

MUSKRAT FALLS OVERSIGHT

PRESENTATION TO PREMIER

MAY 27, 2014

Background

- The Muskrat Falls Project was sanctioned in December 2012 with direct capital costs of \$6.2 B plus financing costs of \$1.2 B.
- Costs will be capitalized during the construction period up to in-service of the generation and transmission projects.
- On December 10, 2013, the Government of Canada issued the \$5 billion Federal Loan Guarantee (FLG) for the Project.
- The FLG 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 Newfoundland and Labrador, Nalcor Energy and applicable Nalcor Project subsidiaries have established Project oversight mechanisms.

Project Oversight - NRCan

- Independent Engineer
- Internal and external legal counsel
- Internal and external financial advisors
- Collateral Agent (Toronto-Dominion Bank)

Project Oversight – Independent Engineer

- Nalcor retained (August 2012), at its cost, MWH Canada as an independent engineer to complete due diligence and ensure compliance with terms of the FLG and all financing documents required by the Government of Canada for financial close
- Although the contract is between Nalcor (with Nalcor's project subsidiaries as of financial close) and MWH, the client is the Government of Canada and the lenders (TD Bank as Collateral Agent)
- MWH's scope of work covers two phases of the project:
 - Phase 1 – Pre-financial Close
 - Phase 2 – Construction/Operations

Project Oversight – Independent Engineer

- Phase 1 (Pre-financial Close) - scope of work:
 - Review project design and projected performance
 - Review construction plan and schedule
 - Review capital budget
 - Review commercial operation and maintenance services
 - Review project agreements (such as power purchase agreements)
 - Review permits and licenses
 - Review basis of project pro forma financial model
 - Prepare Independent Engineer's report
 - Support financial close
- Phase 2 (Construction/Operations) - scope of work:
 - Monitor engineering and procurement relative to milestone schedules
 - Conduct site visits/review quality control documents to assess compliance with milestone schedules
 - Review change orders to construction contracts
 - Prepare periodic and final report/other documentation as required
 - Verify project completion

Project Oversight – Independent Engineer

- Phase 1 Progress Report:
 - MWH submitted its interim report on November 29, 2013. The report was used to support FLG financing of the Project, which Canada finalized following receipt of the report. The final version was submitted on December 30, 2013.
 - MWH's report expressed satisfaction with the project team, schedule, capital budgeting, post-construction reliability and performance, and other significant aspects of the project.
 - Areas where project practices diverge from standard megaproject construction practice 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.

Project Oversight - Nalcor

- External Auditors (currently Deloitte & Touche LLP)
 - Reviews project related costs and prepares consolidated financial statements for annual report
- Board of Directors
 - Receives regular updates on actual versus forecasted expenditures
- Internal Audit committee - reports to Board of Directors
 - Determines whether the organization's network of risk management, control, and governance processes is adequate and functioning as intended.
- Lower Churchill Project (LCP) Finance and Administration (internal)
- Nalcor Corporate Finance
- Annual Reports/Annual General Meeting (June 4, 2014)
- Annual Transparency and Accountability Report
- Quarterly consolidated financial statements (due late 2014)
- Public monthly benefits reports
 - Details on employment, construction and procurement activities; construction costs; safety and environmental activities; stakeholder and community consultation; and engagement initiatives
- CEO updates to Cabinet

Project Oversight - Government

- Pre-Sanction Reports
 - Navigant Consulting: Review of Nalcor's DG2 decision (Sept. 2011)
 - MHI: Report to PUB (post DG2/pre-DG3) on Two Generation Expansion Alternatives for the Island Interconnected Electrical System (Jan. 2012)
 - MHI: Review of DG3 MF and LIL and Isolated Island Options (Oct. 2012)
- Pre-Financial Close Financing NR/Finance
 - Project evaluation and financing
- NR/Finance meet regularly with Nalcor
- Updates to Cabinet
- New Departmental Oversight Committee
 - Focused on project costs, scheduling, and project performance

Oversight Committee Members

- Clerk of the Executive Council (Chair)
- Deputy Minister of Finance
- Assistant Deputy of Finance (Fiscal and Tax Policy)
- Director of Debt Management
- Deputy Minister of Natural Resources
- Associate Deputy Minister of Natural Resources
- Assistant Deputy Minister of Natural Resources (Energy Policy)
- Deputy Minister of Justice
- Assistant Secretary to Cabinet for Economic Policy

An Executive Director, reporting to the Clerk of the Executive Council will facilitate the committee's work.

Oversight Committee

Objectives

- Formalize project oversight between GNL and Nalcor
- Ensure adequate reports/documentation to support Nalcor's requests for equity contributions
- Assure general public, Opposition parties and other groups that GNL is providing appropriate oversight to Nalcor/MF project
- Provide oversight consistent with other global projects of similar scale

Role

- Reviews information from Nalcor, Nalcor's external auditors and the Independent Engineer
- Reviews and monitors equity requirements
- Provides updates and discusses issues with relevant departments
- Reports to Cabinet (with Cabinet providing direction to Ministers as required)
- Meets quarterly with Nalcor officials
- Provides quarterly reports to the public starting July 2014

Information Required by Committee

- Current estimates of total project costs and comparison to budget/DG3 with explanations for all material deviations
- Project costs incurred to date including a breakdown by major expense category
- Value of contracts awarded – current and cumulative
- Status of project financing including details on drawdown of funds
- Details of tendered but not yet awarded contracts along with expectations as to award
- Update on project scheduling including information on variations from plan
- Status of potential contingencies or cost overruns that have not yet been realized/quantified
- Other qualitative commentary on project process, significant developments and details of potential issues that may become public over the short-medium term, incl. related communication strategies
- Copies of all audit reports
- Any other information as the Committee might from time to time require
- Any other information that Nalcor Management thinks the Committee should be made aware of

*Ernest & Young LLP has been retained to provide advice on the robustness of the information that Nalcor will be required to provide and to identify any additional information requirements.

Information Required by Committee

- Monthly Reports*
 - Actual incurred costs by major expense category for current month and project to date versus budget
 - Final Forecast Cost to Complete versus Project Budget
 - Commentary, variance explanations for material differences and recovery strategies relating to above
 - Project schedule and progress against key milestones
 - Updates on the award of major construction contracts
 - Details on monthly debt and equity advances
 - Construction Reports and Funding Requests (incl. IE Confirmation Certificate)

* Monthly Construction Reports and Funding Requests issued to Canada, Collateral Agent and IE as per the Project Finance Agreements. IE provides certification prior to advance of debt funds.

Information Required by Committee

- Quarterly/Annual Reports
 - Highlights from the Construction Reports, Funding Requests and any IE progress reports issued in the previous quarter
 - Forecasted capital expenditures broken down by month for the next 12-month period
 - Details of any new Authority for Expenditures approved during the previous quarter
 - Details of internal audit reports pertaining to medium to high risk areas identified in the previous quarter
 - Nalcor's external auditors (currently Deloitte) to provide separate annual report
 - Updates on any other items specifically requested by the Committee

Committee Review and Assessments

- Examine current estimates of total project costs and comparison to budget and obtain explanations for material deviations
- Assurance that MF project costs are within the scope of the latest approved Authority for Expenditure
- Ensure equity advances are in accordance with the Shareholder's Letter
- Maintain understanding of major contracts tendered and awarded – current and cumulative
- Monitor status of project financing including details on drawdowns of funds
- Monitor progress against project schedule
- Monitor potential for contingent equity
- Examine details of medium to high risk issues identified in internal audit reports
- Examine copies of all Independent Engineer reports and related certifications

Protocol Initiation and Public Information

- Protocol Initiation
 - Shareholder's letter
- Public Information
 - Quarterly reports; content to be determined in consultation with:
 - Ministers of FIN, NR and JUS
 - Clerk of the Executive Council
 - Cabinet
 - Nalcor

Additional Project Oversight - Government

- Auditor General
 - Currently has the mandate to review the operations of Nalcor at any time
 - Any findings and report(s) would have to exclude commercially sensitive information

Key Oversight for the Next 4 Years

- Independent Engineer Report
- Nalcor
 - Internal Audit Committee
 - External Auditor (Deloitte)
 - Special Report (Deloitte)
 - Quarterly Public Report
- Internal Oversight Committee
 - Reports to Cabinet
 - Chaired by Clerk of Executive Council
 - Public Report
- Cabinet Direction to Appropriate Ministers