

**IN THE MATTER OF AN ARBITRATION UNDER CHAPTER ELEVEN OF
THE NORTH AMERICAN FREE TRADE AGREEMENT
AND THE ICSID ARBITRATION (ADDITIONAL FACILITY) RULES**

BETWEEN:

MERCER INTERNATIONAL INC.

Claimant

AND:

GOVERNMENT OF CANADA

Respondent

WITNESS STATEMENT OF FRED FOMINOFF

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I, Fred Fominoff, declare as follows:

1. I was born on [REDACTED]. I currently reside at [REDACTED].
2. I am currently the General Manager, Fibre & Energy at Howe Sound Pulp & Paper Corporation (“Howe Sound”). Howe Sound owns and operates a pulp mill and a paper mill with self-generation capacity that is located in Port Mellon, along BC’s Pacific coast. I am responsible for fibre supply and logistics at the mill, including the supply of wood as raw material for manufacturing in the pulping process, and as biomass fuel for steam and electricity generation. I am also responsible for electricity purchases and sales, and the administration of the corresponding contracts with BC Hydro. In this capacity, I was the lead negotiator for Howe Sound’s Electricity Purchase Agreement with BC Hydro (“BC Hydro EPA” or “2010 EPA”).
3. I hold a Master of Business Administration (“MBA”) from the University of Northern British Columbia (2006), Certified General Accountant Designation (“CGA”) (1994) and a Certified Management Accountant Designation (“CMA”) (1983).
4. I have worked in the Forest Industry in BC since 1980 in financial and management roles. From 1983 to 1989, I worked as Assistant Controller at Celgar Pulp Company. In 1989, I joined Skeena Pulp Operations in Prince Rupert as Controller; I was appointed General Manager, Operations at that mill in 1998. In 1999, I assumed the Chief Financial Officer role at Finlay Forest Industries. After the sale of that company later that year, I joined Slocan Forest Products as General Manager of the Taylor Pulp mill. In 2006, I joined Howe Sound as General Manager, Operations while a search to fill the President role was conducted. The search was concluded in 2008, and I assumed my current role.
5. I attach my resume as Appendix A.
6. In this witness statement, I will first discuss the operations at the Howe Sound mill, including a facility overview, the operating conditions at Howe Sound prior to the

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2010 EPA, and Howe Sound's reasons for wanting to negotiate an EPA with BC Hydro. Next, I will discuss the conclusion of the 2010 EPA in the context of BC Hydro's Integrated Power Offer ("IPO"), including the terms on which BC Hydro was willing to enter into negotiations and the negotiation of the generator baseline ("GBL") provision in the EPA.

7. I have personal knowledge of the matters described in this witness statement, except where based on information and belief, in which case I indicate the source of the information and my belief that it is true.

8. I have reviewed the documents cited in my witness statement for purposes of preparing this witness statement. I am a fact witness in this NAFTA arbitration.

A. HOWE SOUND'S PORT MELLON MILL

1. Facility Overview

9. The Port Mellon site consists of three main parts: (1) a kraft mill; (2) three thermo-mechanical pulping ("TMP") mill lines; and (3) a paper machine.

10. The purpose of pulping is to separate woodchips into individual microscopic fibres to be used for different purposes, such as making paper.

11. The TMP pulping process heats the woodchips using steam and then mechanically tears the fibers apart. The TMP process does not generate electricity. The mechanical pulp produced by the Howe Sound mill is used in our paper machine.

12. The kraft pulping process utilises a chemical treatment to dissolve "lignin" - the substance that binds woodchip fibers together - to release the individual fibers. The dissolved organic compound that is generated as a by-product in this process is called "black liquor" and is combusted in a recovery boiler to generate high-pressured steam for use in the pulping process and to generate electricity through a turbine generator. Howe Sound has two turbine generators: TG No. 1 is an extraction turbine and the generator has a rated capacity of [REDACTED] megawatts ("MW"), and TG No. 2 has both extraction and condensing capability, with a rated capacity of [REDACTED] MW.

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13. In addition to a recovery boiler, Howe Sound also has a power boiler that generates high-pressured steam by combusting biomass, such as bark, sawdust and shavings (commonly referred to as “hog fuel”), often purchased from sawmills. When economical to do so, Howe Sound has also burned natural gas in the power boiler to generate additional steam in order to generate electricity.

14. The mill requires large amounts of electricity to run. The total load of Howe Sound is [REDACTED] MW. The kraft process accounts for approximately [REDACTED] MW of that load, while the TMP and paper machine processes account for approximately [REDACTED] MW of the load.

2. Operating Conditions Prior to the 2010 EPA

15. Between 2005 and 2009, electricity generation at Howe Sound had been [REDACTED]
[REDACTED].

16. [REDACTED]
[REDACTED]
[REDACTED].

17. [REDACTED]
[REDACTED]
[REDACTED]. Since 2005, however, lumber prices had been dropping, resulting in curtailed production from sawmills and a reduction in the supply of hog fuel. With the reduction in supply, hog fuel prices increased, [REDACTED]
[REDACTED].

18. [REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

19. [REDACTED]

20. [REDACTED]

3. The Pulp & Paper Green Transformation Program and Howe Sound's Rationale for Negotiating an EPA with BC Hydro

21. In early 2009, I began evaluating several capital investment options to address the equipment problems described above. [REDACTED]

¹ [REDACTED]

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[REDACTED]

22. [REDACTED]

[REDACTED]. I was aware at the time that other companies were supplying green energy to BC Hydro through the addition of new capacity and I thus initiated discussions with BC Hydro (specifically, Scott Janzen, our Key Account Manager, and Lester Dyck) about the possibility of generating additional power from biomass and selling that power at prices that would support the additional fuel and other costs.²

23. On June 17, 2009 the Pulp & Paper Green Transformation Program (“PPGTP”) was announced by Natural Resources Canada, a ministry of the Government of Canada, which would make funds available for capital investment in renewable energy projects.³ Shortly thereafter, in August of 2009, BC Hydro announced the Integrated Power Offer (“IPO”) in order to leverage PPGTP funding to British Columbia for investment in electricity generation and conservation.⁴ I was hopeful that Howe Sound could take advantage of both the PPGTP funding and an EPA with BC Hydro.

24. [REDACTED]

² Letter from Fred Fominoff to Lester Dyck, dated June 16, 2009, bates 022474, **R-59**.

³ Natural Resources Canada, “Pulp and Paper Green Transformation Program: Mission accomplished”, 3 March 2014, online: <<http://www.nrcan.gc.ca/forests/federal-programs/13141>>, **R-60**.

⁴ BC Hydro, “Integrated Power Offer for Pulp & Paper Customers”, online: <https://www.bchydro.com/powersmart/business/industrial/your_sector/pulp_paper/ipo.html>, **R-56**.

B. BC HYDRO'S INTEGRATED POWER OFFER

1. The Terms on Which BC Hydro Was Willing to Negotiate an EPA

25. After meeting with BC Hydro on August 28, 2009, to discuss opportunities available to our mill,⁵ I signed a confidentiality agreement on behalf of Howe Sound on September 17, 2009, to initiate the discussion of an EPA under the IPO.⁶ A confidentiality agreement is important in the context of negotiating an EPA because, during the course of negotiations, Howe Sound was expected to share sensitive business information such as production data, operational costs, operating strategies, and capital investment options. It was my expectation at all times that BC Hydro would not disclose to any third party confidential business information belonging to Howe Sound that it learned during the negotiation process.

26. On November 6, 2009, BC Hydro drafted a Letter of Intent outlining the terms on which it was prepared to move forward with the negotiation of an agreement under the IPO.⁷ The Letter of Intent stated:



27. The issues to be addressed in advance of reaching an agreement included: (1) a due diligence review and project risk assessment with results satisfactory to BC Hydro;

⁵ Integrated Power Offer Meeting Summary, Howe Sound Pulp and Paper, 28 August 2009, bates 044244 to 044245, **R-61**.

⁶ BC Hydro and Howe Sounds Pulp and Paper Limited Partnership, Electricity Purchase Agreement, Integrated Power Offer, 7 September 2010, bates 016362 to 016499, at Appendix 11 (bates 016491-016496), **R-62**.

⁷ Letter from BC Hydro Power Authority to Fred Fominoff, dated November 6, 2009, **R-63**. I signed the Letter of Intent and returned it to BC Hydro on November 23, 2009.

⁸ Letter from BC Hydro Power Authority to Fred Fominoff, dated November 6, 2009, **R-63**.

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(2) confirmation of Howe Sound’s energy profile; (3) confirmation of firm and non-firm energy prices; and (4) the setting of a generator baseline (“GBL”).⁹

28. In addition, there was the issue of the existing 1989 Generation Agreement between BC Hydro and Howe Sound.¹⁰ Under the terms of this agreement, Howe Sound committed to install generation equipment and to generate [REDACTED] to displace its load for a period of [REDACTED] years. In exchange, BC Hydro provided Howe Sound with a [REDACTED] loan. Howe Sound repaid the loan fully in [REDACTED].¹¹

29. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].¹² [REDACTED]
[REDACTED].¹³

2. GBL Negotiations with BC Hydro

30. BC Hydro was clear from the start of the EPA negotiations that only incremental electricity, or electricity that would not otherwise be generated, would be eligible for purchase. This was consistent with the existing rules resulting from BCUC Order G-38-01, and Howe Sound did not challenge this position. [REDACTED]
[REDACTED]
[REDACTED]. BC Hydro wanted to know what

⁹ Letter from BC Hydro Power Authority to Fred Fominoff, dated November 6, 2009, **R-63**.
¹⁰ Generation Agreement between BC Hydro and Howe Sound Pulp and Paper Limited, 1 October 1989, bates 016601-016639, **R-64**.
¹¹ Further details of the 1989 Generation Agreement are provided in the Witness Statement of Pierre Lamarche, at ¶¶ 17-18.
¹² Letter from BC Hydro Power Authority to Fred Fominoff, dated November 6, 2009, at 4, **R-63**.
¹³ Summary of HSP EPA: Key Negotiation Issues, 22 March 2010, bates 163021-163022 at 163022, **R-65**.

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Howe Sound generates in a normal operating year, so that it could determine what electricity would be incremental and thus eligible for purchase.

31. Early in the process, I proposed that [REDACTED] normal operating year to set the GBL because [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].

32. In equal measure, BC Hydro [REDACTED]
[REDACTED]. If BC Hydro had taken this position, [REDACTED]
[REDACTED]. BC Hydro did not, however, agree that [REDACTED]
[REDACTED].¹⁴ They believed a GBL based on [REDACTED]
[REDACTED]
[REDACTED]. Thus, even though using generation data from [REDACTED], I agreed with BC Hydro that [REDACTED]
[REDACTED]. I thus reached an agreement with BC Hydro [REDACTED]
[REDACTED]. I also believed that the agreement would be justifiable before the BCUC.¹⁵

¹⁴ Howe Sound Pulp and Paper LP, Generation Baseline Calculations, 1 August 2006 – 31 July 2009, bates 157669, R-66.

¹⁵ While the EPAs in the IPO were eventually exempt from this review by the *Clean Energy Act*, SBC 2010, c 22, Howe Sound and BC Hydro settled on the GBL at a time when BCUC justification was foreseen.

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33. Howe Sound and BC Hydro agreed that the generation data [REDACTED]
[REDACTED], should be used to set the GBL under the EPA.

In particular, [REDACTED]
[REDACTED]
[REDACTED].¹⁶ It also represented the [REDACTED]
[REDACTED]
[REDACTED].¹⁷

34. On October 28, 2009, [REDACTED]
[REDACTED].¹⁸ [REDACTED]
[REDACTED]
[REDACTED].¹⁹ [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED].²⁰

¹⁶ Email from Scott Janzen to Lester Dyck, dated November 3, 2010, bates 157667-157668, **R-67**.

¹⁷ [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]. See Howe Sound Pulp
and Paper LP, Generation Baseline Calculations, 1 August 2006 – 31 July 2009, bates 157669, **R-66**.

¹⁸ Email from Fred Fominoff to Scott Janzen Re: HSPP GBL, October 28, 2009, bates 159757-159757, **R-68**; Howe Sound Pulp and Paper LP, Generation Baseline Calculations, 1 August 2006 – 31 July 2009, bates 157669, **R-66**.

¹⁹ Howe Sound Pulp and Paper LP, Generation Baseline Calculations, 1 August 2006 – 31 July 2009, bates 157669, **R-66**; Consent and Electricity Purchase and Sale Agreement, April 19, 2007, bates 021866-021877, **R-69**.

²⁰ [REDACTED] (Powerex
Sales [REDACTED] / Total Generation [REDACTED]): Howe Sound Pulp and Paper LP,
Generation Baseline Calculations, 1 August 2006 – 31 July 2009, bates 157669, **R-66**.

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35. Based on Howe Sound's generation data from the [REDACTED], we tentatively agreed with BC Hydro to an annual GBL of [REDACTED]. The generation data we used, [REDACTED]. For example, it was possible that, [REDACTED]. To reduce the risk, [REDACTED].

36. BC Hydro [REDACTED] pointed out that [REDACTED]. I agreed with BC Hydro [REDACTED].²¹

37. During the EPA negotiations, BC Hydro also offered to purchase firm energy under one of two options. [REDACTED]. Pulp production can be complex with periods when black liquor (fuel for the recovery boiler) is not available for electricity production. [REDACTED].

²¹ [REDACTED]
[REDACTED] See email from Scott Janzen to Fred Fominoff re: GBL, dated June 24, 2010, bates 143058 - 143059, R-70.

²² [REDACTED].

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

3. Conclusion of the 2010 EPA

38. Howe Sound and BC Hydro agreed that under the EPA the GBL would be, on an annual basis, [REDACTED] GWh/year. I believe that this GBL was set on clear principles articulated by BC Hydro and was fair to both parties. Agreement on the GBL allowed us to continue negotiating the EPA.

39. Among other provisions discussed during negotiations was an exclusivity clause whereby Howe Sound would agree not to sell any electricity below its GBL to a third party unless the mill's generation levels were greater than mill load.²³ In my view, this clause was consistent with BC Hydro's position that the GBL must be generated before any electricity could be sold into an EPA. This clause (or something very similar) was included in the Domtar and Canfor Pulp EPAs (redacted versions were available from the BCUC). Howe Sound did not challenge this provision.

40. Howe Sound had previously taken a similar position when faced with the question of below-GBL sales. Howe Sound had been approached in late 2008 by Brian Merwin from Celgar to join him in pursuing the ability to sell what would amount to below-GBL generation.²⁴ In Mr. Merwin's view, Howe Sound stood to gain an incremental [REDACTED] [REDACTED] per year in EBITDA.²⁵ Howe Sound did not pursue the scenario that he presented. After discussing it internally, Howe Sound decided that the possibility of convincing the government to agree to the proposal was extremely remote, and would

²³ This might happen, for example, if the kraft mill was operating and the TMP and newsprint machines were down for maintenance.

²⁴ Email from Brian Merwin to Fred Fominoff, Re: Follow-up to Pulp and Paper Task Force Meeting, December 15, 2008, MER00075219, **R-71**.

²⁵ Email from Brian Merwin to Fred Fominoff, Re: Follow-up to Pulp and Paper Task Force Meeting, December 15, 2008, MER00075219, **R-71**; Modelled Impacts of Revaluing P&P Power, December 15, 2008, MER00075220, **R-72**.

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face opposition from all other BC Hydro ratepayers. We did not invest any resources in pursuing this proposal.

41. The EPA was eventually concluded on September 7, 2010.²⁶ The termination of the Generation Agreement was also concluded on September 7, 2010.²⁷ [REDACTED]

[REDACTED]

[REDACTED]²⁸ [REDACTED]

[REDACTED]²⁹ [REDACTED]

C. CONCLUSION

42. I believe BC Hydro was fair, reasonable and transparent when negotiating a GBL with Howe Sound. I understand that BC Hydro has no incentive to pay for existing electricity that would have been generated without an EPA. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

43. I affirm that the information provided above is true and correct.

²⁶ BC Hydro and Howe Sound Pulp and Paper Limited Partnership, Electricity Purchase Agreement, Integrated Power Offer, 7 September 2010, bates 016362 - 016499, **R-62**.

²⁷ Termination Agreement, 7 September 2010, bates 016535, s. 3, **R-73**.

²⁸ Termination Agreement, 7 September 2010, bates 016535, s. 3.2 **R-73**.

²⁹ [REDACTED]
[REDACTED] : Termination Agreement, 7 September 2010, bates 016535-016536, s. 3, **R-73**.

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SWORN BEFORE ME at the City)
Of Gibsons, in the Province of British)
Columbia, this 19th day of August, 2014.)



A Commissioner for taking Affidavits for)
British Columbia.)



Fred Fominoff

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