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April 30, 2007

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

**VECC's Comments on OEB Staff's March 30, 2007 Discussion Paper re: Filing Requirement for Ontario Power Generation**

As Counsel to VECC, I am writing to provide our comments regarding the OEB Staff's March 30th Discussion Paper regarding Filing Requirements for Ontario Power Generation. In general, VECC finds the Staff Proposal to be reasonably comprehensive. The comments presented are generally aimed at "fine tuning" proposal and are organized according to the filing framework proposed by Board Staff.

***General***

*Test Year*

- In its November 30, 2006 Decision regarding the Regulatory Methodology for Setting Payment Amounts for the Prescribed Generation Assets of Ontario Power Generation Inc., the OEB indicated that it was "considering" 2008 (April 1, 2008 to March 31, 2009) as a "test year". The Board also indicated that it expected its first rate order will be in place until December 31, 2009. The reason given is that this would enable coordination of OPG's fiscal year (calendar year) with the Board's periodic payment setting cycle. VECC agrees with the objective of aligning the payment setting period with OPG's fiscal year. This would allow OPG's audited statements to align with its reporting of historical data in future proceedings. Given this, VECC would suggest that the first test period cover April 1, 2008 to December 31, 2009. This would align the cost base used to set OPG's payments with the anticipated duration of the first rate order. (Note: In its Filing OPG would be expected to report the costs for 2008 and 2009 separately)

*Process*

- The Board also indicated in its November 2006 Decision that the nuclear and hydroelectric businesses would be reviewed separately. The Staff Paper (page 10) has taken from this that there would be two separate proceedings with two separate filings. In VECC's view, it would be more efficient if the nuclear and hydroelectric businesses were reviewed separately, but within the context of a single filing/proceeding. There are a number of issues that are common to both business such as the allocation of common corporate OM&A costs, the allocation of common corporate assets and the allocation of corporate debt costs. It would be most beneficial to have these issues only dealt with once, but to be also able to explore the implications for both the nuclear and hydroelectric businesses when the matter is being dealt with. Furthermore, from an elapsed time perspective while the proceeding will be longer if the consideration of the two businesses is combined it will not be as long as two proceedings running consecutively. (Note: If managed as two separate proceedings it is assumed that they would be done consecutively and that any determinations on the common issues would primarily be dealt with in the first proceeding and then applied in the second proceeding).

***Exhibit A – Administrative Documents***

*Administration*
- The section should also address any dealings or business arrangements with "affiliates" that are relevant to the operation of the regulated businesses

*Overview*

- This section should also include a general description of the regulated business and how it relates/fits in with the other aspects of OPG's business. This would serve as a prelude to more detailed discussions in subsequent sections on the specific assets included in the regulated nuclear/hydraulic business and the allocation of corporate costs to the regulated businesses.
- The economic assumptions should also include a section on OPG's assumptions regarding the state of the IESO-administered market in the bridge and test years. This discussion would support more detailed assumptions on matters such as market prices (for both energy and operating

reserves) as well as congestion required later in the Filing to support the Operating Revenue and Payment Structure sections.

- There is no reference in the Filing Requirements to performance measures. The Filing requirements should direct OPG to propose appropriate performance measures in the areas of cost, safety, availability (reliability) and environment. OPG should then provide both historical and comparative (i.e., relative to other utilities) for each measure.

*Finance*

- In term of financial statements, the filing should include not only historical audited statements but also any quarterly financial reports issued since the most recent audited statement.
- The filing should also include a copy of OPG's most recent prospectus.

***Exhibit B – Rate Base***

- This section should be prefaced by an "written description" of the regulated assets, including:
    - The demarcation between generation assets and transmission assets owned by Hydro One Networks
    - Any share of common assets that is allocated to the regulated business
- Continuity Schedules for Gross Assets should include annual amounts for:
    - Capital Spending
    - In-Service Additions
    - Construction Work In Progress
- This section should address whether there are any financlal assets (e.g., hedges) included in rate base and, if so, why.
- It is not immediately clear what the Variance Analysis discussed on page 13 is referring to (e.g., Is it variance in terms of gross assets, assets or in-service additions? Capital Expenditure variances are discussed on page 14). Also it is not clear what the proposed materiality threshold of 0.15% of total net fixed assets is to be applied to.

*Gross Assets*

- The discussion of OPG's capitalization policy should address:
    - When costs are capitalized (e.g., at what stage in the planning and implementation of capital project are costs capitalized as opposed to being expensed?)
    - OPG's overhead capitalization policy (along with the determination of the overhead capitalization rates for each year and what they are applied to) and

    - OPG's policies with respect to the determination and treatment of allowance for funds used during construction (AFUDC)/capitalized interest.
- VECC believes the proposed materiality threshold of $14 M for capital budget detail is too high. OPG's 2006 Audited Statements indicate that the year-end asset values (net fixed assets) for the regulated nuclear and hydraulic business segments are $4,378 M and $4,159 M respectively. Therefore, the proposed materiality threshold represents roughly 0.32% and 0.34% of the nuclear and hydraulic net fixed assets respectively – not the 0.14% suggested in the Discussion Paper.
  BC Hydro (whose heritage generation assets are regulated by the BCUC) includes in its rate applications a detailed project by project cost breakdown for capital projects and programs costing more than $2 M and a summary project description for projects and programs costing in excess of $5 M. Furthermore, VECC notes that BC Hydro's overall net fixed assets are in the order of $10,000 M. Also, Hydro One Networks current Transmission Revenue Requirement application, where the total net fixed assets for 2007 are over $6,000 M, includes details for capital projects in excess of $3 M. Given this context, VECC suggests that the threshold for OPG should be reduced to no more than $5 M.
- VECC also believes that proposed materiality threshold of 10% for written explanations of variances is too high. In VECC's view a 5% threshold would be more appropriate.

*Working Capital*

- The requirements should include a lead/lag study to support any working cash requirements for the test year.

***Exhibit C – Operating Revenue***

- Market revenues should include more than just energy revenue but also revenue from selling operating reserve in the IESO-market and well as any other IESO-market related payments such as those associated with Congestion Management Settlement Credits.

*Energy Revenue*

- The energy revenue forecast includes assumptions regarding both production volumes and market prices. Details regarding both sets of assumptions are required.

*Other Revenues*

- It is not clear where in the Filing the costs and revenues associated with Bruce (per section 6(2)9 of Regulation 53/05) will be addressed. Both could be dealt with in this section, so that the net effect is reported in one place.

## ***Exhibit D – Operating Costs***

*Operations and Maintenance*

- For purposes of the Filing it is assumed that O&M includes fuel costs and water rentals. However, this should be clarified.
- $20 M may be a reasonable threshold for nuclear. However, the $20 M figure is far too high for regulated hydraulic where segment OM&A for 2006 totaled less than $100 M.
- The discussion on pension costs should also indicate how the overall pension costs for OPG are allocated to the regulated businesses.
- Again, VECC believes that proposed materiality threshold of 10% for written explanations of variances is too high. In VECC's view a 5% threshold would be more appropriate.

*Corporate Cost Allocation*

- Corporate Cost Allocation includes not only the allocation of annual expenses incurred at the corporate level, but also the allocation of assets that are held at the corporate level and used to support both OPG's regulated and unregulated businesses. The Allocation Study should address both.

*Taxes*

- Presumably payments in lieu of property taxes would also be addressed here.

## ***Exhibit E – Deferral and Variance Accounts***

- Regulation 53/05 specifies the interest rate (6%) to be used for a number of the variance and deferral accounts (e.g., section 5(5)(b) and section 5.1(2)). However, it is not immediately clear that this interest rate is meant to continue during the period of the Board's first (and any subsequent) rate order. This is also a matter that should be addressed in this section of the Filing.

***Exhibit F - Cost of Capital and Rate of Return***

*Component Costs of Debt*

- VECC is assuming that OPG has a common borrowing program that supports the capital requirements of both its regulated and unregulated businesses. The Filing should include an explanation of how the debt costs (both in total and by debt issue) are attributed to the regulated nuclear and hydroelectric businesses.

***Exhibit G – Calculation of Revenue Deficiency or Surplus***

- Presumably the calculation of revenue deficiency/surplus would be based on the current payment scheme.

***Exhibit H – Payment Structure***

*Existing and Proposed Payments Schedule and Analysis*

- The Board's November 2006 Decision indicated that submissions would be sought on:
    - The question of maximizing the efficient use of the prescribed nuclear assets (i.e., maximizing availability in peak demand periods).
    - Whether a separate "incentive price" mechanism for setting payments for output from the Beck pump generation facility would be a useful tool to increase the efficient utilization of this asset.
    - Whether the payments should be capped or limited in some fashion if past payments have exceeded market prices for an extended period.

  Presumably, in this section OPG would set out its position and proposals on these issues with supporting rationale.

*Additional Direction in the OPG Report*

- VECC agrees that the types of data identified in this section would be useful in assessing any alternative payment structures.
- With respect to item (i), outage data should be provided for both the historic and test periods. Furthermore, the Filing should include written commentary supporting any material year to year changes.
- With respect to item (ii), the Staff Discussion Paper calls for a schedule to be provided of the hours when the total output from <u>each</u> of the prescribed hydraulic generation assets exceeded 1500 MW per hour on an historic basis. It is not clear why the Paper includes this requirement. Regulation 53/05 uses 1900 MW per hour from <u>all</u> designated hydroelectric facilities as the trigger for the application of market prices (section 4(2)). It may be more appropriate for the Filing to provide a longer term perspective on the possible range of water

flows; the resulting potential range for hydroelectric output from each of the designated facilities; and the recent output levels for each facility.

- With respect to item (iv), the information provided for the Beck Pumped Storage facility should address both the likely (expected) level of operation for 2008 and 2009 as well as the range of possible levels of output (and consumption).

VECC appreciates the opportunity to comment. If there are any questions regarding the comments please contact either Bill Harper (416-348-0193) or myself (416-767-1666).

Yours truly,

Michael Buonaguro
Counsel for VECC