

Date : 1/29/2012 8:17:04 PM

From : "Scott, Paul G."

To : "Bown, Charles W."

Attachment : Support document re redress settlement payments by province jan 23 12 r1 (2).pdf;
Charles,

This is Nalcor's support document; I am not sure I sent it before. They no longer claim that covering the Redress payment will have a detrimental impact on LCP financing. Rather they claim it will have a negative effect on their 2011 net income as they say they have to book the full value of the Redress payment (\$40M) against their 2011 net income. It is not clear as to why. First I thought we covered the 2011 costs and second, this accounting treatment puzzles our people as they say that it should be possible to spread out the income effects of such a long term debt. They also offer no figures on what their net income would be in 2011 under their proposed accounting treatment

[REDACTED]

I have enclosed their paper in case I did not before. I have also gone back to Mark with questions on themes noted in the first paragraph.

Paul

CONFIDENTIAL**SUPPORT DOCUMENT FOR MEMORANDUM TO EXECUTIVE COUNCIL****Title: RE: Churchill Falls Hydroelectric Development Redress Agreement
Settlement Payments****ISSUE:**

Whether to assume the obligations for Settlement Payments as defined in the Upper Churchill Redress Agreement between the Province, Nalcor, Innu Nation, Mushuau Innu First Nation and Sheshatshiu Innu First Nation (Redress Agreement) executed on November 18, 2011.

RECOMMENDATIONS:

It is recommended that:

1. the Government of Newfoundland Labrador agree to accept responsibility for Nalcor's obligations under Clause 2.1 of the Redress Agreement, and;
2. funding for those obligations be added to the Department of Natural Resources' Fiscal Forecast that would allow for payment of this grant on an annual basis for the life of the Redress Agreement, and;
3. Natural Resources enter into a formal agreement with Nalcor whereby the Settlement Payment obligation of the Province is formally documented.

BACKGROUND:

The Redress Agreement was one of the agreements that resulted from the Tshash Petapen (New Dawn) Agreement with Innu Nation dated September 26, 2008. The New Dawn

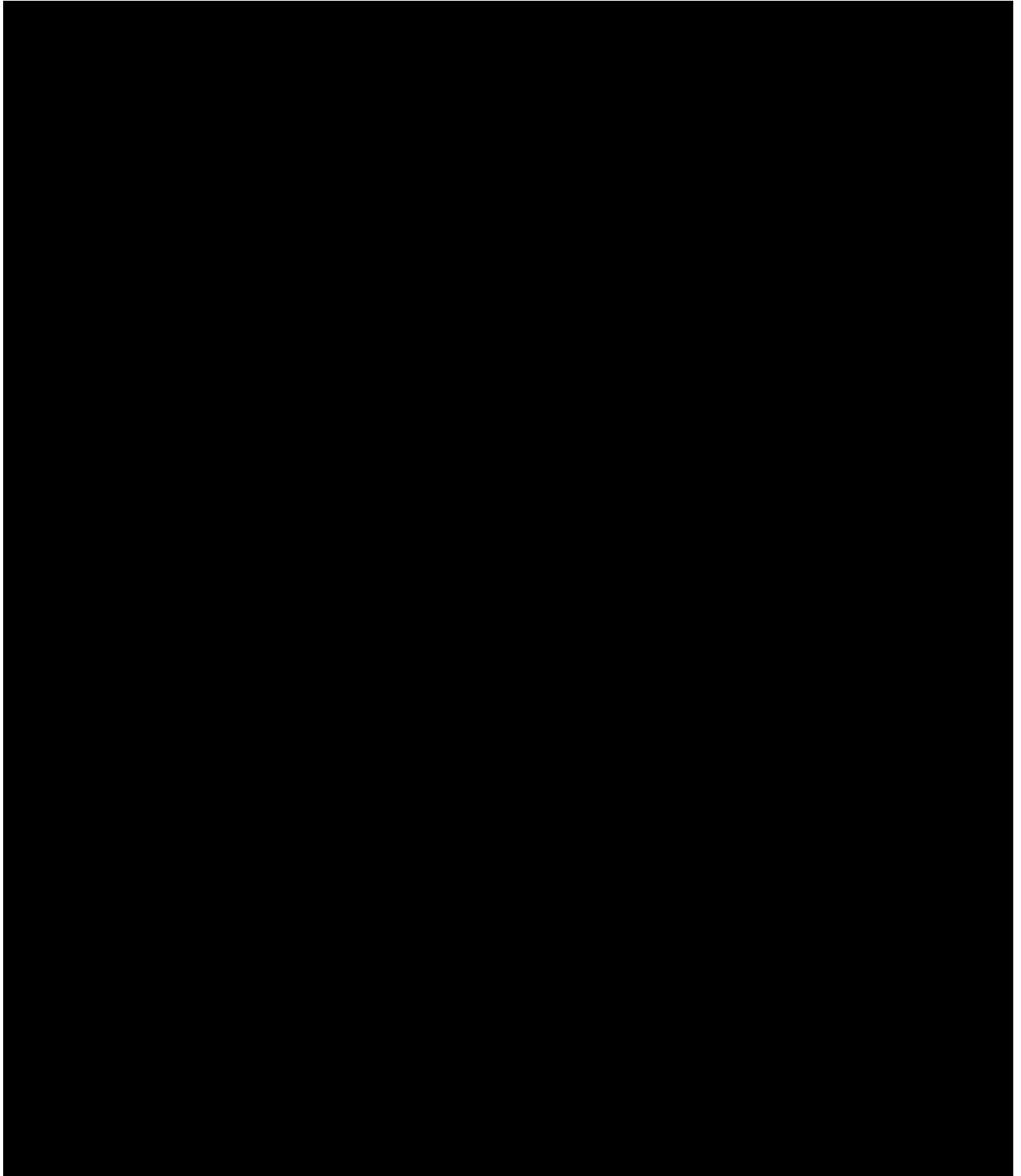
Agreement was intended to resolve key issues relating to matters between the Province and Innu Nation surrounding the Innu Rights Agreement, the Lower Churchill Impacts and Benefits Agreement (IBA) and Innu redress for the Upper Churchill hydroelectric development.

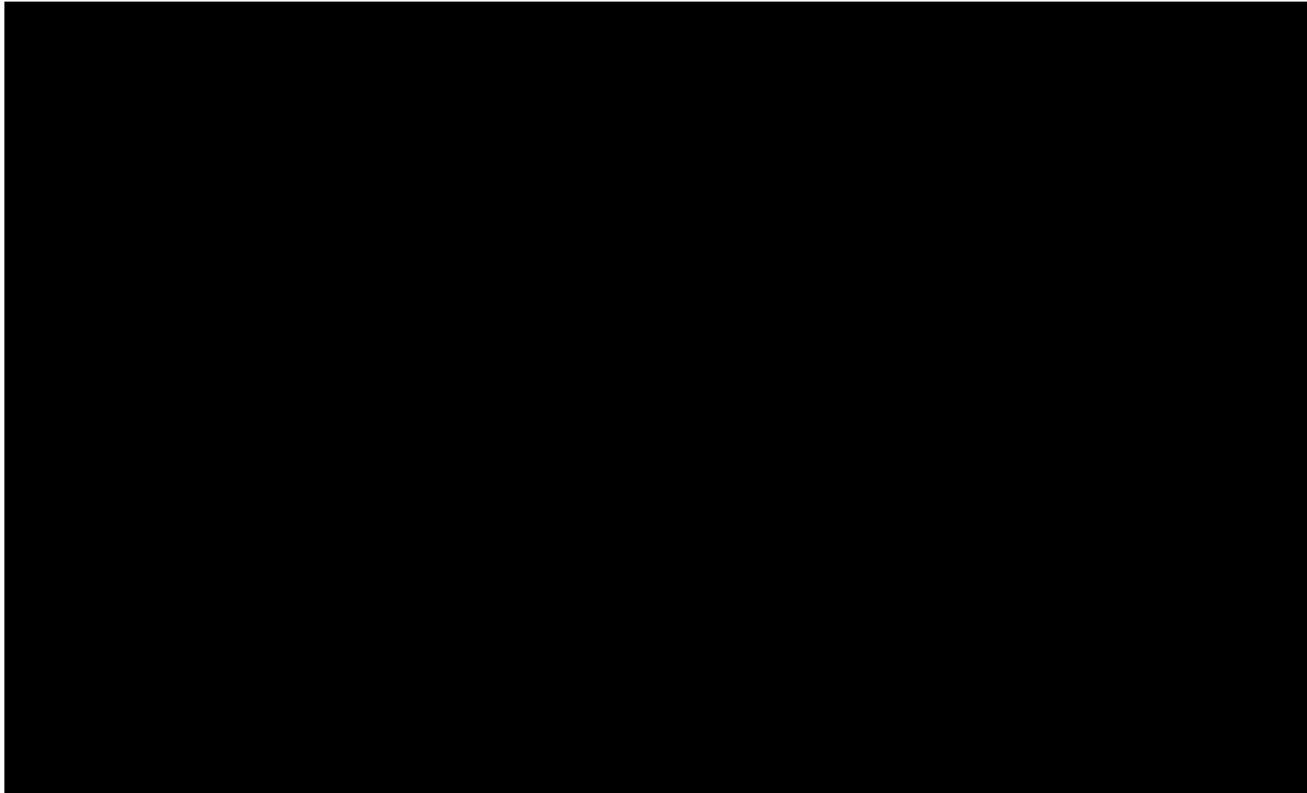
New Dawn laid out quantum and location for various selections of Innu lands, and established economic areas assuring Innu participation in resource projects in the region. The agreement also provided compensation to the Labrador Innu for impacts associated with the Churchill Falls development and was meant to settle the outstanding grievance of Innu Nation with respect to damages suffered to Innu lands and properties as a result of the flooding caused by the Upper Churchill River development in the 1960s. The Redress Agreement was meant to address this latter matter.

Clause 2 (a) of the New Dawn Agreement (of which MC2008-0475, MC2008-0492, and MC2009-0493 refers) stated that:

“The Province shall pay to Innu Nation, or if established, the Innu Government (collectively hereafter “Innu Nation”) an annual payment of two million dollars Canadian (\$2,000,000) commencing upon ratification and execution of the IBA and terminating on August 31, 2041. The payments will be indexed annually using a rate of two and one half percent (2.5%) commencing on the date of IBA ratification and execution.”

This same obligation was reflected in the final Redress Agreement, but while the New Dawn Agreement assigned responsibility for the Settlement Payments to the Province, the Redress Agreement specifies Nalcor as having responsibility for those payments. Under current economic assumptions, Nalcor estimates the total present value of these future payments at \$40 million.





Financial Impact on Nalcor

After further internal discussion and a review of the final agreements associated with the New Dawn Agreement, Nalcor has determined that in the event that it is obliged to bear the Settlement Payment costs, it is not appropriate to capitalize them, either as part of the Lower Churchill Project, or otherwise. In the absence of an agreement by the Province to accept the obligation for these payments, Nalcor will be obliged to expense the present value of the entire \$40 million as a charge against Nalcor's 2011 earnings.

This charge represents over 50% of Nalcor's average net income for the past four years ending December 31, 2010 and hence is significant from a net income perspective. While forecast results to the end of 2011 indicate some improvement in Nalcor's net income levels in comparison to previous years, due in large measure to new oil revenues, these improvements would be virtually eliminated as a result of this additional expense. In a year where Nalcor's investments in oil and gas have begun to produce a return, it would be beneficial if the

company were able to show a demonstrative improvement in net income as a result. The presence of this unanticipated charge will compromise the company's ability to achieve this objective.

It is the position of Nalcor's Finance Department that an agreement by the Province to accept the obligation to fund all future Settlement Payments would eliminate the requirement to reflect the \$40 million as a charge to Nalcor's 2011 net income.

ALTERNATIVES:

Alternative 1 : Adopt Recommendations 1, 2 & 3 as stated above with necessary funding provided to Nalcor .

Advantages:

1. Adopting these recommendations would eliminate the requirement for Nalcor to reflect the related cost of the obligation under Clause 2.1 as a charge against its 2011 net income in its Annual Report.
2. Presents the opportunity to demonstrate enhanced total earnings in Nalcor driven largely by oil revenues.

Disadvantages:

1. The Province will be obliged to arrange funding on an annual basis in support of reimbursement to Nalcor
2. There may be a requirement to record a liability on the Province's Consolidated Statement of Financial Position pertaining to the future payment obligations.

Alternative 1 is the recommended alternative.

Alternative 2 : Ignore Recommendations 1, 2 & 3 above and let Nalcor make all Settlement Payments without reimbursement.

Advantages:

1. The Province will not be obliged to arrange funding on an annual basis in support of reimbursement to Nalcor.
2. There will be no requirement to record an obligation pertaining to unpaid amounts under Clause 2.1 on the books of the Province.

Disadvantages:

1. Failure to adopt these recommendations will result in an immediate charge of approximately \$40 million to Nalcor's 2011 earnings.
2. Such a charge will compromise Nalcor's ability to point to increased overall earnings, in a year where there was a significant contribution from new oil revenues.
3. The charge will result in an added funding requirement for Nalcor that will hamper returns to the shareholder and likely increase future equity requests accordingly.
4. The value of the Province's investment in Nalcor as recorded on the Consolidated Statement of Financial Position of the Province would be immediately reduced by \$40 million.

Alternative 2 is not recommended.

LEGAL/LEGISLATIVE CONSIDERATIONS:

None noted.

FINANCIAL CONSIDERATIONS:

By virtue of its 100% ownership investment in Nalcor Energy, economically speaking, the Province is indifferent, regardless of whether Alternative # 1 or #2 is selected. If Alternative # 1 is selected and the Province agrees to accept the obligation for these payments, then a \$40 million liability may have to be recorded on the Province's Consolidated Statement of Financial Position, which would serve to increase the Province's Accumulated Deficit by that same amount. If Alternative # 2 is selected and Nalcor is obliged to fund these payments, the value of the Province's investment in Nalcor will be correspondingly reduced by the \$40 million, which will also serve to increase the Accumulated Deficit by that same amount.

INTERDEPARTMENTAL CONSIDERATIONS:

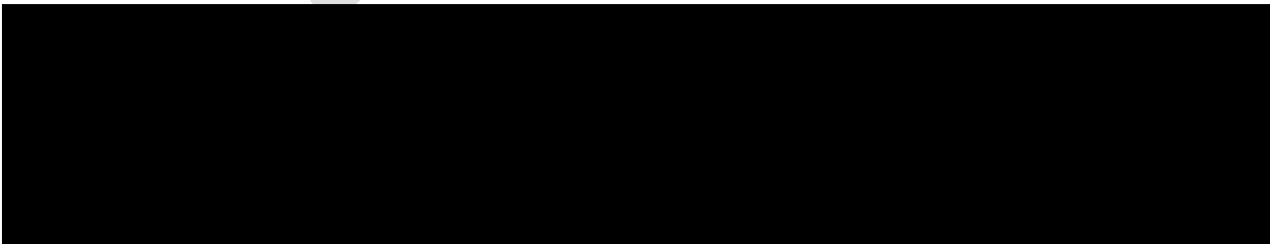
The Departments of ?? (*NTD: To be determined by NR*) were consulted in the preparation of this submission.

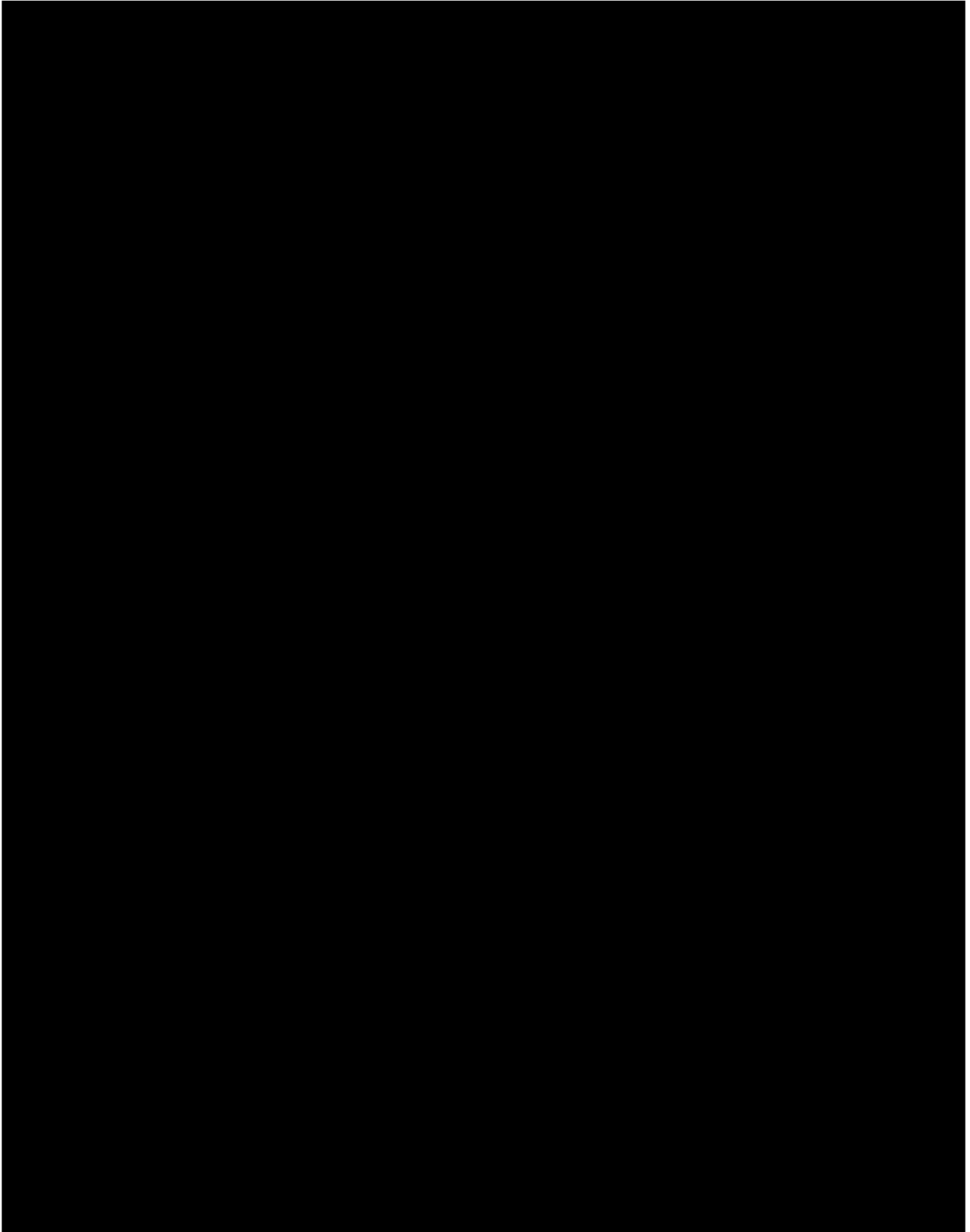
ABORIGINAL CONSIDERATIONS:

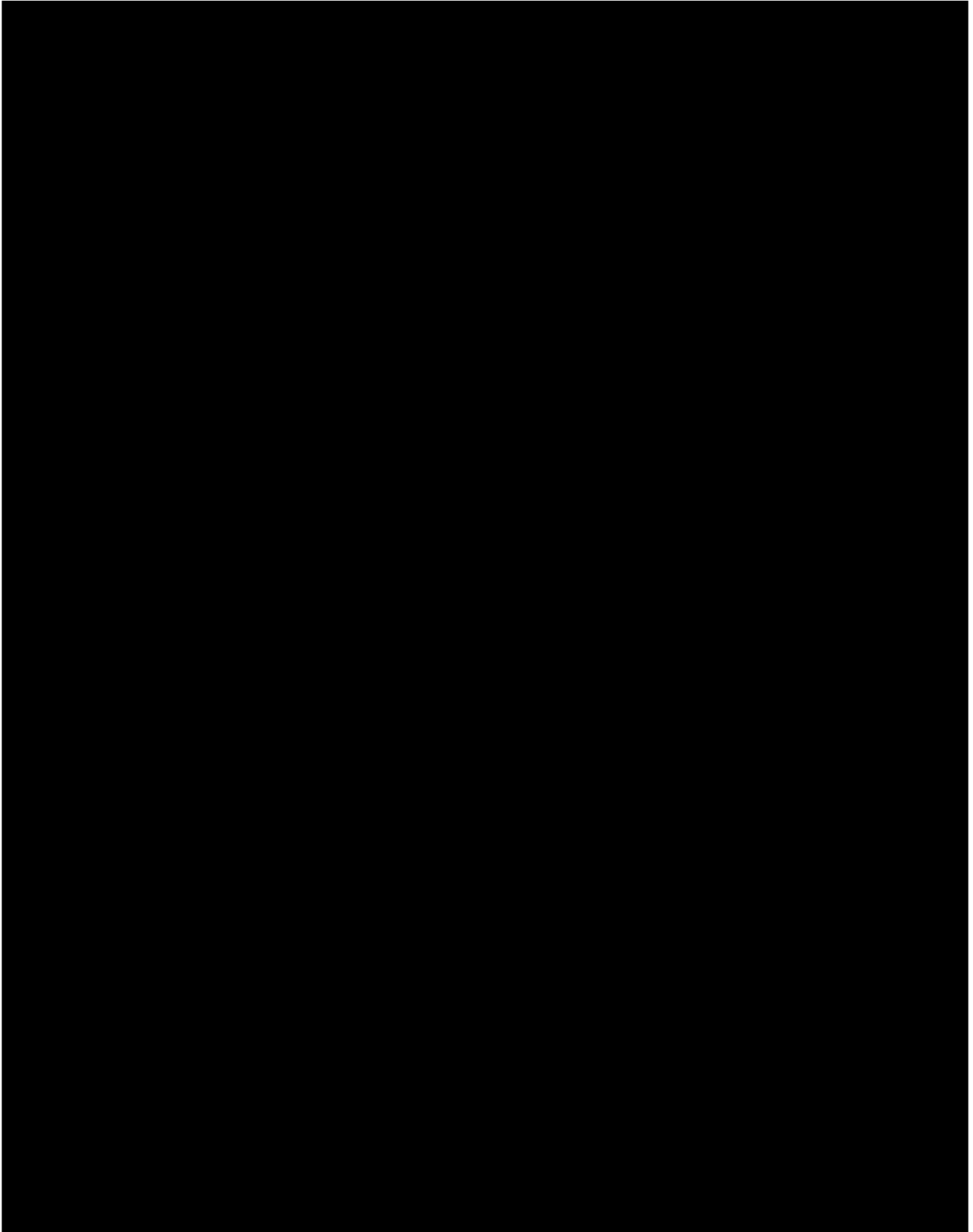
There will be no impact on the other parties to the Redress Agreement as a result of this change, since the Redress Agreement itself will remain unchanged. This will be a separate arrangement between the Province and Nalcor.

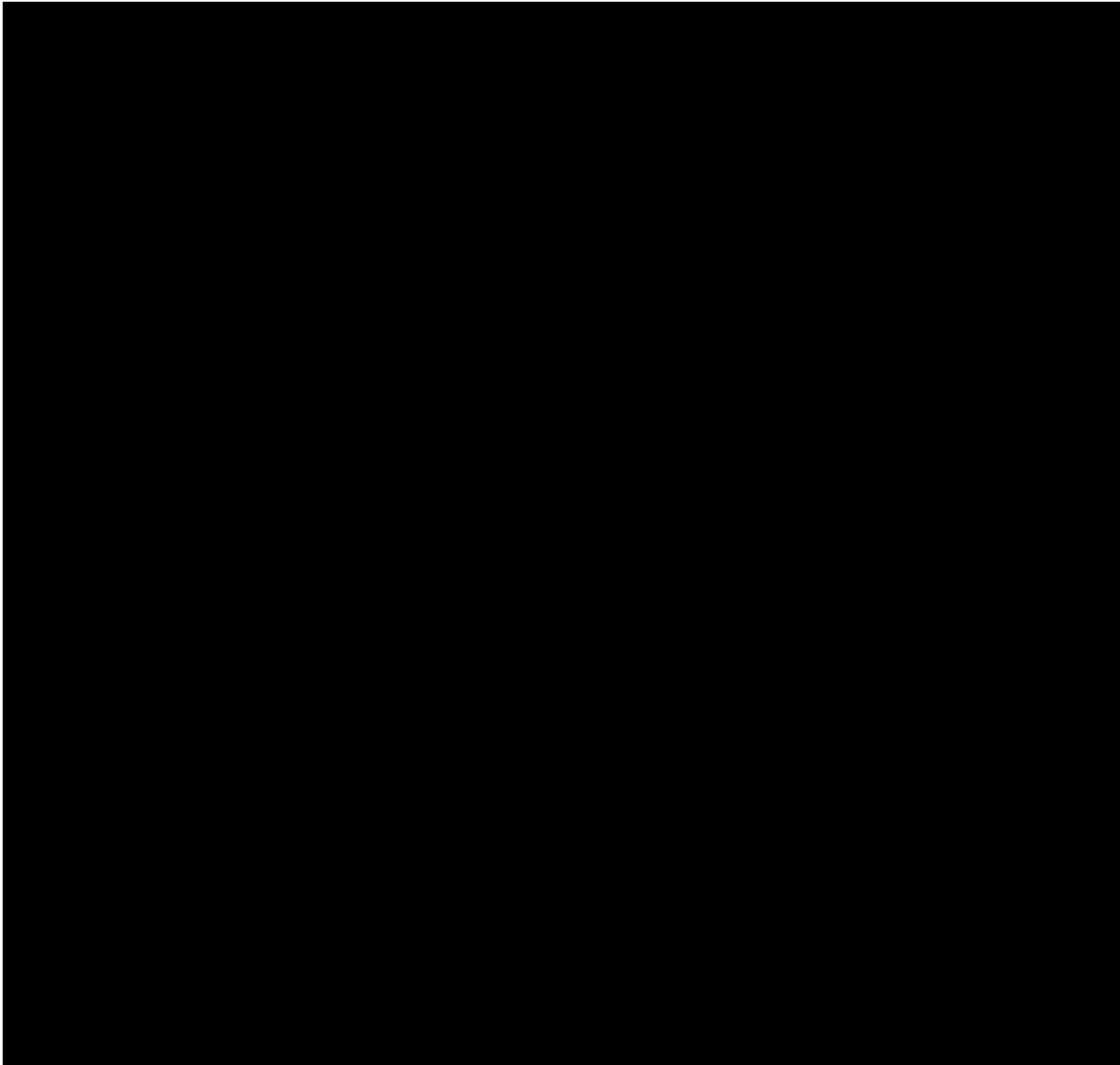
INTERGOVERNMENTAL CONSIDERATIONS:

(NTD: To be addressed by Natural Resources)

OTHER JURISDICTIONS:







CONSULTATIONS:

Nalcor has been consulted and support the recommendations.

ENVIRONMENTAL CONSIDERATIONS:

N/A

COMMUNICATIONS AND CONSULTATION SYNOPSIS:

(NTD: To be confirmed by NR and Nalcor Communications team).

Date: January 23, 2012

DRAFT