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# Staff Discussion Paper

## Regulatory Options for Setting Payments for the Output from OPG's Prescribed Generation Assets

### 1.0 Introduction

Under section 78.1 of the *Ontario Energy Board Act, 1998* (the "Act"), the Board will determine the payments to be made to Ontario Power Generation Inc. ("OPG") with respect to the output of certain of OPG's generation facilities (the "prescribed assets") that currently receive payments set by regulation. The *Payments Under Section 78.1 of the Act Regulation*, O. Reg. 53/05 ("Regulation 53/05") establishes April 1, 2008 as the date on which the Board's authority to determine those payments commences. Section 78.1 of the Act and Regulation 53/05 are reproduced as Appendix A to this Discussion Paper.

On March 21, 2006, the Board issued a letter to all interested parties setting out the process to be followed for establishing the methodology by which payments in relation to the prescribed assets would be determined by the Board.

This Discussion Paper has been prepared by Board staff as an initial step in that process. It describes different regulatory options that could be used to set payments for the prescribed assets, as well as advantages and drawbacks of each.

### 2.0 Background

### 2.1 Electricity Conservation and Supply Task Force

In January 2004, the Electricity Conservation and Supply Task Force ("ECSTF") delivered its final report to the Minister of Energy. One of the recommendations in the report was to replace the "Market Power Mitigation Agreement (MPMA)"[1] with a simpler arrangement based on "heritage (power) contracts". "Heritage power" is defined in the report as:

[1] The MPMA was a negotiated agreement between OPG and the Market Design Committee that set revenue rebates from OPG to consumers based on floor prices for energy and specific decontrol targets for OPG's "price setting" and total generation capacity. This agreement was implemented by means of conditions in the licence of OPG and other entities.

> "Power provided from existing Government-owned assets which is sold to ratepayers at a price that reflects the historical costs of the associated assets."

The provinces of British Columbia and Quebec have heritage contract arrangements for selling most of the power generated from provincially-owned hydroelectric facilities. These contracts with government-owned distributors set prices paid for energy and may specify the volume of energy that must be delivered to the distributors (Quebec). In the case of British Columbia, contract delivery volumes are not specified but any shortfalls are made up through market-priced purchases. Surpluses are exported at market prices.

Discussion at the ECSTF focussed on the specific assets of OPG that would best fit a "heritage power" designation. OPG's nuclear and hydroelectric assets were commonly thought to be the most likely facilities to be designated as "heritage" and, as noted below, these are the assets that have now been prescribed by the Government.

## 2.2 The Prescribed Assets

The prescribed assets are the nuclear facilities operated by OPG (Pickering A and B nuclear generating stations ("N.G.S.") and Darlington N.G.S.) and OPG's base load hydroelectric facilities (Sir Adam Beck I, II and pumped storage, De Cew Falls I and II, and the R.H. Saunders generating station on the St. Lawrence River).

## 2.3 Prescribed Asset Payments

Regulation 53/05 prescribes the payments that are made for output from OPG's prescribed assets and states that these apply for the period from April 1, 2005 until March 31, 2008 or the day before the effective date of the Board's first order under section 78.1 of the Act in relation to OPG's prescribed assets. The nuclear facilities receive $49.50 per megawatt hour. The payment amount for energy produced by the prescribed hydroelectric facilities is $33.00 per megawatt hour for the first 1900 megawatt hours of output in any hour. Output greater than 1900 megawatt hours in any hour receives the market price. This financial incentive encourages OPG to maximize output from the prescribed hydroelectric facilities.

These payments are settled in a manner similar to a two-way contract for differences, and are in essence a price guarantee for OPG's prescribed asset output. OPG offers the energy into the market and is compensated through the wholesale settlement system of the Independent Electricity System Operator (the "IESO"). When average market clearing prices (Hourly Ontario Energy Price or "HOEP") are higher or lower than the prescribed asset payments, the difference

is incorporated into the global adjustment that is credited or charged to market participants through the IESO.

### 2.4 Rules for the Board's Determination of Payments

Regulation 53/05 requires OPG to establish a variance account and a deferral account, and contains certain rules that must be followed by the Board when it determines the payments to be made for output from OPG's prescribed assets. The rules refer to how amounts recorded in the deferral and variance accounts will be recovered, the source of certain financial values for the first payment determination by the Board and the specific recovery of costs from the nuclear waste disposal agreement with the Province and the lease of the Bruce nuclear station.

Regulation 53/05 identifies a significant proportion of the costs that the Board must include as a revenue requirement for the prescribed assets. However, the costs identified in Regulation 53/05 are not exhaustive. The Board may consider other costs in its determination of the payments for the prescribed assets.

#### 2.4.1 Recovery of Costs Recorded in Variance and Deferral Accounts

OPG must establish a variance account that records costs incurred on or after April 1, 2005 in relation to a variety of matters, and must establish a deferral account to record non-capital costs incurred on or after January 1, 2005 that are associated with the return to service of units at the Pickering A nuclear generating station. The Board must ensure that OPG recovers any balance recorded in the variance account over a period not to exceed three years to the extent that the Board is satisfied that the costs recorded in the account were prudently incurred and accurately recorded. The Board must also ensure that OPG recovers any balance recorded in the deferral account on a straight line basis over a period not to exceed 15 years.

#### 2.4.2 Recovery of Other Costs

Regulation 53/05 also deals with the recovery by OPG of the following other costs:

**Investments to increase output of, refurbish or add capacity to the prescribed assets:** if the Board confirms that these costs or firm financial commitments are within the project budgets approved by OPG's board of directors before the making of the Board's first order under section 78.1 of the Act or the Board is satisfied that they were prudently incurred, then the Board must ensure that OPG recovers these costs or firm financial commitments.

**Nuclear waste:** the Board must ensure that OPG recovers all the costs it incurs in connection with the Ontario Nuclear Funds Agreement.

**Bruce N.G.S.:** the Board must ensure that OPG recovers all costs it incurs with respect to the Bruce N.G.S. (both A and B).

### 2.4.3 Other Rules

Regulation 53/05 contains the following additional rules relating to the determination by the Board of payment amounts for OPG's prescribed assets:

**Acceptance of Values from OPG's Financial Statements:** for its first payment order, the Board must accept the values in OPG's most recently approved and audited financial statements for the following measures: assets and liabilities; earnings from any lease of the Bruce N.G.S.; and costs with respect to the Bruce N.G.S. This specifically includes values relating to the deferral account for Pickering A non-capital costs; capital cost allowances; the revenue requirement impact of accounting and tax policy decisions; and investments to increase the output of, refurbish or add operating capacity to the prescribed assets.

**Lease earnings:** if OPG's earnings from the lease of the Bruce N.G.S. exceed the costs incurred for the Bruce stations, the excess is to be applied to reduce the payments with respect to the output of the prescribed nuclear assets.

## 3.0 Objectives of the Board's Proceedings

The determination of the appropriate approach to setting payments for the prescribed assets is driven by the substantive objectives of the Board, as well as the Board's responsibility to provide an effective, fair and transparent process.

The two objectives in the *Ontario Energy Board Act, 1998* with respect to electricity are:

- to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electric service; and,
- to promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Both of these objectives are fundamentally important to the Board's setting of payments for the output from OPG's prescribed assets.

These objectives also demonstrate the need to both protect the interests of consumers and ensure the financial viability of the electricity industry. This is reflected in the Board's Key Business Objective from its 2006-2009 Business Plan: "To provide sound economic regulation that balances the interests of consumers with the need for a financially viable energy sector." This balancing is primarily concerned with trade-offs between the interests of consumers in

obtaining reliable service at a low cost, and the interests of the regulated company and its shareholder in receiving sufficient revenues. This is not to suggest that regulated companies and their customers are inherently adverse in interest. They have many common interests, such as price stability, and reliability and quality of service. In a market environment, these interests are reflected in the intersection of supply and demand. In a regulated environment, these interests are reflected by the regulator's balancing of interests.

In addition to this balancing requirement, the Board also has the objective of achieving efficient and cost effective outcomes. Efficiency can be defined in a number of ways. The Board's key focus in this regard is to encourage productivity gains that are enduring and for the benefit of both the regulated company and the consumer. This means that regulated companies have incentives to manage costs while maintaining or improving their service levels. This objective is less about balancing than about identifying incentives that provide both consumer benefits and opportunities for the regulated company.

In addition to its substantive objectives, the Board must also ensure that it makes decisions through regulatory processes that are effective, fair and transparent. This requirement is also reflected in the Board's 2006-2009 Business Plan. The Board's concern with regulatory process is driven by both its statutory obligations and by the Board's belief that an open debate over the issues before it will lead to better decisions.

There are many ways to address the value of openness in decision making. Sometimes, this involves the adjudicative process. However, the Board has a number of regulatory instruments at its disposal. The challenge is often in finding the best instrument to suit the underlying purpose of the regulation. For example, where specific and detailed factual findings are required to support a decision, the adjudicative process provides a level of scrutiny that will allow this. On the other hand, where the Board is seeking to provide clear guidance, rules, codes and guidelines are more effective. In either case, the important point is that the Board has the opportunity to hear from stakeholders to assist in its decisions.

The goals of balancing interests, achieving efficiencies and ensuring an open process are not conflicting, but they may lead in different directions. They therefore constrain each other. In the end, the Board's approach to setting payments for output from generation assets, like its responsibilities more generally, will require an application of its judgment and expertise in these areas.

## 4.0 Regulatory Models

Setting payments for generation will be a new activity for the Board. In principle, it could be considered analogous to setting transmission and distribution rates for

electricity. In both instances similar issues arise about determining the appropriate capital structure and cost of capital, examining operating cost and capital expenditure budgets for need and benefit, and assessing the appropriate sharing of risks and benefits that arise from normal operations.

Although there are similarities between these two payment setting exercises there is a very significant, and fundamental, difference between the types of entities that are being regulated. There are numerous precedents for regulatory control and rate regulation for natural monopoly enterprises such as pipelines and electricity transportation systems. Generation is not a natural monopoly and securing the benefits of competition has been an often cited reason for competitive restructuring of the electricity sector in a number of jurisdictions. There are few, if any, examples of regulators setting payments for generation alone (rate setting for vertically integrated utilities that include generation, transmission and distribution is commonplace).[2]

The regulatory models presented in this paper are derived from standard regulatory procedures for traditionally regulated industries as well as from some approaches that may not typically be used by an economic regulator.

### 4.1 Cost of Service

Cost of service ("CoS") ratemaking is the "standard" regulatory model used for decades by regulators in numerous jurisdictions.

CoS usually begins with a monopoly service provider applying to the regulator for a change in its compensation levels. In its application, the applicant will make a case, supported by financial and cost information, that a change in compensation is justified for specific reasons. These reasons can be numerous and varied but are usually the result of increased real costs in providing and maintaining service levels, the need for new capital investment, inadequate returns to shareholders or a change in capital structure.

The regulator examines the evidence submitted and based on its assessment of need and the applicant's filed information makes a determination of whether the applied for change in compensation is justified. The regulator may grant the request as filed, grant a different change in the level of compensation based on (among other things) determinations regarding the evidence submitted, or, reject the application altogether.

CoS proceedings can be lengthy, focussing on a detailed evidentiary record and occasionally on some of the less commonplace financial accounting questions. In a complicated rate case, or an initial filing where the issues and controversial

[2] Research commissioned by the Board found no examples of rate or payment regulation for stand-alone generation through a regulatory proceeding. Precedents may exist but they are either not documented or subordinated in reports of other proceedings.

elements are not well defined, a CoS proceeding can be very costly to the regulator, the applicant and intervenors. Generally, CoS proceedings set rates (or payments) for a specific period of time (in many cases, one year) and require another filing to change the level of compensation. On the positive side, CoS proceedings lead to certain outcomes for the applicant, resulting in financial certainty and a clear delineation of how risks are allocated.

If a full CoS model were to be used, OPG's financial and cost accounts would have to be segmented by production facility. Questions would arise about accounting methods, allocation of corporate overhead costs, appropriate capital structures and rates of return on equity.

To avoid some of the complexities and related costs associated with a full CoS proceeding, the Board could consider a modified CoS process. Specifically, the Board could accept the existing payments prescribed in Regulation 53/05 as a "base payment", and then focus on establishing the changes that should be made to the base payment. These payments were established by the Government and are based on forecast production volumes and total operating costs, including the cost of capital and assuming an average five percent return on equity.

Over several years the Board could examine all major issues by addressing single topics annually. In the case of the prescribed assets, mature production facilities with well-known operating costs and budgeted capital expenditures for maintenance and renewal, a partial CoS proceeding spread over several years may be appropriate. A modified CoS process would likely reduce costs for the Board and for intervenors but would still require considerable effort by OPG to provide evidence. Another advantage of a modified CoS process would be the ability of the Board and intervenors to concentrate their resources on specific segments of OPG's costs in a single proceeding instead of spreading resources widely to examine the entire range of costs in one proceeding.

One major disadvantage of a CoS-type process, whether full or modified, is that it provides little incentive for the rate regulated entity to improve efficiency and reduce costs. The outcome of a CoS proceeding allows the regulated entity to recover a specific level of costs with a high degree of certainty. Therefore, regulated entities have an incentive to overstate costs, knowing that the regulatory process will focus on examining these costs to ensure that they are justified. Once awarded a specific payment to recover approved costs, the regulated entity is unlikely to undertake to reduce these costs, knowing that future proceedings will re-examine them. All other things being equal, lower costs in the future will result in decreased revenue requirements and reduced payments.

The lack of efficiency incentives in CoS-type decisions is one factor that has led to the development of alternative regulatory methods and processes. These

alternatives substitute regulatory incentives for the discipline of the market to reduce costs and improve operational efficiency.

## 4.2 Incentive Regulation

Incentive regulation ("IR"), also referred to as Performance Based Regulation, has become a popular method of reducing the regulatory costs associated with rate setting proceedings while securing productivity savings for consumers. The Board has used IR to set rates for natural gas distribution services and is currently undergoing an extensive reformation of its electricity distribution rate setting processes to develop an IR regime for that sector.

An incentive regulation approach to the Board setting initial payments for OPG's prescribed assets could begin in two ways. In the first method, the Board could require OPG to submit cost information similar to what is required for a CoS proceeding. The Board would determine an appropriate initial base payment amount that would be in effect for a specific time, e.g., five years. Alternatively, the Board could in setting the initial base payment accept the payments in Regulation 53/05 as providing a level of revenue sufficient to meet OPG's costs and provide a return on equity. This method would reduce the initial costs of all participants in the proceeding. However, after the initial base payment has been set using either of these approaches, the process associated with an incentive regulation regime would be the same.

The most common example of incentive regulation applies a cost inflation and productivity factor formula to a base payment, e.g. Payment Level = (Base Payment) x (Inflation Index – Productivity Index). The inflation index accounts for expected cost increases for OPG's factor inputs (capital, labour, materials) while productivity indices are developed from a historical analysis of productivity trends. An inflation index can be relatively simple – a projection of widely reported indices such as the CPI or industrial input costs – or complex – a weighted average of projected cost increases for specific inputs for OPG's facilities.

Developing productivity indices is a complex process and would probably entail the Board commissioning a study of OPG's historical cost data to derive a suitable index. Questions about the adequacy and accuracy of data would be an issue. However, these complications are offset by the longer-term approach of incentive regulation – once set, the payment level adjusts according to the formula for a period of years and requires only minimal regulatory attention to address extraordinary circumstances. Regulatory costs for all participants are reduced significantly compared to other regulatory methods such as CoS that require more frequent proceedings.

The Board would also have to ensure that OPG does not increase its net returns by cutting costs inappropriately. One method of doing this would be to set the

payment as a unit payment based on projections of OPG's output from the prescribed assets over the period during which the IR mechanism is in effect. OPG would have an incentive to maintain its facilities and increase production because higher output would result in higher gross revenues. The Board could also establish a revenue sharing factor for output above the projected level to ensure that consumers, as well as OPG, benefit from productivity increases beyond expectations that are reflected in the formula.

Another issue that the Board could address with incentive regulation is ensuring that OPG's prescribed generation output is available to the Ontario market when it is most valuable to consumers, i.e., during peak demand periods. The Board could consider a "two-part payment", combining incentive-based unit payments that compensate for variable costs and "sculpted, capacity payments" that compensate for fixed costs and give OPG an incentive to make generation available. "Sculpted payments" could vary seasonally (summer and winter peak payments greater than off-peak payments) or even daily (higher peak hour payments vs. off-peak hour payments). The Board could selectively apply these capacity-like payments to the most appropriate facilities, i.e., pump storage or dam-based hydroelectric may be most appropriate for daily sculpting while nuclear and "run-of-the-river" hydroelectric would be more suited to seasonal payments.

These capacity payments need not be "all or nothing" payments but could also be bifurcated with a base payment and premiums for production during peak periods. For example, a base payment could ensure a flow of revenues whether the facilities are on-line or not and could generate revenues adequate to keep facilities well maintained. The premium payment could represent the return on capital or equity and would only be made when the facility was on-line and delivering electricity to the grid.

The prescribed facilities are primarily base load generating units[3] and would not generally be considered candidates for "gaming" of capacity payments, i.e., declaring a facility to be on-line and available when the grid is congested to secure a capacity payment while avoiding the variable costs of operation. However, the Board may want to thoroughly examine the potential for gaming related to capacity payments before establishing similar payments for these generation units.

Incentive regulation uses regulatory incentives to substitute for market signals to influence operating decisions. On a going forward basis, the Board would need to monitor any incentive regulation regime to ensure that the intended behaviours are being encouraged and to make adjustments if needed.

[3] The Niagara pump storage facilities appear to be an exception to the base load category. The Board may consider whether these facilities warrant special consideration because of their peak load serving potential.

### 4.3 Regulatory Contracts

Currently, the output from new generation facilities that are being built in Ontario are subject to long-term supply contracts between the Ontario Power Authority and prospective generators. These contracts generally have compensation provisions that guarantee cost recovery and a specific return on invested capital. A portion of the contractual revenues are recovered from selling the generator's output into the market and the remainder, if needed, is collected through a "top up" payment that is recovered from market participants through the global adjustment. In the event that market prices result in revenues in excess of the contracted levels, the IESO retains the over payment as a credit to market participants also in the global adjustment. In effect, these contracts are long-term, two-way "contracts for differences" with gross revenue limits in place of a "strike price".

Conceptually, OPG's prescribed assets could also be compensated through a similar set of contractual arrangements. This could be done by means of a formal contract or contracts with a suitable counterparty or counterparties, or by means of a "regulatory contract" mechanism consisting of a regulatory accounting process developed by the Board and subject to Board oversight. Several contracts could be struck, based on the type of generation with different revenue requirements for hydroelectric and nuclear facilities. These contracts could be for any length of time up to the remaining accounting life of the individual generating assets. However, this option has significant complexities to overcome in developing the contract terms, determining a suitable counterparty or counterparties (if a formal contract mechanism is used) and addressing settlement issues.

This option would require OPG to separate its cost accounts by generation type – something that OPG may have to do for either a CoS or an initial incentive type regulatory regime. Therefore, the regulatory costs for OPG under a contractual approach may be no different than for the other regulatory alternatives. Again, as with the other regulatory options, the Board could choose to accept the payments set out in Regulation 53/05, and the associated costs that were used to determine those payments, as a starting point for setting revenue requirements for the contracts.

A bifurcated payment mechanism could be used to bring market forces into the contractual arrangements to encourage efficient operation of the assets. OPG's total compensation would be comprised of two separate payments:

- a minimum fixed kilowatt-hour payment by generation type that guarantees recovery of OPG's verified unit costs (operating, capital and depreciation); and,
- a variable payment, linked to the market price, would constitute a return on equity. The variable payment would be linked to the HOEP through a

proportional formula based on the historical average percentage of the price represented by OPG's actual return on equity since market opening.

Any excess resulting from the difference between HOEP and the sum of the fixed and variable payment amounts would be rebated to the market.

In addition, similar to the incentive regulation productivity arrangements, an I-X productivity formula could be added to the fixed payment to drive cost efficiencies to reduce unit operating costs. The Board could also impose an "excess earnings sharing mechanism" when OPG's return on equity exceeds a threshold level in a particular year because of higher than expected market prices or revenues earned from other sources such as sales of ancillary services.

One attractive feature of the regulatory contract option is that the Board need not have the annual, or periodic, review process that is required in a CoS process. Also, the Board would not have to conduct a productivity study to determine "X factors" as in the incentive regime unless it were to add the I-X productivity formula referred to above. Compared to the other regulatory models, the regulatory contract option is more complicated because of the complexity in determining the contract terms and in relation to implementation issues such as settlement. However, the IESO has considerable experience in conducting complicated settlements (such as those associated with the OPG rebate, the global adjustment and OPA procurement contracts).

## 5.0 Conclusion

The purpose of this staff Discussion Paper is to generate discussion by interested parties about different approaches that the Board could use in determining payments for OPG's prescribed assets. The basic regulatory models, and their variations, presented are not an exhaustive listing of alternatives that could be considered by the Board. However, the models presented are potential choices that Board staff believe can satisfy the basic objectives of the Board:

- to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electric service; and,
- to promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

No regulatory process is without cost. Any process or proceeding will require the Board, OPG and interested parties to invest resources, time and effort. The ultimate goal is to derive payments that balance the interests of consumers, OPG and other stakeholders through an open and transparent process.

Stakeholder comments on this draft Discussion Paper will be carefully considered and will help shape subsequent drafts that will be used to formulate a Board staff proposal to the Board on the methodology to be used to determine payments for the output from OPG's prescribed assets.

## Appendix A

## Statutory References

### A. Section 78.1 of the *Ontario Energy Board Act, 1998*

**Payments to prescribed generator**

78.1(1) The IESO shall make payments to a generator prescribed by the regulations, or to the OPA on behalf of a generator prescribed by the regulations, with respect to output that is generated by a unit at a generation facility prescribed by the regulations.

**Payment amount**

(2) Each payment referred to in subsection (1) shall be the amount determined,

(a) in accordance with the regulations to the extent the payment relates to a period that is on or after the day this section comes into force and before the later of,

(i) the day prescribed for the purposes of this subsection, and
(ii) the effective date of the Board's first order in respect of the generator; and

(b) in accordance with the order of the Board then in effect to the extent the payment relates to a period that is on or after the later of,

(i) the day prescribed for the purposes of this subsection, and
(ii) the effective date of the Board's first order under this section in respect of the generator.

**OPA may act as settlement agent**

(3) The OPA may act as a settlement agent to settle amounts payable to a generator under this section.

**Board orders**

(4) The Board shall make an order under this section in accordance with the rules prescribed by the regulations and may include in the order conditions, classifications or practices, including rules respecting the calculation of the amount of the payment.

**Fixing other prices**

(5) The Board may fix such other payment amounts as it finds to be just and reasonable,

(a) on an application for an order under this section, if the Board is not satisfied that the amount applied for is just and reasonable; or

(b) at any other time, if the Board is not satisfied that the current payment amount is just and reasonable.

**Burden of proof**

(6) Subject to subsection (7), the burden of proof is on the applicant in an application made under this section.

**Order**

(7) If the Board on its own motion or at the request of the Minister commences a proceeding to determine whether an amount that the Board may approve or fix under this section is just and reasonable,

(a) the burden of establishing that the amount is just and reasonable is on the generator; and

(b) the Board shall make an order approving or fixing an amount that is just and reasonable.

**Application**

(8) Subsections (4), (5) and (7) apply only on and after the day prescribed by the regulations for the purposes of subsection (2).

## B. *Payments Under Section 78.1 of the Act Regulation* (Regulation 53/05)

**Prescribed generator**

**1.** Ontario Power Generation Inc. is prescribed as a generator for the purposes of section 78.1 of the Act.

**Prescribed generation facilities**

**2.** The following generation facilities of Ontario Power Generation Inc. are prescribed for the purposes of section 78.1 of the Act:

1. The following hydroelectric generating stations located in The Regional Municipality of Niagara:

i. Sir Adam Beck I.

ii. Sir Adam Beck II.
iii. Sir Adam Beck Pumped Generating Station.
iv. De Cew Falls I.
v. De Cew Falls II.

2. The R. H. Saunders hydroelectric generating station on the St. Lawrence River.

3. Pickering A Nuclear Generating Station.

4. Pickering B Nuclear Generating Station.

5. Darlington Nuclear Generating Station.

**Prescribed date for s. 78.1 (2) of the Act**

**3.** April 1, 2008 is prescribed for the purposes of subsection 78.1 (2) of the Act.

**Payment amounts under s. 78.1 (2) (a) of the Act**

**4.**(1) For the purpose of clause 78.1 (2) (a) of the Act, the amount of a payment that the IESO is required to make with respect to a unit at a generation facility prescribed under section 2 is,

(a) for the hydroelectric generation facilities prescribed in paragraphs 1 and 2 of section 2, $33.00 per megawatt hour with respect to output that is generated during the period from April 1, 2005 to the later of,

(i) March 31, 2008, and

(ii) the day before the effective date of the Board's first order in respect of Ontario Power Generation Inc.; and

(b) for the nuclear generation facilities prescribed in paragraphs 3, 4 and 5 of section 2, $49.50 per megawatt hour with respect to output that is generated during the period from April 1, 2005 to the later of,

(i) March 31, 2008, and

(ii) the day before the effective date of the Board's first order in respect of Ontario Power Generation Inc.

(2) Despite subsection (1), for the purpose of clause 78.1 (2) (a) of the Act, if the total combined output of the hydroelectric generation facilities prescribed under paragraphs 1 and 2 of section 2 exceeds 1,900 megawatt hours in any hour, the total amount of the payment that the

IESO is required to make with respect to the units at those generation facilities is, for that hour, the sum of the following amounts:

1. The total amount determined for those facilities under clause (1) (a), for the first 1,900 megawatt hours of output.

2. The product obtained by multiplying the market price determined under the market rules by the number of megawatt hours of output in excess of 1,900 megawatt hours.

(2.1) The total amount of the payment under subsection (2) shall be allocated to the hydroelectric generation facilities prescribed under paragraphs 1 and 2 of section 2 on a proportionate basis equal to each facility's percentage share of the total combined output in that hour for those facilities.

(2.2) Subsection (2.1) applies in respect of amounts payable on and after April 1, 2005.

(3) For the purpose of this section, the output of a generation facility shall be measured at the facility's delivery points, as determined in accordance with the market rules.

**Deferral and variance accounts**

**5.** (1) Ontario Power Generation Inc. shall establish a variance account in connection with section 78.1 of the Act that records costs incurred on or after April 1, 2005 that are associated with,

(a) differences in hydroelectric electricity production due to differences between forecast and actual water conditions;

(b) changes in nuclear electricity production due to unforeseen changes to the law or to unforeseen technological changes;

(c) changes to revenues assumed for ancillary services from the generation facilities prescribed under section 2;

(d) Acts of God, including severe weather events; and

(e) transmission outages and transmission restrictions.

(2) Ontario Power Generation Inc. shall establish a deferral account in connection with section 78.1 of the Act that records non-capital costs incurred on or after January 1, 2005 that are associated with the return to service of units at the Pickering A Nuclear Generating Station.

**Rules governing determination of payment amounts by Board**

**6.**(1) Subject to subsection (2), the Board may establish the form, methodology, assumptions and calculations used in making an order that determines payment amounts for the purpose of section 78.1 of the Act.

(2) The following rules apply to the making of an order by the Board that determines payment amounts for the purpose of section 78.1 of the Act:

1. The Board shall ensure that Ontario Power Generation Inc. recovers any balance recorded in the variance account established under subsection 5 (1) over a period not to exceed three years, to the extent that the Board is satisfied that the costs recorded in the account were prudently incurred and are accurately recorded in the account.

2. The Board shall ensure that Ontario Power Generation Inc. recovers any balance recorded in the deferral account established under subsection 5 (2) on a straight line basis over a period not to exceed 15 years.

3. The Board shall ensure that Ontario Power Generation Inc. recovers costs and firm financial commitments incurred for investments to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2, if,

    i. the costs and financial commitments were within the project budgets approved for that purpose by the board of directors of Ontario Power Generation Inc. before the making of the Board's first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., or

    ii. the Board is satisfied that the costs and financial commitments were prudently incurred.

4. In making its first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., the Board shall accept the values for the following matters that are set out in Ontario Power Generation Inc.'s most recently audited financial statements that were approved by the board of directors of Ontario Power Generation Inc. before the making of that order:

    i. Ontario Power Generation Inc.'s assets and liabilities.

    ii. Ontario Power Generation Inc.'s earnings with respect to any lease of the Bruce Nuclear Generating Stations.

iii. Ontario Power Generation Inc.'s costs with respect to the Bruce Nuclear Generating Stations.

5. Without limiting the generality of paragraph 4, that paragraph applies to values relating to,

   i. the deferral account established under subsection 5 (2),

   ii. capital cost allowances,

   iii. the revenue requirement impact of accounting and tax policy decisions, and

   iv. investments to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2.

6. The Board shall ensure that Ontario Power Generation Inc. recovers all the costs it incurs in connection with the Ontario Nuclear Funds Agreement entered into between Her Majesty the Queen in right of Ontario, Ontario Power Generation Inc. and certain subsidiaries of Ontario Power Generation Inc. as of April 1, 1999, including any amendments to that agreement.

7. The Board shall ensure that Ontario Power Generation Inc. recovers all the costs it incurs with respect to the Bruce Nuclear Generating Stations.

8. If Ontario Power Generation Inc.'s earnings with respect to any lease of the Bruce Nuclear Generating Stations exceed the costs Ontario Power Generation Inc. incurs with respect to those Stations, the excess shall be applied to reduce the amount of the payments required under subsection 78.1 (1) of the Act with respect to output from the nuclear generating facilities referred to in paragraphs 3, 4 and 5 of section 2.