Newfoundland Labrador

Government of Newfoundland and Labrador
Office of the Premier

December 3, 2007

Dear Prime Minister:

At our meeting of November 30, 2007, we discussed a range of issues of interest to the Province of Newfoundland and Labrador. I indicated that your commitment to remove non-renewable resource revenues from the equalization formula had a value to Newfoundland and Labrador of approximately $10 billion to 2020-21. In addition to other options which were discussed, two specific options which could assist in closing this value gap were the transfer of the federal government's 8.5% interest in the Hibernia project to the province, and the transfer of the federal government's option to acquire a Net Profits Interest in the Hibernia Project. The purpose of this letter is to clarify issues concerning the Government of Canada's investment in Hibernia.

The Canada Hibernia Holding Corporation (CHHC) was established in 1993 in order to carry the federal government's 8.5% interest, acquired when Gulf Canada withdrew from the Hibernia Project. CHHC's sole purpose is the holding, management and funding of an 8.5% interest in the Hibernia Project. As confirmed by notes to CHHC's audited financial statements, when the Government of Canada acquired the 8.5% share in 1993, there was no cash outlay for this investment.

While the federal 8.5% share in Hibernia was acquired without cost, the Government of Canada contributed its share of capital from the date of acquisition. The audited financial statements show parliamentary appropriations of $431 million for the years 1993 to 1998 to allow CHHC to fund its share of capital costs. Audited financial statements also show that in 1999, CHHC began to return parliamentary appropriations to the Government of Canada and had repaid $431 million by 2002.

Not only was the federal investment in CHHC repaid by 2002, but federal records also show that from 2003 to 2006, CHHC returned to the federal treasury, through its parent the Canadian Development Investment Corporation (CDIC), $660 million in dividends. At the end of 2006, there were $236 million in retained earnings accrued for the benefit of the federal government, but not yet paid over to the Consolidated Revenue Fund. This is a total of $896 million direct return to the Government of Canada on a consolidated basis.

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The 2007 financial year for CHHC will be closing in a few weeks. The Government of Newfoundland and Labrador estimates that CHHC's net cash flow for 2007 will be about $190 million. In summary, by the end of this year, CHHC will not only have paid back its initial investment, but will have generated estimated returns of $1,086 billion.

Additional to this is the estimated $320 million federal corporate taxes generated from CHHC, and about $3.1 billion generated by the project in total. The evidence is clear that the Government of Canada received a significant and substantial return on its investment in CHHC.

Nevertheless, there have been suggestions that the federal government has not recovered its investments in Hibernia.

We are aware that at the outset of the Hibernia project, the federal government committed to loan guarantees of $1.66 billion. However, loan guarantees should not be confused with expenditures. As you are aware, a loan guarantee becomes an expenditure only in the case of default, which in this case, will not occur.

Also, prior to the creation of CHHC and the federal government acquiring 8.5% interest in Hibernia, the Government of Canada committed to a $975 million non-repayable grant for the project. By definition, the federal government did not expect this grant to be re-paid. As you are aware, industrial assistance by way of non-repayable contributions is not uncommon in Canada. The Government of Canada investment in the Hibernia project is one of the soundest such investments in the history of the country. This is evident from the direct, indirect and induced returns to both the economy and treasury of Canada. As well, the oil resources produced from Hibernia, and the other projects spawned from this initial investment, have contributed to security of supply and self sufficiency of petroleum resources for Canada as a whole, and therefore serves the national interest.

As you are also aware, the sale by the Government of Canada of its PetroCanada shares contributed significantly to the federal treasury. The value of PetroCanada shares was significantly enhanced by its holdings in the Newfoundland and Labrador offshore area, and the Hibernia project in particular.

In addition to CHHC, the federal government has the option to take even greater returns from the Hibernia Project through its Net Profits Interest Agreements. While Newfoundland and Labrador is not a party to these agreements, we understand that the federal government has the option to receive 10 to 12.5% of the net profits of each Hibernia Project Owner, beginning in 2009, if not earlier for some owners. As you may be aware, by virtue of the Hibernia Royalty Agreements, the province faces some impediments in charging additional royalties to the Hibernia Project. This is so even though the profitability for the project is high. In the province's view, the NPI is tantamount to a royalty on a provincial resource, and should be provincial revenue.

While the investments in the Hibernia project have served the federal government well, the Hibernia project has underperformed from the perspective of provincial royalties. Much of this is attributable to federal demands at the time of the negotiation of the 1990 agreements. For instance, at the insistence of federal negotiators, the $975 million federal non-repayable contribution did not operate to reduce eligible costs for royalty purposes. It is sound policy and consistent with Generally Accepted Accounting Principles that the amount of eligible costs would be net of government assistance. As well, when Gulf Oil pulled out of the project in 1992, the historical costs incurred by Gulf remained with the project, notwithstanding the new owners of the 25% Gulf interest did not incur any cost to acquire the Gulf interest. Essentially cost not incurred by the project owners were eligible expenses for royalty purposes.

The Atlantic Accord 1985 commits that the Province of Newfoundland and Labrador will be the principle beneficiary of Newfoundland and Labrador offshore resources. In my view, there is sound, fair and reasonable policy rationale for the federal government to transfer the shares of CHHC to the province and also to cede its interest in NPI, which is essentially a royalty, to the province.

You had also asked about any precedent for these types of transfers. In my brief search, I have found examples of federal entities transferred to a province or territory, each involving resources.

For example, in 1964, Canada and the United States (US) ratified the Columbia River Treaty (CRT), the purpose of which was to coordinate flood control and optimize electrical energy production in the Columbia River Basin in the US and Canada. Under the CRT, Canada agreed to build three storage dams in the Canadian Columbia Basin and fourth dam was built in the US. In return for the storage of water, Canada is entitled to one half of the additional power generated at the American power plants on the Columbia River. This entitlement, called the "Canadian Entitlement of Downstream Benefits," was transferred to British Columbia from the Government of Canada in 1963. British Columbia sold the first 30 years of these benefits to a group of US utilities for US$254 million. This sales agreement began to expire in 1998 and BC is now receiving the Canadian Entitlement for the remaining 30 years of the CRT. The estimated value of the entitlement over the next 30 years is $5-9 billion.

In another example, in 1948, the federal government established the Northwest Territories Power Commission, later renamed the Northern Canada Power Commission (NCPC) when operations expanded to include the Yukon. The NCPC provided coordinated electrical utility services (generation and distribution) in the North until 1987, when the Crown-Corporation's assets were divested to the Northwest Territories and Yukon governments.

I look forward to your consideration of my proposals in the very near future. Ideally I believe all of our interests would be best served if this matter was resolved prior to the end of the new year. I am available to discuss these issues and others which are of great importance to the people of Newfoundland and Labrador.

Sincerely,

Danny Williams

DANNY WILLIAMS, Q.C.
Premier