

**Hydro One Networks Comments on OEB Staff Discussion Paper
Proposal for Setting Payment Amounts for Ontario Power Generation
Prescribed Generation Assets
(Board File: EB-2006-0064)**

General Observations:

- The regulatory process to be adopted by the Board in regulating the price of OPG's prescribed assets should be consistent with the original intent used to establish the concept of "heritage power" as envisaged by the Electricity Conservation and Supply Task Force
- The intent behind establishing "heritage power" is that consumers benefit from price stability associated with assets that for the most part operate in a base load manner
- In addition, the prices associated with "heritage power" assets help to remove volatility from electricity prices which is not a welcome feature with the small and mid-volume electricity consumers in Ontario
- The concept behind the use of "heritage power" assets is consistent with the trend towards greater reliance on the competitive contracting for supply that is a feature of some Canadian jurisdictions and of some mature markets in a number of overseas jurisdictions
- OPG is, apart from the setting of prices for the output of its heritage assets, not a regulated business

Comments on Regulatory Models

- The overall objective of setting the payments for the prescribed assets is to ensure that Ontario electricity consumers receive fair and reasonable commodity prices from assets that were originally constructed to provide the prescribed service
- In order to maintain the full functionality of OPG's heritage assets, capital investments will be required and allowance should be made to allow OPG to recover the costs accordingly
- On balance Hydro One agrees with the Board Staff assessment that CoS regulatory models are costly, time consuming and lack efficiency incentives
- However, Hydro One is of the view that in order to initiate a firm basis for an efficient regulatory process for setting prices for the output of the heritage assets a full Cost of Service (CoS) regulatory model is necessary at the outset. This will provide an opportunity for cost discovery and for OPG, the OEB and Intervenors to agree on a cost base that should lead to setting the appropriate prices for the output of the prescribed assets.
- Hydro One recognizes that going forward there may be incremental costs that may be required in support of ongoing maintenance and operating costs associated with these heritage assets to ensure reliability and to guarantee the quantity of output from the heritage system, and that these may be reviewed on a less frequent basis once the cost base has been set.
- Once the cost base has been set Hydro One's preferred approach is to use incentive regulation since this provides greatest incentives for the regulated entity to be more efficient in managing its costs and in any investments required to maintain the functionality of the prescribed assets. At the same time incentive regulation can also contain mechanisms that give the Regulator sufficient clout to exercise its powers in the

- event that the company that is subject to regulatory oversight does not deliver the requisite level of services
- An important aspect of incentive regulation is that it provides for greater efficiency and streamlining in the regulatory process since this avoids costly and time consuming annual cost reviews
 - Hydro One is supportive of the Board adopting an incentive regulation mechanism that applies a combination of cost inflation and productivity factor formulae to the base payment, as well as including factors that recognize capital investment where necessary.
 - Hydro One agrees that the Board would have to develop the requisite productivity indices for the prescribed assets but this is not a barrier to efficient regulation as this approach enhances innovation and behaviours that lead to better cost management and investment strategy all of which tend to reduce the regulatory burden.
 - Given the high dependence on the delivery of electricity commodity from the heritage assets, Hydro One agrees that the Board would have to set strong targets in place in the regulatory model to ensure the reliability and quantity of output from heritage system provided by the prescribed assets. In this respect Hydro One is in favour of some form of mechanism that will incent OPG to manage costs and invest funds in respect of the prescribed assets in a way that benefits both electricity consumers and OPG.
 - Hydro One suggests that simplicity is the best approach to approving payments in respect of the prescribed assets. Therefore we recommend against a bifurcated approach proposed in the paper which looks at two-part payment that would involve variable and fixed charges. Complexity of charge mechanisms takes away from transparency and there is little to be gained in this case where the nature of costs of the prescribed assets is reasonably straightforward in that they operate as base load plant. Also payments tied to volume tend to increase risks to OPG that are not commensurate with actual operations, i.e. fuel costs are a small part of the overall revenue requirement that is not significantly affected by the volume of sales.
 - In setting the rates, Hydro One suggests that the Board should consider setting a price cap associated with payments for output from the heritage assets. This approach can be effective when combined with an RPI-X type regulatory model that provides the requisite penalties and rewards and leaves appropriate flexibility for the regulated company to manage its business as it knows best. This type of regulation has worked well in other jurisdictions and is consistent with the nature of the issue at hand which is setting payments for assets that are generally not under a regulatory regime.
 - An innovative and simple approach to pricing is required as the current method of setting commodity prices is complex and inefficient. The use of artificial market prices, subsidies and special costs does not help in establishing the “right” signals desired by the Government that consumers should pay for the true cost of power.
 - Hydro One is also keen on promoting the efficient, timely review and approval of prices by the OEB.
 - Finally, the OEB should bear in mind that although a fully commercial market model is not feasible at this time its approach to setting the price for the output from heritage assets should not prevent future development in the evolution of the electricity market in Ontario. One of the features is the development of competitive commercial contracting for the electricity commodity.