From: Xeno Martis <xmartis@fasken.com>
Sent: Monday, November 4, 2013 6:32 PM
To: 'AuburnWarren@nalcorenergy.com'; 'CraigHippern@nalcorenergy.com'; 'JamesMeaney@nalcorenergy.com'; 'KentLegge@nalcorenergy.com'; 'RobHull@nalcorenergy.com'; 'ScottPelley@nalcorenergy.com'; 'dsturge@nalcorenergy.com'; Félix Gutierrez; Angela Onesi; Alexandre Gagnon; Marc Novello
Cc: Xeno Martis
Subject: Fw: The Cost Overruns Event of Default [IWOV-Legal.FID1640195]
Attachments: 2013-11-04_draft email on cost overruns.docx

----- Original Message -----
From: Manzer, Alison [mailto:amanzer@casselsbrock.com]
Sent: Monday, November 04, 2013 04:53 PM Eastern Standard Time
To: Xeno Martis; Newman, Charles <CNewman@CasselsBrock.com>; Sullivan, Peter J. <psullivan@casselsbrock.com>
Subject: RE: The Cost Overruns Event of Default [IWOV-Legal.FID1640195]

Here is the cost overrun provision that will be required.

Alison Manzer . Partner
Direct: 416 869 5469 . Fax: 416 350 6938 . amanzer@casselsbrock.com
2100 Scotia Plaza, 40 King Street West, Toronto, Ontario, Canada M5H 3C2
www.casselsbrock.com
-----Original Message-----
From: Xeno Martis [mailto:xmartis@fasken.com]
Sent: Monday, November 04, 2013 10:49 AM
To: Manzer, Alison
Cc: Xeno Martis
Subject: Re: The Cost Overruns Event of Default [IWOV-Legal.FID1640195]

That's fine. My clients just arrived. We'll do it later.

----- Original Message -----
From: Manzer, Alison [mailto:amanzer@casselsbrock.com]
Sent: Monday, November 04, 2013 10:44 AM Eastern Standard Time
To: Xeno Martis
Subject: RE: The Cost Overruns Event of Default [IWOV-Legal.FID1640195]

Juggling some other things - but more importantly trying to get ok to send a written outline - hopefully soon.

Alison Manzer * Partner
Direct: 416 869 5469 * Fax: 416 350 6938 * amanzer@casselsbrock.com
2100 Scotia Plaza, 40 King Street West, Toronto, Ontario, Canada M5H 3C2
www.casselsbrock.com

-----Original Message-----
From: Xeno Martis [mailto:xmartis@fasken.com]
Sent: Monday, November 04, 2013 10:39 AM
To: Manzer, Alison
Cc: Xeno Martis
Subject: The Cost Overruns Event of Default

If you're around and would like to walk me through the above captioned matter, I have a little time now while I wait for my clients to come in from Pearson.

Best,

Xeno

We have spent a very great deal of time and effort reviewing the mix of the specific terms of the Term Sheet at s. 4.10; your comments and concerns around the NL Equity assurances and the need for a clause; the negotiations and purpose of the term including the evolution of the drafting and the Cabinet mandate that directed the Term Sheet. We have determined that we do have to include a term addressing the requirements of s. 4.10 when we balance out these considerations and require it to be a covenant of each of the credit agreements. Let me know if you want to draft from this explanation or want us to do so.
The elements that we have to have to cover off to satisfy Term Sheet s. 4.10 are a) Cost Overruns defined properly b) “funded” defined c) payment obligations that include the annual funding option d) IE confirmation including as to adjustments e) respect s. 3.1 debt to equity, caps etc. and 4.8 Additional Debt restrictions f) IE certificate re Expected Costs to Complete.

1. The calculation of the Cost Overruns starts at Financial Close and is determined at any time there is a draw request or a change approval. In both cases of a draw or a change order approval a progress certificate is required (the draw and change certificate s will include all of the elements of s. 4.10 and more; which is to be reviewed and confirmed or commented on by the IE). This certificate will include a costs to date and a cost to complete calculation, this is standard for project finance during construction. The first of such packages will be delivered at Financial close to set a base line.

2. We need a definition of Cost Overruns to flesh out the definitions of s. 4.8 a) I suggest calculated at the relevant point in time –
   The concept should be - a) the remaining costs on the committed contracts b) plus the budget amount for the non-contracted items including related contingency and escalation c) plus contingency exposure and escalation as contracted in committed contracts (if any) d) less saving available under contracts reasonably achievable (IE determines) e) plus finance costs due at COD **LESS** the aggregate of a) budget amount less amounts paid to date b) Additional Debt then available to finance by the tests c) Guaranteed Debt remaining d) Equity on the debt to equity ratio to match the Guaranteed Debt not yet advanced gives Cost Overrun for purpose of funding. What this is doing is pinning down what the cost increases are in a reasonable manner and then backing out the prior allowed financing and required equity which leaves the additional equity component.

   The concept and mandate being (for this section and this fits with s. 4.8) all amounts over the firmed up budget amount and the prior sources of amount funded by the debt, equity on the usual advance for debt to equity and additional debt [it] to be funded by equity. The assessment of each amount is part of the draw or change approval engineer certificates in the ordinary course. This limits Cost to actual and firmly identified cost, which is intended to deal with the current project status as not fully contracted and provide allowances for savings.

   This translates to a formula approach as follows:
   “costs” means
   (a) remaining costs (payment obligations) on committed contracts; plus
   (b) budget amount for non-contracted items including related contingency and escalation; plus
   (c) contingency exposure and escalation as contracted in committed contracts (if any)
   LESS

(d) savings available under executed contracts reasonably achievable (IE determines);
(e) contingencies under completed contracts;
(f) allowance for cost savings reasonably achievable in yet to be contracted items as certified by the IE

PLUS

(g) finance costs due and payable up to COD.

Then Cost Overrun which is defined as cost increase in s. 4.8 should be defined as the following to take into account all of the terms of s. 4.10:

"cost increase" or "Cost Overrun" means costs less

(i) the aggregate of the budget amounts less amounts paid to date against budget;
(ii) Guaranteed Debt not yet advanced;
(iii) equity required by the usual course payments needed to meet the debt to equity requirements for the Guaranteed Debt not yet advanced;

This takes the costs then remaining with the estimates of higher costs included and takes off the related remaining budget (because you cannot have an increase until you exceed aggregate budget) and the otherwise committed sources that precede a need for further equity funding.

3. Then we need to define "funded" in a manner that is reasonably efficient but meets the needs of s. 4.10. This requires an actual flow of funds with respect to cost overruns on the time table that is set out in the term sheet (which was a heavily negotiated term). To make this fit in the context of the transaction as it has evolved Canada can accept that funds i.e. cash (if and when required by the cost overrun provisions) can go, at your option, either to the Project or to an escrow account for later application. Canada will also permit annual adjustment of the escrow amount required against subsequent assessments of the cost overrun based on the formulas above and in the term sheet. In the event that funds are put into escrow, the project will continue to first be funded by baseline equity and guaranteed debt, and the balance of the escrow account would not factor into the pro rata contributions of the guaranteed debt and baseline equity to meet the debt-equity ratio requirements of the term sheet. Once guaranteed debt and baseline equity are exhausted, then the contingent cash set aside in the escrow account would fund the remaining project costs, however should such cash not be sufficient, Nalcor will be responsible for further funding either with additional contingent equity or additional debt that is borrowed subject to the restrictions in the term sheet.

   The escrow account will be under the control of the Collateral Agent for the purpose of funding cost overruns but subject to return on adjustment or no requirement as that emerges. The funds in the account will be part of Canada's security package.

   This is a form of funding meeting the requirements of s. 4.10 but allowing for actual advance to the project only when actually needed, which allows adjustments as reductions are identified and therefore the funds are held against "real" need as opposed to speculation and potential reversing using debt if savings are found.