term of the contract ends
 - Provincial tax concessions end
 - Renewal at \$2 per MWh for next 25 years
 - CFLCo loses on the contract / GWAC subsidizes
 - HQ still owns 34.2% of CFLCo
- **2041**
 - Renewed contract ends
 - HQ still owns 34.2% of CFLCo
- **2060**
 - Lease ends, but renewable for 99 more years
 - HQ still owns 34.2% of CFLCo
- **2159**
 - Renewed lease ends
 - HQ still owns 34.2% of CFLCo

Options to Explore (1)

- **Taxation – post 2016**
 - existing taxes apply
 - New taxation on electricity generation
 - Section 92A of the Constitution Act
 - Can HQ be legally liable for provincial tax?

Options to Explore (2)

- **CFLCo could**
 - **Seek renegotiation of renewal**
 - **Take HQ to court, challenging renewal**
 - **Reject renewal, putting onus on HQ**
 - **Re-direct the energy, and pay the “deficiency penalties”**

But

- **CFLCo’s inherent conflict of interest**

Options to Explore (3)

- **Ownership Issue (deal with it now)**
 - NLH negotiate HQ shares in CFLCo
 - Province expropriation
 - Possible constitution issue but that is how HQ obtained its initial position
- **The Lease**
 - In 2041, do a “Water Rights Reversion Act”



Questions?

Comments?