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# AMPCO Response to the May 19, 2006 OEB Discussion Paper On Ontario Power Generation ("OPG") Prescribed Asset Price Regulation

In 2003 the Ontario Government established the Electricity Conservation and Supply Task Force ("ECSTF") to develop an action plan to achieve affordable supply adequacy in Ontario within a framework of environmental soundness and competitiveness of the Ontario economy. Among the ECSTF's conclusions was the assertion that "spot markets should not be the primary determinant of electricity prices for most consumers in Ontario". It recommended that certain OPG assets be designated "Heritage Assets" with prices for the output of these assets, "reflecting the costs of power generated from most of OPG's water power and nuclear assets". This idea of Heritage Assets was supported by various groups who had made submissions to the ECSTF, including AMPCO and OPG.

The ECSTF suggested that the experience of British Columbia and Quebec in implementing the concept of Heritage Assets could provide practical guides to the mechanisms that might be used in Ontario. In British Columbia, for example, Heritage Resources and Heritage Contracts are part of the government's overall Energy Plan. The objective of introducing Heritage Contracts was:

> **To give customers in the province who have supported development of low-cost Heritage Resources first claim on the output of these Resources at cost.**

The Government of Ontario accepted this recommendation of the ECSTF and introduced in the *Electricity Restructuring Act, 2004* regulated prices based on costs for the output of prescribed assets of OPG. Whereas Heritage Resources in British Columbia included virtually all of BC Hydro's assets and the recommendation of the ECSTF was to include all hydro and nuclear assets, the Ontario Government limited prescribed assets to baseload hydro and nuclear. Most other assets of OPG were covered by a revenue cap.

In arriving at a reasonable basis for the regulation of the price of prescribed assets, AMPCO believes that it is essential that their history be taken into consideration. This will provide an understanding of the true costs of Heritage Assets and the manner in which the risks for meeting these costs have been allocated. Heritage and other OPG assets were initially financed primarily by debt issued by Ontario Hydro. After the restructuring of Ontario Hydro all of its assets and liabilities were assumed by the Ontario Electricity Financial Corporation ("OEFC"). These included an estimated $26.9 billion in generation assets and $24.5 billion in debt that related to these assets. The generation assets were revalued to $8.5 billion and transferred to OPG. In the private sector this would have resulted in an enormous loss of invested equity capital. The market would have been quite unsympathetic to the cause of the loss in value, that is, non-controllable market conditions or poor management. Given that both the Epp Report ( "responsibility must lie with the OPG Board and senior management") and the Manley Report ("a company that is neither well run nor well governed") pointed to management as the prime cause for this value destruction, the loss of invested capital would seem to be particularly appropriate. The shareholder, the government on behalf of the people of Ontario, should have been left to deal with the fallout. In fact, it is consumers that were left with the financial burden in the form of the ultimate obligation to service the original Ontario Hydro debt.

While OPG received all of the generating assets, it was assigned just $3.5 billion in debt. The full amount of the original debt must still be serviced by OEFC through funds that are ultimately raised from consumers in the form of the Debt Reduction Charge, Payments in Lieu of taxes, Dedicated Income, etc.

**Consequently, the reality is that consumers continue to pay not only the regulated price of $33/MWh for baseload hydro resources and $49.50/MWh for output from nuclear resources but the full original cost of these assets.**

The consumer clearly bore all the risk related to these assets and continues to do so. This is further reinforced through the provision of variance accounts related to the regulated rates in place until 2008. This history suggests that the provision for a risk return for equity has no basis in reality.

The OEB's discussion paper of May 8, 2006 appropriately refers to the ECSTF's Heritage Asset recommendation as the genesis of the provisions of *Bill 100* for OPG price regulation. AMPCO maintains that (as has been the case in other Canadian provinces) the history of Heritage Assets in Ontario must be taken into consideration in deciding on appropriate regulated prices for output from these assets.

With regard to the appropriate regulatory model to be used by the OEB in implementing regulated prices for the output of prescribed assets, AMPCO takes a very pragmatic approach. The development of the electricity sector in Ontario to date has been characterized by an exceedingly complex market structure (one need only glance at the many hundreds of pages of IESO Market Rules and OEB Codes) and very large overhead costs – three large and growing government agencies whose costs are borne by ratepayers. This has also created significant and unwanted internal overhead costs for industrials participating in this market. All of this together has resulted in a very significant increase in electricity costs faced by consumers in Ontario. The model selected by the OEB must not add to the complexity and cost of the existing market. For this reason AMPCO recommends that the OEB not develop a regulatory model from first principles nor attempt to contribute towards market development during the course of settling on a regulatory model for OPG's Heritage Assets.

AMPCO recommends that the OEB adopt the process it has described in its discussion paper as a "modified Cost of Service process". That is, the Board should start with the existing prices as defined in Regulation 53/05. Since the basis for the determination of these rates is not publicly available, this information should be established as the reference case. The focus should then be on any changes that should be made to the reference case. This would allow for a reconsideration of the assumptions of the reference case in the light of the history of Heritage Assets, the incentives that are built into the current arrangement and the possible inclusion of other incentives. This approach could be implemented expeditiously and at far less expense and complexity than a full cost-of service study or the development of an incentive regulation model from first principles.

At this time AMPCO does not support the Regulatory Contracts approach described in the OEB's May 19, 2006 discussion paper. As the paper points out, this option introduces "significant contractual complexities". It also presumes a common understanding of the transition of the Ontario electricity sector to some end state and the characteristics of this end state. In the light of the significant changes in market structure since the IESO market started operations, it is reasonable to conclude that there is no such common understanding. That is, a discussion that has yet to take place and the OEB's determination of a regulatory model for the determination of OPG prices is not the appropriate forum for the resolution of this issue.

AMPCO believes that the approach recommended here would limit additional cost burdens faced by consumers, is amenable to the inclusion of incentives and multiple year price setting and does not foreclose transition to a competitive market when the features of that market are better defined and broadly accepted.

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