



MEMO

TO: BOARD OF DIRECTORS

FROM: JAMES MEANEY
VICE PRESIDENT FINANCE, POWER SUPPLY

SUBJECT: TRANSITION TO OPERATIONS (“TTO”) AUTHORIZATION FOR EXPENDITURE REVISION

DATE: FEBRUARY 28, 2019

Background

- The Boards of Directors approved the original TTO Authorizations for Expenditure (“AFE”) for \$63M in June 2016, covering expenditures for the 2016-2019 period:
 - Labrador-Island Link/Labrador Transmission Assets (“LIL/LTA”) - \$50M
 - Muskrat Falls (“MF”) - \$13M
- TTO costs are included in the *Financing & Other Costs* category from the June 2017 Project in-service cost estimate of \$12.7B, which includes \$10.1B in Facilities Capital Costs and \$2.6B in Financing & Other Costs.
- In addition to TTO costs, included in the *Other Costs* category noted above was an estimate allowance for pre MF full commissioning (“Pre-Comm”) operating costs for the LCP assets of \$196M. This included an estimate of \$142M for LIL/LTA interim operating costs - the Interim Transmission Fund Agreements (“TFA”) between LIL/LTA and NL Hydro that provide for recovery of these costs, following LIL mono-pole commissioning, were subsequently executed in August 2018. The remaining \$54M related to MF Pre-Comm Costs.
- Further advancement of TTO deliverables and delays in the achievement of LIL mono-pole commissioning (compared to the 2018 assumption that was included in the June 2016 TTO AFE estimate) have resulted in the need for a revision to the TTO AFE totaling \$61M, which includes:
 - LIL/LTA - \$27M in operations “start up” capital costs for 2019/2020 and additional Pre-Comm costs to be incurred prior to LIL mono-pole commissioning in 2019; and
 - MF - \$34M primarily associated with commissioning support and Pre-Comm costs for the MF plant between first and full power in 2019/2020, as well as operations “start up” capital costs forecasted to be incurred in 2020.

- As noted above, an estimate allowance for MF Pre-Comm costs was included in the \$12.7B estimate, but to date it has not been formalized under a Board approved AFE.
- In the November 2018 Board meetings, Management indicated it would re-engage with the LCP Boards in the February 2019 meeting to discuss the required TTO AFE revision, with the objective to trying to absorb any incremental costs within the existing overall Project budget/contingency. At that time, the undrawn contingency within the \$10.1B Facilities Capital Cost AFE's totaled \$178M.

Recommendation

- Given (i) the remaining work for MF, (ii) recent drawdowns from the LIL/LTA contingency associated with the GE Grid amendment and replacement contractor readiness initiative, (iii) potential commercial disputes associated with other contractors, and (iv) the potential cost impact of identified strategic risks which were not included in the June 2017 AFE, Management is recommending the additional \$61M TTO AFE requirement not be absorbed from the undrawn contingency associated with the Facilities Capital Cost AFE's, as was originally being considered in November 2018.
- With respect to LIL/LTA, it should be noted the \$27M requirement assumes LIL mono-pole commissioning under the Interim TFA's is agreed to occur by the end of March 2019 by NL Hydro and LIL/LTA - a delay beyond this point increases the requirement by approximately \$3-4M/month.
- Additionally, it should be noted that to date \$30M of the MF Facilities Capital Cost AFE contingency has been drawn for commitments that were not contemplated when the June 2017 AFE was approved, including \$15M for Government directives and \$14M for IBA costs prior to MF full power previously forecasted to be allocated to Gull Island.
- While this recommendation would require a \$61M increase to the TTO AFE's, as outlined in the chart below, it does not result in an increase to the \$10.1B Facilities Capital Cost estimate or the overall Project Cost estimate of \$12.7B released in June 2017. It would, however, require an additional \$40M in pre-funded equity from Nalcor/NL for the December 2019 Cost Overrun Escrow Account ("COREA") payment as compared to December 2017 and 2018 payments of \$321M (as the calculation of these amounts already included an estimate allowance for MF Pre-Comm Costs in 2020 of \$21M).

Project In-Service Cost / Approved AFE Summary

(\$ Millions)		Jun 2017 Update	Feb 2019 Proposed
Facilities Capital Costs			
MF	(1)	5,500	5,500
LIL/LTA	(1)	<u>4,617</u>	<u>4,617</u>
		10,117	10,117
Financing Costs			
IDC	(1)	1,365	1,365
Other Financing Costs	(1)	212	212
AFUDC	(2)	439	425
Reserves	(2)	<u>343</u>	<u>348</u>
		2,359	2,350
Other Costs			
TTO	(1)	63	124
Pre-Comm Costs		<u>196</u>	- (3)
		259	124
Total Project Cost at In-Service		<u>12,736</u>	<u>12,592</u> (4)

(1) Expenditure authorization provided under Board Approved AFE's.

(2) Expenditure authorization from the Boards not required as either non-cash cost (AFUDC) or pre-funded with equity and returned at a later date, post MF full commissioning (Reserves). These figures represent estimate allowances at a point in time.

(3) Updated to reflect that (i) LIL/LTA Pre-Comm Costs will be recovered from NLH through the Interim TFA's prior to MF full commissioning and then NLH will recover these costs (subject to PUB approval) from ratepayers through a regulatory deferral account that is separate from the PPA/TFA with the LCP entities; and (ii) the formalization of expenditure authorization for MF Pre-Comm Costs under the revised TTO AFE. The current estimate for LIL/LTA Pre-Comm Costs between Apr 2019 and Aug 2020 is approximately \$65M.

(4) Management does not intend to update the \$12.7B public cost estimate at this point in time.