Information Note
Department of Natural Resources

Title: September 23 Meeting on Enhanced Federal Loan Guarantee (FLG2)

Issue: NR, FIN, and Nalcor officials met with PCO, NRCan, and federal Finance officials and their advisors to answer questions on the Province's request for enhancements to the federal loan guarantee for the Muskrat Falls and Labrador-Island Link projects.

Background and Current Status:

- The September 23 meeting in Ottawa was intended to provide additional information to the federal government to help their officials to brief federal ministers on available options to assist the project and the Province.

Analysis:

- Serge Dupont (Deputy Clerk and DM for Intergovernmental Affairs) opened the four-hour meeting by saying that federal officials did not have a negotiating mandate but were seeking information to help determine their approach in assisting the project financing. He indicated that doing nothing was not an option but also that the four requests from the Province are beyond what they would consider fiscally prudent. He also stated that any additional assistance would need to be recognized through either a guarantee fee or an ability for the guarantor to share in any project upside.

- Mr. Dupont also indicated federal concern that FLG2 would be seen as a precedent and that other projects across the country would expect similar treatment.

- Mr. Dupont stated that, while FLG2 would not have direct costs, it would increase the federal government's contingent liabilities, and that this is an area that has been identified by the federal AG.

- Charles Bown (Deputy Minister, NR) indicated that officials from the Province also did not have a negotiating mandate and he expressed the Province's willingness to provide additional information to the federal government. He expressed the view that FLG2 would not be a new precedent-setting loan guarantee but rather an enhancement to the existing guarantee designed to assist the Province with its fiscal challenges at minimal cost to the federal government.

- FIN gave a presentation outlining the Province's fiscal situation and Blair Franklin (the federal government's advisory firm) gave a presentation summarizing their analysis of the Province's FLG2 request.

- The rest of the meeting was dedicated to providing responses to the original seven questions sent by the federal government as well as the new questions which were raised during the meeting. The questions largely focused on their perceived risks to the project, including the Astaldi contract, which is viewed as the biggest risk and will likely affect the timing of any assistance. Federal officials expressed a concern about the optics of a potential situation where an FLG2 is immediately followed by Astaldi being replaced, leading to a significant increase in powerhouse costs.

- The content and tone of the questions indicate that federal officials and their advisors believe that the current situation with the project has come about due to a lack of fiscal discipline, largely brought about by the presence of the original loan guarantee and an assumption that more will be available if there is a problem. They believe that, if there had been private debt or equity, then there would have be greater oversight and discipline.

- It is clear that there is a willingness to assist but not to provide all the requested enhancements. Federal officials indicated a desire to adjust the structure of the FLG2 to reduce their risk and demonstrate that normal commercial terms/practices apply. This includes requiring:
  - A guarantee fee
  - A sharing of upside from the project with the federal government
  - A portion of the funding requirement be covered by un-guaranteed third party debt or equity. Debt would come from Nalcor or Province.

- Federal Finance officials indicated that this new request will be looked at with fresh eyes by the new federal government, however it will need to be supported by sufficient justification.
  - Questions answered by the Province in the meeting included:
  - What is the Province's current interest rate spread?
  - What is the posted security for the Astaldi contract?
  - Is the Province concerned about the financial position of Astaldi SpA (the parent company)?
  - How material is this project to Astaldi SpA?
  - What are the cost and schedule implications of bringing in a new contractor compared to the amount of the posted security?
  - Are we already at the point where we can access the security, i.e. an act of default?
  - Has anything changed in the most recent phase of the contract that would lead Astaldi to be more productive?
  - How far advanced is Nalcor's plan B, i.e. bringing in a new contractor to replace Astaldi?
  - Which companies have you included in a potential plan B?
  - What will happen in October when the bridging agreement expires?
  - Could Nalcor or the Province provide additional subordinated debt to the project, to increase the Province's "skin in the game"?
  - Would there have been any difference in how Nalcor managed the project it there had been third party (non-guaranteed) debt or third party equity?
  - What are alternatives to the COREA concept that could be used in an FLG2?
  - What is Province's plan to address the NG's concern with methylmercury?
  - What is Nalcor's current relationship with Hydro-Quebec, which had vocally opposed the first federal loan guarantee?

- Federal officials indicated that they were satisfied with the answers provided and thanked the Province for the meeting.

Action Being Taken:

- Officials from the Province and Nalcor will share additional data with the federal government if any additional answers or clarifications are required.

Prepared/Approved by: W. Parsons/C. Bown
Ministerial Approval:

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