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

June 6, 2006

VIA EMAIL

Mr. Russell Chute
Policy Advisor
Ontario Energy Board
P.O. Box 2319
26th Floor
2300 Yonge Street
Toronto, ON
M4P 1E4

Dear Mr. Chute:

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

VECC's Comments on OEB Staff May 8, 2006 Discussion Paper

Unfortunately, due to the transit interruption in Toronto, representatives for the Vulnerable Energy Consumer's Coalition (VECC) were unable to attend the Consumer Affinity Group meeting on May 29, 2006. As Counsel to VECC, I am writing to provide our preliminary views on the options outlined in the OEB Staff's May 8th Discussion Paper.

The Discussion Paper outlines possible regulatory models (Cost of Service, Incentive Regulation and Regulatory Contracts) for setting the payment for OPG's prescribed assets. In choosing between these models (or variations/combinations thereof), VECC believes that there are number of key considerations that must be taken into account:

1. Basis for the Current Payment Scheme

The current Regulation (53/05) governing the payments that are to be made for output from OPG's prescribed assets is based on financial forecasts prepared in

2004. It would be inappropriate to use such information as the basis for payments that will not commence until 2008. VECC considers it essential that the payments for the prescribed assets be based on up to date financial information. At the same time the appropriate capital structure and return on equity applicable to OPG's prescribed generation assets would need to be reviewed and established.

In addition, the overall approach set out by the current Regulation is subject to interpretation and could likely be improved based on experience to date. It is VECC's view that it would be inappropriate to consider a continuation of the regulatory framework as set out in the current Regulation without a full review and consideration of possible alternatives.

2. Integration with the Market

The designated assets represent a material portion of Ontario's overall generation resources. VECC believes that the pricing scheme established for OPG's prescribed assets should encourage OPG to bid the production for these assets into the Ontario market in a manner that supports the objectives of the IESO-administered market.

3. Uniqueness of Hydraulic

There are complexities associated with the operation of OPG's hydro-electric designated assets, particularly those located at Niagara Falls. However, at the same time there is flexibility, particularly with respect to the Sir Adam Beck PGS. As noted in point 2, the regulatory scheme should encourage OPG to operate these assets in a manner that supports consumers' need for reliable and competititively priced electricity. At the same time, the hydraulic production can vary from year to year depending upon water flows. In VECC's view, while the regulatory model adopted for OPG should ensure that they are encouraged (and rewarded) for operating the prescribed assets in a manner that supports these objectives, it must also ensure that OPG is not rewarded (or penalized) for production variations that are attributable to Mother Nature as opposed to OPG management.

4. OPG Only Partially Regulated

The prescribed assets represent only a portion of the generation assets that OPG owns and operates. The costs attributable to the prescribed assets should carry an appropriate portion of the overheads and corporate costs associated with managing and operation OPG as a business. In VECC's view, the allocation of overhead and corporate costs will be a critical issue for the Board to address in the development of any regulatory model for OPG's prescribed assets.

5. Hydraulic and Nuclear are Fundamentally Different Businesses

The cost structures underlying OPG's nuclear and hydro-related prescribed assets are significantly different. For example, in the case of nuclear, OM&A costs represent well over half of the required revenues. Whereas, for the hydro assets, OM&A costs represent just over 10% of the total required revenues. These differences suggest that the issues to be addressed by any regulatory model may be substantially different as between the two lines of business. VECC believes that it will be necessary for the OEB to more clearly understand the business fundamentals for both OPG's nuclear and hydro prescribed assets before appropriate prices can be established.

Based on these considerations, it is VECC's view that OPG should be directed to develop its Application for pricing of prescribed assets on a "cost of service" basis. However, the Company should also be directed to put forward proposals for:

- Variance accounts to address variations in water flows and other factors beyond its control, and
- Incentive mechanisms that will encourage optimal dispatch of the prescribed resources into the Ontario market.

The starting point for any good incentive regulatory scheme is a cost base that is acceptable to both the owner of the regulated assets, the ratepayers and the regulator, typically established through a cost of service type review. In VECC's view, the groundwork has not been laid for introducing incentive based regulation for OPG's prescribed assets. Perhaps, at some future point in time, when the OPG's costs have been publicly vetted and its cost structure is better understood, incentive regulation may be viable option.

In terms of Regulatory Contracts, VECC does not consider this to be viable option at this time. As the Discussion Paper indicates current contracts between OPG and prospective generators are designed to ensure cost recovery. However, the costs underlying the current Regulation are not viable starting point for establishing a contract for output from OPG's designated assets. Furthermore, transparency in regulation suggests that establishing such a cost basis must entail some public review of what the appropriate costs are.

VECC looks forward to reviewing both the positions of other stakeholders in this process and the second draft of the OEB Staff Discussion Paper. Based on this review, VECC anticipates refining its comments and position and looks forward to participating in the second Plenary Session scheduled for June 16, 2006

Yours truly,

Michael Buonaguro
Counsel for VECC