

XX2013- [REDACTED]

BN-2013- [REDACTED]  
 Limited Circulation  
 Premier R. Reid  
 J. Mullaley P. Burt  
 T. King M. Afonso  
 M. Byrne C. Evans  
 J. Tulk G. Power  
 L. Carroll  
 December 2, 2013

**Information Note  
 Department of Justice**

(Contents may be Solicitor & Client Privileged)

**Title:** Lower Churchill Project – Contingent Equity Funding of Cost Overruns

**Issue:** To advise respecting the Cost Overrun Escrow Account process required as part of the Lower Churchill Financing and corresponding changes in the Province's Equity Support Guarantee obligations.

**Background and Current Status:**

- The terms and conditions of the Federal Loan Guarantee (FLG) for the Lower Churchill Project were set out in the FLG term sheet executed November 30, 2012. Those terms included the requirement for the Province to guarantee the equity contribution commitments that will be made by Nalcor respecting the equity investments to bring each element of the Projects to commissioning.
- Those commitments have been developed into two (2) agreements: an Equity Support Agreement (ESA), in which Nalcor commits to provide the equity investment as required to the Project subsidiaries; and the Equity Support Guarantee (ESG), in which the Province commits to provide equity requests made upon Nalcor if Nalcor does not or cannot fund. A separate ESA and ESG exists for the three project elements: Muskrat Falls, the Labrador-Island Link, and the Labrador Transmission Assets. The essence of these agreements is that the Province is providing a completion guarantee for each element of the Project.
- Drafts of the ESA and ESG's involved were presented to LGIC and approved on or about October 31, 2013. At that time, the Agreement contemplated the necessary equity contributions to be the Base Equity and the Contingent Equity (any additional equity that may be required once the Base Equity amount and debt financing have been exhausted), as well as separate reserve accounts required by Canada to provide payment buffers.
- Except for these minor buffer accounts, the expenditures of equity as included in these drafts would occur on an as needed basis as project costs were incurred, and funded either alongside the debt financing or after the debt financing had been exhausted.
- The FLG also contained provisions which dealt with the use of equity to establish reserve accounts to cover actual and estimated cost overruns on an ongoing basis during construction. The provisions necessary to capture these commitments have been developed, negotiated and agreed between the parties since the October 31 drafts were reviewed by Cabinet. This has required subsequent amendments to the ESA and ESG to capture the additional equity funding obligations imposed by these provisions.
- The resolution to this issue requires the creation by each Project entity of a Cost Overrun Escrow Account with the following characteristics:
  - This account shall be established one (1) year from financial close. At that time, the Independent Engineer will provide an assessment of the projected cost overruns for each

- of the Projects. The baseline for this cost overrun assessment will be the projected costs for each of the Projects as of financial close, as determined by the Independent Engineer;
- The Project entity will then be required to fund that projected cost overrun over the remaining anticipated years to commissioning, by placing equal annual installments into the account to fully fund the amount by the commissioning date;
  - The funds placed in this account will be funded 100 per cent from equity, and once deposited will otherwise be unavailable until commissioning. They may count towards the equity contributions of Nalcor/the Province, but will not be included in the calculation of debt/equity ratio unless and until actually expended, nor increase available corresponding debt financing; and,
  - In the event the Base Equity commitment and project financing are exhausted prior to commissioning, the funds in the Cost Overrun Escrow Account will be drawn on first to fund additional equity contributions; only once it were to be exhausted would additional equity contributions be required by Nalcor/the Province.
- The effect of these provisions is to increase the equity funding obligations from that which was originally planned, as in addition to actual expenditures equity needs now also be invested to cover anticipated cost overruns.
  - The inclusion of such a requirement had been strongly resisted by Nalcor and the Province at the time of the negotiation of the FLG, as it is redundant in the context where Nalcor/the Province will be guaranteeing equity funding to cover all cost overruns in any event. Nalcor and the Province's financing counsel have characterized the requirements as being highly unusual in such a context. In the negotiations of the financing arrangements Nalcor and the Province again tried to have these requirements removed. Canada's position in both sets of negotiations, however, was that such provisions were required and included in the FLG and must be complied with.
  - The provisions governing the Cost Overrun Escrow Accounts are included in the Project Finance Agreements for each project, which are not signed by Nalcor or the Province. However, because these amounts have to be funded from equity, the ESA and ESG have to be amended to acknowledge that equity funding will also be required and provided in respect of the amounts necessary to fund the Cost Overrun Escrow Accounts, in addition to other equity funding requirements of the Project entities.
  - Provisions to implement these acknowledgements are contained in sections 2.14 of the final ESA and 2.19 of the final ESG.

**Prepared/approved by:** T. Stanley/P. Myrden/H. Jacobs

**Reviewed by:** D. Coombs/T. King, Cabinet Secretariat

**Ministerial approval:** Received from Hon. Tom Marshall, Q. C.

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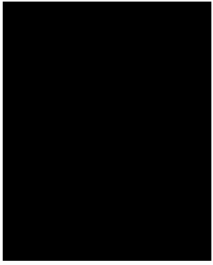
- of the Projects. The baseline for this cost overrun assessment will be the projected costs for each of the Projects as of financial close, as determined by the Independent Engineer;
- The Project entity will then be required to fund that projected cost overrun over the remaining anticipated years to commissioning, by placing equal annual installments into the account to fully fund the amount by the commissioning date;
  - The funds placed in this account will be funded 100 per cent from equity, and once deposited will otherwise be unavailable until commissioning. They may count towards the equity contributions of Nalcor/the Province, but will not be included in the calculation of debt/equity ratio unless and until actually expended, nor increase available corresponding debt financing; and,
  - In the event the Base Equity commitment and project financing are exhausted prior to commissioning, the funds in the Cost Overrun Escrow Account will be drawn on first to fund additional equity contributions; only once it were to be exhausted would additional equity contributions be required by Nalcor/the Province.
- The effect of these provisions is to increase the equity funding obligations from that which was originally planned, as in addition to actual expenditures equity needs now also be invested to cover anticipated cost overruns.
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  - The provisions governing the Cost Overrun Escrow Accounts are included in the Project Finance Agreements for each project, which are not signed by Nalcor or the Province. However, because these amounts have to be funded from equity, the ESA and ESG have to be amended to acknowledge that equity funding will also be required and provided in respect of the amounts necessary to fund the Cost Overrun Escrow Accounts, in addition to other equity funding requirements of the Project entities.
  - Provisions to implement these acknowledgements are contained in sections 2.14 of the final ESA and 2.19 of the final ESG.

**Prepared/approved by:** T. Stanley/P. Myrden/H. Jacobs

**Reviewed by:** D. Coombs/T. King, Cabinet Secretariat

**Ministerial approval:** Received from Hon. Tom Marshall, Q. C.

December 2, 2013



Newfoundland  
and Labrador



2013/11/29

OC2013-345

NR/ DM  
FIN/DM  
JUS/DM  
Asst. Sec/EPC  
Hon. S. Kent  
S. Dutton  
E. Martin/Nalcor  
AG  
Deputy Clerk  
File

MC2013-████. NR2013████. FIN2013████ EPC2013-████ XX2013████

Under the authority of sections 10 and 11 of the Executive Council Act, section 7 of the Intergovernmental Affairs Act and sections 25 and 27 of the Energy Corporation Act, the Lieutenant Governor in Council is pleased to authorize the Minister of Finance, as designate for the Minister of Municipal and Intergovernmental Affairs, to sign separate Guarantees for the NL Equity Support Agreements for each of Muskrat Falls, Labrador Transmission Assets, and the Labrador Island Link and the Master Definition Agreements, substantially as outlined in the drafts on file with the Clerk of the Executive Council.

Clerk of the Executive Council

2013/11/14

MC2013-██████

NR/DM  
 FIN/DM  
 Asst Sec/EPC  
 Hon S. Kent  
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 File

NR2013-██████ FIN2013-██████ EPC2013-██████ XX2013-██████

The joint Submission of the Minister of Natural Resources and the Minister of Finance respecting Muskrat Falls Project – NL Equity Support Agreements and Guarantees for NL Equity Support Agreements was considered. A presentation was provided by the Deputy Minister of Natural Resources.

The following direction was provided:

- 1) Approval was given for Nalcor Energy to sign separate NL Equity Support Agreements for each of Muskrat Falls, Labrador Transmission Assets, and the Labrador Island Link, substantially as outlined in the draft on file with the Clerk of the Executive Council, and the Master Definitions Agreements, substantially as outlined the draft on file with the Clerk of the Executive Council; and
- 2) Approval was given for the issuance of an Order in Council, under the authority of sections 10 and 11 of the Executive Council Act, section 7 of the Intergovernmental Affairs Act and sections 25 and 27 of the Energy Corporation Act, to authorize the Minister of Finance, as designate for the Minister of Municipal and Intergovernmental Affairs, to sign separate Guarantees for the NL Equity Support Agreements for each of Muskrat Falls, Labrador Transmission Assets, and the Labrador Island Link and the Master Definition Agreements, substantially as outlined in the drafts on file with the Clerk of the Executive Council.

(NO ACTION IS TO BE TAKEN ON ITEM 2 UNTIL AN ORDER IN COUNCIL IS ISSUED)

*Julia Mullaley*  
 Clerk of the Executive Council