Needs For and Alternatives To

APPENDIX 15.1

Keeyask Aboriginal Partnership Business Risks

This page is intentionally left blank.

Keeyask Aboriginal Partnership Business Risks

There are risks in constructing and operating the Keeyask Project through a partnership that Manitoba Hydro would not face if it had chosen to develop the Project as the sole owner and operator. These are business risks. A partnership is a relationship, or, as is the case with the Keeyask Hydropower Limited Partnership (the "KHLP"), a number of relationships. Each partner brings with it its own particular interests, concerns and objectives, some of which are shared by all of the partners and some of which are not. Partnerships, accordingly, risk incurring costs to manage and negotiate the interests and concerns of particular partners that are not shared by all partners and, occasionally, partnerships and the businesses they operate dissolve when partners are unable to reconcile their concerns and individual interests.

The Terms of Reference for the NFAT Review specifically state that "The commercial arrangements between Hydro and its aboriginal partners for the development of the proposed hydro-electric generating facilities arrangements" are not within the scope of the review. Manitoba Hydro provides the following information, not for the purpose of reviewing or commenting these arrangements but rather for the purpose of identifying the risks inherent in the commercial arrangement as concluded and providing an understanding of how they have been addressed. It should be recognized that adoption of partnership risks results in the avoidance of some risks and other benefits being achieved. A risk/benefit analysis resulting from the commercial arrangements as between Manitoba Hydro and its aboriginal partners is beyond the scope of the NFAT and for this reason, benefits projected to be achieved as a result of the arrangements in place are not detailed herein.

Typically, the business risks that a partnership introduces that a 'sole proprietorship' does not face include:

- The possibility that one or more partners will fail to deliver, when required, perhaps on a 'closing date', money or assets essential to the operation of the business, necessitating a costly search for other funds or assets, or the collapse of the business;

- The problems of one or more partners in managing their individual finances can create problems for the partnership when creditors of such partners seek to collect on a partner's obligations by demanding the liquidation or transfer of the partner's interest in the partnership;
- Changed conditions, financial or otherwise, can motivate a partner to seek amendments to the partnership's governing documents in order to accommodate its own new, or altered, interests;
- Perceived inequities in the control of the partnership or the sharing of income generated by the partnership can lead to demands from one or more partners to amend the partnership's governing documents;
- The costs of maintaining a partnership can themselves result in a disproportionate drain on revenues to the dissatisfaction of one or more partners;
- Most businesses generate information that is confidential to the business; partners have certain rights to review that information; and when confidential information is shared with a number of parties, there is a greater potential that it will either unintentionally or intentionally become public to the detriment of the business; and
- Partnerships can fail when they do not manage one or other of the foregoing risks or when they do not have an effective process through which disputes can be resolved; failure can bring with it the loss of the investment of partners in the business and, in many cases, the termination of the business itself.

The KHLP was negotiated with all of the foregoing risks in mind and the various agreements pursuant to which it will operate, starting with the Joint Keeyask Development Agreement (the "JKDA") incorporate a variety of terms intended to eliminate, mitigate, or provide mechanisms to deal with risks associated with developing the Keeyask Project as a partnership.

The Risk of Failure to Deliver Essential Funding

The cost to the Partnership of planning and constructing the Keeyask Project is, initially, almost entirely born by Manitoba Hydro through credit facilities made available to the Partnership. These funds would be expended in any event regardless of the business construct utilized. Each of the Keeyask Cree Nations ("KCN") does have an obligation to pay to the Partnership, through its chosen "KCN Investment Entity", a significant sum upon "Final Closing". However, in the event that any KCN Investment Entity elects not to proceed or simply does not pay, Manitoba Hydro has the right to purchase all of that partner's Units, or share, of the KHLP. Moreover, the Final Closing occurs when the last turbine is commissioned. Uniquely, this Partnership is not dependent upon any partner, other than Manitoba Hydro, providing its investment before the business is built and becomes operational. A decision by one, or more, of the KCN Investment Entities not to proceed, or a failure of one or more to meet the terms of the JKDA at the Final Closing, will result in some very modest administrative costs, not the collapse of the business, and these administrative costs will be modest.

The Risk of Individual Finances Impacting Partnership Business

The KHLP is a limited partnership. As such, the KCN Investment Entities are not exposed to the liabilities of the Partnership as each is a 'limited partner', legally immune from being liable for the debts of the Partnership unless it violates its obligations as a limited partner and tries to take part in the day to day operations of the business. Each KCN has opted not to select the First Nation itself to hold its interest in the Partnership, rather each has either incorporated a holding company, as FLCN has done, or has set up a limited partnership structure of its own, as is the case with TCN and WLFN and as is the case with YFFN. The legal consequence of this is that each KCN is 'doubly' removed from exposure to the debts and accruing liabilities of the Partnership and, conversely, the Partnership is 'doubly removed' from exposure to the liabilities and debts of each KCN for limited partners are not permitted to incur debt to the account of the Partnership.

In order to eliminate the necessity that would otherwise exist for each KCN Investment Entity to borrow funds in the market place in order to meet its financial obligations to the Partnership, the JKDA and the three 'financing agreements' negotiated on behalf of the three KCN Investment Entities provide that the primary financing each requires will be provided by Manitoba Hydro. This is not an incremental cost to Hydro when compared to the cost of developing the Keeyask project as solely a Hydro project. Interest is chargeable by Hydro on funds advanced. In particular, these financing agreements provide each of the three KCN Investment Entities with the financing that they will require, during the years the Project is being constructed, to meet their obligations as owners of common equity. Further, to the extent that each KCN Investment Entity is obligated to look to a party other than Manitoba Hydro for its minimum cash investment in the Partnership, the JKDA restricts it to a small list of sources, namely federal and provincial funding opportunities and certain First Nation controlled trusts. There are also restrictions imposed upon the KCN Investment Entities with respect to granting security interests in their Units or in the revenues to which they will be each entitled as owners of those Units. Manitoba Hydro must approve any security interest granted in the Units. Accordingly, there will be no opportunity for creditors of any of the KCN, or any of the KCN Investment Entities, to pursue, against the Partnership, claims for payment of debts owing which could disrupt either the finances or operations of the Partnership or result in a new and perhaps undesirable partner taking the place of a KCN.

The Risk of Changing Circumstances

The JKDA and the additional agreements which together make up the mutual promises exchanged between Manitoba Hydro and the KCN are contracts. Although they were negotiated over a number of years, with sound expert assistance and as much foresight as could be brought to the negotiations, they are at best contracts. They reflect an understanding of costs and markets and technologies as of the moment in May 2009 when the JKDA was signed. The Partnership is intended to exist as long as the Keeyask Project is operational, a period estimated to be about 100 years. Necessarily, over time, conditions will change and one

or more of the partners will be motivated in response to such changes to seek amendments to one or more of the contracts. The most likely changes will be with respect to costs and markets and technologies. In an effort to reduce the number of situations that could motivate a partner to seek amendments, the JKDA includes an option, 60 days prior to Final Closing, when costs of construction will have been incurred and market forecasts for the first years of operation will be more certain, for each KCN Investment Entity to choose a 'preferred' investment as opposed to a 'common equity' investment. A KCN Investment Entity which chooses a 'preferred investment' will not have to carry the burden of significant loans from Manitoba Hydro and will, at the same time, be entitled, annually to a "Preferred Minimum Distribution", to be paid regardless of whether, in a particular year, the Partnership has "Distributable Cash" available. In addition, if at Final Closing, a KCN, taking into consideration the costs incurred to build the Project and the market forecasts then existing, concludes that its investment in the Project is no longer attractive, it can opt not to proceed and Manitoba Hydro will then have the right to acquire its Units. The concept of developing a 'preferred investment alternative' whose design is intended to accommodate a 'risk averse' investor, particularly one facing uncertainties regarding the costs of construction and the expected price for energy in the market place, originated through Manitoba Hydro's experience in negotiating the Wuskwatim Project Development Agreement which did not incorporate a similar option but whose parties did have to confront the same complexities of uncertainty regarding costs and markets.

A consequence of the foregoing provision of a preferred investment for each KCN that chooses it and the corresponding entitlement to a "Preferred Minimum Distribution" to be paid even in years when there are no 'profits' from the business, is that to the extent there are such years, Manitoba Hydro and any KCN opting to invest in common equity will have to fund such distributions as an additional expense of the Partnership. This is a cost that Partnership adds to the project which Manitoba Hydro would not face if it were the sole proprietor of the project. However, in return for this guaranteed revenue flow, Hydro is in effect compensated in years of high revenue through receiving a greater portion of the revenue earned.

Virtually all partnerships face the general risk that any business does regarding whether or not the service it provides, or the goods which it produces, will be marketable and will provide enough revenue to pay expenses and yield a profit. The KHLP is unique in that Manitoba Hydro is committed through the JKDA and the Power Purchase Agreement to purchase all of the energy and capacity of the Keeyask Generating Station. Further, Manitoba Hydro is responsible for taking 'delivery' of that energy at the Keeyask Generating Station and thus is solely responsible for the maintenance and reliability of the transmission system necessarily required to transmit the energy to the market. Moreover, in order to deal with the concern that the Partnership naturally will seek to benefit from increases in market price over the years, the Power Purchase Agreement incorporates a flexible formula tied to market rates for 'On-Peak Energy' and 'Off-Peak Energy' from time to time. In effect, one important purpose of the Power Purchase Agreement, is to set as fair a price as possible with as close a tie as possible to the market, with a view to reducing, if not eliminating, the concerns that would otherwise exist with each KCN Investment Entity, when market conditions change and the question regarding whether the Partnership is receiving a 'fair' return is asked. The detail and thought that has gone into this aspect of the JKDA and the Power Purchase Agreement should sensibly reduce the motivation of any limited partner to seek revision to the contracts with a view to increasing the Partnership's revenues.

Notwithstanding the above, it still remains a possibility that situations will arise in which Manitoba Hydro will need to consider whether to renegotiate a portion of the agreements, particularly in regards to the income sharing aspect.

One consequence, however, of the unique terms of the Power Purchase Agreement, is that Manitoba Hydro is committed to paying for the entire output of energy each year even though it, in turn, may have no 'use' for that energy. In effect, Manitoba Hydro bears the primary risk that there will be export market constraints for the energy or that its domestic load will not require energy from the Keeyask Generating Station. Arguably, these are risks that Manitoba

Hydro would carry in any event as the sole owner of the Keeyask Project, though, as a sole owner, it would have somewhat more flexibility in determining how to respond to what would amount to a serious collapse in demand. The incremental risk would in any event be limited to a percentage of the cost of the purchased energy commensurate with the interests held by the KCN.

Addressing the Risk of Disputes Arising Re Perceived Inequities in Control or Income Sharing

Partnerships can be disrupted when differences arise between the partners over the degree of control, or lack of control, each has in the operation of the business. Or, similarly, partners have been known to dispute how profits are allocated. With respect to the KHLP, a number of provisions of the JKDA and supporting contracts have been designed to reduce or eliminate the risk of such disputes. For example, the JKDA clearly provides that Manitoba Hydro has the exclusive right to operate the Generating Station and associated infrastructure. In addition, by virtue of the provisions of the Power Purchase Agreement discussed above, Manitoba Hydro effectively will have exclusive control of the marketing of the energy from the Partnership. These provisions will facilitate the efficient operation of the business and reduce the possibility of the other partners seeking to increase their control of the business through taking a role in operations or marketing. Indeed, the fact that the other partners hold their investments as 'limited' partners in order to limit their 'liability' also acts as a disincentive to dispute these fundamental aspects of the Partnership. However, additional provisions have been included in the JKDA with a view to reducing the instances wherein the KCN might otherwise be motivated to dispute Manitoba Hydro's day to day management of the business through the General Partner. Manitoba Hydro has guaranteed the performance of the General Partner, thus eliminating any concern that a failure on the part of the General Partner, a wholly owned subsidiary of Manitoba Hydro, could be ignored by Manitoba Hydro on the grounds that it would otherwise be immune from the financial obligations of a subsidiary corporation. Further, 'expert review mechanisms' are set out in the JKDA which provide a ready mechanism for review by an independent third party of the operating and maintenance costs, the system

operation costs and various costs 'charged' by Manitoba Hydro pursuant to the Power Purchase Agreement. Manitoba Hydro will incur these costs at first instance and is entitled to flow them through to the Partnership, a fact which, could in some Partnerships arouse concerns in the minds of those holding minority interests. The 'expert review processes', by providing a clear route and a reasonable one to have the amount and propriety of various costs reviewed, will reduce the motivation, or grounds, for partners to engage in disputes that could create distrust and, potentially, result in the termination of the Partnership were there no alternative to the 'will of the major Partner'.

In the same vein, the JKDA and the Limited Partnership Agreement set out detailed definitions and provisions governing the calculation of "Distributable Cash" and the allocation and timing of the distribution of that "Distributable Cash". Similarly, for those KCN Investment Entities which opt for the 'preferred investment', there are detailed definitions and rules governing the calculation and timing of their distributions. The purpose of negotiating such detailed definitions and rules was to reduce the risk of disputes arising over the annual calculation and distribution of profits to partners.

Aside from clearly delegating exclusively to Manitoba Hydro the functions of planning, engineering, construction, maintenance, operations and administration, the JKDA does provide ample opportunities for members of the KCN to participate and contribute to the work of the Partnership in fields where the KCN have said that they have vital concerns. For example, the KCN by the terms of the JKDA were directly involved in developing the Environmental Impact Assessment that the Partnership was required to file as part of the application for an Environment Act License. Each KCN is entitled to have members on the Advisory Committee on Employment and the Construction Advisory Committee, in part so as to contribute to the development of processes and the resolution of problems touching upon issues of employment and discrimination. Similarly, each KCN is entitled to nominate members to the Monitoring Advisory Committee to assist in the work of monitoring and mitigation, processes which

connect directly to concerns about the impacts of the project on the environment and on the KCN communities. Each KCN that holds Units in the Partnership is also entitled to nominate a stipulated number of members to sit on the Board of the General Partner and while such nominees to the Board will necessarily, as directors, be obligated to participate in the work of the Board and to make decisions in the best interests of the General Partner, and through it the Partnership, they will be a visible reflection of the nature of the Partnership and will be a route through which the wisdom and concerns of the KCN will be heard within the Partnership.

Addressing the Risk of Costs of Maintaining Partnership Disproportionately Draining Revenues

Relative to the annual costs of servicing the debt of the Partnership and paying the salaries of the staff required to operate the generating station, the costs of partnership meetings and multiple advisory committees will not be significant. Some might argue that were the Project being advanced as a wholly owned Manitoba Hydro venture, the wisdom of having multiple advisory committees, and the cost of same, would still be necessary and well-advised, though in that case, the cost of them would be solely born by Manitoba Hydro.

Addressing the Risk of Disclosure of Confidential Information

Partners stand in a fiduciary relationship to one another. Accordingly, they are obliged, one to the other, to hold in confidence information that is confidential to the Partnership and which could prejudice it were the information to become public. In addition to relying upon the common law, the parties to the JKDA have followed throughout the history of negotiations, the practice of asking individual participants to sign confidentiality agreements in order to heighten the awareness of the need to protect certain information and thus to reduce the risk of sensitive information being released.

Manitoba Hydro is currently re-negotiating these confidentiality agreements in order to increase the controls associated with its confidential document sharing processes, following a

recent incident where a top secret Manitoba Hydro document (2010/11 Power Resource Plan) was leaked to the Public through one of the KCNs.

Addressing Dispute Resolution

Notwithstanding all of the foregoing, including the provision for 'expert reviews' of the propriety of certain costs, there remains the risk that disputes will arise that must be resolved. Accordingly, a relatively detailed dispute resolution process has been agreed in the JKDA so as to ensure, should such disputes arise, that they are handled in an efficient manner and a fair manner. First, the partners are obligated to try to resolve a dispute in discussions between themselves before elevating it to a more formal platform. Given that the KCN and Manitoba Hydro now have a history extending over 20 years of being able to meet and negotiate the resolution of a number of difficult issues, including the negotiation of individual 'impact settlement agreements' between Manitoba Hydro and each of the KCN, there is a reasonable prospect that the partners will be able to resolve disputes without having to resort to the more formal steps of dispute resolution in the JKDA. However, if initial, informal discussions are unsuccessful, the next step, which is optional, allows for an aggrieved partner to appoint a neutral 'fact-finder' to investigate a grievance and report upon it with a view to assisting in a resolution. Alternatively, or failing resolution with the assistance of a neutral 'fact-finder', the matter must be referred to the senior persons responsible for each disputing party who are obligated to meet and in good faith endeavour to resolve the dispute. And, should that be unsuccessful, the parties have agreed to be bound by arbitration, the details of which process are set out in the JKDA but which require arbitration pursuant to *The Arbitration Act* of the Province of Manitoba.

Although outside the scope of the NFAT review, it is of interest to note that were Manitoba Hydro to have proceeded to plan and develop the project as a sole owner, it would have incurred other risks that it has avoided by partnering with the KCN plus it has gained various benefits.