Cost Allocation Review

1. Background

OPG utilizes a cost allocation methodology to allocate support and administrative costs between its regulated and unregulated operations. The methodology has been utilized in several hearings with the Ontario Energy Board ("OEB") to establish rates for 2008-2009, 2011-2012, 2014-2015, and 2017-2021. It has also been reviewed by Black & Veatch consultants in 2006 and 2009 and found to be appropriate. This methodology is also used to allocate costs to business segments in its financial statements which are audited by Ernst & Young. The same methodology is used to develop the OPG's business plans.

OPG's cost allocation methodology follows its organizational structure, in which the majority of costs of services provided by Centralized Support and Administrative ("CSA") groups (e.g., engineering and human resources) are integral to running the Business Units (e.g., nuclear, hydro-thermal). Business Units receive many of their necessary support functions and services from CSA departments rather than decentralized resources residing in/reporting to the Business Units. OPG tracks the majority of its revenue and expenses by Business Unit. This permits extensive use of direct cost assignment. To the extent costs cannot be directly assigned internal allocators such as OM&A, FTEs, Capital Expenditures, etc. for costs initially distributed to CSA groups are used given the centralized support structure. As noted above, the direct assignment and allocation approach used by OPG has been accepted by the OEB.

OPG is undergoing a large Nuclear Refurbishment on its Darlington station, preparing for the end of operations of its Pickering station, engaging on market renewal, and continuously looking for efficiency opportunities. OPG will continue to drive the realignment of the Company's cost structure and operating model in order to further improve the current and post-Pickering operations of the core generating fleet and corporate support functions. Through the OPG25 strategic initiative, OPG plans to implement enterprise wide efficiency improvements and cost saving opportunities that will improve corporate profitability, support a culture of continuous improvement, and assist OPG in achieving industry-leading generation cost targets.

In addition, OPG's strategic direction seeks to grow the business through strategic investments to maintain industry leadership, gain economies of scale and provide a strong return on the Shareholder's investment.

OPG is currently working on its 2020-2026 business plan which will reflect organizational changes resulting from the OPG25 strategic initiative, with a target completion date of June 30. OPG's approved cost allocation methodology will be applied to the revised budgets at that time. Documentation of the budget transfers and changes to the description of the cost allocation methodology will take place in July.

At this time, OPG is preparing for its prefiled evidence for its rate application to support rates for 2022-2026. As part of the application, OPG will include evidence speaking to its cost allocation methodology.

2. Scope of Work

OPG would like to engage Elenchus to review the application of its existing OEB-approved cost allocation methodology, to its 2020-2026 business plan. The purpose of the review is to assess whether any organizational changes made to OPG's structure over the 2020-2026 business plan result in a similar allocation of costs to the regulated operations as prior to the reorganization.

3. Deliverables

A report, suitable for filing in a regulatory forum, describing scope of work, methods used and findings. Findings will specifically address the question of whether the organizational changes made to OPG's structure after developing the 202-2026 business plan result in a similar allocation of costs to the regulated operations as prior to the reorganization. OPG envisions that the work take place in three phases as follows:

Phase 1: Support through BP2020-2026 development: This phase would include support through the development of the 2020-2026 Business Plan

1) Refresh understanding of the cost allocation methodology approved by the OEB;
2) Validate that OPG has applied the approved cost allocation methodology to its 2020-2026 business plan costs and revenues.
3) Identify any major changes to the presentation of cost resulting from the reorganization compared to the business plan.
4) Based on the approved cost allocation methodology, generally assess the impact of the major cost changes resulting from OPG25
5) OPG will process the revised budgets based on the organizational changes described above through its cost allocation model. Based on the work completed above, determine if the costs being attributed to the regulated operations is reasonable.

Phase 2: Final Report: This report would validate the assessment provided in Phase 2 and would be used for submission to the OEB in the next rates submission:

1) Validate any change in costs for the regulated operations resulting from the OPG25 initiative and organizational changes
2) Validate that OPG has applied the cost allocation methodology approved by the Board
3) Validate the initial assessment provide in the interim deliverable.

Phase 3: Optional (at OPG's option):

The proponent may be required to testify at the OEB's public hearing into OPG's application for 2020-2026 rates.

4. Schedule (Major Milestones)

Phase 1:

Work to commence July 8.
Interim Review Meeting July 30

Phase 2:

Work to commence July 30
Interim Report September 14
Report completed September 21