

**Setting Payment Amounts for Output from Ontario Power Generation Inc.'s
Prescribed Generation Assets, EB-2006-0064**

**Cost of Service Group Presentation
to the Ontario Energy Board
September 15, 2006**

[Introduction]

On March 20, 2006, the Ontario Energy Board (“OEB” or “Board”) issued a letter to interested parties giving notice of the process that it intended to follow to establish the methodology by which it would determine payment amounts for the prescribed assets of Ontario Power Generation Inc. (OPG) under section 78.1 of *the Ontario Energy Act, 1998*.

Board staff released Draft Number 1 of its Discussion Paper on May 8, 2006, and held a Plenary Consultation Meeting on May 19th, 2006, followed by a number of Affinity Group Sessions ending on June 5th, 2006. Interested parties filed comments on Draft Number 1 shortly thereafter.

A second Plenary Consultation Meeting was held by Board staff on June 16th, 2006, followed by release of Draft Number 2 of its Discussion Paper on June 20th, 2006 and a report prepared on behalf of Board Staff by London Economics International, LLC –

“Alternatives for Regulating Prices Associated With Output From Designated Generation Assets”. Comments from interested parties were filed by the end of June 2006.

The final version of the Staff Discussion Paper was released on July 6th, 2006, with comments from interested parties filed by the end of that month.

On August 10, 2006, a Board letter announced that Board staff and participants would have the opportunity to make an oral presentation to the Board on issues related to the Board’s selection of a method for setting payment amounts for the output from OPG’s prescribed generation assets. The Board’s stated objectives for the opportunity to make oral presentation are:

- a) to allow Board staff to clarify and elaborate on the alternatives and recommendations contained in staff’s July 6, 2006, Discussion Paper;
- b) to allow participants to clarify and elaborate on their written submissions; and,
- c) for the Board to gain a clearer understanding through these written submissions and an interactive exchange with staff and participants.

In its letter of August 10, 2006, the Board stated that a set of questions or issues would be circulated to guide participants in the preparation of their presentations. On August 17th, 2006, the Board circulated the set of questions and issues.

In the August 10, 2006, letter the Board also requested participants that have expressed a preference for a particular regulatory model to consult with one another and make a common presentation representing the joint views of the proponents of that model.

This presentation is the joint view of the proponents of the Cost of Service (“CoS”) approach. The participants identified by the Board as proponents of the CoS approach and whose joint views I am presenting today are the Consumers Council of Canada, Energy Probe Research Foundation, the Power Workers’ Union, the Vulnerable Energy Consumers Coalition and Hydro One Networks Inc. While members of this Group are not aligned on all issues, we have attempted to reach consensus on most issues and this presentation represents that consensus.

In this presentation, I start of by articulating the CoS Group’s guiding principles to be applied in determining a regulatory approach for setting payment amounts for the output from OPG’s prescribed generation assets (“prescribed assets”). We then examine the applicability of the guiding principles to CoS and through this process identify attributes of CoS which makes it well suited for setting the payment amounts for the prescribed assets. Next we identify our concerns with the Incentive Regulation approach in the context of the guiding principles. Similarly, we present our concerns with the Regulatory Contract approach. As requested we then address the questions for the CoS Group and the general questions set out by the Board in its August 17th, 2006, communication.

OPG’s prescribed assets, some of which are over 80 years old, have never been under a “formal” regulatory regime. The most recent, albeit limited, public review of related revenues and costs occurred in 1994. The current payment amounts for the prescribed assets were crafted in a “black box” by the Ontario Government, with an absence of any public demonstration as to whether the current payment amounts are “just and reasonable”, or even just “reasonable”. By April 1, 2008, the date on which the Board’s

legislative authority to determine the payments comes into effect, the current payments will have been in place for three years. This background sets the stage for the CoS Group's presentation.

[Guiding Principles]

I will now take you through the guiding principles that the CoS Group believes the regulatory approach for the prescribed assets must meet for effective regulation by the Board. The regulatory approach must be:

- Consistent with Government objectives
- Consistent with Ontario Energy Board's objectives
- Consistent with Ontario Regulation 53/05
- Transparent
- Flexible
- Logical

[Consistent with Government Objectives]

Our guiding principles require the regulatory framework to be consistent with the Government's objectives as they pertain to OPG's prescribed assets. As we understand them, these objectives include: the price of electricity is to reflect the true cost of power; pricing for heritage power is to be cost-based; prices should be stable and predictable; and, payments are to be set by an arms-length agency.

The Government's objective for electricity prices to reflect the true cost of power is articulated in a December 18th, 2003, Government press release on the *Ontario Energy Board Amendment Act (Electricity Pricing), 2003* as follows:

"The act delivers positive change where it's needed most by providing Ontarians with a responsible, sustainable approach to electricity pricing that better reflects the true cost of electricity."

As identified in Board staff's Discussion Paper, one of the recommendations of the Electricity Conservation and Supply Task Force in its final report to the Minister of Energy was the replacement of the Market Power Mitigation Agreement with a simpler arrangement based on "heritage (power) contracts" with heritage power defined in the report as:

"Power provided from existing Government-owned assets which is sold to ratepayers at a price that reflects the historical costs of the associated assets."

The Government's objective for price stability is reflected in a statement made by the Minister and quoted in a December 10, 2004, press release on the *Electricity Restructuring Act, 2004*, which provides for the prescribed assets:

"This legislation brings much needed stability to Ontario's electricity sector" said Energy Minister Dwight Duncan. "Ontarians will benefit from stable and predictable prices, and an electricity sector that will address the growing gap between supply and demand in a coordinated way."

Further, the Government's objective set out in legislation is to transfer the payment-setting responsibility to an arms-length agency i.e. the OEB. We submit that this objective is intended to ensure that the OEB's statutory objectives apply in the determination of the payments for the output from the prescribed generation assets. We address the OEB's statutory objectives next.

[Consistent with OEB Statutory Objectives]

The OEB's statutory objectives in relation to electricity are:

1. To protect consumers with respect to price and adequacy of supply.
2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Consistency with the OEB's statutory objectives requires the regulatory approach to ensure that prices are just and reasonable both from the consumers and the regulated entity's perspectives in a manner that promotes economic efficiency and cost effectiveness.

[Consistent with Ontario Regulation 53/05]

Regulation 53/05 provides for variance accounts to record costs associated with:

- a) differences in hydroelectric electricity production due to differences between forecast and actual water conditions;

- b) changes in nuclear electricity production due to unforeseen changes to the law or to unforeseen technological changes;
- c) changes to the revenues assumed for ancillary services from the generation facilities prescribed in section 2 of the Regulation;
- d) Acts of God, including severe weather events; and
- e) Transmission outages and transmission restrictions.

Regulation 53/05 also provides for a deferral account that records non-capital costs incurred on or after January 1, 2005, that are associated with the return to service of units at the Pickering A nuclear Generation Station.

With regard to these variance accounts and deferral account, the Regulation requires the Board to ensure that OPG recovers any balance recorded in the variance accounts, to the extent that the Board is satisfied that the costs were prudently incurred and accurately recorded.

Regulation 53/05 also provides for the pass-through of:

- o Costs incurred in connection with the Ontario Nuclear Funds Agreement.
- o Costs incurred with respect to the Bruce Nuclear Generating Stations.

The objective of consistency with Regulation 53/05 requires the regulatory framework to include the examination of costs and prudence reviews of some of these costs.

[Transparent]

The guiding principle of transparency allows for public confirmation through a cost discovery process that both ensures and publicly demonstrates that the payments are just and reasonable and that there is balanced consideration of the protection of consumer interest and the revenue sufficiency for the regulated entity.

This principle requires a public process, which as identified earlier is a Government objective in transferring the payment-setting responsibility to the Board.

[Flexible]

Flexibility in the application of the regulatory framework is required to respond to changing circumstances faced by OPG. The flexibility should also allow the Board to manage its limited regulatory resource.

[Logical]

The guiding principle of requiring a logical methodology ensures that it is “doable”. As such, this principle requires that the regulatory framework must provide a well-defined process to identify and address issues such as ROE, joint expenses etc. It should also ensure that an acceptable outcome is achievable within a reasonable timeline.

[Application of Guiding Principles to CoS]

The CoS Group submits that all six guiding principles that we identified support a CoS regulatory approach.

CoS supports the Government's direction towards requiring consumers to pay electricity prices that fully reflect the cost of power in the future. In our opinion, of the three regulatory methods considered by the Board, CoS provides the best assurance that the payments will reflect costs. Board staff has expressed the concern that the CoS approach could lead to price increases in the short-term and suggested that this is inconsistent with the objective of "price stability". As a Group, we acknowledge that this could well occur. However, the CoS approach is the most appropriate model for ensuring that such increases (or decreases) are just and reasonable. Also, while other "models" may delay such increases, consumers will eventually have to pay the "true cost" of the prescribed assets. In the interim, maintaining payment levels below costs could have significant consequences for the assets involved and the overall Ontario electricity supply situation.

For economic efficiency and cost effectiveness, utilities will not take a rational and long-term approach to efficiency improvements unless the starting point provides for recovery of reasonably incurred costs established through a CoS review. Otherwise, the focus is likely to be too much on the short-term and inappropriate decisions may result.

CoS supports the Board's statutory objectives through its prudence review process which can ensure that prices are just and reasonable from both the interest of the consumers and OPG's financial viability perspectives.

CoS will accommodate Regulation 53/05's requirement for the Board to establish whether amounts were prudently incurred in clearing the variance and deferral accounts. CoS will also accommodate the review of establishing the accuracy of recorded amounts that the Regulation establishes as pass-through costs.

CoS assures transparency by providing a well-defined cost discovery process that has been widely applied by the Board in the past and that is well understood by the Board and stakeholders.

CoS has inherent flexibility to accommodate unplanned for changes which might be encountered more frequently for OPG than by other regulated entities given the large amount of ongoing change in the generation sector.

Concerns have been expressed regarding both the regulatory resources required and whether the information exists to carry out a CoS based review. Both of these issues are addressed in our responses to the specific questions posed by the Board, which I will address shortly. At this point, I would just like to note that the resourcing requirements for a CoS review can be managed by staging the review of the necessary issues over more than one year. Flexibility of scope has been demonstrated in the Board's past CoS regulatory processes which have varied considerably in scope to accommodate the differing levels of review complexity.

Similarly, in past practice the OEB has demonstrated the ability to address and work through information shortfalls similar to (if not more serious than) those that currently exist regarding OPG.

Overall, COS provides for logical processes that have been historically demonstrated to be achievable within required timelines by regulatory agencies.

[Concern with Incentive Regulation]

Next I would like to share with you the CoS Group's concern with the proposed Incentive Regulation ("IR") approach. First, it must be noted that the Group has no fundamental objection to IR. Indeed, some members of our Group believe that IR may be appropriate for OPG at some future point in time, but that it is not appropriate at this time in the absence of cost-based payments and in the form recommended by Board Staff. Others take the view that IR designed for investor-owned utilities may require adjustment if it is ever to be applied successfully to a Crown-owned utility.

In part, our concern with Board Staff's IR proposal stems from the use of current payment levels as the starting point rather than payment levels based on a CoS review, which is the norm in setting base rates in IR. Clearly, basing an IR approach on the existing payment levels established by the Government in the absence of a CoS review, provides no assurance on the accuracy and reasonableness of the base payments. In addition, we note that OPG's business outlook and cost structure has changed since the existing payment levels were set in Regulation.

IR does not accommodate Regulation 53/05's requirement of establishing that the amounts in the variance accounts were prudently incurred and accurately recorded in clearing these accounts. This requires a CoS approach. An IR approach for determining

the payment levels for the prescribed assets would, at minimum, still require a limited CoS review to address these issues.

Conceptually IR decouples price from cost through incentives for efficiency gains where the starting point is base rates that are cost-based. There is no link between the current base payments and OPG's costs for the prescribed assets in the IR approach proposed by Board Staff. The proposal therefore is not consistent with the guiding principle that requires consistency with the Government objectives for electricity to reflect the true cost of power, cost-based heritage power, price stability and payments set by an arms-length agency.

Reliance on an IR approach that lacks a CoS base is also inconsistent with the guiding principle for consistency with the OEB's objectives in that there is no assurance that the base payments are just and reasonable from the perspective of consumer interest and OPG's financial viability. In the absence of establishing the reasonableness of the base payments there is no way of knowing whether an IR approach has the potential of promoting economic efficiency and cost effectiveness, or whether it puts at risk the financial viability of the prescribed generation assets and consumer protection with respect to adequacy of supply. If the initial assumption or basis in respect of costs is incorrect then the IR approach can lead to perverse outcomes. As an example, if the existing payments are unreasonably low relative to costs, the IR mechanism will provide for insufficient funds for maintenance which can result in the deterioration of the performance of the generation assets, and jeopardize Ontario's on going supply adequacy and system reliability, and impact operational safety.

The proposed IR approach does not meet the guiding principle for transparency in that it precludes a public cost discovery process with respect to the cost basis of the current payment levels.

With regard to the principle of flexibility, IR seeks to address changes in the Applicant's (i.e., OPG's) circumstances through the introduction of Z-factors and/or off-ramps. Qualification for Z-factors however is based on predefined circumstances that are extraordinary and outside of the applicant's control while off-ramps require renewed regulatory efforts. IR therefore does not provide the flexibility that CoS affords.

Similarly, Board staff's IR proposal seeks to reduce the need for regulatory resources by putting in place a simple formula for base year payment and annual price adjustments. However, over the period of the first rate order, IR that lacks a CoS base could prove to be more onerous than using a CoS approach as the need for Z-factor adjustments will increase in the absence of an understanding of the prescribed assets' cost circumstances. There are also issues associated with determining the appropriate inflation factors, efficiency factors and a suitable term for the proposed IR plan. Proper attention to these issues will require significant resources while more simplistic approaches will, again, likely increase the need for Z-factor adjustments or unplanned intra-period reviews.

These difficulties make the proposed IR approach a less logical methodology than CoS. Furthermore, the IR proposal provides no supporting evidence of experience with IR to illustrate previous Board success with an IR approach.

[Concerns with Regulatory Contract]

Moving on to the our concerns with the Regulatory Contract (“RC”), the COS Group’s position is that this approach would have the least likelihood of demonstrating adherence with any of the guiding principles. This point is also reflected in the following quote from Board staff’s Discussion Paper:

“Board staff notes that the regulatory contract model can, depending on how it is implemented, provide interested parties with the least amount of disclosure regarding OPG’s cost information and may provide less of an opportunity for involvement by interested parties. Although Board staff expect that the Board would, through a public proceeding, provide significant direction on the broad concepts and terms and conditions that would form the basis of a regulatory contract, it is likely that the negotiating parties will raise additional issues and details during the negotiations.

With this scenario for a RC approach there would be no confirmation that there has been adherence with the principles of consistency with Government or OEB objectives, or with Regulation 53/05, because of the lack of transparency.

Board staff then correctly notes:

“The Board has been entrusted with the statutory responsibility of determining payment amounts for the prescribed assets. Board Staff does not believe that the Board can cede that responsibility to the negotiating parties. Accordingly, Board

staff contemplate that the negotiated contract terms and conditions would then be subject to regulatory review in a public proceeding. To the extent that the negotiating terms and conditions are not suitable, the Board would be faced with the difficult decision of requiring the negotiating parties to start anew (which could gender delays) or of imposing different terms and conditions based on the results of the regulatory review. This potential outcome raises questions about the regulatory efficiency and consistency of the regulatory contract methodology.

This scenario demonstrates that there is no known logical methodology for the implementation of a RC at this point in time and that the Board's alternative would be to revert to some form of CoS review to test any proposed Regulatory Contract. The RC approach therefore, would not reduce the regulatory burden and would be less efficient than CoS.

In response to the Regulatory Contract Group's concern with OPG's management and operation of the prescribed generation assets, it is our position that the Market Surveillance Panel has the oversight of market behaviour and there is no need to address market behaviour issues in establishing the payment levels for the output from the prescribed assets. We submit that market integration issues for dispatchable capacity can be addressed through the consideration of appropriate management or payment schemes, once the overall level of required payment for the prescribed assets has been determined.

The current payment scenario might be described as a Regulatory Contract.

[SPECIFIC QUESTIONS FOR COS GROUP]

Having identified the guiding principles that the regulatory approach for the prescribed generation assets needs to meet, and having illustrated our perspective on how these principles apply to COS and raise concerns with the IR and RC approaches, we now turn to the list of questions that the Board has asked the COS Group to address in our presentation.

[Question 1]

- 1. Cost of service requires the assessment of a revenue requirement for a business. OPG's prescribed assets could be organized under a number of business units that might have a revenue requirement including: all prescribed assets as one business unit; nuclear assets and hydroelectric assets as separate business units; or some combination of individual generating units. For which businesses would the Board establish a revenue requirement?*

CoS Group Response to Question 1

OPG best understands its business structure and organization and therefore OPG should propose a preferred approach on how the prescribed assets should be organized into business units for the purpose of assessing revenue requirement. Furthermore, the statutory onus is on OPG to “make its case” and OPG should be allowed some flexibility in how it presents that case. This is consistent with how the Board receives evidence from other entities that it regulates. In addition, having OPG “make its case” will provide

a good starting point for the Board's and stakeholders' education on OPG's regulated business through the conventional COS discovery process as well as, presumably, OPG's stakeholder consultations on its proposal.

[Question 2]

- 2. Cost of service requires the Board to establish both the capital structure and the rates of return under that capital structure for the business or businesses that are rate regulated. Would the cost of capital methodology determined by the Board as appropriate for other regulated utilities apply to OPG's prescribed assets? If not, how should an appropriate return on equity be determined? What group of industries would be appropriate comparisons? What are the relevant considerations and benchmarks for determining an appropriate return on equity for the prescribed assets?*

COS Group Response to Question 2

A determination on the appropriate ROE for the prescribed assets will need to be made regardless of the regulatory approach used. A CoS review for the prescribed assets could follow the same process as for other entities regulated by the OEB. Similar considerations to those the Board is accustomed to using may be applied to OPG. For example, an appropriate risk premium could be determined for OPG's prescribed assets.

The selection of a group of industry comparators for OPG will need to be given careful consideration as to the consistency and appropriateness of the comparators' business

operations with that of the prescribed assets. Given that there is little or no supporting data at this stage, one possible starting point is the comparators suggested by Prisman and Lazar, Board staff expert consultants in the initiative on the electricity distributors' cost of capital and second generation incentive regulation mechanism initiative, many of which were also generators. However, in all likelihood a more appropriate list of comparators could be developed

[Question 3]

- 3. How should the reduction in OPG's risk associated with (a) the assumed continuation of the variance accounts provided for in section 5(1) of Regulation 53/05; and (b) the assurance of recovery of capital costs provided by section 6 (2) 3 of Regulation 53/05 be factored into the determination of an appropriate return on equity?***

COS Group Response to Question 3

The deferral and variance accounts are an accepted component of regulatory frameworks and would be taken into account in the ROE study that would be undertaken for the prescribed assets, as is generally done with other regulated entities. Therefore, there is no need to depart from this well established process to address OPG's risks.

[Question 4 & 5]

4. There is no prior Board-approved O&M or capital budgets for the business or businesses at issue. Would historical spending of the businesses be considered as a suitable point of departure for forecast spending?

If not, what would be the basis on which O&M and capital spending would be reviewed?

5. Nuclear Operations, Maintenance and Administration costs are the largest cost component of OPG's budget. What would be the basis on which the Board would review those costs given the absence of recent experience with such reviews?

COS Group Response to Questions 4 & 5

The OEB has faced and managed similar challenges in the past. A useful parallel is the first rate order issued to Hydro One Networks (“HON”) for both transmission and distribution rates. In both cases, there were no prior Board approved OM&A or capital budgets. In each case, the review relied upon historical spending levels and business cases for the planned spending levels as the basis for reviewing and testing the requested level of spending. Further examples of Board CoS reviews in the absence of approved historic spending levels are the Board’s reviews of the IESO’s and OPA’s initial revenue requirements.

The Board will not have a history of approved spending levels for OPG's prescribed generation assets until it makes a start to review spending proposals and makes findings as to what an appropriate level of spending is considered to be. The CoS Group submits that it is timely for the Board to initiate this review process now.

[Question 6]

6. *What would the term of the Board's first order be?*

Would an annual COS review be used or could payments be set for multiple years based on a forecast?

Should there be an initial series of annual reviews to establish a baseline of data to assist the Board in setting future payment amounts for the prescribed assets?

COS Group Response to Question 6

The term for the Board's first order is largely dependent on how the multitude of issues that have not been previously addressed in a public forum should be managed. For example if:

- Time is needed to review all issues, assuming a comprehensive review of the issues cannot be accomplished in one year.
- Time is required for OPG to complete pertinent studies that are likely to be required by the OEB for the subsequent proceeding.

If OPG recommends dividing the issues into for example three manageable groups of issues, each group of issues could be reviewed in separate CoS reviews spanning a three year period. The first group of issues would be reviewed for a payment adjustment in 2008, the second group for payment adjustment in 2009 and the third group for payment adjustment in 2010. The payment levels would be adjusted following each of the separate CoS reviews based on the outcome of the review. As such, current payment levels would be adjusted for the first group of issues in 2008. When OPG comes in for the review of the second group of issues, the first group of issues that were settled in the first COS review would not be reviewed again, unless there was a significant change in circumstances. Similarly, when OPG comes in for the review of the third group of issues, the issues settled in the first and second COS reviews would not be revisited.

[Question 7]

7. Does the allocation of costs between prescribed assets and other generation assets create additional complexity?

How would the cost allocation methodology, particularly with respect to corporate overhead costs, be determined?

COS Group Response to Question 7

While the need to distinguish between prescribed and non-prescribed assets and the allocation of corporate costs between the two is an issue, it should not be a major problem because:

- a. The prescribed assets are clearly set out in the Regulation;
- b. The OEB has recent experience with both the gas (Enbridge and Union) and electricity (HON) industries on issues of corporate cost allocation and there are established principles and methodologies for approaching such allocations;
- c. Initial indications from OPG are that those corporate costs which can not be directly allocated are a very small part of the overall revenue requirement;
- d. OPG has the benefit of a recently completed cost allocation study that can form the basis of OPG's proposal on an appropriate approach.

[Question 8]

8. Is CoS consistent with the existing incentive mechanism for the hydroelectric facilities, where a portion of the output receives the market price?

Under CoS, what incentive mechanisms could be developed to reduce unit costs?

How viable is the 'sculpted payments' methodology as suggested in the Board staff Discussion Paper in the context of CoS?

COS Group Response to Question 8

There is no inconsistency between CoS regulation and permitting market-based incentive mechanisms. Indeed, examples can be found in the current CoS regulation of Ontario's gas utilities. One example is the incentive mechanism for transactional services. Such

schemes can benefit both ratepayers and shareholders (as well as Ontario electricity customers in general) and should be encouraged and explored as part of the Board's first rate order.

There is a need to distinguish between an approved payment level and payment structure. An analogy would be the distinction between a distribution utility's revenue requirement and rate structures. There is no reason why some form of sculpted payment could not be designed which, on a forecast basis, would recover the "approved" revenue for the prescribed assets. A sculpted payment structure could:

- Allow OPG's payments to fluctuate with actual costs e.g., variable payments could recognize variable costs such as water rentals
- Encourage OPG to maximize output, to the extent that a variable component is included
- Encourage OPG to operate its assets when most needed by the Ontario market

It is unlikely that the same "sculpted payment scheme" would optimize all of these objectives. Clearly some trade-offs will be required. However, this is no different than what takes place now when the OEB determines the rate structure for other regulated entities. Therefore, OPG should propose a payment approach that addresses the above objectives for consideration by the Board.

[Question 9]

9. Would automatic adjustment mechanisms be required to account for uncertainties in nuclear operations?

Would deferral and/or variance account mechanisms need to be maintained or established?

COS Group Response to Question 9

The need to deal with the “uncertainties of nuclear generation” is not unique to the CoS-approach. It is also relevant under the IR and RC approaches. However, CoS is best set up to deal with issues of uncertainty. Uncertainties that are unique to the nuclear generation business and increase risk relative to other types of generation businesses could be identified by OPG and variance/deferral accounts established (e.g., costs implications of changes in nuclear regulation). CoS proceedings provide the appropriate venue for OPG to propose such accounts, and for their merits to be considered. In addition, the clearance of the variance/deferral accounts can be addressed through the CoS cost discovery process.

[GENERAL QUESTIONS]

The COS Groups input to the Board's general questions are as follows.

[Question 1]

1. *How will recovery of the amounts in the variance and deferral accounts as contemplated in Regulation 53/05 be addressed when using the methodology that you are proposing?*

COS Group Response to Question 1

In taking a CoS approach to the recovery of the amounts in the variance and deferral accounts contemplated in Regulation 53/05, OPG would put forward evidence regarding the balances accumulated in each of the accounts as well as a proposal for their recovery in the first proceeding.

[Question 2 & 3]

2. *Comment on the type/detail of information that would need to be filed to support the methodology that you are proposing.*
3. *Suggest a preliminary list of issues that would need to be addressed in the first proceeding.*

COS Group Response to Questions 2 & 3

With regard to the type and detail of information to be filed and a suggestion on a preliminary issues list, the COS Group provides the following input.

Given that this will be the first proceeding on the prescribed generation assets and the Board and stakeholders are at the start of their learning curve with respect to these assets, OPG would be expected to provide more fulsome detail than applicants that have historically been regulated by the Board, at least at the outset. With this requirement in mind, OPG should identify a list of proposed exhibits and suggested filing detail. OPG could then consult with Board Staff and stakeholders to determine whether the proposal provided the detail required to effectively conduct a COS review.

Assuming that not all issues can be reviewed in the first proceeding and that there will need to be a number of initial COS reviews, the materials filed in the first proceeding (in particular the level of detail) would depend on the issues “slated” for consideration in the first proceeding.

The following are suggestions of an issues list, which is preliminary and not exhaustive for a first proceeding:

Topic	Treatment in First Proceeding
1. Description of Business	<u>Issue/Oral Review</u> Details required on definition of prescribed assets and supporting activities
2. Rate Base	<u>Non-Issue</u> : Asset values as of latest audited statements. OEB required to accept under Reg. 53/05 <u>Issue/Written Review</u> : I/S assets since last audited statements / Working Capital <u>Issue/Oral Review</u> : Planned capital expenditures for next 3 years.
Cost of Capital	<u>Non-Issue</u> : ROE. Adopt ROE for approved for HON – undertake full review in subsequent proceeding <u>Non-Issue</u> : Capital Structure. Adopt values from 53/05. Undertake detailed review in subsequent proceeding <u>Issue/Written Review</u> : Cost of Debt
3. Cost of Service	<u>Issue/Written Review</u> – Depreciation / Taxes / Bruce Lease costs and revenues (will be dictated mainly by contractual arrangements) / Fuel Costs <u>Issue/Oral Review</u> : OM&A / Output levels <u>Non-Issue</u> : Corporate Cost Allocation. Adopt OPG approach per 53/05 and undertake detailed review in subsequent proceeding. Could have written comments on application of OPG methodology, i.e. was it done right.
4. Variance/Deferral Accounts	<u>Issue/Oral</u> : Request OPG proposal. Require proposal on variance account for hydro (weather based fluctuations)
5. Incentive Schemes	<u>Issue/Oral</u> : Schemes to encourage market coordination for dispatchable capacity
6. Payment Structure	<u>Issue/Oral</u> : Request OPG proposal. Priority should be given to market coordination.

Detailed evidence would be required on all written and oral issues.

[Closing Statement]

This concludes the presentation of the CoS Group in which we articulate our guiding principles for a regulatory approach to adjust the payments in respect of the output of OPG's prescribed generation assets that includes consistency with Government and OEB objectives, consistency with Regulation 53/05, transparency, flexibility and logical methodology. We have demonstrated how CoS best meets these principles and provides regulatory certainty. We have demonstrated the shortcomings of the IR and RC approaches with regard to the principles. And, we have provided the Board with our responses to the question on which the Board requested our input.

On behalf of the CoS Group, I would like to thank the Board for providing us with the opportunity to clarify and elaborate on our position and for the opportunity for the interactive exchange that will ensue.