

**Information Note  
Department of Natural Resources**

**Title:** Oversight of the Muskrat Falls Hydroelectric Project

**Issue:** To provide background information on oversight mechanisms for the Muskrat Falls Hydroelectric Project.

**Background and Current Status:**

- The Muskrat Falls Project was sanctioned in December 2012 with direct capital costs of \$6.2 billion plus financing costs (\$1.2 billion) to be capitalized during the construction period up to in-service of the generation and transmission projects.
- On June 26, 2014 Nalcor updated the capital cost forecast for the project to \$6.99B. Nalcor indicated that the increase in cost was attributed to market conditions (\$235M), construction productivity and performance enhancement measures (\$347M) and design enhancements to improve quality and system reliability (\$206M). During the announcement, Nalcor indicated that engineering is now more than 98% complete and that contracts have been awarded or are through advanced evaluation for more than 90% of project costs.
- On December 10, 2013, the Government of Canada issued the \$5 billion Federal Loan Guarantee (FLG) for the Project. This guarantee provides a direct, absolute, unconditional and irrevocable, present and continuing, obligation of Canada. To provide oversight of the Project and meet Conditions Precedent for the Guarantee, the Government of Canada, the Government of NL, Nalcor Energy and applicable Nalcor Project subsidiaries have established Project oversight mechanisms.

Independent Engineer

- A FLG requirement was to retain an Independent Engineer (IE) to permit the lenders and the guarantor (Government of Canada) to complete diligence and to ensure compliance with the terms of FLG and all financing documents required for financial close. Nalcor retained MWH Canada, Inc. (MWH) in August 2012 as the IE to represent the lenders and the guarantor, the cost of which is borne by the borrowers (i.e. Nalcor's subsidiaries). The IE will be in place for the duration of the construction phase and into the operations phase.
- Phase 1 of the IE agreement enabled the IE to visit the Muskrat Falls site, identify required documentation and commence an initial report prior to engagement of lenders. Phase 1 scope of work included a review of: project design and projected performance; construction plan and schedule; capital budget; commercial operation and maintenance services; project agreements (such as power purchase agreements); permits and licenses; basis of project pro forma financial model; preparation of a report; and support for financial close.
- MWH submitted its interim report on November 29, 2013. This report was used to support financing of the Project through the FLG, which Canada finalized following receipt of the report. The final version was submitted on December 30, 2013. The report expressed satisfaction with the project team, schedule, capital budgeting, post-construction reliability and performance, and other significant aspects of the project. However, the IE also highlighted areas where further work is required and where project practices diverge from

standard megaproject construction practice. Divergent areas included contingency funding, renewal and replacement budgeting, operational and maintenance costs, and allowances for cost estimates. Additional work areas included investigations and analyses to further enhance the design parameters of the North Spur.

- In order to be provided the necessary funds for the Project, the Nalcor subsidiaries, as borrowers, are required to submit detailed information to MWH and the Collateral Agent (Toronto-Dominion Bank). These include construction reports and budget information. On a monthly cycle, the Nalcor subsidiaries submit to MWH and the Collateral Agent monthly drawdown requests along with supporting documentation comparing the actual costs and progress against the project budget and schedule. Through Nalcor, each of the major contractors for the Project also submits monthly updates to MWH with respect to the progress of their work during that month. After review and receipt of any required additional information, MWH recommends release of the funds by the Collateral Agent.
- On July 21, 2014, Nalcor and MWH established a formal arrangement to provide NL with access to all materials and activities undertaken by the Independent Engineer. This includes providing NL with a copy of any certificates and reports that are required to be submitted to Canada; participating in any meetings, site visits and conference calls between the MWH, Canada, Nalcor and its subsidiaries; and the ability to ask questions and request information from MWH.
- As part of its ongoing due diligence related to the project, during the third week in July 2014, MWH participated in various project site visits. MWH is expected to make future site visits in the fall 2014 and will release its next report late in the calendar year.

#### Nalcor Oversight

- Nalcor has significant oversight in place for the Muskrat Falls project, including an internal audit committee that was established to determine whether the organization's network of risk management, control, and governance processes is adequate and functioning as intended. This committee reports to the Board of Directors.
- Nalcor has also retained an external independent auditor (currently Deloitte & Touche LLP) to review project related costs and to prepare a report consisting of consolidated financial statements (e.g. balance sheet, cash flows, statement of income and retained earnings) which is incorporated into its Annual Report.
- Within Nalcor there are additional levels of financial oversight from groups that have different accountabilities, including Lower Churchill Project (LCP) Finance and Administration and Nalcor Corporate Finance. Nalcor's Board of Directors also receive regular updates on actual versus forecasted expenditures. As required by legislation, the Boards of Nalcor's LCP subsidiaries must include at least two independent directors.
- Similar to publicly traded companies, Nalcor issues Annual Reports and holds an Annual General Meeting (AGM) to report on progress. The last AGM was held June 4, 2014. Nalcor will also be issuing quarterly consolidated financial statements later this year and prepares an Annual Transparency and Accountability Report for filing in the House of Assembly.



- Nalcor issues public monthly project benefits reports which include details on employment, construction and procurement activities; construction costs; safety and environmental activities; stakeholder and community consultation; and engagement initiatives.

#### NL Government Oversight

- To strengthen and formalize existing oversight of the Muskrat Falls Project, the NL Government established the Oversight Committee in March 2014 to focus on project costs, scheduling, and project performance.
- The committee consists of senior officials from NR, FIN, JUS, Executive Council, and is chaired by the Clerk of the Executive Council (Clerk). During its early deliberations, Ernst and Young was retained to conduct an assessment of the committee's terms of reference and to provide advice on what is required to effectively monitor the project's cost, schedule and risks. An Executive Director, reporting to the Clerk, facilitates the committee's work. The work of the committee is also supported by a working group comprised on internal and external resources, as required.
- The committee will review information provided by Nalcor's external auditors, the IE and Nalcor; provide updates and discuss issues with relevant departments; meet regularly with Nalcor officials; report to Cabinet, which will provide direction to Ministers as required; and provide quarterly updates to the public.
- On July 29, 2014, the Premier and the Minister of Natural Resources jointly issued a Shareholder's Letter to Nalcor Energy and its subsidiaries advising Nalcor of its information requirements and prescribing the details and timing for the information required by the Committee.
- The committee's first report was released on July 31, 2014 and presents the work since its appointment. It includes information on its governance structure and processes, existing project oversight measures, project's budget and schedule, and next steps. Ernst and Young's recommendation report was also released with the committee's first report. The committee's next report is due in fall 2014 and will provide an assessment of the management of project cost, schedule and risk.

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Approved by:

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