ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act,1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF an application by Ontario Power Generation Inc. pursuant to section 78.1 of the *Ontario Energy Board Act, 1998* (the "Act") for an Order or Orders determining payment amounts for the output of certain of its generating facilities.

OPG REPLY SUBMISSION

On December 29, 2011, OPG filed an application seeking approval to establish a deferral account to record, up to the effective date of the next payment amounts order, the financial impacts resulting from the transition to and implementation of the Generally Accepted Accounting Principles of the United States of America ("US GAAP") effective January 1, 2012.

On January 13, 2012, the OEB issued a Notice of Application and Hearing and Procedural Order No. 1.

In the Procedural Order, the OEB indicated that it was considering granting the deferral account on the following terms:

- As is the case with all deferral accounts, the approval of the establishment of the deferral account provides no indication at all of recovery of any of the balance;
- Approval of the establishment of the deferral account has no bearing on the Board's determination with respect to the adoption of US GAAP for regulatory accounting purposes in OPG's next payment amounts application; and,
- The manner in which OPG will track and record items in the deferral account will be determined in the next payment amounts application.

The OEB invited parties to make submissions on whether its proposal is appropriate or whether there is a need for further discovery of OPG's evidence filed in this Application.

Four parties filed submissions. Board staff and SEC, supported by the CME, opposed the granting of the account. The PWU supported the OEB's proposal to grant the deferral account, subject to conditions.

OPG submits that the concerns raised by Board staff and SEC are either not applicable to the OEB's proposal, or are adequately addressed by the conditions of approval proposed by the OEB. Board staff and SEC claim that the evidence is inadequate but neither raises any specific deficiency with the information in this Application.

OPG, together with the PWU, submit that there is an appropriate basis to conclude that the financial impacts arising from the transition to US GAAP are beyond management's ability to control, are directly attributable to prudently incurred costs, are material and are being incurred as a result of adopting US GAAP effective January 1, 2012.

The OEB's proposal to grant the account subject to conditions is efficient from a regulatory processing perspective, and there have been no issues raised in the submissions that should dissuade the OEB from proceeding as it has proposed.

THE EVIDENCE IS SUFFICIENT TO SUPPORT THE GRANTING OF THE ACCOUNT

Board staff, SEC and CME state the evidence is inadequate, without citing any specific inadequacies. The PWU supported OPG's Application, finding the evidence adequate.

Board staff refers to the "Board's experience" in the Union and Enbridge applications as a reason for further discovery, without noting any specific deficiencies with OPG's Application or addressing the conditions associated with the OEB's proposal to grant the account. In addition, Board staff fails to draw any connection between the circumstances related to the Union and Enbridge applications and the facts underlying OPG's Application. Notably, Union and Enbridge are under incentive regulation in 2012 while OPG is under cost of service regulation.

Only the submission of the PWU considers the information presented in this Application and addresses the adequacy of that evidence in supporting a decision on the OEB's proposal. The PWU submits that the evidence demonstrates that the proposed account is consistent with the regulatory principles or criteria that apply when considering a new account and therefore it should be approved. OPG agrees with this submission.

The traditional criteria for deferral and variance accounts are causation, materiality, inability of management to control, and prudence[1]. The manner in which OPG's Application addresses these criteria is summarized below.

Causation: It is clear from the information provided with this Application that the financial impact underpinning the account arises because of a new accounting standard; a standard that is different from the one used to establish current rates.

Materiality: It is also clear that, to date, OPG ***has*** identified one major difference which it expects to have a financial impact of approximately $40M. This is a material amount.

Inability of Management to Control: Maintaining Canadian Generally Accepted Accounting Principles ("CGAAP") beyond January 1, 2012 is not an option given decisions by the Canadian Accounting Standards Board. OPG is therefore required to adopt a different accounting methodology.

Prudence: As the evidence notes, OPG decision to adopt US GAAP results in smaller financial impacts than adoption of International Financial Reporting Standards ("IFRS")

[1] 1st Generation Electricity Distribution Handbook, Revision 1.0, November 3, 2000, Pages 5-5 and 5-6.

and, as US GAAP is substantially similar to CGAAP, it will result in greater rate and financial stability.

As described in both OPG's Application and highlighted later in this submission, the financial impact on OPG occurs as a result of the transition to and implementation of US GAAP on January 1, 2012 in relation to costs in the 2011-2012 period and continuing up to the effective date of the next payment amounts order.

The information contained in OPG's Application demonstrates that OPG's Application passes the tests for granting such an account. OPG submits that the OEB's proposed approach is the right one and it should approve the account subject to the identified conditions.

PROPOSED ACCOUNT IS CONSISTENT WITH THE GUIDANCE IN THE OEB REPORT[2] AND ADDENDUM[3]

Board staff argue that since OPG's requested deferral account includes an issue (OPEB) which Union and Enbridge have raised in their Z-Factor proposals; the three utilities should be treated on a consistent basis.

However, the Addendum (p. 14) is clear that the OEB expects to address pension/OPEB issues on a utility-specific basis.

OPG also notes that the cause and impacts of the pension/OPEB variances for Union and Enbridge are different than in the case of OPG. There is no 2012 rate impact associated with the implementation of US GAAP for Union and Enbridge, who are on IRM and can use Z-factors, but there is for OPG. Consideration of an account for OPG should be assessed on its own merits as opposed to the generic assessment proposed by Board staff.

SEC argues that the requested account is too broad, and that the OEB requires a more detailed understanding of potential variances before it can establish the account. In reply, OPG would note that this is already addressed in the OEB's third condition of approval.

OPG submits that the scope of the deferral account should include all financial impacts resulting from the transition to and implementation of US GAAP. In addition, OPG submits that the regulatory principles cited in the OEB Report, specifically the need to balance the impacts on customers and shareholders, support the approval of an account that records all financial impacts, whether they result in amounts owed to OPG or to the ratepayer.

OPG's assessment to date has identified only one financial impact resulting from the transition to and implementation of US GAAP (OPEB costs). However, other impacts may emerge once OPG's analysis is complete. There is no reason to exclude other financial impacts associated with the implementation of US GAAP simply because they

[2] EB-2008-0408 Report of the Board Transition to International Financial Accounting Standards, July 28, 2009.
[3] EB-2008-0408 Addendum to the Report of the Board, Implementing International Financial Accounting Standards in an Incentive Rate mechanism Environment, June 13, 2011.

haven't yet been identified. All variances, regardless of whether they produce amounts owing to ratepayers or OPG, resulting from the causal event (i.e., the transition to and implementation of a new accounting standard) should be considered once the materiality threshold has been reached.

SEC points to the OEB-approved PP&E variance account as an example of the level of precision that is required in establishing a new account. However, in OPG's view, the PP&E account is very broad as it captures all differences in asset costs resulting from the implementation of a new accounting standard without regard to the multiple types of assets reflected in PP&E.

In OPG's submission there is little difference in the level of precision between an "all assets" deferral account and an "operating costs/revenue" deferral account. In fact, for Hydro One Transmission, the OEB has approved an "Impact for USGAAP" account, noting specifically that the account will be "symmetrical", and that "the Board will take into account whether Hydro One adequately reviewed in its application ***all of the impacts*** of the accounting changes associated with the transition, which in this case have been identified as only changes in capitalization policies"[4] *[emphasis added]*.

Neither the Report nor the Addendum provides any basis to preclude the OEB from establishing the deferral account based on its merits. Indeed, as highlighted in OPG's Application and noted above, approval of the requested deferral account is entirely consistent with the traditional regulatory principles cited in the OEB Report.

THE PROPOSED CONDITIONS WILL ADEQUATELY ADDRESS THE CONCERNS RAISED

SEC raises a number of other generic concerns that are either incorrect, or misrepresent the nature of the account requested.

SEC is incorrect in its assessment of an issue it refers to as "timing". As discussed in section 3.1 of OPG's Application, all previous deferred actuarial gains or losses and all past service costs related to the long term disability plan are recognized immediately on transition to and implementation of US GAAP effective January 1, 2012. In addition, this change in accounting treatment is expected to result in higher OPEB costs in the 2011/2012 period which will continue until rates are reset as part of OPG's next payment amount order. It is clear that, in OPG's case there is a financial impact on the transition to US GAAP in relation to costs relating to the 2011/2012 period, and a deferral account is required to address those impacts.

If the proposed deferral account is not approved for the period up to the effective date of the next payment amounts order, the financial impact of adopting US GAAP may be characterized as an out-of-period cost and the recovery of such a cost may be denied due to retroactive rate-making considerations. This is the very situation the accounting order process and the OEB's consultation on the implementation of new accounting standards were designed to address.

SEC has other concerns, namely that:

[4] EB-2011-0268 Decision with Reasons, November 23, 2011, Page 12.

- unless the OEB gives direction to OPG as to how to make account entries, there is no reason to have the account (which SEC describes as "practicality");
- the OEB must know what the difference must be, and why it exists (which SEC describes as "open-endedness"); and,
- an applicant must provide clear evidence of the future uncertainty that is being addressed, and why a variance account is the appropriate regulatory response to that uncertainty (which SEC describes as "precedent value").

In reply, OPG would note that its Application is clear that the future uncertainty being addressed is the transition to and implementation of a new accounting standard effective prior to the setting of new rates for OPG. Current rates are set using CGAAP and material financial impacts have been identified between the new accounting standard and CGAAP. A deferral account is appropriate in OPG's circumstances as it enables the OEB to consider amounts for future recovery that would have been deferred under the current CGAAP accounting standard and reflected in future payment amounts (i.e., OPEB costs). The proposed approach is also entirely consistent with the regulatory principles articulated in the OEB Report.

OPG has addressed above the issue of precision required at the approval stage. In this regard, OPG also notes that SEC's argument references a variance account, rather than the deferral account proposed in this Application. Variance accounts typically address cost items that are both budgeted and reflected in approved utility rates. A variance account may be more precisely defined so as to reflect only those costs/revenues incremental to those already covered in current rates based upon circumstances that are known but variable.

In contrast, a deferral account typically addresses cost consequences that were not known when rates were set. OPG's Nuclear Liabilities Deferral Account is an example of a deferral account which records a number of cost impacts that result from an event (the approval of a new approved Ontario Nuclear Funds Agreement reference plan) that is not included in approved rates. It is the event, its impact on any number of factors and the response to those factors that drive the cost consequences that form the deferral account balance. Each of those factors is not delineated at the creation of the account or likely even known. The level of precision sought by SEC cannot be obtained on further discovery and in any event will be known and be subject to review (especially given the OEB's proposed conditions) as part of OPG's future rate proceeding on account disposition.

OPG submits that SEC has mischaracterized OPG's proposal, and the standard of precision it suggests is unnecessary in the context of OPG's deferral account proposal.

What is necessary is for OPG to demonstrate at the time of account disposition that amounts recorded in the account are indeed directly caused by the transition to and implementation of US GAAP, that management acted prudently, and that amounts recorded were not otherwise included in OPG's approved rates. This is captured by the OEB's proposed conditions.

CONCLUSION

As demonstrated above, it is submitted that there is sufficient information before the OEB to grant the proposed deferral account without additional discovery and there have been no valid reasons advanced that should cause the OEB to question whether its inclination to grant the proposed account was in fact correct.

OPG submits that the OEB's proposal to establish the proposed deferral account is reasonable, and accepts the conditions of approval as stated in Procedural Order 1.

In the event that the OEB does not agree and determines that additional discovery is required before it can approve the proposed deferral account, OPG submits that the most efficient way to conduct that discovery would be to consider this Application in conjunction with OPG's next payment amounts application.

OPG does not support a separate discovery process. A separate discovery process as part of this Application would require OPG to divert critical resources that are currently fully engaged in the preparation of OPG's next payment amounts application and in the US GAAP conversion project.

If the OEB's decision is to defer consideration of the account, OPG submits that this decision should make clear that the deferral will not impact OPG's proposal to record the financial impacts resulting from the transition to and implementation of US GAAP, effective January 1, 2012, to the effective date of the OEB's next payment amounts order (i.e., costs will not be considered out-of-period costs as a result of the deferral of the consideration of the Application).

All of which is Respectfully Submitted.