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Ontario Energy Board

CONSULTATION
REGARDING INCENTIVE RATE MAKING OPTIONS
FOR
ONTARIO POWER GENERATION'S
PRESCRIBED GENERATION ASSETS

COMMENTS OF
ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")

October 1, 2012

BOARD CONSULTATION
IRM OPTIONS FOR
OPG' S PRESCRIBED GENERATION ASSETS

Comments of Energy Probe Research Foundation

Background

Energy Probe Research Foundation ("Energy Probe") participated in the Stakeholders Meeting on August 28, 2012, hosted by staff of the Ontario Energy Board ("OEB" or "Board"), on the issues associated with establishing an incentive rate making regime for Ontario Power Generation's prescribed generation assets.

By letter dated August 30, 2012, the Board staff requested written submissions commenting on the issues and options presented in, and content of, the Power Advisory LLC report and the presentations and discussion at the Stakeholder Meeting.

As is its custom, Energy Probe has not commented on each and every topic but reserved its comments for topics where it felt it might assist the Board.

By its letter of September 19, 2012, Board staff has decided that a one-stage process does not give interested parties the opportunity to consider and comment on alternative options for IRM that may emerge from the first stage of written submissions. Energy Probe understands that it will have the opportunity to do so and to submit further comments by October 31, 2012.

Comments on Nuclear IRM and Nuclear Safety:

At the Consultation, there was a great deal of discussion of the potential impact of Nuclear IRM incentives on the safety of nuclear generating stations -- some of it initiated by questions from Energy Probe, and some included in the presentation by George Fitzpatrick[1].

Among the points established and discussed:

- **The U.S. Nuclear Regulatory Commission (NRC) has expressed significant interest in the potential impact of Nuclear IRM on safety, stating (according to George Fitzpatrick) that it "can have unintended consequences that could affect decision making and safety." They have intervened with their licensees (nuclear utility companies) and others, to the point of urging state regulators and licensees to inform the NRC of any Nuclear Performance Standards programs being <u>considered</u> -- i.e., the mere scheduling of the OEB's August 28 Consultation would have triggered, in the U.S., a responsibility for both the OEB and OPG to inform the nuclear regulator that the issue was being considered!**

- **No mention was made of any similar statements, requests, or actions by Canada's nuclear-safety regulator (the CNSC, Canadian Nuclear Safety Commission), nor is Energy Probe aware of any.**

- **At the Stakeholder Meeting, Energy Probe's Norman Rubin suggested that some nuclear-safety indicators should be included in Nuclear IRM for OPG, as a kind of Quality-of-Service indicator, to help reduce the likelihood or magnitude of these "unintended consequences".**

[1] George L. Fitzpatrick, "Analytical and Regulatory Issues Surrounding U.S. Nuclear Performance Standards (NPS)", HarbourFront Group, Inc., August 28, 2012.

- The authors of the Power Advisory report -- who had not included this concern in their report -- referred to Energy Probe's suggestion as "a friendly amendment, and a useful suggestion".

- OPG's Randall Pugh also responded positively by saying (from our notes): "Just because you're doing well on something [like nuclear safety] doesn't mean it shouldn't be measured, and included in IRM as a Quality of Service indicator."

While the views expressed were certainly not unanimous -- for one, London Economics' A.J. Goulding was quite hostile to the suggestion -- we were impressed by the broad support for addressing this concern in Nuclear IRM, and Energy Probe would urge the OEB to address it.

In our submission, the fact that Canada's nuclear-safety regulator, unlike its U.S. counterpart, seems not to have responded yet to this logical, sensible, and important concern, should logically increase the OEB's responsibility to address it before changing the incentives for nuclear-plant operations. We do not claim to have perfected a design of nuclear-safety indicators to be included in Nuclear IRM for OPG, but we would be pleased to be included in future discussions of their design, and we would propose the nuclear-safety benchmarks in the Scott/Madden report as one useful starting point.

Comments on the Power Advisory Report

The Power Advisory Report is lengthy and detailed in its presentation and analysis of options for the incentive regulatory regime that the Board should consider for OPG’s Prescribed Generation Assets. As a general matter, Energy Probe supports the recommendation that IRM should be applied to both of OPG’s regulated nuclear and hydroelectric businesses.

Energy Probe has long been concerned that the traditional cost-of-service approach to ratemaking does not provide sufficient incentives for least-cost operation and innovation by regulated utilities.

In addition, Energy Probe has been critical of the cost allocation methodologies that have been proposed during various rate hearings at the Board. As the Power Advisory Report notes (slide 16), IRM weakens the link between prices and costs, and thereby reduces the need for cost allocation procedures that, in Energy Probe's view, are arbitrary and susceptible to manipulation.

The potential for manipulation of costs is of particular regulatory concern and considerable and costly efforts are made by all parties to ensure that cost allocations are "reasonable". However, the various attempts[2] to control manipulation of cost allocations do not address the central issue, i.e., that all such allocation methods are arbitrary, even when they are deemed to produce "reasonable" results.

In Energy Probe's view, it would be highly desirable to regulate rates in a manner that does not require such arbitrary allocation procedures. However, one of the many issues that arise is the starting point for introducing IRM and in this regard Energy Probe supports the Power Advisory Report's recommendation that initial prices would be based on a traditional cost-of-service analysis, even though doing so would require arbitrary cost allocations.

[2] Such as reliance on the opinions of independent experts on so-called "best practices" in the industry.

In Energy Probe's view, the Power Advisory Report has not sufficiently emphasized this important benefit of IRM and, indeed, its options for IRM may not reduce the need for cost-allocation methods appreciably.

In particular, the Power Advisory Report option H4 for IRM in the hydroelectric business (slide 30) would provide incentives for OPG to maximize "other revenues" from providing ancillary services. Energy Probe submits that this option is not an IRM option at all and would require significant cost-allocation efforts, and urges that the regulated hydroelectric assets of OPG be dedicated to the regulated service.

Comment on Fitzpatrick Presentation

In his presentation at the Stakeholder Meeting, Mr. Fitzpatrick states that, based on his U.S. performance modelling and regulatory experience,

> **"Based on my U.S. experience, incentives (penalties) tied to performance standards would not change nuclear performance" (slide 9)**

In support of his conclusion, Mr. Fitzpatrick refers to his "interactions with a representative sample of U.S. nuclear plant management". He also notes that "the vast majority of U.S. state commissions that he has worked with have reached that same conclusion.

Energy Probe recognizes Mr. Fitzpatrick's expertise. However, the fact that plant managers and their regulators appear to share the same view (i.e. that change would not be desirable) is not uncommon in regulatory affairs. In Energy Probe's view, Mr. Fitzpatrick's conclusion regarding the U.S. situation should not be given undue weight.

More importantly, Energy Probe sees no direct conflict in adopting nuclear performance standards and an IRM regime, subject to the concerns expressed above in our Comments on Nuclear IRM and Nuclear Safety. Presumably the IRM regime would provide for exceptional situations in which OPG could apply to the Board to resolve those situations expeditiously.

Comment on London Economics Presentation[3]

London Economics is generally supportive of the Power Advisory Report. At the Stakeholder Meeting, London Economics referred to, and apparently relied on, its "report" that was not yet available. Energy Probe requests that this report be made public as soon as possible.

Energy Probe agrees with London Economics' recommendation that IRM for OPG's regulated nuclear and hydroelectric businesses be separated. Energy Probe notes that the Board has allowed Hydro One to separate its rate applications for transmission and distribution.

However, Energy Probe disputes London Economics' statement that

> **"In COS ratemaking to date, cost allocation reviews conducted by OEB have not raised any concerns on the current allocation methodology deployed by OPG" (slide 10).**

As indicated above, Energy Probe regards the essentially arbitrary nature of all cost-allocation methodologies as a reason to move from a cost-of-service approach to an IRM.

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[3] London Economics International LLC. "Considering Incentive Rate Making Options for OPG's Prescribed Generation Assets", August 28, 2012

Comment on OPG presentation[4]

OPG's presentation also supports the Power Advisory Report generally.

In addition to OPG's other suggestions that have been adopted by London Economics, Energy Probe generally supports OPG's suggestion that ratesetting for its nuclear business continue on a cost-of-service basis until the Darlington refurbishment is completed and Pickering is out of service.

[4] Ontario Power Generation. "OPG's Views on Incentive Regulation and the Power Advisory LLC Report", August 28, 2012.