



OPG Submission on the Form of Regulation

Presentation to the Ontario Energy Board and Stakeholders

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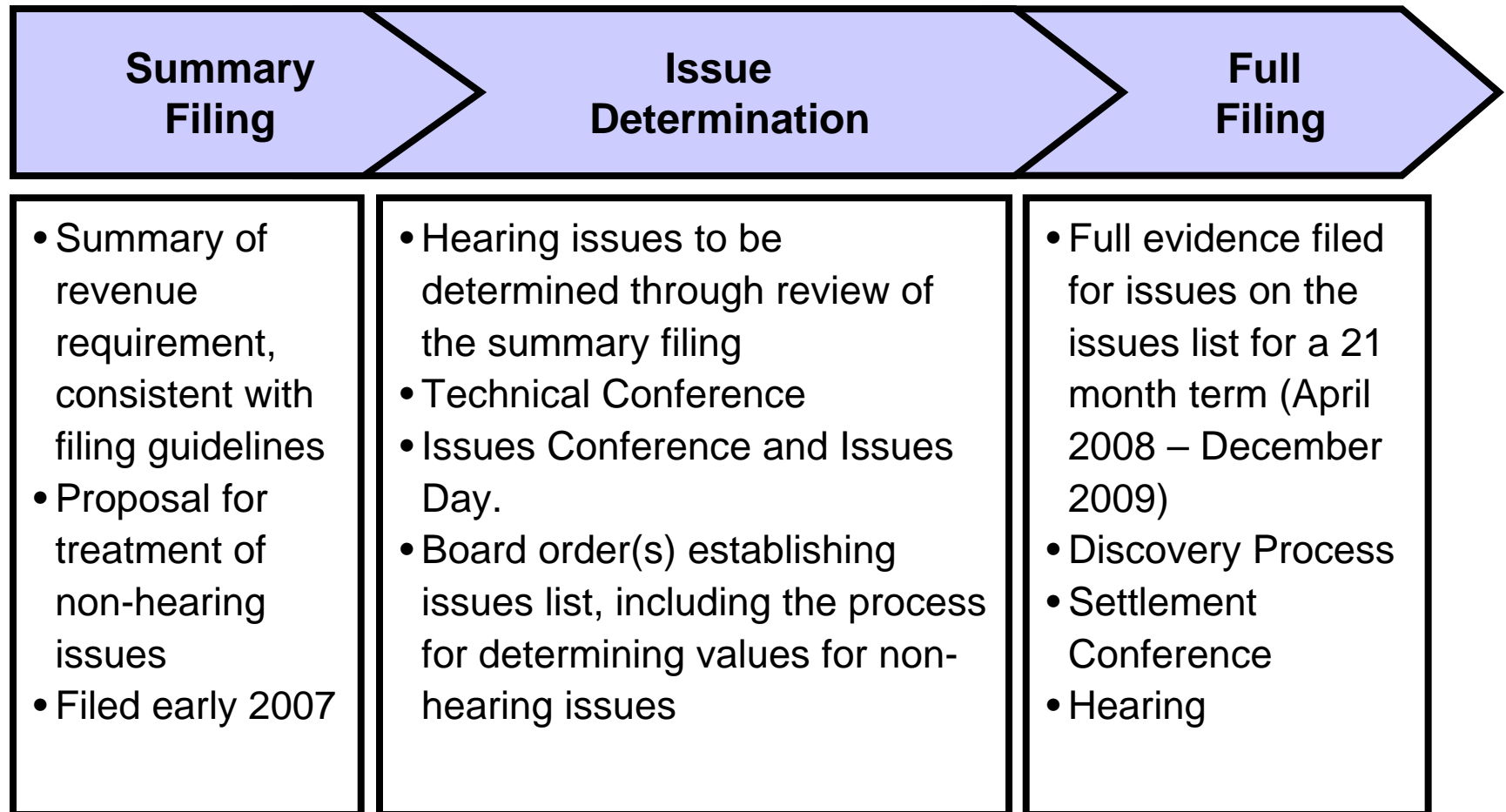
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Criteria for Selecting a Regulatory Approach

- **Effectiveness**
 - Primary task is to establish just and reasonable payment amounts
 - Recover costs of operating, maintaining and developing prescribed assets
 - Risk-appropriate ROE
 - Encourage overall cost efficiency of the prescribed facilities
 - Appropriate use of operational incentives (i.e., efficient use of peaking hydro capability)
- **Transparency**
 - Availability of information to determine whether proposed payment amounts are just and reasonable
 - Fair opportunity for stakeholders to participate in determination of payment amounts
- **Regulatory Efficiency**
 - Set just and reasonable payment amounts in a manner that uses regulatory resources efficiently
 - Regulatory efficiency is a secondary consideration to effectiveness. Regulatory efficiency must be achieved within an effective framework

Market Compatibility is a criterion that can be met by all regulatory approaches. These baseload plants operate under the market rules in the same manner as other generators.

Limited Issues COS – Summary Filing Approach



Limited Issues COS - Offers the best path forward

COS is a necessary precursor to establishing just and reasonable payment amounts.

- No other way to know if revenues will meet required expenditures and provide a reasonable opportunity to earn a risk-appropriate rate of return
- No other way to truly understand the business

COS offers the greatest transparency.

- Provides the most information on OPG's costs, capital plans and operations
- Allows for participation by all parties

COS is a flexible method.

- Any method of setting just and reasonable payment amounts will require cost information as a starting point
- Allows movement to other regulatory models over time including incentive regulation

Incentive Regulation

Incentive Regulation (IR) is not an appropriate methodology to implement at this time.

- Absent a CoS evaluation of OPG's revenue requirement to establish an appropriate base, IR will not result in just and reasonable payment amounts. A CoS review will confirm costs are contained and encourage cost efficiency over the term of the payment amounts
- Starting with IR is inconsistent with the Board's regulatory experience and precedents
- The level of effort under Board Staff's proposed IR model will be at least as onerous as a properly scoped and managed CoS proceeding
- Operational efficiency is not exclusive to IR. Additional incentives for hydroelectric operation can be easily integrated into a CoS methodology

Regulatory Contracts

Regulatory Contracts present a number of unresolved problems.

Transparency Issues

- A counterparty negotiation process will not be publicly transparent

Dissimilar Processes

- Negotiation of bilateral contracts and regulatory proceedings are dissimilar processes that would need to be “force-fit” together
- Potentially onerous process, where guidelines are set by the Board, the contracting parties negotiate in another forum, and approvals are rendered in a third proceeding

Unanswered Questions

- How will the contract price be determined and how will this be evaluated against the just and reasonable standard? What is the term of the contract?
- How will various risk factors influence either the contract price or other contract terms?
- Can the Board simply change the contract terms negotiated by the parties or is it required to accept or reject the contract as a whole? If the initial contract is rejected, what is the process for renegotiation?

Regulatory Contracts - CfD

CfD is a particular type of regulatory contract - includes a specific quantity that OPG must produce or purchase from the market.

- **Typically for a CfD (or any other forward sales arrangement), the strike price, as negotiated between the buyer and the seller, reflects the market price and not the underlying cost of production**
 - The IESO proposal ignores this point by assuming that the strike price would be equal to the interim payment amounts
 - Normally, the risk inherent in taking a position on the forward market is reflected in the contract price. The IESO proposal ignores this
 - For example, average price of all energy sold in OPA forward energy auction was over \$73/MWh¹
- **Concerns about market power or the interaction between OPG's prescribed assets and the market are unfounded**
 - Market power is not relevant to OPG's prescribed assets because they are baseload plants which rarely set price and, in any event, market power is fully addressed through existing mechanisms
 - The interaction between the prescribed facilities and the market has not been an issue to date and there is no basis for speculation that it will become an issue in the future
- **The quantity requirement of the CfD adds significant risk to OPG. The additional risk would be very difficult to hedge cost effectively.**

1. Source – OPA website

Summary

OPG strongly recommends that the Board adopt a limited issues Cost of Service approach for setting payment amounts.

- **A limited issues CoS approach** best meets the objectives of effectiveness, transparency and regulatory efficiency
- **A limited issues CoS approach** will provide the Board and intervenors the information necessary to assure prudent cost recovery of material items, without being overly onerous
- **A limited issues CoS approach** allows the Board and intervenors to play an active role in determining the hearing issues
- **A limited issues CoS approach** allows for movement to other regulatory models in the future, if desired