

Notes for Remarks

Ontario's electricity supply – what is the status?

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(Check against delivery)

Good afternoon ladies and gentlemen, and thank you for the opportunity to speak to you.

The topic I've been asked to address is the status of Ontario's electricity supply:

Are conditions sufficient to ensure we have what we need, when we need, at a price we can afford?

What are the options available to us?

Is Ontario ready for investments that will be needed over the coming months and years in order to secure our energy future.

But first a bit about APPrO.

APPrO is the collective voice of generators in Ontario: a non-profit organization representing more than 100 companies involved in the generation of electricity in Ontario. APPrO members produce power from co-generation, hydro-electric, gas, coal, nuclear, wind energy,

waste wood and other sources. Our members currently produce over 95% of the electricity made in Ontario, and include both investor-owned and publicly-owned generators. Our mission is "To promote the interests of electricity generators within a open and competitive power industry in Ontario."

APPPrO's objective in electricity restructuring is to achieve an open and competitive power industry in Ontario with multiple sellers and buyers, providing reliable supply and incenting reliable and economically efficient operation, supporting private sector investment and appropriate allocation of risk, and providing a healthy, equitable and environmentally-responsible business environment. These are the tests by which we are measuring the government's success in its restructuring efforts.

But back to our topic for today: the status of Ontario's supply needs.

That's a big question to answer, and one many people have pondered at length for some time. In fact a whole industry has

developed around this issue, and it is growing daily. Just look a round you in this room....

Coincidentally, I've just come back from IPPSA's conference in Alberta where many of the same questions are being asked there – and Alberta is widely viewed as a success in deregulation so we are not alone. Even in Texas, they are asking the same questions – and in both these jurisdictions capacity exceeds demand by substantial margins approaching 30%.

Hopefully this conference will examine whether or not Ontario can meet its electricity supply needs but at a more fundamental level it's about whether or not we can establish a true cooperative partnership between private capital and governments. We need to do this in Ontario and in other jurisdictions because taxpayers simply cannot shoulder the burdens – and risks – of investment in essential infrastructure.

Let's cut to the chase -- reinvesting in energy infrastructure in Canada and indeed Ontario is arguably the single most important public policy

challenge facing Canada and especially Ontario today. Very large amounts of capital need to be secured, and basic questions need to be addressed about the degree of competition and the regulatory structures into which that investment must be attracted. In addition public policy needs to deal with an increasingly thorny challenge in terms of managing price increases.

Despite continued demand growth in world and North American energy markets, investments in energy supply and infrastructure (which includes electricity transmission and distribution) in Ontario are lagging. A new reality of higher prices coupled with very large investment needs for new and replacement capacity as well as new technology and environmental improvements has put energy back into the public policy and investment climate spotlight, and I would wager that it will become even more central as time goes on.

In short, energy has become a strategic issue because energy is the essential underpinning to much of Ontario's economic prosperity.

The next several slides illustrate this very well.

But it isn't just about investment – we need to consider the public interest.

As Ontario discovered so graphically in August 2003, with a blackout that affected 50 million people and 61,800 MW of electric load in Ohio, Michigan, Pennsylvania, New York, Vermont, Massachusetts, Connecticut, New Jersey and Ontario, electricity has value well beyond that normally recognized in its price.

The Blackout illustrated (if I could use that word) the central importance of electricity to the functioning of modern society. It also revealed the vulnerability of our electric system and raised serious questions about the management and operation of the North American electric system.

It underscored a key reality for all participants in Ontario's electricity sector: the key jugular issues are energy security and reliability for Ontario's citizens, and affordability both for individual consumers and to support the industries on which they rely for jobs. Electricity is the very life blood of Ontario's economy. There's no getting around it:

without an adequate, reliable and affordable supply of electricity the prosperity and quality of life we enjoy in this province would not be possible.

To achieve this, APPrO has argued that the overall policy framework for Ontario's energy industry needs to be clear, stable, and sensitive to the competition for investor capital: Ontario needs an energy policy -- not just an electricity policy -- and framework that reconfirms its commitment to a rules-based, competitive approach to energy investment and supply. If our policy and regulatory processes are clear, sustainable, efficient and effective, these and many other of Ontario's advantages will ensure we are a destination of choice for energy investment.

All investors in generation, transmission and distribution (private and public) recognize that their investments are for the long term. The best prices are available to consumers when infrastructure investments can be amortized over significant time-frames. A stable energy framework is necessary in order that infrastructure capital costs and financing can be spread over a long period.

Uncertainty about the regulatory framework makes it difficult to predict industry structure or market expectations, and this deters long term, large-scale capital investment – or at the least, makes it more expensive with the addition of needless risk premiums.

So, given the long lead times required to bring new capacity and transmission on-line, we need to stabilize our energy policy in order to provide a more certain foundation for the sector over the long-term, and to attract new investment to Ontario. A period of regulatory and legislative stability will demonstrate that Ontario is a solid jurisdiction in which to invest.

The conclusion is that we need a new energy framework in Ontario to meet today's needs:

- The need to ensure secure, reliable supply: energy investment is not keeping up with demand growth or the need to replace aging delivery infrastructure;

- The need to adapt to higher prices: driven by fast growing world demand and growing dependence on remote and energy unconventional sources;
- The need to meet growing environmental imperatives: greenhouse gas emissions are only one part of a complex portfolio of environmental issues.

Consumer education continues to be a critical area of development to transition Ontario to a robustly competitive market. Ontarians must be empowered and provided with the information necessary to make informed choices as consumers, which includes providing them with an understanding of the tools available to them to assist Ontario in conserving electricity.

So that's the overarching policy framework we see working for Ontario.

What is does the investment climate for Ontario's electricity sector look like?

We think it looks promising but are prevailing conditions sufficient to ensure that enough reasonably-priced supply will be built in the short time available? How do we ensure the system encourages healthy competition? How do we create a level playing field amongst the various supply options? How do we promote efficient development while looking after our environmental responsibilities? The fact is that we still need long term PPAs to persuade investors to put their money into generation whether it's here or elsewhere.

Basically, generators (and their investors) need to see:

- A stable political dynamic, with no undue political interference;
- Allocation of resources to government owned parties based on a rational and transparent application of long term policy;
- A stable independent regulatory environment with a commitment to regulation that aims to coordinate and, where possible, harmonize regulatory requirements among departments and agencies within governments and jurisdictions without undue regulatory or economic burden;
- Certainty and continuity in energy and environmental policy;

- Creditworthy power purchasers who are willing to enter into long term contracts, predictable pricing over the long term, the ability to hedge risk, willing financiers and finally,
- A level playing field for all participants.

So where are we against these factors?

First it's important to note that we have made progress. We believe the government has the right intentions and generally the right goals.

We believe that the Ontario government understands the benefits of a competitive market, and is prepared to allow the market to evolve by bringing Ontario's electricity sector to an appropriate balance between regulation and open markets. It's a bold experiment but the government's evolutionary approach may be the right one. In theory, a hybrid market should work -- it's not a bad place to build a foundation for evolution -- time of course will tell. It's encouraging that over the past 18 months we haven't moved backwards -- and that's progress in this sector...

Bill 100 was an important milestone in our energy journey. APPrO members were part Ontario's Electricity Conservation and Supply Task Force, and this Bill and the government's underlying policy approach reflect many of the Task Force's recommendations to achieve a balanced energy supply from a variety of technologies. Everyone who is here today should be familiar with the supply challenge Ontario faces.

As the Minister of Energy and others have noted, factoring in the growth of our economy, we will need to refurbish, rebuild or replace 25,000 megawatts of generating capacity over the next 20 years.

That represents more than 80 per cent of Ontario's current capacity of about 30,500 megawatts.

The estimate is that that this will require an investment anywhere from 25 to 40 billion dollars, depending on what generation resources we choose to build, and when.

This will require Ontario to move to a state where prices reflect the true cost of power but of course we recognize that the government will have to balance this with the need for fair and competitive electricity costs to support the sustainability of our economy. It will no mean feat to balance a huge array of competing priorities and interests, and to ensure we're getting it right.

Part of the recipe the government has brought forward includes the introduction of a new body called the Ontario Power Authority.

The OPA will have the ultimate responsibility for ensuring long-term electricity supply adequacy in the province, principally through what will be known as the Integrated Power System. The Integrated Power System Plan will lay out a plan for conservation, supply, and transmission that will hopefully ensure an adequate supply of electricity based on a 20-year outlook.

Aside from its planning function, the OPA will also have the ability to procure supply, if necessary.

The current reality is that there is an opportunity to bring forward robust generation projects with quality sponsors if there are creditworthy off-takers. This means power purchase agreements with the OPA. While one obvious process for procurement would be a "request for proposal" process, similar to the two RFPs Ontario has already initiated, these need not be the only way to ensure that adequate generation supply is developed in Ontario.

Bilateral negotiations (like the Bruce 1 & 2 restart discussions) are another way. And various forward markets could begin to fill this role more effectively over time.

APPPrO supports ongoing evolution of the IMO/IESO market.

We need this to provide a safe reliable supply of electricity in the most economical manner, mobilizing the benefits of competition and of private capital and expertise.

It's our view that current capacity procurement activities (e.g., RFPs, bilateral negotiations) should not replace efforts to arrive at a general long term resource adequacy mechanism that is market based and

that could ultimately take over from RFPs. Our strong trading relationships with NY and other states where such structures exist suggest we should have similar structures. Forward markets provide reliability benefits and bring gas and electricity closer together. Furthermore, we should be able to see a better price regime if participants have a clearer view of the market

APPPrO believes that unless this issue is successfully managed, it will be impossible for Ontario to transition out of an RFP-based approach to supply adequacy.

We would not want this to drop off the policy agenda while we focus on Ontario's current supply challenges.

To make that a reality, multiple competitors will be required not only on the supply side, but also on the demand side.

Some have suggested that Ontario needs to develop "load-serving entities", other have suggested that the Regulated Price Plan covering small consumers' needs to be managed differently.

We recognize that this is an area that requires further policy development and we encourage the government and all stakeholders to focus their efforts in the near term to work out a durable solution that would move us toward multiple buyers and multiple sellers.

Last June, the government announced that it was seeking proposals for 2,500 megawatts of new electricity capacity through either generation or conservation initiatives. In response, they received 33 proposals, offering a variety of options for new power by 2007.

We expect that the results will be announced in the coming weeks.

Reflecting important environmental objectives the government has set a target that 5 per cent of all electricity will come from new renewable sources by 2007. By 2010, the target increases to 10 per cent – or 2,700 megawatts.

Late last year at the APPrO 2004 Conference the government completed a call for proposals for 300 megawatts of electricity from

renewable sources. In fact, they were able to secure contracts to provide 395 megawatts of renewable energy – more than they anticipated -- mostly from wind power projects, but also from small hydro and biomass projects.

This is a good sign and, over the next few weeks, we expect to see an additional renewables RFP process.

These two RFPs were a reasonable first start but there is lots of room for improvement...

What worked well?

- The overall integrity of the process was unquestioned.
- Overall, technical requirements were well-thought out.
- Overall, pre and post bid processes worked well – however, the Q&A system needs improvement and better responsiveness
- Financial requirements were onerous but it can be argued that they did enforce greater discipline.
- It is very encouraging that the government has announced the second renewable RFP so soon after awarding the first – this

suggests that the 31 bids not selected in the first round are substantive projects.

What didn't work so well?

- 21 of the 41 proposals submitted were disqualified because of a misinterpretation of the RFP document. Further clarity is required in the upcoming RFP.
- There was much ambiguity in the financial requirements as set out in the RFP.
- The RFP assumed that most project developers are far along in the permitting process. Therefore, it cuts out a lot of small developers who do not have the financial wherewithal to spend a considerable amount of money on permitting a long time before an RFP is issued. The criteria for proponent selection should be made less onerous so that more 'early stage' projects have an opportunity to get picked.

The ideal procurement process would:

- Better recognize the time required to develop renewable facilities;

- Provide better flexibility to accommodate and encourage projects that are not completely developed to be submitted to an RFP;
- Encourage as many qualified participants as possible, regardless of size;
- Provide a schedule showing the amount and timing of renewables to be secured in order to take the mystery out of the government's expectations/requirements;

What we should be encouraging is the development of optimal renewable projects and ensuring the broadest level of qualified participation and competition.

But this also begs the question around supply needs. As these slides illustrate well, if the government does intend to phase out all coal by the end of 2007 (a year in which we will have an election) then we should have an honest and open debate about how we are going to do this and what the risks of the various options really are.

Again, the key thing is to bring forward solutions that may be optimal in terms of economic and environmental cost/benefit.

Perhaps we need to reconsider the timelines for this, and we should definitely consider keeping these units into the near term at least as “insurance” against any significant unplanned outages that could occur among our remaining fleet.

There is another key policy area which has huge impacts on supply: the sector strategy for Transmission and Distribution, both in its own right and for its major impact on generation investment and operation in Ontario.

The Ministry’s current consultation paper identifies the challenges largely from the perspective of the participants in the transmission and distribution sub-sectors. But it is important that Ontario transmission and distribution issues be viewed in the broader industry context, and that the policy solutions drive towards the safety, reliability and economy of supply to consumers in a way that is stable and sustainable for the whole electricity sector.

In circumstances where transmission and generation compete we need to consider the long term plan - not just short term.

An important principle for the OPA in undertaking its integrated planning function will be a reasoned analysis of transmission and generation options to arrive at the best solution in light of a number of environmental, cost and supply issues.

Transmission planning must be proactive in nature so the transmission system must efficiently anticipate and keep pace with forecast growth in demand and the anticipated generation development to meet that demand throughout the province. However, optimal solutions demand that the OPA (and OEB) need to avoid either under-investment or over-investment in transmission.

Transmission and distribution must serve and facilitate Ontario's hybrid market. There are four key points here:

- Transmission should be reinforced so that most economic wholesale transactions can be realized with minimal congestion.
- Transmission development must also recognize that inter-ties are an essential part of a competitive market.
- We need fair and effective policies to resolve issues which will arise from a hybrid system.
- Again, we need multiple contract buyers for the regulated small consumer supply, but do not have attachment to any one particular model for this.

We should also keep the same focus on new transmission build as we are doing in generation – there's no reason private sector capital can't be employed to meet growth needs. It would be wrong to assume that Hydro One is the only possible builder or investor

Private bidders can offer to invest and/or build in exchange for a predetermined revenue stream. This could transfer financing, construction and maintenance risk to the private sector and off the public. If we rule out private development as an option, we may end

up stretching Hydro One to the point where it can't do all the other things it needs to do. This suggestion is intended to optimize scarce public resources and get lower priced construction, not to advance any privatization agenda -- central operating control need not be weakened

This illustrates I think that T&D Policy directions must be framed by principles, goals, objectives and issues. Once these are articulated, strategic options can be discussed. This needs to be a first order of business in these discussions. A government policy on delivery (T&D) of supply is needed to provide guideline for the formulation of an integrated plan.

In conclusion, we are making progress. We have a long way to go, but I believe we are putting in place some fundamentals that will provide a reasonable foundation upon which we can build. It seems to me however that we need to arrive at a shared understanding of the appropriate role of market forces and private capital in the electricity sector. Until we achieve this our ability to achieve our

common goals and objectives will be in doubt. None of us can afford that.

Thank you.