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October 1, 2012

Kirsten Walli
Board Secretary, Ontario Energy Board
P.O. Box 2319
27th floor – 2300 Yonge Street
Toronto, Ontario M4P 1E4

Dear Ms. Walli,

Re: **Consultation Regarding Incentive Rate Making Options for Ontario Power Generation's Prescribed Generation Assets**
Retail Council of Canada – Written Submissions
Board File No.: EB-2012-0340

Please find the written comments of Retail Council of Canada respecting the above-referenced matter attached as requested by your letter dated August 30, 2012.

Please feel free to contact me if the Board requires any further information in relation to these comments.

Sincerely,

Zizzo Allan Climate Law LLP

[Signed Original Sent to Board]

Travis J. Allan

CC: G. Rygus, RCC
J. Farkouh, RCC
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Consultation regarding Incentive Rate Making Options for Ontario Power Generation's Prescribed Generation Assets

Board File No.: EB-2012-0340

Comments of Retail Council of Canada

Retail Council of Canada ("RCC") represents Ontario and Canada's retail sectors. The retail sector employs over 800,000 people in Ontario, and RCC's members account for 80% of total retail sales across the country. Ontario's retailers rely heavily on electricity to remain competitive and to deliver the goods Ontarians need.

Increases in electricity price, particularly sudden ones, reduce retailer profit, creating a strong likelihood that retailers will need to cut staffing and fixed costs to preserve returns, putting jobs and economic activity in Ontario at risk.[1]

These realities frame RCC's evaluation of an Incentive Rate Making ("IRM") approach for Ontario Power Generation's ("OPG") prescribed generation facilities. An evaluation of IRM options is particularly important because electricity generated by the prescribed facilities accounts for a significant proportion of the electricity bills paid by consumers, and OPG has indicated that it is contemplating significant capital investments. RCC would like to thank the Ontario Energy Board (the "Board") and staff for allowing stakeholders to provide comments on this issue. In addition, RCC would like to express its appreciation for the work completed by Power Advisory LLC ("PA"), London Economics International LLC ("LEI"), OPG and Mr. Fitzpatrick.

Overview of key points in this submission (with relevant section following in parenthesis):

- RCC's members want to encourage lower electricity bills and electricity price predictability (section 1).

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[1] Parsons Brinckerhoff, Loop Initiatives and Halsall Associates "Retail Electricity Use and Implications of Proposed Regulatory Changes" Appendix B to RCC "Stakeholder Submission" (April 3, 2012) http://www.rds.ontarioenergyboard.ca/WEBDRAWER/WEBDRAWER.DLL/webdrawer/rec/339238/view/ ("PB Report"), pp. 7-9.

- RCC supports some form of IRM for Hydro. Based on the information provided so far, a traditional price cap (H5) appears most likely to meet consumer objectives. However, RCC believes a specific comparison of H5 with a "building blocks approach" (H7) would be helpful, because it was unclear from LEI's presentation which IRM tool would provide the greatest likelihood of reducing electricity bills. If the two options are predicted to have relatively similar effects on electricity bills, the IRM option with the lowest predicted regulatory cost should be adopted (section 3).
- RCC supports a treatment of multi-year capital projects that will encourage accurate ex-ante cost estimates and cost control during construction. An IRM based on Board-approved forecasted project costs would best support these objectives for multi-year capital projects (section 5).
- Benchmarking data suggest there may be opportunities to increase efficiency at OPG's existing prescribed nuclear facilities. Stakeholder discussion suggested a number of important concerns with implementing an IRM on OPG's existing nuclear facilities, but failed to identify an alternative solution that would effectively increase efficiency at the prescribed nuclear facilities. If no solution more likely to increase efficiency can be found, RCC supports PA's recommendation that N2 be adopted for OPG's prescribed nuclear facilities.

1. Consumer objectives & the consequences of price increases

During stakeholder outreach for the Renewed Regulatory Framework for Electricity ("RRFE"), retailers told RCC that they are primarily concerned with lowering electricity bills and electricity cost predictability.[2] Expert analysis by Parsons Brinkerhoff et al. has provided the following key points that give context for discussions relating to OPG's prescribed facilities and proposed multi-year capital plans:

- "Electricity represents a significant cost to both large and small retailers"[3];
- "[A] large chain can spend $30-50 million per year on electricity and a single grocery store may spend $200,000"[4];

[2] RCC "Stakeholder Submission" Renewed Regulatory Framework for Electricity (April 20, 2012) http://www.rds.ontarioenergyboard.ca/WEBDRAWER/WEBDRAWER.DLL/webdrawer/rec/339240/view/ ("RCC Stakeholder Submission"), p. 14 & 15.

[3] PB Report, *supra* note 1, p. 7.

[4] PB Report, *supra* note 1, p. 7.

- Higher electricity prices can have a "measurable impact on retailers…"[5]; and
- "For smaller retailers, electricity reduction initiatives beyond 'switching off' may be unattainable due to lack of competency and technology…capital availability and contract structures."[6]

Furthermore, retailers face strong economic challenges, such as

- An increased minimum wage;
- An overall decline in retail sales nationally, and a 1.5% decline in sales in Ontario (April 2011-April 2012)[7]; and
- Increased cross-border shopping limits that will cost the Canadian economy $20 billion annually.[8]

Any cost increases relating to OPG must also be considered in conjunction with cost increases forecast for other parts of Ontario's electricity system, which if accurate, will put significant pressure on electricity bills, even before any price changes relating to OPG are considered.[9]

In this vein, RCC would like to express its support for the IRM Outcome Goals and IRM Implementation Goals set out in the Power Advisory LLC report.[10] Power Advisory's approach recognizes the importance of contributing to lower electricity bills, which is a primary concern for RCC's members. Combining or otherwise

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[5] PB Report, *supra* note 1, p. 8.

[6] PB Report, *supra* note 1, p. 9.

[7] RCC "Retail Fast Facts" (member publication available by request to RCC) (June 2012).

[8] Douglas Porter "Cross-Border Shopping: Here Comes the Flood" BMO Capital Markets *Focus* May 18, 2012 http://www.bmonesbittburns.com/economics/focus/20120518/feature.pdf pp.7-9.

[9] Bruce Sharp, P. Eng. Aegent Energy Advisors Inc. "Ontario Electricity Price Increase Forecast December 2011 to December 2016" report to RRFE dated March 21, 2012 prepared for Canadian Manufacturers & Exporters ("CME"); Consumers Council of Canada ("CCC"); Federation of Rental-housing Providers of Ontario ("FRPO"); School Energy Coalition ("SEC"); Vulnerable Energy Consumers Coalition ("VECC") [referred to hereafter as the "Aegent Price Forecast" http://www.ontarioenergyboard.ca/OEB/_Documents/EB-2010-0377/CME_SUB_Ontario%20Elec%20Price%20Increase%20Forecast%202012.pdf.

[10] Power Advisory LLC "Incentive Regulation Options for Ontario Power Generation's Prescribed Generation Assets" (April 20, 2012) http://www.ontarioenergyboard.ca/OEB/_Documents/Decisions/Power_advisory_report_OPG_20120511.pdf ("PA Report"), pp. 42-43.

obscuring this objective when evaluating potential IRM options suggests that this primary consumer concern is not being given adequate attention.

2. Separate treatments for hydroelectric and nuclear facilities are appropriate

RCC supports the recommendation made by both PA and LEI that OPG's prescribed nuclear and hydroelectric facilities should be subject to separate IRM options based on their important technological and operational differences.

3. IRM for Hydro Electric Facilities

Based on the information provided during this consultation, RCC supports the development of a price cap mechanism for prescribed hydroelectric generation facilities as set out in Option H5 of the Power Advisory report. Such a proposal should encourage cost stability and provide incentives for OPG to locate further efficiencies, if possible, while also recognizing the relatively good comparative performance of OPG's hydroelectric facilities observed in the ScottMadden, Inc. report.[11]

As LEI pointed out in its presentation, the differences between a COS system with regulatory lag and a traditional IRM are not dramatic.[12] Extending the time between cost re-basing, if paired with an appropriate structure for multi-year capital projects, appears likely to encourage OPG to find efficiencies, while also providing some cost certainty for electricity consumers in Ontario.

RCC read with interest LEI's proposed H7 (building blocks) option.[13] Unfortunately, the goals used by LEI to assess the proposal do not allow for a clear understanding of its predicted effect on electricity bills.[14] Without a clear analysis of this issue, it is impossible for RCC to adequately evaluate this option.

If H5 and H7 are predicted to have similar effects on electricity bills, which could occur if PA is correct that because of "the capital-intensive nature of these facilities,

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[11] ScottMadden Report, Phase 2, p. 58 as reprinted in PA Report *supra* note 10, p. 21.

[12] London Economics International LLC "Considering Incentive Rate Making Options for OPG's Prescribed Generation Assets" http://www.ontarioenergyboard.ca/OEB/_Documents/Documents/LondonEconomics_OPG_stakeholdermeeting_20120828.pdf ("LEI Presentation"), slide 4.

[13] LEI Presentation *supra* note 12, slides 12, 13 and Appendix A.

[14] LEI Presentation *supra* note 12, slide 11.

and the limited focus on hydroelectric OM&A costs in recent payment reviews, the prospect for significant reductions may be limited",[15] the deciding factor in determining which IRM approach is best should be the regulatory cost of implementation. It is unclear from LEI's report, which option would have lower regulatory cost, particularly since some of the options for setting a price cap productivity factor (under H5) could be relatively straightforward (eschewing a total factor productivity study in favour of an inflation index and a relatively modest productivity offset, based on judgement).[16]

Based on the above, RCC would like to see a further specific comparison between H5 and H7 to better understand their predicted effects on (1) overall electricity costs to consumers for hydroelectric power generation and (2) regulatory cost.

Unless both of these effects are predicted to be equal, RCC does not believe that H7 should be adopted simply because it may "facilitate learning that can be directly applied to nuclear IRM…"[17] If, as proposed, hydroelectric and nuclear facilities are treated separately because of the many differences between them, the Board's focus should be on implementing the best IRM for each type of facility, even if that means different options are applied. This is especially true in light of OPG's proposal (discussed below, along with RCC's alternate perspective on this point) to delay implementation of a nuclear IRM until 2023.

4. The Hydroelectric Incentive Mechanism ("HIM")

RCC read with interest PA's observation that there may be times in which OPG would be better off spilling water than making use of the Sir Adam Beck Pump Generating Station, even when Surplus Baseload Generation conditions exist.[18] RCC also notes the Board's concern that "the net benefits to consumers are likely substantially less than estimated by OPG on the basis of market price differentials alone."[19] In addition to ex-post prudence reviews, as recommended by PA, RCC would like to see a more in-depth policy review of the HIM as it relates to the broader electricity market to determine if additional opportunities to create efficiencies for consumers and deal with Ontario's SBG issues can be found.

[15] PA Report *supra* note 10, p. 80.

[16] PA Report *supra* note 10, p. 80.

[17] LEI Presentation *supra* note 12, slide 12.

[18] PA Report *supra* note 10, p. 74.

[19] OEB, Decision with Reasons, EB-2010-0008, March 10, 2011, p. 146.

5. Incentive regulation for multi-year capital projects such at the DRP

As the Board has noted, there is a worrying history of cost overruns for CANDU refurbishments.[20] Incentive regulation could assist in the planning and development of multi-year capital projects if it meets the following consumer objectives:

- **Accurate cost forecasting —** in addition to nuclear energy, the Province of Ontario has numerous electricity generation options, such as natural gas, renewables and more aggressive energy conservation (which can reduce electricity demand, thereby freeing up supply for other uses). Electricity consumers want to know that any new generation financed via the ratebase makes the most effective and efficient use of ratepayer money. It is only possible for the Board and ratepayers to determine that the right investments are being made if ex-ante cost projections are accurate.
- **Cost Control** — during project development and implementation of multi-year capital projects, electricity consumers want strong incentives in place at all levels to keep costs at or below forecasts and to ensure timely development of prudent projects.

PA suggests that an IRM for multi-year capital projects based on OPG's forecasted project costs (if pre-approved by the Board) could "create an incentive for OPG to avoid underestimating refurbishment costs and give increased confidence in the validity of the business case for this large expenditure."[21] RCC supports this objective and believes that an IRM based on OPG's pre-approved cost forecasts is the best option, particularly since Power Advisory LLC has identified a lack of applicable data from refurbished CANDU reactors that could be used for external benchmarking.[22]

In response to questions about how best to incentivize OPG to pass the risk of cost-overruns onto its contractors via procurement documents, OPG's representatives indicated that OPG's business planning process is rigorous, that "….the planning process and the engagement process for vendors will need to build [costs] in and

[20] OEB, Decision with Reasons, EB-2010-0008, March 10, 2011, p. 72.

[21] PA Report *supra* note 10, p. 61.

[22] PA Report *supra* note 10, p. 61.

has started to build that in" and that there may be a concern that requiring contractors to bear the risk of cost-overruns will lead to additional expense.[23]

Based on this response, it appears that an IRM based on pre-approved cost forecasts would provide maximum flexibility for OPG to make its own decisions as to when the risk of cost overruns should be passed down to its contractors via procurement contracts and when they should be bourn by OPG's shareholder. Such an approach, as further discussed by PA[24] best meets the consumer objective of cost control.

An IRM based on OPG's pre-approved cost forecasts could be used not only for the DRP, but also for other multi-year capital projects and could become a prerequisite for any approvals under an incremental capital module for OPG.

6. IRM for prescribed nuclear facilities

RCC appreciated the valuable contribution made by other stakeholders regarding the difficulties of developing a cost-effective IRM for OPG's prescribed nuclear assets and recognizes challenges not only because of the limited experience with IRMs for similar CANDU facilities, but also because of the age and lifespans of the facilities in question. RCC notes that OPG has asked the Board to defer implementation of nuclear IRM until the DRP is completed and Pickering is out of service.[25]

The result of such a proposal would be to exempt OPG's prescribed nuclear generation facilities from incentive regulation (beyond that which they currently face) for the short and medium term. Based on figures provided by OPG and its consultant, LEI, such implementation would not take place until 2023, assuming the relevant projects proceed based on OPG's current, publicly released schedules.[26]

These facts create a serious dilemma, because the ScottMadden benchmarking report suggests that there are important opportunities to increase efficiency at the

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[23] Voice Recordings of August 28, 2012 Stakeholder Meeting EB-2012-0340 http://www.ontarioenergyboard.ca/OEB/_Documents/EB-2012-0340/OPG_Audio_6_20120828.mp3, Part 6 at 39:10 minutes.

[24] PA Report *supra* note 10, p. 61.

[25] Ontario Power Generation "OPG's Views on Incentive Regulation and the Power Advisory LLC Report" August 28, 2012 http://www.ontarioenergyboard.ca/OEB/_Documents/Documents/OPG_OPG_stakeholdermeeting_20120828.pdf, slide 7.

[26] LEI Presentation *supra* note 12, slide 8.

existing prescribed nuclear facilities.[27] These efficiency improvements should be a top priority in the short term, and should not be delayed under 2023 or later.

As a result, RCC supports an immediate search for a more effective means of encouraging productivity gains from the prescribed nuclear facilities. If a more effective approach cannot be found quickly, however, it appears that some form of IRM is the best means of encouraging efficiency in spite of the planned changes to the existing nuclear plants.

An approach such as PA's N2 option, ranked favourably by both LEI[28] and PA[29], would allow the Board to create specific target adjustments for individual facilities. It could be implemented until covered facilities go offline for retirement or refurbishment, respectively. Such an approach has the added benefit of being extendable if the projects and dates mentioned above, which are not finalized, are delayed and/or cancelled.

7. Variance accounting

An issue that requires further exploration is how IRMs for OPG's prescribed facilities would function with OPG's fairly complex variance and deferral accounting framework.[30] If an IRM is adopted, RCC believes consultation would be useful to examine whether subsuming some of the variance and deferral accounts, particularly those containing costs over which OPG exercises some degree of control, within a price cap or building blocks approach and/or Z-factor would encourage efficiency.

ALL OF WHICH IS respectfully submitted October 1st, 2012.

[Signed original sent to Board]

Zizzo Allan Climate Law LLP
Travis J. Allan
Counsel for RCC

[27] ScottMadden Report, Phase 2, as summarized in PA Report *supra* note 10, pp. 14-18.

[28] LEI Presentation *supra* note 12, slide 15.

[29] PA Report *supra* note 10, pp. 53-56.

[30] PA addresses OPG's relatively complex variance and deferral accounting framework in PA Report *supra* note 10, pp. 9-11.