UNDERTAKING J13.7

Undertaking

Provide a calculation of the revenue requirement impact of moving from accrual to cash basis, including transition issues, using the employer pension contribution values from the Pension Plan Valuation as at January 1, 2014

Response

The difference over the test period between pension and OPEB costs determined on an accrual basis and on cash basis, including the related income tax impacts, is provided in the chart below:

Chart 1

		Pension Costs ($M)			OPEB Costs ($M)			Totals ($M)
		2014	2015	Test Period	2014	2015	Test Period	Test Period
1	Accrual	471.3	405.3	876.6	204.6	212.8	417.4	1,294.0
2	Cash	321.9	407.6	729.5	89.6	95.8	185.4	914.9
3	Cost Difference (line 1 – line 2)	149.4	(2.3)	147.1	115.0	117.0	232.0	379.1
4	Income Tax Gross-Up (line 3 * (25% tax rate / (1 – 25% tax rate))	49.8	(0.8)	49.0	38.3	39.0	77.3	126.4
5	Revenue Requirement Decrease (Increase) (line 3 + Line 4)	199.2	(3.1)	196.1	153.3	156.0	309.3	505.5

In addition, OPG has identified two important transition issues that would need to be part of any consideration to move away from the use of accrual based accounting costs for pension and OPEB.

Need for Higher Equity Ratio:
Even under the accrual method, which provides higher cash flows due to the matching of costs and benefits, OPG's financial ratios have been weak. Concerns over OPG's current weak financial ratios were raised in the evidence of Ms. McShane, OPG's cost of capital expert (Ex. L-3.1-1—Sec-024, pp. 222-23). A change to the cash basis will result in a reduction to OPG's net income of $379.1M in the test period alone (see Chart 1, line 3 above) as OPG's costs would continue to be accounted for on an actual basis and its revenues would not reflected those costs. This change would reduce OPG's FFO to Total debt by approximately 1.5% and FFO Interest coverage by at least 0.3 times in the

test period. With this further weakening of OPG’s financial ratios and corresponding increase in OPG’s financial risk, OPG expects that there would have to be an upward adjustment to its common equity ratio to ensure that OPG’s continues to be provided with a fair return.

Risk of a Significant Write-off:

A change to the cash basis for pension and OPEB could have significant financial consequences for OPG (and other similarly affected utilities). OPG has consulted with its external accounting advisors and they have indicated that OPG may have to reverse its recognition of USGAAP regulatory assets of up to $3 billion, which currently offset amounts in other comprehensive income (Tr. Vol. 13, pp. 55-58, 102). The $3B in regulatory assets were recognized by OPG on the expectation that the current methodology of recovering accrual based cost pension and OPEB costs remains unchanged.