

NR 2011

Title: Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project

ISSUE:

Whether to approve a Memorandum of Principles that will govern the commercial arrangements between Newfoundland and Labrador Hydro and the Nalcor subsidiaries developing Phase One of the Lower Churchill Project.

RECOMMENDATION:

It is recommended that:

Lieutenant Governor-in-Council approve a Memorandum of Principles, substantially along the lines of the draft attached in Annex D, that will govern the commercial arrangements between Newfoundland and Labrador Hydro and the Nalcor subsidiaries developing Phase One of the Lower Churchill Project.

BACKGROUND:

As part of its financing plan for Phase One of the Lower Churchill Project (the "Project"), Nalcor Energy has asked the Government of Newfoundland and Labrador ("Government") to approve the attached Memorandum of Principles.

The Memorandum of Principles is being developed at this point as a key document in the finance-raising process for the Project. During this rigorous multi-year process (described in detail in Annex A), Nalcor will need to provide credit rating agencies, the Federal Government, and potential lenders with confidence in the Project's business case and its ability to cover all debt payments and other costs over the life of the loans. This includes providing supporting documents to allow successful completion of due diligence, establishing early indicative credit ratings to demonstrate the creditworthiness and level of risk in the Project, finalizing the terms of the federal loan guarantee, selecting a lead lender that will recruit a larger team of lenders, and negotiating and completing final documents and advancing the funds.

The finance-raising process also includes executing a term sheet for the federal loan guarantee announced August 19, 2011. The federal loan guarantee term sheet will be a key document in Nalcor's finance-raising efforts, as it will significantly strengthen the attractiveness of the Project's debt to potential lenders.

The finance-raising process began upon execution of the November 18, 2010 term sheet between Nalcor and Emera Inc. (the "Term Sheet") outlining how they will collaborate to develop the Project, which consists of the following components:

- the \$2.5 billion Muskrat Falls hydroelectric plant on the Churchill River (the "Muskrat Falls Plant"), which Nalcor will wholly own and fund the related capital costs;
- a \$0.4 billion transmission interconnect to be constructed between the Muskrat Falls Plant and the existing generating plant located at Churchill Falls (the "Labrador Transmission Assets"), which Nalcor will wholly own and fund;
- a \$2.1 billion High Voltage Direct Current (HVdc) transmission line and all other related components to be constructed between the Muskrat Falls Plant and Soldier's Pond, NL (the "Labrador-Island Link"), which Nalcor will own approximately 71% and Emera 29% with funding shared in those proportions; and
- a \$1.2 billion HVdc transmission line connecting the Island interconnected system to Nova Scotia (the "Maritime Link"), which Emera will wholly own and fund (with ownership reverting back to Nalcor for \$1 after 35 years).

The Term Sheet also outlines the provision of electricity by Nalcor to Emera's subsidiary Nova Scotia Power Inc. and the transmission of electricity through Nova Scotia and New Brunswick for sale in the Maritimes and the New England market.

For its portion of the Project costs, Nalcor plans to raise project finance debt in the capital markets. Project finance debt is a commonly-used structure in the energy and infrastructure sectors, wherein project sponsors provide the equity and lending institutions provide non-recourse loans that are typically serviced entirely from project cash flows and secured by the project assets alone, with no recourse back to sponsors (in this case, the Government and Nalcor). Using non-recourse financing prevents lenders from accessing Government's other non-Project assets in the case of a default.

The Memorandum of Principles outlines the commercial arrangements between Newfoundland and Labrador Hydro ("NL Hydro") and the proposed Nalcor subsidiaries associated with the Project. These arrangements relate to the supply and transmission of power from the Muskrat Falls Plant to meet NL Hydro's demand and the sale of electricity in markets outside Newfoundland and Labrador as a result of the interconnection of the provincial electricity system with the North American grid. The Memorandum of Principles provides details on the proposed transactions including how cost recovery will be implemented. It also describes the way in which Nalcor companies will cooperate to maximize the value for both taxpayers and ratepayers. Finally, the memorandum provides credit rating agencies, the Federal Government, and prospective lenders with information reinforcing the credit-worthiness of the Project, the benefit of which will ultimately be passed on to ratepayers in the form of lower financing costs.

The formal documents that will reflect the agreements outlined in the Memorandum of Principles are required for the finance-raising process before the end of 2011 and these will also be submitted for Cabinet approval.

The Project is being undertaken primarily to provide a reliable supply of energy to meet future industrial, commercial, and residential electricity demand in the Province. While the Maritime Link, the arrangements with Emera, the potential sales of excess electricity to export markets, and the revenues associated with these activities will all benefit Nalcor and Government, they are additional or ancillary elements to the primary purpose for this development. Nalcor's and NL Hydro's position is that even if these elements were not present, they would continue to recommend the Project as the least cost alternative to meet the Province's energy requirements.

Consistent with this position, the commercial arrangements proposed by Nalcor provide that the ratepayers of the Province will pay the majority of the cost of the Muskrat Falls Plant, and all of the cost of the Labrador-Island Link and the Labrador Transmission Assets. Revenues generated from sales of power in excess of NL Hydro's requirements and the commitment to Emera will accrue to Nalcor but not automatically benefit the ratepayers - this instead is being left as a policy decision of the government at the time. Most of the debt-carrying capacity for Muskrat Falls, and all for the Labrador-Island Link and the Labrador Transmission Assets, will be based on the arrangements made between Nalcor and NL Hydro for energy from the Project. This is because revenues from export markets will not be supported by long-term price-certain contracts and thus will be less highly-rated by lenders for debt-carrying capacity.

Some key concepts in the Memorandum of Principles include:

- The Muskrat Falls Plant, the Labrador Transmission Assets, and Nalcor's share of the Labrador-Island Link partnership will each be held by a new special-purpose subsidiary of Nalcor.
- Trading of energy in external markets will be done via a new Nalcor energy marketing division or subsidiary (called "NEM" in the memorandum).
- Total electricity supply from the Muskrat Falls Plant will consist of specific blocks designated i) to meet NL Hydro's forecasted demand, ii) to meet any additional NL Hydro demand not forecasted when volumes are set for the power purchase agreement, iii) for export to external markets, and iv) to supply Emera's customers in Nova Scotia.
- The power purchase agreement will be for 50 years and will oblige NL Hydro to take all energy designated as needed for its own demand in the contract. The price for this energy will reflect the cost of service of the Muskrat Falls Plant and the Labrador Transmission Assets.
- The proceeds from export sales will flow back to Nalcor through its subsidiary's ownership of the Muskrat Falls Plant and will not automatically benefit ratepayers in the Province.

As part of Nalcor's finance-raising process, the company is also asking Government to approve and sign a Commitment Letter outlining Government's intentions in support of the Project. The Commitment Letter is the subject of a separate Cabinet Submission.

ALTERNATIVES:**1. Approve the Memorandum of Principles. (recommended)****Pros:**

Approving the Memorandum of Principles will enable Nalcor to maintain its financing schedule and overall project schedule to support a Project sanction decision in 2012. The Memorandum of Principles will also facilitate the process of finalizing the federal loan guarantee, which will reduce interest expenses for the Project and thus lead to reduced rates for electricity customers in both Newfoundland and Labrador and Nova Scotia.

The proposed structure strikes a fair balance between ratepayers and taxpayers. Ratepayers will benefit from stable, reasonably-priced electricity over the life of the Project and taxpayers funding Government's investment in the Project will benefit because any export sales revenue that accrues to Nalcor will be available to the Government in the form of dividends.

Cons:

The Memorandum of Principles assigns all Project costs to NL Hydro's regulated ratepayers, while export sales revenue will flow to Nalcor and will not directly reduce regulated rates. Government critics and Project opponents may suggest that export profits should be used to lower electricity bills and attract industrial development. Critics may also take the position that this structure discourages ratepayers from reducing consumption as they have to pay the full cost of the Project, regardless of usage.

2. Do not approve the Memorandum of Principles.**Pros:**

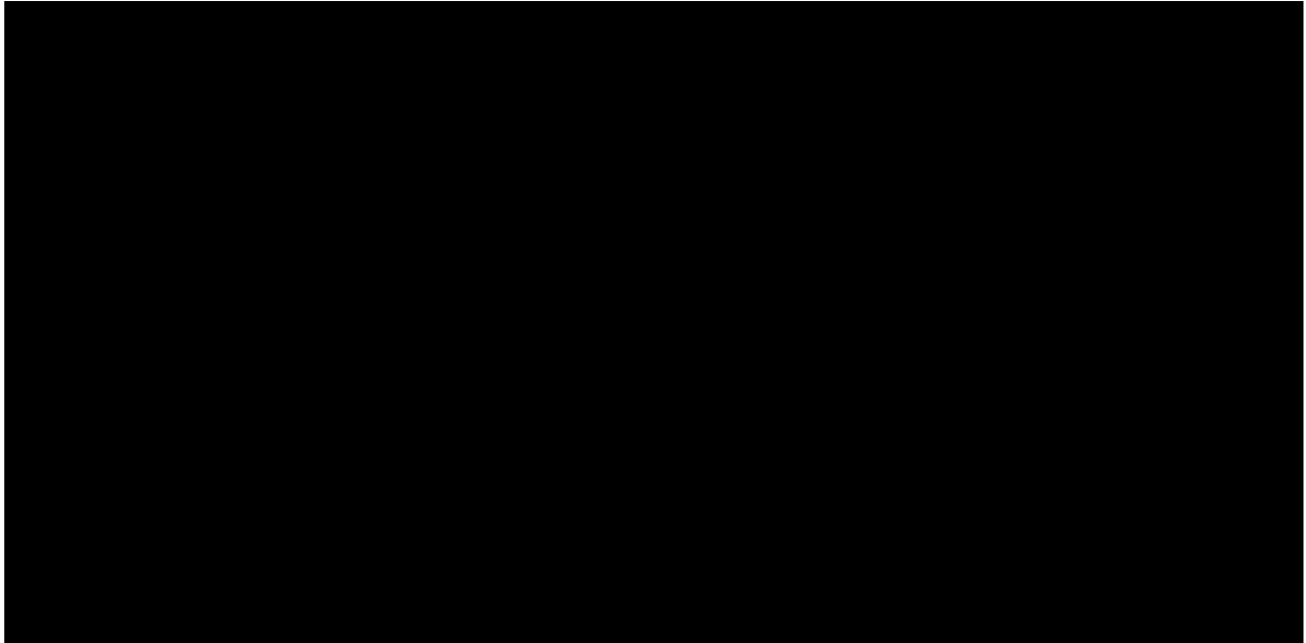
No action required by Government. Not approving the Memorandum of Principles may allow Government to modify the proposed power purchase framework and explore other commercial structuring options.

Cons:

The federal loan guarantee will be delayed. The Memorandum of Agreement announced August 19, 2011 affirms a Federal Government requirement for indicative credit ratings for the Project borrowing entities as a key measure to assess the Project's creditworthiness. These credit ratings may not be available in a timely manner unless the Memorandum of Principles is authorized.

Debt finance funding will likely be delayed, which would increase the amount of up-front equity contributions required from Government prior to putting debt financing in place. Without this additional equity, the present Project schedule would be jeopardized as necessary financing

activities may not be completed in time to support Project sanction. This would likely delay start up and completion, thus eroding investor and public confidence in the Project.



A Regulatory Impact Analysis is not required for this cabinet submission does not involve any immediate regulatory or legislative change.

FINANCIAL CONSIDERATIONS:

Authorizing the Memorandum of Principles does not place any financial obligation on Government, however it effectively determines ratepayer financial obligations and authorizes Nalcor to structure its operations and operating entities in such a way that allows the Project to proceed as scheduled. It also effectively sets out how electricity bill payments will flow from ratepayers through to Nalcor and subsidiaries and how these related companies will conduct inter-company business.

The Project and the commercial arrangements proposed in the Memorandum of Principles will result in significant revenues to Nalcor. Forecasted net cash flow to Nalcor is approximately \$100 million for the first full year of operation. This could climb to \$900 million per year by the end of the 50-year power purchase agreement with NL Hydro (see chart in Annex B). These projections reflect current capital cost estimates, financing assumptions and the latest forecast of market prices.

INTERDEPARTMENTAL CONSIDERATIONS:

The Departments of Finance, Justice, Labrador and Aboriginal Affairs, as well as Nalcor were consulted during the development of this memorandum and the Memorandum of Principles and have given approval.

Officials from the Rural Secretariat have also reviewed this memorandum and the Memorandum of Principles and have confirmed that a Rural Lens is not required due to the nature of the submission.

LABRADOR OR ABORIGINAL CONSIDERATIONS:

Labrador Affairs has reviewed this memorandum and concurs with the recommendation. Labrador Affairs is interested in further discussions on the Project's anticipated impact on commercial rates for Labrador as commercial rates are a commitment under the Northern Strategic Plan for Labrador.

Aboriginal Affairs has also reviewed this memorandum and the Memorandum of Principles and concurs with the recommendations provided that the commitments made in the Tshash-petapen Agreements which include the Lower Churchill Impacts and Benefits Agreement, the Churchill Falls Hydro-Electric Development Redress Agreement and the Innu Land Claim Agreement in Principle are met.

INTERGOVERNMENTAL CONSIDERATIONS:

The Memorandum of Agreement for the federal loan guarantee outlines a requirement for indicative credit ratings for the Project borrowing entities as a key measure to assess the Project's creditworthiness. Therefore the Memorandum of Principles, a prerequisite for the credit ratings, is necessary to meet the requirements of the Federal Government in finalizing the loan guarantee.

Successful completion of the Project is also imperative for the Government of Nova Scotia to reach its target, defined in the NS Clean Energy Act, of 40% renewable electricity by 2020.

OTHER JURISDICTIONS:

Nalcor Energy has highlighted Ontario Power Generation's ("OPG") 2011 project financing of the \$3 billion Lower Mattagami hydroelectric generation project as a parallel to the financing structure being proposed for the Project. It is a structure that credit rating agencies and lenders will likely use as a comparator for the Lower Churchill. The Lower Mattagami will be funded with a capital structure of 65% debt and 35% equity, with OPG's equity investment coming from \$400 million of existing assets and a \$600 million cash injection. The project risks were considered modest by rating agencies given that the buyer, the Ontario Power Authority, was committed to a contract where all project costs will be recovered. Such contracts are preferred by lenders and this is the model being proposed for Phase One of the Lower Churchill Project.

CONSULTATIONS:

This memorandum and the attached Memorandum of Principles have been reviewed and the recommendations are supported by the Departments of Justice, Finance, Labrador and Aboriginal Affairs, and the Rural Secretariat. Nalcor and its financial and legal advisors were involved in the drafting of the Memorandum of Principles and also support the recommendation.

ENVIRONMENTAL CONSIDERATIONS:

N/A

COMMUNICATION AND CONSULTATION SYNOPSIS:

Please see the attached communications plan.

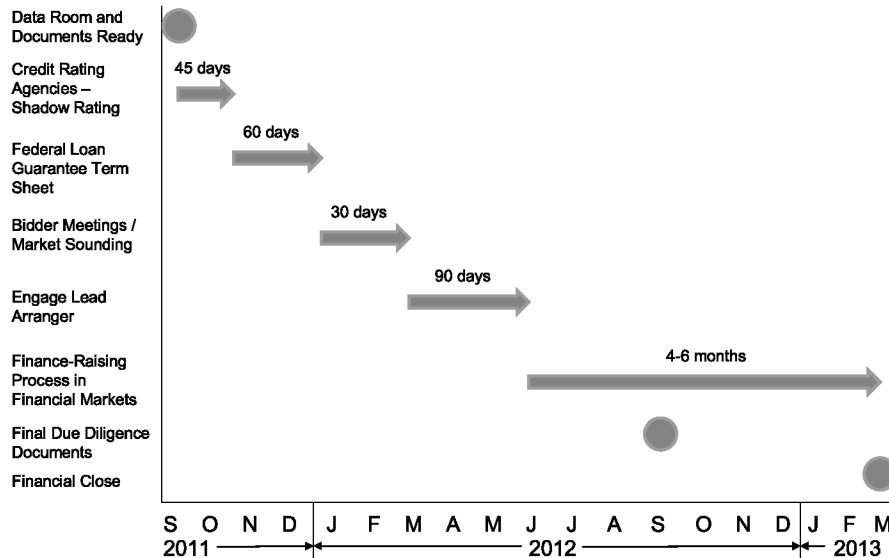
SHAWN SKINNER
Minister of Natural Resources

August 31, 2011

ANNEX A – THE FINANCE-RAISING PROCESS

The finance-raising process for the Project is currently under way and is projected to conclude in early 2013 (see timeline below). Timely approval of the Memorandum of Principles is a crucial step in this timeline. Each major step in the process is defined below.

Finance-Raising Process Phase One of the Lower Churchill Project



- Data Room and Documents Ready** - Nalcor is currently preparing documentation that credit rating agencies, the federal government and potential lenders will require for their assessment of the Project, which is often referred to as the due diligence process. The documents will be stored in a data room, which is a physical and electronic site equipped with appropriate security and confidentiality protection. Only approved organizations and individuals will have access to the data room. The contents of the data room will be extensive and will include financial models and their underlying assumptions as well as documents outlining how the Project will be undertaken (including key engineering documents). The documents in the data room will necessarily evolve during the process with drafts being replaced by finals, assumptions replaced by facts, and commitments replaced by realities. The Memorandum of Principles is a critical document for the data room since it demonstrates Government’s support for the proposed commercial structure, one that reflects that the Project is being undertaken principally for the benefit of the Newfoundland and Labrador market. The target date for initial opening of the data room is September 15, 2011, and it will remain open throughout the finance-raising process.
- Credit Rating Agencies - Shadow Rating** – Once the data room is open, and before receiving the finalized federal loan guarantee, Nalcor will seek a *shadow credit rating* for the borrowing entities for the Muskrat Falls Plant, the Labrador-Island Link and the Labrador Transmission Assets. A shadow credit rating is a confidential credit rating that potential

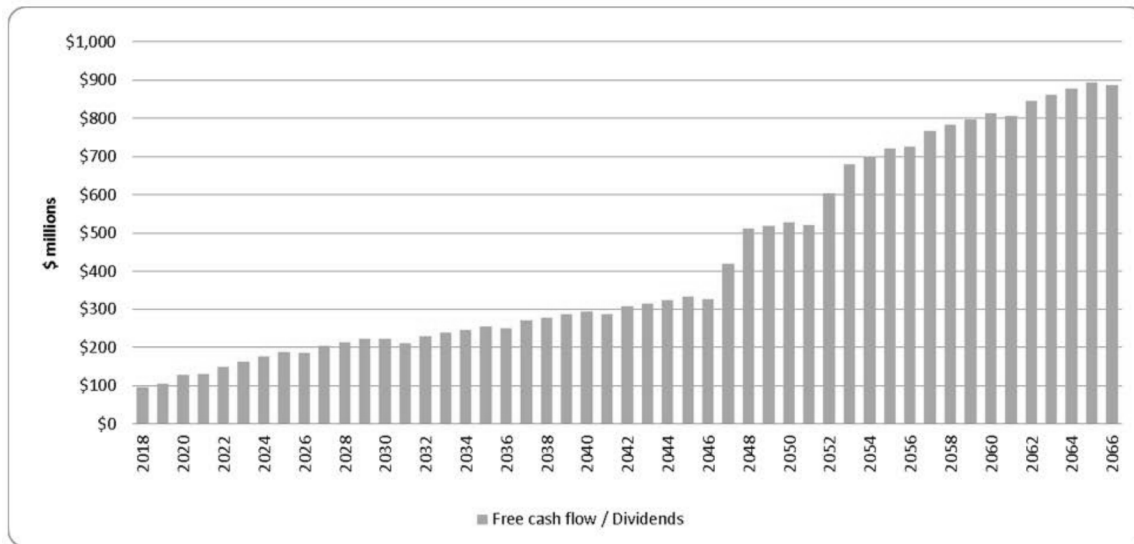
borrowers use to get an indication of the level of risk and creditworthiness that capital markets associate with a project's debt. The immediate need for the shadow credit ratings is to advance the federal loan guarantee discussions. In this regard, the commercial arrangements outlined in the Memorandum of Principles will be critical for the project debt to obtain an *investment-grade* rating, which is a rating of a quality suitable for investment by pension funds and other similar institutions. Standard & Poor's, Moody's and Dominion Bond Rating Service will be engaged for this rating process and have indicated that this will take approximately 45 days. The shadow ratings are therefore projected to be available by mid-November 2011. Lenders will likely also require a formal credit rating, replacing this shadow rating, prior to the commencement of debt funding.

- **Federal Loan Guarantee Term Sheet** – On August 19, 2011, Nalcor reached a Memorandum of Agreement with the Government of Canada on a federal loan guarantee for the Project. The federal government has indicated that a binding term sheet for the loan guarantee will be executed eight weeks after the shadow ratings are provided by Nalcor. In the meantime, federal government due diligence is expected to begin upon their engagement of a financial advisor in September 2011. The federal loan guarantee term sheet will be a key document in Nalcor's finance-raising efforts, as it will significantly strengthen the attractiveness of the Project's debt to potential lenders.
- **Bidder Meetings/Market Sounding** - Once the terms of the federal loan guarantee are confirmed, Nalcor will be in a position to begin the actual finance-raising process and will conduct a series of bidder meetings with financial market participants including Canadian and international banks, investment banks, pension funds, and insurance companies. These meetings, slated for early 2012, will allow Nalcor to communicate the scope, nature and schedule of the Project, along with the proposed financing structure, and to gain information to adjust its financing strategy where necessary. During this phase and the Engage Lead Arranger phase, the commercial agreements outlined in the Memorandum of Principles will need to have been executed, as the financial community will place high importance on this being achieved. Participants in these meetings will include prospective *lead arrangers*, which is one or a team of financial market participants that will lead the raising of project debt financing alongside Nalcor and its other advisors. Canadian and international banks, and Canadian and international investment banks are expected to be candidates for this important role, however, it may also include sophisticated institutional investors who may wish to take on a leading role in the financing process. A primary objective of the bidder meetings will be to demonstrate to potential lead arrangers and lenders that: (i) the Project has the full support of Government and that Government will take the necessary actions to ensure the Project's success; and (ii) Project cash flows will enable servicing and repayment of the associated loans with minimal risk of default. In that regard, the concepts laid out in the Memorandum of Principles serve to minimize any perceived risk to the Project cash flows.
- **Engage Lead Arranger** – The engagement of the lead arranger is projected to begin in April 2012, following completion of the bidder meetings. Preparation of the request for proposals ("RFP") for the lead arranger role, including securing appropriate approvals, as well as updating the data room contents, will be underway from the fall of 2011. Proponents will be given approximately two months to prepare responses indicating their qualifications for the lead arranger role and outlining the approach they intend to take in finance-raising. The RFP will set out Nalcor's financing requirements and critical priorities in detail. Nalcor anticipates

receipt of proposals at the end of May 2012, and engagement of the lead arranger by the end of June 2012.

- **Finance-Raising Process in the Markets and Final Due Diligence Documents** – The lead arranger, in co-operation with Nalcor its advisors, will then commence the finance-raising campaign which includes (i) recruitment of the larger team of banks, investment banks, and principal investors such as pension funds and insurance companies, that will provide the project debt financing; (ii) development and negotiation of the lending documents; and (iii) due diligence investigation by the lead arranger and its larger team. The final stage of finance-raising after the disclosure of final due diligence documents will see the lead arranger coordinate the approvals of all the members of the larger team of banks, investment banks and principal lenders. Final due diligence documents include environmental approval for the Labrador-Island Link, major Project contracts, supporting documents relating to agreements outlined in the Memorandum of Principles, provisions outlined in the Government Commitment Letter, and final public credit ratings for Project borrowing entities.
- **Financial Close** – This is the event at which all lending documents are executed and project debt funding commences. This final step in the finance-raising process depends on the completion of all material aspects of the project disclosure, and is expected to occur 4 to 6 months after the final due diligence documentation is released.

ANNEX B – CHART SHOWING FREE CASH FLOW FROM THE MUSKRAT FALLS PLANT, LABRADOR TRANSMISSION ASSETS, AND LABRADOR-ISLAND LINK



ANNEX C – COMMUNICATIONS PLAN

COMMUNICATIONS PLAN
Department of Natural Resources

Title: Memorandum of Principles Outlining Commercial Arrangements to enable Financing of Phase One of the Lower Churchill Project

Issue: Nalcor is requesting governments support by approving a memorandum outlining principles that will govern the commercial arrangements between Newfoundland and Labrador hydro and Nalcor subsidiaries developing Phase One of the Lower Churchill Project.

Consulted with:	Drafted:	Anticipated Announcement:
<p>Charles Bown, Deputy Minister (Acting), Department of Natural Resources</p> <p>Paul Scott, Assistant Deputy Minister, Energy Policy, Department of Natural Resources</p>	<p>August 31, 2011</p>	<p>Announcement not recommended.</p>

Communications Analysis

Public Environment

On November 18, 2010, the Governments of Newfoundland and Labrador and Nova Scotia announced the signing of a Term Sheet between Nalcor Energy (Nalcor) and Emera Incorporated (Emera) to develop Muskrat Falls, Phase One of the Lower Churchill Project. Phase One includes construction of the 824 megawatt generation station, the Labrador-Island Transmission Link, and the Maritime Link.

On August 19 the Government of Canada signed a Memorandum of Agreement in support of a loan guarantee for the project. In order to qualify for financial assistance, the project was required to demonstrate national and regional significance, economic and financial merit, and its ability to significantly reduce greenhouse gas emissions. The agreement to provide a loan guarantee confirms the project has met these criteria. There will be no fees payable for the loan guarantee, and it will extend to both the construction and post-construction periods for the project. The guarantee will apply to the project’s aggregate construction debt and the initial long-term debt arranged with lenders at the financial close for each phase of the project. The Government of Canada will engage financial advisors to undertake a process to aid in finalizing

the details of the loan guarantee. This process will not affect the timelines associated with the project's development schedule.

The development of Phase One of the Muskrat Falls development is a \$6.2 billion project and will include the Muskrat Falls generating station, Labrador-island transmission Link, and Maritime Link. Newfoundland and Labrador will fund construction of the generating station and the Labrador-island transmission link at a cost of \$5 billion. Emera will invest \$1.8 billion which includes \$1.2 billion for the Maritime Transmission Link, and \$600 million towards construction of the Labrador-Island Transmission Link.

An environmental assessment report by the joint federal-provincial panel was released in August which included 83 recommendations for consideration by both levels of government. The report was critical of the analysis conducted by Nalcor, and provided commentary which has generated moderate media discussion which relate to financial returns and alternatives to the project.

Public commentary continues to focus on electricity rates; growing electricity demand and oil prices; deal with Emera in Nova Scotia and proposed benefits to Nova Scotians; project cost, and debt concerns. Premier Dunderdale, Minister Skinner and Nalcor Energy's Ed Martin and Gilbert Bennett have all been vocal in explaining the inevitable rise of electricity rates in the province of Newfoundland and Labrador remains tied to oil-based power which is affected by price volatility. Countering claims by critics that the people of Newfoundland and Labrador will see an astronomical rise in rates as a result of the Muskrat Falls development, both the Provincial Government and Nalcor Energy have clearly articulated the potential of Muskrat Falls to stabilize electricity rates in the long-term and address the province's growing future energy needs based on projections by PIRA and the International Energy Agency.

Strategic Considerations

- The Memorandum of Principles outlines the commercial arrangements between Newfoundland and Labrador Hydro and newly formed Nalcor subsidiaries associated with the project.
- The memorandum sets the stage for development and execution of the definite agreements among Nalcor entities, which will be required to achieve financial close and advance debt funding.
- Nalcors' financing-raising activities are set to commence in the next few months.
- Approving the memorandum will enable Nalcor to maintain its financing schedule and the overall project schedule to support a project sanction decision in late 2011.
- The memorandum assigns all project costs to Newfoundland and Labrador Hydros regulated ratepayers, while export sales revenue will flow to Nalcor and will not reduce regulated rates. Critics may argue that export profits should be used to lower bills.
- If government chooses to not authorize the memorandum of principles the project schedule, debt financing funding, and federal loan guarantee would likely be delayed.

- Nalcor plans to raise more than half of its \$4.4 billion portion of project construction costs in the capital markets.
- Nalcor has also requested approval of a Commitment Letter which outlines governments intentions in support of the project – this is a separate submission to Cabinet.

Target Audiences

Internal

- Executive Council
- Premier's Office
- Department of Natural Resources
- Department of Justice
- Department of Finance
- MHAs
- Nalcor

External

- Government of Nova Scotia
- Government of Canada
- Emera
- Opposition
- Media
- Public

Consultation

Consultation has taken place with the Department of Justice, the Department of Finance, Labrador and Aboriginal Affairs, Women's Policy Office, Rural Secretariat and Nalcor. No public consultations are planned or required.

Communications Objectives

- To clearly articulate that the memorandum of principles would identify certain commercial arrangements in anticipation of developing the Lower Churchill project.

Communications Strategy

Messages

- The Provincial Government is supporting Nalcor with activities to assure potential lenders have information on governments intentions on the development of the Lower Churchill project, and the generation of sufficient cash flow to service its debts.
- The Memorandum of Principles outlines the commercial arrangements between Newfoundland and Labrador Hydro and newly formed Nalcor subsidiaries associated with the project.

- The commercial arrangements relate to the supply and transmission of power from the Muskrat Falls plant and the sale of electricity in markets outside Newfoundland and Labrador as a result of the interconnection of the provincial electricity system within the North American Grid.
- The memorandum provides details on proposed transactions and cost recovery, efforts to maximize value for taxpayers and ratepayers, and information on credit-worthiness of the project.
- The effort to secure financing will reduce overall projects costs and will benefit ratepayers in the province.
- We are confident that Nalcor is managing the risks of the Lower Churchill Project appropriately, and assuming an appropriate amount of risk that balances the benefits and rewards Newfoundlanders and Labradorians will gain from this development.

The Announcement (and activities)

An announcement is not recommended.

Minister's Involvement

The Minister of Natural Resources will be the lead.

Interdepartmental Coordination

The Departments of Natural Resources, Finance, Justice in consultation with Nalcor are engaged.

Briefing of Members of the House of Assembly

Members will be briefed as required.

Internal Communications

The Departments of Natural Resources, Finance, Justice, and Nalcor continue to be engaged with this issue.

Follow-up Activities

N/A

Evaluation Criteria

Media will be monitored and responded to appropriately in the event that the commitment letter becomes public.

Budget

N/A

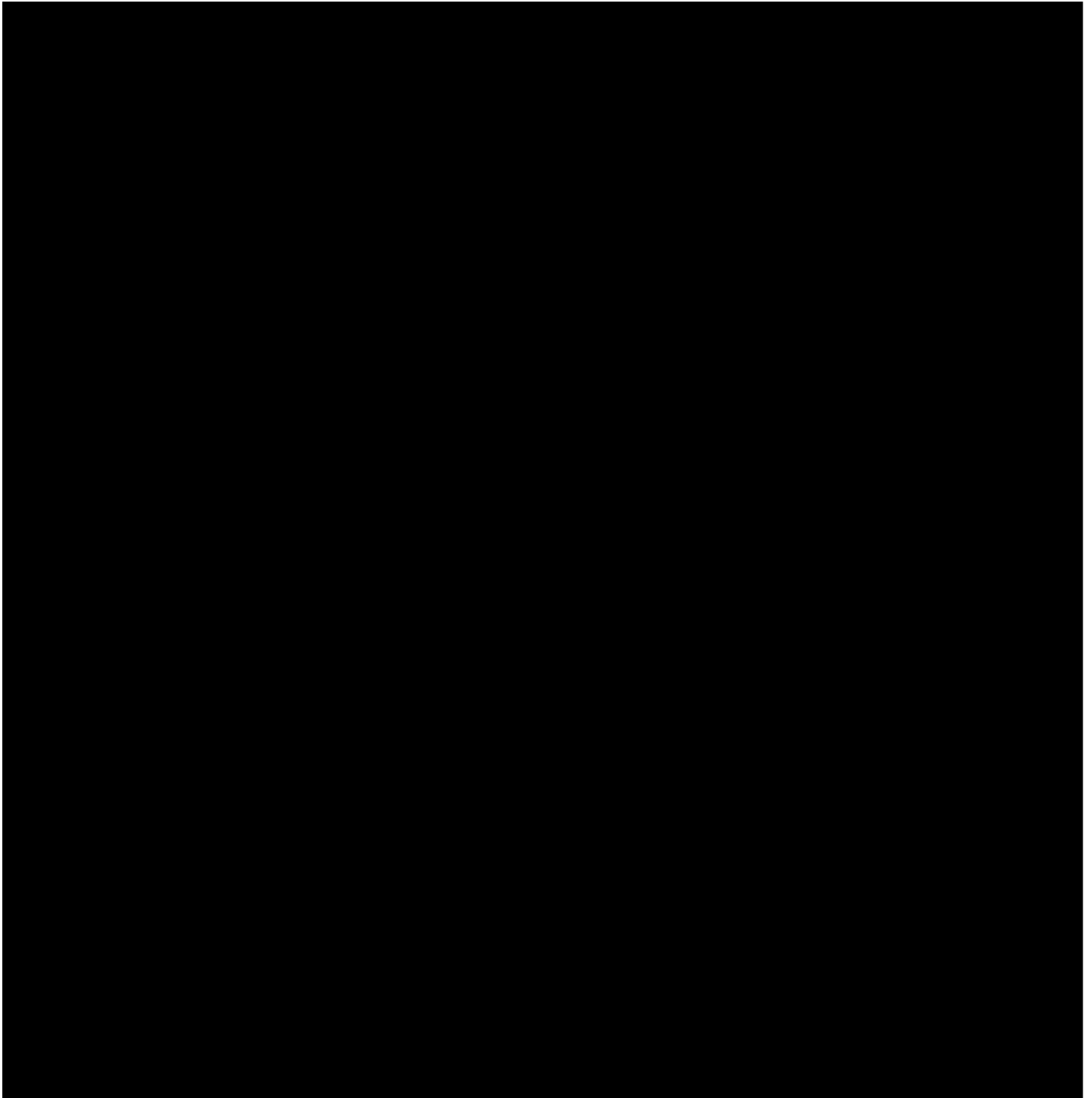
Drafted by:

Heather Maclean, Director of Communications, 709-729-5282

Approved by:

Charles Bown, Associate Deputy Minister, 709-729-2349

Paul Scott, Assistant Deputy Minister, Energy Policy, 709-729-1406

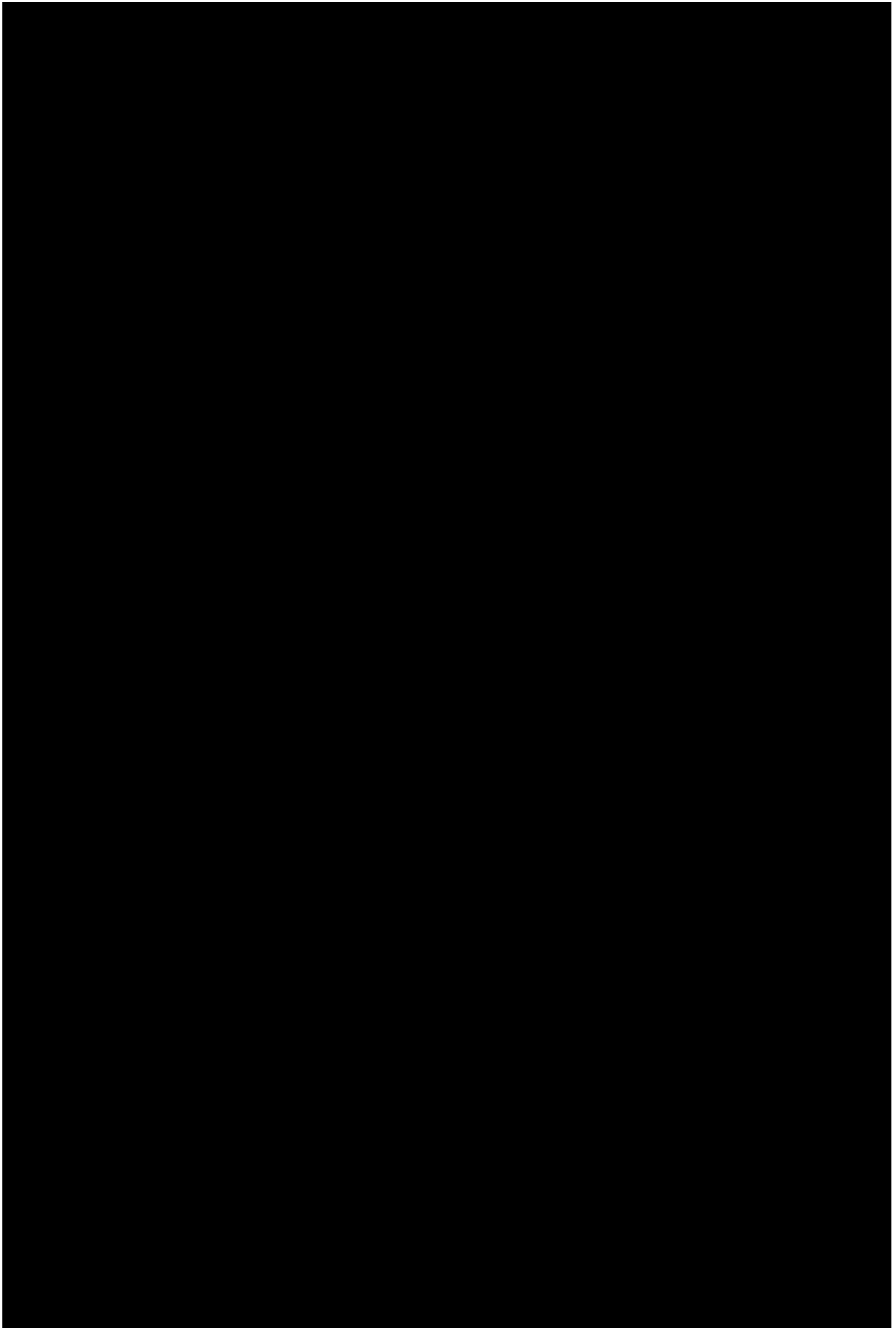


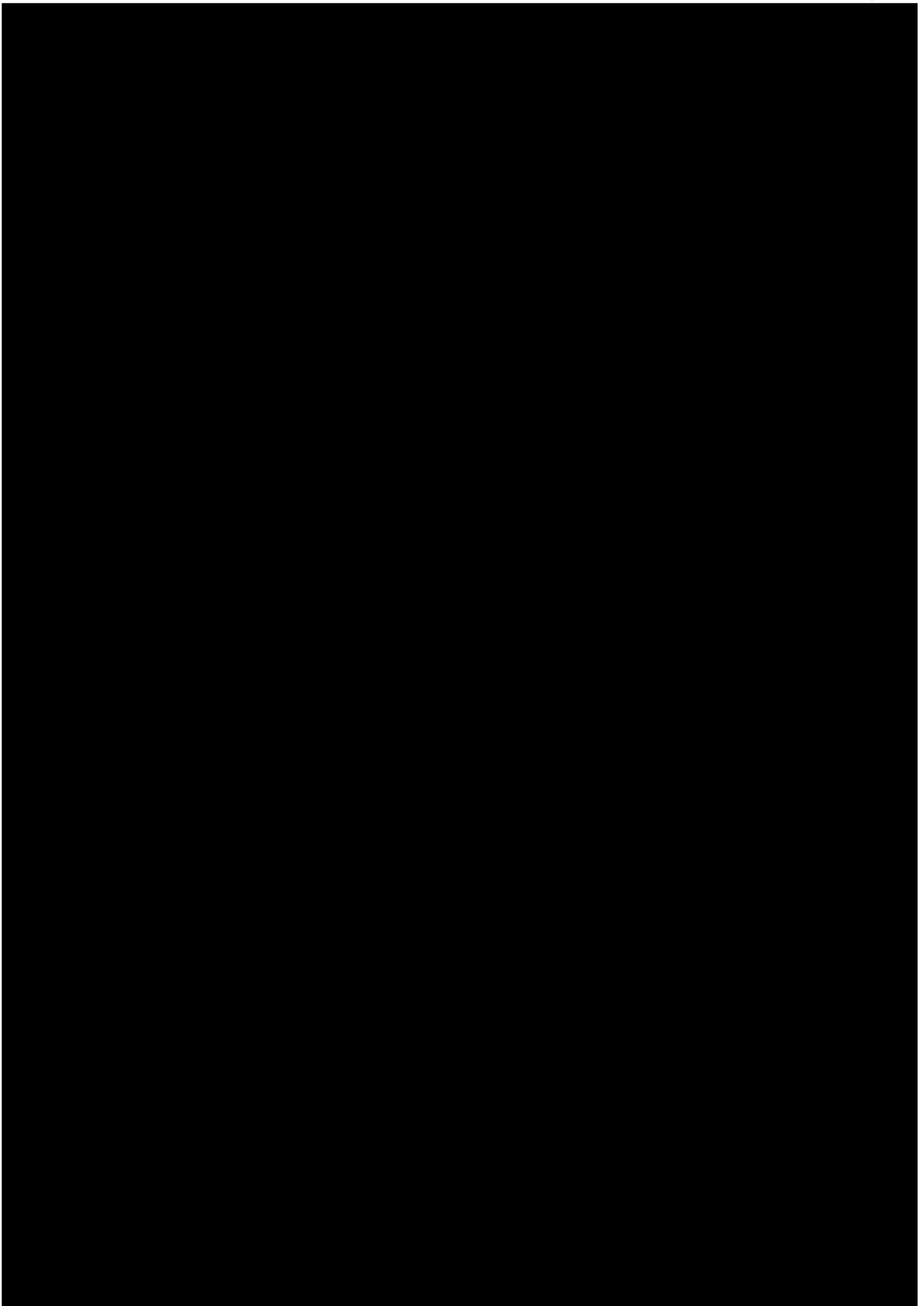
Draft: August 29, 2011

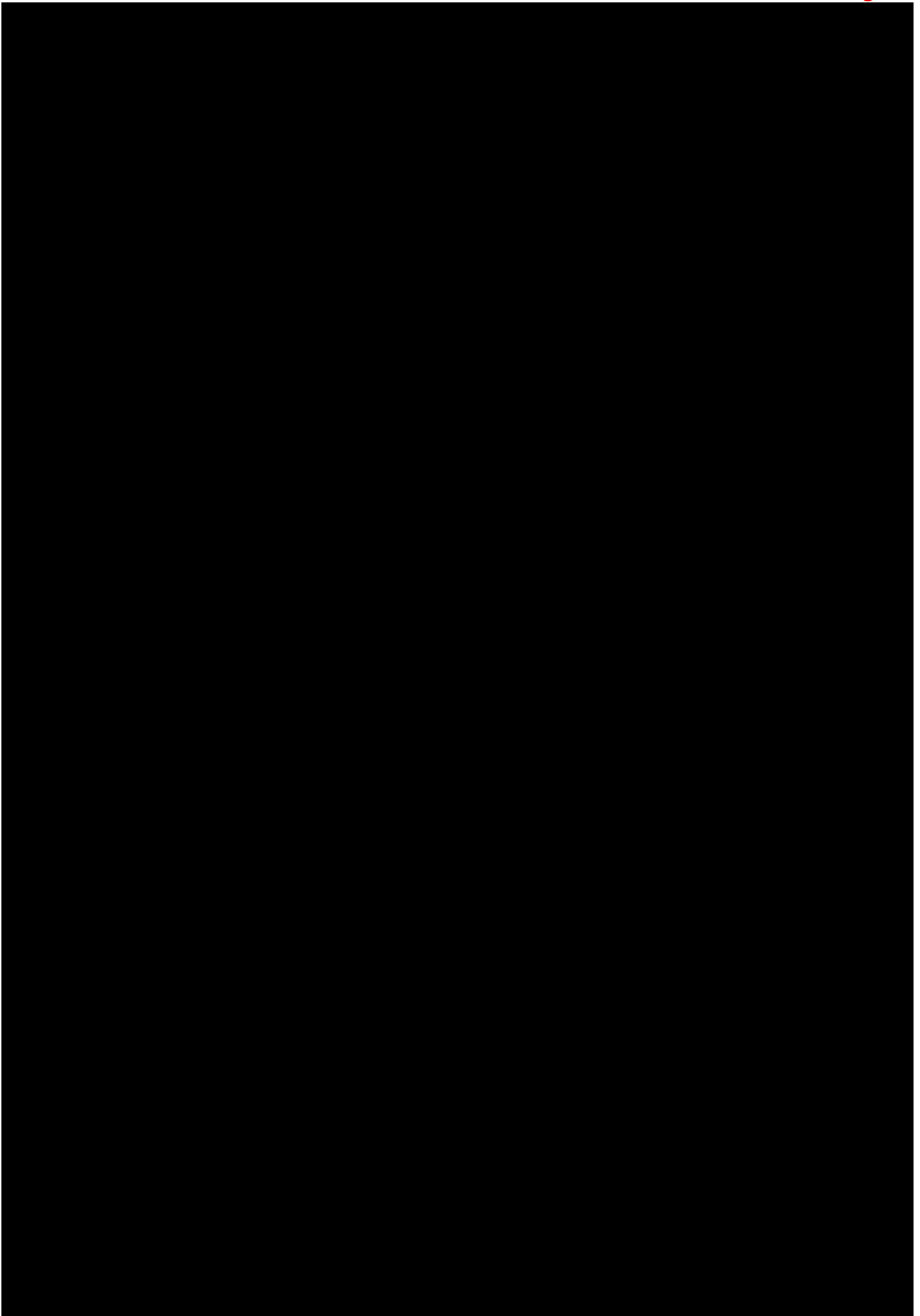
Confidential & Commercially Sensitive

LAWYER-CLIENT PRIVILEGE ASSERTED



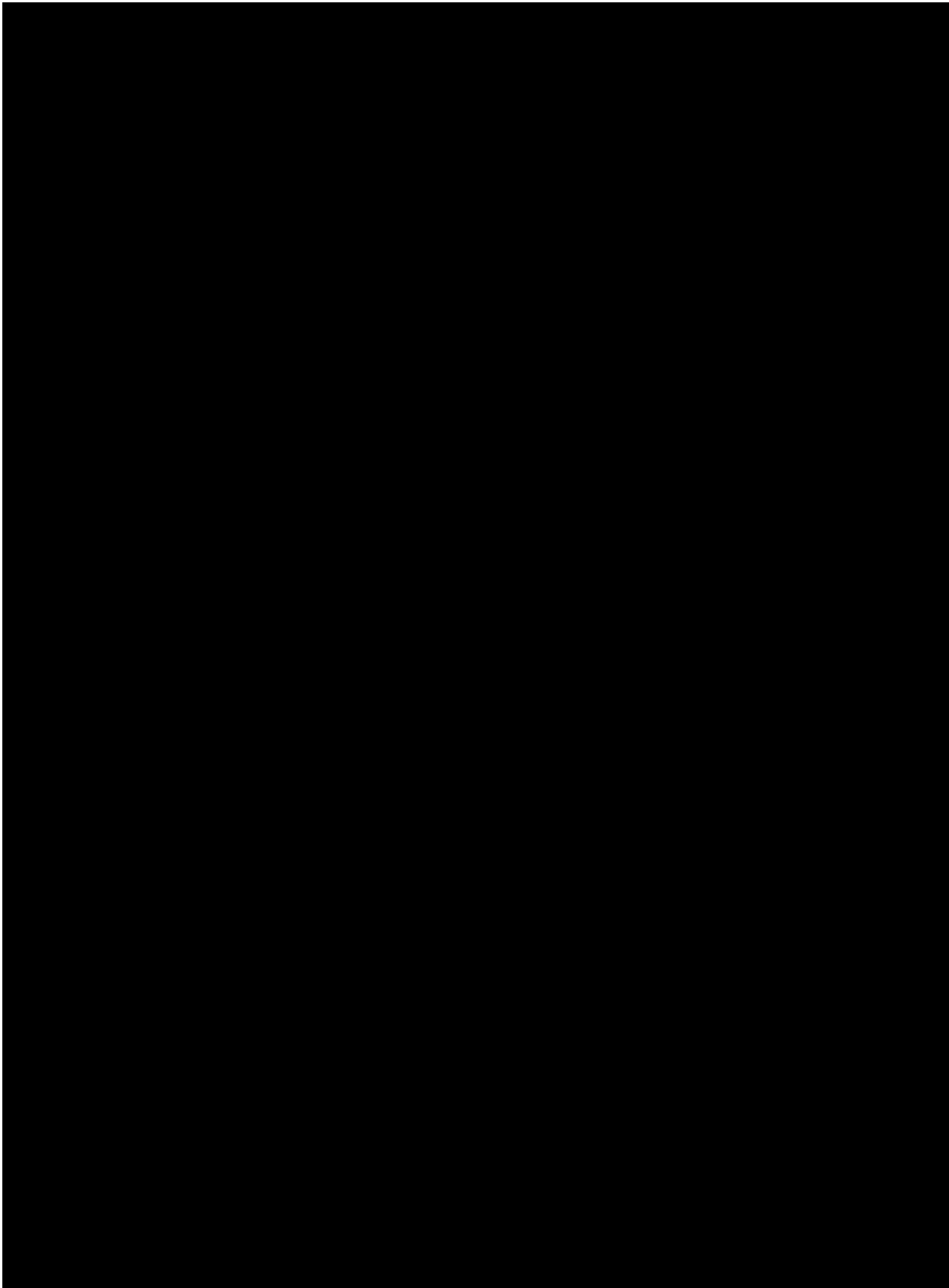






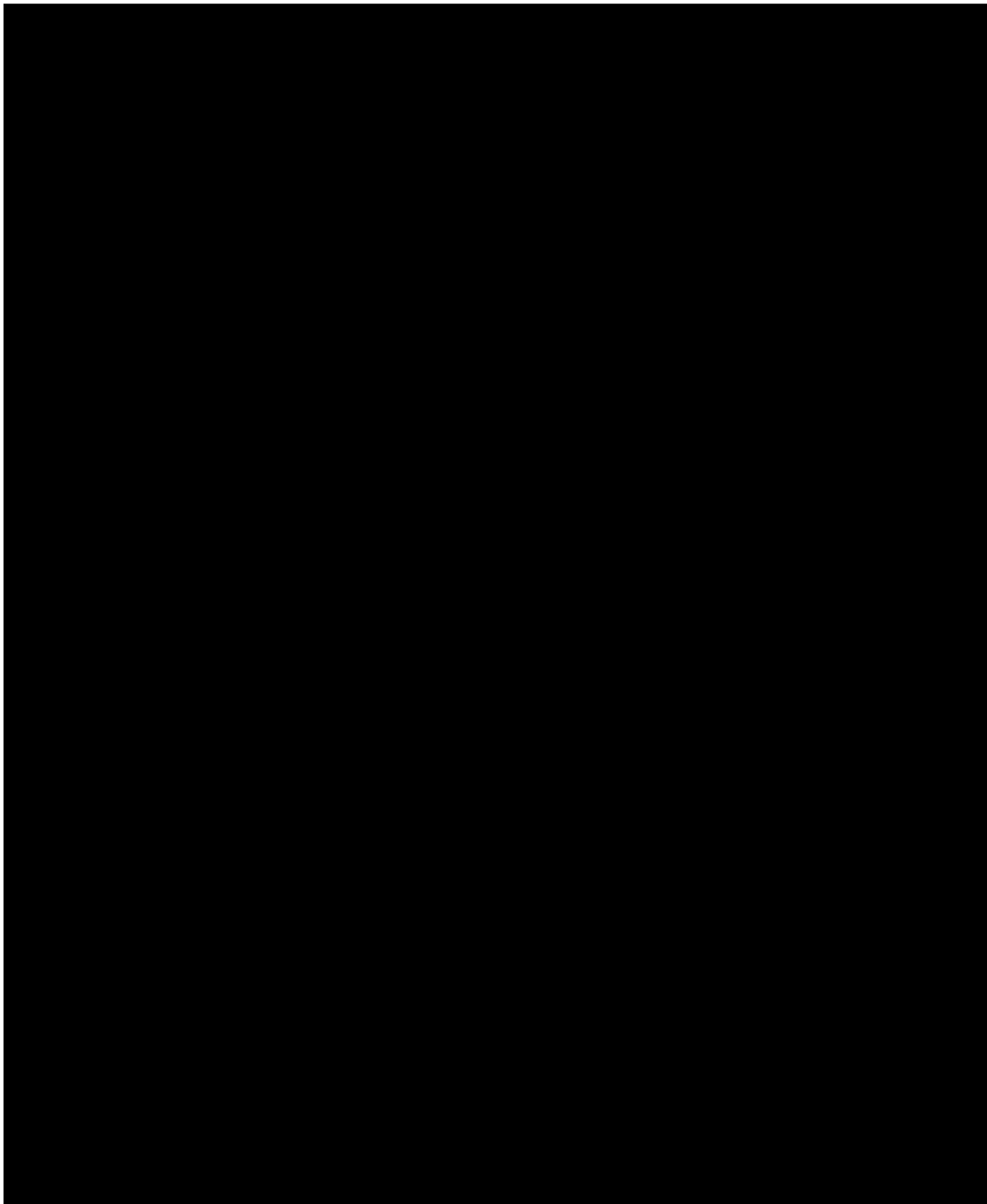
██████████ August 29, 2011
LAWYER-CLIENT PRIVILEGE ASSERTED

Confidential & Commercially Sensitive



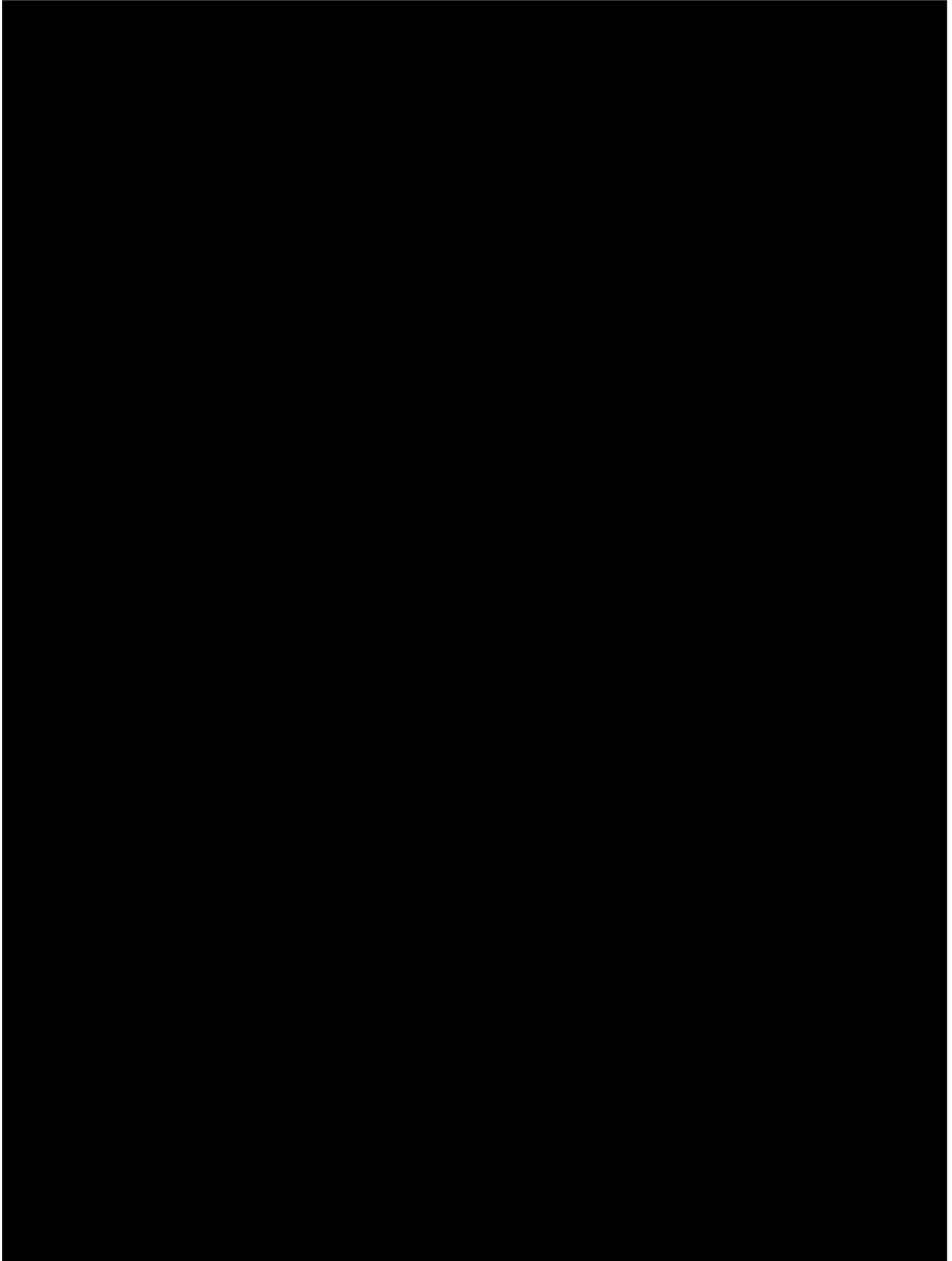
Draft: August 29, 2011
LAWYER-CLIENT PRIVILEGE ASSERTED

Confidential & Commercially Sensitive



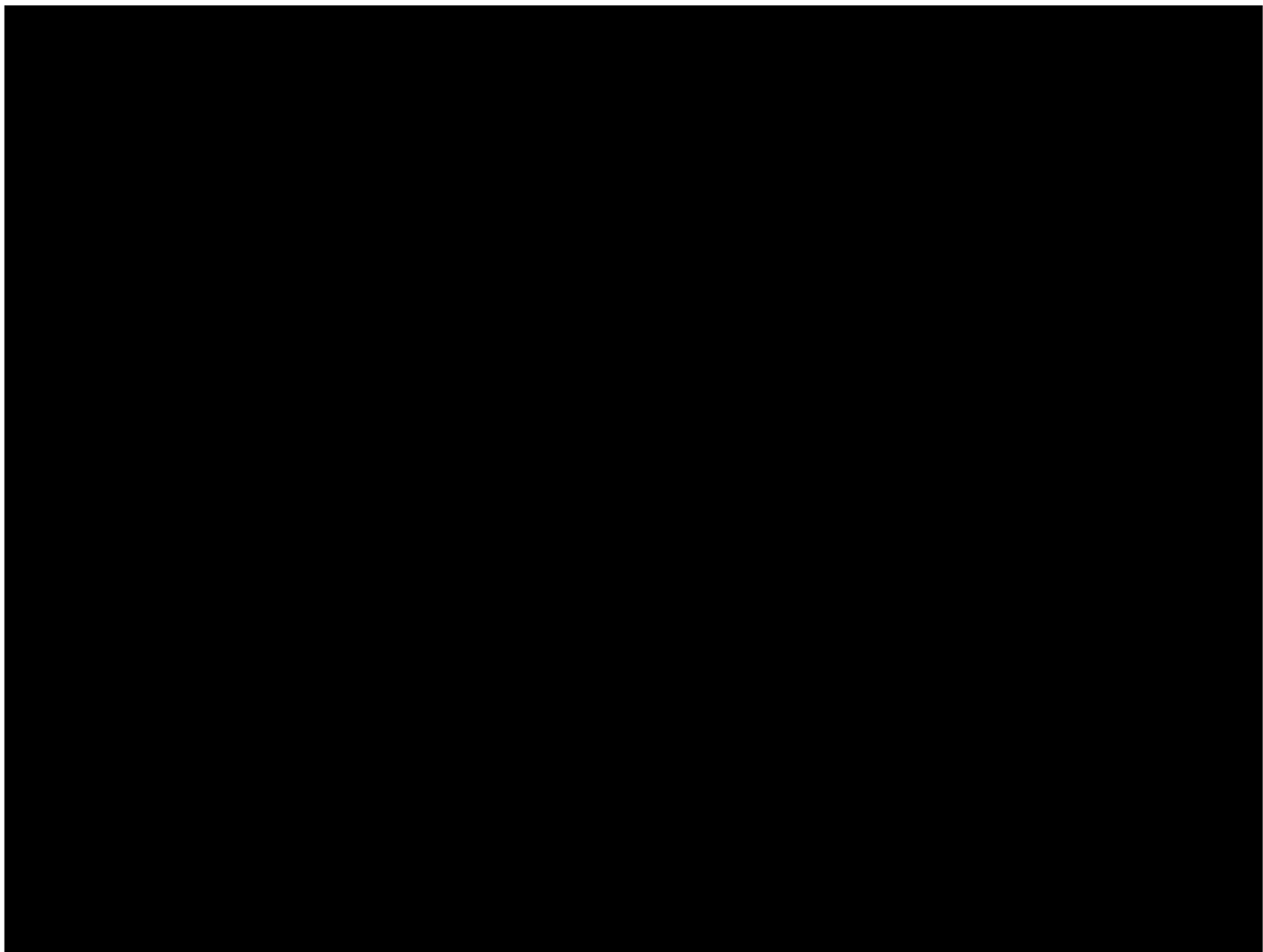
Draft: August 29, 2011
LAWYER-CLIENT PRIVILEGE ASSERTED

Confidential & Commercially Sensitive



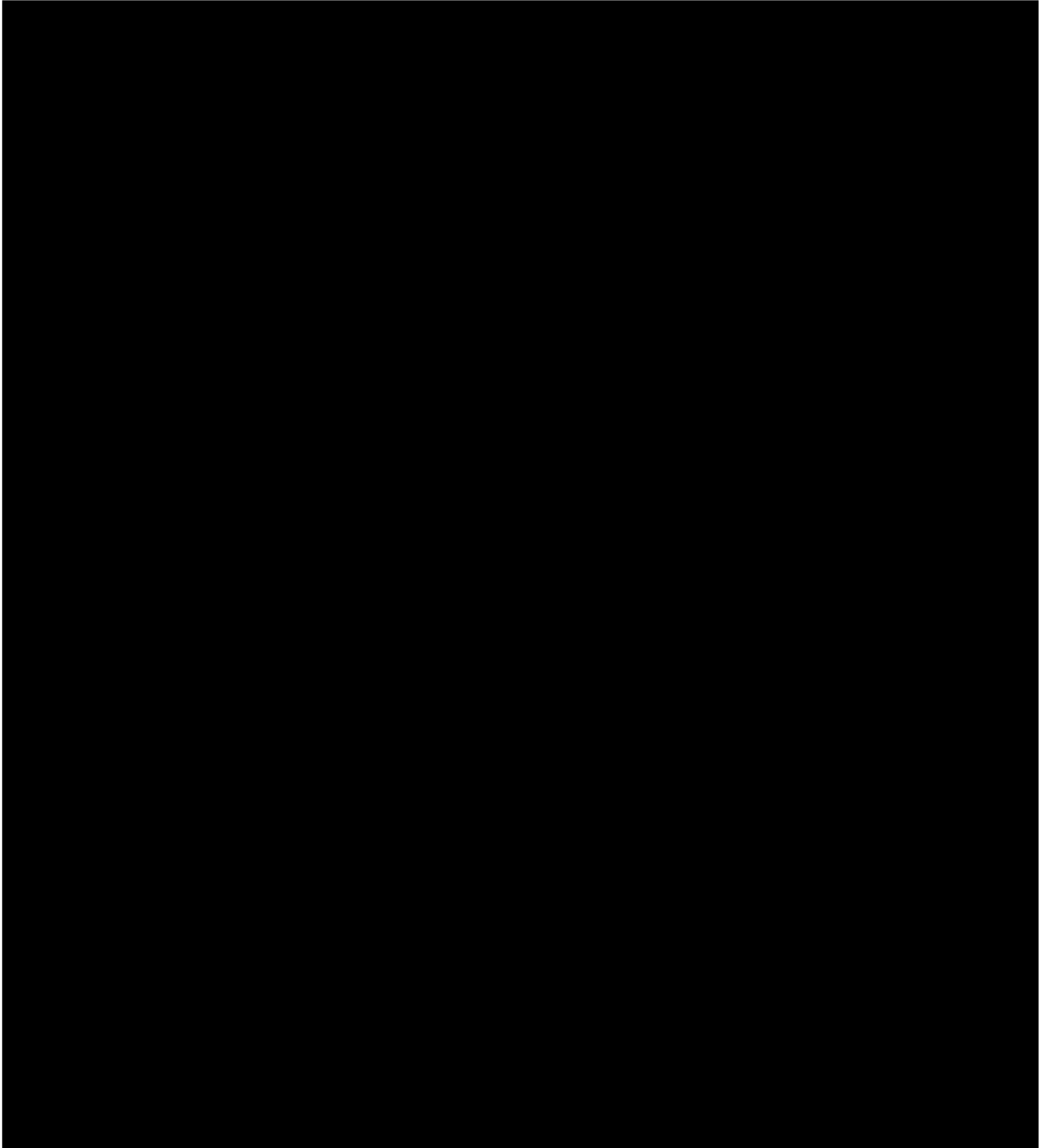
Draft: August 29, 2011
LAWYER-CLIENT PRIVILEGE ASSERTED

Confidential & Commercially Sensitive



Draft: August 29, 2011
LAWYER-CLIENT PRIVILEGE ASSERTED

Confidential & Commercially Sensitive



Attach To:NR2011-

COMMUNICATIONS BRANCH ANALYSIS**Title:**

MEMORANDUM OF PRINCIPLES OUTLINING COMMERCIAL ARRANGEMENTS TO ENABLE FINANCING OF PHASE ONE OF THE LOWER CHURCHILL PROJECT

Branch**Comment:**

The Communications Branch has reviewed the submission and has the following comments:

Key Messages:

There are several points raised in the cabinet submission that will have significant communications impacts. Key messages need to be developed around these, which include:

- Criticism that export profits should be used to lower electricity bills and attract industrial development. There may also be criticism that the proposed structure discourages ratepayers from reducing consumption as they will have to pay the full cost of the project, regardless of usage.
- Hydro's regulated rates will cover the province's share of the entire cost of the project (rate payer's money). Why are rate payers paying if Nalcor is getting significant revenue?
- This could negatively impact the province's credit rating and ability to borrow in future years
- Interest and debt servicing costs will not be paid by tax payers.

Target Audience:

The following should be added to external audiences: credit rating agencies and lenders

Announcement:

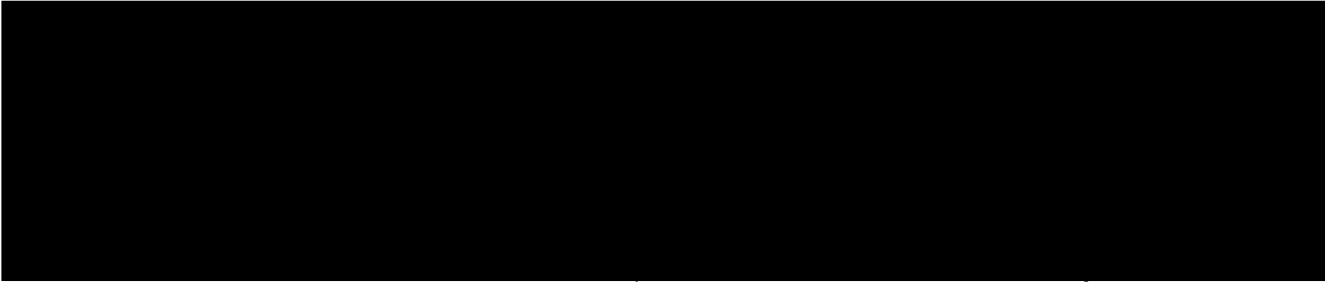
The plan does not recommend an announcement. However, given that legislative changes will be required, the issue will be debated publicly during the Spring 2012 session of the House of Assembly. The Provincial Government may be criticized at that time for waiting to disclose the memorandum and the Minister should be fully prepared to address such criticism. Consideration may be given to making a public statement sooner.

The communications plan must be revised / updated – particularly key messages - in conjunction with the Branch and the Communications Director for the Premier's Office once cabinet direction is received.


Date: 02/09/11

Prepared by: Jennifer Collingwood


Reviewed by: Jacquelyn Howard



2011/09/06

MC2011-

NR/DM
E. Martin
J. Cheeseman
AG
Deputy Clerk
File

NR2011-

The Submission of the Minister of Natural Resources respecting Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project was considered.

Approval was given for the Memorandum of Principles, substantially along the lines of the draft attached to the Minister's Submission as Annex D, that will govern the commercial arrangements between Newfoundland and Labrador Hydro and the Nalcor subsidiaries in developing Phase One of the Lower Churchill Project, subject to the Department of Natural Resources consulting with the Communications Branch on a revised communications plan.

Clerk of the Executive Council

Email Message

From: Constantine, Robert [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=RCONSTANTINE]
To: Hammond, Vaughn [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=VAUGHNHAMMOND]
Cc: Marshall Q.C., Hon. Thomas [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=TOMMARSHALL], Paddon, Terry [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=TPADDON], Myrden, Paul [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=PMYRDEN], Blanche, Pauline [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=PAULINEBLANCHE], Quigley, David [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=DQUIGLEY]
Sent: 9/2/2011 at 12:11 PM
Received: 9/2/2011 at 12:11 PM
Subject: RE: NR2011-████ and NR2011-████

The Department of Finance has reviewed the ongoing drafts of the Commitment Letter and the Memorandum of Principles, as well as NR 2011-████ and NR2011-████. FIN has provided text for the Financial Considerations section of the submission, and this text has been incorporated.

Perhaps the most significant public policy issue/communications challenge (although these are not public documents at this stage) lies in the proposed Power Purchase Agreement between Muskrat Falls and NL Hydro as outlined in the Memorandum of Principles (MOP).

Under the proposed PPA

- * There are 3 power blocks - the Base Block, the Supplemental Block and the Residual Block.
- * Hydro is agreeing to purchase all 3 blocks, with power in excess of Hydro's needs being sold in export markets.
- * Hydro must take the Base Block on a "take or pay basis" meaning they will pay for this power whether or not they need all of it.

Base Block

- * Revenues paid to Muskrat Falls (and Nalcor) by Hydro for the Base Block will be sufficient to recover the Cost of Service which essentially includes all costs plus an Internal Rate of Return (IRR).
- * The IRR amount is not specified, so as not to commit government at this time, but an 8.4% IRR is used for modeling purposes.
- * Hydro will recover its costs through regulated rates in accordance with the commitment letter.
- * This essentially means the ratepayer will pay for Muskrat Falls Project through the Base Block. Any revenues above the base block will accrue to Nalcor and will not reduce rates to the NL ratepayer.
- * This is the basis of the modeling, and the basis of determining the Free Cash Flows/ Dividends in Appendix B of NR2011-████. The cabinet submission states that it will be a decision of future governments as to whether these profits are returned to the taxpayer or to the ratepayer.

* The amount of energy available within the Base Block increases over time with domestic demand and would be fully subscribed by Hydro by 2066.

Supplemental Block

* If Hydro requires energy over and above the Base Block, it can acquire a Supplemental Block. Hydro will pay export market rates (based upon a published price) for the Supplemental Blocks, which in the near term would be less than the cost of Base Block energy.

* It may be argued that the ratepayer is already paying for the project through regulated rates for the Base Block, and is paying again for the Supplemental Block.

Residual Block

* The residual Block is any amount of energy not in the Base Block or Supplemental Block.

* Hydro will purchase this from Muskrat and will sell it to NEM. Hydro will purchase and sell this energy at the same price, resulting in no net cost to Hydro.

* Again, arguably, Hydro (the ratepayer) has paid for the power through the Base Block.

From: Hammond, Vaughn
Sent: Friday, September 02, 2011 10:16 AM
To: Constantine, Robert
Subject: FW: NR2011-████ and NR2011-████
Importance: High

Hi Bob,

In Terry's absence, please see below.

Regards,

Vaughn

From: Hammond, Vaughn
Sent: Friday, September 02, 2011 10:15 AM
To: Quigley, David; Blanche, Pauline; Paddon, Terry; Stanley, Todd; Cheeseman, Josephine; Collingwood, Jennifer; Manning, Bryan; Dutton, Sean
Cc: Bowles, Ron; Gover, Aubrey; English, Tracy
Subject: NR2011-████ and NR2011-████
Importance: High

Good morning,

The above noted, and related, Cabinet submissions, titled "Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project" and "Commitment Letter to Assist Financing of Phase One of the Lower Churchill Project" were signed by the Natural Resources Minister last evening and Cabinet Secretariat expects to receive hard copies of the submissions later this morning. However, Cabinet Secretariat's analyses of these submissions have to be completed by end of day today because these papers will be considered by Cabinet during its meeting on Tuesday September 6. Therefore, I have had the submissions placed on your departmental secured drives for you to retrieve for review and ask that you have your comments on the submissions sent to me by 1 pm today (Friday September 2). I recognize that this does not give you much time and sincerely apologize for this. If you have concerns getting access to the submissions, please let me know.

Sean, I'm sending this to you for LAA's and IGAS' perspective and have copied Ron, Aubrey and Tracy.

Regards,

Vaughn Hammond

Cabinet Officer

Cabinet Secretariat

729-2418

vaughnhammond@gov.nl.ca

Email Message

From: Blanche, Pauline [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=PAULINEBLANCHE]
To: Hammond, Vaughn [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=VAUGHNHAMMOND]
Cc: Grandy, Glenn [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=GLENNGRANDY], Quigley, David [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=DQUIGLEY], Morris, Joan E. [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=JMORRIS], Terry, Kayla [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=KAYLATERRY]
Sent: 9/2/2011 at 1:13 PM
Received: 9/2/2011 at 1:13 PM
Subject: RE: NR2011-████ and NR2011-████

NR2011-████

We have reviewed the Cabinet Paper entitled 'Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project' and note that the Memorandum of Principles is necessary to meet the requirements of the Federal Government in finalizing the loan guarantee and authorizing the Memorandum does not place any financial obligation on Government, thus there are no financial implications at this time.

It should be noted however, that statements on pg 3 (last bullet on pg) and pg 4 (last par under Pros) are somewhat contradictory. The first states proceed from export sales will go to Nalcor and not automatically benefit taxpayers whereas pg 4 states taxpayers will benefit as proceeds from export sales will be available to GNL in form of dividends. Which is it? Earlier statement on pg 3 (3) states that revenue proceed will be dependent on policy decision of GNL at the time.

NR2011-████

We have reviewed the Cabinet Paper entitled 'Commitment Letter to Assist Financing of Phase One of the Lower Churchill Project' and note that the Commitment Letter is necessary to meet the requirements of the Federal Government in finalizing the loan guarantee and authorizing the Letter does not place any immediate financial obligations on Government, thus there are no financial implications at this time.

It should be noted; however that one of key component of the Lower Churchill deal has been investment of Emera in the Labrador-Island link - 29% (.6 B). Several statements made in this paper seem to cast possible doubt on Emera's participation (ie pg 6, bullet 1); Appendix D (pg 1, bullet 2) and pg 2 (# 2). What are cost implications to ratepayers and/or taxpayers should Emera back out of the agreement?

Vaughn, please note that given the short turnaround time we were unable to review both papers in detail.

Should you require any further information please do not hesitate to contact me.

Pauline

From: Hammond, Vaughn
Sent: Friday, September 02, 2011 10:15 AM
To: Quigley, David; Blanche, Pauline; Paddon, Terry; Stanley, Todd; Cheeseman, Josephine; Collingwood, Jennifer; Manning, Bryan; Dutton, Sean
Cc: Bowles, Ron; Gover, Aubrey; English, Tracy
Subject: NR2011-██████ and NR2011-██████
Importance: High

Good morning,

The above noted, and related, Cabinet submissions, titled "Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project" and "Commitment Letter to Assist Financing of Phase One of the Lower Churchill Project" were signed by the Natural Resources Minister last evening and Cabinet Secretariat expects to receive hard copies of the submissions later this morning. However, Cabinet Secretariat's analyses of these submissions have to be completed by end of day today because these papers will be considered by Cabinet during its meeting on Tuesday September 6. Therefore, I have had the submissions placed on your departmental secured drives for you to retrieve for review and ask that you have your comments on the submissions sent to me by 1 pm today (Friday September 2). I recognize that this does not give you much time and sincerely apologize for this. If you have concerns getting access to the submissions, please let me know.

Sean, I'm sending this to you for LAA's and IGAS' perspective and have copied Ron, Aubrey and Tracy.

Regards,

Vaughn Hammond

Cabinet Officer

Cabinet Secretariat

729-2418

vaughnhammond@gov.nl.ca <mailto:vaughnhammond@gov.nl.ca>

Email Message

From: English, Tracy [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=TENGLISH]
To: Hammond, Vaughn [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=VAUGHNHAMMOND]
Cc: Janes, Mark [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=MARKJANES]
Sent: 9/2/2011 at 12:52 PM
Received: 9/2/2011 at 12:52 PM
Subject: RE: NR2011-████ and NR2011-████

Vaughn

Given the short turn around time, we reviewed the papers solely for IG implications. As a result, we have no issues with the Submissions.

tracy

From: Hammond, Vaughn
Sent: Friday, September 02, 2011 10:15 AM
To: Quigley, David; Blanche, Pauline; Paddon, Terry; Stanley, Todd; Cheeseman, Josephine; Collingwood, Jennifer; Manning, Bryan; Dutton, Sean
Cc: Bowles, Ron; Gover, Aubrey; English, Tracy
Subject: NR2011-████ and NR2011-████
Importance: High

Good morning,

The above noted, and related, Cabinet submissions, titled "Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project" and "Commitment Letter to Assist Financing of Phase One of the Lower Churchill Project" were signed by the Natural Resources Minister last evening and Cabinet Secretariat expects to receive hard copies of the submissions later this morning. However, Cabinet Secretariat's analyses of these submissions have to be completed by end of day today because these papers will be considered by Cabinet during its meeting on Tuesday September 6. Therefore, I have had the submissions placed on your departmental secured drives for you to retrieve for review and ask that you have your comments on the submissions sent to me by 1 pm today (Friday September 2). I recognize that this does not give you much time and sincerely apologize for this. If you have concerns getting access to the submissions, please let me know.

Sean, I'm sending this to you for LAA's and IGAS' perspective and have copied Ron, Aubrey and Tracy.

Regards,

Vaughn Hammond

Cabinet Officer

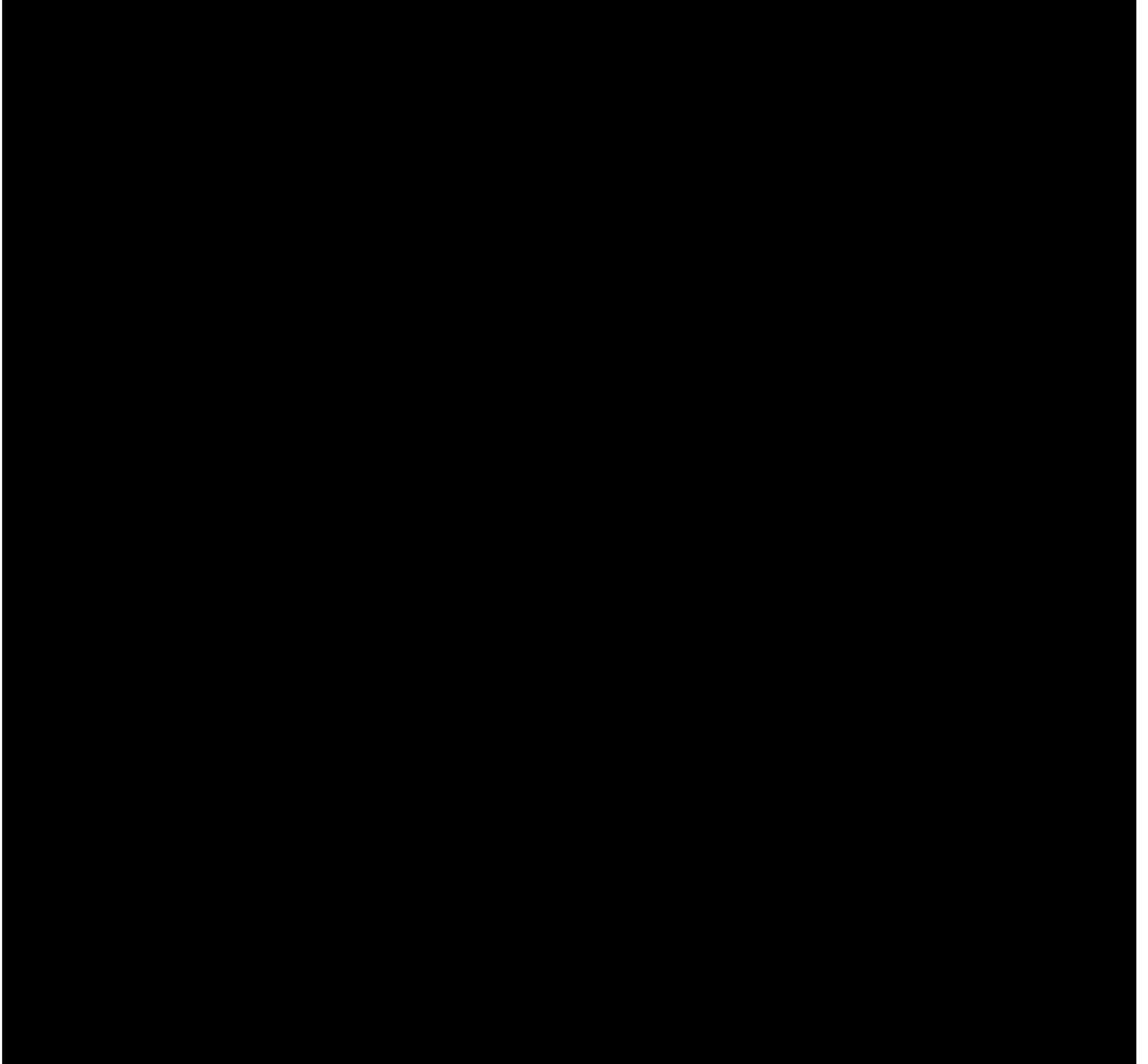
Cabinet Secretariat

729-2418

vaughnhammond@gov.nl.ca

Email Message

From: Stanley, Todd [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=TODDSTANLEY]
To: Scott, Paul G. [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=PAULS], Tucker, Ian J. [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=IANTUCKER]
Cc: Pelletier, Randy [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=RANDYPELLETIER]
Sent: 9/7/2011 at 9:33 AM
Received: 9/7/2011 at 9:33 AM
Subject: RE: NR2011-[REDACTED]



From: Tucker, Ian J.
Sent: Tuesday, September 06, 2011 2:54 PM
To: Scott, Paul G.
Subject: NR2011-██████

Good afternoon Paul - I am preparing an MC for the above-noted paper re the MOP for LCP commercial arrangements. The recommendation in the paper seeks approval of the Lieutenant Governor in Council. I am wondering whether there is a legislative authority requiring LGC approval (which would require an OC) or whether the MC from Cabinet is sufficient?

Thanks,

Ian

Ian Tucker

Cabinet Officer

Cabinet Secretariat, Executive Council

Government of Newfoundland and Labrador

P.O. Box 8700

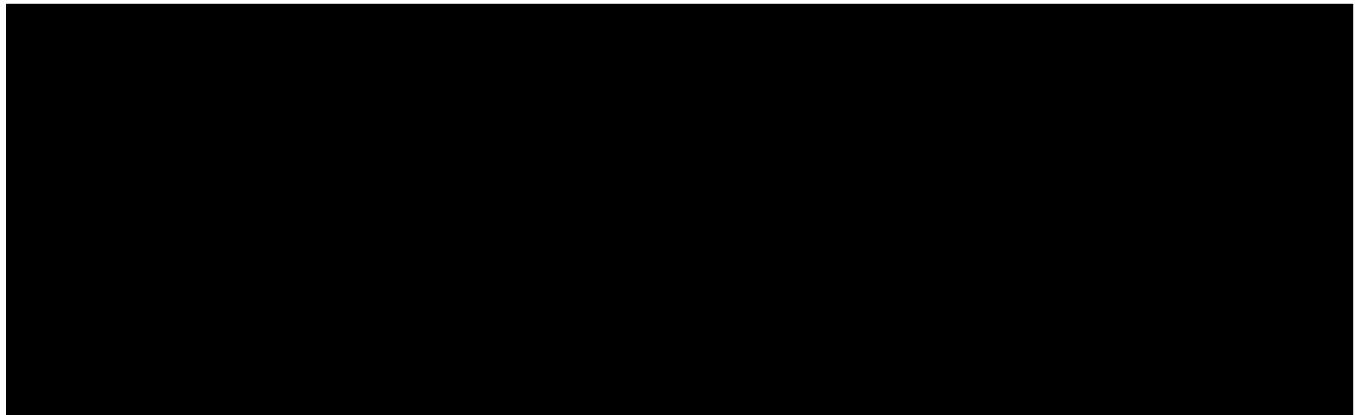
St. John's, NL A1B 4J6

Telephone: (709) 729-0966

Email: iantucker@gov.nl.ca

Email Message

From: Stanley, Todd [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=TODDSTANLEY]
To: Hammond, Vaughn [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=VAUGHNHAMMOND]
Cc:
Sent: 9/2/2011 at 10:36 AM
Received: 9/2/2011 at 10:36 AM
Subject: RE: NR2011-████ and NR2011-████



████ e-mail (including any attachments) is confidential and is intended only for the use of the addressee(s). The contents of this e-mail may contain personal information and / or be covered by various forms of privilege, including solicitor/client privilege. Any unauthorized copying, distribution, publication or disclosure is prohibited. Receipt of this e-mail by anyone other than the intended recipient does not constitute waiver of privilege. If you have received this e-mail in error, please notify the sender or the Civil Division of the Department of Justice, Government of Newfoundland and Labrador and delete all versions of same. Thank you.

From: Hammond, Vaughn
Sent: September 2, 2011 10:15 AM
To: Quigley, David; Blanche, Pauline; Paddon, Terry; Stanley, Todd; Cheeseman, Josephine; Collingwood, Jennifer; Manning, Bryan; Dutton, Sean
Cc: Bowles, Ron; Gover, Aubrey; English, Tracy
Subject: NR2011-████ and NR2011-████
Importance: High

Good morning,

The above noted, and related, Cabinet submissions, titled "Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project" and "Commitment Letter to Assist Financing of Phase One of the Lower Churchill Project" were signed by the Natural Resources Minister last evening and Cabinet Secretariat expects to receive hard copies of the submissions later this morning. However, Cabinet Secretariat's analyses of these submissions have to be completed by end of day today because these papers will be considered by Cabinet during its meeting on Tuesday September 6. Therefore, I have had the submissions placed on your departmental secured drives for you to retrieve for review and ask that you have your comments on the submissions sent to me by 1 pm today (Friday

September 2). I recognize that this does not give you much time and sincerely apologize for this. If you have concerns getting access to the submissions, please let me know.

Sean, I'm sending this to you for LAA's and IGAS' perspective and have copied Ron, Aubrey and Tracy.

Regards,

Vaughn Hammond

Cabinet Officer

Cabinet Secretariat

729-2418

vaughnhammond@gov.nl.ca

Email Message

From: Gover, Aubrey [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=AUBREYGOVER]
To: Dutton, Sean [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=SDUTTON], Hammond, Vaughn [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=VAUGHNHAMMOND]
Cc: Watkins, Michelle [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=MICHELLEWATKINS]
Sent: 9/2/2011 at 11:23 AM
Received: 9/2/2011 at 11:23 AM
Subject: RE: NR2011-████ and NR2011-████

I think it was last Friday that AA basically advised-Given the short time allowed to comment on this, AA has no concerns as long as the arrangements are consistent with the New Dawn Agreements.

From: Dutton, Sean
Sent: Friday, September 02, 2011 10:17 AM
To: Hammond, Vaughn
Cc: Watkins, Michelle; Gover, Aubrey
Subject: Re: NR2011-████ and NR2011-████

I think LAA already commented?

Sean

Sent Via BlackBerry

From: Hammond, Vaughn
To: Quigley, David; Blanche, Pauline; Paddon, Terry; Stanley, Todd; Cheeseman, Josephine; Collingwood, Jennifer; Manning, Bryan; Dutton, Sean
Cc: Bowles, Ron; Gover, Aubrey; English, Tracy
Sent: Fri Sep 02 10:14:34 2011
Subject: NR2011-████ and NR2011-████

Good morning,

The above noted, and related, Cabinet submissions, titled "Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project" and "Commitment Letter to Assist Financing of Phase One of the Lower Churchill Project" were signed by the Natural Resources Minister last evening and Cabinet Secretariat expects to receive hard copies of the submissions later this morning. However, Cabinet Secretariat's analyses of these submissions have to be completed by end of day today because these papers will be considered by Cabinet during its meeting on Tuesday September 6. Therefore, I have had the submissions placed on your departmental secured drives for you to retrieve for review and ask that you have your comments on the submissions sent to me by 1 pm today (Friday

September 2). I recognize that this does not give you much time and sincerely apologize for this. If you have concerns getting access to the submissions, please let me know.

Sean, I'm sending this to you for LAA's and IGAS' perspective and have copied Ron, Aubrey and Tracy.

Regards,

Vaughn Hammond

Cabinet Officer

Cabinet Secretariat

729-2418

vaughnhammond@gov.nl.ca

Email Message

From: Smith, Franca [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=FRANCASMITH]
To: Hammond, Vaughn [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=VAUGHNHAMMOND]
Cc: Hickey, John [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=JHICKEY], Dutton, Sean [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=SDUTTON], Bowles, Ron [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=RABOWLES], Gover, Aubrey [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=AUBREYGOVER], Watkins, Michelle [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=MICHELLEWATKINS], Harvey, Brian [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=BRIANHARVEY], Keats, Janet [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=JANETKEATS]
Sent: 9/2/2011 at 11:43 AM
Received: 9/2/2011 at 11:43 AM
Subject: NR2011-████

Good Day Vaughn:

Labrador Affairs has reviewed the Memorandum to Executive Council titled "Memorandum of Principles Outlining Commercial Arrangements to Enable Financing of Phase One of the Lower Churchill Project" (NR 2011-████) and concurs with the recommendations outlined in the submission. Labrador Affairs would like to note that its comments from previous drafts are accurately reflected and has no addition comments for inclusion.

Thank you,

Franca

Franca Smith

Senior Analyst

Department of Labrador and Aboriginal Affairs

Government of Newfoundland and Labrador

(709) 896-1780 (t)

(709) 897-5473 (bb)

(709) 896-0045 (f)

FrancaSmith@gov.nl.ca