EB-2014-0369

ONTARIO ENERGY BOARD

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

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 determine payment amount for the output of certain generation facilities;

AND IN THE MATTER OF a motion by Ontario Power Generation Inc. pursuant to Rule 32 of the Ontario Energy Board's *Rules of Practice and Procedure* for an order or orders to vary the Decision with Reasons in EB-2013-0321.

SUBMISSIONS OF THE SCHOOL ENERGY COALITION

1. Ontario Power Generation Inc. ("OPG") filed an application with the Ontario Energy Board (the "Board") pursuant to section 78.1 of the *Ontario Energy Board 1998*, seeking approval for payment amounts for its prescribed generation facilities (EB-2013-0321 proceeding). After a lengthy hearing, and argument from all parties, the Board issued its Decision with Reasons on November 20th 2014 (the "Decision").

2. On December 10th 2014, OPG filed a Notice of Motion to review and vary the Board's Decision with respect to aspects, alleging that the Board made material factual errors leading to the Board's i) disallowance of $88M of additions to rate base for the Niagara Tunnel Project, and ii) direction to reduce its 2014 income tax provision to account for and to recognize the carry forward of its regulatory tax loss in 2013.

3. The School Energy Coalition ("SEC") was an intervenor in the EB-2013-0321 proceeding, and filed extensive arguments on both issues. OPG's motion to review and vary should be dismissed. Pursuant to the Notice of Hearing and Procedural Order No. 1, these are SEC's submissions on the threshold question and merits of the motion.

Threshold Question

4. SEC submits that OPG has not met the threshold test. It is simply seeking to re-argue aspects of the Decision.

5. Pursuant to Rule 43.01 of the *Board's Rules of Practice and Procedure*, the Board conductsa threshold inquiry, i.e. "whether the matter should be reviewed before conducting any review on the merits".[1] The "threshold test" was articulated by the Board in the *Motion to Review Natural Gas Electricity Interface Review* ("NGEIR") Decision.[2] The Board stated that the purpose of the threshold test is to determine whether the grounds relied upon by the moving party raise a question as to the correctness of the decision, and whether there is enough substance to the issues raised that a review based on those issues could result in the Board varying, cancelling or suspending that decision.[3] While the grounds listed in Rule 44.01(a) are not exhaustive[4] , in order for the threshold test to be met, there must be an "identifiable error" and the "review is not an opportunity for a party to reargue the case".[5]

6. While OPG has claimed that there is an identifiable error in the Board's Decision, in reality, it is simply seeking to re-argue the case, which is not the purpose of a motion to review. The Divisional Court in *Grey Highlands v. Plateau* has confirmed the Board's principle that re-argument of issues is not an appropriate ground for review.[6]

7. There is a principle behind why the Board applies the threshold test to ensure that there is an identifiable error that goes to the correctness of the decision. A Board panel that rendered the original decision has a much better appreciation of the entire context and evidence. The correctness of a specific factual question, within the context of a larger factual dispute, is not a simple binary decision for a reviewing panel.

8. While a motion to review is not an appeal or judicial review, it is also not a *de novo* hearing. The reason for this is very evident in a proceeding such as this. The Niagara Tunnel portion of the OPG

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[1] Ontario Energy Board, *Rules of Practice and Procedure*, Rule 43.01
[2] *Decision with Reasons*, (EB-2006-0322/338/340, dated May 22 2007 ["*NGEIR*"]. Also see *Decision and Order on Motion to Review* (EB-2011-0053) dated April 21, 2011, *Decision and Order on Motion to Review* (EB-2013-0193), dated July 4 2013, p.4, *Decision on Motion to Review Decision and Order* (EB-2013-0331), dated January 16 2014, p. 3.
[3] *Ibid,* p.18.
[4] *Ibid*, p.14.
[5] *Ibid*, p.18.
[6] *Grey Highlands (Municipality) v. Plateau Wind Inc*., 2012 ONSC 1001, para 7.

proceeding was the most extensive prudence review of a single asset that the Board has ever undertaken. It involved thousands of pages of evidence, and multiple days of the oral hearing. The issues within were complex and interrelated. Parties, including intervenors, took a wide range of positions in argument.[7] It is because of this that reviewing panels should accord the original panel deference in their decisions regarding factual questions. This is especially important in a proceeding such as this, where there was extensive cross-examination on the NTP issues. OPG's motion to review portions of the NTP issue is exactly the type of motion that the Board should refuse to consider, since it is simply an opportunity for it to reargue its case. The errors alleged in this motion raise the same arguments that were made by OPG in the original proceeding.[8] The Board considered them, and ultimately did not accept their position.

9. OPG's alleged errors of fact with respect to the tax loss carry forwards are not errors at all. OPG's position is based entirely on their theory – already argued and rejected by the Board - that the Board should apply the "benefits follow costs" principle in this case. That principle has never been applied in situations such as this. Further, the interpretation OPG proposes would mean that tax loss carry forwards are never applied to test year tax calculations. That would mean that at least ten Board decisions are incorrect.

A. Niagara Tunnel Project

10. In its application, OPG sought to include $1,452.6M in rate base for its Niagara Tunnel Project. This amount was $486.8M more than had originally been forecast and approved by its Board of Directors. After reviewing the significant evidence and arguments, the Board disallowed $88M, or 6% of the total amount. This disallowance was significantly less than had been sought by most intervenors. The Board's decision on the disallowance had two parts. First, $28M related to the settlement OPG made with Strabag, and second, $60M related to the Amended Design Build Agreement ("ADBA"), specifically incentives paid to Strabag to complete the project. OPG alleges that the Board made errors in fact in reaching its decision on both aspects of the disallowance.

11. In 2005, after receiving Board of Directors approval, OPG entered into a Design Build Agreement ("DBA") with Strabag to construct the Niagara Tunnel Project. While the total approved budget of the project was for $985, $622.6M was the price to be paid to Strabag under the DBA. The

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[7] For example, SEC proposed a reduction of $245.7M, AMPCO proposed a reduction of $407.4M, and CME proposed a $208.5M.
[8] See OPG Reply Argument, p.62-64, 71-77.

DBA is a complex and detailed document that in part, allocates cost responsibilities between OPG and Strabag. One of the documents that were incorporated in the DBA was the Geotechnical Baseline Review ("GBR"). The GBR incorporated into the DBA is negotiated between the parties and sets out the expected subsurface conditions that are expected.[9] Under the DBA if the subsurface conditions were materiality different then what was set out in the GBR, than there was what is known a differing subsurface condition ("DSC"), and the additional costs would be the responsibility of OPG.[10] If there were additional costs that were not the cause of a DSC, than the contractor Strabag would be responsible. The DBA provided provisions for the creation of a non-binding Dispute Resolution Board ("DRB") to adjudicate DSC disputes.

12. By mid-2007, Strabag began to encounter delays and cost overruns. It filed a notice with OPG and ultimately sought to recover $90M which it claimed were a result of a DSC. OPG disagrees and after being unable to resolve the issue it was referred to the DRB.

13. After a hearing, the DRB rendered its decision on five disputed issues. It found that with respect to the first three issues (large block failures, St. David's Gorge, and insufficient stand-up time) there was no DSC. With respect to the excessive overbreak issue, the DRB did find that there was a DSC, but did not lay the responsibility solely at the feet at OPG. The DRB stated:

> Since the GRB was a mutual responsibility of both Parties, we 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 encounter and 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."[11]

14. On the final issue, inadequate table of rock conditions and rock characteristics, the DRB found that there were insufficient and imprecise to define the subsurface conditions, so as "essentially renders the concept to the DSCs meaningless and make the GBR defective".[12]

15. OPG determined the best way forward was to settle the pre-December 2008 claims of Strabag for $40M, and renegotiated its agreement which resulted in the signing of the target price contract, Amended Design Built Agreement ("ADBA").

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[9] Ex.D1-2-1, Attachment 6, p.71.
[10] *Ibid.*
[11] Ex. D1-2-1-Attachment 7 ["Dispute Review Board Report"], p.18.
[12] Dispute Review Board Report, p.19.

16. The ADBA allowed OPG to audit Strabag's claimed loss of $90M and to the extent the amount was not substantiated, it could reduce the $40M payment on a propionate basis. OPG evidence was that its internal auditors found that only $77.4M were for legitimate expenses, yet it determined that it would not reduce the settlement payment as allowed for under the ADBA.

17. In its Decision the Board determined the payment to Strabag of $40M to settle a claim of $90M was imprudent. The $28M disallowance was based on the following:

- The proper starting point for OPG should have been $77.4M as found in OPG's audit. The Board found there was no evidence or testimony providing support for Strabag's claimed amount.[13]

- Since the DRB found OPG had only shared only had <u>shared</u> responsibility over 2 of the 5 issues, ratepayers should only be responsible half of that portion of the $77.4 amount, or $15.5M.[14]

- A reduction of $3.5M for the carrying costs of the disallowed $24.5 described above.[15]

18. The Board also determined that all the costs associated with the ADBA should not be passed on to ratepayers and a disallowance of $60M was appropriate. While accepting that Strabag may have walked away if held to the original DBA, and completing the project with a new contractor would have been much more expensive, the Board found the ADBA was still too generous to Strabag, and that OPG was not prudent in agreeing to those terms. Specifically, the ADBA incentive provisions which totalled $60M were "not necessary and not prudent" considering the ADBA provided enough incentive for Strabag to complete the work.[16]

19. The Board came to this conclusion based on the evidence that showed Strabag was not as likely to walk away as OPG would have had the Board believe. First, pursuant to the original DBA, Strabag had posted a letter of credit of $70M and provided a parental indemnity guaranteeing performance of the contract and indemnifying OPG of any breaches of the contract. Second, OPG's witness confirmed that Strabag would suffer serious repercussions if it simply walked away, including being sued by OPG for breach of contract, and suffering harm to its business reputation.

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[13] *Decision with Reasons* (EB-2013-0321), dated November 20 2014 ["Decision"], p.32.
[14] *Ibid.*
[15] *Ibid.*
[16] *Ibid.*

Settlement of Strabag's $90M Claim

20. OPG claims that the Board misapprehended the evidence relating to the findings and process of the DRB, which it claims was the basis for the disallowance. In essence, it would appear OPG is arguing that there was only a single DSC dispute that went to the DRB, and that it did not matter how many reasons they were rejected, if a DSC was found on any basis, according to the DRB the additional costs were their responsibility. SEC submits this is not error in fact. It is also contrary to the evidence.

21. The DRB decision found that while there was a DSC with respect to excessive overbreak and inadequate table of rock conditions, the entire $90M claimed by Strabag was not related to the DSC. The question before the Board in the Decision was not if Strabag did encounter issues which caused it to incur costs in excess of what it was being paid under the DBA. The question was if the $40M amount that OPG agreed to pay was prudent.

22. The fact that a DSC did occur, does not mean that all added costs incurred were attributable to it. OPG itself did not subscribe to such a patently ridiculous interpretation to the DBA. If it had, then it would have agreed to pay the entirety of Strabag's claim, not less than 50% of that amount.

23. While the issues may have been at some level interconnected, they are not totally interdependent. By way of example, Strabag would have incurred added costs because of large block failures that it encountered at station 0+815 and 0+839. It claimed the underlying rock conditions where this occurred were not adequately described in the GBR and because of that constituted a DSC.[17] The DRB disagreed. This is different than the issue of excessive overbreak. Strabag would have also incurred added costs because of the significant overbreak in excess of what it has expected as set out in the GBR. Here the DRB ruled that if the defective provisions of the GBR were overlooked, there was a DSC. While Strabag would have incurred added costs to deal with both issues, OPG was only responsible for the costs associated with excessive overbreak, not large block failures. While some of the costs may overlap between the two issues, not all of them do.

24. Similarly, the DRB found that Strabag was not entitled to make a claim for a DSC within the 800m width of the St. David's George because of the specific provision of the DBA.[18] So whatever added costs Strabag incurred in tunnelling that area it could not be considered a DSC and recoverable from

[17] Dispute Review Board Report, p.1.
[18] Dispute Review Board Report, p.10,18.

OPG. As Mr. Everdell said of the DRB findings on this issue, "[it] was entirely Strabag's responsibility".[19]

25. In absence of any information provided by OPG or its expert witness, the Board took a reasonable approach to determining what cost responsibility should have been OPG's, and what was not. OPG never internally broke out the costs between the various issues.[20] There was no evidence on the record that would allow the Board and parties to determine what amount of the claimed amount could be attributed to the DSC and what was not. OPG's own expert witness, ".. usually the procedural aspects for the dispute review board is that you listen to the merit of the allegations first and then you deal with costs later, after the decision or recommendations came through."[21] The parties, on what appears to be the urging of the DRB itself, negotiated a settlement. There never costs phase of the DRB proceeding to determine what amount of the Strabag's claims were attributable to the DSC, and what was not. Even the issues the DRB determined did constitute a DSC, they specifically comment that both parties were responsible because of the defective nature of the GBR.

26. The Board with left with no precise information to determine what amount of Strabag's claim was appropriate for OPG to have paid. It was OPG who had the onus and provided no specific information to help Board with this task.

Amended Design Build Agreement

27. OPG claims that the Board's disallowance should be reversed do its error in its findings that OPG had leverage in its negotiation with Strabag. SEC disagrees that any error were made.

28. The question of what leverage OPG had in renegotiating the ADBA is not something that could easily be precisely quantified. It is a judgement call that the Board was required to make based on all the evidence to answer what it recognized was the "salient question: Could OPG have achieved better terms than it did in negotiating with Strabag to move forward after the Dispute Review Board findings?"[22]

29. Contrary to OPG's argument for the reasons discussed already, the Board did not misapprehend the DRB findings. In fact, SEC submits the DRB findings further confirm the leverage in negotiations

[19] Tr. Vol.1, p.69.
[20] Tr. Vol.1, p.67.
[21] Tr. Vol.1, p.66.
[22] *Decision*, p.32.

that OPG had over Strabag. The evidence is clear that OPG was negotiating from a position of strength after the DRB findings were released. Not only had Strabag's claim of a DSC been rejected on most grounds, even where the DRB could find a DSC, it stated that both parties shared responsibility. In its Notice of Arbitration[23], which both parties both file seemingly to keep their options open if negotiations failed, Strabag wrote that it would "place great weight on the Recommendations received by the DRB Board [sic] and will use them as a basis for further negotiations with OPG".[24]

30. Further, the Board did not err by relying on the parental guarantee and indemnity ("the Indemnity Agreement") as evidence of the leverage that OPG would have had during negotiations. [25] The question was not if Strabag was in default at that point, but that if OPG pushed harder in negotiations it had leverage since the Indemnity Agreement provided a level of financial protection against Strabag just walking away without finishing the work. The evidence showed that the risk of Strabag walking away was at best overstated. Strabag is an internal construction company with significant experience undertaking large projects. It is one of the reasons OPG chose them as tunnel contractor in the first place. When questioned by Member Hare, Mr. Young testified OPG is not aware of Strabag ever having walked away from a project.[26] As the Decision correctly concludes, to do so would have had serious repercussions for Strabag in terms of legal liability and harm to its business reputations and would "have been an extremely expensive and unpalatable option."[27]

31. Lastly, OPG claims that the Board misapprehended the nature of incentives paid to Strabag. The Board was correct in its findings that the specific incentive provisions were imprudent considering the revised contract (the ADBA) that paid Strabag significantly more than the original DBA.

> The Board is mindful of the Dispute Review Board's recommendations that Strabag have appropriate incentive to complete the work. However, in the Board's view the Amended Design Build Agreement provided adequate "incentive" even without the specific incentive clauses. OPG agreed to pay Strabag hundreds of millions of extra dollars more than was provided of the original Design Build Agreement. In the Board's judgment, the provision of incentives above this was not necessary and not prudent".[28]

32. After the settlement of the $90M claim, all the added costs of the project were the responsibility of OPG under the ADBA. The only financial consequence to OPG was a somewhat lower profit margin.

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[23] Ex.L, Tab 4.5, Schedule 17-SEC-040, Attachment 1 and 2.
[24] Ex.L, Tab 4.5, Schedule 17-SEC-040, Attachment 2.
[25] OPG Submission, para 39.
[26] Tr. Vol.2, p.155.
[27] *Decision*, p.33.
[28] *Decision*, p.33.

Even that conclusion may not have actually been correct considering OPG did not know what profit Strabag would have received under the DBA.[29] The evidence before the Board was also that various cost items contained in the ADBA, including office and general cost and overhead recovery, were not included in the DBA. OPG witnesses did not know if these costs were embedded in other categories in the DBA or not included at all.[30] The Board correctly found that the specific incentive provisions were not needed. The DRB recommended, and the Board agreed, that Strabag required sufficient incentive to complete the job.

33. There was also incentives that the Board disallowed that were not included in the original ADBA. As SEC argued, OPG unreasonably agreed to further amendments which adjusted the completion date and resulted in an increase in the incentives paid by $15M. The increase in the completion date of 17 dates under Amendment No.1, and 94 days under No.2 were not required since Strabag substantially completed the project earlier than the original date set out in the ADBA.

34. OPG relies on the Board's recognition that of the DRB recommendation that Strabag have appropriate incentives to complete the project to argue that the Board erred in disallowing the incentive provision. In the context of what occurred, incentive does not mean sufficient profit. It should be recalled that at the time the DRB made its recommendation, OPG and Strabag were working under a fixed price DBA. The renegotiated ADBA was a target price contract. Strabag got more than just an incentive to complete the project, the entire structure of the agreement, and thus allocation of risk was fundamentally altered in its favor. Instead of being held to fixed price contract with some modifications to account for OPG's share of the DSC, it received over $300 million dollars more with almost no risk of losing money under the target price ADBA. The ADBA essentially shifted all the risk from Strabag to OPG. Whatever the cost was at the end of the project, OPG was responsible for it all. Strabag risk going forward was essentially eliminated. While it may have not received as a large of a profit as it first hoped when it entered into the DBA, circumstances had dramatically changed due in part to its fault. It did not need specific incentive provisions, some added after the ADBA was signed, to finish the project.

B. <u>Tax Loss Carry-Forward</u>

35. In 2013, OPG incurred a regulatory tax loss of $211.6M due to a loss in its nuclear operations. It its application, it did not apply the regulatory tax loss to its forecast 2014 taxable income that it sought to

[29] Tr. Vol.2, p.86.
[30] Tr. Vol., p.78, 86.

recover from ratepayers. In the Decision, the Board ordered OPG to reduce its 2014 income tax provision by applying the carry-forward of the 2013 regulatory tax loss. The Board found that to do so would be consistent with its long-standing policies, and distinguished the issue from other Board decisions, including its previous OPG decision (EB-2007-0905).[31]

Essence of the OPG Argument – "Benefits follow Costs"

36. In its Motion, and its written submissions, OPG tries to make this a complicated issue. It is not.

37. If the Board panel looks at each of the arguments on this issue put forward by OPG, the result of each argument is that the Board should have followed the "benefits follow costs" principle, and in failing to do so it was in error.

38. One inevitable result of OPG's submissions is therefore that, if the benefits follow costs principle does not apply in this situation, then all of OPG's arguments on this point fail, and the threshold is not met.

"Benefits follow Costs" Does Not Apply

39. The "benefits follow costs" principle states that certain benefits go to the entity – utility or ratepayers – that bore the costs that generated those benefits. In certain limited circumstances, that has been applied by the Board to allocate the tax reduction benefits of tax losses. This is not one of those situations.

40. Under the OPG argument, tax losses generate a benefit, and whoever bears the tax loss, gets the benefit. That sounds good, except for one thing: ALL tax losses are borne by the utility. There is never a situation in which the Board orders rates on the assumption that there will be a tax loss. Therefore, by definition, there would never be a tax loss carry forward that can be used to reduce the PILs in rates. The tax loss carry forward would always be retained by the utility for the shareholder's benefit. That is the necessary result of the OPG argument.

41. In fact, the Board's policy is that, when rates are set, any tax loss carry forward available is used to reduce the PILs provision included in rates. Staff, in their submissions, have listed eleven cases in which this has been the Board's ruling, and both the Board, in its Decision, and Staff, in their

[31] *Decision*, p.101

submissions, have cited the general policy established in, among other places, the 2006 EDR. The Board has consistently required that tax losses be applied, in this way, to reduce rates.

42. This makes sense. When rates are based on cost of service, one of the "costs" to be calculated is PILs. Under the Income Tax Act, taxes for a given year are reduced by the carry forward of certain losses from prior years. Thus, when OPG says that it has a test period cost of $188.5 million for PILs[32], that is not factually correct. The actual tax to be paid is $70.5 million less, due to the normal application of the tax rules in OPG's test period circumstances.

43. The essence of the OPG argument is that they want to recover from ratepayers more for PILs than they will actually pay. Not surprisingly, that is not consistent with Board policy, and the many decisions the Board has reached on precisely this point.

What About the Two Cases Cited?

44. OPG has cited two cases, EB-2007-0744, and EB-2007-0905, both of which they say show that the "benefits follow costs" principle should apply in this case. They don't, and it shouldn't.

45. EB-2007-0744 is a case involving Great Lakes Power. In that case, GLP included amounts it was including in Account 1574 (for mitigation of rate increases) in revenues for tax purposes in the 2002 through 2006 period. When they sought clearance of those amounts in 2007, the Board denied recovery. The Board also exercised its judgment not to require the utility, after bearing that entire rate mitigation cost after the fact, also to reduce its taxes going forward because the amount of the denial would be tax deductible. None of that is applicable here.

46. EB-2007-0905 is the first OPG Payment Amounts case. The issue in that case was how the benefits of tax losses should be allocated between the unregulated and regulated activities of the utility. The Board was very specific in determining that it was that regulated vs. unregulated distinction that drove the application of the "benefits follow costs" principle.

47. Neither of these cases, therefore, has facts applicable to the current OPG situation, in which a utility with regulated rates loses money, and then applies for rates on a cost of service basis. In every situation in which <u>those</u> facts have been true, the Board has determined that the tax loss carry forward must be applied to reduce test period PILs.

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[32] OPG Submissions, para. 48.

Conclusion

48. Therefore, it is submitted that the OPG argument on the tax losses fails, because it is based on an assumption that is untrue. The "benefits follow costs" principle does not apply to tax loss carry forwards from one regulated year to another, and it has never applied in those circumstances. The OPG argument sounds good, but is revealed as being a complete misunderstanding of the principle OPG is proposing to apply.

All of which is respectfully submitted.

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