Frequently Asked Questions: FPI's Income Trust Proposal

Government's Efforts to Protect the Public Interest

1. What has the Government of Newfoundland and Labrador done to ensure that the best interests of communities, workers and the province are protected?

As part of the discussions with FPI, government sought the input of many groups and individuals including communities, union officials, and individuals. This includes the Harbour Breton IAS (Industrial Adjustment Service) Committee and representatives from Harbour Breton, and representatives from Fortune. Their positions were placed before the Company and the Company was asked to respond. Government's position was that any proposal brought before the House of Assembly must have substantial protections for communities dependent on FPI. Throughout the discussions, government officials repeatedly emphasized the need for stronger community commitments. In the proposal from FPI, it has agreed with Government's request that if there is a breach of FPI's undertakings then the penalty would be that FPI's groundfish quotas revert to the Provincial Government. This type of penalty is a major type of protection for rural communities.

2. Why is government proceeding to present this proposal to the House of Assembly?

Our goal was to push as far as possible the interests of the impacted communities and workers, as well as to protect the fish caught by the Company. Government did not get everything requested; however, the Terms brought forward are a substantial gain from the Company's initial position. MHAs will now decide with a free vote on the proposal.

Overview of the Proposal made by Fisheries Products International (FPI)

1. What is being proposed by FPI?

FPI Ltd is proposing to restructure its Marketing and Value-Added Group (MVA). FPI would initially retain a 60 percent interest in the new U.S. marketing company. By establishing an Income Trust to hold the additional 40 percent, the company expects to receive cash proceeds of up to $100 million from the initial sale. (In the future, FPI's stake in the MVA could be diluted through the issuance of additional trust units or by the further sale of FPI's share of the company.) The community investments and other undertakings being made by FPI to the Provincial Government will be financed from this initial issue of trust units. The company has also agreed to place certain restrictions on how it distributes dividends to shareholders to ensure that the capital from the initial offering, and any future offerings, contributes to the growth of FPI's business operations.

2. What is the MVA Group?

The MVA of FPI includes the Company's operations based in the United States (known as Ocean Cuisine International (OCI)) which includes a secondary processing facility in Danvers (Massachusetts), a cold storage and distribution facility in Peabody, the secondary processing facility in Burin, and its North American sales and marketing functions in the United States and Canada.

3. What is an Income Trust?
Income trusts have been used to unlock value from a company's assets. They are found most often in the mining and oil and gas industries, although in recent years their coverage has been broader.

Income trusts are a form of equity arrangement that provides for public ownership of assets. A corporation can achieve significant tax savings because the income (trust payout per unit-holder) is treated as an interest expense and is thereby taxed at a lower rate than dividends. As a result, investors tend to receive a higher level of cash distribution than when the assets are held by a corporation. Generally, income trusts pay a fixed yield or payment to unit-holders; however, they are not required to do so. The unit-holder can benefit financially through capital appreciation of its shares and through the yield payment.

4. Why does FPI want to proceed with an Income Trust?
There is an international trend of the consolidation of seafood and food providers. FPI indicates that the establishment of an Income Trust is needed to allow the Company to grow. The Company indicates that it cannot assume any more debt and, at current debt levels, the Company requires alternate forms of financing in order to grow and continue its role as a market leader. Without the Income Trust, or other equity financing, it is likely the Company's influence in world seafood markets would diminish.

5. Will the Government of Newfoundland and Labrador make the Income Trust Prospectus available to Members of the House of Assembly?
It is up to the Company to disclose its draft prospectus. Government is respectful of the fact that FPI is a publicly traded company and must manage its affairs accordingly.

6. What would be the corporate structure associated with this transaction?
Under its proposal, the Company indicates that it would retain control of the U.S. marketing business and would hold a majority of Board seats. Initially, the new subsidiary would be 60 percent owned by the Company and the remaining income trust units would be broadly held. Future corporate growth in the US could result in the dilution of FPI's interest below 60 percent. FPI could also choose to sell part of the 60 percent which it will hold at the outset. While the corporate structure is complex, and FPI could lose control over some Boards within the overall structure if its interest is diluted, FPI has committed to the Provincial Government that it will not permit its interest in the U.S. marketing company to be diluted below a level whereby it would lose the ability to appoint a majority of its Board of Directors. If this happened it would constitute a breach of the agreement and the penalty clauses would be activated.

The Income Trust would be established in Canada; however, the actual MVA assets and head office would be based in the United States. FPI would retain 100 percent ownership in the primary group (all of its Newfoundland-based operations except for Burin), which will not be part of this transaction.

The establishment of an Income Trust involves the establishment of a number of different corporate structures. Under FPI's proposal there would be an Income Trust, a managing partner company, and an operating partner. As well, there would be intermediate companies formed that would serve as a means to transfer assets and liabilities.

7. What commitments does FPI's proposal make for growing local operations?

The Government of Newfoundland and Labrador has sought assurances from the Company including specific benefits for local operations (to be financed from the initial sale of interest in the U.S. marketing company) and commitments that restrict the use of funds (for the initial and subsequent issues). The Company is committing that the funds raised from this transaction would be primarily directed to the support and improvement of its primary harvesting, processing and marketing operations and business. It has committed to operating the plants in Burin, Fortune, Marystown, Port au Choix, Port Union and Triton for five years as long as it is economically viable to do so (note that "viability" is a defined term and can be subject to arbitration). In regard to Bonavista, FPI commits to either replacing the plant or combining the operation with Port Union within two years, and will consult with the union and the communities.

One of the Company's major commitments is that its valuable Enterprise Allocations (EAs, or quotas) would be landed and processed in this province. If the Company defaulted on the provisions contained in the contract, the EAs would revert to the Province.

The commitments for expenditures in Newfoundland and Labrador operations include:

- Repayment of $30 million in debt;
- Investment of $8 million to expand secondary production on the Burin Peninsula subject to a $4 million interest free government loan;
- Investment of $4 million funding in IT in this province over the next 3 years which will provide the information technology platform for the entire operation;
- Transfer of most plant assets in Harbour Breton to the community and a commitment to provide up to $3 million to benefit the workers affected by the plant closure;
- The possible expansion of marketing services subject to a market inventory loan guarantee program; and,
- Investment of $1 million in Research and Development subject to matching funds being provided by government(s).

8. What would this transaction mean for Fortune?

The Company has committed $8 million for the expansion of its secondary processing operations on the Burin Peninsula at a site to be determined subject to negotiations with the FFAW.

9. Were the FFAW or community members involved in the development of this contract or in obtaining concessions for workers?
FPI has prepared a proposal for discussion in the House of Assembly. In arriving at this proposal, the Company has been in regular contact with the Fish, Food and Allied Workers (FFAW). The provincial government has met with representatives of Fortune and Harbour Breton, and also relayed the requests that these communities were making of FPI. The final proposal of FPI to the provincial government contains the results of this process. As well, government will be briefing MHAs and the FFAW, and welcome their feedback.

10. What commitments have been made by FPI regarding quotas?
FPI has committed to landing and processing its Enterprise Allocations (EAs), or quotas, in the province. If the Company were to irrevocably breach its commitments, the Enterprise Allocations would become the property of the Government of Newfoundland and Labrador, subject to the approval of the federal minister.

11. What groundfish quotas does FPI have in Newfoundland and Labrador? What commitments have the Company made on these?
FPI has a number of Enterprise Allocations (EAs, or quotas) in the province for species such as cod, American plaice, yellowtail flounder, redfish, pollock, greysole, and turbot. The Company has committed to landing and processing the EAs in Newfoundland and Labrador, regardless of whether the Income Trust provision proceeds, provided that the legislative changes are made. In the event of a breach in the conditions of the contract, the ownership of the EAs reverts to the Government with the Company having a right to lease the EAs from the Government for processing.

12. What commitments has the Government of Newfoundland and Labrador received from the Company on its shellfish quotas?
No commitments were sought concerning FPI's shellfish Enterprise Allocations (EAs, or quotas), other than the general commitments to continue plant operations in the shrimp processing communities. Unlike groundfish, most of the shellfish EAs tend to be processed at sea. As such, the issues of landing and processing them in this province are not as significant.

13. Are these quota commitments legally binding?
Yes. If the Government of Newfoundland and Labrador enters into this contract with FPI, any breaches of the contract by the Company results in the ownership of the Company's groundfish Enterprise Allocations reverting to the province.

14. Does the proposed contract between the provincial government and the Company protect against corporate raiding?
The proposed contract requires that FPI maintain control of the Board of the new marketing company associated with this transaction, as long as the Company has at least 10 percent ownership stake in the OCI business. Changes beyond this would require Ministerial approval. There are no ownership restrictions on who owns the shares of the Trust or the MVA group; however, FPI will

obtain from Clearwater and Sanford a firm commitment to restrict the level of their ownership of Trust units to below 15 percent.

15. Will shares in the income trust be tendered to or purchased by the provincial government?
Government does not have any plans to purchase Income Trust units. Government does not normally purchase shares in publicly traded companies.

16. What has FPI committed in regard to its continued marketing arrangements with the new US Company??
There would be a long-term marketing agreement with the MVA Group. The new company, Ocean Cuisine International (OCI), would have a marketing contract with FPI for seven years with another renewable term at the discretion of FPI. This would be to ensure that FPI retains the ability to market its primary products through this channel in the United States.

Government Legislation & FPI

1. What were the original objectives of the *FPI Act*?
The original objectives of the *FPI Act* were to: (a) protect pre-1987 public monies invested in the Company; (b) provide a hedge against where unfettered private ownership could lead; c) avoiding corporate raiding and/or asset break-up; (d) ensure operations in the Province continue; and e) generally make the 1987 privatization publicly defensible. In general terms, the *FPI Act* provided a means to ease the transition of the Company from government ownership to private sector ownership.

> a) Protect public monies invested in the Company.
> Prior to privatization in 1987, the federal and provincial governments and the Bank of Nova Scotia (secured by government loan guarantees) invested some $252 million in the form of cash and equity investment into the newly created and restructured FPI in the period between 1984 and 1987. Of this, $66 million came from the Province, $18 million came from the Bank of Nova Scotia and $168 million came from Canada. The Bank received back its full investment, however the return to Canada on the sale of its shares in FPI was $118 million, and to Newfoundland and Labrador was $49 million, leaving in the case of the province a shortfall of $19 million.
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> b) Hedge against where unfettered private ownership could lead.
> At the time FPI was privatized, there was concern among the general population and government that the Company should remain outside the control of one specific shareholder. As well, there was general uncertainty of what this would mean for the Company and the communities dependent upon its operations. FPI has been under private ownership with the only fetter on its ownership being the 15 percent share restriction. This was a common practice at the time.

c) Avoiding corporate raiding and/or asset break-up.
One of the stated purposes of the 15 percent shareholding restriction, in concert with the prohibition on the sale of substantially all of the assets of the Company, was to prevent any one person or group of persons from acquiring control of the Company and selling off its assets on a piecemeal basis for their break up value.

d) Ensuring Operations in the Province (i.e. employment and industry activity).
The 1987 restrictions require the Company to have its head office in Newfoundland and Labrador, mandate that it operates under the provincial law (the *Corporations Act*), and preclude the shutdown of any one or more of FPI's plants without giving the federal and/or provincial governments on notice the opportunity to continue funding such operation(s). These restrictions were not a guarantee of performance and do nothing to ensure the operations of any FPI fish plant in Newfoundland and Labrador in the short, medium and long-term where FPI management makes a business decision not to operate a facility.

e) Made Privatization Publicly Defensible.
The *FPI Act* made the privatization publicly defendable at the time. The importance of the Company to the province and rural Newfoundland and Labrador required that the public be given a degree of assurance that the Company would remain a dominant force in the Newfoundland and Labrador fishing industry.

2. What have been recent changes to the *FPI Act*?
In 2002, a Committee traveled throughout the province to hear the views of people regarding the future of FPI. The change of the Board of Directors in 2002 and the new directions announced for the remaining groundfish plants created concern for many of the people in the province. This was especially true for communities where FPI was still a significant presence.

In response to the report of the Committee, in March 2002, the *FPI Act* was amended. Bill 65 provided for changes to the *Act* including a new section that stated the purpose of the *Act*, the 15 percent ownership restriction was changed to include all types of shares, it provided for legal immunity for the Government of Newfoundland and Labrador, and clarified the requirement for the headquarters to remain in this province.

3. Are the original objectives relevant today?
For the most part, the objectives for FPI remain relevant. It is now a private company and government has limited influence over the day-to-day operations of the Company, however, the Company remains important to many areas of Newfoundland and Labrador. The purpose of the 1987 *Act* was for governments to create a company whose primary objective was to strengthen the Newfoundland fishery and that was economically viable, efficient and modernized so that it would be highly competitive especially in international markets.

4. Why does this require a provincial government decision?

The *Fishery Products International Act* limits the sale of its business. The Company is prohibited from selling or disposing of "all or substantially all of its property or business which relates to the harvesting, processing and marketing of seafood." The placing of the marketing group into an Income Trust could be interpreted as a sale of substantially all the marketing functions of the Company. FPI indicates that it would initially retain 60 percent ownership of the Income Trust; however, it is likely that FPI's share would diminish as the Company expands. The potential for lower ownership levels suggests that this could be perceived as a sale of a substantial portion of the Company. This created the need to refer the matter to the House of Assembly to clarify the existing legislation.

5. What are the applicable provisions of the *FPI Act*?

The *Act* reads:

7. (1) Neither FPI Limited nor Fishery Products International Limited shall sell, lease, exchange or otherwise dispose of all or substantially all of its property or business which relates to the harvesting, processing and marketing of seafood.

6. Why is an amendment to the *Act* necessary to deal with the Income Trust?

An amendment is necessary to ensure that the transaction is consistent with Section 7 of the *FPI Act*.

7. What other legislative changes are being proposed to the *FPI Act* and why?

The other legislative changes being proposed to the *Act* include repeal on a "go forward" basis of Section 11. That part of the *Act*, known as the "privative clause," prevented the Company from seeking legal recourse against any subsequent actions governments may make. This section was inserted in 2002, but it is reasonable to remove it at this time to re-establish this part of FPI's relationship with government on the same basis as other companies.

8. What changes to other legislation are being proposed and why?

No changes to other legislation are being proposed nor are they required. FPI had proposed additional changes to the FPI Act to allow for a 20% ownership restriction, instead of the current 15%, and to reduce the constraint against the sale of assets outside the Province, but the Province rejected these proposals.

9. Why has it taken so long for the Government of Newfoundland and Labrador to respond to this proposal?

The proposed Income Trust is a complicated financial transaction. The analysis of these types of proposals involves considerable time and resources. As well, the Government asked the company to consider many specific undertakings to protect the public interest, and the interests of communities in which FPI operates. These discussions resulted in numerous revisions to FPI's proposals.

10. Will the Government of Newfoundland and Labrador provide legal and other opinions it has received?

Government does not release legal opinions given that they contain proprietary information. FPI's proposal is being brought to the House of Assembly for debate and a free vote. The ability of MHAs to arrive at an informed vote decision is not contingent on the content of these legal opinions, but rather on the content of FPI's proposal.

11. What role do governments play in sharing quotas among plants and communities?

The provincial government has no role in sharing Enterprise Allocations (EAs, or quotas) among plants and communities. Enterprise Allocations are the jurisdiction of the Federal Government.

12. Why didn't the Government of Newfoundland and Labrador require FPI to operate the Harbour Breton facility as part of its deal with the Company?

Government relayed the requests of the Harbour Breton IAS (Industrial Adjustment Service) committee as part of its discussions with the Company. The commitments made by FPI for Harbour Breton reflect their position on the facility and this is included in the proposal that is before the House of Assembly.

13. What other commitments did the Provincial government seek?

Government has requested a number of commitments from the Company. FPI indicated that some of the requested restrictions would inhibit their ability to operate the Company. Specific restrictions requested but not received in total from FPI relate to control and the distribution of funds and include requests that:

- FPI retain 60 percent ownership control in all subsidiaries including those in Income Trust structure, and not permit merger or sale;
- Proposed dividend policy not to exceed 4.7 percent;
- 10-year commitment not to close plants;
- A firm commitment from FPI to invest in aquaculture industry;
- Cabinet approval required for current shareholders holding more than 5% of shares to purchase Income Trust units; and,
- Establishing the Income Trust under laws of Newfoundland and Labrador instead of Manitoba or Ontario.

14. Why does the Government of Newfoundland and Labrador think it is necessary to restrict how funds are used, such as the amount of dividends paid to shareholders?

Government wanted to ensure that the money raised through the sale of trust units would be used to improve the debt position, expand working capital, and allow FPI to pursue growth opportunities. If the capital instead were distributed to shareholders, the Company's growth prospects would be harmed.

15. Has the Company asked the Government of Newfoundland and Labrador to make any legislative changes?
The Company has asked for amendments to the *Act*, including changes to the clause limiting government liability, lessening the restriction on the sale of assets to include only those assets in this province, and changes to the ownership section from 15 percent to 20 percent. Government refused to make any changes other than those outlined.

16. What happens if FPI fails to honour its commitments under this Agreement?
Government has insisted upon explicit default provisions that will result in FPI groundfish enterprise allocations reverting to the Government of Newfoundland and Labrador should a breach occur.

17. What is the Government of Newfoundland and Labrador's position on the Income Trust?
Government is not taking a formal position on the Income Trust, instead encouraging each Government Member of the House to vote as they see necessary.

18. If the Government of Newfoundland and Labrador approves the income trust proposal, when will FPI proceed with sale?
If approved, the timing of the establishment of the Trust will be FPI's decision, subject to the finalization of the Agreement with Government.

19. What is the process?
If the House of Assembly passes the proposed amendments, the Government of Newfoundland and Labrador will negotiate an Agreement with FPI setting out the commitments in greater detail. The amendments to the FPI Act will not be proclaimed unless and until the Agreement has been finalized; the Government will review the final form of the Income Trust transaction before finalizing the Agreement.