ONTARIO POWER GENERATION – 2017-19 BUSINESS PLAN

On November 28, 2016, OPG provided its Board Of Directors approved 2017-19 Business Plan ("Business Plan") to the Minister of Energy.

Fiscal Impacts

The following tables provides a comparision between Budget 2016 and the latest financial projections submitted by OPG in its 2017-19 Business Plan.

Note that OPG contributions to the fiscal plan in Budget 2016 was primarily based on OPG's 2015 business plan, as its board-approved 2016-18 multi-year business plan had not yet been approved, and was provided well after the timeframe when the 2016 Budget fiscal plan numbers had been locked.

Based on the OPG 2017-19 Business Plan, OPG's Earnings Before Tax (i.e., net income plus payments-in-lieu of corporate income tax) is now forecasted to be lower by $250 million in 2016-17, lower in 2017-18 by $173 million, lower in 2018-19 by $42 million and higher in 2019-20 by $84 million, compared to the 2016 Budget fiscal plan.

The key drivers of the variances include the following:

- The one-year delay in OPG's previously planned rate application timing (from 2015 for rates starting in 2016 to the revised plan to submit in Spring 2016 for rates effective January 1, 2017) had an adverse impact of about $100 million as OPG previously assumed a rate increase in 2016.
- The current production outlook is lower than the forecast at the time of OPG's 2015 business plan due to factors such as incremental planned outage days at the Pickering station to enable work required to implement the planned continued operations for a few years beyond about 2020, announced in January 2016, as well as additional forecast outages in OPG's hydroelectric stations.
- Increased prudence to reflect risks related to OPG's rate application (see risk section below).

Note that the 2017-18 forecasts in the 2017-19 Business Plan have had preliminary staff adjustments for fiscal planning purposes to remove for this table the projected pre-tax gain of $296 million included in OPG's business plan in 2017 from the sale of OPG headquarters properties to avoid double-counting as those revenue amounts are included under asset optimisation.

Note also that the following is on OPG's U.S. GAAP basis of accounting, and does not show consolidation adjustment for the nuclear funds, nor potential IFRS consolidation adjustments.

Budget 2016 / Fiscal Plan ($M)	2016-17	2017-18	2018-19	2019-20
Net Income After Tax (Adjusted)	471	586	673	705
Income Tax PILs	224	159	182	108
Earnings Before Tax	**695**	**745**	**855**	**812**

OPG 2017-19 Business Plan ($M)	**2016-17**	**2017-18**	**2018-19**	**2019-20**
Net Income After Tax (Adjusted)	349	406*	678	726
Income Tax PILs	96	166**	135	170
Earnings Before Tax	**445**	**572***	**813**	**896**
EBT Variance to 2016 Budget Plan	**(250)**	**(173)*,****	**(42)**	**84**

* Pre-tax gain on sale of OPG head office property of $296M is backed out in the net income after tax calculation in 2017-18. In 2017 Business Plan, Net Income Attributable to Shareholder in 2017-18 is $702M. The expected gain on sale is reflected as an asset optimization component captured in the Sales and Rental line under Non Tax Revenue.
** Income Tax PILs do not have OPG head office sale backed out. Further details required from OPG.

Key Risks

OEB's decision on OPG's 2016 rate application

- The OPG business plan reflects its rate application, which includes OPG rate increases of about 1.5% per year for hydroelectric base rate starting in 2017 and 11% per year increase for nuclear generation consistent with its rate smoothing proposal, which are estimated to result in average increases of about 0.7% or $1.05 per month annually on a typical residential customer's monthly bill. (Commodity costs represent about half of a typical bill, and OPG generation accounts for about half of total commodity costs.)
  - E.g., for each $1 per megawatt-hour (MWh) reduction in OPG's nuclear rate, OPG's projected financial results would decrease by about $40 million, and for each $1 per MWh reduction in the regulated hydroelectric rate, OPG's resuls would be $30 million lower.
- There is a risk that a portion of Darlington Refurbishment Project's assets coming into service (about $700-800 million) may be disallowed. A portion of the expenditures on the heavy water (D2O) storage facility and other Campus Plan Projects (which totalled about $300 million) may be at greater risk of being disallowed.
- In addition, in its rate decision for OPG's 2014 and 2015 rates, OEB's decision to allow OPG to recover only its cash requirements for pension and other post-employment benefits (OPEB) in 2014 and 2015 rates will put at risk about $450-500 million for the difference in OPG's accrued costs that it recognises on its audited financial statements versus the cash costs. OPG has been recording this difference in a regulatory deferral account, but it is not certain if the OEB will approve recovery of that amount.
- As the decision for OPG's rate application is not expected until Q3 2017, the outcome of the new rate application will not be known in time to be reflected in OPG's projected results that will be included in the 2017 Document's fiscal plan, nor consolidated with the Province's 2016-17 fiscal year results.
- In the 2017-19 Business Plan, new regulated rates are assumed to be effective January 1, 2017.
  - A delay in this effective date is expected to result in an approximately $50 million to $60 million reduction in net income per month, which could be reflected, cumulativel, in 2017-18, when the OEB rate decision is expected to occur. [TBC]
  - The OPG business plan's 2017 accounts receivables includes accrued revenues for new regulated rates for the period from January 1, 2017 to the implementation date of the OEB's decision, which is assumed to be received in the third quarter of 2017. The accrued balance is assumed to be fully collected by the end of 2018.
  - The business plan also has the recognition of regulatory assets for the portion of the nuclear revenue requirement deferred for future recovery under nuclear rate smoothing starting in 2017.

Accounting Treatment and Reporting Standards

- The OEB has been holding a generic consultation on the treatment of rate-regulated utilities' pensions and other post-employment benefits (OPEBs).
  - OPG currently collects pension and OPEB costs in regulated rates on a cash basis, with the difference between cash and accrual recorded in a deferral account until the conclusion of the consultation and OEB decision.

    - There would be a significant financial impact if OPG is required to permanently collect pension and OPEB costs on cash basis with no deferral account recovery.
- Adoption of International Financial Reporting Standards (IFRS) for OPG results, and as consolidated into Public Accounts, would result in a significant increase in income volatility and would require a reassessment of OPG's fiscal commitments in the Business Plan.
    - OPG's current exemption with the Ontario Securities Commission that allows it to report on a basis other than IFRS expires at the end of 2018.
    - OPG planning and financials are still on a U.S. GAAP basis.
    - IFRS 14, the interim standard for rate regulated accounting effective January 1, 2016, allows entities adopting IFRS to avoid major changes in accounting policy until the IASB broader project to develop a reporting standard on rate-regulated activities is completed.
    - Some regulatory accounts may not be recognized by the eventual IFRS principles as creating economic benefits and obligations.
    - Principle differences for several different accounting methods between US GAAP and IFRS, including pension costs, asset retirement obligations, and fair value measurement, may significantly impact the financial statements of OPG as well as the Province on consolidation.
    - The cost of switiching accounting standards, including the retrospective application of IFRS principles, must also be considered.

Other Risks

- Failure to keep the Darlington refurbishment project on track in terms of cost, schedule, and other associated activities.
- Failure to maintain appropriate staff level and resources during Darlington refurbishment and Pickering operations.
- Risk of technical challenges in confirming ability to operate Pickering beyond 2020.

OTHER BUSINESS PLAN HIGHLIGHTS

Executive Compensation Framework

- OPG reports that its current management compensation restraint initiatives have made attracting and retaining talent a challenge. OPG has requested approval for a proposed Executive Compensation Framework (ECF), generally targeted at the 50th percentile of market peers.
    - *CEFD Staff Comments*: On November 22, 2016, the Province amended the Executive Compensation Framework regulation to ensure broader public sector organizations can benchmark compensation for senior nuclear technical experts against other jobs that require the same unique skills and experience. This amendment will ensure Ontario is able to attract and retain the highly specialized executive talent necessary to safely operate its large nuclear facilities and generate Ontario's single largest source of emissions-free electricity.

Other Highlights

- The sale of OPG's head office is on track for 2017-18 fiscal year.
- OPG's headcount continues to decline, as reported in the monthly update. Note that the Darlington Refurbishment headcount is not considered part of ongoing operations.

- Total long-term debt for general corporate (i.e., financing through OEFC) is forecast to increase by $1.6 billion, from $0.2 billion in 2016 to $1.8 billion in 2017. [The actual borrowing under the facility was $0.1 billion in 2016.]
- The Business Plan includes approved budget and schedule for the Darlington Refurbishment Project, with the first unit beginning in October 2016, and assumes it returns to service in February 2020.
- The plan assumes all six operating Pickering units operate until 2022, with four of these units operating until 2024. The plan includes additional costs and outage days to achieve Pickering operations beyond 2020, in line with the business case approved by the Board.
    - The Business plan reflects currently approved station service lives, *for accounting purposes*, for the Pickering GS to the end of 2020 and for the Darlington GS to 2052.
        - The Pickering service life will be reassessed upon technical work confirming ability to achieve operations beyond 2020.
- OPG presented 4 proposals in the Business Plan to provide greater shareholder value and keeping electricity prices low. Note, while these proposals are presented in the BP, they are **not** assumed in the Business Plan.
    - Align OPG's Capital Structure with the OEB's deemed capital structure to improve OPG's actual return on equity.
        - *CEFD Staff Comments:* OPG's revenue requirements are based on deemed capital structure rather than actual capital structure. As a result, OPG's shareholder (the Province) is not compensated for the increased equity capital put at risk. Therefore, OPG is referring to a higher measured percentage rate of return being higher, not higher net income. For the same net income, with lower equity, the ROE percentage would be higher. Furthermore, should the level of debt be increased to achieve the deemed capital structure, the weighted cost of capital and revenue requirement would reflect the increased debt service costs.
    - Invest in OPG's assets to maintain OPG's critical size, so it can continue to mitigate prices for customers, about 30% to 40% below other generators.
    - OPG to establish a dividend program tied to key business outcomes, which could return about $2.4 billion to the shareholder. The Province could use this dividend to fund government priorities including lowering the price of electricity should it so choose.
        - *CEFD Staff comment:* Dividends are not revenues to the Province. OPG's net income is. Using the dividend cash for rate mitigation would have a dollar-for-dollar fiscal impact upfront, plus an IOD impact.
    - Use OPG public debt to reduce Provincial debt through public financing strategy.
        - Maturing debt and future additional debt could be financed through the public debt markets. In addition, the OEB's deemed capital structure can be achieived and drive a level of discipline and commercial orientation within the Company.
            - *CEFD Staff comment:* To-date, the government has not permitted OPG to borrow in public capital markets for general corporate purposes. OPG borrowing on its own would likely have a negative fiscal impact as its cost of borrowing is expected to be higher than the Provincee's.

Corporate and Electricity Finance Division
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