OPG Payment Amounts - OEB Decision

As noted in my email from January 3, 2018, the OEB has issued its Decision and Order for OPG's Application for payment amounts for the output of its nuclear generating facilities and most of its hydroelectric generating facilities, for the period of January 1, 2017 to December 31, 2021.

Next Steps

- January 17, 2018 - OPG is to file a draft payment amounts order (including a smoothing proposal) that reflects the OEB's findings in the Decision and Order
- January 26, 2018 - Intervenors and OEB staff shall file any comments on the draft payment amounts order
- February 5, 2018 - OPG to file a response to any comments

OEB Decision

<u>Darlington Refurbishment Program (DRP)</u>

The DRP is a $12.7 billion program to refurbish all four units of the Darlington nuclear station. By the time of the hearing, about $2.9 billion had already been spent. In the Application OPG is seeking the following:

- approval for rate base additions of $4.8 billion of in-service amounts associated with the Unit 2 refurbishment along
- $377 million in-service amounts for other DRP related facilities that will enter into service during the test period
- In-service additions to rate base for Unit 2 of $4,800.2 million in 2020 and 2021

The OEB approves all of the above as requested by OPG. There is no doubt that this is one of the largest projects that the OEB has ever considered but the OEB finds the planning undertaken by OPG for the DRP was reasonable. The OEB also finds that OPG has developed reasonable project control systems to manage the cost and schedule of the DRP.

DRP Reporting – OPG proposed to provide annual reports to the OEB on its DRP progress. The OEB accepts OPG's reporting proposal of providing meaningful updates on the programs progress and provide an early warning system if the program starts going-off plan.

Nuclear Benchmarking – OPG's current approach to benchmarking was implemented in 2009 and has formed a key component of every payment amounts application since that time. OPG uses a top-down, gap based nuclear planning process developed by ScottMaden Consultants. OPG benchmarks itself annually against other North American nuclear operators on 20 measures.

Although the OEB finds the methodology is appropriate, OPG's nuclear operations benchmarking results have been a concern to the OEB since it began regulating OPG in 2008. In all three previous cost of services cases, the OEB noted OPG's poor performance relative to its peers and has made disallowances at least partially on account of this. OPG argues that its poor results are driven to a large extent by the Pickering units. Pickering's performance is hampered by its small size, first generation CANDU technology, and low capability factor attributable to the extensive planned outage program that is required to extend its operating life. The OEB expects OPG to file a review from ScottMadden regarding OPG's nuclear benchmarking methodologies with the next cost based application.

Pickering Life Extension

OPG is proposing to extend the operations of Pickering beyond the current life of 2020. OPG estimates that an additional 62 TWh would be generated and the value to the Ontario electricity system ranges from $500 million to $600 million. OPG has forecasted enabling costs of $307.2 million of which $292.2 million are costs that will be incurred during the period covered in application. The OEB approves the the costs that will fund technical assessments to determine fitness for service of Pickering beyond 2020.

Nuclear Operating Costs

The OEB has reduced the proposed the nuclear operating expenses by a base amount of $100 million per year. The basis for this disallowance is based on Operations, Maintenance and Administration (OM&A), excessive compensation (including pensions) and excessive nuclear allocated corporate costs. The $100 million consists of $25 million from base OM&A, $45 million from allocated costs, and $30 million from compensation.

OM&A –Nuclear operations OM&A, are the OM&A costs incurred for normal operations of the nuclear stations. Nuclear operations is divided into base, project, and outage OM&A. OPG has forecasted these expenditures at $1.7 billion per year, which is around 60% of OPG's total forecasted OM&A. Base OM&A is the single largest category of OM&A averaging around $1.25 billion per year (most relates to staff costs including overtime). The OEB will disallow $25 million per year on account of the forecast base OM&A expenses being higher than the actual spending that OPG is likely to incur.

Corporate Held Costs - The corporate support costs have been allocated using the methodology that was accepted by the OEB is previous proceedings. OPG filed a benchmarking study completed by the Hackett Group. Hackett found that while OPG's benchmark performance improved between 2010 and 2014. OPG still lagged in Executive and Corporate Services (ECS) functions.

The OEB finds that OPG's ECS costs are much too high compared to comparators. The nuclear OM&A related revenue requirement will be reduced by $45 million per year on account of the allocated costs. The OEB expects OPG to file an updated benchmarking study of corporate costs with its next cost based application.

Centrally Held Costs - Centrally held costs are allocated to the nuclear business, the regulated hydroelectric business and the unregulated business. The allocation methodology applied is the same as that applied in previous payment amount applications. The OEB agrees with the proposed allocation of centrally held costs.

Compensation - There is no "line item" for compensation in OPG's application, rather, compensation costs are a function of both the number of employees and the amount of the total compensation paid to those employees. At the end of 2015, almost 80% of OPG's regular employees worked directly in, or in support of, OPG's nuclear facilities. In 2017, total compensation costs approaches 50% of the requested revenue requirement. OPG's compensation costs are relatively flat over the test period. The evidence in the proceeding demonstrated that OPG has made positive steps toward controlling its overall compensation costs. However the OEB finds that forecast total compensation is in the range of $40 to $50 million too high for each year of the test period. The OEB will reduce OPG's overall OM&A budget by $30 million per year on account of excessive compensation. This includes direct compensation and pension and benefits. This is in addition to the disallowance of $45 million per year for excessive corporate allocation costs. The OEB expects compensation benchmarking with the next cost based application. The benchmarking shall include a detailed overtime analysis,.

Fitness for Duty Program - The OEB will also disallow $41 million for the "Fitness for Duty Program". The Fitness for Duty Program is a random drug and alcohol testing program for employees in nuclear facilities. Although the CNSC has not yet imposed the program OPG is generally aware of the details and has attempted to budget accordingly. Both the quantum and the time of the costs are uncertain and the OEB is not prepared to include them in the payment amounts at this time. But the OEB will allow OPG to establish a deferral account to track costs.

<u>Hydroelectric Payment Amounts</u>

OPG has applied for approval of the payment amount setting formula for the five-year period 2017 to 2021. OPG also seeks approval for the regulated hydroelectric payment amount of $41.71/MWh effective January 1, 2017. The starting point for the payment amounts are those approved in EB-2013-0321. OPG proposed an inflation rate of 1.8% for 2017, a productivity factor of zero and a stretch factor of 0.3%. OPG proposes to file an application in the fall of each year to set the next year's payment amounts. Adjustments would be based on determination of an updated inflation factor.

OEB has accepted the base payment amount of $41.09/MWh by approving the settlement proposal. The OEB expects some trend reporting and trend analysis in future benchmarking. OPG shall file a benchmarking study with its next cost based payment amount application.

<u>Nuclear Production Forecast</u>

OPG sought approval for a test period production of 188.3 TWh and a mid-term review to update the nuclear production forecast for the final two and a half years of the test period. The production forecast methodology is based on maximum production less adjustments for planned outages, estimates of forced production loss and adjustment for other losses. The OEB approves the proposed nuclear production forecast for the test period.

Mid-Term Review

OPG sought approval of a mid-term production review in the first half of 2019. The mid-term application would seek to update the nuclear production forecast and related nuclear fuel expenses for the period July 1, 2019 to December 31, 2021 and disposal of applicable audited 2018 year-end deferral and variance account balances.

For a number of reasons OPG has never achieved its production forecast in the 2008-2015 period. OPG states that a mid-term review is necessary as there is substantial uncertainty with respect to production in the second half of the Custom IR term. The OEB does not approve the mid-term review proposal related to production forecast. The OEB agrees with interveners that the forecasting is not an exceptional circumstance requiring a mid-term review.

Payment Amount Smoothing

The original application filed in May 2016 proposed an 11% increase on current base nuclear payments and 11% increases for each year of the test period. Ontario Regulation 53/05 was amended in March 2017 with a view to making more stable the year-over-year changes in the OPG weighted average amount (WAPA). OPG amended its application and proposed a 2.5% year over year increase. With this proposal, OPG forecast that 1.0 billion would be added to the Rate Smoothing Deferral Account and that there would be$116 million of interest in 2017-2021.

The OEB agrees that that a final decision regarding the weighted average payment amount smoothing cannot be made until the outcomes of this Decision are reflected in unsmoothed hydroelectric and nuclear payment amounts and nuclear payment amount riders. Once the unsmooth payment amounts are known, rate smoothing can be considered. It is up to OPG to propose a reasonable smoothing approach that is consistent with the regulation

The OEB has decided that the effective date for payment amounts will be June 1, 2017. The final implementation date will be subject to the completion of the payment order process. However, for efficiency, the draft payment amounts order shall include the following implementation date scenarios: March 1, 2018, April 1, 2018 and May 1, 2018. OPG will propose smoothing for each scenario including WAPA, bill impacts, deferred amounts and RSDA carrying charges. OPG shall determine foregone revenue riders for each scenario. OPG shall propose a recovery period for foregone revenue in the draft payment amounts order. OPG shall propose a recovery period for the disposition of the deferral and variance account balances. It would be helpful if OPG included an analysis of customer bill impacts, and an updated version of its response to undertaking J20.1 which set out the bill impacts for medium and large businesses.

Implementation

The OEB approves and implementation date of June 1, 2017 instead of the January 1, 2017 requested by OPG. This was due to the substantial application OPG filed on May 27, 2016. It was unrealistic of OPG to expect that a final decision would be rendered and a payment amounts order processed in time for

January 2017. The change in implementation date will require OPG to determine the foregone revenue. In arriving at the June 1, 2017 effective date, the OEB has attempted to balance the revenue requirement needs of OPG and rate certainty expected by ratepayers. The change in implementation date will have an impact on revenue

OPG must file a draft payments amount order reflecting the payment amount setting determinations in this Decision for nuclear based on the parameters established for the five-year term and for hydroelectric based on the 2017 and 2018 parameters. The draft payment amounts will include the final revenue requirement and final production forecast for the nuclear facilities, and the final hydroelectric rate setting mechanism and 2017 and 2018 parameters. OPG shall include supporting schedules and a clear explanation of all calculations and assumptions used in deriving the amounts uses, and final unsmoothed payment amounts.

Background

Approvals Sought by OPG

- The approval of revenue requirements for the nuclear facilities
- Approval of the rate base for the nuclear facilities
- Approval of the production forecasts for the nuclear facilities
- Approval of deemed capital structure of 51 percent debt and 49 percent equity
- Payment amounts for the regulated hydroelectric facilities
- Approval of rate setting formula and related elements for setting payment amounts for the prescribed hydroelectric generation facilities
- Approval of payment amounts for the nuclear facilities
- Approval of nuclear rate smoothing proposal and mid-term production review
- Approval for recovery of the audited December 31, 2015 balance of the deferral and variance accounts
- Approval to continue existing deferral and variance accounts
- Approval of a hydroelectric rider to receive the approved balances of the hydroelectric deferral and variance accounts
- Approval of a nuclear rider to recover the approved balances of the nuclear deferral and variance accounts
- Approval to establish a number of deferral and variance accounts
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