Board Staff Interrogatory #8

Interrogatory

Reference:
Exhibit A1 / Tab 3 / Schedule 2 / p. 13
Exhibit I1 / Tab 1 / Schedule 1 / p. 2

Preamble:

OPG proposed to continue its existing off-ramp provision (+/- 300 basis points deadband for determining whether a regulatory review should be initiated) in the 2022-2026 Custom IR term.

OPG achieved earnings in excess of the OEB-approved return on equity (ROE) in 2019 and forecasts that it will do so again in 2020 and 2021.

Question(s):

a) Please provide OPG's views on the inclusion of an asymmetrical earnings sharing mechanism (ESM) for the 2022-2026 Custom IR term.

b) Please discuss whether it is possible to apply the ESM only to earnings generated by the nuclear business or could only be applied for earnings generated by the entire regulated business (both hydroelectric and nuclear).

c) Please provide OPG's views on an ESM structure whereby: (a) the first 100 basis points of earnings in excess of the OEB-approved ROE is to the benefit of OPG's shareholder; (b) earnings between 100-200 basis points above the OEB-approved ROE are shared 50:50 with ratepayers; and (c) earnings in excess of 300 basis points above the OEB-approved ROE are shared 90:10 to the benefit of ratepayers.

Response

a) and c)

While OPG does not believe that an ESM is necessary, if an ESM were established for the IR Term, OPG's view is that it should operate on a symmetrical basis to reflect the risk associated with OPG's regulated assets. OPG's earnings are prone to significant variations year-over-year due to the volumetric nature of its payment amounts and variable production. As demonstrated in Chart 1, over the 2008 to 2019 period, OPG's actual ROE has ranged from approximately 900 basis points

below the +/-300 basis points deadband to approximately 300 basis points above it.[1]

Chart 1

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Actual	(3.11)%	1.10%	4.71%	4.80%	4.73%	0.46%	6.32%	3.63%	3.80%	6.02%	10.72%	15.72%	17.12%
OEB-Approved	8.65%	8.65%	8.65%	9.43%	9.55%	9.55%	9.36%	9.30%	9.30%	9.16%	9.16%	9.16%	9.06%

Average (2008-2020)
5.83%

Average (2017-2020)
12.33%

On average, OPG has performed below the bottom end of the deadband, with lower earnings being only partially offset by higher earnings in other years. An asymmetrical ESM could increase OPG's overall exposure to production-related risks, potentially substantially.

Further, it is OPG's view that that the division of benefits under an ESM should not unduly diminish the incentive for a utility to continue driving continuous improvement over the period.

Accordingly, OPG believes that, if an ESM were established, it should reflect the volatility in OPG's earnings by sharing risk of both over- and under-earning and reflect a division of benefits that incents continuous performance.

b) As stated in EB-2016-0152, Ex. L-1.2-5 CCC-006, OPG operates as a single company, with a single management structure, a single corporate cost structure, and a single OEB-authorized cost of capital that covers both the hydroelectric and nuclear generating facilities. OPG obtains corporate financing as a single company. Accordingly, OPG reports achieved return on equity for the prescribed facilities as a whole. For these reasons, OPG believes that it would be appropriate for any earnings sharing to be done on the same total regulated company basis, rather than on a nuclear only basis. To do otherwise, while mathematically possible, would be inconsistent with the basis on which payment amounts are set and therefore would not meaningfully compare the financial performance of OPG's regulated business relative to the OEB-approved ROE.

OPG understands that the reference to "earnings between 100-200 basis points above the OEB-approved ROE" in the question is intended to read "earnings between 100-300 basis points above the OEB-approved ROE."

[1] Ex. L-H1-01-AMPCO-178, Attachment 1, Chart 1.