OVERVIEW OF DEFERRAL AND VARIANCE ACCOUNTS

1.0 PURPOSE
This evidence summarizes the deferral and variance accounts for OPG’s regulated hydroelectric facilities (section 3.0) and nuclear generating facilities (section 4.0) that have been in place during the interim period. OPG proposes to clear the balances in these accounts as described in Ex. J1-T2-S1.

2.0 SUMMARY
OPG has established variance and deferral accounts as required under O. Reg. 53/05. In addition, OPG has recorded amounts in a variance account related to its proposed sharing of a portion of the profits from power sales to Quebec and water transactions with the New York Power Authority in an additional “Segregated Mode and Water Transactions Net Revenue Variance Account” (see sections 3.2.1 and 3.2.2).

In relation to its regulated hydroelectric operations, OPG has established two variance accounts: (1) the Interim Variance Account (“IVA”), with sub-accounts for water conditions and ancillary services and (2) a Segregated Mode and Water Transactions Net Revenue Account with sub-accounts for segregated mode of operations and water transaction net revenues. In relation to its nuclear operations, OPG has established three deferral accounts: (1) Pickering A Return to Service (“PARTS”), (2) Nuclear Liability, and (3) Nuclear Development as well as two variance accounts: (1) Capacity Refurbishment, and (2) the IVA, with sub-accounts for transmission restrictions and limitations, and ancillary services.

OPG’s proposed recovery is based on its deferral and variance account balances as at December 31, 2007 as reflected in OPG’s 2007 audited financial statements, consistent with the requirements of subsection 6 (2) 5 of O. Reg. 53/05. Differences between amounts reflected in its interim payment amounts and OPG’s actual costs/revenues incurred after December 31, 2007 will continue to be recorded in the deferral and variance accounts discussed above until the effective date of the OEB’s first payment order. These post-
December 31, 2007 balances will be brought forward for disposition in OPG’s next payment amounts application.

OPG proposes to continue to apply interest to the opening monthly balance of these accounts until the balances are fully recovered. OPG will record in its deferral and variance accounts the actual interest costs at the rate approved by the OEB for the 2008/2009 test period. OPG will seek to recover these costs in its next payment application.

The total balance of variance and deferral accounts was 342.8M at December 31, 2007, as summarized in Ex. J1-T1-S1 Table 1.

3.0 EXISTING HYDROELECTRIC VARIANCE AND DEFERRAL ACCOUNTS

In accordance with O. Reg. 53/05, OPG has established a variance account for the interim period to record capital and non-capital costs incurred and revenues earned or foregone on or after April 1, 2005 due to deviations from forecasts, as set out in the “Forecast Information (as of Q3/2004) for Facilities Prescribed under Ontario Regulation 53/05” as posted on the OEB website for the following hydroelectric matters:

- Differences in hydroelectric electricity production due to differences between forecast and actual water conditions.
- Ancillary service revenues.
- Costs associated with transmission outages and restrictions not otherwise recovered.

OPG has used “sub-accounts” to record these variances. The IVA sub-accounts associated with the revenue requirement impact of changes due to acts of God and transmission outages and restrictions had zero balances on December 31, 2007.

In addition OPG has established and recorded a Segregated Mode and Water Transactions Net Revenue Variance Account to record the amounts OPG has proposed to share with consumers. The amounts are associated with:

- Segregated mode of operations
• Water transaction net revenues.

The proposed sharing mechanism is described in Ex. G1-T1-S1.

3.1 Interim Variance Account - Hydroelectric

OPG established an IVA to record capital and non-capital costs incurred and revenues earned or foregone after April 1, 2005 for its hydroelectric operations for water conditions and ancillary services revenues. OPG has used “sub-accounts” to record these variances.

Exhibit J1-T1-S1 Table 2 shows the account’s closing balances for 2005, 2006, and 2007.

3.1.1 Hydroelectric Water Conditions Sub-Account

The interim hydroelectric rate is based on a forecast of the total production and the total costs for the regulated hydroelectric facilities over the interim period as set out in the “Forecast Information (as of Q3/2004) for Facilities Prescribed under Ontario Regulation 53/05” as posted on the OEB website. The production forecast in turn is based on a forecast of water availability. Water availability is not something that OPG can control, yet it can have a significant effect on hydroelectric revenues. The IVA - Hydroelectric Water Conditions Sub-Account addresses this risk by capturing the financial consequences of differences between forecast and actual water conditions. Because the account captures both positive and negative variances, it keeps OPG financially whole while at the same time protecting consumers.

A number of variables affect water availability, including local and total basin inflows, temperature, precipitation, humidity, and wind. These variables are considered in producing a forecast of flow. The flow forecast is entered into a hydroelectric production model to determine the forecast energy production. Therefore, to determine the production impact of changes in water conditions, the actual flow values are entered into the same production forecast model, holding all other variables the same. The resulting production based on actual flows is then compared to the original energy production forecast to determine the
deviations from forecast. Details of the production forecast methodology are described in Ex. E1-T1-S1.

The revenue impact is determined by multiplying the deviation from forecast, as described above, by the interim hydroelectric payment amount of $33/MWh as specified in O. Reg. 53/05. The resulting amount is recorded in the IVA - Hydroelectric Water Conditions Sub-Account.

OPG pays gross revenue charges to the Ontario Electricity Financial Corporation, the Niagara Parks Commission, and the Minister of Finance. These payments are based on production. As such, changes to energy production (as described above) would also change OPG’s gross revenue charges payments. Therefore, changes in gross revenue charges are also recorded in the IVA - Hydroelectric Water Conditions Sub-Account. OPG also makes payments to the St. Lawrence Seaway Management Corporation for the conveyance of water in the Welland Ship Canal, which is used for power generation at Decew Falls. Variations in these payments are recorded in this account. For a full discussion of gross revenue charges see Ex. F1-T4-S1.

Exhibit J1-T1-S1 Table 3 shows how the water condition variances were calculated for 2005, 2006, and 2007.

3.1.2 Ancillary Service Net Revenue Sub-Account
For the purpose of recording amounts in this sub-account, actual hydroelectric ancillary service revenue is compared against the forecast amounts that were provided to the Province for use in determining the interim payments. Each month the difference or variance is recorded in the IVA. The specific ancillary services for regulated hydroelectric operations included in forecast information provided to the Province were: black start capability, operating reserve, automatic generation control, and reactive support/voltage control service. For a full discussion of ancillary service revenues see Ex. G1-T1-S1.
Exhibit J1-T1-S1 Table 3 summarizes the hydroelectric ancillary services variance for 2005, 2006, and 2007.

### 3.2 Segregated Mode and Water Transactions Net Revenue Account

In addition to the variance accounts listed in O. Reg. 53/05, OPG has established a Segregated Mode and Water Transactions Net Revenue Account to share a portion of its profits from segregated mode of operations and water transaction activities.

#### 3.2.1 Segregated Mode of Operations Sub-Account

R.H. Saunders can, with the approval of the IESO, segregate some of its generation units from the Ontario grid and reconnect them directly to the Quebec grid. This is known as segregated mode of operation ("SMO"). When OPG’s generation is in SMO, the units involved are no longer participating in the Ontario market, but instead receive revenues from Hydro Quebec. The remaining units, not on SMO, continue to participate in the Ontario market. SMO is described in greater detail in Ex. G1-T1-S1.

The treatment of SMO transactions is not prescribed by O. Reg. 53/05. However, OPG believes that it is appropriate to share with ratepayers a portion of the net revenues from SMO transactions earned during the interim period. OPG’s SMO revenue sharing mechanism is discussed in Ex. G1-T1-S1. The proposed sharing mechanism recognizes that OPG is using prescribed assets to earn this revenue so it would only be fair to share a portion of the net revenues from SMO transactions.

Exhibit J1-T1-S1 Table 3 summarizes amounts recorded in the Segregated Mode of Operations Sub-Account for 2005, 2006, and 2007.

#### 3.2.2 Water Transactions Net Revenue Sub-Account

OPG’s regulated hydroelectric facilities also earn revenue when a portion of its water entitlement is used at the New York Power Authority generating facilities in the United States. This is referred to as a water transaction and can occur for a number of reasons as set out in Ex. G1-T1-S1. Occasionally, New York Power Authority ‘transfers’ a portion of its water
entitlement to OPG for the same purposes. Further details of water transactions are discussed in Ex. G1-T1-S1.

While the treatment of water transaction revenue is not prescribed by O. Reg. 53/05, OPG believes that sharing with Ontario ratepayers a portion of the profits earned during the interim period, is appropriate. OPG’s water transaction revenue sharing mechanism is discussed in Ex. G1-T1-S1. The proposed sharing mechanism preserves an incentive for OPG to engage in water transactions while sharing a portion of the net revenues with ratepayers. The proposed division of water transaction net revenues is fair to consumers and recognizes OPG’s role in developing opportunities and facilitating arrangements and encourages OPG to optimize the use of its regulated assets.

Exhibit J1-T1-S1 Table 3 summarizes water transactions for 2005, 2006, and 2007.

3.2.3 Interest on Hydroelectric Variance Accounts
Ontario Regulation 53/05 establishes an interest rate (six percent) and a methodology for applying interest (compounded annually, on the opening monthly balance) for the hydroelectric variance accounts OPG has been directed to establish. OPG has applied this rate and methodology to the Segregated Mode and Water Transactions Net Revenue account described above.

In May 2005, OPG started to apply interest at six percent, as May was the first month with an opening balance.

4.0 EXISTING NUCLEAR VARIANCE AND DEFERRAL ACCOUNTS
Ontario Regulation 53/05 established three nuclear deferral accounts and two variance accounts. The deferral accounts capture:

- Non-capital costs associated with the PARTS Deferral Account.
- Costs associated with an increase in nuclear decommissioning liabilities that result from any change in its nuclear decommissioning liability arising from an approved reference plan (Nuclear Liability Deferral Account, Transition).
• Costs to develop nuclear generation capacity (Nuclear Development Deferral Account, Transition)

The variance accounts established for the interim period are for recording:
• Costs to refurbish, increase or add generation capacity (Capacity Refurbishment Variance Account).
• Capital and non-capital costs incurred and revenues earned or foregone on or after April 1, 2005 due to deviations from forecasts as set out in the “Forecast Information (as of Q3/2004) for Facilities Prescribed under Ontario Regulation 53/05”, posted on the OEB website for the following nuclear matters:
  o Unforeseen changes to nuclear regulatory requirements or unforeseen technological changes.
  o Ancillary service revenues.
  o Acts of God.
  o Costs associated with transmission outages and restrictions not otherwise recovered.

The nuclear deferral and variance account balances are summarized in Ex. J1-T1-S1 Table 4. The IVA “sub-accounts” associated with the revenue requirement impact of unforeseen changes in nuclear technology or regulatory requirements and acts of God had zero balances on December 31, 2007.

4.1 Pickering A Return to Service (“PARTS”) Deferral Account

There are three sections of O. Reg. 53/05 that establish and specify the treatment and recovery of costs related to the PARTS Deferral Account, as follows:
• 5 (4) OPG shall establish a deferral account in connection with section 78.1 of the Act that records non-capital costs incurred on or after January 1, 2005 that are associated with the planned return to service of all units at the Pickering A Generating Station, including those units which the Board of Directors has determined should be placed in safe storage.
5 (5) For the purposes of subsection (4), the non-capital costs include, but are not restricted to:

(a) Construction costs, assessment costs, pre-engineering costs, project completion costs, and demobilization costs.

(b) Interest costs, recorded as simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually.

6 (2) 3 The Board shall ensure that OPG recovers the balance recorded in the deferral account established under subsection 5 (4). The Board shall authorize recovery of the balance on a straight line basis over a period not to exceed 15 years.

Subsection 6 (2) 5 of O. Reg. 53/05 provides that the OEB shall accept the balances in OPG’s audited financial statements. OPG’s audited financial statements specifically provide OPG’s PARTS balance in the financial statement note associated with regulatory assets and liabilities. OPG’s 2007 audited financial statements continue this note disclosure.

The PARTS Deferral Account balance, net of accumulated amortization is $183.8M on December 31, 2007. Exhibit J1-T1-S1 Table 5 summarizes the activity in the PARTS Deferral Account from January 1, 2005 - December 31, 2007.

4.1.1 Pickering A Return to Service Project Costs

Effective January 1, 2005, as a result of O. Reg. 53/05, OPG deferred all non-capital (OM&A) costs related to the PARTS project. These costs are tracked in OPG’s project management and financial systems, and were audited as part of OPG’s financial statement audit process.

From January 1, 2005 - December 31, 2007, OPG deferred costs of $271M as follows:
Unit 1 Return to Service Costs

Two hundred and thirty two million dollars of non-capital costs were incurred to return Unit 1 to service during the January 1, 2005 - December 31, 2007 period. Forty-three percent of this total cost was for performing maintenance and minor refurbishment of equipment. Sixteen million dollars was spent on safety, licensing, environmental qualification, and policy and procedures and related work. Thirty-eight million dollars of the total represents project management costs incurred by contractors and includes time for estimating, scheduling, and costing work, time for all managers above the general foreman level, and administrative support. Thirty-five million dollars of this total cost was for OPG support functions including Management, Engineering, Human Resources, Finance, and Regulatory Affairs. Forty-two million dollars represents infrastructure costs for leases and maintenance of facilities, as well as training and small tools and equipment.

Assessment Costs for Units 2 and 3

The scope of the PARTS project included an assessment of the physical condition of plant components at Units 2 and 3 in order to estimate the cost of returning these units to service. Following the condition assessment, OPG conducted a financial analysis in order to determine whether these units should be returned to service. On August 11, 2005 the Board of Directors of OPG accepted management’s recommendation not to return Units 2 and 3 to service. These assessment costs were recorded in the PARTS Deferral Account because they meet the criteria in section 5 (5) of O. Reg. 53/05.
After this decision was made, the Board directed management to preserve the value of the work that had been completed to date. This consisted of completing documentation and storage of engineering drawings and inspections. Total costs recorded in the PARTS Deferral Account for Units 2 ($16.0M) and Unit 3 ($3.4M) are reflected in the chart above. The costs for placing the units in safe storage are not recorded in the PARTS Deferral Account and are discussed in Ex. D2-T1-S1.

General Project Completion and Demobilization Costs

Once the decision was made to not return Units 2 and 3 to service, OPG took steps to close down the PARTS project. OPG has recorded $19.5M of general costs in the PARTS Deferral Account for project completion and demobilization. The costs include construction close out costs for moving materials, costs for cleaning and dismantling scaffolding, costs to reassign staff working on the PARTS project to other activities, leasing costs for storage facilities, prepaid insurance costs, and regulatory requirements such as satisfying environmental assessment conditions. These types of costs are normally incurred at the end of a project and meet the criteria in section 5 (5) of O. Reg. 53/05.

4.1.2 Pickering A Return to Service Amortization

During the interim rate period the PARTS amortization was calculated using a “unit of production” method. Amortization was calculated as actual nuclear production multiplied by an amortization rate. The amortization rate, in $/MWh, was calculated based on the information provided by OPG to the Province for the purposes of establishing the interim payment amount. This information reflected a 10-year amortization of costs from the in-service date of each unit. The amortized costs forecast for each period, divided by the forecast production in that period, resulted in a $/MWh rate, which was applied to OPG’s actual nuclear production during the interim rate period. Exhibit J1-T1-S1 Table 6 illustrates how the PARTS amortization was determined and applied.

The amortization method used during the interim period ensures that the opening balance of the PARTS Deferral Account for the test period excludes costs that were already recovered
through interim rates. OPG proposes to continue this methodology going forward with one exception: OPG proposes that the amortization period be extended to 15 years to more closely match the recovery of costs with the benefits of increased generation associated with PARTS project. The recovery methodology is discussed more fully in Ex. J1-T2-S1.

4.1.3 Interest on PARTS Deferral Account Balances

OPG has applied interest to the PARTS Deferral Account as specified in O. Reg. 53/05. It states in section 5 (5) that for the purposes of subsection 5 (4), “the non-capital costs include, but are not restricted to: b) interest costs, recorded as simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually”. In February 2005, OPG started to apply the six percent interest rate, as February was the first month with an opening balance.

4.2 Nuclear Liability Deferral Account

OPG will incur costs associated with decommissioning its nuclear facilities and managing used fuel and intermediate level waste. These costs are recognized as expenses over the life of the nuclear stations and are included in payment amounts because they are part of the cost of operating the nuclear stations. On December 31, 2006, OPG recorded in its financial statements an increase of approximately $1,386M to its nuclear decommissioning, nuclear used fuel management, and nuclear low and intermediate level waste management liabilities (together the “nuclear decommissioning liabilities”) and correspondingly increased the nuclear fixed asset balance. This increase in nuclear decommissioning liabilities is as a result of a new reference plan approved by the Province on December 13, 2006. The increase in the nuclear decommissioning liabilities and the related revenue requirement impacts were not contemplated when interim payment amounts were set by the Province. OPG’s accounting and regulatory treatment of nuclear liabilities is discussed in Ex. H1-T1-S2.

Under O. Reg. 53/05, OPG is required to establish a deferral account “that records for the period up to the effective date of the Board’s first order under section 78.1 of the Act the revenue requirement impact of any change in its nuclear decommissioning liability arising
from an approved reference plan, approved after April 1, 2005, as reflected in the audited financial statements approved by the board of directors of Ontario Power Generation Inc.” In the context of O. Reg. 53/05, “nuclear decommissioning liability” is defined as “the liability of Ontario Power Generation Inc. for decommissioning its nuclear generating facilities and the management of its nuclear waste and nuclear fuel”. The change in the liability must arise from an “approved reference plan,” which is defined by O. Reg. 53/05 as “a reference plan, as defined in the Ontario Nuclear Funds Agreement, which has been approved by Her Majesty the Queen in the right of Ontario in accordance with that agreement.” OPG established a Nuclear Liability Deferral Account - transition to reflect recovery of costs incurred prior to the OEB’s first payment order (a separate “Nuclear Liability Deferral Account” will reflect recovery of costs after the OEB first payment order, as discussed in Ex. J1-T3-S1.

As per the terms of O. Reg. 53/05 OPG has recorded amounts in the Nuclear Liabilities Deferral Account - transition for the revenue requirement impacts of the return on rate base, depreciation expense, capital tax, and fuel expense as specifically identified in O. Reg. 53/05.

Additionally, O. Reg. 53/05 requires OPG to record “simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually.”

The Nuclear Liability Deferral Account-transition balance as at December 31, 2007 consists of:

<table>
<thead>
<tr>
<th>Chart 2</th>
<th>Nuclear Liability Deferral Account-Transition Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>$M$</td>
<td></td>
</tr>
<tr>
<td>Return on Rate Base</td>
<td>75.4</td>
</tr>
<tr>
<td>Depreciation</td>
<td>53.7</td>
</tr>
<tr>
<td>Capital Tax</td>
<td>3.1</td>
</tr>
<tr>
<td>Fuel Expense</td>
<td>(5.2)</td>
</tr>
<tr>
<td>Interest</td>
<td>3.5</td>
</tr>
<tr>
<td>Total</td>
<td>130.5</td>
</tr>
</tbody>
</table>
In summary:

- Return on rate base for the interim period is computed using a rate base of $1,358M (the average value for 2007), a deemed capital structure of 55 percent debt with a six percent interest rate and 45 percent equity with an allowed rate of return on equity of five percent, consistent with the information used by the Province for the purpose of establishing OPG’s interim payments.

- Depreciation expense corresponds to the actual accounting depreciation expense related to the increase in OPG’s nuclear liabilities.

- The fuel expense recorded in the deferral account is the present value of the variable costs related to incremental quantities of used fuel generated in each period, and is recovered as a portion of OPG’s nuclear fuel expense, as presented in Ex. F2-T5-S1 Table 1. The variable rate applied to each fuel bundle extracted in 2007 is lower than the initial rate that was used in the reference plan, which results in an increase in the nuclear liability account. The lower rate resulted from new operating assumptions, specifically, station lives were extended, which results in a lower rate because there is a longer period of time available to collect these costs.

- Capital taxes are calculated on the increase in rate base resulting from the recording of OPG’s revised asset retirement obligations. The accounting for the asset retirement obligation and rate base impact is discussed in Exhibit H. OPG calculates capital taxes for regulatory purposes by applying OPG’s actual capital tax rate applicable to 2006 of 0.3 percent to its forecast rate base for the period. OPG’s capital tax methodology is described in Ex. F3-T2-S1.

- Income tax expense is incurred as OPG collects the balance in this deferral account. However, no income tax expense was recorded in the deferral account during the interim rate period because OPG did not incur any income tax expense related to this account during this period. During the test period, any income tax associated with this account will be offset by the return of regulated tax losses. Beginning in 2010, OPG expects that there will be a requirement to include income tax expense related to this account in the revenue requirement as all of the regulated tax losses will have been returned to ratepayers.
Interest expense is determined at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually, as provided in O. Reg. 53/05.

4.3 Nuclear Development Deferral Account, Transition and Capacity Refurbishment Variance Account

During the interim period, OPG incurred costs associated with assessing the feasibility of refurbishing certain of its nuclear facilities and beginning the approvals process for new nuclear capacity at an existing site.

This work is being undertaken in furtherance of a directive that OPG received on June 16, 2006 from its shareholder, the Province as represented by the Minister of Energy. This directive recognizes that maintaining the current level of nuclear capacity through 2025 requires a combination of refurbishment and the addition of capacity at existing nuclear sites.

The costs for these two accounts are summarized in Ex. J1-T1-S1 Table 7 and Table 8.

4.3.1 Nuclear Development Deferral Account, Transition

There are four sections of O. Reg. 53/05 that establish and specify the treatment and recovery of costs related to the Nuclear Development Deferral Account, Transition as follows:

- 5.3 (1) Ontario Power Generation Inc. shall establish a deferral account in connection with section 78.1 of the Act that records, for the period up to the effective date of the Board’s first order under section 78.1 of the Act, the costs incurred and firm financial commitments made on or after June 13, 2006, in the course of planning and preparation for the development of proposed new nuclear generation facilities that are associated with any one or more of the following activities:

  1. Activities for carrying out an environmental assessment under the Canadian Environmental Assessment Act.
2. Activities for obtaining any governmental licence, authorization, permit or other approval.

3. Activities for carrying out a technology assessment or for defining all commercial and technical requirements to, or with, any third parties.

- 5.3 (2) Ontario Power Generation Inc. shall record simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually.

- 6(2) 4.1 The Board shall ensure that Ontario Power Generation Inc. recovers the costs incurred and firm financial commitments made in the course of planning and preparation for the development of proposed new nuclear generation facilities, to the extent the Board is satisfied that,
  
  i. the costs were prudently incurred, and
  
  ii. the financial commitments were prudently made.

- 6(2) 7.1 The Board shall ensure the balances recorded in the deferral account established under subsection 5.3 (1) and the variance account established under subsection 5.4 (1) are recovered on a straight line basis over a period not to exceed three years, to the extent the Board is satisfied that,
  
  i. the costs were prudently incurred, and
  
  ii. the financial commitments were prudently made.

Subsection 6 (2) 5 of O. Reg. 53/05 provides that the OEB shall accept the balances in OPG’s audited financial statements. OPG’s 2007 audited financial statements includes the Nuclear Development Deferral Account, Transition balance in the regulatory asset described as Nuclear generation development costs in financial statement note 7.
OPG has incurred costs associated with developing nuclear capacity at Darlington. No costs for nuclear development were included in the information provided to the Province for the purposes of establishing the interim payment amount. OPG’s costs for adding capacity at Darlington including budgets and other supporting information are discussed in Ex. D2-T1-S3. OPG’s balance in this account on December 31, 2007 is summarized in Ex. J1-T1-S1 Table 8.

4.3.2 Capacity Refurbishment Variance Account

Paragraph 6 (2) 4 of the Regulation, dealing with rules governing the determination of payment amounts by the OEB, states that the OEB:

“Shall ensure that Ontario Power Generation Inc. recovers capital and non-capital costs, and firm financial commitments incurred to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2, including, but not limited to, assessment costs and pre-engineering costs and commitments, (i) if the costs and financial commitments were within the project budgets approved for that purpose by the Board of Directors of OPG before the making of the Board’s first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., or (ii) if the costs and financial commitments were not approved by the Board of Directors of OPG before the making of the Board’s first order under section 78.1 of the Act in respect of OPG, if the Board is satisfied that the costs were prudently incurred and that the financial commitments were prudently made.”

OPG has incurred costs associated with plans to refurbish units at Pickering B and Darlington. The costs were incurred to perform an assessment of the feasibility of refurbishing units at Pickering B and Darlington, including developing a cost estimate based on the physical condition of plant components, considering environmental and regulatory requirements, and timing for completing the work. This work is in furtherance of the June 16, 2006 directive. The costs associated with this work are covered by subparagraph 6 (2) 4 (i) of O. Reg. 53/05 and were within the project budgets approved by the Board of Directors of OPG for this purpose.
OPG’s Capacity Refurbishment Variance Account records costs that were not included in the information provided by OPG to the Province for the purposes of establishing the interim payment amount. OPG’s nuclear development costs, budgets, and other supporting information are discussed in Ex. D2-T1-S3. OPG’s balance in this account on December 31, 2007 is summarized in Ex. J1-T1-S1 Table 8.

The process of life extending an existing facility is very complex and has not been undertaken in Canada for many years. Both the costs and the detailed schedule commitments are subject to change over a relatively short period due to changing regulatory requirements, work schedules, and supplier constraints. This is one of the characteristics that support OPG’s position that these expenditures be subject to variance account treatment during the test period.

Subsection 6 (2) 5 of O. Reg. 53/05 provides that the OEB shall accept the balances in OPG’s audited financial statements. OPG’s 2007 audited financial statements includes the Capacity Refurbishment Variance Account balance in the regulatory asset described as Nuclear generation development costs in financial statement note 7.

4.3.3 Interest

Interest expense related to OPG’s Nuclear Development Deferral Account, transition is described in Section 5.3(2) of O. Reg. 53/05. Section 5.3 (2) provides that OPG shall record simple interest on the monthly opening balance of the account at an annual rate of six percent applied to the monthly opening balance in the account, compounded annually. O. Reg. 53/05 does not prescribe a methodology or interest rate associated with recovery of costs of capacity refurbishment, increase or addition. As the Government Directive of July 16, 2007 provides that a combination of nuclear development and refurbishment is required to meet the objective of maintaining the current level of nuclear capacity until 2025, OPG has applied the same rate and methodology to amounts recorded in the Capacity Refurbishment Variance Account established above.

4.4 Interim Variance Account (“IVA”) - Nuclear
The basis for the IVA was discussed in section 3.1 above. This section highlights those aspects of the IVA associated with the nuclear matters:

- Unforeseen changes to nuclear regulatory requirements or unforeseen technological changes which directly affect the nuclear generation facilities.
- Ancillary service revenues.
- Costs associated with transmission outages and restrictions not otherwise recovered.

Subsection 5 (3) of O. Reg. 53/05 states that OPG shall record simple interest on the monthly opening balance of the interim variance account at an annual rate of six percent, compounded annually.

OPG has used “sub-accounts” to record capital and non-capital costs incurred and revenues earned or foregone after April 1, 2005 for its nuclear operations for: ancillary services revenues and transmission outages and restrictions, which are described below. As noted above, OPG had a zero balance at December 31, 2007 for the other IVA provisions (e.g., no amounts were recorded with respect to acts of God). Exhibit J1-T1-S1 Table 9 summarizes the account balances for 2005, 2006, and 2007.

4.4.1 Ancillary Service Net Revenues Sub-Account

OPG compares the actual nuclear ancillary services revenue with the amounts included in the forecast information provided to the Province for establishing the interim payment amounts and records the difference in this variance account. Ancillary services include operating reserve, and reactive support/voltage control service. For a full discussion of ancillary service revenues see Ex. G1-T1-S1. Exhibit J1-T1-S1 Table 10 summarizes the results for 2005, 2006, and 2007.

4.4.2 Transmission Outages and Restrictions Sub-Account

When OPG’s nuclear generation facilities are derated or constrained-off due to a transmission outage or restriction, OPG tracks the details for posting to this sub-account.
OPG calculates the lost production immediately following any transmission-related event that
derates or constrains-off OPG’s regulated generation, including from nuclear facilities. The
amount of lost production is determined as the variance between actual production and the
hourly capability of the facility for the duration of the transmission related event, multiplied by
the regulated rate of $49.50/MWh. The duration of the outage is equal to the length of time
that the grid is not available, plus the length of time that it takes for a facility to return to full
production following the transmission outage. As required by O. Reg. 53/05, OPG reduces
the financial impact of a transmission outage/restriction by any congestion management
settlement credits payments that are received from the IESO.

OPG has recorded in the nuclear variance account amounts in excess of the congestion
management settlement credits received for three transmission outages. These outages
occurred at its Darlington Generating Station on: December 12, 2005; April 25/26 and June
17/18 2006. Exhibit J1-T1-S1 Table 11 summarizes the three outages.

4.4.3 Interest on Nuclear Variance Account Balances
Section 5 (3) of O. Reg. 53/05 states that OPG shall record simple interest on the monthly
opening balance of the variance account at an annual rate of six percent, compounded
annually.