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2006-09-07

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700, 2300 Yonge Street,
Toronto, ON M4P 1E4

By email: boardsec@oeb.gov.on.ca

Dear Ms. Walli:

Re: Payments for prescribed generation assets of Ontario Power Generation Inc. Board file EB-2006-0064; comments on behalf of LIEN prior to Presentations to Board Members on September 15, 2006

FRC Canada represents the Low Income Energy Network ("LIEN") in matters of economics and pricing before the Ontario Energy Board (the "OEB or the "Board"). FRC on behalf of LIEN has participated orally and actively in all general meetings of stakeholders and in the meetings of affinity groups within the consultative process for EB-2006-0064.

In planning for the September 15th presentations to Board members, LIEN was not assigned to a specific group of stakeholders as to favouring pricing of output from the prescribed assets based on "Regulatory Contract" regulation, "Incentive Regulation", or Cost of Service regulation. LIEN identifies with the views and approaches found in the presentation notes for the Cost of Service group, but appears to differ in how it sees the actual determination of prices.

LIEN wishes to recapitulate some of the submissions it has made throughout the process and, hence, to assist the Board in understanding LIEN's interests and its current view on a regulatory approach which would advance its interests. We will do this while commenting on the three identified approaches.

In providing these written submissions for the consideration of Board members and other participants, we are not asking for an opportunity to make a separate oral presentation on September 15th.

Regulatory Contract approach

A "Regulatory Contract" approach to regulating the pricing of output from prescribed assets is in our view not yet well-defined. Nonetheless, given that the contracting for services in the private sector (e.g. for gas plants, for service hydrocarbon pipelines, and for project dedicated power plants) often follow an accounting model of cost recovery, the Regulatory Contract approach could turn out to be just a multitude of individual CoS approaches each with little differences from the others adding up to a lack of transparency in the process for determining prices ... and some, of course, may have little relation to cost but be not subject to public scrutiny. A "Regulatory Contract" approach suffers from a number of negatives set out in the presentation notes of the Cost of Service group.

Incentive Regulation approach

We are familiar with incentive regulation as implemented for both gas and electricity utilities before the Board. In our view, such an approach is not appropriate for the circumstances of the prescribed assets. It may be important to incent certain behaviour of management with respect to the operation of those assets in order to achieve certain operating productivity, but that does not require the adoption of "incentive regulation" as it is known. Incentive regulation as it is currently known may not even be possible if the excess of revenues over defined costs ("excess revenues") are required to go to pay the costs of the "stranded debt" of the old Ontario Hydro.[1]

High(er) productivity as a goal

We also made the observation, in the second general consultation meeting, that given the capital intensive nature of (low-operating-cost) electricity generation, a focus on ensuring productivity of capital (by ensuring efficient choices of generation technology and location and efficient incurrence of capital costs ... whether "making" or "buying" generation assets) would have the potential to achieve productivity benefits possibly considerably larger than productivity improvements achievable from operations. We support finding incentives to achieve productivity both of operations and of capital. The board has some experience with incentives for productivity in operations within a cost-of-service framework. A cost of service approach as part of the regulatory framework would also allow a focus on productivity (and prudence) in capital cost incurrence.[2]

Cost of Service approach

In our view, it will be necessary to determine a cost of service for the prescribed assets, whether the pricing is to be based directly on that cost of service, or whether the output is to be priced on some other basis, say at market-determined prices. We put forward the market- determined approach as a rational possibility during the early part of the first general meeting of stakeholders.

We hastened to add that there would be good reasons, however, in following a market-determined pricing approach to determine the annual cost of service. We saw and still see a need to understand to what extent the operation of the prescribed assets might be "subsidizing" the electricity generated from other OPG assets. We saw and still see it as desirable to have a proxy measure of the magnitude of the benefits of historical cost investment (together with write-downs of nuclear assets)[3], so that we could focus on it and argue that it should go to the Ontario customers for whom those generation assets were built to serve. So **we are strongly in favour of determining a cost of service for output from the prescribed assets**. (Like some others, including the Cost of Service group, we see no need to consider all elements of the cost of service in detail in one proceeding, but rather the Board and intervenors could test all aspects of the cost of service over say three years of proceedings.)

Market-determined Pricing combined with a cost of service determination

While strongly in favour of determining a cost of service, **nonetheless, we are of the view that output from the prescribed assets should be priced at market-determined prices**, presumably at prices at which OPG offers electricity into the market today. We are of the view that market prices are a better proxy for current and future generation costs of electricity than are cost-of-service costs. Market-determined prices would give better signals for conservation and, in our view, result in a more appropriate allocation of electricity as a resource competing with other forms of energy. We are also of the view that, if any electricity is under-priced (in this case potentially by regulation), it can discourage new entrants to the market for electricity generation. This would be contrary to LIEN's

[1] Of course, these excess revenues might go to "subsidize" electricity production from other generation assets, but how would that be known without having determined a cost of service for the prescribed assets?.
[2] In a traditional utility cost of service determination, asset costs are supposed to be reviewed and approved (in whole or in part) for inclusion in the asset rate base, from which is determined the depreciation expense, the costs of capital and derivatively the provision for income taxes.
[3] The excess of revenues over the cost of service are actually these benefits and any economic rent related to a less than perfectly/workably competitive market and its prices in excess of perfectly/workably competitive prices.

understanding of current government policy and would be contrary to the interests of LIEN's constituents, and other Ontarians, to have a ready sufficient supply of electricity supply.

However, in addition to LIEN's interest in efficiency and conservation, we believe that the market-determined pricing, coupled with a cost of service determination, can ensure that the benefits that should flow to LIEN's constituents, and to all Ontario consumers who should benefit, will flow to them. Furthermore, we hold the view that these benefits can be better determined and tracked through this combined approach (of market-determined prices and a comparison of revenues to cost of service) than through the other approaches.

In our view, the benefits should flow to end users of electricity in Ontario either (1) by reducing the costs of servicing and retiring the stranded debt of the old Ontario Hydro, or (2) by some other reduction to rates of customers for whom those assets were built. By combining an approach of market-determined pricing for the prescribed assets with the determination of a cost of service for the same assets (and for the same time period), we can know how much benefit should flow to ratepayers. As for benefits flowing to customers by "some other reduction" (if possible and if desirable, now or at some future date), consideration should be given to a credit per KWh on the bills of all end-use customers served off provincial "wires" (transmission or distribution); thus excluding a credit for KWh exported from the province, and also excluding some KWh generated locally which is not carried on the grid (since this electricity cannot have come from the prescribed assets).

As a credit to reduce the stranded debt costs, or as KWh bill credit as described above, this combined approach could ensure a benefit would go to LIEN's constituents and to all other Ontarians that should receive it, while at the same time allowing customers to "see" a market-determined conservation-inducing electricity price, one that is not understated in relation to electricity commodity prices offered by other sellers.

Summary

In summary, of the three groups defined by the Board for presentation purposes on September 15th, 2006, LIEN sees much in common with the views of the Cost of Service group. Nonetheless, it continues to see advantages in pricing the output from the prescribed assets of OPG at market-determined prices and using the cost-of-service as an integral measure to determine the benefits that should flow to electricity consumers in Ontario for whom the assets were built to serve.

We look forward to continuing to participate in this process.

Thank you for considering our views.

Respectfully,

ORIGINAL SIGNED

Malcolm Jackson
participating for LIEN

MJ/hs Ref.: EB-2006-0064, LIEN submission of 2006-09-07 re pmts for OPGI Prescribed Assets (noSig).doc

cc. all participants