

August 26, 2014

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

Re: Ontario Power Generation – 2014 and 2015 Payment Amounts – EB-2013-0321

Please find the final argument of the Consumers Council of Canada in the above-referenced proceeding. Please feel free to contact the undersigned if you have any questions.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC: OPG Regulatory
Crawford Smith, Torys
Charles Keizer, Torys
All Parties

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application by Ontario Power Generation pursuant to the *Ontario Energy Board Act* for an Order or Orders approving payment amounts for the years 2014 and 2015

EB-2013-0321

FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA

INTRODUCTION:

By Application dated September 27, 2013, Ontario Power Generation applied pursuant to section 78.1 of the *Ontario Energy Board Act, 1998*, for an order or orders approving the payment amounts and payment riders for the period from January 1, 2014, to December 31, 2015. OPG is requesting payment amounts for the output of its currently prescribed nuclear and hydroelectric facilities to be effective as of January 1, 2014. In addition, OPG is requesting an effective date of July 1, 2014 for 48 newly regulated hydroelectric facilities.

These are the submissions of the Consumers Council of Canada (“Council”) regarding OPG’s Application. The Council will not address each and every issue on the Board approved issues list, but will focus primarily on those issues where the potential impacts on Ontario ratepayers are the greatest. In addition, the Council has had the opportunity to review the submissions of Board Staff filed on August 18, 2014, and the draft submissions and argument sections of other ratepayer groups including the School Energy Coalition (“SEC”), the Vulnerable Energy Consumers Coalition (“VECC”) and the Association of Major Power Consumers in Ontario (“AMPCO”). We have set out below where we are in agreement with those submissions. The Council worked closely with Counsel for the Canadian Manufacturers and Exporters (“CME”) on many issues during the hearing process,

and argument, and we have in some cases adopted their argument submissions in full.

The Council will provide a brief overview of the Application. We will highlight important issues that provide context for the Board’s consideration of OPG’s Application. We will then set out our submissions on the issues that we have addressed specifically.

OVERVIEW OF THE APPLICATION:

OPG filed its application and supporting evidence on September 27, 2013. It subsequently filed three updates, one on December 6, 2013, one on May 16, 2014, and one on July 2, specifically related to the Darlington Refurbishment Project.

OPG is now seeking approval of the revenue requirements, payment amount levels and the related rate riders set out in the May update:

	Revenue/ Amortization (\$M)	Production (TWh)	Payment Amounts and Riders \$/MWh
Previously Regulated Hydro			
Test Period Revenue Requirement	1,757.8	41.1	42.75
2015 Deferral & Variance Accounts	70.6	21.0	3.36
Newly Regulated Hydro			
18 month Revenue Requirement	853.2	17.9	47.57
Nuclear			
Test period Revenue Requirement	6,395.4	94.6	67.60
2015 Deferral & Variance Accounts	62.2	46.1	1.35

(Ex. N2/T1/S1/p. 10)

OPG has indicated that the net impact of this change in payment amounts would increase the monthly bill of a typical residential consumer by \$5.31, which according to OPG results in an overall payment amount increase of 23.4 %. (Argument in Chief, p. 2). The revenue deficiency associated with the Previously Regulated Hydroelectric facilities is \$286.8 million and for the Nuclear facilities it is \$1.521 billion. (Ex. N2/T1/S1/Table 4)

If OPG is granted the relief it is seeking with respect to implementation dates of January 1, 2014 for the Previously Regulated Hydroelectric assets and July 1, 2014 for the Newly Regulated Hydroelectric assets, the rates and riders proposed would represent a 43% increase over the current riders. Going back to January 1, 2014,

would entitle OPG to retroactively recover approximately \$649 million from Ontario consumers (J3.10).

OPG is not seeking to recover amounts in certain deferral and variance accounts until the Board has considered these amounts in the context of another Application that will be filed later this year. These are costs have been incurred and the current estimate of those balances is \$177.2 million for those related to hydroelectric and \$1.265 billion (Tr. Vol. 3, pp. 85-87 and J3.10).

In OPG's last payment amounts proceeding for 2011 and 2012 OPG applied for an increase of 6.2% and the Board ultimately approved an increase of less than 1% (Decision, EB-2010-0008, p. 8).

As set out in the sections below the Council is concerned about OPG's overall Application and the adverse impact it will have on Ontario consumers, if approved by the Board. The Council will be opposing many of OPG's requests for cost recovery on the basis that OPG has not justified those requests. Although OPG has a mandate to operate as a commercial enterprise it has also committed to operate as efficiently and cost-effectively as possible. The evidence is that OPG has failed to live up to that commitment. The Council believes that OPG's first and foremost consideration should be to operate its business in a way that provides Ontario consumers with safe, reliable electricity at a reasonable cost. Operating as efficiently and cost-effectively as possible would ensure that Ontario consumers are provided with value for service. The evidence in this proceeding is that OPG is not, in large measure, providing the best value for Ontario consumers. At a high level our concerns with the Application are as follows:

1. OPG is seeking to increase its payment amounts by 23.4% which represents an unacceptable level of increase over the current payment amounts. If OPG is granted the relief it is seeking with respect to an effective date of January 1, 2014 the increase in payment amounts will be almost 50%. Implementing a retroactive adjustment back to January 1, 2014 would represent an unfair and unacceptable burden for Ontario consumers;
2. Despite OPG's claims that the company has undertaken significant cost control over the last several years the evidence in this case is to the contrary. OPG when benchmarked against others with respect to its nuclear costs, and with specifically with respect to compensation, is not consistent with its claim that it has focused on cost control in a meaningful way;
3. OPG is seeking approval of costs in this proceeding that have been highly criticized by the Ontario Auditor General regarding pensions and overall compensation costs. The Auditor General of Ontario released its 2013 Audit Report and raised a number of serious concerns regarding many components of OPG's overall compensation portfolio;

4. OPG is seeking approval to include in rate base the full costs of the Niagara Tunnel Project. This project represents the largest OPG project that the Board has ever been asked to approve. The cost of the OPG project is almost \$500 million over and above the original forecast cost approved by OPG's Board of Directors. OPG has not provided sufficient evidence to support the inclusion of the full amount of the NTP project in rate base;
5. Although the Darlington Refurbishment Project is in the initial stages of development it has already been subject to cost overruns. OPG is seeking approval from the Board of its contracting strategies which goes well beyond what the Board would typically approve in a cost of service proceeding for a project that is not expected in service for many years;
6. OPG's parent, the Government of Ontario has decided that previously unregulated OPG assets should now be regulated. This decision increases costs to Ontario consumers relative to leaving the assets unregulated and subject to market conditions.

This is the third payments amounts proceeding. Many of OPG proposals, forecasts and requests for relief were vigorously challenged by the intervenors. The Council observes that with each Application OPG seems to be less and less concerned with what is best for Ontario ratepayers. OPG has been consistently, through the years, criticized for a lack of cost control, and the evidence in this proceeding is that OPG is not addressing that criticism sufficiently, nor is it doing what it needs to do to operate efficiently and cost-effectively with a focus on what is best for Ontario consumers.

GENERAL ISSUES

Issue 1.3 – Has OPG appropriately applied USGAAP accounting requirements, including identification of all accounting treatment differences from its last payment order proceeding?

In its submission Board Staff addressed the issue regarding changes to regulatory accounting policies and procedures that occur outside of the cost of service proceedings. Specifically, Board Staff submitted the regulatory accounting basis, on which rates are approved by the Board, should not be altered without Board approval.

Board Staff used an example regarding the end of service life for the Pickering nuclear generating station. On December 31, 2012, OPG extended the service life resulting in a decrease of \$47 per year in its depreciation expense. This change was considered by parties in the deferral and variance accounts proceeding, and a deferral account was established to capture the change. Had that proceeding not occurred the amount would have resulted in a windfall for OPG at the expense of the

ratepayers, as the approved revenue requirement assumed a different depreciation expense.

Board Staff has suggested that the Board direct OPG to bring forward any accounting changes that would result in revenue requirement impacts of \$20 million or more (Board Staff Submission, p. 5). The Council supports this proposal. This could be accomplished by establishing an accounting change deferral account with a threshold of \$20 million. This would ensure that any material accounting changes that occur between applications will be brought forward for consideration and implementation. It will also ensure that with material mandated accounting changes OPG's ratepayers and shareholders are kept whole.

Issue 1.4 - Is the overall increase in 2014 and 2015 revenue requirement reasonable given the overall bill impact on customers?

The Council will be making submissions throughout this argument that will support the contention that the overall increase in the revenue requirement for 2014 and 2015 not reasonable and should be reduced by the Board.

CAPITAL STRUCTURE AND COST OF CAPITAL:

Issue 3.1 What is the appropriate capital structure and rate of return on equity for the current regulated facilities and newly regulated facilities?

Capital Structure:

OPG has applied for payment amounts based on the deemed capital structure that was approved by the Board in its last two payment amount proceedings (EB-2007-0905 and EB-2010-0008). That capital structure is 47% equity and 53% debt. OPG's position is based on its view that there have been no significant changes in the risks faced by OPG's regulated asset portfolio that are not otherwise addressed by proposals to establish new variance and/or deferral accounts (Argument in Chief, p. 12).

OPG retained Kathleen McShane of Foster Associates to provide an analysis as to whether the cost of capital approved in the last payment amounts proceeding remained appropriate given the fact that the Niagara Tunnel Project was complete and that the newly regulated hydroelectric assets were included in OPG's rate base. Ms. McShane concluded that OPG's deemed common equity should, at a minimum remain at 47% for a number of reasons. Her conclusions were as follows:

- The business risks specific to OPG's regulated hydroelectric generation operations, including the newly regulated facilities, are somewhat higher largely due to higher operating risks of the newly regulated facilities;

- The fundamental business risks of the nuclear generation operations have not changed materially;
- The lower end of a reasonable range of equity ratios for the regulated hydroelectric generation operations, including the new assets, consistent with their relative business risks and the fair return standard is, conservatively 45%. As such a 47% common equity ratio for OPG's combined hydroelectric and nuclear operations remains reasonable;
- The Darlington Refurbishment Project, due to its size, will reverse the relative proportions of the test period hydroelectric and nuclear generation rate base. Capital structure decisions reflect longer term, not test period business risks. Maintaining the 47% common equity ratio is a conservative approach that OPG should revisit once a Decision on the Darlington refurbishment has been reached;
- Darlington will require significant capital including \$1.5 billion during the test period. OPG's allowed common equity ratio should remain at the previously approved 47% to avoid further weakening of credit metrics;
- The characteristics of incentive regulation expose regulated companies to a higher risk than under cost of service regulation. The higher business risk of the regulated operations under incentive regulation provides support for, at a minimum maintaining the 47% common equity ratio. (Ex. L T3.1/S17/SEC 24)

OPG has indicated that it agrees with Ms. McShane's analysis and opinion, which in its view supports maintaining the current level of equity thickness. (Argument in Chief, p. 14) This is based primarily on the assumption that OPG's business risk has not changed since the last proceeding.

In the EB-2007-0905 case Ms. McShane recommended an equity level 57.5%, which the Board rejected. In that case the Board found Ms. McShane's recommendation "excessive." The Board noted that the McShane's recommendation was higher than all other regulated utilities and well in excess of the levels for merchant generators. Instead the Board adopted the recommendations of Drs. Kryzanowski and Roberts which was 47%, noting the higher risk of OPG relative to other regulated utilities. (Decision, EB-2007-0905, pp. 141-143).

In that case Kryzanowski and Roberts presented an analysis that considered the risk of the hydroelectric and nuclear operations separately. They recommended a ratio for each of the operating units and calculated a weighted average based on OPG's rate base asset breakdown as per the amounts set out in the Electricity Restructuring Act of Ontario, 2004. In that analysis they recommended 45-50% for

nuclear and 40% for hydroelectric. In arriving at the 47% they assumed a “conservative” 50% for nuclear.

In the last payment amounts proceeding Kryzanowski and Roberts also testified on the issue of the appropriate capital structure and proposed an equity thickness of 43% for hydroelectric and 53% for nuclear. This analysis was based on asset net book values at the time.

It is a matter of Board policy to only review capital structure when there has been a significant change in financial, business or corporate fundamentals. (Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities, December 2009, p. 49). So, in this case the Board must consider the extent to which there has been a change in risk and to the extent there has, how should that be reflected in the approved debt and equity levels for OPG.

What has changed is the addition of the Niagara Tunnel Project to ratebase and the regulation of hydroelectric assets that were previously unregulated. The level of hydroelectric assets relative to the nuclear assets has shifted. McShane agrees that this would put downward pressure on the appropriate equity thickness if that was the only thing being considered (Tr. Vol. 10, p. 97). It is also her position, however, that the newly regulated assets are riskier. (Tr. Vol. 10, p. 103).

Ms. McShane was questioned during the hearing regarding her conclusion that the newly regulated assets are riskier. It became clear, however, that although she may be an expert in cost of capital issues, she is not an expert in hydroelectric operations. (Tr. Vol. 10, pp. 102-112) Therefore, the Board should be cautious about her testimony in this regard. Is there evidence before the Board that these new assets are riskier? No, there is not. The Council agrees with SEC that in the absence of a determination that the new hydroelectric assets are riskier relative to those that are currently regulated, the Board should assume that the risk of these assets is comparable.

Ms. McShane’s assessment of risk also includes the fact that the Darlington Refurbishment Project will be coming on stream in the future. She concludes that because the asset mix will change in the future when Darlington is in-service maintaining the 47 equity level now is appropriate and ultimately a conservative approach.

The Board is determining the appropriate capital structure for the test period, 2014 and 2015. The mix of capital beyond that period is not known. If it changes and the risk profile of OPG changes it is at that time that the Board can assess whether changes in the capital structure are required. The Council sees no reason why the addition of the Darlington Refurbishment Project in a period well beyond the test years should impact what the Board considers to be an appropriate capital structure now.

Ms. McShane also attempts to make a link between the current capital structure and the fact that OPG may be moving to an incentive regulation model. She claims that the higher risk faced by OPG under such a model is further justification for maintaining the 47% equity level. First, there is no evidence that regulation under an incentive rate-making model OPG will be subject to a greater level of business risk. In fact, the two large Ontario natural gas utilities have consistently overearned during their incentive regulation plans, and the Board has never adjusted their capital structures to reflect the introduction of incentive rate-making. Second, the Board is setting payment amounts for 2014 and 2015 on a cost of service basis. To reflect the fact now, that they may be under an incentive rate-making model in the future, is not appropriate.

The Council submits that the Board may also want to consider the extent to which the Pension and OPEBs Cost Deferral Account, established as a part of the EB-2012-0321 proceeding has reduced OPG's business risk.

The Council submits that what is most relevant to the determination of OPG's capital structure for the test period is that the mix between nuclear and hydroelectric assets has changed significantly and there is no evidence that the relative risks have changed. The Council has reviewed the arguments of VECC and SEC on this issue regarding the calculation of the equity level. If the Board maintains the methodology used in the last two payment amount proceedings OPG's equity level should be reduced to something in the range of 42%.

The Council notes that OPG made a comment in its Argument in Chief, that Ms. McShane was the only cost of capital expert to testify in the proceeding. (Argument in Chief, p. 13) If that implies that, in the absence of other expert testimony, the Board must accept her analysis. The Council urges the Board to reject this proposition. The test that needs to be applied in terms of assessing whether to adjust the level of equity thickness is a determination of whether OPG's business risk has changed. The Board does not need an expert to allow it to make that determination.

Return on Equity

The Board has an established policy that it uses for determining the appropriate Return on Equity ("ROE") for cost of service applications. The ROE is set on the basis of its ROE formula and Consensus Forecasts and calculated prior to the beginning of the year. The Council supports this approach for OPG, as it sets an ROE based on current broad-based information, not in a forecast prepared in 2013.

Issue 3.2 Are OPG's proposed costs for its long-term debt and short term debt components of its capital structure appropriate?

It is OPG's position that it's the determination of its long-term and short-term debt components for the test period are consistent with the methodologies approved by

the Board in the last two payment amount decisions, EB-2007-0905 and EB-2010-0008. OPG is seeking approval of the cost of its long-term debt based on what was filed in its original filing on September 27, 2013 (Argument in Chief, p. 15).

The Council supports this approach as it is consistent with what has been applied in the last two payment amount proceedings, and no other methodologies were proposed by others.

CAPITAL PROJECTS

Issue 4.3 – Are the proposed test period in-service additions for regulated hydroelectric projects (excluding the Niagara Tunnel Project) appropriate?

OPG is seeking approval of \$151 million for hydroelectric in-service capital (excluding the NTP) for the test period (Ex . D1/T1/S2/Tables 1-5). OPG has a consistent pattern of not actually putting into service the assets that it planned to put in place. In addition, there is no evidence that its forecasting methodology has changed to better align actual spending with planned spending. Accordingly, the Council supports a downward adjustment of the hydroelectric in-service capital forecast to reflect historical experience.

Issue 4.5 - Are the proposed test period in-service additions for the Niagara Tunnel Project reasonable?

Niagara Tunnel Project:

The Niagara Tunnel Project (“NTP”) was put into service on March 9, 2013. The purpose of the tunnel was to make better use of the available water flow from the Niagara River to produce an additional 1.5 TWh per year from the two generating stations at the Adam Beck facility.

The original budget for the NTP, which was approved by OPG’s Board of Directors in 2005 was \$985.2 million with a projected in-service date of June 2010. It is OPG’s evidence that the \$985.2 million was based on a “a realistic estimate of the project’s cost based on extensive geotechnical investigations including consultation with recognized professional and academic experts and the costs proposed by the international tunneling consortia that responded to OPG’s competitive solicitation.” (Argument in Chief, p. 22)

As discussed below, OPG encountered “extremely difficult rock conditions” during tunneling which necessitated a revised project schedule (42 months delay) and a revised budget of \$1.6 billion. These changes were approved by OPG’s Board of Directors in 2009. The project ultimately cost \$1.476.6 billion. From OPG’s perspective the actual amount OPG spent on the NTP represents the true cost of completing the project given the subsurface conditions actually encountered (Tr. Vol. 2, pp. 85-89).

Ontario Regulation 53/05 requires that the OEB approve recovery of the capital and non-capital cost of the NTP as approved by OPG's Board of Directors prior to the first payment amounts order (EB-2007-0905). So, in effect, the scope of the Board's review in this proceeding is to review the prudence of the amounts incurred beyond that original budget of \$491.4 million. The Council notes that of the \$286.8 million revenue deficiency over the test period related to hydroelectric operations \$231.8 is related to the NTP.

A "Design-Build Agreement" for the NTP was awarded to Strabag AG ("Strabag") in 2005. OPG and Strabag jointly developed and agreed upon a Geotechnical Baseline Report ("GBR") which was put in place to describe the rock conditions that the contractor would encounter while undertaking the project. Once the boring started Strabag encountered significant rock "overbreak" and other issues claiming the rock conditions were not consistent with the conditions set out in the Design-Build Agreement. Scheduling delays and increased costs resulted, and Strabag claimed that it was entitled to \$90 million in cost over-runs (Tr. Vol. 1, p. 65). This triggered a review process, as set out in the Design-Build Agreement with a non-binding Dispute Review Board ("DRB"). This process was relevant specifically to the first 3 km of boring undertaken by Strabag. The full length of the tunnel was 10 km.

The DRB issued its recommendations on August 2008. The DRB accepted that the GBR was defective, but did not assign specific financial responsibility to either OPG or Strabag for with respect to the cost over-runs (Tr. Vol. 1, p. 72). OPG went on to negotiate a new Amended Design-Build Agreement with Strabag which increased the costs of the Diversion Tunnel from \$406.9 to \$689.4 (Tr. Vol. 1, p. 75). This includes \$40 million paid to Strabag for claimed losses.

The Council accepts that the NTP has been an extremely large, complex and challenging project. The Council accepts that the project is delivering benefits to Ontario consumers by increasing the production of the Adam Beck facility in an environmentally sound way. We are not saying it is project that should not have been undertaken. What we question is the extent to which the full costs associated with the project should be borne by Ontario ratepayers. If the Board deems that some of OPG's decisions during the course of this project were not prudent decisions then the Board should not allow all of the costs associated with the project to be recovered through the payment amounts.

The Council has reviewed the submissions by Board Staff, AMPCO, SEC and CME on regarding the Niagara Tunnel Project. In each of those cases the parties have presented valid arguments for disallowances based on a test of prudence.

The Council supports the conclusions reached by CME on this issue with respect to the Diversion Tunnel and the dispute with Strabag. CME argues that in light of the circumstances regarding the dispute it would not be prudent for OPG to pay Strabag for subsurface conditions for the last 7 km that is materially in excess of the

incremental amount paid for the first 3 km. This would result in the Board disallowing \$149.5 million of OPG's NTP cost related to the Diversion Tunnel.

In its submissions Board Staff argued for reductions of an additional \$59 million related to issues regarding incremental design work, profit for Strabag, carry costs related to the delay, Office and General Costs and Ovehead Recovery Costs and an amount related to the fall of ground due to an improperly closed borehole (Board Staff Submissions, pp. 24-26). The Council agrees with these submissions and the proposed disallowances.

Both AMPCO and SEC have proposed disallowances of \$374.9 million and \$245.7 million for the NTP based on the Diversion Tunnel decisions made by OPG a number of other issues. We agree with CME that the appropriate range of reduction to the in-service amounts for the NTP are between \$208.5 million and \$375 million.

Issue 4.8 Are the proposed test period in-service additions for nuclear projects (excluding those for the Darlington Refurbishment Project) appropriate?

OPG is proposing in-service addition for its nuclear operations of \$158.3 million in 2014 and \$141.7 in 2015 (Ex. D2/T1/S3/Table 4). The Council supports the conclusions reached by Board Staff, that in light of a history of underspending relative to forecast amounts in this area that a 12% reduction in 2014 and 2015 nuclear in-service amounts should be reflected in the 2014 and 2015 rate base amounts.

Darlington Refurbishment

The Darlington Refurbishment Project ("DRP") is a multi-year, multi-phase program for OPG's Darlington Nuclear Generating Station to enable the replacement of life-limiting critical components, the completion of upgrades to meet current regulatory requirements and the rehabilitation of other components. The DRP will allow the Darlington Station to continue operating for an additional 30 years. (Ex. D2/T2/S1/p. 1).

The project was given approval by the OPG's Board of Directors on November 19, 2009. The project was given further approval by the Minister of Energy on March 11, 2008. In a 2012 economic assessment of the DRP the OPA concluded that there is a high likelihood that refurbishing Darlington would be less costly than other sources of supply, including new nuclear or gas-fired facilities for a wide range of potential future conditions. (Ex. D2/T2/S1/p. 3). It also forms part of the Government of Ontario's Long-Term Energy Plan released in December 2013.

In the last payments amount proceeding the Board approved forecast DRP capital expenditures of \$105.2 million for 2011 and \$255.8 million for 2012. In addition, the Board approved test year OM&A expenditures \$5.9 million and \$4.5 million for 2011 and 2012. The Board noted, however, that it did not need to make a finding

that the project as whole was in the public interest in order to grant the approval OPG sought in that application. (Decision with Reasons, EB-2010-0008, pp. 66-72) At that time OPG's overall cost estimate for the project was a range of \$6-10 billion.

With respect to the application OPG is seeking approvals in relation to certain test period OM&A expenditures, capital expenditures and a request for "more modest in-service additions to rate base" (Tr. Vol. 1, p. 31). In addition, OPG is seeking a finding that OPG's commercial and contracting strategies are reasonable.

Issue 4.9 Are the proposed test year period in-service additions for the Darlington Refurbishment Project appropriate?

The Council supports the analysis and recommendations provided by CME with respect to the Campus Plan projects projected to go into service in 2014 and 2015.

Issue 4.10 Are the test period capital expenditures associated with the Darlington Refurbishment Project reasonable?

OPG is seeking a finding from the Board that the proposed capital expenditures of \$839.9 million in 2014 and \$842 million for 2015 are reasonable. The Council submits that the Board should not make any findings on the Darlington capital expenditures at this time. The Board should assess prudence once the project is complete, in service and the assets are added to rate base. A determination of prudence at this time would be premature.

Issue 4.11 Are the commercial and contracting strategies used in the Darlington Refurbishment Project reasonable?

During the hearing, from the Council's perspective, there was a considerable amount of confusion as to what OPG was seeking approval of with respect to its contracting strategies and what approval by this Board would actually mean. OPG set out in its Argument in Chief that it was seeking approval of the following:

- A multi-prime contractor model in which OPG retains the overall project management and design authority responsibility for the DRP;
- The division of the DRP into five major packages; Re-tube and feeder replacement ("RFR"), Turbine Generator, Steam Generators, Defueling and Fuel Handling, and Balance of Plant;
- A Model where the prime contractor is responsible for engineering, procurement, and construction (or some combination of those) within each of the five major packages
- A means to allocate risk to the party most able to manage that risk, through a pricing structure tailored to the level of project definition and the level of required owner oversight. This means the use of target pricing where

- projects are less defined and require more oversight, and fixed pricing for those projects with greater definition; and
- For all of the above, subject to the available contract options in the marketplace.

In addition:

OPG also noted that if the Board finds that the record is sufficiently developed to render a finding on the reasonableness of the contracting strategies, it requests a finding that OPG's application of the above guiding principles to the contracting strategies is reasonable as it applies to the pricing structure in terms of utilization of fixed, target, or other pricing structures for each of the five major packages.

OPG indicated that it was not requesting approval of the contracts, conduct of negotiations or the procurement process, any prices established through the contracting process, and its selection of the winning proponent. (Argument in Chief, pp. 44-45)

From the Council's perspective it is important to highlight the fact that the Board's primary responsibility in this application and future applications is to set payment amounts that are reasonable. The Board should not be expected to pre-approve the process that OPG should follow in its development of the DRP. OPG is undertaking a multi-billion dollar project over a long period of time. It is OPG's responsibility to proceed with the project in a prudent manner. Management oversight of the project must rest with OPG.

The Council urges the Board to reject OPG's request to approve its contracting strategies. It is unclear as to how that might bind the Board in the future. What are the implications of such a ruling on future payment amounts? In addition, it is not the role of the Board to pre-approve an approach to contracting. The Board's role as a regulator is to approve any "cost consequences" arising out of OPG's contracting decisions.

HYDROELECTRIC INCENTIVE MECHANISM ("HIM")

Issue 5.4 Is the proposed new incentive mechanism appropriate?

OPG has had in place a hydroelectric incentive mechanism since the Board began setting payment amounts. The purpose has been to provide OPG with an incentive to produce peaking supply in response to demand. This benefits customers by having an additional low-cost peaking resource available to improve system reliability and temper market prices through increased supply.

In the last payment amounts decision the Board expressed concern about the current HIM and the extent to which provided real benefits to consumers. The

Board also expressed concern about the interaction between how the HIM works and surplus baseload generation. The Board approved a model whereby the financial proceeds of the HIM would be shared on a more equitable basis between OPG and the ratepayers (Decision, EB-2010-0008, pp. 144-146).

In the 2012-0321 proceeding OPG filed evidence proposing a variation to the HIM, the enhanced HIM (“eHIM”) attempting to deal with the interaction of the HIM and surplus baseload generation.

In this case OPG is proposing that the eHIM apply to both the previously regulated facilities and the newly regulated facilities. OPG is also proposing that the HIM variance account be closed.

The Council agrees with Board Staff that OPG’s reworking of the HIM does not address the Board concerns regarding the need to better align the interests of ratepayers and OPG. From Board Staff’s perspective the eHIM proposal could generate results that benefit OPG, but does not allow for any sharing of benefits after the fact (Board Staff Submission, p. 48).

As a matter of principle OPG should be focused on providing benefits to its ratepayers. The Council questions why OPG would not support an HIM proposal that balances the interests of its ratepayers and its shareholder.

Board Staff has proposed a more generous sharing mechanism that favours consumers through a graduated, increasing percentage of net revenues (Board Staff Submission, p. 50). The Council agrees that this proposal would be appropriate. It is a similar approach to the transactional services accounts that are in place for each of the two large natural gas utilities. Those mechanisms have provided both incentives for the utilities to generate increased revenue, and a balanced sharing of those revenues between ratepayers and shareholders.

OPERATING COSTS

Issue 6.1 Is the test period Operations, Maintenance and Administration budget for the regulated hydroelectric facilities appropriate?

Total Operations, Maintenance, and Administration costs for 2014 and 2015 are \$234.9 million and \$237.3 million. As illustrated by both SEC and Board Staff OPG has consistently spent less than forecast with respect to hydroelectric OM&A. OPG is also on track to spend less than forecast for 2014 (Ex. J3.13). The Council supports the approach set out by SEC which is a reduction of 4.3% a year for both 2014 and 2015. This would result in a reduction of \$9.7 million in 2014 and \$10 million in 2015.

Issue 6.2 Is the benchmarking methodology reasonable? Are the benchmarking results and targets flowing from those results for the regulated hydroelectric facilities reasonable?

In its submissions Board Staff highlighted the deficiencies with OPG's hydroelectric benchmarking. These include:

1. None of the benchmarking is done independently by a third party;
2. OPG has not completed any independent benchmarking to date and does not intend to on a go forward basis;
3. OPG exercises its discretion in the costs that are included in any benchmarking analysis;
4. OPG selectively benchmarks only 50% of total OM&A costs, completely excluding all regulatory costs. (Board Staff Submission, p. 60)

To date OPG has not provided benchmarking that has been useful to the Board in terms of assessing the reasonableness of its costs. Furthermore, OPG has not undertaken benchmarking that could assist it internally in terms of driving out efficiencies and cost control. The Council submits that the Board should order OPG to undertake meaningful and comprehensive benchmarking for its hydroelectric facilities and bring that analysis forward in the next proceeding.

COMPENSATION

Issue 6.8 Are the 2014 and 2015 human resource costs (wages, salaries, benefit incentive payments, FTEs and pension cost) appropriate?

In December 2013 the Ontario Auditor General released its 2013 Annual Report. (AG Report) In that Report the Auditor General specifically addressed OPG's whether OPG has adequate procedures and systems to:

- Ensure that its human resources are acquired and managed with due regard for economy and efficiency, and in accordance with applicable policies, legislative requirements, contractual agreements and sound business practices; and
- Measure and report on its results in this regard. (Annual AG Report, 2013, p. 153)

Some of the key findings in the AG report relevant to this proceeding were as follows:

- OPG's overall staffing levels have gone down by 8.5%, but the size of its executive and senior management group has increased by 58%;

- OPG has rehired some of its former employees mainly for the purpose of succession planning. Almost all of these were rehired shortly after leaving OPG and some continued to receive significant amounts in allowances and Annual Incentive Plan awards;
- We found a number of cases between 2005 and 2012 where the annual base salaries of non-unionized staff exceeded the maximum set out in the base schedule by more than \$100,000;
- OPG gives Annual Incentive Plan awards to all non-unionized employees. From 2010 to 2012 67% of OPG's executive and senior management staff received high scores (3 or 4 out of 4) relative to 24% of staff in lower bands;
- OPG engaged a consultant to conduct a compensation benchmarking study in 2012, which found that base salary, cash compensation and pension benefits for a significant proportion of staff were excessive compared to market data;
- OPG has contributed disproportionately more to its pension plan than its employees have;
- OPG's total overtime costs were about \$148 million in 2012. The number of OPG employees earning more than \$50,000 in overtime pay has doubled since 2003. (Annual 2013 AG Report, p. 155)

Many of the more detailed observations by the AG were discussed during the oral hearing process.

In the EB-2010-0008 proceeding compensation costs were considered at length with the Board making a \$145 reduction related to nuclear compensation over the two-year period. The Board in making these reductions concluded:

The ratepayers should only be required to bear reasonable costs – and in determining reasonable costs the Board can be guided by market comparisons. It is the responsibility of the Board to send a clear signal that OPG must take responsibility for improving its performance. (Decision, EB-2010-0008, p. 86)

In making its decision the Board was encouraging OPG to move its compensation levels to the 50th percentile as per the benchmarking studies presented in that case. Despite the Board's decision, OPG concluded collective bargaining with both the Society of Energy Professionals and the Power Workers Union at compensation levels that are once again excessive.

All of the evidence in this proceeding, and the two previous proceedings points to the fact that OPG is top heavy in terms its employees and its employees are simply

paid too much. We hear this over and over and it has been recently confirmed, yet again, by the Auditor General.

This Board has the ability to reduce the overall compensation amounts that OPG is seeking to recover from its ratepayers and the Council is encouraging it to do so. We question, however, why the Government of Ontario, OPG's shareholder, and OPG itself is not making any strides to address these issues. The Auditor General provided a well-documented critique of OPG compensation levels and policies. It will be incumbent on OPG, going forward, to demonstrate that it is moving to a more market based approach in terms of those compensation levels and policies.

Board Staff, SEC and CME have presented useful, comprehensive analyses demonstrating that OPG's compensation and staffing levels continue to be problematic and out of market. The Council supports the conclusion advanced by SEC that the Board should reduce OPG's compensation (staffing and compensation levels) costs by \$100 million for each of 2014 and 2015. According to SEC this would reflect moving PWU compensation to the 50th percentile, further staffing level reductions, as well as an allowance to take into account amounts embedded in OPG's forecasts oversight and accountability issues.

PENSION AND OTHER POST-EMPLOYMENT BENEFITS

Issue 6.8 Are the 2014 and 2015 human resources related costs (wages, salaries, benefits, incentive payments, FTE's and pension costs appropriate

The evidence in this proceeding highlighted serious concerns regarding the regulatory treatment of pension and OPEB costs. OPG currently uses the accrual method to account for its pension and OPEB costs. This has resulted in OPG recovering significant amounts from ratepayers over and above the actual OPEB and pension costs incurred in any given year. As pointed out by Board Staff it is inequitable for today's ratepayers to pay for pension and OPEB costs that OPG will have to find the cash to pay in the future. This arises from the fact that these amounts are not going into a fund for future payment, but simply form part of the revenue requirement and can be spent the discretion of management. OPG has no clear plans as to how to fund these liabilities (Argument in Chief, p. 100).

The Council submits that the Board should order OPG to move to a cash basis for the recovery of pension and OPEB costs.

Issue 6.10 Is the proposed test period depreciation expense appropriate?

The Council's only issue with respect to depreciation relates to the Niagara Tunnel Project. OPG, as per the Gannett Fleming Depreciation study is proposing a useful life of 150 years. The Council supports the recommendation of Board Staff that a more realistic service life for the tunnel (given how long the previously constructed tunnels have lasted) is 135 years.

Issue 6.11 Are the amounts proposed to be included in the test period revenue requirement for income and property taxes appropriate?

With respect to taxes the Council adopts the recommendation made by SEC that the regulatory tax loss in 2013 should be carried forward to 2014 to reduce taxable income and the payment amounts. Ratepayers have paid the income taxes provision in 2013 so it only follows that the 2013 tax loss should be used to reduce the 2014 amount.

NUCLEAR WASTE AND DECOMMISSIONING LIABILITIES

Issue 8.1 Is the revenue requirement for recovering nuclear liabilities in relation to nuclear waste management and decommissioning costs appropriate?

The Council takes no position on this issue.

DEFERRAL AND VARIANCE ACCOUNTS

Issue 9.2 Are the balances for recovery in each of the deferral and variance accounts appropriate?

OPG has indicated that the 2013 year-end balances for all of deferral and variance accounts is \$217.3 m for the hydroelectric operations and \$1,478.4 million for the nuclear operations (Ex. L/9.1/SEC/132). The Council not taking issue with the balances in these accounts, although parties will be free to consider the balances in those accounts when OPG seeks to clear those accounts.

OPG is only disposing of the four accounts which were the subject of the EB-2012-0002 proceeding. Those accounts are the Hydroelectric Incentive Mechanism Account, the Hydroelectric Surplus Baseload Generation Account, portions of the Capacity Refurbishment Variance Account and the Nuclear Development Variance Account (Ex. H1/T1/S1/p. 1). OPG intends to seek review and clearance of 2014 year-end audited balances for all of its deferral and variance accounts through a separate application which it will file later this year.

The audited balances in these accounts are \$126.9 million for the previously regulated hydroelectric and \$62.2 million for the nuclear facilities (Ex. N2/T1/S1, Tables 9 and 10).

The Council has no issue with the balances in these accounts and the proposed recovery.

Issue 9.5 Is OPG's proposal to not clear deferral and variance account balances in this proceeding (other than the four accounts directed for clearance in EB-2012-0002) appropriate?

As noted above OPG is proposing to defer clearance of all of its account, except for the four listed and seek to recover the 2014 year-end balances in a separate proceeding. Given that this application has proceeded on that basis the Board is not in a position to deal with these account balances (except the four) now.

What is important from the Council's perspective is that OPG's "ask" in this case should not be considered in isolation. The amounts that OPG is seeking to recover in a future proceeding later this year form part of the overall costs that OPG is seeking to recover from ratepayers during the test year period. In assessing the reasonableness of OPG's Application the Board needs to consider the amounts in those accounts. They are a current cost for ratepayers. OPG's proposal simply defers recovery of those current costs.

Going forward the Council submits that OPG should bring forward audited balances in its deferral and variance accounts as part of the cost of service proceeding given relationship between the accounts and the revenue requirement. This will ensure the Board has a clear picture of the overall request from OPG in terms of what is proposing to recover from ratepayers.

Issue 10.1 - Has OPG responded appropriately to Board direction on establishing incentive regulation?

The Council has been supportive of incentive regulation for both the Ontario natural gas utilities the electric distributors. Incentive regulation has, in recent years, tempered rate increases and provided a framework that promotes the utilities to find efficiency improvements and productivity gains.

OPG is very different from the other entities that the Board regulates. It is distinct in terms of its size, the complexity of its operations, and the fact that it is subject to regulatory oversight by many other bodies. It is also subject to many unique and complicated accounting requirements, particularly with respect to its nuclear liabilities. It is definitely not a typical utility.

The Board has over the last few years indicated its preference for OPG to move to an incentive regulation model. The Board has expressed its intent to establish a working group to develop recommendations on the details of an IR mechanism for OPG's hydroelectric assets. A second working group will be established to develop a methodology for setting OPG's nuclear payment amounts based on a multi-year cost of service approach (Decision, EB-2012-0340, pp. 2-9).

OPG has retained London Economics International to provide advice on potential incentive regulation mechanisms that might be suitable for setting OPG's payment amounts (Ex. A3.T1/S1/p. 1). LEI has also been engaged to undertake an independent productivity study for OPG.

The Council is supportive of the Board's plans to initiate a working group to consider an IR model for the regulation of OPG's hydroelectric assets. The Council is not necessarily convinced that an appropriate model could be established. As noted above, OPG is a large entity with complex operations and subject to extensive regulatory oversight by other bodies. It simply may not be the type of entity that can be regulated through an IR model. The Council encourages the Board, in establishing the working group, to reconsider as a threshold issue whether or not incentive regulation is appropriate for OPG. Ultimately, it may be better for Ontario consumers to continue with a cost of service approach.

Issue 12.1 Are the effective dates for the new payment amounts and riders appropriate?

OPG has requested an effective date of January 1, 2014, for the payment amounts related to the previously prescribed hydroelectric and nuclear operations. For the newly prescribed facilities OPG has requested an effective date of July 1, 2104. The Board approved interim rates effective for both dates.

It is OPG's position that because the Board declared the rates interim "that is when the rate review process begins". OPG asserts that from those dates, it is incumbent on the OEB, under section 78.1 of the Act to set payment amounts that are just and reasonable. OPG also asserts that if the Board were to establish effective dates that were later than the dates that the payment amounts were deemed interim, OPG would recover less than its full cost of service over the test period and accordingly the just and reasonable standard would be breached. It is OPG's view that the costs embedded in the application are OPG's costs for the period, which it needs in order to operate its business in a safe and reliable manner (Argument in Chief, pp. 146-147).

The Council disagrees with OPG assertion that if the Board does not approve rates effective January 1, 2014, they will not be just and reasonable. In addition, the Council does not accept OPG's position that the costs underlying the Application are the costs that OPG "needs in order to operate its business in a safe and reliable manner." These assertions imply that the Board must approve all of the costs included in OPG's application and allow for recovery retroactively back to January 1, 2014.

The Board noted in the interim payment order issued on December 17, 2013, that its approval of interim rates is made without prejudice to the Board's ultimate decision on OPG's Application, and should not be construed as predictive of the Board final determination with regard to the effective date.

The Board has, in many cases, chosen effective dates beyond the interim date. At the end of the day the Board must decide what it views as just and reasonable rates. Denying an applicant recovery of some of the amounts that it has applied for is common practice for the Board. In setting just and reasonable rates the effective date is simply one of the Board's considerations.

OPG has admitted that the timing of the Application was driven by the Government of Ontario's consideration of whether or not to regulate the newly prescribed hydroelectric facilities. That fact should not imply that it should be treated any differently than other regulated entities. The Application was filed on September 27, 2013. There was an update on December 6, 2013, which required a new notice to be issued. There was another update on May 16, 2014. In July there was another update related to the Darlington Refurbishment Project. It was not until July that the full "ask" was determined.

The Council submits that for OPG's rates to be effective January 1, 2014, the Application should have been filed earlier. The Board has made it clear in recent years that applicants need to file well in advance of the date on which they are seeking to have their rates effective. The Board has become less inclined to allow for retroactive recovery, and from the Council's perspective this is important for electricity consumers. It is simply not fair to say to customers, "By the way, we are asking you now to pay more for the electricity you consumed over the last year." There may be isolated reasons to allow for retroactive adjustments, but in this case the Council urges the Board to reject an effective, as requested by OPG, of January 1, 2014. The Council supports an effective date one month following the issuance of the final payments order.

The Council notes that if a January 1, 2014, effective date were approved, the payment amounts would increase by almost 50% over the current amounts (EX. J3.10). This would represent an unacceptable increase for Ontario electricity consumers.

With respect to the newly regulated hydroelectric assets the Council accepts the conclusion reached by Board Staff that Ontario Regulation 53/05 as amended requires that the Board set an effective date of July 1, 2014, for the new payment amounts specific to those assets.

COSTS

The Council asks that it be awarded 100% of its reasonably incurred costs related to its participation in this proceeding. The Council chose not to be as active as some of the other intervenors in the proceeding and our costs will reflect this. We also chose to work closely with CME on several issues with CME taking the lead on behalf of both intervenors, particularly with respect to cross-examination.

All of which is respectfully submitted
August 26, 2014