

## **Agreement in Principle on the financial restructuring of the Lower Churchill Projects**

**July 28, 2021**

This agreement in principle (“**AIP**”) sets out the key terms that would be used to negotiate term sheets followed by definitive agreements between Her Majesty the Queen in right of Canada and Her Majesty the Queen in right of Newfoundland and Labrador, each by their respective representatives, in respect of the Muskrat Falls Generating Station, the Labrador Transmission Assets and the Labrador-Island Link (collectively the “**Projects**” or the “**Lower Churchill Projects**” and each individually a “**Project**”).

The financial restructuring of the Lower Churchill Projects would be implemented jointly through definitive agreements in order to lower and re-profile the financing costs of the Projects over the period to 2071 (the “**Restructuring**”). The GOC and the Province intend the restructuring to contribute to a sound, long term sustainable financial base for the Lower Churchill Projects and to contribute effectively to regional electrification.

The Restructuring is intended to reduce or otherwise offset financing costs that would be recovered under the revenue agreements, upon and after commissioning. The resulting structure is designed to allow the Province to retain revenue from the Projects to cover going forward its cost of capital for the Projects (3%), with the excess revenue over this return to be used as the first priority to mitigate electricity rates, according to the Province’s intent.

This AIP is for discussion purposes only and is not a detailed or definitive expression of the terms and conditions upon which the parties would enter into a binding transaction. Other than as set out in Section 3, it is not intended to, and does not create, any legally binding or enforceable obligations. It does present the base concepts on which GOC and the Province would discuss the details of the transactions.

### **1. PARTIES**

#### **Parties to this Agreement in Principle:**

**GOC:** Her Majesty the Queen in right of Canada as represented by the Deputy Prime Minister and Minister of Finance and the Minister of Natural Resources.

**Province:** Her Majesty the Queen in right of Newfoundland and Labrador, as represented by the Premier and Minister for Intergovernmental Affairs.

**Other Entities that will be Party to Definitive Agreements:**

**NLCos:** The agencies or corporations through which the Province owns and controls the MF/LTA and LIL Projects comprising the Lower Churchill Projects, and for certainty includes Nalcor (and any successor to Nalcor resulting from the publicly announced restructuring of Nalcor).

**Canada Cos:** The agencies, ministries or corporations through which Canada will deliver the facilities described herein, including NRCan.

**Musktrat:** Muskrat Falls Corporation, a corporation incorporated under the laws of the Province of Newfoundland and Labrador.

**Lab Transco:** Labrador Transmission Corporation, a corporation incorporated under the laws of the Province of Newfoundland and Labrador.

**LIL Holdco:** Labrador-Island Link Holding Corporation, a corporation incorporated under the laws of the Province of Newfoundland and Labrador, which holds Nalcor's limited partnership interest in Labrador-Island Link Limited Partnership, a limited partnership formed pursuant to the laws of the Province of Newfoundland and Labrador, acting by its general partner Labrador-Island Link General Partner Corporation.

**Project Cos:** Muskrat, Lab Transco and LIL Holdco, collectively.

**LIL SPV:** A newly formed holding corporation or limited partnership to be incorporated or formed by Nalcor under the laws of the Province of Newfoundland and Labrador.

**NRCan:** Natural Resources Canada.

## 2. TRANSACTION

**Proposed Transactions:** The GOC and the Province intend to negotiate transactions pursuant to which:

- (i) NRCan will extend an additional (approximately) \$1.0 billion federal loan guarantee substantially on the same terms as that guarantee entered into May 10, 2017 and referred to as “FLG2” for the MF/LTA Project;
- (ii) A CanadaCo will extend a financing arrangement allowing a drawing of up to \$1.0 billion against a subscription for a redeemable equity interest (preferred limited partnership unit or preference shares) of a special purpose vehicle (“**LIL SPV**”) to be initially formed and owned by Nalcor with Nalcor transferring all of the existing equity of LIL Holdco (the holding limited partner comprising the NLCo in Labrador-Island Link Limited Partnership (“**LIL**”)) into LIL SPV contemporaneously with CanadaCo committing to extend financing and thereafter becoming a joint owner by extension of its financing, as detailed below;
- (iii) Distributions from the LIL will be used to offset financing costs recovered through the revenue agreements and to service the return on and repayment of capital invested by the Province and the CanadaCo as outlined below under “LIL SPV Investment and Governance Agreement”;
- (iv) the capital structure for the Project Cos. holding MF/LTA will be restructured as detailed below under “MF/LTA capital restructuring” and additional structures will be put in place that will result in a reduced rate of return to contribute to reduced financing costs as detailed below under “Power Purchase Agreement”;
- (v) amendment to the terms of the finance agreements for FLG2 (both MF/LTA and LIL) to waive the payment of the guarantee fee to GOC which would be payable June 2022 relating to the period June 2021 to June 2022 and for each payment period thereafter; and
- (vi) amendment to the terms of the finance agreements for the MF/LTA FLG to delete the requirement to make sinking fund payments on Tranche A of the MF/LTA FLG.

The terms and conditions with respect to the Proposed Transactions would be negotiated in the Master Agreements.

**Master Agreements:** Agreements would be entered into between the relevant entity for GOC and the Province, and the relevant Project Cos., Canada Cos. and NLCos that incorporate the terms of this agreement in principle, with the following definitive agreements being contemplated:

- (i) A set of documents and the public market facing bond issue for FLG3 for MF/LTA will be on substantially the same terms and conditions, with the final business terms and bond profile to be agreed, as the documentation used for the FLG2 transaction for the MF/LTA Project;
- (ii) An agreement to set the terms for the formation, governance and ownership of the LIL SPV; there will be inclusion of agreement that the Canada Co. facility of \$1.0 billion is to be used for Muskrat Falls and LIL related purposes of offsetting financing costs recovered through the revenue agreements and which will be implemented under the LIL SPV Investment and Governance Agreement;
- (iii) An agreement to set the terms of the rollover transaction which will be implemented to transfer the LIL Holdco equity (and thereby indirectly transfer the LIL limited partnership interest) to LIL SPV;
- (iv) An amendment or waiver to the FLG2 documents to delete the guarantee fee which would be payable to GOC in June 2022 relating to the period June 2021 to June 2022 and for each payment period thereafter, further reducing financing costs;
- (v) An amendment or waiver to the FLG documents for MF/LTA to remove the requirement for the making of sinking fund payments on Tranche A of the MF/LTA FLG;
- (vi) An agreement to revise the capital structure for MF/LTA to convert equity contributed towards cost overruns (approximately \$2.0 billion, to be verified against 2012 budget) to preferred equity with a 3%

coupon rate, together with other measures to reduce financing costs; and

- (vii) The amendments to the Province's regulations to extend the current regulatory terms of FLG and FLG2 to FLG3.

**FLG3 Agreements:**

A full set of FLG3 Agreements would be negotiated on substantially the same terms and conditions as those for FLG2 with the following revisions:

- NRCan would agree to guarantee a new FLG3 facility (guarantee of market issued public bonds) for MF/LTA to be raised as soon as reasonably possible following the execution of the definitive agreements and satisfaction of the conditions precedent;
- The bond issue will be \$1 billion, \$992m of which will cover all principal payments due before June 30, 2029 under the MF/LTA FLG and MF/LTA FLG2 bonds (including the Dec. 1, 2021 FLG2 principal payment) with the remaining balance to contribute to the funding of issuance costs;
- Proceeds of the bonds will be placed in escrow and used to fund MF/LTA FLG Tranche A plus all MF/LTA FLG 2 bullet bonds until June 30, 2029 with the corresponding sinking fund payments that would otherwise fund those payments to be waived upon the deposit to escrow (other than the December 2021 sinking fund payment, which will be waived regardless of the timing of receipt of FLG 3 funds);
- Interest on and principal repayment of the FLG3 debt to be included in the cost recovery regulatory protected structure in the same manner as FLG and FLG2;
- The bonds are to be amortized on a level amortization basis over 20 years between 2037 and 2057 or an amortization schedule mutually agreed upon;
- The parties will work to optimize the debt capital structure of the Projects (including using alternatives to a level amortization if optimal);
- There will not be a guarantee fee;
- The funds will be raised in a market based public facing offering and bear the rates that a Canada bond structured

for ratings credit substitution (as is the case with FLG and FLG2) bears in the market; and

- the structure and document terms would otherwise be consistent with terms of FLG2.

**MF/LTA capital restructuring:**

Nalcor would amend the capital structure of the MF/LTA Project so that equity invested in cost overruns for the MF/LTA Project (approximately \$2.0 billion, to be verified against 2012 budget) will be converted at or before Commissioning of the MF/LTA Project on terms satisfactory to GOC into preferred shares with a 3% coupon payable from Commissioning Date of the Lower Churchill Projects. These preferred shares will not be redeemed during the period that any of FLG, FLG2 or FLG3 debt is still outstanding.

**LIL SPV Investment and Governance Agreement:**

An agreement would be entered into between a CanadaCo and LIL Holdco pursuant to which:

- LIL SPV will be set up initially to own Nalcor's full direct interest in LIL Holdco and thereby own Nalcor's and NL's full interest in the LIL and CanadaCo will commit to the investment detailed herein;
- The LIL SPV will be entitled to all distributions from LIL (as fully flowed through LIL Holdco (other than ordinary course expenses customary for a holding company and reinvestment of LIL distributions required to meet partner capital contribution requirements)) and on the same terms;
- GOC will make a phased (on drawn call based) \$1.0 billion subscription committing to make unit purchases for capital into LIL SPV;
- Subscriptions may be called and drawn down on a quarterly basis, post Commissioning to a maximum \$150m per annum or such lower amounts as may minimize the net cost of financing. Draws will be to the maximum of \$1.0 billion and must be drawn within 20 years;
- The capital in the SPV from this source is to be applied to offset financing costs that are recovered through the revenue agreements;
- Until Dec. 31<sup>st</sup>, 2041, the relevant NLCo holding the Province's interest in LIL SPV may receive distributions from the LIL SPV in preference to distributions to

CanadaCo, provided these distributions are either required (with MF/LTA dividends also being so used) to cover the cost of the debt incurred to fund NL's equity investment in the Lower Churchill Projects or used to offset financing costs that are recovered through the revenue agreements;

- After 2041, LIL SPV distributions are to be made in priority as a distribution to CanadaCo as return of capital contributed plus a rate of return for the full term reflecting Canada's long-term cost of funds on an annual, compounded basis and structured as a PIK style return using further share or unit issues over the entire life of the investment. For certainty, Canada's cost of funds for long-term debt for the purposes of determining the rate of return on the LIL distributions to be made to CanadaCo will be determined by the forward interest rate curve for 30 year Canada bonds based on the projected capital draws, adjusted to reflect the increased duration of the LIL investment repayment period. Rate of return will be set on a one time basis at closing of the transactions contemplated herein upon satisfaction of Conditions to Closing;
- A distribution and sharing adjustment for a transition period could be negotiated prior to the settling of and as set out in the definitive agreements, to avoid a significant cost and related revenue requirement increase in 2042 arising from the shift in LIL revenue allocation to GOC and to otherwise to minimize the net cost of financing, though any such transition period would not prolong the estimated LIL investment repayment period;
- CanadaCo will be investing in a manner that is to provide Canada with suitable protections as an investor in the LIL Project. Appropriate governance equivalent to senior secured creditor protections to be provided by the agreement covenants. CanadaCo will have rights of control over specified matters relating to the limited partnership and the general partner intended to preserve the capital structure as agreed, this will include restrictions on further debt being incurred. The structure and documentation of LIL will be used as the base to prepare this agreement.

A separate agreement would be entered into with Nalcor to transfer the ownership interest in LIL Holdco to LIL SPV with Nalcor taking LIL SPV equity as consideration.

**Power Purchase Agreement:**

The PPA may be amended, on terms satisfactory to the parties, such that the MF/LTA supply price will be calculated to take into account the costs associated with FLG3 and may be amended to reflect the conversion of approximately \$2.0 billion (to be verified against 2012 budget) of equity associated with cost overruns for the MF/LTA Project to preferred shares. Such PPA amendments are acknowledged by the parties to be a condition precedent to the arrangements set out herein and the GOC facilities. Therefore, the parties acknowledge that such amendments must be agreed or other agreements or mechanisms must be implemented to achieve the same result contractually as between themselves; provided that such amendments or other agreements may be structured to only be effective so long as the CanadaCo LIL investment and the FLG, FLG2 and FLG3 remain outstanding.

**Due Diligence:**

From and after the effective date of this AIP, the Province will give access to GOC's representatives to a data room to allow GOC and its advisors to complete GOC's due diligence update review of the Project, the Project Cos, and their assets including key agreements. The concepts and requirements of FLG and FLG2 as to GOC consents will be used for FLG3. The due diligence investigation will include, but is not limited to, a review of the Issuers' financial, legal, tax, technical aspects, environmental and intellectual property and any other matters as legal counsel to GOC and to GOC's representatives, and other advisors deem reasonably necessary.

**Conditions to Closing:**

The closing of the Transactions would be subject to customary conditions, including:

- (a) Approval of the Transactions by the GOC and the Province, including any revisions to regulations, legislation or ministerial authorizations as are necessary to complete the transactions;
- (b) Approval of the boards of directors of each CanadaCo and NL Cos. so requiring;
- (c) Completion of satisfactory due diligence by GOC and the Province;



- (d) Commissioning of the Projects to the requirements of Commissioning as set out pursuant to the project finance agreements for FLG and FLG2, or as GOC agrees otherwise;
- (e) Confirmation that the allocation of responsibility for the Lower Churchill Projects reaching Commissioning as to cost and technical aspects remains with the Province and the NLCos as set out in FLG and FLG2;
- (f) Confirmation that the scope of the Lower Churchill Projects subject to the arrangements with Canada remains unchanged such that any additional investments in project assets or broader electrical system assets that may be required will be to the risk of the Province and Nalcor and such other NLCos; and
- (g) Execution of the described Agreements by the relevant party for each of GOC and the Province and each other party in a form acceptable to each such party.

Notwithstanding the forgoing: a) upon i) the Commissioning of the MF/LTA Project and ii) signing of the Definitive Agreements (including the signing of agreements associated with the LIL Investment, held in escrow), NL can proceed with the issuance of FLG3 with all proceeds to be placed in escrow; b) funds will remain in escrow until Commissioning of the LIL but with release permitted of the amount required to fund the December 1, 2021 sinking fund and principal payments. As a condition for the issuance of FLG3 on this basis, the amount of equity cost overruns in MF/LTA will be converted to Preferred Shares and all other equity invested in MF/LTA will be deemed to be invested as of the date of MF/LTA commissioning for purposes of determining the revenue requirements under the PPA. Furthermore, any further cost overruns on MF/LTA from that date forward will be funded with preferred equity with a 3% coupon rate payable commencing once all final costs have been determined for MF/LTA (such preferred equity to otherwise be on the same terms and conditions as describe under “MF/LTA capital restructuring” above).

**Finality:**

The parties acknowledge that the steps taken in this restructuring are to be a full and final accommodation by Canada to the terms

of the financing of the Projects. The Province and its entities have the responsibility to manage any outstanding risks and costs of the Projects, as may arise from legal, policy, regulatory, market, operational, or other factors.

**Definitive Agreements:** In addition to the terms specifically described in this AIP, which are to be addressed and included in general, the definitive agreements relating to the Transactions will contain standard representations, warranties, survival periods, indemnification, limits on indemnification, covenants, termination rights and other provisions appropriate for a transaction of the type contemplated in this AIP.

**Negotiations:** The parties agree to make or cause to be made their reasonable best efforts to finalize the drafts of the definitive agreements by no later than September 30, 2021 and to work to meet the Conditions to Closing. The negotiation of the definitive agreements will be done in good faith and in keeping with these terms.

### 3. GENERAL

**Expenses:** The parties to the AIP and to the master/definitive agreements will pay the transaction expenses, including the fees and expenses of legal, investment bankers and other advisors incurred in connection with the Transactions on the same basis as for FLG and FLG2.

**Confidentiality:** This AIP and any Term Sheet that is prepared in furtherance of this AIP are confidential to the parties and their representatives and is subject to the confidentiality agreement entered into between GOC and the Province as of February 23, 2021, which continues in full force and effect.

**Publicity:** All public notices to third parties and publicity concerning this AIP and detailed Term Sheet and the proposed transactions they describe will be jointly planned and coordinated by the GOC and the Province and neither will act unilaterally in this regard without the prior approval of the other party (such approval not to be unreasonably withheld).

**Governing Law:** The Definitive Agreements to be entered into among the parties to reflect the Transactions will be governed by and construed in accordance with the laws of the province of Newfoundland and Labrador and the federal laws of Canada applicable therein.

**Binding Agreements:**

This Section 3 constitutes a legally binding and enforceable agreement between the parties. The parties acknowledge that, other than this section 3, this AIP is non-binding on the parties and further that the purpose of this AIP is only to express the parties' understanding of the terms to be used to negotiate future agreements.

IN WITNESS WHEREOF, the Parties hereto have executed this AIP as of the date set forth above.

**HER MAJESTY THE QUEEN IN RIGHT OF CANADA, as represented by the Deputy Prime Minister and Minister of Finance**

**HER MAJESTY IN RIGHT OF NEWFOUNDLAND AND LABRADOR, as represented by the Premier and Minister for Intergovernmental Affairs**

By (Original signed by)

Name: Honourable Chrystia Freeland  
Titles: Deputy Prime Minister  
Minister of Finance

By (Original signed by)

Name: Honourable Andrew Furey  
Titles: Premier  
Minister for Intergovernmental Affairs

**HER MAJESTY THE QUEEN IN RIGHT OF CANADA, as represented by the Minister of Natural Resources**

By (Original signed by)

Name: Honourable Seamus O'Regan Jr.  
Title: Minister of Natural Resources