OPG's Comments on the May 8, 2006 Staff Discussion Paper: "Regulatory Options for Setting Payments for the Output from OPG's Prescribed Generation Assets" EB-2006-0064

Ontario Power Generation Inc. (OPG) submits the following comments on the May 8, 2006 Ontario Energy Board (OEB) Staff Discussion Paper presenting regulatory options for setting the payment amounts for OPG's prescribed generation facilities.

OPG's comments are organized into four sections. The first section addresses general regulatory issues that should be considered irrespective of the particular option chosen. The remaining three sections address the three regulatory approaches presented in the paper: cost of service (CoS), performance-based regulation (PBR) and regulatory contracts.

With respect to the consultation process, OPG believes that all stakeholders should have the opportunity to share views in plenary sessions rather than small group meetings. This would allow all participants to benefit from the comments of others and to gain focus on the key issues with respect to the methodology. OPG, as the intended applicant under the regulatory option chosen, should, in all cases, have an opportunity to respond to any stakeholder comments.

General Regulatory Issues

Any regulatory option chosen should:

- Be consistent with the Government's policy direction underlying the designation of the prescribed facilities
- Operate in a transparent manner
- Allow OPG a reasonable opportunity to recover the costs associated with operating, maintaining and improving the prescribed facilities so that they can continue to benefit the people of Ontario
- Ensure that OPG has a reasonable opportunity to earn a risk-appropriate return on the capital associated with these facilities when viewed against returns authorized for other regulated entities
- Contain mechanisms to address risks beyond OPG's control
- Operate on a technology specific, rather than a plant specific, basis in recognition of the way the prescribed facilities are operated and managed
- Structure the regulated payment amounts to recognize the large proportion of fixed costs associated with the prescribed facilities
- Allow for evolution of regulation as the Board, OPG and intervenors all gain greater experience with regulating generation facilities
- Provide consistent direction and appropriate operational incentives over a multiple year period
- Be implemented efficiently by focusing on the central issues related to the cost and operation of the prescribed facilities

Cost of Service (CoS)

- CoS offers advantages because it is familiar to the Board and other parties, relatively transparent and provides an opportunity for all those involved in the regulatory process to gain a greater understanding of the costs associated with the prescribed facilities.
- CoS regulation can be complex, resource intensive and time consuming. One way of addressing these attributes is to properly scope the initial proceedings to address a limited set of issues and defer the excluded issues to subsequent proceedings. The Board has identified this as a "modified" CoS proceeding as opposed to a "full" CoS proceeding.
- As the staff paper indicates, a starting point could have the first modified proceeding review major changes from the current interim rates. The major changes that OPG would see as being addressed include a risk appropriate rate of return, consideration of major capital additions (e.g. the Niagara tunnel in late 2009), disposition of the variance and deferral account balances, and adjustments to reflect the decision not to return Pickering units 2 and 3 to service. In addition, OPG would ask the Board to consider a mechanism to address general cost increases since the interim rates were established in 2005.
- The next draft should discuss available mechanisms to provide incentives for increased efficiency in the context of CoS regulation. In particularly, the draft should compare the incentives toward efficiency created by setting rates for a multi-year period under CoS with those created by PBR.

Performance-Based Regulation (PBR)

- PBR has the potential to promote efficient operation and reduce regulatory costs if it starts from an appropriate base and includes a well designed mechanism that fairly balances the allocation of risk and includes appropriate incentives.
- The current interim rates would require adjustment, as noted above, before they could represent an appropriate starting point for PBR.
- In many ways, PBR based on adjusted interim rates can be seen as similar to a modified CoS proceeding because many of the issues involved in adjusting the interim rates to become the starting point for PBR would be the same as the issues considered in a modified CoS proceeding.
- Any PBR mechanism adopted by the Board should include Z factors for items beyond OPG management's control and off-ramps to address large unanticipated changes that call into question the viability of the established PBR mechanism.
- The initial PBR mechanism adopted by the Board should have a term of no more than 3 years. The next few years could see substantial changes to both the prescribed generation facilities and the environment in which they operate. Moreover, given that Ontario has no experience with regulating generation, a longer period for the initial mechanism may involve unacceptable risk.

Regulatory Contracts

- This regulatory model requires significantly more detail before it can be properly evaluated. For example, if this option is to be further investigated, the next staff discussion paper should state who will be the parties to the contract, the anticipated term for such an agreement and fully describe the process by which it will be developed and approved. In particular, if Board staff envisions a role for the OPA in this process, the next draft should specify that role and indicate how it relates to existing OPA activities and the OPA's mandate.
- Regulation is inherently a compulsory process while contracts are voluntary agreements. The resolution of this fundamental dichotomy requires explanation if contracts are to be used as a regulatory mechanism.
- If this option is to be further investigated, the next draft of the staff paper should explain how regulatory contracts compare to more commonly used regulatory mechanisms and indicate the advantages that Board staff sees in using a regulatory contract approach.
- A contract is generally developed by the parties. This process will likely provide less transparency and opportunity for stakeholder involvement than would be provided by a more conventional regulatory mechanism.
- If the contract is negotiated between OPG and a counterparty, what would be the consequences if the Board failed to approve the negotiated contract terms? Would the Board have the ability to impose different terms and on what basis, or would the contract revert back to the parties to renegotiate? If the Board will ultimately impose terms of its choosing at the end of the process, why have the parties go through a negotiation in the first place? If, on the other hand, the Board will require the parties to renegotiate rejected terms, it is possible that significant delays will occur before reaching an approved contract.