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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

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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.*



The better the question. The better the answer.
The better the world works.

Framing the negotiation

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Page 4

- ▶ 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

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

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Page 6

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- ▶ 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

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Page 7

- ▶ 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

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Page 8

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- ▶ 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)