



## Ontario's Power Trip: A megaplex of costs

*Posted: April 20, 2010, 7:04 PM by NP Editor*

### **Ontario electricity is based on an expanding regime of expensive government directives**

**By Parker Gallant**

**L**ast week in this series on Ontario's electricity market I outlined the growing dysfunction of the province's major government-owned operating companies: Ontario Power Generation, Hydro One and the Independent Electricity System Operator (IESO). They deliver less and less electricity at ever higher costs and prices. Today we look at the main direct regulatory vehicles that control the overall system: The Ontario Power Authority, the Ontario Energy Board and Ontario Electricity Financial Corp.

These regulatory agencies and the operating companies, all beholden to Premier Dalton McGuinty and his government's energy machine, form Ontario's electric power megaplex, an agglomeration of government agencies and Crown monopolies. Through a raft of new energy laws, regulations, and directives, the government and the companies seem to operate outside of any critical oversight or attention.

Even though electricity demand is falling and the economy is slow, electricity rate increases keep coming and the Ontario electricity system has become an incomprehensible maze. The only clear message is one of rising costs and burdens on industry and consumers.

Not too long ago I received official confirmation from the Ontario Energy Board, the province's electricity "regulator," for what my Ontario electric bill on a cottage property already told me. A 91% increase in the distribution portion of the bill, paid to Hydro One, the government-owned monopoly power distribution company, had been formally approved by the OEB. How did this happen?

Simple. Hydro One applied to the OEB (via 3,400 pages of documentation) to cover the cost of an earlier buying spree, the purchase of a collection of local municipal electricity distribution companies. The takeovers created 280 different rate classifications. Hydro One then applied to the OEB to reduce the 280 classifications to 12. "Based on the evidence," said the OEB, "the Board accepts Hydro One's judgment with respect to the proposed classes for the purpose of this decision. Moving from 280 rate classes to 12 new rate classes is not a simple exercise."

That's how my distribution cost jumped 91%.

Last week, the OEB issued another rate notice, a 12% increase in the cost of regulated power and an increase on the time of use plan proposed for the province's new Smart

Meter regime.

Why are rates rising 12%? It all starts at the top, with Premier McGuinty, who in 2007 issued a famous decree: “Come hell or high water, Ontario coal plants will close by 2007.” That quote has been the subject of attacks by opposition parties, environmental groups, and the media. But it remains a policy that will cost Ontario industry and consumers billions of dollars.

The coal plant diktat is just one of many handed down by Mr. McGuinty and his Liberal cabinet in recent years. The Ontario government’s seizure of the electricity market began long before the hell-or-high-water mark. In 2004 the Liberals passed the Energy Restructuring Act, amending the Electricity Act of 1998. This created the Ontario Power Authority (OPA), which was given sweeping powers in the energy sector, including responsibility to develop an integrated power system plan (IPSP).

In a Throne speech of October 12, 2005, the McGuinty government began fleshing out its plans for the electricity market. “Consumers can look forward to getting smart meters that will help them save money by telling them when they can pay less.” At that time the price of electricity was 4.5 cents per kilowatt hour, no matter what the time of day. The smart meter plan is expected to cost consumers about \$2-billion in coming years. It will, in fact, tell consumers when they will pay more for electricity, which is pretty much always.

Thus instructed, the OPA has utilized consulting groups (30% of its annual budget) mainly to focus on how to take the energy minister’s directives forward.

In 2009, Energy Minister George Smitherman unleashed the Green Energy Act, designed to regulate the price of electricity and force consumers to pay more for alternative wind and solar energy.

To achieve objectives, Mr. Smitherman instructed Hydro One and the local distributors to spend billions of dollars. Hydro One’s 2009 annual report states: “Our estimated future capital expenditures have increased from those disclosed in the 2008 annual report.” The report now projects future capital expenditures increases 27% above 2009 levels for 2010. It specifically states that the government’s new Green Energy Act added \$190-million in 2010, \$450-million for 2011 and \$750-million for 2012 to their projected capital expenditures. The report states that “smart meters” will increase capital expenditures.

As a result of all this, Hydro One has commenced applications to the OEB for increases in their delivery rates, as all of the additional capital costs will need to be paid back through rate increases on industry and consumers. That’s how the system works. Government dictates, consumers pay.

The OPA — the government’s vehicle for carrying out directives — is charged with

pushing through the provisions of the Green Energy Act and fulfilling government dictates. It has signed hundreds of contracts with renewable energy producers under a green feed in tariff (FIT) program. The FIT program essentially forces consumers to pay ultra-high prices of 13.5 to 19 cents per kWh of wind power and 80 cents per kWh of solar power, the higher costs to be averaged into the bills of all consumers across the province.

One of the new contracts calls for Samsung, the Korean energy giant, to install a 2000 megawatt wind farm. Samsung will be paid at the FIT wind rate of 13.50 cents per kWh plus a 1 cent adder. To put that price per kWh in perspective the time of use rates that come into effect later this year price power at an average of 6.5 cents per kWh over a normal week. If the Samsung wind farm produces at the “ideal” 29 % capacity level, the cost to ratepayers will be \$1.1-million per day or \$406-million for each year the farm operates. Assuming the contract is 20 years the subsidy committed to by the province is in excess of \$8-billion.

Wind and solar power are somewhat unreliable. Backup power is needed in the event the sun isn't shining or the wind isn't blowing. The above Samsung price guarantee doesn't include backup costs. It doesn't include costs associated with the transmission lines that Hydro One will have to erect. It doesn't include costs for substations to alter voltage coming out of the wind farms.

Now let's move on to the OEB, the regulator. The OEB operates under its own act and its first “guiding principal,” which is to “protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.” A worthy objective, except that the OEB must simultaneously contend with conflicting directives, legislation and regulation governing the production, delivery and distribution of energy.

When an act such as the Energy Conservation Responsibility Act or the Green Energy Act is passed, the minister is granted the right to issue directives. These are issued to the entities under the ministry's direct control, which includes all members of the electricity megaplex: the Ontario Power Authority (OPA), Ontario Power Generation (OPG), Hydro One, the Independent Electricity System Operator (IESO), the OEB and several others.

When Mr. Smitherman was the minister he sent a September 24, 2009, directive to the OPA to establish a FIT program and sign contracts for green energy projects under the FIT. The FIT program developed by the OPA sets the price of power based on the type and size of renewable energy produced. Payout set per kWh was 10.3 cent/kWh at the low end and 80.2 cents/kWh at the high end.

FIT contracts get first to the grid rights, so the most expensive power doesn't even have to compete with OPG and other established electricity producers. In other words the more wind and solar power produced raises the ultimate costs of electricity distributed to the consumers. Cheaper and cleaner hydro power will be displaced by expensive green power.

On top of this we have the new time of use rates and adoption of smart meters. As power costs rise, consumers also face the \$750 cost to install smart meters. These costs further distort the regulatory process. Under OEB rules, the power operating companies are allowed to achieve an acceptable rate of return (ROE), generally set at the 8% to 9.5% level. Having been forced by the minister's directives to buy smart meters, build transmission lines and buy energy under the FIT program, Hydro One and others can't hope to achieve their ROE without asking for big rate increases.

Rate increase applications involve mountains of paper. A recent Hydro One application for a small increase in delivery rates contained 3399 pages. The increase was for \$3-million for 2010 and \$4-million for 2010. Hidden in the application was the suggestion that Hydro One would have to recover monies related to 2,300 contracts in negotiation by OPA for small facilities (less than 10 MWs) connecting to the Hydro One grid. This same application adds that "the Green Energy Plan and Smart Grid initiatives would be very costly, and most of the cost would fall on Hydro One. They felt that investments in renewable generation should be funded through a global adjustment paid for by all Ontario electricity customers."

Another example of latent future applications would be the \$615-million dollar cost overrun for OPG's Niagara tunnel (See Beckygate in the Ontario Power Trip series at FPCComment online).

We end our trip through the Ontario power megaplex with a visit to the sixth member of the group, the Ontario Electricity Financial Corp. (OEFC). OEFC was originally established to hold the "stranded debt" of the old Ontario Hydro Group and to receive the money that appears on consumer electricity bills as a "Debt Retirement Charge." Alas, not much debt is being retired. As at March 31, 2000 the total debt on the OEFC books was \$32-billion and as at March 31, 2009, it was \$28.1-billion. At that rate it will take another 63 years to pay off. Nevertheless, OEFC's annual report states "The residual stranded debt will likely be retired between 2014-2018."

Where's the money going? Over the last nine years, the ratepayers of the province have paid approximately \$1-billion each year towards the debt retirement. OEFC also annually received "payments in lieu of taxes" from OPG and Hydro One, which averaged almost \$700-million per annum, and they have collected interest of approximately \$700-million per annum from OPG and the province. Gross revenues from the ratepayers and taxpayers total about \$27-billion but the debt has only reduced by \$ 4-billion because OEFC is building up more debt to finance the growth and expansion of the megaplex.

Ontario's official tourism slogan is "There's no place like this!" It's an appropriate slogan for the province's electricity market.

*Financial Post*

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