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CHRONICLES

Quebec-Newfoundland Electricity Agreement

A copy of the controversial 1969 contract



PHOTO GREG LOCKE, REUTERS ARCHIVES

Handshake between the premiers of Quebec and Newfoundland and Labrador, François Legault and Andrew Furey, on the sidelines of the signing of the agreement in principle on electricity between the two provinces, in St. John's, in

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I have to weigh my words carefully, knowing how sensitive Newfoundlanders are on this issue. But all things considered, the Quebec-Newfoundland agreement bears a striking resemblance to the controversial 1969 contract, at least for the new electricity projects on the Churchill River.

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There are nuances to be made, of course, but a detailed analysis of the 30-page agreement in principle, made public on December 12, allows us to lean towards this conclusion.

As was the case then, Hydro will not pay for new electricity from contracts at market prices in the first year or 50 years later. Instead, its payments to Newfoundland between 2028 and 2084 will be based on the cost of producing the new plants, regardless of the market value of the electricity¹.

In short, Hydro will pay cost, not market. And the cost, as expected, would be the lowest of any potential project in North America.

These new facilities will produce 3,900 megawatts (MW) of electrical power, capable of supplying nearly 1.3 million homes. Hydro-Québec will purchase 90% of this new energy, divided between the Gull Island (2,250 MW), Churchill Falls 2 (1,100 MW) and the upgrade of the old Churchill Falls generating station (500 MW) projects.

"It's the same deal as in 1969 at the end of the day," Dave Rhéaume, Hydro-Québec's senior vice-president who co-led the negotiations with CEO Michael Sabia, told me.

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To benefit from such an advantage, Hydro agreed to assume virtually all the risks of cost overruns on the projects, as in 1969. It also financed almost all of the projects, even the down payment that Newfoundland had to pay to be the majority shareholder in the joint ventures with Hydro-Québec.

The difference with 1969, in fact, is the distribution of this cost price over time. At the time, it had been agreed that Hydro-Québec would pay a fixed annual amount, essentially, which meant that the payments were actually much higher during the first years given the loss in value of money over time².

Under the new agreement, the cost price paid annually by Hydro will start at a much lower level and will increase by 2% per year until 2084.

This mechanism ensures that the gap between the price paid by Hydro and that of the market will be smaller, at the end of 50 years, than is the case with the current Churchill Falls contract (0.2 cents per kilowatt hour compared to 13 cents for recent Hydro-Québec supplies).

But Dave Rhéaume is categorical: in today's dollars³, all the payments at cost price made by Hydro-Québec over 50 years, even indexed at 2%, will give the same overall sum as if Hydro had chosen to make constant fixed payments as in 1969.



PHOTO GREG LOCKE, REUTERS ARCHIVES

Interior of Churchill Falls Generating Station, 2007

Another certainty: the 2% indexation will not be increased if inflation jumps.

"They wanted a curve that rises to 2% per year. So we're going to start lower, but in the end, it's the same cost price on all project payments," Mr. Rhéaume told me.

This cost price will be on average 11 cents per kilowatt hour in today's dollars for the entire duration of the new energy contracts, estimates Hydro-Québec, which has taken some margins of prudence to arrive at such a figure.

Hydro-Québec concessions

Hydro was able to obtain these terms by ceding various benefits to Newfoundland (in addition to absorbing cost overruns).

First, Hydro-Québec pays 3.5 billion over 11 years (present value in 2024) to have the option to develop the projects, an amount which is included in the cost price.

Newfoundland Hydro will use the \$3.5 billion to advance its share of the down payment in the joint venture with Hydro-Québec for the Gull Island projects (60%-40%) and the Churchill Falls expansion (65.8%-34.2%).

Second, Hydro-Québec agreed to reopen the old contract that ended in 2041, even though the courts had upheld its legality. The Crown corporation thus agreed to gradually increase the price from 0.2 cents per kilowatt-hour currently to an average of about 9 cents between 2041 and 2075 (updated to today's dollars).

But be careful, Hydro believes that it will recover in the long term this price concession granted to Newfoundland for the first years. In fact, the price of 9 cents post-2041 compares favorably to the 13 cents per kilowatt hour that its current comparable new supplies cost Hydro. And again, the 9 cents falls to 7 cents, in reality, since Hydro is a 34.2% shareholder of the old plant and will therefore pocket profits from its own payments.

Over the entire period, before and after 2041 (2025-2075), the average cost of energy from this old plant for Hydro comes to 4 cents per kilowatt hour (in today's dollars), once its share of the profits is deducted.

This price is very interesting for Hydro, but it must be said that it is also interesting for Newfoundland.

Hydro must also finance the earlier cash advances to Newfoundland by increasing rates for its commercial and industrial customers by 0.4 percentage points and reducing its annual net income by \$200 million to \$300 million for 10 years⁴.



PHOTO GREG LOCKE, REUTERS ARCHIVES

Transmission lines carrying electricity from the Muskrat Falls Generating Station in Labrador

Third concession: Hydro agrees to accommodate Newfoundland regarding the source of energy that the province wants to keep for its own purposes. By the end of the contracts, Newfoundland will increase its purchases from 525 MW to 1990 MW.

But most of that additional block will come from the least risky (and least expensive) segment of Labrador, the old Churchill Falls plant. Hydro has therefore agreed to gradually transfer to Newfoundland 1,105 MW that it was buying from that old plant, leaving it with 3,660 MW after 2060, rather than the current 4,765 MW.

So again, Newfoundland is dissociating itself from the risks of new projects and the higher energy costs that will result.

One of Hydro's hopes is that Newfoundland will not be able to take all of the 1990 MW it

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This hope is based on the fact that Newfoundland will not likely be able to use this energy outside of Labrador, because the undersea transmission line between Labrador and the island of Newfoundland is at capacity and unreliable.

The submarine line is currently being used to transport energy from the Muskrat Falls power plant in Labrador, a project led by Newfoundland that has turned into a fiasco . Newfoundland therefore wants to use its new energy in Labrador, notably for mining or green hydrogen projects, although the region is very sparsely populated and the environment is difficult ⁵ .

The unused blocks sold to Hydro would be in addition to the approximately 7,200 MW that Hydro will purchase in Labrador ⁶ .

The big unknown in this agreement remains the risks of the projects, almost all of which are assumed by Hydro-Québec. What will happen if the First Nations refuse to collaborate on Quebec's transmission lines, if permits are delayed, if costs explode?

Hydro relies on its expertise in dam construction, which has few equivalents in the world.

In the end, Newfoundland will pocket billions without really taking any risk. Newfoundlanders should not come complaining in 25 years if the Quebec Crown corporation succeeds in doing what Newfoundland failed with Muskrat Falls.

- 1. For Hydro-Québec, the energy from one of the projects will be available from 2028 and the other two would be available around 2035.**
- 2. In fact, the cost price of the 1969 contract declined after a few decades once all the costs of the plant had been amortized. In the new agreement, this decline was incorporated into the long-term projection of payments incorporating the annual indexation of 2%.**
- 3. Wherever today's dollars are mentioned in the text, it should be understood that this refers to the present value (as of December 31, 2024) of future payments. These payments are discounted at a rate of 5.822%.**
- 4. In the case of the old plant, the price indexation will not be 2%, as for the new energy. The**

5. In theory, Newfoundland could resell the surplus to the United States or Ontario via Hydro-Québec lines, but the Régie de l'énergie has already ruled that Hydro's lines to the final recipient were being used at maximum capacity. As for Quebec customers, Hydro-Québec Distribution has the monopoly. Under the agreement, Hydro could notably buy back at cost the 360 MW from new electricity projects that its partner would not use. The price paid could be lower if the availability of energy is not long-term (the conditions remain to be negotiated in the final agreement). Hydro could also buy back the unused energy from the old plant at the same price as the rest of the energy from the old plant .

6. In fact, the total purchased by Hydro-Québec will be 7200 MW in 2075, but it will have climbed to 7700 MW between 2037 and 2050, before gradually decreasing, according to the agreement.

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