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Check Against Delivery

Thank you very much. It is a pleasure to be with you this morning.

This is a complex but interesting time to be regulator in this sector. This Province has for decades been the engine of economic growth in Canada. And much of that growth was fueled by cheap electricity.

In recent decades, however, the supply system has changed significantly. Ontario's generating capacity is now lower than what it was a decade ago. This decline occurred at the same time as substantial economic growth, particularly in the GTA. The growth in the economy and population continues to cause demand to escalate.

However, the biggest challenge we face is that, over the next 15 to 20 years, about 80 per cent of Ontario's existing generating capacity will reach the end of its useful life.

We have also discovered along the way, some other realities. First and foremost is that we have been wasting this scarce resource. That is because we have never considered it scarce and priced it below cost. All that needs to change.

Where the average cost of production is significantly below the marginal cost of new generation, conservation becomes an imperative. Conservation is Avoided Generation. Avoided Generation is not only cheaper; it can be built in a more timely fashion. Typically, there are no land owner claims. No environmental concerns. We often hear that the approval process for transmission and distribution assets takes twice the time it takes to build the facility. That is not an issue with conservation. For conservation initiatives, timelines are more friendly.

The Ontario Energy Board has much greater authority over transmission and distribution than over generation. But in the last two years, we have been given an increasing role in certain aspects of generation, both directly and indirectly. I thought this morning I would discuss the main generation issues facing us over the next few years. I would like to focus on the following three areas;

1. The Natural Gas Electricity Interface Review;
2. Standard Offer Contracts; and
3. Distributed Generation and Standby Charges.

Finally, I would like to talk about the Board's ongoing role in conservation. Where we are today? Conservation is the flip side of Generation.

First, let's look at the Natural Gas Electricity Interface Review. This is a case where the Board hopes to stay "ahead of the curve". That is, to anticipate potential bottlenecks in the system, rather than stumble across them when they arise unexpected.

This proceeding was started by the Board's own Motion and reflects increasing awareness that the Province will become dependent on gas-fired generating facilities. Prior to issuing the first Procedural Order in this matter, the Board issued a Report with three main conclusions.

First, the natural gas sector will need to make new infrastructure investments for gas-fired power generation, but this should not call for a fundamentally different regulatory approach than the current one.

Second, the Board should consider in generic proceeding, whether new services should be offered to gas-fired generators. Specifically, the Board should focus on designing a new rate for generators with the following two features:

- Hourly nomination for distribution, storage and transportation; and
- Firm high deliverability service.

The Report also identified three other service related issues;

- Identification of specific barriers to the inter franchise movement of gas;
- Redirection of gas to different delivery points at short notice; and
- Whether the transfer of title of gas in storage should be considered a purely administrative matter.

The third issue was whether the storage of gas should be deregulated. The question of storage regulation has been very much an issue in the United States with the new FERC rules. And many of the same pressures exist in Canada.

The issues will be complex. Do gas utilities either collectively or individually have market power in the provision of storage services? How do we measure market power? If the gas utilities do not have market power, is it in the public interest that some customers continue to pay storage rates at cost as opposed market rates? How should the extra storage revenue from storage services at market rates be allocated? If some customers pay for storage services at cost and others pay for the service at market prices, how should the line be drawn between the two types of customers?

Things have moved forward in this proceeding. The first Procedural Order identified the issues to be addressed in this proceeding. Those included

rates for gas-fired generators, storage regulation, and transportation capacity bidding process and allocation. On March 20th, Enbridge and Union filed their proposals and new rates. A Technical Conferences was held providing all parties an opportunity to question that evidence. A further Technical Conferences is scheduled for April 27th.

On May 1st, all parties will file evidence on the question of storage deregulation. Technical Conferences will be held on May 18th and 19th to allow questioning with respect to that material.

A Settlement Conference is scheduled for late May and a settlement proposal is expected to be placed before the Board on June 12th. However, the Board has stated that certain matters are not subject to settlement and that includes the matter of storage deregulation. A four week hearing is planned throughout selected parts of June and July.

The fact that this proceeding has created a high degree of interest is not surprising. Ontario needs new generating capacity and gas-fired generation is an immediate solution particularly for peak requirements.

The next subject that I would like to discuss is the Standard Offer Program.

All of us are aware that the Government's objectives in dealing with the supply mix are not only to increase capacity but to increase capacity in an environmentally friendly manner.

The Government policy with respect to the phrase 'out of coal' is well known. A complimentary aspect is the initiative to develop clean power. Government procurements have been successful in attracting proposals for renewable projects. They will partially meet the government's target of having 2700 MW of power generated by renewable energy by 2010. However, in that process, a number of barriers to entry were identified that discouraged the development of smaller generation projects. These barriers include:

- Financial security requirements;
- Complexity of the contracting process; and
- The overall administrative burden of the competitive RFP process.

On March 21st the OEB and OPA issued a Joint Report containing various recommendations to make it easier for small electricity generators in Ontario to connect to the grid. That Report responded to a request from the Minister of Energy in August 2005 to develop standard terms and conditions to improve access for smaller generators using clean and renewable resources.

This program fixed the price for these projects in order to make it easier for smaller generators to access the market. Under the plan, the OPA will purchase electricity generated by wind, bio mass and small hydro electrics at a base price of 11 cents per kWh. The fixed price of solar will be 42 cents per kWh. The Government indicated that this plan should add up to 1000 MW of renewable energy to Ontario's electricity supply.

The OEB and OPA continue to work on the program and expect to have it up and running by the fall. The OEB is working largely on code changes to facilitate connection and non-discriminatory access. The OPA is working on the terms and conditions of the Standard Offer Contract itself.

The next topic I would like to discuss is Distributed Generation. The benefits of Distributed Generation are set out in detail in the Energy Conservation and Supply Task Force Report. The Report noted that supplying power near load may make it possible to avoid or defer distribution and transmission investments. In addition, transmission and distribution line losses can be reduced by reducing transmission and distribution distances. At times of system stress, Distributed Generation can also enhance system reliability.

This is another one of these issues that has been around for a long time but is now subject to some rethinking. Around the Province, there are a number of customers who have their own generation facilities but require service from the LDCs in the event their facilities failed. The LDCs, understandably, expect to be paid for providing those facilities. The question is, is it the standard rate or some kind of special rate?

Some 16 of the 95 LDCs in Ontario have standby rates. As the Board noted in its' recent discussion paper on the Standard Offer Program, they incorporate many different approaches and a variety of charge determinants. Some of these rates were established a long time ago before restructuring the market. Others are new rates being proposed by standby customers in the 2006 rate applications. While traditionally, these customers may have been load displacement customers, some of the newer ones are merchant generators. Some are both.

The Board faced this issue in the 2006 rate application by EnerSource, Hydro Mississauga. There, the Greater Airport Authority intervened, claiming a special standby rate. The GTAA, a non-profit corporation which operates the Lester B. Pearson International Airport, recently commissioned a natural gas-fired co-generator facility and entered into a clean energy supply contract with the Ontario Power Authority. The new facility has the capacity to supply the GTAA's own power needs as well as supply power to the grid. GTAA is connected to the grid by way of a new interconnection with the EHM's distribution system.

The GTAA filed extensive evidence from Charles River Associates. They argued that standby rates should be based on cost but they should also reflect any benefits a distributed generator yields to the system. These, they argued included avoided cost, reduced line losses, and improved reliability. GTAA claimed that the utility was ignoring these principles when they proposed that load displacement customers should simply be charged the same monthly rate for standby service as for standard distribution service.

The Board created generic proceeding to deal with this and a number of other issues which were common to the 2006 rate application of all Ontario LDCs. In that Decision of March 21st, the Board ruled that there should be a standard methodology for standby rates and a separate proceeding be established to deal with that matter. Accordingly, all the standby rates of the Province were declared to be interim, whether they were existing rates or proposals for new rates.

The last topic that I would like to discuss is Conservation. Or to put it differently, Avoided Generation.

First, I would like to review the results of the first year of the third Trianche spending. Next, an examination of where we are on the issue of the utility spending above third Trianche and the role of LDCs generally. Finally, the current status of Smart Meter Program and the Board's recent ruling with respect to line losses.

As I indicated at the outset, the challenge we face is that the Ontario generating capacity is now lower than a decade ago. And yet, demand continues to grow. As we all know, over the next 20 years, 80 percent of the existing capacity reaches the end of its useful life. That is the capacity side of the equation.

The consumption side is equally disturbing. When we survey North America, Ontario stands out with one of the highest per capita consumption rates and the lowest CDM spending levels. The numbers are very dramatic.

The consumption side of the equation deserves extra attention because it may produce results more quickly and more cheaply. There is little NIMBYism, no environmental road blocks.

And the average cost is below the marginal cost. So, if we can recover a low cost MW, it is better than building a high cost MW. Ontario came late to this realization for whatever reason. But the new religion does seem to be growing.

The first formal initiative in this area started with the Ontario Energy Board's approval of $163 million in CDM spending over three years for what is

called the third Trianche spending. The first of those Decisions related to the six largest utilities in Ontario and was issued on December 10, 2005.

What are the results so far? We just received the first year's Report Card. At year end, December 31st, some $34.7 million had been spent over the previous twelve months by all Ontario LDCs. The utilities reported total energy savings of 152 million kWhs in 2005 which has a value of approximately $15 million. However, this was the saving only in 2005. The reported savings over the life time of those investments was 1.2 billion kWhs with a value of $120 million.

What can we conclude from the first year's results? While the Board has not conducted a thorough examination of the Reports, it appears that the spending is on track, particularly if we recognize that 50 percent of the first year's spending occurred in the last quarter. And the results, at least on first examination, appear to be impressive.

It is also interesting to note that of the Province-wide $34 million spending level, $24 million was accounted for by the six urban utilities that make up a consortium of large distributors plus Hydro One. One of the things that became apparent in the process is the high degree of co-operation among six urban distributors in evaluating programs and sharing results. We sometimes worry whether we can coordinate the conservation programs through 95 LDCs. But in reality, 75 percent of spending is done by seven companies in what appears to be fairly sophisticated program management.

The other development the Board faced regarding the conservation initiative was the question of whether utilities should be required to spend more than they have proposed in their 2006 rate case filings. Various parties intervened in a number of cases, particularly those involving large utilities, arguing that the Ontario LDCs spending on conservation was well below the level of other utilities both in Canada and the United States.

The Board made two important findings in its recent Decision. The first was that it had jurisdiction within a rate case to adjust the proposed expenditures on CDM either upward or downward. Secondly, in the context of the present application, it would be best to wait for the Report of the OPA on this subject. In the OPA Fees case, a number of intervenors questioned the conservation activities of the OPA. The OPA undertook to file by the end of June, a report that would recommend specific spending levels by the LDCs, and the role of LDCs, in the ongoing conservation initiatives.

Another area that continues to engage the Board is the Smart Meter initiative. This initiative began two years ago when the Premier stated that 800,000 smart meters would be installed by 2007 and there would be a smart meter in every home and business by 2010. Subsequently, the Ministry issued

a directive to the Board under section 7.1 of the OEB Act requiring the Board to develop a plan to implement the Government's program. Following an extensive stakeholder process, the Board submitted its proposed Smart Meter Implementation Plan to the Minister on January 26, 2005.

On February 27, 2006, the Energy Conservation Responsibility Act received third reading. A major element of that legislation concerned the Smart Meter Program. The legislation established a Smart Meter Entity to implement the Program, and if authorized to have exclusive authority over these activities. The legislation provides that the meters will be installed by all Ontario electricity local distributors or "any other persons" licensed by the Board to do so. The types of meters to be used will be prescribed by regulations, OEB codes, or OEB Orders.

While the specific legislation will be in regulations, yet to be promulgated, it is clear that the LDCs of the Province bears a major responsibility, subject to the regulatory oversight of the Board, for the implementation of Government's Smart Meter Plan.

In the recent rate applications, before the OEB, ten of the Applicants included specific expenditures on Smart Meters in their 2006 rate cases. The Board established a generic proceeding to deal with this and a number of other issues that were common to all the cases. The Board ruled that utilities that have proposed Smart Meter spending should be allowed that as an expense in 2006 rates on the basis of $3.50 per meter for each month during the year in which the Smart Meter was installed.

One of the largest commitments was at Toronto Hydro which proposed in the 2006 rate year to install 150,000 Smart Meters for residential customers and 7,500 for general service customers. In the case of the residential customers, this added a revenue requirement of $3.5 million and an additional cost of 48 cents per month for residential customers.

With respect to the vast majority of Ontario utilities that did not include any Smart Meter expenditures, the Board ruled that they should increase their rates by 30 cents a month in order to establish a source of capital to fund Smart Meter development programs. They were also required to file a proposed Smart Meter implementation program within 90 days of the date of the Decision.

The Board stated that given the increased need for electricity and importance of conservation, specific funding should be included in 2006 rates by all Ontario utilities and concluded,

> "This is an important step in the development of technology. It will increase the effort and commitment by both the utilities and technology suppliers. In the electricity sector, costs are

> often driven by peak demand and a pricing mechanism is the most effective tool to shift that demand. Time shifting demand offers substantial savings and Ontario stands to become a world leader in this technology. Given the recent legislation, no further delay is warranted."

Time shifting demand can produce large savings. Consider an example from last summer. On July 25, 2005, the Province was paying $278 in the 1 p.m. to 6 p.m. period to import power, a dramatic increase over the previous hour. The demand curve for electricity in the summer months looks like a hockey stick. Because every utility in the North East is bidding for the power at the same time, small increases in demand result in large increases in prices. The IESO calculated that if the demand in those hours on July 25th had been reduced by 100 MW, (one half of one per cent of total demand), the price would have been $221. The saving is $57 per MW. If we assume that 25,000 MW were purchased in that time frame, the saving can be as high as $8.5 million.

The trade-off between conservation and generation will be explicitly addressed in the OPA's Integrated Power System Plan ("IPSP"). Under the IPSP, the government will provide the OPA with directives setting out the government's goals with respect to both CDM and new supply. The IPSP is to set out the path to achieve those goals. The OEB will review the proposed IPSP to ensure that the Minister's directives are achieved and to ensure that the plan is cost effective. In other words, the idea is to use CDM goals in the planning process for the Province's supply mix. We are expecting the first IPSP to be filed later this year.

The Ministry is currently working with the coalition of Large Distributors on a procurement relating to the first phase of the Smart Meter target. The functional specifications for the Smart Meter are also under development. And the OEB is currently developing the regulatory framework of rates and codes to carry out this initiative.

The Smart Meter initiative has taken some time to implement but now appears to be firmly on track. Last week the Board announced the new time-of-use prices that would become effective on May 1st. They are somewhat higher than the previous year with the off peak being 3.5 cents per kWh compared to a peak price of 10.5 cents per kWh during the summer peak period between noon and 5 p.m. Currently, these prices are implemented on a voluntary basis. The Board will subsequently determine when they should become mandatory. That timing will relate to the speed with which the Smart Meters are installed.

A final conservation issue results from the Board's recent rate Decision regarding line losses. This has been an issue for the Board for a number of years with the intervenors arguing that the current regulatory treatment of line losses creates no incentive for utilities to reduce them.

The costs are substantial. Approximately 7.5 per cent of Ontario's total electricity is lost in transmission and distribution systems. If we assume annual electricity production of 155 million MWhs and average commodity cost of $60 per MWh, the annual cost of line losses is over $685 million.

In the recent 2006 rate Decisions in the Toronto and Ottawa cases, the Board, for the first time, took a step to deal with this matter. The Board ordered those two utilities to file a plan to reduce their line losses by 5 per cent within 90 days and identify in that plan both the cost and benefits.

It is difficult to forecast the exact nature of those plans but it is an important first step in developing techniques to reduce this cost.

We all recognize the challenges and responsibilities in regulating the electricity sector. It is a complex market with many players. It also has many regulatory agencies. The need for coordination among all of the agencies, whether it is the OPA, the IESO, or the OEB is critical.

We should remember that the break up of Ontario Hydro was done in the name of efficiency. The myriad of agencies bring with it the potential of overlapping regulatory costs. All of the costs, whether it is the IESO, OPA, or the OEB, are paid by the consumers. The OEB, in the fees case involving both the IESO and OPA, has been wary of overlapping regulation. And the agencies have cooperated to avoid this type of duplication. It is important to pursue this cooperation going forward, particularly in generation where the challenges may be the greatest.