

The Ontario Power Generation Review Committee

Transforming Ontario's Power Generation Company

(Yannick Vennes, Econalysis Consulting Services Inc., March 22, 2004)

Introduction

In response to perceived financial, operational and governance problems that plagued Crown corporation Ontario Power Generation (“OPG”), the Ontario Minister of Energy Dwight Duncan announced on December 16, 2003 the formation of the OPG Review Committee. The Committee, chaired by former federal Finance Minister John Manley, was asked to provide advice on long-term issues such as the role of OPG in the Ontario electricity market, the appropriate structure of OPG, its corporate governance and senior management structure, and the potential refurbishing of Pickering A Units 1, 2 and 3. The Committee’s final report was handed to the Government of Ontario on March 15, 2004.

The Committee was of the view that two major problems plagued the utility and the electricity sector in Ontario. First, the Committee noted that the sector had been destabilized by abrupt and often unpredictable policy swings. Second, OPG’s internal problems were of significance. In summary, the Committee concluded, OPG looked like a company that was neither well-run nor well-governed.

In delivering its report to the Government the Committee relied on three guiding principles:

- OPG should remain a government-owned company;
- OPG should be given the tools and mandate to become an effective steward of public assets; and
- OPG should be one of many suppliers of electricity to the Ontario grid.

Supply Options for Ontario:

In the longer run, the Committee said the market design in Ontario should aim to be self-sufficient in electricity, including an appropriate reserve margin, and pricing should reflect the full cost of electricity. In addition, the Committee warned the Government against being too much reliant on imports from neighbouring jurisdictions to supply power to Ontario, as those jurisdictions may be facing high demand as well. Also, Ontario should try and increase the diversity of supply sources to enhance reliability and security of supply, including green power, hydraulic, natural gas and nuclear.

The Committee commented on the Government’s stated intention of decommissioning of OPG’s coal fired plants, which will likely result in important supply planning challenges as well as in electricity cost increases. However, the Committee acknowledged that other benefits, such as improved environment, health and productivity, may result from the decommissioning of those plants.

The Committee also pointed out at nuclear plants as a way to provide reliable and cost-

effective base load power, and more stable prices. In the Committee's view, Ontario should begin planning new investments in the nuclear technology to eventually replace current facilities. The other supply options, however important they were, were not seen as being capable of fully bridging the supply gap.

Role, Structure and Governance of OPG:

It was the Committee's view that OPG should become rate-regulated by the Ontario Energy Board. In addition, OPG should focus on its major operating assets (nuclear, hydro-electric and fossil facilities), and exit from non-core electricity businesses, such as wind power, solar power, biomass and small hydro projects. The Committee also recommended that the OPG exit from the North American markets. OPG's involvement in new, large scale generation projects should be assessed by an independent authority that would oversee Ontario's electric supply planning; new generation should in principle be left to the private sector.

The Committee proposed the internal restructuring of OPG into two distinct business units: one for the nuclear generating business and one for the other generating business, each with its own management team. Furthermore, the Committee made a number of recommendations addressing OPG's governance problems to improve accountability and transparency within the organization. The Committee particularly stressed the need for the Company to articulate a clear mission and vision about its role and goals, through the issuance of five-year strategic plans on an annual basis. The Committee further stressed the importance of control systems to manage risks and monitor progress, especially in the nuclear business unit. In addition, the Committee urged the utility to improve internal labour relations and personnel morale.

Pickering:

The Committee recommended that the Unit 1 project proceed under the risk management measures having been put in place by the OPG project management team. The total cost of the project was estimated to be within the \$775 to \$925 million, and at that cost the Unit 1-produced electricity should be competitive relative to a combined cycle gas fired plant. In addition, success in the Unit 1 project was seen of paramount importance in the eventual decision to proceed with the refurbishing of Pickering A's Units 2 and 3.

Comments:

The OPG Review Committee's report is conceivably one of the most comprehensive report on the future of the most important electricity supplier in Ontario since the break-up of the predecessor utility Ontario Hydro. The Committee calls on Ontario citizens and stakeholders to draw lessons from the painful experience of the past few years. By focusing on standard management issues (determination of the mission, governance, control systems, risk management, etc.) the Committee highlights the need for OPG to

act independently and as any other corporation, but at the same time as a Province-owned utility it needs to be held accountable for its actions.

Although it was not explicitly stated in the report, the Committee's recommendations that OPG remain responsible for its older hydro, fossil and nuclear facilities and be rate-regulated may form the basis for an Ontario-type of Heritage Contract in the likes of British Columbia and Québec. This, in turn, is a long way from the market design that was envisioned at the time market opening was undertaken. How such recommendations would be consistent with full deregulation (and the premise that risks should be borne by investors rather than customers) is still unknown at this point, as well as the exact role OPG and private investors would play in meeting future electricity demand in Ontario. More specifically, who would oversee the electricity supply planning, how that party would fulfil its role, and what would be the mechanism to call OPG to step in the future generation business are questions not answered. As a result, uncertain response from third-party investors can be expected.

Finally, with respect to the supply shortage that Ontario faces today and the risks of relying too much on imports, the Committee held the view that natural gas fired plants, however cleaner and more efficient than some other supply sources, were a risky path in terms of price volatility and level. While this comment about price volatility may be true, it is doubtful that Ontario is in a position to do without that option, at least in the short run. Natural gas plants being typically constructed within a shorter time frame than other technology like nuclear and hydraulic, if Ontario is to address rapidly its internal supply shortage problem, natural gas will likely be a necessity.