



APPrO
ASSOCIATION OF
POWER PRODUCERS
OF ONTARIO

August 20, 2004

Technical Advisors
Ontario Electricity RFP
Toronto, Ontario

Re: Request for Information /Request for Qualifications (RFI/RFQ) for 2,500 MW of New Clean Generation and Demand-side Projects

Dear Sirs,

Ontario's power producers view the recent Request for Information /Request for Qualifications (RFI/RFQ) for 2,500 MW of New Clean Generation and Demand-side Projects as another important step in addressing Ontario's electricity supply. APPrO congratulates the government on a rigorous approach to both the 300 and 2500 MW RFPs.

Clearly, Ontario needs to bring on the most cost-effective power within the RFI/RFQ framework in as efficient and timely a fashion as possible. As we noted in our commentary on the renewables RFI/RFP, the process should minimize project uncertainties whether with respect to process, or terms and conditions which could lead to increased prices arising from delay, uncertainty or unclear allocation of risk. We made similar recommendations on the RES process in May.

APPrO noted at that time that the current process is a good start, but much remains to be done to ensure Ontario receives the best outcomes. With modifications the RFP process can deliver solid benefits. This will send both an important signal to potential investors and set important precedents for future RFPs.

While we are pleased to see that a number of our recommendations have been brought forward in the final RES RFP and in the process itself, a number of other concerns raised in our commentary on the renewables RFP remain unaddressed (e.g., the inclusion of expansions and upgrades, subject to market power considerations), and we remain convinced that the process itself must be improved in terms of openness, transparency and a level playing field for all prospective participants.

APPrO's major concerns on the most current tranche are in these areas:

- Timely assurance of the OPA's credit rating;
- Exclusion of peakers;
- The pre-selection of deemed heat rate to exclude many gas fired cogen projects;

- Oversimplification of locational credits;
- Oversimplification of deemed / imputed dispatch in the real time market
- Oversimplification of start-up cost treatment
- Lack of criteria for comparative evaluation of DR/DSM and generation;
- DR & DSM Verification program;
- Protection against cross-subsidization by OPG or regulated entities;
- Incomplete response to questions.

Assurance of OPA's credit rating

APPrO has already written separately to the Minister on the need for a timely resolution and communication on the OPA credit issue. We are pleased to see the indicative ratings published in the last couple of days, and expect to be discussing the implications with our members.

Exclusion of Peakers

The Ministry has stated it is seeking a mix of Intermediate Generation, Baseload Generation and Demand-Side Projects from new generation facilities located within Ontario. While the exclusion of peakers is apparently intentional, the problems caused for cogeneration projects by a deemed heat rate may not be fully appreciated. We question why the government has made a decision to move forward with an RFI/RFP which is based solely on intermediate power, and not including peakers. We are aware of no compelling logic to suggest that there is no role for new peakers in the supply mix.

Inflexibility in use of the deemed Heat Rate

It is important that the Ministry appreciate the impact of its selection of a pre-determined deemed heat rate for all gas fired facilities. The use of a deemed 7500 heat rate as presently proposed significantly hedges market risk for large combined cycle-type projects but leaves additional market risk with proponents of projects with heat rates either higher or lower than 7500, thereby biasing technology choices away from other types. The effect of using a deemed 7500 heat rate also creates a disadvantage for any project in which incremental investment would achieve significantly lower heat rates, e.g., industrial cogeneration.

Proponents of non-7500 heat-rate projects must surmise how future market prices will depart from historical prices in order to determine the adjustments to make to the NRR for the purpose of submitting a competitive NRR. Such proponents are fully exposed to the risk that this forecast is not correct. This is not the case for a 7500 heat rate plant. Further, the forecast of market prices will be somewhat dependant on the results of this and other RFPs and therefore may be influenced by the actions of the government.

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Plants with heat rates lower than 7500 will make more actual revenue than deemed. In order to be competitive in the RFP process, they will need to use the expectation of such incremental market revenue to offset the higher capital cost that is associated with higher efficiency installations, and to mitigate the contract NRR. If prices vary from a proponent's projections, the cogen proponent will not generate enough extra market profit to supplement this lower NRR. This adds major risk for cogen projects, and again renders their competitiveness and financeability problematic.

The essential issue is that the deemed 7500 heat rate favours a certain set of combined cycle projects and renders all others (whether higher or lower heat rates) uncompetitive. We believe this is a fundamental fairness issue. Furthermore, two hour runtimes favour combined cycle projects with quick and low cost startups, and renders others less competitive. We believe this may jeopardize optimum solutions being brought forward under this RFI/RFP.

Oversimplification of locational credits

The concept of using locational credits is good but the evaluation bonus provision for priority zones contemplated appears to be overly simplistic. While it is clear that the greater Toronto area (GTA) is in need of additional generating capacity due to reliability issues and to defer transmission investments, presumably there is a supply curve for the actual benefit realized from generating capacity located in each GTA zone. For example, the value associated with the first 1,000 MW of capacity located in either zone is likely to be considerably greater than the second 1,000 MW. However, the evaluation framework does not consider this. This is particularly significant because there are more than 2,200 MW of generation that have been proposed that are capable of satisfying the two identified locational objectives. Under the contemplated RFP structure, subsequent successful proposals in each zone would qualify for the same 7.5% bonus, but would not benefit the system to the same degree as the first (lowest-cost) successful proposal. Such a provision places proposals located at other attractive sites (from a system perspective) that are not inside the greater Toronto area at an unfair competitive disadvantage.

If, on the other hand, the government's intention is simply to address IMO GTA priorities first in this RFI/RFP with other priority areas to be addressed later, then the government should simply say so rather than causing proponents considerable time and expense to figure this out for themselves. It's important to note that these pursuit costs (not including bid bonds) are not inconsiderable and could approach \$200-300,000. Clarification about the expected means of recognizing other locational benefits would help increase confidence in the current process.

Oversimplification of Deemed / Imputed dispatch in the real time market

There is a fundamental problem until Ontario has a Day Ahead Market (DAM) - likely several years. APPrO believes that the deemed dispatch should be in accordance with market prices as indicated on the pre-dispatch schedule well in advance of dispatch, eg in the Day Ahead. This type of arrangement would enable plants to be operated in a manner that would largely match the deemed dispatch. Without such arrangement the lack of reliable advance pricing signals conflicts with the need for advanced nomination of gas deliveries and effectively prevents matching of actual operation with deemed operation. This risk is extremely difficult to mitigate in advance of an effective DAM. Due to the uncertainties in the introduction of the DAM, it is not possible even to quantify the duration of this risk. This will seriously complicate risk assessment by potential suppliers, and may materially impact the overall cost of new generation.

Oversimplification of start-up cost treatment

The provision for compensation for unit start-up costs as contemplated is too simplistic. There are material costs for the fuel used during start-up as well as additional wear and tear on equipment. In general start-up costs should be built into the imputed cost calculations associated with real time market operation.

Lack of criteria for comparative evaluation of DR/DSM and generation

In previous meetings with the Ministry and NERA, we have advised that it is difficult to compare supply solutions and DR/DSM. Without a level playing field between the two, unnecessary biases and cost inefficiencies could arise.

For example, there is a lack of detail in the public domain about evaluation of:

- Seasonal impacts of DR & DSM profiles (i.e., will all be assessed on the basis of July / August capabilities?)
- Comparisons of 5 year contract term with 20 year contract term
- Impact of commissioning date

APPrO suggests that this issue requires much further work, if the province is to bring forward optimum solutions under this and future RFPs.

DR & DSM Verification program

The RFQ indicates that “Proponents must provide a Measurement and Verification Plan for the Project Annual Savings.” (p. 22-23). Unless this Measurement and Verification Plan conforms to accepted industry measurement and verification protocols, this is likely to create a number of issues when evaluating DSM proposals.

The quality of the Measurement and Verification Plan (M&V Plan) is critical to ensuring that

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DSM savings are realized and that DSM proposals can be properly compared to each other and to clean generation alternatives. There are numerous examples of DSM bidding programs that failed to deliver anticipated savings because the M&V Plan was inadequate. This resulted in the buyer paying for savings which were considerably higher than achieved. Industry practice is that the buyer specifies M&V protocols that all DSM projects must meet. There are several such protocols that have widespread acceptance. Without such a requirement if proposals have different M&V protocols it is extremely difficult (virtually impossible) to evaluate properly and make selection decisions that adequately consider the relative risks of the different proposals. Furthermore, the evaluation framework proposed does not allow for the consideration of the relative risks of DSM resources based on differences in the M&V protocols. Without such protections there is an incentive for DSM proponents to propose M&V protocols that overstate realized savings.

The industry standard is the International Performance Measurement & Verification Protocols (IPMVP) that were developed by multiple stakeholders. The US Federal Energy Management Protocols (FEMP) are derived from IPMVP and are somewhat more operational in perspective. The New York State Energy Research and Development Administration (NYSERDA) protocols are also derived from IPMVP, and perhaps easier to use in administering a utility program or DSM bid. The NYSERDA program establishes a one or 2 year measurement period based upon the difficulty of predicting energy savings from "as-built" conditions.

These risks are compounded by the fact that the RFI/RFQ appears to allow the DSM Proponent to specify the load profile proposed for the DSM project. Under this framework, the DSM Proponent can specify an unrealistic load shape that benefits its proposal and then specify a measurement and verification framework that enables the Proponent to overstate the level of savings realized. The third party technical consultant to verify that savings are realized is unlikely to provide sufficient protection given that this consultant is engaged by the Proponent at its own cost. While this technical consultant must be acceptable to the Buyer, if the means by which savings are measured is inadequate a third party technical consultant engaged by the Proponent is not a sufficient safeguard against biased savings estimates that favour DSM projects.

Additionally, we note that there is no requirement to post the terms of the DSM contracts publicly to ensure the parties are living up to responsible commitments, and for ratepayers to know what are the obligations on a party pursuing a DSM contract. In other jurisdictions such contracts have been included in the RFP. The issues here is how to ensure the penalties for non-performance and how they are established are matters for the public record, even if figures and names are not.

Protection against cross-subsidization by OPG or regulated entities

While the RFI/RFP contemplates the possibility of private interests entering into commercial arrangements with OPG or other regulated entities, other proponents have no way of knowing if the commercial terms with such entities are more beneficial than might otherwise have been obtained under similar circumstances operating on a purely commercial basis. We wouldn't expect otherwise, but financial arrangements require solid assurances in this respect. It is simply good

practice to ensure that the nature of the arrangements that such parties enter into should be vetted by a third party to ensure they are fair, during the evaluation process.

Incomplete response to questions

A number of APPrO members maintain that they have never received a response to questions they posted on the 300 MW RFP. Other responses have been incomplete. This is also a criticism of the technical conference held last month. It appears to be largely a one-way street that places limits on serious discussion of certain complex issues which are arising from the RFPs. We understand the need for fairness – but we maintain that the principles of open discussion, transparency and fairness are not incompatible. The Ministry has made some important strides in this area, but can do more.

On a related issue, APPrO members are asking about the technical committee evaluating the proposals. Again, it is important that the make-up of this committee and the credentials of its members be made known to proponents so that they and the wider public can have faith that the process is technically and financially robust and fair.

Other

The 5% timing bonus for achieving commercial operation before December 31, 2006 appears to have been explicitly structured to benefit only projects that received environmental approval prior to the 2500 MW RFP announcement. Since the government has stated that coal-fired projects are targeted to be phased out in 2007, there is little system requirement for these new projects to enter into service before 2007. The early commercial operation bonuses should be designed to allow all proponents to compete fairly.

In addition there were some other concerns raised in our commentary on the renewables RFP which remain unaddressed. A key example of this would be the treatment of expansions and upgrades, which seem to be excluded without a complete explanation. APPrO is also puzzled as to why these should be excluded if verifiable results can be achieved. There seems to be two sets of issues here;

- Offer to an RFP bid of an upgrade or expansion, and
- Later expansion & upgrade of an RFP facility – presumably there would be nothing to preclude this being permitted if entirely at the generator's risk.

We also want to reiterate our previous recommendations about distributed generation. We see no reason for the a priori exclusion of projects under 5MW from the 2500 MW RFP and feel that such a rule is discriminatory in the sense that smaller DSM projects are permitted to aggregate to reach 5 MW. The best way to address this problem would be through a standard contract offer for small scale projects, using standard prices determined through the other RFPs and by relaxing the requirement for IMO market participation.

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Finally, in addition to submission of this document, a number of APPrO members will be submitting comments and questions individually on the RFP provisions. Of course, our comments represent the general view of the organization and may differ in some cases from the positions of individual members. Similar correspondence is being sent simultaneously to the Ministry of Energy.

APPrO looks forward to working with the Ministry and its advisors over the coming weeks and months and we are committed to ensuring that these processes produce their intended results at the best cost and in the fairest manner.

Sincerely,

A handwritten signature in black ink, appearing to read 'D. Butters', written over a large, light-colored oval shape.

David Butters
President