PUBLIC INTEREST ADVOCACY CENTRE
LE CENTRE POUR LA DEFENSE DE L'INTERET PUBLIC
ONE Nicholas Street, Suite 1204, Ottawa, Ontario, Canada K1N 7B7
Tel: (613) 562-4002. Fax: (613) 562-0007. e-mail: piac@piac.ca. http://www.piac.ca

Michael Janigan
Counsel for VECC
(613) 562-4002 x.26
mjanigan@piac.ca

September 29, 2006

VIA EMAIL AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
26th Floor
2300 Yonge Street
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: OEB's Regulatory Process for Setting Payment Amounts for Ontario Power Generation (OPG) Inc's Prescribed Generation Assets (EB-2006-0064)

VECC's Final Written Comments

As Counsel to VECC, I am writing to provide our final written comments regarding the OEB Staff's recommendations as to the payment-setting methodology to be applied to OPG's Prescribed Generation Assets. Overall, VECC's position is unchanged from the conclusions presented in its July 24th submission to the Board which were:

a) The Board should reject the Staff Proposal to adopt an Incentive Regulation model for OPG using the existing payments as the starting point.
b) The Board should also reject the use of an Incentive Regulation Model based using COS to establish the base year payments.
c) The Board should adopt a phased COS-type approach as the initial regulatory model for OPG.
d) The full consideration of traditional COS issues should occur over 2-3 years.
e) The scope of the first proceeding should be managed by dealing with certain issues through written as opposed to oral processes and the Board pre-specifying a number of issues that would be held over to future years.

VECC's rationale for arriving at these conclusions is set out in its July 24th and June 28th submissions to the Board and VECC would request that the Board consider these submissions along with these final comments in making it determinations.

VECC's purpose in submitting the following comments is to offer its perspective and response to issues raised during the Technical Conference held on September 15, 2006.

Support for Cost of Service

First, VECC wants to confirm that it supports and agrees with the comments made by Mr. Richard Stephenson (Transcript pages 51-66) on behalf of the Cost of Service Group during the Technical Conference. Indeed by the end of the day, it appeared that a number of other parties in the room recognized the importance of a cost of service in setting the <u>level</u> of payments to OPG for Prescribed Assets. For example:

- Board Staff has acknowledged (as discussed on Transcript pages 28-29 & 31-32) that the use of a formulaic approach and the adoption of the current payment levels as the base are transitional measures until sufficient information is developed to undertake a cost of service review. They also acknowledge that even during this transition period the base payments could be adjusted to reflect changes in costs since the establishment of the initial payment levels (Transcript pages , 32 and 45).
- Similarly, Schools sees the use of a formula based on the initial payments as a transitional strategy to allow sufficient information to be gathered to undertake a cost of service review (Transcript pages 20-21). At the same time, Schools also suggests that adjustment could be made during this transition if "it looks like OPG is not getting sufficient amounts of money to do the job well".
- AMPCO too seems to view the Board Staff's proposal more as an opportunity to build the necessary information over time to do a proper cost of service assessment and accepts that adjustments to costs could be made during the transition (Transcript pages 22 - 24).
- OPA has acknowledged that a cost of service to determine payment levels should precede any determination of payment structures (Transcript pages 83 and 112).
- The IESO's principle concern is with the structure of the payments and it appears to be indifferent as to whether the payment level should be based on the current payments or a limited cost of service review (Transcript page 123). It also acknowledges that new investment may require a cost of service review (Transcript page 123).
- EMIG recognizes the distinction between setting the level of payments and establishing the structure for such payments and has acknowledged that a cost of service type review could be undertaken now to establish the level of payment (Transcript page 107).

Perceived Drawbacks to Doing Cost of Service Now

During the Technical Conference parties supporting the use of the current payment levels and a formulaic adjustment mechanism offered a number of reasons for not proceeding immediately with a cost of service review. Each of these are identified and discussed below:

a) <u>Insufficient Information Available</u>: One of the concerns expressed by Board Staff, Schools and AMPCO is that time is required to assemble the necessary information to undertake a cost of service based review and this can not be accomplished in time for the first proceeding. Mr. Stephenson addressed (Transcript pages 64 - 65) this issue directly in his opening comments noting a number of examples where the Board has successfully established cost of service based rate orders in the first proceeding for entities newly falling under its oversight. In the case of OPG the types of information that could be brought to the table to help parties judge the reasonableness of OPG's proposed costs include:
   - Historic and projected spending trends as well as business cases for projected spending (see COS Group response to COS Issues #4&5),
   - Reports on costs and benchmarking prepared by OPG per its shareholder agreement (Transcript page 43), and
   - Variance explanations from the costs projections underlying Regulation 53/05 (Transcript pages 174-175).

b) <u>Likely to Lead to Increased Payments</u>: One of the apparent concerns of Board Staff (and others) is that basing the initial rate order on a cost of service approach will lead to an increase in payments. The Cost of Service Group has addressed this issue in its filed materials (page 9). Also, it must be noted that if the payments are insufficient to meet OPG's financial requirements then, under the Board Staff's proposal (Transcript page 45), OPG has the option of applying for a Z-factor adjustment. Furthermore, under any regulatory scheme, OPG (as the regulated entity) has the right to submit an application to the Board if it believes the existing payment levels are unreasonable (Transcript pages 126 -127). Thus if the application of the Board Staff proposal leads to results substantially lower than a cost of service review, one could reasonably expect OPG to file an Application seeking redress through an increase in payments.

c) <u>Too Costly and Time Consuming</u>: With respect to timing, as Mr. Stephenson has indicated there is no firm requirement for the Board to issue its first rate order on this matter before April 1, 2008. More importantly, in both its written materials (Response to Board Cost of Service Issue #6 and General Issues #2&3) and in response to questions Cost of Service Group members have described (Transcript pages 77, 86 and 88) how a staged cost of service review could be accomplished over a couple of years. Under such an approach, a limited number of key issues would be addressed in the first proceeding, leading to a determination by the Board (prior to April 1, 2008) regarding the appropriate payment level for OPG's prescribed assets. Subsequent proceedings would then review the balance of issues in detailed manner. Furthermore, VECC believes that the process outlined by OPG (Transcript pages 157 and 173) is a reasonable way of determining the issues that should be addressed in detail in the first proceeding.

With respect to the cost of the process, VECC agrees with Mr. Stephenson's observation to Ms. Nowina (Transcript page 67) that there will be significant opportunity costs if the payment level approved in the first proceeding is not appropriate. These costs could include inefficiencies in OPG's operations (as discussed in the COS Groups written materials – page 12). They could also include inefficiencies in the regulatory process if the Board attempts to design an incentive-based mechanism for OPG with inadequate data or finds itself have to respond, in an ad hoc manner, to requests from OPG for Z-factor adjustments.

d) <u>Incentive Regulation Preferred Long Term Solution</u>: One of the Board Staff's reasons for starting off with an incentive based approach is that this is what they see as the long-term goal for the methodology (Transcript page 31). As VECC has indicated in its earlier submission, it is not opposed to considering incentive regulation for OPG at some future point in time. However, any such scheme must be preceded by cost of service. To use Mr. Stephenson's analogy "you can not build a house without building a foundation, and the foundation to any future regulatory model is doing the cost of service" (Transcript page 66).

Payment Level versus Payment Structure

In VECC's view, one of the more useful outcomes of the Technical Conference was to help clarify EMIG's, OPA's and IESO's views regarding regulatory contracts. One of VECC's primary concerns regarding the regulatory contract option going into the Technical Conference was that it appeared to be assigning to OPA responsibility for setting the <u>payment level</u> for prescribed assets or, at a minimum, placing the OEB in somewhat of an untenable position when the "contract" was brought back to it for "approval". However, as VECC understands their positions, the main focus of the regulatory contract and the "negotiation" with OPG would be with respect to the <u>payment structure</u> as opposed to the overall payment levels. Furthermore, the OPA's vision of the process appears to allow for input from the OEB and other stakeholders into the principles that would frame the negotiation of the payment structure (Transcript page 149). Also, both the EMIG and OPA have suggested (Transcript pages 107-108 and 133) that the two processes (i.e., contract negotiation and cost of service review) could go on in parallel.

Based on this new information, VECC believes there is a fair degree of congruence between its position and that of parties supporting the Regulatory Contracts option – particularly OPA. Furthermore, VECC sees the process suggested by OPG is quite amenable to this parallel path approach. OPG could simultaneously come forward with both its summary filing on cost of service and suggestions (developed in concert with OPA and IESO if practical) as to the parameters around the “contract” negotiations. There could then be a Technical Conference and presentations to the Board that would result in direction from the Board regarding the Issues List for the first cost of service proceeding and Principles that should drive the negotiation between OPG and OPA. The detailed cost of service filing and the proposed payment scheme[1] would then be developed and subsequently filed with the OEB for review.

Contract versus Settlement Scheme

The implications of including in the “contract” forward contracting and third party assignment provisions similar to those in existing OPA contracts (Transcript pages 112-113) generated significant discussion during the Technical Conference. In VECC’s submission the result of the first rate order should not be characterized, at this point in time, as a “contract” that can be bought or sold. Rather, VECC favours the IESO characterization (Transcript pages 138 – 139) of the first rate order as a “settlement scheme” that determines what dollars will be paid to OPG and what dollars will be set aside to go into the Global Adjustment. It is early days in terms of regulating OPG and, in VECC’s view, we should not be confounding the determination of appropriate payment levels and structures with issues such as forward contracting and 3rd party assignment.

VECC appreciates the opportunity to make these final comments. If there are any questions or if clarification is required regarding the Comments please contact either Bill Harper (416-348-0193) or myself (416-767-1666).

Yours truly,

Michael Buonaguro
Counsel for VECC

[1] If OPG and OPA are unable to come to an agreement they could both file their positions with the OEB.