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July 21, 2008

VIA MAIL and E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: Vulnerable Energy Consumers Coalition (VECC)
EB-2007-0905 Ontario Power Generation Inc.

Please find enclosed the submissions of VECC with respect to the above noted proceeding.

Yours truly,

Michael Buonaguro
Counsel for VECC
Encl.

EB-2007-0905

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* for an Order or Orders determining payment amounts for the output of certain of its generating facilities.

ARGUMENT OF THE VULNERABLE ENERGY CONSUMERS COALITION ("VECC")

July 21, 2008

TABLE OF CONTENTS

Introduction

1. These are the submissions of VECC with respect to the application by Ontario Power Generation for rates for the 21 month period beginning April 1, 2008 to December 31, 2009.

2. For the 21-month test period, April 1, 2008 to December 31, 2009, OPG has applied for payment amount increases of 14.8%. In its prefiled evidence, OPG provided a calculation that indicated that the total bill impact of this increase, excluding OPG's deferral and variance account proposals, would be about 2.73% or $3.05 per month for a typical residential electricity customer: in an undertaking response (J15.8), OPG calculated that the impact on the energy line for a typical residential customer would be 5.10%.

3. The 14.8% increase is <u>after</u> moderation by a significant amount of mitigation, absent which the payment amount increases would have amounted to 19.0% (K1 T1 S2). The impact on the energy line of a typical residential energy customer's bill would be 6.5% absent any mitigation.

4. The instruments of mitigation proposed by OPG include (i) using the carry forward of tax losses accumulated from the years 2005-2008 to reduce 2009 regulatory taxable income to $0, (ii) accelerated use of the 2009 remaining tax loss balance of $503.2M as at the end of 2009 to reduce the revenue requirement over the test period by $228M (K1 T1 S2), and (iii) deferring the clearance of $214.0M of the December 31, 2007 nuclear deferral and variance account balance of $342.1M, until after the 21-month test period.

5. The mitigation instruments used by OPG are one-time in nature and will therefore be unavailable for any mitigation in the future. In addition, known current and future expenditures (i.e. the Niagara Tunnel Project) suggest that the next test period filing will feature further significant increases to the revenue requirement. As such, VECC

is concerned that the mitigation masks the size of the past, current, and test period costs incurred to the typical customer looking at her bill. VECC is also concerned that the using up of mitigation headroom sets customers up for large future increases.

6. In VECC's view, the best mitigation is mitigation of utility costs through efficient operations, established, in part, through effective regulation. It is against the background that VECC makes the following submissions.

The Interpretation of O. Reg. 53/05

7. VECC submits that accounting treatments, whether prescribed by standards bodies or adopted by entities, should not be interpreted or taken as constraining regulatory treatment in general. Whereas accounting treatment can provide guidance in a regulatory context, in VECC's view the method of accounting presentation is not determinative of appropriate regulatory treatment.

8. Accordingly, while regulation 53/05 may prescribe the Board's task in regulating OPG "by setting certain financial values that must be accepted by the Board when making its first order under section 78.1 of the Act"[1], and while the regulation may further prescribe the Board's task "by requiring that the Board ensure that certain costs, financial commitments or revenue requirement impacts be recovered by OPG"[2], it remains in the hands of the Board to determine the methodology by which OPG will be entitled to recover the prescribed costs, and how the prescribed financial values translate into revenue requirement impacts and rate recovery.

9. Specific to the issue of Nuclear Liabilities, for example, VECC respectfully disagrees with OPG's submission that the fact that Asset Retirement Costs are recorded in its fixed assets means that the Board is required, for regulatory purposes to a) include ARC in rate base and b) provide a rate of return on ARC at the WACC. VECC

[1] Board Staff submissions page 5.
[2] Ibid.

respectfully submits that whether and how a particular accounting item is included in the regulatory construct of “rate base” is entirely at the discretion of the Board, and not something that is imposed on the Board by non-regulatory accounting policy.

10. VECC respectfully submits that regulation 53/05, despite whatever constraints it may impose, leaves it to the Board to determine the appropriate revenue requirement impact of any and all of the values and costs which it is required to accept as true (in the case of values) and which it is required to provide recovery for (in the case of specified categories of costs). This preservation of the Board’s powers over the regulatory treatment of OPG’s values and cost items is obvious, for example, in section 6(2) 7 of O.Reg. 53/05, wherein, even when the regulation

    a) requires recovery of specific cost items recorded in the two Nuclear Liabilities Deferral Accounts,
    b) specifies the values in the OPG audited statement that relate to those accounts to be accepted by the Board, and
    c) sets out the types of revenue requirement items that can be recovered in the account (return on rate base, depreciation expense, income and capital taxes, and fuel expense),

    the regulation still recognizes the Board’s regulatory power, requiring that <u>the Board be satisfied</u> that the “revenue requirement impacts are accurately recorded in the accounts”. Accordingly, VECC submits, it while the regulation identifies return on rate base as item that can be recovered, it remains in the Board’s discretion as to whether there is an appropriate return on rate base to be included in rates.

11. Likewise, section 6(2) 8 stipulates that the Board shall ensure that OPG recovers the “revenue requirement impacts” of its nuclear decommissioning liability arising from the current approved reference plan; VECC respectfully submits that it always

remains in the Board's discretion, even under O.Reg. 53/05, to determine the appropriate revenue requirement impact to be reflected in rates.

Nuclear Liabilities – Asset Retirement Costs

12. VECC makes the following submissions in respect of Asset Retirement Costs ("ARC")

13. VECC agrees that the quantum of the Nuclear Liabilities has been established by the Reference Plan such that the issue of the base amount of the Nuclear Liabilities is not for this Board to decide; clearly, VECC accepts, the Nuclear Liabilities "cost" at issue is derived from the $24 billion in the reference plan.

14. The question for this Board to determine is how this cost (after accounting for that part of the cost that has already been "funded") is to be recovered from ratepayers.

OPG's claim that the Reference Plan provides for an Asset Retirement Obligation value, which provides for an Asset Retirement Cost, which for accounting purposes is added to fixed assets, and that all fixed assets must end up in rate base earning a return based on the WACC, seeks to circumvent any review by this Board of the public interest considerations that necessarily impact the regulatory treatment (as opposed to the accounting treatment) of such a massive cost item.

15. VECC accepts that in terms of paying the cost of Nuclear Liabilities it would be inappropriate and against the public interest to simply pay those costs as expenses in the manner most expenses are paid. The costs, which are, it would seem, unavoidable, are simply too large to allow them to be recovered from ratepayers only as they are incurred.

16. The question that this Board must answer, then, is how best to recover the cost of Nuclear Liabilities from ratepayers in advance of the costs actually being incurred.

17. For regulatory purposes, the future liability should be funded by an approach which provides the necessary funds when the associated liability comes due and in a manner that is least cost to ratepayers, while being mindful of the issues (including rate shock and intergenerational equity) inherent in the approaches under consideration.

18. Rate base items are typically property, plant, and equipment – including working capital and materials and supplies – that (i) have been financed by investor supplied capital (debt or equity), (ii) are "in service," i.e., are providing current services of value to ratepayers, and (iii) are capital goods in the sense that they are expected to provide benefits to ratepayers over time.

19. To treat ARC as a component of rate base, without, at a minimum, distinguishing it from the other elements in the rate base) is not appropriate because it is

    a) not the least cost to ratepayers and
    b) there is no asset in service – corresponding to the liability – that is currently providing benefits to ratepayers.

20. With respect to the latter point, OPG's proposal appears to be the polar opposite, i.e., relating to something that will provide a service in the future in the sense of retiring the obligation when it comes due in the future.

21. VECC's position is that no rate base return on equity should be earned upon capital that

    a) has not been supplied by investors as debt or equity, and/or
    b) does not relate to capital providing benefits to ratepayers, i.e. is (currently) used and useful.

22. ARC is the present value of the unfunded Asset Retirement Obligations (“ARO”), and, as such, ARC is related to ARO. More specifically, according to OPG’s undertaking response to J15.1, ARC equals the difference between the present value of the ARO and the value of the segregated funds at a point in time.

23. OPG’s witness, Ms. McShane, admitted under cross-examination that there were no regulatory precedents in Canada for OPG’s suggested regulatory treatment of nuclear liabilities. (Tr. Vol. 11, p. 137, lines 3-8).

24. VECC submits that Exhibit K11.7 (FERC Rule 631) indicates that, at the very least, OPG’s proposed ARC rate base treatment would not be routinely approved by FERC. Paragraph 62 of this rule states that

> The Commission finds that the issue of whether, and to what extent, a particular asset retirement cost must be recovered through jurisdictional rates should be addressed on a case-by-case basis in the individual rate change filed by the public utilities, licensees, and natural gas companies. To ensure that all rate base amounts related to asset retirement obligations can be identified and excluded from the rate base calculation in a rate change filing, the Commission adds sections 35.18 and 154.315 to its rate change filing requirements. . .In addition, the regulations require that all asset retirement obligations related rate base items be removed from the rate base computation through an adjustment. . .

25. VECC submits that OPG’s proposed ARC treatment effectively uses rate base and ratepayers responsibility thereof to <u>implicitly</u> hedge the performance of its segregated fund: if actual returns on the fund are sufficiently poor in any given period, the ARC will increase in the following period corresponding to an increase in rate base in the following period which increases rates paid by ratepayers. There are no

consequences for OPG in the event that it makes sub-optimal decisions in managing its segregated funds: OPG will collect a weighted average cost of capital plus depreciation and any associated taxes from ratepayers on the ARC rate base component regardless of the performance of the fund.

26. VECC submits that the FERC approach recognizes that the accounting treatment and the regulatory treatment of Asset Retirement Obligations (and the related Asset Retirement Costs) are distinct from one other, so much so that FERC requires all such accounting costs to be removed from rate filings (including rate base) and treated separately on a case by case basis. VECC submits that it would be appropriate for this Board to take a similar approach with respect to OPG's Nuclear Liabilities, rather then, as OPG suggests, attempting to mechanically extend an accounting treatment of Nuclear Liabilities to the regulatory context.

27. VECC submits that consideration of a funding strategy similar to a "sinking fund provision" be given in respect of funding the ARC over the test period.

28. By way of example of a sinking fund approach, if an entity has a $1.0B (undiscounted) liability that is due in 10 years and the company can get a fund return of 10% per year, the entity could choose to contribute $57.0M now, and each year thereafter up to the end of the ninth year/beginning of the tenth year and, at the end of 10 years would have a fund of $1.0B, exactly enough to fund its obligation.[3] VECC notes that the entity could choose to fully fund this obligation as of today by contributing $385.5M immediately – and no contributions thereafter – and also have $1.0B in 10 years with which to fully fund the liability. Likewise, the entity could structure the payments on either an increasing basis or a decreasing basis, depending on how it prefers to spread the payments over time. However VECC maintains that in cases where ratepayers are responsible for funding the liability, the first approach ($57.0M contributions annually) would generally be preferred since it

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[3] The formula used here is $A = rL/D$ where A is the required annual contribution, L is the undiscounted liability, r is the fund return, and $D = (1+r)^{N+1} - (1+r)$ with N being the number of years until the liability comes due.

would result in far less rate shock, would promote rate stability, and would be consistent with an appropriate intergenerational sharing of the cost of Nuclear Liabilities across all ratepayers.

29. VECC notes that in the real world, actual fund performance would typically deviate from expected fund performance annually. Conceptually, however, this source of variance poses no major difficulty for our sinking fund approach: given our $1.0B example above, the initial contribution would be $57.0M; after one year – when actual fund performance was observed – the adjusted required levelized contribution could be recalculated and adjusted (up or down) for the remaining nine years until the liability matures. This process could be undertaken annually to ensure that in 10 years, the fund would cover the liability. This approach could also fully capture changes in required contributions that arise due to changes in the liability that arise when the Reference Plan is subsequently revised. . VECC respectfully submits that, conceptually, such treatment of the Nuclear Liabilities is no different, and appropriately so, then the treatment of pension costs for many regulated utilities, including OPG.

30. When there are a number of liabilities that give rise to the ARC, a sinking fund approach could be applied to all of them to calculate an aggregate required ratepayer contribution.

31. In the present case, the Board is faced with implementing a regulatory mechanism for the recovery of Nuclear Liabilities where the utility has, in conjunction with its shareholder, created its own “sinking fund”, setting aside amounts in segregated funds that are intended to cover the cost of the Reference Plan. In accordance with these segregated funds, the amount to be added to the sinking fund within the test period, VECC presumes, is less then what it might otherwise have been.

32. With respect to the appropriate regulatory treatment of monies supplied by OPG to the segregated fund <u>prior to the 21-month test period being considered in the instant</u>

case, VECC submits that the first determination that the Board should make is whether or not the interim payments amounts as established contemplated the necessity of making some provision for nuclear liabilities: if so, then VECC submits that the appropriate inference to be drawn is that the forecasted revenues from prior payment amounts were sufficient to cover forecasted expenses including a provision in respect of nuclear liabilities. If this is the case, VECC submits that prior contributions have been funded by ratepayers and constitute zero cost capital provided by ratepayers to OPG and that no return on or of this capital is properly recoverable from ratepayers.

33. If the Board determines that approval of the payment amounts was made absent any recognition of a need to fund future nuclear liabilities over the interim period, then the Board must determine the amounts that to be appropriately recovered from ratepayers. In this event, VECC submits that its previous comments in respect of (i) the assets in-service providing current and future benefits and (ii) the implicit ratepayer fund hedge that were made above still apply. Consequently, VECC submits that in this case a rate of return lower than the WACC is appropriate for this component of the fund. In VECC's view, such a return should, were it allowed, reflect the reality that rather then having invested funds in assets providing current and future benefits (i.e. assets that are used and useful), OPG will have acted as a lender to ratepayers in respect of those funds, attracting a return commensurate with a debt rate rather then a return on equity.

34. VECC has had the opportunity to preview the submissions of CME with respect to Nuclear Liabilities, and respectfully submits that the arguments of VECC and CME on this issue are compatible with one another. Accordingly, VECC respectfully submits, one way in which to apply the sinking fund approach in the case is to adopt the treatment recommended by CME. Additionally, similar to the comments advanced by CME, VECC respectfully submits that the Board should consider explicitly making its determination of the treatment of Nuclear Liabilities interim, so as

to allow for further consultation and review of the subject prior to OPG's next rate application.

Streaming

35. Specific to the possible application of a sinking fund mechanism in a manner similar to what CME has proposed (namely by including ARC in rate base but excluding any return component from it), OPG, In Exhibit J1.3 addendum, sets out what it considers to be precedents for the Board to rely on in declining to trace or stream the financing related to certain items once those items are included in rate base. OPG asserts that

> Capital leases are used to finance many assets. There is financing directly related to the asset; therefore terms such as "streamed" or "traced" refer to this financing relationship. The asset appears in the rate base; however the financing directly related to that asset is not specifically identified in the utility weighted cost of capital. In effect, the weighted cost of capital used to finance all other capital assets is used as the proxy for the financing charges in the capital lease.

36. OPG relies on this view of the treatment of leases in rate base to support its inclusion of ARC costs in rate base as sufficient to justify a return on ARC amounts at the WACC, even though the actual cost of capital related to ARC may be different then the WACC (i.e., as VECC and others suggest, the ARC is no cost capital that attracts no return). OPG refers to two Board decisions in opposition to streaming or tracing, EB-2007-0680 (Toronto Hydro 2008/09 rates) and EBRO 474 (Centra Gas).

37. In the case of the Toronto Hydro decision, a very recent application before this Board, the lease in question related to $200,000.00 in vehicle leases as a component of Toronto Hydro's request $1.97 billion rate base for 2008.[4] In the Centra Decision,

[4] EB-2007-0680, THESL Application Decision dated May 15, 2008.

the leases related to Centra's head office facilities (the amount not appearing in the decision) as a component of Centra's Rate Base.

38. In both cases, VECC submits, the issue the Board was confronted with was whether it was appropriate to include lease costs in rate base. The appropriateness of distinguishing the financing costs related to the leases on the assumption that the leases would be included in rate base was never raised, it appears, by any party, and was never addressed by the Board in these decisions; the concepts of "tracing" or "streaming" were simple not at issue. In addition, it is clear, at least in the case of Toronto Hydro, that the lease in question was a fraction of the total rate base, and that the difference in the actual financing costs and the WACC for Toronto Hydro on $200,000.00, once the leases were included in rate base, would have been *de minimus* from a ratemaking perspective. Likewise, the leases for Centra's Office Facilities, which OPG assumes would have been more substantial, would still, VECC asserts, only constitute a small fraction of the total rate base.

39. In the present case, OPG's proposal to include ARC in rate base has the effect of increasing the rate base (for 2009, for example) associated with Nuclear assets by 266%, constituting $2.178 billion of the total Nuclear Rate Base of $3.483 Billion (B1T1S1 Table 2) or nearly 2/3's the total Nuclear Rate Base. Likewise, the differential between the WACC and the actual financing costs associated with an ARC value of $2.178 (particularly if the actual costs are determined to be zero) are not only material, but constitute one of the major cost items in the application. Finally, whereas the vehicle and office leases referred to in the Toronto Hydro and Centra decisions were, *prima facie*, used and useful in the provision of services to ratepayers, the ARC is still only an amount relating to future liabilities.

40. For all these reasons VECC submits that it is entirely appropriate, should it allow ARC costs to be included in rate base, to "stream" or "trace" an appropriate financing cost to the ARC rather then mechanically apply the WACC. Pursuant to the CME proposal, inclusion of ARC in rate base should be as no-cost capital.

Bruce Assets

41. VECC has reviewed and adopts CME’s analysis of the proper interpretation of the regulation with respect to the treatment of Bruce Asset related issues including the appropriate deferral account treatment for Bruce related “costs” and nuclear liability, as opposed to the costs and nuclear liability associated with prescribed assets.

Cost of Capital and Capital Structure

42. Along with CCC, VECC was a co-sponsor of Dr. Booth’s evidence in this proceeding.

43. VECC supports and adopts the submissions made by CCC on the issues of return on equity and capital structure, namely that Dr. Booth’s recommendations of an ROE of 7.75% and an equity thickness of 40% are appropriate for OPG over the test period.

44. VECC would like to emphasize the following salient points:

45. While the identity of any private group of shareholders or owners is not of relevance, ownership of a utility by the same entity that can simultaneously direct utility operations and direct regulatory treatment is of the utmost relevance in this case especially with respect to “risk and return.”

46. Regarding the Memorandum of Agreement’s requirements that OPG mitigate the Province’s financial and operational risk in operating its assets and reducing the Province’s risk exposure in its nuclear investments (A T1 S4 Appx B), VECC submits that this lower risk again implies a lower return than would otherwise obtain.

47. Similarly, the requirements imposed by O. Reg. 53/05 on the Board with respect to acceptance of OPG's balance sheet as per its audited 2007 financial statements and with respect to required cost recoveries serve, in VECC's view, to further lower the risks faced by OPG, in comparison with the risks faced by other regulated entities and especially in comparison with unregulated generators.

48. While VECC has, elsewhere in these submissions, not objected to OPG's requested deferral and variance account proposals, VECC submits that these accounts generally increase the probability of recovering unforecast changes and, in the specific cases of the accounts proposed for Tax Changes and for Pension and Other Post-Employment Benefits, serve to reduce OPG's risk relative to other utilities which do not enjoy such protection.

Capital Expenditures

49. VECC notes that this is the first regulatory filing made to the Board by OPG. VECC further notes that in making its filing OPG adhered strictly to the Minimum Filing Requirements established by the Board, i.e., interim period information only, and declined (in most instances) to provide any additional historical information that was subsequently requested by intervenors.

50. With respect to OPG's forecasted hydroelectric capital spending, VECC has no objections, noting that the Niagara Tunnel Project, the one area of hydroelectric capital spending with significant rate implications, does not have a revenue requirement impact in the test period, and is discussed elsewhere in the argument with respect to the escalation of rates beyond the test period.

51. According to OPG, the capital expenditures subject to Board review in this proceeding are provided in column (g) of Table 1 of J6.5.

52. With respect to other nuclear projects, VECC notes that spending (capital plus OM&A) was approximately $290M for 2005, 2006, and 2007 on an actual basis (D2

T1 S1 p. 2 and Tr. Vol. 6 p. 72 lines 7-8) and that OPG is forecasting that it will manage to a $290M envelope for 2008 and 2009.

53. Given the limited regulatory record and the limited information on the record plus the proximity of forecast spending on nuclear projects in the test period to actual spending in the interim period, VECC can find no compelling reason to take issue with OPG's forecasted capital expenditures on a project by project basis.

54. With respect to the overall capital spending, VECC submits that appears that OPG has, in linking its historical spending to its test period budgets, recognized a manageable level of capital spending.

55. VECC notes that in cross examination OPG explained that while it had, in previously reported years, forecasted much higher overall capital spending, its actual spending ended up at around the $290 million level in each year such that, for the purposes of the 2008/2009 portfolios it was recognized that that there was an apparent "doability" or "executable" limit to what they could do in the portfolios, leading to a reduction of the capital and OM&A portfolios to $290 Million for the nuclear fleet. OPG further explained that whereas overbudgeting in previous years lead to deferral of planned projects to future years, the "new" process, starting with the $290 million limited budget, caused the company to defer some projects as part of the original budgeting process.[5]

Rate Base

56. VECC notes that the Board is required to accept the balance sheet assets and liabilities in the 2007 audited financial statements in this proceeding. Further, as indicated above, VECC takes no issue with OPG's forecasted capital expenditures over the test period.

[5] Transcript, Volume 6, pages 70-71

57. VECC does however take issue with the cost of capital implications of the inclusion by OPG of ARC in the rate base. VECC has submitted elsewhere that the ARC is an unfunded liability that is not supported by investor supplied capital: as such, in VECC's view it is inappropriate to charge ratepayers a return on capital that has not been supplied.

58. VECC's position is that the ARC should be funded, going forward, as a ratepayer expense item calculated as a sinking fund provision for regulatory purposes as this provides a least-cost recovery of the liability from ratepayers; if the ARC is included in rate base, it should only be for the purpose of collecting a depreciation contribution towards the future liability and not for return on investment purposes.[6]

59. Finally in this regard, VECC reiterates that appropriate regulatory treatment is not prescribed by (i) accounting rules or protocols promulgated for reporting to the investment community by organizations such as CICA or FASB or (ii) by the choice of accounting presentation or treatment proposed by the Applicant.

OM&A Costs

60. VECC's view is that OM&A cost increases should track at about the general rate of inflation assuming no productivity increases, other things equal: to the extent that there are productivity increases, a lower rate of increase would be expected.

61. VECC understands that over 90% of the employees working at prescribed facilities are unionized and being compensated according to the provisions of collective bargaining agreements which prescribe wage and salary levels and benefits entitlements. (AIC p. 66).

[6] VECC supports the CME argument with respect to, if ARC is to be recovered as an item in rate base, how it should be treated.

62. The Navigant study indicates that OPG's staffing levels for its nuclear facilities exceed the CANDU benchmark by 12% which, other things equal, implies total labour costs being 12% above benchmark levels.

63. VECC notes that for 2008 over 2007 and for OPG's regulated operations, excluding corporate costs, Base OM&A increases by 9.4% and Project OM&A increases by 32.8% (Board Staff Tables 1 and 2 in J9.3 from Table 1 of F1 T1 S1 and Table 1 of F2 T1 S1).

64. VECC further notes that according to Undertaking Response J9.1, total year end staff numbers for OPG's regulated operations are expected to slightly decline from a total of 9,345 at the end of 2007 to 9,297 at the end of 2008.

65. A troubling aspect for VECC was the 6.5% "spike" shown in compensation per nuclear FTE – excluding pension and OPEB – in 2008 over 2007 as shown in J2.4. Union's witness was unable to satisfactorily account for this large increase under cross-examination:

> MR. BUONAGURO: Thank you. I just have some questions related to undertaking J2.4 that was produced this morning, and in particular, the second table which is specific to nuclear, O&M.
> Okay? Now, I understand from the first page of the interrogatory response how you adjusted our initial table to come up with your picture of how you would represent labour, excluding pension and OPEB costs per regular FTE for 2005, 2006, 2007, 2008 and 2009.
>
> I just wanted to know if I can get an explanation for the -- for what appears to be a spike in 2008 on the percentage change from year to year. So from 2005 to 2006, this graph is showing, or this chart is showing a

3.4 percent increase in labour costs. 2007, 3.7 percent. And then 2008, it jumps to 6.5 percent. I was wondering if you are able to isolate why that year has jumped compared to the other years.

MR. MAUTI: We attempted to go down to a level of detail to try to identify any one specific cause from that. As yet, we haven't.

We know that there are amounts in the base labour, the first line, which at times do not have or are not impacted by pension and OPEB, things like shift allowances, certain kinds of benefits, things like an outage bonus, components such as that which go into the labour line are not impacted by pension and burden. That might be a cause for the total sort of labour per FTE to jump to the 6.5 percent.

I know over the four years in total, it averages to roughly a little over 4 percent, but we haven't been able to specifically identify anything within 2008. (Tr. Vol 4, pp 55-56)

66. The response to J2.4 shows a spike in Total Regular Staff FTEs in nuclear, from 7,542.0 in 2007 to 8,109.1 in 2009, an increase of 567.1 or 7.5%

67. The response to J2.4 indicates that labour excluding Pension and OPEB increased by only 3.4% per FTE in 2006 and 3.7% per FTE in 2007.

68. Given the FTE spike in 2008 and the further labour cost (excluding pension and OPEB) spike in 2008, VECC submits that the Board should, at a minimum, disallow the excessive increase in 2008 in per FTE compensation: VECC submits that a cost increase of 4% per FTE is generous given the increases in 2005 and 2006.

69. If the Board finds that a 4% increase in cost per FTE is appropriate, this would result in a labour (excl. Pension and OPEB) cost of $104.6K per FTE for 2008. If the Board

further found that the staff FTEs forecast for 2008, 8109.1, was appropriate, this would result in a decrease of $20.6M in compensation per nuclear FTE in 2008. (Total compensation “excluding” would be $848.2M versus the $868.8M shown in line 6 of J2.4 Attachment.)

70. Should the Board find that Total Regular Staff FTEs are inflated, VECC submits that a further reduction to this line item be made accordingly.

71. VECC submits that any changes the Board makes to the 2008 figure should then serve as a reference point for the comparable 2009 figures.

Corporate Cost Allocation

72. VECC notes that to justify the large increases in corporate cost allocations to its regulated hydroelectricity and prescribed nuclear facilities, OPG relies on the Rudden Report (F4 T1 S1) dated April 30, 2006.

73. Under cross examination OPG’s witness stated that this was the most recent study performed and, while OPG had used the Rudden methodology for 2007, 2008, and 2009, there had been no independent evaluation of the 2007, 2008, or 2009 numbers that were derived in running the methodology. (Tr. Vol. 9 pp 19-23).

74. VECC submits that due to the significant increases in corporate cost allocations to OPG’s regulated operations, an external evaluation should have been undertaken to review the allocations that OPG proposes in this application. As it is too late for this to be done in this proceeding, VECC suggests that the Board include a directive in its decision on this application requiring OPG to file such an independent evaluation of its corporate cost allocation methodology and results thereof in its next rates application.

Deferral and Variance Account Proposal

75. OPG has proposed 3 new variance accounts that VECC would like to address, the Pension and Other Post Employment Benefits account, the Nuclear Fuel Costs account, and the Tax Changes account.

Pension and Other Post Employment Benefits

76. With respect to Pension and Other Post Employment Benefits, VECC submits that there is no apparent distinction to be drawn between OPG's Pension and OPEB plans and those of any other regulated utility. In the event that there were material differences, VECC submits that the onus would be on OPG to demonstrate that to be the case.

77. In VECC's view, OPG has not demonstrated that there are any circumstances particular to OPG to justify the establishment of such an account. VECC notes that while the Uniform System of Accounts used for electric LDCs allowed for a deferral account associated with pension amounts, deferral/variance account treatment on the basis of the uniform system of accounts was discontinued effective May 1, 2006.[7] Accordingly, absent special circumstances, VECC asks the Board to deny this request.

Nuclear Fuel Costs

78. Having reviewed the evidence concerning the manner in which OPG acquires Nuclear Fuel, VECC views these costs for OPG as analogous to commodity costs for gas distributors. As such, VECC supports the establishment of this account for the test period.

[7] Ontario Energy Board Accounting Procedures Handbook, Article 220, page 16-17, Revised July, 2007.

Tax Changes

79. VECC has had the opportunity to review the submissions of CCC with respect to the Tax Changes Variance account and agrees with those submission save for the following.

80. With respect to reassessment of filings previously made by OPG, ratepayers should not be responsible for adverse impacts resulting from reassessments on issues that OPG could have reasonably avoided. Accordingly VECC expects that in entering any amounts in this account, and in coming to clear that account before the OEB, the Board and ratepayers will have an opportunity to explore the circumstances leading to any reassessment related impacts and OPG's control over those impacts.

Interest Rates on Deferral Accounts

81. With respect, VECC submits that there is no justification for allowing OPG to earn a different interest rate for its deferral accounts then that set by the Board for all other utilities in the Prescribed Interest Rate Policies (Exhibit K15.1).

82. In terms of carrying amounts in deferral accounts VECC submits that there are no factors distinguishing the utilities subject to regulation from one another; amounts are tracked in the account, and the interest is calculated and added to compensate for the deferred payout.

83. As Board Staff points out in its argument, several electric LDCs have had to carry large amounts in deferral accounts, similar in quantum to the accounts proposed by OPG, without attracting "special" interest rates.[8] While VECC could envisage specific factors associated with certain expenses recorded in deferral accounts that could distinguish one kind of account from another based on what is recorded in the account, VECC would expect that such factors would affect what gets recorded in the

[8] Board Staff Submission, p. 45.

account as the principal amount. The principal attracts the prescribed interest rate; at the point the principal is determined: there are simply no relevant factors distinguishing one deferral account from another in terms of interest rate to be applied.

Production Forecasts

84. Due to the limited historical data available and the lack of any alternatives proposed, VECC submits that OPG's production forecasts be accepted for the test period.

Segregated Mode of Operations and Water Transactions Sharing Proposals

85. OPG's proposal is to share the net revenues arising from these activities with ratepayers on a 50:50 basis.

86. VECC submits that the net revenues that arise from these activities are activities that use OPG's regulated assets. These assets are included in rate base and earn OPG a return on capital and a return of capital, both of which are costs recoverable from ratepayers. As such, sharing the net proceeds with ratepayers is appropriate.

87. VECC asks that the Board consider whether the 50:50 sharing proposed by OPG is appropriate, or whether ratepayers, who cover the costs of such assets and substantiate OPG's ROE associated with the assets, should receive a majority share of the net revenues.

Hydroelectric Incentive Payment System

88. VECC agrees in principle that the Board should consider a mechanism that incents the applicant to move production from off-peak to on peak times, and that such a mechanism would have to account for the applicant's costs of moving production, as

well as account for the net loss in production as a result of the mechanics of shifting production through pumping. Intuitively increasing the availability of OPG's production in the on-peak period should, theoretically, impact on the HOEP to the benefit of consumers.

89. OPG's proposal is that it would receive the regulated rate for the actual average "hourly" (i.e., 5 minute interval) net energy production in each hour of the month from the regulated hydroelectric facilities and this total payment to OPG would then be adjusted according to OPG's proposed incentive plan.

90. The incentive adjustment would operate as follows: for hours during which net energy production supplied into the IESO market was greater than the monthly hourly average production, OPG's payment amount would be increased by an amount equal to the market clearing price multiplied by the amount by which the actual net energy production exceeded the monthly hourly average production; for hours during which net energy production supplied into the IESO market was less than the monthly hourly average production, OPG's payment amounts would be reduced by an amount equal to the market clearing price multiplied by the amount by which the actual net energy production was less than the monthly hourly average production. (I1 T1 S1 p. 11, formula box)

91. The actual threshold value in any month for determining the amount of production that receives market rates will depend on OPG's actual production in that month.

92. VECC submits that it would be preferable to have an exogenous threshold for determining incentive payments during any month rather than a threshold value dependent on actual performance in that interval for determining incentive payments in that same month.

93. OPG is requesting a payment of $37.80/MWh for its hydroelectric production, not including any incentive payments. In addition to the proposed incentive described

above, OPG proposes to retain some or all revenues from Water Transactions, Segregated Mode of Operation ("SMO"), and Congestion Management Settlement Credits ("CMSC").

94. OPG has forecast an average HOEP for 2008 of $40.16 and for 2009 of $40.54 (Technical Conference Tr. P. 10, lines 16-19).

95. VECC submits that the formula for the proposed hydroelectric payment amount, as given on page 11 of I T1 S1 updated, Section 5.2,

$$\sum_{t} [MWavg \times RegRate + (MW(t) - MWavg) \times MCP(t)], \quad (1)$$

96. can be rearranged to express the payment amount as follows:

$$MW_{TOTAL} \times (RegRate - MCP_{AVG}) + \sum_{t} MW(t) \cdot MCP(t) \quad (2)$$

97. where MW_{TOTAL} is total monthly production, MCP_{AVG} is average monthly market price, and all other variables are as defined by OPG. The first term is equal to what would be received if total production were "priced" at the difference between the regulated rate and the average market rate for the month; the second term equals the amount that OPG would receive if OPG received market prices for each "hour" (interval) in the month.

98. VECC notes that OPG has either control or influence over all the variables in the alternate expression (2) above – which determines its payment amount - except for the RegRate variable. By its decisions with respect to shifting production, OPG can determine its production in each interval (and hence its monthly total production) and can influence the market clearing price in each interval (and hence the monthly average market price).

99. Although VECC believes that the following scenario will not likely be realized given the proposed hydroelectric payment amounts and the forecast (and historical) HOEP,

VECC submits that in adopting any incentive scheme one must be wary of unintended consequences. Under the unlikely scenario that the regulated rate exceeds the average market price in any month, OPG would, under its proposal, receive an amount equal to what it would receive if all production were sold at market prices plus an additional bonus equal to the difference between the regulated rate and the market price on all production during the month.

100. VECC also notes the possibility that when OPG shifts some production from an off-peak period to a peak period, that the decreased supply in the off-peak period may increase the market price in the off-peak period (due to the decrease in quantity supplied), directly reducing the customer benefits in the off-peak period.

101. Further, VECC submits that since the OPG-forecasted customer benefits of the company time-shifting production were based on runs of a simulated model, the forecasted benefits are necessarily speculative in nature.

102. VECC adds that there will be no definitive and objective method to verify actual consumer benefits after the fact, since the market prices that would have prevailed had OPG not responded to the proposed incentive will not and can not be known. On this point VECC notes that even if parties had access to all offers in all periods after the fact, it can never be known how those offers would have changed had the status quo (1900 MWh) incentive remained in place. Hence, the consumer benefits will remain speculative even with the benefit of hindsight.

103. VECC also notes that whether or not the time-shifting produces net benefits for OPG and for ratepayers depends on the accuracy with which OPG can forecast market prices on a day-ahead basis. Although evidence of OPG's efficacy in forecasting such prices was sought, there is no evidence on the record as to its ability to accurately forecast HOEP. (Undertaking Response J15.10)

104. However, VECC does accept OPG's submission that the existing incentive mechanism does not always provide an economic incentive to behave optimally.

105. VECC submits that, due to concerns regarding the proposed incentive mechanism as described above, the Board should order that OPG track the operation of the mechanism in a deferral account during the test period, and that the clearance of the account could then be presented to the Board. In this way the Board will have the opportunity to review the effectiveness of the mechanism, along with the appropriateness of the incentive. VECC would anticipate that the Board, after reviewing the operation of the mechanism over an appropriate period, would be in a position to either approve (or disapprove) it for future use, with or without modification, and to determine whether the incentive should be augmented (i.e. through sharing with ratepayers of the net benefits) depending on the results.

Nuclear Fixed Charge Design

106. VECC notes that OPG's evidence is that the greatest operational risk OPG faces is that nuclear facilities will not generate forecast energy. OPG has also stated that over 90% of the costs associated with its nuclear facilities are fixed costs. OPG has applied to recover 25% of its revenue requirement associated with nuclear generation through a fixed charge.

107. VECC submits that by recovering through fixed charges 25% of the amount formerly recovered entirely through energy charges, OPG's has significantly reduces its risk of not recovering nuclear costs.

108. VECC does not object to the proposal.

Costs

109. VECC respectfully submits that it has acted responsibly and efficiently throughout this proceeding and requests an award of its reasonably incurred costs, and supports the submissions that CCC will be making for the issuance of an interim award covering costs reasonably incurred up to and including the conclusion of the oral hearing on June 20, 2008.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 21st day of July, 2008