ADDITIONAL QUESTIONS FOR OPG

Question OPG-1

What confidentiality issues are anticipated to arise in relation to OPG's filing and what is the anticipated impact?

Response OPG-1

Similar to the other entities regulated by the Board, OPG has confidentiality issues relating to areas such as labour union negotiations, contract negotiations, aboriginal past grievance negotiations, contract-related information and other commercially sensitive information that may become relevant to an issue in the proceeding. OPG believes that these issues can be addressed through the processes and procedures the Board has in place to deal with confidential information as part of the Board's Rules of Practice and Procedure.

In addition, OPG has specific confidentiality requirements, regarding certain projects and programs related to nuclear safety and security, in relation to the Canadian Nuclear Safety Commission (CNSC). Under the Nuclear Safety and Control Act and its associated regulations, certain information regarding OPG's nuclear facilities is "prescribed information" and OPG is required to prevent unauthorized transfer or disclosure of such information. OPG identified the need to address treatment of this information in its comments on the Board's proposed new Practice Direction on Confidential Filings. OPG anticipates the Practice Direction, when finalized, will consider this information.

Question OPG-2

Could financial information for 2006 Actuals, 2007 Estimates and 2008 Budget be filed for any of the proposed business segments under which CoS could be derived? What are the timelines by which OPG would need to know the businesses according to which CoS would be structured?

Response OPG-2

The business segments proposed in question CoS 1 are: all prescribed assets as one business unit; nuclear assets and regulated hydroelectric assets as separate business units; or some combination of individual generating stations.

Comprehensive financial information could be provided for all prescribed assets as one business unit and for nuclear assets and regulated hydroelectric assets as separate business units. While some of OPG's financial information is available at the plant level (e.g. Pickering, Darlington), a number of important elements of revenue requirement (e.g. working capital, interest, payments in lieu of taxes (PILs)) are not determined at the plant level as OPG does not require this level of detail for internal management or external financial reporting. The additional complexity of allocating costs to individual plants is one of the reasons why OPG believes the payment amounts should continue to be established on a technology level.

If the Board were to set payment amounts on some combination of individual generating facilities, and assuming a fall/winter 2007 initial hearing, OPG would need to know the specific division of plants for the CoS filing by October 2006. This timing would enable OPG to begin evidence preparation for its forecast test year on the basis determined by the Board.

<u>Question OPG-3</u>

Can OPG file a depreciation study (or studies) for all of the prescribed assets?

<u>Response OPG-3</u>

Yes.

GENERAL QUESTIONS TO BE ADDRESSED BY ALL PRESENTERS

Question GEN-1

How will recovery of the amounts in the variance and deferral accounts as contemplated in Regulation 53/05 be addressed when using the methodology that you are proposing?

Response GEN-1

OPG is proposing a limited issues cost of service hearing. The OEB will ultimately decide on the issues for the first hearing; but regardless of the issues selected for setting future payment amounts, disposition of any interim variance and deferral account balances is necessary under the requirements of O. Reg 53/05. OPG proposes that it would file information on the balances in the deferral and variance accounts for review. This information would address the requirements of O. Reg. 53/05 regarding recovery of the balances in the variance account and propose a method for disposition.

The OEB has significant experience providing for the recovery of deferral and variance accounts under a cost of service methodology. One of the advantages of a cost of service approach over other approaches is that it most easily accommodates the review and disposition of the variance and deferral accounts.

Question GEN-2

Comment on the type/detail of information that would need to be filed to support the methodology that you are proposing.

Response GEN-2

OPG proposes a limited issues cost of service methodology that would entail the following:

- OPG would file a summary of its revenue requirement for the test period April 1, 2008 – December 31, 2009 in early 2007. This filing would be consistent with the filing guidelines to be established by the Board. It would include historic, bridge and test year information on the major elements of the revenue requirement and an overview explanation of these elements. It would also include a proposed process for addressing non-hearing issues.
- The Board would hold a Technical Conference to allow intervenors to ask questions on the summary.
- The Board would convene an Issues Conference and Issues Day that would result in a Board determination of an Issues List for the first hearing. The Board would also determine the process to address non-hearing issues.
- OPG would develop evidence for issues on the Issues List and file the evidence with the Board and intervenors. These issues would be addressed through a standard cost of service hearing process (i.e., discovery process, settlement conference, hearing, etc.)
- For non-hearing issues, OPG would file further information only if and as required by the Board.

<u>Question GEN-3</u>

Suggest a preliminary list of issues that would need to be addressed in the first proceeding.

<u>Response GEN-3</u>

OPG expects that issues selected for the first hearing would likely include:

- Cost or revenue streams that are materially changed from the amounts provided to the Province for use in establishing the interim payments
- Capital budgets
- Issues that entail a significant impact on the level of the payment amounts
- The resulting implications of changes in the structure of the payment amounts
- Issues that must be addressed to meet the requirements of O.Reg 53/05
- Return on equity, and
- Risk mitigation measures.

Under OPG's proposed limited issues cost of service approach, the list of issues to be addressed in the first proceeding would be determined based on a proposal by OPG, review and comment by interested parties and a Board decision.

QUESTIONS TO BE ADDRESSED FOR THOSE PROPOSING

COST OF SERVICE (CoS)

Question COS-1

Cost of service requires the assessment of a revenue requirement for a business. OPG's prescribed assets could be organized under a number of business units that might have a revenue requirement including: all prescribed assets as one business unit; nuclear assets and hydroelectric assets as separate business units; or some combination of individual generating units. For which businesses would the Board establish a revenue requirement?

Response COS-1

The grouping of assets for regulation is independent of the determination of revenue requirement. The issue of whether to group assets as a single entity, by technology, or by plant group or by plant, applies equally to the IR and Regulatory Contract methods. The IR and Regulatory Contract methods generate unique issues as the number of asset groups increases. For example under IR, it would have to be determined whether a different escalation and/or productivity factor is required for each asset group.

OPG submits that the Board should establish payment amounts on a technology basis, i.e., set payment amounts separately for nuclear and regulated hydroelectric. This approach is consistent with the manner in which OPG plans and operates these businesses and recognizes the significant differences in the design, operation and management of the nuclear and hydroelectric businesses.

OPG does not support regulation of combinations of individual units or individual facilities as this is contrary to the manner in which these facilities are operated, which can only be done efficiently on an integrated basis within nuclear and hydroelectric. Regulation of individual facilities would also be administratively inefficient, as preparing cost of service filings for each station would result in repetitive regulatory proceedings which would result in a longer and more complicated process.

Regulation at the facility level would require facility-specific allocations of support and common costs, thereby increasing the complexity of allocating costs, and would also distort cost control as some allocated costs would be beyond any individual facility's control.

Payment amounts for individual facilities would provide incorrect incentives for allocation of resources for maintenance among the plants, leading to inefficient maintenance strategies. From a system perspective, the output from all nuclear facilities is equally important.

Question COS-2

Cost of service requires the Board to establish both the capital structure and the rates of return under that capital structure for the business or businesses that are rate regulated. Would the cost of capital methodology determined by the Board as appropriate for other regulated utilities apply to OPG's prescribed assets? If not, how should an appropriate return on equity be determined? What group of industries would be appropriate comparisons? What are the relevant considerations and benchmarks for determining an appropriate return on equity for the prescribed assets?

Response COS-2

The cost of capital approach approved by the Board for other regulated utilities, specifically the formula-based approach confirmed by the Board in RP-2002-0158, would form an appropriate basis for determining the return on OPG's prescribed assets if the specific business and financial risks faced by OPG were recognized. Electricity generation is a fundamentally different business than either electric or gas distribution or electric transmission and has a significantly higher risk profile.

OPG submits that a study is required in order to establish its capital structure and a risk-appropriate rate of return on capital. The study would provide an analysis of the operational, technological, regulatory, financial and other risks that need to be assessed to establish a reasonable rate of return.

The considerations in establishing an appropriate return on equity relate to the identification and quantification of the risks associated with owning and operating OPG's prescribed assets. Only after these risks have been identified and quantified can the process of determining whether there are suitable benchmarks begin.

Question COS-3

How should the reduction in OPG’s risk associated with (a) the assumed continuation of the variance accounts provided for in section 5(1) of Regulation 53/05; and (b) the assurance of recovery of capital costs provided by section 6 (2) 3 of Regulation 53/05 be factored into the determination of an appropriate return on equity?

Response COS-3

The reduction in risk associated with the assumed continuation of the variance and deferral accounts provided for in section 5(1) of Regulation 53/05 and the recovery of capital costs provided for by section 6 (2) 3 would be factored into an assessment of the business and financial risks faced by OPG in operating the prescribed facilities. The variance account provided for in section 5(1) addresses some risks that are outside of OPG management’s control, however the extent of the risk coverage is not as extensive as that provided by deferral and variance accounts for other utilities regulated by the OEB. OPG’s required return will need to reflect this higher relative risk exposure.

In general, the risk and return implications of any variance and deferral accounts proposal, payment regulation provisions (including section 6 (2) 3), payment structure and other proposals in OPG’s application are best examined on an integrated basis with other factors that impact risk.

Question COS-4

There is no prior Board-approved O&M or capital budgets for the business or businesses at issue. Would historical spending of the businesses be considered as a suitable point of departure for forecast spending? If not, what would be the basis on which O&M and capital spending would be reviewed?

Response COS-4

OPG supports the use of historical information and trend analysis as one factor in assessing the reasonableness of OPG's forecasts. OPG would provide information to enable the Board to understand historic capital and O&M budget details, OPG's forecast spending and the variances between these amounts.

In OPG's submission, the best approach to confirm the reasonableness of O&M and capital expenditure requirements is a limited issues cost of service proceeding based on evidence filed by OPG. A review of budget detail is also consistent with the way the OEB has traditionally conducted its review of forecast test year budgets under cost of service regulation for Ontario's natural gas utilities.

<u>Question COS-5</u>

Nuclear Operations, Maintenance and Administration costs are the largest cost component of OPG's budget. What would be the basis on which the Board would review those costs given the absence of recent experience with such reviews?

<u>Response COS-5</u>

OPG plans to provide the Board with information on both historical OM&A costs and test period OM&A information so that the Board and intervenors will be able to review and understand the level of costs for OPG's regulated nuclear assets and to analyze trends in these costs. In addition, as part of a CoS filing, OPG would provide to the Board descriptions of the major nuclear OM&A work programs, as well as information regarding the resources required for the work programs.

Because the payment for OPG's output has never been regulated before, the absence of recent experience with such reviews will be an issue regardless of the methodology chosen.

Question COS-6

What would the term of the Board's first order be? Would an annual CoS review be used or could payments be set for multiple years based on a forecast? Should there be an initial series of annual reviews to establish a baseline of data to assist the Board in setting future payment amounts for the prescribed assets?

Response COS-6

OPG submits that the term of the Board's first order should be 21 months, followed by further orders covering two calendar years. Assuming that the first order is effective April 1, 2008, a 21 month term would enable future reviews to be done on a calendar year basis. This would be consistent with OPG's current business planning cycle and financial fiscal year, both of which are on a calendar year basis.

A two year term going forward is recommended because it would provide additional incentive to OPG to reduce its costs as compared to annual reviews. It would strike an appropriate balance between the resources required for review, and the need to periodically revisit OPG's costs. A period of longer than two years would not be appropriate given the significant initiatives underway at OPG's prescribed facilities.

It is OPG's submission that a baseline (OPG interprets "baseline" to mean the initial revenue requirement) should be established using a limited issues cost of service review on the 21-month basis suggested above. This would entail the Board deciding upon those issues to be addressed in the first hearing based on submissions of the parties and their review of a summary of the revenue requirement of the prescribed facilities filed with the Board in early 2007. Issues selected by the Board would receive typical cost of service scrutiny. In subsequent hearings, the Board would decide which issues to review based on considerations such as materiality and policy implications.

Question COS-7

Does the allocation of costs between prescribed assets and other generation assets create additional complexity? How would the cost allocation methodology, particularly with respect to corporate overhead costs, be determined?

Response COS-7

There is no additional complexity created by the allocation of costs between prescribed assets and other generation assets when compared to the issue of distribution of common costs addressed by the Board in regulating other entities. As discussed in OPG's May 19, 2006 presentation to Board staff and stakeholders, 97% of the fixed asset values used to establish interim rates and 87% of OM&A costs are directly attributable to regulated nuclear or regulated hydroelectric operations. The allocation issue relates only to the reasonableness of the cost drivers associated with the relatively small amount of remaining costs.

OPG engaged an expert in cost allocation reviews to evaluate OPG's methodology for distributing centralized support and administrative costs between regulated nuclear, regulated hydroelectric and unregulated operations. The expert's report largely supported OPG's methodology; however OPG did amend its approach to reflect the report's recommendations.

Question COS-8

Is CoS consistent with the existing incentive mechanism for the hydroelectric facilities, where a portion of the output receives the market price? Under CoS, what incentive mechanisms could be developed to reduce unit costs? How viable is the ‘sculpted payments’ methodology as suggested in the Board staff Discussion Paper in the context of CoS?

Response COS-8

Cost of service is consistent with the existing incentive mechanism for the regulated hydroelectric facilities. The existing payment amounts were based on the principles of a cost of service methodology (i.e. a revenue requirement and production forecast were developed and used to establish the payment amounts), and the incentive structure formed part of that methodology. The incentive structure has supported the efficient dispatch of peaking regulated hydroelectric capacity during the interim period.

OPG’s proposal to conduct cost of service reviews every two years will provide the incentive to control costs and, if possible, reduce them over the term that the payment amounts are in effect.

OPG supports the continued use of an incentive mechanism to maximize the value of regulated hydroelectric production and submits that this is best achieved by an incentive mechanism based on market prices. The “sculpted payments” methodology suggested by Board staff in the Discussion Paper would not be as effective for hydroelectric facilities. Baseload capacity from these facilities is a function of water availability throughout the year and therefore no incentive would be derived by “sculpting” payments by season. Peaking capacity should respond to actual market signals on a daily basis and not a predetermined “sculpted” payment structure which would presumably be seasonal.

OPG does not support the “sculpted payments” methodology for nuclear facilities. The only times the nuclear units are not producing at their maximum capability is during outages and derates. OPG plans its outages consistent with good utility practice and these outages must be approved by the IESO after consideration of reliability and other system impacts. Thus a seasonal incentive is unnecessary and, in any event, is likely to be ineffective because OPG’s ability to alter the availability of its nuclear units in the peak periods in response to an incentive is extremely limited.

OPG does support consideration of a fixed ($/MW) and variable ($/MWh) payment structure, which was one aspect of Board staff’s sculpting proposal. The structure of the payment amounts is analogous to a rate design consideration and the determination of revenue requirement under all methodologies (including CoS) is independent of rate design.

Question COS-9

Would automatic adjustment mechanisms be required to account for uncertainties in nuclear operations? Would deferral and/or variance account mechanisms need to be maintained or established?

Response COS-9

It is OPG's submission that a mechanism should be put in place to guard against significant events that are beyond management's control with respect to nuclear production in whatever methodology is chosen. A variance account currently exists within the interim period, and would be compatible with CoS regulation, going forward.

OPG interprets O. Reg. 53/05 as intending that the existing variance / deferral account mechanisms need not necessarily extend past the end of the interim period. As a result, OPG will propose appropriate risk mitigation strategies, including variance and deferral accounts.

It should be noted that the need for a variance account is not exclusive to a CoS methodology – it is equally applicable to IR, and could be accomplished through a Z-factor, as indicated on page 12 of OPG's July 24, 2006 submission. In OPG's submission even the Regulatory Contracts option would require some form of effective risk mitigation for events beyond management's control.