CLEARANCE OF DEFERRAL AND VARIANCE ACCOUNTS

1.0 PURPOSE

This evidence describes OPG’s proposed approach for clearing the deferral and variance account balances described in Ex. J1-T1-S1.

2.0 SUMMARY

OPG’s proposed recovery is based on its deferral and variance account balances as at December 31, 2007, as reflected in its 2007 audited financial statements, consistent with the requirements of subsection 6 (2) 5 of the Regulation.

This subsection requires the OEB to use the asset and liability values in the last audited financial statements approved by OPG’s Board of Directors prior to the making of the OEB’s first payment order.

OPG proposes to recover its total December 31, 2007 hydroelectric variance account balances during the test period as a reduction in OPG’s proposed hydroelectric revenue requirement. OPG proposes to recover a portion of its December 31, 2007 nuclear deferral and variance accounts during the test period through a payment rider as explained in section 5.0 below. OPG has summarized its proposals for the recovery of the deferral and variance balances in Ex. J1-T2-S1 Table 1.

OPG does not propose to recover amounts recorded after December 31, 2007 as part of this Application. As discussed in Ex. J1-T1-S1, OPG will continue to apply interest to the opening monthly balance in these accounts, as reduced by the actual amounts recovered, until the balances in these accounts are fully recovered.

OPG proposes to clear the deferral and variance account balances associated with its nuclear operations by December 31, 2010, with the exception of the Pickering A Return to Service (“PARTS”) Deferral Account balance, which OPG proposes to recover by December 31, 2019 as discussed below. OPG proposes to apply a payment rider on its test period
nuclear production to recover the test period portion of the December 31, 2007 variance and deferral account balances.

The methodology and rationale for OPG’s proposed recovery of its December 31, 2007 deferral and variance account balances is described in section 3.0. The recovery of hydroelectric variance account balances in OPG’s proposed test period revenue requirement is discussed in section 4.0. The recovery of nuclear deferral and variance account balances through a payment rider is discussed in section 5.0.

3.0 METHODOLOGY

OPG generally favours recovering deferral and variance account balances through separate payment riders. However, given that the size of the resulting hydroelectric payment rider would be very small, OPG proposes instead to recover its hydroelectric variance account balances in its test period revenue requirement.

The use of payment riders in the form of a $/MWh rate is consistent with past OEB decisions pertaining to the recovery of regulatory assets (i.e., RP-2004-0117, RP-2004-0118, RP 2004-0100, RP-2004-0069, RP-2004-0064).¹ On page 84 of these decisions the OEB approved the recovery of variance and deferral accounts balances through a variable charge, rather than a fixed charge or combination of the two. The OEB stated that this approach is “consistent with the principle that fixed charges should be generally associated with longer term assets of the utility; regulatory assets are not seen as fitting this profile” and that “recovery for the volumetric component is more conducive to encouraging and rewarding ratepayers for their conservation efforts.” The OEB concluded that “the most practical and administratively efficient method of recovery is through a single rate rider per rate class on the volumetric distribution charge.”

OPG proposes to use a single payment rider rather for 2008 and 2009 as this is easier to understand, implement, and explain than separate riders for each year. As the payment rider

¹ These decisions issued December 9, 2004 address many policy issues regarding the disposition of deferral and variance accounts for four large electricity distributors, and provide disposition guidelines for Ontario’s other electric distributors.
is based upon forecast production, any differences between forecast and actual production
during the test period will cause a variance. This variance will be carried forward to OPG’s
next payment application. This approach is fair both to consumers and to OPG as the
balances approved by the OEB would not be over- or under-recovered. This approach is also
consistent with the requirements of O. Reg. 53/05, which provides that the OEB shall ensure
recovery of specific deferral and variance account balances.

OPG’s proposed recovery period for each deferral and variance account is based on the
nature of the balances recorded. Deferral or variance account balances associated with long-
term assets or liabilities will be recovered over a longer period to match the recovery of the
costs/revenues as closely as possible with the benefits associated with those
costs/revenues. Deferral or variance account balances, which flow from differences between
actual expenditures/revenues in the interim period and the forecast expenditures/revenues
included in the information provided to the Province for the purpose of establishing the
interim payment amounts, will be recovered over a shorter period consistent with the terms of
the Regulation.

OPG proposes that all recovery periods extend until the end of OPG’s fiscal year (i.e.,
December 31) Recovery by the end of a fiscal year simplifies OPG’s year end financial
reporting and provides a validation of the account balance recovery through OPG’s financial
statement audit process. Specific recovery periods for deferral and variance accounts are
discussed in section 4.0 for hydroelectric variance accounts and section 5.0 for nuclear
deferral and variance accounts.

4.0 RECOVERY OF HYDROELECTRIC VARIANCE ACCOUNTS
All of OPG’s regulated hydroelectric variance accounts have balances that reflect the
differences between actual expenditures/revenues or revenue sharing in the interim period
and the forecast expenditures/revenues included in the information provided to the Province
for the purpose of establishing the interim payment amounts. As such, recovery over a short-
term period is appropriate.
The hydroelectric variance account balances, coupled with its forecast hydroelectric production for the test period, would produce a payment rider of $0.1/MWh. Given the very small size of the resulting payment rider and the nature of the amounts in these accounts, OPG proposes to include these balances in its test period revenue requirement in the interest of simplicity. OPG’s proposed hydroelectric revenue requirement reflects the recovery of these balances over the test period on a straight-line amortization basis.

Paragraph 6 (2) 1 of the Regulation requires that the OEB ensure variance account balances recorded pursuant to section 5 (1) (the interim variance account balances) are recovered over a period not to exceed three years. OPG’s proposal to include interim variance account balances in its 21 month test period revenue requirement is within the limits established by the Regulation.

5.0 RECOVERY OF NUCLEAR DEFERRAL AND VARIANCE ACCOUNTS
The nuclear payment rider calculation is shown in Ex. J1-T2-S1 Table 3.

With the exception of the PARTS Deferral Account, none of OPG’s nuclear deferral or variance account balances are associated with long-term assets or liabilities. The PARTS Deferral Account balance is associated with a long-term asset, and the extended service life of the Pickering A Generating Station will provide benefits in the form of nuclear electricity production that will be received by future ratepayers.

The deferral of costs associated with the PARTS project enables OPG to more appropriately match these costs with the benefits associated with the PARTS project. The primary benefit of the PARTS project is the increase in the productive service life of the two Pickering A units.

OPG proposes that the forecast recovery period for its PARTS Deferral Account end December 31, 2019. In a future payment application, OPG expects to make a proposal to recover the balance as at December 31, 2019 resulting from the differences between actual and forecast production in the preceding test period. OPG’s recovery proposal would permit
complete recovery by November 2020, which is 15 years from the in-service date of Unit 1.

The proposed recovery period slightly shorter than the expected service life of Unit 1. It will also be consistent with the wording of subsection 6 (2) 3 of the Regulation which requires that OPG recover the balance in this deferral account on a straight line basis over a period not to exceed 15 years.

OPG proposes to include the test period amortization of its December 31, 2007 PARTS balance in the $/MWh nuclear payment rider, rather than using a separate fixed payment rider amount, as this approach is simple to both understand and implement. The test period amortization is calculated on a straight line basis (as required by the Regulation) commencing April 1, 2008 and ending December 31, 2019.

All of OPG’s other nuclear deferral and variance accounts (non-PARTS accounts) have balances that reflect the differences between actual expenditures/revenues in the interim period and the forecast expenditures/revenues included in the information provided to the Province for the purpose of establishing the interim payment amounts. For example, the amount recorded in the Nuclear Liability Deferral Account represents the variance in defined aspects of OPG’s revenue requirement prior to regulation by the OEB. Similarly, the Nuclear Increases/Additions and Refurbishments Deferral Account records the variance between the amounts actually spent on these activities in the interim period and the amounts reflected in OPG’s payment amounts. The costs recorded are related to planning and pre-assessment activities, and are therefore short-term in nature.

OPG proposes to also include the test period amortization of its December 31, 2007 non-PARTS account balances in the nuclear payment rider. The test period amortization is calculated on a straight line basis commencing April 1, 2008 and ending December 31, 2010. This forecast recovery period is consistent with the portions of the Regulation that require the OEB to ensure that certain deferral or variance account balances are recovered over a period not to exceed three years.