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**BY EMAIL**

February 5, 2019

Kirsten Walli  
Board Secretary  
Ontario Energy Board  
P.O. Box 2319  
2300 Yonge Street, 27<sup>th</sup> Floor  
Toronto ON M4P 1E4

Dear Ms. Walli:

**Re: Ontario Power Generation Inc.  
Application for 2019 Hydroelectric Payment Amount Adjustment and  
Clearance of Deferral and Variance Account Balances  
OEB File Number EB-2018-0243**

In accordance with Procedural Order No. 1, please find attached OEB staff's submission on the filed settlement proposal for Ontario Power Generation Inc.'s above noted application. This document is being forwarded to Ontario Power Generation Inc. and to all registered parties to this proceeding.

Yours truly,

*Original signed by*

Georgette Vlahos  
Advisor, Incentive Rate-setting & Accounting

Attachment

**ONTARIO POWER GENERATION INC.  
APPLICATION FOR 2019 HYDROELECTRIC  
PAYMENT AMOUNT ADJUSTMENT AND  
CLEARANCE OF DEFERRAL AND VARIANCE  
ACCOUNT BALANCES**

**EB-2018-0243**

**Ontario Energy Board  
Staff Submission – Settlement Proposal  
February 5, 2019**

## Introduction

On January 30, 2019<sup>1</sup>, Ontario Power Generation Inc. (OPG) filed a settlement proposal with respect to its application for an order or orders related to deferral and variance accounts, including disposition of account balances as at December 31, 2017.<sup>2</sup> OPG also provided a draft Payment Amounts Order for the OEB's consideration.

The settlement proposal represents a full settlement and is proposed by OPG and the intervenors who participated in the settlement discussions (collectively, the Parties).

OEB staff typically files a submission on settlement proposals commenting on “whether the settlement proposal represents an acceptable outcome from a public interest perspective, and whether the accompanying explanation and rationale is adequate to support the settlement proposal.”<sup>3</sup> This submission reflects observations which arise from OEB staff's review of the evidence and the settlement proposal, and is intended to assist the OEB in deciding upon OPG's application with respect to the issues laid out in the settlement proposal and in setting just and reasonable payment amounts.

## Customer Impacts

OPG calculates that the incremental year-over-year impact on typical residential customers' bills resulting from the agreed upon payment riders is estimated to be 0.7% (\$0.75/month) in 2019, 0.0% (\$0.05/month) in 2020, and 0.9% (\$0.97/month) in 2021.

OEB staff submits that the OEB's approval of the settlement proposal as filed represents an acceptable outcome from a public interest perspective. Based on the payment amounts and payment riders approved and still in effect from OPG's last cost based application<sup>4</sup>, and the payment riders as calculated in this settlement, OEB staff submits that a relatively smooth trend in weighted average payment amounts has been achieved for the period 2019 to 2021.<sup>5</sup>

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<sup>1</sup> On January 29, 2019, OPG filed a request for an extension to file the Settlement Proposal to January 31, 2019. The OEB accepted this request on January 30, 2019.

<sup>2</sup> The OEB issued its decision on OPG's 2019 hydroelectric payment amount adjustment on December 13, 2018, and therefore the settlement proposal represents the parties' proposal with respect to OPG's deferral and variance accounts only.

<sup>3</sup> Practice Direction on Settlement Conferences, October 28, 2016, Page 7.

<sup>4</sup> EB-2016-0152.

<sup>5</sup> EB-2018-0243, Settlement Proposal, Exhibit M1, Attachment A, Table 5.

## Rationale to Support Settlement Proposal

The OEB's decision on the issues list for this proceeding set out four issues for this application.<sup>6</sup> OEB staff provides its submission by issue below to provide background and context for the OEB's consideration. For the purposes of this submission, OEB staff's submission on issues 1 and 2 are combined given their interrelated nature.

### **Issue 1 - Are the amounts recorded in the applicable deferral and variance accounts appropriate? And, Issue 2 - Are the balances for recovery in each of the deferral and variance accounts appropriate?**

OEB staff agrees with Parties and accepts the balances as at December 31, 2017 for all accounts proposed for disposition. OPG has provided continuity schedules showing the starting point for all accounts (i.e. year-end 2015) and provided sufficient explanations relating to the applicable transactions in 2016 and 2017 to determine the appropriate balances as at December 31, 2017.

The amount to be recovered from the Hydroelectric Surplus Baseload Generation (SBG) Variance Account is a debit amount of \$278 million. The Parties have agreed that OPG is to:

Prepare a forward looking study to assess OPG's management of its generating facilities in relation to surplus baseload generation conditions, including any opportunities OPG can take to help the system respond to surplus baseload generation conditions in order to mitigate the associated cost to customers. In preparing the study, OPG will consult with the IESO and take into consideration IESO forecasts. Such study will be filed as part of OPG's next rebasing application.<sup>7</sup>

OEB staff submits that this reporting provision will assist the OEB with future review of SBG and OEB staff supports the proposal.

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<sup>6</sup> EB-2018-0243, Decision on Issues List, January 7, 2019, Schedule A.

<sup>7</sup> EB-2018-0243, Settlement Proposal, Exhibit M, Tab 1, Schedule 1, Page 15.

### Issue 3 - Are the proposed rate riders and disposition periods for the account balances appropriate?

The settlement proposal between Parties accepts OPG's proposed disposition periods for its deferral and variance accounts as documented in its original application<sup>8</sup>, with the exception of the disposition period of its Pension & OPEB Cash versus Accrual Differential Deferral Account (Interim Account). The Parties have agreed that this account will be recovered over a 72-month period on a straight line basis, instead of the 96-month period that was originally proposed. The recovery of this account is further discussed below.

As part of the settlement proposal, the Parties agreed that the recovery of the portion of the December 31, 2017 balance in the Interim Account related to registered pension plan costs, and the income tax impacts associated with the recovery of this portion of the account balance, will be deferred to OPG's next cost based application (Deferred Pension Amount). The Deferred Pension Amount, including the related tax impacts, totals \$55.1 million for the regulated hydroelectric facilities and \$354.6 million for the nuclear facilities. See table below.

(\$millions)	Pension	OPEB	Total
<b>Nuclear</b>	354.6	352.7	707.3
<b>Hydroelectric</b>	55.1	55.9	111.0
<b>Total</b>	409.7	408.6	818.3

Note: all amounts include related tax impacts

Parties agree that the remaining portion of the December 31, 2017 balance in the Interim Account, which relates to OPEB costs, and the income tax impacts associated with the recovery of this portion of the account balance of \$408.6 million, will be disposed over a 72-month period on a straight line basis, effective January 1, 2019. Given the Deferred Pension Amount described above, the Parties agree that a 72-month recovery period appropriately balances OPG's cash flow needs with consumer impacts. It is for this reason that OEB staff also supports a 72-month recovery period.

<sup>8</sup> OPG's original application proposed to clear the majority of its account balances over a three-year period, with the following exceptions: the Interim Account, including associated tax impacts, and the Bruce Lease Net Revenues Variance Account – Non-Derivative Sub-Account - eight-year recovery period for both accounts; the Pension and OPEB Cost Variance Account (Future Recovery) - six-year recovery period; the Pension and OPEB Cost Variance Account (Post 2012 Additions) – two and a half year recovery period.

## Is the Agreement to Dispose of Only a Portion of the Interim Account Balance Appropriate?

OEB staff has no concern with the settlement reached by the Parties in relation to the above. The OEB's *Report on the Regulatory Treatment of Pension and OPEB Costs*<sup>9</sup> (OEB Report) does not address the manner in which the Interim Account should be disposed. OEB staff supports the proposal to defer disposition of the pension cost portion of the Interim Account balance as at December 31, 2017, plus related tax impacts. OEB staff submits that the approach agreed to by the Parties supports just and reasonable payment amount riders and minimizes the potential for any future rate volatility (i.e. having ratepayers overpay today only to have a portion their current payments returned back to them the next time the Interim Account is disposed).

OPG's current rates up to December 31, 2021 are set based on the cash amounts for its pension and OPEB costs, as was ordered by the OEB in its previous rate applications.<sup>10</sup> As a result, OPG will be required to continue to track the variance between the cash and accrual amounts for its pension and OPEB costs in the Interim Account until at least its next rebasing application (for the 2022 payment amount year). By electing to defer disposition of the pension portion of the Interim Account balance as of December 31, 2017, it will allow for the natural drawdown (offset) of that amount in the coming years based on the currently forecast cash versus accrual differential for the period 2018-2021. The natural drawdown occurs by virtue of the fact that the cash contributions to the pension fund are projected to exceed the accrual accounting expense by a cumulative \$157 million over the 2018–2021 period.<sup>11</sup> Therefore, by December 31, 2021 the pension cost component of the Interim Account is expected to be reduced from the \$307 million as at December 31, 2017<sup>12</sup>, to approximately \$150 million by December 31, 2021.<sup>13</sup>

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<sup>9</sup> EB-2015-0040, Report of the Ontario Energy Board on the Regulatory Treatment of Pension and Other Post-Employment Benefit (OPEB) Costs, September 14, 2017.

<sup>10</sup> OPG was ordered to recover its pension and OPEB costs on a cash basis in EB-2013-03214, and continued in EB-2016-0152, pending the outcome of the OEB's generic consultation on the regulatory treatment of pension and OEB costs.

<sup>11</sup> EB-2018-0243, JT 1.1, Chart 1 – sum of (in millions): 2018: \$72.1 + 2019: (\$49.6) + 2020: (\$82.1) + 2021: (\$97.4) = (\$157).

<sup>12</sup> EB-2018-0243, JT 1.7.

<sup>13</sup> The \$150 million at December 31, 2021 is calculated as follows: Pension portion of Interim Account as per JT 1.7 is \$307.3, less the annual variance between cash and accrual for the period 2018 – 2021, as calculated in footnote 11 above of (\$157). Therefore \$307.3 - \$157 = \$150.3.

**Issue 4 - Does OPG's treatment of pension and OPEB costs appropriately reflect the OEB's Decision in EB-2013-0321 and OEB policy as set out in the Report of the Ontario Energy Board: Regulatory Treatment of Pension and Other Post-employment Benefits (OPEBs) Costs, issued in the generic proceeding EB-2015-0040?**

Is it Appropriate to Dispose of the Interim Account at this Time?

The OEB Report states the following with respect to a utility that seeks disposition of its Interim Account balance:

Utilities will be expected to dispose of the account(s) at their next cost-based rates application if the OEB approves the accrual method to recover pension and OPEB costs in rates. However, a utility may request alternate timing for its transition to accrual, and disposition of the accounts, if it provides sufficiently compelling reasons, in its next rate application.

The affected utilities may have to consider mitigation measures if the net impact on ratepayers from the disposition of these accounts is significant. Presuming that the OEB orders that these utilities will recover costs for that interim period based on the accrual method, they will be required to credit to ratepayers the carrying charges on the balance on a prospective basis.<sup>14</sup>

Although OPG is requesting disposition of its Interim Account prior to its next rebasing application, it had requested and received OEB approval to do so as part of the OEB decision on OPG's payment amounts for the period from January 1, 2017 to December 31, 2021.<sup>15</sup>

OPG states that its request to dispose of its Interim Account balance in advance of its next rebasing application is due to certain restrictions that US GAAP places on the Interim Account balance. In particular, US GAAP requires that the recovery of a regulatory asset such as OPG's Interim Account must commence within five years of the date that the amounts were initially recognized in the account. Failure to meet this requirement may result in the balance being written-off for accounting purposes. OPG

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<sup>14</sup> EB-2015-0040, Report of the Ontario Energy Board on the Regulatory Treatment of Pension and Other Post-Employment Benefit (OPEB) Costs, September 14, 2017, Page 11.

<sup>15</sup> EB-2016-0152, Decision and Order, Page 160.

had argued that the amounts added to its Interim Account in November 2014 would reach the threshold by November 2019 and therefore may be at risk of being written-off if it waited until its next rebasing application to commence disposition.

OEB staff makes no comments on the US GAAP standard but does confirm that it has no concerns with OPG requesting disposition of the Interim Account in this proceeding as the OEB has already allowed for that in OPG's most recent payment amounts proceeding.

In the context of considering the subject balances, the Parties have agreed that the accrual method is the appropriate regulatory accounting and recovery basis. Parties reached this agreement on the basis of the findings in the OEB's Report and consistency with past OPG proceedings.<sup>16</sup> OPG's proposed use of the accrual method is addressed in more detail in the next section of OEB staff's submission.

#### Is the Accrual Method Appropriate?

Parties accept that the accrual method is the appropriate regulatory accounting and recovery basis for pensions and OPEB costs for purposes of the subject balances consistent with the OEB's Report in EB-2015-0040.

The OEB Report prescribes the use of the accrual method as the default method to recover pension and OPEB amounts for regulatory purposes, unless that method does not result in just and reasonable rates.<sup>17</sup> OPG supported its position by stating that the accrual method recognizes the costs of these benefits in the payment amounts in the period that they are being earned by the employees. This results in the appropriate matching of costs and benefits and thereby ensures intergenerational equity. As part of its responses to OEB staff interrogatories, OPG listed several other benefits to using the accrual method, including alignment between regulatory reporting and financial reporting, avoidance of complex issues arising from transitioning away from the accrual basis of recovery, and that it promotes transparency and provides appropriate price signals to encourage efficient consumption.<sup>18</sup>

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<sup>16</sup> EB-2018-0243, Settlement Proposal, Exhibit M, Tab 1, Schedule 1, Page 13

<sup>17</sup> EB-2015-0040, Report of the Ontario Energy Board on the Regulatory Treatment of Pension and Other Post-employment Benefit (OPEB) Costs, Page 8.

<sup>18</sup> EB-2018-0243, Exhibit L, H-Staff-8.



In OEB staff's view, in order to assess the reasonability of applying the accrual method to the historical balances, a review of OPG's forecast differential between cash and accrual for its pension and OPEB costs may be helpful.

To that end, OEB staff notes that as part of the OEB's decision on OPG's 2014-2015 Payment Amounts application<sup>19</sup>, the OEB directed the use of the cash basis of recovery starting in 2014. The OEB was concerned that OPG was collecting money on an accrual basis from ratepayers that was in excess of its pension and OPEB cash requirements, when OPG's use of these excess funds was not understood, and the benefit to ratepayers was uncertain.<sup>20</sup> OEB staff submits that since then, the differential between an accrual versus cash based recovery has narrowed significantly and is expected to eventually crossover (where the cash basis will exceed the accrual basis).

As per the below table, the pension and OPEB cash versus accrual variance forecast prepared by OPG<sup>21</sup> shows that starting in 2020, OPG expects that on an aggregate basis, its pension and OPEB cash requirements will exceed accrual, and further expects that this trend will persist into the future. This, in combination with the OEB Report issued subsequent to the 2014-2015 OPG proceeding which protects ratepayers in years where the accrual amount set in rates exceeds actual cash payments made by the utility (discussed further below), adequately address in OEB staff's view the initial concerns raised by the OEB in the 2014-2015 Payment Amounts proceeding.

	2018	2019	2020	2021	2022	2023	2024
\$millions	Projection	Projection	Projection	Projection	Projection	Projection	Projection
<b>Pension</b>	72.1	-49.6	-82.1	-97.4	-119.3	-139.6	-139.5
<b>OPEB</b>	93.6	75.4	75.9	77.3	80.0	81.9	85.1
<b>Total</b>	165.6	25.8	-6.2	-20.1	-39.3	-57.7	-54.4

Note: A positive number within the above table denotes that accrual exceeds cash

OEB staff takes this position without prejudice to its position on future OPG payment amount applications given that this current proceeding is not a cost based payment amounts application.

<sup>19</sup> EB-2013-0321.

<sup>20</sup> EB-2013-0321, Decision with Reasons, Page 88

<sup>21</sup> EB-2018-0243, H-Staff-12, and updated in JT 1.1.

## Is the Regulatory Treatment of the Recoveries from the Interim Account Consistent with the OEB Report?

In relation to the Interim Account, OPG's original application sought that amounts recorded in this account as of December 31, 2017 should not be captured in the new Pension & OPEB Forecast Accrual Versus Actual Cash Payment Differential Variance Account (the new Tracking Account) established by the OEB Report<sup>22</sup> and therefore would not be subject to the carrying charges prescribed in the OEB Report. OPG argued that its proposal to exclude these amounts from the new Tracking Account would ensure that it receives the same effective treatment as other Ontario utilities.

As part of the settlement, the Parties agree that as the amounts from the Interim Account are collected from ratepayers, they will become subject to the OEB's new Tracking Account and will therefore be assessed asymmetric carrying charges in favour of ratepayers on a prospective basis from the time of collection. OEB staff submits that the settlement reached on this matter is consistent with the requirements of the OEB Report and therefore OEB staff has no issue with this proposal.

OEB staff also notes that in OPG's response to OEB staff interrogatory H-Staff-11, OPG confirmed that amounts that will be recorded in the Interim Account related to the next variance period (2018-2021) will be subject to the new Tracking Account if and when those amounts are recovered from ratepayers. Therefore these amounts will be subject to the OEB's asymmetric carrying charges policy, as applicable.

All of which is respectfully submitted

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<sup>22</sup> Established in the OEB's September 2017 *Report on Regulatory Treatment of Pension and OPEB Costs* which came out of the OEB's generic consultation on pensions & OPEBs (EB-2015-0040). This account tracks the difference between the amounts in recovered rates (on an accrual basis) and the actual cash payments made by utilities (employer contributions to the pension plan and expenditures paid out to OPEB plan beneficiaries) for all utilities recovering pension and OPEB amounts on an accrual basis, effective January 1, 2018. This account is used to calculate a carrying charge to be credited to customers on the cumulative cash-to-accrual difference. Only the carrying charges applied to the account are subject to disposition.