

Attach to: NR2011

## CABINET SECRETARIAT ANALYSIS

<b>Title</b>	<u>Commitment Letter to Assist Financing of Phase One of the Lower Churchill Project</u>
<b>Summary of Proposal</b>	The Submission seeks approval for the Premier to sign a letter outlining Government's intentions in support of Phase One of the Lower Churchill Project.
<b>Secretariat Comment</b>	<ol style="list-style-type: none"><li>1. On November 18, 2010, Nalcor Energy (Nalcor) and Emera Inc. signed a term sheet defining how they would collaborate on the development of the Lower Churchill Project (Project). Also, on August 19, 2011, the Province and the federal government signed a Memorandum of Agreement (MOA) on a federal loan guarantee for the Project.</li><li>2. A Commitment Letter (Letter) has been identified as a key document required in raising financial backing for the Project. The finance-raising process that Nalcor is undertaking will provide lenders with confidence in the Project's business case and its ability to cover all debt payments and other costs over the life of the loans.</li><li>3. As per the term sheet signed with Emera, Inc., Nalcor's share of project construction costs is \$4.4B. Nalcor intends to raise more than half of its share in the capital markets through project finance debt. According to the submission, this is a commonly used structure in the energy and infrastructure sectors and, in case of default, will protect Government's other assets not related to the Project.</li><li>4. The Letter outlines what Government intends to do in support of the Project, including: approving the creation of the necessary Nalcor subsidiaries, with sufficient borrowing powers to support the Project's implementation; provide the Government investment in the Project, currently estimated at \$1.5B to \$2B; and ensure that Newfoundland and Labrador Hydro's (Hydro) regulated rates provide enough annual revenue to recover the Project's costs.</li><li>5. Implementation of the commitments outlined in the Letter is a prerequisite to finalize the federal loan guarantee and to commence debt funding. The implementation of some of these commitments may require legislative changes and this will be determined at a later date. If it is necessary to amend legislation, Government would have to introduce any amendments by the Spring 2012 sitting of the House of Assembly.</li><li>6. While the Letter does not provide lenders with any legal recourse if Government does not carry out its intentions, failure to provide the letter could compromise the Project's schedule and could negatively affect Nalcor's ability to obtain credit ratings, advance the federal loan guarantee and borrow in the future.</li><li>7. The Project and the electricity industry structure proposed in the Letter will result in significant revenues for Nalcor. Net cash flow to Nalcor is forecasted to be approximately \$100M in the first full year of operation and possibly \$900M annually by the end of the 50-year power purchase agreement with Hydro. However, Cabinet Secretariat notes that this includes revenues from domestic sale of energy, as well as</li></ol>

sales of power in excess of Hydro's requirements and the commitment to Emera Inc.

8. The Department of Finance supports the recommendation, but notes that consideration should be given to whether the profits generated by the Power Purchase Agreement as outlined in the MOP should be returned to the taxpayer or the ratepayer. Currently, revenue generated from the sales of power in excess of Hydro's requirements and the commitment to Emera Inc. will benefit Government and Nalcor, but not automatically the ratepayers of the Province. Government will have to make a future policy decision on whether these revenues should automatically benefit ratepayers.
9. The Departments of Labrador and Aboriginal Affairs and Justice and the Intergovernmental Affairs Secretariat support the recommendation and have no concerns with the submission.
10. The Communications Branch has reviewed the submission and agrees with the activities as outlined. The Branch notes that there are several points raised in the submission that will have significant communications impacts. Key messages need to be developed related to Hydro's regulated rates covering the Province's share of the costs of the Project; the possible negative impacts to the Province's credit rating and ability to borrow in future years; and interest and debt servicing costs will not be paid by taxpayers.
11. The Communications Branch also notes that credit rating agencies and lenders should be added to the external audience list. As well, the communications plan does not recommend an announcement. However, given that legislative changes will be required, this will come to light publicly during the Spring 2012 session of the House of Assembly. The Government may be criticized at that time for waiting so long to disclose the commitment letter and the Minister should be fully prepared to address such criticism. Thus, consideration should be given to making this public sooner.

<b>Budget Division Consultation</b>	Budget Division of the Department of Finance has reviewed the submission. It states that approval of the recommendation does not place any financial obligation on Government and, therefore, there are no financial implications at this time.
<b>Secretariat Recommendation</b>	Cabinet Secretariat recommends approval of the submission, subject to the Department of Natural Resources consulting with the Communications Branch and the Premier's Office on a revised communications plan.

VH/DH  
September 2, 2011