Ontario

Ontario Energy Board
Commission de l’énergie de l’Ontario

DECISION AND ORDER

EB-2017-0375 / EB-2018-0102

ONTARIO POWER GENERATION INC.

Fees under subsection 19(3) of the *Ontario Fair Hydro Plan Act, 2017* for June 1, 2017 to December 31, 2017 and January 1, 2018 to March 31, 2019

BEFORE: **Allison Duff**
Presiding Member

Susan Frank
Member

Michael Janigan
Member

July 5, 2018

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1 INTRODUCTION AND SUMMARY

This Decision and Order addresses two related fee applications submitted by Ontario Power Generation Inc. (OPG) in its capacity as the “Financial Services Manager” for the purposes of the *Ontario Fair Hydro Plan Act, 2017* (OFHPA). One application relates to the period from June 1, 2017 to December 31, 2017[1] and the other relates to the period from January 1, 2018 to March 31, 2019.[2]

Under the OFHPA, which was enacted to implement the Government of Ontario’s Fair Hydro Plan, OPG is named as the Financial Services Manager.[3] One of the Financial Services Manager’s powers is to establish one or more “financing entities” to raise debt financing for the purpose of the OFHPA.[4] The Financial Services Manager may establish and charge fees to financing entities, subject to approval by the Ontario Energy Board (OEB).[5] OPG has established a financing entity known as the Fair Hydro Trust. These applications concern the fees to be charged by OPG to the Trust.

The General Regulation under the OFHPA (O. Reg. 206/17) (Regulation) sets out what the Financial Services Manager may charge fees for, and what it must include in fee applications to the OEB. There are different rules for different time periods. Especially for the first two periods, i.e., those covered by these two applications, the OEB’s discretion is limited. For subsequent applications, the scope of the OEB’s review will be somewhat broader.

OPG proposes a fee of $5,733,684.11 for the period from June 1, 2017 to December 31, 2017, which, as per the Regulation, will allow OPG to recover certain costs for acting as the Financial Services Manager, and to earn a prescribed return. For the reasons that follow, the OEB approves the fee subject to a deduction of $57,692.87 for an out-of-period expense identified in the external audit report filed with the EB-2018-0102 application.

For the period from January 1, 2018 to March 31, 2019, OPG seeks approval of its interest rate forecasts for the funding tranches to be issued in the period. The OEB

[1] EB-2018-0102.
[2] EB-2017-0375.
[3] OFHPA, s. 18. The OFHPA came into force on June 1, 2017.
[4] OFHPA, s. 22(2).
[5] OFHPA, ss. 19(3) and (4); O. Reg. 206/17, s. 10.1. Pursuant to s. 78.1(3) of the *Ontario Energy Board Act, 1998*, OPG’s costs for serving as the Financial Services Manager, and the fees it charges in that capacity, are not taken into account when the OEB sets payment amounts for OPG’s regulated generation activities.

approves the application as filed. The OEB is satisfied that the forecasts are not "materially inconsistent with market comparable forecast interest rates",[6] and therefore approves the forecasts for the purpose of OPG's calculation of the fee for the period. OPG estimates that the total fee over the period will be between $0.5 million to $5 million, depending on the actual amount and timing of the financing and the actual interest rate it obtains for that financing.

[6] Regulation, s. 10.6(1).

2 THE PROCESS

On December 15, 2017, OPG applied for approval of the fee for the January 1, 2018 to March 31, 2019 period and was assigned OEB file number EB-2017-0375. OPG filed supplemental evidence on February 9, 2018.

On February 28, 2018, OPG applied for approval of the fee for the June 1, 2017 to December 31, 2017 period and was assigned OEB file number EB-2018-0102.

Because of the similarities between the two applications, the OEB assigned the same panel.

The OFHPA provides that the OEB may exercise any of its responsibilities under the Act without a hearing. The OEB decided not to hold a hearing on these two fees applications for the following reasons. First, the scope of the OEB's jurisdiction in respect of these applications is narrow. The Regulation is highly prescriptive, leaving little discretion to the OEB. Second, the quantum of the proposed fees is limited. Third, in respect of the proposed fee for January 1, 2018 to March 31, 2019, the OEB recognizes that these are still the early days of the Fair Hydro Trust financings. As subsequent tranches are issued and OPG gains operational experience as the Financial Services Manager, there will be lessons learned which will inform future applications. Fourth, as OPG notes, the assessment of forecast interest rates is "a matter in respect of which the OEB has extensive relevant experience and expertise."[7] The decision not to hold a hearing on these initial applications should not be construed as implying that a hearing would not be warranted in a future application.

The panel decided to address both applications in this Decision and Order for efficiency purposes, given the similarities between the applications and the Regulation common to both.

[7] EB-2017-0375 application, p. 4.

3 DECISION ON THE ISSUES

3.1 The fee for January 1, 2018 to March 31, 2019 (EB-2017-0375)

The methodology for setting out the fee for this period – and this period alone – is set out in section 10.5 of the Regulation. In brief, that section provides that the fee comprises two parts. The first, referred to by OPG as the “base fee”, is based on a proportion of the debt incurred by the financing entities, specifically, “0.00625 per cent of the average monthly funding obligation for each month in the period”.[8] The second, the “incentive fee” is based on a formula that provides an incentive for OPG to obtain the best interest rate on any debt incurred by the financing entities. If the actual interest rate for any funding tranche is lower than OPG’s forecast for that tranche, OPG earns an incentive; if the actual interest rate is higher, there is a penalty. Both the incentive and penalty are capped.[9]

OPG forecasts that the base fee for this period will be approximately $2.75 million, and that the incentive fee will be plus or minus $2.25 million, for a total fee of around $0.5 million to $5 million.[10]

Under subsection 10.6(1), the OEB’s role in reviewing the fee for this period is limited:

> 10.6 (1) The Board may,
>
> (a) approve the fee proposed under section 10.5; or
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> (b) refuse to approve the fee if the Board is of the view that any forecast interest rate used for the purposes of paragraph 1 of subsection 10.5 (2) is materially inconsistent with market comparable forecast interest rates.

Pursuant to this section, the only reason to deny an application is if OPG’s forecast interest rate, which is an input in the formula to determine the incentive fee, is materially inconsistent with market comparable forecast interest rates.[11]

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[8] Regulation, para. 10.5(2)5.
[9] Regulation, paras. 10.5(2)1 to 4.
[10] The actual amounts may vary from the forecast, depending on the actual amount of debt incurred, the timing of the tranches, and in the case of the incentive fee component, the actual interest rates. Under the Regulation, the OEB is not required to approve the actual amount of the fee (either as a dollar amount or a rate); rather, as described below, the OEB’s role is limited to approving OPG’s forecast interest rates, which then form an input into the calculation of the fee by OPG.
[11] The term “market comparable forecast interest rates” is defined in subsection 1(1) of the Regulation as follows:

OPG proposes that the OEB approve the following forecast interest rates, to be used as inputs in the formula for calculating the incentive fee:

10-year term	15-year term	20-year term	30-year term
3.53%	3.70%	3.94%	4.05%

OPG explains that these forecasts were derived from: (i) a forecast of long-term Government of Canada bond rates; (ii) a forecast risk premium for Government of Ontario long-term bonds; and (iii) an additional risk premium for the Fair Hydro Trust. For example, the 3.53% forecast for the Fair Hydro Trust 10-year financings is equal to OPG's forecast for Canada bonds of the same duration (2.46%), plus a premium for Ontario bonds (0.88%) and an incremental premium for the Trust (0.19%).

OPG states that "[b]onds with the characteristics that the [Fair Hydro] Trust is offering have never been issued in the Canadian markets."[12] Nevertheless, in order to demonstrate that the forecast interest rate for the Trust is not materially inconsistent with market comparable forecast rates, OPG compared the debt to be issued by the Trust to two other "market comparable" securities: Ontario Government bonds and Hydro One bonds. OPG provided evidence to show that the risk premium for the Trust is higher than for Ontario but lower than for Hydro One.

The OEB is satisfied that OPG's interest rate forecasts are reasonable as inputs into the incentive formula. For the purposes of this first application, OPG's evidence is sufficient to show that the forecast is in line with market comparable forecast rates.

In subsequent applications, OPG is to provide forecast interest rates for each of the planned tranches to be issued during the approval period. In addition, OPG is directed to include more market comparisons, such as comparisons to debt issued by other provinces or low-risk industrial issuers.

"market comparable forecast interest rates" means, in relation to a funding tranche, interest rates for a debt obligation that,
(a) has a principal amount that is comparable to the principal amount of the funding tranche,
(b) has a term that is comparable to the term of the funding tranche,
(c) is based on a type of instrument that is comparable to the type of instrument of the funding tranche
(d) has payment rights that are similar to the payment rights of the funding tranche, and
(e) is issued by an issuer with a risk profile comparable to the risk profile of the financing entity issuing the funding tranche.

[12] EB-2017-0375, Supplemental Evidence, p. 6.

3.2 The fee for June 1, 2017 to December 31, 2017 (EB-2018-0102)

The methodology for setting out the fee for this period – and this period alone – is set out in section 10.2 of the Regulation. This stipulates that the fee is the sum of (1) $3.1 million, reflecting the amount of return payable on services provided by the Financial Services Manager during the period, and (2) the amount of any costs and expenditures incurred and paid by the Financial Services Manager during the period.

The first element of the equation – the $3.1 million – is specified in the Regulation and the OEB must approve it if (1) any financing entities were established during the period, and (2) any funding obligations were incurred during the period or work was substantially completed during the period in order for funding obligations to be incurred afterwards.[13] The OEB is satisfied that those conditions are met, and therefore the $3.1 million component of the fee is approved.

The application requests recovery of $2,633,684.11 for the second element of the equation, the Financial Services Manager's actual costs incurred and paid during the period. Even here, the OEB's discretion is constrained. The OEB can only refuse a portion of the proposed amount of $2,633,684.11 if the OEB finds that the cost or expenditure was not actually incurred during the period in relation to prescribed matters (that is, in relation to the Financial Services Manager's legislative mandate), or that the cost or expenditure was not actually paid during the period.

The types of costs and expenditures eligible for recovery through the second element of the fee include fees paid by the Financial Services Manager for underwriter, banking and legal services, as well as the direct costs for OPG employees who work exclusively on the Fair Hydro Trust.[14] As required by the Regulation,[15] OPG included with its application an auditor's report confirming that the costs and expenditures claimed by OPG are accurate, that they were incurred by OPG, and that (except for the costs of OPG employees), the claimed amounts were paid to third parties.

The report, by Ernst & Young LLP, the Fair Hydro Trust's external auditor (audit report), notes one "exception" that is of concern to the OEB.[16] The audit report identified one cheque in the amount of $57,692.87 that was not issued by the Fair Hydro Trust until

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[13] Regulation, s. 10.3(2).
[14] Regulation, s. 10.2(3).
[15] Regulation, s. 10.2(4).
[16] There are a few other minor exceptions noted in the Report which the OEB is satisfied do not impact OPG's calculation of the proposed fee.

January 2, 2018, which was two calendar days (one business day) after the end of the period.[17] OPG urges the OEB to approve recovery for the cheque, as the delay was "immaterial". The OEB finds that materiality is not a factor for the OEB's consideration. The Regulation is prescriptive and leaves the OEB with no discretion to approve out-of-period expenditures. Accordingly, the OEB does not approve the amount of the cheque.

In summary, the approved fee for the June 1, 2017 to December 31, 2017 period is $5,675,991.24, a reduction of $57,692.87 from the $5,733,684.11 proposed by OPG.

In support of its application, OPG filed a transfer notice from the IESO to the Fair Hydro Trust, which included the IESO's banking information. OPG requested that the banking information be treated confidentially. The OEB grants the request. Only the redacted version of the transfer notice will be available to the public.

[17] The cheque was made out in US dollars; $57,692.87 is the Canadian dollar equivalent. In response to an inquiry from OEB staff, OPG confirmed that the amount of C$57,692.87 is included in the second element of the proposed fee (the $2,633,684.11).

4 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. For the period from January 1, 2018 to March 31, 2019, OPG shall establish and charge a fee under subsection 19(3) of the *Ontario Fair Hydro Plan Act, 2017* calculated using the approved forecast interest rates:

10-year term	15-year term	20-year term	30-year term
3.53%	3.70%	3.94%	4.05%

2. For the period from June 1, 2017 to December 31, 2017, OPG shall establish and charge a fee under subsection 19(3) of the *Ontario Fair Hydro Plan Act, 2017* of $5,675,991.24.

3. OPG's request for confidential treatment of the IESO's banking information is granted.

DATED at Toronto July 5, 2018

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary