

Date : 10/30/2010 11:12:39 AM

From : "Thompson, Robert"

To : "Dunderdale, Kathy"

Subject : FW: Cost Risk Framework

Attachment : Cost Risk Framework and Logic.doc;image001.jpg;
Minister

FYI attached is the new cost-sharing framework that Nalcor has developed. It is consistent with the concepts discussed yesterday. According to Brian the Premier is reasonably comfortable with it.

From last night we know that Emera is comfortable with the concept, but today the specific numbers will be placed on the table. The key issue is whether Emera can bear a 15% cost overrun on the Maritime link.

I had another telephone call with NS Govt this morning on benefits. They were more specific on what they need from us. I am summarizing these points in a document so you can consider it further, later today. Brian indicated the Premier may want to discuss this topic tomorrow.

Robert

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Sent: Saturday, October 30, 2010 12:35 AM

To: Crawley, Brian; Thompson, Robert; Bown, Charles W.

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Subject: Cost Risk Framework

Ed asked me to forward the following to you...

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Cost Risk Framework and Logic
Muskrat Falls/Island Link/Maritime Link
Nalcor/Emera/NL Ratepayers/NS Ratepayers

Background

In exchange for receiving 20 percent of the output of Muskrat Falls and the opportunity to invest an additional ~\$560 million of their capital in NL, Emera would pay 20 percent of the total Project cost and provide Nalcor with transmission rights through Nova Scotia, New Brunswick and into New England.

Emera would therefore own ~29 percent of the asset base and Nalcor will own ~71 percent of the asset base of the Project. The Muskrat Falls generating plant will be 100 percent owned by Nalcor, therefore Emera's investment will be held in both the Maritime Link and the Island Link. Emera's total ownership of these transmission assets will be limited to 49 percent overall, comprised of 100 percent of the Maritime Link (which Nalcor can acquire after the initial 35 year term), and 27 percent of the Island Link (which Nalcor can re-acquire at any time, provided they reimburse Emera for the value of the investment).

In the event of cost increases over and above budgeted costs that are deemed prudent by a regulator or government, the extra costs will be included in either the NS or NL rate base through a regulatory board order or government OIC. Any cost risk that, for whatever reason, is not permitted to be included in a rate base is cost risk that has to be absorbed by either Nalcor or Emera.

If this cost risk were to be shared by each party in proportion to their ownership, Emera has indicated, as is typical, they want a series of "fundamental decisions" whereby consensus is required prior to implementing these decisions with no means to break a tie. Failure to obtain such a "consensus decision" could result in delays in Project decision making. This would mean that the Project could not proceed unless Emera is satisfied with the cost increases, and such decision making authority would provide them with a strong element of control.

Such a level of control would be disproportionate to the risks assumed by Emera as a minority investor, particularly when cost risk is generally borne by ratepayers in accordance with accepted utility regulatory practice. Therefore with a limited amount of direct cost risk, Emera would be able to exert significant control over the Project and potentially hold the Project up until they were satisfied with how such unlikely cost risk would be handled, i.e. who would bear such cost. Proceeding with this model may give Emera an opportunity to hold up the Project under the guise of determining who is responsible for assuming cost overruns.

If we agree to allow Emera consensus decision making on key decisions, then we are deferring establishment of the cost sharing formula until some time in the future, such as at the time of sanction or some other critical point in time. It is important that this issue be resolved now, as Emera will likely have more leverage in the future. While Emera would be giving up a large investment opportunity and one means to meet the NS renewable energy target, Nalcor/NL would be unable to complete the Project.

The issue of cost risk allocation should therefore be handled now, as our leverage positions are currently similar.

Risk Profile and Cost Risk Allocation

It is important to consider the risk profiles of Nalcor and Emera. The following points are relevant:

- Nalcor is managing over 70% of the total Project cost risk.
- The ratepayers of both provinces will be assuming a significant portion of any cost risk.
- It is important to the Province that Nalcor/NL have the “hammer” on a go/no go decision on Muskrat Falls, the Island Link, and the Maritime Link.
- The Project Team’s focus is on reducing cost exposure.

The following risk allocation strategy is therefore recommended:

1. Muskrat Falls Generation: 100% ownership by Nalcor
 - The NL ratepayer would assume the cost risk to the level accepted in a cost of service order.
 - Any cost risk in excess of this would be absorbed by Nalcor.
 - Nalcor/NL has full decision making authority.
2. Island Link: ~73% ownership by Nalcor, ~27% ownership by Emera
 - The NL ratepayer would assume the cost risk to the level accepted in a cost of service order. *Emera may wish to proportionally fund cost overruns and therefore earn a return based on their proportional investment. This will be a negotiating point.*
 - Any cost risk in excess of this would be absorbed by Nalcor. As a result, Emera’s proportionate share of the Island Link may decrease, i.e. their initial investment would be the same but it may be a smaller percentage of a larger amount.
 - Nalcor/NL has full decision making authority.

3. Maritime Link – 100% ownership by Emera

- The NS ratepayer would assume the cost risk to the level accepted by the NSUARB.
- Any cost risk in excess of this would be borne by:
 - i. Emera, up to an additional 15% ~ \$180 million. *This will be a key negotiating point.*
 - ii. Nalcor, the remainder. In absorbing this tier of risk, Nalcor has the sole right to determine if the Maritime Link will proceed. If Nalcor were to decide not to proceed with the Maritime Link, then Emera involvement in the Project would be terminated (no Maritime Link, no Emera participation in the Island Link, no Emera transmission rights transferred to Nalcor in NS, NB, or NE.) Nalcor would have the sole right to proceed only with Muskrat Falls and the Island Link, with no Emera involvement.
- Nalcor/NL has full decision making authority.

Governance Structure

Nalcor and Emera would set up a structure for Committee meetings and budget approvals etc, however Nalcor would have controlling vote on all decisions.

Operating Costs

The above summary relates to capital costs only. With respect to operating costs, these costs are generally approved by utility regulators. In addition, the level of control over operating expenses exerted by minority shareholders is minimal, as the facilities are producing or transmitting power and shutdowns during a delay cannot be tolerated. As a result, a protocol for cost sharing must be developed, and will likely see more participation by Emera. This will be negotiated with Emera.



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