ONTARIO POWER GENERATION

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VIA RESS AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

Re: EB-2012-0002 - Niagara Tunnel Project Prudence Review

This letter presents OPG's reply to the comments of Board staff and intervenors on OPG's proposal for a separate proceeding to review the prudence of the Niagara Tunnel Project ("NTP") expenditures.

All parties have expressed support for a separate review of NTP impacts. These reply comments discuss the disadvantages of a phased proceeding relative to a separate proceeding and address the issue of filing evidence on the NTP's impacts in the 2013-2014 Payment Amounts application.

OPG also responds to the questions raised by Board staff and others. The final section of this reply addresses SEC's comments about the OEB's jurisdiction, the standard of review for NTP costs, and precedent.

Disadvantages of a Phased Proceeding

OPG asks the OEB to reject the approach of holding a phased proceeding. The submissions on a phased proceeding reveal no advantages and several disadvantages. In contrast, a separate NTP proceeding will promote both regulatory efficiency and certainty.

OPG notes that no clear preference was expressed by intervenors in response to Board staff's invitation to comment on the alternative of a phased proceeding. PWU and Energy Probe supported OPG's proposal for a separate proceeding, CCC, SEC and AMPCO supported a phased proceeding and CME took no position.

The benefit of a separate proceeding is that it allows for a focussed review of a large and complex project unencumbered by the other issues in the 2013-2014 Payment Amounts application. This is efficient because consideration of NTP prudence can be undertaken independent of these other issues. OPG's proposal is that, except for those determinations specific to the tunnel, all other matters necessary to establish the incremental NTP-related rate rider will have already been decided in the Payment Amounts proceeding.

For example, the Payment Amounts application will have already established the cost of capital for 2014.[1] This approved cost of capital will be an input in deciding the NTP-related rider and there will be no need nor any opportunity to revisit it in a separate proceeding.

The primary disadvantage of phasing is that parties will use the existence of a single record and interim payment amounts as a wedge to reconsider issues that should be properly and finally decided in the Payment Amounts application. In a phased proceeding, any party would be free to argue that issues, for example the cost of capital, which they believe have the potential to impact the determination of the NTP-related rider, should be reconsidered. Certainty would be lost and along with it, regulatory efficiency.

OPG's concern in this regard is not theoretical. Already, SEC's comments foreshadow this type of claim. SEC suggests that the payment amounts established in the first phase may have to be re-opened to avoid "inconsistent results when final NTP costs are integrated with the remaining components of revenue requirement" (SEC comments, page 2). SEC's suggestion regarding "inconsistent results" and Board staff's comment regarding "full severability" of the NTP impact need not be a concern. To the extent any cost or revenue impacts of the NTP are identified in a separate NTP proceeding, they can be factored into the calculation of the proposed rider for the NTP project.

One claimed advantage of a phased proceeding is that the same panel would hear both phases. OPG finds it hard to see this as a potential advantage given its view that NTP prudence is a standalone issue. In any event, if the OEB determined that continuing with the same panel was advantageous, it could simply assign the same Board Members to both proceedings. Having a separate proceeding for the NTP would only increase the OEB's scheduling flexibility because it allows, but does not require, a single panel for both matters.

In OPG's view, a rate rider to collect approved NTP costs for 2014 is preferable to having the 2013-2014 payment amounts declared interim. As discussed above, interim rates are inherently uncertain and open to changes unrelated to the NTP. Moreover, in terms of transparency, it is at least arguable that having a rate rider that clearly presents NTP costs is more transparent than blending these costs with others in the interim payment amounts. In any event, as discussed below, OPG will present information in the Payment Amounts application that shows the impact of NTP costs on both the revenue requirement and the payment amounts.

Board staff indicate that a "two phase proceeding would be more consistent with the spirit of the Filing Guidelines." Board staff provides no comment on the impact of being "more consistent with the spirit of the Filing Guidelines" in terms of outcomes for rate payers. OPG submits that there is no impact. The Filing Guidelines expressly contemplate the need for the OEB to retain the flexibility to develop the process it needs to most efficiently establish OPG's payment amounts: "This document is not a statutory regulation, rule or code issued under the Board's authority and does not pre-empt the Board's discretion to make any order or give any direction as it determines necessary concerning any matters raised in relation to the setting of payment amounts" (see EB-2011-0286, Filing Guidelines for Ontario Power Generation Inc., Revised November 11, 2011, page 1).

[1] Board staff's submissions requested clarification of this point. OPG's proposal is that Cost of Capital would be established for both 2013 and 2014 in the Payment Amounts proceeding.

For these reasons, OPG submits that the efficient way to proceed is to have a separate proceeding to hear and decide matters related to the NTP. This will allow for a final decision on the Payment Amounts application and allow the subsequent proceeding to focus solely on NTP-specific issues.

Evidence of the NTP's Impacts on Payment Amounts

OPG will include in the Payment Amounts application a statement showing the impacts on the revenue requirement and payment amounts of the currently budgeted amount of NTP capital costs ($1,600 M) based on the planned in-service date of December 2013 and forecast incremental production in 2014. This should meet the request by CCC and CME and also address the transparency concerns raised by Board staff and AMPCO.

Responses to Questions

Board staff asks whether OPG will "exclude NTP production and tax impacts from the 2013-2014 payment amounts application." For production, the answer is yes. NTP-related tax impacts will also be excluded with one minor exception. OPG elected to claim early Capital Cost Allowance related to the NTP and has passed the benefit of this election on to customers in each of the past two Payment Amount applications as a reduction in income tax expense (see EB 2010-0008, Ex. L-1-20, page 2). OPG proposes to continue doing so in the upcoming 2013-2014 application.

Board staff also asks that OPG comment on how the NTP will impact "the surplus baseload generation ("SBG"), hydroelectric incentive mechanism ("HIM"), SBG variance account and HIM variance accounts." With respect to SBG, the hydroelectric production forecast used for the test period will exclude any consideration of SBG-related production curtailments, consistent with the OEB's Decision in EB-2010-0008.

In respect of the SBG and HIM variance accounts, OPG notes that there will be no impact on 2013-14 payment amounts from these matters because the 2013 and 2014 entries in these variance accounts will not be reviewed for disposition until a future proceeding, likely covering 2015-2016. OPG does not anticipate any changes to the HIM that would be affected by the NTP. Nonetheless, OPG will discuss any potential interactions between the NTP coming into service, and SBG and HIM as part of its evidence in the Payment Amounts application.

Response to SEC on OEB Jurisdiction, Prudence and Precedent

In its letter, SEC questions the jurisdiction of the OEB to consider the recovery of costs of a specific generation project. SEC is alone in raising this question. There is no proper basis for SEC's question; the OEB has a broad jurisdiction to order the recovery of prudently incurred costs in relation to the NTP as determined in a separate proceeding.

SEC's question appears to be based on reading the *Ontario Energy Board Act* as though it provided that the OEB must include all costs and set payment amounts for an entire period covered by an application in a single proceeding. But this reading overlooks the plain language of the Act and the regulation. Section 78.1(4) of the Act states as follows:

> *78.1(4) The Board shall make an order under this section in accordance with the rules prescribed by the regulations and <u>may include in the order conditions, classifications or practices, including rules respecting the calculation of the amount of the payment.</u> (Emphasis added.)*

Equally, s. 6(1) of O. Reg 53/05 states, in part, that the Board may establish “the form, methodology, assumptions and calculations used in making an order that determines payment amounts for the purpose of section 78.1 of the Act.” Together, these provisions provide a complete answer to SEC’s question.

SEC’s statements on the applicability of the prudence standard to NTP expenditures are contrary to prior OEB decisions and applicable regulation. The NTP commenced in 2005, years before OPG was regulated by the OEB. SEC first assumes the existence of an obligation on OPG’s part to have brought the forecast NTP costs before the OEB in previous applications and then determines that failure to meet this putative obligation is that OPG should be denied the presumption of prudence for all costs after 2007.

Among the many problems with this argument, two stand out. First, in previous proceedings the OEB has rejected attempts to create the very obligation that SEC would impose. In its EB-2010-0008 Decision (page 28), the OEB states the following regarding review of forecast NTP costs: “The Board does not intend to manage the project, nor will it conduct any sort of intermediate review, or “mini-hearing”. The appropriate course of action is for the Board to conduct a thorough prudence review at the time that OPG proposes to add the project to rate base.”[2]

Second, review of NTP costs under the prudence standard is embodied in the regulations that control the OEB’s setting of payment amounts. O. Reg. 53/05 section 6(2)4ii states that for amounts in excess of those approved by the OPG Board prior to OEB regulation, the OEB shall ensure recovery, “if the Board is satisfied that the costs were prudently incurred....”

As far as precedent goes, by any measure the NTP is a unique project. To date, the OEB has never considered a project of this scale, scope and complexity; they are few and far between. SEC’s expressed concern that a dedicated proceeding to review the NTP could serve as a precedent for piecemeal consideration of issues is unrealistic.

For the reasons above, OPG requests that the OEB accept OPG’s proposal to have the prudence of NTP costs in excess of the project’s original budget determined in a standalone proceeding rather than as part of the 2013-2014 Payment Amounts proceeding.

Respectfully submitted,

[Original signed by]

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[2] The OEB reached a similar conclusion on the NTP in the first payment amounts decision (EB-2007-0905 page 44): “However, no finding related to the cost is required because it is not forecast to enter rate base in the test period. To the extent the final costs exceed the OPG Board approved level, the recovery of those incremental costs will be the subject of a future proceeding.”