

Ontario Energy Board



Board Report

A Regulatory Methodology for Setting Payment Amounts for the Prescribed Generation Assets of Ontario Power Generation Inc.

EB-2006-0064

November 30, 2006

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1.0 Introduction

1.1 *Legislative Context and Description of Report*

Section 78.1 of the *Ontario Energy Board Act, 1998* (the “Act”) authorizes the Ontario Energy Board (“OEB” or “Board”) to set payments to be made to Ontario Power Generation Inc. (“OPG”) with respect to the output of certain of OPG’s generation facilities (the “prescribed generation assets”). Under the *Payments Under Section 78.1 of the Act Regulation, O. Reg. 53/05* (“Regulation 53/05”), the Board’s authority in that regard commences on April 1, 2008.

Under section 6(1) of Regulation 53/05, the Board may establish the form, methodology, assumptions and calculations to be used in making an order that determines payment amounts for the purpose of section 78.1 of the Act.

Earlier this year, the Board indicated that it would establish the regulatory methodology to be used to determine payment amounts for the prescribed generation assets.

This Report summarizes the consultative process used by the Board to establish that regulatory methodology, as well as the regulatory methodology that the Board has selected. This Report also describes the next steps in the regulatory process and the information and data filing obligations of OPG that will support the Board’s ultimate determination of the payment amounts for the prescribed generation assets.

1.2 *Summary of Selected Methodology*

As described in greater detail in sections 2.1 and 3.0 below, Board staff has, in its July 6, 2006 Discussion Paper, made certain recommendations regarding the regulatory methodology for setting payment amounts for the prescribed generation assets.

The Board accepts staff’s recommendation that in the longer term, the method for setting payments should be based on an incentive regulation regime. However, the Board considers that a full incentive regulation regime is in this case better implemented once the parameters of the incentive regulation formula (i.e., base payments, productivity and cost inflation factors) have been determined by a review of OPG’s financial and cost data. The Board has therefore concluded that a limited issues cost of service process should be used for determining the base payments for incentive regulation. Details regarding the implementation of the selected methodology, including in relation to filings that will be required to be made by OPG, are set out in sections 5.0 and 6.0 below.

2.0 Background

2.1 Consultation Process

In March 2006, the Board initiated a consultation process to obtain the input of interested parties in support of the establishment of the regulatory methodology for setting payments for OPG's prescribed generation assets. OPG's prescribed generation assets are identified in Regulation 53/05: the De Cew and Sir Adam Beck baseload and pump storage hydro-electric facilities at Niagara Falls, the Saunders generation station on the St. Lawrence River and the nuclear generation facilities at Pickering and Darlington.

Nearly twenty organizations registered to participate in this consultation process, as listed in Appendix A of this Report.

Board staff commissioned a consulting study on regulatory options and methodologies, which it then used to inform the development of a staff Discussion Paper. The Discussion Paper presented three possible methodologies: cost of service, incentive regulation and regulatory contracts. Two drafts of the Discussion Paper were circulated for comment and discussion by interested parties. The final draft of the Discussion Paper, with Board staff's recommendations, was issued on July 6, 2006.

Staff sought comments on the drafts of the Discussion Paper through large- and smaller-scale meetings with interested parties as well as written submissions. On September 15, 2006, interested parties, Board staff and two Board members participated in a series of oral presentations and an open question and answer period. A transcript of this session is posted on the Board's website.

Interested parties were given a further opportunity to submit written comments by September 29, 2006. An additional opportunity to comment by November 3, 2006 was also provided.

Throughout this consultation process, the Board has greatly benefited from the thoughtful input of all participants.

2.2 The Board's Mandate

The legal authority for the Board to set payments for the output from OPG's prescribed generation assets is set out in section 78.1 of the Act. Regulation 53/05, for its part, identifies the prescribed generation assets and sets certain rules to be followed by the Board in determining payment amounts for those

assets. Appendix B sets out the text of section 78.1 of the Act and of Regulation 53/05.

Setting payments for output from OPG's prescribed generation assets, or any generation assets for that matter, is an unusual and unique task for the Board. The Board's usual domain is setting rates and service levels and conditions for natural monopoly service providers such as gas distributors and electricity transmission and distribution utilities. Economic regulation may be considered a substitute for market discipline on the costs, and hence the prices, for goods and services that are not amenable to competitive market discipline.

OPG is not a natural monopoly supplier of goods or services. There is a market for selling the output from its generation assets. OPG does not have a statutory obligation to serve nor does it have a franchise territory. The output of OPG's prescribed generation assets has been sold into Ontario's wholesale electricity market since the market opened in the spring of 2002. Until section 78.1 of the Act came into force and Regulation 53/05 was made, OPG received revenues based on market prices for the output of the prescribed generation assets. Other arrangements, such as the Market Power Mitigation Agreement and price caps, have limited the total revenue that OPG retained. The current regulated price arrangement is another example of limiting OPG's total revenues while the energy produced from the prescribed generation assets is offered into the market.

The usual condition for regulatory control (natural monopoly) is therefore absent in the case of OPG. In addition, section 78.1 of the Act and Regulation 53/05 do not direct the Board to use any particular methodology in setting payments for the prescribed generation assets. In the staff Discussion Paper and consultation sessions with interested parties, consideration was given to the underlying rationale for rate regulation of the prescribed generation assets and the associated question of the aims that might be achieved in the Board undertaking to set payments for those assets, as the answers to these questions can inform the choice of payment-setting methodology. Five broad themes emerged:

1. To allow for an open and transparent examination of OPG's financial and cost accounts with the expectation that the Board will find cost efficiencies that will allow payments to be lower than they might be if set through another process.
2. To use the Board's expertise to set "just and reasonable" payments that will drive operational efficiencies.
3. To ensure that Ontario consumers benefit from OPG's "heritage assets" through administered price setting.

4. To limit the potential financial benefits to OPG of exercising its market power.
5. To provide an objective decision-making process for setting OPG payments.

Discussion in the consultation sessions noted that the Government had alternatives to the Board to achieve some of the possible results listed, including the Ontario Power Authority and using Government directives or regulation. The Board is, however, uniquely positioned to achieve the first two and the last of the above objectives.

The Board's mandate is to set just and reasonable payments. The Board believes that transparency and objectivity are important attributes for any process that it might use to address issues that may arise when determining these payments. These issues include providing incentives to improve OPG's operational efficiency, considering methods to share efficiency benefits between consumers and the shareholder, determining an appropriate revenue requirement and rate base, and establishing an appropriate capital structure and rate of return.

2.3 OEB Objectives

The determination of the appropriate approach to setting just and reasonable payments for the prescribed generation assets is driven by the substantive objectives of the Board, as well as the Board's responsibility to provide an effective, fair and transparent process.

The two objectives in the *Ontario Energy Board Act, 1998* with respect to electricity are:

- to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electric service; and,
- 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.

Both of these objectives are fundamentally important to the Board's setting of payments for the output from OPG's prescribed assets.

These objectives also demonstrate the need to both protect the interests of consumers and ensure the financial viability of the electricity industry. This is reflected in the Board's Key Business Objective from its 2006-2009 Business Plan: "To provide sound economic regulation that balances the interests of consumers with the need for a financially viable energy sector." This balancing is

primarily concerned with trade-offs between the interests of consumers in obtaining reliable service at a low cost, and the interests of the regulated company and its shareholder in receiving sufficient revenues. In a market environment, these interests are reflected in the intersection of supply and demand. In a regulated environment, these interests are reflected by the regulator's balancing of interests.

In addition to this balancing requirement, the Board also has the objective of achieving efficient and cost effective outcomes. Efficiency can be defined in a number of ways. The Board's key focus in this regard is to encourage productivity gains that are enduring and for the benefit of both the regulated company and the consumer. This means that regulated companies have incentives to manage costs while maintaining or improving their service levels. This objective is less about balancing than about identifying incentives that provide both consumer benefits and opportunities for the regulated company.

In addition to its substantive objectives, the Board must also ensure that it makes decisions through regulatory processes that are effective, fair and transparent. This requirement is also reflected in the Board's 2006-2009 Business Plan. The Board's concern with regulatory process is driven by both its statutory obligations and by the Board's belief that an open debate over the issues before it will lead to better decisions.

2.4 Experiences in Other Jurisdictions

The consulting study prepared for Board staff reviewed the regulatory experience with setting payments, or prices, for generators in several other jurisdictions. Although there is an extensive history of setting prices for vertically integrated utilities, there is little precedent for regulators setting payments for "stand alone" generation. Two provinces, British Columbia and Quebec, set administered prices for substantial portions of energy generated by provincially-owned hydroelectric facilities, generally referred to as "heritage power".¹

The BC Utilities Commission reviews and approves BC Hydro's proposed rates for power from heritage assets subject to the provisions of the government's Heritage Contract. The Heritage Contract places generation obligations on BC Hydro Generation and purchase obligations on BC Hydro Distribution. Terms and conditions of the Heritage Contract oblige BC Hydro Generation to supply a specific amount of energy annually based on average water conditions. The amount of energy to be delivered can vary from year-to-year depending on BC Hydro's revenue requirements. BC Hydro determines the price for heritage power

¹ The Ontario Electricity Conservation and Supply Task Force defined heritage power 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."

through a revenue requirements model that is similar to a cost-of-service process.

The BC Heritage Contract has a ten-year term. Consumers pay the actual cost of supply including energy costs, operating costs, asset-related expenses, generation-related transmission asset costs and a return on equity, less other revenues. BC Hydro is protected from the financial impact of year-to-year price volatility (the result of varying water conditions) through the revenue requirement provisions. Consumers assume all volume risk but have a “no cost” option on generation output above the forecasted Heritage Contract volumes.

Quebec’s heritage contract was established by an Order-in-Council in 2001. Provisions of the contract oblige Hydro-Quebec Generation to deliver to Hydro-Quebec Distribution a maximum amount of energy at a fixed price for a specific period of time. The Regie de l’Energie approved Hydro Quebec Distribution’s supply plan for 2002-2011 that requires Hydro Quebec Generation to supply 165 tWh per year at an average price of 2.79 cents per kWh.

Both the BC and Quebec heritage contract arrangements allow energy that is surplus to the contract requirements to be sold at market prices. These provisions provide some incentive for the generation companies to optimize storage capability. However, under both contracts there are no explicit incentives that are directed to improving operating efficiencies and reducing costs. The Quebec contract places some volume risk on the generation company.

The experience in Canada’s other provinces is informative for the Board’s task but not instructive. Both British Columbia and Quebec have directive-driven processes instead of adjudicative processes for setting “heritage contract” payments and rely overwhelmingly on a single generation type (large scale hydro-electric). Both of these differences simplify the information filing requirements of the generation utilities and the regulatory reviews prior to setting payments. The Board’s mandate and the different generation technologies of the prescribed generation assets make the Board’s task unique.

3.0 Staff Discussion Paper Recommendations

The staff Discussion Paper considered three regulatory methodologies for setting payments for OPG’s prescribed generation assets: cost of service, incentive regulation and regulatory contracts.

Cost of service regulation requires the determination of a “rate base” through an examination, and approval, of the costs of production, capital structure and capital budgets. Generally, cost of service rate making (or payment setting in this context) requires forecasts of costs and production volumes for a forward year to determine prospective rates or payments.

Incentive regulation uses a formulaic approach to set payments over a period of time. Incentive regulation usually contemplates the application of the formula over several payments setting periods. Incentive regulation formulae usually have a base payment established through a cost of service proceeding (or another appropriate method) and input cost and productivity adjustment factors that are established through analytical studies.

Regulatory contracts are negotiated agreements between two parties that are governed by terms and conditions set by the regulator. The regulator would also have approval authority for the final contract. Establishing the appropriate terms and conditions of the contract may be the outcome of another regulatory proceeding with input from intervenors and interested parties.

Board staff's central recommendation was for the Board to adopt an incentive regulation methodology for determining the payments for output from OPG's prescribed generation assets. Staff evaluated the three options (incentive regulation, cost of service and regulatory contracts) and concluded that incentive regulation was the best choice of a long-term methodology having regard to the Board's mandate and its statutory objectives of protecting the interests of consumers, promoting economic efficiency in generation and facilitating the financial viability of the electricity industry. Staff also concluded that an incentive regulation methodology met the regulatory criteria of transparency, fairness, efficiency and consistency.

Staff rejected the regulatory contracts option on several grounds. First, Board staff was not convinced that a regulatory contracts approach would be sufficiently transparent or open. Second, staff felt that a regulatory contracts approach with parallel or sequential contract negotiation and Board review processes (as advocated by some interested parties and as may be required to ensure that the Board does not cede its payment-setting responsibility to the negotiating parties) did not compare favourably in terms of regulatory efficiency or consistency with the alternative methodologies. Third, staff was not convinced that the Board should select a regulatory methodology because it may be "more market friendly" than alternatives, and advocated instead that the choice of methodology should be "policy neutral" as regards the future end state for Ontario's electricity industry.

Although an incentive regulation methodology was the central recommendation, staff acknowledged that a number of proceedings would be required to determine some of the components of a complete incentive regulation formulation. In particular, Board staff recommended that the Board commission studies to determine cost inflation and productivity factors and investigate the need for "Z" factors and "off ramps" to account for unforeseen circumstances. Board staff acknowledged that these studies would also have to consider the appropriate

methodologies to examine OPG's data and the availability of credible information and comparators to establish these factors.

Also, recognizing that there was no objectively determined Board baseline for applying the incentive regulation formula, Board staff recommended that the existing payments established in Regulation 53/05 serve as the initial base payments for the Board's first order. Staff recommended that subsequent rate (payment) orders could investigate costs and other components (rate of return) of the existing payments in cost of service-type proceedings to determine subsequent adjustments to the payments.

In developing its recommendations, Board staff considered the limitation set out in Regulation 53/05 in relation to certain financial values that must be accepted by the Board when it makes its first payment-setting order.

Specifically, sections 6(2)4 and 6(2)5 of Regulation 53/05 state:

4. In making its first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., the Board shall accept the values for the following matters that are set out in Ontario Power Generation Inc.'s most recently audited financial statements that were approved by the board of directors of Ontario Power Generation Inc. before the making of that order:
 - i. Ontario Power Generation Inc.'s assets and liabilities.
 - ii. Ontario Power Generation Inc.'s earnings with respect to any lease of the Bruce Nuclear Generating Stations.
 - iii. Ontario Power Generation Inc.'s costs with respect to the Bruce Nuclear Generating Stations.
5. Without limiting the generality of paragraph 4, that paragraph applies to values relating to,
 - i. the deferral account established under subsection 5 (2),
 - ii. capital cost allowances,
 - iii. the revenue requirement impact of accounting and tax policy decisions, and
 - iv. investments to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2.

While these sections of Regulation 53/05 do not limit the Board's ability to examine in detail many of the rate base components that would inform a full cost of service proceeding, they do require the Board to accept values for certain of these components that were approved by the OPG Board of Directors. Effectively, Regulation 53/05 restricts the Board in its first order to examine and determine freely the two most significant components of OPG's costs and revenue requirement: operating, maintenance and administrative (OM&A) costs and a rate of return on equity. Therefore, Board staff recommended that, in making its first order, the Board accept the existing payments as a base payment with some adjustments for cost changes and productivity that would be informed by OPG's information filings and by benchmarking and other studies. Subsequent orders would not be constrained by sections 6(4) and 6(5) of Regulation 53/05, allowing greater scope to determine the value of components of OPG's revenue requirement.

4.0 Interested Parties' Positions on the Board Staff Recommendations

All three regulatory options presented in the staff Discussion Paper had supporters among the interested parties. Some interested parties supported portions of the staff recommendations but none supported all of the recommendations.

Advocates of regulatory contracts (OPA, IESO, EMIG) asserted that the Board could oversee and direct an efficient payment setting process through the use of a contract negotiated between OPG and a third party (generally assumed to be the Ontario Power Authority). Regulatory contracts were characterized as the most flexible option available and the most "market friendly" choice in that they could be used to develop additional market instruments such as forward contracts. Some regulatory contract supporters (OPA, IESO) and the Board staff consultant's report noted that a cost of service proceeding may be required to inform the Board's setting of initial contract parameters and negotiating conditions.

Supporters of cost of service (Energy Probe, PWU, VECC) maintained that the only way to set just and reasonable payments was to conduct a full cost of service proceeding. These parties asserted that only through an examination of OPG's information and data filings, subject to cross examination and expert evidence, would the Board be able to make a fully informed decision about payments for the output from the prescribed generation assets. Cost of service supporters cited the Board's experience with cost of service and previous Board decisions that used the outcome from cost of service proceedings as the basis for applying the incentive regulation parameters.

In the consultation sessions, most interested parties did not voice opposition to an incentive regulation regime as a long-term payment setting methodology, *per se*. Interested parties objected to Board staff's view that the existing payments are a suitable initial base payment. Interested parties advocated that the Board should use a cost of service process to determine the base payments and the inputs for an incentive regulation formula.

Several interested parties cited the Board's legislated responsibility to set just and reasonable payments and noted that the manner in which the existing payments were determined was not a transparent one. Some of the interested parties noted that, by using the existing payments as the starting point for an incentive regulation regime, the Board would be determining, *de facto*, that the existing payments are just and reasonable without ever investigating the basis for setting these payments or demonstrating that they are just and reasonable.²

5.0 Regulatory Methodology

The Board notes that all three proposed methodologies were supported by some interested parties.

The Board accepts staff's reasons for rejecting the regulatory contracts option. Furthermore, the Board accepts the proposition that a blending of regulatory methodologies can be used to fulfil its payment-setting mandate in a manner consistent with its statutory objectives.

The Board notes that a number of interested parties supported an incentive regulation regime as a long-term regulatory methodology if appropriate processes and proceedings were used to establish the payment parameters. The Board concludes that the fundamental recommendation in the staff Discussion Paper for an incentive regulation regime for setting payments for the output of OPG's prescribed generation assets is sound because incentive regulation offers the best opportunity to secure efficiency gains for consumers while ensuring that OPG's financial integrity is maintained.

However, the Board also concludes that the path to an incentive regulation regime should differ from that recommended by staff. The Board believes that using the existing payments as the base payment for an incentive regulation regime does not satisfy the Board's commitment to transparency. The existing payments were set without the type of public input or review that a hearing would provide. These payments may have been based on financial and cost data that is

² The initial payments were determined through negotiations among the Ministry of Finance, Ministry of Energy and OPG, with review by a third party. The rate of return for the prescribed generation assets was determined by the shareholder, the Government of Ontario.

similar to what the Board will examine in a hearing. But the Board believes that testing this data in an open and transparent process will provide a more appropriate starting point for incentive regulation.

The Board finds that, instead of using the existing payments as a base payment for the incentive regulation formula, the Board will undertake a series of limited issues cost of service processes to set the base payment. The Board will extend the limited cost of service process over several payment orders until all relevant issues have been examined. The Board will implement an incentive regulation formula when it is satisfied that the base payment provides a robust starting point for that formula.

The Board's first payment proceeding will consider the most substantive issues that are not affected by the prescriptive rules set out in Regulation 53/05 – OM&A costs and the rate of return on equity. OPG's rate base for the first payment order would then be determined by a combination of valuations derived from the Board's proceedings and values approved by OPG's Board of Directors and contained in OPG's most recently audited financial statements. Subsequent Board proceedings will address issues associated with the values that were not examined in the first payment setting proceeding.

The Board has therefore concluded that the regulatory methodology to be used to set initial payment amounts for the prescribed generation assets will be a cost of service review, limited to OM&A and rate of return, with each of the nuclear and hydroelectric businesses being reviewed separately.

1. For the prescribed nuclear assets, the Board:
 - a) will set the payment amount through a limited issues cost of service proceeding that examines OM&A costs and rates of return on equity while accepting the value of other cost inputs for rate base determination as and to the extent required by Regulation 53/05. This base payment, or subsequent base payment levels, will be used as a base payment for an incentive regulation regime that will be determined in subsequent Board proceedings; and
 - b) will ask for submissions on the question of maximizing the efficient use of the prescribed nuclear assets (i.e., maximizing availability in peak demand periods), subject to the limitations imposed by the market rules. This may include "sculpted" payments (i.e., payments differentiated by time of production, or by generation concept, such as capacity or energy payments), but may take other forms.

2. For the prescribed hydroelectric assets, the Board:

- a) will set a payment amount through a limited issues cost of service proceeding that examines OM&A costs and rates of return on equity while accepting the value of other cost inputs for rate base determination as and to the extent required by Regulation 53/05;
 - b) will consider the impact of capital expenditures for the Beck tunnel expansion on OPG's costs and revenue requirement in its first proceeding;
 - c) will retain the existing payment structure whereby some of the output of the hydroelectric facilities receives the market price, but the Board will examine whether the existing threshold of 1900 MWh should be changed to encourage more efficient use of these assets; and
 - d) will examine 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.
3. The Board will ask for submissions on whether the payments should be capped or limited in some fashion if past payments have exceeded market prices for an extended period.³
 4. The Board's first order will address the recovery of the balances in, and the potential continuation of, the variance and deferral accounts identified in Regulation 53/05, as well as the recovery of the other costs referred to in that Regulation.
 5. The Board's first order will be in effect for a period of time that will enable coordination of OPG's fiscal year (calendar year) with the Board's periodic payment setting cycle. The Board anticipates that the first order will be in effect until December 31, 2009. However, the actual duration of the first order will be set after review of OPG's financial and cost information.
 6. After the first order is made, the Board will conduct a series of more typical cost of service proceedings with the objective of implementing an

³ If such a limitation were to be proposed, it would be necessary to deal with several implementation issues, including what is the relevant market price and whether any limitation would apply to the payments for output from all prescribed generation assets or just output from the prescribed nuclear assets.

incentive regulation regime for payment orders that will be made post-2010. The payments set in the Board's first order as per section 1(a) and 2(a), or subsequent payments set in a similar manner, will become "base payments" for the incentive regulation regime.

The methodology described above will be supported by data filings to be made by OPG as described in the next section.

6.0 Board Determination on Filing Guidelines

The Board finds that OPG should make periodic filings of specific information with the Board in order to inform and support the future Board proceedings that will set the payments. The Board also finds that filing requirements and accounting and reporting framework will be developed in consultation with interested parties.

The Board will use the concepts and definitions in the Board's "Filing Requirements for Transmission and Distribution Rate Applications and Leave to Construct Projects"⁴ to inform its public consultations.

The Board considers it appropriate that OPG file historical data with the Board for the years 2004, 2005 and 2006. The Board is considering 2008 (April 1, 2008 to March 31, 2009) as a "test year". The Board expects that its first rate order will be in place until December 31, 2009, assuming that the Board's review of OPG's financial and cost data will accommodate this timeframe. Therefore, OPG will be required to file in early 2009 the data to support a new payment setting for 2010.

⁴ The final Filing Requirements ([EB-2006-0170](#)) were posted on the Board's website on November 14, 2006.

Appendix A - List of Interested Parties

1. Ontario Power Authority (OPA)
2. Power Workers Union (PWU)
3. Independent Electric System Operator (IESO)
4. Bruce Power
5. Ontario Energy Savings Corporation (OESC)
6. Direct Energy
7. Constellation Energy (EMIG)
8. Schools Energy Coalition
9. Low Income Energy Network (LIEN)
10. Canadian Manufacturers and Exporters
11. Association of Major Power Consumers of Ontario (AMPCO)
12. Energy Probe
13. Hydro One
14. Vulnerable Energy Consumers Coalition (VECC)
15. TransAlta Corporation (EMIG)
16. Consumers' Council of Canada
17. Ontario Power Generation Incorporated
18. Energy Markets Investment Group (EMIG)
19. Coral Energy

Appendix B - Statutory References

A. Section 78.1 of the *Ontario Energy Board Act, 1998*

Payments to prescribed generator

78.1(1) The IESO shall make payments to a generator prescribed by the regulations, or to the OPA on behalf of a generator prescribed by the regulations, with respect to output that is generated by a unit at a generation facility prescribed by the regulations.

Payment amount

- (2) Each payment referred to in subsection (1) shall be the amount determined,
- (a) in accordance with the regulations to the extent the payment relates to a period that is on or after the day this section comes into force and before the later of,
 - (i) the day prescribed for the purposes of this subsection, and
 - (ii) the effective date of the Board's first order in respect of the generator; and
 - (b) in accordance with the order of the Board then in effect to the extent the payment relates to a period that is on or after the later of,
 - (i) the day prescribed for the purposes of this subsection, and
 - (ii) the effective date of the Board's first order under this section in respect of the generator.

OPA may act as settlement agent

- (3) The OPA may act as a settlement agent to settle amounts payable to a generator under this section.

Board orders

- (4) The Board shall make an order under this section in accordance with the rules prescribed by the regulations and may include in the order conditions, classifications or practices, including rules respecting the calculation of the amount of the payment.

Fixing other prices

- (5) The Board may fix such other payment amounts as it finds to be just and reasonable,
 - (a) on an application for an order under this section, if the Board is not satisfied that the amount applied for is just and reasonable; or
 - (b) at any other time, if the Board is not satisfied that the current payment amount is just and reasonable.

Burden of proof

- (6) Subject to subsection (7), the burden of proof is on the applicant in an application made under this section.

Order

- (7) If the Board on its own motion or at the request of the Minister commences a proceeding to determine whether an amount that the Board may approve or fix under this section is just and reasonable,
 - (a) the burden of establishing that the amount is just and reasonable is on the generator; and
 - (b) the Board shall make an order approving or fixing an amount that is just and reasonable.

Application

- (8) Subsections (4), (5) and (7) apply only on and after the day prescribed by the regulations for the purposes of subsection (2).

B. *Payments Under Section 78.1 of the Act Regulation (Regulation 53/05)*

Prescribed generator

- 1. Ontario Power Generation Inc. is prescribed as a generator for the purposes of section 78.1 of the Act.

Prescribed generation facilities

- 2. The following generation facilities of Ontario Power Generation Inc. are prescribed for the purposes of section 78.1 of the Act:
 - 1. The following hydroelectric generating stations located in The Regional Municipality of Niagara:
 - i. Sir Adam Beck I.
 - ii. Sir Adam Beck II.

- iii. Sir Adam Beck Pumped Generating Station.
 - iv. De Cew Falls I.
 - v. De Cew Falls II.
- 2. The R. H. Saunders hydroelectric generating station on the St. Lawrence River.
 - 3. Pickering A Nuclear Generating Station.
 - 4. Pickering B Nuclear Generating Station.
 - 5. Darlington Nuclear Generating Station.

Prescribed date for s. 78.1 (2) of the Act

- 3. April 1, 2008 is prescribed for the purposes of subsection 78.1 (2) of the Act.

Payment amounts under s. 78.1 (2) (a) of the Act

- 4.(1) For the purpose of clause 78.1 (2) (a) of the Act, the amount of a payment that the IESO is required to make with respect to a unit at a generation facility prescribed under section 2 is,

- (a) for the hydroelectric generation facilities prescribed in paragraphs 1 and 2 of section 2, \$33.00 per megawatt hour with respect to output that is generated during the period from April 1, 2005 to the later of,

- (i) March 31, 2008, and
- (ii) the day before the effective date of the Board's first order in respect of Ontario Power Generation Inc.;
- and

- (b) for the nuclear generation facilities prescribed in paragraphs 3, 4 and 5 of section 2, \$49.50 per megawatt hour with respect to output that is generated during the period from April 1, 2005 to the later of,

- (i) March 31, 2008, and
- (ii) the day before the effective date of the Board's first order in respect of Ontario Power Generation Inc.

- (2) Despite subsection (1), for the purpose of clause 78.1 (2) (a) of the Act, if the total combined output of the hydroelectric generation facilities prescribed under paragraphs 1 and 2 of section 2 exceeds 1,900 megawatt hours in any hour, the total amount of the payment that the

IESO is required to make with respect to the units at those generation facilities is, for that hour, the sum of the following amounts:

1. The total amount determined for those facilities under clause (1) (a), for the first 1,900 megawatt hours of output.
 2. The product obtained by multiplying the market price determined under the market rules by the number of megawatt hours of output in excess of 1,900 megawatt hours.
- (2.1) The total amount of the payment under subsection (2) shall be allocated to the hydroelectric generation facilities prescribed under paragraphs 1 and 2 of section 2 on a proportionate basis equal to each facility's percentage share of the total combined output in that hour for those facilities.
- (2.2) Subsection (2.1) applies in respect of amounts payable on and after April 1, 2005.
- (3) For the purpose of this section, the output of a generation facility shall be measured at the facility's delivery points, as determined in accordance with the market rules.

Deferral and variance accounts

5. (1) Ontario Power Generation Inc. shall establish a variance account in connection with section 78.1 of the Act that records costs incurred on or after April 1, 2005 that are 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 revenues assumed for ancillary services from the generation facilities prescribed under section 2;
 - (d) Acts of God, including severe weather events; and
 - (e) transmission outages and transmission restrictions.
- (2) Ontario Power Generation Inc. shall establish a deferral account in connection with section 78.1 of the Act 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 Generating Station.

Rules governing determination of payment amounts by Board

6.(1) Subject to subsection (2), the Board may establish the form, methodology, assumptions and calculations used in making an order that determines payment amounts for the purpose of section 78.1 of the Act.

(2) The following rules apply to the making of an order by the Board that determines payment amounts for the purpose of section 78.1 of the Act:

1. The Board shall ensure that Ontario Power Generation Inc. recovers any balance recorded in the variance account established under subsection 5 (1) over a period not to exceed three years, to the extent that the Board is satisfied that the costs recorded in the account were prudently incurred and are accurately recorded in the account.
2. The Board shall ensure that Ontario Power Generation Inc. recovers any balance recorded in the deferral account established under subsection 5 (2) on a straight line basis over a period not to exceed 15 years.
3. The Board shall ensure that Ontario Power Generation Inc. recovers costs and firm financial commitments incurred for investments to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2, if,
 - i. the costs and financial commitments were within the project budgets approved for that purpose by the board of directors of Ontario Power Generation Inc. before the making of the Board's first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., or
 - ii. the Board is satisfied that the costs and financial commitments were prudently incurred.
4. In making its first order under section 78.1 of the Act in respect of Ontario Power Generation Inc., the Board shall accept the values for the following matters that are set out in Ontario Power Generation Inc.'s most recently audited financial statements that were approved by the board of directors of Ontario Power Generation Inc. before the making of that order:
 - i. Ontario Power Generation Inc.'s assets and liabilities.
 - ii. Ontario Power Generation Inc.'s earnings with respect to any lease of the Bruce Nuclear Generating Stations.

- iii. Ontario Power Generation Inc.'s costs with respect to the Bruce Nuclear Generating Stations.
- 5. Without limiting the generality of paragraph 4, that paragraph applies to values relating to,
 - i. the deferral account established under subsection 5 (2),
 - ii. capital cost allowances,
 - iii. the revenue requirement impact of accounting and tax policy decisions, and
 - iv. investments to increase the output of, refurbish or add operating capacity to a generation facility referred to in section 2.
- 6. The Board shall ensure that Ontario Power Generation Inc. recovers all the costs it incurs in connection with the Ontario Nuclear Funds Agreement entered into between Her Majesty the Queen in right of Ontario, Ontario Power Generation Inc. and certain subsidiaries of Ontario Power Generation Inc. as of April 1, 1999, including any amendments to that agreement.
- 7. The Board shall ensure that Ontario Power Generation Inc. recovers all the costs it incurs with respect to the Bruce Nuclear Generating Stations.
- 8. If Ontario Power Generation Inc.'s earnings with respect to any lease of the Bruce Nuclear Generating Stations exceed the costs Ontario Power Generation Inc. incurs with respect to those Stations, the excess shall be applied to reduce the amount of the payments required under subsection 78.1 (1) of the Act with respect to output from the nuclear generating facilities referred to in paragraphs 3, 4 and 5 of section 2.