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Ontario Energy Board  
2300 Yonge Street  
P.O. Box 2319  
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Toronto ON M4P 1E4

**Attention: Ms Kirsten Walli**  
**Board Secretary**

Dear Ms. Walli:

**Re: Transmission Connection Cost Responsibility Review**  
**Board File No.: EB-2008-0003**

## **Introduction and Summary**

These submissions are provided on behalf of Great Lakes Power Transmission ("GLPT"). GLPT appreciates the insight and hard work that went into developing the policy options in the Discussion Paper. The process by which the paper was developed and the insight demonstrated in the Discussion paper has been a model in OEB policy development. As a participant in the Ontario electricity sector, GLPT is grateful to the OEB staff for the opportunity to participate in these discussions and is encouraged to see the OEB taking a proactive, thoughtful approach towards implementing government policy objectives, such as increasing renewable energy supply.

Although GLPT has some specific suggestions to add to the options developed in the Discussion Paper, we think the Discussion Paper sets out options in a clear and helpful manner.

In summary, GLPT supports a revised version of the hybrid option. The virtue of the hybrid option is that connection costs are allocated to the generator, thus leading to a more refined commodity price signal. The limitation of the hybrid option is that it does not incentivize transmitters to construct facilities because subscribed capacity is removed from the rate base.

The virtue of the pooling option is that transmitters may be incentivized to build facilities<sup>1</sup>. The limitation of this approach is that, by not distinguishing between used and unused capacity, the pooling option does not provide incentives for the proponent to “right-size” the facilities.

The solution to both issues (unutilized capacity and price distortion) is to modify the hybrid option by having transmitters earn a premium on utilized transmission capacity (the “Capacity Premium”). A transmitter will therefore earn its rate of return on all facilities and an additional premium on utilized capacity. This provides an incentive to the transmitter to right-size the transmission line and build in areas where the capacity is more likely to be taken up. This option is discussed in greater detail below.

### **Background and Purpose of Review**

The facts giving rise to the Generation Connection Cost Responsibility Review (the “GCCRR”) were identified by the Ontario Energy Board (the “OEB” or the “Board”) in its January 4, 2008 announcement as follows: “The OPA already has under contract 1384 MW of generation from renewable sources expected to connect at the transmission level. In response to government directive, the OPA has launched a process to contract for an additional 2000 MW of renewable generation resources to be in service by 2015. Much of the renewable capacity under contract or expected to be contracted would operate intermittently, and at a relatively low capacity factor. It is expected that some of these resources are to be located relatively distant from the existing transmission grid. Connection costs could therefore be a significant component of the total cost of power from these facilities.”

We understand the principle objective of the new generation connection cost policy (the “Connection Policy”) is to ensure that the lines get built, at the lowest economic cost to ratepayers and in a timely manner. Secondary objectives include providing an accurate electricity price signal to consumers, regulatory predictability and administrative efficiency.

In the OEB Staff Discussion Paper dated July 8, 2008, OEB Staff outlined four options for discussion: (i) status quo, (ii) pooling, (iii) hybrid, and (iv) shared, each as more fully described in the Discussion Paper.

### **Analysis of Status Quo and Shared Options**

In contrast to conventional generators, which consist of large, single proponents whose facilities are close to the grid, a renewable resource may have more than one proponent, and each proponent with different project development timelines<sup>2</sup>. Under the status quo and the shared

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<sup>1</sup> This general statement reflects the Averch-Johnson effect. However, it is over-simplified in the sense that it underappreciates the disincentives to building transmission facilities in an environment of relatively low rates of return and relatively high regulatory uncertainty (environmental approvals, etc..).

<sup>2</sup> This is consistent with the Board Staff’s definition of a “renewable resource cluster”, which is “a defined geographic area identified in an integrated power system plan approved under Part II.2 of the *Electricity Act, 1998*, where renewable resources suitable for electricity generation are present and where the renewable generation resources are, or are expected to be, owned or controlled by more than one proponent.” (see p. 18 of the Discussion Paper).

option, the cost and development of the connection facilities would be the responsibility of the generators. This would require extensive coordination between them. The cost, the time taken to build the enabler facilities, and the risk of the line not being built are significantly increased under the status quo and the shared option for the following reasons:

- Generators who are otherwise in competition need to act in concert to develop and construct the new transmission line;
- Generators have little experience of the regulatory framework for new transmission lines;
- The lack of familiarity with electricity transmission amongst the generation community will make it more difficult, expensive, and time consuming for them to raise project finance;
- The generators may lack the ability or long-term plans to correctly size the new line;
- There may not be enough generators ready at the same time to cover the up-front costs, with the result that the line is never built.

As a result of the foregoing, it does not appear that either the status quo option or the shared option provide solutions to the issue identified by OEB Staff.

### **Analysis of Pooling and Hybrid Options**

#### *Pooling Option*

Under the pooling option the transmitter has lead responsibility and the costs are pooled. The cost of the enabler facility is included in the transmission rate base and the cost is recovered in its entirety from transmission rate payers.

The pooling option has merit in that, unlike the other options, transmitters have an incentive to build the line since they will have the opportunity to expand their rate base. Of all the options, the pooling option is most likely to result in the enabler line being built. The economic efficiency is also increased since the most experienced party, the transmitter, is taking the lead in the regulatory process, financing and eventual development of the facility.

The major limitation is that the enabler lines will not be “right sized” because transmitters are only weakly incentivized to build to capacity or to avoid building unused capacity. An additional concern is that including generator related transmission costs in the transmission rate base will distort price signals.

#### *Hybrid Option*

The hybrid option involves the licensed transmitter temporarily owning the facilities and the associated costs pooled. According to the Discussion Paper, because the transmitter will not keep the enabler facility in its rate base permanently, the problem of over sizing the line is

minimized. In addition, because the generator has to contribute to the cost of connecting, the cost of new transmission will be reflected in commodity costs through the Global Adjustment Mechanism (“GAM”), resulting in more accurate price signals. However, if the transmitter cannot earn a return on subscribed capacity, it has little incentive to construct the facilities<sup>3</sup>. Furthermore, the eventual transfer of ownership of the line to the subscribing generators creates uncertainty with respect to transmission investment.

### **Proposed Solution**

Of the four options GLPT believes that a modified version of the hybrid option is the most attractive.

The virtue of the hybrid option is that connection costs are allocated to the generator. The limitation of the hybrid option is that it does not incentivize transmitters to construct facilities because subscribed capacity is removed from the rate base.

The virtue of the pooling option is that transmitters may be incentivized to build facilities<sup>4</sup>. The limitation of this approach is that the pooling option does not provide incentives for the proponent to “right-sizing” the facilities because no distinction is made between used and unused capacity.

To summarize, the optimal Connection Policy would minimise unused transmission capacity, allocate costs properly between transmission and generation, but would also result in enabler facilities being built where needed and when required. This latter point is important since, given the province’s current need for transmission, in particular to meet renewable resource targets set by the government, the OEB is looking to solve for unutilized capacity of the enabler facility rather than overbuild of transmission.

We believe the solution to both issues (unutilized capacity and price distortion) is to modify the hybrid option by requiring generators to pay transmitters for utilized transmission capacity (the “Capacity Premium”). A transmitter will therefore earn its rate of return on all facilities and a premium on utilized capacity. This provides an incentive to the transmitter to right-size the transmission line and build in areas where the capacity would be entirely taken up. In order to right-size the enabler facility, the transmitter would work closely with generators to achieve optimize the capacity of the new line. The Capacity Premium essentially allows for a greater rate of return on a more economically built transmission line. This serves public policy objectives since it connects renewable energy to the grid at the lowest cost while creating a desirable investment environment for transmitters to operate. Furthermore, the cost of the Capacity Premium could be recovered via the GAM. Recovering the Capacity Premium from the GAM would effectively keep commodity costs for generation capacity out of the transmission rate base, thereby preventing price signal distortion.

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<sup>3</sup> There is little commercial incentive for a transmitter to develop and operate a transmission line if it does not increase the capital value of its rate base, the only return is a pass-through of operating costs and taxes.

<sup>4</sup> This general statement reflects the Averch-Johnson effect. However, it is over-simplified in the sense that it underappreciates the disincentives to building transmission facilities in an environment of relatively low rates of return and relatively high regulatory uncertainty (environmental approvals, etc..).

At a conceptual level, the value of the Capacity Premium could be based on the difference between the transmitter's cost of capital and the generator's cost of capital, and should fall somewhere between the rate of return of a regulated transmitter and that of a merchant generator<sup>5</sup> proportionate to the risk. This will reflect the notional difference between transmission and generation costs.

GLPT further suggest that the Capacity Premium be collected as a monthly lease payment over the duration of the generator's power purchase agreement with OPA rather than as a lump sum up-front. This benefits the generator because they don't have to provide the capital as a single lump sum, up front payment – this is important for smaller generation developers who might otherwise be precluded from the market. Furthermore, the transmitter can source the funds more cheaply than the generator, which will result in lower costs to the ratepayer. The advantage for the transmitter is that they can invest in the enabler line and receive a return on investment over a reasonable period of time. The advantage for the OEB is that the payment stream can be based on a slightly higher return on capital than the return on capital for network assets, without opening up the issue of different returns on capital for the same class of assets. Administratively, the Capacity Premium could be collected through GAM by the Independent Electricity System Operator (IESO), and paid directly to transmitters, thereby reducing the administrative costs of collection by reusing existing IESO systems.

### **Regulatory predictability and administrative efficiency**

The hybrid option proposed here relies on incentives for transmitters to build right-sized connection facilities. It is therefore more likely to increase administrative efficiency than an approach that requires the Board to initiate a proceeding on its own to order a transmitter to build facilities. In fact, the proposed approach does not involve significant departure from the current approach towards approving transmission development. A transmitter who seeks to recover costs for developing a transmission option could apply to the OEB for prior approval of development costs.

Such an application would be similar to leave to construct applications, but would be filed earlier in the transmission development process. The key goal for the OEB is to determine the level of project detail it should expect from a transmitter in this “leave to develop” type of application. Although the level of project detail will be less than for a leave to construct application, it should be sufficient to demonstrate that the project is credible and that its development should be contributed to by ratepayers. GLPT suggests that a transmitter who is seeking approval for “leave to develop” should be required to demonstrate that it has a credible plan to develop the facility; examples of this could include a requirement to demonstrate that:

- Its proposal facilitates and is consistent with an OPA procurement of resources;

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<sup>5</sup> If the generators pay for the new enablers, the cost to the rate payer for the new line will be based on the cost of capital for merchant generation. This is considerably higher than the cost of capital were the transmitter to build the line and include it in the network pool. Depending on how the performance targets with the connecting generators are structured, the hybrid option presents a higher investment risk to the transmitter than rate recovery through the network pool, but a lower risk than would be seen by the generator. The rate of return should therefore be somewhere between that of a rate regulated transmitter and a merchant generator.

- Its proposal is supported by necessary land rights;
- Its proposal contains a series of realistic development time lines;
- The transmitter has the demonstrated financial wherewithal to support the financial commitment required through development to construction;
- The transmitter has the financial strength to support the equity requirement of the project;
- The transmitter is prepared to deposit a security fee at a value of, for example, 0.1% of the project cost to a maximum of \$1 million; and
- The project will be designed, constructed and operated in compliance with all relevant acts, regulations and codes.

If the OEB approves the application, a transmitter may seek to recover costs incurred in accordance with the OEB's approval in its rate base, subject to prudence.

This approach is consistent with the OEB's treatment of prior review of applications for approval of costs related to upstream gas transportation and supply contracts discussed in the Natural Gas Forum Report.<sup>6</sup>

The information obtained in developing the project can be used in a subsequent leave to construct application.

### **Initiating Enabler Facility Development**

Three additional questions raised in the Discussion Paper are (i) the appropriate definition of enabler line; (ii) whether the Board should designate a transmitter as responsible for the development phase of the enabler facilities; and (iii) whether any such proceeding should await the completion of the IPSP.

With respect to (i), the definition of enabler facilities should be those facilities that serve multiple **renewable** generation facilities with different non-affiliated owners. The focus should be on renewable facilities because the OEB derives its mandate to promote and regulate enabler facilities from the government's objective to increase Ontario's renewable energy supply. Allowing multiple proponents to participate reflects the reality that fuel sources for renewable generation sources are spread out over a broad geographic area as opposed to a single location. Enabler lines would be used merely to connect renewable generation projects that, without the cost of the enabler line, would otherwise be economical to develop.

Defining enabler facilities as serving different owners with multiple generation facilities also helps the OPA achieve its stated principle of fairness when procuring renewable generation and as laid out in the IPSP: "Procurements are to be open to a broad range of proponents capable of meeting the identified resource requirements."

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<sup>6</sup> In that report, the OEB stated, "Given the importance of security of supply and to provide greater clarity in the marketplace, the Board will offer utilities the opportunity to apply for pre-approval of long-term supply and/or transportation contracts." (Natural Gas Forum Report, March 30, 2005 at p. 73).

With respect to (ii), GLPT submits that the process should be applicant driven. A transmitter who identifies an opportunity to build new transmission to facilitate OPA resource procurements is in the best position to scope the proposed application. It is not practical for the OEB to launch a proceeding on its own that would be able to provide a meaningful factual or project specific context for an application. Further, given that the OEB will have to review proponent proposals, and how these proposals facilitate an OPA procurement, it should remain neutral as to different proposals so that it can provide a balanced review.

This is not to challenge that the OEB has the legal authority to order a transmitter to implement transmission requirements identified in an IPSP. But it should be borne in mind that there is nothing new about this type of authority. The OEB has always had the power to direct transmitters and distributors to expand or reinforce their facilities. However, the Board has only exercised this power in exceptional circumstances where it appeared that a proponent was not prepared to come forward. As a result, it has been the OEB's practice to treat transmission enhancements as applicant driven, and the OEB only intervenes and forces an application where it appears that a proponent will not do so. GLPT submits that this practice should continue.

With respect to (iii), the OEB should not wait for the IPSP to be approved in order to initiate the regulatory process for development of enabler facilities. As stated above, the OEB derives its mandate for enabler development from the government's policy decision to increase Ontario's renewable energy supply. However, the government is not waiting for the IPSP to be approved to take steps to meet this policy objective, as evidenced by the Renewable Energy Supply directive dated August 27, 2007, which calls for 2000 MW of additional renewable power in-service by 2015. Nor should the OEB. As stated by the Board in their letter to stakeholders dated January 4, 2008, the "Board believes that cost responsibility issues associated with "enabler lines" are appropriately examined as part of a policy consultation process rather than within the proceeding to review the IPSP."

In addition, this approach imposes an enormous regulatory burden and time lag on developing transmission options. The IPSP is a complex and lengthy proceeding. It operates at a strategic planning level. It identifies a number of options to be developed and considered. For example, for each identified enabler line, the IPSP identifies several supply and transmission options that will require further development and consideration. It does not seek to choose between them. The preferred supply options will be determined through procurements. The OPA does not have a process to choose a preferred transmission option.

The IPSP hearing is not a good forum to finalize either the supply or transmission options. It will either provide insufficient direction with respect to development work or, if it is to provide sufficient direction (including contributions on credible development projects, with land rights, time frames, financial commitments, etc.), the IPSP proceeding will require a level of detailed evidence in the application that will distract from its main purpose.

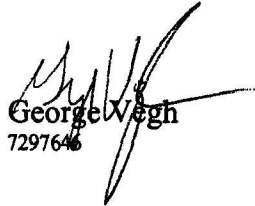
### **Conclusion**

In conclusion, and to summarize, GLPT supports a revised version of the hybrid option that would:

- allocate connection costs appropriately between transmission and generation, thereby leading to a better commodity price signals; and
- provide incentives for transmission proponents to both build and “right-size” new transmission facilities.

Thank you for the opportunity to participate in this process. GLPT looks forward to continuing to work with the Board and staff on this matter and hopes that it has provided a helpful contribution.

Sincerely,



George Weigh  
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