Royalties and Rents

Video #4 in CRPP Series

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Some Observations

- In the hydroelectric generation process, capital (K), labour (L), purchased materials (M), and purchased services (S) are relatively **fixed i**n the short and medium term.
- The variable input is the **water inflow (W)**! This input can be controlled on an hourly, daily, and seasonal basis, depending on the electricity demand. Still, its supply can be limited at times, as is the case on La Grande Riviere in Quebec, because of the current drought!
- It is the water that has production value, but water costs almost nothing. It is this low cost of water, including the 17% of total electricity in Quebec that comes from Churchill Falls, that plays the primary role in explaining why electricity costs in Quebec are the lowest in Canada and the G7.

Revenue and Costs for CF(L)Co

CHURCHILL FALLS (LABRADOR) CORPORATION LIMITED
CONSOLIDATED STATEMENT OF PROFIT AND COMPREHENSIVE INCOME

For the year ended December 31 (thousands of Canadian dollars)	Notes	**2024**	2023
Energy sales	22	**125,542**	113,070
Guaranteed winter availability	22	**38,293**	38,897
Net finance income	17	**9,046**	8,964
Other revenue	18	**22,615**	3,642
Revenue		**195,496**	164,573
Operating costs	19	**70,798**	70,673
Depreciation and amortization		**30,640**	37,423
Other expense	20	**12,525**	2,378
Expenses		**113,963**	110,474
Profit for the year		**81,533**	54,099
Other comprehensive income (loss)			
Total items that may or have been reclassified to profit or loss:			
Net fair value gain on reserve fund	9	**2,465**	1,409
Actuarial loss on employee future benefits	15	**(933)**	(3,046)
Other comprehensive income (loss) for the year		**1,532**	(1,637)
Total comprehensive income for the year		**83,065**	52,462

See accompanying notes

https://nlhydro.com/wp-content/uploads/2025/06/Churchill-Falls-Labrador-Corporation-Limited-12312024-Final-FS-Secured.pdf

Other Expenses, CF(L)Co

20. OTHER EXPENSE

For the year ended December 31 (thousands of Canadian dollars)	**2024**	2023
Rental and royalty	**8,790**	6,553
Loss on disposal of property, plant and equipment	**3,045**	2,620
Environmental liabilities	**593**	-
Insurance proceeds	**-**	(6,251)
Other	**97**	(544)
	12,525	2,378

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Operating Costs, CF(L)Co

For the year ended December 31 (thousands of Canadian dollars)	**2024**	2023
Salaries and benefits	**43,247**	42,069
Maintenance and materials	**12,708**	15,173
Insurance	**4,813**	4,703
Professional services	**2,791**	3,321
Travel	**4,009**	3,151
Grocery store cost of goods sold	**2,191**	1,037
Other operating costs	**1,039**	1,219
	70,798	70,673

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Existing Water Royalties in NL & Quebec

- CF(L)Co pays the GNL **$0.25** per MWh or **.025 cents** per kWh.
- HQ currently pays the Government of Quebec around $**9.00** per MWh, or **0.9 cents** per kWh, and it is indexed each year. This should be verified.
- The Government of Quebec receives approximately **36 times** more water royalty per kWh than the Government of Newfoundland and Labrador.
- NLH has stated that the current rate will be modernized, but the specifics are unknown.

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Water Royalties Based on Production

- Set a rate equal to that set by the Quebec Government at $9 per MWh. This would give the GNL for existing Churchill Falls production of around **$310.5 million** if annual production is around 34,500 MWh. Presumably, CF(L)Co would add this as an expense and pass it along to NLH and HQ as its customers.
- This approach is arbitrary and does not capture the cost of any new alternative generating projects. It also does not take into account seasonal variations in prices in free competitive markets.
- NL power into NE-ISO: Jan. $192 CAD/MWh; July $86 CAD/MWh, and a low of $48 CAD/MWh in May.

Water Royalties Based Sales Values

- Some have argued that a water royalty rate should be tied to the **sales value** of electricity that is generated by hydro power, but this would present a problem in CF(L)Co's case.
  - Monopsonistic market issues.
  - Dissipation of rents by the Government of Quebec to households and industrial users. Impacts equalization payments from the Federal Government.
  - It could be argued that the very low costs of electricity to users and therefore the low value of sales is an objective of the Quebec Government, which would result in the GNL receiving reduced royalties.

Resource Royalty Based on Rents

- There are two types of resource rents: differential and scarcity rents.
- Some initial thoughts are that:
  - The differential rents might be preferred in this situation, but the price at the generation gate is not set in a competitive market environment.
  - The rent would have to be adjusted in 2041.
  - A valuable piece of information would be the unit cost of the lowest-cost new facilities that can produce the same amount of power as the proposed infrastructure projects, such as Gull Island.
  - The challenge is to capture the seasonal changes in the process that occur in free export markets.
  - Requires thought and discussion since the Churchill River Projects operate in a market environment which is much more complex than the simple theoretical models commonly discussed in microeconomic theory.

Thanks for Watching!