Board Staff Interrogatory #85

Interrogatory

Reference:
Exhibit C2 / Tab 1 / Schedule 1 / p. 25
EB-2016-0152 / Decision and Order / December 28, 2017 / pp. 96-98

Preamble:

In the OEB's findings on the nuclear liabilities revenue requirement methodology in OPG's 2017-2021 Payment Amounts Proceeding, OPG was directed to file a jurisdictional study for cost recovery methodologies of nuclear liabilities. In the current application, OPG proposed to recover nuclear liabilities using the same methodology as approved in OPG's 2008-2009 Payment Amounts proceeding[1] and subsequent proceedings.

Question(s):

a) Given the OEB's findings on the nuclear liabilities revenue requirement methodology in the 2017-2021 Payment Amounts Proceeding and the direction to file a jurisdictional study, please explain whether OPG has considered any alternative methods of recovery for nuclear liabilities for the 2022 to 2026 period.

b) If so, please discuss OPG's consideration of these alternatives and whether any of these alternatives were deemed to be appropriate.

c) Please provide supporting rationale for OPG's proposal to continue to use the methodology as approved in OPG's 2008-2009 Payment Amounts proceeding.

d) If OPG was approved to recover nuclear liabilities using a different methodology than currently proposed, please explain whether there would be any transitional matters to consider and what these matters may be.

Response

a) to c)

KPMG's jurisdictional study of cost recovery methodologies for nuclear liabilities identified two potentially applicable methods to OPG's prescribed facilities – the forward-looking funding requirement methodology and the accounting expense

[1] EB-2007-0905.

methodology (Section 28 of Ex. C2-1-1, Attachment 2). OPG's consideration of these methodologies is summarized below.

For OPG, the forward-looking funding methodology is similar to a cash-based methodology that was raised by the parties in the EB-2016-0152 proceeding. In its EB-2016-0152 Reply Argument (pp. 182-202), OPG set out extensive submissions against a change to the cash-based methodology. Having considered the findings of the jurisdictional study, OPG continues to hold the view that, although applied widely for US regulated utilities, a cash-based methodology is not appropriate in OPG's situation.

As highlighted in the jurisdictional study, there are a number of key differences between OPG's circumstances and those of the US utilities, including the upfront funding profile under the Ontario Nuclear Funds Agreement (Section 28.3 of Ex. C2-1-1, Attachment 2), the role of the US regulatory commissions in effecting the actual funding amounts based on underlying variables (Section 5.2 of Ex. C2-1-1, Attachment 2), and the fact that US utilities have been subject to a funding-based methodology since inception (pp. 5-6 and pp. 139-140 of Ex. C2-1-1, Attachment 2).

Given the extent of OPG's submissions in the EB-2016-0152 Reply Argument, they are not detailed in this response. For reference, key highlights of the submissions included OPG's explanations that:

- Its contribution requirements under the Ontario Nuclear Funds Agreement do not represent a proper measurement basis for OPG's costs because they are severely front-loaded to prior periods, rather than being matched to the productive life and output of the nuclear stations; thereby creating significant inter-generational equity and fairness concerns.
- A pay-as-you-go recovery methodology for internally funded expenditures on nuclear waste management and decommissioning would similarly result in a mismatch between the incurrence of the cost at the time of generation output and the period of cash outlay, such that amounts recovered in a given period would bear little relationship to electricity then consumed.
- If a cash-based methodology were to be adopted on a prospective basis, without adequate consideration of transitional impacts, OPG and its shareholder would be deprived of an ability recover the full cost of the nuclear liabilities and therefore experience a financial and accounting loss; this would be inconsistent with the thrust of O. Reg. 53/05 to keep OPG whole on the issue of nuclear liabilities.
- An ONFA-based methodology is inherently less transparent, as it would be based on a complex bilateral contract between OPG and the Province of Ontario that at times requires interpretation by the parties and can be amended if the

two parties agree, and over which the OEB has stated it does not have authority.[2]

The current approved methodology for the prescribed facilities is, to a large degree, an accounting-based methodology. It leverages accounting values determined in accordance with generally accepted accounting principles, such as depreciation expense, with the exception of replacing the net amount of accretion expense and segregated fund earnings with the return on rate base for the asset retirement cost balance (Ex. C2-1-1, Section 4.1). As set out in the EB-2016-0152 Reply Argument, OPG continues to hold the view that an accounting-based methodology is superior to a cash-based method for OPG. Key highlights of those submissions included:

- An accounting methodology provides better matching of the nuclear liabilities costs to the productive life and output of the nuclear stations, thereby minimizing inter-generational inequity concerns and providing for a fairer outcome for both customers and OPG.
- An accounting methodology provides better transparency to the rate-setting process as it is aligned with OPG's financial reporting and based on an established, common set of accounting principles and requirements.
- An accounting methodology typically supports greater stability in recovery amounts due to the amortization of cost impacts over the remaining asset life, compared, for example, to inherent unevenness of cash outlays for internally funded expenditures.
- Continuing with an accounting-based methodology mitigates the need for material transition adjustments that would need to be considered in the case of a switch to a cash-based methodology.

While OPG has not conducted an in-depth analysis on the topic, it considered whether the current methodology for the prescribed facilities could be modified to include accretion expense and segregated fund earnings, rather than the return on rate base component. This would have the benefit of aligning the methodology with that for the Bruce facilities' portion of the nuclear liabilities. In OPG's view, this would also have the benefit of greater transparency than the current methodology for the return component. For example, as discussed in Ex. L-C2-01-Staff-082, OPG has been unable to identify the specific basis for each of the computational elements of the return component formula based on the OEB's EB-2007-0905 Decision with Reasons.

Conversely, OPG recognizes that one of the implications of the current approach is that ratepayers are not exposed to investment performance risk for the prescribed

[2] EB-2013-0321, Decision with Reasons, p. 110.

facilities' portion of the segregated funds (Ex. C2-1-1, p. 15, lines 15-17), whereas a pure accounting methodology would likely lead to such increased exposure.[3]

Finally, OPG observed that, as a practical matter, the differences between the return on rate base component and the net of forecasted accretion expense and segregated fund earnings for the prescribed facilities is, in the overall context of nuclear liabilities, relatively modest over the 2022-2026 period, averaging about $10M per year (in favour of ratepayers).[4] Additionally, the value of the return on rate base component itself declines significantly by 2026, to just over $5M per year, as the Pickering asset retirement cost balance is fully depreciated.

On balance of the above considerations and in recognition that the current methodology has been applied since the company's first payment amounts proceeding, OPG did not further proceed with an analysis for transitioning to a pure accounting methodology for the prescribed facilities.

OPG did not consider any alternative recovery methodologies for the Bruce facilities' portion of the nuclear liabilities. In addition to these costs already being recovered using a pure accounting methodology, the OEB has previously determined that, in accordance with O. Reg. 53/05, sections 6(2)9 and 6(2)10, the costs of the nuclear liabilities (as well as other OPG revenues and costs that form part of Bruce Lease net revenues) are to be calculated using generally accepted accounting principles applicable to unregulated entities.

d) Neither OPG nor KPMG have conducted a specific analysis of transition matters and impacts that would arise if a different recovery methodology were to be adopted for OPG's nuclear liabilities. Given the complexity and potential magnitude of the issue, additional analysis would need to be undertaken with respect to any such transition once the target successor methodology has been identified. OPG's view is that any such transition should be undertaken when the full extent of the impacts and implications – both near and long term – has been understood and considered, and should not be in response to short-term changes, particularly given the very long-lived nature of the nuclear liabilities.

As an overriding principle, it is OPG's view that any transition should fairly consider the prospective economic impacts to customers, as well as to OPG and its shareholder, of having been subject to a different recovery methodology in the past. As OPG identified in EB-2016-0152 and updated in Ex. L-C2-01-Staff-086, any transition to a cash-based methodology, for example, should consider the material differences between amounts previously recovered under the current

[3] Given the inherent potential volatility of fund asset performance driven by external factors, this may include consideration of a variance account mechanism to manage the impact of such volatility.
[4] Based on pre-filed evidence at Ex. C2-1-1, Tables 1 and 2.

methodologies and those that would have been recovered under a cash-based methodology. As noted above, a prospective transition to a cash-based methodology would result in OPG experiencing a financial loss.