UNDEARTAKING J8.1

Undertaking

Calculation of the net revenue contribution from the Bruce assets computed on a conventional GAAP basis for 2007, 2008 and 2009.

Response

While OPG does not believe that the use of a conventional GAAP basis is an appropriate methodology for calculating the Bruce “revenue less costs” to use as an offset to the revenue requirement, OPG has prepared an income statement for the Bruce lease and generating stations under GAAP (Attachment 1) in response to an undertaking request. OPG has also provided a reconciliation of the net income under GAAP to the Bruce revenues less costs that are presented in Exhibit K (Attachment 2).

The Bruce station and lease are not one of OPG’s business segments for reporting purposes. Therefore, the attached income statement was prepared specifically for this undertaking. OPG does track certain costs associated with the Bruce station for management reporting purposes, and where this information was available, OPG has used it in the attached income statement.

The major differences between OPG’s proposal and the attached GAAP-based income statement are:

- the inclusion of a return on rate base as a cost;
- the treatment of asset retirement costs; and
- the revenue recognition policy for lease revenue.

In the income statement approach, OPG has allocated a portion of accretion expense and earnings on nuclear segregated funds to the Bruce stations. In the evidence, OPG used the same treatment for asset retirement costs for the Bruce station as for OPG’s other stations. The rationale for this treatment is that O. Reg 53/05 states that OPG shall recover all the costs it incurs with respect to the Bruce Nuclear Generating Stations. Decommissioning the Bruce stations, as well as disposing of used fuel and low and intermediate level waste generated by the Bruce stations are OPG’s responsibility under the Bruce Lease Agreement. Further, section 6(2)5 of the regulation requires the Board to accept the fixed asset values related to the Bruce facilities as per the 2007 audited financial statements. These values include the Bruce asset retirement cost.

Section 6(2)10 of the regulation states that if OPG’s revenues earned with respect to the Bruce lease exceed the costs OPG incurs with respect to the Bruce stations, the excess shall be applied to reduce the amount of the nuclear payment amounts. OPG financed the Bruce assets through a combination of debt and equity. The cost of debt for the Bruce assets is represented by OPG’s interest cost and the cost of equity for the Bruce assets is represented by an opportunity cost. Therefore, OPG has determined interest and equity costs for the Bruce assets, using the same capital structure, deemed interest rate, and rate of return on equity that is applicable to its prescribed assets. OPG
continues to own the Bruce assets and bears the risks associated with ownership. The
lease payments OPG negotiated with Bruce Power included an assumed return on this
investment. Therefore, OPG is entitled to the opportunity cost of its ownership of the
Bruce assets.

OPG’s interpretation of the regulation is that all of its costs of ownership are costs
associated with the Bruce lease. This interpretation of the regulation is supported by the
fact that the interim payment amounts approved by the Province include a return on rate
base as one of the costs associated with the Bruce lease.

In addition, section 6(2)8 of the regulation requires the Board to ensure that OPG
recovers the revenue requirement impact of its nuclear decommissioning liability arising
from the current approved reference plan. This liability includes the nuclear liabilities
associated with the Bruce facilities. OPG’s proposal for recovery of the revenue
requirement impact of the nuclear decommissioning liability is supported by the fact that
the regulation specifies a return as one of the components of revenue requirement that
should be recorded in the nuclear liabilities deferral account. Since section 6(2)7 of the
regulation specifically mentions a return as part of the revenue requirement for the
nuclear liabilities deferral account, the only reasonable interpretation of section 6(2)8 is
that a return on rate base must be included as part of the revenue requirement for
OPG’s total nuclear liabilities.

Because OPG funds its asset retirement costs for nuclear stations through segregated
funds, earnings from these funds are recorded in OPG’s income statement based on
GAAP. However, inclusion of these earnings as part of the revenue associated with the
Bruce generating stations is not appropriate for rate setting purposes because the
contributions to these funds were predominately made from investor supplied capital.

OPG’s proposal related to the Bruce assets results in a similar treatment for these
assets as OPG’s prescribed facilities. If this treatment is changed, it would not be
appropriate to give rate payers the benefit of the tax losses associated with the Bruce
stations. This would result in a significant reduction to the tax losses available for rate
mitigation purposes during the test period.
### Attachment 1

**BRUCE Net Income for the 12 Months Ending**

($Millions)

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Revenue</strong></td>
<td>284.6</td>
<td>290.1</td>
<td>291.3</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel (note 2)</td>
<td>16.8</td>
<td>14.1</td>
<td>14.8</td>
</tr>
<tr>
<td>Depreciation (note 2)</td>
<td>76.6</td>
<td>69.8</td>
<td>66.7</td>
</tr>
<tr>
<td>Property Tax</td>
<td>13.8</td>
<td>15.2</td>
<td>15.5</td>
</tr>
<tr>
<td>Capital Tax (note 2)</td>
<td>1.1</td>
<td>4.4</td>
<td>3.6</td>
</tr>
<tr>
<td>Other (Income) Loss</td>
<td>0.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accretion on fixed asset removal and nuclear waste management liabilities (note 4)</td>
<td>207.2</td>
<td>255.9</td>
<td>282.0</td>
</tr>
<tr>
<td>Earnings on nuclear fixed asset removal and nuclear waste management funds</td>
<td>(194.2)</td>
<td>(234.9)</td>
<td>(262.0)</td>
</tr>
<tr>
<td>Interest expense (note 3)</td>
<td>20.3</td>
<td>21.2</td>
<td>21.1</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>141.6</td>
<td>145.7</td>
<td>141.7</td>
</tr>
<tr>
<td><strong>Income Tax</strong> (note 5)</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td><strong>Net income after tax</strong></td>
<td><strong>143.0</strong></td>
<td><strong>144.4</strong></td>
<td><strong>149.6</strong></td>
</tr>
</tbody>
</table>
Notes to the Bruce Income Statement:

1. Revenues include Bruce lease revenues as per Ex. G2-T2-S2 Table 1, and consist of fixed (base) rent, supplemental rent, amortization of prepaid rent, and services. OPG accounts for Bruce lease revenue using the cash basis of accounting. This is consistent with GAAP. Under the cash basis of accounting, OPG recognizes lease income as stipulated in the lease agreement to the extent that the lease payments are expected to be included in future regulated prices charged to customers. As a result of changes to accounting for regulatory operations, OPG will account prospectively for these lease revenues on a straight-line basis beginning January 1, 2009. However, in response to this undertaking, OPG has constructed the Bruce income statement as if the lease revenue was accounted for on a straight line basis, as requested by Mr. Rupert. This results in an additional $21 Million of revenue in the income statement compared to the evidence for 2007 and 2008, and an additional $16 Million in 2009.

Section 6(2)6 of the regulation states that in making its first order, the Board shall accept the values in OPG’s most recently audited financial statements, including the revenue requirement impact of accounting policy decisions. It is OPG’s position that the Board shall accept OPG’s accounting policy for recognizing Bruce lease revenue.

2. OPG deferred certain costs that are normally expensed by unregulated entities in the nuclear liabilities deferral account for 2007 and the first quarter of 2008. These consist of a portion of depreciation expense, fuel expense, low and intermediate level waste expense, capital tax, and interest. OPG also recorded a return as part of the nuclear liabilities deferral account as prescribed by regulation. The accretion expense in the income statement for 2007 and the first quarter of 2008 is net of the interest and return that were recorded in the nuclear liabilities deferral account. The expenses that are recorded in the nuclear liabilities deferral account are presented in Exhibit G on a gross basis and do not reflect the fact that OPG deferred them. The deferral of these expenses is recognized in Exhibit C for 2007 as part of historic regulatory earnings and in Exhibit K for Q1 2008.

3. Interest that is specifically related to a particular business unit is directly assigned to the business unit. The remaining interest is allocated based on the proportion of each stations’ average net book compared to the net book value for OPG’s other stations.

4. Accretion expense and earnings on nuclear fixed asset removal and nuclear waste management funds are allocated to each station as specified by the Ontario Nuclear Funds Agreement.

5. Income tax is calculated on earnings before tax as per the Bruce income statement, adjusted for items with different accounting and tax treatment to determine taxable income for Bruce on a standalone basis. OPG’s operations
related to the Bruce lease and generating stations result in tax losses. The tax
losses arise from tax deductions for OPG’s contributions to nuclear segregated
funds. It should also be noted that OPG has only considered current tax expense
in its determination of tax expense for the Bruce lease and assets, and has not
incorporated the impact of future tax expense.
### Attachment 2

**Reconciliation of Accounting Net Income to Regulatory Net Income in the Filing (Exhibit K)**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net income after tax per income statement (M$)</strong></td>
<td>143.0</td>
<td>144.4</td>
<td>149.6</td>
</tr>
</tbody>
</table>

**Adjustments to net income to calculate Bruce income per payment amounts**

- **Add:** GAAP based expenses in income statement that are not part of regulatory earnings
  - Bruce lease accrual: (20.7) (20.7) (15.5)
  - Expenses recorded in nuclear liabilities deferral account: (3.5) 0.0 0.0
  - Accretion: 207.2 255.9 282.0
  - Segregated fund earnings: (194.2) (234.9) (262.0)
  - Interest: 20.3 21.2 21.1
  - Capital taxes: 1.1 4.4 3.6

- **Deduct:** OPG’s proposed regulatory costs (as explained in Ex. G)
  - Deemed interest: (37.6) (28.4) (27.6)
  - Return On Equity: (27.7) (70.2) (66.1)
  - Deemed capital taxes: (2.8) (2.6) (2.5)

**Bruce net income as per payment amounts (Exhibit K)**

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bruce net income</td>
<td>85.1</td>
<td>69.1</td>
<td>82.6</td>
</tr>
</tbody>
</table>