From: David Leather <dleather@uk.ey.com>
Sent: Tuesday, March 15, 2016 1:33 PM
To: Mullaley, Julia
Cc: Paul Hickey
Subject: Comments on Nalcor's Negotiating Strategy
Attachments: Comments on Nalcor's Negotiation Strategyv0.2.pptx

Importance: High

Dear Julia

I attach our comments on Nalcor's Negotiating Strategy as discussed earlier.

Please let me know if you have any comments or questions; otherwise I assume that you will circulate to the attendees of the meeting tomorrow evening.

Kind regards

David

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Muskrat Falls Project

Comments on Nalcor’s Negotiating Strategy

DRAFT

NOTICE TO READER

PRIVILEGED AND CONFIDENTIAL – PREPARED IN CONTEMPLATION OF LITIGATION
Any actions contemplated and/or considered in or arising from this document should only be undertaken by Government or Nalcor Energy after receipt of legal advice related thereto.

Framing the negotiation

- It is critical to have a clear and objective understanding of the history and current status of the contract position and the key drivers and issues that will impact any negotiation with Astaldi
- This should include:
  - definition of a quantified vision for success, with BATNAs and maximum limits
  - range of project cost to complete scenarios (for the contract, the project, for Astaldi)
  - drivers for successful execution of the remaining work
  - the formal contractual position, detailed understanding of potential for terminate for cause scenarios
  - the critical issues and outcomes for Astaldi, Nalcor, GNL and other stakeholders
  - influence of Astaldi Group's financial position
- All of the above are covered in the Nalcor Strategy to some degree, but it isn't clear how they influence the development of a coherent strategy for negotiation
- To date, Nalcor has placed significant emphasis on Astaldi Group's liquidity as a critical factor influencing the timing and quantum of a negotiated settlement with Astaldi
- The financial results of Astaldi announced on 9 March 2016 show an improved cash position, with €153 million of cash generated through working capital management initiatives in the 3 months ended 31 December 2015
- At 31 December 2015, Astaldi had €611 million cash on hand and could have an estimated line of credit available of approximately € 200 million, with consolidated equity of €637 million
- Astaldi could take further steps to improve cash flows such as sale of assets/concessions, reducing investments, deferring capital investment, reducing costs or raising additional equity/long term debt

EY Perspective – Foundation for negotiations

The starting point for negotiations should be repositioned to focus on Astaldi's contractual entitlement not the Group's liquidity issues

- Focus should be on contractual arrangements between Astaldi Nalcor
- Astaldi should set out their 'case' for entitlement to additional payments and should be quantified in terms of cause and effect
- Potential structure as well as quantum of payments to be considered. For example; additional costs incurred by Astaldi could be met through a mix of:
  - Astaldi funding (resulting in losses being incurred by Astaldi over time)
  - additional payments by Nalcor linked to achievable milestones
  - the potential to earn further bonus payments for exceptional performance
  - secured loan to Astaldi, repayable to Nalcor post completion

EY perspective - Strategy Contents

- Principles for negotiation
- Negotiation team – appropriate mix of internal members/ use of external experts
- Financial Limits of authority for negotiating team
- Governance for decision making/ sign off of revised deal
- Base line assumptions around alignment of interests/ conflicting interests
- Legal review/ Counsel's Opinion
  - Principles for entitlement – strengths and weaknesses of the contract
  - Remedies
  - Options analysis of how contract may be adjusted following negotiation
- Basis of case from Astaldi position
- Nalcor potential for counter claim
- Trade-offs – key levers for each party
- Assessment of range of financial outcomes
- Timeline for negotiation – (how strength of each party's position varies over time)
- Risk assessment
- Communication strategy (internal and external)

EY perspective – Risks and protections

- Assessed risks should include:
  - the quantified risks (particularly cost and schedule risks) that Nalcor is currently exposed to and how it can use the negotiation to reduce its risk exposure
  - the quantified, risks that Nalcor will still be exposed to after any new deal is agreed and contracted
  - any new risks that Nalcor will be exposed to as a consequence of any deal eg the potential for claims from the 3 original bidders in the procurement process
  - the knock on consequences on other contracts
- Protections should include:
  - ability to terminate without cause/penalty
  - right of step in and ability to novate workforce to Nalcor or a third party in the event of default
  - ability to communicate the novation agreement to Astaldi employees to give the workforce comfort in relation to their job security
  - ability to recover LDs, LOCs, PB and retain PCG
  - incentives to minimise exposure to risk of additional cost and delay, linked to delivery milestones
  - protection from future claims, requiring full disclosure from Astaldi of **all** underlying causes of cost increases to date

Negotiation Influencers

- Costs to be incurred by Astaldi to complete the Project (particularly costs of work planned for 2016, prior to winter), compared to contract price
- Profit included in overall contract price
- Amount of any penalties that Astaldi will incur if they default
- Additional costs that Nalcor will incur if a new contractor has to be appointed
- Loss of time if Nalcor has to appoint a new contractor
- The tipping point/ BATNA – the level at which an alternative option is more financially attractive
- The quantum of the securities available to Nalcor
- The costs incurred by Nalcor as a direct consequence of the late delivery (including extensions of time on other contracts, additional project management, camp costs, other direct and indirect costs)