OVERVIEW OF DEFERRAL AND VARIANCE ACCOUNTS

1.0 PURPOSE

This evidence summarizes the deferral and variance accounts for OPG's regulated hydroelectric facilities (section 3.0) and nuclear generating facilities (section 4.0) that have been in place during the interim period. OPG proposes to clear the balances in these accounts as described in Ex. J1-T2-S1.

2.0 SUMMARY

OPG has established variance and deferral accounts as required under O. Reg. 53/05. In addition, OPG has recorded amounts in a variance account related to its proposed sharing of a portion of the profits from power sales to Quebec and water transactions with the New York Power Authority in an additional "Segregated Mode and Water Transactions Net Revenue Variance Account" (see sections 3.2.1 and 3.2.2).

In relation to its regulated hydroelectric operations, OPG has established two variance accounts: (1) the Interim Variance Account ("IVA"), with sub-accounts for water conditions and ancillary services and (2) a Segregated Mode and Water Transactions Net Revenue Account with sub-accounts for segregated mode of operations and water transaction net revenues. In relation to its nuclear operations, OPG has established three deferral accounts: (1) Pickering A Return to Service ("PARTS"), (2) Nuclear Liability, and (3) Nuclear Development as well as two variance accounts: (1) Capacity Refurbishment, and (2) the IVA, with sub-accounts for transmission restrictions and limitations, and ancillary services.

OPG's proposed recovery is based on its deferral and variance account balances as at December 31, 2007 as reflected in OPG's 2007 audited financial statements, consistent with the requirements of subsection 6 (2) 5 of O. Reg. 53/05. Differences between amounts reflected in its interim payment amounts and OPG's actual costs/revenues incurred after December 31, 2007 will continue to be recorded in the deferral and variance accounts discussed above until the effective date of the OEB's first payment order. These post-

December 31, 2007 balances will be brought forward for disposition in OPG's next payment amounts application.

OPG proposes to continue to apply interest to the opening monthly balance of these accounts until the balances are fully recovered. OPG will record in its deferral and variance accounts the actual interest costs at the rate approved by the OEB for the 2008/2009 test period. OPG will seek to recover these costs in its next payment application.

The total balance of variance and deferral accounts was 342.8M at December 31, 2007, as summarized in Ex. J1-T1-S1 Table 1.

3.0 EXISTING HYDROELECTRIC VARIANCE AND DEFERRAL ACCOUNTS

In accordance with O. Reg. 53/05, OPG has established a variance account for the interim period to record capital and non-capital costs incurred and revenues earned or foregone on or after April 1, 2005 due to deviations from forecasts, as set out in the "Forecast Information (as of Q3/2004) for Facilities Prescribed under Ontario Regulation 53/05" as posted on the OEB website for the following hydroelectric matters:

- Differences in hydroelectric electricity production due to differences between forecast and actual water conditions.
- Ancillary service revenues.
- Acts of God.
- Costs associated with transmission outages and restrictions not otherwise recovered.

OPG has used "sub-accounts" to record these variances. The IVA sub-accounts associated with the revenue requirement impact of changes due to acts of God and transmission outages and restrictions had zero balances on December 31, 2007.

In addition OPG has established and recorded a Segregated Mode and Water Transactions Net Revenue Variance Account to record the amounts OPG has proposed to share with consumers. The amounts are associated with:

- Segregated mode of operations

- Water transaction net revenues.

The proposed sharing mechanism is described in Ex. G1-T1-S1.

3.1 Interim Variance Account - Hydroelectric

OPG established an IVA to record capital and non-capital costs incurred and revenues earned or foregone after April 1, 2005 for its hydroelectric operations for water conditions and ancillary services revenues. OPG has used “sub-accounts” to record these variances.

Exhibit J1-T1-S1 Table 2 shows the account’s closing balances for 2005, 2006, and 2007.

3.1.1 Hydroelectric Water Conditions Sub-Account

The interim hydroelectric rate is based on a forecast of the total production and the total costs for the regulated hydroelectric facilities over the interim period as set out in the “Forecast Information (as of Q3/2004) for Facilities Prescribed under Ontario Regulation 53/05” as posted on the OEB website. The production forecast in turn is based on a forecast of water availability. Water availability is not something that OPG can control, yet it can have a significant effect on hydroelectric revenues. The IVA - Hydroelectric Water Conditions Sub-Account addresses this risk by capturing the financial consequences of differences between forecast and actual water conditions. Because the account captures both positive and negative variances, it keeps OPG financially whole while at the same time protecting consumers.

A number of variables affect water availability, including local and total basin inflows, temperature, precipitation, humidity, and wind. These variables are considered in producing a forecast of flow. The flow forecast is entered into a hydroelectric production model to determine the forecast energy production. Therefore, to determine the production impact of changes in water conditions, the actual flow values are entered into the same production forecast model, holding all other variables the same. The resulting production based on actual flows is then compared to the original energy production forecast to determine the deviations from forecast. Details of the production forecast methodology are described in Ex. E1-T1-S1.

The revenue impact is determined by multiplying the deviation from forecast, as described above, by the interim hydroelectric payment amount of $33/MWh as specified in O. Reg. 53/05. The resulting amount is recorded in the IVA - Hydroelectric Water Conditions Sub-Account.

OPG pays gross revenue charges to the Ontario Electricity Financial Corporation, the Niagara Parks Commission, and the Minister of Finance. These payments are based on production. As such, changes to energy production (as described above) would also change OPG's gross revenue charges payments. Therefore, changes in gross revenue charges are also recorded in the IVA - Hydroelectric Water Conditions Sub-Account. OPG also makes payments to the St. Lawrence Seaway Management Corporation for the conveyance of water in the Welland Ship Canal, which is used for power generation at Decew Falls. Variations in these payments are recorded in this account. For a full discussion of gross revenue charges see Ex. F1-T4-S1.

Exhibit J1-T1-S1 Table 3 shows how the water condition variances were calculated for 2005, 2006, and 2007.

3.1.2 Ancillary Service Net Revenue Sub-Account

For the purpose of recording amounts in this sub-account, actual hydroelectric ancillary service revenue is compared against the forecast amounts that were provided to the Province for use in determining the interim payments. Each month the difference or variance is recorded in the IVA. The specific ancillary services for regulated hydroelectric operations included in forecast information provided to the Province were: black start capability, operating reserve, automatic generation control, and reactive support/voltage control service. For a full discussion of ancillary service revenues see Ex. G1-T1-S1.

Exhibit J1-T1-S1 Table 3 summarizes the hydroelectric ancillary services variance for 2005, 2006, and 2007.

3.2 Segregated Mode and Water Transactions Net Revenue Account

In addition to the variance accounts listed in O. Reg. 53/05, OPG has established a Segregated Mode and Water Transactions Net Revenue Account to share a portion of its profits from segregated mode of operations and water transaction activities.

3.2.1 Segregated Mode of Operations Sub-Account

R.H. Saunders can, with the approval of the IESO, segregate some of its generation units from the Ontario grid and reconnect them directly to the Quebec grid. This is known as segregated mode of operation ("SMO"). When OPG's generation is in SMO, the units involved are no longer participating in the Ontario market, but instead receive revenues from Hydro Quebec. The remaining units, not on SMO, continue to participate in the Ontario market. SMO is described in greater detail in Ex. G1-T1-S1.

The treatment of SMO transactions is not prescribed by O. Reg. 53/05. However, OPG believes that it is appropriate to share with ratepayers a portion of the net revenues from SMO transactions earned during the interim period. OPG's SMO revenue sharing mechanism is discussed in Ex. G1-T1-S1. The proposed sharing mechanism recognizes that OPG is using prescribed assets to earn this revenue so it would only be fair to share a portion of the net revenues from SMO transactions.

Exhibit J1-T1-S1 Table 3 summarizes amounts recorded in the Segregated Mode of Operations Sub-Account for 2005, 2006, and 2007.

3.2.2 Water Transactions Net Revenue Sub-Account

OPG's regulated hydroelectric facilities also earn revenue when a portion of its water entitlement is used at the New York Power Authority generating facilities in the United States. This is referred to as a water transaction and can occur for a number of reasons as set out in Ex. G1-T1-S1. Occasionally, New York Power Authority 'transfers' a portion of its water entitlement to OPG for the same purposes. Further details of water transactions are discussed in Ex. G1-T1-S1.

While the treatment of water transaction revenue is not prescribed by O. Reg. 53/05, OPG believes that sharing with Ontario ratepayers a portion of the profits earned during the interim period, is appropriate. OPG's water transaction revenue sharing mechanism is discussed in Ex. G1-T1-S1. The proposed sharing mechanism preserves an incentive for OPG to engage in water transactions while sharing a portion of the net revenues with ratepayers. The proposed division of water transaction net revenues is fair to consumers and recognizes OPG's role in developing opportunities and facilitating arrangements and encourages OPG to optimize the use of its regulated assets.

Exhibit J1-T1-S1 Table 3 summarizes water transactions for 2005, 2006, and 2007.

3.2.3 Interest on Hydroelectric Variance Accounts

Ontario Regulation 53/05 establishes an interest rate (six percent) and a methodology for applying interest (compounded annually, on the opening monthly balance) for the hydroelectric variance accounts OPG has been directed to establish. OPG has applied this rate and methodology to the Segregated Mode and Water Transactions Net Revenue account described above.

In May 2005, OPG started to apply interest at six percent, as May was the first month with an opening balance.

4.0 EXISTING NUCLEAR VARIANCE AND DEFERRAL ACCOUNTS

Ontario Regulation 53/05 established three nuclear deferral accounts and two variance accounts. The deferral accounts capture:

- Non-capital costs associated with the PARTS Deferral Account.
- Costs associated with an increase in nuclear decommissioning liabilities that result from any change in its nuclear decommissioning liability arising from an approved reference plan (Nuclear Liability Deferral Account, Transition).

- Costs to develop nuclear generation capacity (Nuclear Development Deferral Account, Transition)

The variance accounts established for the interim period are for recording:

- Costs to refurbish, increase or add generation capacity (Capacity Refurbishment Variance Account).
- Capital and non-capital costs incurred and revenues earned or foregone on or after April 1, 2005 due to deviations from forecasts as set out in the “Forecast Information (as of Q3/2004) for Facilities Prescribed under Ontario Regulation 53/05”, posted on the OEB website for the following nuclear matters:
    - Unforeseen changes to nuclear regulatory requirements or unforeseen technological changes.
    - Ancillary service revenues.
    - Acts of God.
    - Costs associated with transmission outages and restrictions not otherwise recovered.

The nuclear deferral and variance account balances are summarized in Ex. J1-T1-S1 Table 4. The IVA “sub-accounts” associated with the revenue requirement impact of unforeseen changes in nuclear technology or regulatory requirements and acts of God had zero balances on December 31, 2007.

4.1 Pickering A Return to Service (“PARTS”) Deferral Account

There are three sections of O. Reg. 53/05 that establish and specify the treatment and recovery of costs related to the PARTS Deferral Account, as follows:

- 5 (4) OPG shall establish a deferral account in connection with section 78.1 of the Act that records non-capital costs incurred on or after January 1, 2005 that are associated with the planned return to service of all units at the Pickering A Generating Station, including those units which the Board of Directors has determined should be placed in safe storage.

- 5 (5) For the purposes of subsection (4), the non-capital costs include, but are not restricted to:
  (a) Construction costs, assessment costs, pre-engineering costs, project completion costs, and demobilization costs.
  (b) Interest costs, recorded as simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually.

- 6 (2) 3 The Board shall ensure that OPG recovers the balance recorded in the deferral account established under subsection 5 (4). The Board shall authorize recovery of the balance on a straight line basis over a period not to exceed 15 years.

Subsection 6 (2) 5 of O. Reg. 53/05 provides that the OEB shall accept the balances in OPG's audited financial statements. OPG's audited financial statements specifically provide OPG's PARTS balance in the financial statement note associated with regulatory assets and liabilities. OPG's 2007 audited financial statements continue this note disclosure.

The PARTS Deferral Account balance, net of accumulated amortization is $183.8M on December 31, 2007. Exhibit J1-T1-S1 Table 5 summarizes the activity in the PARTS Deferral Account from January 1, 2005 - December 31, 2007.

4.1.1 Pickering A Return to Service Project Costs

Effective January 1, 2005, as a result of O. Reg. 53/05, OPG deferred all non-capital (OM&A) costs related to the PARTS project. These costs are tracked in OPG's project management and financial systems, and were audited as part of OPG's financial statement audit process.

From January 1, 2005 - December 31, 2007, OPG deferred costs of $271M as follows:

Chart 1

OPG Deferred Costs – January 1, 2005 – December 31, 2007

	2005	2006	2007	Total
Unit 1	228.1	4.0		232.1
Unit 2	16.0			16.0
Unit 3	3.4			3.4
General	10.8	8.6	0.1	19.5
Total	258.3	12.6	0.1	271.0

<u>Unit 1 Return to Service Costs</u>

Two hundred and thirty two million dollars of non-capital costs were incurred to return Unit 1 to service during the January 1, 2005 - December 31, 2007 period. Forty-three percent of this total cost was for performing maintenance and minor refurbishment of equipment. Sixteen million dollars was spent on safety, licensing, environmental qualification, and policy and procedures and related work. Thirty-eight million dollars of the total represents project management costs incurred by contractors and includes time for estimating, scheduling, and costing work, time for all managers above the general foreman level, and administrative support. Thirty-five million dollars of this total cost was for OPG support functions including Management, Engineering, Human Resources, Finance, and Regulatory Affairs. Forty-two million dollars represents infrastructure costs for leases and maintenance of facilities, as well as training and small tools and equipment.

<u>Assessment Costs for Units 2 and 3</u>

The scope of the PARTS project included an assessment of the physical condition of plant components at Units 2 and 3 in order to estimate the cost of returning these units to service. Following the condition assessment, OPG conducted a financial analysis in order to determine whether these units should be returned to service. On August 11, 2005 the Board of Directors of OPG accepted management’s recommendation not to return Units 2 and 3 to service. These assessment costs were recorded in the PARTS Deferral Account because they meet the criteria in section 5 (5) of O. Reg. 53/05.

After this decision was made, the Board directed management to preserve the value of the work that had been completed to date. This consisted of completing documentation and storage of engineering drawings and inspections. Total costs recorded in the PARTS Deferral Account for Units 2 ($16.0M) and Unit 3 ($3.4M) are reflected in the chart above. The costs for placing the units in safe storage are not recorded in the PARTS Deferral Account and are discussed in Ex. D2-T1-S1.

General Project Completion and Demobilization Costs

Once the decision was made to not return Units 2 and 3 to service, OPG took steps to close down the PARTS project. OPG has recorded $19.5M of general costs in the PARTS Deferral Account for project completion and demobilization. The costs include construction close out costs for moving materials, costs for cleaning and dismantling scaffolding, costs to reassign staff working on the PARTS project to other activities, leasing costs for storage facilities, prepaid insurance costs, and regulatory requirements such as satisfying environmental assessment conditions. These types of costs are normally incurred at the end of a project and meet the criteria in section 5 (5) of O. Reg. 53/05.

4.1.2 Pickering A Return to Service Amortization

During the interim rate period the PARTS amortization was calculated using a "unit of production" method. Amortization was calculated as actual nuclear production multiplied by an amortization rate. The amortization rate, in $/MWh, was calculated based on the information provided by OPG to the Province for the purposes of establishing the interim payment amount. This information reflected a 10-year amortization of costs from the in-service date of each unit. The amortized costs forecast for each period, divided by the forecast production in that period, resulted in a $/MWh rate, which was applied to OPG's actual nuclear production during the interim rate period. Exhibit J1-T1-S1 Table 6 illustrates how the PARTS amortization was determined and applied.

The amortization method used during the interim period ensures that the opening balance of the PARTS Deferral Account for the test period excludes costs that were already recovered through interim rates. OPG proposes to continue this methodology going forward with one exception: OPG proposes that the amortization period be extended to 15 years to more closely match the recovery of costs with the benefits of increased generation associated with PARTS project. The recovery methodology is discussed more fully in Ex. J1-T2-S1.

4.1.3 Interest on PARTS Deferral Account Balances

OPG has applied interest to the PARTS Deferral Account as specified in O. Reg. 53/05. It states in section 5 (5) that for the purposes of subsection 5 (4), “the non-capital costs include, but are not restricted to: b) interest costs, recorded as simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually”. In February 2005, OPG started to apply the six percent interest rate, as February was the first month with an opening balance.

4.2 Nuclear Liability Deferral Account

OPG will incur costs associated with decommissioning its nuclear facilities and managing used fuel and intermediate level waste. These costs are recognized as expenses over the life of the nuclear stations and are included in payment amounts because they are part of the cost of operating the nuclear stations. On December 31, 2006, OPG recorded in its financial statements an increase of approximately $1,386M to its nuclear decommissioning, nuclear used fuel management, and nuclear low and intermediate level waste management liabilities (together the “nuclear decommissioning liabilities”) and correspondingly increased the nuclear fixed asset balance. This increase in nuclear decommissioning liabilities is as a result of a new reference plan approved by the Province on December 13, 2006. The increase in the nuclear decommissioning liabilities and the related revenue requirement impacts were not contemplated when interim payment amounts were set by the Province. OPG’s accounting and regulatory treatment of nuclear liabilities is discussed in Ex. H1-T1-S2.

Under O. Reg. 53/05, OPG is required to establish a deferral account “that records for the period up to the effective date of the Board’s first order under section 78.1 of the Act the revenue requirement impact of any change in its nuclear decommissioning liability arising from an approved reference plan, approved after April 1, 2005, as reflected in the audited financial statements approved by the board of directors of Ontario Power Generation Inc." In the context of O. Reg. 53/05, "nuclear decommissioning liability" is defined as "the liability of Ontario Power Generation Inc. for decommissioning its nuclear generating facilities and the management of its nuclear waste and nuclear fuel". The change in the liability must arise from an "approved reference plan," which is defined by O. Reg. 53/05 as "a reference plan, as defined in the Ontario Nuclear Funds Agreement, which has been approved by Her Majesty the Queen in the right of Ontario in accordance with that agreement." OPG established a Nuclear Liability Deferral Account - transition to reflect recovery of costs incurred prior to the OEB's first payment order (a separate "Nuclear Liability Deferral Account" will reflect recovery of costs after the OEB first payment order, as discussed in Ex. J1-T3-S1.

As per the terms of O. Reg. 53/05 OPG has recorded amounts in the Nuclear Liabilities Deferral Account - transition for the revenue requirement impacts of the return on rate base, depreciation expense, capital tax, and fuel expense as specifically identified in O. Reg. 53/05.

Additionally, O. Reg. 53/05 requires OPG to record "simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually."

The Nuclear Liability Deferral Account-transition balance as at December 31, 2007 consists of:

Chart 2

Nuclear Liability Deferral Account-Transition Balance

	M$
Return on Rate Base	**75.4**
Depreciation	**53.7**
Capital Tax	**3.1**
Fuel Expense	**(5.2)**
Interest	**3.5**
Total	**130.5**

In summary:

- Return on rate base for the interim period is computed using a rate base of $1,358M (the average value for 2007), a deemed capital structure of 55 percent debt with a six percent interest rate and 45 percent equity with an allowed rate of return on equity of five percent, consistent with the information used by the Province for the purpose of establishing OPG's interim payments.
- Depreciation expense corresponds to the actual accounting depreciation expense related to the increase in OPG's nuclear liabilities.
- The fuel expense recorded in the deferral account is the present value of the variable costs related to incremental quantities of used fuel generated in each period, and is recovered as a portion of OPG's nuclear fuel expense, as presented in Ex. F2-T5-S1 Table 1. The variable rate applied to each fuel bundle extracted in 2007 is lower than the initial rate that was used in the reference plan, which results in an increase in the nuclear liability account. The lower rate resulted from new operating assumptions, specifically, station lives were extended, which results in a lower rate because there is a longer period of time available to collect these costs.
- Capital taxes are calculated on the increase in rate base resulting from the recording of OPG's revised asset retirement obligations. The accounting for the asset retirement obligation and rate base impact is discussed in Exhibit H. OPG calculates capital taxes for regulatory purposes by applying OPG's actual capital tax rate applicable to 2006 of 0.3 percent to its forecast rate base for the period. OPG's capital tax methodology is described in Ex. F3-T2-S1.
- Income tax expense is incurred as OPG collects the balance in this deferral account. However, no income tax expense was recorded in the deferral account during the interim rate period because OPG did not incur any income tax expense related to this account during this period. During the test period, any income tax associated with this account will be offset by the return of regulated tax losses. Beginning in 2010, OPG expects that there will be a requirement to include income tax expense related to this account in the revenue requirement as all of the regulated tax losses will have been returned to ratepayers.

Interest expense is determined at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually, as provided in O. Reg. 53/05.

4.3 Nuclear Development Deferral Account, Transition and Capacity Refurbishment Variance Account

During the interim period, OPG incurred costs associated with assessing the feasibility of refurbishing certain of its nuclear facilities and beginning the approvals process for new nuclear capacity at an existing site.

This work is being undertaken in furtherance of a directive that OPG received on June 16, 2006 from its shareholder, the Province as represented by the Minister of Energy. This directive recognizes that maintaining the current level of nuclear capacity through 2025 requires a combination of refurbishment and the addition of capacity at existing nuclear sites.

The costs for these two accounts are summarized in Ex. J1-T1-S1 Table 7 and Table 8.

4.3.1 <u>Nuclear Development Deferral Account, Transition</u>

There are four sections of O. Reg. 53/05 that establish and specify the treatment and recovery of costs related to the Nuclear Development Deferral Account, Transition as follows:

- 5.3 (1) Ontario Power Generation Inc. shall establish a deferral account in connection with section 78.1 of the Act that records, for the period up to the effective date of the Board’s first order under section 78.1 of the Act, the costs incurred and firm financial commitments made on or after June 13, 2006, in the course of planning and preparation for the development of proposed new nuclear generation facilities that are associated with any one or more of the following activities:

    1. Activities for carrying out an environmental assessment under the *Canadian Environmental Assessment Act.*

2. Activities for obtaining any governmental licence, authorization, permit or other approval.
3. Activities for carrying out a technology assessment or for defining all commercial and technical requirements to, or with, any third parties.

- 5.3 (2) Ontario Power Generation Inc. shall record simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually.

- 6(2) 4.1 The Board shall ensure that Ontario Power Generation Inc. recovers the costs incurred and firm financial commitments made in the course of planning and preparation for the development of proposed new nuclear generation facilities, to the extent the Board is satisfied that,

    i. the costs were prudently incurred, and

    ii. the financial commitments were prudently made.

- 6(2) 7.1 The Board shall ensure the balances recorded in the deferral account established under subsection 5.3 (1) and the variance account established under subsection 5.4 (1) are recovered on a straight line basis over a period not to exceed three years, to the extent the Board is satisfied that,

    i. the costs were prudently incurred, and

    ii. the financial commitments were prudently made.

Subsection 6 (2) 5 of O. Reg. 53/05 provides that the OEB shall accept the balances in OPG's audited financial statements. OPG's 2007 audited financial statements includes the Nuclear Development Deferral Account, Transition balance in the regulatory asset described as Nuclear generation development costs in financial statement note 7.

OPG has incurred costs associated with developing nuclear capacity at Darlington. No costs for nuclear development were included in the information provided to the Province for the purposes of establishing the interim payment amount. OPG's costs for adding capacity at Darlington including budgets and other supporting information are discussed in Ex. D2-T1-S3. OPG's balance in this account on December 31, 2007 is summarized in Ex. J1-T1-S1 Table 8.

4.3.2 Capacity Refurbishment Variance Account

Paragraph 6 (2) 4 of the Regulation, dealing with rules governing the determination of payment amounts by the OEB, states that the OEB:

> "Shall ensure that Ontario Power Generation Inc. recovers capital and non-capital costs, and firm financial commitments incurred to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2, including, but not limited to, assessment costs and pre-engineering costs and commitments,
> (i) if the costs and financial commitments were within the project budgets approved for that purpose by the Board of Directors of OPG before the making of the Board's first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., or
> (ii) if the costs and financial commitments were not approved by the Board of Directors of OPG before the making of the Board's first order under section 78.1 of the Act in respect of OPG, if the Board is satisfied that the costs were prudently incurred and that the financial commitments were prudently made."

OPG has incurred costs associated with plans to refurbish units at Pickering B and Darlington. The costs were incurred to perform an assessment of the feasibility of refurbishing units at Pickering B and Darlington, including developing a cost estimate based on the physical condition of plant components, considering environmental and regulatory requirements, and timing for completing the work. This work is in furtherance of the June 16, 2006 directive. The costs associated with this work are covered by subparagraph 6 (2) 4 (i) of O. Reg. 53/05 and were within the project budgets approved by the Board of Directors of OPG for this purpose.

OPG's Capacity Refurbishment Variance Account records costs that were not included in the information provided by OPG to the Province for the purposes of establishing the interim payment amount. OPG's nuclear development costs, budgets, and other supporting information are discussed in Ex. D2-T1-S3. OPG's balance in this account on December 31, 2007 is summarized in Ex. J1-T1-S1 Table 8.

The process of life extending an existing facility is very complex and has not been undertaken in Canada for many years. Both the costs and the detailed schedule commitments are subject to change over a relatively short period due to changing regulatory requirements, work schedules, and supplier constraints. This is one of the characteristics that support OPG's position that these expenditures be subject to variance account treatment during the test period.

Subsection 6 (2) 5 of O. Reg. 53/05 provides that the OEB shall accept the balances in OPG's audited financial statements. OPG's 2007 audited financial statements includes the Capacity Refurbishment Variance Account balance in the regulatory asset described as Nuclear generation development costs in financial statement note 7.

4.3.3 Interest

Interest expense related to OPG's Nuclear Development Deferral Account, transition is described in Section 5.3(2) of O. Reg. 53/05. Section 5.3 (2) provides that OPG shall record simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually. O. Reg. 53/05 does not prescribe a methodology or interest rate associated with recovery of costs of capacity refurbishment, increase or addition. As the Government Directive of July 16, 2007 provides that a combination of nuclear development and refurbishment is required to meet the objective of maintaining the current level of nuclear capacity until 2025, OPG has applied the same rate and methodology to amounts recorded in the Capacity Refurbishment Variance Account established above.

4.4 Interim Variance Account ("IVA") - Nuclear

The basis for the IVA was discussed in section 3.1 above. This section highlights those aspects of the IVA associated with the nuclear matters:

- Unforeseen changes to nuclear regulatory requirements or unforeseen technological changes which directly affect the nuclear generation facilities.
- Ancillary service revenues.
- Acts of God.
- Costs associated with transmission outages and restrictions not otherwise recovered.

Subsection 5 (3) of O. Reg. 53/05 states that OPG shall record simple interest on the monthly opening balance of the interim variance account at an annual rate of six percent, compounded annually.

OPG has used “sub-accounts” to record capital and non-capital costs incurred and revenues earned or foregone after April 1, 2005 for its nuclear operations for: ancillary services revenues and transmission outages and restrictions, which are described below. As noted above, OPG had a zero balance at December 31, 2007 for the other IVA provisions (e.g., no amounts were recorded with respect to acts of God). Exhibit J1-T1-S1 Table 9 summarizes the account balances for 2005, 2006, and 2007.

4.4.1 Ancillary Service Net Revenues Sub-Account

OPG compares the actual nuclear ancillary services revenue with the amounts included in the forecast information provided to the Province for establishing the interim payment amounts and records the difference in this variance account. Ancillary services include operating reserve, and reactive support/voltage control service. For a full discussion of ancillary service revenues see Ex. G1-T1-S1. Exhibit J1-T1-S1 Table 10 summarizes the results for 2005, 2006, and 2007.

4.4.2 Transmission Outages and Restrictions Sub-Account

When OPG’s nuclear generation facilities are derated or constrained-off due to a transmission outage or restriction, OPG tracks the details for posting to this sub-account.

OPG calculates the lost production immediately following any transmission-related event that derates or constrains-off OPG's regulated generation, including from nuclear facilities. The amount of lost production is determined as the variance between actual production and the hourly capability of the facility for the duration of the transmission related event, multiplied by the regulated rate of $49.50/MWh. The duration of the outage is equal to the length of time that the grid is not available, plus the length of time that it takes for a facility to return to full production following the transmission outage. As required by O. Reg. 53/05, OPG reduces the financial impact of a transmission outage/restriction by any congestion management settlement credits payments that are received from the IESO.

OPG has recorded in the nuclear variance account amounts in excess of the congestion management settlement credits received for three transmission outages. These outages occurred at its Darlington Generating Station on: December 12, 2005; April 25/26 and June 17/18 2006. Exhibit J1-T1-S1 Table 11 summarizes the three outages.

4.4.3 Interest on Nuclear Variance Account Balances

Section 5 (3) of O. Reg. 53/05 states that OPG shall record simple interest on the monthly opening balance of the variance account at an annual rate of six percent, compounded annually.

Numbers may not add due to rounding.

Updated: 2008-06-18
EB-2007-0905
Exhibit J1
Tab 1
Schedule 1
Table 1

Table 1
Summary of Deferral and Variance Accounts
Closing Account Balances 2005 through 2007 ($M)

Line No.	Account	2005	2006	2007
		(a)	(b)	(c)
	Regulated Hydroelectric (including interest):			
1	**Interim Variance Account**	2.4	(2.3)	13.4
2	**Segregated Mode and Water Transactions Net Revenue Variance Account**	(11.2)	(13.6)	(16.2)
3	**Total**	(8.8)	(15.9)	(2.8)
	Nuclear (including interest):			
4	**Interim Variance Account**	(0.5)	0.1	(0.1)
5	**Deferral Accounts (including Capacity Refurbishment Variance Account)**	254.3	254.5	342.2
6	**Total**	253.8	254.6	342.1
7	**Grand Total**	245.0	238.7	339.3

Numbers may not add due to rounding.

Table 2
Variance Accounts - Regulated Hydroelectric
Summary of Closing Balances 2005 through 2007 ($M)

Line No.	Account	2005	2006	2007
		(a)	(b)	(c)
1	**Water Conditions**	(3.3)	(3.8)	6.7
2	**Ancillary Services**	5.7	1.5	6.7
3	**Segregated Mode**	(9.9)	(10.6)	(11.5)
4	**Water Transactions**	(1.2)	(2.1)	(3.0)
5	**Total Interest**	(0.1)	(0.9)	(1.7)
6	**Total**	(8.8)	(15.9)	(2.8)

Numbers may not add due to rounding.

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Tab 1
Schedule 1
Table 3

Table 3
Variance Accounts - Regulated Hydroelectric
Summary of Annual Amounts 2005 through 2007 ($M)

Line No.	Account	2005	2006	2007
		(a)	(b)	(c)
	Water Conditions and Ancillary Services			
	Water Conditions:			
1	**Reference Plan Production (MWh)**	12,598,933	17,354,503	17,614,335
2	**Calculated Actual Production (MWh)**	12,800,850	17,457,904	17,097,556
3	**Difference**	(201,917)	(103,401)	516,779
4	**Revenue @ 33 $/MWh**	(6.7)	(3.4)	17.1
5	**GRC/Water Rental**	3.4	2.9	(6.6)
6	**Net Amount for Variance Account**	(3.3)	(0.5)	10.5
	Ancillary Services:			
7	**Reference Revenue**	29.7	39.9	40.8
8	**Actual Revenue**	24.0	44.1	35.6
9	**Difference**	5.7	(4.2)	5.2
10	**Net Amount for Variance Account**	5.7	(4.2)	5.2
11	**Interest on Above Two Accounts**	0.0	0.0	0.0
	Segregated Mode and Water Transactions			
	Segregated Mode of Operation:			
12	**Revenue in Excess of 33 $/MWh**	15.6	5.6	3.1
13	**Revenue in Excess of HOEP**	8.3	6.2	2.9
14	**Ratepayer Share**	7.3	(0.6)	0.2
15	**Revenues for 50/50 Sharing (Note 1)**	9.0	8.9	6.4
16	**Costs**	(4.0)	(6.1)	(4.8)
17	**Net Revenue to Share**	5.0	2.8	1.6
18	**Ratepayer's Share 50%**	2.5	1.4	0.8
19	**Net Amount for Variance Account**	(9.9)	(0.7)	(0.9)
	Water Transactions:			
20	**Ratepayer Share**	1.2	0.9	0.9
21	**Net Amount for Variance Account**	(1.2)	(0.9)	(0.9)
22	**Interest on Above Two Accounts**	(0.1)	(0.8)	(0.8)
23	**Grand Total**	(8.8)	(7.1)	13.1

Note 1: Changed formula as per the "Adjustment to SMO Sharing Methodology" in G1-T1-S3.

Table 4
Variance and Deferral Accounts - Nuclear
Summary of Closing Balances 2005 through 2007 ($M)

Line No.	Account	2005	2006	2007
		(a)	(b)	(c)
1	**PARTS Deferral Account**	255.7	251.4	183.8
2	**Nuclear Liability Deferral Account**	0.0	0.0	130.5
3	**Nuclear Development Deferral Account**	0.0	0.3	11.7
4	**Capacity Refurbishment Variance Account**	(1.4)	2.8	16.2
	Interim Variance Account:			
5	**Ancillary Services Variance Sub-Account**	(0.9)	(1.5)	(1.7)
6	**Transmission Outages/Restrictions Variance Sub-Account**	0.4	1.6	1.6
7	**Interest on Interim Variance Account**	0.0	0.0	0.0
8	**Total Balances**	253.8	254.6	342.1

Numbers may not add due to rounding.

Table 5
Continuity of PARTS Deferral Account - Nuclear
Years Ending 2005 through 2007 ($M)

Line No.	Account	2005 Additions	2005 Closing Balance	2006 Additions	2006 Closing Balance	2007 Additions	2007 Closing Balance
		(a)	(b)	(c)	(d)	(e)	(f)
1	**PARTS - Costs**	258.3	258.3	12.6	270.9	0.1	271.0
2	**PARTS - Accumulated Amortization**	(11.9)	(11.9)	(31.9)	(43.8)	(80.5)	(124.3)
3	**PARTS - Accumulated Interest**	9.3	9.3	15.0	24.3	12.8	37.1
4	**PARTS - Total**	255.7	255.7	(4.3)	251.4	(67.6)	183.8

Table 6
PARTS Amortization - Nuclear
For the Years 2005 through 2007

Line No.	Year	Reference Plan[1] Total[2] (M$)	Reference Plan[1] Production (MWh)	Reference Plan[1] Rate[4] ($/MWh)	Actual Results Production (MWh)	Actual Results Amortization (M$)
		(a)	(b)	(c)	(d)	(e)
1	**2005[3]**	12.1	33,837,000	0.36	33,028,952	11.9
2	**2006**	34.5	50,557,000	0.68	46,921,808	31.9
3	**2007**	96.7	53,007,000	1.82	44,248,098	80.5
4	**Total**	143.3	137,401,000	N/A	124,198,858	124.3

1 Reference Plan refers to forecast information as of Q3 2004 for Facilities Prescribed under O.Reg. 53/05

2 Consists of amortization plus return.
Amortization is based on straight line 10 year amortization of Unit 1 $227M in-service September 1, 2005 and Unit 2 $558M in-service April 1, 2007.
Return is Rate Base x 5.55% WACC (ROE of 5%, interest rate of 6% and debt/equity ratio of 55%/45%.

3 2005 production is for April 1, 2005 to December 31, 2005

4 The amortization rate increases from 2005 to 2006 to reflect the full year amortization impact of PARTS deferred costs. The 2007 increase from 2006 reflects the additional amortization of Unit 2, which was forecast to be placed in service in 2007.

Table 7
Nuclear Development and Capacity Refurbishment Costs
Summary of Closing Balances 2005 through 2007 ($M)

Line No.	Account	2005	2006	2007
		(a)	(b)	(c)
	Deferral and Variance Accounts (including interest):			
1	**Nuclear Development Deferral Account**	0.0	0.3	11.7
2	**Capacity Refurbishment Variance Account**	(1.4)	2.8	16.2
3	**Total Balances**	(1.4)	3.1	27.9

Numbers may not add due to rounding.

Table 8
Nuclear Development and Capacity Refurbishment Costs
Summary of Cost Deferrals and Variances 2005 through 2007 ($M)

Line No.	Year	Reference Plan[1]	Actual	(b)-(a) Deferral or Variance	Interest	(c)+(d) Annual Amount	(f)+(e) Closing Balance
		(a)	(b)	(c)	(d)	(e)	(f)
	Nuclear Development Deferral Account:						
1	**2005**	0.0	0.0	0.0	0.0	0.0	0.0
2	**2006**	0.0	0.3	0.3	0.0	0.3	0.3
3	**2007**	0.0	11.2	11.2	0.2	11.4	11.7
	Capacity Refurbishment Variance Account:						
4	**2005**	2.6	1.2	(1.4)	0.0	(1.4)	(1.4)
5	**2006**	7.0	11.3	4.3	(0.1)	4.2	2.8
6	**2007**	11.0	23.8	12.8	0.6	13.4	16.2

1 Reference Plan refers to forecast information as of Q3 2004 for Facilities Prescribed under O.Reg. 53/05. OPG's reference plan did not include a forecast for Nuclear Development.

Numbers may not add due to rounding.

Table 9
Continuity of Variance Account - Nuclear
For the Years Ending 2005 through 2007 ($M)

Line No.	Account	2005 Additions	2005 Closing Balance	2006 Additions	2006 Closing Balance	2007 Additions	2007 Closing Balance
		(a)	(b)	(c)	(d)	(e)	(f)
1	**Ancillary Services**	(0.9)	(0.9)	(0.6)	(1.5)	(0.2)	(1.7)
2	**Transmission Outages/Restrictions**	0.4	0.4	1.2	1.6	0.0	1.6
3	**Interest**	0.0	0.0	0.0	0.0	0.0	0.0
4	**Total**	(0.5)	(0.5)	0.6	0.1	(0.2)	(0.1)

Numbers may not add due to rounding.

Table 10
Ancillary Services - Nuclear
Summary of Annual Amounts 2005 through 2007 ($M)

Line No.	Account	2005	2006	2007
		(a)	(b)	(c)
1	**Reference Plan Revenue**	1.9	2.5	2.6
2	**Actual Revenue**	2.8	3.1	2.8
3	**Difference**	(0.9)	(0.6)	(0.2)
4	**Net Amount for Variance Account**	(0.9)	(0.6)	(0.2)

Numbers may not add due to rounding.

Table 11
Transmission Outages
Summary of Annual Amounts 2005 through 2007 - Nuclear ($M)

Line No.	Account	Lost Production (MWh)	(a)x49.50 $/MWh Revenue	CMSC	(b)-(c) Net Amount for Variance Account
		(a)	(b)	(c)	(d)
1	**December 12, 2005**	13,756	0.7	0.3	0.4
2	**Closing Balance 2005**				0.4
3	**April 25/26, 2006**	12,827	0.6	0.0	0.6
4	**June 17/18, 2006**	12,740	0.6	0.0	0.6
5	**Closing Balance 2006**				1.6
	(No 2007 events)				
6	**Closing Balance 2007**				1.6

CLEARANCE OF DEFERRAL AND VARIANCE ACCOUNTS

1.0 PURPOSE

This evidence describes OPG's proposed approach for clearing the deferral and variance account balances described in Ex. J1-T1-S1.

2.0 SUMMARY

OPG's proposed recovery is based on its deferral and variance account balances as at December 31, 2007, as reflected in its 2007 audited financial statements, consistent with the requirements of subsection 6 (2) 5 of the Regulation.

This subsection requires the OEB to use the asset and liability values in the last audited financial statements approved by OPG's Board of Directors prior to the making of the OEB's first payment order.

OPG proposes to recover its total December 31, 2007 hydroelectric variance account balances during the test period as a reduction in OPG's proposed hydroelectric revenue requirement. OPG proposes to recover a portion of its December 31, 2007 nuclear deferral and variance accounts during the test period through a payment rider as explained in section 5.0 below. OPG has summarized its proposals for the recovery of the deferral and variance balances in Ex. J1-T2-S1 Table 1.

OPG does not propose to recover amounts recorded after December 31, 2007 as part of this Application. As discussed in Ex. J1-T1-S1, OPG will continue to apply interest to the opening monthly balance in these accounts, as reduced by the actual amounts recovered, until the balances in these accounts are fully recovered.

OPG proposes to clear the deferral and variance account balances associated with its nuclear operations by December 31, 2010, with the exception of the Pickering A Return to Service ("PARTS") Deferral Account balance, which OPG proposes to recover by December 31, 2019 as discussed below. OPG proposes to apply a payment rider on its test period nuclear production to recover the test period portion of the December 31, 2007 variance and deferral account balances.

The methodology and rationale for OPG's proposed recovery of its December 31, 2007 deferral and variance account balances is described in section 3.0. The recovery of hydroelectric variance account balances in OPG's proposed test period revenue requirement is discussed in section 4.0. The recovery of nuclear deferral and variance account balances through a payment rider is discussed in section 5.0

3.0 METHODOLOGY

OPG generally favours recovering deferral and variance account balances through separate payment riders. However, given that the size of the resulting hydroelectric payment rider would be very small, OPG proposes instead to recover is hydroelectric variance account balances in its test period revenue requirement.

The use of payment riders in the form of a $/MWh rate is consistent with past OEB decisions pertaining to the recovery of regulatory assets (i.e., RP-2004-0117, RP-2004-0118, RP 2004-0100, RP-2004-0069, RP-2004-0064).[1] On page 84 of these decisions the OEB approved the recovery of variance and deferral accounts balances through a variable charge, rather than a fixed charge or combination of the two. The OEB stated that this approach is "consistent with the principle that fixed charges should be generally associated with longer term assets of the utility; regulatory assets are not seen as fitting this profile" and that "recovery for the volumetric component is more conducive to encouraging and rewarding ratepayers for their conservation efforts." The OEB concluded that "the most practical and administratively efficient method of recovery is through a single rate rider per rate class on the volumetric distribution charge."

OPG proposes to use a single payment rider rather for 2008 and 2009 as this is easier to understand, implement, and explain than separate riders for each year. As the payment rider

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[1] These decisions issued December 9, 2004 address many policy issues regarding the disposition of deferral and variance accounts for four large electricity distributors, and provide disposition guidelines for Ontario's other electric distributors.

is based upon forecast production, any differences between forecast and actual production during the test period will cause a variance. This variance will be carried forward to OPG's next payment application. This approach is fair both to consumers and to OPG as the balances approved by the OEB would not be over- or under-recovered. This approach is also consistent with the requirements of O. Reg. 53/05, which provides that the OEB shall ensure recovery of specific deferral and variance account balances.

OPG's proposed recovery period for each deferral and variance account is based on the nature of the balances recorded. Deferral or variance account balances associated with long-term assets or liabilities will be recovered over a longer period to match the recovery of the costs/revenues as closely as possible with the benefits associated with those costs/revenues. Deferral or variance account balances, which flow from differences between actual expenditures/revenues in the interim period and the forecast expenditures/revenues included in the information provided to the Province for the purpose of establishing the interim payment amounts, will be recovered over a shorter period consistent with the terms of the Regulation.

OPG proposes that all recovery periods extend until the end of OPG's fiscal year (i.e., December 31) Recovery by the end of a fiscal year simplifies OPG's year end financial reporting and provides a validation of the account balance recovery through OPG's financial statement audit process. Specific recovery periods for deferral and variance accounts are discussed in section 4.0 for hydroelectric variance accounts and section 5.0 for nuclear deferral and variance accounts.

4.0 RECOVERY OF HYDROELECTRIC VARIANCE ACCOUNTS

All of OPG's regulated hydroelectric variance accounts have balances that reflect the differences between actual expenditures/revenues or revenue sharing in the interim period and the forecast expenditures/revenues included in the information provided to the Province for the purpose of establishing the interim payment amounts. As such, recovery over a short-term period is appropriate.

The hydroelectric variance account balances, coupled with its forecast hydroelectric production for the test period, would produce a payment rider of $0.1/MWh. Given the very small size of the resulting payment rider and the nature of the amounts in these accounts, OPG proposes to include these balances in its test period revenue requirement in the interest of simplicity. OPG's proposed hydroelectric revenue requirement reflects the recovery of these balances over the test period on a straight-line amortization basis.

Paragraph 6 (2) 1 of the Regulation requires that the OEB ensure variance account balances recorded pursuant to section 5 (1) (the interim variance account balances) are recovered over a period not to exceed three years. OPG's proposal to include interim variance account balances in its 21 month test period revenue requirement is within the limits established by the Regulation.

5.0 RECOVERY OF NUCLEAR DEFERRAL AND VARIANCE ACCOUNTS

The nuclear payment rider calculation is shown in Ex. J1-T2-S1 Table 3.

With the exception of the PARTS Deferral Account, none of OPG's nuclear deferral or variance account balances are associated with long-term assets or liabilities. The PARTS Deferral Account balance is associated with a long-term asset, and the extended service life of the Pickering A Generating Station will provide benefits in the form of nuclear electricity production that will be received by future ratepayers.

The deferral of costs associated with the PARTS project enables OPG to more appropriately match these costs with the benefits associated with the PARTS project. The primary benefit of the PARTS project is the increase in the productive service life of the two Pickering A units.

OPG proposes that the forecast recovery period for its PARTS Deferral Account end December 31, 2019. In a future payment application, OPG expects to make a proposal to recover the balance as at December 31, 2019 resulting from the differences between actual and forecast production in the preceding test period. OPG's recovery proposal would permit complete recovery by November 2020, which is 15 years from the in-service date of Unit 1. The proposed recovery period slightly shorter than the expected service life of Unit 1. It will also be consistent with the wording of subsection 6 (2) 3 of the Regulation which requires that OPG recover the balance in this deferral account on a straight line basis over a period not to exceed 15 years.

OPG proposes to include the test period amortization of its December 31, 2007 PARTS balance in the $/MWh nuclear payment rider, rather than using a separate fixed payment rider amount, as this approach is simple to both understand and implement. The test period amortization is calculated on a straight line basis (as required by the Regulation) commencing April 1, 2008 and ending December 31, 2019.

All of OPG's other nuclear deferral and variance accounts (non-PARTS accounts) have balances that reflect the differences between actual expenditures/revenues in the interim period and the forecast expenditures/revenues included in the information provided to the Province for the purpose of establishing the interim payment amounts. For example, the amount recorded in the Nuclear Liability Deferral Account represents the variance in defined aspects of OPG's revenue requirement prior to regulation by the OEB. Similarly, the Nuclear Increases/Additions and Refurbishments Deferral Account records the variance between the amounts actually spent on these activities in the interim period and the amounts reflected in OPG's payment amounts. The costs recorded are related to planning and pre-assessment activities, and are therefore short-term in nature.

OPG proposes to also include the test period amortization of its December 31, 2007 non-PARTS account balances in the nuclear payment rider. The test period amortization is calculated on a straight line basis commencing April 1, 2008 and ending December 31, 2010. This forecast recovery period is consistent with the portions of the Regulation that require the OEB to ensure that certain deferral or variance account balances are recovered over a period not to exceed three years.

Numbers may not add due to rounding.

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Exhibit J1
Tab 2
Schedule 1
Table 1

Table 1
Summary of Deferral and Variance Accounts Recovery Period and Methodology

Line No.	Account Description	Balance at December 31, 2007 ($M)	Recovery Period	Test Period Amount ($M)	Recovery Method
	Regulated Hydroelectric:				
1	**IVA - Ancillary**	6.7	Test Period	6.7	Revenue Requirement
2	**IVA - Water Conditions**	6.7	Test Period	6.7	Revenue Requirement
3	**Segregated Mode**	(11.5)	Test Period	(11.5)	Revenue Requirement
4	**Water Transactions**	(3.0)	Test Period	(3.0)	Revenue Requirement
5	**Interest**	(1.7)	Test Period	(1.7)	Revenue Requirement
6	**Total**	(2.8)		(2.8)	
	Nuclear:				
7	**PARTS**	183.8	Test Period + 10 years	27.4	Payment Rider
8	**Nuclear Liability**	130.5	Test Period + 1 year	83.0	Payment Rider
9	**Capacity Refurbishment and Nuclear Development**	27.9	Test Period + 1 year	17.8	Payment Rider
10	**IVA**	(0.1)	Test Period + 1 year	(0.1)	Payment Rider
11	**Total**	342.1		128.1	
12	**Nuclear Forecast Production (TWh)**[1]			88.2	
13	**Nuclear Payment Rider ($/MWh)**			1.45	
	(line 11 / line 12)				

1 Production for 2008 from April 1, 2008 to December 31, 2008

Numbers may not add due to rounding.

Table 2
Deferral and Variance Accounts
Regulated Hydroelectric

Line No.	Account Description	Recovery Amount ($M)
		(a)
	Recovery Amount at Dec. 31, 2007:	
1	**IVA - Ancillary**	6.7
2	**IVA - Water Conditions**	6.7
3	**Segregated Mode**	(11.5)
4	**Water Transactions**	(3.0)
5	**Interest**	(1.7)
6	**Total**	(2.8)
7	**2008 Recovery Amount**	(1.2)
8	**2009 Recovery Amount**	(1.6)

Numbers may not add due to rounding.

Table 3
Deferral and Variance Accounts
Nuclear Payment Rider

Line No.	Account Description	Balance Dec. 31, 2007 ($M)	Recovery Period Ending	Recovery Amount ($M)
		(a)	(b)	(c)
1	**PARTS**	183.8	Dec. 31, 2019	27.4
2	**Nuclear Liability**	130.5	Dec. 31, 2010	83.0
3	**Nuclear Development and Capacity Refurbishment**	27.9	Dec. 31, 2010	17.8
4	**IVA**	(0.1)	Dec. 31, 2010	(0.1)
5	**Total**	342.1		128.1
6	**2008 Production (TWh)[1]**			38.3
7	**2009 Production (TWh)**			49.9
8	**Total Production (TWh)**			88.2
9	**Nuclear Payment Rider ($/MWh)**			1.45
	(line 5 / line 8)			
10	**2008 Recovery Amount**			55.7
11	**2009 Recovery Amount**			72.5

1 Production for April 1, 2008 to December 31, 2008

ESTABLISHMENT OF NEW AND/OR CONTINUATION OF EXISTING DEFERRAL AND VARIANCE ACCOUNTS

1.0 PURPOSE

This evidence provides a summary of OPG's proposals to establish and/or continue existing deferral and variance accounts for the test period.

2.0 OVERVIEW

OPG's deferral and variance account proposals are presented under the following two categories:

- The continuation of certain deferral and variance accounts as provided for in O. Reg. 53/05 ("Current Accounts").
- New Accounts.

A third category of accounts ("Potential Future Accounts") is also presented. This category includes accounts which may be included in OPG's update to this application or in a future application.

OPG proposes to dispose of the December 31, 2007 balances in its existing deferral and variance accounts as described in Ex. J1-T2-S1. Amounts recovered through interim payment amounts will be recorded on a monthly basis up to the effective date of the OEB's first payment order. Interest will be determined on the monthly opening (unrecovered) balances in these accounts as described in Ex. J1-T1-S1.

OPG proposes to record interest on both existing and new deferral and variance accounts commencing at the effective date of the OEB's first payment order. Interest will be recorded as simple interest on the monthly opening balances of the accounts, compounded annually until the later of December 31, 2009 or the effective date of the OEB's next payment order in respect of OPG's prescribed assets.

OPG proposes that the interest rate applicable to all deferral and variance account balances (with the exception of the Pickering A Return to Service ("PARTS") Deferral Account discussed below) shall be the forecast interest rate applied to OPG's other long-term debt provision as discussed in Ex. C1-T2-S2. OPG's current average age to maturity of its long-term debt portfolio is just over four and a half years. Therefore the use of a long-term debt rate for these accounts is consistent with the manner in which OPG has used long-term financing arrangements.

The PARTS Deferral Account balance is to be recovered over a period not to exceed 15 years as required by O. Reg. 53/05. OPG is of the view that this asset is similar to other long-term assets reflected in rate base. Therefore OPG proposes to use the weighted average cost of capital approved by the OEB as the carrying charge for this account.

3.0 CURRENT ACCOUNTS

The Company requests approval to continue the following six deferral and variance accounts:

- PARTS Deferral Account as per subsection 5 (4) of the Regulation.
- Nuclear Liability and Deferral Account as per subsection 5.2 (1) of the Regulation.
- Interim Variance Account - Water Conditions Variance Sub-Account as per subsection 5.1 (a) of the Regulation.
- Interim Variance Account - Ancillary Services Variance Sub-Account as per subsection 5.1 (c) of the Regulation.
- Nuclear Development Variance Account as per subsection 5.4 (1) of the Regulation.
- Capacity Refurbishment Variance Account to record costs as per subsection 6 (2) paragraph 4 of the Regulation.

The need for these accounts and their operation is described in further detail in the remainder of this section.

3.1 PARTS Deferral Account

OPG shall continue the PARTS Deferral Account established pursuant to subsection 5 (4) of the Regulation.

Going forward, the only entries in the PARTS Deferral Account will be for interest and the amounts recovered. However, continuation of this account is required to satisfy the provision in the Regulation that requires the OEB to ensure OPG recovers its costs associated with the PARTS project.

Simple interest is being calculated on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually, in accordance with the Regulation. OPG proposes to apply the weighted average cost of capital approved by the OEB as the carrying charge for the PARTS Deferral Account commencing on the effective date of the OEB's first payment order. OPG's proposed recovery period of 15 years is consistent with the recovery period for OPG's PARTS capital costs as reflected in OPG's depreciation expense. Therefore, the financing of the related non-capital costs should reflect a consistent approach (i.e., the weighted average cost of capital).

3.2 Nuclear Liability Deferral Account

OPG shall establish a Nuclear Liability Deferral Account in accordance with section 5.2 of the Regulation. This account will ensure that OPG recovers its costs associated with any future changes in OPG's obligations to decommission its nuclear stations and to manage nuclear waste and used fuel (collectively, the "nuclear liabilities"). OPG's nuclear obligations, the factors used to determine the cost to address these obligations, and the potential for such factors to change over time is briefly highlighted below. OPG's nuclear liabilities are more fully described in Exhibit H1.

OPG established a Nuclear Liability Deferral Account (transition) in accordance with section 5.1 of the Regulation. As provided in the Regulation, this account records the revenue requirement impact of any change in OPG's nuclear decommissioning liability arising from an approved reference plan approved after April 1, 2005 up to the effective date of the OEB's first payment order, as reflected in the audited financial statements approved by the Board of Directors of OPG. Any balance in this account will be transferred to the Nuclear Liability Deferral Account established in accordance with section 5.2 of the Regulation on the effective date of the OEB's first payment order, and the Nuclear Liability Deferral Account (transition) will be discontinued.

The Regulation defines nuclear decommissioning liability as the liability of OPG for decommissioning its nuclear generation facilities and the management of its nuclear waste and used fuel. OPG's current obligations relate to the Pickering and Darlington Generating Stations that are operated by OPG, as well as the Bruce A and B Generating Stations that are leased by OPG to Bruce Power.

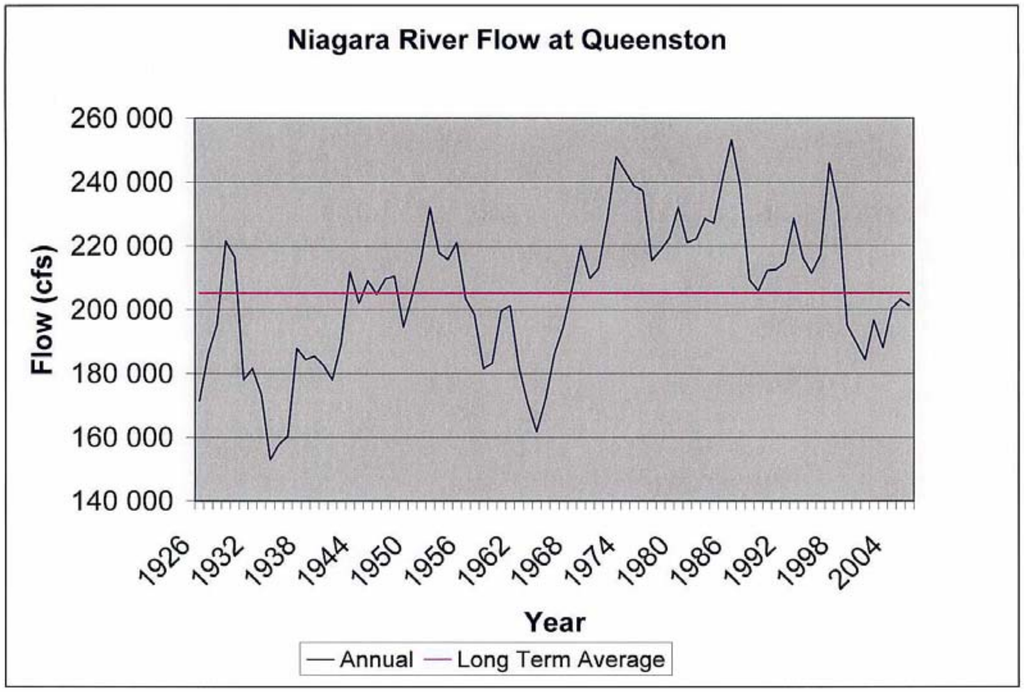
3.3 Hydroelectric Water Conditions Variance Account

OPG proposes to continue the variance account for water conditions established pursuant to subsection 5 (1) (a) of the Regulation, which directs OPG to establish a variance account to capture the impact of differences in hydroelectric electricity production due to differences between forecast and actual water conditions for its regulated hydroelectric facilities.

Forecast water conditions are subject to a high degree of forecast risk/error due to contributing factors that are beyond OPG's ability to manage or control, such as weather. The actual water flow is volatile as illustrated in the following chart which provides Niagara River flows at a point just downstream of the Sir Adam Beck plants:

Chart 1

Niagara River Flow at Queenston



Variances from forecast are highly likely based on historical experience. For example, OPG has recorded variances of ($3.3M) in 2005 and $6.7M in 2007, a range of about $10M within the last three years. Without this variance account, ratepayers would be exposed to the risk of OPG earning additional revenues and OPG would be exposed to the risk of foregone revenues due to favourable or unfavourable deviations from forecasted water conditions in the test period. These outcomes could unduly penalize or benefit one party at the benefit or expense of the other. This variance account ensures that such effects are eliminated.

A variance account to address differences between forecast and actual water conditions was accepted by the Province in respect of OPG's interim payment amounts.

3.4 Ancillary Services Variance Account

OPG proposes to continue the Ancillary Services Variance Account established pursuant to subsection 5 (1) (c) of the Regulation, which directs OPG to establish a variance account to capture the impact of changes to revenues for ancillary services from the prescribed generation facilities.

For nuclear business operations, ancillary revenues are earned through voltage control/reactive support as discussed in Ex. G2-T1-S1. OPG's forecast earnings from these services are included as an offset to its nuclear revenue requirement

For regulated hydroelectric operations, ancillary revenues are earned from the regulated stations through the offering of available generating capacity as operating reserve and through the supply of other ancillary services including voltage control/reactive support, certified black start capability, and automatic generation control as discussed in Ex. G1-T1-S1. OPG's forecast earnings from these services are included as an offset to its regulated hydroelectric revenue requirement.

The Ancillary Services Variance Account is proposed as forecast variances are highly likely and the underlying circumstances are beyond OPG's ability to manage or control. OPG has a limited ability to influence the revenues from these services as they are a function of changing demand and system/grid operating requirements and the emergence of other service providers. These factors also reduce the predictability and increase the potential variability of these revenues.

While the total variance to date has not been significant, the use of a variance account would alleviate any stakeholder concerns about forecast risk/error. The objective of fairness to customers is also achieved through a tracking and true up process.

3.5 Nuclear Development Variance Account and Capacity Refurbishment Variance Account

3.5.1 Nuclear Development

OPG shall establish a Nuclear Development Variance Account in accordance with section 5.4 of the Regulation. This account will ensure that OPG recovers differences between actual non-capital costs incurred and firm financial commitments made and the amount included in payments for planning and preparation for the development of proposed new nuclear generation facilities. OPG's nuclear development activities are described more fully in Ex. D2-T1-S3.

There are two other sections of the Regulation that establish and specify the treatment and recovery of costs related to the Nuclear Development Variance Account:

- 6(2) 4.1 The Board shall ensure that Ontario Power Generation Inc. recovers the costs incurred and firm financial commitments made in the course of planning and preparation for the development of proposed new nuclear generation facilities, to the extent the Board is satisfied that,

  i. the costs were prudently incurred, and
  ii. the financial commitments were prudently made

- 6(2) 7.1 The Board shall ensure the balances recorded in the deferral account established under subsection 5.3.(1) and the variance account established under subsection 5.4.(1) are recovered on a straight line basis over a period not to exceed three Years, to the extent the Board is satisfied that,
  i. the costs were prudently incurred, and
  ii. the financial commitments were prudently made

OPG established a Nuclear Development Deferral Account, Transition in accordance with section 5.3 of the Regulation. As provided in the Regulation, this account records development costs incurred and firm financial commitments made on or after June 13, 2006 up to the effective date of the OEB's first payment order. The account records costs incurred in the course of planning and preparation for the development of proposed new nuclear generation facilities that are associated with any one or more of the following activities:

1. Activities for carrying out an environmental assessment under the *Canadian Environmental Assessment Act.*
2. Activities for obtaining any governmental licence, authorization, permit or other approval.
3. Activities for carrying out a technology assessment or for defining all commercial and technical requirements to, or with, any third parties.

Any balance in this account will be transferred to the Capacity Refurbishment Variance Account established in accordance with section 5.4 of the Regulation on the effective date of the OEB's first payment order, and the Nuclear Development Deferral Account, Transition will be discontinued.

3.5.2 Capacity Refurbishment

OPG proposes to continue the Capacity Refurbishment Variance Account as discussed in Ex. J1-T1-S1. OPG established this account to record amounts associated with the cost recovery provisions defined in the Regulation. Paragraph 6 (2) 4 of the Regulation, dealing with rules governing the determination of payment amounts by the OEB, states that the OEB:

> "Shall ensure that Ontario Power Generation Inc. recovers capital and non-capital costs, and firm financial commitments incurred to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2, including, but not limited to, assessment costs and pre-engineering costs and commitments,
> (i) if the costs and financial commitments were within the project budgets approved for that purpose by the Board of Directors of OPG before the making of the Board's first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., or
> (ii) if the costs and financial commitments were not approved by the Board of Directors of OPG before the making of the Board's first order under section 78.1 of the Act in respect

of OPG, if the Board is satisfied that the costs were prudently incurred and that the financial commitments were prudently made."

OEB approval of the requested variance account would be consistent with the terms of the Regulation.

This account includes costs for work that is undertaken pursuant to a directive that OPG received on June 16, 2006 from its shareholder, the Province as represented by the Minister of Energy. This directive recognizes that maintaining the current level of nuclear base load through 2025 requires a combination of refurbishment and the addition of capacity at existing nuclear sites. The account includes costs that were incurred to perform an assessment of the feasibility of refurbishing units at Pickering B and Darlington, including developing a cost estimate based on the physical condition of plant components, considering environmental and regulatory requirements, and timing for completing the work. OPG forecasts to continue its nuclear refurbishment initiatives during the test period, as discussed in greater detail in Ex. D2-T1-S3.

OPG is not currently planning to commence any refurbishment of its regulated hydroelectric facilities during the test period. Should OPG incur hydroelectric refurbishment costs for its regulated facilities, the costs will be recorded in a separate sub-account.

4.0 NEW ACCOUNTS

OPG requests approval to establish the following four new deferral and variance accounts:

- Nuclear Fuel Cost Variance Account
- Segregated Mode and Water Transactions Net Revenue Variance Account
- Pension/Other Post Employment Benefits ("OPEB") Cost Variance Account
- Changes in Taxation Rates or Rules Variance Account

The rationale for these accounts and their operation is described in further detail in the remainder of this section.

4.1 Nuclear Fuel Cost Variance Account

OPG proposes to establish a Nuclear Fuel Cost Variance Account to record the difference between the forecast and actual cost of nuclear fuel expensed in the test period.

The uranium market has moved from a contract market towards a commodity market. Prices have increased substantially in recent years, and the prices have been significantly more volatile than in the past. As a result, nuclear fuel purchasing costs are becoming increasingly difficult to predict with any reasonable degree of precision for the test period. While OPG has implemented some risk mitigation measures, nuclear fuel cost volatility remains a significant business risk for OPG, and the probability of a material cost variance is high.

As noted at Ex. F2-T5-S1, the cost of the uranium concentrate is expected to represent about 63 percent of the total cost of the fuel bundles used in OPG's nuclear plants by 2009. As explained in that exhibit, the other components of the fuel bundle cost are expected to remain reasonably stable, generally increasing at the rate of inflation. Given that the cost of the uranium concentrate is the largest component of the full bundle cost and given that the remaining components are expected to remain relatively stable, the variability in the total cost of the nuclear fuel is essentially the same as the variability in the cost of the uranium concentrate.

For simplicity, OPG is proposing to determine the variance based on the variance in the total cost of the fuel bundles. The nuclear fuel cost and production forecast approved by the OEB will be used to determine the $/MWh rate for the test period. The difference between this amount and OPG's actual cost of nuclear fuel on a $/MWh basis will be applied to OPG's actual nuclear production during the test period. The resulting amount will be recorded as the cost variance.

OPG's nuclear fuel procurement forecast and the potential variability associated with the forecast cost for the test period is discussed in Ex. F2-T5-S1.

4.2 Segregated Mode and Water Transactions Net Revenue Variance Account

OPG proposes to continue the Segregated Mode and Water Transactions Net Revenue Variance Account described in Ex. J1-T1-S1 Section 3.2 during the test year period. OPG's segregated mode of operations and water transactions, and OPG's sharing of a portion of the net revenues from these activities, are discussed in Ex. G1-T1-S1. This variance account will record:

- The ratepayer share of revenues from hydroelectric power sales negotiated from time to time with Hydro Quebec for electricity generated at the R.H. Saunders Generating Station on the St. Lawrence River.
- The ratepayer share of revenues from water transactions from OPG to the New York Power Authority ("NYPA") or from NYPA to OPG.

OPG proposes to continue its Segregated Mode and Water Transactions Net Revenue Variance Account to facilitate the sharing of OPG's actual segregated mode of operation and water transaction net revenues earned during the test period. OPG does not forecast revenues from segregated mode of operations or water transactions as they are difficult to forecast with sufficient accuracy.

Segregated mode of operations revenues are difficult to forecast because they are dependent upon several factors, including OPG's ability to reasonably estimate activity levels and anticipate the results of price negotiations. Transactions only occur when certain operating circumstances permit, opportunities exist in the Quebec energy market and a sales agreement can be successfully negotiated.

Water transactions are also not very predictable. These transactions involve the use of some of OPG's water entitlement to generate additional electricity at NYPA's facilities, which NYPA then sells into the New York market. These transactions also take place to a lesser degree from NYPA to OPG, with the energy sold into the Ontario market. The revenue associated with the transaction is shared by OPG and NYPA, based on the type of transaction. Because these transactions are based on water conditions, they are subject to the same uncertainty as the general energy forecast. In addition, acceptance of water transactions by either OPG or NYPA is often discretionary. OPG enters into water transaction arrangements to make the best use of the available resource.

OEB approval of this variance account would result in a reduction of future regulated payments to be established by the OEB.

4.3 Pension/Other Post Employment Benefit ("OPEB") Cost Variance Account

OPG proposes a Pension/OPEB Cost Variance Account to record the impact of changes in the discount rate used to determine pension and OPEB cost for OPG's regulated operations. A change in this discount rate will cause a variance between the pension and OPEB cost included in the revenue requirement and the actual pension and OPEB cost. The Pension/OPEB Cost Variance Account would only be cleared if it exceeds a threshold/trigger amount of $75M (excluding interest). If the accumulated actual variance plus the forecast variance to the end of the bridge year exceeds the threshold/trigger amount of $75M, OPG proposes to recover/refund the forecast balance during that test period. This clearance mechanism would apply to both positive and negative variances.

The nature of OPG's pension and OPEB plans, expected pension and OPEB costs for the test period and OPG's accounting for its pension and OPEB plans are discussed in Ex. F3-T4-S1.

Consistent with Generally Accepted Accounting Principles ("GAAP"), pension and OPEB costs for the current year are based on the measurement of pension fund assets and the benefit obligations at the end of the previous year. Therefore, in order to project pension and OPEB costs for business planning purposes, it is necessary to estimate the value of the obligations and the pension fund assets at the end of each year. This requires making projections of the actual pension fund performance and of economic, demographic and other key assumptions, such as the discount rate, that will be used to determine the costs. Relatively small changes in this discount rate can have significant impacts on pension and OPEB costs actually recorded by OPG for a given year. In most instances, the discount rate used to determine the actual pension and OPEB costs will only be available after payment amounts have been set by the OEB. Therefore, the change in the discount rate and the resulting impact on pension and OPEB costs is not within OPG's control.

OPG's company-wide pension and OPEB costs have exhibited significant variances from forecast (2005 - $11M under forecast, 2006 - $130M over forecast, 2007 - $55M over forecast). Changes in the discount rate were a significant part of these variances. The variances were calculated relative to forecasts which were prepared two years in advance of each of the above years, which is consistent with the concept of forecasting for a two year test period. Approximately 80 percent of these variances are attributed to OPG's regulated operations. For example, the total pension/OPEB expenses for 2008 would have been $68M under forecast if the discount rate used in OPG's 2006 business plan had been used to forecast the 2008 pension/OPEB expense. The portion of the variances attributed to OPG's regulated operations is consistent with the portion of the actual historical pension/OPEB costs that OPG attributes to its regulated operations, as presented in Ex. F3-T4-S1.

While the determination of actual pension/OPEB costs in accordance with GAAP is impacted by a number of factors, historically one of the most significant contributors to variances has been changes to the discount rate. OPG does not control the actual discount rate assumption that is ultimately required to be used to determine OPG's actual pension and OPEB costs for the current year. Consistent with GAAP, OPG uses the discount rate as of the end of the preceding year, however, the cost forecasts are prepared approximately two to three months earlier, as part of OPG's standard business planning process.

The proposed $75M threshold/trigger is consistent with variances from forecast experienced by OPG for its regulated operations in recent years, as noted above. A change in the discount rate of 25 basis points is not uncommon and can produce a financial impact on OPG's company-wide pension and OPEB costs of approximately $50M[1]. OPG is proposing to use $75M as the upper and lower disposition threshold. The proposed $75M

[1] The approximate financial impact of a change of 25 basis points in the discount rate is based on OPG's company-wide pension and OPEB costs for the year ended December 31, 2007.

threshold/trigger should generally allow for the impact of more than a 25 basis point change in the discount rate on the pension/OPEB costs associated with OPG's regulated operations.

OPG's proposed Pension/OPEB Cost Variance Account will adequately address the underlying risk of cost recovery, and fulfill the OEB's regulatory objective of maintaining rate stability. In order to appropriately address forecast risk, the cumulative balance in the account should be cleared. In this regard, recording of the cumulative balance would address OPG's forecast risk and the inclusion of interest on the balance would address concerns with respect to financing of the account balance. The proposed variance account reduces forecast risk for OPG and assessment risk for electricity consumers associated with material variances in these costs. This contributes to a review process that can be less contentious and the long-run rate impact that is more accurate and fair to both OPG and ratepayers (i.e., reflective of actual versus forecast costs).

4.4 Changes in Tax Rates, Rules, and Assessments Variance Account

OPG proposes a Change in Tax Rates, Rules, and Assessments Variance Account to capture the impact on revenue requirement of:

- Any differences that result from a legislative or regulatory change to the tax rates or rules of the *Income Tax Act* (Canada) and the *Corporations Tax Act* (Ontario), as modified by the regulations under the *Electricity Act, 1998* to determine payments in lieu of corporate income taxes and capital taxes and the regulations under the *Electricity Act, 1998* to determine payments in lieu of property tax to the Ontario Electricity Financial Corporation. Details of these above payments are provided in Ex. F3-T2-S1.
- Any differences in municipal property taxes that result from a legislative or regulatory change to the tax rates or rules for its regulated assets under the *Assessment Act, 1990*. Details of these municipal property taxes are provided in Ex. F3-T2-S1.
- Any differences that result from a change in, or a disclosure of, a new assessing or administrative policy that is published in the public tax administration or interpretation bulletins by relevant federal or provincial tax authorities, or court decisions on other taxpayers that OPG will incorporate in determining its actual payments in lieu of corporate income taxes and capital taxes.

- Any differences that result from tax assessments or re-assessments (including reassessments associated with the application of these rates and rules to OPG's regulated operations or changes in assessing or administrative policy including court decisions on other taxpayers).

As discussed in Ex. F3-T2-S1, OPG is currently being audited by the Provincial Tax Auditors. Based on a preliminary communication from the Tax Auditors with respect to their initial findings, OPG expects to receive a reassessment that may result in an increase to income taxes. This event is beyond OPG's control. OPG expects that the reassessment may result in a material financial impact; however the amount of the ultimate settlement is not predictable with sufficient accuracy to include it in OPG's forecast. Including a reassessment value in its forecast would reduce the tax loss carry forward amount. OPG has applied these tax loss carry forward amounts to reduce income tax expense during the test period, and to mitigate the consumer impact of OPG's revenue requirement proposals as described in Ex. F3-T2-S1 and Exhibit K.

OPG notes that in December 2005, the OEB issued a communication (Response to Frequently Asked Questions with respect to the Accounting Procedures Handbook for the Electricity Distribution Utilities – Response #19) that allowed regulated electric distributors to use Account 1592, 2006 Payments In Lieu and Taxes Variances, to capture the tax impact a number of items including "any differences that result from a legislative or regulatory change to the tax rates or rules assumed" and "any differences that result from a change in, or a disclosure of, a new assessing or administrative policy "as well as specified tax re-assessments.

OPG forecasts taxes and payments in lieu of taxes (where applicable) for the test period based on the enacted tax rates and laws currently in effect. OPG has not forecast the impact of potential changes in laws, tax rates, rules or reassessments pursuant to these rules (e.g., potential amendment to O. Reg. 224/00 pursuant to the *Electricity Act, 1998* impacting the amount of payments in lieu of property taxes is discussed in Ex. F3-T2-S1). All these matters are beyond the control of OPG.

While the impact of an announced or anticipated tax change is generally known for some period of time in advance of its effective date, typically the timing and implementation requirements associated with the change are uncertain, making it difficult to define the financial impact. Such a change is beyond OPG's ability to control. In addition, there are several processes associated with tax such as reassessments or appeal settlements, which can take place when OPG is not before the OEB for a revenue requirement determination. Such processes can have significant impacts on the tax provisions included in the prevailing payment amounts at the time. These financial impacts are also beyond the control of OPG.

5.0 POTENTIAL FUTURE ACCOUNTS

OPG wishes to bring to the OEB's attention the possibility that OPG may apply for a variance account via an accounting order application in the event unforeseen material events/activities occur.

Such potential future accounts which are described below include, but are not limited to:

- Unforeseen Changes in Nuclear Technology
- Changes in Regulatory Requirements
- Acts of God
- Transmission Restrictions and Limitations
- First Nation Settlements
- Changes in the Gross Revenue Charge

5.1 Unforeseen Changes in Nuclear Technology

OPG is not proposing at this time to re-establish an Unforeseen Changes in Nuclear Technology Variance Account, which is contemplated by the Regulation. However, OPG may apply for a variance account for this purpose if OPG experiences a material financial consequence arising from an unforeseen change in nuclear technology or regulatory requirements.

The purpose of this variance account would be to record the revenue requirement impacts due to deviations from the forecasts that are associated with unforeseen changes to nuclear regulatory requirements or unforeseen technological changes which directly affect the nuclear facilities (excluding nuclear decommissioning liabilities, which are accounted for elsewhere).

OPG has not recorded any activity in this account since it was established. OPG notes that the Regulation does not require the continuation of this account. Nonetheless, the financial impact of an unforeseen technological or regulatory change is not predictable, is not generally controllable and can be significant.

5.2 Changes in Regulatory Requirements

OPG is not proposing to establish a Regulatory Requirements Variance Account at this time. However, in the event that the IESO changes the market rules and/or the Canadian Nuclear Safety Commission or other regulators establish new requirements that impose potentially significant costs in respect of the prescribed facilities, OPG will consider whether an application for a variance account is warranted.

5.3 Acts of God

OPG is not proposing at this time to re-establish an Acts of God Variance Account, which is contemplated by the Regulation. Rather, the Company proposes to proceed by way of separate accounting order applications on a case specific basis in the event unforeseen material impacts arise from Acts of God.

The purpose of this variance account would be to record the revenue requirement impacts due to deviations from the forecasts that are associated with Acts of God, including severe weather events.

OPG has not recorded any activity in this account since it was established. OPG notes that the Regulation does not require the continuation of this account, and that this type of account is not typically approved by the OEB. However, the financial impact of an Act of God is not predictable, is not controllable and can be significant.

5.4 Transmission Restrictions and Limitations

OPG is not proposing at this time to re-establish this variance account, which is contemplated by the Regulation. Rather, the Company proposes to proceed by way of separate accounting order applications on a case specific basis in the event a transmission restriction or limitation results in a material financial impact.

The purpose of this variance account would be to record the revenue requirement impacts due to deviations from the forecasts that are associated with transmission outages and transmission restrictions that are not otherwise compensated for through congestion management settlement credits under the market rules.

While there is a high probability such an event will occur, and management has no ability to control this risk, the financial impact is frequently mitigated through congestion management settlement credits payments. This is substantiated by OPG's experience to date. Three incidents with a combined financial impact of less than $2M have been recorded in this account during the two year period this variance account has been in place. This cost is reasonably predictable and the expenses do not appear to vary significantly from year to year. However, the risk of a material/significant event is not reflected in OPG's production forecast.

5.5 First Nation Settlements

OPG is not proposing at this time to establish a First Nations Settlements Variance Account. However, in the event that the status of negotiations or settlements associated with legal claims related to OPG's regulated operations result in a change in OPG's liability provision and associated expense, OPG would consider whether an application for a variance account is warranted at that time.

The negotiation of various First Nation claims are sensitive matters that are generally conducted over many years, the timing and amount of any particular settlement is not predicable, and the status of negotiations and actual settlement of claims can result in significant changes in OPG's expected liability and associated expense.

There is no First Nations settlement costs included in the proposed revenue requirement.

5.6 Changes in the Gross Revenue Charge

OPG is not proposing at this time to establish a variance account to reflect changes in the regulation that sets out the gross revenue charge. Gross revenue charge is derived from the annual generation of electricity from its hydroelectric generating assets and paid to the Ontario Government, the Niagara Parks Commission and the Ontario Electricity Financial Corporation. OPG forecasts gross revenue charge for the test period based on the enacted tax rates and laws that are currently in effect.

The purpose of this variance account would be to record the financial impact on OPG of any changes in the gross revenue charge regulation, including changes in the rates and the methodology used to calculated gross revenue charge. OPG intends to apply for a variance account if changes in the matters described above are forecast to result in a potentially material financial impact.