

From: kentlegge@nalcenergy.com
To: carolannelutz@nalcenergy.com; elizabethgray@nalcenergy.com
Subject: Fw: Redress
Date: Tuesday, February 21, 2012 6:59:16 AM

fyi below - will let you know if I hear anything.

Kent



S. Kent Legge, CA
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----- Forwarded by Kent Legge/NLHydro on 02/21/2012 06:58 AM -----

From: Kent Legge/NLHydro
To: Kent Legge/NLHydro@NLHydro
Cc: "Scott, Paul G." <pauls@gov.nl.ca>
Date: 02/21/2012 06:58 AM
Subject: Re: Redress

Hi Paul,

Just following up with respect to where things stand currently, as we are in the throws of finalizing the statements.

Kind regards,

Kent



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Kent Legge---02/14/2012 10:01:39 PM---Hi Paul, Best suggestion in this way is Friday afternoon. I am traveling tomorrow, back Thursday eve

From: Kent Legge/NLHydro

To: "Scott, Paul G." <pauls@gov.nl.ca>

Date: 02/14/2012 10:01 PM

Subject: Re: Redress

Hi Paul,

Best suggestion in this way is Friday afternoon. I am traveling tomorrow, back Thursday evening. Does this work for you?

Kind regards,

Kent

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From: "Scott, Paul G." [pauls@gov.nl.ca]

Sent: 02/13/2012 09:54 PM NST

To: Kent Legge; Mark Bradbury

Cc: Derrick Sturge; "Ivimey, Philip" <philipivimey@gov.nl.ca>; "McGrath, Rob" <robmcgrath@gov.nl.ca>

Subject: RE: Redress

Hi Kent,

Thanks for this. As you are likely aware the paper has gone forward for the Minister's consideration. However, we need to be aware that we may get follow up questions from the Minister, Cabinet Secretariat, Finance and others. As such, it might be useful to get together to discuss these answers to ensure we can put our best foot forward, rather than email back and forth. If this makes sense to you, I'd suggest sometime this week. Perhaps you could let me know?

Paul

From: KentLegge@nalcoreenergy.com [mailto:KentLegge@nalcoreenergy.com]

Sent: Friday, February 10, 2012 4:37 PM

To: MBradbury@nalcoreenergy.com

Cc: Scott, Paul G.; DSturge@nalcoreenergy.com; Ivimey, Philip; McGrath, Rob

Subject: Re: Redress

Hi Paul,

Further our conversation earlier this week, I offer the following in response to queries posed by you and your team at that time.

1. What will be the harm to Nalcor if the Company continues to assume this obligation (and record the estimated \$40M charge to its 2011 I/S)?

The answer to this is tied to Mark's response number 4, below, as well as the 'disadvantages' noted to Alternative 2 in the paper previously provided. To summarize these points, and offer some additional considerations:

Demonstration of Nalcor's improved net income in comparison to historical results can only lead to instill greater confidence by stakeholders in the company's ability to execute on its strategy. Particularly, confidence by rating agencies in management's ability to execute on its strategy will be a critical success factor in our efforts to introduce reasonably priced debt into the Lower Churchill Project capital structure;

The charge will result in an added funding requirement for Nalcor that will hamper returns to the shareholder and likely increase future equity requests accordingly; and,

The visibility such a significant charge will have in the context of the 2011 results will likely bring a heightened level of scrutiny on the obligation itself. Particularly, key stakeholders (including the investment community) may question the rationale behind Nalcor satisfying an obligation for which the primary beneficiary of future benefits may be viewed as being the Province.

2. Why is it an issue to 'explain' this charge in the messaging surrounding the 2011 financial statements?

Again, a \$40M charge to the financial statements of Nalcor in one year increases the probability of drawing a heightened level of scrutiny on the obligation itself, and also the attention of Nalcor's key stakeholders as to the appropriateness of the Company funding an obligation to which the primary beneficiary of future benefits may be viewed as being the Province.

Admittedly it is difficult to say how this charge will be viewed by the rating agencies, but it is this uncertainty that is the concern. The fact is that we would rather not expose the company to this uncertainty at such a critical time. An update to the Nalcor credit rating is now under consideration. If Nalcor's current rating is adversely impacted by this charge, then it is possible that it might have an adverse impact on the favourable indicative ratings that we just received in connection with the LCP project components. Based on this, we think it an inopportune time to introduce a \$40 million charge to Nalcor's bottom line.

I trust this answers the questions posed. As always, if we can be of further assistance, please advise.

Kind regards,

Kent



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From: Mark Bradbury/CRP/NLHydro
To: "Scott, Paul G." <pauls@gov.nl.ca>
Cc: DSturge@nalcorenergy.com, KentLegge@nalcorenergy.com, "Ivimey, Philip" <philipivimey@gov.nl.ca>, "McGrath, Rob" <robmcgrath@gov.nl.ca>
Date: 01/31/2012 08:29 AM
Subject: Re: Redress

Hi Paul

Re your question # 1:

Upon further review of the benefits associated with the Upper Churchill Redress Agreement (UCRA), it was determined that although there is a benefit to the LCP by way of facilitating the signing of the IBA, the main benefits (as outlined in our submission) are to the Province. The original submission which contemplated capitalizing these costs did so based on the assumption that the IBA could not have been negotiated without the UCRA, therefore the costs associated with the UCRA were directly attributable to the LCP. However, in subsequent discussions between Nalcor Finance and LCP, the LCP team has indicated that the signing of the UCRA was not required to negotiate the IBA and therefore the two should not be linked from an accounting perspective. The following factors were considered relevant:

No linkage in final agreements between the Redress Agreement and the Lower Churchill.

All release and indemnity in respect to the Lower Churchill is covered in the IBA.

Redress simply deals with release and indemnity for the Upper Churchill, which is a Provincial and Nalcor (CFICo) matter.

It was not appropriate to capitalize the payments as a separate asset as the payments relate to settlement of past issues and provide no future economic benefits (other than indemnities against potential claims).

With respect to impact on LCP financing, please see our comments under # 4 below.

Re your question # 2:

Upon signing of the UCRA, Nalcor has entered into a contractual agreement to pay \$2.0 million (escalated annually) per year to the Innu. This agreement meets the definition of a liability under both Canadian GAAP and IFRS as it entails the settlement by future transfer of assets (cash). Nalcor has little or no discretion to avoid making the payments (since Nalcor is named as the payee in the agreement as an agent of the Province) and the payments are in respect of an event that has already occurred. Accordingly, Nalcor is obligated to record the present value of these future payments which is \$40 million.

It is recognized that the Province made the 2011 payment. The estimate of the present value of the liability (\$40 million) was computed under the assumption that the first payment was made by the Province.

Re your question # 3:

Over the past four years Nalcor's net income has ranged from \$60-82 million. Due to positive Oil and Gas and Energy Marketing results, 2011 earnings were anticipated to increase by over \$40 million which would not be the case if Nalcor were required to accept this obligation.

Re your question # 4 -

Net income results that reflect growth would be "beneficial" in that it would support the validity of Nalcor's business strategy. A circumstance where Nalcor's net income is demonstrably improved in comparison to historical results can only lead to instill greater confidence in the company's ability to execute on its strategy. Confidence in Management's abilities in this regard will be an important factor in the eyes of the investment community and in particular the rating agencies. The views of these agencies will be a critical success factor in our efforts to introduce reasonably priced debt into the Lower Churchill Project capital structure.

I trust this answers your questions, but if further information is required, please let us know and we will arrange a meeting to discuss.



Mark Bradbury
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You owe it to yourself, and your family, to make it home safely every day. What have you done today so that nobody gets hurt?

From: "Scott, Paul G." <pauls@gov.nl.ca>

To: <MBradbury@nalcorenergy.com>

Cc: <DSturge@nalcorenergy.com>, <KentLegge@nalcorenergy.com>, "Ivimey, Philip" <philipivimey@gov.nl.ca>, "McGrath, Rob" <robmcgrath@gov.nl.ca>

Date: 01/29/2012 08:06 PM

Subject: Redress

Hi Mark,

A few comments/questions on your most recent submission:

1. Your first submission last fall took the view, in basic terms, that if Nalcor was required to absorb the full \$40M cost of the settlement, it would have a detrimental impact on the financing of the LCP. The recent submission indicates that "it is not appropriate to capitalize them (the \$40M) either as part of the Lower Churchill Project or otherwise". For my benefit, does this mean that should Nalcor be required to accept the cost that there would be no detrimental impact to LCP financing? It is also noted that Nalcor determined that it was not appropriate to capitalize the costs. What was the basis for that determination?
2. The paper seems to say that if the Province does not incur the costs, then Nalcor would be required to book the entire \$40M as a charge against its 2011 earnings. A detailed explanation of why this approach is necessary as it is not clear to our accounting people? Also, remind me, didn't the province cover the 2011 payment?
3. You note that should Nalcor be required to cover the cost, it would represent over 50% of Nalcor's net income for the past 4 years. Also it is stated that Nalcor's net income is projected to improve in the current year due to increased oil revenues. It would be useful if you could provide the dollar amount of the improvement. It would also be helpful to know, under the accounting treatment Nalcor has proposed, what the net income might be for the company for this year, again should it have to cover the full amount.
4. You note that in a year where oil revenues have increased, it would be "beneficial" if the company could show net improvement as a result. Beneficial from what perspective? If Nalcor could not show such improvement due to having to pay this bill, what would be the detrimental impact to the company?

I am copying Rob and Phil in case they have any further questions which they should feel free to ask. Also I will confer with Charles on the budget process. As I mentioned to you last Monday the budget process is now well along and Charles mentioned that there may not be enough time to have this request considered for this year.

Paul

Paul Scott, B.A., LL.B.

Assistant Deputy Minister, Energy Policy

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