OPG's Views on Incentive Regulation and the Power Advisory LLC Report

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Consultation regarding Incentive Rate Making Options for Ontario Power Generation's Prescribed Generation Assets

Pankaj Sardana Vice President, Regulatory Affairs

Randy Pugh Director, Regulatory Research & Analysis

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Outline

Opening Remarks

AGENDA:

- Views on Incentive Regulation
- Comments on Power Advisory Report
- Issues/Concerns
- Path Forward

Views on Incentive Regulation

- OEB's approved payment amounts already include significant incentives and the top down planning processes incorporates performance targets and improvements. Incentive regulation need not involve radical changes
- OPG's views on IR were provided in its RRFE comments. In particular:

1) Any additional incentives should support performance objectives that are meaningful, measurable and attainable. OPG believes its balanced scorecard meets this standard
2) While the setting of metrics often involves a consideration of industry standards, the performance objectives in a balanced scorecard reflect the current operating circumstances facing each utility; therefore they are more meaningful standards for setting utility-specific performance and for assessing the performance of that utility
3) A scorecard can be used directly to set rewards and penalties that are incorporated into future rates, or scorecards results can be applied to an earnings sharing mechanism

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Views on Incentive Regulation (continued)

4) Benchmarking is a useful tool that can be used as the starting point for additional analysis of significant deviations in cost or performance. Additional analysis then informs reasoned judgement. Benchmarking should not be used directly to set rates

5) Multi-year capital plans would provide greater certainty to both ratepayers and utilities during an incentive regulation period, provide rate smoothing opportunities and eliminate the incentive to back-load capital investments towards the end of an incentive rate period, and improve the ability of the utility to fund capital requirements

6) Price caps and other forms of incentive regulation can work in stable business environments since they are grounded in historic trends. They are less suited to periods of significant transition and re-investment in capital

Comments on Power Advisory Report

In general, OPG accepts a number of the PA Report's conclusions and the comments provided by London Economics. Specifically OPG supports:

- ***Separate IRM models for hydro and nuclear***: Can be workable due to separate operational businesses and different operating environments
- ***Adopt Prescribed Assets Earnings Sharing:*** The mechanism adopted must be fair (i.e., symmetric). This provision limits the risks of unintended consequences; which makes sense given there is only a limited experience with other generators regulated using IRM
- ***Base Rates Set using COS***: IRM benefits from the establishment of a price based on COS principles as the initial value or "cast-off" point
- ***TFP Studies may be problematic:*** OPG agrees. As discussed later, data availability and relevance to future operations are concerns

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Comments on Power Advisory Report

- ***Evaluate Options based on Objectives:*** OPG supports this approach
- ***Cost efficiencies have already been established for hydro:*** Given concerns with generation TFP development, two other options are: 1) the approved Enbridge approach (ratio of GDP-IPI-FDD); and 2) the N2 approach for nuclear, which facilitates "learning by doing" if the OEB agrees to defer implementation of nuclear IRM
- ***Safety has not been called into question***: However OPG's conservative approach, appropriate given the proximity of generation to large populations, accounts for some additional costs that must be considered in any IRM
- ***The Report lays the groundwork for consideration of IRM approaches:*** OPG agrees that the assessment should consider options that will promote more efficient operations; however OPG is uncertain what "promoting more efficient investments" means. If it means considering project management assessment for investments that have passed a cost/benefit test, OPG accepts this as a valid consideration. It is part of OPG's corporate scorecard discussed previously

Issues/Concerns

- ***Timing of applying IRM to nuclear:*** OPG believes implementation should be delayed until Pickering is out of service and Darlington is refurbished, rather than develop a series of fixes required to adapt IRM to such circumstances
- ***Treatment of significant capital investments***: This issue must be dealt with in conjunction with IRM being applied – OPG is facing large and “lumpy” capital requirements in the near future. To this end, OPG has supported some of the proposals for the treatment of capital in the OEB’s RRFE initiative which contemplates a generic capital module
- ***Application of benchmark efficiency targets in a nuclear context:*** OPG agrees with the recommendation in principle, as OPG’s current business plans reflect a consideration of such benchmarks in the context of OPG’s ability to make strides to achieve such targets. OPG’s concern is with how benchmarks are intended to be applied; i.e., will the starting point be OPG’s business plans?
- ***Data Availability:*** Many of OPG’s competitors are unregulated, unlike transmission / distribution utilities, so data sharing is a more sensitive topic
- ***Data Relevance:*** OPG is undergoing a dramatic change and historic performance is likely not a useful predictor of future performance; therefore efficiency studies based on past performance are likely of little relevance

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Path Forward

- OPG expects to file a hydro "rebasing" application in 2013 for a typical two-year test period (2014-2015)
- OPG would conduct additional analyses during 2013 and 2014 as a result of guidance flowing from the current consultation process
- In 2015 OPG would file an IRM application with the objective of establishing a hydro IRM that would apply to rates in 2016
- Nuclear proposed to continue on Cost of Service until Darlington refurbishment is completed and Pickering is out of service

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