# SUBSIDIARY AGREEMENT

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# PULP AND PAPER

## Modernization of the industry

## 1979-1984

**Canada—Québec**

Gouvernement du Canada
Government of Canada

Expansion Économique Régionale
Regional Economic Expansion

Office de planification et de développement du Québec

December 1979

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# CANADA-QUÉBEC SUBSIDIARY AGREEMENT ON MODERNIZING THE PULP AND PAPER INDUSTRY

## 1979-1984

THIS AGREEMENT made this 15th day of May 1979

| | |
|---|---|
| BETWEEN: | THE GOVERNMENT OF CANADA (hereinafter referred to as "Canada") represented by the Minister of Regional Economic Expansion |
| | OF THE FIRST PART, |
| AND: | THE GOVERNMENT OF QUÉBEC (hereinafter referred to as "Québec") represented by the Minister responsible for the Québec Planning and Development Bureau and the Minister of Intergovernmental Affairs. |
| | OF THE SECOND PART. |

WHEREAS Canada and Québec signed a General Development Agreement on the fifteenth day of March 1974 to achieve the following objectives:

a) to improve opportunities for productive employment and to consolidate employment in the traditional sectors;

b) to improve the standard of living;

c) to reinforce the industrial and urban structure of Québec and promote the optimal development of the various regions;

d) to promote increased participation by Québecers in their own development; and

e) to promote balanced development in Québec in relation to the various regions of Canada.

AND WHEREAS the pulp and paper industry is one of the economic and industrial mainstays of Québec, by virtue of both the volume of its exports and its production and employment levels;

AND WHEREAS there is a need to make the industry more competitive through modernization and reduced operating costs, thus making it possible to consolidate existing jobs and to continue promoting the creation of new employment in this key sector of the Québec economy;

AND WHEREAS it is necessary to encourage the protection of the environment and the conservation of energy;

AND WHEREAS the Governor in Council by Order in Council P.C. 1979-3/1359 of the 2nd day of May 1979 has authorized the Minister of Regional Economic Expansion to sign this Agreement on behalf of Canada;

AND WHEREAS the Lieutenant-Governor in Council by Order in Council No. 1007-79 of the 11th day of April 1979 has authorized the Minister responsible for the Québec Planning and Development Bureau and the Minister of Intergovernmental Affairs to sign this Agreement on behalf of Québec.

NOW THEREFORE the parties hereto mutually agree as follows:

**DEFINITIONS**

1. In this Agreement:

   a) "Schedule A" means the attached Schedule "A" forming an integral part of this Agreement and containing the background, objectives and plan of action;

   b) "Schedule B" means the attached Schedule "B" forming an integral part of this Agreement and containing the description of the program, the distribution of costs and the project completion schedule;

   c) "Development Committee" means the Committee established pursuant to subsection 9.1 of the General Agreement;

   d) "Management Committee" means the Committee established pursuant to subsection 12(2) of this Agreement;

   e) "Approved capital costs" means the total authorized capital costs which in the opinion of the Management Committee were incurred and disbursed by the applicant for direct costs connected with design, acquisition, construction, transportation and installation of the fixed assets and the facility, at their fair market value;

   f) "Termination date" means the date on which the eligible assets of the subsidized project have been put into operation, in the opinion of the Management Committee;

   g) "Term of this Agreement" means the period from the date of this Agreement until March 31, 1984;

   h) "General Agreement" means the Agreement between Canada and Québec on the socio-economic development of Québec, signed on the 15th day of March 1974 and terminating on the 31st day of March 1984;

   i) "Facility" means the plant in which the production factors associated with the processing of forest resources into pulp and/or paper are housed and co-ordinated;

   j) "Fiscal year" means the period commencing on April 1 of any year and terminating on March 31 of the immediate following year;

   k) "Prime contractor" means Québec or its agents;

   l) "Department" means the Department of Regional Economic Expansion;

   m) "Ministers" means the federal Minister and the Québec Minister;

n) "Federal Minister" means the Minister of Regional Economic Expansion and includes anyone authorized to act on his behalf;

o) "Québec Minister" means the Minister responsible for the Québec Planning and Development Bureau and includes anyone authorized to act on his behalf;

p) "Bureau" means the Québec Planning and Development Bureau;

q) "Program" means the factors that constitute the modernization of the industry as defined by this Agreement;

r) "Project" means any of the components of the program mentioned in Schedule "B";

s) "Applicant" means a company that has a modernization project relating to pulp and paper facilities located in Québec;

t) "Incentive" means government assistance granted with regard to a facility modernization project as set forth in Schedule "B".

**PURPOSE**

2. This Agreement makes possible the establishment of a federal-provincial assistance program for the modernization of the pulp and paper industry in Québec.

3. Without restricting the meaning of the foregoing, the purpose of this Agreement is, more specifically, to offer financial assistance to pulp and paper companies eligible for the program, to enable them to:

   a) modernize their facilities with a view to reducing production costs;

   b) install equipment that will help protect the environment and conserve energy.

4. (1) Canada and Québec shall finance the projects listed in Schedule "B" to the extent and in the manner mutually agreed upon, as specified in the said Schedule.

   (2) Canada's contribution shall not exceed 60 per cent of the government incentive granted for a project under this program, and that of Québec shall not exceed 40 per cent.

5. The eligible costs used to determine the amount of the incentive are generally, but not exclusively, those related to the following categories:

   a) converting the pulp manufacturing process or increasing the efficiency of existing processes;

   b) pulp production equipment;

   c) modernization of equipment through the introduction of advanced technology;

   d) modernization of control techniques;

   e) organization of the production line;

   f) increasing the value added by manufacturing a product of greater value;

g) environmental protection equipment;

h) energy conservation equipment.

6. (1) With the exception of equipment required to meet environmental protection standards, the Management Committee in making its incentive offer may give priority to those categories of assets that bring about the greatest reduction of production costs.

(2) The granting of an incentive shall not be authorized under this Agreement for the modernization of a facility where the approved capital costs will not, in the opinion of the Management Committee, exceed $500,000.

7. The government incentive granted under this federal-provincial program may amount to 25 per cent of the approved capital costs of a project.

8. The granting of an incentive shall not be authorized under this Agreement for the modernization of assets for which an incentive has previously been authorized under this Agreement.

9. (1) Unless written approval is obtained from the Ministers, the Management Committee shall not authorize any incentive after March 31, 1984.

(2) Unless written approval is obtained from the Ministers, the Management Committee shall not announce a project termination date after March 31, 1986, and the applicant shall present the prime contractor with his claim for the final instalment on the incentive within six months following this date.

10. Notwithstanding any other provisions of this Agreement, Canada's contribution shall not exceed $90 million and that of Québec shall not exceed $60 million.

11. This Agreement, including the Schedules thereto, may be amended with the written consent of the Ministers, with the exception of sections 10 and 15 which may only be amended with the consent of the Governor in Council and the Lieutenant-Governor in Council.

**MANAGEMENT**

12. (1) This Agreement shall be supervised by the Development Committee, the composition and duties of which are set forth in subsections 9.1 and 9.2 of the General Agreement.

(2) A Management Committee, comprising an equal number of representatives of Canada and Québec appointed by their respective ministers, shall be responsible for the routine management of projects.

(3) The Management Committee shall answer to the Development Committee and its specific tasks shall be:

a) to examine the application received by the prime contractor;

b) to determine the amount of the incentive and the conditions attached to it;

c) to inform the applicant of the decision reached by the two governments on whether the project should be approved;

d) to see to the implementation of the program and projects and, to this end, to draw up the detailed administrative standards and terms and conditions that will govern relations between the applicant, the Management Committee and the prime contractor;

e) to propose amendments to this Agreement and the Schedules subject to the provisions of sections 10 and 15;

f) to set up subcommittees if necessary to assist in the fulfilment of its mandate; and

g) to provide the people and groups affected by this Agreement with information on it.

(4) In all cases, the Management Committee shall inform the applicant of its decision in a letter of offer signed by representatives of the Department of Regional Economic Expansion, the Québec Planning and Development Bureau and the Department of Lands and Forests; the letter represents a commitment by the two governments within the limits of the Agreement. The letter shall constitute an Agreement between the applicant and the prime contractor upon the applicant's acceptance of the offer.

(5) All revisions and amendments to the original offer must be approved by the Management Committee and shall be governed by the same procedure.

(6) Canada and Québec undertake to provide the Management Committee, through their respective representatives, with all the information it requires to perform its tasks.

13. Québec as prime contractor undertakes that each applicant shall:

(1) appoint an officer to act as liaison with the Management Committee for the purpose of providing it with the necessary data for project analysis, keeping it informed of the status of work and submitting at least every six months a report, in the agreed format, on the progress of work and costs;

(2) permit the Management Committee at least every six months to inspect work for the purpose of checking the progress that has been claimed and obtaining any other information about the project;

(3) make a formal request to the Management Committee for permission to proceed with a major change in the implementation of a project included in Schedule "B";

(4) make use of the assets for which an incentive has been given for a period of 24 months after the completion of the project as determined by the Management Committee. In the event that the assets are sold, destroyed or otherwise disposed of, the applicant may be required to repay all or part of the incentive.

14. Should the applicant make any major change in the implementation of the project as described in Schedule "B", without the approval of the Management Committee, Canada and Québec reserve the right to modify their financial commitment to the project.

## IMPLEMENTATION PROCEDURES

15. The implementation of the program and projects covered by this Agreement shall be subject to the following provisions:

(1) no incentive shall be given for investments directly related to newsprint machine speed-up;

(2) future expenditure only shall be regarded as eligible costs when a formal incentive application is submitted.

16. Assistance for cost-cutting modernization projects shall be given on the following conditions:

a) incentives shall be provided only for those investments which would probably not be made without government assistance;

b) mills for which incentives are given must be shown to be commercially viable in the long term;

c) a socio-economic cost/benefit analysis must show that the project will result in a net profit.

17. Applicants requesting an incentive for one of their facilities shall submit a corporate investment program for the next five years.

## RECORDS AND AUDIT AND PAYMENT PROCEDURES

18. (1) Subject to section 21 of this Agreement, Canada shall pay Québec, according to progress made and expenses incurred and paid, a maximum of 80 per cent of its share, as defined in subsection 4(2), of the incentive for a modernization project. These payments shall be made upon recommendation by the Management Committee and upon receipt of a claim certified by the President-Director General of the Bureau or his representative and submitted by Québec in the manner prescribed.

(2) Canada shall not pay the final 20 per cent of its share of the incentive until Québec submits a certificate in the manner described, to the effect that all of the project's eligible assets are in operation in the opinion of the Management Committee.

(3) Québec shall keep accounts of the payments made under subsection 18(1) for each of the projects in Schedule "B" and shall submit on the 31st day of March each year a detailed statement of expenditures verified in the manner prescribed and to the satisfaction of the Federal Minister who shall receive the said statement no later than the 31st day of May.

(4) Any discrepancy between the amounts paid by Canada and the amounts payable by the Department shall be rectified by Canada and Québec as quickly as possible.

19. All payments made to Québec by Canada pursuant to section 18 shall be paid into the consolidated fund of Québec.

20. Québec agrees that applicants shall keep up-to-date and detailed accounts of their work programs and shall provide Canada upon request with all the accounting information required to audit claims relating to work carried out under the terms of this Agreement.

21. In each fiscal year the contribution made by Canada and Québec for the purposes of this Agreement shall be conditional upon the allocation of funds by the Parliament of Canada and the Québec National Assembly.

## EVALUATION

22. As provided for in subsection 6.5 of the General Agreement, the program and projects shall be assessed, in accordance with criteria established by the Development Committee, in the year following the signing of this Agreement.

## GENERAL PROVISIONS

23. Canada and Quebec agree that:

    (1) The texts of all calls for tenders and public advertising connected with the project covered by this Agreement shall contain the following statement: "This project is being subsidized by the Department of Regional Economic Expansion of Canada and the Québec Planning and Development Bureau" or any other statement to the same effect approved by the Ministers;

    (2) Canada and/or Québec shall supply, erect on site and maintain during the entire period that work is in progress, one or more signs indicating that the work in question is undertaken in accordance with this Agreement or bearing any other statement to the same effect approved by the Ministers;

    (3) Canada reserves the right to provide and install wherever suitable, on completion of the work, a permanent plaque or sign bearing an inscription similar to that described in subsection 23(2);

    (4) Official inauguration ceremonies for the project shall be organized jointly by the Ministers.

24. No member of the House of Commons or the Québec National Assembly shall be admitted to any share of any contract, agreement or commission made pursuant to this Agreement or to any benefit arising therefrom.

25. The party responsible for the implementation of the program or projects shall indemnify and save harmless the other party, its officers and agents against all claims and demands of third parties arising in any way out of the implementation of the said program or projects.

26. All construction work done during the implementation of the program or projects shall be carried out in accordance with labour conditions agreed to by Canada and Québec.

27. All contracts relating to the implementation of the program shall be awarded without discrimination on the grounds of sex, age, marital status, race, ethnic origin, religion or political affiliation.

28. Canadian material as well as Canadian professional services shall be used in respect of all projects to the extent to which such material and services are available and consistent with proper economy and without prejudice to the expeditious completion of the program or projects.

IN WITNESS WHEREOF this Agreement has been executed on behalf of Canada by the Honourable Marcel Lessard, Minister of Regional Economic Expansion, and on behalf of Québec by Messrs. Jacques Léonard, Minister of State for Planning and responsible for the Québec Planning and Development Bureau and Claude Morin, Minister of Intergovernmental Affairs, on the above-mentioned day and year.

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| IN THE PRESENCE OF: | SIGNED ON BEHALF OF CANADA |
| ______________________<br>Witness | ______________________<br>Marcel Lessard<br>Minister of Regional<br>Economic Expansion |
| IN THE PRESENCE OF: | SIGNED ON BEHALF OF QUÉBEC |
| ______________________<br>Witness | ______________________<br>Jacques Léonard<br>Minister of State for Planning<br>and responsible for the Québec<br>Planning and Development Bureau |
| ______________________<br>Witness | ______________________<br>Claude Morin<br>Minister of Intergovernmental<br>Affairs |

# SCHEDULE "A" PROBLEMS, OBJECTIVES AND PLAN OF ACTION

## INTRODUCTION

The purpose of this schedule is to describe the problems, objectives and plan of action that set the terms of this Agreement between the governments of Canada and Québec.

## PROBLEMS

Over the past two years, major studies on the forest products industry, undertaken by the two levels of government in close consultation with the industry and its employees, led to the identification of a number of problems and factors restricting the growth and development of the industry in Canada. With a view to solving these problems, on February 1, 1979 the federal government unveiled a national policy on the development of the industry, consisting of two main facets: measures concerning the management of forest resources, and financial assistance for the modernization of the forest products industry. These measures are to be implemented under the General Development Agreement concluded between the Department of Regional Economic Expansion and the provinces concerned. This concerted effort on the part of the two levels of government should help make government policies and assistance more effective, which will benefit the industry's companies and its employees. It should be noted that over the past ten years the Department of Regional Economic Expansion alone has contributed about $114 million in incentives to Québec's forest industries, and $83 million under the subsidiary agreement on forest management, to which the Department of Regional Economic Expansion will be contributing an additional $110 million this year.

Québec, for its part, has invested a total of $450 million in the pulp and paper and forest industries during the same period, through the budgets of its Department of Lands and Forests, Rexfor, and the Industrial Development Corporation.

The pulp and paper industry is the most important sector of Québec's forest industry. In 1977 it produced 7 million tons of pulp and paper of every kind — newsprint (62%), commercial pulps (13%), cardboard (13%), fine papers (5%), packaging paper (3%) and other products (4%).

The pulp and paper industry has a direct impact on the economic agents that are either directly or indirectly involved in harvesting timber, processing it into pulp and paper and delivering these products to consumers.

In Québec, at least 114 municipalities owe their existence solely to the forest industry. The pulp and paper industry is the source of 45,000 direct jobs in the mills and forests, and its activities have given rise to 130,000 indirect jobs in other sectors. This industry ranks second among all the manufacturing industries in terms of average weekly pay, with total wages amounting to $600 million annually. It provides additional income for close to 25,000 independent timber producers, and purchases more than two million tons of chips from the lumber industry, which results in more than $75 million in revenues for this industry.

Neither Canada nor Québec constitutes a significant market for this industry, and its exports, valued at approximately $1.8 billion, are of considerable importance in the balance of payments. It is estimated that this industry is 65% Canadian owned.

The fundamental problem of Québec's pulp and paper industry lies in its decreasing ability to compete on the domestic and foreign markets.

Four main indicators show that the industry is in a general state of decline:

— the return on capital in the Canadian pulp and paper industry for the period from 1965 to 1978, which stands at 8.3% compared with 11.1% for this industry in the United States and 11.2% for the whole of the Canadian manufacturing sector;

— the gradual but steady erosion of its portion of American markets, which moved from 40% to 30% between 1950 and 1976;

— the continually widening gap between the cost of manufacturing and delivering one ton of newsprint in Québec and this cost in the southern United States, which moved from $16 in 1968 to $20 in 1970, then to $45 in 1976 and $52 in 1977;

— temporary work stoppages and mill shutdowns associated with fluctuating demand and resulting in losses of income for employees, companies and the governments.

This state of affairs stems from a number of structural problems: expensive raw materials, low productivity in the mills, and high delivery costs for finished products.

Procuring supplies of wood is the most important factor in the cost structure, and is responsible for nearly half the disparity with competitors' costs. Vigorous corrective measures are being introduced with regard to timber management and allocation; it is hoped that the cost gap between the Québec industry and its main competitors with regard to wood delivered to the mills will be reduced by half. Under another subsidiary agreement on forest development signed in 1975, $138 million has already been allocated for this purpose; this will be boosted by an amendment providing for substantial additional funds.

The low productivity of the mills means high manufacturing costs. This is due to the fact that the mills are not modern. The organization of production lines is inadequate, and the pulp manufacturing processes and paper machines are not very efficient. Furthermore, the hourly wage rates are higher than those in effect in the United States. On the other hand, the Québec industry should continue to benefit from lower energy costs.

With regard to all the various sources and destinations of the finished product, the average transportation cost incurred by Québec mills is far higher than in the case of American mills. This difference is due mainly to the fact that rapidly growing markets are located further away. However, certain discrepancies in costs for equal distances stem from the tariff structure and the overlapping of American and Canadian regulations, which are being studied by the governments.

Finally, market problems, combined with the disadvantages of the costs of raw materials, manufacturing and delivery, are the main reasons for the companies' low profit-earning capacity. This situation has made it exceedingly difficult for the companies themselves to finance the modernization needed to improve their competitive position. These same factors have made it expensive, if not impracticable, to turn to the financial market to compensate for the lack of capital, because the rate of return on investment is below the average generally observed in the industry.

All the same, in the past five years the industry has invested an average of $360 million annually in Quebec. Of this amount, about $120 million went for maintenance and replacement of obsolete equipment, $100 million for the construction of new mills, leaving only $140 million per year for the modernization of existing mills and pollution control. It is estimated that modernization and pollution control in existing mills would require capital expenditures on the part of the companies amounting to $1.3 billion over the next five years. It is obvious that under these conditions, if left to itself, the pulp and paper industry will find it extremely difficult to make the necessary investment to narrow the gap separating it from its main competitors.

## OBJECTIVES

Even under more favourable circumstances, Québec companies are hesitant to invest enough because they do not feel it is possible to reverse this situation in which the gap between themselves and their competitors is widening with regard to the various components of the cost structure. The obligation to comply with environmental protection standards means additional financial burden. The companies will have to be persuaded to commit their liquid assets to these investments so that they can regain their position on the market. The government must therefore take steps that will encourage the industry to direct its investments toward this objective; otherwise, the hesitancy will persist and, as in the past, capital expenditures will be inadequate and too few and far between to make any appreciable contribution toward improving the industry's competitive position.

Thus, the objectives to be attained are the modernization of the pulp and paper industry through the rationalization of its processing activities, the diversification of its production, and technological change to reduce costs and improve the industry's competitive position, while at the same time conserving energy and protecting the environment.

The anticipated cost reductions will be of sufficient magnitude to enable the industry to revise its investment priorities. It will be in a position to further improve its ability to compete on the market by capturing a portion of the increase in demand and by improving its economy of operation, so that it can continue on its own to make the investments needed to pursue its modernization activities.

## PLAN OF ACTION

Government assistance should be regarded as a catalyst for activating the industry's investments and encouraging the industry to modify the order of priority for its investment plans with a view to correcting basic structural weaknesses.

The financial assistance offered will take the form of incentives of up to 25 per cent of the eligible assets based on a five-year investment plan for each of the companies' investments, as explained elsewhere in this Agreement. This program will also take into consideration the other commitments set forth in a general agreement between the firms and the Quebec Department of Lands and Forests with regard to manpower, environmental protection, forest management and allocation of wood.

# SCHEDULE “B”
# SUMMARY TABLE

| PROJECT DESCRIPTION | DISTRIBUTION OF COSTS (in millions of $) | | | PROPOSED DISTRIBUTION OF EXPENDITURES (Canada 60%, Québec 40%) | |
|---|---|---|---|---|---|
| | TOTAL ESTIMATED COSTS | CANADA DREE | QUÉBEC | 1979-1980 | 1980-1984 |
| | 150 | 90 | 60 | | |

APPROVED BY THE DEVELOPMENT COMMITTEE OF THE CANADA/QUÉBEC GENERAL AGREEMENT

FOR CANADA ______________________ DATE May 15, 1979

Marcel Lessard

Minister of Regional Economic Expansion

FOR QUÉBEC ______________________ DATE May 15, 1979

Jacques Léonard

Minister of State for Planning and responsible for the Québec Planning and Development Bureau