



APPrO

ASSOCIATION OF
POWER PRODUCERS
OF ONTARIO

May 20, 2004

Technical Advisors
Ontario Electricity RFP
Toronto, Ontario

Dear Sirs,

Ontario's power producers welcome the recent Request for Qualifications (RFQ) for Renewable Energy as an important step in addressing Ontario's electricity supply while at the same time moving forward on the government's commitment to a greater role for renewable energy in Ontario's energy mix. As we noted on April 29, this is a concrete commitment that bodes well for clean air and more reliable energy supply in Ontario, and is likely to bring out firm proposals for new environmentally-friendly power supplies.

Clearly, Ontario needs to bring on the most cost-effective renewable power within the RFP framework in as efficient and timely a fashion as possible. Therefore, the RFP 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.

In general APPrO believes that the current RFP process is a good start but needs improvement. It appears to be consistent with APPrO recommendations to the government especially on the clarity of the evaluation criteria. With modifications it can deliver solid benefits. This will send both an important signal to potential investors and set important precedents for future RFPs.

APPrO's primary concerns focus on two major areas:

- Financeability (i.e., counter-party creditworthiness and contract duration)
- A need for further development on a number of technical and financial issues affecting how the bids will be assessed.

Financeability

Creditworthiness

The creditworthiness of the Ontario Power Authority (OPA) will be vitally important to success in this current tranche of RFPs and for future contracted arrangements between

the Province and power producers. The duration of contracts is also a significant issue. Stronger credit assurance and longer terms reduce prices.

APPrO believes that:

- The OPA must be demonstrably able to sustain a revenue stream over the life of the contracts through clear legislative and statutory authority;
- The OPA must have at a minimum the equivalent credit rating as the OEFC
- The OPA must demonstrate that there are in place clear remedies for successful proponents should its credit fall below this mark
- The Legislative framework in which the OPA is embedded demonstrates certainty going forward.

We understand that these considerations are likely to be addressed in forthcoming legislation. However, as the legislation if passed into law will not be proclaimed until later this year, it is important that the government make its intentions in this regard known as early as possible.

Contract duration alternatives and a standardized escalation feature within the contracts
Longer terms can allow fixing of variable costs (fuel, etc.) and reduced volatility. Lowest financing cost comes when contract term is tied to asset life. APPrO recommends that proponents be allowed to optionally bid for 20 years (or other periods) in addition to 15 years. In addition a standard escalation factor - say 2%, to avoid front-end price shock should be instituted. Longer term enables financing at lower cost per unit.

A need for further development on a number of issues

These are addressed more fully in the attached Appendix. It includes the following:

- Arbitration procedure for unexpected changes in conditions
- SIA and CIA requirements in the context of time constraints
- Need to de-couple project size and contracted amount
- Long-term arrangements
- Unnecessary stipulations
- Non-Collusion provisions
- Demonstration of financial backing
- Risk management
- Inclusion of ERG (Energy Recovery Generation).

Existing Generation

As you know, there is broad agreement that the RFP process should not in any way disadvantage or prejudice existing generation in the province. We were pleased to hear that sentiment confirmed in recent meetings with Ministry officials. We would recommend

trying to have concrete propositions under development for existing generators on approximately the same time schedule as the development of the contracts under the first two RFPs.

Contracts for Differences

The RFQ referred to the contract as a "financial bilateral agreement", i.e. a Contract for Differences. The Draft Contract now released is a physical supply contract where OPA is the Metered Market Participant. In this arrangement, the OPA makes all payments to the generator, not just making up for differences from the market price. This has significant credit issues, and is less flexible with respect to embedded projects.

Greater flexibility and enhanced project value can be achieved by structuring payments as contracts for differences. It would also relieve government of some major responsibilities associated with acting as the "Metered Market Participant."

Finally, in addition to submission of these documents, we believe that 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 you and your colleagues and advisors over the coming weeks and months to ensure that the process produces its intended results.

Sincerely,

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

David Butters
President

Cc NERA Economic Consulting
(via website at: <http://www.ontarioelectricityrfp.ca/>)

APPrO Detailed Recommendations* on the Renewable Energy RFQ
May 20, 2004

1. Creditworthiness, longer terms, and escalators will all reduce initial prices

The primary reason APPrO is recommending the use of highly creditworthy counterparties, longer contract terms and standard escalators on bid prices is that each of these measures will serve to reduce bid prices, or initial bid prices in the case of escalators.

The public acceptance of the contracting process will depend to a large degree on the level of prices that come forward. Power prices usually increase when new capacity is built, and the increase could be steeper in Ontario than elsewhere. Therefore it's particularly important to take steps to moderate the likely bid prices such as those mentioned above.

APPrO's recommendations on creditworthiness largely focus on the legislative basis for the OPA to sustain a revenue stream over the life of the contracts, but also depend on assurance that contracts, once signed, will not be transferred to another agency with lower creditworthiness.

On contract terms we recommend that bidders be invited to submit both 15 and 20 year bids, at their option. Government will then have a basis on which to compare the prices that become available with longer terms.

There are two potential approaches to escalators: Either a standard escalator can be used to make sure that proponents do not have to heavily front-end load their bids. Or market-based escalators can be used: these have the benefits of the first approach but also allow both sides to benefit from risk-sharing. (For example, prices rise in step with CPI.)

2. Arbitration re: changes in laws or regulation

Any changes in law or regulation that affect the position of the contractor or contractee should be subject to arbitration, to preserve the original intent of the contract - unless of course the regulatory or legal change was under the control of the affected party. This would reduce risk and incent each party to be cautious about making changes that would negatively impact the other.

* The order of the following recommendations is not intended to suggest their relative order of priority.

3. System and Customer Impact Assessment requirements in the context of time constraints

While fully complete System Impact Assessments and Customer Impact Assessments are desirable, we recommend that in cases where Hydro One is unable to complete a Customer Impact Assessment (CIA) within the necessary time-frame, that a preliminary CIA from Hydro One be deemed acceptable, and that in such cases the associated System Impact Assessment be considered acceptable if it is otherwise complete, recognizing that final approval is conditional on the completion of the full CIA in due course. This way, proponents will not be held liable for delays outside their control.

We encourage the Government to talk to the IMO and Hydro One and we recommend that the Government modify its requirements and stipulate that Project(s) must have completed a SIA, conditional upon a completed CIA and a completed draft version of the CIA that does not necessarily incorporate direct feedback from all relevant customers potentially affected by the Project.

4. Need to de-couple project size and contracted amount

It appears that nameplate capacity is assumed to be related to the size of the contract. In our view, nameplate capacity should be irrelevant to the amount of services provided under the contract. As a matter of public policy, the more power that can be supplied outside the contract, the better.

Concern has been expressed by APPRO members that the agreement appears on its surface to give government a first right of refusal to power produced above the defined capacity. This kind of presumption would be counter-productive and should be removed if it was implied in the first place. If it is the government's intention to maintain exclusivity rights, then that should be clarified and paid for separately. (Reference page 6, end of first full paragraph "For the energy supplied in excess of the cap set out in the RES Contract, the supplier would receive a proportion of the revenues associated with the difference between the market clearing price and the supplier's actual cost of energy production at the facility.")

There should be some greater percentage revenue-sharing for selling above the cap in times when the Proponent does not wish to do so voluntarily.

5. Existing Generation

Existing generators must not be prejudiced as a result of the RFP. They should have the opportunity to earn a fair rate of return on their investment. They can be expected to be

exposed to development risk (including financing, permitting and other risks) production risk and environmental performance risk.

APPrO has publicly advocated inclusion in the RFP of anything commissioned after April 2001.

6. Longer-term market structure

The present RFP does not deal with the need for a capacity market in Ontario. In principle this should be covered in the broader context of the second RFP. If there are expectations about how contracts under the RFP will be transferred to a competitive model, proponents would need to know that information. More broadly, if there are expectations that the system overall will move from one where supply is driven by government contracting to one where there is a long term resource adequacy mechanism, this will require some development.

7. Revenue Sharing

Sharing upside revenues will:

- Incent appropriate real time behaviour
- Improve investor and lender confidence
- Reduce bid prices

There needs to be a general approach to the sharing of revenues from the sale of ancillary services that will be both economic and equitable. If all the benefit goes inequitably to one party or the other, then one party will have no incentive to maximize value in that area. For this reason, we recommend 50/50 basis for sharing revenues from ancillary services.

The performance incentives should be extended to include adjustments for delivery of energy when it is more valuable; e.g. some wind power facilities can deliver more output during winter, often coincident with peak demand.

Such revenue sharing will also reduce bid prices.

8. Unnecessary stipulations

Precipitation data should not be necessary for most waterpower proposals. Site hydrology is usually based on water flow data in which precipitation is already recognized.

The use of refurbished equipment should be acceptable, since that is essentially a matter of the proponent's business risk. The stipulation that equipment must be new should be removed. This will allow cost reduction in some cases.

9. Non-Collusion provisions

The non-collusion stipulations would appear to prohibit many otherwise sound proposals that make use of input from partners or consultants associated with other projects. This can be addressed through a statutory declaration such as that used in British Columbia:

“Each bidder represents and warrants to BC Hydro that its Tender has been fairly prepared without collusion or fraud and in particular and without limitation:

- (i) the price and its tender has been arrived at independently from that of any other bidder;
- (ii) no attempt has been made, nor will be made, to induce any other person not to submit a Tender or take any other act or omission for the purpose of restricting complication; and
- (iii) the bidder has required its consultants, advisors and contractors to comply with the foregoing provisions. The foregoing does not preclude a bidder holding a financial interest whether by way of ownership in whole or in part and directly or indirectly, or otherwise, in another bidder.”

In principle, people should be allowed to work on multiple projects, but they should be prevented from having knowledge of or participating in the bid pricing on more than one project.

10. Demonstration of financial backing

We recommend that letters of intent from equity and debt providers should be acceptable in lieu of legally binding commitments for equity or debt. Perhaps some minimum standards could be established for such letters of intent.

The Proposal security and net worth requirements as put forward appear to be approximately an order of magnitude too high. We recommend \$5000/MW for proposal security with a cap in the range of \$500,000 and similar adjustments to net worth requirement. Completion and Performance fees should be similarly reduced and should disappear on commercial operation.

11. Risk management

Proponents should be allowed to submit a proposal price that is subject to changes in

interest rates, changes in foreign exchange rate and changes in connection costs, according to pre-determined indexes. This would relieve proponents from the need to build in a buffer, and would thereby reduce bid prices.

Similarly, once a bid has been selected and an RES Contract has been entered into, the RES Contract should provide for changes in the price to reflect changes in law or regulation that will increase the costs of compliance and of operation of the Renewable Generating Facility.

Liquidated damages should be mitigated if delays are caused by government, regulatory or government owned or controlled bodies.

There is need for a standard provision to cover currency and commodity risks during the 6 months between submission and contract execution. This will also relieve proponents from the need to build in a buffer, and thereby reduce bid prices.

If the Government wishes to incent parties to complete projects ahead of time as well as to punish them for failure to meet deadlines, then a system of bonuses for early completion should be considered.

Proponents should be allowed to amend their Statements of Qualifications to reflect changes in the basic information.

12. Standard offer for smaller projects

Distributed generation-type projects will probably require a “standard offer” for smaller projects, as well as removal of the stipulation about IMO market participation which acts as a barrier to embedded projects.

13. Co-ordination with Ontario’s system for emission trading

It will be important for the RFP process to support and if possible enhance the integrity of the province’s existing framework for regulating emissions, including the emission trading system. The Ontario Emission Trading Code is an important system for recognizing the environmental costs and benefits of various options, and it enables relatively objective comparisons in cases where impacts are complex. Generators have already begun to make investments which rely on projected estimates of the forward value of emission reductions – as the system intended them to do.

If it has not already done so, we recommend that the Ministry of Energy engage fully with the Ministry of the Environment to make sure that the RFP process is co-ordinated with the emission trading system. We recommend further that one or both of the Ministries

issue statements clarifying how emission issues will be administered in the context of the RFPs going forward.

14. Inclusion of other zero emission technologies

It is important that Ontario not be too narrow in its definition of what is eligible for the RFP. Other technologies with no significant environmental emissions should be considered for inclusion. One example of this kind of technology would be ERG or Energy Recovery Generation, based on recovery of waste heat. Net emissions are usually well below zero given the amount of thermal generation it would normally displace.

E.R.G. (Energy Recovery Generation) is defined as electricity that:

- Is generated from the surplus (waste) energy contained in gas or liquid flows stemming usually from industrial or commercial process, and
- Has incremental emissions near zero but in all instances has a greenhouse gas emissions intensity <0.375 tonnes/MWh.

15. Further comments

Note that intermittent renewables can not factor very much revenue from Operating Reserve (OR) into their pricing proposals since they cannot plan to produce during peak periods.

Recommended Allocation of Risk

Generator	Buyer
Development (financing and permitting)	Market regulation changes
Construction (time and cost)	
Operation performance	Environmental regulation changes
Operating cost	
Environmental performance	Credit / payment risk

Fuel price risk needs to be assigned to optimize economic efficiency (e.g. tolling contracts). After a prolonged period of regulatory stability, generators will be able to

assume additional risk.