

**Board Staff Scoping Paper
EB-2009-0331**

Consultation on OPG's Payment Amounts Application

INTRODUCTION

In anticipation of the filing by Ontario Power Generation ("OPG") of its next Payment Amounts application in the first quarter of 2010, Board staff has considered how the various subject areas of the application might be dealt with to ensure that each area receives the necessary review by all parties, and the application proceeds in an efficient and timely manner.

This scoping paper sets out the likely subject areas of the payment amounts application; a brief description of the anticipated evidence (based on the first filing, directions in the first payment amounts decision (EB-2007-0905 or the "Decision"), and the draft Filing Guidelines which is being circulated contemporaneously with this scoping paper); and an initial list of issues that are likely to arise out of each subject area.

The draft Filing Guidelines focus primarily upon the evidence that will be filed by OPG; the focus of the scoping paper is on the issues that evidence will give rise to. The scoping paper is organized by subject area and for each area parties are asked to consider and comment upon the following:

- What are the issues that parties are likely to want to explore for each subject area?

Ultimately, the Board will decide the Issues List and how the evidence for each of the subject areas will be canvassed. In making its determination, Board staff is of the view that the Board will be assisted by hearing from the parties prior to making its determinations, and that the parties will be assisted in forming their views by discussions which are initiated in a timely manner. By canvassing these matters in advance of the filing of the application, a common approach to some aspects of the application may be agreed upon, and placed before the Board for its consideration. It may also be possible to agree upon many of the issues that will appear on the final Issues List.

PROPOSED PROCEDURAL STEPS

Set out below are a series of proposed procedural steps for the hearing of the OPG payment amounts application. Parties are asked to comment on them.

- Filing of OPG application
- Distribution of Draft Issues List
- Issues Conference/Day

- Procedural order fixing Issues List and setting schedule
- Filing of intervenor or staff evidence
- Interrogatories
- Second round of interrogatories, if necessary
- Motions to compel answers to interrogatories/further filing of evidence, etc. (the motions could be dealt with in writing, and occur after the second round of interrogatories and if necessary after the technical conference, or after the technical conference only)
- Technical conference(s), if necessary
- Settlement conference
- After the settlement conference (or technical conference, if no settlement conference) the parties finalize the list of issues requiring an oral hearing (including those for which there is no agreement) which is submitted in writing to the Board, and the Board finalizes the oral hearing subject areas
- Oral hearing
- Written argument and submissions on all subject areas.

SUBJECT AREAS

The draft Filing Guidelines set out the subject areas in detail, along with the evidence that should be filed. The summaries of the subject area and the evidence to be filed below are for contextual purposes only, and to assist parties in considering and formulating possible issues.

1. RATE BASE

In accordance with the original filing guidelines, OPG filed statements of gross assets, accumulated depreciation and working capital calculation for the first payment amounts proceeding. The decision stated “The treatment of nuclear waste management liabilities and decommissioning was the only significant aspect of rate base which was disputed in the proceeding.... the return awarded on the rate base associated with the unamortized ARC and unfunded liabilities for Pickering and Darlington will be 5.6%. The balance of the rate base will be used for purposes of determining the amounts to be included in the revenue requirement for cost of capital related to the deemed capital structure and return on equity. The Board accepts the remainder of the proposed rate base.”

Anticipated Filing:

OPG will provide a similar filing for the next test period; however, an updated lead/lag study is not required. OPG will be required to explain any differences in 2008 and 2009 rate base from that accepted by the Board. In keeping with the Decision, a focused examination of rate base is anticipated.

Proposed Issue:

Is the rate base appropriately determined in accordance with regulatory accounting requirements?

2. CAPITAL STRUCTURE AND COST OF CAPITAL

a. Capital Structure

For the 2008 and 2009 fiscal years, OPG sought a capital structure comprised of 57.5 % common equity. In the Decision, the Board concluded that OPG is of higher risk than LDCs, gas utilities and electricity transmission utilities and of lower risk than merchant generation, and that an equity ratio of 47% is appropriate.

Anticipated Filing:

OPG will file documentation supporting the debt to equity ratio for the test period and detailed explanation for any deviation from an equity ratio of 47%. If an equity ratio of 47% is maintained for the test period, a focused examination of capital structure is anticipated.

Proposed Issue:

Is the capital structure proposed for the test period appropriate?

b. Return on Equity

The Board approved an ROE of 8.65% for the 2008-2009 period. For purposes of determining its ROE in future proceedings, OPG proposed adoption of the existing ROE adjustment formula outlined in the Board's *Report on Cost of Capital and 2nd Generation Incentive Regulation for Ontario's Electricity Distributors*. That formula results in a 75 basis point change in ROE for every one hundred basis point change in the 30-year Long Canada Bond forecast. The Board approved the adoption of the formula.

Following the Decision, the Board initiated a consultation process (EB-2009-0084) to determine whether current economic and financial market conditions warrant an adjustment to the methodologies and formulae set out the report noted above.

OPG's ROE filing for the next payments amount application will refer and relate to the outcome of EB-2009-0084. If the outcome of EB-2009-0084 is followed, or in the event of a delay in the EB-2009-0084 proceeding, OPG's application continues to use the existing ROE adjustment formula, a focused examination of ROE is anticipated; if a different ROE is proposed, an oral hearing may be necessary.

Anticipated Filing:

Evidence supporting that the ROE set by the Board in EB-2009-0084 is adopted (or the existing formula is retained); if not, evidence supporting an alternative ROE will need to be filed.

Proposed Issues:

- i) Has OPG complied with the Board's direction in EB-2009-0084 (or retained the existing formula)? If not, is the proposed alternative ROE appropriate?
- ii) Given that OPG has deferred the filing of its payment amounts application, are the payment amounts appropriate? Will OPG's 2010 earnings exceed the Board approved rate of return?

c. Cost of Debt

The Board accepted OPG's forecast cost of short term debt (5.83% for 2008 and 5.98% for 2009) and the Board accepted OPG's proposed rates for 2008 and 2009 for existing and planned long term debt (5.79% across the test period).

The Board found that the method for setting the cost of other/plug debt was not appropriate. (Other/plug debt is the difference between the debt needed to equate the proposed deemed capital structure to the proposed rate base and the allocated debt.) The Board found that it is appropriate to use the average of the hedged cost of planned debt. The cost of long term other debt will be set at 5.63% for 2008 and 6.16% for 2009 (vs. 5.65% for 2008 and 6.47% for 2009).

Anticipated Filing

OPG will file documentation supporting test period rates for short term debt, long term debt and other/plug debt for the test period.

Proposed Issue:

Are OPG's proposed costs for its long term and short term debt components of its capital structure appropriate?

d. Reporting for Hydroelectric and Nuclear Businesses

Although the regulated hydroelectric and regulated nuclear businesses are held by the same entity, in many respects they are operated quite separately. In the Decision, the Board found that there may be merit in establishing separate capital structures for the two businesses, and concluded that further investigation of separate capital structures should be explored in OPG's next proceeding.

Anticipated Filing

OPG will file the results of its investigation related to separate capital structures for the hydroelectric and nuclear businesses.

Proposed Issue:

Should the same capital structure and cost of capital continue to be used for OPG's regulated hydroelectric and nuclear businesses? If not, what is the appropriate capital structure and cost of capital for each business?

3. CAPITAL PROJECTS

a. Hydroelectric

In the first payment amounts decision, the Board accepted all of the hydroelectric capital projects, the largest of which were the Niagara Tunnel Project and the Sir Adam Beck 1 GS Unit 7 Frequency Conversion Project ("Beck Unit 7 project"), as all were within project budgets approved by the OPG Board of Directors prior to the Board's first order under section 78.1. The Board accepted the inclusion of the Beck Unit 7 project in rate base, and noted that other hydroelectric projects that became in-service during the test period would also be added to rate base. No finding was made regarding the Niagara Tunnel project because it was not forecast to enter rate base in 2008-2009.

Anticipated Filing:

It is anticipated that OPG will make a similar filing for hydroelectric capital expenditures for the next test period, and will likely address any variance between the budget forecast approved by the OPG Board of Directors and the actual cost of each project. OPG will file details related to delays and costs associated with the Niagara Tunnel project, reflecting all increased actual and forecast costs, and detailed budgets for the test period. To the extent that the final costs of any of the completed projects exceed the OPG Board approved level, the recovery of those incremental costs will be reviewed by the Board.

Proposed Issues:

- i) Were the Niagara Tunnel costs in excess of those approved by the OPG Board of Directors prudently incurred?
- ii) Were the costs associated with the hydroelectric projects that became in-service during the previous test period within the project budgets approved by the OPG Board of Directors? If not, were the excess costs prudently incurred?

- iii) Are the proposed test period hydroelectric capital expenditures costs and/or financial commitments appropriate, and supported by business case summaries?

b. Nuclear

The Board accepted OPG's forecast nuclear capital expenditure of \$189M in 2008 and \$182M in 2009. This envelope did not include nuclear refurbishment or new build.

Anticipated Filing:

The Decision set out two additional filing requirements for the next payments application.

- The Board directed OPG to file cost and benefit analyses (business case summaries) of capital expenditures as part of the pre-filed evidence for its next application. As an efficiency measure, the initial filing could consist of a list of all capital projects and business case summaries for projects larger than \$10 M.
- With respect to capitalization of the Pickering Unit 2&3 isolation project costs, the Board directed OPG to provide in its next application a more detailed analysis of the nature of the costs and why accounting standards require that such costs be capitalized as part of the book values of the operating units rather than treated as costs of shutting down units.

OPG's filing should support its forecast nuclear capital expenditure for the test period and include business cases and analysis of the Pickering Unit 2&3 isolation project. OPG's filing should also address any variance between the budget forecast and the actual cost of the 2008 and 2009 capital expenditures.

Proposed Issues:

- i) Are the variances between the budget forecast and the actual capital expenditures justified and supported by evidence?
- ii) Are the proposed test period nuclear capital expenditures appropriate and supported by business case summaries?

c. Nuclear Refurbishment and New Build

In EB-2007-0905, OPG's forecast included \$148.8 M of capital expenditure related to the possible refurbishment of Pickering B. At the time of the hearing, OPG's Board of Directors had yet to approve proceeding with the refurbishment and as a result, the Board did not

consider the refurbishment; the Board noted that if the project was approved during the test period, it would not enter rate base until a later period.

The Board found that the other proposed nuclear expenditures fell within sections 6(2)4 and 6(2)4.1 of Reg. 53/05 and approved the inclusion of the costs in the revenue requirement.

Anticipated Filing:

OPG is required to file details of the status of refurbishment and new build projects and the rationale for OM&A and capital expenditures, noting the impact of the recent announcement related to the suspension of new build procurement. OPG's filing should also address any variance between the budget forecast approved by the OPG Board of Directors and the actual cost of the 2008 and 2009 nuclear refurbishment and new build expenditures. If the refurbishment of Pickering B has been approved by the OPG Board of Directors, details concerning the approval and the refurbishment costs should be provided.

Proposed Issues:

- i) Are the variances between the budget forecast and the actual nuclear refurbishment and new build expenditures justified and supported by evidence?
- ii) Are the proposed test period nuclear refurbishment capital expenditures, which include costs and/or financial commitments, prudently incurred? Are they supported by business case summaries?
- iii) Are there proposed new build capital expenditure costs and/or firm financial commitments made in the course of planning and preparation for the development of proposed new nuclear generation facilities? If so, are the costs incurred prudent? Are they supported by business case summaries?
- iv) If the refurbishment of Pickering B has been approved by the OPG Board of Directors, are the refurbishment costs incurred and/or financial commitments made prudent? Are they supported by business case summaries?
- v) Will OPG's accounting policies result in capitalization of an appropriate amount of costs incurred in the test period with respect to the construction or acquisition of capital assets?

4. PRODUCTION FORECASTS

a. Hydroelectric

The hydroelectric production forecast is impacted by water availability. OPG uses computer models to derive production forecasts for the regulated hydroelectric sites. The Board accepted the evidence of OPG in respect of the hydroelectric production forecast in the EB-2007-0905 proceeding and no parties took issue with the forecast. There is also an approved variance account to capture the impact of variations in natural water conditions.

Anticipated Filing:

OPG will file documentation supporting test period hydroelectric production forecast. Assuming methodologies consistent with the previous decision are applied and historical variances can be explained, it is anticipated that there will be a focused examination of the hydroelectric production forecast.

Proposed Issues:

- i) Is the methodology used by OPG to generate the proposed hydroelectric business production forecast appropriate?
- ii) Has the methodology been appropriately applied to create the production forecast?

b. Nuclear

The forecast of nuclear production is dependent on planned outages, estimates of forced outages and a fleet uncertainty adjustment. During the first payment amounts proceeding, the parties expressed reservations about forced loss rate and fleet level uncertainty. The Board accepted the OPG forecast of nuclear production for the 2008-2009 test period. OPG did not seek a variance account for deviations between actual production and forecast. Accordingly OPG is at risk if actual production is less than forecast.

Anticipated Filing:

OPG will file documentation supporting test period nuclear production forecast, including methodologies and an explanation for historical variances. The filing will support OPG's position related to forced loss rate and fleet level uncertainty.

Proposed Issues:

- i) Is the methodology used by OPG to generate the proposed nuclear business production forecast appropriate?
- ii) Has the methodology been appropriately applied to create the production forecast?

5. OPERATING COSTS

a. Hydroelectric

The Board accepted the forecast hydroelectric OM&A for the test period in EB-2007-0905 and noted that the benchmarking results supported a conclusion that the OM&A levels for the hydroelectric business are appropriate.

Anticipated Filing:

OPG will likely provide a similar filing for the next test period. OPG is required to explain any variances in 2008 and 2009 hydroelectric OM&A.

Proposed Issue:

Is the OM&A budget for the prescribed hydroelectric business appropriate?

b. Nuclear

In the first payment amounts proceedings, parties expressed concern about the increases in nuclear OM&A, labour costs and OPG's benchmarked nuclear performance. The Memorandum of Agreement (MOA) with the Province, dated August 17, 2005, sets out the Province's expectations regarding OPG's mandate, governance, and performance; the benchmarking requirements, set out below, were a specific focus of the Decision:

OPG will seek continuous improvement in its nuclear generation business and internal services. OPG will benchmark its performance in these areas against CANDU nuclear plants worldwide as well as against the top quartile of private and publicly-owned nuclear electricity generators in North America. OPG's top operational priority will be to improve the operation of its existing nuclear fleet.

In EB-2007-0905, the Board disallowed 10% of the Base OM&A costs of Pickering A (\$14.9 M in 2008 and \$20.1 M in 2009) on the basis of its relative production unit energy cost.

Anticipated Filing:

The Board directed OPG to produce and file further benchmarking studies in its next application which specifically address the questions raised in the proposed Phase 2 and 3 of the Navigant Study, filed at the hearing, and that fulfill the benchmarking requirement set out in the MOA. OPG

will likely file updated benchmarking studies, including EUCG, WANO, Navigant, and salary surveys, as directed, as well as a discussion of results and trends.

OPG should explain any variances in 2008 and 2009 nuclear OM&A, and in particular, the costs associated with Pickering A.

Proposed Issues:

- i) Is the OM&A budget for the prescribed nuclear business appropriate?
- ii) Are the 2008 and 2009 human resources related costs (wages, salaries, benefits, incentive payments, FTEs and pension costs) appropriate?
- iii) Are the production unit energy costs and capacity factors for OPG's nuclear facilities reasonable when compared with other nuclear facilities, both CANDU and other technologies?

c. Allocation of Corporate Cost

In EB-2007-0905, OPG provided a review of corporate cost allocation prepared by R.J. Rudden Associates. The Board accepted the allocation of corporate costs for the test period. OPG undertook to present an independent evaluation of corporate cost allocation as part of its next application.

Anticipated Filing:

The Board directed OPG to file an independent evaluation of corporate cost allocation which includes an evaluation of the cost allocation methodology and a consideration of the Board's three prong costs test as set out in Enbridge Gas Distribution EB-2005-0001/EB-2005-0437. OPG should explain any variances in 2008 and 2009 corporate cost allocation.

Proposed Issue:

Are the corporate costs allocated to the regulated hydroelectric and nuclear businesses appropriate?

d. Asset Service Fee Amounts

The Asset Service Fee is nuclear and hydroelectric's share of the costs of the fixed assets that are centrally held by OPG, and is used to provide services for the regulated nuclear and hydroelectric businesses. These fixed assets include OPG's head office, the Kipling Building complex, and

OPG-wide IT systems and applications. These fees were not challenged in the first payment amounts proceeding.

Anticipated Filing:

A similar filing for the next test period will be made and an explanation of historical variances provided.

Proposed Issue:

Are the asset service fee amounts charged to the regulated hydroelectric and nuclear businesses appropriate?

6. NUCLEAR FUEL COSTS

The Board accepted the forecast nuclear fuel expense in the first payment amounts proceeding and a variance account to capture the difference between forecast and actual nuclear fuel expense was established. No intervenor objected to the nuclear fuel forecast.

Anticipated Filing:

A similar filing for the next test period will be made and explanation of historical variances provided.

Proposed Issue:

Is the forecast of nuclear fuel costs appropriate?

7. INCOME AND OTHER TAXES

In the first payment amounts proceeding, the Board approved a variance account to track variations in municipal property taxes, and variations in payments in lieu of capital taxes, property taxes and income taxes.

The motion proceeding, EB-2009-0038, established a tax loss variance account, which records any variance between the tax loss mitigation amount which underpins the rate order for the initial test period and the tax loss amount resulting from the re-analysis of the prior period tax returns.

Anticipated Filing:

The Board directed OPG to file better information on its forecast of the test period income tax provision; to that end, the income tax provision for the prescribed facilities in future applications should not include any income or loss in respect of the Bruce lease. OPG was also directed to file an analysis of its prior period tax returns that identifies all items (income inclusions, deductions, losses) in those returns that should be taken into account in the tax provision for the prescribed facilities. That analysis should be based on

the principle that if OPG is proposing that electricity consumers should bear a cost (or should benefit from revenues) they will receive the related tax benefit (or will be charged the related income taxes).

The Board also directed OPG to file a complete set of audited financial statements, including a balance sheet, for the prescribed facilities. These documents are to be provided in addition to consolidated financial statements.

Proposed Issue:

Are the amounts proposed to be included in test period revenue requirements for taxes and other operating cost items appropriate?

8. DEPRECIATION

OPG's depreciation method, depreciation expense and internal review process were examined in the first payment amounts proceeding. The regulatory treatment of OPG's nuclear liabilities and its asset retirement obligation was a major issue in the first payment amounts decision. The Board accepted the depreciation methodology and the inclusion in the revenue requirement of depreciation expense for the nuclear plants in accordance with GAAP.

Anticipated Filing:

A similar filing for the next test period should be made, with updates on implementation of the Ganett Fleming report recommendations.

Proposed Issue

Are the proposed depreciation rates and resulting expense appropriate?

9. OTHER REVENUES

a. Ancillary Services and Other Nuclear Revenues

The Board accepted OPG's EB-2007-0905 forecast for ancillary services and other nuclear revenues. Further, there are the Ancillary Services Net Revenue Variance Accounts for hydroelectric and for nuclear.

Anticipated Filing:

A similar filing for the next test period should be made.

Proposed Issue:

Are the forecasts of ancillary services revenues and other nuclear revenues appropriate?

b. Segregated Mode of Operation (“SMO”), Water Transactions (“WT”) and Congestion Management Settlement Credit (“CMSC”)

OPG earns SMO revenues by segregating some Saunders generation from Ontario and reconnecting directly into Quebec. WTs occur pursuant to agreements between the New York Power Authority and OPG related to water that would otherwise be spilled over Niagara Falls. In the Decision, the Board concluded that an appropriate approach to SMO and WT would be to include the average net revenues over the last 3 years into the forecast as a revenue offset in each year of the test period.

A CMSC is paid to any market participant in compensation for either being constrained on or off. The Board accepted OPG’s proposal to retain all of the CMSC payments, as these payments are designed to compensate for losses.

Anticipated Filing:

OPG should provide an updated filing for the next test period and provide an explanation for historical variances.

Proposed Issue

Are the proposed revenues from segregated mode of operation, water transactions and congestion management settlement credits appropriate?

10. BRUCE NGS

OPG’s revenues and costs related to the Bruce NGS lease were major issues in the first payment amounts proceeding. The Board found that the appropriate method to calculate OPG’s test period revenues and costs related to Bruce NGS is to use amounts calculated in accordance with GAAP.

Anticipated Filing:

OPG should file test period revenues and costs related to Bruce NGS, calculated in accordance with GAAP. The Board also directed OPG to include an income tax (PILS) provision, calculated in accordance with GAAP, in its computation of Bruce costs. The Board directed OPG to establish a variance account to capture the difference between the forecast costs and revenues related to Bruce NGS that are factored into the test period payment amounts for Pickering and Darlington, and OPG’s actual revenues and costs in respect of Bruce.

Proposed Issue:

Are OPG’s forecasts of costs related to the Bruce Nuclear Generating Station, and cost and revenues related to the Bruce lease, appropriate?

11. NUCLEAR WASTE MANAGEMENT AND DECOMMISSIONING, NUCLEAR LIABILITIES

OPG's liability for nuclear used fuel management, nuclear decommissioning, and low and intermediate level waste management is expected to be \$11.7 billion by the end of 2009. The regulatory treatment of these liabilities was a major issue in the first payment amounts proceeding. The nuclear liabilities are relevant to the determination of Bruce NGS costs, the balance in the nuclear liability deferral account, rate base and cost of capital.

The Board found that it had the discretion to determine the methodology that OPG should use to calculate and recover the revenue requirement impact of the nuclear liabilities. The methodology proposed by OPG permitted it to recover its cost of capital on a rate base that included 100% of unamortized ARC. After considerable evidence, the Board determined that rate base shall be calculated using average annual fixed asset balances that are determined in accordance with GAAP, which include unamortized ARC. However, to limit the cost of capital impact to 'funded ARC' only, the Board put into place a formula which limits the amount of interest that shall be paid on unamortized ARC.

Anticipated Filing:

OPG will file the amounts of forecast average unfunded liabilities related to Pickering and Darlington.

Proposed Issue:

Is the forecast of unfunded liabilities reasonable?

12. DEFERRAL AND VARIANCE ACCOUNTS

The balances to the end of December 31, 2007 were approved for 7 accounts in EB-2007-0905. The balances for two of accounts related to hydroelectric operations are recovered through the prescribed payment. The balances in the remaining 5 accounts are recovered through riders. During the period from January 1, 2008 to March 31, 2008, OPG continued to make entries into these accounts. It is expected that OPG will request clearance of these balances in the next payment amounts application.

The first payment amounts decision also established new deferral and variance accounts. The Board also directed OPG to accrue interest on deferral and variance account balances after March 2008 using the interest rates set by the Board.

The clearance of the tax loss variance account established in EB-2009-0038 will be reviewed in the next payment amounts application.

Anticipated Filing:

OPG will file continuity schedules noting balances, transactions, interest and carrying charges for all accounts.

Proposed Issues

- a) Are the balances in each of the deferral and variance accounts appropriate?
- b) Where applicable, are the proposed disposition amounts appropriate?
- c) Where applicable, is the disposition methodology appropriate?
- d) Where applicable, is the proposed continuation of deferral and variance accounts appropriate?
- e) Where applicable, are the proposed new deferral and variance accounts appropriate?

13. DESIGN OF PAYMENT AMOUNTS

a. Hydroelectric

Under the previous payment design, OPG received \$33/MWh for the first 1,900 MWh of output in any hour. Production greater than 1,900 MWh received market price. Under OPG's proposed incentive mechanism, which was accepted by the Board, OPG would receive market price for production greater than average hourly production during the month. For production which is less than the threshold, OPG would notionally pay the market price for the production shortfall.

Anticipated Filing:

The Board required OPG to present a review of the mechanism, and its impact on OPG's operating decisions, as part of its next application.

Proposed Issue:

Has the incentive mechanism resulted in decision making based on a comparison of market prices rather than a comparison between the market price and regulated payment?

b. Nuclear

In the first payment amounts decision, OPG proposed that the Board approve a \$1,221.6 M fixed payment, with recovery of the balance through a variable payment. The proposal was not approved and the Board continued with a 100% variable payment structure for nuclear output.

Anticipated Filing:
Not known at this time.

Proposed Issue:
Pending

14. REPORTING AND RECORD KEEPING REQUIREMENTS (RRRs)

The Board has established reporting and record keeping requirements which set the minimum reporting and record keeping requirements for which most licensees must comply. Other reporting and record keeping requirements specific to a licensee may also be contained in individual licences or regulatory instruments specific to a licensee (for example, in a rate order). Currently, the Board's RRRs do not set out requirements for OPG.

Anticipated Filing:
Not known at this time.

Proposed Issue:
Should OPG be required to report regularly? If so, what are the appropriate reporting and record keeping requirements for OPG's prescribed generation facilities?