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January 26, 2015

RESS, EMAIL & COURIER

Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto, ON M4P 1E4

Attention: Ms. K. Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2014-0369 - Ontario Power Generation Inc. - Motion for Review and Variance of the November 20, 2014 Decision with Reasons in EB-2013-0321

We are counsel to Ontario Power Generation Inc. ("**OPG**") in the above-referenced proceeding. Filed with this letter are OPG's submissions on its motion for review and variance and a supplementary motion record.

Yours truly,

Crawford G. Smith

cc: OPG
Intervenors in EB-2013-0321

14504-2111 18758255.1

ONTARIO ENERGY BOARD

IN THE MATTER OF the Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Schedule B;

AND IN THE MATTER OF an application by Ontario Power Generation Inc. pursuant to section 78.1 of the Ontario Energy Board Act, 1998 for an Order or Orders determining payment amounts for the output of certain of its generating facilities;

AND IN THE MATTER OF a motion by Ontario Power Generation Inc. pursuant to Rule 42 of the Ontario Energy Board's *Rules of Practice and Procedure* for an order or orders to vary the Decision with Reasons EB-2013-0321.

SUBMISSIONS OF ONTARIO POWER GENERATION (on Motion To Review and Vary)

January 26, 2015

PART I - OVERVIEW

1. These are the submissions of Ontario Power Generation Inc. ("**OPG**") in support of its motion to review and vary the Ontario Energy Board's (the "**Board**") Decision with Reasons dated November 20, 2014 in EB-2013-0321 (the "**Decision**").

2. In the Decision, the Board:

   (a) disallowed the addition to rate base of $88.0M out of the proposed $1,452.6M for the Niagara Tunnel Project; and

   (b) directed OPG to reduce its 2014 income tax provision to account for and to recognize the carry forward of its regulatory tax loss in 2013.

3. In reaching its Decision in respect of the above two issues, the Board made material factual errors. OPG therefore seeks an order, among other things:

(a) (i) varying the finding that $88.0M of the Niagara Tunnel Project (the "**NTP**") capital expenditures were imprudently incurred, (ii) finding that the $88.0M portion of the NTP capital expenditures were prudently incurred, and (iii) finding that the full amount of the proposed $1,452.6M in NTP capital expenditures should therefore close to rate base in the test period;

(b) (i) varying the finding that OPG reduce its 2014 income tax provision to account for and to recognize the carry forward of its $211.6M regulatory tax loss that was incurred in 2013 due to a shortfall of nuclear production, and (ii) finding that OPG is entitled to receive the benefit of the $211.6M regulatory tax loss and that it does not need to reduce its 2014 income tax provision to account for and to recognize the carry forward amount; and

(c) varying the amount of OPG's test period revenue requirement by increasing the test period revenue requirement to reflect (a) and (b) above.

PART II - THE NIAGARA TUNNEL PROJECT

A. Facts

OPG's Application and Evidence

4. The NTP is a 10.2 km long tunnel constructed by OPG with an interior diameter of 12.7 metres which runs under the City of Niagara Falls, Ontario. Its purpose is to increase the flow of water to the Niagara plant group, and thereby increase generation by an annual average of approximately1.5 TWh. Following a competitive bidding process, Strabag Inc. ("**Strabag**") was selected as the designer and builder of the NTP and entered into a Design Build Agreement ("**DBA**") with OPG. After several years of construction, the asset was placed in service in March 2013. OPG's capital costs associated with the NTP were $1,472.2 of which $1,452.6M is the amount OPG sought to close to rate base in this application.[1]

5. Of the amount included in the application, $985.2M was approved by the OPG Board of Directors in 2005 as the initial budget. As this approval predated the Board's first order

[1] Decision, p. 21, Motion Record ("**MR**"), Tab 1.

in respect of OPG in 2008 it was specifically excluded from Board consideration by section 6(2)4 of O. Reg. 53/05.[2] The issue before the Board, therefore, was whether the $491.4M that OPG spent beyond the $985.2M budgeted in 2005 was prudently incurred.

6. In its application, OPG submitted that the NTP's original budget of $985.2M was 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 three international tunneling consortia that responded to OPG's competitive solicitation.[3]

7. The additional cost of construction of the NTP was due <u>entirely</u> to the extremely difficult rock conditions encountered by Strabag, which were significantly more challenging than expected. An overriding and recurring issue experienced by Strabag was overbreak in the tunnel crown. Overbreak is the cracking and loosening of rocks above the tunnel boring machine ("**TBM**") cutterhead, which has the effect of distorting the circular profile created by the TBM. Substantial overbreak was encountered as soon as the TBM reached the Queenston shale.[4]

8. The uncontroverted evidence before the Board was that if the rock conditions had been known in advance with perfect foresight, the tunnel would have cost at least what OPG paid and may have cost more.[5]

The Dispute Review Board Decision

9. Owing to the rock conditions encountered, in May 2007 Strabag issued claims and notices all aimed at recovering additional costs because the subsurface conditions being encountered were significantly more adverse than were contemplated in the DBA, i.e. differing subsurface conditions ("**DSC**").[6]

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[2] Decision, p. 22, MR, Tab 1.

[3] Ex. D1-2-1, p. 136-37, Appendix B, MR, Tab 2.

[4] Decision, pp. 24-25, MR, Tab 1.

[5] Tr. Vol. 2, pp. 82,148, MR, Tab 3.

[6] Ex. D1-2-1, pp. 96-97, MR, Tab 2; Attachments 1 and 2 to IR 4.5-17 SEC-039, Supplementary Motion Record ("**SMR**"), Tab 2.

10. Under the DBA, OPG was responsible for the resulting costs if the subsurface conditions actually experienced were more adverse than anticipated.[7] This is a common feature of tunnel projects; the owner, here OPG, bears the risk associated with DSC.[8]

11. OPG disputed Strabag's claims. In February 2008, OPG and Strabag agreed to present the matter to the Dispute Review Board ("**DRB**") established in the DBA.[9]

12. The DRB process was included in the DBA as a mechanism to address disputes over the project through the use of industry experts familiar with the NTP and without the time and expense of litigation. The DRB is not a court where parties bring different causes of action and ask for a decision on each of them and, unlike a court, the DRB cannot impose remedies based on its findings. What the DRB can do, and what it did do here, is to determine whether it believes that the issues raised by the contractor, individually or collectively, present a valid claim for DSC and recommend to the parties how this claim should be addressed.[10]

13. The DRB hearing was held from June 23 through 26 in Niagara Falls, Ontario.[11]

14. In attempting to convince the DRB, Strabag offered five reasons that it believed supported its claim for DSC. Strabag did not assign separate costs to each of these five reasons because its position was that any one of the five factors or all of them together constituted DSC and were therefore the cause of the extra cost to mine and support the tunnel, and restore its circular profile so that the lining could be installed. There was not one cost for "large block failures" and another for "inadequate stand up time" because the actions that Strabag took addressed all the conditions it was encountering, which it contended differed from those included in the DBA.[12]

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[7] The GBR, which is Appendix 5.4 of the DBA, states at page 5, paragraph 4: "Those consequences associated with subsurface conditions more adverse than the baseline conditions are accepted by OPG" (Ex. D1-2-1, Attachment 6 (PDF p. 1724)).

[8] Tr. Vol. 1, pp. 54-55, SMR, Tab 3.

[9] Decision, p. 25, MR, Tab 1.

[10] Ex. D1-2-1, p. 36, SMR, Tab 1.

[11] Ex. D1-2-1, Attachment 7, MR, Tab 4.

[12] Tr. Vol. 1, pp. 63-66, SMR, Tab 3.

15. On August 30, 15 2008, the DRB issued its Report and Recommendations ("**DRB Report**"). The DRB's conclusions were unanimous.[13]

16. While the DRB did not accept three of the five reasons offered by Strabag, it found that the other two did and therefore determined that DSC existed. Once the DRB made that determination, responsibility for the cost consequences of the more adverse subsurface conditions became OPG's. Ultimately, there was only one question before the DRB: "Are there differing subsurface conditions?" The DRB answered "yes" to this question and gave reasons for its decision.[14]

17. The DRB proceeded to recommend that the dispute be resolved on a cost sharing basis, stating that:

> [W]e recommend that the Parties negotiate a reasonable resolution based on a fair and equitable sharing of the cost and time impacts resulting from the overbreak conditions that have been encountered and the support measures that have been employed. Both Parties must accept responsibility for some portion of the additional cost, but at the same time the Contractor must have adequate incentives to complete the Work as soon as possible.[15]

The Settlement and the Amended Design Build Agreement

18. After receiving the DRB Report, OPG examined a number of potential responses and concluded that negotiating with Strabag based on the DRB recommendations was the path mostly likely to complete the NTP in the least amount of time and at the lowest cost.[16]

19. In reaching its decision, OPG relied on the the independent expert advice of the Contract Litigation Oversight Committee ("CLOC"). The CLOC was formed to advise on the dispute with Strabag. Its purpose was:

> to provide independent oversight of OPG's strategy for contract dispute resolution and negotiations and to advise the CEO on the

[13] Ex. D1-2-1, Attachment 7, MR, Tab 4.
[14] Ex. D1-2-1, Attachment 7, MR, Tab 4.
[15] Ex. D1-2-1, Attachment 7, pp. 18-19; MR, Tab 4.
[16] Ex. D1-2-1, pp. 102-103, MR, Tab 2, p. 59, 60.

> conduct of the dispute. The CLOC was chaired by OPG's Chief Financial Officer and included external members Norman Inkster, former head of the RCMP, and Barry Leon, a lawyer then at Torys who specialized in international litigation and arbitration. Both men have significant experience in investigating and resolving complex disputes.
>
> The CLOC also obtained independent technical advice from John Hester, an expert on tunnel construction and the tunneling industry. In the period leading to presentation of the dispute between OPG and Strabag to the DRB, the CLOC provided independent review of the strategy OPG employed and the presentations OPG made. After the DRB rendered its decision, the CLOC continued to advise the company on negotiations with Strabag until an agreement was reached.[17]

20. The advice of the CLOC following the DRB Report was that working with Strabag to achieve an amended agreement rather than seeking to replace it with a new contractor was the preferred alternative to complete the NTP.[18]

21. OPG and Strabag ultimately developed a Principles of Agreement document which was based on a hybrid approach that included resolution of Strabag's past claims for differing subsurface conditions in the Queenston formation and renegotiation of the DBA going forward. This approach closely followed the recommendations of the DRB to share the cost and schedule consequences of the DSC that had been experienced and negotiate a new agreement to finish the NTP "that, while not commercially optimum for either party, will allow the Project to proceed to optimum completion."[19]

22. Following negotiations, OPG agreed to pay Strabag $40M to resolve all issues through November 30, 2008, which reflected a sharing of Strabag's claimed losses of $90M. The parties negotiated an Amended Design Build Agreement (the "**Amended DBA**") based on the original DBA.[20] Most DBA provisions were retained unchanged except as necessary to convert the agreement to a target cost contract.[21]

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[17] Ex. D1-2-1, p. 50, MR, Tab 2.
[18] Tr. Vol. 2, pp. 136-137, 148-149, MR, Tab 3.
[19] Ex. D1-2-1, Attachment 7, p. 19, MR, Tab 4.
[20] Ex. D1-2-1, Attachment 9, SMR, Tab 4.
[21] Ex. D1-2-1, pp. 106-112, MR, Tab 2.

23. As set out above, the extremely difficult rock conditions encountered during tunneling necessitated the revised project schedule and cost forecast of $1,600M contained in the 2009 Superseding Business Case Summary approved by the OPG Board of Directors. The target price contract with cost and schedule incentives allowed the NTP to be completed at a cost some $120M below the approved funding with commercial service beginning nine months sooner than the approved completion date in the Superseding Business Case Summary. The amount OPG spent on the NTP represents the true cost of completing the project given the subsurface conditions actually encountered.[22]

OPG's evidence on the NTP

24. For many years prior to the application, OPG and the parties were aware that the costs of the NTP would exceed the original budget approved by OPG's Board of Directors in 2005 prior to Board regulation. OPG and the parties were also aware that once the NTP went into service the Board would conduct a prudence review of these additional costs, including the costs arising from the Amended DBA. While OPG led extensive evidence on the prudence of these costs, as described below, neither Board staff nor a single intervenor chose to provide any evidence on this issue.

25. OPG presented extensive evidence on the prudence of its NTP costs in this application. OPG's initial evidence included a detailed 145-page narrative on the NTP. OPG's initial filing included copies of the key project documents totaling almost 6,000 pages of material. As a result of this comprehensive evidence, there were relatively few interrogatories on the NTP. As additional project documents were requested through interrogatories, at the Technical Conference or at the hearing, they were provided.

26. At the application hearing, OPG adduced evidence on the NTP from an expert witness and two fact witnesses:

(a) Mr. Roger Ilsley, an independent expert with 40 years' experience in all aspects of tunnel design and construction who has also served on at least 16 DRBs;[23]

[22] Ex. L-4.4-2 AMPCO-016, MR, Tab 6; Tr. Vol. 2, pp. 85-89, MR, Tab 3.
[23] Ex. JT1.5, Attachment 1, MR, Tab 7.

(b) Mr. Rick Everdell, OPG Project Director for the NTP, from November 2005 through December 2013;[24]

(c) Dr. Chris Young, OPG Vice President of Hydroelectric and Thermal Project Execution and project sponsor for the NTP until his retirement in 2014.[25]

27. Though they led no evidence, intervenors and Board staff challenged OPG's costs on several grounds and sought disallowances of up to $407.4M (about 83 per cent of the costs in issue). These arguments all failed to recognize the consequences of the fact that DSCs were OPG's responsibility under the DBA.

The Board's Decision Relating to the Niagara Tunnel Project

28. In the Decision, the Board correctly held that its review of the NTP was a "prudence review" and that the Board was not permitted to use hindsight when considering OPG's actions. Applying this holding to the evidence as the Board Panel understood it, the Board disallowed $88M (or approximately 18%) of the $491.4M cost of the NTP subject to review. The Board stated that these disallowances were "based primarily on OPG's response to the Dispute Review Board's decision and recommendations, in particular OPG's decision to pay $40M for claims prior to December 2008, and the terms negotiated with Strabag in the Amended Design Build Agreement." The Board divided its disallowance into these two main components, as described below.

The pre-December 2008 disallowance

29. First, the Board disallowed $28.0M attributable to pre-December 2008 claims made by Strabag because the Board was not satisfied that paying Strabag $40M for its claimed loss of $90M up to December 2008 was prudent. The Board specifically found that "the non-binding recommendations of the Dispute Review Board were reasonable, and that some level of shared responsibility between OPG and Strabag was appropriate." The Board went on to find, however, that "paying a $40M settlement (44% of Strabag's $90M claim) is excessive in the Board's view." Specifically, the Board found that it was:

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[24] Mr. Everdell, in fact, had been involved with the NTP in positions of increasing responsibility for nearly 40 years, dating back to 1976: Tr. Vol. 1, p. 41, SMR, Tab 3.

[25] Tr. Vol. 1, p. 40, SMR, Tab 3.

> … unable to find that a $40M settlement of Strabag's claim was prudently incurred. In the absence of information regarding the costs attributable to each of the five issues, the Board must use its judgment of what is a reasonable amount. In determining the amount, the Board has decided to utilize the findings of the Dispute Review Board. As a result, the Board finds that OPG's ratepayers should not pay any amount for the three issues which OPG was not responsible, but should pay 50% of two issues for which OPG was jointly responsible. In addition, the Board is persuaded by the results of OPG's audit and considers the $77.4M to be the appropriate starting point for the Board's calculation, not the $90M claim by Strabag. There was no evidence or testimony provided supporting Strabag's claimed amount. As a result, the Board finds that ratepayers should only pay 20% of the $77.4M audited amount, or $15.5M. In addition, the Board denies the associated carrying costs of the disallowed $24.5M which results in a reduction of another $3.5M. The Board finds this disallowance of $28.0M reasonable given the evidence provided.[26]

The Amended Design Build Agreement disallowance

30. Second, the Board disallowed $60M associated with the terms of the Amended Design Build Agreement. The Board stated:

> … the Board finds that the incentives offered to Strabag through the Amended Design Build Agreement were excessive. OPG understood that a contractor default was a potential risk, and indeed, it took steps that should have mitigated that risk through a letter of credit and a comprehensive parental indemnity. However, when it came time to renegotiate the Design Build Agreement, OPG did not properly use its leverage to secure a more favourable deal.[27]

31. The Board went on to state that, "OPG agreed to pay Strabag hundreds of millions of extra dollars more than was provided for in the Design Build Agreement. In the Board's judgment, the provision of incentives above this was not necessary and not prudent".[28]

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[26] Decision, pp. 31-32, MR, Tab 1.

[27] Decision, p. 33, MR, Tab 1.

[28] Decision, p. 33, MR, Tab 1.

B. Submissions - The Material Errors in the Board's Decision

Material Errors Relating to the NTP

32. Underpinning the Board's findings in relation to both major aspects of the NTP disallowance is a misapprehension of the evidence relating to the findings of the DRB.

The pre-December 2008 disallowance error

33. The Board viewed the five items in dispute before the DRB as being independent from one another. The Board stated:

> There were five issues of dispute that were referred to the Dispute Review Board. The dispute Review Board found that OPG was not responsible for three of the five issues and that OPG had only joint responsibility for the remaining two issues. No evidence was filed on the relative value or cost of the five issues. OPG's witnesses testified that the individual issues were not quantified .[29]

34. This view of the DRB dispute in factually incorrect and inconsistent with the evidentiary record before the Board. This view also shows that the Board fundamentally misunderstood the nature of the DRB process and the findings of the DRB with regard to the dispute between OPG and Strabag over the NTP. There was a single DSC dispute between OPG and Strabag that went to the DRB, which found that DSC existed. Had Strabag offered ten reasons in support of its claim for DSC and the DRB rejected nine of them, the same result would have obtained. The DRB would have found that DSC existed.

35. The Board's failure to understand the nature of the DRB process and the findings of the DRB with regard to the dispute between OPG and Strabag was a fundamental misapprehension of the evidence. As OPG's evidence explains:

> Strabag's fundamental position was that OPG remained responsible for the consequences of the geologic conditions different from those enumerated in the GBR and that the conditions actually experienced in tunnelling were different. Strabag claimed that DSC were evidenced by large block failures, excessive overbreak and inadequate "stand-up" time (i.e.,

[29] Decision, p. 31, MR, Tab 1.

> insufficient time to install rock support prior to rock failure). Strabag further claimed that the Table of Rock Conditions and Rock Characteristics in the GBR failed to adequately describe the rock conditions encountered and either represented a DSC on its own, or alternatively confirmed the presence of DSC.[30]

36. The DRB summarized the test for DSC in the DBA and the allocation of responsibility among the parties as follows: "The Contractor is responsible for design and construction of the Work. The Owner is responsible for more adverse subsurface conditions than are represented in the GBR.[31]

37. It was materially wrong for the Board to conclude, as it did, that OPG's ratepayers should not bear the consequences "for the three issues [for] which OPG was not responsible". The dispute with Strabag was not over the individual reasons that Strabag gave for claiming DSC, or "the relative value or cost of the five issues" (as the Panel expressed the matter), but rather whether the conditions being experienced in mining the NTP constituted DSC. In evaluating this dispute, the DRB agreed with Strabag that DSC existed.[32]

The Amended Design Build Agreement disallowance error

38. In the Decision, the Board concluded that OPG had leverage that it did not use in its negotiations with Strabag over the terms of the Amended DBA. This conclusion also hinged on the Board's misapprehension of the DRB findings as set out above. Put simply, having lost on the issue of a DSC, OPG simply did not have the leverage the Board wrongly believed that it did.

39. The Board's error is plain in its reference and reliance on the parental guarantee and indemnity provided by Strabag (the "Indemnity Agreement"). The Indemnity Agreement provides no leverage to OPG. It is an agreement to indemnify OPG in the event of a default by Strabag. However, given the DRB findings there was no reasonable basis to conclude that Strabag was in default; if the matter were litigated (and Strabag had issued

[30] Ex. D1-2-1, p. 99, MR, Tab 2.
[31] Ex. D1-2-1, Attachment 7, pp. 5-6, MR, Tab 4.
[32] Ex. D1-2-1, Attachment 7, pp. 18-19, MR, Tab 4.

a notice of arbitration following the DRB Report), based on the DRB finding of DSC, Strabag, not OPG, was likely to prevail.

40. The Board made other material errors in relation to this disallowance.

41. First, the Board failed to apprehend the nature of the "incentives" paid to Strabag as part of the Amended DBA. At page 33 of the Decision, the Board held that:

> The Board is mindful of the Dispute Review Board's recommendation that Strabag have appropriate incentives to complete the work. However, in the Board's view the Amended Design Build Agreement provided adequate "incentive" even without the specific incentive clauses. <u>OPG agreed to pay Strabag hundreds of millions of extra dollars more than was provided for in the original Design Build Agreement. In the Board's judgment, the provision for incentives above this was not necessary and not prudent.</u> [Emphasis added].[33]

42. The finding that incentives included in the Amended DBA were unnecessary because OPG was agreeing to pay Strabag "hundreds of millions of dollars" in additional costs is inconsistent with the Board's own recognition that the incentives encouraged Strabag to complete the NTP ahead of schedule and below target cost. Strabag began working on this project in August 2005 when the DBA was signed.[34] The amended contract meant that Strabag had worked for more than three years to achieve what it considered to be a \$50M loss (\$90M in claimed loss minus the \$40M settlement of past costs) and that going forward, Strabag was agreeing to work for another four and half years at cost (from December 2008, the effective date of the ADBA to June, 2013 the targeted completion). Without the negotiated incentives, Strabag would have had no reason to seek out schedule and cost savings because the benefits of any successful efforts would have flowed entirely to OPG, while the cost and risk of undertaking these efforts would have remained with Strabag.

43. At the time the Amended DBA was agreed to, it was highly uncertain that Strabag could achieve the incentives. While the Amended DBA was being negotiated (Fall 2008

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[33] Decision, p. 33, MR, Tab 1.

[34] Ex. D1-2-1, p. 132, MR, Tab 2.

through Spring 2009), the NTP was tunneling through difficult rock in the Queenston formation and was falling further behind schedule.[35] Of course, in hindsight, Strabag was able to complete the project months ahead of the target schedule and did earn incentives as a result, but this was far from known or knowable when the contract was executed.

44. Using OPG's $77M figure for Strabag's losses (accepted by the Board), Strabag earned a profit of $26M on a $985M contract (or about 2.64 percent) for a project lasting almost eight years. This is a very low level of profit by any estimation for a project of the size, length and complexity of the NTP and nowhere near "hundreds of millions of dollars".[36]

45. Second, the Board misapprehended the uncontradicted evidence that Strabag would have abandoned the NTP had OPG not agreed to the incentives that were, in fact, included in the Amended DBA.

46. The uncontradicted evidence was that neither Strabag's parent-company guarantee nor its $70M letter of credit would have dissuaded it from walking away from the NTP (even if available which, as set out above, they were not).[37] [38]

47. The Board's disallowances rest on the conclusion that Strabag having sustained a $40M loss during the first three years of the contract, would have worked at <u>cost</u> for nearly five more years, without the possibility of earning any profit at all, to complete the NTP on budget and ahead of schedule. There is no evidentiary support in this conclusion.

PART III - TAX LOSS CARRY FORWARDS

A. Facts

OPG's Application and Evidence

48. In the Application and Pre-filed Evidence, OPG sought approval to recover its 2014 and 2015 income tax expense of $49.7M and $64.2M for the previously regulated hydroelectric facilities, $29.9M and $42.7M for the newly regulated hydroelectric

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[35] Ex. D1-2-1, pp. 75-76, MR, Tab 2.
[36] Tr. Vol. 2, p. 124-125, MR, Tab 3.
[37] Tr. Vol. 2, p. 126, MR, Tab 3.
[38] Tr. Vol. 2, pp. 147-148, MR, Tab 3.

facilities, and $108.3M and $16.8M for the nuclear facilities, respectively, for a total income tax expense of $187.9M in 2014 and $123.7M in 2015 for the regulated facilities.[39]

49. In 2013, OPG incurred a regulatory tax loss of $211.6M (Ex. J13.4, Attachment 1; MR, Tab 9). OPG did not apply the regulatory tax loss to reduce its forecast 2014 regulatory taxable income since the tax loss arose as a result of a 2013 nuclear operating loss attributable to reduced production levels. In particular, as explained in Ex. L, Tab 6.13, Schedule 1, Staff-166, MR, Tab 10:

(a) OPG's actual nuclear production in 2013 was 44.7 TWh;

(b) OPG's forecast nuclear production was 50.4 TWh for 2011 and 51.5 TWh for 2012, for an average of approximately 51.0 TWh, as approved by the Board in EB-2010-0008;

(c) the difference between OPG's actual 2013 nuclear production and the average of its approved nuclear production forecasts for 2011 and 2012 (which OPG uses as a proxy in the absence of an approved nuclear production forecast for 2013) represents a shortfall in nuclear production for 2013 of approximately 6.3 TWh;

(d) using the nuclear base payment amount of $51.52/MWh, the 6.3 TWh nuclear production shortfall results in a reduction in revenue in 2013 of approximately $325M; and

(e) as a result of the reduction in its revenue arising from the shortfall in nuclear production, OPG incurred an operating loss of $325M in 2013.

50. OPG absorbed the operating loss. The loss was not recoverable from rate payers. OPG (and therefore its shareholder) bore the volumetric risk related to production levels and any resulting loss. In effect, the actual 2013 production level was below the level of production reflected in payment amounts applicable in 2013.

51. The principle endorsed by the Board in EB-2007-0744,[40] and further articulated by the Board in EB-2007-0905,[41] is that ratepayers should only bear the costs for which they are

[39] Ex. N2-1-1, Table 1, MR, Tab 8.

[40] Ontario Energy Board, *Decision and Order re Great Lakes Power Limited*, dated October 30, 2008 in EB-2007-0744, pp. 41-44, MR, Tab 12.

[41] Ontario Energy Board, *Decision with Reasons re Ontario Power Generation*, dated November 3, 2008 in EB-2007-0905, pp. 168-17, MR, Tab 14.

responsible and, if ratepayers are held responsible for costs then they are entitled to the tax benefits associated with the costs. However, if ratepayers do not bear the costs, they are not entitled to the tax benefits associated with the costs. This is the principle that "benefits should follow the costs".

52. As the $325M operating loss due to the 2013 nuclear production shortfall was incurred by OPG and was not borne by ratepayers, it is OPG, not ratepayers, that is entitled to the benefit of the resulting tax loss. On this basis, OPG did not apply the $211.6M regulatory tax loss from 2013 to reduce its forecast 2014 regulatory taxable income for the benefit of ratepayers.

The Board's Decision relating to the Tax Loss

53. In the Decision, the Board directed OPG to reduce its 2014 income tax provision to recognize and carry forward its regulatory tax loss in 2013 on the basis that this finding was consistent with the Board's 2006 Electricity Distributor's Rate Handbook (the "**Handbook**").

54. The Board reached this conclusion on the basis of a series of findings.

(a) The Board found that OPG's circumstances in 2013 are distinct from the two Board decisions referenced by OPG in its reply submissions.[42] Those decisions were in EB-2007-0744 and EB-2007-0905.

(b) The Board found that the Handbook was not applied by the Board in EB-2007-0744.[43]

(c) The Board indicated that the "benefits follow cost" principle has been interpreted differently by the parties, but provided no interpretation of its own. Instead, it relied only on the strict wording of the Handbook.[44]

(d) The Board found that the fact that OPG incurred a tax loss was a risk OPG decided to take on its own accord and should not change the application or treatment of the Board's tax loss carry-forward policy because, according to the

[42] Decision, p. 101, MR, Tab 1.
[43] Decision, p. 101, MR, Tab 1.
[44] Decision, p. 102, MR, Tab 1.

> Board, OPG decided not to apply to change its payment amounts for 2013, which had the effect of continuing its (then current) payment amounts for 2013.[45]

55. In making its decision the Board misapplied and failed to consider the Board's decision in EB-2007-0744 and EB-207-0905 relating to the application of loss carry forwards and in doing so the Board mischaracterized the nature of OPG's 2013 operating loss and incorrectly applied the Handbook. The Board also incorrectly relied on a circumstance which has no basis in fact by assuming that OPG would have avoided the impact of the operating loss in 2013 by filing for 2013 rates. In the end, the Board failed to apply the benefits follows the cost regulatory principle causing the rate payers to be unfairly subsidized to the detriment of OPG.

B. Submissions - Material Errors Relating to Tax Loss Carry Forwards

56. In concluding that OPG should carry forward its 2013 regulatory tax loss of $211.6M for the purpose of reducing its 2014 income tax provision in regulated rates, the Board erred by mischaracterizing the nature of OPG's 2013 operating loss and incorrectly applied the Handbook. The Board also relied on a circumstance that has no basis in fact. As a result, the Board failed to apply established regulatory principles relating to cost responsibility, namely the principle that benefits follow costs, causing the rate payer to be unfairly subsidized to the detriment of OPG.

57. The Board's errors raise material questions as to the correctness of its Decision because it can be concluded that but for the errors, the principle of benefits follow costs should have been applied such that OPG's 2013 regulatory tax loss is not carried forward to reduce its 2014 income tax provision for the regulated facilities.

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[45] Decision, p. 102, MR, Tab 1.

Incorrectly Characterizing the Nature of OPG's 2013 Operating Loss and Incorrectly Applying the Handbook

58. The Board's decision in the Great Lakes Power Limited ("**GLPL**") proceeding EB-2007-0744 stands for the proposition that when interpreting and applying the Handbook in respect of tax loss carry forwards the Board must look at the basis for the loss and its attribution to the shareholder or ratepayer in order to correctly apply the regulatory principle of benefits must follow the cost. The EB-2007-0744 Decision was considered by the Board in making its decision that is the subject of this motion.

59. In its Decision, the Board erroneously concluded "*OPG's circumstances in 2013 are distinct from the two referenced Board decisions.*"[46] One of the two referenced decisions was the EB-2007-0744 Decision. The other Decision was in EB-2007-0905 relating to OPG's first payment amounts. The Board's finding is incorrect since the facts in each of those decisions are directly analogous to the nature of OPG's operating loss and the beneficiary of the use of that loss.

60. The Board's incorrect finding is based on the fact that GLPL conducted both regulated and non-regulated businesses and, according to the Board, the Board's decision in EB-2007-0744 "*addressed the fact that the corporate tax loss carry-forwards arose due to losses in Great Lakes Power Limited's non-regulated businesses*". The Board goes on to state that OPG's circumstances in 2013 are distinct because "*there is no evidence filed to indicate the tax loss was related to OPG's non-regulated businesses*".

61. In making its findings with respect to OPG's 2013 tax loss and the consistency of those facts with the EB-2007-0744 Decisions. The Board completely ignored pages 41 to 44 in the EB-2007-0744 Decision[47] that specifically considers the benefit of tax losses in GLPL's *regulated* business. Like GLPL, OPG's tax loss also arose in respect of its regulated business. The Board only turned its mind to that part of the EB-2001-0744 decision related to GLPL's unregulated business that arose in relation to an entirely separate issue.

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[46] Decision, p. 102, MR, Tab 1.

[47] Ontario Energy Board, *Decision and Order re Great Lakes Power Limited*, dated October 30, 2008 in EB-2007-0744, pp. 41-44, MR, Tab 12.

62. Furthermore at page 43 of the EB-2007-0744 decision the Board stated that *"[s]ince the Board has denied recovery of a major portion of account 1574, the amount denied would be excluded from GLPL's pre-2007 financial results thereby indicating that GLPL would have incurred significant* ***operating losses*** *for the period 2002 to 2006"* (emphasis added). The Board took note that any pre-2007 losses, arising from the Board's denial of recovery of account 1574, related to variations in load or expenses compared to the amounts on which GLPL's then existing rates were based. The Board stated further that *"[i]t is highly unlikely, in the Board's view, that GLPL's customers absorbed any of those losses. Except for some increases in rates authorized by the Board to collect certain regulatory assets, GLPL's distribution rates have not increased since May 2002, when GLPL's rates first became subject to Board oversight."*

63. The loss in the EB-2007-0744 Decision and OPG's loss in 2013 both relate to losses arising only from the regulated business and both related to tax losses that were due to costs, which were absorbed by the utility and its shareholder and not the ratepayer. The Board failed to properly consider this fact and the nature of OPG's 2013 operating loss was mischaracterized.

Handbook Was Misapplied

64. In the Decision, the Board found that its decision related to tax loss carry forwards was consistent with the Handbook. This conclusion is incorrect. Furthermore, the Board's finding that the Board in the EB-2007-0744 decision did not apply the Handbook is also incorrect. The Board in the EB-2007-0744 decision specifically interpreted and applied the Handbook and its underlying policy.[48] The Board clearly concluded that when interpreting and applying the Handbook in respect of tax loss carry forwards the Board must look at the basis of the loss and its attribution to the shareholder or ratepayer to correctly apply the regulatory principle of benefits must follow the cost.

65. In EB-2007-0744, the Board specifically stated:

> "The 2006 DRH sets out for electricity distributors how the Board generally intended to address applications for 2006 distribution rates. Among other issues, it dealt with how loss carry-forwards would be treated in setting the 2006 revenue requirements of distributors. The DRH sets out the consensus view of the working group as to how loss carry-forwards should be treated:
>
> *'A distributor expecting to have any loss carry-forwards still available on December 31, 2005 must disclose the amount of those loss carry-forwards in the 2006 application, apply them in full to reduce the taxable income calculated in the 2006 regulatory tax calculation.'*
>
> The Report of the Board that accompanied the 2006 DRH discussed the Board's rationale for approving this treatment of loss carry forwards:
>
> *'The Draft Handbook requires the distributor to take into account the potential reduction in actual taxes payable where a loss carry-forward is applicable.*
>
> *Hydro One submitted that any loss carry-forward resulting from revenue or expense variations in prior years was irrelevant*

[48] Ontario Energy Board, *Decision and Order re Great Lakes Power Limited*, dated October 30, 2008 in EB-2007-0744, MR, Tab 12.

> *for the 2006 calculation. It argued that the ratepayer has not contributed to the prior loss and therefore is not entitled to the future tax savings. Hydro Ottawa made similar submissions.'*
>
> *'Conclusions*
>
> *The Board has no evidence before it to determine whether loss carry-forwards are the result of revenue or expense variations or whether the loss carry-forwards arise for reasons that may be related to ratepayers. The Board notes that the consensus approach [take loss carry-forwards into account when setting 2006 rates] will reduce the variance between taxes collected in rates and actual taxes paid. The Board will accept this approach in the Handbook.28 (emphasis added)' [by the Board in EB-2007-0744]*
>
> Although the Board accepted the position in the 2006 DRH that loss carry-forwards should be taken into account in setting 2006 rates, **the Board does not believe that position is applicable in all rates cases before the Board. It is clear from the highlighted sentence in the Report of the Board that the Board attaches some significance to the reasons for losses.** It is also clear from that sentence that approval of the 2006 DRH position on loss carry-forwards was taken without the opportunity to hear any evidence on what might have led to the losses."[49] (emphasis added)

66. Furthermore, in interpreting and applying the Handbook in EB-2007-0744, the Board applied the principle of benefits follows the cost and stated as follows:

> "that the pre-2007 losses of the distribution business should not be used to eliminate the tax provision for the 2007 test period. The Board reiterates its view **that the benefits of a tax loss should be realized by the party - shareholders or ratepayers - that bore the expenses or losses that gave rise to the tax loss** . . . the resulting losses should not be attributed to ratepayers but rather to GLPL, which sustained those losses and should retain the related tax benefits" (emphasis added).[50]

67. Based on the foregoing, to apply the Handbook correctly, the Board should have (as in the EB-2007-0744 decision) considered the basis of the loss and the attribution of that loss to the shareholder or rate payer. In OPG's case, because the loss arose from

[49] Ontario Energy Board, *Decision and Order re Great Lakes Power Limited*, dated October 30, 2008 in EB-2007-0744, pp. 42-43, MR, Tab 12.
[50] Ontario Energy Board, *Decision and Order re Great Lakes Power Limited*, dated October 30, 2008 in EB-2007-0744, pp. 42-43, MR, Tab 12.

production levels and the consequences of its loss were borne by OPG, OPG should have the benefit of any resulting tax loss.

68. The Board also failed to consider and ignored the fact that the Board's decision in EB-2007-0905 related to tax loss carry forwards and not just, as the Board maintained, to the Board's uncertainty regarding OPG's tax calculation. In the Decision, the Board found that the circumstances in EB-2007-0905 "were unique and are not comparable to OPG's current circumstances" and that "the Board's finding in that case resulted from the absence of information and the Board's uncertainty regarding OPG's tax calculation" (Decision, p. 102; MR, Tab 1). The Board then provides, as support for its finding, a quotation using selected passages from pages 169-170 of the decision in EB-2007-0905 (MR, Tab 14).

69. In reaching its conclusion that the decision in EB-2007-0905 is not comparable to OPG's current circumstances, the Board has failed to consider a key part of the decision in EB-2007-0905. At page 170 of the EB-2007-0905 decision, the Board states:

> **The Board believes that the benefit of tax deductions and losses that arose before the date of the Board's first order should be apportioned between electricity consumers and OPG based on the principle that the party who <u>bears a cost should be entitled to any related tax savings or benefits</u>.** The Board has adopted this principle in other cases where a company owns both regulated and unregulated businesses.
>
> The practical consequences of this principle can be illustrated by reference to two of the items that OPG cites as causes for the 2005 to 2007 regulatory tax loss . . .
>
> OPG's evidence indicated that in 2007 its **regulated operations** incurred an $84 million loss before income taxes . . . It would appear that the operating loss in 2007 was **borne completely by OPG's shareholder. Consumers have not been required to absorb that loss because the payment amounts for 2007 were set in 2005 and did not change. Accordingly, in the Board's view, none of the tax benefit of that loss should accrue to consumers.**[51] (emphasis added)

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[51] Ontario Energy Board, *Decision with Reasons re Ontario Power Generation*, dated November 3, 2008 in EB-2007-0905, pp. 168-17, MR, Tab 14.

70. Based on the foregoing, it is clear that the circumstances considered by the Board in EB-2007-0905 are directly analogous to the circumstances under consideration in the Decision. In each case, OPG experienced losses in its regulated operations, those losses were borne entirely by OPG's shareholder and consumers did not absorb any of the operating loss. However, whereas the Board in EB-2007-0905 applied the principle of benefit follows cost and concluded that none of the tax benefit arising from the loss should accrue to ratepayers, the Board in the Decision ignores this finding and has instead determined that all of the tax benefit arising from the loss should accrue to ratepayers. As such, the Board has erred in the Decision by failing to consider or address these critical aspects from the EB-2007-0905 decision.

Principle Not Applied

71. Notwithstanding that the principle of benefits follows cost was explicitly applied in EB-2007-0744, the Board in the decision that is the subject of this motion, erred in not applying the "benefits follows the costs" principle. Relying only on its erroneous interpretation of the Handbook, the Board only stated that "it is apparent to the Board from the submissions of OPG and the parties that the "benefits follow cost" principle has been interpreted differently by the parties.[52]

72. Notwithstanding this finding, the Board failed to identify the various interpretations to which it refers or to engage in any consideration whatsoever of the relative merits of those interpretations. Moreover, the Board failed to offer its own determination as to how the "benefits follow cost" principle should be interpreted or how it should be applied in OPG's circumstances. The Board also does not attempt to reconcile any of the interpretations to which it refers with any of the Board's prior interpretations of the principle, including in particular those set out in EB-2007-0744 and EB-2007-0905[53] (MR, Tab 12).

[52] Decision, p. 102, MR, Tab 1.

[53] Ontario Energy Board, *Decision with Reasons re Ontario Power Generation*, dated November 3, 2008 in EB-2007-0905, pp. 168-17, MR, Tab 14.

73. Rather than grappling with this fundamental issue, the Board simply relies on its observation that different parties in the hearing process put forward different interpretations of the principle. By failing to determine how the "benefits follow cost" principle should be interpreted in this case, the Board is effectively concluding - contrary to established regulatory principles - that regardless of whether a cost is borne by ratepayers or not, the ratepayers will always receive the benefit. Furthermore, if the Handbook is to be applied, the Board has misapplied the Handbook in respect of OPG's tax loss carry forward.

74. As a result of its error in finding that OPG's circumstances in 2013 are distinct from the facts in EB-2007-0744 and EB-2007-0905 and because of its failure to consider the Board's previous findings in respect of the Handbook, the Board in the Decision failed to consider the reason for OPG's underlying loss and the party that incurred the consequences of the loss and, as such, it failed to apply the principle of "benefits follow cost". As a consequence, rate payers improperly and unfairly receive the benefit of the tax losses and are in being effect subsidized by the utility resulting in rates that are not just and reasonable.

Giving Weight to a Circumstance that has no Factual Basis

75. The Board erred by giving weight to the fact that OPG decided not to apply to the Board to change its payment amounts for 2013, which fact is not relevant to the consideration of the nature of the loss incurred by OPG or the treatment of the tax loss. The Board sees significance in the fact that OPG did not apply to change its payment amounts for 2013. In particular, the Board's view is that when OPG decided to not apply for new payment amounts for 2013, it did so with the knowledge that by making this choice OPG took a risk of an operating loss.[54]

76. Given the Board's approach to rate-setting on a forward test year basis, an application for 2013 payment amounts would have had to be filed by OPG sometime in 2012 based on forecast production levels for 2013. As such, even if it did seek new payment amounts

[54] Decision, p. 102, MR, Tab 1.

for 2013, OPG could not have known that it would end up having an operational loss in 2013 or the magnitude of that loss where such loss would give rise to a tax loss. It is unreasonable for the Board to suggest that OPG ought to have applied for 2013 payment amounts so as to avoid losses. The losses could only have been known on a retrospective basis.

77. The approach taken by the Board is retrospective in nature with the application of hindsight and is not based on an accepted regulatory principle or practical in its application.

PART IV – THRESHOLD TEST

A. The Threshold Test

78. The threshold question was articulated in the Board's Decision on a Motion to Review in the Natural Gas Electricity Interface Review proceeding (the "**NGEIR Decision**"). The Board found that the purpose of the "threshold test" in then-Rule 45.01 must be derived from the language of then-Rule 44.01 (now Rule 42.01), which requires that a motion for review "raise a question as to the correctness of the order or decision."[55] The Board stated that the purpose of the threshold question is to determine whether the grounds put forward by the moving party raise a question as to the correctness of the decision, and whether there is enough substance to the issues raised such that a review based on those issues could result in the Board varying, cancelling or suspending the decision.

79. The Board also indicated in the NGEIR Decision that in order to meet the threshold test there must be an "identifiable error" in the decision for which review is sought. In demonstrating an error, the moving party must show that the findings are contrary to the evidence, the panel failed to address a material issue or something of a similar nature. The alleged error must be material and relevant to the outcome of the decision. It is not enough to argue that conflicting evidence should have been interpreted differently. A motion to review cannot succeed in varying the outcome of the decision if the moving

[55] Decision with Reasons, EB-2006-0322/-0338/-0340, May 22, 2007, SMR, Tab 5; *Rules of Practice and Procedure*, Rule 42.01, SMR Tab 6.

party cannot satisfy these tests, and there is no purpose in proceeding with the motion to review.[56]

B. OPG Has Met The Threshold Test

80. OPG has met the threshold test. The errors of fact set out above raise material questions as to the correctness of the Board's Decision in respect of the Niagara Tunnel Project, and the tax loss carry forward. The Board's findings are contrary to the evidence that was before the panel. Once corrected, the amount that OPG will be permitted to add to its rate base in respect of the Niagara Tunnel Project, as well as the amount of the tax expense approved for recovery in the test period, will be materially different than as set out in the Decision. As such, with respect of each issue, OPG has satisfied the threshold test in Rule 43.01 of the Board's *Rules of Practice and Procedure*.

81. In establishing just and reasonable rates, the Board is obligated to permit the recovery of, and OPG is entitled to recover, its reasonable and prudently incurred costs. Because of the errors set out herein, the Decision does not permit OPG to recover a return on the full amount of its reasonable and prudently incurred capital costs associated with the Niagara Tunnel Project, or its reasonable and prudently incurred income tax costs for the test period. In the result, payment amounts are not just and reasonable.

PART IV - REMEDIES

Remedies Sought

82. For the reasons set out above, OPG is seeking, by way of its motion, an Order:

(a) (i) varying the finding that $88.0M of the NTP capital expenditures were imprudently incurred, (ii) finding that the $88.0M portion of the NTP capital expenditures were prudently incurred, and (iii) finding that the full amount of the proposed $1,452.6M in NTP capital expenditures should therefore close to rate base in the test period;

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[56] Decision with Reasons, EB-2006-0322/-0338/-0340, May 22, 2007, p. 18, SMR, Tab 5.

(b) (i) varying the finding that OPG reduce its 2014 income tax provision to account for and to recognize the carry forward of its $211.6M regulatory tax loss that was incurred in 2013 due to a shortfall of nuclear production, and (ii) finding that OPG is entitled to receive the benefit of the $211.6M regulatory tax loss and that it does not need to reduce its 2014 income tax provision to account for and to recognize the carry forward amount;

(c) varying the amount of OPG's test period revenue requirement by increasing the test period revenue requirement to reflect (a) and (b) above;

(d) amending the payment amounts order (currently pending) to reflect the test period revenue requirement arising from (c) above; and

(e) as a method to give effect to (c) above, establishing a deferral account to record the impact of the Board's decision on this motion, over the period from November 1, 2014 until the effective date of the amended payment amounts order arising from this motion, with such amount to be disposed of pursuant to the payment amounts order referred to in (d) above.

All of which is respectfully submitted this 26th day of January, 2015.

ONTARIO POWER GENERATION INC.

By its Counsel

Torys LLP

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for Charles Keizer and Crawford G. Smith