Ontario Energy Board | Commission de l'énergie de l'Ontario

**BY EMAIL**

May 19, 2023

Ms. Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4
Registrar@oeb.ca

Dear Ms. Marconi:

**Re: Ontario Energy Board (OEB) Staff Submission**
**Ontario Power Generation Inc.**
**Request for an Accounting Order Establishing a Variance Account to Capture the Nuclear Revenue Requirement Impact of the Overturning of Bill 124**
**OEB File Number: EB-2023-0098**

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Please find attached OEB staff's submission in the above referenced proceeding, pursuant to Procedural Order No. 1.

Yours truly,

Vithooshan Ganesanathan
Digitally signed by Vithooshan Ganesanathan
Date: 2023.05.25 13:34:33 -04'00'

Vithooshan Ganesanathan

Advisor, Generation & Transmission

Encl.

cc: All parties in EB-2023-0098

# ONTARIO ENERGY BOARD

## OEB Staff Submission

**Ontario Power Generation Inc.**

**Request for an Accounting Order Establishing a Variance Account**

**To Capture the Nuclear Revenue Requirement Impact**

**of the Overturning of Bill 124**

**EB-2023-0098**

**May 19, 2023**

## Application Summary

Ontario Power Generation Inc. (OPG) applied to the Ontario Energy Board (OEB) on March 1, 2023 for approval to establish a variance account to record the nuclear revenue requirement impacts resulting from the overturning of Bill 124[1] by the Ontario Superior Court.

Bill 124 set a 1% limit on annual wage and total compensation increases for the Ontario public sector, including OPG, for a three-year moderation period, effective November 8, 2019. The limits on compensation set out in Bill 124 were the basis of the forecast compensation costs reflected in OPG's approved revenue requirements for the 2022-2026 period.[2]

The Ontario Superior Court overturned Bill 124 on November 29, 2022 and declared it to be "void and of no effect". OPG's affected unions have indicated that they will seek enhanced wages for the periods that their members' compensation has or would have been restrained due to Bill 124.

OPG has proposed that a new variance account be approved to record the impact on the nuclear revenue requirement of the overturning of Bill 124, effective March 1, 2023 until the effective date of the OEB's next nuclear payment amounts order. The proposed variance account would record the difference between the forecast compensation costs included in OPG's last nuclear payment amounts order and the compensation costs for the nuclear facilities resulting from the overturning of Bill 124.

OPG also requested that the OEB issue an interim order effective March 1, 2023, approving the establishment of the requested variance account on an interim basis. On March 22, 2023, the OEB approved the establishment of the new variance account on an interim basis effective March 1, 2023.

OPG expects that information supporting the balance in the proposed account (if approved), as well as the timing and manner of its disposition, would be reviewed in a future OPG application.

## OEB Staff Submission

### *Overview*

OEB staff submits that the OEB should not approve OPG's request to establish a new variance account to record the nuclear revenue requirement impacts resulting from the overturning of Bill 124.

[1] *Protecting a Sustainable Public Sector for Future Generations Act, 2019*
[2] EB-2020-0290

OEB staff submits that the compensation costs affected by the overturning of Bill 124 are an element of business risk that OPG should and can manage. In addition, the overturning of Bill 124 cannot be considered unforeseen (or unforeseeable), and the proposed account does not meet all of the criteria traditionally used by the OEB to consider the creation of new deferral and variance accounts. A new deferral account is not appropriate or necessary. Instead, OPG should be expected to manage the impacts of the overturning of Bill 124 within the envelope of OPG's approved revenue requirements during the current custom incentive ratemaking term (2022-2026).

If the OEB decides to approve OPG's request to establish a new variance account, OEB staff recommends that the account should only be permitted to record revenue requirement impacts on and after the effective date of the final order in this proceeding. No amounts accrued in respect of a period before this time, including any "catch-up" payments, should be eligible for the account.

### *Analysis*

As a starting point, it should be noted that unless legislated, deferral and variance accounts that are created during the term of an approved rate framework are an unusual remedy that should be reserved for circumstances where a cost could not reasonably have been foreseen at the time the rate framework was approved. Utilities are expected to manage their costs throughout the term of the rate framework and should not expect to have access to "true ups" (for example through a deferral or variance account) every time a cost is higher than what was forecast. Variances from forecast costs are part of business risk, for which the utility is compensated through its return on equity. In addition, to allow for routine access to new deferral and variance accounts would be inefficient (in that where the cost was foreseeable, it could have been addressed in the proceeding establishing the rate term) and detract from rate certainty.

OPG's current rate framework, which covers the period 2022-2026, was established through the OEB's decision and order in OPG's 2022-2026 (the Custom IR Proceeding). Many of the components of the rate framework were agreed to by the parties through a Settlement Proposal that was accepted by the OEB and approved through the decision and order.

The Settlement Proposal itself does not specifically address the treatment of "unforeseen events". Under the heading "Rate Framework", it states that "[t]he Parties agree to the application of OPG's proposed rate framework for the IR term from 2022 to 2026", subject to certain modifications.[3] None of the modifications listed in the Settlement Proposal relate to unforeseen events. In its 2022-2026 custom IR

[3] EB-2020-0290, Settlement Proposal, p. 17.

application, OPG's proposed treatment of unforeseen events was as follows:

> OPG proposes that unforeseen events affecting the nuclear business continue to be addressed through an accounting order process, subject to the $10M regulatory materiality threshold that has historically applied to OPG and which was accepted for this purpose in the EB-2016-0152 Decision. The approach is consistent with the accounting order application requirements currently in place for accounting changes impacting the calculation of OPG's nuclear liabilities and changes in depreciation end-of-life dates for the prescribed nuclear facilities. OPG's most recent accounting order application pursuant to these requirements was filed, and approved by the OEB, in EB-2018-0002.[4]

Although OPG's proposal relating to unforeseen events (which appears to have been adopted in the Settlement Proposal) establishes a materiality threshold of $10 million, it is otherwise silent on the test the OEB should employ when considering an accounting order application (i.e., a deferral or variance account) related to unforeseen events. The only specific criteria identified in the application was that the event must be "unforeseen".

The "accounting order proceeding" referenced in the quote above[5] was an application for a deferral account to capture the revenue requirement impact of OPG's prescribed nuclear facilities resulting from changes in station end-of life dates, in particular a decision to extend the life of the Pickering nuclear facilities (which had not been accounted for in OPG's then current rate framework established through the decision and order in OPG's 2017-2021 payment amounts proceeding[6]). In that case the OEB considered the request through the criteria from the Filing Requirements for Electricity Distribution Rate Applications: causation, materiality, and prudence. It should be noted, however, that the decision and order in OPG's 2017-2021 payment amounts proceeding required OPG to apply for a deferral account in the event Pickering's operations were extended, and that the result of the extended operations was a credit to ratepayers.

OEB staff submits that the new deferral account proposed by OPG does not relate to an "unforeseen" event, nor does it meet all of the OEB's criteria for new deferral and variance accounts.[7] In particular, OEB staff argues that the costs were both foreseeable, and that they do not fully meet the materiality criteria. OEB staff further submits that the proposed account may not meet the causation and prudence criteria.

*Foreseeability*

OEB staff submits that a potentially successful legal challenge to Bill 124 was foreseen, or at least clearly foreseeable, prior to the filing of OPG's 2022-2026 custom IR

[4] OPG's application in EB-2020-0290, Exhibit A1, Tab 3, Schedule 2, p. 13.
[5] EB-2018-0002
[6] EB-2016-0152
[7] OEB Filing Requirements for Electricity Distribution Rate Applications, December 15, 2022

application. That application was filed with the OEB in on December 31, 2020. The first legal challenge to Bill 124 was filed on February 11, 2020, more than 10 months earlier.[8] Legal challenges were filed by the Power Workers' Union (PWU) and the Society of United Professionals (SUP) – the unions whose increased compensation is proposed to go into the new variance account – on November 24, 2020, more than a month before the application was filed.[9]

Even to the extent that OPG remained unaware that its unions had filed legal challenges to the bill that underpinned their compensation related revenue requirement proposal, the decision and order in OPG's 2022-2026 Custom IR Proceeding was not issued until November 15, 2021 – some 21 months after the initial challenge was filed and almost a year after the filing of challenges from their own unions. Under these circumstances, OPG cannot legitimately claim that the risk to its forecast compensation expenses (which were based on the maximum increases mandated through Bill 124) was unforeseen, or unforeseeable with due diligence. This alone should be ample reason for the OEB to reject the request for a variance account.

It should also be noted that OPG's collective agreement with SUP, which covered the period December 2021 to December 2023 included a "reopener" provision in the event that Bill 124 was overturned. It was therefore clearly contemplated at least as early as December 2021 that Bill 124 could be overturned, and that if that were to happen at minimum the SUP's collective agreement would be subject to renegotiation. It is not known when OPG first learned that SUP would be seeking a reopener provision. In its response to OEB staff IR 5 stated that it learned the reopener provision would be included in the SUP's collective agreement November 19, 2021 (which is four days after the 2022-2026 Custom IR decision was issued). It seems very unlikely, however, that this was when OPG became aware that SUP would be seeking such a provision. In any event, the possibility that Bill 124 would be overturned was clearly foreseeable during the course of the 2022-2026 Custom IR Proceeding, and indeed accounted for in one of OPG's collective agreements in December 2021 (more than two years prior to the application for the variance account).

*Causation*

Under the "causation" criteria the OEB requires that, in order to establish an account, the forecasted expense must be clearly outside of the base upon which rates were derived. OPG states that the cost impacts resulting from the overturning of Bill 124 "will result in a nuclear revenue requirement impact that is not reflected in the payment amounts established by the EB-2020-0290 Payment Amounts Order".[10] OPG explains that the impacts arise "from a change in a law and could not have formed a part of the approved revenue requirement as OPG was obliged to abide by applicable laws and

[8] EB-2023-0098, Exhibit L, OPG response to VECC interrogatory 2
[9] EB-2023-0098, OPG reply to SEC Request for Further IR Responses, May 12, 2023
[10] EB-2023-0098, OPG Application, p. 11

had no knowledge of the outcome of the Bill 124 Decision at the time of the payment amounts application".[11]

OEB staff submits that the causation criteria is related to the foreseeability criteria. As noted above, OEB staff submits that the overturning of Bill 124 was foreseeable and that the request for a variance account should be denied on that basis. However, OEB staff agrees that costs related to the overturning of Bill 124 would be incremental to the compensation amounts currently embedded in OPG's payment amounts.

*Materiality*

The OEB also requires that, in order to establish an account, the forecasted amounts must both exceed the OEB-defined materiality threshold and have a significant influence on the operation of the utility. OPG states that the forecast amounts "will result in an annualized nuclear revenue requirement impact that is expected to be higher than the $10M materiality threshold".[12] OEB staff submits that, although the estimated costs related to the overturning of Bill 124 may exceed OPG's materiality threshold of $10 million per year, they will not have a significant influence on the operation of OPG.

For example, OPG has estimated impacts between $14 million and $48 million per year between 2022 and 2026 with respect to PWU-represented employees, totaling approximately $130 million cumulatively.[13] In comparison, OPG's approved revenue requirement for the same 2022-2026 period ranges between $2.6 billion and $3.6 billion per year, totaling approximately $16.7 billion cumulatively.[14] In other words, estimated impacts of the overturning of Bill 124 with respect to PWU-represented employees will be less than 1% of OPG's approved revenue requirement over the current custom incentive ratemaking term.

Estimates are not available yet for SUP-represented employees. However, as in the case of PWU-represented employees, OEB staff also expects that the impacts of overturning Bill 124 on SUP-represented compensation costs will not have a significant influence on the operation of OPG.[15]

Although it initially declined to do so, OPG has now filed information relating to its estimated return on equity for 2022. OPG's preliminary estimate is that its 2022 actual ROE for its regulated facilities will be between 12.5% and 13.0%.[16] This is significantly in excess of the OEB approved ROE that is embedded in rates for 2022: 8.66%. OEB staff accepts that this is for 2022 only, and that the actual ROE can be expected to

[11] Ibid.
[12] EB-2023-0098, OPG Application, p. 11
[13] EB-2023-0098, Exhibit L, OPG response to OEB staff interrogatory 1
[14] EB-2020-0290, Decision and Order, November 15, 2021, p. 1
[15] OPG has estimated that the PWU represents nearly two thirds of OPG's unionized employees, and the SUP represents the remainder. Source: EB-2020-0290, Exhibit F4, Tab 3, Schedule 1, p. 4 of 31
[16] EB-2023-0098, OPG reply to SEC Request for Further IR Responses, May 12, 2023

fluctuate over the term of the rate framework. However, given the magnitude of OPG's overearning in 2022 there can be no serious argument that the absence of the requested variance account will lead to any operational hardships at OPG.

The OEB's criteria for establishing deferral and variance accounts also provide that if forecasted expenses do not exceed the OEB-defined materiality threshold and have a significant influence on the operation of the utility, they must be expensed in the normal course and addressed through organizational productivity improvements. OEB staff submits that OPG should absorb the impacts of the overturning of Bill 124 - given how small the revenue impacts are expected to be compared to OPG's approved revenue requirement, and the fact that OPG is currently significantly over-earning compared to its OEB approved ROE - rather than seek to record the impacts in a new variance account for potential recovery from ratepayers at a later time.

*Prudence*

In its application, OPG states that the prudence of any costs recorded would be determined in a separate process. OEB staff accepts that in most cases prudence is determined when a utility seeks to clear a deferral or variance account.

For purposes of establishing an account however, the nature of the amounts and forecast quantum to be recorded in the proposed account must be based on a plan that sets out how the amounts will be reasonably incurred.[17]

OPG states that the cost impacts resulting from the overturning of Bill 124 "are appropriate to be recorded in a variance account pending the consideration of prudence since these compensation costs reflect costs necessary for the continued operation of OPG's nuclear facilities".[18]

The OEB's test for prudence in terms of establishing a deferral or variance account was developed with the incurrence of future costs in mind. This is not strictly the case with OPG's request. On that basis, OEB staff does not disagree that these costs have been agreed to by OPG and to that extent are part and parcel of its continued operation of its nuclear facilities. But OEB staff also observes that based on the evidence filed in the EB-2020-0290 proceeding, compensation for OPG's PWU and SUP staff was already above the market median.[19] It is by no means clear that the OEB will find that any increases over what was included in the current approved payment amounts will be prudent. It can also be expected that the proceeding in which OPG seeks to dispose of the account could require significant evidence and discovery to explain to the OEB why these costs are prudent.

[17] OEB Filing Requirements for Electricity Distribution Rate Applications, December 15, 2022, p. 71 of 84
[18] EB-2023-0098, OPG Application, p. 11
[19] For example, see EB-2020-0290, Exhibit F4 Tab 3 Schedule 1, Figures 11 and 12, p. 27 of 31

### Effective date of new variance account (if approved)

OEB staff submits that, if the new variance account is approved, the effective date of the account should be the date that the decision is issued, and in any case not earlier than March 1, 2023. OEB staff accepts that the OEB granted OPG an interim order for the account dated March 1, 2023, and therefore has the legal authority to set the effective date as far back as March 1, 2023. However, OEB staff submits that the date of any order granting final approval for the new account would be a more appropriate effective date. The OEB's order granting interim approval of the account specifically noted that the interim approval was made without prejudice to the OEB's final determination on both the creation of the account and the effective date of the account. OPG has requested an effective date of March 1, 2023, and therefore appears to accept that an earlier date would be inappropriate.

As noted above, the legal challenges to Bill 124 were already a matter of public record when OPG filed its 2022-2026 custom IR application. Additional compensation costs resulting from this challenge were foreseeable, and OPG could have requested a deferral account in the 2022-2026 custom IR proceeding. It did not do so. The OEB's ordinary practice is to make variance accounts effective on the date of the final approval. OPG had ample opportunity to apply for an account prior to March 2023, and OEB staff see no compelling reason for the OEB to make any order effective earlier than the date of the final decision.

OPG has stated that it "would record additional compensation resulting from the overturning of Bill 124 paid post March 1, 2023 that relates to the pre-March 1, 2023 period in the proposed variance account".[20] Whether March 1 or the date of the decision is selected as the effective date, OEB staff submits that only amounts that are accrued **after** that date should be eligible for the account and for potential recovery. To the extent any new contract with PWU or SUP provides for a "catch-up" payment for any period prior to this date, these amounts should not be placed in the account, irrespective of the date when any "catch-up" payment is actually made. To allow for entries into the account for periods prior to the creation of the account would amount to impermissible retroactive ratemaking. In addition, OPG had the opportunity to request such a deferral account in the EB-2020-0290 proceeding and did not do so.

~All of which is respectfully submitted~

[20] EB-2023-0098, Exhibit L, OPG response to SEC interrogatory 6