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Via email and courier

June 28, 2006

Mr. John Zych
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, Ontario, M4P 1E4

Re: EB-2006-0064
Ontario Power Generation Inc. – Setting Payment Amounts for Prescribed Generation Assets
Board Staff Discussion Paper #2

Dear Mr. Zych,

In response to the 2nd Draft Discussion Paper ("Draft") issued by Staff of the Ontario Energy Board (the "Board) on June 21, 2006, Coral Energy Canada Inc. ("Coral") provides these initial comments. Given the quick turnaround time, and the intent of Staff to issue their final recommendations on June 30th, Coral will be focussing additional review and future comments on the final report.

Coral does not agree with the Staff preference for incentive regulation, so these comments will focus on this aspect of the Draft rather than the specific recommendations that result from it. Some of the reasoning in support of the preference appear to conflict, and there is a lack of consideration of impacts the chosen method will have on the behaviour of OPG and the resulting interaction with the competitive electricity market.

Staff have asserted in the Draft, and in meetings with stakeholders, a desire to develop a process for determining the payments for the designated assets, while avoiding any impact or prejudice to how OPG interacts with the competitive market or government policy around market structure or evolution. This is captured in section 5.3.3 of the draft as, *"Absent policy direction in this regard, Board staff advocate that the choice of methodology should be "policy neutral" in the sense of allowing the Board sufficient flexibility to adjust the methodology to respond to specific market policy direction in the future."*

This stated desire to avoid policy issues and OPG impact on the competitive aspects of the market as part of this process conflicts with Staff contemplations around removing the Beck pumped storage generating station from the designated assets and creating "sculpted capacity payments" that would influence OPG behaviour, which almost certainly require changes to government policy and regulations. Depending on the details, these may be changes that Coral could support, but this position is additionally puzzling since Staff use these arguments for reasons why not to choose option #3, which Coral and some other stakeholders would view as the most flexible of the methodologies reviewed.

What has been viewed as option #3, or regulation by contract, should be viewed as more than simply a discrete option, but more practically as an implementation method or tool that can accommodate the most desired aspects and outcomes of both cost of service regulation and incentive regulation. Some parties may identify the regulated contracts approach as the most "market friendly", yet this is really just a result of the flexibility inherent in setting the terms around behaviours and outcomes and the incentives that drive them. These qualities are valuable regardless of the future direction of policy or market evolution, and so this approach of implementation through contracts is desirable under the status quo or any future market changes toward increased regulation or improved competition. Choosing the approach of incentive regulation, while avoiding discussion or incorporation of the role OPG plays in the broader market, is not policy neutral since it will cause unintended market consequences of OPG behaviour and restrict the flexibility the Board would have to respond to future situations.

Incentive regulation applied to utilities focuses on cost minimization with additional effort to prevent the activities of the monopoly from impacting the competitive commodity market. OPG is not like a traditional utility, since although we may wish it to operate at low cost and not exercise its market power in a harmful way, however, we need it to act in a very competitive fashion since the size of its role in the market has a significant impact on the market operations, market efficiency, and ultimately the financial viability of the electric industry. These aspects of regulating the output of the prescribed assets appear to have overlooked by Staff, and could result in the failure to achieve a key objective of the Board.

Monopoly utilities are generally regulated in a fashion that prevents them from competing in the commodity supply business with the cost of commodity treated as a pass-through, while returns to the shareholder are based on delivery / regulated revenues from the asset base. Their sale of commodity as a default supplier usually comes with an explicit purpose of not providing a competitive alternative, and not participating as a seller in the competitive commodity market. In the case of a generator like OPG that is an integral part of the market, while there is the similarity of wanting to earn revenues to pay for asset investments and provide a rate of return, the single source of revenue is the commodity sale. Any influence, regulatory or otherwise, on the prices and revenues associated with the commodity has an automatic and significant interaction with the competitive commodity market. So, even if it is desired, it is not possible to construct a regulatory process or oversight that does not influence the behaviour of the regulated entity in the competitive market. Given this, it is necessary for the Board to at least consider these influences and possible outcomes proactively within any approach adopted for setting the payments for OPG's designated assets.

Coral agrees with the conclusion of the London Economics report in support of the regulation by contract approach. This approach is not as complicated as Staff seems to fear, and issues around transparency of process can be addressed. Ontario has a "hybrid" market now, and even maintaining the viability of this policy and market we have today requires attention to the competitive aspects. We need an approach that is flexible enough to provide opportunity to improve upon the status quo in areas of market liquidity and resource adequacy. An example of how the contract approach may be useful would be the provision for incentives or settlement processes to shift from being focussed on real time prices to being determined based on a potential day ahead market. Similarly, a focus on cost containment and productivity factors through incentive regulation may ignore or even impede the ability of OPG to participate in forward contracts or markets that are necessary for liquidity and the reliability of the electricity supply. OPG plays an important role in the efficiency and overall health of our electric industry, and the impacts of its behaviour on the competitive side for reliability, quality of service, and consumer interests are as significant as the impacts on the regulated side.

As a matter of future process, Coral recommends the Board actively solicit comments on the final Staff report from bodies that would include the Market Surveillance Panel of the Board, the Independent Electricity System Operator, and the Ontario Power Authority. On review of the formal comments of stakeholders on the final report, the Board may also wish to consider additional consultation directly with stakeholders through an oral process or other process, prior to reaching a final determination. Coral appreciates this opportunity to comment and will participate as an interested party as this proceeding continues.

Sincerely,

Original signed

Paul Kerr
Manager, Market Affairs

Copy via email only to Mr. Russell Chute, OEB