

Date : 2/26/2016 1:40:58 PM
From : "Parsons, Kelvin"
To : "Ball, Dwight"
Cc : "Murphy, Tim"
Subject : Fw: EY Meeting Notes
Attachment : Feb 26 Cabinet Meeting.docx;
Premier,

Here are the notes taken from our EY meeting yesterday. I believe they accurately reflect what EY said. To avoid missing anything, avoid misinterpretation, insure Cabinet completely understands the EY position I strongly recommend you begin the meeting today by having Tim or I READ these notes then fill Cabinet in on your conversation with Ed Martin then go from there. This is too important and sensitive an issue to loose anything in translation.

KP

Sent from my BlackBerry 10 smartphone on the Bell network.

From: Murphy, Tim <TimMurphy@gov.nl.ca>
Sent: Friday, February 26, 2016 1:23 PM
To: Parsons, Kelvin
Subject: EY Meeting Notes

For review.

Speaking Notes from Feb 25th Meeting with EY

- Following yesterday's Cabinet Meeting, we had a 3+ hour meeting with EY to get their thoughts on the Astaldi issue, and on the Muskrat Falls project more generally. The Premier, Min Coady, KP, TM and JM attended.
- The lead EY rep was David Leather, who in a past life was CFO for the London Olympics which had a budget of 9 billion Euros. That project came in on time and on budget.
- EY's key conclusion from their work to date is the current cost estimate of \$7.65 Billion is not reasonable, particularly as it relates to the Astaldi situation.
- EY's estimate is the problem with Astaldi is in the range of \$600-\$800 million. Nalcor has been referring to a \$650 million issue.
- One of EY's key findings is when the MF project was initially set up, there was no Management Reserve put in place. This Reserve is normal for major capital projects and is a finite pot of funds available for unforeseen technical and management risks that arise above the project level.
- The Risk Register document for the MF project refers to the plan to establish such a reserve – but there is no record of how the decision was taken not to establish a reserve.
- Not only was there no Management Reserve included in the budget, Nalcor's view is the amount of money available for the MF project is unlimited given that Nalcor believes Government will provide whatever funding is required. That has been the practice and experience until now.
- EY's view is there should have been a 5-25% set aside for a Management Reserve, based on the initial \$6.2 Billion budget.
- Another major concern EY has identified is the project doesn't have a risk-adjusted cost and schedule forecast, and no documented assessment of

cost and schedule performance. This is a basic requirement of Board reporting and normal practice for major capital projects.

- From EY's analysis to date, there has been no challenge function to the MF leadership team – not from a CFO, not from the Nalcor Finance group, even though there is a fiduciary responsibility to do so.
- EY told us there is no sense of responsibility at Nalcor for MF cost escalation. The focus is on completing the project regardless of the cost, with government being there to provide unlimited funds. Nalcor's view is the cost increases are "unfortunate" but the long-term benefits surpass the cost increases.
- EY described a culture of "we know best" on the MF project at the senior levels (CEO and direct reports). EY added that the mid-management level and down in Nalcor are extremely competent and committed to the project.
- EY also looked at the issue of the change in strategy not to have SNC Lavalin as the EPCM contractor. This change in strategy to not have a world-class EPCM contractor manage but rather turn project delivery over to an Integrated Project Management Team, was not fully thought out, in EY's opinion.
- EY asked Nalcor for the documentation on why this major strategic decision was taken. No documentation was made available, nor was there any evidence of a report to the Board on such a significant strategy change. This would have been expected to be normal practice.
- Before getting into the Astaldi details we asked for EY's view on other project risks beyond Astaldi. The key risk is delivery risk regarding the transmission lines. EY noted there is a definite schedule risk. Valard and Nalcor are talking and Nalcor is confident they can fight a Valard claim. EY doesn't have an opinion as they don't have anything to assess and there is no claim at present.

- Astaldi aside, the remaining components of the project are generally within what you would expect though the remaining contingency is low. EY doesn't know how much contingency is left though with a starting 5% contingency and the \$600-\$800 million problem with Astaldi, a less than prudent amount of contingency remains.
- Specific to the Astaldi issue: EY is real surprised that discussions with Astaldi to resolve the \$600-\$800 million issue are still at a high level, even though the problem has been evident for 18 months.
- EY seriously questioned the Nalcor approach of hiring a consultant to convince itself that Astaldi was in financial trouble. They described this as a type of covert, private eye approach. So far, Nalcor has provided a report on Nalcor letterhead but refused to identify for EY who did this work on their behalf (to allow EY to follow-up and validate the findings).
- Nalcor told EY that Astaldi keeps saying to Nalcor "why are you so worried about our financial situation; we want to focus on our MF contract problem".
- EY indicated that the agreement with Astaldi stipulates that Nalcor pays Astaldi for every hour worked, and payments are not tied to achieving concrete poured milestones. Nalcor officials described this specific contract provision as "one regret they have". So, Astaldi has been paid for every hour worked, even for building the failed dome and taking it down.
- Given that EY was kept away from the Astaldi file until very recently, they have only started to think about our options going forward. When EY asked Nalcor to walk them through the options Nalcor considered, EY got the "we know best" response, essentially dismissing anything beyond more cash to Astaldi now.
- In terms of timing, Astaldi's 2015 financial statements will be released on March 8 or 9. EY doesn't know what Astaldi is telling KPMG, their auditors. Astaldi will obviously try to prevent booking any loss on MF in their statements.

- Even if the loss on the MF contract is made public on March 8-9, EY's view is there still is ample time to get an agreement with Astaldi – the right agreement, not a rushed agreement.
- When we asked why Nalcor would be pressing for permission from the government to get a mandate to settle with Astaldi prior to March 8-9, EY indicated these dates were likely being used as a pressure tactic by Nalcor on government (rather than by Astaldi on Nalcor).
- EY noted that what's missing from Nalcor for government to make a decision on whether to provide Nalcor with a negotiating mandate is a Negotiating Strategy. That strategy, which Nalcor should have prepared, would outline objectives of an agreement, parameters around amount of funding, how and when funding could be made available, who would be involved in the negotiations, the terms and conditions we would attach to any agreement, starting and acceptable closing positions, where the other side would likely be coming from, etc.
- EY recommended that the Premier call Ed Martin asking that he provide government with Nalcor's Negotiating Strategy.
- EY recommended that Government's negotiating objective should be to cover as little as possible of the Astaldi cost increase, while ensuring Astaldi maintains its good productivity for the next nine months. After March 8-9, we will have a better sense of how big a financial problem Astaldi has, and we can then enter into negotiations in a measured way. They noted the negotiation with Astaldi should be framed as a commercial negotiation, and we need strong commercial lawyers on our side. EY has little faith in Nalcor's ability alone to negotiate the type of agreement that is required (because money isn't an issue for Nalcor).
- In EY's view, the real window to finalize an agreement with Astaldi is by late April, or into May, before the peak summer season.

Premier's Follow-up Call with Ed Martin – Premier to provide debrief