

NR 2008-

Title: Issuance of Water Rights for the Lower Churchill River to the Energy Corporation of Newfoundland and Labrador

ISSUE:

The option held by the Lower Churchill Development Corporation (LCDC) to acquire rights to the Lower Churchill River expired on November 24, 2008. The Minister of Natural Resources has advised LCDC that the option will not be renewed. A request has been received by the Minister of Natural Resources from the Energy Corporation of Newfoundland to obtain water rights to the Lower Churchill River pursuant to the *Energy Corporation of Newfoundland and Labrador Water Rights Act*. Issuing these rights will enable the Energy Corporation to enter into discussions with CF(L)Co on a water management agreement. Both the water rights and water management agreement are necessary to obtain project financing.

Recommendation:

It is recommended that:

- (1) The Lieutenant Governor in Council be authorized to issue to the Energy Corporation of Newfoundland and Labrador a water rights lease for the Lower Churchill River pursuant to Section 6 of the *Energy Corporation of Newfoundland and Labrador Water Rights Act*, similar to that currently on file with the Clerk of the Executive Council.

Background:

On November 21, 2008, the Minister of Natural Resources advised the Lower Churchill Development Corporation (LCDC) that the Government of Newfoundland and Labrador would not be renewing the Option Agreement. As a consequence, the Lower Churchill Development Corporation's option to acquire water rights to the Lower Churchill expired on November 24, 2008. This action will also have the effect of terminating the Option Agreement.

LCDC is incorporated under the laws of Newfoundland and Labrador and is jointly owned by NL (51%) and the Government of Canada (49%). It was established in 1978 with the objective of developing all or part of the hydroelectric potential of the Lower Churchill River. The "Principal Agreement" and the "Option Agreement" were ratified by *the Lower Churchill Development Act*.

The Province's shares in LCDC are vested in NLH (but will be transferred to ECNL along with the shares of CF(L)Co and Gull Island Power Company). LCDC is currently inactive, but held, through the Option Agreement, the right to use the Lower Churchill to generate power exercisable if the shareholders agreed to pursue development through the company. The option was first granted in 1978 and was renewed regularly by the Province and LCDC.

In the Spring Session, 2008, the House passed *The Energy Corporation of Newfoundland and Labrador Water Rights Act*. The *Act* permits the Lieutenant Governor in Council to issue water rights to the Lower Churchill to the Energy Corporation and to establish the terms and conditions upon which the rights will be granted in a lease. A request has been received by the Department of Natural Resources from the Energy Corporation to issue water rights to the Lower Churchill.

Issuance of the water rights, together with proclamation of the 2007 amendments to the Electrical Power Control Act 1994 and the promulgation of regulations pursuant to that amended Act, are required for ECNL to enter into a water management agreement with CF(L)Co. Both the water rights and water management agreement are necessary to obtaining project financing..

Alternatives:

1. Authorize the Lieutenant Governor in Council to issue a water rights lease to the Energy Corporation of Newfoundland and Labrador for the Lower Churchill River under Section 6 of the *Energy Corporation of Newfoundland and Labrador Water Rights*, similar to that currently on file with the Clerk of the Executive Council.

Issuing water rights will enable the Energy Corporation to enter into discussions with CF(L)Co on a water management agreement as provided for in the amendments made to the *Electrical Power Control Act, 1994*. The water rights and a water management agreement are necessary to obtaining project financing for the project.

This is the recommended alternative.

2. No Action.

Without water rights, the Energy Corporation will not be able to enter into discussions with CF(L)Co on a water management agreement and will not be able to proceed with project financing discussions.

This alternative is not recommended.

LEGISLATIVE / REGULATORY CONSIDERATIONS:

Section 6(1) of the *Energy Corporation of Newfoundland and Labrador Water Rights Act* provides authority for the Lieutenant Governor in Council to issue a license, lease or other instrument, upon the request of the Energy Corporation of Newfoundland and Labrador, granting water rights with respect to the Lower Churchill River to the Energy Corporation of Newfoundland and Labrador where the Energy Corporation of Newfoundland and Labrador proposes to use the water rights for water power generation purposes. Section 6(2) of the Act provides authority for the Lieutenant Governor in Council to establish the terms and conditions applicable to the licence, lease or other instrument.

The recommended action involves the issuance of a lease under an existing statute. There are no Red Tape Reduction considerations to the recommended action, and no Regulatory Impact Analysis is required.

FINANCIAL CONSIDERATIONS:

The *Energy Corporation of Newfoundland and Labrador Water Rights Act* did, among others, extinguish all rights to the Lower Churchill Basin, including those held by Newfoundland and Labrador Industrial Development Corporation (NLIDC). NLIDC acquired these rights and the shares of CF(L)Co held by Brinco in 1974. Up to March 31, 2008, NLIDC has shown the water rights as an asset valued at \$30 million with an equivalent liability to the province for the purchase of \$30 million in commons shares in LCDC should the option be exercised. The net effect of extinguishing the water rights held by NLIDC on the consolidated position of the province is \$0. It will, however, have an impact on the financial statements in terms of changing how the transaction is recorded on the consolidated balance sheet of the Province but the overall impact will be the same.

INTERDEPARTMENTAL CONSIDERATIONS:

The Departments of Justice, Labrador and Aboriginal Affairs, Finance and the Intergovernmental Affairs Secretariat were consulted in the drafting of this Memorandum.

LABRADOR OR ABORIGINAL CONSIDERATIONS:

Innu Nation has been extensively consulted on the Lower Churchill development by the Energy Corporation during IBA discussions and through the environmental assessment process.

INTERGOVERNMENTAL CONSIDERATIONS:

LCDC is a joint venture of the Government of Newfoundland and Labrador and the Government of Canada, which is represented in this matter by the federal Minister of Natural Resources. The Deputy Minister of Natural Resources has contacted the Deputy Minister responsible for Natural Resources Canada to discuss actions taken by the Government of Newfoundland and Labrador regarding the Lower Churchill Project.

OTHER JURISDICTIONS:

N/A

CONSULTATIONS:

The Energy Corporation was consulted in the drafting of this Memorandum.

ENVIRONMENTAL CONSIDERATIONS:

The Lower Churchill project is undergoing a full environmental assessment through a joint federal- provincial Panel Review.

COMMUNICATIONS AND CONSULTATION SYNOPSIS:

A Communications Synopsis is attached as Annex 1.

KATHY DUNDERDALE
Minister of Natural Resources

Attachments

- Annex 1. Communications Synopsis
- Annex 2. Outline of Lease Terms and Conditions from the Option Agreement under the *Lower Churchill Development Act*.

Date: November 26, 2008

Annex 1.**Consulted with:**

Charles Bown, ADM, Energy
Policy

Date Drafted:

November 14, 2008

Anticipated Announcement:**Communications Objectives**

- To communicate that the Provincial Government is issuing a water rights lease to the energy corporation for the Lower Churchill River to enable the corporation to proceed with project planning and financing.
- To explain that the Provincial Government is not renewing the Option Agreement for water rights on the Lower Churchill for the Lower Churchill Development Corporation (LCDC) as that corporation is inactive and is no longer leading the development of the Lower Churchill Project.
- To demonstrate that this action in no way infringes upon potential support from the federal government for the Lower Churchill Project as LCDC has not been leading the project for some time.

Target AudiencesInternal

Premiers Office

Department of Natural Resources

Department of Intergovernmental Affairs

Department of Environment and Conservation

Department of Labrador and Aboriginal Affairs

Executive Council

External

Federal Government

Media

Opposition parties

Anticipated Media Reaction**Medium**

This issue was debated in the House of Assembly in the spring of 2008 when Bill 36, *An Act to Enable the Issuance of Water Rights to the Energy Corporation of Newfoundland and Labrador for the Lower Churchill River*, was introduced and passed. Media reported on government's rationale for bringing the legislation forward at that time and no real controversy resulted. The media will cover the fact that the government is now moving forward to grant a water rights lease for the Lower Churchill River to the energy

corporation as another important step in the development of the Lower Churchill River. The main question will be around the significance of the timing in granting the water rights lease and what happens now. Attention will be given to the fact that once the energy corporation has been granted the water rights lease, it will enter into negotiations with the Churchill Falls (Labrador) Company (CF(L)Co, and indirectly Hydro Quebec, on a water management agreement.

Anticipated Reaction

Medium

This will be seen as an important step in the development of the Lower Churchill Project and will raise questions within the public as to the federal involvement in the project and who will ultimately own the power when it is developed. These are the same issues that were raised when the legislation was originally debated in the House of Assembly. The public will also follow closely the subsequent negotiations between the energy corporation and the Churchill Falls (Labrador) Company (CF(L)Co, and indirectly Hydro Quebec, on a water management agreement.

Possible Headlines

Positive: Energy Corporation Secures Water Rights to the Lower Churchill

Negative: Provincial Government Ready to Square off Against Hydro Quebec over Water Management on the Churchill River

Key Messages

- The intent in not renewing this option is to enable the issuing of water rights for the Lower Churchill to the newly formed energy corporation, which is leading the development of the Lower Churchill Project.
- With these rights, the energy corporation can now begin negotiating with Hydro-Quebec (CF(L)Co) on the specifics of a water management agreement for the Churchill River.
- A water management agreement will give the financiers and potential customers of the Lower Churchill Project the certainty they need to finance the project and sign power purchase agreements.
- This is another step in providing the people of the province with the tools to get the most out of our energy developments.
- The river belongs to the people of Newfoundland and Labrador and it is the responsibility of the province to retain control of its resources and ensure that the use of that water supply is regulated in such a way that it maximizes the benefits to the province.
- The project is particularly important to the people of Labrador, who will receive a significant portion of the jobs and business spin offs.
- Normally water rights on rivers in this province are issued through the *Water Resources Act*. In the case of the Lower Churchill, however, issuing water rights is optioned under the *Lower Churchill Development Act*. When this Act was

proclaimed, the option to obtain water rights was granted to the Lower Churchill Development Corporation. Our government is not exercising this option as we are leading the project through the energy corporation.

- This action does not preclude federal government support of this project, which we will continue to pursue. We recognize that this is an important project not only for Newfoundland and Labrador, but for all of Canada as well, and there is an opportunity for the federal government to participate in and benefit from this project.
- This is important in the planning process and timelines for this development. We are ensuring that the energy corporation can fulfill its mandate, that the Lower Churchill Project team can proceed with the planning of this development, and that the people of Newfoundland and Labrador benefit fully from this development.

Activities

- The Minister of Natural Resource will contact the Minister for Natural Resources Canada discuss recent actions by the Government of NL regarding the Lower Churchill Project.
- The Minister of Natural Resources will issue a press release once the water rights lease has been granted to the energy corporation reiterating the importance of this step in the development of the Lower Churchill Project and in ensuring maximum benefit from resource development for the people of the province.

Follow-up Activities

Response will be monitored by reviewing media coverage, correspondence and inquiries. Monitoring will also ensure that Government/Hydro messages have been received and presented correctly.

Drafted by: Tracy Barron, Communications, 709-729-5282

Approved by: Charles Bown, ADM, Energy Policy

Annex 2.

Outline of Lease Terms and Conditions from the Option Agreement under the *Lower Churchill Development Act*

- (i) the Corporation will have the exclusive (subject to Permitted Encumbrances) royalty-free right and license to use the Water Rights for an initial term of 99 years from the Closing Date;
- (ii) the Corporation will have the option to renew the Water Lease for one further term of 99 years commencing at the end of the initial term, with such renewal lease to contain the same terms and conditions as the original Water Lease (other than the renewal option);
- (iii) the Corporation will not be required to pay to Newfoundland during the term of the Water Lease including any renewal thereof, any amount in respect of the Water Rights, whether by way of rent, license fee, royalty, concession fee, tax, tariff or any payment no matter how described;
- (iv) the Corporation will have the full right and liberty to flood any lands within the catchment area of the Water Lease, subject to Permitted Encumbrances and any rights granted to others as permitted by clause 6;
- (v) the Corporation shall have the exclusive right (subject to Permitted Encumbrances and the other provisions of this Agreement) to exploit, harness and make use of all hydro-electric and hydraulic power rights comprised in the Water Rights, and the right to regulate the flow of all water courses in the catchment area of the Water Lease; provided that the Corporation's rights shall be subject to the rights of all upstream proprietors, licensees and other users of the waters of the said Churchill River existing immediately before the date of the execution of the Principal Agreement and which accrued or were accruing on February 14, 1978;
- (vi) Newfoundland will, from time to time, grant to the Corporation by way of a royalty-free lease, license, permit or other assurance of or in respect of such Crown Lands not then irrevocably granted, leased, licensed or otherwise alienated to any third party as may be reasonably necessary in connection with or incidental to any aspect of the Project, and where any such lease, license, permit or other assurance is reasonably required for the term of the Water Lease or any renewal thereof, the term of such lease, license, permit or other assurance shall be co-extensive with the term of the Water Lease, and where any such lease, license, permit or other assurance is required for a shorter period, the term shall be such as may be reasonably necessary for the Project, and every such lease, license permit or other assurance shall be granted upon such rentals and other terms and conditions as may from time to time and as to each particular request be mutually agreed upon as reasonable and equitable by the parties to this Agreement, and as shall not be more burdensome than those generally applying at the date of the Principal Agreement for similar leases, licenses, permits or other assurances;
- (vii) Newfoundland shall acquire private land or rights at the request of the Corporation on terms similar to that set forth in clause 10 of the Option Agreement;
- (viii) the Corporation shall have the right to grant any form of security interest in the rights granted under the Water Lease for the purpose of financing the Project without the prior consent of Newfoundland, and any lender (including a trustee, receiver or agent acting on behalf of such lender) may realize on such security interest without the consent of Newfoundland;
- (ix) the Lease shall be governed by Newfoundland law;

and the Water Lease shall contain such other ancillary provisions as may be reasonably necessary for the construction and operation of the Project.

- (b) full right and liberty without cost to the Corporation to utilize the Optioned Assets without interference during the term of this Agreement for the purposes of carrying out the Study Stage Work, with the Corporation having the right to grant similar rights to its consultants retained pursuant to the Principal Agreement in connection with the Study Stage Work.

Attach to: NR2008- [REDACTED]

Title **Title Issuance of Water Rights for the Lower Churchill River to the Energy Corporation of Newfoundland and Labrador**

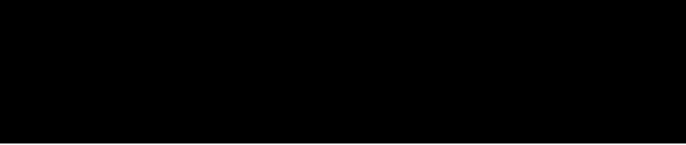

Summary of Proposal The Submission recommends issuance of water rights lease for the Lower Churchill River, pursuant to the terms and conditions in Annex A, in accordance with Section 6 of the *Energy Corporation of Newfoundland and Labrador Water Rights Act*.

Secretariat Comment

1. The Submission notes that the option held by the Lower Churchill Development Corporation (LCDC) to acquire rights to the Lower Churchill River expired on November 24, 2008. LCDC is currently inactive but the Option Agreement gives them the right to use the Lower Churchill to generate power if the shareholders agree to pursue development through the company. The option was first granted in 1978 and was renewed annually, with annual approval from Cabinet, up until 2004.
2. The Department received Cabinet Approval ([REDACTED] refers) in 2004 to authorize the Minister of Natural Resources to execute an annual Supplementary Agreement to the Lower Churchill Development Act Option Agreement between the Province and the Lower Churchill Development Corporation Limited, with such authorization to continue until there are known or expected material changes to the status of Lower Churchill developments or the conditions and terms of the Lower Churchill Development Act or any of its attached agreements. Since that time, the Minister has carried out this renewal in accordance with the direction as there has not been a requirement to issue the Water Rights to the Lower Churchill to another party.
3. However, the Minister of Natural Resources has advised LCDC that Government would not be renewing the Option Agreement on November 21, 2008 based on material changes having occurred with respect to the status of the Lower Churchill Development – the most notable of which being the announcement in May 2006 that the Province and Hydro would take the lead on developing the Lower Churchill Hydroelectric Resource. The Province's shares (51% with 49% shares owned by the Government of Canada) in LCDC are vested in Newfoundland and Labrador Hydro and will be transferred to the Energy Corporation along with the shares of CF(L)Co and Gull Island Power Company.
4. The termination of the Option Agreement and issuance of the water rights are the expected next steps to the passage of the *Energy Corporation of Newfoundland and Labrador Water Rights Act*. Cabinet Submission [REDACTED] (May 2008) indicated that the Department would seek to terminate the Option Agreement with concurrence from the federal government, [REDACTED]
[REDACTED]
[REDACTED] The study stage work as defined in the *Lower Churchill Development Act* is an extensive study to identify and analyze all data to determine the most economically feasible means of developing the Lower Churchill project. As a result, the only available option with respect to the Option agreement was to terminate (i.e. not renew) it upon its expiry date of November 24, 2008.

5. This action is necessary to enable the Minister to respond to a request from the Energy Corporation for the water rights to the Lower Churchill. The rights have been requested at this time because obtaining them and subsequently entering into a water management agreement with CF(L)Co. (see bullet #6) are required to obtain project financing.
6. The recommended terms and conditions have yet to be finalized but the Energy Corporation advises that they would be willing to enter into a lease subject to similar terms and conditions as exist under the Option Agreement and as presented in Annex 2 of the Submission. These include: (i) exclusive royalty free rights and license for an initial term of 99 years; (ii) option to renew for ~~one~~ further term of 99 years with the same terms and conditions; (iii) no compensation to Government required; (iv) right to flood lands subject to permitted encumbrances; (v) right to exploit, harness and make use of all hydro-electric and hydraulic power rights and regulate the flow of all water courses subject to rights of all upstream proprietors, licensees and other uses of the water existing immediately before February 14, 1987; (vi) grant from time to time by way of royalty free lease, license, permit or other assurance Crown Lands not granted, leased, licensed or otherwise alienated to any third party as may be necessary in connection with or incidental to the Project; (vii) the Province to acquire private land or rights at the request of the Corporation on terms similar to clause 10; and, (viii) right to grant security interest in the rights granted for the purpose of financing the Project without the consent of Government and any lender.
7. As the terms and conditions are not final Cabinet Secretariat recommends that the final terms and conditions be signed-off by the Minister of Natural Resources and Justice and the Premier.
8. *The Energy Corporation of Newfoundland and Labrador Water Rights Act*, as passed in the Spring 2008 session of the House of Assembly, effectively extinguished any existing water rights with respect to the Lower Churchill and permits Cabinet to issue water rights to the Lower Churchill to the Energy Corporation and establish terms and conditions [REDACTED]. The area of water rights is defined in *Energy Corporation of Newfoundland and Labrador Water Rights Act* as "Lower Churchill River" means that part of the Churchill River below the 425 foot contour line or all the area that lies below elevation 425 feet as referenced in Appendix A of The Churchill Falls (Labrador) Corporation Limited (Lease) Act, 1961, downstream to the intersection of the Churchill River with the meridian of 60 ° 45' west of Greenwich, and includes all waters that originate within the Churchill River catchment area and all rivers that naturally flow within the catchment area or from diversions into the catchment area.
9. This Act also indicated that section 5.4(1) of the amended *Electrical Power Control Act*, regarding water management agreements, was applicable to these rights when issued to the Energy Corporation.
10. Issuance of water rights, together with proclamation of the 2007 amendments to the *Electrical Power Control Act, 1994* and regulations, which set out the need for a water management agreement when two or more parties have water rights on the same body of water for power production, are required for ECNL to enter into a water management agreement with CF(L)Co. Such an agreement is necessary to ensure that both the Upper and Lower Churchill hydro-electric developments can satisfy their delivery schedule requirements. A separate Natural Resources Submission [REDACTED] is currently under consideration to deal with the

proclamation of the amendments to the *Electrical Power Control Act, 1994* and associated regulations.

11. Environment and Conservation advises that they have no issues with the Submission and support its recommendation.
12. Labrador Affairs have reviewed the above noted draft cabinet submission and concur with the recommendations. Aboriginal Affairs has no comment on the recommendation of the 
13. 
14. Intergovernmental Affairs advises that they have no concerns about the recommendation. IGA further notes that the termination of the water rights held by LCDC, effective November 24, is not expected to create a negative reaction by the federal government and create problems for federal-provincial cooperation on this matter as the LCDC has been inactive for years. The federal government has been aware that LCDC will not be developing the project for some time and federal-provincial cooperation on the environmental assessment is proceeding smoothly.
15. Communications and Consultations Branch advises that they agree with the approach recommended in the Submission.

**Budget Division
Consultation**

The Financial Considerations section indicates that the Energy Corporation Water Rights Act did extinguish the water rights to the Lower Churchill Basin held by NL Industrial Development Corporation (NLIDC). Up to March 31, 2008, NLIDC has shown these rights as an asset valued at \$30M with an equivalent liability to the Province for the purchase of \$30M in common shares in LCDC should the option be exercised. Finance advises that under this proposal a liability would remain on the financial statements of NLIDC with respect to a receivable of \$29,411,000 due to Government and therefore recommends that it include a recommendation that pursuant to Section 18 (1) of the *Financial Administration Act*, the Lieutenant Governor in Council authorize that the receivable of \$29,411,000 due to the Province from NLIDC be written off thereby removing the liability from the financial statements of NLIDC. Natural Resources advises that this matter was discussed with the Department of Finance subsequent to this comment and that Finance will be bringing forward a separate submission to address this issue. Finance notes this won't impact the consolidated financial statements of the Province since both the asset and liability will

be removed from NLIDC. This is a “housekeeping” issue since without the express approval for the write-off the liability and receivable would remain on the financial statements of the Province.

Secretariat Cabinet Secretariat recommends approval of the Submission subject to the final terms and
Recommendation conditions of the water rights lease being approved by the Premier and the Ministers of Natural Resources and Justice.

JC

November 26, 2008

2008/11/27

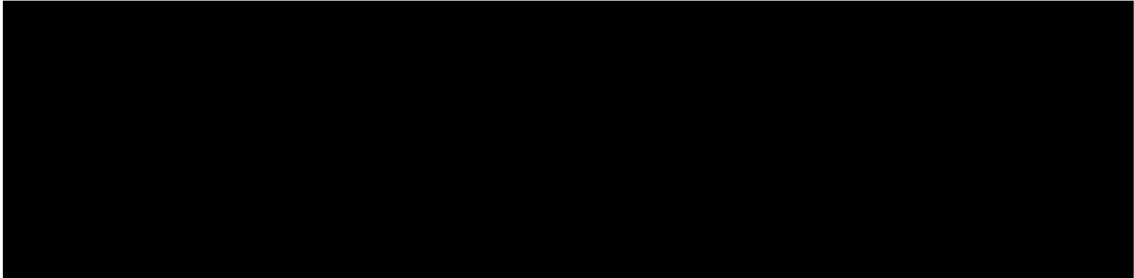
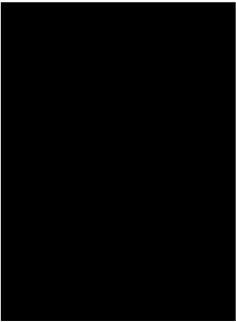
P
NR/DM
ENVC/DM
JUS/DM
AG
Deputy Clerk
File

The Submission of the Minister of Natural Resources respecting the issuance of water rights for the Lower Churchill River to the Energy Corporation of Newfoundland and Labrador was considered. The following direction was provided:


- 1) Approval was given for the issuance of an Order in Council pursuant to section 6 of the Energy Corporation of Newfoundland and Labrador Water Rights Act, to issue the Energy Corporation of Newfoundland and Labrador a water rights lease for the Lower Churchill River substantially to that currently on file with the Clerk of the Executive Council; and
- 2) The final terms and conditions of the water rights lease to be approved by the Premier, the Minister of Natural Resources and Minister of Justice and Attorney General.

(NO ACTION TO BE TAKEN ON ITEM 1 UNTIL AN ORDER IN COUNCIL
IS ISSUED)


Clerk of the Executive Council



2008/12/04



NR/DM
ENVC/DM
AG
Deputy Clerk
File



Under the authority of section 6 of the Energy Corporation of Newfoundland and Labrador Water Rights Act, the Lieutenant Governor in Council is pleased to issue a water rights lease for the Lower Churchill River to the Energy Corporation of Newfoundland and Labrador, as outlined in the document on file with the Clerk of the Executive Council.

Clerk of the Executive Council