

**Email Message**

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**From:** [Haynes, Brenda \[EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=BHAYNES\]](#)  
**To:** [Delaney, Brian \[EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=BJDELANEY\]](#)  
**Cc:** [Power, Yvonne A \[EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=YPOWER\]](#)  
**Sent:** 5/11/2011 at 1:36 PM  
**Received:** 5/11/2011 at 1:36 PM  
**Subject:** Muskrat Falls Independent Review Decision/Direction Note

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**Attachments:** Muskrat Falls Independent Review Decision Note.pdf

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<<Muskrat Falls Independent Review Decision Note.pdf>> Hi Brian,

Attached is a Decision/Direction Note regarding above-noted, and signed by both Minister Marshall and Minister Skinner.

Brenda

Brenda Haynes  
Administrative Assistant, Office of the Minister  
Department of Natural Resources  
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The message is ready to be sent with the following file or link attachments:

Muskrat Falls Independent Review Decision Note.pdf

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**Decision / Direction Note**  
**Departments of Finance and Natural Resources**

**Title:** Muskrat Falls Hydro Development Project

**Decision / Direction Required:**

- Whether to approve the selection and retention of a qualified consultant to provide an independent review and report on the detailed project analysis prepared or commissioned by Nalcor, including an assessment of the various risks associated with the Muskrat Falls Hydro Development Project (“MFP”) and their potential implications for the Province.
- Finance and Natural Resources are supportive of the proposed initiative as it represents both good business practice as well as an enhancement to the existing robust due diligence process.

**Background and Current Status:**

- The development of the MFP was announced by the Province and Nalcor on November 18, 2010 with the project to include a generating station at Muskrat Falls, a Labrador transmission line, a Labrador-Island link and a Maritime link to Nova Scotia. Emera Inc., a Nova Scotia based electrical utility, will partner with the Province and Nalcor on the transmission component and will own 29% of the Labrador-Island link and 100% of the Maritime link. Total project capital costs are estimated to be \$6.2 billion with Emera’s share to be \$1.8 billion and the balance of \$4.4 billion to be shared between the Province and Nalcor.
- Project size and related financial requirements are significant relative to the capacity of the Province. Given the combined Nalcor and Provincial commitment of \$4.4 billion, development of the MFP will add substantially to Provincial debt and could possibly impact future borrowing capacity for other uses. For this reason alone, it is prudent for the Province have a clear and independent review of project risks and their potential consequences.
- From a credit rating perspective, the best current indicator of the market’s perception of the project comes from Standard and Poor’s which recently upgraded its rating for the Province from A to A+. Commentary in the news release announcing the upgrade included the following statement - “While the decision to proceed with the Lower Churchill project augurs well for the local economy, we think it could expose Newfoundland to substantial construction risk and borrowing requirements.” In terms of future outlook, they also made the following comment – “... sustained deterioration in economic performance, operating surpluses, or liquidity, or any cost overruns or other developments at Lower Churchill that add material risk to the province or Nalcor could lead to a downgrade or an outlook revision to negative.” Both statements should be interpreted as a warning regarding the potential for the project to have a negative impact on Provincial finances.
- In terms of due diligence procedures already applied, Nalcor has completed the following:
  - Retention of PricewaterhouseCoopers (“PWC”) to provide independent analysis.
  - Internal financial analysis including sensitivity assessments.
  - Discussions with financial advisors related to capital markets issues.
  - Engagement of rating agencies with respect to potential credit rating challenges.
  - Preparation of a detailed submission seeking Federal loan guarantee support.
- In addition to the above, Nalcor is also planning to undertake additional due diligence as follows:
  - Completion of a project cost analysis by Independent Project Analysis Inc., an international organization that specializes in the review of large scale projects.

- Completion of an thorough review and commentary on the readiness of the project to proceed by Independent Project Review, a group recognized for their knowledge and experience in particular aspects of large scale project delivery.
- Retention of a consultant to complete an updated review of the Island Supply Decision Review.
- While the due diligence work completed and contemplated by Nalcor is rigorous, it has all been initiated or completed by Nalcor and has, therefore, been developed primarily from a Nalcor perspective. While the concerns of Nalcor and the Province are aligned in many ways, the Province might benefit from an expanded view given its various roles, both project-specific such as shareholder and equity contributor, and those more general in nature, such as responsible custodian of Provincial finances. This need to take a broader view would be premised on the possibility that there could be issues or risks, of an overriding Provincial nature or concern, that may not be as apparent or relevant to Nalcor's considerations and its due diligence processes.

### Scope

- The retention of an independent consultant by the Province would be intended to obtain a new MFP project specific assessment of both the fundamental assumptions underlying the project development plan and the detailed accompanying analysis completed by Nalcor or its agents and advisors. It could also include an assessment of the due diligence completed to date including a report on the rigour of this process. It would be a risk-based assessment which would focus on the various types of project risk and the potential implications for the Province.
- While preliminary in nature, the risk assessments that might be included in the consultants' mandate could include the following:
  - Design and engineering risk.
  - Construction risk.
  - Generation / technical risk.
  - Market risk.
  - Financial risk.
  - Contractual risk.

These themes will have to be expanded into a detailed statement of work which will be required as a pre-condition of negotiating the retention of a consultant.

- A key component of the project financial structure will be a Power Purchase Agreement ("PPA") between the Nalcor generating entity and NL Hydro. In addition to the risk assessments above, the consultant could also be asked to provide an independent assessment of this PPA.

### Process

- To move this initiative forward, the first decision points involve the identification of possible qualified consultants and determination of the process which will be employed for the selection of the successful one. The ideal consultant would most likely be an international management consulting firm as these organizations have the ability to combine strong general business expertise and advice, while also incorporating expert input from in-house industry specialists. The pool of such potential candidates would appear to be limited by the fact that at least two are conflicted as a result of existing relationships with Nalcor. This would rule out Deloitte, as Nalcor's auditor, and PWC, as the current consultant to Nalcor on the Lower Churchill project generally. This leaves Ernst & Young, KPMG and possibly Grant Thornton as potential candidates.
- With respect to a process for selection of a consultant, consideration should be given to the high level of confidentiality required, the limited pool of potentially qualified candidates and the compelling need





to move forward expeditiously. Given these factors, it is felt that a public selection process would unnecessarily delay consultant selection and, ultimately, project deliverables. It would, however, be the intention to have a limited call for proposals to the extent there are sufficient qualified candidates.

- In order to proceed on this basis, approval could be requested from Treasury Board under paragraph 3.6(b) of the Consultants' Guidelines for an exemption from the requirement to call limited or public proposals. This could be justified on the basis that there are an insufficient number of qualified consultants and a limited time to have the work completed such that the overall project development timetable is not disrupted. It could also be argued that the highly confidential nature of the project could justify an exemption under 3.6(c) of the Guidelines. As well, Cabinet approval of the consultant selection, pursuant to section 4.1 of the Guidelines, will be required as the total fees and expenses are expected to exceed \$100,000.
- If the above exemption is provided, an informal process could be developed to scope out the statement of work and identify and interview one or more preferred candidates with a view to negotiating an arrangement to complete the work as required. Authority to execute and approve such a process, including the selection of a consultant, could be delegated jointly to the Ministers of Finance and Natural Resources.
- In terms of timelines, the process of consultant screening and selection should be completed by early May with the consultants' work to proceed over the summer months with a target initial reporting date in September. Once the initial report is completed, it may well be desirable to have the consultant provide periodic updates as the project progresses.

**Prepared By:** Paul Myrden, Department of Finance  
**Approved By:** Terry Paddon/Charles Bown

**Ministerial Review:**  
**Date:** May 9, 2011

  
May 10, 2011  
  
May 11/11