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October 2, 2017

Honourable Premier Dwight Ball
Government of Newfoundland and Labrador
P. O. Box 8700
St. John's, NL
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Dear Premier Ball:

I write on behalf of the Board of Directors of Nalcor Energy in response to your letter of September 12, 2017. The subject of that letter was Nalcor's use of "embedded" contractors on the Lower Churchill Project (LCP) and the Corporation's withholding of billing rates for those contractors in response to an Access to Information request. You included two inquiries in your letter, which I will address below.

(1) Can the Board of Directors justify the management structure at Muskrat Falls as providing best value to the Province? Would the current board have approved the structure as it is currently in place?

I will address the second question first. It is very difficult for the current Board of Directors to put itself in the place of the Board of Directors which several years ago oversaw the implementation of the management structure of Muskrat Falls which forms the basis for the current structure. I will therefore not comment on the initial structure that was implemented, but will rather focus on management of mega-projects generally and more specifically, the present structure utilized for the LCP and the successes that have been achieved under it.

There are members of the Board and Management with extensive experience in the execution of large projects and in their experience it is standard if not best, practice to supplement an owner's team with contractors on large construction projects. Such personnel are for the most part retained through consulting companies, independent consultants and personnel agencies and are used to augment and provide project management services to supplement the owner's team. Typically they are not employees of the owner and that is the case with respect to the LCP; they are not

employees of Nalcor and they do not participate in the benefits plan in which Nalcor employees are members. We believe this is standard practice on large projects here in the Province, in other parts of Canada and internationally. The use of such consultants/contractors provides for flexible engagement of personnel for project specific work of varying lengths of time. Contracting of personnel for such work allows for short notice of termination, which enables effective and timely downsizing of staff as various components of work come to a close. As well, there are no ongoing obligations like those associated with Nalcor employees, such as overheads, benefit plans, pension plans, etc.

Nalcor's core business is in energy and not the construction of mega-projects. Therefore, as many other developers of such projects have done, Nalcor contracts personnel with the required expertise, experience and skill to carry out the construction of the LCP. This ensures that personnel with the appropriate skill set are involved in the construction of the LCP and allows the vast majority of Nalcor employees to continue to focus on the core business, with a relatively small group of employees involved in the management and oversight of the LCP construction. This approach has been utilized on a number of occasions in the past in Newfoundland and Labrador, more specifically with respect to oil and gas mega-construction projects.

It is important that there be some owner personnel involved in large construction projects to ensure there is a smooth transition from construction to the long term operation of the facility. The owner's team presently includes approximately 50 Nalcor employees and approximately 80 contracted resources. The total number of personnel working on the Project in the areas of owner's team, Engineering and Project/Construction Management is approximately 500, with the balance of 370 personnel being contracted resources. In our view, this 90-10 split represents a typical and appropriate division between owner employees and contractors; it is in keeping with best practices for large construction projects. Based on information reported by international organizations with expertise in the management of large projects, it is our understanding that budgets for Project/Construction Management and the owner's team combined typically run between 9 to 11% of total costs. The costs associated with these groups for the LCP are currently running at 9.5% of total costs, but are forecasted to decline to 7% by Project completion.

Reviews of the project team's effectiveness have been performed and results have been positive. An above average score was provided by Independent Project Analysis (IPA) and multiple reports of the Project's Independent Engineer have been supportive of the management structure. As well, the EY reports have not included any recommendations for improvements to the management structure.

Finally, it should be noted that soon after his arrival as Chief Executive Officer of Nalcor, Stan Marshall divided the LCP into two distinct components, one relating to the

construction of the Muskrat Falls Plant and the other focused on the construction of the associated transmission lines. As part of that division, there was also a re-structuring of the management of the LCP such that there are now two separate management structures. It is evident to us that this has proven to be instrumental in getting the costs and schedule of the LCP under better control.

So to answer the second question, we believe that the structure of the project management team for the LCP is appropriate.

As for whether the management structure associated with the Lower Churchill Project is providing best value to the Province, we can tell you that the Project has been continually scrutinized over the past several years. There presently are three internal auditors, all three of whom are employees of Nalcor Energy and one of whom has a strong mega-project auditing background, who are primarily dedicated to carrying out reviews of the various aspects of the LCP. The first audit of the project was carried out in 2013 and the complement of 3 auditors for the project Internal Audit team was fully implemented in 2014. As well, Nalcor's Manager of Internal Audit provides oversight of the work of these auditors, with approximately 50% of her time being focused on this work.

The focus of the Internal Audit team was initially on procurement, risk management and change management as these were the areas of highest risk in the early years of the Project. It was important to focus on these aspects of the Project as it ramped up and procurement activity was high. Audits were also performed on hiring practices with respect to qualifications of personnel hired (both contractors and corporate personnel), as well as training of personnel. Internal audit focus was then placed on, amongst other things, compensation of non-Nalcor personnel. An audit of compensation strategy for non-Nalcor personnel was included in the 2017 Internal Audit Plan that was approved by the Board of Directors in November of 2016 and subsequently commenced in July of this year.

In addition to the activities of the Internal Audit team, management continually assesses the management structure and its effectiveness and makes changes as it deems necessary. A case in point is the division of the Project into two components described above.

With respect to the first question, there is no simple or straightforward way to measure the value which management structure brings to a project. However, we believe that the Internal Audit processes that are in place, as well as the continual review by senior Management, the Independent Engineer and outside agencies such as IPA, provide appropriate oversight of the project management function and help to ensure it provides good value to the Province.

(2) Can the Board of Directors justify to the people of Newfoundland and Labrador exactly how the billing rates for embedded contractors are commercially sensitive?

Nalcor received multiple Access to Information requests related to, amongst other information, the billing rates for contractors on the LCP. This request was the subject of review by internal personnel, including Nalcor's Legal Department. The Board has been provided with an opinion of Nalcor's Vice-President, General Counsel and Corporate Secretary stating that the Corporation is required to withhold the billing rates of the contractors.

As you are aware, the *Energy Corporation Act* (ECA) makes available to Nalcor and its subsidiaries an exemption to Access to Information requests over and above the exemptions contained in the Access to Information legislation. It allows, and in some cases requires, the retention of "commercially sensitive" information when it is the subject of an Access to Information request. The definition of "commercially sensitive" is broad and includes:

"financial or commercial information, including financial statements, details respecting revenues, costs and commercial agreements and arrangements respecting individual business activities, investments, operations or projects and from which such information may reasonably be derived".

The Board has been advised that billing rates of contractors falls within the definition of commercially sensitive information as set out in s. 2 of the ECA.

The fact that information is commercially sensitive is not sufficient to withhold it when its disclosure is requested. The next step in determining whether the exemption provided under s. 5.4(1) is applicable is to determine whether the information requested meets one of the conditions listed in ss. 5.4(1)(c) and (d). The information withheld by Nalcor meets more than one of these conditions in that it is reasonable to believe that its disclosure would (i) harm the competitive position of a third party and/or Nalcor, (ii) result in financial loss or harm to a third party and/or Nalcor and (iii) is information that is treated consistently in a confidential manner by the third party.

With respect to third party information, it is important to note that ss. 5.4(1)(b) is a mandatory prohibition against disclosure with respect to the commercially sensitive information of a third party that meets one of the conditions listed in ss. 5.4(1)(c) and (d). It is the Board's understanding that generally the affected third parties (the contractors) believe that disclosure of their information (the billing rates) will harm their competitive position in future negotiations for contracts with other corporations, as knowledge of that information would arguably provide those corporations with a

significant edge when negotiating a contract with the third parties in the future. It is reasonable to believe that this may result in financial loss or harm to the third parties. Further, the information in question is treated consistently in a confidential manner by the third parties and is not customarily provided to competitors. The third party commercially sensitive information in question therefore meets several of the conditions outlined in ss. 5.4(1)(c) and (d) and Nalcor legally has no choice but to withhold it.

We understand the Province's desire to be as open and transparent as possible with respect to the LCP and the work that is being carried out in association with that project. However, Nalcor operates in a commercial environment and it is important that it be able to treat commercially sensitive information that it possesses in an appropriate manner to ensure that the relationships and agreements in which it becomes involved can be respected. The exemption provided under s. 5.4 of the ECA was included in recognition of this fact and while use of that exemption is not always consistent with normal Government transparency practices, it allows Nalcor to form appropriate and strong relationships with its various partners and contractors. This is necessary in order for Nalcor to successfully work in a commercial environment to better enable it to create value for the people of Newfoundland and Labrador. It should be noted that s. 5.4 of the ECA was considered by the panel that reviewed the Access to Information legislation in 2015 and they recommended only one change to the Act, that being the inclusion of wording in s. 5.4 to bring a degree of objectivity to the test used to determine if commercially sensitive information could or must be withheld; the ECA was subsequently amended accordingly.

In closing, I will make the point that while the matter of the management structure is important, more important is the performance of the Project team. A number of significant milestones have been achieved or will be achieved by year end with respect to the LCP, including:

- Safety performance well ahead of industry experience for similar projects
- All transmission line construction completed
- North Dam construction ahead of schedule
- South Dam started and completed in 2017
- Intake primary concrete completed in 2017
- Powerhouse primary concrete completed in 2017
- Powerhouse steel has been erected and powerhouse enclosed in 2017
- Turbine manufacturing completed and installation commenced

So while the Board of Directors believes the Project's management structure to be appropriate, more importantly it is very pleased with the milestones achieved and the level of performance on the Project over the past year.

Honourable Premier Dwight Ball

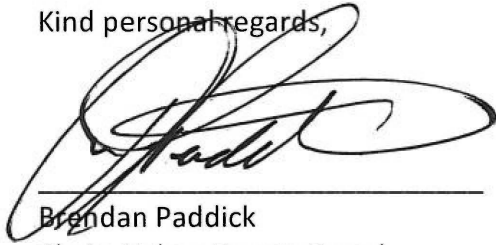
October 2, 2017

Page 6 of 6

Finally, you will find enclosed herein a document containing information with respect to project management staffing on the LCP. I believe it will provide you with further assurance that the approach taken by Nalcor with respect to project management staffing on the Project is appropriate and effective.

I trust that the above sufficiently addresses your inquiries, however, if you require additional information or would like to further discuss this matter, please do not hesitate to contact me.

Kind personal regards,

A handwritten signature in black ink, appearing to read "B. Paddick", is written over a horizontal line. The signature is stylized and cursive.

Brendan Paddick
Chair, Nalcor Energy Board

BP/ab

Attachment

Lower Churchill Project

Project Management Staffing

October 2nd , 2017

Boundless Energy



Lower Churchill Project

What is the Right Staffing Approach for a Major Capital Project?



It Depends, but all Companies Extensively Use Contractors. All companies rely on contracted resources ('contractors') for execution of major capital projects. It is how the industry is organized. The extent of the use of contractors varies by size of company and their project portfolio.

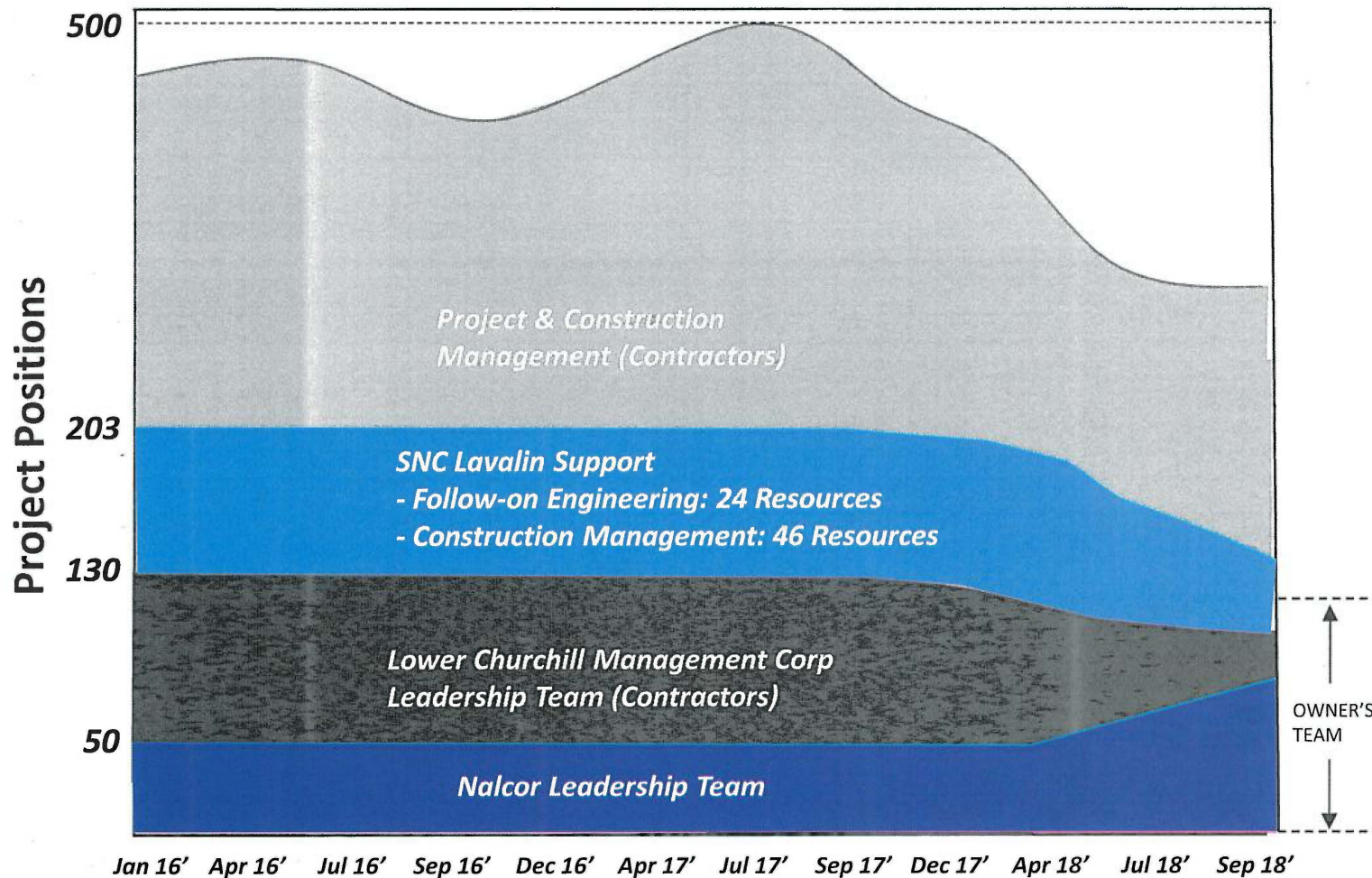
Large Companies Retain Core Competency. Large companies, such as ExxonMobil, have employees who are transient, globally-mobile project specialists that assist in project execution. These project specialists are expensive (double the cost-to-the-project vs Contractors in some cases) but are valuable in retaining core competency and consistency across projects.

No Material Cost Differential. The variance in contractors on an Project Management team usually has little effect on the overall cost. In general, major capital projects see a 8-12% range of Project Management Team cost, of which a portion is always contractors. There are numerous examples of this from the Newfoundland and Labrador offshore sector.

Nalcor's Approach. This is the largest project executed by Nalcor. The model is based on the corporate structure, in-house project competency, and project portfolio. Nalcor's percentage of employees involved in the Owner's Team will likely grow over time.

A Dynamic Organization

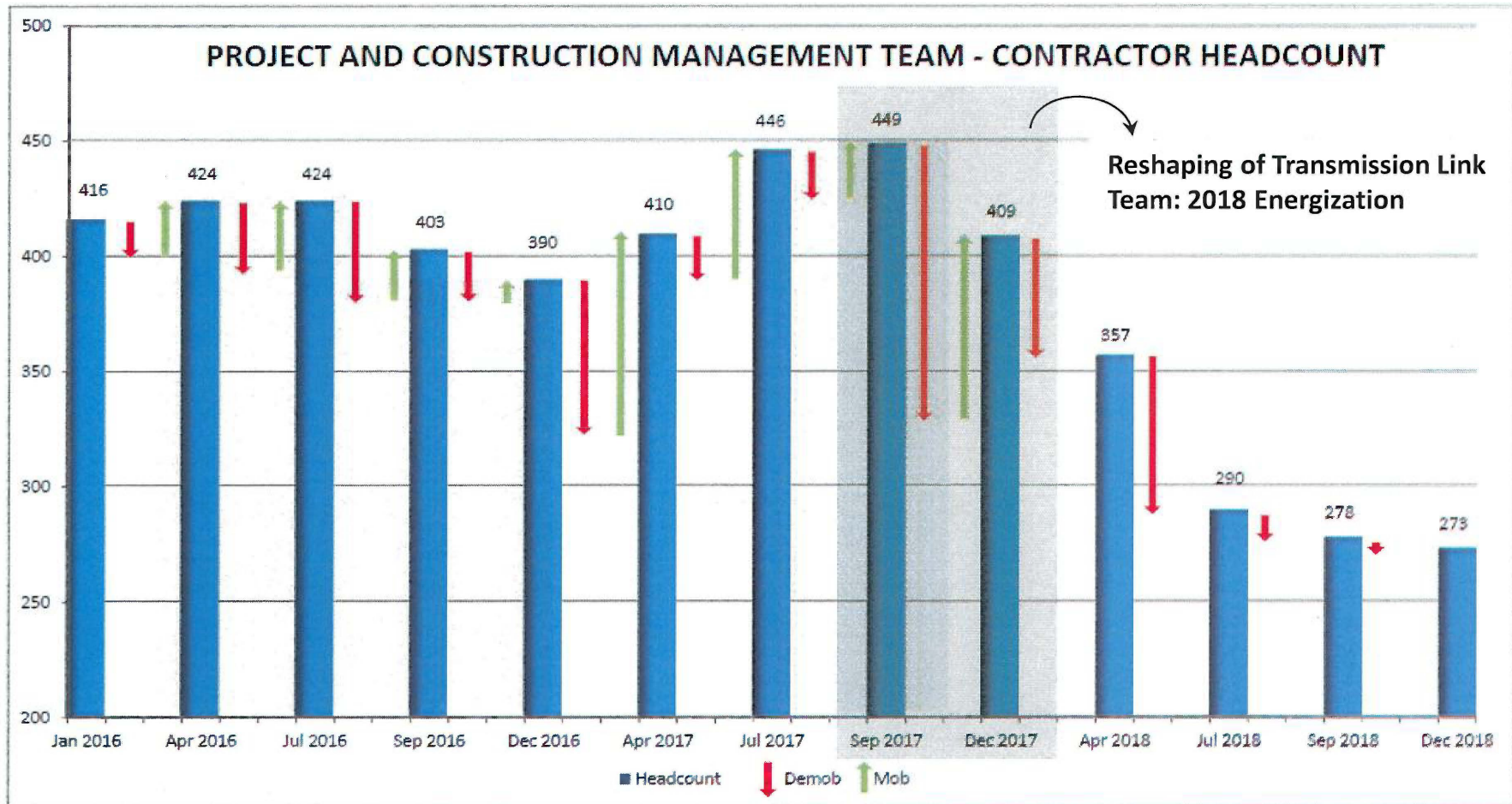
How the LCP Organization Has Shifted to Date



- ❑ Consistent with other major capital projects, there is a 'core' Leadership team of 130 people (40% Nalcor); as the project moves into completions/operations, this will gradually move towards 100%.
- ❑ The Project & Construction Management team is dynamic, and will ebb and flow as skill sets are required

A Dynamic Organization

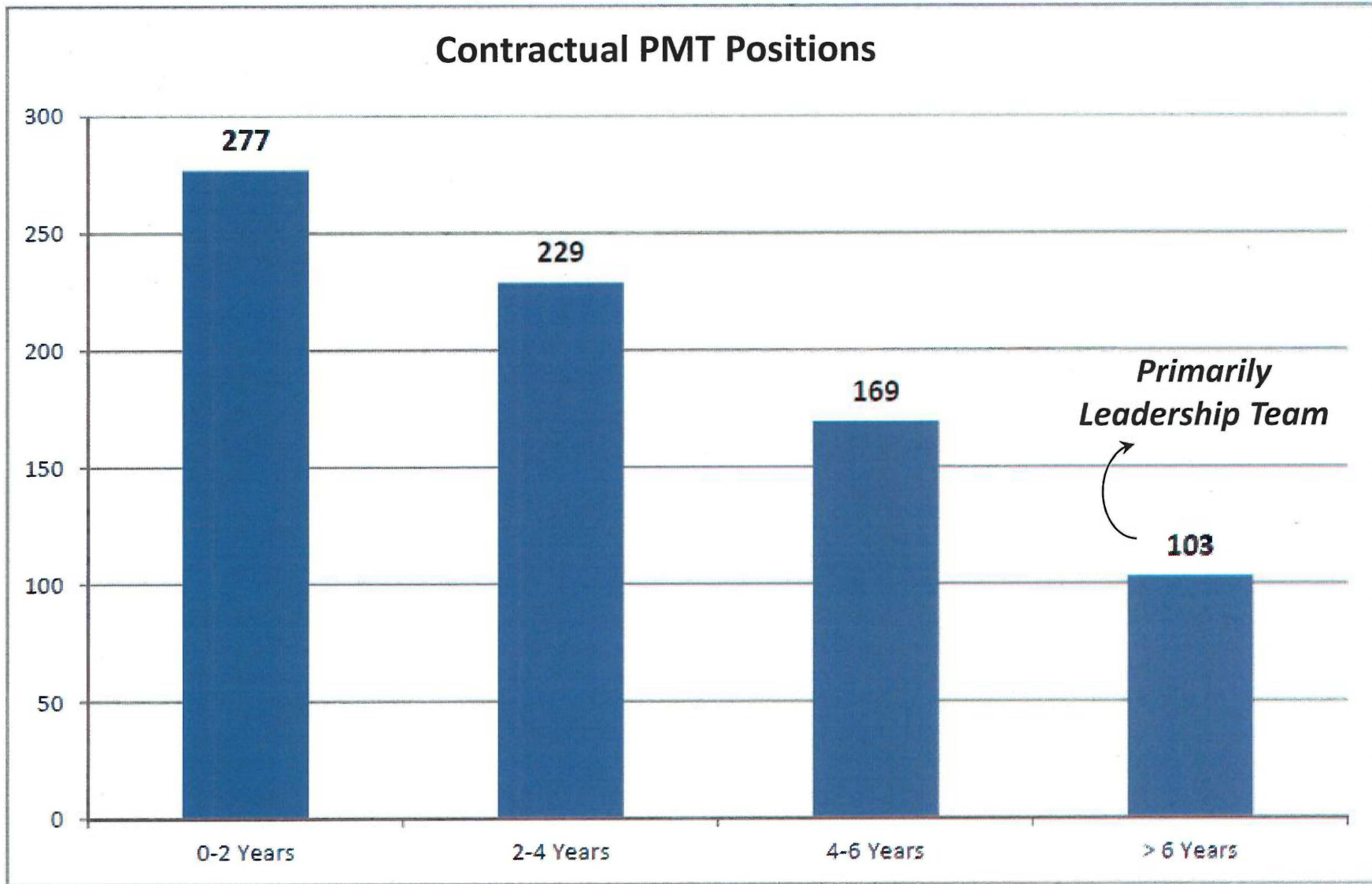
The Ebb and Flow of Skill Sets



Reshaping to Address Stage/Needs of Project. The Project team has undergone multiple 'reshaping' exercises. For example, in December 2017, there will be a significant reduction of package engineers and field resources on the Transmission Link Project; there will be an increase in completions, commissioning and energization skill sets/resources.

A Dynamic Organization

The Average Tenure



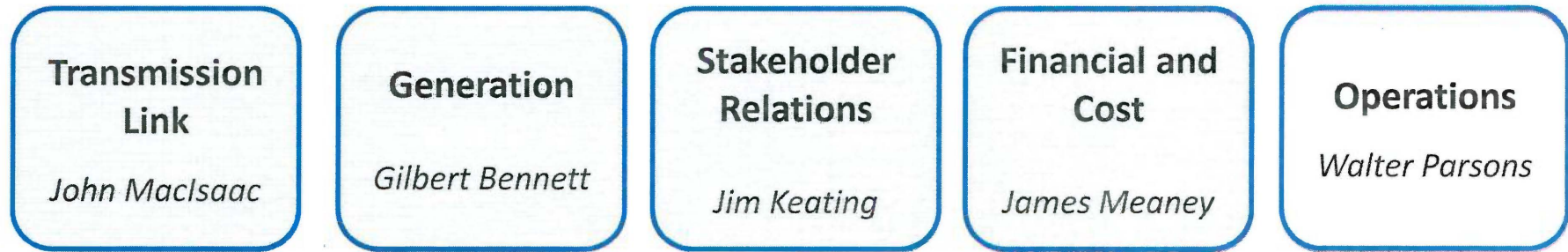
* By Position

Nalcor is at the Helm

With Sponsors and Leadership in Every Aspect



Robust Executive Sponsors – Reporting to the CEO, they are on top of decision making and hold the signing authority.



Robust Embedded Owners Team – Makes up 40% of the Project Leadership Team in every aspect of the project.

- *Owners Engineering*
- *Technical and Design Integrity*
- *Construction*
- *Contracting*
- *Procurement*
- *Operations and Transition*
- *Cost Management*
- *Stakeholder Engagement*
- *Communications*

The Nalcor Model

Was the correct approach taken?



The LCP team structure follows a typical megaproject model for a smaller company.

- ✓ *The right approach for the corporate structure.*
- ✓ *The right approach for the project portfolio.*
- ✓ *The right level of executive sponsorship and employee embedment.*
- ✓ *A balanced approach.*

Sharing our ideas in an open and supportive manner to achieve excellence.

Teamwork

Open Communication

Fostering an environment where information moves freely in a timely manner.

Honesty and Trust

Being sincere in everything we say and do.

Relentless commitment to protecting ourselves, our colleagues, and our community.

Safety

Respect and Dignity

Appreciating the individuality of others by our words and actions.

Leadership

Empowering individuals to help, guide and inspire others.

Holding ourselves responsible for our actions and performance.

Accountability