Ontario Energy Board
P.O. Box 2319
27th. Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

Commission de l'Énergie de l'Ontario
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone; 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273

Ontario

BY E-MAIL ONLY

November 21, 2005

To: All Interested Parties in the Coal Displacement Directive Interpretive Guidelines

Re: **Board Staff Draft Coal Displacement Directive Interpretive Guidelines**
Board file number EB-2005-0522

The Board has received comments from the following parties on the Board Staff Draft Coal Displacement Directive Interpretive Guideline (the "Draft Guidelines"): TransAlta Energy Corporation ("TransAlta"), Toromont Energy Ltd. ("Toromont"), Brascan Power Corporation ("Brascan"), the Power Workers' Union ("PWU"), Hydro One Networks Inc. ("Hydro One"), and Ontario Power Generation ("OPG"). Another party, Coral Energy Canada Inc. filed a letter but made no comments.

The Draft Guidelines proposed an approach to applying the Directive of the Minister of Energy to the Ontario Power Authority (the "OPA") dated June 15, 2005 (the "Directive"). The Directive directed the OPA to enter into contracts with a number of electricity generators with the objective of displacing coal fired generation. The Draft Guidelines set out three threshold components that the OPA must demonstrate in order for the contracts to be considered reasonable in light of the Directive: First, the OPA must demonstrate that the contracts result in the procurement of electricity supply or capacity; second, that the supply or capacity acquired under the contract must displace coal fired generation; and third, the OPA must demonstrate that the economic value of the contracts is reasonable when compared to the economic value associated with the Clean Energy Supply Contracts entered into by the OPA in accordance with the direction issued to the OPA on March 24, 2005 (the "CES Contracts"). Comments were received on all three of these components.

1. Procurement Contracts

TransAlta and Toromont filed a joint submission in which they submitted that the Draft Guidelines have an unduly restrictive definition of "Procurement Contracts". Specifically, the Draft Guidelines provide that, in order to qualify as Procurement Contracts, the contracts must lead to the procurement of electricity capacity or

supply. TransAlta and Toromont argued that a contract need only "relate to" the procurement of electricity capacity or supply to qualify as a procurement contract.

TransAlta and Toromont base this position on the text of s. 25.32(4) of the *Electricity Act, 1998*, which authorizes the Directive. That section provides:

> 25.32 (4) … the Minister may direct the OPA to assume, as of such date as the Minister considers appropriate, responsibility for exercising all powers and performing all duties of the Crown, including powers and duties to be exercised and performed through an agency of the Crown,
>
> (a) under any request for proposals, draft request for proposals, another form of procurement solicitation issued by the Crown or through an agency of the Crown or any other initiative pursued by the Crown or through an agency of the Crown,
>
> (i) that was issued or pursued after January 1, 2004 and before the Board's first approval of the OPA's procurement process under subsection 25.31 (4), and
>
> (ii) <u>that relates to</u> the procurement of electricity supply or capacity or reductions in electricity demand or to measures for the management of electricity demand…(emphasis added).

According to TransAlta and Toromont, the use of the emphasized language in s. 25.32(4) (a)(ii) means that a contract entered into that section need not actually procure electricity supply or capacity. It is sufficient that such a contract "relates to" electricity supply or capacity.

It is not clear what turns on the distinction between a contract for the procurement of electricity capacity or supply, on the one hand, and a contract that relates to the procurement of electricity capacity or supply on the other. This is especially the case in light of the Directive which refers to "payments relating to generation under the contracts specific to the generation facilities set out below…" In any event, the parties should not be precluded from arguing that the statute does allow for a meaningful distinction between the two terms. The Draft Guidelines will therefore be revised to incorporate the statutory language.

2. Displacing Coal Fired Generation

Comments on this section of the Draft Guidelines were provided by OPG and the PWU. OPG noted that the Draft Guidelines require OPA to prove that the electricity capacity or supply acquired under the contracts will displace coal-fired generation. According to OPG,

> "If it is meant that this test would operate in a simple administrative sense (i.e., that the existence of this on-coal generation capacity makes it easier to achieve the Province's coal phase-our policy) then, arguably, the test has already been met – since the coming into service of these plants certainly facilitated the closure of Lakeview G.S. However, if the test is meant to operate literally, then OPG does not see how it is possible to meet this test under the current market construct which includes dispatch based on economic merit. Under this construct, low cost coal facilities will nearly always be dispatched before the higher cost natural gas facilities covered by the guidelines."

The PWU also raises the question of whether a plant's coming into service is sufficient to meet the terms of the Directive:

> "To our knowledge, all of the capacity referenced in the Minister's Directive was online and operational prior to the shutdown of Lakeview Generation Station. Also, to our knowledge, none of the assets listed in the Directive were planned and built knowing for certain that coal-fuelled assets in the province were going to be eliminated by government decree anytime this decade. By any stretch of the imagination, it is difficult to see a connection between the generation assets described in the Directive and the concept of '*coal displacement*'". (emphasis in the original).

Both OPG and the PWU are effectively questioning whether it is the intention of the Directive to compensate the owners of facilities for the simple fact that their facilities were brought on line at some point in the past. The Directive is clear that the initial start up of the facilities is not sufficient to meet the terms of the Directive. It states that the "objective" of the contracts is "displacing coal fired generation." If the displacement of coal fired generation contemplated by the Directive was already achieved by the initial coming into service of the facilities, then the Directive would have been redundant.

The Board sees no reason to change this portion of the Draft Guidelines.

3. Reasonableness of Cost by Reference to Economic Value Associated with CES Contracts

There are two categories of comments on this section. The first category relates to the portion of the Directive that the OPA may, in pursuing Procurement Contracts, "seek to negotiate other matters with the parties that would provide benefits to Ontario electricity customers or the electricity system." The Draft Guidelines notes that any goods and services acquired as a result of such negotiations that do not relate to electricity capacity or supply would not qualify as Procurement Contracts. As a result, unlike costs incurred under Procurement Contracts, costs incurred in relation to "other matters" would not be automatically passed through to customers.

TransAlta, Toromont and Brascan take issue with this approach. According to TransAlta and Toromont, once the OEB approves of the reasonableness of a contract and the OPA enters into it, the entire contract is deemed to be a Procurement Contract pursuant to s. 25.32(7), and the provisions of s. 25.20(4) would then automatically apply such that the OPA's recovery of its costs and payments related to the entire contract shall be deemed to be approved by the Board. This position seems to misunderstand the role of the Board under the Directive pursuant to s. 25.32(7). The Board has been asked to review the reasonableness of contracts entered into pursuant to that section. This means that the Board is being asked to review the reasonableness of Procurement Contracts. Even under TransAlta's and Toromont's definition of "Procurement Contracts" in s. 25.20(4), the contracts must at least "relate to" the procurement of electricity capacity or supply. There is nothing in that section that allows the contractual acquisition of matters not related to the procurement of electricity capacity or supply to be treated as "Procurement Contracts" under the Act. If the subject matter of the contracted for goods or services do not relate to electricity capacity or supply, the contract is not a Procurement Contract. The Draft Guidelines will be amended to remove any ambiguity in this regard.

It is not clear whether Brascan has a substantive disagreement with this approach. According to Brascan:

> "There are two necessary elements to ss.25.32(7). First, a contract must meet the broad requirements ss. 25.32(4)(a), which we submit would include "other initiatives and matters" and "goods and services" provided that they relate to the subject matter of paragraph 25.32(4)(a)(ii). Second, the OPA must be directed to enter into such a contract by the Minister of Energy. If these two factual elements exist, the contract is deemed to be a Procurement Contract for all purposes of the *Electricity Act, 1998* and the *Ontario Energy Board Act, 1998*. These purposes would include the procurement of goods and services through other initiatives, other matters or otherwise, and automatic pass through of costs."

If by this statement Brascan means to say that, goods and services that relate to the procurement of electricity capacity and supply can be acquired through Procurement Contracts, then this statement is consistent with what is in the Draft Guidelines. However, if Brascan means to say that the costs of any goods and services procured by the OPA from a generator must be passed through to ratepayers as if they were acquired under a Procurement Contract – whether or not they relate to the procurement of electricity capacity or supply – then this position is not supported by the Directive or the relevant legislation.

OPG and Brascan also commented upon the statement in the Draft Guidelines that the OPA must demonstrate the reasonableness of the costs of the contracts by reference to the economic value of the CES contracts.

The relevant statement of the Directive is as follows:

> "As a measure of reasonableness [of cost under the contract], reference should be had to the economic value associated with the Clean Energy Supply Contracts, entered into by the OPA in accordance with the direction issued to the OPA on March 24, 2005."

According to OPG:

> "The third proposed test [in the Draft Guidelines] would require that the OPA demonstrate that the economic value of the contracts is reasonable when compared to the economic value associated with the Clean Energy Supply Contracts. In OPG's submission, this test will also be somewhat problematic."

In the Board's view, the test in the Draft Guidelines is taken directly from the Directive.

According to Brascan, some flexibility will be required in applying the part of the Directive, "particularly having regard to the fact that the facilities named in the Directive do not all use the same generation technology as each other or the projects covered by the CES contracts." The Board acknowledges that the generation facilities may have different fuels and therefore require different arrangements. This may demonstrate the need for the OPA to modify its approaches to generators. As a result, the test of economic reasonableness in the Directive may have to be tailored to meet the specific circumstances. This is not precluded from the terms of the Draft Guidelines, and Brascan has not suggested that a change to the Draft Guidelines is necessary to effect this.

In light of the above considerations, the Board approves the attached Interpretative Guidelines.