Q. **Reference: Life Extension Application, Schedule 1, page 22, lines 3-5.**

"Commissioner LeBlanc noted that "A reasonable reserve for strategic risk should have been included in the Project's cost estimate and made known to [the Government of Newfoundland and Labrador]."

a) Confirm that this statement, which is Key Finding 41 in the Muskrat Falls Review report, applies to a reserve for strategic risk when communicating project cost estimates internally to its owner (Government of Newfoundland and Labrador) and does not specifically require the inclusion of a management reserve to apply to base cost and strategic risk when seeking approval from the Board.

b) The Muskrat Falls Review report included nine key findings with respect to the Public Utilities Board. Confirm that the nine key findings did not include recommendations relating to management reserve in capital expenditure approvals by the Board.

A. **a)** Although Key Finding 41 in Volume 1 of the Muskrat Falls Inquiry Final Report[1] ("Inquiry Report") did state that *"a reasonable reserve for strategic risk. . ."*, otherwise known as a management reserve, should be made known to the Government of Newfoundland and Labrador ("Government"), which was secondary to the initial statement that the reserve should have been included in the Muskrat Falls Project's cost estimate the finding goes on to say that there was no reasonable basis to support the exclusion of strategic risk from the Muskrat Falls Project's cost estimates. Within the Executive Summary of the Inquiry Report, Commissioner LeBlanc references draft Independent Engineer ("IE") reports and their statement that "*The IE is not aware of a separate management reserve allowance to fund or accommodate unknown risks or changed field conditions as is typical practice for these types of projects.*"

[1] "Muskrat Falls: A Misguided Project, Commission of Inquiry Respecting the Muskrat Falls Project," The Honourable Richard D. LeBlanc, Commissioner, March 5, 2020, vol. I, Key Finding 41, p. 53.

Other than to opine on whether the Muskrat Falls Project should have been exempt from oversight by the Board of Commissioners of Public Utilities ("Board"), and the impact of the exemption on the development, costs, and operation of the Muskrat Falls Project, the purpose of the Inquiry was not to comment specifically on how approval should be sought from the Board. The Inquiry was specifically requested to address why there were significant differences between the estimated costs of the Muskrat Falls Project at the time of sanction and the costs by Nalcor Energy ("Nalcor") during project execution, to the time of the Inquiry (Term of Reference 4(b)), and whether any risk assessments, financial or otherwise, were conducted in respect of the Muskrat Falls Project, including any assessments prepared externally (Term of Reference 4(v)) and whether the assessments were conducted in accordance with best practice (Term of Reference 4(v)(A)). Recommendation 41 is specific to the Muskrat Falls Project; however, when considering the purpose of a management reserve and the key finding that it should have formed part of the Muskrat Falls Project's cost estimate and be made known to the entity that would sanction the Muskrat Falls Project, it is evident and reasonable to infer that a management reserve should be included in the cost estimates presented to the Board for review and approval in regulated major project applications. This is even more reasonable when considering the purpose of a management reserve component to a project estimate; a management reserve is a financial safeguard typically set aside to cover unknown unknowns—risks that are not specifically identified but are expected in large, complex projects. Including a management reserve in the project budget not only reflects prudent risk management but also provides transparency regarding the potential range of costs should identified risks materialize. Presenting the budget in this way ensures that the Board has a clear view of the upper bound of potential expenditures and allows Newfoundland and Labrador Hydro's ("Hydro") the ability to respond effectively to unforeseen circumstances.

By proposing a management reserve in the project cost estimate provided to the Board for scrutiny, and by having that management reserve approved by the Board, Hydro would have the authority to address initially unknown risks that arise in a timely fashion while remaining in compliance with the legislative requirement of prior approval of capital expenditures. The time that would otherwise be necessary to return to the Board for application and approval of expenditures to address the previously unknown risks would have a significant risk to the project costs.

b) The nine key findings with respect to the Board are specific to the Muskrat Falls Project and associated activities, and relate more directly to the matters put to the Board in the Reference Question. While the findings did not include a specific recommendation regarding management reserve, Key Finding 60[2] stated that the Government should have recognized the importance of insisting that Nalcor had more accurate cost and "risk" estimates prepared before sending the Reference Question to the Board. The risk estimates include the estimates for strategic risk referenced in Key Finding 41. The lack of recommendations specific to management reserve in capital expenditure approvals by the Board does not indicate that management reserve should not be included in a proposed project budget to be approved by the Board. Key Finding 41 stated that a reasonable reserve for strategic risk should have been included in the Muskrat Falls Project's cost estimate, and that there was no reasonable basis to exclude strategic risk from the Cumulative Present Worth analysis or the Muskrat Falls Project's cost estimates. If the Muskrat Falls Project had not been exempted from Board review, it would not have been reasonable to include the reserve for strategic risk in the cost estimate to present to the Government, and then remove it for application to the Board.

[2] "Muskrat Falls: A Misguided Project, Commission of Inquiry Respecting the Muskrat Falls Project," The Honourable Richard D. LeBlanc, Commissioner, March 5, 2020, vol. I, Key Finding 60, p. 58.