

Date : 4/28/2011 2:43:11 PM

From : "Bown, Charles W."

To : "Scott, Paul G." , "Paddon, Terry"

Subject : FW: Draft Response to Queries (Confidential & Commercially Sensitive)

Attachment : Response to Thompson email 11.04.28.1345.pdf;Response to Bown email 11.04.28.1345.pdf;ATT262346.jpg;

From: AuburnWarren@nalcenergy.com [mailto:AuburnWarren@nalcenergy.com]

Sent: Thursday, April 28, 2011 1:53 PM

To: Thompson, Robert

Cc: Bown, Charles W.; DSturge@nalcenergy.com; EMartin@nalcenergy.com; GBennett@nalcenergy.com

Subject: Draft Response to Queries (Confidential & Commercially Sensitive)

Good afternoon all,

Please find attached draft response to your recent queries.

Any questions please advise.

Regards,

Auburn



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Why not have the project reviewed by PUB?

- A PUB review of any kind will require a delay in the project, perhaps by a year or so, to hold hearings, hire experts and prepare reports.
- Any material or significant delay will result in: termination of increased costs of contracts; loss of key project management team members; postponement of key project timelines - such as delivery of submarine cable. If this particular contract is not awarded by the end of 2011, which secures a delivery and installation date within the current project schedule, the delivery and installation of the cable could be significantly delayed.
- Any such delay would create significant regulatory risk in the assessment of financial institutions and it would prove impossible to obtain a credit rating for raising debt capital until certainty had returned.
- Without a credit rating it will be less likely that we can secure the federal loan guarantee. The federal government will argue that the PUB process creates the risk that Muskrat Falls will not even be built. Delay raises risk that the federal guarantee will not happen, thereby harming ratepayer benefits.
- A delay may materially impact or result in a loss of the Emera contract and the associated financial and export benefits that accompany it.

But how can the public be assured that Muskrat Falls is the best choice for ratepayers? Where is the independent oversight?

- Nalcor has already provided and published significant quantities of its data, assumptions and analysis to the PUB, the Lower Churchill Panel and briefings for the Opposition parties, the media and the public. No other realistic lower cost options have been advanced from any other party.
- In addition, as part of the process before final investment decisions are taken, Nalcor and the provincial government will be hiring an independent consultant to review the reasonableness and completeness of the long-term (~60 years) Island supply options considered; the reasonableness of the process followed to screen and evaluate the appropriate Island supply options; the assumptions used by Nalcor in assessing the Island supply options; and the recommended Island supply option. The report will be completed and made publicly available by July 1, 2011.
- The consultant will also be asked to complete the same assessment when the new engineering data becomes available, prior to final investment decisions being made on the project.

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Exactly what role will the PUB play? By what mechanism or directive will the costs of Muskrat Falls and the transmission project get absorbed into the rate base?

- The Project is unique given the magnitude of the capital addition as compared to Nalcor's current balance sheet and the cash flow certainty required by non-recourse lenders for debt service. These lenders will require certainty of cash flows as they form the only basis of security/collateral in a non-recourse financing. Subjecting these cash flows to regulatory uncertainty will negatively impact the amount and cost of debt that will be borne by the ratepayers since the Project is unlikely to receive an investment grade credit rating in this instance.
- Given this and the impact discussed above on the impact a delay from a PUB review of the costs, a mechanism or directive will have to be developed by the Province requiring the inclusion of MF and LIL actual costs in NLH rates.
- Nalcor and NLH will negotiate a PPA related to the supply of MF power and energy and a TSA related to the LIL transmission. Both are expected to be completed by mid-2012 and will be subject to shareholder approval.
- The Province may promote accountability to consumers by providing transparency via a formalized annual update process during the construction phase that allows the PUB and interested stakeholders visibility into Nalcor's performance with a view to demonstrating activities have been conducted in accordance with prudent and good utility practice.

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1. Will the 50MW turbine addition be included in the 2012 Capital Budget submitted to PUB? If so, what will be the scope of PUB review?

No it's not in the approved plan but the PUB is aware that it is required as they have our Generations Planning Issues Report. If this was submitted it would effectively identify to the PUB the decision for the Infeed Option has been made and thus would open it to a PUB review process.

2. If NLH were to proceed with the wind/small hydro projects (Isolated Island), would each of the individual projects be included in the respective years Capital Budget for PUB approval?

The wind would most likely be a PPA. We would proceed and seek approval of cost recovery at the next rate hearing. Assuming no exemption order is sought, the small hydro projects which involve capital expenditures would require PUB approval prior to construction and would be submitted on an individual project basis.

3. How much time is required for a PUB hearing on a capital project?

We've never done it for a generation asset in the Generation Issues Report. The required time is dependent upon the size of the project for which approval is being sought. Large scale projects could require at least 12 months. The time required would be further extended if the PUB required an integrated resource plan process to be followed.

4. How much time has Emera allocated for the UARB review of the Maritime Link?

We are unsure of their current estimates, however during the negotiations they indicated a "best case" requirement of approximately 6 months.

5. In the 2000 OC, it notes that "where approved" the design and construction of facilities would be exempted from PUB review. Do you have any insight into what "where approved" means?

The "where approved" appears to indicate that the design and construction is included in the definition of the "Labrador Hydro Project" once these activities have been sanctioned and approved.

6. The note states that the PPA's for the wind project will be justified to PUB in your upcoming rate application. How is it that NLH concluded contracts for these projects without PUB approval?

The PUB does not have the mandate to pre-approve PPAs. NLH briefed the PUB on our intentions and based on the conditions at the time, including Holyrood costs, wind was deemed to be a cost-effective fuel displacer. The PUB will address the treatment of these costs at the next GRA.

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7. The independent review will compare both generation scenarios based on a 60 year time frame. Is this period considered too long given the limited discounted value of costs/revenues past 30-40 years?

Whereas the in-service is anticipated in 2017 and the study goes to 2067 the study period is actually 50 years post-interconnection. The timeframe was selected to match the estimated useful life of the Infeed asset. The other option was to use a shorter time frame and determine a terminal value for the Infeed which would yield the same mathematical result of \$2.2 billion in ratepayer savings.

8. Can you add another column to the Undertaking table that indicates the timeline required to have these undertakings completed?

In order to proceed with the shadow rating agency process required, currently scheduled for June, 2011, Nalcor requires a commitment letter indicating that the Province is committed to all the undertakings contained in the table below.

Furthermore, for the bidders meetings with potential lenders, currently scheduled for November, 2011, the approval for formation of new Nalcor entities must be completed and a clear line of sight for completion of the remaining undertakings must be provided.

Requested Undertaking	Impact on Credit Quality	Required By
Approval for formation of new Nalcor entities	<ul style="list-style-type: none"> The contemplated structured debt will require special borrowing entities so that lender access to project cash flows is clear and unencumbered 	Oct 31, 2011
Inclusion of costs in NL rate base (including Emera's interest in LIL)	<ul style="list-style-type: none"> Revenues from the NL rate base provide the basis for debt service (all for LIL, most for MF) Lenders will have recourse only to Project revenues, and not Provincial guarantees nor Project assets 	Q1-2012
NLH sole authorized wholesale provider of electricity in NL	<ul style="list-style-type: none"> Absent appropriate undertakings, there is the potential that NLH supply (Island fleet plus MF) could be eroded potentially jeopardizing NLH's ability to meet its PPA and TSA payment obligations that are required by the MF/LIL borrowing entities to service debt. 	Q1-2012
Provincial government indemnification and change in law provisions as part of lending agreements	<ul style="list-style-type: none"> Recognizing that future NL Legislatures cannot be bound, and is a customary provision where debt financing is sensitive to the legislative environment. Provides reasonable compensation to lenders if future legislative acts threaten debt service. 	Q1-2012
Borrowing limits for new and existing Nalcor entities	<ul style="list-style-type: none"> Provides new MF and LIL entities the authority to borrow funds required for construction of assets and provides existing entities, such as NLH, additional liquidity to meet obligations under credit-sensitive agreements (if required). 	Q1-2012

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I would also like to have a better understanding of how the PPA's will be constructed, including

- i. who will be the parties
 - ii. who will "approve" the deal
 - iii. who "approves" the allocation of cost overruns
 - iv. who approves cost/price increases over the life of the projects .
-
- i. *For the PPA related to the supply of MF power and energy, the parties are expected to be a Nalcor entity and NLH. For the TSA related to the LIL transmission, NLH is expected to be a counterparty and assume the related transmission costs. The other counterparty is expected to be the LIL operating entity (a Nalcor entity).*
 - ii. *The approvals of the PPA and TSA are implicit on financial close.*
 - iii. *The approval of cost allocations is made at financial close as a condition precedent.*
 - iv. *Cost / price increases over the project life will form the basis of the escalation clauses under the PPA. A mechanism or directive will have to be developed by the Province to address recovery of MF and LIL costs in NLH rates.*

I see this as a non-arms length transaction that will require some form of transparency and oversight either by a regulator or Government. Can the PPA be made public? Is there a role can PUB play in this process?

The PPA can be made public.

Oversight by the Province is implicit as it is the shareholder of Nalcor. The Province may promote accountability to consumers by providing transparency via a formalized annual update process during the construction phase that allows the PUB and interested stakeholders visibility into Nalcor's performance with a view to demonstrating activities have been conducted in accordance with prudent and good utility practice.