Board Staff Interrogatory #82

Interrogatory

Reference:
Exhibit C2 / Tab 1 / Schedule 1 / p. 15

Preamble:

In its discussion of the methodology used (and previously approved by the OEB) to recover the costs of nuclear liabilities for the prescribed facilities, OPG explained that accounting accretion expense on the ARO and earnings on the segregated funds do not directly form part of the revenue requirement for the prescribed facilities. OPG further stated that the return component of the recovery methodology effectively replaces the net amount of accretion expense and segregated fund earnings recorded for financial accounting purposes.

Question(s):

a) Please explain whether this statement is OPG's interpretation of the relationship between the return component and the accretion expense and segregated fund earnings. If not, please provide the basis for this statement.

b) Please provide OPG's position on the appropriateness of replacing the net amount of accretion expense and segregated fund earnings with the return component of the recovery methodology.

Response

a) The referenced statement is OPG's interpretation. While the OEB's Decision with Reasons in EB-2007-0905 provides a discussion of the conceptual underpinnings of the return component as part of the prescribed facilities' methodology, OPG has been unable to identify the specific basis for, and therefore evaluate each of the computational elements of the formula for this component.

   For additional context, below OPG provides some of its interpretational observations on the relationship between the return component and the accretion expense and segregated fund earnings in the context of the above OEB decision.

   OPG believes that the following observations made by the OEB in its EB-2007-0905 Decision with Reasons recognized the conceptual need for recovery of accretion in setting the currently approved methodology for the prescribed facilities,

given that nuclear liabilities and associated asset retirement costs are initially recorded on a present value basis:

> *Clearly, OPG incurs accretion expense (at an average rate of 5.6%) on its 26 nuclear liabilities whether they are funded or not.* (p. 90) …
>
> *The Board disagrees with CCC's submission that OPG should earn no return on unfunded amounts. Clearly, OPG incurs accretion expense (at an average rate of 5.6%) on its nuclear liabilities whether they are funded or not.* (p. 91)

OPG observes that the financial accounting elements of accretion expense (and segregated fund earnings) would not be included as part of a revenue requirement methodology that also includes asset retirement costs in rate base. Doing so could result in duplication. It appears to OPG that once the OEB determined in EB-2007-0905 that a rate base approach was appropriate, this naturally led to the exclusion of the financial accounting basis of accretion expense and segregated fund earnings from the methodology, with recovery of accretion instead considered through the return component. (For greater clarity, in either scenario, depreciation of asset retirement costs would form part of the recovered amounts.)

Additionally, in establishing the return component, the OEB's decision appears to identify the portion of nuclear liabilities that has been funded by OPG but not yet recovered from ratepayers as attracting the full weighted average cost of capital. For example, this feature appears in the following passages from the OEB's Decision with Reasons in EB-2007-0905:

> *The Board will require that the return on a portion of the rate base be limited to the average accretion rate on OPG's nuclear liabilities, which is currently 5.6%. That portion of rate base that attracts that return will be equal to the lesser of: (i) the forecast amount of the average unfunded nuclear liabilities related to the Pickering and Darlington facilities, and (ii) the average unamortized ARC included in the fixed asset balances for Pickering and Darlington. When the average unfunded nuclear liabilities exceed the amount of unamortized ARC in fixed assets, then the portion of rate base that attracts the 5.6% return would be capped at the average amount of unamortized ARC; if the average unfunded liabilities are forecast to be lower than the average unamortized ARC, it is appropriate to limit the portion of rate base that attracts the 5.6% return to the unfunded amount. That approach*

> *recognizes that OPG has raised debt (or used its retained earnings) to fund part of the unamortized ARC.* (p. 90)

OPG observes that the consideration of the funded yet unrecovered portion of the nuclear liabilities attracting the weighted average cost of capital would not be captured in the financial accounting elements of accretion expense and segregated fund earnings.

b) Please refer to Ex. L-C2-01-Staff-085 (a) – (c).