From: Morris, Paul J.
To: Stanley, Todd; Brewer, Donna; Myrden, Paul; Power, Yvonne A
Cc: Au, Peter; Bown, Charles W.; English, Tracy
Subject: RE: LC - ESA and ESG - Cost Overrun Provisions
Date: Friday, November 8, 2013 8:47:54 AM

I'll check with Nalcor and let you know.

Paul

____

Paul Morris
Assistant Deputy Minister
Energy Policy
Department of Natural Resources
p. 709.729.1406
e. pmorris@gov.nl.ca

From: Stanley, Todd
Sent: Friday, November 08, 2013 8:41 AM
To: Brewer, Donna; Myrden, Paul; Power, Yvonne A; Morris, Paul J.
Cc: Au, Peter
Subject: RE: LC - ESA and ESG - Cost Overrun Provisions

I was advised it is being reviewed by the same people who did the RFF review?

In answer to your last question, the FLG doesn't expressly mention a reserve account - I think the reserve account is Canada's attempt to put 4.10(i) into operation.

Todd Stanley
Assistant Deputy Minister – Courts and Legal Services
Department of Justice
Government of Newfoundland and Labrador
t.709.729.2880 f.709.729.2129

From: Brewer, Donna
Sent: Thursday, November 07, 2013 11:32 PM
To: Stanley, Todd; Myrden, Paul; Power, Yvonne A; Morris, Paul J.
Cc: Au, Peter
Subject: Re: LC - ESA and ESG - Cost Overrun Provisions

Who is looking at this from Nalcor and when do we expect a response.

Sounds like the project cost, debt vs equity schedule they provided over the weekend to Minister may need to change - if they know there is a cost overrun projection at time of FC. Guess we may find out what generally on budget means!

Paul Morris - if the equity projection of 1.886 B is increasing due to this requirement - EPC and Cabinet needs to be informed.

Can someone point out the clause in the FLG term sheet that requires this further "cost overrun reserve".

From: Stanley, Todd
Sent: Thursday, November 07, 2013 05:32 PM Newfoundland Standard Time
To: Myrden, Paul; Brewer, Donna; Power, Yvonne A
Cc: Au, Peter
Subject: Re: LC - ESA and ESG - Cost Overrun Provisions

Not sure I can add much to this as I am not clear myself and I've been focused on possible drafting changes necessary to the ESG not the $ implications.

I do note that BLG has recommended that if we go with option 1 the $ should be specified to be excluded from Canada's security.

The source of this language in the FLG document that they are trying to satisfy on cost overruns which is problematic at best.

From: Myrden, Paul
Sent: Thursday, November 7, 2013 4:45 PM
To: Brewer, Donna; Power, Yvonne A
Cc: Au, Peter; Stanley, Todd
Subject: RE: LC - ESA and ESG - Cost Overrun Provisions

I'm in the process of reading this for the third time and I think I'm starting to get it but it might be useful to get Todd to walk us through if we can. Todd – I've taken the liberty of copying you on this and would appreciate any comments you may have on this rather rudimentary synopsis.

Essentially, it looks as if Nalcor will be required to pre-fund cost overruns based on pro rata annual payments over the period from the date of determination to the commercial operations date. The amount will be determined / certified by the independent engineer with the first such determination to be at financial close. Subsequent to financial close, there will be recalculation each time there is a $ draw request or change approval, events which I assume could occur multiple times during the run of a year. So, for example, if it is determined that the cost overrun at FC is $500 million, Nalcor would be required to fund say one-fifth of this (assuming 5 years to COD), or $100 million, prior to drawing down funds raised pursuant to the FLG. This would be over and above the equity provided to "fund" construction costs prior to FC and there would be no room in the existing 13-14 budget for the Province to provide funds to Nalcor to cover this obligation.

On the subject of funding, there would appear to be two options, presuming of course that either Nalcor can fund the requirement internally or the Province is prepared to seek supplementary supply. First, the funds could be lodged in an escrow account which could be adjusted annually based on updated estimates such that some years could see a return of funds to Nalcor if projected costs come down and overruns and related funding requirements are reduced. However, funds put into escrow will not be credited as Nalcor equity and will not factor into the calculation of debt to equity ratios and periodic rebalancing to maximize utilization of borrowed funds. This will cause an acceleration of and increase in equity contributions over and above what is currently contemplated in the funding schedule (presuming that there will be cost overruns). These funds will also be subject to Canada's security.

The second option would be to pay the funds directly to the project through the collateral agent. While it is not entirely clear that this will qualify as Nalcor equity, it appears that it will and thus credit will be received relative to the DER rebalancing. This will allow leveraging of the additional equity contribution to access guaranteed debt. However, this will not allow a pullback in the event overrun estimates are subsequently reduced but may allow deferral of future planned equity requirements. The same budgetary issues will apply with respect to these "excess" equity requirements. Note that in either case, we will most likely have a 13-14 issue.

It strikes me that there is a bit of overkill here as Canada already has the benefit of the ESA/ESG agreements which provide our commitment to complete the project regardless of ultimate cost but I gather from recent comments by Canada's counsel that there is little negotiating space around this requirement.

On a preliminary basis, my instinct would be to choose the second option as it would allow these funds to be used productively on the project as opposed to potentially hiving off a significant $$ equity amount essentially for most of the construction period. However, I'll be curious to see what the Nalcor take is on this.

From: Brewer, Donna
Sent: Thursday, November 07, 2013 3:02 PM
To: Power, Yvonne A
Cc: Myrden, Paul; Au, Peter
Subject: FW: LC - ESA and ESG - Cost Overrun Provisions
Importance: High

Pls prt

Paul pls advise after you have had a chance to fully digest.

If they are saving that NALCOR has to set up and put funds in yet another dollar reserve and if this reserve is not already reflected in the $1.886 m base equity contribution, then the impact on the province will depend on timing of the additional equity payment.

As previously discussed, there is no flex within the current $531 million budget to make additional equity contributions prior to March 31, 2014, whatever the reason. If this equity can be made in 2014/15 we can adjust the forecast accordingly. If the payment must be made in 2013/14 and Nalcor cannot finance same, then Government will need to approve and introduce supplementary supply.

This is an equity adjustment so only a cash appropriation issue – does not impact deficit position. No impact on net debt (decrease in cash / increase in GBE equity)

Presume we would get AFUDC credit for this additional payment.

Sincerely,

Donna Brewer, CA
Deputy Minister
Department of Finance

From: Stanley, Todd
Sent: Thursday, November 07, 2013 2:14 PM
To: Bown, Charles W.; Brewer, Donna; Myrden, Paul; Morris, Paul J.
Cc: Pelletier, Randy; Bertoldi, Linda; Fowler, Bruce
Subject: LC - ESA and ESG - Cost Overrun Provisions
Importance: High

I need instructions on a $$$ business issue that requires someone contact Nalcor about work they are doing (I think).

The FLG has language in it essentially requiring a continuing accounting for and funding of cost overruns. Canada has apparently been struggling with how to deal with this language which is problematic but from which they feel they have no authority to deviate. They have recommended the attached description of how cost overruns would be handled.

This proposal would apparently change equity funding numbers as it would require additional equity be committed to a fund to cover cost overruns from the beginning of the Project, but with those funds only being expended or returned if not necessary at the end. Nalcor is apparently analyzing the impact of this change now.

From a legal standpoint the drafting changes to the ESG and ESA are likely going to be nominal. The larger issue is whether the approach makes a $$$ issue / concern for the Province. As such I think someone from Finance needs to advise? A revised ESG draft with this concept included is expected soon.

Todd Stanley
Assistant Deputy Minister – Courts and Legal Services
Department of Justice
Government of Newfoundland and Labrador
t.709.729.2880 f.709.729.2129