

From: Derek Hennessey, Director, R.W. Block Consulting
To: Grant Thornton, Muskrat Falls Project Team
Date: November 14, 2018
Subject: Muskrat Falls – Clarifications to RWBC CH0007 Memorandum

The Grant Thornton Muskrat Falls Project Team ("Grant Thornton") requested that R.W. Block Consulting, LLC ("RWBC") to clarify the following areas from its CH0007 memorandum dated November 1, 2018 (the paragraph numbering is from the original memorandum):

1. **Contract Pricing**

The contract provisions contained the following components, which as designed, should have limited Nalcor's cost exposure (Article 12 – Compensation and Terms of Payment, Exhibit 2 – Compensation and Exhibit 3 – Coordination Procedures of the CH0007 contract):

- a. Reimbursable Labour Maximum cost ("LMAX") – this concept established at maximum amount of reimbursable labour that Nalcor would be responsible for, while also providing an opportunity for cost savings if the labour productivity on the project was better than had been estimated by Astaldi.
- b. Labour Profit – The labour profit due to Astaldi for the reimbursable labour is calculated on the Target Cost of Labour, not the actual cost of labour, which translates to Nalcor not paying profit to Astaldi on any of the labour costs more than the target value.
- c. Lump Sum items – certain items had the non-labour components negotiated as lump sum amounts which shifted the cost risk to Astaldi.
- d. Unit Price items – certain items had the non-labour components negotiated as unit prices which shifts the cost risk (on a unit basis) to Astaldi, and Nalcor's risk is limited to increases in the number of units of work performed.

Clarification:

RWBC was asked to clarify its statements in paragraph 1.b.

The target cost of labour in the CH0007 contract was \$507,598,340.87, and the LMAX was \$571,898,340.87. The contractual labour profit of 7% was only to be applied to the target cost of labour, and was calculated as \$507,598,340.87 multiplied by 7%, which equals \$35,531,883.86. Therefore, under the original contract Nalcor was not paying labour profit to Astaldi on the maximum labour cost sharing amount of \$64,300,000 (which is the difference between the LMAX and the target cost of labour).

6. **Invoicing of Labour Costs**

The CH0007 contract did not link payment of reimbursable labour to the percentage of completion of the concrete work, which was how the labour profit was paid. Replicating the labour profit approach, the contract could have capped the cumulative labour payments to the percentage of completion of the concrete work times the LMAX value. An approach such as this would have required Astaldi to

fund its proportionate share of any LMAX over-run as the costs were being incurred. While in our experience, we have not observed instances where payment on cost reimbursable contracts are linked to work put in-place, we deemed it appropriate to mention **give** the contractual approach to paying the labour profit, which is an indication there were concerns about the costs being incurred faster than the work was put in place.

Clarification:

RWBC was asked to clarify its statements in paragraph 6.

The approach Nalcor used for reimbursing the labour costs under the contract (i.e. paying them as costs were incurred and not linking the progress payments to work put in place in the periods of time covered by the progress payments) is similar to other target price utility industry contracts we have reviewed.

Additionally, when discussing the clarifications discussed above, we observed the following typographical errors in the CH0007 Memorandum dated November 1, 2018 (edits are the bold text):

1. Paragraph 3.d replace:

"Irrevocable Letter of Credit No. 3 – CAD **\$10,000,00**)"

with:

"Irrevocable Letter of Credit No. 3 – CAD **\$10,000,000**)"

2. Paragraph 6. Replace:

"While in our experience, we have not observed instances where payment on cost reimbursable contracts are linked to work put in-place, we deemed it appropriate to mention **give** the contractual approach to paying the labour profit, which is an indication there were concerns about the costs being incurred faster than the work was put in place."

with:

"While in our experience, we have not observed instances where payment on cost reimbursable contracts are linked to work put in-place, we deemed it appropriate to mention **given** the contractual approach to paying the labour profit, which is an indication there were concerns about the costs being incurred faster than the work was put in place."