

November 10, 2008

VIA RESS AND COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, Suite 2700
Toronto, Ontario
M4P 1E4

Re: EB-2008-0298 - Reliability Must-Run Agreement for Lennox G.S.

Dear Ms. Walli:

On September 15, 2008, Ontario Power Generation Inc. ("OPG") submitted to the Ontario Energy Board (Board) a Reliability Must-Run ("RMR") agreement for the Lennox Generating Station ("Lennox") covering the period October 1, 2008 to September 30, 2009.

On October 17, 2008, the Board issued a Notice of Application and Hearing and Procedural Order No. 1. This Procedural Order noted evidence in the pre-filed submission by the Ontario Power Authority (OPA) for the Integrated Power System Plan (IPSP) regarding an ongoing requirement for Lennox. The Procedural Order also indicated that the Board wishes to examine the continued need for Lennox as a reliability must-run resource beyond September 30, 2009.

Further to Procedural Order No. 1, OPG is providing additional evidence regarding Lennox's operations over the longer term. OPG has also held discussions with the IESO and OPA regarding the future need for Lennox.

After determining that deregistration of Lennox in the period October 1, 2008 to September 30, 2009 would put the IESO-controlled grid at undue risk, the IESO entered into a fourth RMR agreement for this facility. OPG submits that the Board should approve the 2008-09 RMR agreement as filed.

1. Future Requirement for Lennox Generation

Procedural Order No. 1 notes that there is evidence in the IPSP regarding the longer term need for the continued operation of Lennox. As noted in its September 15, 2008 application, while OPG expressed interest in extending the term of the RMR Agreement beyond 12 months during the negotiations, the IESO's technical assessment indicated that under the expected resource availability and demand forecast assumptions, there was insufficient justification to extend the RMR Agreement beyond September 30, 2009. Since that time, OPG is not aware of any material change in the IESO's view about the need for Lennox as a RMR resource beyond September 30, 2009.

The OPA's pre-filed evidence for the IPSP filed with the OEB on August 29, 2007 proposes that the OPA will contract for Lennox following expiry of the RMR contract with the IESO. The OPA states:

"... the OPA will enter into a procurement contract with OPG to replace the OEB-approved Reliability-Must-Run contract that is currently in place with respect to the Lennox GS through the OEB-approved procurement process." (EB-2007-0707, Exhibit B-1-1, page 28)

The OPA further states:

"While Lennox is assumed to remain in service, its category changes from an existing resource to a planned resource in 2011. This is a result of Lennox, and therefore its RMR contract, not being needed for local reliability purposes after 2010." (EB-2007-0707, Exhibit D-8-1, page 9)

The IPSP hearing began on September 8, 2008. On September 17, the Minister of Energy and Infrastructure issued a directive requiring the OPA to revisit the IPSP with a view to establishing new conservation and renewable targets within the plan, and to undertake enhanced consultations with First Nations. On October 2, the OEB adjourned the hearing and directed that the OPA file its updated evidence by March 16, 2009.

The adjournment of the IPSP will delay the OPA's ability to negotiate a supply contract for Lennox. Lennox could therefore be in a position where there is no contractual support for its continued operation after September 30, 2009. In its decision in EB-2007-0715, the Board indicated that it is prepared to impose a condition that any future RMR agreement have a term of more than one year if that could be demonstrated to be more cost-effective. The Board also indicated that it expects OPG to come forward with the contract term that OPG believes will provide the most cost-effective outcome, having regard to the then-current expectations as to the continued need for Lennox as a RMR resource.

On the assumption that the one-year Lennox RMR agreement as submitted on September 15, 2008 were approved and that no further contractual support mechanism were in place, OPG would have to assess whether it made commercial sense to continue to operate the Lennox facility after October 1, 2009.

If the Lennox facility were to be shut down, OPG would be faced with a number of significant costs including placing the plant in a safe shut-down state, the cancellation of fuel contracts, and staff severance packages. In addition, customers could potentially face higher electricity costs if there was a decision to remove the facility from service or to reduce operations at the facility.

In the event that an approved IPSP eventually did identify a need for Lennox, consistent with the OPA's pre-filed evidence, costs would be incurred to re-start the facility. These would potentially include re-registration and technical preparation of the facility to begin producing power, re-establishment of fuel contracts, and hiring and training of appropriate staff.

In the EB-2007-0715 decision, the Board noted that if OPG were to file a multi-year RMR agreement for Board approval, it expected that OPG would demonstrate that the contractual model used for the RMR contracts is appropriate for an agreement having a term of more than one year. (EB-2007-0715, page 12) While OPG has not filed a multi-year RMR agreement, OPG submits that the RMR contractual structure could be used over a longer term as it provides the counterparty with access to all information necessary to verify OPG's costs and revenues, allows the counterparty to audit this information as and when necessary, and also allows for termination of the agreement at any time should it be determined that Lennox is no longer required.

The Lennox RMR agreement has been in place in essentially the same form since October 1, 2005. The IESO has conducted two audits of the agreements (in 2006 and 2007), both of which concluded that the auditor was satisfied with the Lennox plant operation strategy, costs and practices. The successful operation of the agreement since October 2005 provides comfort that the agreement in its current form is suitable for a multi-year term.

2. Cost Effectiveness of a Longer term Agreement

In its Decision for the 2007-08 Lennox RMR agreement, the Board stated that it "...sees promise in a multi-year RMR arrangement in terms of cost-effectiveness." (EB-2007-0715, page 11) The Decision further stated that while it is reasonable to expect that a longer RMR arrangement would allow OPG additional options, particularly with respect to trading off operations and maintenance against capital, the magnitude and significance of any such

savings resulting from the more economical operation of Lennox over a longer period are not known. It also states that no party to that proceeding disputed the Board's authority to require that future RMR agreements have a term of more than one year.

OPG has identified three main benefits of a longer term contract for Lennox:

1. Allows for more effective and efficient planning and execution of operational programs
2. Results in consideration of value enhancing projects which would benefit all stakeholders
3. Reduces administrative work associated with the re-negotiation, approval and reporting processes for contracts

Further details on these benefits are as follows:

1. Effective and efficient planning and execution of operational programs
Up to this point, Lennox has carried out its planning on the assumption of ongoing need. The strategy behind a long-term business plan and a short-term plan will differ based on the planning horizon. While both plans would be expected to yield good decisions given the set of assumptions, the proposed work programs could vary significantly.

Decisions regarding the execution of maintenance work programs, such as repair vs. replace and appropriate parts inventory levels, will differ significantly depending on the planning horizon. If it is known that the station will be required for capacity purposes for the medium term, this allows for more efficient packaging of maintenance and project work over the planning period. The cumulative benefits of longer term planning would result in a lower expected forced outage rate for the plant. Longer term contracts also have other benefits including more stable vendor relationships and staff continuity.

2. Value Enhancing Investments
The capital program for Lennox includes a proposal for a Combined Heat and Power (CHP) project. This project would improve the efficiency of the facility, on the assumption that the plant would continue to be required on a contractual basis. The project currently has a total estimated capital cost of approximately \$10 million and a planned start date in the fourth quarter of 2009. The project would provide significant operating benefits for OPG, the OPA and the Province in terms of reduced operating costs and environmental improvements. The estimated pay back period is approximately five-years.

Lennox requires approximately \$6M/year for electricity and \$6M/year for natural gas for heating and lighting for the plant, regardless of the amount of generation. A CHP facility utilizes a gas turbine and heat recovery steam boiler to produce both electricity and steam more efficiently than a conventional steam boiler and power purchases from the grid. The installation of a CHP facility is expected to result in cost savings of approximately \$2.0M/year.

Producing both electricity and steam through the CHP plant compared to purchasing electricity from the grid and producing steam from a conventional boiler results in an efficiency increase of approximately 50% to 80%. This efficiency gain results in reduced environmental emissions.

This project is consistent with the OPA's objectives for CHP-based procurement, and the province as a whole would benefit from the lower operating costs and reduced environmental impact associated with the CHP.

3. Reduced Administration Costs

The savings associated with reduced administration are not large in dollar terms, but would free up many hours of staff time currently allocated for contract negotiation and the OEB hearing process for other work. OPG estimates the opportunity costs of staff time and other costs (legal costs, hearing related costs, etc.) associated with negotiating new contracts and seeking approval of the RMR costs to be in the order of \$100,000 per year for both Lennox and head office groups.

3. Conclusion

The IESO has determined that deregistration of Lennox in the period October 1, 2008 to September 30, 2009 would put the IESO-controlled grid at undue risk and has negotiated a fourth RMR agreement for this facility with OPG. In light of developments regarding the timing of the approval of the IPSP and direction provided in Procedural Order No. 1, OPG has provided additional evidence to support the approval of the RMR agreement.

The agreement provides the IESO with access to all information necessary to verify OPG's costs and revenues. Furthermore, it allows the IESO to audit this information as and when necessary. It also allows the IESO to terminate the agreement at any time should the IESO determine that Lennox is no longer required. OPG submits that the Board should approve the RMR agreement as submitted. OPG further submits that a longer term agreement for Lennox would be cost effective.

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Yours truly,

[Original Signed by]

Andrew Barrett
Vice President, Regulatory Affairs and Corporate Strategy