COMMISSION OF INQUIRY
RESPECTING THE MUSKRAT FALLS PROJECT

Transcript | Phase 1	Volume 21

Commissioner: Honourable Justice Richard LeBlanc

Friday 19 October 2018

CLERK (Mulrooney): All rise.

This Commission of Inquiry is now open.

The Honourable Justice Richard LeBlanc presiding as Commissioner.

Please be seated.

THE COMMISSIONER: All right. Good morning.

MS. O'BRIEN: Good morning, Commissioner.

THE COMMISSIONER: All right, Sir, you remain under oath at this time.

And Ms. O'Brien, when you're ready to begin.

MS. O'BRIEN: Thank you.

Mr. Brockway is here today to present a second paper that he wrote entitled Review of the Federal Loan Guarantees and the Power Purchase Agreement. Assuming that there is no objections from other counsel, Mr. Brockway was already qualified as an expert yesterday, and I'm proposing that he deliver the second report under the same terms as he did the report of yesterday.

THE COMMISSIONER: All right.

Do any of the counsel that are present have any objection to that?

All right, so then on the same basis that he was allowed to provide opinion evidence yesterday, that will continue today.

MS. O'BRIEN: Okay.

THE COMMISSIONER: Ms. O'Brien?

MS. O'BRIEN: Thank you.

Can we go to Exhibit P-00452, tab 2 in the book in front of you, Mr. Brockway.

Sorry Commissioner, I've lost my mouse.

Mr. Brockway, I'll ask Madam Clerk if she can scroll down a bit – okay, I see my mouse coming. Thank you.

This is your – an engagement letter that I believe you reviewed yesterday with Mr. Learmonth?

MR. BROCKWAY: Correct.

MS. O'BRIEN: Can you confirm please that the paper that we're looking to review today, on the federal loan guarantees and the Power Purchase Agreement, that you prepared that under the same conditions as you did the one you presented yesterday on the Emera agreements?

And as I recall that you reviewed with Mr. Learmonth, is that you supervised a team that put the paper together, and that you retained some – where you needed it – some legal assistance from Miller Thomson LLP. Is that –

MR. BROCKWAY: That's right.

MS. O'BRIEN: – the same procedure here?

MR. BROCKWAY: That is, yes.

MS. O'BRIEN: Okay.

And I also understand that one of the topics that we're going to be covering today has to do with some US regulation – FERC regulation. And is it correct that Miller Thomson LLP further engaged American counsel?

MR. BROCKWAY: Yes, that's right.

MS. O'BRIEN: Okay.

And what's the name of that firm?

MR. BROCKWAY: The firm was K&L Gates LLP.

MS. O'BRIEN: Okay.

MR. BROCKWAY: And their office based in Washington, DC.

MS. O'BRIEN: Okay.

So you had the advantage of some legal opinions from both those firms, is that correct?

MR. BROCKWAY: That is correct, yes.

MS. O'BRIEN: Okay, thank you.

Having – if we can just see P-00526, please? Tab 28 of your book.

Now, the exhibit we have here, I'm just gonna give it a bit of an introduction. Your paper was prepared and it was circulated to counsel for all the parties with standing here. And similar to the reply that Nalcor gave to the Emera paper, Nalcor provided a reply to this paper on the FLG and the PPA, is that right?

MR. BROCKWAY: That's correct, yes.

MS. O'BRIEN: Okay.

And I understand this is the reply here; it's been filed in evidence. It raised four points from your paper and provided commentary and response, and that – the response in this case also included a report and an analysis of the effect of the PPA and the legislative monopoly that we'll be reviewing this morning, the effect that that had on compliance with the Federal Energy Regulatory Commission, or FERC, in the United States.

MR. BROCKWAY: That's right.

MS. O'BRIEN: Okay.

And Nalcor's response, that material was actually provided by an American law firm, Van Ness Feldman?

MR. BROCKWAY: That's right.

MS. O'BRIEN: Okay.

And just – if we scroll down through this exhibit, we can see that the – attached as an appendix to that exhibit is in fact the report from that law firm.

And did you read Nalcor's response in – or reply – in full?

MR. BROCKWAY: Yes, I did.

MS. O'BRIEN: Okay.

And am I to understand that you provided a response to Nalcor's reply?

MR. BROCKWAY: Yes, that's right.

MS. O'BRIEN: Okay.

P-00723, please, Madam Clerk, tab 21 – sorry, 31.

So this is the response to Nalcor's reply, and of the four points – in Nalcor's initial reply, they raised four points with your paper. And am I understanding correctly that upon your review of Nalcor's work, you agree that one of those four points that they raised actually identified a factual error in your report, and your response that's currently up on the screen acknowledges and corrects that error, is that accurate?

MR. BROCKWAY: That's correct, yes.

MS. O'BRIEN: Okay.

And to be clear, that would've been the second point raised in Nalcor's response?

MR. BROCKWAY: Yes.

MS. O'BRIEN: And of the three of the other four points that were raised by Nalcor, is it fair to say that they added just clarifications with respect to your report?

MR. BROCKWAY: Yes.

MS. O'BRIEN: Okay.

And having reviewed the clarifications, do you agree with the position put forth by Nalcor in their reply?

MR. BROCKWAY: Yes, I do.

MS. O'BRIEN: So is it fair to say while those three points don't affect the accuracy of your report, you agree with the – the clarification: they add to the subject matter of that report.

MR. BROCKWAY: That's right, yes.

MS. O'BRIEN: Okay.

Okay, so can you please confirm that you accept your report as filed, as Exhibit P-00454, and as amended or clarified by your response to Nalcor entered as P-00723.

Do you accept those documents together as a true statement of your opinion on the matters for which you were engaged?

MR. BROCKWAY: Yes.

MS. O'BRIEN: So if we can go to P-00454 now, and this is the actual paper. Great.

So on page 2, Mr. Brockway, this is just your transmittal letter. Is that correct?

MR. BROCKWAY: Yes.

MS. O'BRIEN: Okay.

And then going to the next page is the table of contents. Now we're going to go through the report and review the – all the major sections in some detail, but if you could – we probably will not spend a lot of time, at least in your direct examination, on the appendices. Can you – one of them is a Glossary of Abbreviated Terms.

MR. BROCKWAY: Mm-hmm.

MS. O'BRIEN: Which the name speaks for itself. But can you just please explain for us briefly what are in Appendix A and B? What's covered?

MR. BROCKWAY: Appendix A: We give a little bit of additional detail around the calculation of the debt-service coverage ratio, which we will speak to in the body of our report.

MS. O'BRIEN: Okay.

MR. BROCKWAY: We don't actually quantify or look at the mechanics of the math in our report, so this appendix just provides that information.

MS. O'BRIEN: Okay and Appendix B?

MR. BROCKWAY: Appendix B just notes some additional preconditions to this – to the consigning of the federal loan guarantee. It just puts all of those preconditions in one place.

MS. O'BRIEN: Okay.

So I understand there was – as we're going to get into the evidence in more detail, there was a number of conditions precedent or preconditions to the federal loan guarantee, some of which are reviewed in detail in your report. And this is – but this is a full list of all the conditions precedent, some of which you don't really address in any extent in your report? Is that –?

MR. BROCKWAY: That's correct. Yes.

MS. O'BRIEN: Okay.

Can we go to, please, page 10 of this document?

Okay, so now we're going to get into really – I've skipped over the Executive Summary of the report; it's there and a good introduction and summary of what's in the full document. But because we're going to be going through the full document, I'm going to just start right at the meat of it.

And if you could please – here's the introduction. Can you tell us – explain what you were asked to do in this report, please?

MR. BROCKWAY: So as outlined in the introduction, we were asked by the Commission to review the materials related to the federal loan guarantee and the Power Purchase Agreement. So as part of that, we reviewed the FLG-1, which was the first federal loan guarantee. We were asked to explain how some of the amendments to particular legislation helped facilitate the signing of the federal loan guarantee. We were asked to look at the specific terms in the Power Purchase Agreement and summarize those as well.

We were also then asked to look at the second federal loan guarantee, which came later, and the reasons for seeking that second federal loan guarantee. And then to summarize the effects of both of the Power Purchase Agreement and the legislative changes on – well, no, we were first asked to look at the effects of the Power Purchase Agreement on the ratepayers and taxpayers of Newfoundland and Labrador and, lastly, review the effect of the changes in the legislation and the Power Purchase Agreement on the issue of FERC compliance.

MS. O'BRIEN: Okay. Thank you.

So we'll jump in. The first section is entitled: Background and Information on FLG-1, and that's at page 10 of the document. Can you give us that background and explanation? Really, what was – what is the federal loan guarantee?

MR. BROCKWAY: Yeah, so the federal loan guarantee represents a guarantee by Her Majesty the Queen, in Right of Canada, of the guaranteed debt – which we talk about in a moment – of Muskrat Falls, the Labrador-Island Link, the Labrador Transmission Assets and the Maritime Link Projects. And the parties to the federal loan guarantee are: Nalcor, Emera, the Province of Newfoundland and Labrador, the Province of Nova Scotia and, of course, Canada.

The terms and conditions of the federal loan guarantee were agreed to in November of 2012. There were a number of preconditions included in the federal loan guarantee and, as a result, the actual closing of the financing didn't happen until approximately a year later – a little over a year later – in December of 2013. And that's primarily due to the fact that there was some time needed – the preconditions were fairly extensive and so it took some time to meet those preconditions.

MS. O'BRIEN: And when we hear the word "conditions precedent" in relation to the federal loan guarantee, is that the same thing as preconditions?

MR. BROCKWAY: Yes.

MS. O'BRIEN: Okay.

And we have often heard of the date – and we will, going forward in the Inquiry – this concept of financial close. So I understand that's what you're talking about here: December 2013. So that's when ultimately all of the agreements signed and the money was advanced?

MR. BROCKWAY: Everything was signed off, money changed hands, exactly.

MS. O'BRIEN: Okay. And, specifically, that was December 13 of 2013?

MR. BROCKWAY: December 13, 2013.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: And so continuing on, so the federal loan guarantee was stated to be an absolute, continuing, unconditional and irrevocable guarantee covering all of the payment obligations associated with the project's financing. And all of the parties really worked together to looking to result in the project's debt achieving Canada's Triple-A credit rating.

Now, when we talk about a Triple-A credit rating, there are eight rating-agency firms that actually evaluate the credit worthiness of different organizations, and that's what results in a credit rating. The Triple-A credit rating is the highest rating and the highest rating means the lowest level of credit risk, so the lowest risk that, you know, you will default on your obligations. So what the Triple-A credit rating allows you to do is, because of the low risk it allows lenders to charge a lower interest rate on the debt to acknowledge the lower risk.

MS. O'BRIEN: Okay.

MR. BROCKWAY: So in terms of the – the terms and the conditions of the FLG are highlighted beginning on page 11. It starts with the definition of guaranteed debt; guaranteed debt being defined as the total maximum amount of borrowing obligations. And it was a fixed dollar amount and it was a cap of 6.3 billion allocated as shown.

The Muskrat Falls and the Labrador Transmission Assets was up to 2.6 billion; the Labrador-Island Link was up to 2.4 billion and which – those projects add up to the 5 billion that were allocated to those two projects; and then there was an additional 1.3 billon for the Maritime Link Project.

MS. O'BRIEN: Okay, so the federal government was also guaranteeing a debt for Nova Scotia as well.

MR. BROCKWAY: Correct.

MS. O'BRIEN: Okay.

MR. BROCKWAY: Correct.

MS. O'BRIEN: And in terms of who was actually borrowing the money, I understand the money was actually borrowed by – we'll look at the 5 billion for this province – would've been borrowed by subsidiaries of Nalcor?

MR. BROCKWAY: Subsidiaries of Nalcor and Emera.

MS. O'BRIEN: And Emera.

MR. BROCKWAY: So you're correct, they were subsidiary companies established to borrow these funds.

MS. O'BRIEN: And is it fair to say that without the federal loan guarantee – I know one can't always say what would happen if we didn't have the federal loan guarantee, but the likelihood of those entities getting the highest level credit rating, this Triple-A rating, would have been less.

MR. BROCKWAY: It would have been less. Yes.

MS. O'BRIEN: Yeah. Okay.

Thank you. Please continue.

MR. BROCKWAY: Also articulated as it relates to guaranteed debt is there were limits established in the federal loan guarantee around debt-to-equity ratios. We talked a lot yesterday about debt-to-equity ratios as it related to the LIL Limited Partnership.

But really, the debt-to-equity ratio is just a measure of how you're financing your assets. There's a debt component, which obviously is borrowed money, and then there's an equity component, which effectively reflects your own money, your own contributions to the project.

So these limits were put in place for Muskrat Falls and the Labrador Transmission Assets. It was a debt-to-equity ratio of 65-35. For the Labrador-Island Link, it was 75-25. And for the Maritime Link, there was actually a provision there to take into consideration what was approved by the Nova Scotia Utility and Review Board as part of that application process, and that was actually approved at 70-30, which is – which were the numbers that were provided in the federal loan guarantee.

The term of the FLG was scheduled to begin once all of the relevant financing documents were executed – so that's the financial close that we talked about earlier, being December of 2013. And the term would end at the earlier of full payment of the guaranteed debt or the maximum term allowed for each project. And the maximum terms were defined as 35 years for Muskrat Falls and the Labrador Transmission Assets, 40 years for the Labrador-Island Link and 40 years for the Maritime Link Project.

There was also the introduction of this concept of a debt-service-coverage ratio, which we talked about earlier; the calculation is in the appendix to the report. But effectively, what the debt-service-coverage ratio does – and it's a fairly standard terminology that you would see in debt agreements – in commercial debt agreements – is it provides the ratio of cash available by an organization for debt servicing, which would include principal payments, interest payments and things like that.

And what the federal loan guarantee does is it provides a minimum benchmark for that debt-service-coverage ratio of 1.4 times, which effectively means that each of the projects needs to be generating 40 per cent more cash flow than what's required to service the debt. And so that gives the lenders comfort that there's sufficient cash flow being generated to service the debt. That's the purpose of the debt-service-coverage ratio.

The security was also outlined in the federal loan guarantee. So there's this security has been pledged to Canada as part of the federal loan guarantee, so the security is the assets of the borrowers, all of the contracts of the borrowers. So if you get into a situation where there's a default under the federal loan guarantee, this would be the security pledge to Canada – basically, the projects, all of the assets, all of the contracts, things like that.

MS. O'BRIEN: So in other words, Canada could come in and take those – could take the projects, take the assets if you weren't paying as you should?

MR. BROCKWAY: That's right.

MS. O'BRIEN: If we weren't paying as we should.

MR. BROCKWAY: That's right.

MS. O'BRIEN: Okay.

MR. BROCKWAY: Yeah.

And again, it's normal for borrowers – or for lenders to have security.

MS. O'BRIEN: Sure.

Everyone who has a house mortgage, their house is –

MR. BROCKWAY: Yeah.

MS. O'BRIEN: – pledged as security for that type of – for that loan.

MR. BROCKWAY: Exactly.

MS. O'BRIEN: Yeah.

MR. BROCKWAY: Exactly. The – this is normal in these types of agreements.

The federal loan guarantee also goes on to talk about what the permitted debt is under the federal loan guarantee and some limitations as to what the borrowers can and can't do. And it articulates that the borrowers can't incur debt during the construction period except for the guaranteed debt, which was discussed earlier, and this notion of additional debt.

And additional debt is specifically defined in the agreement and basically states that the borrowers can't incur additional debt except for a couple of things: an operating line of credit for example, which was capped at $10 million; additional debt-to-finance cost increases from the Decision Gate 3 capital cost estimates; debt-to-finance cost escalations; and cost overruns, which are defined in the report.

So those are the only situations where – under the FLG – where the borrowers were allowed to incur additional debt.

MS. O'BRIEN: Okay.

And I think you're going to address how cost overruns are – were covered in a little more detail in a few minutes.

MR. BROCKWAY: That's right.

MS. O'BRIEN: Is that right?

MR. BROCKWAY: Yes.

MS. O'BRIEN: Okay, thank you.

MR. BROCKWAY: Yeah.

And one thing that it did state about the additional debt is that the additional debt that's allowed under the FLG isn't actually covered by the federal loan guarantee. So it would attract normal interest rates. It's not guaranteed by Canada. So that was – I think that was a relevant point as well.

The federal loan guarantee outline requirements around the independent engineer. It stated that there was to be an independent engineer appointed to allow Canada to complete its due diligence and to allow Canada to ensure that there – that the compliance of the various terms and conditions of the federal loan guarantee were met.

The purpose also was for the independent engineer to provide an independent engineer's certificate to confirm that budgeting and the maintenance of the project is being conducted in accordance with good utility practice, and in fact, failure of the borrower to budget and maintain under good utility practice would constitute an event of default under the federal loan guarantee, so it's important for the – for this to be provided.

MS. O'BRIEN: So we have heard evidence already about the independent engineer, and obviously, we'll have more to come. So this is the document that set that out as a requirement of the Government of Canada, is that we have – that an independent engineer be appointed.

Who was appointed as the independent engineer?

MR. BROCKWAY: The independent engineer – there was an agreement signed with MWH

Canada Inc. in 2012, and we did review the agreement with MWH Canada and outlined some of the terms and conditions there just around the timing and the different phases of what they were reporting and things like that.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: Yep.

Beginning on page 17, there was also provisions within the federal loan guarantee on expected costs to complete the project. And this is where we get into the concept of the cost overrun escrow account and the mechanics of how that – how that account works. In terms of the expected cost to complete any of the cost overruns for the project, it was outlined that it must be funded with equity or additional debt. And that's – the expected costs to complete would also include contingencies, it would include escalation, as well as any interest during construction and costs associated with – the costs actually associated with the financing prior to the close of the financing.

So the way the cost overrun escrow account – or the – COREA is the acronym that's used. Prior to the closing date, a COREA was be – was to be established for each project. And the requirement was for that account to actually be funded on an annual basis based on a determination of initial cost overruns and then subsequently a determination of annual cost overruns.

And there were mechanics and calculations put in place to basically define what the overruns were and how to calculate them and then to average those cost overruns out over the period between the calculation date and when the commercial power was gonna be available and for those accounts to be funded on that basis.

MS. O'BRIEN: Okay.

So these COREA accounts, are – these are actual bank accounts, are they?

MR. BROCKWAY: They were actual bank accounts under the control of Toronto-Dominion Bank.

MS. O'BRIEN: Okay.

And there was one you said for each project. So the idea is, according to the calculations that are done based on what's required in the agreement – but the idea is that the borrowers would actually have to put money into those accounts, so it could sit there, essentially, to cover off cost overruns as they –

MR. BROCKWAY: That's right. You're allocating money and putting it aside to cover the cost overruns that you're anticipating.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: Yeah.

So the details of those calculations are included on page 18 and page 19. At the bottom of page 19 and moving on into page 20, there's discussion around debt and equity contributions as well as distributions and reserves that are required under the federal loan guarantee as well. And I don't plan – I don't go through those in detail but they're there for reference.

MS. O'BRIEN: Thank you.

MR. BROCKWAY: Okay.

So, we were then asked as well to review the conditions of the federal loan guarantee as they related to sanction by Nova Scotia, and those related to legislative monopoly and PPA. And really the terms and conditions in Section 3.5 of the federal loan guarantee outlines a number of conditions that must be met to Canada's satisfaction prior to the federal loan guarantee actually being executed.

And, so certain of these conditions required a sanctioning by Nova Scotia, certain of these conditions led to the execution of the Power Purchase Agreement and there were several other conditions attached to it as well that we'll speak to. And as – many of the conditions resulted in additional legal agreements that had to be executed as well. So we'll speak to those in a moment.

MS. O'BRIEN: So just to be clear, you said the preconditions had to be met before the FLG was executed. But you – but then – you don't mean signed because it was actually signed in

November of 2012, but these were preconditions that had to be met before financial closing.

MR. BROCKWAY: Before financial close, yes.

MS. O'BRIEN: Okay.

MR. BROCKWAY: That's right.

MS. O'BRIEN: Okay, before the money got forwarded. Okay.

MR. BROCKWAY: That's right.

So the conditions related to the Nova Scotia sanction that were in the FLG were essentially a requirement to formalize a regulatory framework in the province, and that condition was satisfied through the passing of the *Maritime Link Act,* which happened in December of 2013.

It required execution of a formal agreement between Canada and the Province of Nova Scotia, in which Nova Scotia provides an indemnity to Canada for any costs that it may incur under the federal loan guarantee as a result of regulatory decisions or regulatory change. That agreement was executed in December of 2013 as well, it's titled the Intergovernmental Indemnity Agreement-Maritime Link Project.

So that was the agreement that was put in place to provide that indemnification.

MS. O'BRIEN: And is it fair that – to say that these agreements between Nova Scotia, Emera and the federal government would have dealt with the – just the amount that was being guaranteed for the Maritime –

MR. BROCKWAY: Yes.

MS. O'BRIEN: – Link portion of the project?

MR. BROCKWAY: That's right, only dealing with the Maritime Link portion.

And then there was also an Emera agreement called the Emera Guarantee Agreement, which was required between Canada and Emera, which guaranteed a payment in the event that the execution of the financing documents wasn't – related to the Maritime Link wasn't completed within a certain timeframe. And also a guaranteed completion of the Maritime Link project, or to provide required funds to complete the Maritime Link Project following the first draw on the guaranteed debt.

Some of the conditions in place related to monopoly and the PPA, so a requirement to enact legislation and to execute some formal agreements in Newfoundland and Labrador and Nalcor, which put into effect, basically, the commitments that were made by Newfoundland and Labrador under the federal loan guarantee.

So –

MS. O'BRIEN: So, before you get into the detail on that, could you just give us a – just – we've talked about the monopoly –

MR. BROCKWAY: Mm-hmm.

MS. O'BRIEN: – and you're talking about the conditions relating to the monopoly, give us a short description of what the monopoly is.

MR. BROCKWAY: So, it effectively – as a requirement of the FLG, it basically required the Government of Newfoundland and Labrador to amend certain legislation to effectively guarantee that the full costs of the projects would be recovered in – by Island ratepayers.

So in order to make – in order to ensure that guarantee is happening, we – amendments had to be made to that legislation. And that, in effect, provided a monopoly whereby Newfoundland and Labrador Hydro had the exclusive right to sell energy to the Island ratepayers of Newfoundland and Labrador –

MS. O'BRIEN: So they –

MR. BROCKWAY: – the Island portion.

MS. O'BRIEN: – couldn't buy power from anybody else.

MR. BROCKWAY: They can't buy power from anyone else.

MS. O'BRIEN: So that's the monopoly feature.

And I know you're gonna get into the actual changes in a little more detail, but that's helpful.

MR. BROCKWAY: That's right.

MS. O'BRIEN: Thank you.

MR. BROCKWAY: Yup.

So, the enactment of the legislation was a requirement – a formal requirement – and that has been done through various orders-in-council with amendments to the *Energy Corporation Act* and amendments to the Electrical Power Control Act. Those are the two acts that, specifically, that were amended to facilitate the federal loan guarantee.

MS. O'BRIEN: So those are Newfoundland and Labrador legislation?

MR. BROCKWAY: Correct.

MS. O'BRIEN: Yeah.

MR. BROCKWAY: Yes.

MS. O'BRIEN: Okay.

MR. BROCKWAY: And, as well, as part of that, the formal agreements that were executed between Newfoundland and Labrador and Nalcor refer to Muskrat Falls Equity Support Agreements and Equity Support Guarantees. So those were put in place as well effectively guaranteeing – the Equity Support Agreement effectively guarantees that Nalcor will contribute the required equity to the projects for completion and then the equity support guarantees then puts Newfoundland and Labrador in a position where they're guaranteeing that Nalcor will do that. So, it's a bit of a trickle effect if you will. A lot of agreement stuff –

MS. O'BRIEN: Okay.

MR. BROCKWAY: – to try and keep track of.

MS. O'BRIEN: Thank you for explaining.

MR. BROCKWAY: The – a further condition of the monopoly in the PPA was the execution of an intergovernmental agreement between Canada and Newfoundland and Labrador. And we'll go through that in a little bit more detail in a moment but that condition was also met by the signing of that agreement in November of 2013.

We then outline some of the general conditions that were outlined as part of the federal loan guarantee and, again, I won't go though all of them but I did want to mention the first bullet there where –

MS. O'BRIEN: We're on page 22.

MR. BROCKWAY: – on page 22, under General Conditions starting on line 20. There was confirmation – there was a requirement under the FLG that the credit-rating agencies, and we talked a little but earlier about credit-rating agencies and what they do, but the projects needed confirmation from the credit-rating agencies that each of the projects would receive a rating higher than investment grade. And, effectively, what that means is we talked about the AAA rating being, you know, the highest credit quality. There are different grades that you can get and they range from AAA to AA to A and then it starts BBB. Effectively, investment grade would mean a credit rating of BBB or above.

So, the projects – in the absence of the federal loan guarantee – were required to have an investment-grade credit rating and what that provided for Canada was assurance that these were – that these were bankable deals, that these deals, in the absence of the loan guarantee, would still receive financing from lenders.

MS. O'BRIEN: People would still want to invest in it.

MR. BROCKWAY: People would still want to invest in this. So, I think that's important.

And, again, there were some additional preconditions again, which are summarized in Appendix B. One of them included the satisfaction by Canada of all of the relevant financing documents, the financing structure, the transaction structure, and included within this condition was the signing and execution of the guaranteed assurance agreement – which we speak to on page 23 – which is effectively two agreements: one of them dealing with the Labrador-Island Link and one of them dealing with Muskrat Falls and the Labrador Transmission Assets. And so the two agreements were signed and executed, again, in November of 2013. And effectively, these agreements confirmed the terms and the warranties and the covenants in order for Canada to execute the FLG, and both of the agreements had consistent terms and conditions.

A couple of the articles within the agreement, there are – in article 4 of the agreement lists some events of default and remedies as related to the guarantee assurance agreements. And it's stated that any payment required by Canada under the federal loan guarantee, that Canada could exercise, effectively, step-in rights where they could come in and effectively realize on their security and take control of the assets of the borrowers.

And it also assured – through the equity support agreements that I referred to earlier and including the equity support guarantees provided by the Government of Newfoundland – that Canada could continue to call upon the Government of Newfoundland for the required equity contributions to complete the projects. So I think that's an important term.

MS. O'BRIEN: So if we didn't just – so if we defaulted, and so we didn't do something we were supposed to do, Canada could come in, actually start – take the assets, start operating them and still go to the – our provincial government for the money that they needed to do that?

MR. BROCKWAY: Correct, yes.

I referred to earlier the Intergovernmental Agreement, which is on page 24 beginning on line 10, and as referenced, the execution of this agreement between Canada and Newfoundland and Labrador was a required precondition. The – so we did review the Intergovernmental Agreement as well.

And in section 4 of this agreement, Newfoundland and Labrador agrees to indemnify Canada for any costs – in any costs that it incurs under the FLG as a result of a government action. So a government action is defined as a regulatory decision or regulatory change. And as we'll talk about in a moment, and we talked about the legislative monopoly, certain of the – certain legislation was changed to basically meet the requirements of the FLG. If future governments were to come in and undo that, that would trigger an indemnity for Newfoundland and Labrador to basically make Canada whole for any costs it incurs as a result of that.

MS. O'BRIEN: So while normally – a government of course, we all know, has the ability to pass legislation it wishes, and the current government can pass legislation but they can't typically stop future governments from doing what they want to do down the road – they can't bind future governments. But by signing this agreement and putting in this indemnity that has the effect, essentially, of locking in the legislation. Is that a – maybe an oversimplification, but that's the idea behind it. So any future government would have a great disincentive to alter the legislation because –

MR. BROCKWAY: That's right.

MS. O'BRIEN: – they have to pay this indemnity to Canada.

MR. BROCKWAY: Yeah, there would be consequences for making the changes, yes. And, in addition, section 6 of the Intergovernmental Agreement stated that if the borrowers failed to complete the project that, again, Canada would be indemnified for any costs that it would have to incur under the federal loan guarantee.

In terms of other specific commitments within the FLG, there are some specific commitments noted within the Intergovernmental Agreement that were also mentioned in the FLG and how they were satisfied. And those are articulated on page 25, starting on line 7. The specific commitments included the creation of the Nalcor subsidiaries to ensure – and to ensure that the borrowing abilities of those subsidiaries was sufficient, so as a result that's when those subsidiaries were incorporated.

The commitments we talked about earlier about the Province of Newfoundland and Labrador providing base level and contingent equity support, so effectively backstopping the required equity that Nalcor is – would be required to put into the projects.

MS. O'BRIEN: So that was a condition of the federal loan guarantee?

MR. BROCKWAY: Correct.

MS. O'BRIEN: Okay.

MR. BROCKWAY: Yes.

MS. O'BRIEN: It is something I just wanted to highlight because we have heard, and will hear, lots of evidence about the province backstopping and this idea of giving contingent equity. So that's where the requirement was for this.

MR. BROCKWAY: Yes. Yes.

And the final three commitments that are noted there is upon the projects receiving in service that the regulated rates for Hydro would allow it to collect sufficient revenue to recover the amounts incurred for the purchase and delivery of energy from the applicable projects and that's – those commitments were satisfied by the amendments to the legislation that we discussed earlier. And in fact, starting on the next page, page 27, that's where we get into a little bit more detail on those changes.

I do want to highlight the summary starting on page – or starting on line 11 of page 27. That in summary, the passing of Bill 61 in 2012 which amended the EPCA, effectively, providing the monopoly to Hydro for exclusive rights to supply, distribute and sell power to the Island portion of Newfoundland; that's what formed the legislative monopoly.

I did want to highlight as well that on line 12, we include the word "transmit" there. Nalcor provided us some clarification that the passing of Bill 21 did not include the transmission of energy. So we should not be referring to transmit, but it does refer to the supply, distribution and selling of electricity. I just wanted to make that clarification.

MS. O'BRIEN: Thank you.

MR. BROCKWAY: I don't plan to go through the orders-in-council in detail, but I would like to highlight a couple of them.

MS. O'BRIEN: Please do.

MR. BROCKWAY: I'd like to highlight on page 30, the order-in-council 2013-342, which starts on page [sp line] 9. This is the order that's titled the Muskrat Falls Exemption Order. And again, this order was to satisfy the commitments of the FLG around rate regulations and cost recoveries associated with the projects.

And this is effectively – this order stated that any public utility is exempt from the application of the Newfoundland and Labrador *Public Utilities Act*. So effectively, by passing the Muskrat Falls Exemption Order, Newfoundland and Labrador has satisfied its commitment to ensure the recovery of costs by restricting the oversight ability of the public utility board by stating that these entities are public utilities. So that's the reason why that order-in-council was put in place.

And then starting on page 31, we refer to OC2013-343. And this order directed the PUB to adopt the policy that stated any costs, payments or any other compensation paid by Newfoundland and Labrador Hydro under any of these agreements in – through any of these agreements within the scope of the Muskrat Falls Exemption Order, which we just reviewed, shall be included as costs, expenses or allowances without any alterations, reductions or disallowances in the PUB.

So, effectively, what that does is that ensures that those costs will be included in Hydro's rates, which are ultimately going to be charged to the Island ratepayers of Newfoundland.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: Moving on now, to page 32, beginning on line 13, we start to look at the effect of the federal loan guarantee – what impact that had on financing interest rates and savings to the project.

And there was – you know, this guarantee was presented as a way for the project debt to achieve Canada's Triple-A credit rating, and Newfoundland and Labrador had stated that the federal loan guarantee would result in project savings of a billion dollars – big number – in interest costs for ratepayers and taxpayers and would also contribute to stable electricity rates for consumers in the Province of Newfoundland and Labrador.

And in turn, the – these benefits and cost savings would be fully passed directly to Newfoundland and Labrador ratepayers once the construction was complete.

So that's the main effect as articulated by the Government of Newfoundland and Labrador. It's gonna result in significant cost savings on financing costs, which will translate into lower rates for customers.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: Okay.

Then on page 33, line 7, we begin talking about the second federal loan guarantee, which was entered into in March of 2017. The second federal loan guarantee did not involve Maritime Link. It only involved the Muskrat Falls, the Labrador Transmission Assets and the Labrador-Island Link.

The proceeds of the additional debt under the second federal loan guarantee were to be used to complete the projects being developed by Nalcor. The reasons noted by Nalcor for seeking the second federal loan guarantee was to secure an additional 2.9 billion of debt financing at the low rate of interest under the Triple-A credit rating. That would reduce the required equity required by Newfoundland and Labrador by approximately $2.7 billion. It would also reduce domestic electricity rates by 1.5 cents per kilowatt hour.

MS. O'BRIEN: So we'd already had – the first federal loan guarantee covered debt of five billion, so when we get to the second federal loan guarantee, I understand, it was ultimately concluded for an additional $2.9 billion.

MR. BROCKWAY: That's correct.

MS. O'BRIEN: So 7.9 total.

MR. BROCKWAY: Total.

MS. O'BRIEN: When you say here that would reduce the equity required by Newfoundland and Labrador by 2.7 billion, why the – do you know why there's the difference between the 2.9 billion that's being guaranteed and the 2.7 billion cited as being the reduction of the required equity?

MR. BROCKWAY: I don't know why those numbers are different. I can only assume that the difference of 200 million was needed for some other purpose.

MS. O'BRIEN: Okay.

So this information came from information that was put out by the government, is that –

MR. BROCKWAY: That's correct. That's correct.

MS. O'BRIEN: Okay. All right.

And so when was this happening? When was the second federal loan guarantee –?

MR. BROCKWAY: This was in March of 2017 –

MS. O'BRIEN: Okay.

MR. BROCKWAY: – that this happened. So we go on to outline some of the terms and the conditions of the second federal loan guarantee. A lot of them are very consistent with what we saw in the first federal loan guarantee, so I won't necessarily repeat them, but I will highlight a couple.

So the guaranteed debt under the federal loan guarantee was a maximum of 2.9 billion, and it was allocated to the projects. Muskrat Falls and Labrador Transmission Assets together were allocated 1.85 billion. And the Labrador-Island Link was allocated 1.05 billion under the second guarantee. The term and the amortization profile for the federal loan guarantee remained consistent; however, the end dates were extended to reflect the fact that there were some delays to the first commercial power that were anticipated.

On page 34, starting on line 3, there was a guarantee fee introduced in the second federal loan guarantee that wasn't in the first federal loan guarantee. So this is new. And the guarantee fee represented 0.5 per cent of the net amount of the second federal loan guarantee outstanding. And the guarantee fee was to be split proportionally between the two projects, being Muskrat Falls-Labrador Transmission Assets and the Labrador-Island Link. And the guarantee fee was also to be included in part of the project costs, so that would be part of the costs – the capital costs of the project.

The COREA account that we referred to earlier under FLG1 was basically eliminated under the FLG2. It stated that those payments were no longer required to be made. And those payments were replaced with new equity prefunding requirements that were actually calculated in the federal loan guarantee. So there were no calculations to be done. The amounts were set under the second federal loan guarantee.

And it did also include some dates certain around event of default if the commissioning of the projects did not occur by February of 2019. That would constitute an event of default, but there is – there are options to extend that date out as well.

MS. O'BRIEN: Thank you.

MR. BROCKWAY: So – yeah, that would be it on the federal loan guarantee, the second federal loan guarantee.

MS. O'BRIEN: Okay. Thank you.

I know your paper now goes into the Power Purchase Agreement, and before you get into the details there, if you could just give us a very short overview of what a power purchase agreement is. You know, what is – what's going on here? What does the document do?

MR. BROCKWAY: Yeah. So the Power Purchase Agreement basically puts in place the agreement between Muskrat Falls and Newfoundland and Labrador Hydro that would facilitate the sale of energy from Muskrat Falls to Newfoundland and Labrador Hydro, which Hydro then delivers to the end customer.

So it would articulate the terms as to how much energy would be allocated, what the pricing methodology for that power is, the scheduling protocols for the power, things of that nature.

MS. O'BRIEN: So this is the document that ensures that Muskrat Falls Corporation is enabled to get the full cost of the Muskrat Falls Project from the ratepayers of the province?

MR. BROCKWAY: Right, the Muskrat Falls Project and the Labrador Transmission Assets.

MS. O'BRIEN: Okay.

MR. BROCKWAY: Those costs all flow up through the Power Purchase Agreement.

MS. O'BRIEN: Okay. Yes.

And we have heard evidence already that the Labrador-Island Link is done under cost to service, so a different scenario.

MR. BROCKWAY: Correct. That's right.

MS. O'BRIEN: Thank you.

MR. BROCKWAY: So in terms of – some of the terms of the PPA – the term of the PPA – and I'm on page 35 – the term of the PPA is for 50 years starting on the commissioning date and ending in 2068, and this is what's known as the Supply Period. And the agreement really defines three main blocks of energy.

There's the Base Block Energy, which effectively represents the amount of energy forecasted by Hydro to meet the anticipated requirements. Now, that initial forecast was made in November of 2013 and is articulated in one of the schedules to the Power Purchase Agreement. So that is the basis for the determination of what the Base Block Energy allocation is through the life of the agreement.

It also refers to – and one thing I did want to highlight as well – we do articulate on line 17 of page 35 that the Power Purchase Agreement did not provide any specific characteristics of the Base Block power. And Nalcor did provide some clarification there as well: that really it's not a requirement to show those specific characteristics, because the commitment from Muskrat Falls to Newfoundland and Labrador Hydro has been made on a firm and committed basis, which means when Hydro needs the power, they get the power. So there's no real necessity –

MS. O'BRIEN: There'd be no benefit to describing.

MR. BROCKWAY: No benefit to describing any of those specific characteristics around time of day and things like that.

Beginning on line 20 there is a definition, as well, of a second block of energy called Supplemental Block Energy and that's defined in the PPA as the amount of energy that effectively represents the lesser, or of the amount of energy that the Newfoundland and Labrador customers consume in the year and the amount that that exceeds the initial load forecast that was used to create the determination of Base Block Energy. So, effectively, our consumption exceeded our forecast; we needed more power. Or, secondly, basically power available, that is that the energy production of the Muskrat Falls plant minus our commitment – the Muskrat Falls commitments for delivering power to other organizations.

So, effectively, this was stated as being an amount of energy available to Hydro, if load requirements ever exceeded what we initially determined in our calculations of Base Block Energy, this supplemental energy was meant to provide that incremental energy that was needed.

Thirdly, is the notion of commission period block energy and that's defined as, basically, first commercial – the first power that's generated by Muskrat Falls up to the commissioning date. So, that's defined within the PPA. That energy is available to Newfoundland and Labrador Hydro as well, and it defines what a commission period payment is, and the commission period payment is set at $1 or any greater amount as designated by Newfoundland and Labrador Hydro. So, effectively, $1 for the commissioning block energy prior to commissioning.

The PPA also introduces the concept of deferred energy and, I think, it's basically, if the actual amount of the delivered energy is higher or lower than what you've paid for, through the charges related to Base Block Energy and Supplemental energy, then we'll park that in this deferred energy account and Newfoundland and Labrador Hydro, you have some choices as to how you want to handle that deferred energy, which we'll talk about in a little bit, but that's another block of energy that's there.

In terms of the payment terms, there's a lot of references to base block in these terms so it does get a little bit confusing, but, effectively, Hydro agrees to pay Muskrat Falls for the Base Block Energy each operating month. And the amount that's payable is the Base Block Capital Costs Recovery, as well as the estimated monthly operating and maintenance costs. Those are the amounts that Hydro has agreed to pay Muskrat Falls.

So, when you talk about the Base Block Capital Costs Recovery, the mechanisms related to that are shown on the top of page 37. It effectively includes all of the capital costs related to Muskrat Falls, it includes all of the development costs and it includes distributions to the equity holders, sufficient to enable Muskrat Falls to achieve its assigned internal rate of return, which has been set at 8.4 per cent in the calculation of the Base Block Capital Costs Recovery.

MS. O'BRIEN: So this agreement here, the PPA is really between two subsidiaries of Nalcor, right, Muskrat Falls Corporation and Newfoundland and Labrador Hydro?

MR. BROCKWAY: That's right.

MS. O'BRIEN: Okay, so –

MR. BROCKWAY: Both subsidiaries of Nalcor.

MS. O'BRIEN: Okay, so what's really going on here – so it's Muskrat Falls Corporation is ensuring that it gets from Newfoundland and Labrador Hydro, essentially, all the money that it needs to cover, you know, all the costs of the Muskrat Falls Project, certainly, in the LTA. So –

MR. BROCKWAY: That's right.

MS. O'BRIEN: All those costs, not only being the capital costs, the financing costs, but also the rate of return, so in other words, the profit that the shareholder should be making, to put it in a simple term.

MR. BROCKWAY: Exactly.

MS. O'BRIEN: And they've chosen that amount, that rate of return, to be 8.4 per cent.

MR. BROCKWAY: That's right.

MS. O'BRIEN: So that's all built into the price that Newfoundland and Labrador Hydro has to pay and then Newfoundland and Labrador Hydro, of course, is the regulated entity and it collects that money from ratepayers.

MR. BROCKWAY: It then passes on those costs to the ratepayers through its cost-of-service approach when it delivers the cost – when it delivers the energy to the end customers.

MS. O'BRIEN: And here we'll maybe not use the word cost-of-service approach for this, under this PPA approach.

MR. BROCKWAY: Yes.

MS. O'BRIEN: Because I understand there's a difference between how the – we've heard there's a difference between the way they're recovering rates under the – for the Muskrat Falls generation plant and the LTA under this PPA agreement versus their usual cost-of-service way of recovering rates that they're still using for the LIL.

MR. BROCKWAY: That's right.

Hydro is still under a cost-of-service methodology, but under the PPA, the way the costs related to Muskrat Falls get paid by Hydro under the PPA is more of a cost-recovery approach. It's more of just here are the development capital costs, we're gonna, you know, kind of straight line that over the term of the agreement and factor that into our Base Block Capital recovery.

MS. O'BRIEN: Okay, and I think you get into that a little more at the bottom of the page 37.

MR. BROCKWAY: Yes.

MS. O'BRIEN: And how it's –

MR. BROCKWAY: Yes.

MS. O'BRIEN: Okay.

MR. BROCKWAY: So – and it's worth noting as well that the Base Block Capital Costs Recovery will continue to be refined and recalculated as there's more certainty over what the actual development costs are. So as the development costs get finalized that amount will get adjusted.

MS. O'BRIEN: So we don't know what that number is today.

MR. BROCKWAY: We don't know what the final number is. The PPA has a schedule attached to it, which shows the current calculation of what the Base Block Capital Costs Recovery will be over the 50-year term. But those amounts will be updated.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: The payments do include an adjustment clause that effectively ensures that the debt-service obligations of the Muskrat Falls Project will be met. And this adjustment is known as the Base Block Capital Costs Recovery Adjustment. So, again, another term that we have to think about now.

Payments are also impacted by the Base Block Capital Supply Price and that, effectively, is how the Base Block Capital Costs Recovery is determined. You take your Base Block Energy, you multiply it by your Base Block Capital Supply Price, and that's how you arrive at the Base Block Capital Costs Recovery. So it's a mouthful.

But, effectively – and we do provide the summary there, beginning on line 18, to summarize it, "a calculation is completed to determine what costs are required to be recovered over the term of the agreement." The costs include all of the development costs and the costs of capital, including rate of return to the project owners. And the price is then calculated using the supply price and is designed to recover these costs over the term of the agreement. And there is price escalation built into the supply price of 2 per cent a year. And the 2 per cent a year escalation is meant to account for inflation; the inflationary impacts of those payments over the 50-year life of the project.

MS. O'BRIEN: Okay.

So we've already had some evidence on this already, but – so this is the idea that the payment, once you account for inflation, recognizing that a dollar today won't go as far as a dollar will go, you know – will go further than a dollar will go 10 years down the road. So, the – it's essentially the same payment but it's adjusted for inflation, so the – in terms of nominal dollars, the cost stays the same. Can you just explain that for us a bit –

MR. BROCKWAY: Yeah, it –

MS. O'BRIEN: – maybe, the difference between real and nominal dollars?

MR. BROCKWAY: Yeah, it basically accounts for, just as you articulated, to – because a dollar today won't really go as far as a dollar tomorrow, so, you know, nominal –

MS. O'BRIEN: Will go – a dollar today will go further than a dollar tomorrow.

MR. BROCKWAY: Will go further than what a dollar tomorrow. The purchasing power of that same dollar 10 years from now is not gonna be the same as it is today.

Nominal dollars effectively reflect the actual value of a dollar amount. So if I've got a $10 bill today and I've got a $10 bill 10 years from now, it's still $10, but what the real calculation or the inflationary – the escalation accounts for is the notion of real dollars. And as you stated, you know, that $10 bill isn't going to be able to purchase as much 10 years from now in real dollars because of the impacts of inflation. So that's what this escalation clause is meant to account for.

MS. O'BRIEN: So here it would be like if you paid $10 today you're going to be paying $12, 10 years from now, but the purchasing power of those two amounts of money would be the same, assuming an inflation of approximately 2 per cent.

MR. BROCKWAY: That's right, in real dollars.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: So turning on to page 38 now in summary, in terms of the payment terms, the mechanisms included in the PPA will adjust the amounts paid for changes in cost to be recovered. We also make the comment here: or if there are changes in base block energy.

Nalcor has provided some clarity in their feedback that that's not the case; there will be no changes in base block energy. That has been calculated and will be – will not be changed under the agreement, but the mechanisms included in the PPA will adjust the amount paid for changes in cost to be recovered. So that's –

MS. O'BRIEN: Okay, so that second clause there, or if, in line 7 should essentially be deleted? Or –

MR. BROCKWAY: Correct.

MS. O'BRIEN: – if there are changes in the base block energy.

MR. BROCKWAY: That's right.

MS. O'BRIEN: Okay.

MR. BROCKWAY: That should be deleted. So, ultimately, at the end of the day, all of these mechanisms ensures full recovery from the Island ratepayers of Newfoundland and Labrador over the 50-year term of the PPA to fully recover the costs. Okay?

In terms of some of the other agreements – other terms of the PPA, so Hydro's obligations to pay for the base block energy is absolute, unconditional and irrevocable. So, you know, Hydro is locked in; they must make the base block payments. The PPA provides the specific remedies that in are place if those base block payments don't get made, but as you stated, this is an agreement between Hydro and Muskrat Falls Corporation, both of which are owned by Nalcor so, you know, you wouldn't anticipate any of those types of remedies being necessary.

MS. O'BRIEN: On page 38 you also address greenhouse gas credits. Can you just explain there that this is the PPA – at line 12: The PPA states that Newfoundland and Labrador Hydro will acquire and own all greenhouse gas credits related to the energy delivered to Newfoundland and Labrador Hydro from Muskrat Falls Corp.

MR. BROCKWAY: Yeah, they're important. And I'm not an expert on greenhouse gas credits, but the reason they're important is that companies use these credits to offset emissions that are over certain allowed caps that are instituted by government.

So governments often will establish limits on how many – how much emissions that you can have through generation activities. Companies can use these greenhouse gas credits to the extent they're over those caps to get into compliance with the caps.

MS. O'BRIEN: Okay.

So under certain regulatory regimes there's some benefit to having these credits.

MR. BROCKWAY: There is benefit to the credits, yes.

MS. O'BRIEN: Okay.

MR. BROCKWAY: At the top of page 39 there are some remedies as well in the PPA for Newfoundland and Labrador Hydro, to the extent Muskrat Falls isn't able to provide energy for a 24-hour consecutive period or for 24 non-consecutive hours within a seven-day period. And Hydro effectively has the ability to come in and assume operational control of Muskrat Falls if that were to happen.

So – and the terms of the PPA also articulate when the return of the plant to Muskrat Falls Corporation happens, so those terms are in there as well. And as it relates to external market energy sales beginning on page 11, the PPA goes into further detail, as well, around external market sales and – under section 4.5 of the PPA.

And under this section, Muskrat Falls Corporation is required to deliver, at the end of each operating year basically, an annual report to Newfoundland and Labrador Hydro summarizing the previous operating year. And Newfoundland and Labrador Hydro can specify – we talked about the notion of deferred energy earlier. If Newfoundland and Labrador has deferred energy – in other words, energy that is paid for but hasn't been delivered – it can deem that that deferred energy has been sold by Muskrat Falls to external customers.

And, effectively, there's mechanisms within the agreement whereby Muskrat Falls would then pay Newfoundland and Labrador Hydro for that external sale. So the impact of that is that, you know, Newfoundland Hydro has paid for energy, it hasn't been delivered so they can basically deem that Muskrat Falls, you've sold that for us. We haven't sold that to customers because we haven't delivered it, but Muskrat Falls, you've sold that for us on our behalf to external market customers.

MS. O'BRIEN: So does this mean that if there were export energy sales from the province – so if we earn money from exporting power externally – that the revenue earned from those exports would go back to essentially lower power rates for consumers?

MR. BROCKWAY: I'm not sure if it would lower power rates. Presumably, the deemed sale that would happen on behalf of Newfoundland Hydro would basically be calculated using Muskrat Falls average sales price for the year, so – which would effectively be driven, presumably, off market rates.

So Hydro is basically selling that power through Muskrat Falls at market rates which, I think, would probably be less than what it would receive had it delivered it to customers and charged customers the rates that were approved by the PUB. So it's probably a situation where they're actually receiving less money for this power than they would have received if they had actually delivered it to customers.

MS. O'BRIEN: Thank you.

MR. BROCKWAY: So we begin on line 18 talking a little bit about the effect of the PPA on ratepayers and taxpayers. And, clearly, under the terms and conditions of the PPA, the full cost recovery of Muskrat Falls will ultimately be achieved through these base block energy payments and will allow for a full recovery of costs from the Island ratepayers of Newfoundland and Labrador.

So, given the cost overruns that we've seen, this obviously increases the burden on the ratepayer – on the Island ratepayer, specifically – as they are now required to purchase energy under the exclusive rights that had been put in place under the amendments to the legislation. As well as – on page 40, the top of page 40, the legislation passed by government restricts the PUB's ability to regulate those costs or to do anything about them. So, again, from an Island-ratepayer perspective, it effectively guarantees that they will be paying – the Island ratepayer will be paying all of those costs.

MS. O'BRIEN: And I know that you keep talking about Island ratepayers, but these are the ratepayers just on the Newfoundland portion of the Province of Newfoundland and Labrador.

MR. BROCKWAY: On the Island portion, yes, that's correct.

MS. O'BRIEN: So ratepayers in Labrador are not affected.

MR. BROCKWAY: That's correct.

MS. O'BRIEN: Okay.

MR. BROCKWAY: And, as well, the potential for exporting excess energy – so there are terms in the PPA which define the notion of residual energy. Residual energy isn't on account of Newfoundland and Labrador Hydro necessarily, but the PPA just acknowledges that residual energy is there.

And residual energy, basically, is energy in excess of what Newfoundland Hydro needs. And that residual energy is Muskrat Falls energy and they can use that for external sales.

So the opportunity to have those external sales represents an opportunity for Nalcor and increased revenues as it relates to those external sales.

MS. O'BRIEN: So the revenues from those external sales, do they get tied back to what the ratepayer – you know, does that – do the ratepayers get advantage of revenues from those external sales?

MR. BROCKWAY: No.

MS. O'BRIEN: Okay.

MR. BROCKWAY: No, that's strictly on account of Nalcor.

MS. O'BRIEN: So who would get the benefit, ultimately, of the revenues there, assuming there was profit?

MR. BROCKWAY: The shareholder of Nalcor.

MS. O'BRIEN: So the government of –

MR. BROCKWAY: So the Government of Newfoundland. So, presumably, the benefits of that would translate to the taxpayer.

MS. O'BRIEN: Okay.

MR. BROCKWAY: Yeah.

MS. O'BRIEN: And we've had some talk, obviously, about rate mitigation here in the Inquiry, and it's – no doubt we'll hear more about it. But – so is there anything – so the idea is that the government can use its revenues, its tax dollars, to do things like take measures to lower our power rates, our electricity rates. Is there anything in the PPA that would require that to happen, or not?

MR. BROCKWAY: Not that I saw. No, there was nothing in the agreement that I saw.

MS. O'BRIEN: Okay, so the government could choose to do that, but these agreements don't require to – that ultimately remains the choice of government. Is that a fair summary?

MR. BROCKWAY: Correct. Yeah.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: Yeah.

The final section of our report deals with the effect of the legislative monopoly and the Power Purchase Agreement on the compliance related to FERC, and we talked about that briefly earlier. FERC is the Federal Energy Regulatory Commission. It's a US organization. It's an independent agency that regulates the transmission and wholesale of electricity within interstate commerce, and also requires the sales of electric energy to be at just and reasonable rates.

And the main – it's very complex, US legislation and regulations around FERC and how it exercises its mandate. But the main notion is all around access. That if you are going to sell – if you are going to transmit and sell energy within the United States that you also need to make your transmission facilities available to others to go back and forth, that there's reciprocity there. So that's the main – that's the main function that FERC would provide, or I should say, one of the functions that FERC provides.

As a result of the legislative monopoly that was entered into – as a requirement of the FLG to get the federal loan guarantee as well as the PPA – you know, there were some questions around – you know, now that through the Labrador-Island Link and the Maritime Link Projects, Newfoundland – the Island of Newfoundland will now be directly connected to the North American power grid, there was some questions as to what impact would that legislative monopoly and PPA have. It was irrelevant prior to this because there was no interconnection to the grid and that Newfoundland – the Island portion of Newfoundland kind of stood on its own. But now that it is connected into the network, how would that be dealt with?

As mentioned earlier, we engaged some legal assistance to help us in this regard, which would include a law firm in the US which specializes in – the partner we dealt with there specializes in utility and regulatory matters specifically related to FERC. And we initially concluded that it was unclear to us, based on the information that we had available, if FERC compliance was going to be an issue. We really weren't able to make a definitive conclusion around that. So that's basically what our report states.

MS. O'BRIEN: That's your report at P-00454.

MR. BROCKWAY: P-00454, yes, basically pages 40 through pages 43.

As part of the feedback process from Nalcor, they did provide some feedback which we referred to at the beginning. Due to the complex nature of the FERC regulations, they also engaged US legal experts; in fact, they've been using this US firm since August of 2011 as it relates to these FERC matters. And –

MS. O'BRIEN: And that would be Van Ness Feldman?

MR. BROCKWAY: Van Ness Feldman.

MS. O'BRIEN: Okay.

MR. BROCKWAY: And the information outlined by Van Ness Feldman in their appendix was very helpful. It provided a lot of information and a lot of detail around Nalcor's activities in this area. Our legal team also reviewed that response and that appendix and we're basically to the point now where we've got no reason to dispute the conclusions that have been made by Van Ness Feldman in their appendix. So –

MS. O'BRIEN: And what are those conclusions?

MR. BROCKWAY: Those conclusions are essentially that the activities of Nalcor are in compliance with the FERC regulations. That – and so that their activities – that there would be no issue from that interconnection question that would disallow them from transmitting energy through – into the US for those external market sales.

MS. O'BRIEN: Okay, so just to be clear on this, so Nalcor has provided us with an opinion from an American law firm and the gist of that opinion is that the changes, the monopoly, the PPA, these – the things that we've talked about here today does not affect our ability to be compliant with the FERC regulation in the United States?

MR. BROCKWAY: It provides a lot of clarity in that regard.

MS. O'BRIEN: Okay.

MR. BROCKWAY: It does. And we've got no reason to dispute, based on our review –

MS. O'BRIEN: Okay.

MR. BROCKWAY: – of those findings.

MS. O'BRIEN: And so – and you took that, you actually also went to an American law firm with someone who specializes in power regulation, in FERC in particular, and that lawyer or those lawyers did not raise any concern with the opinion that had been provided by Nalcor's counsel?

MR. BROCKWAY: That's right.

MS. O'BRIEN: Okay. Thank you.

MR. BROCKWAY: So that effectively concludes the report so …

MS. O'BRIEN: Thank you very much. That was a very detailed presentation.

I know it's – these are very complicated agreements.

MR. BROCKWAY: They are.

MS. O'BRIEN: But it's important evidence to have before the Inquiry and for the Commission to hear, so I thank you for that.

Commissioner, we're now at just about 10:45. We can either go on and begin cross-examination or take the morning break now.

THE COMMISSIONER: I think we'll start.

MS. O'BRIEN: Okay.

THE COMMISSIONER: So the Province of Newfoundland and Labrador.

MR. RALPH: No questions, Commissioner.

THE COMMISSIONER: All right.

Nalcor Energy.

MR. SIMMONS: Commissioner, it might actually be useful if we could take the break now –

THE COMMISSIONER: Oh, okay.

MR. SIMMONS: – as it may influence what, if anything, we have to ask afterwards.

THE COMMISSIONER: Okay, so we'll do that then. So we'll take 10 minutes now.

CLERK: All rise.

Recess

CLERK: All rise.

Please be seated.

THE COMMISSIONER: Okay. All right.

Nalcor Energy.

MR. SIMMONS: Thank you, Commissioner, we have no questions.

THE COMMISSIONER: Concerned Citizens Coalition?

MR. BUDDEN: Good day, Mr. Brockway. As you recall from yesterday –

UNIDENTIFIED MALE SPEAKER: Mic – yep.

MR. BUDDEN: Good day, Mr. Brockway.

As you may recall from yesterday, my name is Geoff Budden. I represent the Concerned Citizens Coalition. I do have some questions for you. The first one is the – with respect to the term of the federal loan guarantee.

If certain debt begins to drop off, I guess, before the end of the term of the guarantee, what happens if those bonds roll over? Does the guarantee continue to cover those bonds?

MR. BROCKWAY: If the – I'm not sure I understand the question.

MR. BUDDEN: Okay. So say if the – if some of the debt that's covered by the loan guarantee is, say, a 20-year bond –

MR. BROCKWAY: Mm-hmm.

MR. BUDDEN: – that bond will expire.

MR. BROCKWAY: Mm-hmm.

MR. BUDDEN: When that bond – if that bond is rolled over, would the federal loan guarantee continue to apply? Because obviously it would make an enormous difference in the rate on that bond.

MR. BROCKWAY: Yeah. I would think if it was during the term of the FLG that that would be the case.

MR. BUDDEN: Are you certain? Does the agreement explicitly address that?

MR. BROCKWAY: No it doesn't – not that I'm aware of.

MR. BUDDEN: Okay, so if doesn't, the effect of that would be – I would assume – that the benefit of the federal loan guarantee, which is to have a lower interest rate, would be lost?

MR. BROCKWAY: That would be the case, but I wouldn't understand why anyone would –

MR. BUDDEN: Pardon?

MR. BROCKWAY: – I don't understand why anyone do that – in terms of creating a term of the debt that wouldn't match the federal loan guarantee. That wouldn't –

MR. BUDDEN: Okay.

MR. BROCKWAY: – really be a sensible thing to do.

MR. BUDDEN: So, to your knowledge, all of the subsidiary debt matches the term of the federal loan guarantee?

MR. BROCKWAY: There are amortization profiles in the federal loan guarantee that require the debt to be paid off over a certain amount of time, and it would need to be compliant with those requirements.

MR. BUDDEN: Okay.

Is there a guarantee fee for the federal loan guarantee – is Nalcor or Newfoundland in any way paying any kind of fee for the guarantee?

MR. BROCKWAY: Under the second federal loan guarantee there is a guarantee fee, yes. That's paid by the borrowers.

MR. BUDDEN: Okay. And how much is the fee?

MR. BROCKWAY: It is 0.5 per cent.

MR. BUDDEN: Pardon?

MR. BROCKWAY: It's 0.5 per cent.

MR. BUDDEN: Okay.

So if the bond is – or the second loan guarantee is what, 2.9 –?

MR. BROCKWAY: 2.9 billion.

MR. BUDDEN: Okay, so it's a 0.5 per cent; it'd be $145 million – something like that?

MR. BROCKWAY: I think so. I think that's the amount –

MR. BUDDEN: You're the accountant.

MR. BROCKWAY: Yeah, that's –

MR. BUDDEN: Does that sound about right?

MR. BROCKWAY: Yeah.

MR. BUDDEN: Okay.

The – on page 1 and carrying into page 2, I believe, of your report. There's the – there's a citation of that Newfoundland press release of November 2012. I think I'm thinking of the substantive report, which would be –

THE COMMISSIONER: Page 4.

MR. BROCKWAY: Page 4, line 25?

MR. BUDDEN: Yes, that's right. Yeah, I thought I caught all those but evidently I didn't.

THE COMMISSIONER: So that's at line 25, Mr. Budden?

MR. BUDDEN: It is yes, it carries over. And perhaps just for the benefit of everybody, you can start reading at page – at line 25 and carry through to line 2 of page 5, Mr. Brockway?

MR. BROCKWAY: "In a press release issued by NL on November 30, 2012, it noted that 'the Federal Government's loan guarantee will reduce the cost of financing for the project through reduced interest rates and this will result in stabilized electricity rates for consumers in the Province'. Nalcor noted that the benefit to electricity consumers in the Province would be in excess of $1 billion."

MR. BUDDEN: Okay, so the first part of that isn't controversial; obviously the cost of financing is reduced. That –everybody agrees with that. The second part of that sentence: "… this will result in stabilized electricity rates for consumers in the Province." Has it been part of your mandate to confirm whether or not that is correct?

MR. BROCKWAY: No – no we did not review that.

MR. BUDDEN: Okay.

The – I guess this is just sort of a more general question – do the effect of these various agreements that you examined, is their general effect more to establish stability of return of equity or establish stability of rates?

MR. BROCKWAY: I interpret it to be saving interests costs.

MR. BUDDEN: Okay.

MR. BROCKWAY: Yeah.

MR. BUDDEN: Are you aware how the independent engineer was actually selected?

MR. BROCKWAY: No.

MR. BUDDEN: Okay, so that wasn't part of your mandate.

MR. BROCKWAY: No.

MR. BUDDEN: Okay.

Likewise, when Stantec bought out MHW Global and – were you aware of how the independent engineer was addressed through that transition?

MR. BROCKWAY: No.

MR. BUDDEN: Okay. Again, not part of your mandate?

MR. BROCKWAY: That's right.

MR. BUDDEN: Okay.

I'm looking at the quote on page 3 – page 6, I guess, the one beginning prior to executing. Perhaps we can scroll down.

Yeah, line – beginning at line 14. Could you just perhaps read that down to the word monopoly? Yeah. If you could Mr. Brockway?

MR. BROCKWAY: "Prior to executing the FLG-1 NL passed an amendment to the EPCA that provided NLH the exclusive right to supply, transmit, distribute and sell electrical power or energy to the island portion of Newfoundland and Labrador."

I will point out that we've removed the word transit; it was transmit and in –

MR. BUDDEN: Of – yes, that's one of the –

MR. BROCKWAY: – according to our corrections.

MR. BUDDEN: – subsequent to the – Nalcor's submission, fair enough.

MR. BROCKWAY: That's right. Okay.

MR. BUDDEN: That's okay.

MR. BROCKWAY: Okay.

"This restriction further ensured the recovery of the full costs of the Nalcor projects by providing" – Hydro – "the exclusive right to collect sufficient revenues from island ratepayers. Ultimately the exclusive right passed through this amendment formed the basis for the creation of the legislative monopoly."

MR. BUDDEN: Okay.

I guess I would suggest to you that this monopoly creates perhaps the most favourable circumstances to guarantee the – to provide the rate of return. But it doesn't guarantee that that would happen.

MR. BROCKWAY: I'm not sure I understand.

MR. BUDDEN: Okay. So the intent of this is to guarantee a rate of return. That presumably is the intent, you would agree?

MR. BROCKWAY: It's to meet the requirements of the FLG that all of the costs are recovered.

MR. BUDDEN: Yes, but obviously it can not guarantee that all those costs would be covered. It merely creates favourable circumstances where that might happen.

MR. BROCKWAY: Well, that was the purpose of all of the additional agreements that were entered into, to make sure that all of those commitments were supported by commercial agreements.

MR. BUDDEN: Sure.

Carrying on a little bit on that, I believe it's further down that page when you scroll down. Yes, the next paragraph of – I won't have you read it but the – what's said there, obviously, is the Power Purchase Agreement signed between Hydro and Muskrat Falls Corporation in which Muskrat Falls would sell and Hydro would purchase.

It says here the payments for these servicers would allow Muskrat Falls to collect sufficient revenue each year to recover the amounts incurred for the purchase and delivery of energy from Muskrat Falls. I guess, firstly, it's – the intent clearly is that it recover sufficient revenue, but it doesn't guarantee that it will recover sufficient revenue, does it?

MR. BROCKWAY: Doesn't – can you repeat the question?

MR. BUDDEN: Sure.

MR. BROCKWAY: I'm not sure I understand (inaudible).

MR. BUDDEN: That essentially expresses an intent that the payments would allow Muskrat Falls to collect sufficient revenue each year to recover the amounts incurred for the purchase of – but that's all it is, is an intent. It's not some sort of locked-in guarantee that would happen.

MR. BROCKWAY: Anything can happen, I don't know, but the purpose of the federal loan guarantee and all of the supporting agreements were to ensure that it happened.

MR. BUDDEN: Okay.

And the Nalcor – Nalcor-related companies, their essential – their side of the guarantee was to create and the Newfoundland government, through its legislative powers, to create favourable circumstances for all of that to happen.

MR. BROCKWAY: They were required –

MR. BUDDEN: It's a general point.

MR. BROCKWAY: – to meet the preconditions of the federal loan guarantee.

MR. BUDDEN: Yes.

MR. BROCKWAY: Yes.

MR. BUDDEN: Perhaps we could go on to page 6 and the passage that begins: By entering.

MR. BROCKWAY: Page 9, line 2?

MR. BUDDEN: Nine, sorry. Just did it again. Yeah.

Yeah, could you read that passage down to province, please?

MR. BROCKWAY: Yes.

"By entering into this agreement, the risks associated with the recovery of" Muskrat Fall's "costs were assumed by the Newfoundland and Labrador island ratepayers through the PPA mechanism for Nalcor to recover all construction costs as well as future operating and maintenance costs of MF. Given the significant cost overruns and delays from the initial budget, at the" timing "of signing the

PPA, this increased the burden on the Newfoundland and Labrador island ratepayers as they are required to purchase energy from" Hydro "under the exclusive rights on the island portion of the Province."

MR. BUDDEN: Okay.

So I guess these, obviously, impose a financial burden on the province. And I guess my question to you: Does that burden go beyond the contingent equity obligation relating to capital cost that is contemplated here?

MR. BROCKWAY: The burden we're referring to here is the recovery of the Muskrat Falls costs through the rates Hydro is charging to the ratepayers.

MR. BUDDEN: Yes.

MR. BROCKWAY: Yeah.

MR. BUDDEN: If we move on to page – let's see, it's a passage: Further, as the legislative – legislation passed by Newfoundland limited. I believe that's – it's either page 9 or page 12. Yeah, that's it.

Perhaps you could just briefly read from 9 through 12 and I'll have a question or two on that.

MR. BROCKWAY: I'm sorry, where are we?

MR. BUDDEN: Line 9, page 9, I believe. It's the one that's on your screen in front of you now: Further, as the legislation passed by Newfoundland limited –

MR. BROCKWAY: Oh, I see.

MR. BUDDEN: – limited the PUB's ability. Yeah.

MR. BROCKWAY: Okay.

Further, as the legislation passed by Newfoundland and Labrador limited the PUB's ability to regulate rates once Muskrat Falls achieved in-service, the PUB is not able to set rates or disallow costs incurred. This limitation ensures the full recovery will be assumed by the Island ratepayers through the PPA mechanisms in place to recover the full costs of Muskrat Falls.

MR. BUDDEN: Okay, I guess this – I may be going beyond the scope of your report, but it is a point I do want to pursue – ensures the full cost recovery. I guess I would take issue somewhat with, ensures, because obviously this assumes that the Island ratepayers come through and continue to purchase in sufficient amounts to meet this requirement. I'm correct on that I assume?

MR. BROCKWAY: Well, the – what it ensures is that the full cost recovery will be included in rates.

MR. BUDDEN: Okay.

MR. BROCKWAY: Whether customers end up paying their hydro bills, I don't know, but this ensures that the full recovery will be included in rates charged to customers.

MR. BUDDEN: Yes, which would assume that – in turn, that demand projections are accurate –

MR. BROCKWAY: Yes.

MR. BUDDEN: – that rates are somewhat inelastic. This, again, is outside, but we've heard evidence about whether power rates are or are not elastic and to what degree, meaning as people have to pay more and more, will they find other ways of meeting their basic needs to heat their house and so on.

MR. BROCKWAY: Mm-hmm.

MR. BUDDEN: So I guess what I'm asking there is it's not really possible, is it, that this agreement can ensure the obligation will be met? That the – you know, it's assuming ratepayers will hold up their end of the bargain, but that's not really possible to ensure, is it?

MR. BROCKWAY: I personally think the agreements ensure it's going to happen, that that – the full cost recovery will ultimately happen through the Island ratepayers.

MR. BUDDEN: Okay, but the full cost recovery, that's a finite amount. We can say now, really, what that will be. That's a known quality. You would agree with me?

MR. BROCKWAY: I don't know if those costs have been finalized yet.

MR. BUDDEN: Okay, but they are realizable. There will be a schedule of costs and so on that have to be met by the Island ratepayer.

MR. BROCKWAY: That's right.

MR. BUDDEN: And I guess I'm asking you, as I would see it, there are various scenarios there; one is that the ratepayers may grumble but reach into their pockets, continue to, you know, stay on the grid and buy their power and so on, and that demand will continue to rise.

If that were not to happen and there is a shortfall, I guess what I'm suggesting to you it can only be addressed through rates going up and up and up or through some sort of program of rate mitigation that achieves, out of the public purse, the same result.

MR. BROCKWAY: Yes, if demand were to decrease, then that would need to be addressed by Newfoundland and Labrador Hydro in its rate-setting process related to how do I recover the costs that I'm incurring because I'm paying all of the costs of Muskrat Falls. If the demand goes down at the hydro level, then, that will need to be addressed through their rate-setting process.

MR. BUDDEN: And this commitment extends decades into the future?

MR. BROCKWAY: That's right, 50 years.

MR. BUDDEN: Fifty years.

MR. BROCKWAY: Yeah.

MR. BUDDEN: And, again, you haven't really looked at, as I think you've said a moment ago, the independent engineers. You can't speak as to the terms under which the independent engineers appointed or anything like that?

MR. BROCKWAY: That's correct.

MR. BUDDEN: Okay.

Are you aware – and the answer may be no, but did the independent engineer's mandate require him – or him – require that this institution of the independent engineer, the verifier, in any way check the rates that were there at DG2 turn – well, the risk allocations, strategic risk, tactical risk, the P-factors, anything like that. To your knowledge, did they fall under the ambit of the independent engineer?

MR. BROCKWAY: I don't know that.

MR. BUDDEN: Simply don't know?

MR. BROCKWAY: Yeah.

MR. BUDDEN: Okay.

So I guess a final question for – again, if the ratepayers are not going to come through, that essentially is a potential significant obligation for the province in the form of rate mitigation, you would acknowledge that?

MR. BROCKWAY: If the ratepayers don't come through?

MR. BUDDEN: Yes. If either though the elasticity of demand or through simply a falling population or other measures – the demand forecasts are way too ambitious. That – essentially, that's a contingent liability of the province, collectively, to meet this obligation.

MR. BROCKWAY: The demand would need to be addressed by Hydro in its rate-setting process. That's all I know.

MR. BUDDEN: Which is controlled by the PUB?

MR. BROCKWAY: Which is controlled by the PUB.

MR. BUDDEN: Okay.

And as we've already discussed, rate mitigation would be another way of meeting this obligation that has been entered into with the federal government?

MR. BROCKWAY: I don't know that.

MR. BUDDEN: Okay.

MR. BROCKWAY: I don't know that.

MR. BUDDEN: And there's been obviously no attempt on your part to quantify the potential liability of Newfoundland for that potential mitigation?

MR. BROCKWAY: No.

MR. BUDDEN: Okay.

To your knowledge, if – we've already discussed the independent engineer. Have you seen any other evidence that the federal government exercised any other form of due diligence with respect to cost or scheduling projections of the Muskrat Falls Project?

MR. BROCKWAY: I haven't seen anything as part of what I did.

MR. BUDDEN: Okay. Falls outside your ambit?

MR. BROCKWAY: Yes.

MR. BUDDEN: Okay.

Did the federal government require that Muskrat Falls – the project development be exempted from the jurisdiction of the Public Utilities Board? Was that a term of any of these agreements?

MR. BROCKWAY: It was a condition to the FLG that legislation be put in place that ensured full recovery of costs.

MR. BUDDEN: Okay, which doesn't really answer my question, though it's an interesting answer. Was it a condition of the FLG, either FLG, that the Muskrat Falls Project be removed from the jurisdiction of the Public Utilities Board – the oversight jurisdiction, not rates particularly –?

MR. BROCKWAY: No, no. That was the mechanism that was used to meet the conditions around ensuring full cost recovery.

MR. BUDDEN: Okay, but it wasn't explicitly set out as a term of the FLG?

MR. BROCKWAY: No.

MR. BUDDEN: Okay.

Similarly, Bill 61, which established, I would say loosely, a monopoly with respect to – not transmission, understood – but the other aspects of power generation and delivery in Newfoundland, was that a condition of the FLG, that that or similar legislation be passed by the Province of Newfoundland?

MR. BROCKWAY: No.

MR. BUDDEN: Okay.

So basically the FLG said you must do these things, but how specifically they were accomplished, that wasn't specified. That was an issue for Newfoundland to do however it saw fit?

MR. BROCKWAY: That's right.

MR. BUDDEN: Okay.

I had some questions about FERC, but I think they've been answered.

Have you – and again, I'm – this may or may not be within your area of expertise, but have you ever seen an escalating supply price be used in a public utilities rate setting, as is contemplated here?

MR. BROCKWAY: I've never seen it, but my breadth of experience in this area is very limited. It's outside my area of expertise.

MR. BUDDEN: Okay.

But you haven't encountered it to the extent that you have worked in this –?

MR. BROCKWAY: No

MR. BUDDEN: Okay.

Thank you.

THE COMMISSIONER: Edmund Martin?

MR. CONSTANTINE: No questions, Mr. Commissioner.

THE COMMISSIONER: Kathy Dunderdale?

MS. E. BEST: Good morning, Mr. Brockway.

MR. BROCKWAY: Good morning.

MS. E. BEST: I introduced myself yesterday. I'm Erin Best, counsel for Kathy Dunderdale.

Madam Clerk, I'm wondering if we can pull up the report which is P-00454, please?

Thank you. And page 4, near the bottom there. If you can scroll down please. That's great, thank you.

So the – you state there, around line 21 to 24, that the federal government – I take it to say – the federal government would not guarantee the loan unless the project had "economic and financial merit."

Can you just elaborate on that? Does that indicate to you that the federal government concluded that the project had economic and financial merit?

MR. BROCKWAY: I think it does, and then that was part of the precondition around the credit rating – the investment grade credit rating that we talked about earlier as well.

MS. E. BEST: Thank you.

Nova Scotia Power Maritime Link Incorporated, which is an Emera subsidiary, was a party to the federal loan guarantee, right?

MR. BROCKWAY: Correct.

MS. E. BEST: And the federal government guaranteed – I think the number is $1.3 billion for the Maritime Link?

MR. BROCKWAY: Think that's the number, yes.

MS. E. BEST: Thank you.

Do you know – did the Nova Scotia entities involved have any ancillary agreements with – requirements such as project costs being recovered from the Nova Scotia ratepayers and describing consequences to Nova Scotia entities in the event of an overrun or a default?

MR. BROCKWAY: There were preconditions associated with Nova Scotia as well that I reviewed, including execution of agreements between Canada and Nova Scotia indemnifying Canada for any costs incurred, similar to what happened with Newfoundland and Labrador.

MS. E. BEST: Thank you.

The federal loan guarantee resulted in a cost savings to ratepayers by reducing financing costs. I think we've agreed on that. It resulted in the project achieving a Triple-A credit rating. And I think you said this morning, without the federal loan guarantee, the likelihood of Newfoundland and Labrador getting the Triple-A credit rating would have been less, right?

MR. BROCKWAY: That's right.

MS. E. BEST: So if the project went ahead, what would the impact on the ratepayer be if Newfoundland and Labrador had not secured the federal loan guarantee?

MR. BROCKWAY: Assuming that interest rates would be higher because the rating on the project would have – would not have attracted a Triple-A rating. So the financing costs that form part of the cost of the assets would have been higher.

So as a result of that, the costs that would ultimately need to be paid by the Newfoundland and Labrador ratepayer through rates would have been higher.

How that would have been determined or worked out within the agreements, I don't know, but ultimately, in totality, the costs would have been higher.

MS. E. BEST: Thank you.

Those are my questions, thanks.

THE COMMISSIONER: Former Provincial Government Officials '03-'15.

MR. KING: No questions, Commissioner.

THE COMMISSIONER: Charles Bown and Julia Mullaley.

MR. FITZGERALD: No questions.

THE COMMISSIONER: Robert Thompson.

MR. COFFEY: Good day, Sir. My name is Bernard Coffey. I represent Mr. Robert Thompson.

If I could – yes, Exhibit P-00454, page 37, please. Lines 1 through 7, Mr. Brockway, I believe you were taken through these.

MR. BROCKWAY: Mm-hmm. Yes.

MR. COFFEY: "The Base Block Capital Costs Recovery is defined as the recovery over the supply period of the following (as set out in Schedule 1 of the PPA)."

The third bullet is: "distributions to equity holders sufficient to enable MFCo to achieve its Assigned Internal Rate of Return ('IRR'), which the PPA Schedule 1 sets at 8.4%."

My question is this, is that because the agreement in question, the PPA, is between Muskrat Falls Corporation and Newfoundland and Labrador Hydro.

MR. BROCKWAY: Correct.

MR. COFFEY: Anytime, generally, in law, anytime two parties to an agreement agree to change it, they can do so. That's a basic proposition of law. If Muskrat Falls Corporation and Newfoundland and Labrador Hydro were to agree to lower that assigned IRR from 8.4 per cent to some lower rate, say, for example, 4 per cent or 3 ½ per cent, would doing so, from your examination of the documentation you looked at, would doing so trigger a default under the federal loan guarantee, in and of itself?

MR. BROCKWAY: I don't know.

MR. COFFEY: You don't know.

MR. BROCKWAY: I don't know.

MR. COFFEY: Okay.

Based upon your analysis of the agreements you've gone through and, in particular, the PPA, the federal loan guarantee itself, does it require that the assigned RR be 8.4 per cent?

MR. BROCKWAY: No, the 8.4 per cent is identified in the PPA as what the IRR is. I don't – I didn't see that as being a requirement anywhere else.

MR. COFFEY: Federal governments – correct me if I'm wrong, but their general interest is to ensure that the bond holders are paid?

MR. BROCKWAY: That's right.

MR. COFFEY: And that's what – because that's what the – their guaranteeing covers is the debt.

MR. BROCKWAY: That's what they're guaranteeing.

MR. COFFEE: Thank you, Sir.

THE COMMISSIONER: Okay, thank you.

Todd Stanley and Terry Paddon.

MS. VAN DRIEL: Yeah, just one question.

(Inaudible.) Did I not – yes, now it works. Thank you.

My name is Gerlinde Van Driel, and I represent Todd Stanley and Terry Paddon, former employees of the Government of Newfoundland. I just have one question really, and more comment.

I read your report, and I note in two places – and that's Exhibit 00454 on pages 4 and pages 10 – you refer to an agreement that was reached between the Government of Canada and the various parties on November 30, 2012 on a federal loan guarantee and the terms and conditions, essentially, of that.

I just want to clarify, that was not the actual date that the loan guarantee was issued, that was just an agreement in principle?

MR. BROCKWAY: No, that was the date that the terms of the federal loan guarantee were agreed to.

MS. VAN DRIEL: Agreed. But the actual –

MR. BROCKWAY: The financial –

MS. VAN DRIEL: – loan guarantee was not issued until about a year later.

MR. BROCKWAY: The actual financial close of the transaction, which involved the exchange of money, didn't happen until roughly a year later.

MS. VAN DRIEL: Yeah, so that included –

MR. BROCKWAY: Because there were several (inaudible).

MS. VAN DRIEL: – the actual issuance of the official federal loan guarantee. In your review of the loan guarantee, did you come across that?

MR. BROCKWAY: No.

MS. VAN DRIEL: Okay.

MR. BROCKWAY: No.

MS. VAN DRIEL: Well, that will be clarified then in some subsequent evidence.

Thank you.

MR. BROCKWAY: Okay.

THE COMMISSIONER: Okay, thank you.

Consumer Advocate.

MR. PEDDIGREW: Good morning, Mr. Brockway. My name is Chris Peddigrew. We met briefly at the – oh, there we go.

Good morning, Mr. Brockway. Chris Peddigrew again for the Consumer Advocate.

Just a few questions for you. Just going back for a moment to the signing of the term sheet, November 30, 2012, and then about 2½ weeks later was the announcement of the sanctioning of the project by the Government of Newfoundland and Labrador.

Any – I guess in reviewing the documents to prepare you report – any evidence of any public debate that took place between the date of the term sheet and the sanctioning of the project, or whether that was considered prior to sanction?

MR. BROCKWAY: I didn't see anything related to that, no.

MR. PEDDIGREW: And, again, just in terms of timing, sanction was announced in December of 2012. The Nova Scotia UARB had not, at that point, sanctioned the Maritime Link – didn't happen until about seven months later. And then it was conditional on some other things happening, even after that conditional sanction in July of 2013.

MR. BROCKWAY: Mm-hmm.

MR. PEDDIGREW: I guess, any comment on whether that would put the Government of Newfoundland, Nalcor in a weaker position in terms of negotiating some of the conditions that were announced in the term sheet for the federal loan guarantee or even subsequently announced as part of the USARB's [sp NSUARB's] condition of approval?

Newfoundland had committed to doing the project without knowing whether the conditions of the federal loan guarantee would be made or whether Nova Scotia would approve the Maritime Link. Any comment on what position that would put Newfoundland in – Nalcor?

MR. BROCKWAY: I can't comment on that.

MR. PEDDIGREW: Not part of what you looked at?

MR. BROCKWAY: No.

MR. PEDDIGREW: If I could just take you to your report, Exhibit 00454, and just the issue of indemnity, and that's, I believe, dealt with on page 24, in two different places I believe. And in your direct examination this morning, I believe, you did touch on both types of indemnity, I guess, that could result in terms of the Province of Newfoundland.

So, just in line 15, so here it says: Section 4 of the agreement states that Newfoundland agreed to indemnify Canada for any costs it may incur under the federal loan guarantee as a result of governmental action. So this would be things that would happen after the fact. That's how that indemnity would arise, if government took some form of action after.

And then if we scroll down to lines 21 to 25. Section 6 of the agreement also stated that if some of the subsidiaries of Nalcor failed to complete their project, and this was a result of failure by Newfoundland to comply with the five specific commitments, Newfoundland agreed to indemnify Canada.

So how – can you just elaborate on that a little bit? How that would arise? How that indemnification might happen?

MR. BROCKWAY: If under section 6 that – if any of those projects were failed to be – were failed to complete, because of a result of failure to comply with any of the five specific conditions that I outlined earlier, Newfoundland agreed to indemnify Canada for any costs that Canada may incur under the FLG as a result of the project not achieving commissioning, not being completed.

MR. PEDDIGREW: Any limit on that indemnification?

MR. BROCKWAY: It would – I assume it would be limited for the actual costs that Canada incurred.

MR. PEDDIGREW: Up to the maximum amount that they incurred, okay.

Mr. Brockway, last week some of the former Nalcor board members were witnesses here and gave evidence about proceeding with the projects even if the federal loan guarantee had not been – had not come through – would have been willing to do that.

Can you comment on Nalcor's ability to have proceeded with the project in the absence of a federal loan guarantee? In terms of, you know, what costs it might have added or what additional risk –

MR. BROCKWAY: I think so. It was – and it goes back to on the earlier point around Canada requiring these projects to having got investment grade credit ratings prior to Canada providing the federal loan guarantee.

So, basically, Nalcor and Emera had to demonstrate that these were doable deals and that they would attract an investment grade credit rating as a result of that. Had they not entered into the federal loan guarantee, they would have been able to proceed on that basis and attract investment grade financing at a higher interest rate. So it would've increased the costs of the project.

MR. PEDDIGREW: And would Newfoundland have met that minimum threshold investment grade rating without the federal loan guarantee? Do you know if they would have or not?

MR. BROCKWAY: They were required to demonstrate that prior to execution of the FLG; it was a precondition from Canada.

MR. PEDDIGREW: Right. But absent the federal loan guarantee, you didn't look into whether Newfoundland would have met that – the minimum threshold investment grade requirement, I think BBB, you said it was?

MR. BROCKWAY: Yes. They were required to demonstrate that prior to the FLG being executed.

MR. PEDDIGREW: Right.

In terms of the second federal loan guarantee, again, it did not apply to the Maritime Link Project. In your report you commented about how the federal loan – second federal loan guarantee had the result of decreasing domestic rates by 1.5 per cent.

How did you arrive at that 1.5 per cent figure? Or is that something that was given to you by Nalcor?

MR. BROCKWAY: That was just quoted from a – I believe it was the government press release –

MR. PEDDIGREW: I see –

MR. BROCKWAY: – announcing the FLG-2.

MR. PEDDIGREW: And, you know, 1.5 per cent from what rate? Was there any reference to what –?

MR. BROCKWAY: No.

MR. PEDDIGREW: And what about the 0.5 per cent fee that was applicable to the second federal loan guarantee? Can you explain why that fee was applicable? Or do you know why it was applicable?

MR. BROCKWAY: It wasn't articulated as to why it was applicable; it was just shown as something new that was not applicable under the FLG-1 scenario.

MR. PEDDIGREW: Did it have anything to do with the fact that it wasn't an interprovincial federal loan guarantee like the first one? Do you know that?

MR. BROCKWAY: I don't know.

MR. PEDDIGREW: I have some questions about FERC compliance, Mr. Brockway. So there's been some discussion about open access and ways to comply with FERC. And then I think in the – I guess, the Nalcor response to your report and then some of your evidence here this morning, you indicated that you don't take issue with Nalcor's position on FERC compliance following the – I guess, the legislative monopoly.

I think you indicate in – if we could call up Exhibit P-00723 and page 7.

THE COMMISSIONER: Tab 31?

MR. PEDDIGREW: Tab 31?

MR. BROCKWAY: Tab 31.

MR. PEDDIGREW: Tab 31, yes, Commissioner.

Okay, page 7, about not quite halfway down, in your response you start with: "However, and as noted above, the question of whether Nalcor complies is ultimately a factual determination for FERC. In addition, Grant Thornton notes that based on its review, Nalcor received market-based rate authority in 2014 and Nalcor's MBR authority has not been updated or challenged since its initial application."

I guess I'm just wondering: It hasn't been challenged since its initial application, is it subject to challenge? I mean for instance, if Quebec were going to – do Quebec have the ability to challenge Nalcor's FERC compliance?

MR. BROCKWAY: As it relates to the FERC, any of the FERC matters, we relied on our US legal support team to provide that clarification. I don't have any insight as to what can or can't be challenged.

MR. PEDDIGREW: In terms of – I guess your comment about: It's ultimately a factual determination, do you mean by that, that, you know, every situation is different and while, in theory, Nalcor has complied with FERC, it's possible that, based on the – a fact-specific challenge by another jurisdiction, that we may not be compliant?

MR. BROCKWAY: Yes, they will make the ultimate determination.

MR. PEDDIGREW: What about Newfoundland Power? If Newfoundland Power wasn't satisfied – if Newfoundland Power could source a cheaper source of power elsewhere for its customers, is it possible that Newfoundland Power could bring a complaint under FERC saying that, you know, although there's transmission compliance, that it's – it has access to cheaper power, but no way to bring it in to the customers, to the ratepayers?

MR. BROCKWAY: I don't know.

MR. PEDDIGREW: One of the last issues that came up during your direct examination was in relation to external sales.

MR. BROCKWAY: Mm-hmm.

MR. PEDDIGREW: As the –or deemed sales and the benefits – who would benefit from external sales by Nalcor? And you indicated, I believe, that you said it would be the taxpayers opposed to the ratepayer who would get the benefit of those external sales. Could you elaborate on that?

MR. BROCKWAY: Yeah, in any residual energy that's available to Muskrat Falls over and above what's required for – based on Newfoundland and Labrador Hydro's projection of what's needed, could be sold through this external market sale mechanism to external markets, and any sales realized on that would be a benefit to Nalcor.

MR. PEDDIGREW: With no obligation – in the agreements that you've seen no obligation to pass those savings or that revenue – savings through revenue on to the ratepayers.

MR. BROCKWAY: No.

MR. PEDDIGREW: When Mr. Budden was asking you some questions a moment ago he touched on the concept of elasticity. So as the price increases, customers may drop out for alternative sources of heat. They may wear sweaters instead of turning up their heat. They may do anything to try to reduce their power cost if the price rises to a certain level.

You know, we've seen some evidence that when – prices here are just over 11 cents a kilowatt hour now. Once they start rising to 16, 17 cents, there is evidence that customers will start dropping their use of electric heat for alternative sources.

Do you know, in the lead up to all these agreements and all the negotiations that took place between the Government of Canada, Nalcor, Government of Newfoundland – was there any discussion about the – or consideration given to the demographics of the province? The aging population and how that might impact ratepayer's ability to pay for the Muskrat Falls Project through rates.

MR. BROCKWAY: I didn't see anything like that in reviewing the agreements, no.

MR. PEDDIGREW: Would you agree that – I guess one of the key considerations for the Nova Scotia Public Utilities – or USARB in granting their conditional approval – one of their key considerations was what would be the impact on ratepayers in the Province of Nova Scotia?

MR. BROCKWAY: Yes.

MR. PEDDIGREW: And in fact, they introduced conditions upon which they would not approve the Maritime Link project unless they knew what the impact would be on ratepayers.

MR. BROCKWAY: No, I think they wanted assurances that the availability of Nalcor market-price power would be available –

MR. PEDDIGREW: Right. But –

MR. BROCKWAY: – under contractual terms.

MR. PEDDIGREW: They wanted to make sure it was tied to market-priced power.

MR. BROCKWAY: Yes, to make the – to make it work whereby it would be the best option for ratepayers – the availability of market-priced power was key to that determination.

MR. PEDDIGREW: And so, I guess in comparison to the question that was put to our Public Utilities Board in this province – did you find it interesting at all that the, you know, the focus of the NSUARB – the questions that were put to them, did focus on the impact on ratepayers in Nova Scotia, whereas that same focus seemed to be lacking in terms of what our PUB was asked to look at?

MR. BROCKWAY: Yes, but it was due to the different circumstances giving rise to the review. The UARB process was initiated because NSP, Maritime Link, had actually submitted an application to recover the costs. Whereas under the PUB scenario, it was the government who asked the PUB to review the reference question related to the least-cost option. So a little bit of a different scenario.

MR. PEDDIGREW: Exactly, yes.

So the difference in this province being that it was government that was putting the question to the PUB as opposed to a private entity in Nova Scotia?

MR. BROCKWAY: Right.

MR. PEDDIGREW: Okay.

Okay, those are all my questions – thanks.

THE COMMISSIONER: Thank you.

Um – Emera Inc.?

MS. PHILPOTT: No questions, Commissioner:

THE COMMISSIONER: Okay.

And I don't believe the Board Members are present.

Redirect.

MS. O'BRIEN: I just had one area that I just would like to clarify on redirect, and it's following out of some of the questions that Mr. Peddigrew just asked you.

MR. BROCKWAY: Okay.

MS. O'BRIEN: So I just want to get some – just maybe clarify the evidence of how changes in the demand load – so the energy consumption on the Island – could potentially affect power rates under the PPA.

MR. BROCKWAY: Mm-hmm.

MS. O'BRIEN: So I know – we know that – and I'm gonna put a suggestion out there for you and you can tell me whether or not I have it right. And please, I'm not trying to put words in your mouth. Just – I just want to make sure we have a clear understanding.

So we're talking about all the people who use electricity on the Island. And I appreciate that the consumers of electricity are in different groups – so there's domestic consumers, there's industrial consumers and so on. And I know that pricing can change among the different groups. But just generally speaking, the entire amount of the costs of Muskrat Falls have to be covered from the ratepayers on the Island portion of the province.

So if demand on the province goes up because we have more people who are using power or we have, you know, people who are using more power – so demand goes up, is it fair to say that then, generally, the price per kilowatt hour would – you know, all other things being equal – would tend to go down for each individual consumer, and then the opposite also being true that if our load decreases because we have fewer consumers, because we lose industrial customers or whatever the case might be, the general tendency would then be for the individual price per kilowatt hour, say, to go up?

MR. BROCKWAY: Yes.

MS. O'BRIEN: Is that a fair –

MR. BROCKWAY: Yes.

MS. O'BRIEN: Okay, thank you. I just wanted to clarify that. Thank you.

THE COMMISSIONER: And I just want to just check on one thing, Mr. Brockway.

Your initial report related to FERC basically said you concluded that you really didn't – couldn't answer the question. Subsequent to receiving the information, or further information, from Nalcor, that view has changed.

And I'm wondering, is it because of the fact that you got additional information from Nalcor that allowed your US lawyers to look at this, or was there some other reason for the change?

MR. BROCKWAY: No. It was the availability of the additional information.

And to be clear, we have not made a conclusion as it relates to the compliance, we've just stated that we've got no reason to dispute what Nalcor has put forward in that response.

THE COMMISSIONER: All right, good.

Thank you very much, Sir, you can step down.

I believe that's it for the evidence for the day.

MS. O'BRIEN: That is.

THE COMMISSIONER: Okay, so we'll adjourn now until Monday morning at 9:30.

CLERK: This Commission of Inquiry is completed for the day.